Facts and Analysis

Utah Legislature Passes Pyramid Scheme "Safe Harbor" Amendments

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PYRAMID SCHEME ALERT

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Product-based pyramid schemes have become a major Utah export

Two and two now equals five – at least in Utah, where chain-selling schemes have become a leading export. With a new bill amending Utah's Pyramid Scheme Act, these schemes now have state protection in Utah, similar to the protection that has been provided – de facto – by the government of Nigeria to the notorious Nigerian scams.

On February 17, the President of the Utah State Senate signed a bill (SB 182 – "Direct Sales Amendments") that effectively nullifies Utah's Pyramid Scheme Act, at least as it applies to the most damaging of all the classes of pyramid schemes – product-based programs that have proven to cause financial loses to over 99% of participants. This extraordinary loss rate has been documented in at least four separate independent investigations. The financial harm is mathematically pre-determined by the scheme's multi-level and recruitment-based structure and operation.

These schemes have proliferated in Utah to the point that the state holds a commanding lead over all other states in per capita sponsorship of multi-level marketing (MLM) programs, with pay plans that primarily reward recruitment of participants as customers and in which relatively few products are legitimately sold on a retail basis to end users. In fact, Utah County has the highest concentration of MLM schemes, with no county in the country holding even a close second place.

The vast majority of victims of Utah-based schemes are not in Utah, but in other states and countries. Approximately 85% of revenues of Nu Skin, for example, which is one of the nation's largest MLM's based in Utah, are from Asia. When Utah Governor Jon Huntsman, Jr., signs the bill on February 27, victims will only have protection against the classic, no-product pyramid scheme, such as the "gifting schemes" – which have never been a Utah-based export.

In fact, a Nu Skin company spokesman at the hearings claimed the "direct sales" (actually "MLM") industry brought in four times as much revenue as the ski industry, for which Utah is famous – and which was highlighted at the 2002 Winter Olympics.

This may be good for Utah in purely monetary terms, but ignores the financial harm to people in other states and around the world caused by the Utah-based schemes. It also ignores the further damage caused to Utah's reputation – already being called the "scam state" – for its affiliation with pyramid selling schemes.

Washington-based DSA Lobbies for Changes in Pyramid Laws

Utah Senate Bill SB182 was initiated by the Direct Selling Assn. (DSA), which has been essentially taken over by the network marketing (or MLM) industry and has been lobbying from state to state and even in Congress to take the teeth out of laws against pyramid schemes – at least as they apply to product-based programs, where investments in the schemes are laundered through what appear to be legitimate product purchases. The clear purpose for those who understand DSA's tactics is to protect their member MLM companies from being prosecuted for violations of statutes against pyramid schemes.

DSA membership has included some of the most notorious of pyramid schemes, including Equinox International and Trek Alliance,* which were prosecuted and shut down by federal and state (other than Utah) prosecutors. DSA lobbyists and communicators go to great lengths to re-classify multi-level or endless chain selling programs as legitimate "direct selling" programs, *even though with the DSA-influenced legislation, little if any direct selling is required. Indeed, most of the MLM companies in DSA engage in little actual "direct selling." The products of the member companies are purchased primarily by newly recruited sales representatives ("distributors", "consultants", etc.) in an endless chain of recruitment. The recruits seldom resell the goods to non-participating end users, but instead seek to recoup their investment by recruiting other "downline" participants in the chain who will buy goods and services to "play the game."*

The DSA has successfully influenced some regulators, legislators, and many in the media and the general public into believing that these chain-selling schemes are profitable and viable, despite their verified record of causing 99% loss rates among participants. In Utah, with only a handful of dissenting votes, SB 182 passed both houses of the legislature.

Among other tactics, the DSA has engaged in the web version of identity theft, registering alternate name extensions of web sites critical of their programs and then redirecting web surfers to the DSA site and its skewed definition of pyramid schemes, exempting MLM's.

The numbers demonstrate the harm by MLM or chain selling schemes.

Recent studies demonstrate that product-based (MLM) schemes are the worst of all pyramid schemes by virtually any measure – loss rate, aggregate losses, and number of victims. Four separate studies by three independent researchers (not connected to the DSA or any MLM) have established that the percentage of participants who lose money is over 99% – even as much as 99.9% in one report using the MLM companies' own published statistics.

The loss-rates of no-product pyramid schemes, such as the infamous "Women Helping Women" and other "gifting schemes" that recently swept the country approximate 90% loss rates. So one has at least ten times the likelihood of gaining a profit from these obvious scams (which are illegal under SB 182) as from a "recruiting MLM" program (which rewards recruitment over actual sales of products to end users) " – which gets a pass under SB 182.

