ATTN: FTC officials 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 forum 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 through 522418-12096 by Joseph Mariano.

Qualifications of this analyst, Dr. Jon M. Taylor (and request for a hearing)

Consumer Awareness Institute was initially set up by Jon M. Taylor, Ph.D., in the late 1970's to do research and to educate on consumer issues. However, in 1997, the focus changed to one problematic issue that absorbed all our resources – 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.

Dr. Taylor has presented, testified, and/or presented papers before legal teams at the Federal Trade Commission, National White Collar Crime Center, Economic Crime Summit Conferences (2002 and 2004), Senior Fraud Summit Conference. As a director of Pyramid Scheme Alert, Dr. Taylor organized the first conference on product-based pyramid schemes for federal and state regulators in Washington, D.C., on June 1, 2001. He has consulted on numerous state and private legal actions against MLM firms, some of them members of the Direct Selling Association (DSA), and has performed extensive comparative and statistical research to help regulators and consumers clearly identify which schemes cause the most consumer losses in terms of loss rates, aggregate losses, and number of victims world-wide. Dr. Taylor has evaluated the compensation plans of over 200 MLM firms, most of them past or present members of the DSA. Much of this research and resultant consumer guides are posted on the web site – www.mlm-thetruth.com.

Addressing FTC officials personally, I, Jon M. Taylor, personally request 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

The Direct Selling Association, recently taken over by chain sellers, now promotes chain selling (pyramid marketing) – even more than legitimate direct selling.

First and foremost, consider the source of this voluminous series of comments (522418-12055 through 12096 – the DSA. What is today known as the Direct Selling Association 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 chain selling or pyramid marketing schemes 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 must be doing legitimate direct selling. 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 rumps, 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: "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 noticeably 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 Equinox 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 rewards or 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.

Using the "5 Red Flags" analysis of compensation plans, the harm in chain selling, or pyramid marketing schemes, 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. Where the data was available, and after debunking deceptions in reporting by the MLM's, 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 is discussed in my July 17 comments (#522418-12585). Or it can be obtained from the research page of our web site at – http://www.mlm-thetruth.com/mlm_research.htm.

DEFINITIONAL NOTE: In my reporting, I use the term "recruiting MLM" to refer to an MLM that is dependent on recruitment of a revolving door of new recruits as customers, rather than on legitimate sales to end users. Using this definition, nearly all MLM's are recruiting MLM's. An equivalent term used in the report is "product-base pyramid scheme," which the FTC refers to as a "pyramid marketing scheme." Another appropriate term is "chain selling," denoting endless chain recruitment of participants as primary customers.

Without any effort at debunking the reports of the MLM's, Robert Fitzpatrick of Pyramid Scheme Alert arrived at a similar conclusion – approximately 99% of participants are paid less than $14 dollars a week by their 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.

It should be noted that even in the worst of the chain selling schemes found on the DSA membership roster, one can find participants who are making a lot of money – 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 (a haven for many of these schemes) 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 (MLM)? 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 can be substantially improved by willingness of participants 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 a "recruiting MLM" (see "5 Red Flags" report), one must go through three stages:

1. Be deceived.
2. Maintain a high level of self-deception.
3. Go about aggressively deceiving others.

Then – and only then – can the hard work can pay off in a highly leveraged chain selling (pyramid marketing) scheme, such as Amway/Quixtar, Nu Skin, or Melaleuca. For a list of typical deceptions used in MLM recruiting, go to – http://www.mlm-thetruth.com/Misrepresentations-RecruitingMLMs.pdf

The DSA lumps together legitimate direct selling with chain (pyramid) selling, which meets the technical definition of an illegal pyramid scheme in most jurisdictions.

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 not that my analyses of their compensation plans reveals all "5 Red Flags" in nearly all of the DSA's MLM's.

In other words, most of the revenue from MLM members of the DSA is from highly leveraged chain selling schemes, or (to use the FTC term) pyramid marketing schemes. They are not legitimate direct sellers at all. So lumping chain sellers with legitimate direct sellers in its extensive collection of statistics is misleading, if not blatantly fraudulent. If the standards used to identify illegal pyramid schemes in other cases (such as Equinox) were used by the FTC and the states, nearly all of these chain selling or pyramid marketing schemes would be found to be illegal pyramid schemes.

Using deceptive tactics, the DSA lobbies to legalize blatant chain (pyramid) selling.

As further proof of the motivation of DSA officials to protect chain selling more than legitimate direct selling, DSA lobbyists 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 (and even some in law enforcement who testify for the bills) in getting such bills passed in several states.

