

Introduction

This comment is submitted by William W. Keep, PhD, professor of marketing at The College of New Jersey. All comments and evidence pertain to the multilevel marketing (MLM) industry, including MLM companies subject to successful pyramid scheme enforcement actions. I do not presume the two to be one and the same, but sixty years of regulatory enforcement by the Federal Trade Commission (hereafter, “Commission”) have demonstrated a clear and ongoing overlap. The industry, “there are a lot of pyramid schemes that like to disguise themselves as legitimate direct-selling companies,¹” and Commission “there is significant concern that some pyramid schemes may masquerade as legitimate MLMs.²” have recognized the coexistence of both

In some instances, distributors in an MLM company have been identified as investors³ and the scheme described as a lottery.⁴ Here I refer to MLM firms operating legally or otherwise as offering a money-making “business opportunity.” Those pursuing the business opportunity have been referred to as “independent business owner,” “affiliates,” “independent representatives,” and “distributor.” I will refer to them as “distributors” and potential recruits as “prospects.”

My history with this industry dates to 1996 when I served as an expert witness in *U.S. v. Gold Unlimited Inc.* and extends to a current case *U.S. v. Richard G. Maike, et al.* In addition to serving as an expert witness in numerous public and private cases, I co-authored with Dr. Peter Vander Nat, senior economist at the FTC (retired), two academic articles on the MLM industry and pyramid schemes, one that offered for the first time a quantifiable approach to distinguishing between a legal MLM company and an illegal pyramid scheme, and the other providing an historical industry overview.

My comment is organized under broad themes connected with one or more of twenty-eight questions listed at the end of the *FTC 16 C.F.R. Part 462, Trade Regulation Rule on the Use of Earnings Claims, Advance notice of proposed rulemaking; request for public comment*. Support follows after providing a short answer to the questions.

How Big is the Problem and How Do We Know? The problem is pervasive and ongoing.

[Q 1] An MLM company relies on individuals and upline distributors to offer a money-making opportunity. Within the industry deceptive and/or misleading earning claims are pervasive, ongoing, and appear across a wide range of communication media.

[Q 2] Due to the volume of messages intent to promote the money-making opportunity, and the overall net impression from those messages, no circumstances in the MLM industry should be excluded from the scope of any rulemaking.

¹ Greenberg, Herb. 2013. “Why Spotting a Pyramid Scheme Isn’t So Easy.” *CNBC: SELLING THE AMERICAN DREAM: INVESTIGATIONS INC.* January 9. Accessed May 7, 2022. <https://www.cnbc.com/id/100364484>

² Federal Register, Rules and Regulations, Vol. 76, No. 236, December 8, 2011, page 76822.

³ SEC v. International Heritage, Inc., 4 F. Supp. 2d 1368 (N.D. Ga. 1998).

⁴ *FTC v. Koscot Interplanetary Inc.* (1975), 86 FTC at 1180.

[Q 3] Consumer harm by MLM companies is pervasive and well-documented. In 2011 the Commission explicitly recognized the potential for consumer harm in the industry (see Support). Since then, numerous enforcement actions by the FTC, Securities and Exchange Commission (SEC), and State Attorneys General, warning letters, and statements by the Commissioners further document ongoing concern.

[Q 4] Success in the MLM industry has long been recognized as deriving in part from affinity selling⁵ and by creating a “warm list,”⁶ that is to say selling to family, friends, and others with an affiliate connection. Exploited affiliation may be based on ethnicity⁷, race⁸, gender⁹, a shared life experience (e.g., stay at home mothers¹⁰), generation,¹¹ and even political views.¹²

[Q 5] Evidence is provided below under the heading “Support.”

[Q 6] In addition to the evidence presented here, Commission enforcement actions within the last seven years against two award-winning members of the Direct Selling Association (DSA) – Vemma and Advocare – and the settlement with Herbalife demonstrate consumer harm. Commission warning letters sent in 2021 to hundreds of MLM companies, and the prosecution of deceptive MLM-style schemes using cryptocurrency (e.g., *FTC v. Thomas Dluca et al.*) demonstrate a compelling need to protect consumers with a new rule and aggressively prosecute MLM companies causing consumer harm.

[Q 7] To minimize costs while maximizing benefits (described below), such a rule can: a) prohibit certain behaviors and/or types of communications (e.g., lifestyle/earnings claims) without imposing new costs, b) prohibit the use of disclaimers without imposing new costs, c) prohibit the imposition of forced arbitration and/or non-disparagement agreement in distributor contracts and MLM policies, at minimum new cost, d) require accurate descriptions of typical earnings and earnings statements based on data routinely collected by the DSA at minimum additional cost, and d) impose the reporting of typical distributor expenses, which would be a new cost but well justified by the benefits gained.

[Q 8] Consumer education will always be an ongoing challenge with each generation of new consumers entering with their own perspective and preferred communication media. A closer working relationship with State Attorneys General and international enforcement officers holds the potential of creating a multilayered, clear, and consistent set of messages that can be developed for a wider range of communication media.

⁵ Macchiette, Bart and Abhijit Roy. 1992. “Affinity Marketing: What Is It and How Does It Work?” *The Journal of Services Marketing*. 6 3 (Summer): 47-58.

⁶ Greyson, Kent. 2007. “Friendship Versus Business in Marketing Relationship.” 71 (October): 121-139.