Studies on the (lack of) profitability of MLM programs are available at::
www.mlm-thetruth.com (Several reports are linked from the MLM research and numbers pages)
and
http://www.pyramidschemealert.org/PSAMain/news/MythofMLMIncome.doc.pdf

The main deception that seems to be common to all product-based pyramid schemes is the presentation of the MLM as a "business" or "income opportunity," while the odds of profiting are so abysmally low. This would be analogous to placing signs above gaming tables in Las Vegas with these words in big and bold type: "Business Opportunity" or "Opportunity of a Lifetime." As with gambling, MLM is an opportunity only for the "winners." In MLM, the "winners" are those who are pre-positioned at or near the top of their respective pyramids – or who by employing aggressive and misleading recruitment tactics manage to recruit a large and continuously churning downline of participants, over 99% of whom lose money.

As harmful as recruiting MLM's may be, it is apparent that few participants in these programs are aware of the harm they are causing. And most of the victims are tactically led to believe their losses were "their own fault." We find even top officials in extreme denial about the verified losses their programs are causing.

If there is a villain, it is the inherently uneconomic nature of all endless chain selling schemes, which produce the losses by their design and promotion.

Utah has found a substitute for gambling used by other states as a source of revenue

We have observed addictive behavior among some compulsive MLM participants akin to gambling addiction. Compulsive MLM "addicts" have been called "MLM junkies." Indeed, we see MLM as problematic as gambling – even worse, in some respects. Legalized gambling in the U.S. is regulated, but MLM typically is not – or not enforced. Also, persons who gamble usually know they are gambling, while promoters of MLM programs are allowed to promote them as offering "permanent income" or "residual income that will free you from having to work – ever again." "Time freedom" is the mantra at MLM opportunity meetings.

Yet strangely, Utah is only one of two states with legislatures that stand foursquare against gambling, even if it were to enhance state revenues. But statistics from leading MLM companies show a loss rate among MLM participants far worse than for playing craps or roulette in Las Vegas.

In a survey of all the tax preparers in one county in Utah where 6% of the population participates in MLM, there were *no* MLM participants in 2002 who had reported a profit in any recruiting MLM. However, during that same year, over 300 persons had reportable profits from gambling. In Utah County, where MLM is highly concentrated, some top-of-the pyramid promoters were making as much as a million dollars a month!

So the lack of revenue from any state-sponsored lottery is more than replaced in Utah by revenue from out-of-state victims of Utah-based endless chain MLM schemes.

At the legislative hearings, the sponsors of SB 182 stressed how much revenue came into Utah from these MLM companies, as well as the jobs to support their operations. No mention was made of the millions of

victims worldwide who have suffered losses from the recruitment campaigns of their promoters.

Among some consumer activists, Utah is referred to as the "scam capital of the world" – usually in reference to product-based pyramid schemes. SB 182 gives that reputation statutory support. For example, Nu Skin, the largest of Utah's chain selling schemes, enjoys the unique distinction of having been fined by the FTC two times for more than one millions dollars for making deceptive income or product claims to recruits.

How SB 182 weakens Utah's Pyramid Scheme Act

The existing Pyramid Scheme Act (Title 76) specifies that in a pyramid scheme, "a person gives consideration to another person in exchange for compensation or the right to receive compensation which is derived *primarily* from the introduction of other persons into the sales device or plan rather than from the sale of goods, services, or other property." This suggests that if compensation is derived from sales that are *primarily* to downline participants recruited into the scheme and not from legitimate retail sales by the participants to end users, it is an illegal pyramid scheme. SB 182 turns that language around by specifying: "'Compensation' does not include payment based on the sale of goods or services to *anyone* purchasing the goods or services for actual personal use or consumption" (meaning the newly recruited participants can be induced or incentivized to buy the goods without ever having to resell them to retail customers.)

Under this wording, the workings of a product-based pyramid are magically legalized. The purchase of goods and payments of fees serve as "Consideration" that the participants pay for joining. For making these payments, the participant gains "the right to receive compensation which is derived *primarily* from the introduction of other persons into the sales device." Based on the recruitment of new participants and their subsequent purchase of goods and services to "play the game,", the recruiter is compensated with commissions and bonuses. No real customer base is established.

These "incentivized" sales to newly recruited participants are the engine that drives the schemes. The scheme can be a closed system at fixed prices in which the currency for joining and the compensation paid out for recruiting are based primarily on the participants' own purchases of the scheme's products.

This kind of scheme violates Utah's existing Pyramid Scheme Act, but is "perfectly legal" with the amendments in SB 182. The wording actually facilitates the harmful consequences that the existing law sought to prevent, i.e., the losses suffered by 99% of the participants who are doomed – by the scheme's design – to lose money.

Closed Door Maneuverings: What happened at the legislative hearings

SB 182 was "protected" from public scrutiny until the very last day for "numbering," then rushed to committee hearings in two days, obviously to limit input from experts and consumers who could be affected.

The bill was misrepresented to both the Senate and the House as providing added protection to consumers against the worst schemes. In fact, the bill has the opposite effect, as explained above, by using the word "anyone" instead of "non-participants."

