# CONSUMER AWARENESS INSTITUTE

A non-profit corporation
Jon M. Taylor, Ph.D., President
291 E. 1850 South, Bountiful, UT 84010

Tel/fax: (801) 298-2425
E-mail: jonmtaylor@juno.com
Web site: www.mlm-thetruth.com

## REBUTTAL OF COMMENTS BY DSA (522418-12055 through 12096) AND MEMBER MLM FIRMS REGARDING FTC BUSINESS OPPORTUNITY RULE

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

ATTN: FTC officials and other interested parties considering this rebuttal of Direct Selling Association (DSA) comments:

Thank you for this opportunity to debunk some of the many deceptions put forth by the DSA. This exchange of comments could have long-term beneficial effects, assuming FTC personnel finally forge ahead with meaningful disclosure.

Below is my rebuttal of comments by Direct Selling Association (DSA), comments numbered 522418-12055, 12058, 12061, 12066, 12070, 12074, 12079, 12083, 12087, 12092, and12096 — all by Joseph Mariano, et al.

### Qualifications of this analyst and request for a hearing

In the late 1970's, I established Consumer Awareness Institute, to do research and education on consumer issues. However, in 1995, the focus changed to one problematic issue that absorbed all my time (including a one-year experiential test) – the phenomenon of multi-level marketing (MLM), a unique marketing model that makes use of numerous deceptive marketing practices that were doing incalculable damage to consumers. These schemes promoted participation in what amounted to endless chains of recruitment of participants as primary (sometimes only) customers.

I have presented, testified, and/or presented papers to the National White Collar Crime Center, Economic Crime Summit Conferences (2002 and 2004), Senior Fraud Summit Conference, and before officials at the Federal Trade Commission. IN 2001, while acting as a director of Pyramid Scheme Alert, I organized the first conference on product-based pyramid schemes for federal and state regulators in Washington, D.C. I have consulted on several state and private legal actions against MLM firms, some of them members of the Direct Selling Association (DSA), and have performed extensive comparative and statistical research to help regulators and consumers clearly identify which schemes cause the most damage in terms of loss rates, aggregate losses, and number of victims world-wide. I have evaluated the compensation plans of over 250 MLM's (MLM companies), many of them past or present members of the DSA. Much of this research and resultant consumer guides are posted on the following web site – www.mlm-thetruth.com.

I have officially requested a hearing or opportunity to present summaries of my research to aid the process of developing meaningful disclosure to protect consumers – something which all qualified experts (not funded by the DSA/MLM

lobby) agree is sorely needed. For my unique qualifications to address these issues, read my bio at - http://www.mlm-thetruth.com/JonTaylorsStory.htm and vita at - http://www.mlm-thetruth.com/JMTaylorVITA6-6.pdf

**Our focus in this rebuttal is MLM – a.k.a., multi-level marketing, network marketing, consumer direct marketing, pyramid marketing schemes, predatory chain selling schemes, entrepreneurial chains, pyramid fraud, simple fraud, recruiting MLM's, or product-based pyramid schemes,. Of course, the DSA would have all MLM's referred to as "direct selling."**

In its invitation to the public to comment on its proposed business opportunity rule, the FTC used the term "pyramid marketing scheme." However, over time these programs have been assigned many labels, at least partly dependant on the motivations of the person or organization assigning the label.

"Pyramid schemes" were the designation given to programs in which a chain of participants were recruited in a structure that rewarded those at the top at the expense of a pyramid of participants at the bottom, all of whom lost money. Initially, no products were exchanged – only money. Such no-product pyramid schemes were considered illegal in most jurisdictions.

When products were introduced as the investment vehicle for participation, promoters were eager to avoid the "pyramid scheme" label, even though the endless chain recruitment into a pyramidal structure was essentially the same. So "multi-level marketing" was born. But this sounded too much like a pyramid scheme to some people, so a new label was needed. Someone came up with "network marketing," which sounded more like a legitimate business. So promoters eagerly jumped on board.

In 1979, an FTC judge ruled that Amway was not a pyramid scheme, assuming certain "rules" were met to assure at least some retail sales. Without any evidence to support it, promoters were able to convince many consumers, the media, and even law enforcement that "network marketing" is a legitimate business and that the "really bad pyramid schemes" were programs that offered no legitimate products for sale. However, we now know from extensive research that the pyramid schemes that are product-based (MLM's) are far more harmful by any valid measure – loss rates, aggregate losses, or number of victims.

When the MLM's essentially took over the DSA to promote its ends, member firms insisted that they were doing "direct selling." While they may be selling directly to participants, we know that in most MLM's little direct selling is being done to consumers who are not part of the network.

Critics used other – not especially endearing – terms. Bruce Craig, who was Assistant to the Attorney General in Wisconsin and has dealt with cases and issues related to pyramid schemes for 30 years, said at one time that these MLM schemes amounted to little more than "entrepreneurial chains." Others have referred to them as "predatory chain selling schemes," "pyramid scheme fraud," or simple "fraud," since most MLM's obtain money from recruits on the basis of a whole set of deceptions. The problem with the term "fraud" is that it implies willful deceit, but my communications with most MLM promoters convinces me that they are in extreme denial of the harm done by their programs. I consider most of them *naïve perpetrators* of their schemes. A better term might be *"system fraud,"* implying that it is an inherently flawed and fraudulent *system* that is the villain.

As explained below, in the extensive research on MLM compensation plans, I use the term "recruiting MLM" to refer to an MLM that rewards primarily

the recruitment of a downline of participants who purchase products in order to participate in the scheme, thus providing commissions to the upline recruiters. Nearly all of the over 250 MLM's I have studied fall into this category.