⁷ Reddit. n.d. “what MLM annoys you the most?” Accessed May 4, 2022.

https://www.reddit.com/r/antiMLM/comments/lh5fak/what_mlm_annoyes_you_the_most/

⁸ Reddit. n.d. “what MLM annoys you the most?” Accessed May 4, 2022.

https://www.reddit.com/r/antiMLM/comments/p3wwdc/the_black_community_and_mlms/

⁹ Tiffany Kaitlyn. 2021. “How the Pandemic Stoked a Backlash to Multilevel Marketing.” *The Atlantic*. January 27.

¹⁰ Cunha, Darlene. 2018. “Beware of Selling Yoga Pants on Facebook.” *The Atlantic*. April 18.

¹¹ Tiffany Kaitlyn. 2021. “When Multilevel Marketing Met Gen Z.” *The Atlantic*. November 30.

¹² Tiffany, Kaitlyn. 2020. “THIS WILL CHANGE YOUR LIFE.” *The Atlantic*. October 28.

[Q 9] Complements, as opposed to alternatives, to a new rule should include aggressive enforcement actions and a more public display of successful enforcement actions directly related to consumer education and information. In the past, the Commission often highlighted the uniqueness of each enforcement action, thereby limiting the warning message to consumers and providing the opportunity for MLM companies to deflect any comparison. Consumers are then challenged with trying to discern similarities and differences (a task the MLM companies are more than happy to assist with). Consumers need clear guidance and real illustrative examples across multiple enforcement actions.

[Q 18] No. The Commission should not automatically exempt any “businesses or individuals that are subject to the Business Opportunity Rule, the Franchise Rule, or the Telemarketing Sales Rule” from a proposed new rule. Business models can change and/or combine different pieces of current practices. For example, in the 1990s Avon had some distributors operating under a single-level direct selling model and others operating under a multilevel marketing model. A company subject to the Business Opportunity Rule may decide to offer an option similar to an MLM structure. Each company subject to any of the three existing rules or new rule should include in their reporting a statement justifying their compliance to that rule.

[Q 19] I do not have enough information to provide an answer.

[Q 20] No, in the absence of compelling evidence narrowly focused, choosing to exempt requires a separate analysis and a level of refinement well beyond what is possible with the data available. I address the issue of costs and benefits from requiring all MLM business and individuals to be covered by a new rule briefly above [Q 7] and in greater depth below.

[Q 23] The evidence shows the practice of misleading earnings claims to be pervasive, ongoing, and industry-wide. I am unaware of any comprehensive industry-wide study but research by the non-profit TruthInAdvertising.org (TINA.org), recent actions by the Commission (the penalty offense notice issued in Fall, 2021), and growing evidence from numerous journalistic inquiries and social media activist ALL support the argument that the practice is pervasive, ongoing, and industry-wide.

Support

Decades of successful enforcement actions against MLM companies demonstrate the relationship between misleading earnings claims by MLM companies and illegal pyramid schemes. I begin with Commission evidence regarding pyramid schemes and then move to MLM industry-level evidence of documented “false, unsubstantiated, or otherwise misleading earnings claims,” their prevalence, evidence of “consumer complaints,” and the “extent of such practices.”

The 2004, first ever, Commission consumer fraud survey documented consumer harm from MLM-style pyramid schemes (i.e., “Although such a business may look like a legitimate multi-level marketing program, it differs because the income earned by distributors comes ultimately from recruiting, rather than the sale of products or services to consumers.”¹³). The data (collected in 2003) show the incidence of pyramid scheme fraud seventh among the ten types of consumer fraud, second in terms of individual loss, and first in terms of the hesitancy of victims to

¹³ Federal Trade Commission Staff Report, *Consumer Fraud in the United States: An FTC Survey*, August 2004.

complain. Every MLM-style illegal pyramid scheme necessarily relies upon misleading earnings claims to sustain the scheme.

The 2004 survey estimated the number of pyramid scheme victims to be 1.55M annually, the midpoint of a 95% confidence interval with endpoints of 800K and 2.3M. Statistically speaking, any point within the interval has an equal probability of being the true measure. The survey design adopted a conservative approach that, I argue, severely undercounts the number of victims. By defining a pyramid scheme victim as an MLM distributor who failed to earn the “Promised level of earnings,” a respondent must recall not a misleading earnings claim but, rather, an earnings “promise.” The notion of a “promise” is open to interpretation, allowing some respondents to conclude that a misleading earnings claim represented a promise and others to conclude it did not. In addition, the survey made no attempt to inquire about expenses, thereby failing to measure the true degree of financial loss associated with being misled. Given the available industry evidence of disclaimers that claim no promises are made and the high percentage of distributors with little or no earnings excluding expenses, the survey’s weaknesses produce data that severely undercounts the incidence of pyramid scheme victims who relied on one or more misleading earnings claims and/or incurred expenses that exceeded any earnings.

Design flaws notwithstanding, the 2004 survey provides an important baseline in two ways. First, undercounting the number of victims harmed supports an argument that the actual number of victims annually exceeds, perhaps by multiples, even the high end the confidence interval of 2.3M victims. Second, identifying pyramid scheme victims as the least likely (by far) to complain among ten types of consumer fraud victims, undermines the claimed effectiveness of MLM industry self-regulation and delegitimizes the industry’s reliance on complaint behavior as a suitable approach to consumer protection.

