

June 30, 2006

CAI
CONSUMER
AWARENESS
INSTITUTE

A non-profit corporation
291 Ea. 1850 South
Bountiful, UT 84010
Te/fax (801) 298-2425
jonmtaylor@juno.com
www.mlm-thetruth.com

Jon M. Taylor, Ph.D.,
President
Author: *5 Red Flags of a
Recruiting MLM, or
Product-based Pyramid
Scheme, The Network
Marketing Game, et al*

Advisors:

Robert Fitzpatrick, Pres.,
Fitzpatrick Mgmt. Inc. &
Pyramid Scheme Alert
Author: *False Profits*
Charlotte, North Carolina

Douglas M. Brooks, Esq.
Attorney for Victims
of Pyramid Schemes
Gilman and Pastor, LLP
Saugus, MA 01906

Eric Schiebeler, former
federal auditor, Author:
Merchants of Deception

Andrew S. Kneeter, Pres.
A.S.K. Solutions, L.L.C.
Financial consultant
for hedge funds

Loraine T. Pace, Former
State Representative
Logan, Utah

Calvin Welling, Certified
Financial Planner
Ogden, Utah

Anthony Martin
Investment Advisor
Austin, Texas

Ray Carpenter, D.D.S.
Prosthodontist
Poway, California

Max W. Roberts,
Retired Executive,
Former city councillor
Payson, Utah

Plus numerous informal
advisors in government,
academia, law, and
consumer protection

ATTN: Federal Trade Commission/Office of the Secretary,
Room H-135 (Annex W)
600 Pennsylvania Avenue, NW
Washington, DC 20580

RE: Business Opportunity Rule, R511993

Dear Sir/Madam,1

I am writing in response to the proposed New Business Opportunity Rule R511993, which is sorely needed to protect consumers from deceptive pyramid marketing schemes and chain selling schemes (for which I shall use the acronym "MLM" for "multi-level marketing") that have defrauded millions of consumers of tens of billions of dollars – far more than are represented by official complaints received by the Commission – because victims rarely file complaints due to self-blame and fear of self-incrimination or consequences from or to their upline. (See below).

My background and research applies directly to this disclosure rule.

Let me explain why my comments, drawn from over 30 years of education and experience in the field of "business opportunities", should have special relevance for FTC officials. Having taught college classes in management, entrepreneurship, and ethics, and having been a successful salesman and entrepreneur (including sponsorship of an Income Opportunity Show), I was skeptical of chain selling schemes labeled as "network marketing" or "MLM." However, under pressure from respected friends to join various MLM programs in 1994, I decided to do a one-year test of a leading MLM to prove to myself and to others whether or not it was a viable business model. Though I became successful at recruiting and climbing the ladder of distributors (top 1% of all distributors), I was still losing money after a year (I kept detailed records of all costs). It became apparent that to earn the huge income that was promised, I would have to be at or near the top of the pyramid – and deceive people I recruited about the odds of success. So after carefully considering my situation, I quit MLM and decided to tell the world about my experience and my findings. This led to 12 years of research and reporting on odds of "success" in MLM/pyramid marketing schemes. For my vita, go to – <http://www.mlm-thetruth.com/JMTaylorVITA6-6.pdf>

Research on income taxes of MLM participants proves need for disclosure.

I wrote the book *The Network Marketing Game*, which exposed the ethical problems of exploiting and deceiving others for personal gain. While on a speaking tour promoting the book, I got feedback from tax accountants who asked why – with all the promises of MLM promoters of "residual income" – they were not seeing profits reported on tax returns of MLM participants. I decided to interview other tax professionals – almost 300 of them over a period of several years. I also interviewed programmers of tax software and persons involved in seminars for tax professionals. *With a total of over two million tax returns represented, a clear picture emerged of who was making money in MLM – the TOPP's (top of the pyramid promoters), at the expense of huge downlines of participants/victims who lost money.* This seemed to confirm the findings of Bruce Craig, an Assistant Attorney General for the state of Wisconsin in the 1970's. He discovered that net income on tax returns of the top 1% of Amway dealers in Wisconsin was minus \$900!

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My tax study revealed that the profits of MLM companies and of the TOPP's are fed by a revolving door of recruits, an endless chain of participants as primary (and sometimes only) customers. Actual sales to end users not in the network were insignificant. In Utah County, which leads the nation in per capita participation in and sponsorship of MLM's, *one survey showed FOUR MLM distributors for every ONE customer!* The details of these tax studies can be found at the following web address – http://www.mlm-thetruth.com/tax_study.htm (Hard copies of these reports will be supplied to the Commission with a copy of this letter.)

Based on these tax studies, I would wager that of the thousands of Public Comments already received by FTC officials from MLM adherents that oppose the new disclosure rule, the vast majority did not report a profit on their income taxes from MLM participation – except for those who are TOPP's!

“5 Red Flags” of MLM schemes lead to huge losses, which should be disclosed.

