

Consumer Awareness Institute

**THE CASE (FOR AND) AGAINST
MULTI-LEVEL MARKETING:
The Complete Guide to Understanding
the Flaws – and Proving and
Countering the Effects – of Endless
Chain “Opportunity” Recruitment,
or Product-based Pyramid Schemes**

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

Preface

This book 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 thousands 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.

At the outset it should be noted that *The Case (for and) against Multi-level Marketing* is not strictly a book of legal arguments for and against 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 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. To all of these I extend my gratitude.

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MLM's powerful appeal

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

The products are often attractive, seeming to answer some 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 provides 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 years 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 you are told that in helping yourself, you will be helping others – often hundreds in the organization you recruit and build – who look to you for guidance and encouragement, as they each build their own business under you.

As 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. Who would not want all that?

The Amway precedent.



In 1979, Robert Pitofsky, acting as an administrative law judge for the FTC (Federal Trade Commission), ruled that Amway was “not a pyramid scheme.”¹ 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 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 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 trade practices.”

This is an important topic because since 1979, hundreds of millions of MLM participants have in the aggregate been affected to the tune of 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 and fraudulent 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..

MLM is said to level the playing field and allow 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. Who would not want all that?

A much needed investigation

This 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 15 years of research on this topic – and that will be addressed in this publication.

The many questions to be answered in the 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?

¹ 93 F.T.C. 618, 716-17 (1979).

- 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?
- Do MLM compensation plans reward part-time or seasonal participation with enough income to be worth their time and investment?
- 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 if so, how can one tell the difference?
- 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 MLM products 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?
- 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? If technically illegal in some states, why are they still operating?
- Where are consumer protection officials in all this? Do they 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 are needed to protect the public from “unfair and deceptive practices?”
- What actions can a victim take to recover losses from MLM?

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.

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 practiced throughout the industry. Technically, this should make MLMs subject to prosecution under Section 5 of the FTC Act.

Loss rates are extraordinary – over 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 it is promoted as an “income opportunity” – or even as a “business opportunity” – a misrepresentation in itself.

After reading these chapters, the reader may wonder if it is appropriate to refer to MLM, 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 virtually any MLM as a scam.

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 misrepresentation in itself.

The book’s title and logical bias

The reader may wonder why the strange punctuation of the title of this book: *“The Case (for and) against Multi-level Marketing.”* The parentheses suggests that although arguments will be presented both for and against MLM, it will be clear from the first chapter that arguments favoring MLM will not be emphasized, but will be debunked. This is because 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 pyramid schemes.

Every one of the compensation plans of the hundreds of MLMs I have analyzed assume an infinite market and a virgin market, neither of which exists in the real world. MLM as a system is therefore *fundamentally flawed, uneconomic, and deceptive. And in addition, worldwide feedback strongly suggests that MLM is also extremely viral and predatory.* The evidence from independent research and analysis as reported in this book will clearly support these conclusions.

The FTC considers classic, no-product pyramid schemes unfair and deceptive and therefore illegal². Bruce Craig, former assistant to the Attorney General of Wisconsin wrote: “The premise of ‘multi-level

² 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).*

vs. pyramid’ marketing may well represent a distinction without a difference.”³ 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 would agree with this conclusion. So I will not attempt to present the entire catechism of deceptive arguments used by MLM defenders. Thus the parenthesis.

However, in Chapter 8 (“A Litany of Misrepresentations”) is a list of over 100 typical misrepresentations used in MLM recruitment. They are refuted one by one.

Source material for the book

The information for this book is compiled from the extensive research and writing I and other independent analysts have done, while incorporating worldwide feedback from visitors to my web site and those of others in the field for over 17 years. Most of the information about specific MLMs is downloaded from their company web sites. The book is currently available for free download as an e-book from my web site – www.mlm-thetruth.com.

Additional selective input from regulators, attorneys, scholars, and other independent consumer advocates has been utilized. Where appropriate, MLM officials and advocates have been incorporated, even though their arguments defending MLM may often seem deceptive or convoluted.

In making decisions on which research and comments to include in the book, I assume full responsibility. However, I am confident that – based on extensive training, research and experience (see Chapter 1) – 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

³ Letter dated February 25, 2000, from Bruce Craig to Robert Pitofsky, Chairman of the FTC – and the official who drafted the Commission’s 1979 Amway opinion

affect consumers; and on ways to protect consumers from the worst abuses.

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 the book will serve as an invaluable tool for consumer advocates, law enforcement officials, educators, media reporters, and seekers of legitimate home income opportunities. It should also be helpful as a primary reference guide for plaintiff attorneys representing MLM victims.

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.armydiller.com/financial-scam/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/cgi/viewcontent.cgi?article=2563&context=wmlr>

Three other treatises are very helpful in gaining a thorough understanding of the subject. They are written by Robert FitzPatrick of Pyramid Scheme Alert:

– I heartily recommend *The Main Street Bubble: How the Federal Trade Commission (FTC) has Ignored and now Protects Business Opportunity Fraud on Main Street*,⁴ Earlier reports include [Pyramid Nation: The Growth, Acceptance, and Legalization of Pyramid Schemes in America](#),⁵ and [The Case for Reopening the Amway Pyramid Scheme Case](#).⁶

I also highly recommend the following:

– [What’s Wrong with Multi-level Marketing](#), by Dean VanDruff, presents powerful arguments to help grasp the fundamental flaws in MLM as a business model.

– www.pyramidschemealert.org – the official web site for Pyramid Scheme Alert – and

– www.falseprofits.com – which has some insightful blogs worth reading.

– www.mlmwatch.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.

– <http://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*”⁷ 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.

Many other useful reports and blogs are available from the following web sites:

– www.mlm-thetruth.com – and check out numerous other recommended web sites, which are annotated for the reader’s convenience. Go to –

<http://mlm-thetruth.com/recommendedLinks.html>

⁴ For description and instructions on how to order, go to – <http://www.pyramidschemealert.org/PSAMain/resources/resources.html>

⁵ Available for free download from www.falseprofits.com.

⁶ Available for free download from www.falseprofits.com.

⁷ See Peter J. Vander Nat and William W. Keep, *Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes*, 21 J. of Pub. Pol’y & Marketing (Spring 2002), (“Vander Nat and Keep”) at 140.

Summary of Findings about MLM (Multi-level Marketing)

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

After analyzing the compensation plans and claims of over 500 MLMs (multi-level marketing programs), summarizing thousands of pages of research and 18 years of worldwide feedback, and reviewing applicable federal and state laws, I come to the conclusions below in answer to key questions about MLM. For more details, see my e-book entitled: *"The Case (for and) against Multi-level Marketing: The Complete Guide to Understanding and Countering the Effects of Endless Chain Selling and Product-based Pyramid Schemes."* (The ebook and numerous reports and guides can be downloaded for free from the web site www.mlm-thetruth.com.)

What is the appeal of MLM? (See Introduction and Chapters 1 and 2 of my e-book.)

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 or annuities), 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 legitimate?
(See Chapters 2-11.)

1. MLMs depend on unlimited recruitment of a network of endless chains of participants,
2. *Participants secure and advance to ranks or positions in a pyramid ("downline") of participants based on timing and recruitment, rather than on merit or appointment.*
3. As endless entrepreneurial chains, or "opportunity" recruitment schemes, MLMs assume infinite markets and virgin markets, neither of which exists in the real world. They would be doomed to eventual market saturation and collapse, except that some avoid this by expanding to other countries and/or re-pyramiding through the same markets with new product offerings and divisions.
4. *As endless chains, MLMs are inherently flawed, deceptive, and unfair – profitable primarily for those at or near the top (top-level "upline", or "TOPPs", for top-of-the-pyramid promoters) – who are often the first ones to join.*
5. 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.
6. *I have challenged regulators to identify any "business opportunity" that is systemically more unfair, deceptive, viral, and predatory than MLM. None have met the challenge.*
7. MLMs typically finance their operations from purchases by participants who are incentivized to buy products to qualify for commissions and 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.*
8. Typically, MLM products are unique (making it difficult to compare with alternative products), consumable (to

encourage repeat purchases), and priced higher than products sold elsewhere – to pay commissions on many levels of participants.

9. *In MLMs, most of the commissions are paid to those at or near the top levels in the hierarchy of participants (TOPPs). It is this extreme concentration of commissions paid to TOPPs that motivates them to work tirelessly to expand downlines, thereby assuring the MLM's survival and growth. They also must continually recruit to replace dropouts due to high failure rates.*
10. Most MLMs become even more top-weighted with five or more layers in their compensation plans – more than are functionally justified.
11. Some have asked if it is possible to design an MLM that is honest and fair to all participants. To accomplish this would require major adjustments, such as:
 - a) Commissions would be paid only on sales to non-participants – and no overrides or commissions for personal consumption of participants.
 - b) Most (over 50%) of the commissions and bonuses paid by the company would be paid to the front-line person who sells the products, with amount of commissions decreasing at each higher rank level.
 - c) 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).
 - d) There would be no minimum ongoing purchase requirements to qualify for commissions or rank advancement.

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)

12. The villain in MLM abuse is not so much the leaders as a flawed system built on unlimited recruitment of endless chains 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.

13. 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.*

What are the effects of MLM on participants and on society? (See Chapters 3-9.)

1. Based on available company data, approximately 99.7% of all MLM participants lose money – spending more on company purchases and minimal operating expenses than they receive in commissions from the company.
2. *Those who lose the most are those who invest the most*, having accepted deceptive claims that the MLM is a legitimate income or business opportunity, and having continued to invest in the vain hope of eventually profiting handsomely.
3. Based on statistics from the Direct Selling Association, the chief MLM lobbying organization, aggregate losses (which the DSA calls "sales") suffered by tens of millions of victims exceed tens of billions of dollars a year in the U.S., with far greater losses worldwide. MLMs often plunder vulnerable populations overseas.
5. In some cases, monetary losses from MLM participation lead to heavy indebtedness, bankruptcy, foreclosed mortgages, and failed educational and career pursuits.
6. *Addiction to MLM can result from excessive commitment to MLM – which can become a lifestyle. "MLM junkies" – who have internalized its "easy money" appeal – may find it difficult to work again in a normal work setting.*
7. Some MLM participants lose more than money. *Divorces and rifts among extended families are commonplace. Even suicides and murders related to MLM participation, have been reported.*

8. MLM is an unfair and deceptive practice that siphons money away from legitimate businesses. And with the FTC's granting of an exemption to MLMs from having to comply with its new Business Opportunity Rule, the market for legitimate non-MLM direct selling and other business opportunities could be virtually eliminated in favor of an MLM business model that escapes the regulation.

Is MLM legal? If not, what explains the inaction by law enforcement, and what actions can be taken by and for consumers to protect them? (See Chapters 9-12.)

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 are also largely silent.*
 2. *The DSA (Direct Selling Association, the major MLM lobby group), together with major MLMs, work together as a cartel 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 heavily to the political campaigns of presidential candidates to assure that no action is taken on the federal level by the Federal Trade Commission or any other agency.*
 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. *Most MLM participants spend no more than a few hundred dollars in products and services and then drop out. They are the lucky ones. In spite of having spent more than they received, few blame the company for their losses – even large losses. They have been taught that they (not the company) are responsible for any failures. Except for the first ones to join an MLM, generally those who invest the most, lose the most. New recruits are being sold a ticket on a flight that has already left the ground.*
 5. *The silence of victims of MLMs is also explained by the fact that in every endless chain, major victims are also perpetrators, having recruited friends, relatives, and others in a vain effort 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.*
 6. *Consumers must get informed, and regulators should insist that crucial information be made available to prospects to make informed decisions about participation, such as average commissions from – and payments to – the company for all participants.*
 7. *To get the attention of law enforcement, victims must complain to authorities.*

Defining MLM (Chapter 2):

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

1. *They assume unlimited recruitment of endless chains of participants.*
2. *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 override commissions paid by the company are paid to founders and those at or near the top of a pyramid of participants.*
5. *For most MLMs, company payout is to five of more levels of participants.*

I conclude with likely the only accurate, research-based, and consumer-friendly definition of the business model labeled “multi-level marketing”:

Multi-level marketing (MLM) is a purported income opportunity, in which persons recruited into a network of participants make ongoing purchases of products and services, and recruit others to do the same, and they still others, etc. – in endless chains of recruitment and personal consumption, in order to qualify for commissions and bonuses and to advance upward in the hierarchy of levels in a pyramid of participants. Product purchases become the means of disguising or laundering investments in the scheme.

Typically, prospects are lured into an MLM with exaggerated product and income claims. And because the pay plan is heavily stacked in favor of those at the highest levels in the pyramid, the vast majority of participants spend more than they receive and eventually drop out, only to be replaced by a stream of similarly misled recruits, approximately 99% of whom are likewise destined to experience loss and disappointment.

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

The Case (for and) against Multi-level Marketing

By Jon M. Taylor, MBA, Ph.D.

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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- 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

My background & qualifications

Important qualifications for an authority on MLM. 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

My whole career led to my expertise and consumer advocacy in this arena. Some may ask what qualifies me to do this research and to pull all this material together in an authoritative report. That's a fair question and deserves an answer. 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 did 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 70’s, as a young widower, I was determined to find ways to support my two 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 businesses 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 do 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 averaged earnings of over \$750,000 a year.

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



\$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.



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. This was OK with me because in all my previous ventures I could assess the potential profitability of a business within the first few months.

"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.

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 nutritionals, 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."

As recommended, I bought five of these 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.

"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 question "Wanta 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 about 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 over \$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 – 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, entrepreneurial chains, 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 18 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.

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 (Nu Skin doesn’t count dropouts) reach even “Executive” level.

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, one of Nu Skin's communicators released a statement about me and my motives in going after Nu Skin to anyone who would inquire. For Nu Skin's criticisms and my rebuttals to each, read "*Nu Skin Attempts to Discredit it's Whistleblower*" (Appendix 1A)

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.

I share my findings with consumers, regulators, attorneys, and consumer advocates.

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 FitzPatrick⁸, President of Pyramid Scheme Alert; Bruce Craig, former assistant Attorney General in Wisconsin; Kristine Lanning, (former) Assistant Attorney General of North Carolina; Doug Brooks⁹, plaintiff attorney dealing with MLM cases; and Susanna Perkins, author and sponsor of mlmsurvivor.com.

With the cooperation of these extremely knowledgeable and capable experts, and acting as a Director of Pyramid Scheme Alert (with Robert FitzPatrick as President), 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, including the Economic Crime Summit Conference in 2002 and 2004. Robert FitzPatrick 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.¹⁰

I financed all this research myself and did not profit from it, except for legal cases for which I

was hired as a consultant and expert witness. However, for the first few years this did not begin to cover my time and expenses.

Finally – recruitment-driven MLMs, or product-based pyramid schemes defined. 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 from legitimate direct selling business-es. 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 MLM's that were in violation of laws in most states, as well as FTC guidelines. In fact, wherever I could get the earnings reports of participants in MLM's with these “5 Red Flags” in their pay plan, approximately 99.6% of ALL participants (including dropouts) lost money, after subtracting ALL expenses. In fact, with

⁸Sponsor of pyramidschemealert.org

⁹ With Martland and Brooks, LLP, Boston, Mass.

¹⁰ For sample feedback, see Appendix for Chapter 9.

a more strict interpretation of the data, the loss rate is closer to 99.9%.¹¹

These expenses included minimal operating expenses and “incentivized purchases” (necessary to qualify for commissions or bonuses) of goods and services from the company.¹² MLMs even make obviously illegal no-product pyramid schemes look profitable in comparison.

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 and presented *THE 5 RED FLAGS: Five Causal and Defining Characteristics of Product-Based Pyramid Schemes, or Recruiting MLM's* 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”¹³ model to analyze the compensation plans of over 500 MLMs – and correlated them with average income data of participants (where such data was available). All of this has enabled me to make generic observations of consistent structures and practices of MLM as an industry – and losses suffered by participants – that would not have been possible any other way. 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. This is 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 payout.

¹¹ See Chapter 7.

¹² See Chapters 5 and 7

¹³ There are really 5 causative and defining characteristics and a fifth in most, but not all, MLMs.

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 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 a typical MLM. 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.”



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*. This report, along with suggestions for success-ful self-employment and links to websites that provide additional information and point to helpful resources, is posted on my website.

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 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.



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 suggested form letters. I wrote comments rebutting the comments of participants and spokespersons 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!

My resolve to do something for consumers

My resolve to do something for consumers

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 15 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, both individually and in the aggregate, 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 schemes. It is both the outrage I feel at the unchecked growth of this unfair and deceptive 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 statistics for new MLM recruits confirms the inherent 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."

Appendix 1A: Nu Skin attempts to discredit it's whistleblower

Nu Skin's response to inquiries about Dr. Jon Taylor, the whistleblower – and Taylor's rebuttal.

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| <p>Statement by Nu Skin in response to inquiries about Jon Taylor, the primary whistleblower for Nu Skin Enterprises, Inc.</p> | <p>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> |
| <p>NOTE: Unable to refute Taylor's charges that Nu Skin continued its misrepresentations since the 1994 FTC Order for NS to stop misrepresenting earnings of its distributors, NS officials attempted to discredit the company's primary whistleblower. Comments from an official company statement follows (<i>in italics, ed.</i>) in this column: <i>Nu Skin 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 reports 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> |

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|--|---|
| <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? 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)?</p> |
| <p><i>Undoubtedly there are former distributors like Dr. Taylor who have become disenchanted with the business opportunity, just as there are in many industries.</i></p> | <p>A 99.94% loss rate is not normal for a legitimate "business opportunity," but is for a recruiting MLM. As well might a "business opportunity" sign be posted above gambling tables in Las Vegas. See my <i>Report of Violations of the 1994 [FTC] Order for Nu Skin to Stop Misrepresenting Earnings of Distributors . . .</i></p> |
| <p><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.</i></p> | <p>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.</p> |
| <p>Background: <i>Jon M. Taylor is a self-appointed crusader opposed to the network marketing industry, particularly Nu Skin Enterprises</i></p> | <p>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?</p> |
| <p><i>He has formed a non-profit corporation called the Consumer Awareness Institute. Dr. Taylor was a NuSkin IDN 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.</i></p> | <p>My "conversion" and subsequent disillusionment is an important part my story. 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.</p> |
| <p><i>Dr. Taylor is fond of acquiring public data about Nu Skin and then "torturing" it until it suits his purposes.</i></p> | <p>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.</p> |
| <p><i>He has challenged the way the company reports average distributor incomes - despite its being in the prescribed format required by the Federal Trade Commission</i></p> | <p>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.</p> |

| | |
|---|---|
| <p>- as well as the structure of the network marketing model, the pricing of products, the ethics of the industry,</p> | <p>Read <i>The 5 Red Flags (cited above)</i>, and then evaluate the structure, product pricing, and ethics of the typical MLM. New recruits are being defrauded by MLM's like Nu Skin.</p> |
| <p>and even the company's philanthropy.</p> | <p>There they go again on the philanthropy-credibility connection.</p> |
| <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 MLM. 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 MLM companies claim distributors can make millions. Laws prohibit MLM 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 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 and to provide guidance to prevent consumers from being victimized.

The Case (for and) against Multi-level Marketing

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

Chapter 2: MLM DEFINITIONS AND LEGITIMACY – what MLM is – and is not

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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 analyses of over 400 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 plan – 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 pyramid schemes, and (3) recruitment-driven MLMs – or what I call "product-based pyramid schemes."

As I shall explain, there are inherent flaws in any MLM, assuming 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 500 MLMs I have analyzed, but have found none.

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 five - dollar 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, it is mathematically certain that the vast majority will lose money. Chain letters are illegal.

Just like the chain letter, MLM assumes both infinite markets and virgin markets, neither of which exists in the real world. Thus, MLM with its endless chains of recruitment, is inherently flawed, unfair, and deceptive. And fifteen years of worldwide feedback tells me that MLMs are 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. 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 issues about the legitimacy of MLM in this book, I am using the word “legitimate” in the broadest sense; i.e., “conforming to recognized principles or accepted rules or standards,”¹⁴ 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 which is termed “multi-level marketing:”

Multi-level marketing (MLM) is a purported income opportunity, in which persons recruited into a company-sponsored program make ongoing purchases of products and services, and are incentivized to recruit others to do the same, in a program dependent on unlimited recruitment of a network of endless chains of recruitment and personal consumption, in order to qualify for commissions and bonuses and to advance upward in the hierarchy of levels in a pyramid of participants. Product purchases become the means of disguising or laundering investments in what is in fact an endless chain opportunity scheme – or product-based pyramid scheme.

Based on my research that will be explained in later chapters, I would add the following:

Typically, prospects are lured into the scheme with exaggerated product and income claims. And because the pay plan is heavily stacked in favor of those at the highest levels in the pyramid, the vast majority of participants spend more than they receive and eventually drop out, only to be replaced by a stream of similarly misled recruits, approximately 99% of whom are likewise destined to experience loss and disappointment.

¹⁴The New Merriam Webster Dictionary, Springfield, MA, 2008

A problem of definitions. Much confusion exists on the subject of what is – and is not – multi-level marketing (MLM) and how it can be distinguished from illegal pyramid schemes. 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

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.

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 chain 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."¹⁵

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 Ziglar,¹⁶ *who incidentally makes no mention of MLM or*



15 *Wave 3: The New Era in Network Marketing*, by Richard Poe (Prima Publishing: New York), *Salesmanship* author Zig Ziglar 7-8

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

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.

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 on the web site – www.mlm-thetruth.com.

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 definition that would be almost useless in making such distinctions:



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.¹⁷

Again, as with the Wikipedia definition, no mention is made of the inherent flaws in any MLM system – an endless chain 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, David Roller suggests a definition that is rosy and descriptive, but not very helpful in making clear distinctions between MLM and other home-based businesses:

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.¹⁸

A search through the business section of a local Barnes and Noble store reveals that other authors have written on how to be successful at network marketing¹⁹, but without offering any substantive definition of what they are talking about at all, apparently assuming readers all know precisely what they are talking about. This may be somewhat true of veteran MLM participants, but feedback I have received worldwide tells me this assumption may not always be correct, especially for those being recruited for the first time.

The FTC chooses a definition of multi-level marketing that only creates confusion.

In its 2008 announcement by the FTC of its Revised Proposed Business Opportunity Rule (RPBOR), 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

¹⁸ Roller, David, *How to Make Big Money in Multi-level Marketing*, Prentice Hall, 1989

¹⁹ 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.

¹⁷ King, Charles W. and Robinson, James W., *The New Professionals: The Rise of Network Marketing as the Next Major Profession*, Three Rivers Press, 2000

their “down lines.” - Peter J. Vander Nat and William W. Keep, *Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes*,²⁰

At a workshop hearing on the form for the final 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 proposed Rule would be almost totally ineffective in curbing abuse. It would be 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 attempts to define MLM as “direct selling.” The DSA (Direct Selling Association) was once an organization 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.²¹ The DSA now divides its membership into “single level” and “multi-level” pay plans.

The Direct Selling Association, has in recent years lobbied aggressively for 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 a 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

²⁰ 21 *Journal of Public Policy & Marketing* (Spring 2002), (“Vander Nat and Keep”), p. 140. (Cited in Footnote 34 at bottom of page 15 of RPBOR)

²¹ See the section “The DSA/MLM cartel” in Chapter 10

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-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.²²

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 400 MLMs, including DSA firms, confirms this. Comparatively slight rewards for retailing, together with overpriced products, makes recruiting the focus of anyone seeking to profit from MLM.

The suggestion that "the vast majority of salespeople work[ing] 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. Virtually all who do MLM part-time lose money, after subtracting 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 – an endless chain 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 report uses the terms "Recruitment-driven MLM" (implying an emphasis of recruitment over selling) and "Product-based Pyramid Scheme"²³ as interchangeable terms. These programs have also been called "Multi-level Marketing," "Network Marketing," etc. – even "direct selling" (though little selling to the public takes place). "MLM" is a generic acronym for any type of multi-level or endless chain selling program, and we will use it for brevity.

More negative sounding titles include "chain selling," "pyramid selling," "entrepreneurial chains," etc. In this report, a "recruitment-based MLM" employs a compensation plan that rewards recruiting so much more than direct selling that there is comparatively little incentive to sell products.

No-product 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 product-based pyramid scheme. Unfortunately, some of the most damaging programs manage to escape legal action.

After processing extensive data and analytical reports and posting them 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.



²² #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

²³ For a brief history of classic, no-product pyramid schemes, and MLM, or product-based pyramid schemes, see Chapter 10.

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 hereby declared unlawful.”²⁴ 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.²⁵

“. . . 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 (Section 5).

MLMs are typically 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 a significant income 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, harmless MLMs would be extremely rare. In fact, I found no retail-focused MLMs out of hundreds of MLMs I have reviewed.

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 purchases by participants would require analysis of their compensation plans and average earnings data, which most such

companies have not as yet been willing to provide to the general public. So they remain a grey area in my research.



In-home demonstration programs
 (“party plans”)

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 seeking to build credibility is to go to great lengths to be identified as “direct sales” organizations. However, after rigorous comparisons of legitimate business models with characteristics of 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”).

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.

²⁴ Section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1)

²⁵ In re Koscot Interplanetary, Inc., 86 F.T.C. 1106 (1975)

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 objective 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.

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 (or product sales to recruits), or primarily from retailing to consumers outside of the MLM's network of participants.*

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.)

MLM compensation plans can get quite complex. Appendix A 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.*

These widely varying pay plans illustrate the need to understand 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 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 at the expense of a revolving door of unwitting recruits.

How these defining characteristics were derived. Eighteen 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 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 500 MLMs with all types of compensation plans, and surveys of tax professionals.

In the early stages of my research, after months of comparative analysis, I was able to identify a list of characteristics that are common to all MLMs, including the 400 MLMs I have since analyzed. These were compared to characteristics of no-product

pyramid schemes – as well as to legitimate business models to which MLM is often compared, such as direct sales, franchises, distributorships, insurance agencies, etc. (See Appendix 2F 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 highly leveraged 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. Amazingly, 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.” (For terms used in describing MLM compensation plans, see Appendix 2B. See Appendix 2C for additional terms related to MLM.)

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 400 programs). Based on careful analysis of available data, *MLM programs with all of these characteristics have a shocking loss rate – approximately 99.6%²⁶ of ALL participants lose money (after subtracting ALL expenses)! – 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 what I call “recruitment-driven MLMs” or product-based pyramid schemes from all other forms of commercial activity.

²⁶ See Chapter 7: “MLMs Abysmal Numbers”

- And they are *legally significant* because they answer the question that law enforcement has not consistently 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 CDC's 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 effects of the scheme (such as whether or not sales are made to end users, not just participants) and not the essential causes of the problems; i.e., the underlying structure of the scheme or compensation plan, since rewards are what drives 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.

“The Commission has previously condemned so-called “entrepreneurial chains” as possessing an intolerable capacity to mislead.”

The four CDCs of recruitment-driven MLMs, or product-based pyramid schemes, that cause the harm and that clearly distinguish between MLM and legitimate direct selling opportunities

1. Each person recruited is empowered and 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.

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, 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?



The endless chains of recruiters recruiting recruiters – works on the same principle as a “pay to play” chain letter.

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. MLMs assume both infinite and virgin markets – neither of which exists in the real world.

Since MLM as a business model depends on endless chains of recruitment, or infinite expansion in finite markets, MLM is inherently flawed, unfair, and deceptive. It is deceptive because they are sold on an income opportunity that is only an opportunity for those placed at or near the beginning of the chain of recruitment – who are also 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.

MLM is also extremely viral and predatory – expanding rapidly 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 that in the Koscot case²⁷, the court noted, “*The Commission has previously condemned so-called “entrepreneurial chains” as possessing an intolerable capacity to mislead.*”²⁸ 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 warning of an “intolerable capacity to mislead” was set aside, and the deceptions

continued unabated. (See Chapter 8 for lists of over 100 typical misrepresentations used in MLM recruitment.)

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 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 unfortunately was not enforced²⁹), 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. The FTC’s administrative judge (later FTC Chairman) Robert Pitofsky ruled that Amway was not a pyramid scheme,

27 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)

28 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).

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

subject to “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 nonparticipants³⁰), (2) they must be able to prove a sale to each of ten customers each month, and (3) reasonable buy-back provisions be permitted.³¹ 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 and are generally ignored by MLMs. The Amway decision opened the floodgates for some of the most unfair, deceptive, viral, and predatory schemes ever devised. Tens of millions of Consumers 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 fraud.

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

³⁰ 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.

³¹ See 93 F.T.C. 618, 716-17 (1979).

reached when a city has only five or ten distributors, with new ones finding it more and more difficult to recruit more participants.

Avoiding market collapse. When pyramid promoters introduced product purchases as the means for financing the scheme, then labeled multi-level or network marketing, some found ways to avoid ultimate collapse. First, in recruitment campaigns, MLMs used a hard-sell approach to focus

Just like the chain letter, MLM assumes both infinite markets and virgin markets, neither of which exists. Thus, MLM with its endless chain of recruitment, is inherently flawed, unfair, and deceptive. MLM is also extremely viral and predatory.

attention on the quality and unique nature of the products, and away from the endless chain of recruitment of participants as primary (or only) customers.

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 United States, while keeping the “Amway” name and brand in overseas markets. Nu Skin shifted it’s recruiting to Asia to the point that about 85% of its revenues came from Asia. Later, Nu Skin developed new product divisions, such as Interior Design Nutritionals (IDN), Big Planet (internet services), Pharmanex, and Photo-Max – through which it could cycle whole new rounds of recruitment. This is a process I call “re-pyramiding.”

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 recruits, particularly near the bottom, where newly recruited participants replace those who quit. Thus, in MLM there is a continuous collapse of the base of the pyramid, involving the churning of exiting and newly recruited participants. This allows those at or near the top to maintain their positions at the top 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. Any distinction between buyers and sellers is blurred – even evaporating. The sellers are the buyers, and the buyers are the sellers – to themselves and their families. Also, we see the fallacy of the claim of MLM promoters that they are removing the “middle man” in their marketing system. 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.

Any distinction between buyers and sellers is blurred – even evaporating. The sellers are the buyers, and the buyers are the sellers – to themselves and their families.

Recruitment-driven MLMs can become like Ponzi schemes. When MLM promoters expand into other areas to make

it possible for earlier investing participants to be paid off from newer investors, 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, not from the sales of products or fulfillment of services, but from the investments of new investors.³² (With Ponzi schemes, however, the persons doing the selling remain the same.) Ultimate collapse is inevitable as new markets become less accessible, or when perceived or 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.

The more resourceful MLMs prevent market collapse by opening new markets in other states or countries and/or by starting new product divisions and repeating the cycle all over again. As mentioned above, 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.

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 fake sales to cooperating relatives) 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:

³² *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

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

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, in spite of what its promoters claim.

3. Surveys of ex-distributors reveal that few continue buying the products after leaving the MLM. They recall that little if any direct selling occurred outside of the network of distributors and their immediate families. (Surveys of ex-distributors are more valid than those of current distributors, who may have contracted to sell at retail to keep their distributor license.)

4. 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.³³

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 recruits in other areas or shifts to new product divisions in the company. Promoters can then sell to new recruits.

6. Signs of reporting inconsistencies can reveal a lack of direct sales – in contradiction to what MLM officials are telling law enforcement investigators. 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.³⁴

³³ "Survey of Tax Preparers", by Consumer Awareness Institute, (posted in 2004 on website for mlm-thetruth.com)

³⁴ *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 – based on the 1998 report of "Actual Average Incomes" of U.S. distributors for Nu Skin Enterprises." Since that time, NuSkin has not reported retail sales that they could not prove had

7. Direct observation can be revealing. 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 Nu Skin's expensive supplements directly to non-distributors. She sold to rich neighbors who were sympathetic to her struggle to succeed.



MLM is all about getting in early - or climbing to the top of the pyramid - where the big money is made.

2. Advancement in a hierarchy of multiple levels of "distributors" is achieved by recruitment and/or by purchase amounts, rather than by appointment.

Ask: Does a participating "distributor" advance one's position (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?

In MLM, the position in the hierarchy is determined not by appointment, but by time of entrance into the program and by recruiting success. When persons are recruited into such a program and then given incentives to buy products, they 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 retailing 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.” (Some MLMs use other terms for participants, such as “representatives,” “associates,” etc.) This is why I often place the term “distributors” in quotation marks. 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) Unfortunately, MLM participants are led to believe that purchases of goods and services are not part of the cost of doing business, so they don’t subtract these purchases when figuring supposed “income.”

Participants are typically not wise business managers so the customary subtraction of all costs from revenues to figure profits is ignored. Such purchases would be made from less expensive sources if any 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.



MLM participants subscribe to minimum product purchases in order to “play the game” – to qualify for commissions or advancement in the scheme

3. “Pay to play” requirements are met by ongoing “incentivized purchases,” 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” 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 play³⁵ purchases?” I coined the term “incentivized purchases” to refer to the practice of tying purchases of products from an MLM company with requirements to

³⁵ For this insight, I thank Kristine Lanning, former assistant to the Attorney General for North Carolina.

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. They are also called “pay to play” purchases. (See Appendix 2C for definitions)

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 incentivized and adequately enforced.³⁶

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

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 security or “business opportunity.”

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 a recruitment-driven MLM, and hence an illegal pyramid scheme.

However, in the typical scenario, initial registration or license fees are merely the beginning of the total investment for MLM participation. One must add incentivized ongoing purchases, which may total thousands of dollars a year.³⁷ They constitute a substantial portion of the cost of participating in the “business opportunity.” Whether they are used, sold, given away, or stored, is irrelevant.