Two subsequent Commission consumer fraud surveys reinforced the 2004 survey findings. Though the 2007 and 2011 (released in 2013) surveys, based on 2005 and 2011-2012 data, respectively, report a decline in the incidence of pyramid scheme victims based on a “tighter definition,” the decline can be statistically attributed solely to the revised definition. In other words, an unchanged pyramid victim definition would result in the three Commission surveys producing essentially the same result. The revised definition for the 2007¹⁴ and 2011¹⁵ surveys effectively halved the incidence of harm simply by defining a pyramid scheme victim as a distributor that, “failed to earn at least half of the amount the promoter promised would be earned.” Thus, to be classified as a pyramid scheme victim the respondent needed to experience earnings less than half of a “promised” amount, again with no regard to expenses. Commission staff verified there would have been no statistically significant difference across all three surveys using the 2004 definition.¹⁶

Three Commission surveys conducted over eight years producing essentially the same result provide strong evidence of pervasive and persistent misleading earnings claims causing

¹⁴ Federal Trade Commission Staff Report, *Consumer Fraud in the United States: An FTC Survey*, August 2004.

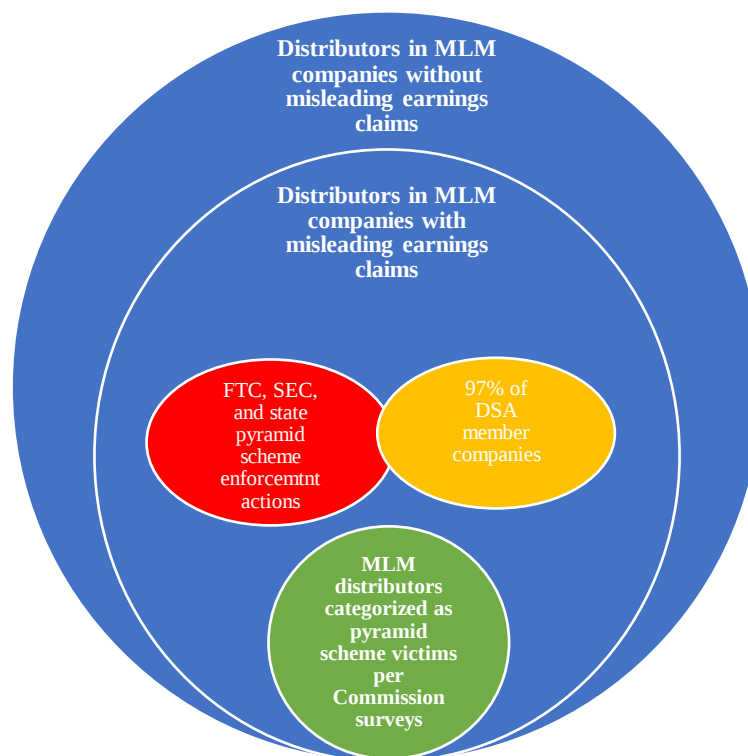
¹⁵ Federal Trade Commission Staff Report, *Consumer Fraud in the United States: An FTC Survey*, August 2004.

¹⁶ Keep, William. 2015. “Pyramid Scheme Victims In The U.S.: Has Anything Changed In The Last Dozen Years?” *Seeking Alpha*. October 17. Accessed May 7, 2022. <https://seekingalpha.com/article/3579426-pyramid-scheme-victims-in-u-s-anything-changed-in-last-dozen-years>

considerable consumer harm. It is important to note that survey respondents identified as pyramid scheme victims were not necessarily distributors in an MLM company subject to a pyramid scheme charge. Since 2003 the number of MLM companies in the United States and total sales attributed to the MLM industry have grown. Based on the Commission surveys, even with the unrealistic measure of “promised” earnings and excluding expenses, a defensible argument can be made that the annual incidence of pyramid scheme victims now reaches 3M to 4M annually. This number would increase significantly with a more realistic measure of net financial loss (i.e., including expenses) and pale in comparison to misleading earnings claims and consumer harm within the MLM industry.

Figure 1 separates MLM companies into three groups. The green circle contains MLM distributors identified as pyramid scheme victims in multiple Commission surveys. The next larger circle contains all distributors in MLM companies with misleading earnings claims. Within it, the circle in yellow represents the high percentage of DSA-member firms with documented misleading earnings claims, and the red circle represent successful pyramid scheme enforcement actions brought by the Commission, the SEC, and states Attorneys General. The overlap between yellow and red represents the DSA firms that faced successful enforcement actions. Data currently unavailable may show an overlap between the red and green circles. MLM distributors in the outer circle are those in companies that do not make misleading earnings claims. All circles are illustrative with sizes not intended to be proportional.

Figure 1



Research by the non-profit (TINA.org) found, “More than 97% of DSA [Direct Selling Association] member companies use or have used misleading income claims.¹⁷” That data alone should worry the Commission. Over decades the DSA has presented itself as the gold standard for the MLM industry. The DSA commissioned via a grant, an academic monograph touting the development of its code of ethics,¹⁸ alternatively described as either “one of the great, positive business stories of the 20th century”¹⁹ or “as part of the positive promotion of the DSA and its Code...not an analysis of the effectiveness of self-regulation per se (though the publisher might hope some readers see it that way).”²⁰ Whatever the intent, the reality is that since 2016 two award-winning DSA members faced successful pyramid scheme enforcement actions brought by the Commission. And the chronic failure of member firms to adhere to the DSA code of ethics motivated a new partnership with the Better Business Bureau,²¹ yet another complaint-based toothless form of ineffective self-regulation.