I also found some MLM's to be more highly "leveraged" than others. Leverage refers to the degree to which "TOPP's" (top of the pyramid promoters) profit from the efforts and investments of downline participants. Breakaway compensation plans, such as are used by Amway and Nu Skin, are the most extreme of all the compensation plans, rewarding those at the top with enormous commission checks while almost everyone beneath them loses money. With honest and meaningful disclosure, such extreme leverage would be transparent.

In recruiting MLM's, sales to participants become the means of laundering pyramid scheme investments. To help dispel the illusion that a scheme is not a pyramid scheme so long as legitimate products are offered, I coined the term "product-based pyramid schemes," which is very accurate. Other terms could be cited, but for the purposes of these rebuttal comments, we will use the shorter term "MLM" or "MLM chain sellers" for any pyramidal program that features a chain of recruitment of participants as primary customers – which is the vast majority of "MLM's" (MLM companies), including those belonging to the DSA.

**The Direct Selling Association (DSA), recently taken over by MLM's, now promotes chain selling even more than legitimate direct selling.**

First and foremost, consider the source of this voluminous series of comments (522418-12055 through 12096 – from the DSA). What is today known as the Direct Selling Association (DSA) was formed in Binghamton, New York in 1910 as the Agents Credit Association, which evolved over time to become the Direct Selling Association in 1968. For several decades, the organization consisted of legitimate agents or direct sellers to bone fide markets; no MLM's were included. However, in the 1960's MLM companies (MLM's) began to make their appearance, though still less than 5% of the membership in 1970.

In the 1990's officers of MLM's began to see the advantage of joining this organization. Apparently they reasoned that if an MLM is a member of the Direct Selling Association, it will be accepted as a legitimate direct selling operation. This could be compared to a farmer seeking a greater price for his pigs by selling them as horses. So he places horsehairs on their buttocks, herds them into the horse corral, and declares, "There, you can see that the pigs are in the horse corral and no longer in the pig pens. This proves that they are horses."

The DSA is correct in at least part of their definition of what constitutes direct selling: They emphatically state: "direct selling is the sale of a consumer product or service, person-to-person, away from a fixed retail location. These products and services are marketed to customers by independent salespeople."

The problem with the DSA definition is that it fails to exclude what legitimate direct selling is NOT; i.e., the recruitment of an endless chain of participants as primary (or only) customers. In fact, using definitional guidelines in FTC cases (such as Omnitrition, Equinox, Skybiz, and Trek Alliance), as well as in most state statutes against pyramid schemes, the key element of a pyramid scheme is compensation obtained primarily from recruitment activities, rather than from actual sales to end users who are not in the network of participants in the sales device or scheme. This distinction can best be determined by careful examination of the compensation plan of an MLM program. If the income from

building a downline is the primary motivator, and if retail sales to non-participants is secondary or only nominal, it should be considered an illegal pyramid scheme.

**MLM – "the 800-pound gorilla in the Commission chambers"**

To understand why we are even dealing with this issue, one must go back to the original "Amway decision" in 1979, when an FTC judge ruled that Amway was not a pyramid scheme, provided it fulfilled its promise to comply with its "retail rules" requiring actual sales of products at retail prices to bone fide customers. The rules have essentially been ignored and have never been enforced to any degree. (For details on the Amway Rules, read "Pyramid Nation: the Growth, Acceptance, and Legalization of Pyramid Schemes in America," by Robert Fitzpatrick. (For information, go to – http://www.falseprofits.com)

Since the 1979 Amway decision, MLM's have proliferated such that literally thousands of MLM's have come and gone. However, some have endured, mostly by repeating their pyramidal recruiting into new areas or by setting up new product divisions as de facto or market saturation sets in, and recruiting dries up where they had at one time successfully recruited. Thus these MLM's soon evolve into a form of Ponzi scheme, with new investors being told they can recruit in other areas when the interest wanes in the present area.

Now, of course, we know that MLM's like Amway are the most damaging of all the various classes of pyramid schemes – by any measure, whether its loss rates, aggregate losses, or number of victims. Were the Commission to have had the information in 1979 that we have now, the decision likely would have been quite different. Had Amway been ruled as an illegal pyramid scheme, the FTC would not be addressing this issue now and dealing with a total of over 17,000 comments from MLM proponents who fiercely object to meaningful disclosure. This is because in order to be successful in their recruiting, these MLM's are dependent on a whole set of clever deceptions.

Pyramid marketing schemes, or MLM, is "the 800-pound gorilla in the commission chambers," to quote Bruce Craig, former Assistant Attorney General of Wisconsin – who for many years has warned of "entrepreneurial chains" such as the MLM's on the DSA membership roster. (See his extremely informative comments – tracking number 522418-12306). The FTC now has the opportunity to rectify to some degree the ill-fated Amway decision by requiring honest and meaningful disclosure.

**Using the "5 Red Flags" analysis of compensation plans, the harm in "recruiting MLM's," can now be identified, and such schemes (many of them DSA members) can finally be clearly differentiated from legitimate business opportunities.**

Years of careful study comparing no-product pyramid schemes and MLM's to a variety of legitimate marketing models led to a paper I wrote, which was summarized as a white paper for the 2002 White Collar Crime Conference. "The 5 Red Flags: Five Causal and Defining Characteristics of Product-based Pyramid Schemes, or Recruiting MLM's" has since been expanded and updated, including testing the "5 Red Flags" against financial reports of actual MLM companies and analysis of the compensation plans of over 250 MLM companies. After debunking deceptions in reporting by the MLM firms for which the data was available, the percentage of participants in these schemes that lose money is

approximately 99.9% – far worse than for clearly illegal no-product pyramid schemes. The “5 Red Flags” and related research reports are discussed in my July 17 comments (#522418-12585). It can be downloaded for free from the research page of our web site at – http://www.mlm-thetruth.com/mlm_research.htm.