Escalating incentives to continue purchasing products to qualify for higher commissions rates and/or ever-higher levels in the hierarchy of participants often leads “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 progress in the organization, *they are paying pyramid investment fees to “play the game,” one of the earmarks of a product-based pyramid scheme.*³⁸

If participants subtracted purchases and the operating costs of recruiting

³⁶ *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.*

³⁷ 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 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 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)

³⁸ *In FTC v. Amway* (1979 – 142-145), *Webster v. Omnitrition* (Discussion on “Pyramid”), and *FTC v. Skybiz* (29)

from commissions, they would find a high breakeven bar rarely exceeded by revenues. In other words, almost all participants below the TOPPs lose money.

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

Why are incentivized MLM product purchases not recognized as pyramid investments? Most MLMs offer lucrative incentives for recruiting an increasing number of “distributors” 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.

Such an amount paid 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 \$60 – \$40 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. Only motivated participants can be induced into paying for overpriced “pills, potions, and lotions” typically sold by MLMs.

In a randomized survey of house-holds in Utah County, Utah, where many MLMs are located, we found *four* MLM distributors for every *one* non-participating customer.

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.*³⁹

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

³⁹ (Advocare) “Policies, Procedure, and the Compensation Plan” (Rev. 10/21/08), “Section II: The Compensation Plan,” Chapter 4: “Advancing to Advisor,” p. 20.

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 when a professional sales person mentioned a bad experience with MLM on his way to becoming a real salesperson⁴⁰. And even in the books that Zig Zigar (who has written on MLM⁴¹) 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 advancement.

For a list of criteria to clearly distinguish between MLM and direct selling, refer to Appendix 2D: *“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 participant/victims of the schemes. It is extremely rare for MLM victims to recognize the fraud in an MLM program 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.

“Tools for success” – or just more money down the drain. The top distributors in some MLMs sell “tools” (books, audio programs, etc.) to aid new recruits in “building their business.” Their message to floundering 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 deficient. If they want to be successful, they need the proper “tools.”

The sellers of these tools may make more money on the sales helps than on the sale of products to or through their downline. While not required “pay to play” items, some upline promoters will not give the 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.

⁴⁰ *The Sales Bible: The Ultimate Sales Resource*, by Jefferey Gitomer (John Wiley & Sons, Inc., N.J., 2003)

⁴¹ Zigar, op cit

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.*”⁴² 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.*”

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 bonuses can be substantial. This is one of the earmarks of a pyramid scheme, as opposed to a legitimate direct selling program.⁴³

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!⁴⁴

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?

⁴² www.ftc.gov

⁴³ In *FTC v. Amway* (1979 – 142-145), *Webster v. Omnitrition* (Discussion on “Pyramid”), and *FTC v. Skybiz* (29)

⁴⁴ 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



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

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.

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.

Why is this top-weighted feature

one of the main problems with recruitment-driven MLMs? Compensation plans of recruitment-driven MLMs lead to extreme inequality in payout (money paid by the company) 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 large multitude of participants to the right of them 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 3,571 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 14,000 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 system, which dooms approximately 99.6% of ALL participants⁴⁵ (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 other sales settings, it is not unusual for a 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 in recruitment-driven MLM programs, 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 company – 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 income of front line “distributors” is extremely limited, forcing him or her to recruit a large downline to realize a significant income from commissions on downline purchases. Powerful incentives are then at work to recruit a downline of hundreds, even thousands, of participants.

A 99% loss rate wouldn’t be so serious, except that in opportunity meetings, the MLM is touted as the path to financial freedom, and the earnings of top distributors are displayed – but with no mention of the abysmal odds of getting there.

⁴⁵ To see how this was calculated, see Chapter 7.

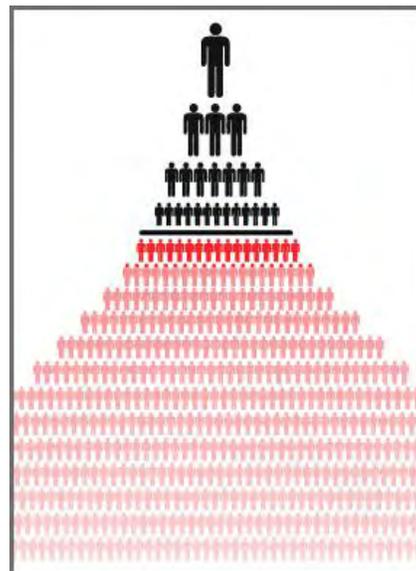
Can't low commissions to front-line distributors be offset by retailing products at marked up retail prices? MLM promoters claim “distributors” who buy products at wholesale prices from the company can then sell them at a higher retail price, such as happens in conventional retail outlets, which allow for a substantial retail profit margin. MLM companies then go to great lengths to assure recruits and 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 miraculous and/or 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.

However, out of over 500 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 – to recruit a revolving door of new recruits who buy products in order to participate in the “opportunity.”



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

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?”⁴⁶

For even the largest of conventional distributor arrangements, the entire U.S. can be covered by four supervisory levels in

⁴⁶ 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.

the distributor 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 unprofitable (except for TOPPs) and unrealistic.

Why does 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 “distributors,” other than to encourage recruiting and the illusion of very large potential incomes to more participants than is mathematically possible – a hallmark of pyramid schemes.

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. (See below.) This should be considered “unjust enrichment” – certainly an unfair and deceptive trade practice.

*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!⁴⁷ 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 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 recruitment-driven MLMs is much higher than for classic, no-product pyramid schemes.

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.

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.

The pyramid grows exponentially as shown below:

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: (3,905x5=) 19,525 + 3,905 =
23,430 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.

⁴⁷ Quixtar Business Reference Guide, 2007, and Amway Business Reference Guide (or counterpart), 1979,

Of course, it seldom works out that way, but these are the type of figures that are often presented to illustrate why recruiting is emphasized, as opposed to selling products to persons outside the pyramid. An income of \$97,650 is much 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).

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.

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, not of individual participants, but 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 in a breakaway system, 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.

Other MLM compensation plans have their own unique problems, primarily obfuscating the fact that the programs are designed to enrich TOPPs at the expense of a multitude of downline participants.

“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 necessarily 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 also be noted that 2-up recruits that fail to recruit two others become in effect the downline of someone above them. This could continue for several levels.

In summary, a recruitment-driven MLM, or product-based pyramid scheme, is characterized by an endless chain of recruitment of participants incentivized by a multi-level pay plan and whose investments (in the pyramid scheme) are typically laundered through ongoing purchases of overpriced products, rather than through upfront recruitment fees.

Harm of recruitment-driven MLMs

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

1. *Loss rates are extremely high.* To those who understand the numbers, this is the harm that is most objectionable.

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



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

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. And the mode, or most common measure, is also zero. 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.

In typical MLMs, the more you invest, the more you lose. Of all those approached, the most fortunate are those who refuse to join at all.

2. *Since the compensation and marketing system is weighted towards recruitment, instead of retailing of products, recruitment-driven MLMs are technically illegal in many jurisdictions. This one effect is the basis of most statutes against pyramid schemes.* Recruiting MLM promoters go to great lengths to make it appear that their revenues come from direct selling of products, which is simply not the case.

3. *Misrepresentations abound.* Deception is essential for the MLM company to survive and grow. If the truth were told about the odds of success, few would join an MLM.

Some MLM promoters also 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 typical misrepresentations used in recruiting MLMs. With this many falsehoods used in MLM recruitment campaigns, it would not be exaggerating to

consider the income thus generated as “theft by deception,” and certainly ill-gotten gain.

4. *Recruiting MLMs evolve into Ponzi schemes, with promoters moving from one location to another, as each area is increasingly perceived by the public 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 are usually found in a losing position. MLM companies sometimes try to get around this by starting new divisions, introducing new products, or entering new geographic regions to start new pyramids, a process I call “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 position they gained. 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. 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.*



Stockpiling is common

6. *Stockpiling of products is common, a fact seldom admitted by MLM participants. Many wind up making excessive purchases in their own name or in the name of downline “distributors” 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.

7. The regulatory process – essential in a democracy to protect consumers – 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 close relatives or friends) – and having been taught that any failure is “their fault.”

Lacking such complaints, law enforcement seldom acts against these scams. *This complacency on the part of those responsible for consumer protection creates, in effect, a “license to steal.”*

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

9. A perverse risk-reward relationship develops with recruiting MLMs. In legitimate businesses, the more time and money one invests (risks) in the business, the more likely it is that success will be achieved. But with recruiting MLMs, with the exception of the first ones in and those at the top of the pyramid, the more one invests, the more one loses.

The luckiest of MLM participants are those who invest the least time and money. Of all those approached, the most fortunate are usually those who refuse to join at all.

10. Extreme leverage results, meaning the majority of company payout goes to participants at the top of the hierarchy or pyramid. Cases of huge gains of some distributors are rare, but are held up as examples for all prospective recruits to see. However, for the vast majority of MLM participants, actual profits are rare.

11. 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. See Table 1 for some of the effects stemming from the CDCs of recruitment-based MLMs, both individually and in combination.

12. Personal losses can be substantial, including psychological, social, and spiritual harm⁴⁸ – far outside of the norm for legitimate businesses. Some MLM participants lose far more than money for their participation. 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 a recruiting MLM. 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 attitudes to more materialistic and greedy motivations often becomes apparent from MLM participation. These consequences help explain why some see MLM as an unethical business model.⁴⁹

Considering all the harmful effects of MLM, it is easy to see why MLMs are far more harmful than classic, no-product 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 no-product pyramid schemes, all the money goes to the top.

Considering all the harmful effects of MLM, it is easy to see why MLMs are far more harmful than classic, no-product pyramid schemes. They have a higher loss rate, cause far greater losses in the aggregate, and affect far more victims.

⁴⁸ For examples, go to feedback in Appendix of Chapter 9.

⁴⁹ Jon M. Taylor, *The Network Marketing Game: Gospel Perspectives in Network Marketing*. op cit. See also *False Profits*, by Robert Fitzpatrick. (Herald Press: Charlotte, N.C., 1997).

The unsavory reputation of MLM among the general public in the U.S. Fifteen years of feedback from all over the world confirms what most consumer advocates have observed – that MLM generally has an unfavorable reputation among the general public. This certainly has been true in surveys of consumers that I and others have done. I also found it interesting to do an advanced Google search of the [exact] term “fraud,” with [one or more of these words] “multi-level marketing,” “network marketing,” or “MLM.” There were over 1 million results!

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.

Few would question the underlying flaws in chain letters of the past, where you pay five

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 influential political candidates and charitable causes; 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. .

Table 1: Characteristics and effects of 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. 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 recruitment-driven MLMs, most recruits are doomed to failure. |
| 3. “Pay to play” requirements are met by “incentivized purchases”. | Raises breakeven bar, assuring losses for most participants. May place MLM in category of a security or business opportunity – or a de facto investment in a pyramid scheme. Encourages hyper-consumption of products by participants – who are the primary buyers. |
| 4. Company payout per sale for upline participant 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 more “distributor” levels than are functionally justified. | Demonstrates primary income is from recruiting, not retailing. 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 that make direct sales with retail markup 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 (approximately 99.7%) – 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 fraud and misrepresentation in order to survive and grow. |

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 schemes⁵⁰ 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 no 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.

As discussed previously, classic, no-product pyramid schemes offer no product, 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 (top-of-the-pyramid promoters).

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 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. In pyramid schemes, the timing of entry affects rank position in the pyramid (and resultant level of pay) of participants.

Unlike Ponzi schemes and no-product pyramid schemes, some of the more successful MLMs are able to continue almost indefinitely, not only by expanding overseas, but by introducing new “product divisions” or name brands and starting the whole recruitment process all over again. And of course, 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 divisions. *This is a process I call “re-pyramiding.”*

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. For example:

- *Are MLM participants employees of the company?* As discussed above, MLM executive 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.⁵¹ 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

⁵⁰ The history of pyramid and Ponzi schemes will be discussed in Chapter 10.

⁵¹ For a thorough discussion of bad legislation (IRC § 3582) pushed by lobbyists in 1982 to reclassify 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>

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 Direct Selling Assn (which I prefer to call the “DSA/MLM cartel”) 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. See Appendix 2D 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 as those purchased 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 business opportunities?* 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 law enforcement officials – including the FTC in comments filed by MLMs regarding its Business Opportunity Rule.

- *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. 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 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 500 MLM schemes, I feel more comfortable than ever labeling them recruitment-driven MLMs, or product-based pyramid schemes.*

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!



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, low payout percentage, degree of leverage enjoyed by TOPPs (at the expense of new recruits), and total number of victims.

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. Definitions and terms designating pyramid schemes used in state statutes are compiled in Appendix 2E. One can see from reviewing these that it is no wonder there is so much confusion on terminology.

Since MLMs depend on unlimited recruitment of a network of endless chains of participants, some insist that a “good MLM” is an oxymoron.

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 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 products.

2. An MLM could reward selling of products more than recruiting by paying at least half of the total company payout 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 to participants was 50% of total 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. This could make retailing to non-participants profitable.

3. “Pay to play,” or incentivized purchase requirements would be minimal or non-existent. Participants would be eligible for commissions and/or bonuses without having to satisfy a minimum of over \$100 a year. They should not lose their status if they have a bad month and fail to meet a monthly quota. This could minimize losses.

4. The number of levels in the payout structure would be no more than are functionally justified. Any sales program 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 individual participants. (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.

5. In a hypothetical “retail MLM” that’s both legal and ethical, products would be sold at competitive prices; and distributors could succeed from retailing the products, not just from recruiting and selling to their downlines at inflated prices. Not having to pay on so many levels would make competitive pricing possible, although MLM may never compete with discount outlets. If the pay plan were limited to three levels, retail sales prices could be even lower.

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 limits 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 “8-ball” 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 selling 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 would 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.

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 they would not make obscene profits with such strict protections against abuse.

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, and many in the media into believing that they were legitimate “direct selling companies.”

Conclusions

An accurate, research-based, and consumer-friendly definition of MLM (multi-level or network marketing). Based on 18 years’ consumer advocacy and research, I can now articulate what I believe to be an accurate definition. It incorporates the four causal and defining factors of a recruitment-driven MLM discussed above. I am confident this definition is the most useful for analytical purposes, as it holds true for all 500 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 in summary, here is perhaps the only real-world, consumer friendly, research-based definition of the business model which is termed multi-level marketing, or MLM. It is much closer to the truth than those cited earlier.

Multi-level marketing (MLM) is a purported income opportunity, in which persons recruited into a company-sponsored program make ongoing purchases of products and services, and are incentivized to recruit others to do the same, in a program dependent on unlimited recruitment of a network of endless chains of recruitment and personal consumption, in order to qualify for commissions and bonuses and to advance upward in the hierarchy of levels in a pyramid of participants. Product

purchases become the means of disguising or laundering investments in what is in fact an endless chain opportunity scheme – or product-based pyramid scheme.

Based on my research that will be explained in later chapters, I would add the following:

Typically, prospects are lured into the scheme with exaggerated product and income claims. And because the pay plan is heavily stacked in favor of those at the highest levels in the pyramid, the vast majority of participants spend more than they receive and eventually drop out, only to be replaced by a stream of similarly misled recruits, approximately 99% of whom are likewise destined to experience loss and disappointment.

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 effects of MLM on the company and on its participants.

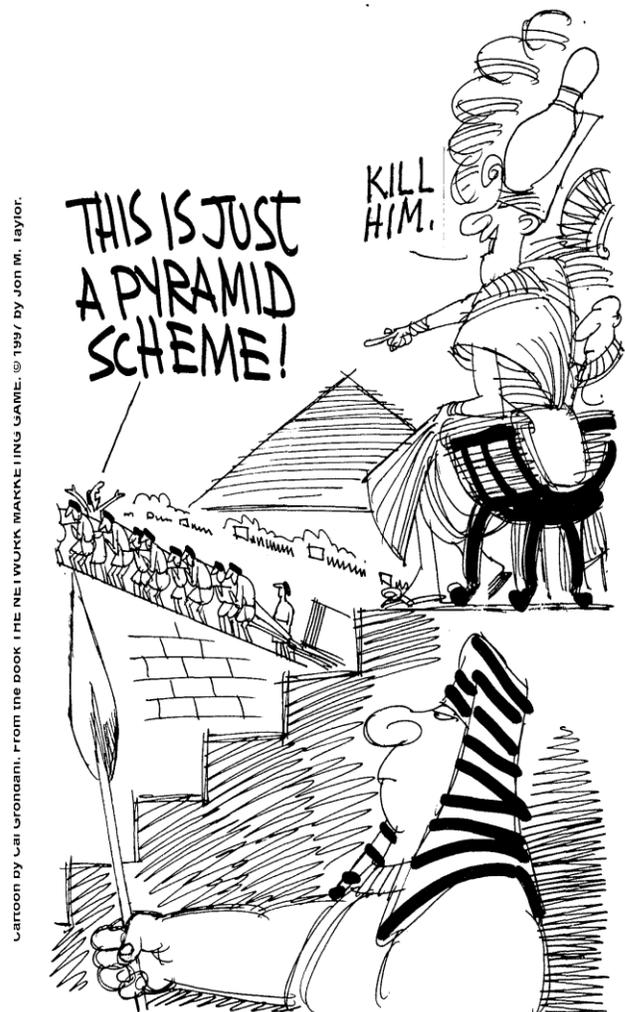
Some regulators made decisions on the theory (and may have been convinced by MLM promoters) that if MLMs were pyramid schemes, they would be destined for ultimate collapse. However, as discussed above, Amway defenders were able to refute this argument on the grounds that Amway had already been operating for some many years without coming even close to saturation and collapse. If is obvious the prosecutors did not understand the difference between total saturation and market saturation, which 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 that the company can continue to thrive. This will also be explained in Chapter 3.

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 a better 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 hypotheses might be framed like this:

Assuming MLM's unlimited 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, which are often those who enrolled at or near the beginning of the chain of recruitment in any specific market. And given the costs of participation, it would be rare for new participants to realize profits above expenses – meaning the vast majority lose money. And accordingly, attrition for MLM participation would be high.

This hypothesis will be tested in upcoming chapters. In fact, in Chapter 7 I will 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: Examples of complex MLM compensation plans (Many are far more complex than these.)

Example #1

| | | | | | |
|---|---|--------------------------------|-------------|---------------------------------|---|
|  | Fast Start | Fast Start will be paid weekly | | |  |
| | Minimum monthly production requirement ¹ | 60 PV Auto | 120 PV Auto | Business Builder 240 PV Auto | |
| | Personally Sponsored | 20% | 30% | 33% | |
| | Business Builder Rollup ² | 20% | 10% | 7% | |

| Unilevel - Dynamic Compression | | Unilevel bonus will be paid monthly | | | | | |
|---|--------------------|-------------------------------------|-------------------|-------------------------|-------------------------|--------------------------|--------------------------|
| Level | Base Camp | | Everest 1 (E1) | Everest 5 (E5) | Everest 20 (E20) | Everest 50 (E50) | Everest 100 (E100) |
| Group Volume | Preferred Customer | Distributor | 1,000 | 5,000 | 20,000 | 50,000 | 100,000+ |
| Minimum monthly production requirement ¹ | Autoship | 60 PV | 120 PV Auto | 120 PV Auto | 240 PV Auto | 240 PV Auto | 240 PV Auto |
| Minimum monthly leg requirement | | | 3 legs | 3 legs 1,000 GV each | 3 legs 4,000 GV each | 3 legs 10,000 GV each | 3 legs 20,000 GV each |
| | 1 | 5% | 5% | 5% | 5% | 5% | 5% |
| | 2 | 5% | 5% | 5% | 5% | 5% | 5% |
| | 3 | 5% | 5% | 5% | 5% | 5% | 5% |
| | 4 | | 5% | 5% | 5% | 5% | 5% |
| | 5 | | | 5% | 5% | 5% | 5% |
| | 6 | | | | 5% | 5% | 5% |
| | 7 | | | | | 5% | 5% |
| | 8 | | | | | | 5% |
| Tashi Shares | | | | 1 | 2 | 5 | 10 |

| ABOVE THE CLOUDS BONUS - 10% | | | | | | | | | | | | | | | | | | |
|---|--------------------|---|-----------|--------------------|------------------------------|-------------------|-----|--|-------------------|-----|--|-------------------|-----|---|--------------------|-----|---|--|
| Tashi Bonus - paid monthly | 6% | Everest Summit Bonus - paid quarterly | 2% | | | | | | | | | | | | | | | |
| <ul style="list-style-type: none"> Share of global bonus pool is calculated as a 'share' with qualification depending upon attaining level requirements. Shares of all qualifiers will be added and global bonus will be paid according to an individual's total number of shares. Bonus will be paid monthly along with 'unilevel bonus.' | | <table border="1"> <thead> <tr> <th>Volume</th> <th>Bonus ³</th> <th>Monthly Average Requirements</th> </tr> </thead> <tbody> <tr> <td>150,000 (E150)</td> <td>.5%</td> <td>3 legs minimum 30,000 GV each plus an additional leg minimum 20,000 GV</td> </tr> <tr> <td>300,000 (E300)</td> <td>.5%</td> <td>3 legs minimum 60,000 GV each plus an additional 2 legs minimum 20,000 GV each</td> </tr> <tr> <td>600,000 (E600)</td> <td>.5%</td> <td>3 legs minimum 120,000 GV each plus an additional 3 legs minimum 20,000 GV each</td> </tr> <tr> <td>1,000,000 (E1M)</td> <td>.5%</td> <td>3 legs minimum 200,000 GV each plus an additional 4 legs minimum 20,000 GV each</td> </tr> </tbody> </table> | Volume | Bonus ³ | Monthly Average Requirements | 150,000 (E150) | .5% | 3 legs minimum 30,000 GV each plus an additional leg minimum 20,000 GV | 300,000 (E300) | .5% | 3 legs minimum 60,000 GV each plus an additional 2 legs minimum 20,000 GV each | 600,000 (E600) | .5% | 3 legs minimum 120,000 GV each plus an additional 3 legs minimum 20,000 GV each | 1,000,000 (E1M) | .5% | 3 legs minimum 200,000 GV each plus an additional 4 legs minimum 20,000 GV each | |
| Volume | Bonus ³ | Monthly Average Requirements | | | | | | | | | | | | | | | | |
| 150,000 (E150) | .5% | 3 legs minimum 30,000 GV each plus an additional leg minimum 20,000 GV | | | | | | | | | | | | | | | | |
| 300,000 (E300) | .5% | 3 legs minimum 60,000 GV each plus an additional 2 legs minimum 20,000 GV each | | | | | | | | | | | | | | | | |
| 600,000 (E600) | .5% | 3 legs minimum 120,000 GV each plus an additional 3 legs minimum 20,000 GV each | | | | | | | | | | | | | | | | |
| 1,000,000 (E1M) | .5% | 3 legs minimum 200,000 GV each plus an additional 4 legs minimum 20,000 GV each | | | | | | | | | | | | | | | | |
| Sibu Discovery Bonus | 2% | Exciting trips, prizes and other incentives to reward the hard work and efforts of Sibu Distributors | | | | | | | | | | | | | | | | |

¹ PV requirements can be satisfied through personal or retail customer/autoship purchases.

² Business Builder Rollup pays out to the personal sponsor's first qualifying Business Builder upline.

³ Prorated based on position volume.

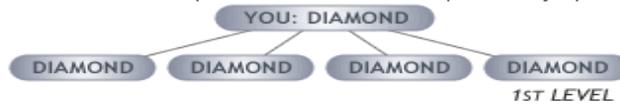
All commissions paid via EFT will be free. Commissions paid by check will be subject to a 2 USD administration fee and will be limited to 10 USD minimum. Sibu reserves the right to make changes to the Compensation Plan.

Example #2:

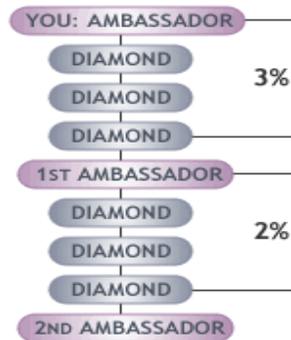
Becoming an Ambassador Affiliate

QUALIFICATION

The fourth stage of compensation: Diamond bonus qualifiers will earn the Ambassador Bonus on is the Ambassador bonus. Diamond bonus qualifiers who have four personally-sponsored s.



BONUSES



The Ambassador bonus pays an additional 3% bonus on your organization’s bonus points down to the first Ambassador bonus qualifier, and then a 2% bonus down to the second Ambassador bonus qualifier.

Becoming a Presidential Affiliate

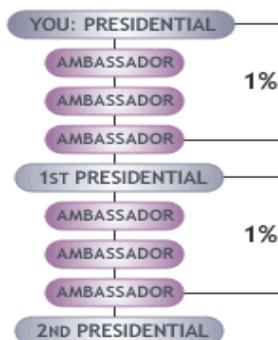
QUALIFICATION

Diamond bonus qualifiers who have eight personally-sponsored Diamond bonus qualifiers will earn the Presidential bonus



BONUSES

The Presidential bonus pays an additional 1% bonus on your organization’s bonus points down to the first Presidential bonus qualifier and a 1% bonus down to the second Presidential bonus qualifier.



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 admitted in a meeting I attended, "Our compensation plan IS our product."

Here are the basic MLM compensation plans:

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.

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. 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 in the first level 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."

Stair step/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 is 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

Definitions of Other Relevant Terms

Compensation plan – the method of compensating participants in a program, which can be very elaborate in recruitment-driven 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 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. De facto 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.

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. 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 – the same as “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 report 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 report, 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 persons recruited into a company-sponsored program make ongoing purchases of products and services, and are incentivized to recruit others to do the same, in a program dependent on unlimited recruitment of a network of endless chains of recruitment and personal consumption, in order to qualify for commissions and bonuses and to advance upward in the hierarchy of levels in a pyramid of participants. Product purchases become the means of disguising or laundering investments in what is in fact an endless chain opportunity scheme – or product-based pyramid scheme.

“Typically, prospects are lured into the scheme with exaggerated product and income claims. And because the pay plan is heavily stacked in favor of those at the highest levels in the pyramid, the vast majority of participants spend more than they receive and eventually drop out, only to be replaced by a stream of similarly misled recruits, approximately 99% of whom are likewise destined to experience 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 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 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 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 recruitment-driven 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 recruitment-driven 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 de facto 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.

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.”⁵² 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 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 recouping it to some degree via recruitment are bound to be disappointed.⁵³

Here is an example of the definition that existed in at least state statute:

“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

⁵² *FTC Consumer Alert*, December 1996

⁵³ *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).

the introduction of other persons into the sales device or plan rather than from the sale of goods, services, or other property.”⁵⁴

While this definition is used extensively for legal purposes, it does not address the issue of harm to participants, which is the primary focus in this paper.

Product-based pyramid scheme – 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, qualifies distributors for commissions in ascending levels in the distributor hierarchy.

Recruitment-driven MLM – an MLM with a compensation plan that rewards primarily distributors who recruit huge downlines, and is therefore a product-based pyramid scheme.

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.”⁵⁵

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.

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.

⁵⁴ *Pyramid Schemes*,” Div. of Consumer Protection, State of Utah – similar to definitions used in other states. Unfortunately, in 2006 the DSA initiated legislation in the Utah legislature exempting companies that sold products that could be sold to anyone, including participants. Testifying on behalf of the bill (SB182) was Attorney General Mark Shurtleff, who failed to disclose that he had received \$50,000 from PrePaid Legal. All told, he has received over \$¼ million from grateful MLM companies.

⁵⁵ Merriam Webster’s Collegiate Dictionary, Tenth Edition, 1993

Appendix 2D: 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. For MLM companies with 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 | LEGITIMATE DIRECT SALES (incl. insurance sales) | RECRUITMENT-DRIVEN MLMs (that reward participants for recruiting large downlines Amway, Nu Skin, Nikken, etc.) |
|---|--|--|
| 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 idle 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. |
| 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 commission <u>per sale</u> from the company as the person doing the selling – or the person who recruited him/her. And reselling at a profit products bought at high wholesale prices is unrealistic. |
| 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 – The primary focus is on recruiting more MLM 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 recruitment-driven MLMs, it is rare for participants (except for those at or near the top of the pyramid), to report profits on their tax returns. |

Appendix 2E: 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 March 5, 2010)

Arkansas

A pyramiding device shall mean any scheme whereby a participant pays valuable consider-

ation 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 inseparable 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 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. (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. (W. Va. Code Ann. § 47-15.1)

Wisconsin

"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. (586 Wis. Admn. Reg. 759 (October 2004), ATCP 122)

Wyoming

"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. (Wyo. Stat. Ann. § 40-3-101)

Appendix 2F

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

Analysis performed 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 500 MLMs to 2012, I could find no examples of true retail-focused MLMs.

How these distinctions were derived

Fortunately, I was able to draw from an extremely broad background in home businesses to make these comparisons, having 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. 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 recruitment-driven MLM's, 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 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) “recruitment-driven MLM” companies. What I found was startling – far worse than expected. After eliminating typical deceptions in their reporting, the loss rate for the recruitment-driven MLMs for which I was able to find average earnings data was approximately 99.7%. That means that less than one in 100 participants earns 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 pyramid schemes are marked in **blue**.

Recruitment-driven MLMs are **red**.

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

Significant effects that are not causal are marked in **green**, 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 500 MLMs have 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) |
|--|------------------------------|------------------------|------------------------|---------------------|---------------------------|--------------------------|---------------------------------|----------------------------|---|
| 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? | 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. |
| 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.? | 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. |
| 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? | 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. |
| 4. THE 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. | 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. |
| 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. | NO | NO | NO | NO | NO | NO – not usually | Usually – if not, #5 is more | 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. |
| 6. ALL THE MONEY GOES TO THE TOP (applies to NPS only). Would participants who recruit other participants into the scheme receive nothing until advancing to the top level in the hierarchy? | 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 (hypo-theoretical) | 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. Addiction 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. Or e-mail questions to Dr. Jon Taylor: jonmtaylor@juno.com. © 2012, 2003 Jon M. Taylor

The Case (for and) against Multi-level Marketing

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

Chapter 3: MARKET SATURATION AND COLLAPSE – how established MLMs skirt two fundamental flaws in their systems

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Introduction and summary

This chapter expands on the concepts related to market saturation and collapse introduced in Chapter 2. The impossible math of endless chains is explained and illustrated. Chain letters are explained and how they evolved into pyramid schemes, which were later enhanced 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 been successful in convincing regulators, the press, and the general public that they operate on a different principle than 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 – allowing unlimited recruitment of a whole network of endless chains of participants.

Market saturation and collapse happens in MLM, but the companies have found ways to circumvent the damage by getting participants to absorb the losses. As a system of unlimited recruitment into a network of endless chains of participants, MLM is flawed,

uneconomic, and fraudulent. It is also extremely viral and predatory.

The impossible math of endless chains

A distinguishing characteristic of multi-level marketing (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.



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. In every case, an underlying assumption in their compensation plans is an infinite market and a virgin market – neither of which exists in the real world. This is illustrated in an MLM that requires each participant to recruit two persons in order to be rewarded commissions (overrides) from the purchases of those beneath them in the pyramid of participants. And each of them must do the same, ad infinitum.

To show how saturation is inevitable, in a binary pyramid one person recruits two people, each of them two more, and they two more, etc., as follows:

$1 \times 2 = 2$
 $2 \times 2 = 4$
 $4 \times 2 = 8$
 $8 \times 2 = 16$
 $16 \times 2 = 32$
 $32 \times 2 = 64$
 $64 \times 2 = 128$
 $128 \times 2 = 256$
 $256 \times 2 = 512$
 $512 \times 2 = 1,024$
 $1,024 \times 2 = 2,048$
 $2,048 \times 2 = 4,096$
 $4,096 \times 2 = 8,192$

. . . 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. An illustration of the viral nature of MLM is depicted in Exhibit 1.

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. MLM is a mathematical trick played on unsophisticated new recruits.

At any point in an endless chain selling scheme, all those on the bottom of the pyramid are left in a losing position, which is the vast majority of participants. MLM is a mathematical trick played on the unwary.

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 website at – www.usps.gov/websites/depart/inspect:

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. . . .

No-product pyramid schemes

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 work⁵⁶ – except for those at the beginning of the recruitment chain who position themselves at 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.

It is interesting that in the Koscot case⁵⁷, the court noted, "*The Commission has previously condemned so-called 'entrepreneurial chains' as possessing an intolerable capacity to mislead.*"⁵⁸ This

⁵⁶ VanDruff, Dean, "What's Wrong with Multi-level Marketing," available from his web site at www.vandruff.com/mlm

⁵⁷ 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)

⁵⁸ 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-

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 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.



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.

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.

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).