The DSA reports rejecting applicants for membership based on their failure to meet DSA standards. A reasonable argument can then be made that most non-DSA member firms follow, some less carefully than others, the incentive-driven practice of making misleading earnings claims. Further support for this argument comes from the fact that approximately 90 percent of successful Commission MLM-style pyramid scheme enforcement actions were against non-DSA member firms. The sum of the available evidence supports a conclusion that the vast majority of all MLM companies directly or indirectly make misleading earnings claims.

But what about consumer harm? Had the Commission consumer fraud surveys included any expenses incurred, the results would have been a greater incidence of pyramid scheme victims. Based on the available data, most MLM distributors earn no income and a sizable group earn little income that does not offset even a reasonable amount of effort-related expenses. To illustrate the point, Figure 1 shows earnings data from one DSA-member company documented by TINA.org to “use or have used misleading income claims.” The connection between problematic company statements and the actual distribution of distributor earnings may be indirect but years of data across multiple MLM companies showing a similar distribution highlights the bothersome yet normalized view of large percentages of distributors ending in a financial loss position.²²

The two horizontal and two vertical axes in Figure 2 show the relationship between: 1) percent of Active Distributors and Average Monthly Earnings (e.g., 81% of Active Distributors earned “\$0” average monthly compensation; .2% (i.e., .002) of Active Distributors earned \$37,474 average monthly compensation – read top horizontal to bottom horizontal axes), 2) Active Distributors as a percent of All Distributors (e.g., 81% of Active Distributors equal 35.27% of All Distributors;

¹⁷ TruthInAdvertising.org. 2017. “DSA Companies’ Income Claims.” Accessed May 1, 2022.

<https://www.truthinadvertising.org/mlm-income-claims-database/>

¹⁸ Wotruba, Thomas R. 1995. “Moral Suasion: Development of the U.S. Direct Selling Association Industry Code of Ethics.” Direct Selling Education Foundation. Washington D.C.

¹⁹ Bartlett, Richard C. (1995), “Ethics: Mary Kay’s Foundation,” *Journal of Business Strategy*, 16, 4: 16.

²⁰ Rotfeld, Herbert J. (1997), “Book Review: Moral Suasion: Development of the U.S. Direct Selling Association,” *Journal of Public Policy & Marketing*, 16, 1: 187.

²¹ BBB National Programs. n.d. Direct Selling Self-Regulatory Council. Accessed May 4, 2022.

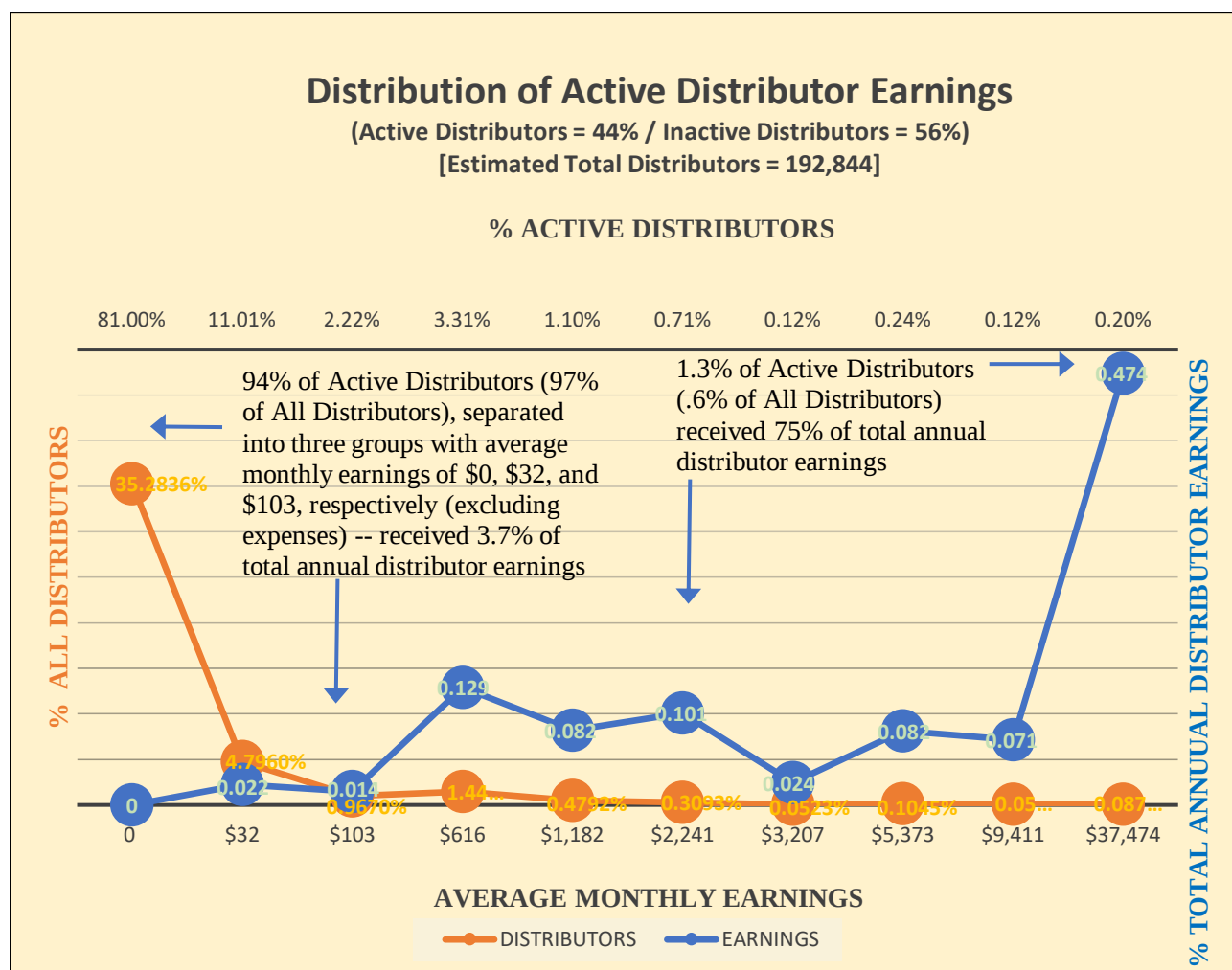
<https://bbbprograms.org/programs/all-programs/dssrc>