As a very brief summary, product-based pyramid schemes, or “recruiting MLM’s” (See definitional note below) incorporate these “Five Red Flags” in their compensation plans, which taken together are the root cause of their horrendous loss rates and which clearly separate them from legitimate businesses:

 1. Recruiting of participants is unlimited in an endless chain of empowered and motivated recruiters recruiting recruiters.

 2. Advancement in a hierarchy of multiple levels of “distributors” is achieved by recruitment, rather than by appointment.

 3. Initial and/or ongoing purchases (products, sales “tools,” etc.) by “distributors” are required or “incentivized” in order for them to be eligible for commissions and to advance in the business ("pay to play").

 4. The company pays commissions and/or bonuses to more than five levels of “distributors.”

 5. For each sale, company payout to the total upline of participants equals or exceeds that for the person actually selling the product, creating an inadequate incentive to sell products directly and an excessive incentive to recruit.

No one of these red flags is sufficient to lead to such high loss rates, but all of them taken together lead to the extreme loss rate of approximately 99.9%.

***DEFINITIONAL NOTE:*** In my reporting, I use the term “recruiting MLM” to refer to any MLM that is dependent on recruitment of a revolving door of new recruits as customers, rather than on legitimate sales to end users not in the network. The “5 Red Flags” mentioned above can be found in the compensation plans of recruiting MLM’s. Using these definitional guidelines, nearly all MLM’s are recruiting MLM’s. An equivalent term used in the report is “product-based pyramid scheme,” which the FTC refers to as a “pyramid marketing scheme.”

Without any effort at debunking the reports of the MLM’s, Robert Fitzpatrick of Pyramid Scheme Alert analyzed public reports of the MLM’s and arrived at a similar conclusion – approximately 99% of participants are paid less than $14 dollars a week by their MLM sponsors – actually losing money, after subtracting purchases of products and services from the company. Varying amounts of purchases are required in order to qualify for any commissions or to advance in the scheme. For a free download of his full report, go to – http://www.falseprofits.com/MythofMLMIncome.doc.pdf

It should be noted that even in the worst of the MLM’s found on the DSA membership roster, one can find participants who are making a lot of money – but only those at or near the top of their respective pyramids. I refer to these persons as TOPP’s, for “top of the pyramid promoters.” A survey of tax preparers I performed in 2002 in Utah (where many of these schemes are headquartered) confirms that it is extremely rare for participants to report a profit on their returns

– except for the TOPP's. For this revealing and very instructive report, read "Who profits from Multi-level Marketing? Preparers of Utah Tax Returns Have the Answer," which is discussed in my July17 comments to the FTC (tracking number 522418-12684) Or go to our web site at – http://www.mlm-thetruth.com/tax_study.htm

The odds of "success" for MLM participants can be substantially improved by their willingness to embrace and promote the deceptions that become the official company line. From twelve years research, I conclude that to be successful in climbing the hierarchical ladder (pyramid) of participants of a "recruiting MLM," one must go through three stages:

- First, be deceived.
- Second, maintain a high level of self-deception.
- And finally, go about aggressively deceiving others.

Only then can the hard work pay off by rising to the top of a pyramid of participants in a highly leveraged MLM, such as Amway/Quixtar, Nu Skin, or Melaleuca. For a list of 30 typical deceptions used in MLM recruiting, go to – http://www.mlm-thetruth.com/Misrepresentations-RecruitingMLMs.pdf

**In its reports, The DSA lumps together chain selling (MLM) programs with legitimate direct selling programs.**

It should be noted by FTC officials considering their comments that the DSA has essentially been taken over by MLM's over the past 15 or 20 years. From less than 5% of membership made up of MLM's in 1970, over 28% of DSA membership today are MLM companies. Financial resources and resultant influence represent a far greater percentage – certainly the majority of revenues from DSA firms comes from MLM's. Please also note that my analyses of their compensation plans reveals all "5 Red Flags" in nearly all of the DSA's MLM's.

So – most of the revenue from MLM members of the DSA is from highly leveraged MLM's. They are not legitimate direct sellers at all. So lumping chain sellers with legitimate direct sellers in the DSA's extensive collection of statistics is highly misleading. If the standards used to identify illegal pyramid schemes in other cases (such as Equinox and Trek Alliance) were used by the FTC and the states, nearly all of these MLM's would be found to be illegal pyramid schemes. This would include most MLM's in the DSA membership roster. Indeed, some DSA members have recently been shut down by the FTC or other law enforcement agencies for conducting illegal pyramid schemes. And in India, Hyderabad police have shut down Amway, claiming the business model of Amway is illegal. For information, go to – http://www.moneycontrol.com/india/news/business/amwayhyderabadpolice/hyderabadpoliceshutsdownamwayoffices/market/stocks/article/242899

**Using deceptive tactics, the DSA and its MLM member firms lobby to legalize uneconomic MLM chain selling programs.**

As further proof of the motivation of DSA officials to protect chain selling more than legitimate direct selling, lobbyists for the DSA and its MLM member firms have been aggressively lobbying state legislatures to weaken their statutes against pyramid schemes. Using highly deceptive lobbying techniques, they have been successful in duping legislators in getting such bills passed in several states (even donating to the political campaign of an attorney general who

testified for such a bill in at least one key state). They also attempted in 2003 to get a bill through Congress (HR1220) that would have exempted MLM companies from prosecution as pyramid schemes.