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 in commissions to recoup their investments. As the aforementioned tax study demonstrated, except for TOPP's, few 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 is also helpful. Go to – http://www.pyramidschemealert.org/PSAMain/news/FLSB2648.html

Such deceptive legislation at the state level underscores the urgency of a rule requiring meaningful disclosure by MLM companies, since it may be one of the only real protective measures available to protect consumers.

In legislative hearings, The DSA has blatantly misrepresented the stance of 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 their 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 Equinox case.)

The DSA appears willing to engage in any 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 – Pyramid Scheme Alert (PSA) – by directing web surfers seeking the PSA site to the DSA site, by registering domain names that rightfully should belong to PSA and then referring them to the 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 deception, as mentioned above.

The DSA and DSA 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 member firms or consultants.

Sampling the first 200 comments posted on the FTC web site in response to the invitation for the public to comment on the business opportunity rule, it appears that the vast majority (as many as 90%) 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 to

which they are attaching their names. One of the objections, as voiced by these submitters (and by the DSA and its member MLM firms), 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.

DSA data and arguments are so highly questionable that most of their input should be discounted 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 with direct selling, hugely skewing and contaminating the results. And the DSA code of ethics does not go nearly far enough; i.e., 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 other corroborative studies, 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, few would participate.

In summary, it is my personal belief is that DSA input should be disregarded because DSA objections to honest disclosure reflect the fact that FTC interests in protecting consumers and fair trade are diametrically opposed to the interests of the DSA in concealing the truth. 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.

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 includes both illegitimate chain sellers as well as legitimate direct sellers – and fails miserably to make the distinction. In fact the comments offered by the DSA

suggest that the illegitimate chain sellers 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. 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 predatory chain selling schemes, both of which are represented in its membership. If anything, the definition needs to be tightened specifically in the case of chain (or pyramid) selling 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 chain sellers who are members of the DSA. While I don’t have statistics to support this, my judgment is 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. 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 if meaningful disclosure were required –thus the need for reform.

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 companies.

3. DSA cannot overstate the harm to legitimate direct sellers that would result from the proposed rule.
Any harm (time, effort, and expense) incurred from compliance should be compared to the harm suffered by victims of MLM companies, including DSA member firms. For proof of this, read about 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, even after we at PSA challenged its compliance. A few changes were made by 2004, but not even half of what was needed to protect new recruits. For details, read the REPORT OF VIOLATIONS of the FTC Order, which was attached to my comment filed July 16 (tracking # 522418-10266). More recent misrepresentation are recorded in Appendix 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
For recent developments, read especially Appendix F and G.

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 could be a very good thing. 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. I would go further in suggesting the FTC recommend all prospects search the web for information on specific companies before making a decision to participate. It is only on the web that such information is available in any depth.

5. The legal action disclosure requirement in the proposed rule is overbroad an unmanageable and will likely produce significant unintended consequences.
Though not all legal charges result in convictions, the very existence of complaints of large amounts or in significant numbers is a red flag that should be looked at. 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. (See comments about the “5 Red Flags” above.) After all, in law enforcement, the squeaky wheel gets the grease. No complaints or legal charges, no action.

Unfortunately, it is extremely rare for victims of chain selling schemes to file formal complaints or to take legal action. There are many reasons for this, including their having been conditioned to believe that any 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 every major victim is a perpetrator (in order to have any hope of recouping 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 chain selling: no law enforcement because there are few complaints, and no complaints because law enforcement does not act. 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. Consumers need to know this type of information, and the FTC is wise in seeking it.

(second part) 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 working with a variety of businesses would make such a statement. 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 chain sellers will soon be ex-participants, as the prior DSA comment suggests.

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

Complicated? Not useful? Has the DSA communicator ever seen the disclosures required by franchisers? By those who prepare financial disclosure documents required by the SEC?

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 good decisions prospects of MLM prospects. 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 have known for years. Meaningful disclosure of earnings information must be mandated by the FTC, much as the SEC requires for investment securities and the FTC requires for franchises.

In addition to the aforementioned tax study, I have gathered statistics on earnings of mostly publicly traded MLM's and compared them with gambling statistics I obtained from Las Vegas casinos. After debugging 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 recruiting MLM's, including several who were 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 relevant disclosure. Not only should average moneys paid to participants at given levels in the pay plan be reported, but also average moneys paid to the company in products and purchases.

It does not matter if the products are used, sold, given away as samples, stored, or disposed of, 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 chain sellers, since 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. As such, it could be disclosed that nearly all participants lose money, even before operating expenses are subtracted. So for obvious reasons, the DSA will come up with every possible excuse for not disclosing such information.

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 chain (pyramid) 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 complained about honest disclosure. The great volume of complaints came mainly from the more predatory chain sellers, many 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 attended. As to the second part of that statement, if any “income opportunities” need a strict business opportunity fraud rule, it should be the chain (pyramid) sellers represented by those among the DSA roster.

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.