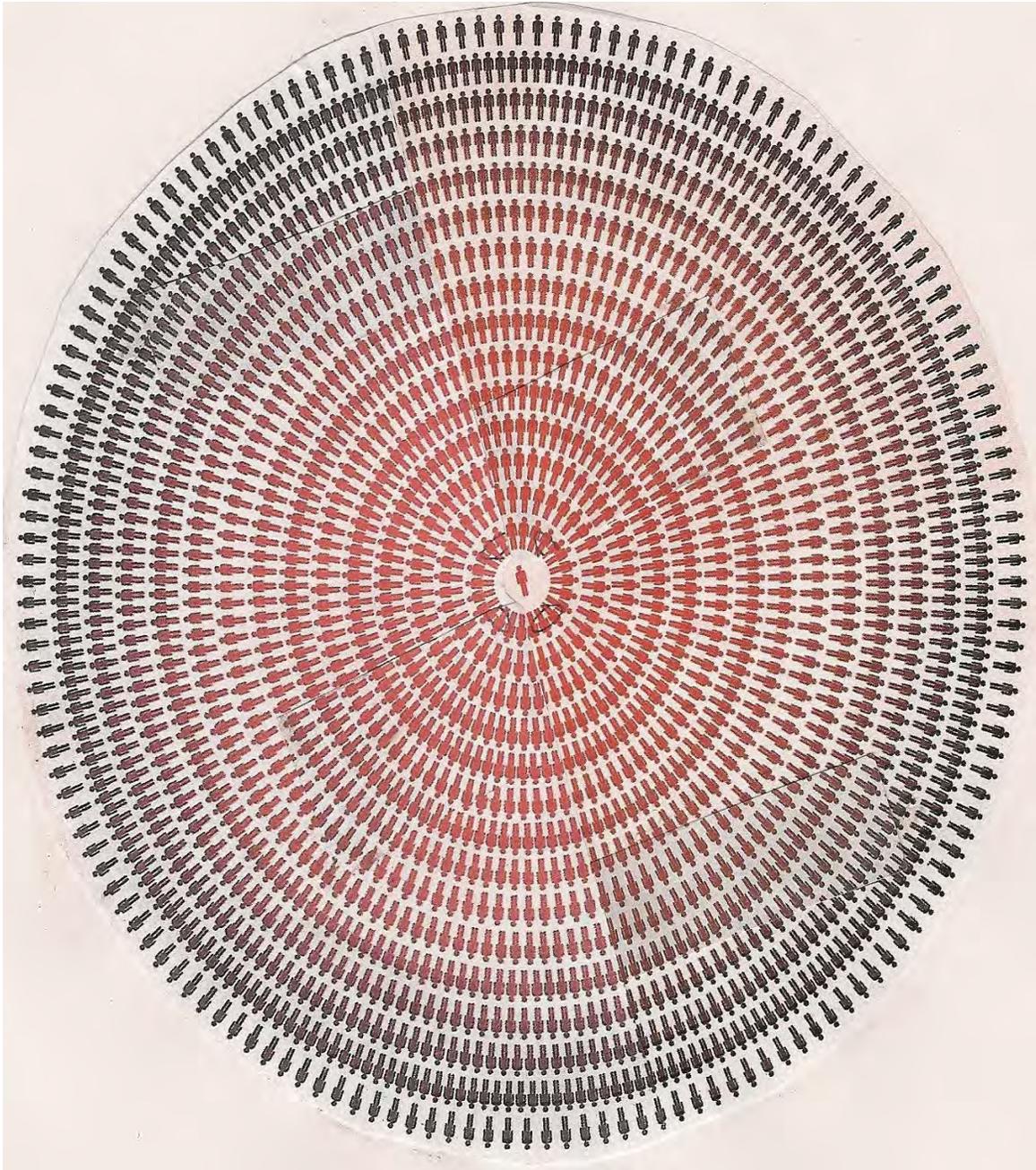


Exhibit 1: MLMs are viral and predatory.
MLM as a business model – which rewards expansive (unlimited) recruitment, is not only flawed, uneconomic, and deceptive, it is also both viral and predatory, like a fast-growing cancer or virus. MLM promoters promise prospects relief from financial want, but their programs result in loss and disappointment for the vast majority of recruits.

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”⁵⁹ - except for the obvious introduction of products into 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.

It is important to draw a distinction between total saturation and market saturation. A city of 100,000 people surely could not support 100,000 direct selling distributors. Any expectation of such total saturation would be absurd unless everyone was selling only to himself/herself. On the other hand, market saturation may be reached with only 10 or 20 distributors.

Market saturation and collapse

Total saturation or market saturation? In the 1979 case, Amway successfully argued to an FTC administrative law judge that total saturation, theoretically associated with a pyramid scheme, had never happened and was not possible.⁶⁰ 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. *And of course, market saturation can be extended not only to communities, but to whole countries and even the entire world. Eventually, 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, sales distribution from numerous competing products adds to the saturation of any given market for any given set of products. So whether or no market saturation has been reached with only a few MLM distributors in a city, the city could be said to have reached 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 for its population of headquarters of MLM companies in the U.S. In a randomized survey of consumers we conducted there⁶¹, 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 respect.

See Exhibit 2, 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 approximately one MLM for every 17,813 persons.

⁵⁹ 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

⁶⁰ Robert L. Fitzpatrick, *Pyramid Nation: The Growth, Acceptance and Legalization of Pyramid Schemes in America*, Pyramid Scheme Alert, page 39.

⁶¹ 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.

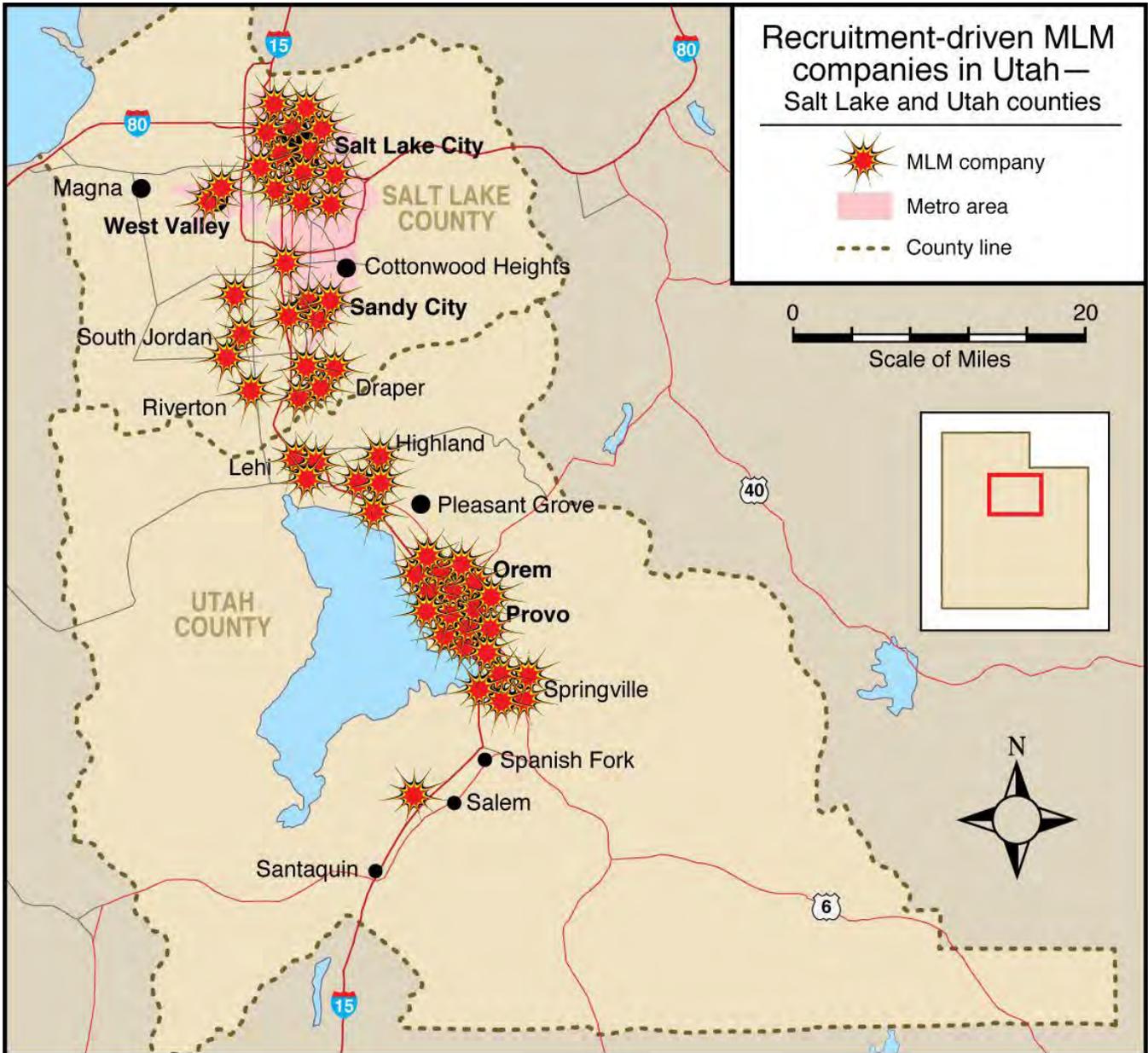


Exhibit 2: Recruitment-driven MLMs are exploding in Utah.

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.

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 law enforcement.

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 positions at or near the top of the pyramid, which are often the first ones in.

Mathematically, approximately 90% of all participants in classic 8-ball (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 - depending on the number of those cashing in at the top 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.

In the case of MLMs, (as with market saturation) the more successful MLMs escape total collapse by recycling a stream of new recruits through new markets and new products. In effect, collapse is continuous, with any losses being born by the new recruits. Meanwhile, instead of collapsing, the company continues to grow, as long as it can continue aggressively recycling new recruits through its system. 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 and Nu Skin.

Survey of households in a 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 households in Utah County 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

It should be noted that 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 contrast, in MLMs, or product-based schemes, 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 minimal expenses, in addition to “pay-to-play” purchases necessary to progress or qualify for commissions. This will be discussed at length in Chapter 4.

MLMs have been successful in positioning themselves as “direct sales” programs that are exempt from laws against pyramid schemes. Regulators, the Better Business Bureau, and the media will be quick to condemn a no-product pyramid scheme, but will exonerate a far more harmful product-based pyramid scheme (MLM).

Many critics and regulators are hesitant to refer to MLMs as pyramid schemes, fearing a vigorous defense by MLM apologists. However, all the evidence gathered in this research suggests that of all classes of pyramid schemes, recruitment-driven MLMs (which is virtually all of them), or product-based pyramid schemes, are by far the most damaging of all classes of pyramid schemes – by any measure, whether it be loss rates, aggregate losses, degree of leverage, or number of victims.

The 8 R's of MLM durability

More established MLMs have managed to avoid collapse and grow massive downlines (pyramids of participants), 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 R's of MLM durability":

1. *Re-pyramiding*. When MLM company officers see that the "pyramid" is about to collapse, they start a new division, introduce new products, 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.

MLMs can spread virally across borders worldwide



We could even consider that an MLM could reach global saturation when it has saturated markets all over the world. But by re-pyramiding, some have managed to continue indefinitely world wide.

2. *Rewards*. The profitability for the MLM company and the payout to TOPPs (top-of-the-pyramid promoters) is so great that they will routinely misrepresent both products and the "opportunity" and will go to great lengths to keep the scheme going, including all of the following:

3. *Ruse*. MLMs have been enormously successful in positioning themselves as direct sales programs that are exempt from laws against pyramid schemes. Even many 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."

As this paper demonstrates, a *recruitment-driven MLM company 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 MLM's is that their program "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!

4. *Repeated investments* ("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 a subscription basis by automatic bank

withdrawal 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 scheme.

5. *Recruitment of a revolving door of replacements.* 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 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 correctly” – 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.

6. *Rationalization and self-blame.* 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.

7. *Retail “rules.”* The trick for a recruitment-driven 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.* The MLM company may go to great lengths to enhance its legitimacy and its credibility. They may 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 recruitment incentives of an MLM or product-based pyramid scheme is 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 recruitment-driven MLMs, with each new recruit under pressure to recruit numerous others to recover his/her costs of participation – let alone profit. Recruitment-driven MLMs are like a fast-growing cancer – *viral and predatory*.

Each new recruit has a personal stake in advancing the scheme so that he or she 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 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, recruiting is essential in many 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 infinite recruiting program in a finite population of prospects – predetermined to failure and losses suffered by nearly all participants, with the exception of a few at the top (or who got in at the beginning) of a pyramid of participants. Therefore, 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. 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.

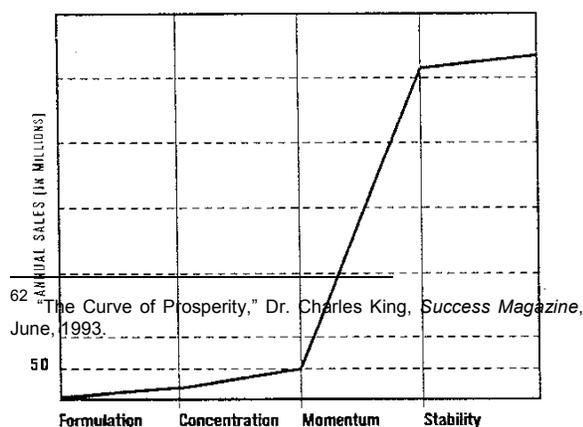
“Residual income,” or payments-in-perpetuity may work in principle on one level with creative writers, inventors, persons who sell insurance or annuities, etc. But in MLM, while such payments in perpetuity for more than one level increases the financial leverage of the upline, they also increase the mathematical absurdity of the whole system. In MLM, you actually have a system that features infinite expansion in time and space in a marketplace that is finite in time and space. To anyone who understands the math, this makes MLM inherently flawed, unfair, and deceptive.

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 MLM promoters, one would think so.

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 recruitment-driven 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” that is experienced by MLM firms⁶². He suggests that they go through stages in a growth cycle from formulation to concentration, then from momentum to



stability. However, he fails to mention the phase of market saturation and collapse, unless measures discussed above are taken to replace the high percentage of dropouts.

The curve of (MLM) prosperity

Conclusions

MLM is inherently flawed, unfair, and deceptive – and both viral and predatory.

A fundamental flaw in all MLMs are compensation systems that empower and motivate each participant to recruit other participants in an endless chain of recruitment. MLM assumes both infinite and virgin markets – neither of which exists in the real world. They are therefore inherently 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 cycle through more 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

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.

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.

The Case (for and) against Multi-level Marketing

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

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 expected 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 500 MLM programs, it has become apparent that a typical strategy of MLM sponsors is to produce dietary supplements that supposedly cure or – with appropriate antioxidants - prevent every disease under the sun. Most MLM companies I have studied claim to have the latest and greatest supplement that is just not available anywhere else in such high quality for the price. They even claim to “bypass the middle

© 2011, 2012 Jon M. Taylor 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

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.

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.

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,⁶³ 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 review⁶⁴ 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.



Highly touted anti-oxidant supplements may not be anti-anything – just costly.

Antioxidant vitamins, including A, E and C, don't help you live longer, according to this analysis of a large sample of

⁶³ 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)

⁶⁴ “Vitamins A, C, and E don't help you live longer.” MSNBC- Associated Press, Updated: 4:18 p.m. MT Feb 27, 2007

studies of these popular supplements. The new review showing no long-life benefit from those vitamins, plus beta carotene and selenium, adds to growing 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.

An estimated 80 million to 160 million people take antioxidants in North America and 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 report⁶⁵ 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.

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 was the way to assure repeat business. As was explained in Chapter Two, MLM companies sustain themselves primarily by incentivizing purchases participants must make in order to qualify for commissions and to advance up the various levels in the pay plan.

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 this out, I asked representatives from ten MLM companies for the prices of their “best reasonably priced formulation of multi-vitamin multi-

⁶⁵ 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.

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 MLM sponsors, including Pharmanex, 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!

I also spoke with three nutritional formulators who formulate and manufacture supplements for both retailers and MLM companies. Allen, one of the three nutritional formulators I mentioned earlier shared an interesting experience. 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."

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

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 five times as much as shelf items!

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 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



\$50 a bottle - for fruit juice? (MLMs use a fancier bottle.)

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 – up or down - has changed very little during the superfruit craze. As one health food owner put it, “The shelf life of the demand for MLM products coincides with the MLM “business opportunity” – and vice versa!”

For more excellent information on superfruit juices, read the article posted by Brian Denning, which includes a summary of a major study by the Australian Consumer Association (See Appendix 4B)

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.*” (See Appendix 2F) 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.

The shelf life of the demand for MLM products coincides with the MLM “business opportunity” – and vice versa!

Why MLM products are priced so high.

Thousands of middlemen (and women). 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 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 several 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 case⁶⁶ 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 the Quixtar’s prices concluded that “Quixtar has few actual customers and that few IBOs (‘independent business owners’) are selling

⁶⁶ 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

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”] 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 Quixtar⁶⁷, 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 is rendered 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.”

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 mentality characteristic of political rallies or sports gatherings – or even of popular cults in other settings.

For years I made my living in legitimate direct selling, including selling 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.

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, 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

⁶⁷ Complaint and demand for Jury Trial, U.S. District Court for the Central District of California, Case No. CV 07-05194 GAF (JTLx), § 117

sold through MLM. Just identify something that people get excited about, and you have the basis for an MLM kickoff. How about online education? Memory enhancers? Exercise programs? And of course – aphrodisiacs to enhance one’s 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 500 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 he/she has recruited.

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. 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.”



MLM participants make minimum "pay to play" purchases (This graphic from Chapter 2 is repeated here, as it so well illustrates this practice.)

Some MLMs have not only volume requirements to qualify for escalating commissions and bonuses as participants moved 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 the need of the participant – and if it becomes a widespread practice encouraged by an MLM, the company may be technically 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 a difficult thing 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 what I found:

- 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 Mangosteen juice for \$0.99

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.

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. 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 scheme's pay structure. 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 incentivized within the compensation plan.

The Case (for and) against Multi-level Marketing

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

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

Chapter contents

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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 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 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 recruitment has already occurred.

Rewards stacked in favor of recruiting

Incentives drive decisions. Since it 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 demon-strated that *you get the behavior you reward*.



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 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

Psychologists know that you get the behavior you reward. And economists teach that incentives drive behavior. So it is imperative to understand the compensation plan to determine the emphasis – on selling products or on recruiting people.

Chapter 2, I explained how such emphasis can best be determined.



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

“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.”⁶⁸ However, in every one of the compensation plans of over 500 MLM programs I analyzed, the rewards were clearly weighted towards building a downline-building 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

⁶⁸ “Ten Myths & Facts about Direct Selling.” Direct Selling 411 web site, registered by DSA communicator Amy Robinson.

(though not high enough to profit), assuming all who signed up were counted.

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 recruiting are so extreme that almost no one seriously attempts to retail products except to a few “sympathy purchasers” – usually close 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 (especially products that are way overpriced) for \$100 to \$200 a month in profits, when they could conceivably be earning the \$100,000 to \$200,000 a month held out as bait for downline-building – a ratio of 1 to 1,000? (These numbers are just for illustration, as the actual returns vary. But the extreme differentials apply to all MLMs I’ve studied.

In actuality, as will be proven in later chapters, the ratio is not 1 to 1,000 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 – and the potential gain of hundreds of thousands of dollars for aggressive, long-term recruitment 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 literally hundreds of MLMs.

However, even the latter perception is incorrect because (as will be shown), 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 one invests in time and money, the more he/she loses – with the exception of the founders and the first ones in.

TOPPs get the lion’s share of the company payout to distributors.

In addition to the founders, those who I call TOPPs (top-of-the-pyramid promoters) are the chief beneficiaries of all MLM programs. 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 downliners from whom he was collecting commissions. Later, careful analysis of Nu Skin’s “Distributor Compensation Summary” report revealed that approximately 61% of company payout to the distributor force (in commissions and bonuses) 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 compensation plans I have analyzed, I found that payout to participants increased exponentially as they were positioned at higher and higher levels in the pay plan.

The life of a recruiter

When a new recruit catches the vision of the enormous rewards supposedly awaiting him for recruiting a large downline, he/she must make some dramatic lifestyle changes.

Forget the drudgery of an 8-hour workday. Now it’s an 18-hour workday! Every waking moment must be 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.

I tested the Nu Skin program in 1994-95 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 background and contacts, within two years I could be making the "750,000 per year." This was the average reported income for Blue Diamonds at that time.

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 level. (Levels in the pay 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 conference. Exciting presentations were offered 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 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.

*“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 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 all the 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. So I would no longer have to make “pay to play” purchases. I got 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 were in a virgin market – which does not exist in this country.

There is another cost that is ignored by MLM enthusiasts – the “opportunity cost” of what income might have been gained doing something else. In my case, that cost was significant – likely three or four times my out-of-pocket costs. I had been selling insurance and

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.

doing very well. So I lost a considerable amount in commissions and residuals.

Table 1: One year of recruiting expenses

| | |
|---|--------------------|
| 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”) | <u>459.98</u> |
| Total amount paid to Nu Skin | <u>\$6,733.94</u> |
| Operating expenses (not paid to NS) | |
| Advertising | \$1,457.81 |
| Supplies | 586.30 |
| Printing & duplication | 418.99 |
| Telephone & computer costs | 3,496.15 |
| Postage & shipping | 329.85 |
| Travel & mileage | 5,277.12 |
| Miscellaneous | <u>216.76</u> |
| Total operating expenses | <u>\$11,782.98</u> |
| Total expenses | <u>\$18,516.92</u> |

Plus – the opportunity cost of income lost doing MLM, when I could have better spent the time doing something profitable. In my case, I lost 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 even 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 2008, allowing for inflation using a standard CPI (Consumer Price Index) adjustment. I will start with a bare minimum of \$18,000 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.

Table 2: Minimum operating expenses for conducting a successful MLM recruitment campaign, adjusted by Consumer Price Index

| Year | CPI | Min. costs of participation and recruitment for the year |
|------|-------|--|
| 1995 | 0.656 | \$18,000 |
| 1996 | 0.638 | 18,507 |
| 1997 | 0.623 | 18,953 |
| 1998 | 0.765 | 19,263 |
| 1999 | 0.600 | 19,680 |
| 2000 | 0.581 | 20,324 |
| 2001 | 0.565 | 20,899 |
| 2002 | 0.556 | 21,237 |
| 2003 | 0.543 | 21,745 |
| 2004 | 0.529 | 22,321 |
| 2005 | 0.512 | 23,062 |
| 2006 | 0.496 | 23,806 |
| 2007 | 0.482 | 24,498 |

2008 0.464 25,448 (2008 is the latest year for which I have the CPI figures)

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.

Like other MLMs, the cost of “building the business” limits any profits

for Amway IBOs. The high cost of recruitment was emphasized in the UK action against Amway. One of the points of objectionability 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).⁶⁹

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 judgment suggests that “instances of those who did have some success . . . are the equivalent of one out of many thousands.”⁷⁰ 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 10.

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.⁷¹

Conclusions

It should be clear to any qualified independent analyst who looks at the available data, MLM compensation plans, and the arguments for and against MLM, that the MLM business model is predicated on recruitment of an endless chain 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 achieve success at recruiting a downline, which is essential if one is to realize significant ongoing profits from MLM. Those who lock in a position as the first ones in the chain of recruitment have a huge advantage over those who come in later, but this is seldom disclosed to new recruits.

It is both very demanding and very expensive to achieve success at recruiting a downline, which is essential if one is to realize significant ongoing profits from MLM.

⁶⁹ Approved Judgment: The Secretary of State for Business Enterprise and Regulatory Reform v. Amway (UK) Limited May 14, 2008. § 7(c),

⁷⁰ Ibid., § 54 (c)

⁷¹ Ibid., § 46

The Case (for and) against Multi-level Marketing

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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.

We will find that attrition rates in MLM are extremely high, which will have a huge impact on profit and loss rates. This may explain why MLM companies are loathe to disclose information on “turnover” or “retention” or “attrition” rates. It requires considerable sleuthing to get this information, but enough is available to make some realistic estimates of actual rates.



Incidentally, replacement of dropouts is accomplished by continual recruitment of a revolving door of new recruits, which is one reason “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 an endless chain 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.”⁷²

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.⁷³

Amway’s “smoking gun.” According to Eric Scheibeler⁷⁴, 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!⁷⁵

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 income because the high attrition rate assures them that they cannot count on those residuals – and because there are seldom any profits at all.

⁷² FitzPatrick, Robert, “10 Big Myths of Multi-level Marketing”. Report published in 2009. Available for free download from the web site pyramidschemealert.org

⁷³ FitzPatrick, Robert, *ibid.*

⁷⁴ Scheibeler was citing a 2005 Quixtar (Amway) internal management report

⁷⁵ Term used by Bruce Craig, former Assistant Attorney General for Wisconsin

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!

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 participants be included for a given time period and none interjected into the data set from an earlier time period.*

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 recruitment-driven 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 businesses⁷⁶ 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.

The following quote from an article in the *Journal of Small Business Management*⁷⁷ 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 Kosticka (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.” MLM is definitely not like a real, legitimate business.

Deleting dropouts from the population of recruits hugely distorts average income statistics.

⁷⁶ William Dennis, Nat'l Federation of Independent Businesses, reported by Karen E. Klein in *Business Week*, September 30, 1999.

⁷⁷ 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)

If 99% of all MLM participants lose money⁷⁸ (compared to 30% of small businesses), and if in 5-10 years, 95% quit (compared to 36% of small businesses), there must be something wrong with the entire MLM industry; i. e., 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.⁷⁹

If 99% of all MLM participants lose money (compared to only 30% of small businesses), and if in five to ten years, 95% quit (compared to 36% of small businesses), there must be something wrong with the entire MLM industry; i. e., 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.

Comparisons of MLM participants with other types of sales persons

Comparisons of attrition rates for MLM participants to those for retail sales persons. In desperate attempts to explain away MLM annual attrition of 50%⁸⁰, 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.⁸¹

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 Christ-mas 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 none of the compensation plans of the hundreds of MLMs I've 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 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 this argument, it rings particularly hollow to me. 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 managers. I could make a good income without recruiting a single person.

This was not self-delusion, as I had a reportable income from selling on my income taxes – which MLMrs seldom do.⁸²

⁷⁸ See Chapter 7.

⁷⁹ See Chapter 2 and 7.

⁸⁰ "Top 10 Myths & Facts About Direct Selling," by DSA's Amy Robinson, posted at – www.directselling411.com.

⁸¹ Letter to Jon Taylor dated October 21, 2010

⁸² "Who profits from MLM? Preparers of Utah tax returns have the answer," by Jon M. Taylor. Posted on mlm-thetruth.com

And I did not have to buy a set of

Decades ago, when direct selling was viable, I sold encyclopedias and other products to help pay my way through college. My commissions were much larger than overrides paid to my sales managers, so that I could make a good income without recruiting a single person.

This was not self-delusion, as I had a reportable 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.

encyclopedias for myself!



A revolving door of recruits replaces dropouts.

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).⁸³

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. 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 loathe 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.

High attrition is one of the most striking attributes of MLM. The “residual” or “permanent” income touted by MLM promoters is a myth.

⁸³ See Chapter 3

The Case (for and) against Multi-level Marketing

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

Chapter 7: MLM's ABYSMAL NUMBERS

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Introduction and summary

Is MLM a profitable business opportunity? 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 18 years' research, worldwide feedback, and analysis of the compensation plans of over 500 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 its endless chain of recruitment 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 just to a specific MLM company, but to the entire MLM industry. It is a systemic problem with the MLM business model itself..

Of the 500 MLMs I have analyzed for which a compensation plan was available⁸⁴, 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 to qualify for commissions and advancement in the scheme, to say nothing of minimal operating expenses for conducting an aggressive recruitment campaign – which (based on the compensation plans) is essential to get into the profit column.

I found the claim by MLM promoters that many participants work for part-time or seasonal income to be a totally bogus argument because 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.

These conclusions were confirmed in the average earnings reports of all 37 current MLMs for which we were able to obtain data published by the companies themselves. 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 misrepresentation. Some would say it is simple fraud.

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. However, these analyses and calculations have been validated by independent experts in fields requiring much sophistication in statistics, finance, and accounting. (See Appendix A)

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

⁸⁴ Listed in Appendix 7a. Most were MLMs for which I responded to inquiries about them.

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 for participants

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 supposedly 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 not living in Wisconsin.) This information was reported on the nationally televised "60 Minutes" show.

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.*

The average net income (after subtracting expenses) for the 200 top Amway distributors in Wisconsin was approximately minus \$900.

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 random-ized 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 4,000 households). While they could not reveal specific amounts, collectively these CPAs could recall 35 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.”

Disclosure of information supporting Income claims – so crucial for consumer protection – 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 to participate – or not.



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.

It is no surprise that recent efforts by the FTC (Federal Trade Commission) to get business opportunity sellers to disclose average earnings has been met with fierce resistance from MLMs and their primary lobby, the DSA (Direct Selling Association). This by itself should be a red flag signaling something very wrong with MLM as an industry and/or as a fundamental business model. Why would they fight so hard to avoid transparency if they had nothing to hide – or if they wanted to prove their legitimacy?

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. It is actually quite absurd, especially since franchisors are required by the FTC to furnish a disclosure document to prospects that is often hundreds of pages long.

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

Handing out a one-page disclosure document to prospects – an intolerable burden?

be identified and a more true portrayal of average earnings be made available. I will also endeavor in this chapter to provide a set of procedures for any qualified analyst to use to debunk such deceptions and to replicate my findings.

MLM’s 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.



All MLM compensation plans assume an infinite market and a virgin market, neither of which exists in the real world. MLM is therefore inherently flawed, unfair, and deceptive.

From analyses of the compensation plans of hundreds of 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 going primarily to founders and 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. A list of the approximately 500 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 B.

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 participants in MLM programs. And that is precisely what I will examine in detail.

MLM compensation plans assume an infinite market and a virgin market, neither of which exists. MLM is therefore inherently flawed, unfair, and deceptive. MLMs are also extremely viral and predatory.

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 is how I would advise persons being recruited into an MLM to estimate the true odds of their being successful, regardless of effort:

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.”

Step 2: Determine total incentivized or “pay to play” purchases – and other purchases expected of participants.

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 infinite markets and virgin markets – neither of which exists in the real world.

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.

TOPPs for many MLMs expect downline participants to pay for training, conferences - and books, recordings, sales literature, and other “tools” needed to be successful. This is on top of other expenses. (In a legitimate sales wetting, 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.

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. 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.

Determine as much as possible what other costs may be involved, such as training meetings, “tools” (books, web site, CD.s etc.) sold by TOPPs (top-of-the-pyramid promoters) that they are selling to assure the “success” of downline participants.

Caution: Avoid falling for the line that purchases that you make for your own use are purchases you would have made anyway and therefore should not count. Typically, similar products can be purchased for a small 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 profitability 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 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 participants.

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 – 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 but 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 MLM's 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 those participants included at the top levels.

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 recruitment-driven 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's 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 –

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.

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.*

Step 5: Obtain – or estimate – minimum operating expenses needed to conduct a successful recruitment campaign.

Estimate minimum operating expenses necessary to successfully recruit. It is true that 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 a period of time.

In 1994-5, I put Nu Skin, a leading MLM program, to the test for a year, devoting all my time to climb to the top 1% of participants (counting ALL participants, including dropouts). During that year 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 approximately \$15,000.

I included incentivized purchases in the amount spent on products and services, even though some or most were personally consumed or given away. This is because these are purchases necessary to qualify for commissions or advancement in the program. 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 the participant would not have made the purchases were he/she not intending to advance in the scheme in some way.

Important note: The \$18,000 (\$1,500/mo.) operating expense figure would be equivalent to well over \$27,000 in 2011 dollars (the year for the latest figures in Exhibit 4). So as a reasonable assumption based on my experience, in typically saturated 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.

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's 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, but are merely contributing to the coffers of the company, founders, and TOPP's.

Tax studies and analyses of reports of average incomes (assuming minimal expen-

Part-timers and seasonal participants are not profiting, but are merely contributing to the coffers of the company, founders, and TOPP's.

ses 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 (often the first ones in) – 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 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 1 demonstrates how a compensation plan with extreme leverage⁸⁵ 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 500 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 2 is extracted from a report of 57,998 “active distributors” in the U.S. for Nu Skin Enterprises⁸⁶, 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.

Cautions: Great care must be taken in reading the numbers in reports of average

⁸⁵ 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.

⁸⁶ “2008 Distributor Compensation Summary” published by Nu Skin, 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.

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, this *annualized* number could be much higher than *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 - 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.)*

➤ 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 campaign⁸⁷, which the author found to be absolutely essential to climb the hierarchy of distributors. In my one-year test⁸⁸ of the Nu Skin program, the minimum total expenses to recruit successfully was over \$18,000 per year (over

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.

\$27,000 in 2011 dollars), including products and services from the company, travel and

⁸⁷ See Chapter 5 for details.

⁸⁸ For a more complete account of my Nu Skin experience, read Chapter 1.

telephone expenses, home office and rooms for opportunity meetings, printing and duplicating expenses, advertising, telephone and internet services, and miscellaneous supplies.

Exhibit 1

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 investments – of those at the bottom.) These become, in effect, 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, 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 recruitment-driven MLMs, such as Nu Skin. In fact, the odds of profiting from a no-product pyramid scheme are many times 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.**

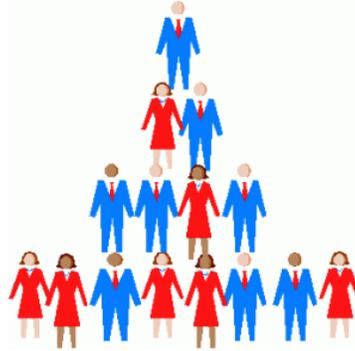
What remains of the commissions paid out is divided up among tens of thousands of downline participants. Few participants get enough commission income to exceed "pay to play" or incentivized purchases and other expenses. Analyses of reports of Nu Skin distributor incomes suggest that about 99.9% of Nu Skin distributors lose money, after all expenses are subtracted – only to enrich the Blue Diamonds at the top and fatten Nu Skin's coffers. 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 60% 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 numbers 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.