Examples of deceptive lobbying include the testimony of DSA President Neil H. Offen, who claimed in hearings before a 2005 Utah legislative committee that the DSA represents "90,000 direct sellers" in Utah who depend on direct selling for income. While it is possible that 90,000 Utahans may have joined various MLM's, they are primarily buyers of MLM products who join in the hope of some day recruiting enough people to get enough back in commissions to recoup their investments – which research shows rarely happens. As the aforementioned tax study demonstrated, except for TOPP's, few participants in "recruiting MLM's" ever report an income on their taxes, and few sell to end users in any volume.

The thing these DSA-initiated bills have in common is not the promotion of legitimate direct selling, but technically illegal chain selling or product-based pyramid schemes. For more information, go to the DSA page on our web site at - http://www.mlm-thetruth.com/dsa.htm. The information on the Pyramid Scheme Alert web site, which includes information about the DSA's efforts to influence legislation before Congress, is also helpful. Go to – http://www.pyramidschemealert.org/PSAMain/news/FLSB2648.html

The deceptive DSA-initiated legislation that has been passed in several states underscores the urgency of a rule requiring meaningful disclosure by MLM companies, since it may be one of the only remaining protective measures available to protect consumers from exploitive or predatory MLM's.

**In legislative hearings, the DSA blatantly misrepresented the FTC.**

At the 2006 Utah legislative hearings, several blatant falsehoods were given to the committee by the bill's DSA/MLM proponents, with no opportunity for me to refute them, since I had already spoken. One of the most blatant falsehoods was that by Misty Fallick, legal representative for the DSA, who misquoted the position of the FTC – the exact opposite of the FTC's long-standing position, which is that unless the majority of sales were made to non-participants, it was a pyramid scheme. (As an example, review FTC definitions used in the Equinox case.) For details on what happened in the Utah legislative hearings, go to – http://www.mlm-thetruth.com/Utah-PyramidSchemesNowLegal.htm

**Like its member MLM firms, the DSA appears willing to engage in deception to further its ends – including the web version of ID theft.**

The DSA has engaged in deceptive and unethical web practices, including "stealing" the identity of one of its top critics – non-profit consumer advocate Pyramid Scheme Alert (PSA) – by directing web surfers seeking the PSA site to the DSA site. The DSA knowingly registered domain names that rightfully should remain available to PSA and then paid site owners of related sites for "sponsored links" to a page on the DSA site explaining a self-serving DSA definition of what is a pyramid scheme. For details, go to – http://www.mlm-thetruth.com/dsa.htm.

This DSA action was not surprising to those who have observed the pattern of deception used by DSA/MLM member firms, who thrive on numerous deceptions to survive and expand their businesses, as mentioned above.

**The DSA and DSA's MLM member firms have mobilized their massive lists to get participants to write in their "concerns" and "objections" to the proposed business opportunity disclosure rule – based on templates or form letters supplied by the DSA or MLM member firms or consultants.**

Sampling the first 200 of the initial comments posted on the FTC web site in response to the invitation for the public to comment on the business opportunity rule, it appeared that the vast majority (over 95%) of MLM participants submitting comments are opposed to the proposed rule – or want it modified so as not to disclose meaningful information. These follow a clear pattern, and we know that most are filling out a form letter or template (apparently initiated by the DSA), to which they are attaching their names. One even submitted the form letter without a signature (Scott Jeff, tracking # 522418-00037)

When the larger number of comments (12,994 of over 17,000 submitted) were finally posted, I sampled 100 comments (every 100th comment) and came up with the revealing statistics in Exhibit A. All but one MLM company or participant opposed meaningful disclosure. It is interesting to note that both of the two ex-MLM participants emphatically expressed approval of honest and meaningful disclosure. It is also relevant that only one person was identified with any other type of business opportunity than MLM, and he was against the rule, as he believed it did not apply to his business. This supports the argument that a business opportunity rule that lumps MLM's and party plans with other types of business opportunities could be a mistake. The proposed rule is clearly an issue for MLM/party plan companies – and should apply primarily (or only) to them.

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**Exhibit A: Random sample of 100 responses to FTC invitation to public comments on proposed business opportunity rule**

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|---|---|
| MLM or party plan companies or participants who oppose the business opportunity rule as proposed by the FTC | 94 |
| Respondents who did not identify did not identify their MLM company, but appeared to be affiliated with an MLM company (because comments parroted objections of DSA) – opposed to FTC business opportunity rule | 2 |
| Total MLM respondents opposing FTC rule as proposed | 96 |
| MLM participants favoring rule as proposed | 1 |
| Ex-MLM participants who oppose honest and meaningful disclosure | 0 |
| Ex-MLM participants who favor honest and meaningful disclosure | 2 |
| Respondents not identified with MLM or party plan – opposed to rule | 1 |
| Total sample | 100 |

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One of the objections, as voiced by these MLM submitters, is that it could negatively affect their income. However, it is clear from the above-mentioned tax survey and other research that few participants other than TOPP's ever show a profit on their taxes (though they may seek a deduction for some expenses). Therefore, of the 17,000 respondents, most of whom are MLM participants, the

vast majority are not likely earning a profit, but are merely hoping to some day profit from what has been proven to be uneconomic for all but the TOPP's. Hopefully, meaningful disclosure will discourage many from participating at all, as they would be much better off doing something else.