Utah's top law enforcement official, Attorney General Mark Shurtleff, came out in support of the bill. He argued, contrary to the facts, that one of the distinguishing features of illegal pyramid schemes was the lack of legitimate products. This may have been a valid argument 30 years ago when product-based schemes were less common. In all cases more recently, the largest and most harmful of all pyramid schemes that have been prosecuted – Equinox, Trek Alliance, International Heritage, etc, among many others – offered legitimate products or services as their form of "paying consideration." The existence or quality of the products is, today, irrelevant to the analysis. Some of Attorney General Shurtleff's top contributors were the very companies that would benefit the most from SB 182. ** Their operations would no longer be in jeopardy of violating the state's anti-pyramid scheme statute.

Also, both the present and former directors of the Division of Consumer Protection supported the statute change. Why would the top directors of consumer protection favor SB 182? One possibility would be that they would no longer have to endure criticism for failure to enforce the existing statute. The current law takes aim at any MLM in which few products are ever retailed to end-users. The products are purchased almost solely by a revolving door of new recruits, resulting in an endless chain recruitment scheme, not a business of "direct selling." Many such schemes operate with impunity in Utah today. With SB 182, not only are multi-level marketing companies safe from future prosecution, but also the Division of Consumer Protection would be "off the hook."

Additionally, at the House committee hearing, the position of the Federal Trade Commission was blatantly misrepresented by the DSA representative on

this issue* – with no opportunity to correct the falsehoods before the committee voted.

A co-sponsor of the bill expressed his concern that he "had a problem with protecting people from themselves." So why have consumer protection laws or anti-fraud statutes at all? It would be interesting to see if he would take the same stance if he had lost most of his money in the Enron or WorldCom debacles. Would he blame himself for having made the investments he was told were solid?

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With SB 182 in effect, be suspicious of any schemes coming out of Utah!

As Bruce Craig, former Assistant Attorney General in Wisconsin, warned in a letter to Utah Senators:

This [SB 182 bill] is a package deal set up by those who want to legalize pyramids . . .. If you want to pass the bill, do it. However, you shouldn't be allowed to pretend that you were unaware of the adverse economic consequences that will be visited upon Utah citizens [and outsiders] by this legislation. Having spent 30 years litigating consumer pyramid cases, and dealing with related legislation, I am familiar with the legal deficiencies of SB 182, the significant damage caused by pyramids, and how some legislation is passed . . . *"The only remaining matter for consideration is whether anyone will hold the Utah legislature accountable for what is about to happen. This may well be the case only after a scandal or some public outcry."*

As Dr. Jon Taylor of the Consumer Awareness Institute (a Utahn and and one of our advisors) lamented after his hard fought efforts to reveal the misrepresentiation that were being used to promote SB 182: :

"Many of our pioneer ancestors sacrificed their all to establish settlements here in the Rocky Mountains where they could be safe to practice their religion without the constant persecution they left behind. *One of the primary tenets of these pioneers was: 'We believe in being honest . . . ' (Article of Faith #13)*

"I fear we have been corrupted and deceived into accepting pyramid schemes as a primary export to enrich our coffers. Passage of SB 182 deeply saddens me. My pioneer ancestors would not have been pleased to see what is happening here."

***** One of the most notorious pyramid schemes of all time was Equinox International, a fraudulent MLM pyramid scheme (among others) that was a member of the DSA, which is the main lobbyist for SB 182. Equinox was a classic recruitment-based MLM in which the salespeople themselves were the primary customers of the scheme, with little or no legitimate retail selling taking place. It took 8 states (Utah was not among them) working together with the FTC to shut Equinox down. For the purposes of definition in that case, the FTC wrote " 'sale of products or services to ultimate users' does not include sale to other participants or recruits in the multi-level marketing program or to participants' own accounts." The word "anyone" now used in Utah's SB 182 contradicts this usage and actually opens the door for the very abuse and fraud that Equinox was prosecuted for by the FTC. The buyers are led to believe they are buying a "business opportunity," when in fact over 99% lose money, as subsequent statistical studies of large MLMs have documented.

** Public disclosure of contributions for Mark Shurtleff (http://globe.utah.gov/allcont/allcont.aspx?CandidateID=941&sort=name) shows at least $72,000 contributed by the DSA, which intiated and lobbied for SB182, and MLM companies directly affected by it. The largest single corporate contributor to Mr. Shurtleff is the MLM company Pre-Paid Legal ($50,000 in contributions). PPL is currently the subject of a "sweeping investigation" by the Connecticut Attorney General's office and in recent months was ordered by a jury to pay over $9 million in damages to distributors who charged deception. PPL is the MLM company that has been accused of operating a pyramid scheme and sued by investors and distributors more often than any other MLM in the country,
Alticor, parent company of Amway is a major contributor. This company has been prosecuted and fined by the FTC for price fixing and deception. It was the subject a 2004 exposé on *NBC Dateline* which revealed extensive misrepresenation of income claims. A controversial decision by an FTC Administrative Law Judge laid down retail requirements on MLMs which SB182 seeks to supercede.
Nu Skin which contributed $5,000, has been fined twice by the FTC for more than $1 million for deception in income and product claims.