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 victims.**

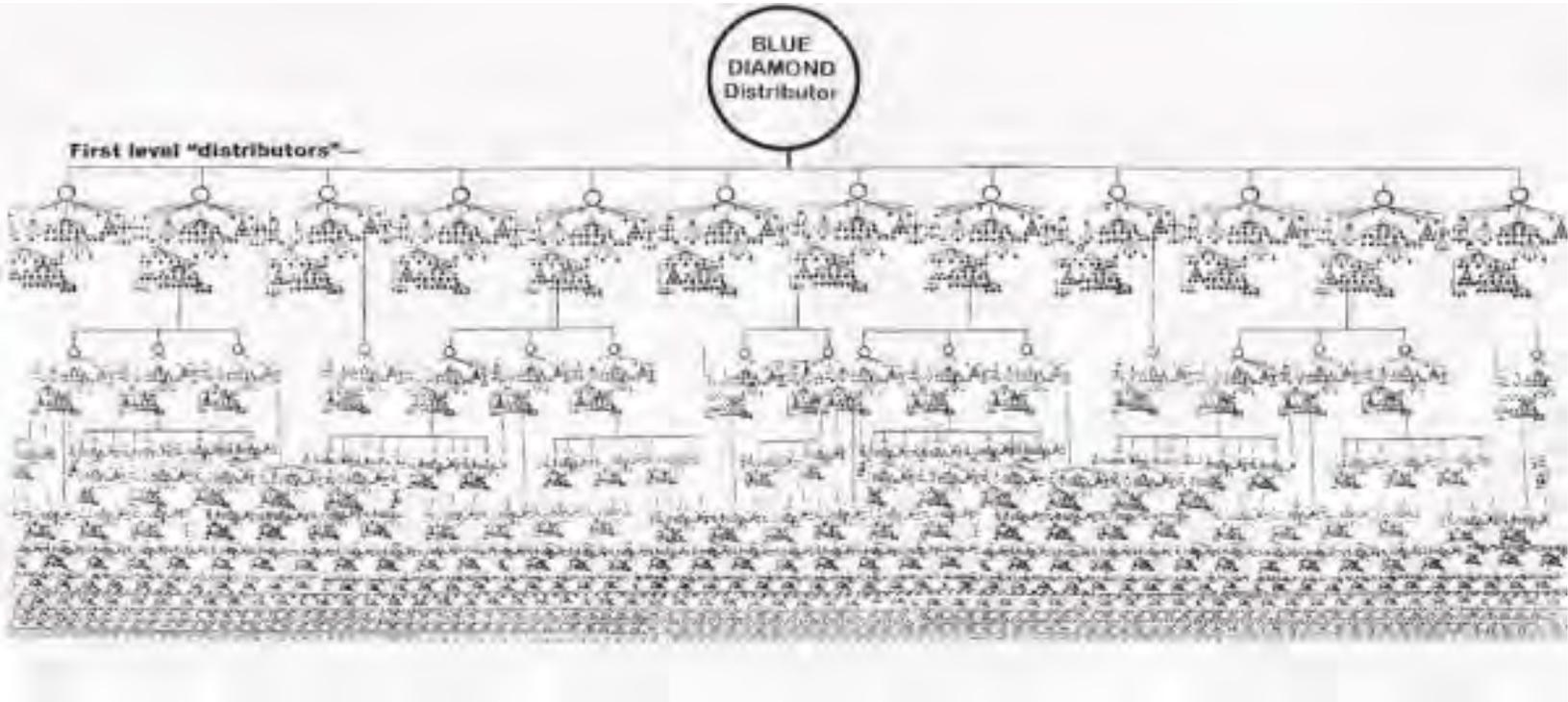
Exhibit 1, continued – In a classic, 1-2-4-8, no-product pyramid scheme, the person at the top collects all the money from only 14 downline persons.

Classic, 1-2-4-8 no-product pyramid scheme:



In a product-based pyramid scheme, the person at the top gets a small commission, but may get commissions from purchases by thousands in his or her downline – having been sold a bogus “business opportunity.” In Nu Skin, a Blue Diamond gets over half of the commissions paid – and almost everyone else loses money (after subtracting “pay to play” purchases and minimal operating expenses). The downline of a Blue Diamond may include thousands of victims. (Chart is only illustrative, with each circle representing a participant.)

Massive downline of a product-based pyramid scheme:



Sample calculations, using Nu Skin data:

Step 1: Average earnings statistics are published by Nu Skin, as shown in the table in Exhibit 2 and labeled “2011 Nu Skin Enterprises, Inc. Distributor Compensation Summary.”

Step 2: “Pay to play” purchases have for years been at least \$100, 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 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 2: Average earnings statistics for Nu Skin Enterprises, Inc. –
Extracted from “2011 Nu Skin Enterprises, Inc. Distributor
Compensation Summary”**

Average number of “Active Distributors” in the United States during 2011 – 80,613

Commissions paid to distributors in the United States in 2008 – 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]⁸⁹

How data are presented by Nu Skin Enterprises, Inc.

| | Annualized Average Commissions at each Level for 2011 ⁹⁰ | Average Percentage of Active Distributors ⁹¹ |
|---|---|--|
| 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 | .0.56% |
| Ruby Executives | \$31,860.00 | .0.24% |
| Emerald Executives | \$64,800.00 | .0.10% |
| Diamond Executives | \$127,500.00 | 0.08% |
| Blue Diamond Executives | \$582,660.00 | .0.14% |

⁸⁹ This percentage is obtained by taking the total average of monthly actives and dividing it by the total average of Distributors on a monthly basis. “Total Distributors” includes all U.S. Distributor accounts currently on file, irrespective of their purchasing products, promotional materials or services or earning commissions. “Distributor” numbers do not include customer or Preferred Customer accounts.

⁹⁰ These numbers are calculated by taking the monthly average commissions and multiplying by twelve. [The column labeled “Monthly Average Commission Income at Each Level for 2008” has been deleted, as it is irrelevant to this analysis.]

⁹¹ 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 2008 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 3: Data with highlighted information that is important for prospects to know, but which is not disclosed in Nu Skin's report

| Title | Annualized Commissions ⁹² | Average % of Active Distributors ⁹³ | Number of Distributors at that Level | Company Payout by Level ⁹⁴ | % of Co. Payout by Level ⁹⁵ |
|---|--------------------------------------|--|--------------------------------------|---------------------------------------|--|
| 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 | .0.56% | 451 | \$7,176,312 | 6.28% |
| Ruby Executives | \$31,860 | .0.24% | 193 | \$6,148,980 | 5.38% |
| Emerald Exec.'s | \$64,800 | .0.10% | 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 who 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 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. A much smaller percent could have achieved significant profits (well above minimum wage). Excluding Blue Diamonds, the loss rate would be 99.98%.**

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%)

⁹² These numbers are calculated by taking the monthly average commissions and multiplying by twelve. The column labeled "Monthly Average Commission Income at Each Level for 2011" has been deleted, as it is irrelevant to this analysis.

⁹³ 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 2008 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.

⁹⁴ 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).

⁹⁵ 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 from the calculations of average earnings. In the fourth column of Exhibit 3, 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 paid 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, or TOPPs (top-of-the-pyramid promoters), 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.

Assuming only \$1,200 minimum “pay to play” purchases is subtracted for each “active Blue Diamond 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 Blue Diamonds = 80,500
distributors (who are not Blue Diamonds)
\$54,421,480 / 80,500 = \$676.04 average
com-missions 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.**

“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 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.*

... 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.

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.

Results when backing off on assumptions. Even if an analyst accepts the MLM/DSA arguments that costs of participation and rate of attrition is 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 made available). 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!*

I should remind readers that 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 for a given time period are included). Yet I was losing over \$1,000 a month. Based on my personal experience and observations, as well as the Utah tax study (Utah is where Nu Skin is based) I seriously doubt that anyone below Emerald Executives were reporting a profit on their taxes from participation in the Nu Skin program.

. . . less than 1/10 of 1% of distributors would have earned a profit – even with such liberal assumptions in Nu Skin’s favor!

: My personal experience with Nu Skin.

As I mentioned above⁹⁶, 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.

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 deceptively presented reports of the MLMs I was 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.

Different realistic assumptions yield similar conclusions

In the calculations in Exhibit 4, 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%.

Then when one eliminates TOPPs (top-of-the-pyramid promoters) from the population used for the average income statistics, one gets an average loss rate of close to 99.99%. This would be reasonable because the outsized commissions paid to TOPPs skews the income distribution to the a very significant degree. 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.

⁹⁶ See Chapter 1 for details.

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 assisting me spend considerable time gathering average earnings data from as many MLMs as would provide such data, however skewed (as explained above).

In Exhibit 4, I show how one can work with this data to calculate average loss rates, which are abysmal, even giving the MLMs the benefit of the doubt on 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%, using liberal assumptions relating to retention and cost of participation, as explained in subsequent sections of this chapter. The average loss rate for the 37 MLMs reported here was 99.71%.*

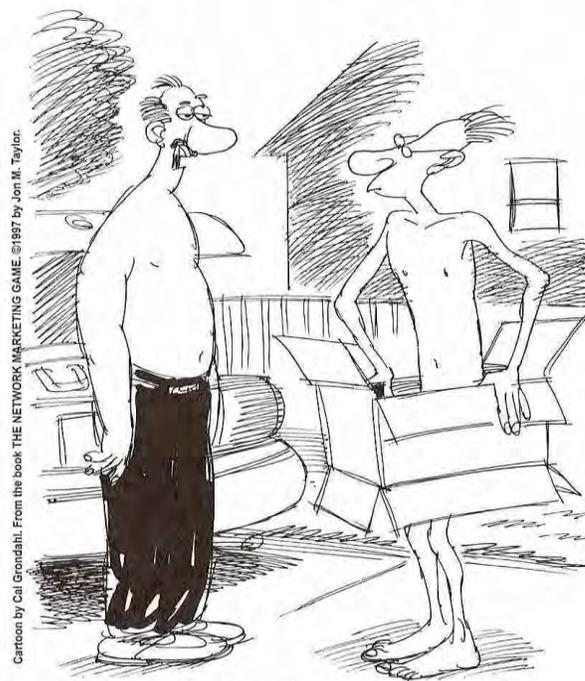
I believe it is safe to assume that MLMs for which promoters do not provide such data are not likely to be more profitable because if they were, at least some would have provided data for competitive advantage. So it is highly likely that others of the 500 MLMs that I have also found to be recruitment-driven and top-weighted (with at least the first four of the five causal an 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 at least four of the causative and defining characteristics (CDCs) of a recruitment-driven MLM, hundreds of additional MLMs would have these same basic characteristics. This provides conclusive support for considering MLM a fundamentally flawed system.

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.

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.



Cartoon by Cal Grendahl. From the book THE NETWORK MARKETING GAME. ©1987 by Jon M. Taylor.

"I went to Las Vegas and lost my shirt. How's your Network Marketing going?"

Exhibit 4

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 (“red flags”)⁹⁷ as a checklist, ALL (100%) of the 40 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 400 MLMs and found that ALL (100%) are recruitment-driven and top-weighted, so it seems justifiable to assume that the same results could be expected for other MLMs.⁹⁸

NOTES: These calculations are based on actual company reports and the best independent analyses used by the author, as explained in the 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.⁹⁹ (See Chapter 8.) *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.¹⁰⁰ And I am doubling the estimated retention rate for 10 or more years to 10%, increasing it to 15% for five to nine years, 30% for from two to four years, and 50% for one year – assuming ALL recruits are counted. (As these percentages are based on the evidence and 15 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.

Please note also that although all MLMs have the same inherent flaw of unlimited recruitment, those that market the bulk of their products to non-participants – or who pay no commissions to for

sales to participants in the program may merit some consideration for trying to operate ethically.

Three important changes have been made in this revised (2012) edition of the book:

1. Ten MLMs have been added as data became available, boosting the sample to 40 MLMs.

2. Included are two defunct MLMs for which we have average income data that ceased operations or were shut down years ago by law enforcement. These were included to illustrate the fact that the unfair top-weighted pattern of income distribution for MLMs still operating is the same as was the case for the “bad MLMs” that were shut down. All could be classified as unfair and deceptive practices.

3. In the 2011 edition, the figure for the column titled “Estimated minimum annual costs for effective recruitment campaign” was 10% of what Jon Taylor spent in his one-year test of a leading MLM program. This was an extremely liberal breakeven point, giving MLM companies the extreme benefit of the doubt. However, our research clearly suggests that it is so low as to be an unrealistic estimate of the minimum cost of a successful recruitment campaign. Some MLM defenders will claim that participants can conduct their business with a much lower investment. 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, conducting 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.)

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.

⁹⁷ See Chapter 2 for these characteristics (“red flags”) – also the full report on web site – mlm-thetruth.com

⁹⁸ We have average income data for other MLMs besides those included in this analysis, but without adequate data to do this analysis.

⁹⁹ See Chapter 8: “MLM – a Litany of Misrepresentations”

¹⁰⁰ In last year’s report a 10% figure was used 30 MLMs, but the end result was essentially the same. As an overall average, 99.6% of participants lost money.

Exhibit 4, 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 ¹⁰¹ | Estimated minimum annual costs for effective recruitment campaign. ¹⁰² | Level at and above which net profits possible ¹⁰³ | Approx. % of active participants at that level or above ¹⁰⁴ | Maximum retention rate ¹⁰⁵ | Approximate % of <u>all</u> participants that could have profited from participation ¹⁰⁶ | Approx. % of all participants who lose money ¹⁰⁷ |
|--|---|--|--|---|---|---|
| Advocare (2011) ¹⁰⁸ | \$13,660 | Gold | 3.5% | 10% | 0.35% (0.0035) – 1 in 286 may profit | 99.65% lose money |
| Ameriplan (2008) ¹⁰⁹ | \$12,724 | NSD | 1.55% | 10% | 0.15% (0.0015) – 1 in 133 profits | 99.85% lose money |
| Amway/Quixtar (2001) ¹¹⁰ | \$10,450 | Platinum | 0.905% | 10% | 0.09% (0.0009) – 1 in 1,111 may profit | 99.91% lose money |
| Arbonne Int'l (2010) ¹¹¹ | \$13,242 | Regional Managers | 0.17% | 10% | 0.017% (0.00017) – 1 in 5,882 may profit | 99.98% lose money |
| Beach Body (2011) ¹¹² | \$13,660 | Diamond | 6.0% | 15% | 0.9% (0.009) – 1 in 111 may profit | 99.10% lose money |
| Cyberwize (2006-2007) ¹¹³ | \$12,249 | Senior Director | 2% | 10% | 0.2% (0.002) – 1 in 500 may profit | 99.80% lose money |
| Ecoquest (2005 - now Vollara) ¹¹⁴ | \$11,531 | Managers in Training | N/A – see next column | Since 2000 – 278,024 Dealers ¹¹⁵ | 0.72% (0.0072) – 1 in 139 may profit | 99.28% lose money |

¹⁰¹ The most recent report available to the author at the time of the analysis.

¹⁰² Estimated minimum costs of conducting a successful recruitment campaign, based on the author's one-year test of a leading MLM. Costs includes incentivized purchases plus minimum operating expenses, corrected by COL (cost of living adjustment, based on Consumer Price Index – with the latest data in 2008) since founding – See chapter 5. Here we use the liberal assumption that total costs were only 50% of those of the author's minimum expenses.

¹⁰³ 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.

¹⁰⁴ Referring to the level in the previous column – per MLM company reports. If only "Active" participants ("Distributors," "Associates," etc.) were counted, we can safely assume that the numbers on the report represent no more than half of the total. If the requirement to be listed as Active is very restrictive, a factor of 25% is used instead.

¹⁰⁵ 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 10% for ten or more years, 15% for five to nine years, and 30% for three to four 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.

¹⁰⁶ Average income exceeding all expenses (second column) for conducting a successful recruitment campaign.

¹⁰⁷ 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 the enjoy the "residual income" that promoters imply at opportunity meetings is possible.

¹⁰⁸ "2011 Income Disclosure Statement" - published by Advocare. Web URL –

<http://www.advocarehope.com/LinkClick.aspx?fileticket=oFx6u0QN0yk%3D&tabid=186&mid=696>

¹⁰⁹ "AmeriPlan Independent Business Owner Income Disclosure Statement for 2008" - published by AmeriPlan. Not currently available on the web.

¹¹⁰ "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. We can only wonder why. Web URL –

http://www.amquix.info/pdfs/quixtar_income_2001.pdf

¹¹¹ "Independent Consultant Compensation Summary – U.S." (2010), published by Arbonne, Int'l. Web URL –

<http://www.arbonne.com/company/info/iccs.asp>

¹¹² "Statement of Independent Coach Earnings" for the year ending 12/28/2011, Published by Team BeachBody

Web URL – <http://www.teambeachbody.com/incomechart.pdf>

¹¹³ "Cyberwize Income Disclosure Statement for 2006-2007" – published by Cyberwize. Not currently available on the web.

¹¹⁴ "Income Disclosure Statement" – for 2005 provided by Ecoquest Int'l (acquired by Vollara in 2009)

| 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 all participants that could have profited from participation | Approx. % of all participants who lose money |
|---|--|---|---|------------------------|---|--|
| FHTM (2009-2010) ¹¹⁶ | \$13,028 | National Sales Mgr. | 0.45% | 15% | 0.045% (0.00045) – 1 in 2,222 may profit | 99.96% lose |
| FreeLife Int'l (2010) ¹¹⁷ | \$13,242 | Star Director V | 6.5% | 10% | 0.65% (0.0065) – 1 in 154 may profit | 99.35% lose |
| Herbalife (2009) ¹¹⁸ | \$13,028 | GET | 0.825% | 10% | 0.0825% (0.00082) – 1 in 1,212 may profit | 99.92% lose |
| Ignite –Stream Energy (2010) ¹¹⁹ | \$13,242 | Executive Director | 0.13% | 15% | 0.019%, (0.00019) – 1 in 5,263 may profit | 99.92% lose |
| Immunotec (2010) ¹²⁰ | \$13,242 | Gold | 5.9% | 10% | 0.59% (0.0059) – 1 in 169 may profit | 99.41% lose |
| iNetGlobal (2009) ¹²¹ | \$13,028 | Blue Diamond Executive | 1.37% | 15% | 0.21% (0.0021) – 1 in 476 may profit | 99.79% lose |
| Isagenix (2010) ¹²² | \$13,242 | 5Star Consultant | 9.18% | 10% | 0.92% (0.0092) – 1 in 109 may profit | 99.08% lose |
| Mannatech (2010) ¹²³ | \$13,242 | Executive | 3.12% | 10% | 0.31% (0.0031) – 1 in 323 may profit | 99.69% lose |
| Melaleuca (2010) ¹²⁴ | \$13,242 | Director VI | 0.8% | 10% | 0.08% (0.0008) – 1 in 1,250 may profit | 99.92% lose |
| Momentum Plus (2006) ¹²⁵ | \$11,903 | Executive Directors | 0.09% | 15% | 0.013% (0.00013) – 1 in 7,407 may profit | 99.99% lose |
| Mona Vie (2010) ¹²⁶ | \$13,242 | Bronze Executive | 3% | 15% | 0.45% (0.0045) – 1 in 222 may profit | 99.55% lose |
| MXI (Xocai Chocolates) (2010) ¹²⁷ | \$13,242 | Silver Executive | 2% | 15% | 0.3%, (0.003) – 1 in 33 may profit | 99.70% lose |

¹¹⁵ 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.

¹¹⁶ “Income Disclosure Statement,” January 23, 2009 – January 20, 2010. FHTM in business since 2006. Web URL –

¹¹⁷ “2010 Annual Income Statistics” - published by FreeLife Int’l. Web URL –

http://corporate.freelife.com/pdf/income_stats_us_en.pdf

¹¹⁸ Herbalife: “Statement of Average Gross Compensation of U.S. Supervisors in 2009” – published by Herbalife: http://opportunity.herbalife.com/Content/en-US/pdf/business-opportunity/statement_of_average_gross_compensation_usen_030410.pdf

¹¹⁹ “Income Disclosure” Jan. 1, 2011 – Dec. 31, 2011” - published by Ignite – Stream Energy. Web URL –

http://pdfs.streamenergy.net/pdfs/Disclosure_Page.pdf

¹²⁰ “Immunotec: INCOME DISCLOSURE REPORT – 2007” – published by Immunotec. Web URL –

http://www.immunotec.com/IRL/en/USA/IncomeDisclosureStatement_2010.pdf

¹²¹ “Income Disclosure Statement For iNetglobal.com” 1 Jan 2009 – 31 Dec 2009

<http://baronessa.inetglobal.com/public/spage.php?p=IncomeDisclosureStatement>

¹²² “Annual 2010 Midyear Isagenix Independent Associate Earnings Statement” - published by Isagenix

<http://www.isagenix.com/us/en/associateearnings.dhtml>

¹²³ “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

http://www.globalwellnessnow.net/yahoo_site_admin/assets/docs/1_Mannatech_2009_incomes.143150044.pdf

¹²⁴ “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 could get the true likelihood of profiting from the information provided. Web URL –

http://pdf.melaleuca.com/BusinessCenter/Reference_Library/Download_PrintCenter/2010Incomestats_enUs.pdf

¹²⁵ “Earning Overrides and Bonuses Disclosure Chart” - published by Momentum Plus and accessed June 27, 2008

¹²⁶ “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

¹²⁷ “Xocai – Income Disclosure Statement – 2010” – published by MXI Corp., Reno, Nevada. Web URL –

<http://us.fotolog.com/adampaulgreen/80795275/>

| MLM company and year of average earnings report | Estimated 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 |
|--|--|--|---|------------------------|---|--|
| Nikken (2007) ¹²⁸ | \$12,249 | Diamond | 1.6% | 10% | 0.16% (0.0016) – 1 in 625 may profit | 99.84% lose |
| Numis (2009-2010) ¹²⁹ | \$13,242 | Four Star Representative | 03.2% | 30% | 0.96% (0.0096) – 1 in 104 may profit | 99.04% lose |
| Nu Skin (2011) ¹³⁰ | \$12,724 | Lapis Executive | 2.23% | 10% | 0.22% (0.0022) – 1 in 454 may profit | 99.78% lose |
| Orenda Int'l (2010-2011) ¹³¹ | \$13,660 | Director | 2.4% | 15% ¹³² | 0.36% (0.0036), – 1 in 278 may profit | 99.64% lose money |
| Reliv (2011) ¹³³ | \$13,660 | 10-MDR ¹³⁴ | 0.50% | 10% | 0.05% (0.0005) – 1 in 2,000 may profit | 99.95% lose |
| SendOutCards (2010) ¹³⁵ | \$13,242 | Executives | 0.30%% | 15% | 0.045% (0.0045) – 1 in 2,222 may profit | 99.95% lose |
| Sunrider (2009) ¹³⁶ | \$13,028 | Business Leader | 7.6%% | 10% | 0.76% (0.0076) – 1 in 132 may profit | 99.24% lose |
| Symmetry (2003) ¹³⁷ | \$10,872 | \$501-2,000/mo. income level | 1.6% | 10% | 0.16% (0.0016) – 1 in 625 may profit | 99.84% lose |
| Tahitian Noni Int'l (2007) ¹³⁸ | \$12,249 | Diamond Pearl | 1.91% | 10% | 0.19% (0.0019) – 1 in 526 may profit | 99.89% lose |
| Tupperware (2009) ¹³⁹ | \$13,028 | Director in Qualification | 1.62% ¹⁴⁰ | 10% | 0.16% (0.0016) – 1 in 625 may profit | 99.84% lose |
| USANA (2010) ¹⁴¹ | \$13,242 | Achiever | 0.11% | 10% | 0.011% (0.00011) – 1 in 9,090 may profit | 99.99% lose |

¹²⁸ “Average Consultant Income Sheet” – published by Nikken. Nikken has two sets of income statistics, one for sponsoring levels and one for leadership levels. I assumed that leadership levels come out of and do not exceed the top sponsoring level (Bronze).

¹²⁹ “U.S. Income Disclosure Statement” – published by Numis for the period July 1, 2009 through June 30, 2010. Still in its second year – and period of momentum – the success rate could drop slightly in the next 2-3 years. Web URL – <https://www.securedcontent.net/numis/pdfs/US-Income-Disclosure-7-27-2010.pdf>

¹³⁰ “Nu Skin Enterprises, Inc.: 2010 Global Distributor Compensation Summary” – published by Nu Skin. Web URL – <http://www.nuskin.com/content/dam/global/library/pdf/distearnings.pdf>

¹³¹ Annual Income for the period 6/2010-5/2011. Published by Orenda International

¹³² Normally 15% for a company this old, but the Orenda report from 2007 indicated 5,077 total distributors – 10x active dist's. Web URL – <http://www.orendainternational.com/cnia.pdf>

¹³³ “2011 Income Disclosure Statement” – published by Reliv. Web URL –

<http://content.reliv.com/old/editor/file/2011IncomeDiscloser.pdf>

¹³⁴ 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>

¹³⁵ “2010 Income Disclosure” – published by SendOutCards

https://www.sendoutcards.com/images/pdf/income_disclosure.pdf

¹³⁶ “Income Disclosure Statement: January 1 – December 31, 2009” – published by Sunrider. Web URL –

http://www.sunrider.com/Contents/PDF/AverageIncome_Eng.pdf

¹³⁷ “Vision: Earnings Matrix Based on 2003” – published by Symmetry. Web URL –

http://www.symmetrydirect.com/Opportunity/Op_EarningsMatrix.htm

¹³⁸ “Average Incomes of U.S. IPCs” – published in 2007 by TNI now Morinda). Web URL –

http://morinda.com/en-us/morinda/company/average_incomes.html

¹³⁹ “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, S2Sales Force Structure.Earnings Conference Call, Jan. 31, 2007.

¹⁴⁰ “Tupperware 2009 Income Disclosure summary.” Assuming at least 50% of participants earned no commissions, which Tupperware failed to report. Web URL – <http://order.tupperware.com/ccm-pdf/income-disclosure-CAD.pdf>

¹⁴¹ “North American AverageTotal 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>

| 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 |
|---|---|--|---|------------------------|---|--|
| Viridian Network (2010-2011) ¹⁴² | \$13,660 | Senior Director | 0.9% | 30% | 0.27%, (0.0027) – 1 in 370 may profit | 99.73% lose |
| Visalus Sciences (2011) ¹⁴³ | \$13,660 | Regional Director | 1.28% | 15% | 0.19% (0.0019) – 1 in 526 may profit | 99.81% lose |
| World Ventures (2010) ¹⁴⁴ | \$13,242 | Director | 0.42% | 15% | 0.063% (0.00063) – 1 in 1,587 may profit | 99.94% lose |
| Xango (2009) ¹⁴⁵ | \$13,028 | 20K | 0.46% | 10% | 0.046% (0.00046) – 1 in 2,174 may profit | 99.95% lose |
| Yor Health (2011) ¹⁴⁶ | \$13,660 | Silver | 2.74% | 15% | 0.41% (0.0041) – 1 in 244 may profit | 99.59% lose |
| Your Travel Biz (YTB-2007) ¹⁴⁷ | \$12,249 | Coach's Corner | 0.35% | 10% | 0.035% (0.00035) – or 1 in 2,857 may profit | 99.96% lose |
| Zamzuu (2009) ¹⁴⁸ | \$13,028 | Coach's Corner | 0.79% | 30% | 0.23% (0.0023) – 1 in 435 may profit | 99.77% lose |
| Approximate average loss rates of participants in sample | N/A | N/A | N/A | N/A | 0.29% (0.0029) – On average, approximately 1 in 342 may profit | On average, approx. 99.71% lose money |
| NOTE: Several other MLMs provide income data, but the reports lacked sufficient information to perform the above analysis. | | | | | | |
| Sample data for defunct MLMs – similar loss rates: | | | | | | |
| Renaissance – the Tax People (2000 – shut down) ¹⁴⁹ | \$10,162 | Emerald | 0.18% | 30% | 0.054% (0.00054) – 1 in 1,852 may profit | 99.95% lose |
| Telecommunications MLM (1994 –now defunct) ¹⁵⁰ | \$9,000 | Rep's with ave. checks exceeding \$9,000/yr. | 4.4% | 0% | 0.44% (0.0044) – 1 in 227 may profit | 99.56% lose |

Concluding comments on Exhibit 4:

¹⁴² “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

¹⁴³ Visalus Store web site, December 29, 2011

¹⁴⁴ “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>

¹⁴⁵ “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

¹⁴⁶ “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>

¹⁴⁷ “Rep Earnings Report July 2007” – Published by YTB (associated with Zamzoo – and ytb Travel Site Owners)

¹⁴⁸ “Associate/Rep Income Disclosure Statement” – published by ZamZuu, Inc., 2010

http://www.yourtravelbiz.com/Policies_Procedures/IDS-US-Rep-Marketing-12pt-copy-v5.pdf

¹⁴⁹ 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 consultants and expert witnesses. Statistics extracted from court records.

¹⁵⁰ 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 we are referring to.)

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 profited after subtracting expenses, and 997 out of 1,000 lose money – to say nothing of the time invested.

The most liberal assumptions that could reasonably be used in favor of the MLMs were applied to this 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. And we assumed 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.

Also, I would estimate that the number of new recruits who wind up receiving the promised substantial “residual income” held out at MLM opportunity meetings (especially if you eliminate TOPPs) is no better than one in 10,000 recruits!

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.”

Why the breakeven point for expenses is so high before MLM participants can net any profits

Recruitment expenses are significant.

In the above and subsequent analyses, the minimum amount spent on purchases and operating expenses – about \$27,000¹⁵¹ – for MLM participation assume that the person is conducting an aggressive recruitment campaign such as I found necessary to climb the hierarchy of distributors at Nu Skin. Of course, MLM defenders will 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.

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. Let’s review these findings.

First, based on extensive comparative research, I identified the four causative and defining characteristics of recruitment-driven MLMs, or product-based pyramid schemes.¹⁵² (A fifth characteristic applies to most, but not all.) These are characteristics (or “red flags”) that clearly separate recruitment-driven MLMs from legitimate direct selling programs or any other business format or 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 program 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 campaign¹⁵³ 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 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 500 MLMs. (including some that folded or were shut down by law enforcement. See Exhibit 4.) In every case, I found that the plans reward primarily those who recruit large downlines of participants; i.e., the “TOPPs” (top-of-the-pyramid promoters). All of the MLMs I analyzed could be said to be recruitment-driven and top-weighted.

Note: The only class of MLMs that may be exceptions are in-home demonstration programs, or “party plans,” which may reward enough for sales to non-participants to be profitable. I left them out of the analysis, as they are quite different in their approach, and I have not been able to obtain either detailed compensation plans for all levels or average commissions and overrides paid to participants by the companies. This is not to recommend or excuse such programs. To evaluate a party plan, one would have to obtain a detailed compensation plan and go through the same analysis, factoring in actual validated sales to non-participants.

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.¹⁵⁴ Only a tiny few manage to recruit enough people to build a profitable downline.

And finally, 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

¹⁵¹ In 2012 dollars

¹⁵² See Chapter 2

¹⁵³ See Chapter 5

¹⁵⁴ A whole litany of these deceptions are listed in Chapter 8.

often priced several times as high as those in retail outlets.¹⁵⁵ 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.*

Even if we assume lower expenses and attrition, loss rates are 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 years or more, the resulting loss rates are still over 99%. See Exhibit 4) 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.

¹⁵⁵ See Chapter 4

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 is 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*¹⁵⁶. Also, according to the NFIB (National Federation of Independent Business), *one nationwide survey of small businesses*¹⁵⁷ *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*¹⁵⁸ 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

¹⁵⁶ "Frequently Asked Questions. SBA, Sept. 2008. U.S. Dept. of Commerce, Bureau of the Census.

¹⁵⁷ William Dennis, Nat'l Federation of Independent Businesses, reported by Karen E. Klein in *Business Week*, September 30, 1999.

¹⁵⁸ Franchise failure rates: an assessment of magnitude and influencing factors. By Castrogiovanni, Gary J., Justis, Robert T., and Julian, Scott C. (April 1, 1993)

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 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, it should be noted that MLM participants do not qualify for SBA loans, SCORE assistance, or other small business funding and assistance programs.¹⁵⁹

The fundamental deception of MLM is that of selling it as an "income opportunity" It is also misleading to call MLM a "business opportunity."

For a graphical depiction of how loss rates for small businesses, direct selling, no-product pyramid schemes, and gambling compare with MLM, see Appendix 7C and 7F. Appendix 7F is especially revealing.

MLM does not offer a part-time or seasonal income option. MLM/DSA 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 some 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, it is not realistic or even possible to earn part-time or seasonal income from any of them. Again, *part-timers and seasonal participants are not profiting, but are merely contributing to the coffers of the company, founders, and TOPP's.*

How does MLM participation compare with gambling? Comparisons of odds of profiting from gambling with participation in MLM have shown conclusively that participants in many games of chance fare far better.¹⁶⁰ For example, in an earlier analysis, I found the odds of winning from **a single spin of the**

wheel in a game of roulette in Las Vegas¹⁶¹

- **286 times** as great as the odds of profiting after enrolling as an Amway "distributor."
- **48 times** as great as the odds of profiting after enrolling as a Nu Skin "distributor."
- **22 times** as great as the odds of profiting after enrolling as a Melaleuca "distributor"

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 Utahns visiting there. I called 16 tax preparers in Tooele County, Utah, which borders Nevada. While *none of them had any clients who reported profits from MLM participation* (6% were active in MLM), they reported *over 300 clients who reported profits from gambling!*

BUSINESS OPPORTUNITY?



MLM does not qualify as a legitimate business any more than gambling, and 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 have a huge advantage. See

¹⁵⁹ From SBA (SCORE), banking, and Internet sources.

¹⁶⁰ See "Shocking Statistics" report on our web site – www.mlm-thetruth.com

¹⁶¹ Statistics published for Caesar's Palace in Las Vegas, April 6, 2001. Calculations are based on MLM average earnings statistics at the time.

Appendix 7 E for a very revealing chart comparing MLM with gambling and with legitimate income options.¹⁶²

While none (of the tax clients) reported profits from MLM participation, over 300 clients reported profits from gambling.