**DSA data are so skewed and its motivation and arguments so highly questionable that most of their input should be dismissed in developing a meaningful business opportunity disclosure rule.**

Considering all of the above, I urge FTC officials to disregard or consider invalid the data and arguments put forth by the DSA to justify and extol their mission and practices, including the "DSA Code of Ethics." Nearly all of their statistics combine chain selling MLM's with legitimate direct selling, hugely skewing and contaminating the results. And the DSA code of ethics does not go nearly far enough; e.g., it does not prohibit endless chain recruitment of participants as primary customers.

Please also discount DSA arguments against meaningful disclosure. On careful analysis, using the "5 Red Flags" research report cited above, as well as tax studies and other corroborative research, it appears that the motivation to resist such disclosure comes more from fear of revealing the truth to prospects than from legitimate objections. After all, if prospects had clearly disclosed to them that their odds of profiting from an MLM were less than 1 in 100, even with their best efforts (without deception), few would participate.

In summary, it is my well-founded belief that DSA input should be dismissed because DSA objections to honest disclosure reflect the fact that the interests of the DSA in concealing the truth are diametrically opposed to FTC interests in protecting consumers and fostering fair trade. Still, I will offer some rebuttals to points raised in the "Executive Summary" on page 4, which is expanded on in later parts of the series of DSA submittals. So these comments apply to the entire series of DSA comment submissions.

**Specific rebuttals of DSA points:**

*[NOTE: DSA comments below are in italics, followed by my rebuttals in regular type.]*

*1. "Legitimate direct sellers play an important role in the national economy."*

This statement by the DSA is true on the face of it. But unfortunately, the DSA's use of the term "legitimate direct sellers" includes both illegitimate MLM chain sellers as well as legitimate direct sellers – and fails miserably to make the distinction. In fact, the comments offered by the DSA reflect the observation of consumer advocates that MLM's have the greatest weight and influence with DSA lobbyists and communicators.

*2. There are several ways that the FTC could revise the proposed rule to ensure that legitimate direct selling companies are excluded.* Then the DSA lists 5 exclusions, that I will label items "a" to "e":

*a. Exclude from the rule's provisions those business opportunity sellers whose opportunities carry minimal (or no) cost or risk.*

The fact that the cost of initial sign up is low is deceptive – a mere ruse. In addition to expensive starter kits that promoters imply are essential for success, MLM's typically "incentivize" the ongoing sale of products and services to new

recruits – often on a subscription basis amounting to hundreds or even thousands of dollars over time. These purchases are “incentivized” by making them necessary to qualify for commission or to advance in the scheme.

*b. Retain the definition of business opportunity contained in the Franchise Rule, which does not include most or all direct sellers.*

Here is an example of the DSA using the term “direct sellers” to include both legitimate direct sellers and MLM chain selling schemes, both of which are represented in its membership. If anything, the definition needs to be tightened specifically in the case of MLM schemes.

*c. Better define “business opportunity” to cover work at home, vending machine, and similar schemes, and not direct sellers.*

In comparison, many “work at home” and “vending machine” opportunities are far more legitimate than the MLM chain sellers who are members of the DSA. While I don’t have statistics to support this, my judgment and observations (having worked in the field of business opportunities for 35 years) are that their loss rates are likely to be far below the 99% loss rate of DSA/MLM member firms.

*d. Exempt companies that adopt and adhere to a set of industry best practices, including, for example, requirements relating to wholesale inventory purchases protected by buyback policies and/or “cooling-off” right for salespeople.*

DSA industry standards, including the “DSA Code of Ethics,” are woefully inadequate and even misleading, as explained above.

Inventory purchases are too restrictive to be helpful. MLM recruits are encouraged to open and share their products, not to keep them unopened. Then they cannot qualify for a refund. In fact, a financial officer for Nu Skin told me that refunds total only 3½% - which is easily absorbed by the company with the large cost-of-sales to revenue ratio Nu Skin enjoys. Besides, few victims of MLM recruitment realize that they have been scammed. Instead, they tend to blame themselves or to fear recrimination if they seek a refund which would affect those who recruited them, who could be close friends or relatives.

The “cooling off” provision would be useful, especially if honest and meaningful disclosure were required and prospects were encouraged to search the web for the pros and cons of the MLM in question.

*e. Exempt companies that are subject to a self-regulation process such as that offered by DSA.*

This is addressed above. The self-regulation provided by the DSA is set up to protect not so much the participants, as the defrauding member companies.

*3. DSA cannot overstate the harm to legitimate direct sellers that would result from the proposed rule.*

Any harm incurred from compliance by MLM’s should be compared to the much greater harm (in time, effort, and expense) suffered by victims of MLM’s, including DSA member firms. Recent research demonstrates that millions of victims lose billions of dollars worldwide every year from participation in these MLM’s. For proof of this in just one DSA member firm, consider the massive harm suffered worldwide by victims of the Nu Skin scheme. Though the FTC issued an Order in 1994 for Nu Skin to cease its misrepresentations of earnings of its distributors, Nu Skin kept right on misrepresenting earnings, even after PSA

challenged its compliance. A few changes were made by 2004, but not half of what was needed to protect new recruits.

The "REPORT OF VIOLATIONS of the 1994 FTC Order for Nu Skin to cease its misrepresentations" is very relevant to the proposed rule, and every FTC official involved in the rulemaking process would do well to read it. The report was attached to my comment filed July 16 (tracking # 522418-10266). More recent misrepresentations are recorded in Appendices F and G as an update of the same report (see tracking # 522418-10051) The full 70-page report can be downloaded (with key points summarized on the contents page) at – http://www.mlm-thetruth.com/Complaint-2FTC-7-15-6-NS-OneCol.pdf

*4. The waiting period requirements in the proposed Rule is impractical and will fundamentally and adversely alter the way in which direct selling operates.*

This result could be a very good thing for consumers. In fact, based on recent research conducted by myself and others on DSA member firms, if all DSA member firms suffered severe setbacks in number of persons recruited into their programs, it would signal a victory for both the FTC and for the consumers it is pledged to protect. And I would go further in suggesting that the FTC recommend all prospects search the web for both positive and negative information on specific companies before making a decision to participate. It is only on the web that such information is available in any depth. They can query the search engine by making two or more entries such as the following:

(1) (name of company) – "advantages or legitimate company"

(2) (name of company) – "fraud or scam or pyramid scheme"

With the enormous search capabilities of search engines such as Google, such a search would yield an abundance of sites expounding on the pros and cons of most any MLM program.

