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Edith Ramirez, Chairperson
Jessica Rich, Director, Consumer Protection Division
US Federal Trade Commission

June 6, 2016

Dear Ms. Ramirez and Ms. Rich,

As president of *Pyramid Scheme Alert* and a co-founder of *International Coalition of Consumer Advocates*, I urge you and your colleagues at the FTC to act decisively and effectively in enforcing anti-fraud laws and related court rulings on unfair and deceptive trade practices against Herbalife International and other similar “multi-level marketing” companies.

PSA and ICCA represent the largest and most enduring non-profit and non-governmental resource of public interest research and analysis, documented consumer experience, court-room testimony and litigation, and advocacy for regulation of “multi-level marketing”, of which Herbalife is one of oldest and largest representative enterprises.

Please note: I am not financially involved with Herbalife and hold no financial interest in it or in any other “MLM”. I am not associated with or compensated by any company or investment proposition related to Herbalife or any other MLM. I offer my knowledge and experience to the FTC on matters related to MLM or Herbalife in particular at any time without charge.

As the FTC considers a possible settlement or a possible lawsuit, the facts and the scale of Herbalife’s deception and harm show that a financial disgorgement fine alone is an insufficient measure against *future* harm. Additionally, measures to require greater disclosure of the nearly 100% loss rates among the newest recruits in Herbalife are inadequate and are virtually impossible to monitor. History has shown that all such after-the-harm-is-done measures involving “complex financial analysis” and remedies that require extensive monitoring do not and cannot address the regulatory challenges posed by Herbalife and similar “MLMs.”

The public interest can only be protected by the FTC’s proactively addressing the fundamental elements of pyramid fraud that are built into Herbalife’s business model as well as in those of similar enterprises.

Pay-to-Play

This letter focuses on one such fundamental element – *the payment of consideration for the right to recruit and receive rewards based on the recruiting, commonly called “pay to play.”* In identifying pyramid schemes operating as “MLM”, the factor of who the “ultimate end user” is has been an FTC criterion for revealing the source of funds for recruiting-related bonuses and identifying the “pay to play” pyramid element. This so-called “retail” criterion, despite its importance to the FTC for identification and prosecution of MLM-style pyramids, is obscured in all MLM enterprises by deliberate policies of not keeping records of distributors’ retail sales transactions and with legal arguments and public claims that *wholesale* transactions *inside* their marketing chains are the same as open-market retail sales.

Such obstructions and confusion of terms and transactions have made pyramid-fraud determinations based on percentages of retail sales outside the marketing plan or on the purchasing “motives” of those inside the marketing plan virtually impossible and rendered this criterion virtually useless for consumer education or for regulatory purposes. The public is left confused and unprotected from MLM predators and unable to identify fraudulent MLMs.

Recommendation

A different approach is needed and is feasible. This approach is to regulate the unfair and deceptive *means* employed by Herbalife and other “MLMs” of obtaining funds from individual participants in the first place

that are facially tied to gaining or increasing recruiting-related bonuses. The means used by Herbalife and other MLMs are *effective purchase requirements*, in the form of *personal purchase quotas*.

The recommendation for regulation of Herbalife and other similar “MLMs” is that the FTC ban the “pay-to-play” factor, or more specifically, *pay-to-receive-recruiting-based-rewards*, from the Herbalife compensation plan as an inherently unfair and deceptive trade practice. I urge the FTC to prohibit any recruiting-based incentives, quotas or requirements that include *personal purchasing* in “multi-level marketing”, thereby taking away Herbalife’s and similar MLM enterprises’ means to unfairly and deceptively gain payments based on promises of rewards tied to “endless chain” recruiting, aka, *pay-to-play*.

For further explanation of how and why the prohibition of personal volume requirements can effectively prevent pyramid fraud by “multi-level marketing” enterprises please refer to the essay by attorney Douglas M. Brooks published Jan. 29, 2016 in the *Seeking Alpha* forum, entitled Multi-Level Marketing: A Modest Proposal. Please note: *This proposal to ban the “pay to play” element of Herbalife’s compensation plan is not intended as a comprehensive approach or to preclude other regulatory actions by the FTC.*

Suggested FTC Language

As Herbalife offers all participants in its marketing plan the opportunity to gain payments that are facially related to unlimited and endless recruiting of new participants into the marketing plan, it may not require purchases or offer financial rewards to participants or impose financial penalties based in any way upon the level of their own personal product purchases that are related to such rewards. Personal purchases also may not be factored, positively or negatively, in the individual participant’s own group volume-based rewards that are tied to recruiting new participants. Personal purchase quotas and incentives, when related to participation in the recruiting-based reward plan, constitute unfair and deceptive marketing practices.

Bright Line

“Payments-to-receive-recruiting-based-rewards” are a defining characteristic – a bright line – of an illegal pyramid scheme when carried on in an “endless recruiting chain” in which funds are transferred from the bottom to the top, *ad infinitum*. Such a plan, fueled by payments from new participants causes and inevitably results in financial losses among virtually all new participants, the proverbial “last ones in.” In a fraudulent “MLM” enterprise, the pay-to-play pyramid trait operates in the form of an *effective requirement to purchase products in order to gain the promised rewards*.