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 not as business losses, but as “hobby losses.”¹⁶³

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.¹⁶⁴

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?

Those MLMs that are publicly traded often draw attention to periods of rapid growth unlike other typical stocks for

legitimate companies traded on the stock market. Properly understood, this hyper-



growth is to be expected of any company using a multi-level or pyramid selling scheme featuring an endless chain of recruitment.

This chart (not an MLM) illustrates the typical growth pattern of MLM stock prices – a sharp rise during the momentum phase, followed by a leveling off or decrease.

They can be extremely viral at the outset, as is true of most pyramid schemes, whether product-based or not. Then they level out or decline as their market becomes saturated. (See Chapter 3.)

All of this reminds me of a consultant for a hedge fund 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 (other than participants) 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 exist in America?

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,

¹⁶² Separate pdf file

¹⁶³ “Instructions for Schedule C: Profit or Loss from Business”

¹⁶⁴ Ibid

with most of the money 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 their superiors, 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 company president has met the challenge. Details of the *Network Marketing Payout Distribution Study* can be found in Appendix 7D (separate pdf file).

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. 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.¹⁶⁵

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 primary promoters (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."

MLM's 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 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.

¹⁶⁵ Fitzpatrick, Robert, *The Myth of "Income Opportunity" in Multi-level Marketing*, 2008.

On the left of 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 Amway¹⁶⁶, 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 points 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 hand *at the base of the candle stick are almost all the recent joiners together with a very considerable number of people who*

¹⁶⁶ Approved Judgment: The Secretary of State for Business Enterprise and Regulatory Reform v. Amway (UK) Limited May 14, 2008. §42-43

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 study of and experience with sales commissions for sales persons and markup practices in retail settings. In a standard retail setting, the retailer (who provides resources to stock and sell the

products, gets the lion's 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 5-10%, but he gets that from the whole country.

In MLM, on the other hand, the distributors are usually several levels deep, but all may get from the company only 5% (or 10%, etc.) commission on the price of the product. 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 only gets 5%, 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 advancement.

Though commissions may be only 5% at all levels (as was the case for breakaways in Nu Skin when I tested their program), a high level distributor with thousands of persons in his/her downline can earn thousands of dollars every week.

So I have advanced a micro-economic formula, or company payout characteristic, that sets MLM apart from all other business models in its deceptive appeal – appearing fair, but actually becoming the most unfair and deceptive of all business models. The formula is as follows –

RVE>>>EHI –

or relative vertical equality in commission structure results in extreme horizontal inequality in distribution of income to the network of distributors (thus the “candlestick distribution”). I have found this characteristic to be typical in the 500 MLMs I've analyzed.

Exhibit 5: MLM Profit and loss rates vs. various income options

SEE CHART – next page.

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 recruitment-driven MLMs |
|--|-------------|---------------------------|----------------|-----------------------------------|---|---|
| Approx. % of participants who may have profited after expenses | 100% | 80% | 39% | 10% | 2.9% | 0.4% |
| Approx. % of participants who lost money after expenses | 0 | 20% | 61% | 90% | 97.1% | 99.6% |

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.

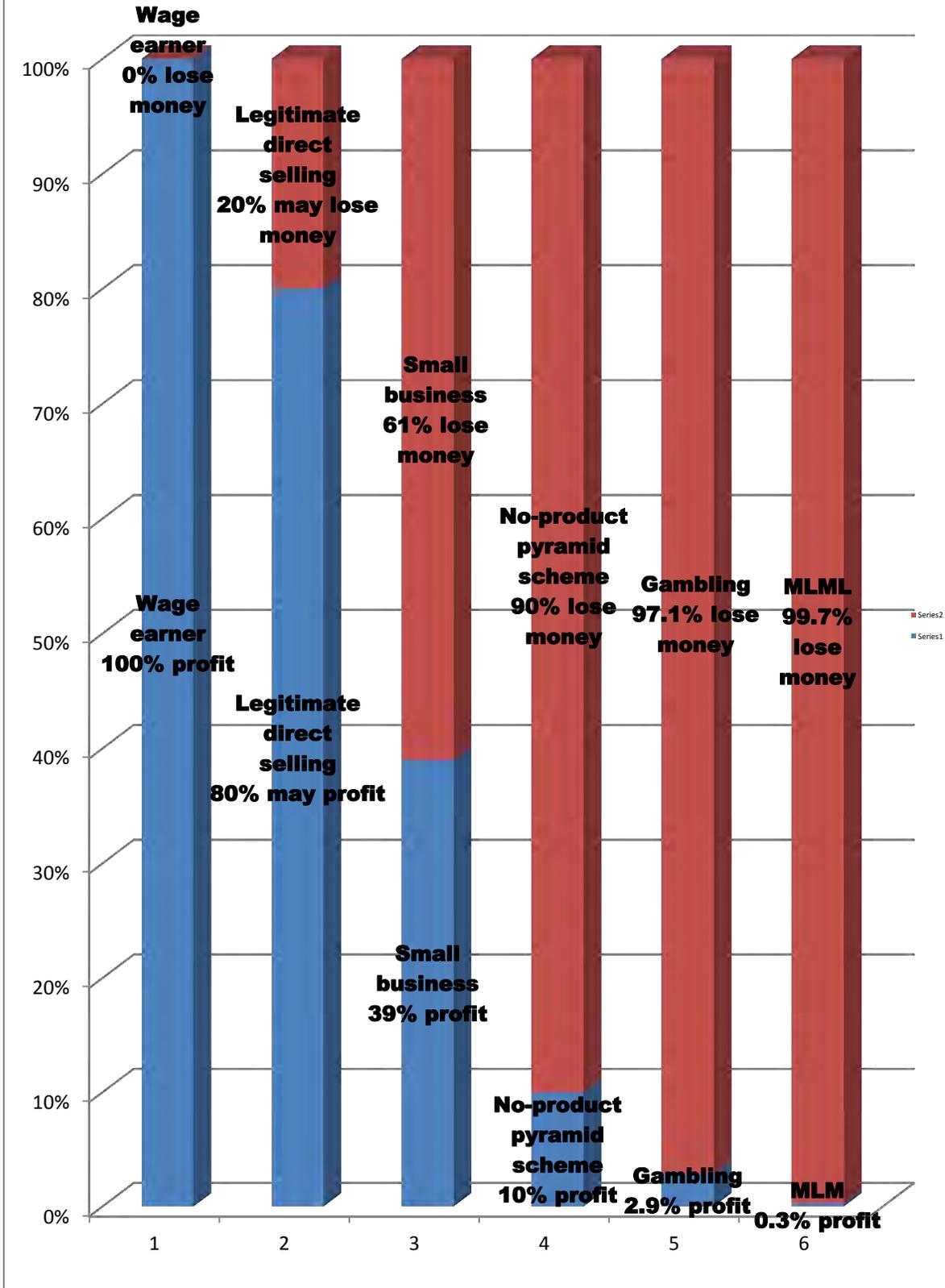
Small business failure rates are not as high as MLM promoters claim. A study by the NFIB (National Federation of Independent Business), using U.S. census figures in 1999, found that approximately 39% of small businesses are profitable over the lifetime of the business.

Classic no-product pyramid schemes are usually 8-ball (or 1-2-4-8) schemes in which some participants recycle into a 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 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 recruitment-driven MLMs. The percentage of people who may have profited is so low (0.004, or 0.4%) 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, including the e-book "The Case (for and) against Multi-level Marketing," chapter 7.

Income Options for Participants



MLMs are the most unfair and deceptive of all 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 8-ball (1-2-4-8) no-product pyramid scheme all the money from 14 downline participants goes to the person at the top. Assuming the pyramid schemes continues, 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 7C for profit and loss rates for classic, no-product pyramid schemes.]

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 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 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 4) is far greater than for participants in classic pyramid schemes, which is approximately 90%.

Put another way, *the odds of profiting from a classic 8-ball 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%). MLM is the worst of all classes of pyramid schemes by any measure – loss rate, aggregate losses, or number of victims.* (For a chart comparing no-product with product-based pyramid schemes (MLMs) – and with

The loss rate for MLMs is at least 99%. This means that less than one in 100 MLM participants make a clear profit, and at least 99 out of 100 participants actually lose money! In fact, classic no-product pyramid schemes are ten to one hundred times as likely to result in profits as are product-based pyramid schemes, or MLMs.

legitimate income options, see Appendix 7E.)

MLM is a mathematical trick played on the unwary. MLM promises significant rewards to those who invest time and money in an MLM program, 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 discussed above, MLM's, or product-based pyramid schemes, cause far more harm than other types of pyramid schemes by any measure – loss rates, aggregate losses, number of victims, etc.

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 Amway¹⁶⁷ 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 is arises from a failure to make a fair presentation of the actual (as opposed to the theoretical or exceptional) chance of success.

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.

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

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.

¹⁶⁷ Approved Judgment: The Secretary of State for Business Enterprise and Regulatory Reform v. Amway (UK) Limited May 14, 2008. §54 (c)

prospect on whether or not to participate. This will be the topic of the next section.

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. 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 convinced themselves that they were making money even when they were spending more¹⁶⁸ 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 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 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, they 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

¹⁶⁸ 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.)

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 is the only cost effective way for the FTC to handle the hundreds of deceptive MLM programs. This problem was magnified when an FTC administrative judge 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, as 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 was – or was not. For the form I proposed (revised some), see Appendix 7C.

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 highly questionable – products, and that they should not expect to make any money from participating, that would be fine with me.

Note to persons being recruited by an MLM participant:

If 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.

Conclusions

This book – especially this chapter – 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 by MLM spokesmen and participants (with the encouragement of MLM promoters) were full of the misrepresentations discussed in this and preceding chapters.

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 37 reported here was 99.7%. And I believe it safe to assume that the hundreds of MLMs (with the four causative and defining characteristics in their compensation plan)¹⁶⁹ 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 and prior chapters are confirmed with this analysis. At the very least, it is safe to conclude that MLMs are not legitimate income opportunities. Recruitment-driven MLMs 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. We will test this in Chapter 8: "A Litany of Misrepresentations."

¹⁶⁹ See Chapter 2.

Appendix 7A: Methodology validated by financial 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. However, these analyses and calculations have been validated by independent experts in fields requiring much sophistication in statistics, finance, and accounting.

Validated by CPA & Certified Fraud Examiner¹⁷⁰

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 statistician¹⁷¹

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

¹⁷⁰ "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/>

¹⁷¹ 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"

MLM. While I was researching this MLM, I became aware of Dr. Taylor's research and started reading information on his website.

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*" by Jon M. Taylor. The primary case in this chapter details data noted in what is referred to [Exhibit 2]¹⁷² in this chapter "[Exhibit 2]: 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 actuary¹⁷³

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

¹⁷² It was Exhibit 1 in early edition. Exhibits re-numbered in later editions

¹⁷³ 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

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, but I find it statistically difficult to conclude that MLM is a viable industry, as a 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." 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 NuSkin, I have examined the calculations in [Exhibits 3 and 4]¹⁷⁴ of Chapter 7 – MLM's 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

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 Certified Financial Planner¹⁷⁵

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.

¹⁷⁴ Exhibits re-numbered in later editions

¹⁷⁵ Letter from Calvin D. Welling, CLU, ChFC, CFP, to FTC dated January 12, 2011. Subject: "MLM marketing practices"

Appendix 7B: List of MLMs for which compensation plans have been evaluated by Jon M. Taylor, MBA, Ph.D. (as of June 1, 2012)

| | | |
|--------------------------------|------------------------------------|-------------------------------------|
| 1Cellnet | Cleur | Gemcap |
| 4Life Int'l | Cognigen | Gem Lifestyle |
| 5Linx | Conklin | Genewize Life Sciences |
| A. L. Williams | Cookie Lee Jewelry | GDI - Global Domain Int'l |
| Acai Plus | Creative Memories | Global Equity Marketing and |
| Achievers Unlimited | Cyberwize | Global Equity Lending |
| ACN | Daisy Blue | (World Leadership Group) |
| Adcalls | Digital Crown Holdings Ltd. (DHCL) | Global Health Trax |
| Advantage Conferences | Direct from Vatican City | Global Research Network (1-up) |
| Advantage Marketing Systems | DoTERRA | Global Resorts Network |
| Advantage Neutraceuticals | Drink ACT | Global Travel Trends (PRT Travel) |
| Advocare | DSX | Global Wealth Trade |
| Affordable Energy | Dubli | GNLD |
| Agel | Dynasty of Diamonds | GoHFT |
| AIM | E. Excel | Gold Mine International |
| AliveMax | Earth Essence | Golden Neo-life Diamite |
| All-star Entrepreneur | Easy Daily Cash (2-up) | GoldQuest |
| Amazon Herb | Ebiz.com | Goldshield Elite |
| Ambit Energy | Ecoquest | Good Life International |
| American Longevity | eFoods Global | Goyin |
| Ameriplan USA | eFusion (acai) | Great Life Int'l |
| Americisciences | Eido | Green World |
| Amkey | Elur | HBW Insurance and Financial |
| Amsoil | Emerald Passport (Profit Masters) | Herbalife |
| Amway-Quixtar | Empire Dreams | Heritage Health Products |
| American Marketing Systems | Empower Net | Heritage Makers/li> |
| American Petroleum Promotions | Enagic (Kangen water) | Hsin Ten Enterprise USA |
| Amigo Health | Enfinitia | iBuzzPro |
| Annasa | Eniva Gold Marketing | Ignite/Stream of Energy |
| Apeus | Enliven | Igonet |
| Arbonne | EnvisionCC | Immunotec |
| Ardyss International | Epic Network | iNet Global |
| Ascend Technologies | Escape International | Inner Light |
| Ascential Bioscience | Essante | Integris Global |
| At Home America | Essentially Yours | IDN (Nu Skin) |
| Avalla-Distributes Nutrmetrics | Evolution International | International Galleries, Inc. (IGI) |
| Avon | eXfuse | Isagenix |
| Baby Crazy | Extreme Research | ITV Ventures |
| Beach Body | EZ Wealth by Design | It Works |
| BeautiControl Cosmetics | First Financial Security | IV-7 Direct |
| Bel'Air | First Fitness International | Jafra |
| Better Universe | Fuel Freedom International | Jewelry by Park Lane |
| Beyond Freedom Seminars | FFSI | Jus International |
| bHIPGlobal | FM Group World | K-Link |
| Big Planet (Nu Skin) | For You | Kaire |
| Biogen | Forever Green | Kangivity Global |
| Biometrics | Forever Int'l | Kanosis |
| Bioperformance | Forever Living | Karemore |
| BioPro | Formor Int'l | Kleeneze |
| Bodywise | Forte Builder (New Vision) | Kyani |
| Bookwise Books | Fortune Hi-tech Marketing | Ky-Ani Sun |
| Brain Garden | Free Life International | Learning Global USA |
| Business in Motion (BIM) | Freedom Rocks | Leaving Prints |
| Celebrating Home | Fruda Vida International | Legacy for Life |
| Cell Tech | Frutaigo | Lexus |
| Cell Wireless | Fuller Brush | Liberty International |
| Ceres Living | Fun Unlimited | Liberty League Int'l (LLI) |
| Champion Communications | Gano Excel | Life Force International |
| Cie Aura | GBG | Life Max |
| Citizenre | | Life Plus |

| | | |
|--------------------------------|--------------------------------|--------------------------------------|
| LifeWave | Oreder International | Tiens Biotech Group |
| Life without Debt | Organo Gold | Tianshi |
| Lifestyles USA | Orovo | Transcend Mktng Int'l, Inc. (TMII) |
| Lightyear Alliance | Our World Network | Tomboy Tools |
| The Limu Company | Oxyfresh | Tom Danley's Tape of the Month |
| Livinity | Palmary | Top Line Creations (TLC) |
| Longevity Network | Passport LLC | Traverus Travel |
| Mandura | Petromagic | Trilogy |
| Mannatech | Pharmanex (Nu Skin) | Triunity Int'l |
| Market America | PhotoMax (Nu Skin) | Trivani |
| Mary Kay Cosmetics | Plexus Pink | Trivita |
| Matol Botanical | PM International AG | Tupperware |
| Mavericks (World Health Card) | Power2Marketing (P2M) | TVI Express |
| Max GXL | Power Mall | Ubifone |
| Max International | Prepaid Legal | UltraStore |
| Maxxis 2000 | Primerica Financial Services | Unicity |
| Me2Everyone | Prixdale Ventures | Univera Life Sciences |
| Melaleuca | The Profit Masters (Emerald | USANA Health Sciences |
| Menage International | Passport) | Vemma |
| ML International | Pureworks | Visalis |
| MMOGULS | Purse Party | Vision for Life |
| Mona Vie | Qing Mei (cards) | Vision Travel |
| Monarch Health Sciences | Quixtar (Amway/Alticore) | Vitageneis |
| Mona Vie | Questnet | Viva Life Science |
| Morinda (Tahitian Noni Int'l) | RBC Life Sciences | VM Direct (Hello world) |
| Moxxor | RMP Infotech | Votre Vu |
| MPB Today | Refer Life | Xyngular |
| Multi-pure | Reliv | Waiora |
| MXI-Xocai | The Right Solution | Watkins |
| My4Life | Rodan & Fields - Victoria | Wealth Pools Int'l |
| My7Diamonds | SkinCare | Wellness Int'l Network (WIN) |
| My Leisure Business | Royal Body Care | Woosh |
| Narc that Car | Saraha of India (Saraha | World Financial Group |
| NAA - National Agents Alliance | Conserve & Comosale) | World Group Securities |
| National Lending Corp. | Scent-sations | World Leadership Group |
| Native American Nutritionals | Sendoutcards.com | World Lending Group |
| Natural Air Products | Sene Gence Int'l | World Marketing Alliance (WMA) |
| Nature's Own | Sensaria | World Ventures |
| Nature's Sunshine | Sevea | Wowgreen |
| NeuroGenesis | Shaklee | Wynlife Healthcare |
| Neways | Share the Wealth | Xango |
| New Quest International | Sibu | XELR8 |
| New Vision USA | Silver Cache | Xocai |
| NextFit | Slender Now | Xooma |
| Nexx | Soteria/ It Works Marketing | XOWii |
| NHT Global | Southern Living at HOME | Xzotto |
| Nikken | Sportron | Yoli |
| Noevir | Spring Wellness | YOR Health |
| Nouveau Cosmeceuticals | Stampin' Up! | Young Living Essential Oils |
| Nouveau Riche University | Stem Tech Health Sciences | Youngevity |
| NSA (Juice Plus) | Stimulife | Your Travel Biz (YTB Travel Network) |
| Nucery | Success University | Zamu |
| Numis Network (coins) | Sunrider | Zamzoo |
| NuLegacy Rx card | Supralife | Zermat International |
| NuMed | Sweet Living | Zija |
| Nu Skin/Pharmanex/Big Planet | Swiss Just | Zrii |
| Nussentials | Symmetry | Zu-B |
| Nutronix | Synergy Worldwide | Zulian |
| Nuvante | Syntec | Zurvita |
| Ohana Health | Tahitian Noni Juice (Morinda) | |
| Omegatrends | Talk Fusion | |
| Ominex | Take Shape for Life | |
| Omnitrition | Team Everest | |
| One24 | Team Life Changes (Nutraburst) | |
| Online Exchange | Team National | |
| OnPoint Direct | The Traveling Vineyard | |

Plus – numerous other MLMs that have come and gone, including a few shut down by authorities – most prior to the year 2000

Appendix 7D: 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

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
other participants within the past three years \$87,835,000

Total payments in commissions to these participants for the past year \$25,390,000
Percentage of distributor-generated revenue rebated to these distributors (payout) 28.9%

Average purchases of products and services⁵ by these participants from WealthPlus \$878.35

Average commissions and bonuses paid by WealthPlus to each of these participants \$253.90

Average income/loss of participants in this group of participants – (*minus*) 624.45

| <u>Range of annual Commissions⁶ received by participants from WealthPlus</u> | <u>Average purchases from com- pany for each level</u> | <u>% of total participants*</u> | <u>Number of participants</u> | <u>Total commissions paid by company to distributors at each level</u> |
|---|--|-------------------------------------|-----------------------------------|--|
| Over \$500,000 | \$20,000 | 0.001% | 1 | \$1,500,000 |
| \$250,000-\$499,999 | \$18,000 | 0.005% | 5 | \$3,500,000 |
| \$100,000-\$249,999 | \$16,000 | 0.01% | 10 | \$3,000,000 |
| \$50,000-\$99,999 | \$14,000 | 0.05% | 50 | \$3,500,000 |
| \$25,000-\$49,999 | \$12,000 | 0.01% | 100 | \$3,000,000 |
| \$10,000-\$24,999 | \$10,000 | 0.03% | 300 | \$3,600,000 |
| \$5,000-\$9,999 | \$8,000 | 0.05% | 500 | \$3,500,000 |
| \$1,000-\$4,999 | \$3,400 | 2.0% | 2,000 | \$3,000,000 |
| \$1-\$999 | \$1,200 | 7.0% | 7,000 | \$700,000 |
| \$0 – participants who made purchases but did not qualify for commissions ⁶ | \$400 | 80% | 80,000 | 0 |
| \$0 – participants who enrolled but made no purchases ⁷ since enrolling | \$0 | 10% | (approx.)10,000 | (approx.) 0 |
| Totals | <u>\$87,835,000</u> | <u>100%</u> | <u>100,000</u> | <u>\$25,300,000</u> |

See “Explanatory Reference Notes for FTC Officials” on the following page.

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 7E: Network Marketing Payout Distribution Study – Letter to Presidents of 60 Prominent MLM* Companies

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”*) 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

* 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 competed 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

Letter to Presidents of 60 Prominent MLMs, page 4

**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 distributor level</u>) | 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 <u>from 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> |
|---|---|---|--|---|
| 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 distributor level</u>) | Total no. of <u>all</u> of your distrib's at this payout level | Aver. total company payout per distrib. 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 distrib. — deduct total products & services distrib's 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% | _____ | \$ _____ | \$ _____ | \$ _____ |

—continued—

Letter to Presidents of 60 Prominent MLMs, page 6

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 distrib's at this payout level | Aver. total company payout per distrib. <u>all commissions and bonuses paid by the company –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 distrib. – deduct total products & services distrib's purchased from your company, from total <u>commissions 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!

The Case (for and) against Multi-level Marketing

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

Chapter 8: MLM – A LITANY OF MISREPRESENTATIONS

Is MLM 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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Introduction and summary

FTC officials warned that “multi-leveling” poses “an intolerable potential to deceive.” 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 assumes both infinite and virgin markets – neither of which exists. 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 37 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 over 100 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 potential to deceive.”**¹⁷⁶ As you will see from reading this and the other chapters, this statement has proven to be very prophetic.

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¹⁷⁶ 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).

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 35 years' experience has proven the 1974 ruling to be correct. As a student of business opportunities

This is worth repeating, as it has been so literally fulfilled: 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 potential to deceive." This chapter proves it.

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 inherently 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 500 MLMs, using the 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 hierarchy (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. 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 the Exhibit 4 of Chapter 7.

Deceptions by the DSA

If 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,"¹⁷⁷ 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.

¹⁷⁷ 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 research¹⁷⁸ showing high rates of satisfaction for direct sellers. But 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 Myth of ‘Income Opportunity’ in Multi-level Marketing,*” by Robert FitzPatrick) will see just 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 some questions a person should ask before joining a program. Here 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. Again 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 500 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.

¹⁷⁸ 2002 National Salesforce Survey, Research International, Inc.)

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.

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, we learn that 99% of 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. I won't bother to comment here on the rest of the “myths” the DSA lady attempts to debunk. But here they are:

MYTH #7: Direct selling companies are unregulated

MYTH #8: Most companies require inventory purchasers; direct sellers who drop out are stuck with the inventory they purchased

MYTH #9: If you attend a direct selling party you are expected to buy something

MYTH #10: Everyone who gets involved in direct selling wants an easy way to make money

JMT: In this chapter the reader will find a list of over 100 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.

Over 100 typical misrepresentations are used in MLM recruitment campaigns.

As mentioned earlier, all of the MLM compensation plans I analyzed are recruitment-driven and top-weighted. In order for them to appeal to prospects, a litany of misrepresentations (including the income misrepresentations in Appendix A) are 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.¹⁷⁹ Included are some I

¹⁷⁹ Primary source materials for this list are listed at the end of the chapter.

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 they don’t deliberately go about seeking to deceive people. I have observed a lot of self-deception 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. All MLMs are built on an endless chain of recruitment. MLM compensation plans assume infinite and virgin markets, neither of which exists in the real world. MLM is therefore inherently flawed, deceptive, and 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.

Built on unlimited recruitment of a whole network of endless chains of recruiters, MLM assumes both infinite and virgin markets, neither of which exists in the real world. MLM is therefore inherently flawed, deceptive, and profitable only for founders and those at or near the top of a pyramid of participants – usually those at the beginning of the chain of recruitment. MLM is also extremely viral and predatory.

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 practices. One must suspend the realities of supply and demand and believe in infinite markets and virgin markets, neither of which exists in the real world – at least not for long. With MLM’s 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.

Conclusions

After studying the compensation plans of over 500 MLMs, I can say with confidence that virtually all MLMs are dependent on deceptive recruitment of a whole network of endless chains of participants as primary (or only) customers. Incentivizing endless chain or infinite recruitment within a finite 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 chain or pyramid of participants.

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 megapyramid 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

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 chain or pyramid of participants.**

potential to deceive.”

Warning to readers

If you are investigating MLM, and you read this chapter – including both appendixes – with an open mind, it is not likely that you will be able to look at MLM as a credible class of business opportunities. At the very least, all of the over 500 MLMs I have analyzed so far can be classified as unfair and deceptive practices. And all (100%) of those for which I was able to obtain average earnings data are misrepresenting the possible earnings of participants.

Primary sources for this chapter

Primary source materials used in compiling the above lists include the following:

- “*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
- *The Network Marketing Game*, by Dr. Jon Taylor, 1997:King Alfred Press
- “*Top 10 Myths & Facts about Direct Selling*,” posted on the DSA-sponsored web site Directselling411
- “*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, published on MLM Watch 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/MLM spokespersons.
- Google search of the top references from among 430,000 results, using as search terms “MLM” combined with the terms “misrepresentations,” “lies,” and “deceptions”
- My one-year test of the Nu Skin program
- Analysis of over the compensation plans of over 500 MLM programs
- Analysis of web sites of 37 MLMs that release statistics of average earnings of participants (reported in Chapter 7)
- Correspondence with and feedback from thousands of MLM leaders and participants worldwide over an 18-year period from 1994 through 2012

Appendix 8A: Quotations from MLM Company Communications and their Misrepresentations as “Income Opportunities” 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 40 MLMs with available average earnings data, most of which are included here.

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.”*¹⁸⁰

[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]**¹⁸¹

Ameriplan

[Average annual income¹⁸² is disclosed for “Active IBO’s” – but with no indication of what percentage of the total of all IBOs signed up are still active. Ameriplan also fails to disclose that approximately 99% of all IBOs lose money after subtracting “pay-to-play” and minimum operating expenses.]

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”¹⁸³

“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**

¹⁸⁰ <https://www.advocare.com/opportunity/default.aspx>

¹⁸¹ From an Advocare-approved posting by one of their distributors, Mary Myers, of Amarillo, TX at - <https://www.advocare.com/10047016/default.aspx>

¹⁸² <http://www.ameriplanusa.com/disclaimer-broker.html>

¹⁸³ <http://www.amway.com/en/start-a-business/how-amway-works>

misrepresentation, as a recent California class action showed that less than 5% of Amways' 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 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 Abonne’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.”¹⁸⁴ [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 Potential¹⁸⁵

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.”¹⁸⁶ [Cyberwize fails to disclose that approximately 99% of all participants lose money.]

Ecoquest (now Vollara)

“Our Opportunity¹⁸⁷ - Unleash Your Future”TM

“. . . 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 exist in the real world. Also, Vollara fails to disclose that approximately 99% of all participants lose money.]

Fortune Hi-Tech Marketing (FHTM)

“Why FHTM?”¹⁸⁸

“. . . 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

¹⁸⁴ http://www.arbonnemarketing.com/PDF/opportunity/2010_US_EN_OpportunityBrochure.pdf

¹⁸⁵ <http://work2benefit.com/tag/beachbody-coach-income>

¹⁸⁶ <http://www.cyberwizehealth.com/understanding-mlm-tiers-and-cyberwize/>

¹⁸⁷ <http://www.vollara.com/join-us/why-vollara>

¹⁸⁸ <http://www.fhtm.net/whyfhtm.aspx>

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.]

FreeLife International

“The Opportunity¹⁸⁹ - 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.¹⁹⁰ 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”¹⁹¹ video portrays Ignite as a great income opportunity, but nowhere is it disclosed that approximately 99% of all of its Independent Associates lose money.]

Immunotec

“Build the Business You Want with Immunotec”¹⁹²

“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 autoship, 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

¹⁸⁹ <http://corporate.freelife.com/international/usa/index.cfm/opportunity>

¹⁹⁰ <http://www.herbalifeopportunity.com/>

¹⁹¹ <http://igniteinc.com/ig/>

¹⁹² <http://www.immunotec.com/IRL/Public/en/CAN/compplan.wcp>

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 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"¹⁹³

"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"¹⁹⁴

"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."¹⁹⁵ 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

¹⁹³ <http://www.inetglobal.com/inetsurf/index.php?pid=iNetSurf:Index>

¹⁹⁴ http://www.isagenix.com/us/en/opportunity_overview.dhtml

¹⁹⁵ <http://www.melaleuca.info/?culture=en-us>

“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 get out of debt. We talk about, reward and teach important money management principles. More importantly, we not only encourage better 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.]

Momentum Plus

“My Momentum Plus – Become a Distribution Agent”¹⁹⁶

“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”¹⁹⁷

“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.”¹⁹⁸

“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!].**

¹⁹⁶ http://www.mymplus.com/index.php?option=com_content&view=article&id=95&Itemid=186

¹⁹⁷ <http://www.mxcorp.com/compplan/>

¹⁹⁸ <http://www.nikken.com/opportunity/>

Numis Network

“Create Wealth, Collect Wealth and Preserve Wealth with Numis Network”¹⁹⁹

“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”²⁰⁰

“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.]

“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”²⁰¹

“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.”²⁰²

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]

¹⁹⁹ <https://www.numisnetwork.com/content.asp?content=opportunity.html>

²⁰⁰ http://www.nuskin.com/en_US/opportunity/financial_rewards.html

²⁰¹ http://www.orendainternational.com/content.asp?page_id=4

²⁰² <http://www.reliv.com/US/EN/Become+a+Distributor.html>

SendOutCards

“Receive Compensation By Sharing SendOutCards”²⁰³

“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]**

Tahitian Noni International

“Want an extra \$500 a month? This home based business is the answer!”²⁰⁴

“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 approximately 99% of all participants lose money]**

Take Shape for Life (Medifast)

“Make Money While You Sleep Anywhere in the World”²⁰⁵

“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.]**

²⁰³ https://www.sendoutcards.com/cgi-bin/trncustomer.pl?income_opportunities:

²⁰⁴ Tahitian Noni International Independent Product consultant web site (likely approved by TNI) at - <http://www.nonijuiceint.com/TahitianNoniHomeBusiness.aspx>

²⁰⁵ <http://www.networkmarketingvideoconferencing.com/Network-Marketing-Companies-Distributor-Tools/Medifast/index.htm>

Tupperware

*“Opportunity – Tupperware, the Perfect Fit.”*²⁰⁶

“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 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”).²⁰⁷ 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”*²⁰⁸

“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”*²⁰⁹

“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.”*²¹⁰

“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 arbitrary fashion and lose their income, as happened to at least one top recruiter.]

Visalus Sciences

*“Discover Prosperity”*²¹¹

“Welcome to Financial Freedom” (sign at top of page). “Discover Prosperity.”

“As a Viaslus 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

²⁰⁶ http://www.tupperware.com/pls/htprod_www/tup_opportunity.opportunity

²⁰⁷ Reported in Presentation Summary, S2Sales Force Structure.Earnings Conference Call, Jan. 31, 2007.

²⁰⁸ <http://www.usana.com/dotCom/opportunity/index>

²⁰⁹ <http://www.usana.com/dotCom/opportunity/comp>

²¹⁰ <http://www.viridian.com/Oppportunity.aspx>

²¹¹ http://visalus.com/sites/default/files/docs/corporate/D1047US_CompPlanBook.pdf

- *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]

World Ventures

*“World Ventures Highlights – Marketing”*²¹²

“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”*²¹³

“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]

Yor Health

*“Take Charge of Your Success”*²¹⁴

“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?*²¹⁵ . . . 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]**

²¹² <http://www.worldventures.com/new/wv-highlights.php>

²¹³ <http://www.xango.com/opportunity/compensation-plan>

²¹⁴ <http://www.yorhealth.com/opportunity/letter-from-the-founder.aspx>

²¹⁵ <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 for 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.²¹⁶</i> In other words, it's easier to sell an “opportunity” than to sell overpriced products.</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.</p> <p>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> |

²¹⁶ “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.</p> <p>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. (See Chapter 2.)</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.²¹⁷</p> | <p>MLM is the most unfair and deceptive marketing methodology ever developed. It's 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.</p> <p>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 MLM'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>²¹⁸</p> |

²¹⁷ “MLM Lies, Exaggeration, and BS,” by John Zehr at johnzehr.com

²¹⁸ “Ten Myths of ‘Income Opportunity’ in Multi-level Marketing,” by Robert Fitzpatrick. Available from pyramidschemealert.org

| | |
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| <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 ay 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 |
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| <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 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, and money you put into it.</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 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> |
| <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.</p> | <p>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?</p> |
| <p>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> | <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> | <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.)</p> |

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| 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 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 . . .” ²¹⁹ | While the buyback provision is laudable, it is seldom exercised because participants have been encouraged to open and use their products, making 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.) |

Misrepresentations regarding legality, regulation, and legitimacy of MLM:

| MLM misrepresentations | The truth |
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| (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. | 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, |
| The market collapse predicted for MLMs never happens. Many MLMs have been around for over 40 years and are still going strong. | 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. ²²⁰ 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. |

²¹⁹ “Top 10 Myths & Facts about Direct Selling,” posted on Directselling411

²²⁰ For a detailed discussion of these strategies, see “The 8 Rs of MLM Durability” in Chapter 3 of this book.