Also, a well-researched 5-step do-it-yourself evaluation process for deciding on MLM participation (using the "5 Red Flags" discussed above) is available for free online at – http://www.mlm-thetruth.com/mlm_evaluations.htm.

*5. The legal action disclosure requirement in the proposed rule is overbroad and unmanageable and will likely produce significant unintended consequences.*

Though not all legal actions result in convictions, the very existence of law suits or complaints to law enforcement of large damage amounts or in significant numbers is a red flag that should be considered before a prospect makes a decision to participate. But I believe that the "5 Red Flags" report above lists red flags that are even more significant than are complaints filed or legal actions taken. In any event, law enforcement seldom takes action against the massive number of MLM abuses that occur daily. Much of the blame for this rests with victims, who rarely file complaints. In law enforcement, the squeaky wheel gets the grease. No complaints, no action.

Many wonder why it is so rare for victims of MLM's to file formal complaints or to seek legal action against MLM's. There are many reasons for this, including their having been conditioned to believe that failure is their fault, the fear that they will suffer consequences from or to their upline or downline – who could be close friends or family, the fear of self-incrimination (since in chain selling MLM's every major victim is a perpetrator – in order to recoup his/her investment), and the reminders by MLM promoters that "if their program were illegal, it would have been shut down long ago." So there is a circular phenomenon in MLM: No law enforcement because there are so few complaints – and no complaints because

law enforcement seldom acts. This is further explained in my comments dated July 13 (tracking #522418-12262) and in my report "Top ten things I learned from Ten Years' Research on MLM." It can be viewed or downloaded at – http://www.mlm-thetruth.com/Top10thingsIlearned-10yrsResearch6-6.pdf.

*6. The cancellation and refund disclosure requirement in the proposed rule would be difficult to comply with and would provide prospects with little useful information.*

Both arguments are self-serving and not reflective of consumer needs, as explained above. And with modern computers that all these MLM companies use, compliance would not be difficult at all. Consumers need to know this type of information, and the FTC is wise to demand that it be disclosed.

(second part of #6) *On the contrary, our high turnover rate is a sign of the vitality of our industry and the ease of entry and egress.*

Does the writer live on another planet where free enterprise does not exist? Only a person inexperienced in business options would make such a statement. It is certainly an insult to the intelligence of FTC officials to assume they would buy this argument. A high turnover rate is a serious red flag in *any* business.

*7. The references requirement in the proposed rule disregards the privacy and property rights of recruits and sellers, respectively, and is simply not workable.*

As mentioned in my July 13 comments (see # 5 above), these references would be extremely helpful, as they are for franchise prospects. But what is needed is a list of ex-participants, as the vast majority of MLM chain sellers will soon be ex-participants, as the prior DSA comment suggests. As I explained in my July 13 comments, at least half of the references should be from ex-participants. However, I expect that MLM officers will find a way to supply sympathetic friends or family to be references and will somehow reward them for saying what they want them to say – making them little better than shills. Knowing the pattern of deceptive behavior routinely engaged in by MLM's, I honestly doubt that much good will come of this requirement.

*8. Finally, the earnings claims disclosure requirement is too complicated and not useful vis a vis direct sellers.*

Complicated? Not useful? Have the DSA communicators ever seen the disclosures required by franchisers? Have they not seen the complicated financial disclosure documents required by the SEC for stocks of publicly traded companies? By comparison, the earnings claims disclosure requirement of the FTC would be a piece of cake.

And if strict disclosure rules apply to stocks for publicly traded companies and for franchises, the widespread deceptions used in MLM recruiting would suggest that disclosure for MLM companies should be even more strict. MLM recruitment depends of many misrepresentations, 30 of which are listed at – http://www.mlm-thetruth.com/Misrepresentations-RecruitingMLMs.pdf

DSA/MLM member firms have historically avoided voluntarily providing meaningful disclosure documenting earnings claims. In fact, I surveyed the presidents of 60 leading MLM firms in the hopes of getting information crucial to the making of good decisions by prospects of MLM programs. The results were predictable: None of the MLM officers were willing to provide the requested

information. The "Network Payout Distribution Study" was reported in my July 1 and July 17 comments (tracking # 52218-12748) and is available online at – http://www.mlm-thetruth.com/NWMpayoutstudy-6-6.pdf

This study illustrates what we consumer advocates have known for years; viz., most MLM's are uneconomic, or beneficial to a handful of people at the top of a pyramid of participants at the expense of a multitude of downline victims, over 99% of whom lose money (after subtracting company purchases and other expenses). So such MLM's will seldom disclose useful information voluntarily. Honest and meaningful disclosure of earnings information must be mandated by the FTC, similar to what the FTC requires for franchises and the SEC requires for the stocks of publicly traded companies.