²² NU SKIN. n.d. “COMPENSATION VELOCITY BY NU SKIN.” Accessed May 1, 2022.

https://www.nuskin.com/content/nuskin/en_US/corporate/compliance-corner/compensation.html

.2% (i.e., .002) of Active Distributors equals .09% (i.e., .0009) of All Distributors – read top horizontal to left vertical axes), and 3) percent of Active Distributors and percent of Total Annual Compensation (e.g., .2% (i.e., .002) of Active Distributors earned 47.4% of Total Annual Compensation – read top horizontal to right vertical axes).

Figure 2



Active Distributors are defined as Distributors “who either made a personal purchase, sponsored another account, or received a Sharing Bonus during the most recent three-month period.” The company reports average monthly compensation to all Active Distributors to be \$160.05; however, 94% of Active Distributors received average monthly compensation of \$6.17, excluding expenses. Even modest expenses put 94% of Active Distributors in a financial loss position, excluding required product purchases.

The Commission long recognized the potential for consumer harm within the MLM industry, “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.”²³ And, the “Commission acknowledged that some MLMs do engage in unfair or deceptive acts or practices, including operating pyramid schemes or making unsubstantiated earnings claims that cause consumer harm.”²⁴ And, “The Commission has not made a finding that there is little or no evidence of fraud within the MLM industry; to the contrary, it has specifically recognized, through its own law enforcement experience, that some MLMs may be pyramid schemes in masquerade and may make false and unsubstantiated earnings claims.”²⁵ That misleading claims are a pervasive, ongoing practice within the industry is documented by independent research referenced above and a literal flood of examples documented in journalist inquiry,²⁶ podcasts,²⁷ and social media (examples limited for the sake of brevity).²⁸

Figure 2 actually **underrepresents** the potential of consumer harm from misleading claims. MLM companies experience high distributor turnover year-to-year resulting in a large percentage of distributors ending with a financial loss – earning little or no income while incurring expenses (e.g., “we experience high turnover among our sales force from year to year...our Sales Leaders in Mainland China declined 46%.”²⁹ Give their annual earnings, top earners have an incentive to persist year-after-year. Thus, a multiyear view would show the large percent of total annual compensation paid going to a fraction of the low percent of Active Distributors indicated above.

Can a disclaimer help solve the problem? No.

[Q 13] No. Research on mandated disclaimers show them to be ineffective and potentially harmful.

[Q 14] In both verbal and written communications, representatives and top distributors of an MLM company may state that earnings claims do not guarantee a result or represent the experience of some distributors. I urge the Commission that any evidence presented, in answer to this question, be viewed within a broad context of the communications directed at current and potential MLM distributors. The “net impression,” a standard familiar to the FTC, goes beyond individual statements or disclaimers. For example, an upline distributor making an explicit earnings claim disclaimer may be the same person who assures downline distributors that success is just around the corner, while never recognizing the upline distributor’s inherent financial interest in retaining the distributors to keep them trying and buying.

²³ Federal Trade Commission. 2004. “Staff Advisory Opinion - Pyramid Scheme Analysis.” Letter to Mr. Neil H. Offen, President Direct Selling Association. January 14.

²⁴ Federal Register. Rules and Regulations. Vol. 76. No. 236. December 8, 2011: 76822.

²⁵ Federal Register. Rules and Regulations. Vol. 76. No. 236. December 8, 2011: 76823.

²⁶ Bond, Casey. 2021. “MLMs Are A Nightmare For Women and Everyone They Know.” *HuffPost*. January 29.

²⁷ Keep, William. 2022. “An MLM Expert On What Everyone Needs To Know About MLMs.” Interviewed by Chelsea Fagan, *The Financial Diet*, February 21, 2022. <https://www.youtube.com/watch?v=afNT9yJ8A8Y>

²⁸ The Recovery Hunbot. Youtube. Accessed May 6, 2022. https://www.youtube.com/channel/UCX8b5D9_f7vMHG1paZ74psA

²⁹ Nu Skin. 2022. Form 10-K. Fiscal year 2021. Filed with the United States Securities and Exchange Commission. February 16, 2022: 29.