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| <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.”²²¹</p> | <p>Recruitment-driven MLMs (see chapter 2), 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 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” 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</i></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> |

²²¹ DSA comments to the FTC on its proposed Business Opportunity Rule, 2006

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| <i>direct sellers. By any measure, this is an extraordinarily low level of consumer.</i> ²²² | |
| 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." ²²³ | Recruitment-driven MLMs (see chapter 2), 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 a hollow, hypocritical, and misleading statement. |
| "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." | 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 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> ²²⁴ |

Misrepresentations regarding MLM products & services – product claims, prices, purchase quotas, stockpiling, investments in products and “tools for success,” etc.:

| MLM misrepresentations | The truth |
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| 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. | 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. |

²²² DSA comments to the FTC on its proposed Business Opportunity Rule, 2006

²²³ DSA comments to the FTC on its proposed Business Opportunity Rule, 2006

²²⁴ “Ten Myths of ‘Income Opportunity’ in Multi-level Marketing,” by Robert Fitzpatrick. Available from pyramidschemealert.org

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| <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> |
| <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" requirements. 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</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, 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> |

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| <p>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>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 and sales aids purchased in the past 12 months for at least 90% of the purchase price.</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 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.²²⁵</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.</p> <p>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> |

²²⁵ 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/_dwnls/newsviews/nv_0209.pdf)

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| <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> |
| <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>²²⁶ |

²²⁶ “The Mirage of Multi-level Marketing,” by Stephen Barrett, MD, published on MLM Watch at mlmwatch.org

Misrepresentations regarding MLM as a “business opportunity” and the importance of timing to take full advantage of it:

| MLM misrepresentations | The truth |
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| Take advantage of “momentum” and “windows of opportunity.” | 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. |
| An MLM is not presented to prospects as a direct selling or as a pyramid/chain selling program, but as a “business opportunity.” | 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. |
| MLM is a business offering better opportunities for making large sums of money – more than all other conventional sales and business opportunities. | 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 80’s, 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. |
| 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. | 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. 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 |

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| | <p>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 being sold a ticket on a flight that has already left the ground.</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 1960's. 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.</i>²²⁷</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</p> |

²²⁷ "Ten Myths of 'Income Opportunity' in Multi-level Marketing," by Robert Fitzpatrick. Available from pyramidschemealert.org

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| | necessary to “do the business.” |
| 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. | 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 revised proposed Business Opportunity rule. |

Misrepresentations regarding emphasis on recruitment over selling to non-participants – and on the recruitment process itself:

| MLM misrepresentations | The truth |
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| 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. .” ²²⁸ |
| 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 | Every one of the hundreds of MLM compensation |

²²⁸ DSA Comments to the FTC on its proposed Business Opportunity Rule, 2006

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| <p>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.²²⁹ 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.²³⁰</p> | <p>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.</p> <p>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.</p> |
| <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</p> | <p>This acknowledgement that other MLMs have not</p> |

²²⁹ 1999 National Salesforce Survey, MORPACE International, Inc. (Quoted in *Direct Selling* 411)

²³⁰ Source: 2004 General Public Attitudes Toward Direct Selling, Burke, Inc.

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| <p>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>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></p> <p><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></p> <p><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 business.</i></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 are 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.</i>²³¹</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 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> |

²³¹ "MLM Lies Exposed," at - mlmliesexposed.com/

Misrepresentations regarding MLM compensation plans and promised or actual income from MLM participation:

| MLM misrepresentations | The truth |
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| 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 is 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. |
| 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. | 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 “.16%” ²³² |
| “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.). | 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. |
| Company payout to participants is reported as “earnings” to them. | <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> |

²³² See the book “How to Lie with Statistics.”

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| <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.²³³</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> |
| <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.²³⁴</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.²³⁵</p> |
| <p>In most MLM reports of average income of participants, gross commissions is 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> |

²³³ Direct Selling 911 web site

²³⁴ Direct Selling 911 web site

²³⁵ See Chapter 6

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| <p>Legitimate direct selling opportunities offer the flexibility to set your own goals and achieve them on your own terms.²³⁶</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.”²³⁷</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 DSA²³⁸ 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 2004.²³⁹</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> |
| <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. (See Chapter 2.)</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> |

²³⁶ Direct Selling 911 web site

²³⁷ Direct Selling 911 web site

²³⁸ 2002 National Salesforce Survey, Research International, Inc.)

²³⁹ Direct Selling 911 web site (DSA 2005 Growth and Outlook Survey.)

Misrepresentations regarding success and failure, or retention and attrition (dropout) rates among MLM participants:

| MLM misrepresentations | The truth |
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| Turnover, as in any business, is a reality that assures an ample supply of available prospects. | <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> |
| If you fail at this program, it is because you failed to properly “work the system.” | 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 exist. 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. ²⁴⁰ |
| “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. | 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. 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 |
| “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. | 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 |

²⁴⁰ See Chapter 7.

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| <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>²⁴¹</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.”²⁴²</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> <p>(See Chapter 2.)</p> |
| <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>²⁴³</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> |

²⁴¹ Quoted in DS411

²⁴² “Top 10 Myths & Facts about Direct Selling” posted on the directselling411 web site.

²⁴³ 1997 Survey of Attitudes Toward Direct Selling, Wirthlin Worldwide. Quoted on DirectSelling 411 web site.

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| <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:</p> <p><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></p> <p><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></p> <p><i>Since MLM is not sales work, but pyramid recruiting, it has no counterpart in the real world of work or employment.²⁴⁴</i></p> |
| <p><i>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:</i></p> <ul style="list-style-type: none"> • <i>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.</i> • <i>89% of direct sellers rate their personal experience in direct selling as excellent, very good, or good.</i> • <i>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.</i> • <i>91% of direct sellers say that direct selling meets or exceeds their expectations as a</i> | <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 99.8% (calculated from our latest data) of direct sellers lose money, 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> |

²⁴⁴ Letter to Jon Taylor dated October 21, 2010

business where the harder they work the more money they can make.^{245 246}

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 williness, 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 |

²⁴⁵ 2002 National Salesforce Survey, Research International, Inc

²⁴⁶ Quoted in DS411

| | |
|--|--|
| | endless chain scam. They will do better with almost any honest work. |
| NOTE: the next five misrepresentations are debunked by Robert FitzPatrick:²⁴⁷ | |
| 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</i> |

²⁴⁷ "Ten Myths of 'Income Opportunity' in Multi-level Marketing," by Robert Fitzpatrick. Available from pyramidschemealert.org

| | |
|--|--|
| | <i>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> |
| MLM is a positive, supportive new business that affirms the human spirit and personal freedom. | <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> |

Misrepresentations relating to credibility of the MLM, its leaders, and important persons whose names are somehow associated with it:

| MLM misrepresentations | The truth |
|---|--|
| Former presidents and other very reputable people have endorsed our MLM or spoken at our events. | 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. |
| 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. | 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. |
| 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. | 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. |
| 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 | The mafia supported local charities. And because a bank robber donates some of his take to charity, does that excuse the robbery? |

| | |
|--|--|
| services to social programs, 89 percent of the direct seller respondents said they contributed to human services programs and charities.” ²⁴⁸ | |
| 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. | 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. |
| NOTE: The next four misrepresentations were debunked by John Fogg ²⁴⁹ | |
| <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. | The U.S. sells about \$6 trillion plus worth of goods and services per year - give and take ten or twenty <i>billion</i> . 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. Super-conservative folks say MLM is about \$10 billion <i>really</i> . |
| Some 20 percent of all the millionaires in America were created through network marketing. | <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> |
| Network marketing is taught at Harvard and Stanford business schools and in numerous other leading colleges and universities throughout the country. | 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. Stanford officials have refused to react to this statement, apparently not considering such a claim as worthy of any comment.</i> |
| Some 20 percent of all the millionaires in America were created through network marketing. | <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> |
| John Naisbitt, in his best-selling book, <i>Megatrends</i> , said network marketing is the wave of the future. | <i>John Naisbitt never mentioned network marketing in <i>Megatrends</i>, <i>Megatrends 2000</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> |

²⁴⁸ 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)

²⁴⁹ “Four Lies about MLM,” by John Fogg. posted on MLMwatch.org In 2002

NOTE: The above 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.

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The Case (for and) against Multi-level Marketing

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

**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 program. 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.

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MLM's villains

As has been established in prior chapters, the loss rate for MLMs is high enough and widespread enough throughout the industry that independent analysts would not consider that multi-level marketing, or MLM, should be considered a legitimate business opportunity 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 do the promotion, in company spokesmen, in lax law enforcement, or some other group of people? Below are the types of players that I believe deserve some credit for specific 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 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.

Once more: 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 potential to deceive.”

Participants may even see consumer protection efforts by government agencies as an encroachment on our free enterprise system.

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. Since they interact mostly with high level people in the MLM organization, they 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 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 at the time was 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 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. A Google search for MLM leaders with criminal – or at least questionable – back-grounds will 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 whistleblowers who challenge the system and plaintiff attorneys and their experts who present evidence of fraud. See Chapter 8 for the many deceptions that are used to counter those who labor on the side of truth in this arena.



These paid pro-MLM forces, especially the DSA (Direct Selling Association), are well-funded and powerful. They can 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 100 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 senator, apparently influenced by implied support from a large block of "90,000 direct sellers in the state" (according to 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.

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.

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 of participation.

In the aforementioned legislative hearings, officials from the 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 victims of Nu Skin's program alone numbered in the hundreds of thousands. But for the reasons mentioned above, it was extremely rare for anyone to file a formal complaint.

In its 2006 proposal for a new Business Opportunity Rule, the FTC noted²⁵⁰

Complaint-based law enforcement agencies. 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 almost never file complaints for a variety of reasons, including the following that we have observed in working with MLM victims:

- They blame themselves, since they've been taught that anyone who properly "works the system" will succeed and that if a new participant fails it is their fault, rather than the fault of the system.
- Since they are part of an endless chain of recruitment, they fear consequences for filing a complaint



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%²⁵¹ of the over 15 million MLM participants²⁵² every

²⁵⁰ Federal Register / Vol. 71, No. 70 / Wednesday, April 12, 2006 / Proposed Rules

²⁵¹ Chapter 7

²⁵² DSA 2009 sales figures, dated 7-27-2010 – showing 16.1 million "direct sales representatives" – which DSA admits are mostly MLM participants

year lose money²⁵³ – all of whom joined the MLM based on a whole litany of misrepresentations²⁵⁴ – 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 would amount to over \$20 billion per year in this country alone²⁵⁵. 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 DSA/MLM cartel would be many times the huge aggregate losses suffered by victims in the Bernie Madoff scandal!

Complaint-based law enforcement or consumer protection simply does not work in combating pyramid marketing schemes, or MLMs. What is needed are consumer protection officials with both the skill and the will to be proactive in dealing with “entrepreneurial chains.” They need to understand the inherent 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.

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 endless chain recruitment SYSTEM. I 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 SYSTEM (and their top-weighted 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 over 1,000 that were clearly violating Section 5.²⁵⁶)



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

²⁵³ Chapter 7

²⁵⁴ Chapter 8

²⁵⁵ DSA 2009 sales figures, dated 7-27-2010 – showing \$28.33 billion in 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.

²⁵⁶ See Chapters 2, 7, 8, and 10

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.²⁵⁷

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 mistake in not ruling MLMs as inherently unfair and deceptive, and therefore illegal (based on Section 5 of the FTC Code), as they do with classic no-product pyramid schemes and “pay to play” chain letters. The Amway decision set up a terrible 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 and other pro-MLM forces to have all their wishes granted in future rulings and legislation.

Adequate disclosure would go a long way towards protecting consumers. For example, if prospects knew that their chances of earning a 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.

Other suggestions that could work to prevent the worst abuses of MLM, thereby creating a “good MLM” (if such were possible), are at the end of Chapter 2. But I don’t expect any of these to be taken seriously, as no one would achieve sudden and massive wealth.

As MLM grows, struggling consumers who fall for MLM suffer, families suffer, legitimate businesses suffer, law enforcement suffers, and society at large suffers.

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 several meetings 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 inherent 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

²⁵⁷ See Chapters 2, 7, 8, and 10.

The knowledgeable but unwary.

Others are just caught unaware, as the dialogue of deception is so pervasive and skillful that even intelligent people are often duped into believing that 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 an MLM program 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 “pill, 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 an unusual pattern of 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, he or she 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 independent churches that are virtually ruined by a pastor’s involvement in some MLM recruitment tied in with a church’s fundraising efforts.

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 tell them 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 young woman reported that during her growing up years 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 new recruits seeking funds to start their MLM “business.”

Products are produced for consumption by pyramid selling participants that draw sales away from legitimate businesses. And people attempting to perform legitimate direct selling functions sometimes find it difficult to compete with MLMs who deceptively use the implied “business opportunity” appeal to sell products. Unfair competition is harmful to legitimate business generally.

Humanitarian causes. We have received reports of MLMs selling nutritious dry-pack meals to poor struggling nations in Africa. New recruits to their programs are told that a portion of their product purchases go to helping feed starving populations through these special meals – or that donations can be made directly to such funds. What they are not told is that the food is supplied with a huge profit margin to the company.

We have also learned of programs tied into MLM recruitment, in which scouts identify AIDS victims in Africa. New MLM recruits are told that they can sponsor an AIDS victim and that a portion of their purchases will go towards helping that person get the help he or she needs. The implication is that if the recruit drops out 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, everyone suffers – because 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 (in the case of MLMs) gives glowing reports of rapidly growing new companies – that are merely following a pattern of early momentum in a typical product-based pyramid scheme.²⁵⁸

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 caused TOPPs (top-of-the pyramid promoters), as well as those who found these companies, to change for the worse 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. As an interesting side note, when I tested the Nu Skin program (IDN Division), I remember vividly one “IDN University” meeting in a large auditorium where a “Blue Diamond” (highest level in the pay plan) was introduced to an enthusiastic audience. He stammered as he admitted sheep-ishly (as best I can recall), “Gosh, I 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 has 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!



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 in 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 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.

²⁵⁸ See Chapter 3

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 or her. And sometimes extended families become split over MLM involvement.

Sadly, MLM leads to worse effects for some. I have learned of three murders, four suicides, and one near suicide resulting directly from intense MLM involvement.

For sample letters from the thousands we have received over the past 15 years related to personal and family problems with MLM, see Appendix 9A.

Conclusions

Together with the information from prior chapters, we see that there are many villains and many victims in MLM. People who have read many reports on my web site, as well as reports of other independent 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. And based on worldwide feedback, the harm is more deeply felt and widespread than I and others supposed when we first began reporting on the subject.

From my communications with thousands of MLM participants and their families, as well as with MLM officials 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 that underlies all MLM programs that is the chief villain – unlimited recruitment of a whole network of endless chains of participants as primary (or only) customers. It is essentially a money transfer scheme, transferring funds from a revolving door of recruits (who must make purchases in order to participate fully – usually by subscription) to a few key people in the organization, including founders, managers, and TOPPs (top-of-the-pyramid promoters).

The victims of MLM are many and varied, including family, friends, affinity groups, and those struggling to get ahead. Most participants are minimally affected because they buy a few products and get out, but those who believe the hype and invest a lot, lose a lot. Some even display patterns of addiction and are never the same. As MLM grows, 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.”²⁵⁹ And I would add – If there was ever an unfair and deceptive practice, MLM is it!

“Section 5 of the FTC Act declares unfair or deceptive acts or practices unlawful.”¹ Many states also have statutes against unfair and deceptive practices. If there was ever an unfair and deceptive practice, MLM is it!

²⁵⁹ *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: 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.

**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!**

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, 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)

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 60's/early 70's. 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."

– Anonymous Amway victim

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

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.

– Anonymous wanting MLM antidote

Girl friend 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 when it comes to 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

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

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 enough through MLM 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 (A copy of this letter addressed to the president of the company was sent to me.)

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

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. Everyday 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.** Thank you for all your work and insight and I'm glad to know there are still people out there trying to

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 – formerly homeless

make the world a better place. Thanks for letting me share.

Nick

From a woman whose family for decades has 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 60's/early 70's. 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

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.

- friend of MLM recruit-turned-zombie

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.**

Thanks a lot for your time and support.

– Mohammad A., Egypt

Swiss financial advisor warns friends and family in Spain against MLM

[Your web site] 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 forward it on to my whole family and network of friends in Spain and asked them to forward it on as well.

– Rosa M., Switzerland

Woman in London finds Nu Skin recruitment methods deceptive:

Thank you so much for the information about mlm on your website.

Nu Skin are 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 jobsites in European countries now.

Thanks again for your website,
– 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

MLM cancer is spreading to developing world

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.**

– friend of MLM recruit-turned-zombie

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.**

Sincerely,

–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 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.

Attorney mom finds web site (mlm-thetruth.com) helpful in debunking deceptions

I found your website and all of it's 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 fiance) 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

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 – thats 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

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

– Ron D.

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 90's 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

**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!
- Phil F., CPA**

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.)

– Phil F., CPA

(Note: For data from other tax professionals, see *Survey of Tax Preparers*.)

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, 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

"Oh, you are OK with being a PIMP, but you don't want to be a PROSTITUTE huh?"

- Response to applicant for MLM staff job who didn't want to be a distributor

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, 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

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.

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.

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.**

Thanks again,
Mick D.

An insider reveals the 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, 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.

My source (an angry ex-husband, so you can take it for what it's worth) wrote me that she has also gone through a succession of 9 husbands, the last a male stripper.

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, 99.8% 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).

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!”

mlm-thetruth.com reveals deceptions and other problems 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)

"They can't be bad people, if they do such good things." (MLMs donating to charities) To use an appropriate metaphor – If you rob a bank and then give 15% to charity, the bank robbery is OK, right?

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.

I wish the Federal Government would put a stop to these people! Or at least the "Federal Trade Commission".
- John T.

Rarely are the products ever mentioned and as far as the Coaches providing me with any type of Standard Operating Procedure (manual or online

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.

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.

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 Big Blue (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".

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...

Its time to start my own business (not MLM). Thank you for ideas! ("[1,357 Ways to Make More Money than in MLM](#)")

Best wishes,
 Irena G.

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 awhile 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

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!

– John T.

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 successfull!! 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.

The Case (for and) against Multi-level Marketing

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

Chapter 10: IS MLM LEGAL?

When is an MLM (multi-level marketing program) a fraudulent 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 admitting I am not an attorney and make no pretense about this being an exhaustive legal treatise on this thorny issue. I am a consultant, teacher, entrepreneur, and consumer advocate. 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 many victims who were not seeking anything) – most of whom had no idea how damaging to their personal and financial well-being it can be to commit to an MLM program.

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.

As a consumer advocate, analyst, and educator, I try to be guided by solid logic and research and by feedback that I have received from victims 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.

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. In fact, if MLMs were classified as pyramid schemes, they would be illegal per se, according to FTC guidelines.²⁶⁰

Though it is not my primary objective in this book to prove that any given MLM is an illegal pyramid scheme,²⁶¹ it is relevant to know whether or not an MLM displays the characteristics of a recruitment-driven MLM²⁶², or what I would label a “product-based pyramid scheme,” because such schemes lead to horrendous loss rates among participants.²⁶³ Where data has become available, approximately 99.7% of MLM participants lose money,²⁶⁴ assuming at least somewhat realistic estimates of attrition, purchases, and minimum operating expenses are factored into the analysis.²⁶⁵

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 pyramid schemes and MLM

I will not attempt to provide here a thorough history of MLM (multi-level marketing) or analysis of all the problems with MLM (or what I like to call product-based pyramid schemes) but merely my observations as a qualified consumer advocate and business analyst. The history of pyramid schemes in this country is interesting, as you will see from the brief sketch below:

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,

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

²⁶⁰ 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)

²⁶¹ Again, I am a business analyst and consumer advocate, not an attorney

²⁶² See Chapter 2.

²⁶³ 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.

²⁶⁴ See Chapter 7. Similar results were also reported in “The Myth of ‘Income Opportunity’ in Multi-level Marketing,” by Robert FitzPatrick, Pyramid Scheme Alert, 2008.

²⁶⁵ See Chapter 7.

infusions of money, for if the play ends and there is an 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 distributorship plans, but there has never been any question about the vice of Ponzi schemes.²⁶⁶

“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 1970's – 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 eventually 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 multiple levels of distributors, each of whom received some type of compensation for the sales of those recruited at lower levels, or one's “downline.”

Early direct selling programs. Parallel to these developments were direct selling programs which focused on door-to-door selling or in-home demonstration plans, or “party plans.” Some of the direct selling programs that were popular in the 50s and 60s included Stanley Home Products, Mary Kay Cosmetics, Fuller Brush, Shaklee, Nutralite, and of course Amway. Even Amway at this time was primarily focused on selling of unique cleaning products to friends and family, rather than primarily to downline participants.

In Chapters 2 and 7, I explained why it is essential to examine carefully the compensation or pay plans of direct selling programs in evaluating them. This, of course, would apply to any packaged home business opportunity.

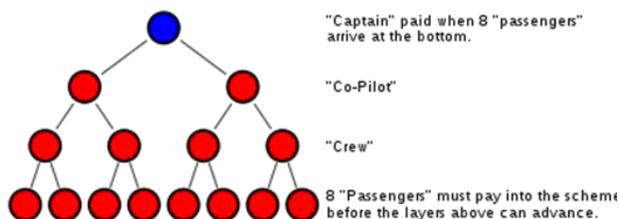
To help pay my way through college, I sold World Book Encyclopedia. When I made a sale, the largest commissions (20-30%) from the company went to me as the person who produced the sale. My division manager got a smaller percentage, and his manager a still smaller percentage – but of course they were 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 goes to the upline.

No-product pyramid schemes. I use this designation to separate these schemes from product-based pyramid schemes, or recruitment-driven MLMs. It is difficult to determine when the first no-product pyramid schemes were promoted, but by the 1980s

²⁶⁶ Joseph Bulgatz, *Ponzi Schemes, Invaders from Mars, and More Extraordinary Popular Delusions and the Madness of Crowds* (New York: Harmony Books, 1992), p. 36.

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 an “8-ball” 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 – and the others each move up a level – or he/she either starts a new pyramid and repeats the process all over or enters at the bottom and recruits his/her way up to the top in order to cash in again. 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 7C: 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% will be in a loss position. These schemes are widely considered to be unfair and deceptive practices. And though the FTC does not specifically address pyramid schemes, such schemes have been deemed unlawful under the above clause in the Federal Trade Commission Act.²⁶⁷

²⁶⁷ The Federal Trade Commission Act states that “Unfair methods of competition in or affecting

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.

To say that the addition of products somehow mitigates the damage done by a pyramid scheme is an uninformed view.

Multi-level marketing – 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, 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 he/she will make money by buying products to qualify for commissions from sales by those he or she recruited, the sale is an easy one.

commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.”²⁶⁷ In re Koscot Interplanetary, Inc., 86 F.T.C. 1106 (1975)

The nutritional products were promoted as effective in treating a variety of ailments, including even cancer, heart disease, and depression. Sales exploded, but the FDA took notice and battled such spurious claims for a brief period. This led to other battles with regulatory agencies later.

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 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 advancement in the scheme.

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.

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 an endless chain of recruitment by TOPPs (top-of-the-pyramid promoters). All of the hundreds of MLM compensation plans I

have analyzed assume infinite expansion in both finite markets and virgin markets, neither of which exist in the real world. MLMs are therefore inherently flawed, deceptive, and profitable primarily for those at the top of a pyramid of participants, who are often the first to join.

A continuing stream of new participants must be recruited to replace those continually dropping out – all to enrich the founders and a few TOPPs. The vast majority of participants become victims, having been promised substantial ongoing income but experiencing a net loss; i.e., having spent more than they received.²⁶⁸ They also lose time and often important

In MLM, an upline person several levels up often receives as much as or even several times as much per sale as the person making the sale. And he/she draws a commission on hundreds – even thousands – of downline participants. This greatly increases the “top weighted” emphasis that drives participants not to sell products, except to those they recruit into huge downlines – because that is where the money is.

These outsized recruitment incentives also are what could technically make an MLM an illegal pyramid scheme – or a money transfer scheme, transferring money from a revolving door of recruits at the bottom to those at the top of the pyramid – and to the company itself.

relationships from incessant recruiting.

Saturation underestimated by FTC.

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

²⁶⁸ See Chapter 7

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.

Judging MLM by behavior vs. structure and rewards. I dedicated considerable space in Chapter 2 to explaining that rewards drive behavior. 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 is the tendency of lawmakers and 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 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.

Needed – Consumer protection against MLM fraud. A far more cost-effective strategy would be to consider all endless chains 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:

1. The fundamental flaws of endless chain systems should be recognized and pointed out to consumers, so they can be given valid guidance to avoid such programs
2. Consumers should be provided adequate disclosure of essential information to make an informed decision. For example, if a prospect knew that less than one in 100 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 incomes reported for TOPPs, they may decide not to participate.

The powerful DSA/MLM cartel. 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 the “DSA/MLM cartel” (my term). 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.

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 promotional 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 an 8-ball no-product pyramid scheme²⁶⁹ paying 100% of investments to TOPPs (top-of-the-pyramid promoters), most of what is left over after cost of goods sold and other expenses goes to TOPPs and founders, and the rest is spread amongst (usually) tens of thousands of participants – at least 99.7% of whom lose money²⁷⁰.

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 product-based pyramid schemes, or MLMs. So participants in MLMs suffer far greater harm than those in no-product pyramid schemes by any measure – loss rate, aggregate losses, and number of victims. In my opinion, 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 systemic or structural standpoint, the difference between “legitimate MLMs” and illegal pyramid schemes is a distinction without a difference,²⁷¹ 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” may be an oxymoron.

I have frequently been asked how one would create a fair and honest MLM program. In response, I have given

²⁶⁹ For more on comparisons between no-product and product-based pyramid schemes, see Chapters 2 and 7.

²⁷⁰ Chapter 7

²⁷¹ This is an argument made by Bruce Craig who was involved in the Koscot Interplanetary case.

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

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.

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 recruitment-driven 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 500 MLMs whose compensation plans I have analyzed. Below is a summary of the characteristics that both distinguish between product-based pyramid schemes and legitimate direct selling programs. These same characteristics are what cause the horrendous loss rates of these MLMs.

Endless chain of recruitment of participants as primary customers. The F.T.C.’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 100 typical misrepresentations used by MLM defenders and in MLM recruitment campaigns, as discussed in Chapter 8.

MLM programs are recruitment-driven. On the basis of hundreds of MLM compensation plans I have personally 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.”²⁷²

²⁷² *Webster v. Omnitrition, IIB*, filed in the Appeals court for the U.S. District Court for the Northern District of California, March 4, 1996

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.

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 site²⁷³ is an article entitled “The Bottom Line about Multi-level Marketing Plans.” 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.

Most MLMs, in fact, 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 a legitimate direct selling program. – re *FTC v. Amway* (1979 – 142-145), *Webster v. Omnitrition* (Discussion on “Pyramid”), and *FTC v. Skybiz* (29)

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 went to me. I did not have to recruit a “downline” to make a good income.*

While the cost of the actual enrollment fee, which includes a sales kit, may be small

²⁷³ www.ftc.gov

and likely not a for-profit item, the cost to qualify for commissions and bonuses can be substantial. In fact, participants are encouraged to satisfy their minimum “pay to play” requirement by purchasing enough products to satisfy their monthly minimum quota to qualify for commissions. This “pay to play” feature of an MLM compensation plan assures that, given the low amounts of commissions and bonuses received for 99% of distributors, it would be extremely rare for any distributors to realize a profit – after minimal operating expenses are subtracted, along with their purchases from company.²⁷⁴

MLM programs are top-weighted. In every one of the hundreds of MLM compensation plans I analyzed, the rewards escalated almost exponentially as viewed commissions and bonuses paid to participants at the highest 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 “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.²⁷⁵

Possible exception: Some party plans may be more retail-focused. The only possible exception I have found to the futility of recruitment-driven MLM programs are in-home demonstration programs, or “party plans.” While their products are typically priced several times those in supermarkets, they may focus on actual sales to non-participants. At least one expert suggested²⁷⁶ that emphasis on sales of products to non-participants could be a mitigating factor in the otherwise despoiling effects of a product-

based pyramid scheme. Whether or not they are recruitment-driven and top weighted would depend on the compensation plan of those at the higher levels, or TOPPs (top-of-the-pyramid promoters).

MLM as simple fraud – or as systemic fraud

When I spoke at a seminar for state and national law enforcement officials on product-based pyramid schemes²⁷⁷, 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 statistics. I asked the group if any believed MLM qualified as a legitimate business opportunity. No one 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 the 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 dictionary²⁷⁸:

Fraud – intentional perversion of truth in order to seduce another to part with something of value or to surrender a legal right.²⁷⁹

As I explained in Chapter 9, it is my observation that few MLM participants

²⁷⁴ See Chapter 7.

²⁷⁵ See Chapter 7.

²⁷⁶ Letter from Bruce Craig to Peter J. Vander Nat, then chief economist of the FTC, April 24, 2001.

²⁷⁷ “Product-based Pyramid Schemes,” sponsored by Pyramid Scheme Alert. Washington, D.C., June 1, 2001.

²⁷⁸

²⁷⁹ Merriam Webster’s Collegiate Dictionary, Tenth Ed.

deliberately seek in their recruiting to defraud prospects into joining. They are merely doing what they have been instructed to do to “build their business.” 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 fact, MLM may be the perfect con game, because many of the very people who are doing the deceptive recruiting are themselves victims, having to recruit large downlines to have any hope of recovering their investments, which include monthly quotas to participate fully in the compensation plan.

Participants keep buying and recruiting until they run out of money and drop off the vine. What they don't know is that they have been conned into participating in a deceptive marketing program with a compensation 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 the SYSTEM that is deceptive, not the participants who are duped into carrying it out.

I know 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 “pay to play” chain letters, Ponzi schemes, and no-product pyramid schemes.²⁸⁰

As Bruce Craig, former assistant Wisconsin Attorney General observed:²⁸¹

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.*

My position – and that of other informed consumer advocates – is that product-based pyramid schemes, or MLMs, should be treated in the same fashion, since they are inherently unfair and deceptive.²⁸² 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 marketing practice – perhaps

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.

the most unfair and deceptive of all existing business practices. At the very least, rules need to be in place to provide consumers some protection against deceptive MLM recruitment.

²⁸⁰ Letter from FTC official Robert Frisby to directors of Pyramid Scheme Alert, citing section 5(a)(1) of the Federal Trade Commission Act, 15

²⁸¹ Letter from Bruce Craig to Jon Taylor dated May 4, 2004

²⁸² As demonstrated in Chapters 2-9

The inherent characteristics of MLM as a flawed business model suggests that all MLMs may be in violation of Section 5 of the FTC Act.

As has been discussed elsewhere, MLM assumes an infinite market and a virgin market, neither of which exists in the real world. It is therefore inherently flawed and deceptive. And it is clear from analyses of MLMs for which data is available that MLMs promise something they cannot deliver except for a tiny few “kingpins” at or near the top of a pyramid of participants, which contrasts sharply with what is promised at opportunity meetings and in company communications. So at the very least, MLM can be said to be an extremely unfair and deceptive practice, which places MLM companies in a position of being in direct violation of Section 5 of the FTC Act.

Efforts of states to confront pyramid schemes and MLM abuse

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 severely 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 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 2E (chapter 2). In Appendix 10A 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 10E. Reviewing and comparing these wide variations in nomenclature, definitions, and statutes should convince anyone that there is far from unanimity across the country on determining what is and what is not 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. In my opinion, the most consumer-friendly of these is Maine’s statute²⁸³.

²⁸³ See Appendix 10A and Appendix 2E

Unfortunately, most of the states fail to mention the inherent flaws of the endless chain 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 DSA/MLM cartel, which works ceaselessly to weaken anti-pyramid legislation to its advantage – but to the detriment of consumers who need protection from such schemes.

State statutes regarding “unfair and deceptive practices.” A problem closely related to MLM and pyramid schemes that is addressed by many state statutes is that of “unfair and deceptive practices” – which an informed person would expect would have to include MLM.²⁸⁴ But unanimity in defining and regulating this category of abuse at the state level is not much better than in defining and regulating pyramid schemes and multi-level marketing at the state level. The wide diversity of statutes related to unfair and deceptive trade practices is included in state laws relating to MLM, along with author’s commentary in Appendix 10E.

Rule 23: Class actions 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 “private attorney general actions” because they may accomplish what state AG’s should be accomplishing – protecting consumer 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 influenced by organizations like the DSA and can be more impartial in their decisions.

Numerous class actions have been reported in this chapter, although given the widespread existence of MLM fraud, the potential for class actions against dozens, if not hundreds, of MLMs exists. This should have knowledgeable plaintiff attorneys wringing their hands at the prospects.

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.²⁸⁵ 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 10B.

A notable success story: Amway/ Quixtar settles for \$150 million.