In addition to the aforementioned tax study, I have gathered statistics on earnings of MLM's (for which such data was available) and compared them with statistics on odds of winning at gambling in Las Vegas casinos. After debunking the deceptions in the reporting of the MLM's, I found the odds of profiting from craps or the roulette wheel at Caesar's Palace in Las Vegas were far greater than for participating in MLM's, including some members of the DSA. These statistics were sent by express mail July 1, and they can be obtained online at – http://www.mlm-thetruth.com/COMPARE12MLMs-vsSellingvsNPSvsVegas-2p-6-06.pdf

And as I explained in my (aforementioned) July 13 comments to the FTC, what is needed is not less disclosure, but far more disclosure, so far as it is honest and meaningful. Not only should average moneys paid to participants at given levels in the pay plan be reported, but also average moneys paid by participants to the company in products and purchases. It is the net figure reflecting money in, minus money out, that is important for prospects to make an intelligent decision. (See Exhibit B)

It does not matter if the products purchased from the company are used, sold, given away as samples, stored, or disposed of (and the services used); the total average of payments to the MLM company needs to be disclosed if earnings disclosure is to be meaningful. This is particularly relevant for MLM chain sellers, since our research demonstrates that most of the revenues received by these companies come from recruits (in the form of incentivized purchases), and not from sales to legitimate customers not in the network of participants. Such honest and meaningful disclosure would show that nearly all participants lose money, even before operating expenses are subtracted. For these reasons, the DSA will come up with every possible excuse for not disclosing such information.

Based on extensive research, including analyses of hundreds of MLM compensation plans and resultant extreme loss rates, it is clear that the requirement to disclose earnings and purchases of participants is the most important step that the FTC can take to inform consumers and to prevent consumer abuse. See Exhibit B for an ideal form that would satisfy the criteria of honesty and relevance for MLM prospects – without violating individual privacy.

Many of these suggestions were also explained in the July 7 comments by Robert Fitzpatrick of Pyramid Scheme Alert (tracking #522418-06415).

In the DSA conclusion paragraph on page 7, several errors are apparent. For example, *"The proposed rule, however, would cast far too wide a net and in doing so would harm and possible destroy many legitimate direct sellers."*

I would suggest that while this may be a small problem for legitimate direct sellers, it certainly would not apply to MLM chain sellers who are members of the DSA. They need far more strict rules, not less.

FTC personnel should take note that of the comments that came in, very few of the legitimate direct sellers submitted comments complaining about honest disclosure. The great volume of complaints came mainly from MLM's – most of whom were from the DSA membership ranks.

*"Direct selling companies are not sellers of business opportunities and should be exempted from an business opportunity fraud rule."*

On both counts, nothing could possibly be further from the truth. While MLM promoters are careful not to position their programs as business opportunities in SEC filings or before regulators, they frequently speak of their programs as "business opportunities" in their recruitment campaigns, including at large rallies that I have personally witnessed. As to the second part of that statement, if any "income opportunities" need a strict business opportunity fraud rule, it should be the MLM chain sellers represented by those among the DSA roster.

**Other comments that provide valuable insight for FTC personnel**

In rebutting the DSA comments, I believe some important comments on the side of consumer protection by other top experts in this field deserve serious consideration by the Commission, since they sharply contradict the comments of the DSA. So rather than restating their arguments, I would just like to recommend they be given serious attention. They include the following:

**Bruce Craig** (tracking number 522418-12306) – served as Assistant Attorney General for the state of Wisconsin for 30 years, during which he litigated a number of pyramid scheme cases, including extensive litigation against Amway in the early 1980's.and Koscot Interplanetary, Holiday Magic, and Bestline in the early 70's. These cases were pursued with the cooperation of Commission staff.

**Douglas M. Brooks** of Martland & Brooks, LLP (tracking number 522418-10570 – plus exhibits – with tracking numbers 10572 and -10579) – has intimate knowledge of legal problems with disclosure of meaningful information, as in the Nu Skin case cited earlier.

**Robert Fitzpatrick** – (tracking numbers 522418-06415 –70036) Mr. Fitzpatrick's article "The Myth of 'Income Opportunity' in Multi-level Marketing" is a must read for anyone considering the issue of earnings disclosure of participants in MLM programs.

**Pyramid Scheme Alert**, also by Robert Fitzpatrick – (tracking numbers 522418-06415, -70036, and –70037) This non-profit organization seeks to expose and prevent pyramid scheme fraud world-wide.

After reading what these experts have to say, one can see agreement with my comments (listed under Consumer Awareness Institute and Pyramid Scheme Alert (Taylor, Jon – tracking numbers 522418-70056, -10051, -12684, -12748, -10058, 10266, -12262, and -12585) – all based on extensive research, much of it drawn from official documents of the MLM companies themselves. These clearly show the need for meaningful disclosure, negating the objections of the DSA as suggested above. The requirements for honest and meaningful disclosure are outlined in these comments. See Exhibit B for a form that would provide honest and meaningful disclosure without violating individual privacy.

***Exhibit B – a simple form that would provide honest and meaningful disclosure:***

**Annual Company Revenues received by WealthPlus International, Inc.[1]**
**– Plus Payments to – and Purchases from –**
**Participants[2] Who Had Enrolled[3] in WealthPlus within the Past Three Years[2]**

| | |
|---|---|
| Total WealthPlus revenues for the year | $95,000,000 |
| Total payments[4] in commissions and bonuses to participants for the year | $40,500,000 |
| Total of all purchases of products and services for the year from Wealth Plus by (the same group of) participants who were enrolled and authorized to recruit other participants within the past three years | $90,000,000 |
| Average purchases of products and services from WealthPlus per participant | $900 |
| Average commissions and bonuses paid by WealthPlus to participants | $405 |