[15] A new rule should explicitly prohibit the use of disclaimers or other efforts that detract from meaningful data illustrating the typical distributor experience, rank retention or earnings persistence, or typical expenses.

Support

Mandated disclaimers have been used in a wide variety of situations, from product safety to health and wellness to financial risk and return. Here I reference two academic papers, one study of disclaimers used regarding financial risk and return and the other regarding disclaimers used in advertising. Similar studies can be readily found.

In a study of the SEC mandated disclaimer regarding mutual funds the authors found: “The SEC requires these advertisements to contain a disclaimer warning that past returns don’t guarantee future returns and that investors could lose money in the funds. This article presents the results of an experiment that finds that this SEC-mandated disclaimer is completely ineffective. The disclaimer neither reduces investors’ propensity to invest in advertised funds nor diminishes their expectations regarding the funds’ future returns. The experiment also suggests, however, that a stronger disclaimer – one that informs investors that high fund returns generally don’t persist – would be much more effective.”³⁰

The authors described the SEC-mandated disclaimer: “The disclaimer is weak; it provides no new information to investors. It merely informs them that past returns don’t *guarantee* future returns and that they could lose money on their investment.” In addition to the mandated disclaimer they also tested a stronger disclaimer and found, “Indeed, we find that a stronger disclaimer – one that warns that high past returns usually do not persist – is much more effective.” In other words, a strong disclaimer conveyed information that gave a more realistic view of the investing experience. It did not simply state investors “could lose money” but instead stated that “past returns usually do not persist.” Thus, they provide some support for using a mandated, more information-rich disclaimer. However, as far as I know, their stronger language: a) has not been tested beyond the experimental design and b) has unknown industry support.

Authors of the second study looked at mandated disclaimers in advertising and found, “We then examined evidence from 18 experimental studies related specifically to mandatory disclaimers. In all cases the mandatory disclaimers caused confusion among consumers. Mandated messages increased confusion in all, and were ineffective or harmful in the 15 studies that examined perceptions, attitudes, or decisions. Quoting Supreme Court Justices Thomas and Ginsburg, “If the disclaimer creates confusion, rather than eliminating it, the only possible constitutional justification for this speech regulation is defeated.”³¹

Should any proposed rule address the issue of lifestyle claims? Yes.

[16] Lifestyle or atypical earnings representations serve no purpose other than to facilitate recruitment and retention. Atypical stories or data serve only to pervert the distributor’s or prospect’s understanding of the opportunity.

³⁰ Mercer, Molly, Alan R. Palmiter, and Ahmed E. Taha. 2010. “Worthless Warnings? Testing the Effectiveness of Disclaimers in Mutual Fund Advertisements.” *Journal of Empirical Legal Studies*. 7, No. 3 (September): 429-459.

³¹ Greem, Kesten C. and J. Scott Armstrong. 2012. “Evidence on the Effects of Mandatory Disclaimers in Advertising.” *Journal of Public Policy & Marketing*. 31, No 2: 293-304.

[17] A new rule should explicitly prohibit all forms of lifestyle claims and atypical earnings representations.

Support

All lifestyle claims and non-typical earnings representations should be prohibited. Both types of representations implicitly correlate participating in the business opportunity with extreme, life-changing, atypical outcomes. The current distributor or prospective faces a dilemma: 1) believe the representation to be relevant and the correlation meaningful, 2) adopt the view that even efforts that fall short of the representation will still be financially rewarding, or 3) deny the relevance of the representation.

Verifying the representation does not resolve the dilemma as the path used to achieve the represented lifestyle may or may not be a path open to the current distributor or prospect. For example, early entrants in an MLM may have international downlines created and developed when the MLM entered a new country. The munificence offered by the newly opened market will not be the same for later distributors. Furthermore, a verified representation provides no information about the correlation between the current opportunity and past success (e.g., two positive correlations – .95 and .05 – have very different implications). Those sharing such representations may downplay this unknowable correlation by saying that “anyone” or “everyone” can achieve this level of success.

Finally, a current or prospective distributor may assume that while the representation is atypical, there are many levels of success. Such an assumption is explicitly reinforced by the ranking structure found in many MLM companies. However, that misleading reinforcement can easily result in a financial loss. Data on the number of distributors who achieve a rank may be public; data on those who sustain at that rank is not. Judging the probability of success in an MLM will remain opaque as long as rank retention or rank persistence remains confidential. A chart of MLM distributor earnings data shows the distribution of annual distributor earnings rise dramatically on the far end with only a fraction of a percentage of distributors receiving a very large percent of total annual earnings (Figure 2, blue line). The actual distribution of earnings does not support the assumption of many levels of success. In fact, if top earners persist year-after-year then the effect becomes even more extreme in a multiyear analysis.

Can a required disclosure with earnings information help solve the problem? Yes.

[Q 10] Yes, a rule should clearly define the format for making earnings claims as to the “typical” or “likely” distributor experience (terms familiar to the Commission in this context) and ALL claims should comply with that format. Any earnings claims (e.g., checks, etc.) presented in the absence of data that complies with the rule-determined format should be considered a violation of the rule.