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; Where’s the FTC and DOJ?*”²⁸⁶

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

²⁸⁴ Or if there is any question whether or not MLM is an unfair and deceptive practice, read prior chapters

²⁸⁵ In *Capone v. Nu Skin Enterprises*, the case dragged on for eight years before a settlement was finally reached.

²⁸⁶ Posted November 11, 2010 on the web site – pyramidschemealert.org

response to consumer accusations that Amway/Quitar is operating an illegal pyramid scheme. The settlement is the largest in MLM history.

Three Directors and Advisory Board members of Pyramid Scheme Alert served individually as experts or consultants in this historic class action case against Amway. 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 as 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 used by Amway for its North American operations):

- 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.
- 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 just several years ago.

Under terms of the settlement, Amway will be restating its “income disclosure” to reflect that the figure offered to consumers is a “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 no commissions at all or no net profit.)

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 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 is ranked as #68 in the 75 top corporate sponsors of Washington politicians, according to the investigative news magazine, *Mother Jones*. It ranks ahead of food giant Archer Daniels Midland, pharmaceutical behemoth Bristol Myers Squibb and just behind in ranking of Walmart, General Motors and oil magnate, Koch Industries.

For a report on how Amway and the MLM industry have so far escaped law enforcement, send for the free report by Robert FitzPatrick, the *Main Street Bubble*. Just put the words, “Main Street Bubble” in your email’s subject area.

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 of 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 violates 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 recently published 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!

Another thorny issue: Are MLM participants employees or independent contractors?

Should direct salespersons 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?"*²⁸⁷ 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.

§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

²⁸⁷ 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 – www.armydillar.com. 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.

- *do not perform work for clients which can impact the success or continuation of the clients' businesses.*

That last point is crucial. Businesses who 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 – 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 executive 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 as from alternative outlets, so they can't qualify as discount buyers' 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 law enforcement officials – including the FTC in comments filed by the DSA and MLMs regarding its proposed Business Opportunity Rule.*
- *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 – at least 99.7% of them (where data is available), lose money. 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 500 MLM schemes, I feel more comfortable than ever labeling them recruitment-driven MLMs, or product-based pyramid schemes.**

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.

IMPORTANT FTC COMMUNICATIONS

Justification for considering pyramid schemes illegal.

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.²⁸⁸

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.

Classic speech by the FTC's Debra Valentine.

In her opening remarks 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

²⁸⁸ Email communication dated May 22, 2001 (in re Koscot Interplanetary, Inc., 86 F.T.C. 1106 (1975))

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.*²⁸⁹

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,⁽⁴⁾ and unlike pyramid or Ponzi schemes, MLM's have a real product to sell. More importantly, MLM's 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

²⁸⁹ 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

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” – which are all, in fact, disguised pyramid schemes.²⁹⁰

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 – 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 10C.

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

²⁹⁰ See Chapter 2.

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 DSA²⁹¹:

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 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. . . .

*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.*²⁹²

I have analyzed over 500 MLMs that finance their operations in precisely the manner described in the last two paragraphs! And since that’s 100% of those

²⁹¹ 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

²⁹² Ibid

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.

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, FTC's Acting Director of Marketing Practices

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.

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.

²⁹³

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 shares 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 10-15% - 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. The MLM cannot compete with discount stores or even standard 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*²⁹⁴ 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. It is a vicious cycle: No complaints, no action by law enforcement. No action by law enforcement, no complaints. So the game goes on.

²⁹³ Ibid

²⁹⁴ 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.

LESSONS FROM LANDMARK CASES²⁹⁵

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: Koscot (‘Kosmetics Company of Tomorrow’) Interplanetary, Inc., the sales arm, and Dare to Be Great, Inc., the training body.”²⁹⁶

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 conspicuously parked in large numbers outside the meeting place.

Dare speakers describe, usually in a frenzied manner, the wealth that awaits the prospects if they will purchase 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.²⁹⁷

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.*²⁹⁸ 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.

²⁹⁷ *Ibid*, p. 42-3

²⁹⁸ 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.

²⁹⁵ For more complete information regarding prominent MLM cases, go to Appendix 10C.

²⁹⁶ I Joseph Bullgatz, *Ponzi Schemes, Invaders from Mars, and More Extraordinary Popular Delusions* (New York: Harmony Books, 1992), p. 42-3

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.

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 since that time have 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 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,”²⁹⁹ such as the “ten-customer rule” (10 customers outside the

²⁹⁹ In the Matter of Amway Corp., 93 F.T. C. 618 (1979)

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 entrepreneurial chains.

The FTC’s 1979 Amway ruling³⁰⁰ 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 a hundred of them listed in Chapter 8. Taken together, MLM constitutes one of the most massive and successful con games in history.

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.

³⁰⁰ 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.

Amway's "retail rules" focused on behavior, not the underlying structural flaws. As discussed in earlier chapters, MLMs typically incentivize an endless chain of recruitment of participants as primary customers. Their compensation plans assume an endless chain or infinite recruitment in finite markets and in virgin markets, neither of which exists. MLMs are therefore 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 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.³⁰¹

Perspective of a former SEC official – and of a former Assistant AG for Wisconsin. Gary Langan Goodenow, Sr., a former senior trial attorney in the SEC enforcement division, wrote:³⁰²

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".

³⁰¹ 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.

³⁰² 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

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.

[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 a population, especially so in MLM, since hundreds of overlapping MLMs are now saturating the market with such schemes.]

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.

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 scheme including the Koscot case. In a letter to Robert Pitofsky, the FTC Chairman who drafted the original Amway opinion, Craig noted that since the Amway decision, "investments in pyramid type offerings have resulted in billions of dollars over the years." He highlights that

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 reexamine 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." In my experience, the fraudsters know that; and that is why, unfortunately, when the SEC Enforcement Division comes in with an asset freeze, the money is long gone.

The premise of "multilevel vs. pyramid" may well represent a distinction without a difference.

– Bruce Craig, formerly assistant Attorney General in Wisconsin

Pitofsky tries to redeem himself for his Amway decision. In 1995 Clinton 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 biz op 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 proved quite the pitbull for the remainder of his six-year term (likely to atone for his disastrous decision as the administrative judge in the 1979 Amway case) 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," including promoters selling "franchises" of vending machines, pay telephones, medical billing biz ops, and envelope-stuffing schemes.

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 decision, 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.”³⁰³

The “basic structure” likely refers to the potential (in a compensation plan) 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.³⁰⁴

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.”³⁰⁵

“ . . . 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.”

³⁰⁴ California Penal Code § 327 (West 1995).

³⁰⁵ 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

³⁰³ 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)

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.³⁰⁶

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 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

³⁰⁶ “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>

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.)*

For more information on MLM cases, go to Appendix 10D.

Surviving MLMs same as those shut down

As I have analyzed by now over 500 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.
5. 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).

This should not be surprising when one understands the inherent flaws of MLM as a business model. For more information on these flaws, read Chapter 2.

The end result of the 1979 Amway decision is an 800-pound gorilla in the (FTC) Commission chambers. Thousands of MLMs have sprung up since then, resulting in losses of literally hundreds of billions of dollars suffered by hundreds of millions of participants worldwide.

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% will lose money.

Based on the FTC's mission to protect against such practices in the marketplace, 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. (See Appendix 10E).

Appendix 10A: Prohibitions and restrictions by federal agencies applicable to MLM – and those in the statutes of the 50 states

| 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 ³⁰⁷ |
|---|---------------------------|------------------|------|------------|--------|------------------|----------|------------|-----------|------------------|----------|------------|------------------------|
| Unfair and deceptive practices | X | | | | X | | | | X | | | | |
| Misrepresentations or no documentation of earnings or marketability claims | | | | X | | | | | | | | | X |
| Initial investment above threshold | X ³⁰⁸ \$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 ³⁰⁹ | X | X | |
| Pyramid or chain referral scheme – primary income from recruitment rather than sales to non-partic's | X ³¹⁰ | | | 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 ³¹¹ | | 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 ³¹² | | | | | | | | | | | |
| Purchase discounts, other incentives to refer others | | | | | | | | | | | | | |
| Failure to file disclosures to state | | | | | | | | | | | | | |
| Failure to provide disclosures to recruits | | | | | | | | | | | | | |

³⁰⁷ In Georgia, extensive disclosures (including signed statements), records retention, and \$75,000 bond required if threshold exceeded

³⁰⁸ If an MLM exceeds the threshold of \$500 over months (laundering investment via “pay to play” purchase requirements, etc.), it could be subject to franchise regulations

³⁰⁹ In Connecticut, contingent consideration is void; i.e., payments for rights, etc. contingent on procurement (recruitment) of other persons with similar rights, etc.

³¹⁰ Requirement for sales to non-participants clarified in recent rulings and staff communications

³¹¹ 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)

³¹² MLMs must avoid franchise classification, including threshold

| Prohibitions or restrictions applicable to pyramid promotional schemes, chain distribution schemes, multi-level marketing, etc. | 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 ₃₁₃ | X ₃₁₄ | X | | | X ₃₁₅ | X ₃₁₆ | | X ₃₁₇ | | X | | X | X | X ₃₁₈ |
| Pyramid or chain referral scheme – primary income from recruitment rather than sales to non-partic's | 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 | | | | | | | | | | | | | | | | |

³¹³ In Idaho, sales to participants exempts an MLM from classification as a pyramid scheme – due to amendment initiated by DSA and/or its members

³¹⁴ 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.

³¹⁵ In Kansas, sales to participants exempts an MLM from classification as a pyramid scheme

³¹⁶ 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)

³¹⁷ Maryland's definition of pyramid promotional scheme excludes sales by participants or others introduced into the scheme

³¹⁸ 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 req'd to participate (inventory loading) | X | | | | | | | | | | | | | | |
| Establishing or promoting pyramid scheme, chain distributor schemes or referral sales plans | X ³¹⁹ | X | X | | X ³²⁰ | X ³²¹ | | X ³²² | | X ³²³ | X ³²⁴ | X ³²⁵ | X ³²⁶ | X ³²⁷ | |
| Pyramid or chain referral scheme – primary income from recruitment rather than sales to non-partic's | | 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 |

³¹⁹ Nebraska exempts sales to participants in definition of pyramid schemes

³²⁰ New Mexico exempts sales to participants in definition of pyramid schemes

³²¹ In New York, chain distributor schemes constitute a security and are subject to law for such

³²² North Dakota exempts sales to participants in definition of pyramid schemes

³²³ Oklahoma exempts sales to participants in definition of pyramid schemes

³²⁴ Oregon uses the term "pyramid club."

³²⁵ Oklahoma exempts sales to participants in definition of pyramid schemes

³²⁶ Oregon uses the term "pyramid club."

³²⁷ 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 req'd to participate (inventory loading) | | X | | | | | | | | | |
| Establishing or promoting pyramid scheme, chain distributor schemes or referral sales plans | X ³²⁸ | X ³²⁹ | | X ³³⁰ | X ³³¹ | X ³³² | X ³³³ | X ³³⁴ | X | X | |
| Pyramid or chain referral scheme – primary income from recruitment rather than sales to non-partic's | | | X ³³⁵ | | | | | | | | 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 |

³²⁸ South Carolina uses the term “pyramid club,” and prohibits chain process of advancement by recruitment

³²⁹ South Dakota exempts sales to participants in definition of pyramid schemes

³³⁰ Texas exempts sales to participants in definition of pyramid schemes

³³¹ 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.

³³² Vermont statute clearly describes uneconomic nature and harmful effects of “chain distributor schemes.”

³³³ Virginia exempts sales to participants in definition of pyramid schemes

³³⁴ Washington exempts sales to participants in definition of pyramid schemes

³³⁵ Tennessee uses the terms “pyramid distributorship” and “chain referral sales plan.

NOTE: For excerpts from actual statutes relating to MLM and pyramid schemes, see Appendix 10E.

Appendix 10B: 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.³³⁶ 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.

³³⁶ 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>

(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 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 10C

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, MLM's 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 | etc. ## | ### | ### | ### |
| \$30 x 81 = \$2430 | ##### | ##### | ##### | #####etc. |
| ----- | | | | |
| \$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 1920's. 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 1970's

The Commission took its first concerted action against pyramid schemes in the 1970's 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 1970's, 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 1970's, 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 Koscot 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 1990's

The 1990's 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 1990's, 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 1970's. Also, the globalization of the economy provided a new outlet for pyramiding. 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 pyramiding. 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 pyramiding 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 1990's, 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 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 Canó 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/nbtcarrol/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 Load 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. 177 (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 Bossi, 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 10D: Some Important MLM Cases

OFF-SHORE MLM – U.S. v. Fortuna³³⁷

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

³³⁷ 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>

pyramids inevitably collapse when no new participants can be recruited and approximately 90% (or possibly more) of the participants consequently lose their money.

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.shtm>

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.shm>

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 Tahiliani 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, 2001.³³⁸

<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

³³⁸ *F.T.C. v. Skybiz.Com, Inc., et al.* (Dist. Ct., N.D. Oklahoma)

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 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.

<http://www.ftc.gov/opa/2003/08/trek.shtm>

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.

Brown Sues To Topple Online Pyramid Scheme

(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_scheme_s.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=C

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.

Appendix 10E

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).

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.

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. (Acts 1981, No. 81-355, p. 510, §5; Acts 1993, No. 93-203, §1.)

[JMT: An MLM's "endless chain" structure or "chain referral sales plan" (Section 8-19-5, §(18) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment. Also, the "pyramid sales structure" in §19 would have to include MLMs.

Misrepresenting earnings or markets (Section 8-19-5 – (20): In every case where average income figures have been released by MLM companies, 99% of 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"(AS 45.50.561, § (3)) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain 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.

(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 (§ 4-88-101 to 4-88-115). 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 (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") 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;

(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" (6-1-102, § (9)) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") 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" (§(1)(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."

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

inseverable 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 (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment.

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" (Title 42, Chapter 735a Section 42-110b). 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 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" (§2561 and §2562) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment.

Also, MLM defenders may object to equating the word "investment" (§2562) 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 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" (§849.091 – (1)) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") 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" – such as in §(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" (§501.207(1)(c)). 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.

(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:

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|--|
| <p style="text-align: center;">NOTICE REQUIRED BY STATE LAW REGARDING DISCLOSURES</p> <p>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.</p> <p>SIGN ONLY ONE OF THE FOLLOWING STATEMENTS:</p> <p>I wish to see the disclosures required by law before I agree to become a participant. _____ Date:</p> <p>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:</p> |
|--|

(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; misappropriation of property; or restraint of trade;

(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:

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|---|
| <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" ((a) (3)) 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 claims (10-1-414 §(1)): 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" (§ 10-1-415 (d) (1)) 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 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; SOURCE: Subsection (c)(21) added by P.L. 22-34:1 (9/27/93).

[JMT: "False, misleading, or deceptive acts or practices" §32201 (a): 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" (§480-3.3) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment.

Hawaii also has a statute called the "Uniform Deceptive Trade Practices Act" (§481A), 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.

(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 statute (§18-3101 (2) (k)). 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" (§18-3101 (2) (a)) 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 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" (IC 24-5-0.5-2 ,§(B)(8)) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") 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 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 inseparable 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 §714.16 (2. a.) 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." (§50-626. (a) 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." (§21-3762 (a)). 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.]

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 367.830, § (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 commerce (KRS § 367.170). 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, 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 participants (§361 (1) (a), 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” (§361 (7)) 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” (§RS 22:574). 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” (§ 2305) is a key red flag for any product-based pyramid scheme (See my book “The Case for and against Multi-level Marketing, Chapter 2: “MLM’s Definitions and Legitimacy”) 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 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 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.”]

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" (§ 14-302) 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” (§4)) 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 (§ 13-301.) 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.

(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 two of chapter ninety-three A.

[JMT: The requirement of a 90% refund for products in "resalable condition" (§69 (c)) 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" (MGL 93A). 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.*

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" (M.S.A. 19.854(28) (1) and (2)) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") 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 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: Minnesota's statute (§ 325F.69, 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 (See my book “The Case for and against Multi-level Marketing, Chapter 2: “MLM's Definitions and Legitimacy”) All MLMs are built on an endless chain 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.

[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; and*

(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” (§ 30-14-103). 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;

.....
(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;

.....
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" (§ (9)) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment.

Unfortunately, the recently revised Nebraska statute allows compensation to be based on personal consumption; e.g. : (§20) . . . "rather than from the sales of goods, services, or intangible property to participants or by participants to others." 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 purchase at not less than ninety percent of the original net cost" (§87-301 (8)) 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 scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain 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 statute (Title 52, Chapter 598) 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 (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") 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 – 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 statute (§P-335; SA213) 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" (§56:8-2) – 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 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. –(2)(C) “by the participant or other persons introduced into the plan or operation” – 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” (§ 57-12-3) 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 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 (See my book “The Case for and against Multi-level Marketing, Chapter 2: “MLM’s Definitions and Legitimacy”) All MLMs are built on an endless chain of recruitment.]

Also, 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.

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.”]

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” (§ 14-291.2. (b)) is a key red flag for any product-based pyramid scheme (See my book “The Case for and against Multi-level Marketing, Chapter 2: “MLM’s Definitions and Legitimacy”) 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.

Another statute (N.C. Gen. Stat. § 75-1.1) 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 (a deceptive practice). It is also common for MLM promoters to misrepresent products, especially those selling “pills, potions, and lotions.”]

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.

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" (§10-15-01). 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 from 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 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 (see 1.a.), 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 (§21-1072 (7)) 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" (§646.609) implies an "endless chain" of recruitment – which is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment.

MLM defenders may object to equating the word "investment" (§646.609) 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, 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 (73 P.S. §§201-1 - 201-9.2). 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” (73 P.S. § 201-2(4)(xiii)) is an apt term for recruitment-driven MLMs.]

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 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. 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, something for which the DSA lobbies; e.g., §37.33-3. "by the participant or other persons introduced into the plan or operation" 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 purchase (§37-33-2). 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:

(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" are prohibited (§47-18-104. (18) and (20). MLM's characteristic "endless chain" of recruitment is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment.

Regarding "deceptive act or practice" (§47-18-104 (a) and (27) – 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 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 purchase (Sec. 17.46 (b)) 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" (Sec. 17.46. (a)) 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 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 (§76-6a-2 (1))

(b)), 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 within a short time almost \$250,000 in total contributions from MLM companies operating in Utah. Consumer advocates pleaded with the Utah's governor to veto the bill, but his main backers were also MLMs.

However, the statute has a provision prohibiting "A deceptive act or practice by a supplier" (§13-11-4 (1)). 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."]

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 rationales 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" (§CF 101.01) is a key red flag for any product-based pyramid scheme (See my book "The Case for and against Multi-level Marketing, Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment.

However, MLM defenders may object to equating the word "investment" (§CF 101.01) 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 statute (§ 2453 (a)) 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."]

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. – (4) "by the participant or other persons introduced into the

plan or operation.” This works to the benefit of MLMs, but severely weakens consumer protection against product-based pyramid schemes.

However, Virginia also has a statute (§ 59.1-200) 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

Antipyramid 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

(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 on it. In particular, compensation can be based on personal consumption (§19.275.020 – (4)), 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.

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.” (RCW 19.86.020) 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.

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.

§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” (§47-15-1. (a)) for securing new members is a key red flag for any product-based pyramid scheme (See Chapter 2: “MLM’s Definitions and Legitimacy”) 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

(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

[JMT: The concept of “endless chain” or “chain distributor scheme” (§ ATCP 122.02) is a key red flag for any product-based pyramid scheme (See Chapter 2: “MLM’s Definitions and Legitimacy”) 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 sign-up 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. 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, 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" (§40-3-103). or "chain distribution scheme" is a key red flag for any product-based pyramid scheme (See Chapter 2: "MLM's Definitions and Legitimacy") All MLMs are built on an endless chain of recruitment.

The requirement to repurchase 90% of products in resalable condition (40-3-104. (i)) 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 "Wyoming Consumer Protection Act" (§ 40-12-105 (xv)), prohibits anyone from engaging in "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 (a deceptive practice). It is also common for MLM promoters to misrepresent products, especially those selling "pills, potions, and lotions."

The Case (for and) against Multi-level Marketing

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

**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 also 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 DSA/MLM cartel's role in weakening consumer protection, political considerations, and the seeming inability of state and federal law enforcement to stem the tide of abuse.

We will then review cases demonstrating the need for adequate disclosure to counteract the natural tendency of MLMs to misrepresent earnings of distributors and products. 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 basic statistics would participate.

Finally, we look at current developments in law enforcement, which reinforces the need for proactive consumer protection through adequate disclosures.

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.

ISSUES FACING LAW ENFORCEMENT

Why complaint-based regulation does not work in addressing MLM abuse.

As explained in Chapters 2 and 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.

Not only are MLM victims led to believe that MLM is legitimate and that failure is their fault, but in endless chains every major victim of necessity becomes 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 – who are often close friends or relatives. Also, they often blame themselves for their “failure,” having been led to believe that those who fail did not try hard enough to “work the system.”

According to my research and the feedback I’ve received, 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 – no action by authorities. And no action by authorities 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.” So much for what was once wise advice to “check out a company with your Better Business Bureau.”

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 enough victims to be willing to be vocal about their losses, so reporters often go with 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 major MLMs are headquartered.

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 cartel. This was forcefully demonstrated to me at hearings before committee hearings of the 2006 Utah State Legislature considering a bill (apparently 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. 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 a total of over a quarter of a million over the past several years from MLMs – his top contributors. 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 leading consumer advocates on the issue to veto the bill.

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.

Consumer protection requires proactive measures, especially average income disclosures

After over a decade 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.

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, not what could happen.

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 have been and 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 cartel – to exempt MLMs from inclusion in its Business Opportunity Rule (BOR), which was enacted in 2011. The BOR would protect consumers by requiring minimal disclosures to help prospects make informed decisions about participation. The DSA/MLM cartel mounted a vigorous campaign and got thousands of MLM participants to object to including MLM in the rule. The FTC caved and chose to rely on enforcement of Section 5 instead. But this is almost totally reactive, not proactive. By the time an MLM is prosecuted, thousands or even millions of consumers may have been defrauded of their resources, and any action coming from the FTC will recover but a tiny fraction of their losses, if anything.

It should also be emphasized that enforcement actions do nothing 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?³³⁹

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.

How can MLM prospects make an informed decision when MLM promoters are allowed to blatantly misrepresent their “opportunity” and their products?

The DSA/MLM Cartel

I have referred to the DSA/MLM lobby as a cartel that seeks to direct the dialogue of deception upon which MLM depends. It also seeks to strengthen and legitimize member MLMs by weakening laws and misleading legislators, regulators,

³³⁹ Over 100 misrepresentations used by MLM companies and defenders are listed in Chapter 8.

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 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 an advantage to 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 their laying claim to be legitimate 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.

Below is a chronological breakdown of the gradual takeover of the DSA by MLMs³⁴⁰:

- In 1970, less than 5% of U.S. DSA members were multilevel (as opposed to traditional 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 “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 100 of which were listed in Chapter 8. DSA could just as appropriately stand for “Deceptive (MLM) 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 so inherently flawed and dependent on a litany of deceptions³⁴¹ to survive.

DSA's deceptive lobbying efforts. As discussed 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 they were

³⁴⁰ Per article “All you need to Know about MLM” – available for download from web site – <http://www.armydiller.com/financial-scam/mlm.htm>

³⁴¹ See Chapter 2 and 8.

90,000 victims of product-based pyramids, over 99% of whom lose money.³⁴²

Then in 2006, 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 even saw that Utah's Attorney General received large contributions from DSA members to assure his support.

I was shocked at the utter corruptness of the whole proceeding. The DSA had no small part in assuring passage of the bill, in spite of eleven emails I sent to each of the senators and representatives in hopes of truth prevailing. I and other consumer advocates appealed to then Governor Jon Huntsman for veto of the bill, to no avail. The DSA/MLM cartel had gotten to him with significant campaign contributions to assure his 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 that protected consumers against MLM fraud. 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.

The DSA even attempted to get a bill³⁴³ passed in the U.S. Congress that would officially legalize the non-retailing, endless chain recruitment model of MLM. Fortunately, that effort failed.

Political considerations

There is no question that the big push for deregulation by conservative politicians has wreaked havoc on those seeking to provide consumer protection from some of the most damaging schemes in history. The mortgage meltdown, severe Wall Street setbacks –

³⁴² See the "Survey of Utah Tax Preparers" – posted under "MLM research" on the web site: mlm-thetruth.com

³⁴³ HR1220 was proposed in 2004.

including the Bernie Madoff scandal³⁴⁴, and depth of the recession in the 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 fraud were a part of that, as MLM promoters capitalize on peoples' misfortunes.

While I would love to pontificate further about political corruption in high places, even at the FTC, I would refer the reader to the excellent annotated references cited at the end of Chapter 10 titled "Notes regarding other resources."

George W. Bush rewards his Amway supporters with very little action against MLMs from 2001 to 2008.

After coming into office in 2001, President George W. Bush quickly replaced Chairman Pitofsky in June 2001 with Timothy Muris, an MLM sympathizer who had worked for Amway's legal firm³⁴⁵. 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.

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 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.³⁴⁶ One

³⁴⁴ Markopolos, Harry, *No One Would Listen: A True Financial Thriller*. (Hoboken, N.J.: John Wiley & Sons, 2010), p. 159

³⁴⁵ 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.

³⁴⁶ 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

of Muris's first actions was to move Dr. VanderNat out of the arena of MLM fraud investigation and analysis to another department of the FTC where he could do no harm to MLMs. He was replaced by David Scheffman, who had argued that Equinox was not a pyramid scheme, largely based on the assertion that Equinox operated *just like Amway*.³⁴⁷

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".³⁴⁸ This may be due in part to lack of information and resources – and the 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:³⁴⁹

The FTC's protection of consumers from MLM as an

"unfair and deceptive practice" is crucial – but not happening.

Why FTC is the most appropriate agency for dealing with MLM abuse. While the Federal Trade Commission has demonstrated little commitment to protecting consumers from the thousands of product-based pyramid schemes that have cropped up since the 1979 Amway decision, it is the appropriate agency for such action. There are two reasons for this:

First, all MLMs have compensation plans 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, they 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 is "not a pyramid scheme" (assuming compliance with its "retail rules") as "*the great FTC blunder*." 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*

³⁴⁷ Robert Fitzpatrick, *The Main Street Bubble, a Whistleblower's Guide to Business Opportunity Fraud: How the FTC Ignored and Now Protects It – Memorandum to President Barack Obama and Members of Congress overseeing the FTC*. ©2009

³⁴⁸ Douglas M. Brooks of Martland & 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."

³⁴⁹ "Analysis: Montana/ACN Settlement Displays the MLM Loophole, Once Again." Go to – <http://pyramidschemealert.org/montana-vs-acn-a-david-and-goliath-battle/>

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.

It is time for the FTC to take corrective action to alleviate at least some of the devastating effects of its 1979 Amway decision.

OTHER DECISIONS & ACTIONS SUGGEST THE NEED FOR ADEQUATE DISCLOSURE BY MLM COMPANIES

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"³⁵⁰ 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.

³⁵⁰ 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"

In 1997, Nu Skin paid a \$1.5 million civil penalty to settle its case but came under scrutiny for continuing to disobey the 1994 FTC Order against it — with the FTC failing to enforce the Order and assess further consequential penalties.³⁵¹

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).*³⁵²

³⁵¹ "Examples of Business Opportunity Scams," posted on FTC web site at – <http://www.ftc.gov/bcp/franchise/tsweep02.shtm>

³⁵² Quoted from the "Army Dillar" article "All You Need to Know about MLM": Is MLM a Scam?," cited in

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 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%³⁵³*. 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 varying periods, ranging from seven to 22 years. This was likely Democratic FTC Chairman Pitofsky's last significant case against pyramid schemes. But while in office, he made sure that some significant actions were taken against some MLMs – possibly to partially redeem himself from the horrible consequences of his decision as the administrative judge in the 1979 Amway decision.

Trek Alliance was ordered to disclose material information. Quoting an FTC release³⁵⁴:

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 observed the effects and behavior 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 happened 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 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

³⁵³ See Chapter 7.

³⁵⁴ FTC.gov – release dated August 4, 2003

Federal District Court of California against BurnLounge, Inc. Quoting from the FTC release in June of 2007:

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.

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 at least the 500 I know of who are 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.

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.

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 cases out of at least 1,700 MLMs 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 10C, 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 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 rates³⁵⁵ also explains why disclosure is such a threat to the MLM industry that Neil Offen of the DSA claimed the industry spent over \$4 million³⁵⁶ fighting the FTC's proposed Business Opportunity 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.

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." (See Appendix 11A) It illustrates 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 was made clear in these later cases that retail sales, or sales to end users, means sales to non-participants in the scheme.

³⁵⁵ Chapter 7: "MLM's Abysmal Numbers"

³⁵⁶ Brittany Glenn, "A United Industry Makes Its Case: FTC Revises Proposed Rule," April 2008 Direct Selling News

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 autoship.

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 robbed.

Now imagine an entire legion of MLMs 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. And 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 10D)

Private or class actions. Numerous class actions have been filed against MLM companies. However, to undertake such a case is so expensive that few legal firms have the resources to proceed with plaintiffs. This challenge is daunting because the MLMs often 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 is often difficult to find victims who have the patience and determination to stand up as lead plaintiffs. Even when victims have lost tens of thousands of dollars, they fear consequences from or to those they have recruited, as well as the emotional toll and demands on their time that they may have to endure for years. They are often so drained from futile efforts and investments in their MLM that they have little time or energy left, except to try to recover through other work.

However, for those who do persist, a class action can be a viable option, and in fact, 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 and even rampant in the MLM field. 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 \$150 million Amway/Quixtar settlement.

I have also suggested that persons who lost only a few thousand dollars consider taking their grievances to a small claims court, but no one to my knowledge has taken the initiative to do that – again because most MLM victims are inclined to remain silent. If hundreds of MLM victims did that, it might get some attention.

CURRENT DEVELOPMENTS

Compliance by MLMs with federal and state laws are 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 10A for a quick overview of the confusion that can result from a state-by-state comparison of applicable statutes.

Careful review 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 (See Chapters 2, 7, and 8)
- 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 definition (See Chapter 2)
- 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 of an unpredictable “downline” that could make them rich.

- 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.

Based on evidence presented here, an impartial analyst could conclude that virtually all of the hundreds of operating MLMs are breaking at least some federal and/or state laws.

The FTC fails to protect against an unfair and deceptive practice.

MLMs are best regulated on a national level – by the FTC. Endless chain recruitment programs 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 functioning today – 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.

Since a primary mission of the FTC is to protect against unfair and deceptive practices, then MLMs, which could easily be considered the most unfair and deceptive of all business practices functioning today – and which quickly expands across states – comes under the ambit of the FTC’s responsibility.

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 violating Section 5 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 exempts MLM from its Business Opportunity Rule – another 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, the FTC has essentially reneged on its responsibility in the MLM arena, even 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 chain 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.

The FTC still flounders with its 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 cartel 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 influence.

What cartel promoters 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 June 1, 2009, in Appendix 11B

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.

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 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 with Amway ties, who wrote on behalf of Primerica Financial Services. *The Primerica letter Mr Muris contributed to actually had the nerve to include the words: "There Is No Evidence of Widespread Fraud in the Direct Selling Industry." The comment by Mr. Muris was essentially parroted in the*

October 2010 staff report on the Business Opportunity Rule, which states on page 30:³⁵⁷

As explained in supra Section I.B., two key problems emerged with the IPBOR's breadth of coverage. First, the IPBOR would have unintentionally swept in numerous commercial arrangements *where there is little or no evidence that fraud is occurring*.

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 support letter for Primerica is J. Howard Beales III, whom Muris appointed as the FTC's *Director of the Bureau of Consumer Protection* (who resigned from his post in 2004). 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.

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.

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 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 used information published from the companies themselves – sales pitches, compensation plans, average incomes, etc. And my calculations were confirmed by financial experts. Apparently, the FTC staff didn't understand the statistics – or didn't want to.

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 cases in ten years. Yet my research (and that of others) demonstrates that all of the over 500 MLMs I have analyzed are blatantly violating the Act³⁵⁸, and that is only a sampling of the hundreds of MLMs that are constantly coming and going – no doubt virtually all of them, likewise violating the Federal Trade Commission Act. This is not because founders want to scam people, but because of the inherent flaws in all MLMs.

Let me put it another way. Reliance on enforcement of Section 5 assumes there are some bad players 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 that 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 sorely 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 easily total hundreds of millions of additional victims, based on DSA “direct sales” figures. It should be obvious that a good rule requiring adequate disclosure of crucial information to prospects would be far more cost effective than falling back on punitive enforcement action.

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

³⁵⁷ Disclosure Requirements and Prohibitions Concerning Business Opportunities Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule (16 CFR Part 437)

³⁵⁸ See prior chapters for compelling evidence that all endless chain recruitment schemes are “Unfair and deceptive practices.”

evidence gathering. As explained in Chapter 9, this simply does not work with endless chain recruitment schemes. Victims of endless chains almost never file complaints because every major victim is almost 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. To 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.”

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.

petence 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.³⁶⁰

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 they will do as other high level officials at the FTC have done.

FTC corruption to the detriment of consumers becoming more evident. Watch to see if the FTC chooses on the side of consumers – or of the DSA/MLM cartel, with whom FTC officials seem altogether too cozy. This collusion between the cartel and the Commission is demonstrated by the revolving door of former high level FTC officials hired by MLM companies and writing comments to the FTC on behalf of the cartel. This includes former FTC 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 Appendix 11B.³⁵⁹

An interesting phenomenon is happening here as happened at the Securities & Exchange Commission. Harry Markopolos, the whistle-blower who exposed the income-

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 inherent flaws in such a system, such an announcement is tantamount to a blatant admission that they are conducting a pyramid scheme. MLMs – with their endless chain of recruitment – assume infinite expansion in a finite market. It not only assumes an infinite market, but also a virgin market – neither of which exist. MLMs are therefore inherently flawed, deceptive, and profitable only for founders and a few early

³⁵⁹ Exhibit 10E is a copy of my comments posted on the FTC web site (FTC.gov).following the June 1979 workshop on the final rule, in which I participated.