*—Breakdown of payments to participants —*

| **Total annual payments received by participants at different levels[5] from WealthPlus in *commissions & bonuses*** | **Average purchases for each level** | **Number of participants*** | **% of total participants** |
|---|---|---|---|
| Over $500,000 | $20,000 | 0.001% | 1 |
| $250,000-$499,999 | $15,000 | 0.005% | 5 |
| $100,000-$249,999 | $12,000 | 0.01% | 10 |
| $50,000-$99,999 | $10,000 | 0.05% | 50 |
| $25,000-$49,999 | $8,000 | 0.1% | 100 |
| $10,000-$24,999 | $6,000 | 0.5% | 500 |
| $5,000-$9,999 | $4,000 | 1.0% | 1,000 |
| $1,000-$4,999 | $2,500 | 10.0% | 10,000 |
| $1-$999 | $1,200 | 25.0% | 25,000 |
| $0 – participants who made purchases but did not qualify for commissions[6] | $400 | 62.0% | 62,000 |
| $0 – participants who enrolled but made no purchases since enrolling[7] | $0 | 1.3334% | 1,334 |
| TOTAL PARTICIPANTS | | 100% | 100,000 |

***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] 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 deceptive reporting practice of some MLM firms that count 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. Also, while eliminating participants that contracted to join and then dropped out, this small base of participants is compared with participants who may have taken five to twenty years to achieve a certain level. The result is numbers that are extremely skewed, making the MLM "opportunity" appear to be profitable for most recruits. The above form would correct these deceptions.

[3] 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.

[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.

[5] 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.

[6] 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.

[7] The listing of those who enrolled but bought no products would be those persons enrolled in order to satisfy a "head count" of recruits for companies who have such requirements in order for participants 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 no concern.

**CONCLUSIONS**

I believe that an honest and meaningful business opportunity disclosure rule is possible and fair to both companies and consumers (prospects), at least as it applies to MLM companies and participants, which apparently represents over 95% of respondents to the FTC invitation for public comments. It would require a form that makes possible comparisons between programs and makes transparent what has heretofore been carefully hidden; viz.- the TRUTH.

After careful review of the arguments put forth by the DSA and member firms against disclosure requirements in the proposed rule, I have designed a form that would satisfy the needs of consumers who are confronted with MLM recruitment. At the same time, it should not be rejected by honest MLM sponsors and sponsors of legitimate business opportunities; i.e., those interested in promoting fair trade and in maintaining integrity in the marketplace. Please study carefully *Exhibit B – a form requiring honest and meaningful disclosure: "Annual Company Revenues received by (any MLM company) – Plus Payments to – and Purchases from – Participants Who Had Enrolled in WealthPlus within the Past Three Years"*

The FTC is faced with a crucial choice in its final rulemaking as it affects MLM. Will the new "business opportunity" rules reflect the objections of the DSA/MLM lobby – or its own mission to protect consumers and promote fair trade?

After reviewing the above rebuttal comments and the comments made by top experts as listed above, it is clear that meaningful disclosure as outlined in my comments above and as submitted July 13 (tracking number 522418-12262) is needed. It is also clear why the DSA and DSA member MLM firms are so fiercely opposed to meaningful disclosure. If the truth were known about what a losing proposition MLM is for almost all participants (at least 99% lose money, after subtracting expenses), sensible people would not join up and the programs would collapse like a house of cards.

*So the FTC personnel responsible with the final rulemaking are faced with a very clear choice between two mutually exclusive options:*

1. They will act to fulfill the mission of the FTC as suggested in its own posting regarding the Business Opportunity Rule, which is as follows:

*"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."*

As clearly explained above and supported by evidence in the associated reports to which I have referred, such deceptive practices are embodied in nearly all of the MLM firms that are members of the DSA. As the research demonstrates, they routinely engage in "fraudulent, deceptive, and unfair business practices." And also as explained above, the DSA itself engages in such practices.

In other words, the motivations and practices of the DSA and its member firms are antithetical to the objectives of those providing consumer protection, which should include the FTC. So if the FTC is to fulfill its mission "to provide information to help consumers spot, stop, and avoid" such practices, by protecting consumers the business opportunity rule will discourage – and even severely hurt – the DSA and its MLM member firms. Who would join their programs if they knew the whole truth?

Or –

2. The FTC could yield to the powerful influence and pressures of the DSA and its member firms, including the cover letter by Jodie Bernstein (who, incredulously, was formerly Director of Consumer Protection for the FTC!) on behalf of Amway/Quixtar/Alticore, one of the industry's worst offenders in using fraudulent, deceptive, and unfair business practices to exploit vulnerable consumers worldwide. As is apparent from their comments, the DSA and MLM member firms and their recruiting participants are clearly opposed to honest and meaningful disclosure. If the FTC chooses this option (or to leave things as they are), consumers worldwide will continue to suffer, and the FTC as a regulatory arm of the US government will be severely compromised.

It is clear from the comments of the DSA and member firms, as well as the comments of those of us who are speaking on behalf of consumers, that the FTC cannot satisfy the needs of consumers and of the DSA at the same time. If you help consumers, you hurt the DSA. Conversely, if you help the DSA, you hurt consumers.

I want to take this opportunity to thank FTC officials for their courage in opening this enforcement issue to public input. It is the hope of myself and others donating our time to warn and protect consumers that the FTC will forge ahead with meaningful reform and not give undue weight to the DSA, whose interests are 180 degrees from those of consumers and of those seeking a fair and equitable marketplace.

Sincerely,

Jon M. Taylor, Ph.D., President, Consumer Awareness Institute
and Advisor, Pyramid Scheme Alert
E-mail: jonmtaylor@juno.com
Web site for MLM research and guides – www.mlm-thetruth.com