That Herbalife’s and other MLMs’ participant purchases are *effectively required* and are *tied to future recruiting rewards* for the purchaser is obvious and beyond question, i.e., a bright line. Herbalife’s official pay plan includes specified initial purchase levels needed to establish various reward positions and periodic purchasing required for maintaining positions. The *pay-to-receive-recruiting-based-rewards* are presented as *personal purchase quotas*, which can be included in the recruiters’ “group volume” quotas. The resulting practice of Herbalife participants as well as participants in other MLMs making *personal purchases* in order to join the pay plan, prevent losing rewards or to reach higher levels of recruiting-based rewards is well documented.

No Business Defense

Herbalife, like other “MLMs”, provides no protected retail sales territories to any participants and no market support for retail sales activity. To the contrary, Herbalife places extraordinary obstacles against those who would seek to profitably sell its products at retail prices. With its “unlimited expansion” model, financial incentives to recruit other *wholesale* participants and its inherent mandate to increase the total number of participants in all areas without regard for market saturation, Herbalife drastically dilutes and undercuts profitable retail selling opportunity for all existing participants.

A *personal purchase quota* for authorization or maintenance of recruiting-based reward status, therefore, cannot be defended on retail (direct selling) business terms. It is clearly a device for inducing purchases to sustain the recruiting-based reward plan. Personal purchasing quotas fund the recruiting rewards. The income promise of the recruiting-based rewards is inherently deceptive because it is based on the illusory “endless chain.” Herbalife’s disastrous “payout” data verify the recruiting model’s inevitable harmful outcome.

Imposing purchase quotas on authorized distributors in unprotected and continuously diluted markets, and

connecting the quotas to an illusory “endless chain” reward plan constitutes an unfair and deceptive trade practice.

No Effect on Direct Selling or Retail-Based Team Building

An FTC restriction of personal purchase quotas, i.e., *pyramid scheme pay-to-play*, does not inhibit purchasing by Herbalife’s or other participants for personal retail selling, i.e., direct selling, or for any other business or personal purpose. It would also not prevent activities related to recruiting other participants into a personally organized or extended marketing chain on which rewards are based upon aggregate purchases.

The restriction would, however, prevent Herbalife or any other MLM from *inducing or effectively requiring* inventory purchases for joining the recruiting-based reward plan, for maintaining a position in the plan or for increasing rewards under the plan’s terms. Additionally, it would prevent financial penalties related to the recruiting-based rewards for not making personal purchases. A participant’s personal purchasing could not be part of that individual’s own group volume that is a determinant of recruiting-based reward status.

Vemma Court Ruling Concurrence:

The recent federal court order against Vemma, confirmed *effective purchase requirements* as a key element of Vemma fraud and a pyramid scheme hallmark. The personal volume quota that can be met by personal purchasing is what the Vemma court ruling called one of the “*features of Defendant’s Marketing Program and bonus structure that tie bonuses primarily to recruiting and to the purchase of product principally to stay eligible for those bonuses.*” At Herbalife, as at Vemma, higher-level qualification for recruiting-based rewards can be gained right at the onset of participation by making a significant product purchase personally, costing hundreds or thousands of dollars.

Enforcement Challenges:

Though the FTC has maintained that the MLM participants’ “retail” sales, not the MLM participants’ own *wholesale purchases*, must be the main funding source of recruiting-related rewards, no regulatory means exist for ensuring that recruiting-related rewards are actually obtained from purchases ultimately made by consumers who are not in the marketing plan. Indeed, the normal definition of “retail,” and by extension the FTC’s “retail” criterion, are systematically rejected and obscured by the “MLM” industry. A current bill, HR 5230, introduced in Congress and backed by the “MLM” industry, would effectively eliminate this criterion for enforcement purposes. The proposed law would allow *all reward funds* to be funded by “reasonable” monthly purchases made only by those inside the MLM marketing plan, without need for “retail” sales to customers outside the marketing plan and without regard to the current practice of tying personal purchases by MLM participants to recruiting-related rewards.

Banning the unfair and indefensible practice of personal purchase quotas that are tied to the recruiting-based reward plan will prevent the *means* of “inventory loading” or *continuous* pay-to-play policies that induce mounting victim payments. Breaking the link between personal purchasing induced by quotas, incentives and penalties and recruiting-related rewards reduces the need for verifying or measuring retail sales that might or might not follow purchases. A clearly stated prohibition of personal purchase quotas tied to recruiting-related rewards will serve as an immediate, long-term and unequivocal deterrent.

Petitions

Attached to this letter is a spreadsheet of approximately 350 consumers from 34 different countries affected by USA-based MLMs who have *recently* signed and submitted online petitions calling for greater law enforcements and oversight of “multi-level marketing” by the FTC. Over 30 different MLMs are named by the Petitioners. These are submitted in addition to the approximately 1,000 others that were submitted to the FTC in October, 2013. I have redacted street and email addresses for privacy, however, some have expressed willingness to assist the FTC should it seek greater insight into consumer experience. Please take time to review their comments, which reflect the realities of unregulated pyramids operating as “multi-level marketing.”

Sincerely,

Robert L. FitzPatrick, Pres.
PYRAMID SCHEME ALERT