[Q 11] Yes, a rule-determined format would require substantiation. As described below, the recordkeeping requirement imposes minimal new costs and delivers industry-changing consumer benefits. The new costs are largely born by the parent MLM company, not individual distributors.

[Q 22] The new rule must require the prominent and ubiquitous display of earnings data before a prospective distributor commits to undermine efforts during the recruitment process that deny, dismiss, or denigrate the typical distributor experience. Disclosures also must be clear that to qualify for earnings, distributors must maintain their own purchase behavior.

Support

Distributor earnings derive from distributor purchases whether or not those purchases result in sales to what the Commission refers to as “real customers,”³² a definition, that despite decades of case law, the DSA³³ refuses to accept and poorly refutes.³⁴ Thus, downline distributor purchases drive upline distributor earnings and represent the key revenue for the MLM company. As the payout of earnings to distributors comes from the MLM company, records must be kept for multiple years to comply with state and federal tax laws. These distributor-specific data must be retained and readily available. A new rule establishing a format for reporting these data can, along with other requirements, reduce misleading earning claims and improve consumer protection.

A new required distributor earnings format could take many forms but whatever the form, the goal of providing clear information on the typical distributor experience remains. The use of averages, now common among MLM companies, obscures distributor earnings data in three ways: 1) the method and interval for aggregating data to determine averages varies across companies and even within a company across years (e.g., see Herbalife’s Summary of Average Gross Compensation in 2015³⁵ and 2020³⁶), 2) averages hide the underlying highly skewed distribution of earnings, and 3) averages provide no information on top earner persistence.

Top earner persistence is the degree to which the same individuals occupy top earning positions within the MLM. For example, if 152 of the approximately 168 individuals with average monthly earnings of \$34,474 (Figure 2) occupied the same top earnings position in the previous year, top earner persistence would be 90% (152/168). Top earner persistence reveals the degree to which top earnings remain with the same individuals or, alternatively, go to new individuals. To begin to understand the typical distributor experience and the path toward higher earnings, current distributors and prospects need all three pieces of information across multiple years.

The format for presenting existing distributor earnings data need not be complex. A line chart or histogram with rule-determined intervals (based on raw numbers or percentage of distributors) can provide a visual view of cumulative annual distributor earnings. A line chart or histogram with rule-determined intervals (based on raw numbers or percentage of length of time as

³² Federal Trade Commission. Business Blog. 2017. “Redress checks and compliance checks: Lessons from the FTC’s Herbalife and Vemma cases.” January 10.

³³ Direct Selling Association. 2017. “‘Lessons’ from the FTC for Direct Sellers – DSA Observations. January 11.

³⁴ To emphasize distributor purchases for their own consumption, the DSA argues that distributor purchases are analogous to the purchases made by salesclerks working in a retail store who purchase and wear the apparel they sell. In order for the analogy to fit, salesclerks would derive their earnings not from an hourly wage or commissions on sales to customers unaffiliated with the retail store but, instead, from the purchases of other salesclerks, which would then incentivize salesclerks to encourage purchases by other salesclerks. The analogy imagines a retail store where “real customers” can be incidental to the business model.

³⁵ Herbalife. 2016. Summary of Gross Compensation Paid By Herbalife to U.S. Members 2015. Accessed May 6, 2022. <https://seekingalpha.com/uploads/2016/4/17/4874239/15avggrosscomp.pdf>

³⁶ Herbalife. 2021. Summary of Gross Compensation. Based on 2020 earnings Accessed May 6, 2022.

https://assets.herbalifenutrition.com/content/dam/regional/nam/en_us/consumable_content/marketing_materials/guides/2020/10-Oct/Statement_of_Average_Gross_Compensation_USEN.pdf/_jcr_content/renditions/original

distributors) can provide a visual view of cumulative annual distributor earnings based on longevity. A line chart or histogram with rule-determined intervals of the percent of distributors maintaining their cumulative annual distributor earnings from the previous year can provide a visual view of top earner persistence. Because of the skewed distribution of distributor earnings, the reporting format should provide more narrow intervals of data for top earners (e.g., as in the reporting of household income,³⁷). Current distributors and prospects should have access to charts showing distributor earnings data and top earner persistence for each of the past three years. All charts will also include numerical data and the basic statistics of mean, median, and mode. Technology can be used to provide multiple years of data, and the accompanying charts in a single interactive visualization (e.g., pivot tables).

To ensure conformity, the new rule will define what criteria determine an “Active” distributor (information use for the data charts) and require a chart of the percentage of distributors who become “Inactive” each year based on longevity. The distributor “churn” rate should be clearly evident. Statements regarding earnings from sales to customers unaffiliated with the MLM by the typical distributor (e.g., using an interval described above) need supporting documentation.

Finally, a new rule-determined expense survey administered every three years by an independent organization will provide insight into typical distributor expenses. This information will be reported with the required earnings data and can similarly be integrated into a single visualization of earnings, expenses, and profits. Collecting expense data represents the only information requiring a new ongoing expense. All data other than expense data currently exists within the MLM. While formulating the data according to new rule standards will require person hours, the effort for producing the revised format will not likely exceed that expended on current opaque distributor earnings statements, compensation claims, and disclaimers.