³⁶⁰ Markopolos, Harry, *op. cit.*, p. 159

entrants or those placed at or near the top of the pyramid in the compensation plan.

We can find instances of the first entrants in a new MLM becoming rich, but only at the expense of thousands 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 those who get positioned at or near the top of a huge pyramid of participants – who are often those who got in at the start.*

Worldwide expansion of an unfair and deceptive practice – MLM.

Because of the viral nature of MLM and the need to feed off of less saturated markets, MLMs are expanding rapidly overseas. Worldwide feedback convinces me and other consumer advocates that great harm is being done to vulnerable populations that can least afford to be impoverished by these fraudulent schemes.

Unfortunately, some of our U. S. trade representatives are encouraging expansion of MLM overseas. This could eventually 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.

CONCLUSIONS

Worldwide feedback convinces me that great harm is being done to vulnerable populations that can least afford to be impoverished by these fraudulent MLM schemes.

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 cartel 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.

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. To stay current on developments, I recommend two web sites, one by us (Consumer Awareness Institute,

As a general rule, in MLM the more a new recruit invests, the more he or she loses, except for those who get positioned at or near the top of a huge pyramid of participants – who are often those who got in at the start.

or CAI), and another sponsored 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 our web site at – www.mlm-thetruth.com

PSA also works with law enforcement and consumer protection agencies and attorneys, and reports on new developments important to those working in the field. The PSA web site is – www.pyramidschemealert.org

Appendix 11A

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.]*

Appendix 11B

Comments on FTC'S RPBOR Workshop June 1, 2009



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Research, education, and advocacy for consumers on selected issues

The Revised Business Opportunity Rule Is Invalid and Must Be Vacated.

By Jon M. Taylor, MBA, Ph.D.
 Consumer Awareness Institute (web site – mlm-thetruth.com)

What began as a consumer-friendly Business Opportunity Rule (IPBOR) quickly degenerated into a corrupt rulemaking procedure, manipulated by the DSA (Direct Selling Association), a lobbying organization now dominated by MLMs (multi-level marketing companies). As a result, the Revised Rule (RPBOR) is invalid and will provide little consumer protection, thanks to the DSA and complicit FTC officials. Below are some of the reasons for this conclusion:

1. False and misleading statements of material facts

Below is just one crucial and glaring example among many of falsehood with the

imprint of the DSA. Either A or B below is true, but not both.

- A. In the text of the Federal Register Notice for the Workshop, and for the Revised Rule, the following is noted about the Revised Rule:
- 1) (RPBOR) narrows the scope of the proposed Rule to avoid broadly sweeping in sellers of multi-level marketing opportunities. (Workshop Notice, Footnote 7)
 - 2) In addition, the revised proposal does not attempt to cover MLMs. (In Section C. Scope of the Proposed Rule – 1st paragraph)
 - 3) The Commission does not believe it is practicable or sufficiently beneficial to consumers to attempt to apply the proposals advanced in this rulemaking against multi-level marketing companies. (In Section C-2 The MLM Industry: Scope of the Proposed Rule)

- 4) The Commission takes MLM companies out of the ambit of the Rule.
 - 5) The MLM industry articulated concerns peculiar to its business model, but these provisions would no longer apply to *MLM companies* inasmuch as these companies, and their representatives, **are excluded from the ambit of the RPBOR.** (Section D-2-d)
- B. In stark contrast to the above, the following is found in Footnote 7 on page 3:

The RNPR did not exempt MLMs from coverage of the RPBOR. Instead, it narrowed the scope of the IPBOR by significantly revising Section 437.1 by redefining the term “business opportunity.” The RNPR noted that while some MLMs do engage in unfair or deceptive acts or practices, including the operation of pyramid schemes or unsubstantiated earnings claims that cause consumer harm, [MLM] commenters generally agreed that the IPBOR’s required disclosures would not help consumers identify a fraudulent pyramid scheme. In the RNPR, the Commission stated its belief that consumer harm flowing from deceptive practices in the MLM industry could be more effectively addressed through the use of Section 5 of the FTC Act.

If A (above) is true, the opening statement for B is false. If B is true, A is false. Either way, one or the other is false and misleading to the public.

2. In all of the Rulemaking procedures, from the original

IPBOR announcement to the June 1 Workshop, I was struck with how much the FTC has underestimated the scope of and the harm done by MLM schemes, which may (or may not) be excluded from the Rule.

The DSA claims that the vast majority (98.2%) of direct sellers are now using a multi-level pay structure and that there are over 15 million people selling over \$30 billion in products and services using a direct selling model³⁶¹. If we assume these DSA figures are correct, and if we use figures on MLM loss rates from analyses from qualified independent analysts of approximately 99%³⁶², the losses to consumers are staggering. **In the aggregate, millions of MLM participants are losing tens of billions of dollars every year in the U.S. alone. To exempt this leading class of business opportunity fraud from the Business Opportunity Rule is unthinkable to any informed consumer advocate.**

Those familiar with the harm done by MLMs, including DSA members, often ask why law enforcement at both state and federal levels seem unaware of the extent of the losses. My answer from having worked with victims worldwide is not the obvious one often given out – embarrassment at having not succeeded at “making the plan work.” Most are not aware that they have been scammed unless and until they have gone through some deprogramming, similar to what is done with victims of cults.

Perhaps the strongest explanation for the lack of law enforcement action against MLMs is that victims of endless chain business opportunity schemes rarely file complaints. This is because nearly every major victim has of necessity become a perpetrator – having recruited some of his close friends and family in the hope of eventually recouping enough in

³⁶¹ DSA Industry statistics – www.dsa.org

³⁶² Available for download at www.mlm-thetruth.com and www.pyramidschemealert.org

commissions to meet their ongoing purchases necessary to qualify for commissions and/or advancement in the scheme. So they fear going public for fear of consequences from or to those who they recruited or persons who recruited them – often close family or friends.

MLM is perhaps the cleverest con game of all time. The very people who are perpetrators are themselves victims until they run out of money and drop off the vine. And since they don't complain, law enforcement does nothing. So the game goes on.

3. The Revised Rule will apply to no one and will therefore provide no consumer protection against unfair and deceptive practices, which the FTC is pledged to protect.

In her closing comments, Ms. Morrissey applauded the Commission and Staff for narrowing the scope of the proposed Business Opportunity Rule. Other DSA members present were obviously please with this apparent exclusion. (I say apparent advisedly, given #1, above)

However, according to the Revised Rule³⁶³, all Business Opportunities that pay commissions to two or more individuals as the result of a sale of the company's products or services are MLMs for purposes of the proposed MLM exemption. Given the

³⁶³ Footnote 34 of the RPBOR announcement:

"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 'down lines.'" See Peter J. Vander Nat and William W. Keep, *Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes*, 21 J. of Pub. Policy & Marketing (Spring 2002), ("Vander Nat and Keep") at 140. See also rebuttal to DSA Comments, Part 1: www.ftc.gov/os/comments/bizoprevised/rebuttals/535221-00081.pdf

facts that (1) there are few, if any, business opportunities sellers ("direct sellers") that do not currently engage in this practice and that (2) the minuscule number of sellers that do not engage in same will do so to gain exemption from the ambit of a final Rule, **the end result, if the MLM exemption is included in a final rule, will be a Business Opportunity Rule that will exclude virtually every single business opportunity in the US from the ambit of the Rule.**

As explained in earlier comments and in FTC announcements regarding both IPBOR and RPBOR, fraudulent practices are common in business opportunity schemes. By exempting virtually all such schemes through RPBOR, the FTC could thereby be complicit in aiding and abetting massive consumer fraud by direct sellers of "business opportunities" - many of them members of the DSA, which is the lobbying group primarily responsible for the MLM exemption. With RPBOR, the FTC is clearly siding with the DSA in direct contradiction to its responsibility to protect consumers from unfair and deceptive practices.

4. The RPBOR and the whole rulemaking process for a Business Opportunity Rule have been corrupted by ex parte communications between FTC officials and the DSA.

After the comment period closed for RPBOR, I and other parties sought to give additional input to correct facts regarding interpretation of prior comments. Such communications were refused on the grounds that they would be ex parte communications. However, **in a DSA revenue generating event after the close of the comment period, certain FTC officials met with DSA members on October 23-24, 2008, in Alexandria, Virginia.** Details of these ex parte communications are

included in the Notice of Corruption at the end of these comments. It should also be noted that **no transcript has been provided by the FTC of such ex parte communications where the Business Opportunity Rule was discussed.**

These ex parte communications are just one of many strong pieces of evidence of collusion between certain present and former FTC officials and the DSA. Another revealing example is the attempt to influence the IPBOR by comments on behalf of DSA members from former high level FTC officials, including Timothy Muris, Howard Beales III, and Jodi Bernstein. It is very disturbing to us as consumer advocates to see this radical transformation by these officials we once trusted from consumer protection to fraud protection.

This also raises the question of what direct or implied enticements DSA members have offered to current officials for supporting the MLM exemption in promises of lucrative consulting jobs, etc., following FTC employment. This and related corruption of the rulemaking procedure deserve Congressional investigation. **At the very least, the Commissioners should be asking how it is that certain FTC officials have allowed the DSA to roam so unbridled over the rulemaking process.**

5. Other rulemaking irregularities include refusal to answer one key question at the Workshop, while responding to others.

At the June 1 Workshop, Ms. Benway answered Mr. Hailey's question about the legal action section of the form – and even discussed Tupperware's lead generation system with Ms. Morrissey (to whom was shown great deference and who was allowed to pitch both Tupperware and the DSA), as well as defending her use of the DSA Code of Ethics, but refused to answer my question

about the obvious contradiction discussed in #1 above.

6. The cost effectiveness of a Rule promoting transparency – vs. utilizing Section 5 on a case-by-case basis – was ignored in RPBOR. Without hugely increasing the personnel at the FTC, it would be impossible to keep up with the MLMs that are forming every year, many if not most of them violating Section 5.

In the April 24 announcement of the Workshop, the FTC also stated in Footnote 7:

. . . In the RPBOR, the Commission stated its belief that consumer harm flowing from deceptive practices in the MLM industry could be more effectively addressed through the use of Section 5 of the FTC Act.

As a business model predicated upon infinite expansion (endless chain of recruitment) in a finite marketplace, MLMs are inherently flawed, uneconomic, and fraudulent. In spite of this mathematical reality, the FTC admitted in the RPBOR announcement that the FTC had used Section 5 in actions against only 14 MLMs in the past ten years. However, FTC officials were in a position to know of the research I cited in my comments showing evidence that at least 250 MLMs (out of over 1,000 extant, according to some industry observers), are currently violating Section 5 and that at least 81 of these are members of the DSA, which has so vigorously objected to a rule requiring their members to provide greater transparency to protect consumers against unfair and deceptive practices.

Extensive research I and others have performed (reported on mlm-thetruth.com)

has demonstrated that the compensation plan of an MLM can determine the extent to which a program depends upon aggressive recruitment by new recruits of a large downline of self-consuming participants in order to profit from the scheme. When this is the case, the MLM is merely a money transfer scheme. (See FTC Staff Advisory letter dated January 14, 2004, from James Kohm to DSA president Neil H. Offen). In other words, they are structured to transfer money from those at the bottom to founders and TOPPs (Top-of-the-pyramid promoters). They accomplish this by using purchases of (usually overpriced) products to disguise or launder their investments in a product-based pyramid scheme.

Such emphasis on revenues from “internal consumption” is positive proof that an MLM is conducting an unfair and deceptive practice in violation of Section 5. Please review the speech on “Pyramid Schemes” by Debra Valentine, General Counsel of the FTC, delivered May 13, 1998, sponsored by the International Monetary Fund. Note the section titled: “What is a Pyramid Scheme and what is Legitimate Marketing?” Note that she asked “What is legitimate marketing? – not legitimate multi-level marketing – an oxymoron to those who understand how sales and recruiting are incentivized in typical MLMs.

In every MLM for which I could obtain the compensation plan, I found five causative and defining characteristics of a recruiting MLM, or product-based pyramid scheme. Please read my “5 Red Flags: Five Causative and Defining Characteristics of Recruiting MLMs, or Product-based Pyramid Schemes” on my web site – mlm-thetruth.com. This report is a summary of literally thousands of pages of research and feedback from all over the world. In every case where data was available on MLMs with these five red flags, the percentage of people losing money was about 99%. Robert Fitzpatrick of Pyramid Scheme Alert found essentially the same thing in his report “*The Myth of ‘Income Opportunity’ in Multi-level*

Marketing” (pyramidschemealert.org). The FTC is in possession of this information as recorded in prior comments by myself and Mr. Fitzpatrick.

Since nearly every MLM I have studied (by now over 300) has these five characteristics, it can be assumed that the vast majority of all MLMs will also have these characteristics, making them likewise unfair and deceptive practices. Army Diller lists over 1,000 past and present MLMs at - www.armydiller.com/financial-scam/links.htm#complaintsmlm

Even if we assume that the number of MLMs with compensation plans that make them merely money transfer schemes – or product-based pyramid schemes – totaled only 500, with at least 50 new schemes originating every year (I personally encounter about one new MLM every week), it would be impossible for the FTC to keep up with them using Section 5 on a case-by-case basis. At the rate of 14 cases every ten years, **applying Section 5 would require 357 years for the FTC to act against the existing base of MLMs, and the FTC would have to increase its staff at least tenfold just to keep up with fraudulent new MLMs forming every year. The DSA recognizes that it is in its members’ best interest to get the FTC to exclude them from having to make meaningful disclosures, and to instead fall back on Section 5, since it would make the threat that any of their many members (violating Section 5) would have to deal with FTC regulation rare to non-existent. By the time the FTC finally got around to investigating any given MLM using Section 5, all the principals would likely be long dead.**

The Business Opportunity Rule requiring meaningful disclosure by ALL sellers of business opportunities would be far more cost effective than exempting MLMs from the Rule – and instead relying upon section 5 to protect against unfair and deceptive practices. I seriously doubt that had the Commissioners been

informed of this reality, they would have voted 4-0 in favor of RPBOR. The exemption of MLMs is not consistent with the FTC's practice of using industry-wide rules to more efficiently discourage unfair and deceptive practices than relying on case-by-case enforcement.

7. The FTC may have exceeded its authority in defining "business opportunity" so narrowly by excluding MLM in RPBOR.

In the announcement of the Workshop, the FTC also states:

. . . It [the RNBOR] narrowed the scope of the IPBOR by significantly revising Section 437.1 by redefining the term "business opportunity. (April 24 Federal Register, Footnote 7)

The DSA is a lobbying and trade organization representing direct sellers in the United States, many of whom – especially MLMs – could be classified as business opportunity sellers. In 2007, according to the DSA, 98.2% of all individual sellers in the United States were compensated under an MLM compensation plan, leaving only 1.8% compensated under a single level compensation plan. (<http://www.dsa.org/pubs/numbers/07qofactsheet.pdf>) And in 2007 the DSA claimed to have 285 MLM direct sellers whose collective MLM sales forces total 15 million distributors. This would suggest that DSA members comprise by far the largest group of business opportunity sellers in the United States. The FTC notice states: "Business opportunity ventures include vending machine routes, rack display operations, and medical billing ventures." To anyone familiar with the business opportunity market, complaints about these three represent only a tiny percentage of problems needing consumer protection.

There is a real question as to whether or not the FTC even has the authority to define business opportunity so narrowly as to limit the Rule to such a miniscule portion of the marketplace of business opportunities; i.e., non-MLM sellers. This makes about as much sense as a Franchise Rule exempting all food services because requiring them to disclose information might contribute to world hunger.

8. The acceptance of the "too great a burden" argument against a one-page disclosure form by MLMs is such an obvious absurdity that only FTC officials partial to the DSA/MLM lobby or those unaware of other disclosure requirements, such as franchises or securities, would have accepted it.

Several panel members at the workshop referred to the issue of the burden of disclosing certain information on a one-page form to those being sold Business Opportunities. However, the FTC requires a Franchise Disclosure Document by franchisors be supplied to prospective franchisees that can be hundreds of pages in length. The IPBOR would have required only a single page disclosure form (plus any supporting information of average earnings, etc.) be provided by business opportunity sellers. But the DSA/MLM and their minions protested it would be "too great a burden" to supply each prospect with only a couple pieces of paper provided by the company. This makes about as much sense as the FTC not requiring franchisors to provide a Franchise Disclosure Document – or the SEC exempting all private corporations from having to publish annual and quarterly reports because it would place "too great a burden" on them to comply.

The "too great a burden" argument is just one of many put forth by the DSA and its many minions and accepted by the FTC.

The “too great a burden” argument is so absurd as to not require further comment, yet the RPBOR clearly shows FTC officials accepting it, again raising serious questions about the motivation behind such cooperation between certain FTC officials and the DSA/MLM lobby. Two and two do not equal five, even if 17,000 commenters claim it is so.

9. The suggestion in the Workshop announcement that disclosures by MLMs would not help consumers is a manifestly bogus argument – as are other arguments for exempting MLM from the Rule. Two and two do not equal five, even if 17,000 commenters claim it is so.

In the April 24 announcement of the Workshop, the FTC stated in Footnote 7:

. . . The RNPR noted that while some MLMs do engage in unfair or deceptive acts or practices, including the operation of pyramid schemes or unsubstantiated earnings claims that cause consumer harm, commenters generally agreed that the IPBORs required disclosures would not help consumers identify a fraudulent pyramid scheme.

In my comments regarding IPBOR, I suggested that MLMs would attempt to circumvent honest disclosure in such a Rule, such as Nu Skin has done in its compliance with the 1994 Order for Nu Skin to cease its misrepresentations of earnings of distributors³⁶⁴. When MLMs do disclose earnings, they do everything they can to report in such a way as to disguise the truth;

viz., that it is extremely rare for anyone to realize a net profit from their pay plan. However, I was in no way suggesting that such disclosures could not help any consumers identify a fraudulent scheme. Some sophisticated consumers may understand the statistics. And such data could be analyzed, debunked, reported by independent analysts, and then conveyed to consumers in print or online. This would not be possible if no data were made available.

Of course, nearly all the DSA/MLM commenters “generally agreed that the IPBOR’s required disclosures would not help consumers identify a fraudulent pyramid scheme.” This response from MLM parties should have been expected, as the last thing MLM promoters want is for the truth to be made obvious – that they are unprofitable for all but the founders and a few TOPPs (top-of-the-pyramid promoters). But regardless of the number of MLM proponents who agreed that disclosure would not help consumers, this should not be accepted by the FTC as fact, but recognized for what it is – desire by MLMs to protect their capability to continue defrauding consumers without regulatory scrutiny.

Other typical DSA arguments that were used to gain an exemption for its member MLM firms (many of which were reiterated by Ms. Morrissey and others at the workshop) include:

- Multi-level marketing is equated to legitimate direct selling. My analysis of over 300 MLM programs reveals that MLMs rarely incentivize direct selling to the public sufficiently to outweigh the enormous incentives to recruit a huge downline, which is where any profits are realized. Participants are primarily incentivized to do pyramid or chain selling, not direct selling.
- MLM is presented as a business with little risk, as the signup fee is small. But this is merely a ruse, as major ongoing incentivized purchases

³⁶⁴ See REPORT OF VIOLATIONS of the FTC Order for Nu Skin to cease its misrepresentations of distributor earnings, linked from the Law Enforcement page of my web site – www.mlm-thetruth.com

(often \$50 to \$300 a month) are required in nearly all MLMs in order to qualify for commissions or advancement in the scheme. And those who invest the most tend to lose the most – some many thousands of dollars.

- MLM companies who are members of the DSA are subject to its Code of Ethics. But members who were found guilty of conducting illegal pyramid schemes were members of the DSA in good standing at the time³⁶⁵. And it is clear from its Code of Ethics that the DSA allows pyramid or endless chains schemes among its membership.³⁶⁶
- Many MLM participants merely work part-time or seasonally to earn enough for Christmas or to meet other temporary needs. Only a person unfamiliar with the compensation plans of MLM companies would accept such a claim. All of the MLMs who are members of the DSA use compensation plans that require enormous full-time and long-term commitment to building and maintaining large downlines before they can realize significant profits. The only way a person could earn enough in commissions to exceed incentivized purchases and minimal operating expenses is if products

were priced competitively to make possible sales to the general public. But my studies and those of other independent analysts has shown prices anywhere from two to six times as much as products sold through more standard outlets.

- For the same reason, the DSA argument that many join one of their MLMs just to get the products at retail just does not hold water. Even at wholesale, the products cannot compete with alternative outlets.

Refer to my previous comments in IPBOR and RPBOR for other weak arguments put forth by the DSA and apparently accepted by the FTC to gain the MLM exemption. FTC personnel had access to all of the information rebutting with irrefutable evidence the fallacy of DSA arguments. If you take away these bogus arguments, there is no justification - for any informed official or analyst not sponsored by the MLM industry - for exempting MLM from the Rule. So this again calls into question the motivation of those FTC personnel who used these bogus arguments as justification for exempting MLM from the ambit of the Rule.

10. For the RPBOR form, the most important disclosure a business opportunity seller can provide is breakdown of earnings of participants. False earnings claims are typical of MLM sellers, so MLMs must not be excluded from the Rule.

After reading IPBOR, RPBOR, the consultant's report on the BOR form, and related materials, one can safely conclude the following:

- a) The making of false earnings claims is the most prevalent problem in the offer and sale of business opportunities.

³⁶⁵ Equinox, Trek Alliance, etc.

³⁶⁶ **Pyramid Schemes (DSA Code of Ethics #6)**
For the purpose of this Code, pyramid or endless chain schemes shall be considered consumer transactions actionable under this Code. **The Code Administrator shall determine whether such pyramid or endless chain schemes constitute a violation of this Code** in accordance with applicable federal, state and/or local law or regulation.

- b) The making of false earnings claims underlies virtually all fraudulent business opportunity schemes.
- c) Earnings claims lie at the heart of business opportunity fraud, and are typically the enticement that persuades consumers to invest their money.
- d) Earnings claims are highly relevant to consumers in making their investment decisions and typically are the single most decisive factor in such decisions.
- e) Earnings claims are the most salient feature of sales (and recruiting) presentations made by business opportunity sellers.
- f) MLMs as business opportunities, often deceive consumers with the promise of large potential income and are thereby highly successful in attracting prospective investors.
- g) By far, the most frequent allegations in business opportunity cases pertain to false or unsubstantiated earnings claims.

The FTC has brought over 140 cases against a multitude of business opportunities and related schemes (including MLMs and pyramid schemes), each of which lured unsuspecting consumers through false or deceptive earnings representations. Narrowing the definition of “earnings claims” could weaken protections regarding the most salient feature of the sales presentation by allowing sellers to avoid disclosing the average incomes of participants at ascending levels in the pay plan.

For MLMs, the impetus for making false income claims is the compensation plan which incentivizes promising whatever will entice prospects to join one’s downline.

According to the FTC, the catalyst for making false earnings claims is the MLM compensation model “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 “down lines.” (Revised Rule, p. 15)

As independent analysts, both Robert Fitzpatrick³⁶⁷ and I³⁶⁸ have done extensive analyses based on the actual reports of average incomes of participants in MLM programs for which data is available to prove that 99-99.9% of participants in their programs lose money. Even promoting such MLMs as income or business opportunities, when the odds of profiting are far greater for gambling in Las Vegas, is deceptive.

This all adds up to the necessity, not just advisability, to include MLMs in the Rule, primarily to assure meaningful disclosure of average earnings of participants at the different levels in the pay plan. This is essential to protect against unfair and deceptive practices, especially false earnings claims.

11. If the Revised Rule (RPBOR) were enacted, consumers would be misled into believing that the FTC’s Business Opportunity Rule provides protection against fraudulent, unfair, and deceptive practices, when in fact it will do just the opposite.

Since any business opportunity seller can easily qualify as an MLM and thereby gain exemption from the Rule, they will likely do so, leaving virtually no business opportunity sellers covered by the Rule. Also, it is not difficult to envision MLM promoters emboldened in their deceptive recruiting practices and saying to prospective recruits: “Our MLM is a

³⁶⁷ “The Myth of Income Opportunity in Multi-level Marketing” is available for downloading from the web site – www.pyramidschemealert.org.

³⁶⁸ Several reports on MLM loss rates are linked from the Statistics page on my web site – www.mlm-thetruth.com.

legitimate business model. If it were not, it would certainly come under scrutiny by the FTC or other regulatory agencies set up to protect against unfair and deceptive practices.”

While a Business Opportunity rule is certainly needed, this Revised Rule is not the answer, but could have extremely harmful unintended consequences for consumers. It would be far better for the FTC to scrap the Rule altogether than to let it go forward with the MLM exemption.

This is one of those cases in which **no rule is better than a bad rule.**

12. Considering the above, the Workshop was a sham, and the form is irrelevant. In exempting MLM from the Rule to satisfy the DSA, the FTC is abandoning its mission to protect consumers from unfair and deceptive practices.

As an analyst and advocate for the tens of thousands of victims and their families who have visited my web site (www.mlm-thetruth.com), as well as www.pyramidschemealert.org – for which I am an advisor), there is ample reason for the DSA to so vigorously object to requiring transparency among its members. Those reasons are all tied to the FTC's role to “prevent fraudulent, deceptive, and unfair business practices and to provide information to help spot, stop, and avoid them.” The DSA thereby presents a direct challenge to all that the FTC is about.

As one who has by now studied the compensation plans of over 300 MLMs, I can testify that **virtually all MLMs employ a business model that assumes infinite expansion in finite markets, which makes them inherently flawed, uneconomic, and fraudulent.** What should surprise FTC officials is that there were only 17,000 comments out of approximately 30 million participants (according to the DSA) in

several hundred MLMs, some with gigantic pyramids of participants – all hoping to eventually earn a profit, but with less than 1% ever receiving enough to exceed their expenses; i.e., meeting quotas of product purchases, training costs, and minimal operating expenses. In other words, for those MLMs for which reliable data is available, approximately 99 out of every 100 participants lose money. And yet these same MLMs are promoted by sellers as the answer to consumers' financial woes. **MLM is almost by definition (infinite expansion within finite markets) an unfair and deceptive practice**, and in addition is both **viral** (all are built up by an endless chain of aggressive recruitment) and **predatory** – taking advantage of the most vulnerable populations among us. If FTC staff were to attend (unannounced) very many MLM recruitment rallies, as I have, they would see the truth of all that I am saying – and reporting on my web site. With 99% doomed to financial loss, why would FTC officials cave to the DSA's demand that MLMs be excluded from the RPBOR? Their motivation must be examined.

It is my hope that the FTC will stop pursuing a disastrous course in abandoning its mission to protect consumers by yielding to the enormous pressure placed upon certain FTC officials by the DSA. Relying on Section 5, rather than the Rule for MLMs would be allowing consumers to be victimized by endless chains of MLM recruiters, and then left like sheep wandering without protection in an enclosure full of wolves.

The Case (for and) against Multi-level Marketing
By Jon M. Taylor, MBA, Ph.D., Consumer Awareness Institute

Chapter 12: IS MULTI-LEVEL MARKETING A MORAL AND ETHICAL BUSINESS MODEL?

This question can be answered in one word:

No!

If one has read the prior chapters, the answer is all too obvious. From decades of analysis of packaged home business opportunities, it is clear to me – and to anyone who reads this book with an open mind – that MLM is the most unfair and deceptive of them all.

All recruitment-driven MLMs³⁶⁹ are built on an endless chain of recruitment of participants as primary customers. As such, their compensation plans assume infinite markets and virgin markets, neither of which exists in the real world. 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. They are also extremely viral and predatory.

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 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 question of whether or not MLM is a moral and ethical business becomes self-evident.

If one wants to explore further the moral and ethical issues relating to MLM participation, he/she may want to read Dean VanDruff's classic article "What's Wrong with Multi-level Marketing." Go to – www.vandruff.com/mlm.html

For an even more thorough ethical analysis, read my book *The Network Marketing Game: Gospel Perspectives in Multi-level Marketing* (1997). The book describes my experience with a major MLM company 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. Inquiries about the book can be sent to my email address at – jonmtaylor@juno.com.

³⁶⁹ The compensation plans of all of the hundreds of 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.

The Case (for and) against Multi-level Marketing

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

Chapter 13: ACTIONS NEEDED – What MLM victims can do to recover losses – How families can deprogram loved ones who come under the spell of an MLM promoter – What actions can be taken to protect oneself and one’s family, and to warn others of MLM fraud

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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 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."

Complain – and loudly!



Don't be silent – complain!

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 eight states to shut down Equinox.

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 cartel 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), 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 a free bottle of lotion or 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

cartel. 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 has been known 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 a legitimate 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 did this very successfully. She lost almost \$7,000 in a prominent MLM, detailing 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 up electronically), and insist that they contact the company for a full refund. Many victims of various schemes have gotten refunds in this way.

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.

Take legal action.

1. Pursue a Class Action Lawsuit.³⁷⁰ This is a long process, but it sometimes gets better results in actions against MLM's than filing complaints with consumer protection agencies. Contact Dr. Jon Taylor (jonmtaylor@juno.com) if you need to find an attorney who can help you. Or contact Robert Fitzpatrick of Pyramid Scheme Alert. Both have worked with law firms handling MLM/pyramid scheme cases – to assist as consultants and expert witnesses.



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 in your upline who misled you with phony promises and misrepresentations than 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 he/she is 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 Act³⁷¹ 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 is that if an individual harmed by the actions of such a "racketeering activity" (as MLM fraud) is successful, he/she can collect treble damages.

Support good legislation – and fight bad legislation or rules

Support good legislation against product-based pyramid schemes – as opposed to what the DSA (Direct Selling Association) is promoting. Be aware that most statutes are adequate as they stand, assuming they are understood and applied. Even when product-based pyramid schemes manage to avoid prosecution as pyramid schemes (for reasons cited on the law enforcement page), they routinely

³⁷⁰ For a more complete discussion of class actions, See Chapter 10.

³⁷¹ 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.

engage in deceptive marketing practices, which may be easier to prosecute.

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 MLM's 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 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 13D (separate pdf file).

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 recruitment-driven 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

Aggressively promote an endless chain of truth-telling – as opposed to an MLM promoter's endless chain of recruitment for gain.

your car's license plate holder, such as: "We don't do drugs, porn, or MLM."

3. Help deprogram victims of MLM abuse. Apply the suggestions in Appendix 13B 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 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." 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 with an open mind has continued to pursue MLM/pyramid/chain selling as an "income opportunity" – or even to regard it as such.

4. 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 "Nuskin Attempts to Discredit its Whistleblower," 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 his 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 complainer! 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.

A dramatic illustration of how important are these anti-SLAPP statutes, read what happened in the case in which Medifast sued Robert FitzPatrick of Pyramid Scheme Alert and forensic accountant Tracy Coenen.

5. 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 13C.

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.

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 for free download from on the web site – www.mlm-thetruth.com

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.

Final conclusions for the book

In the introduction of the book, several questions were raised that I believe have been addressed successfully, based not only on logical arguments, but on the evidence I and others have gathered.

At the end of the introduction, a Summary of Findings was presented, which should be helpful to anyone wishing to quickly grasp the essence of my research findings. In a nutshell, MLM is an inherently flawed, unfair, and deceptive practice. It is also extremely viral and predatory. Since the 1979 FTC vs. Amway decision, hundreds of millions of participants worldwide have been defrauded of hundreds of billions of dollars. Law enforcement has been unable or unwilling to stem the tide of MLM abuse, so consumers need to do what they can to protect themselves. The strategies suggested here should help.

Appendix 13A

Pass-it-on Bulletin from Someone Who Cares

Consumer web site reports on 15 years' research and worldwide feedback – and analysis of over 350 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 fifteen 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 350 MLM programs evaluated
- Free e-book: *The Case (for and) against Multi-level Marketing: : The Complete Consumer-oriented Guide to Understanding and Coping with Endless Chain Selling and Product-based Pyramid Schemes*
 - Frequently asked questions – and straight answers about MLM
 - Free download of the ebook *The Case (for and) against Multi-level Marketing*, which summarizes thousands of pages of research and feedback from victims and observers worldwide
 - "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 350 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

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 [The Case \(for and\) against Multi-level Marketing.](#)

Step 4. Encourage them to track income and expenses to determine if they are actually profiting from the MLM. Show them the [MLM profitability tracker](#). Then have them read what **tax preparers** have to say about who if anyone actually reports profits 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 actual reports from the MLM companies themselves 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 the 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; in fact some [40 typical misrepresentations](#) have been identified. *The list is expanded to over 100 misrepresentations in the 8th chapter of the book 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 convincing 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 such as the "[Parable of the Missing Children.](#)" and [How to Start a Pyramid Scheme and Get away with it.](#)"

Appendix 13C:

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 those 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 (or other level). 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 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 work hard enough 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?

Appendix 13D: 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 *The Case for and against Multi-level Marketing*.

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 *The Case for and against Multi-level Marketing*.

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 *The Case for and against Multi-level Marketing*.

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 *The Case for and against Multi-level Marketing*.

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 *The Case for and against Multi-level Marketing*.

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.

For more on the numbers for MLM, go to – www.mlm-thetruth.com. Download the book *The Case (for and) against Multi-level Marketing*.

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 the late Ed McMahon 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*.

Notice to all MLM recruiters

I would rather invest my life savings into 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*.