A note about types of expenses. The proposed expense survey serves to provide estimates of distributor out-of-pocket expenses when maintaining Active status (i.e., eligible for earnings). No such data currently exists. However, equally less clear is the obligation to make ongoing purchases. Statements such as “There is no cost to become a Nu Skin Brand Affiliate and no required purchase of products or kits³⁸” that appear under the heading “Compensation” belie the fact that distributors are required to make or generate purchases by other distributors to be eligible for earnings. A new rule needs to clearly prohibit language designed to dispel or deny the linkage between ongoing purchases and earnings eligibility.

Should published industry earnings data and statistics be prohibited? Yes.

[Q 21] No. Eighteen years ago the Commission tried producing “guidance” for the industry with a communication that arguably produced more negative than positive outcomes.³⁹ The question references legal compliance. If Commission guidance could help MLM companies produce “lawful earnings claims” what law would be relevant? Non-mandatory disclosures produced under Commission guidance will undermine efforts to protect consumers.

³⁷ Congressional Budget Office. 2019. Projected Changes in the Distribution of Household Income, 2016-2019. December. Accessed May 6, 2022. <https://www.cbo.gov/system/files/2019-12/55941-CBO-Household-Income.pdf>

³⁸ NU SKIN. n.d. “COMPENSATION VELOCITY BY NU SKIN.” Accessed May 1, 2022.

https://www.nuskin.com/content/nuskin/en_US/corporate/compliance-corner/compensation.html

³⁹ Federal Trade Commission. 2004. “Staff Advisory Opinion - Pyramid Scheme Analysis.” Letter to Mr. Neil H. Offen, President Direct Selling Association. January 14.

[Q 24] Yes. The practice of permitting non-mandatory earnings disclosure statements open the door to confusion, misinformation, misinterpretation, and manipulation. Figure 2 above and the related analysis are presented as evidence of harm based on a non-mandatory earnings disclosure. Rather than document success, the disclosure makes opaque the typical distributor experience and the large percentage of distributors that annually end up in a financial loss position.

[Q 25] Yes. Inconsistency across the MLM industry and changing versions over time within an MLM company (see footnotes 35 and 36) demonstrate the need for a rule-determined format and the prohibition of non-mandatory earnings disclosures based on industry or firm data. The new rule should similarly prohibit all other forms of personal statements of success and lifestyle claims.

Can a rule on earnings claims provide benefits that exceed the costs to businesses? Yes.

[Q 12] For many years MLM companies have claimed an inability to ensure distributor compliance – that the cost was prohibitive. For example, “As result, there can be no assurance that our Members will participate in our marketing strategies or plans, accept our introduction of new products, or comply with our Members policies and procedures,” a statement filed annually with the SEC by Herbalife.⁴⁰ The argument tipped the cost/benefit equation toward too much cost and too little benefit, an argument accepted by the Commission in 2011: “The Commission’s decision to narrow the Rule so that MLMs would not be burdened with unworkable disclosure requirements was similarly prompted by concern that any potential benefits would be outweighed by compliance costs. *Id.* at 16119–21.”⁴¹

As described above, underutilized available internal data can improve the quality and presentation of distributor earnings information. A new rule can provide consumers with data formatted for the express purpose of illustrating the typical distributor earnings, expenses, and profits, year-after-year. In addition, compliance can be shifted from being complaint-driven to being proactive. For example, each current and prospective distributor can be required to view and interact with a brief training program that would present information and test distributor knowledge of the new distributor earnings statements described above. Such online training is increasingly common across a variety of compliance situations. The Commission can use penalties and/or a statement of assurance signed by the CEO of the MLM to induce proactive monitoring.

[Q 26] Federal and state laws, rules, and existing case law on various acts of deceptive marketing apply to all businesses (unless there exists a specific carve out exempting small business that I am unaware of). In many industries examples can be readily found where competitor or consumer complaints triggered an enforcement action. Pervasive, ongoing, and harmful misleading statements, whether about products or earnings claims effectively means that all MLM companies and top distributors live in glass houses. It is not in their or the industry’s best interest to throw stones at another firm nor to openly display behaviors that might be viewed as

⁴⁰ Herbalife. 2022. Form 10-K. Fiscal year 2021. Filed with the United States Securities and Exchange Commission. February 23, 2022: 21.

⁴¹ Federal Register. Rules and Regulations. Vol. 76. No. 236. December 8, 2011: 76828.

in flagrante delicto. When it comes to legal compliance, unlike other industries, we do not see in the MLM industry the positive impact of competitive self-interest.

[Q 27] Because MLM distributors: a) represent a primary source for MLM company revenues and upline rewards and b) will turnover at a high rate, retention remains a top priority. Retaining distributors keeps them trying and buying. Therefore, retention efforts that range from events to trainings to coaching provide opportunities to again misrepresent the typical distributor experience. These activities should also be subject to under a new rule as compliance will increase the benefits of imposing the rule.

[Q 28] Technology opens the opportunity to improve consumer awareness and compliance. In general, marketing communications have become more targeted, more customer-specific. This has long been the case in the MLM industry. Technology allows for targeted messaging (as opposed to public service announcements and warnings) to be delivered to consumers prior to them making a decision. The Commission should use the same technology tools to protect consumers as are being used to harm consumers.