Earlier, I had analyzed features of MLM and pyramid schemes and compared them with features of legitimate businesses with which MLM is often compared. After months of comparative analysis and discussions with top experts, *five characteristics became apparent that clearly distinguished chain or pyramid selling schemes from legitimate businesses.* This comparative analysis can be viewed at – <http://www.mlm-thetruth.com/comparisons.htm>

These features, which could be identified in the compensation plans of the MLM programs, clearly contributed to the high loss rates and helped to identify MLM's that were in violation of laws in most states, as well as FTC guidelines, suggesting that pyramid schemes emphasize income from recruitment, rather than from sales of products to non-participants in the scheme. In fact, wherever I could get the earnings reports of participants in MLM's (with these “5 Red Flags” in their pay plan), *approximately 99.9% of ALL participants (including dropouts) lost money, after subtracting ALL expenses, including “incentivized purchases” (applying to qualification for commissions or bonuses) of goods and services from the company. The odds of profiting from some gaming tables in Las Vegas are far better. MLM's even make obviously illegal no-product pyramid schemes look profitable in comparison.* To see these statistics displayed, go to –

<http://www.mlm-thetruth.com/Compare%2010%20MLMs-vsSellingvsNPSvsVegas-2p-barchart-July05.pdf>

For a summary of all my research on these “5 Red Flags of a Product-based Pyramid Scheme, or Recruiting MLM,” which was presented at the 2004 Economic Crime Summit Conference (sponsored by the National White Collar Crime Center), go to – <http://www.mlm-thetruth.com/5RedFlags2column40pages2Color3-6.pdf>

The presentation itself can be viewed by clicking on the link from Item #8 at the following web address – http://www.mlm-thetruth.com/law_enforcement.htm

My statistical analyses required some debunking of deceptions inherent in much of the MLM reporting, including (1) assuming retail sales that did not occur, (2) counting only

“active” participants and ignoring dropouts, and (3) reporting commissions and bonuses as “earnings” without subtracting costs – primarily payments to the company. *Requirements for earnings disclosure for investments and franchises would not allow such skewed reporting of income statistics.*

Robert Fitzpatrick, president of Pyramid Scheme Alert, wrote *“The Myth of Income Opportunity in Multi-level Marketing,” which basically confirmed my findings, except that he used company statistics without any attempt to debug the deceptions in their reporting. He found that even with company-supplied statistics, the average weekly income of seven MLM's ranged from \$1.68 to \$16.57 per week. After subtracting “incentivized purchases” and operating expenses, it can be assumed that nearly all but a few of the TOPP's would report a loss. His report can be found at -* <http://www.falseprofits.com/MythofMLMIncome.doc.pdf>.

A challenge to 60 leading MLM's to disclose earnings of participants remains unmet.

In 1999, upon discovering disturbing evidence of widespread misrepresentations on earnings of participants in MLM, I wrote the presidents of 60 of the largest MLM companies and requested data. They were provided a form for them to demonstrate that they are not a pyramid scheme, based more on loss rates than on structure. Though some tried, officials from none of the 60 companies were able or willing to comply. This challenge, called “The Network Marketing Payout Distribution Study,” has been posted on the internet since 1999, and to this date none of the MLM companies have met the challenge. This is another demonstration of the need for this disclosure rule; government can compel disclosure of critical information for consumers, whereas consumer advocacy groups cannot. The unmet challenge can be downloaded from – <http://www.mlm-thetruth.com/NWMPayoutstudy-6-6.pdf>

Checking a “No” box for earnings claims presents a contradiction for MLM companies.

The FTC proposal offers the option for promoters of a business opportunity to declare that they are not making earnings claims by checking a “no” box in the Earnings category. It is misleading for MLM promoters to suggest a program is a “business opportunity” or “income opportunity” if it is in fact a loss certainty – except for those at or near the top of the pyramid. In the case of MLM/pyramid marketing schemes with the “5 Red Flags” in the compensation plans, recent evidence demonstrates that 99% of participants lose money, after subtracting money paid in to the company for products and services – with even greater losses (99.9%) if operating expenses are subtracted.

So the option of an MLM not making earnings claims would be a contradiction and would mislead consumers into thinking it is an income opportunity when in fact it will lead to almost certain loss. The only exception should be when the promoters do not label it as any kind of “income opportunity” or “business opportunity,” because such terms strongly suggest that it is a legitimate business and that positive earnings are likely with effort – and not just recruiting effort.

A federal level business opportunity disclosure rule is essential for consumer protection.

MLM promoters and DSA lobbyists and sympathizers talk of doing “due diligence” and of the responsibility of consumers to make informed decisions, but this is nearly impossible without availability of true information upon which to make such decisions. Adequate disclosure could go a long way towards supplying this. And state disclosure rules and other statutes are inadequate because pyramid marketing schemes by their very nature quickly spread across state lines and become unmanageable by state law enforcement agencies. To those familiar with the abuses, this appears the type of arena for the FTC to require disclosure.

Twelve years’ research convince me that MLM is a business dependent on deception. I conclude that three things are required to be successful in an MLM or pyramid marketing scheme: (1) to be deceived, (2) to maintain a high level of self-deception, and (3) to aggressively go about deceiving others. The deceptions far exceed those of recent investment scandals, such as Enron or WorldCom. To view *30 typical misrepresentations engaged in MLM recruitment campaigns*, go to – <http://www.mlm-thetruth.com/Misrepresentations-RecruitingMLMs.pdf>

MLM/pyramid marketing schemes are separate and distinct from legitimate business opportunities or direct selling programs.

Having taught entrepreneurship, sponsored an Income Opportunity Show and income opportunity directory, and initiated over 40 business startups, I can certify that *MLM are not direct selling programs, but chain selling programs, and are separate and distinct from all other types of business opportunities*. As suggested above, research demonstrates that it is no more appropriate to refer to most MLM’s as “business opportunities” than it is to place a “Business Opportunity” sign above gaming tables in Las Vegas. *Please note that the vast majority of the “Public Comments” objections to your proposed disclosure rule come from MLM adherents, not from sponsors of legitimate business opportunities. This is because meaningful disclosure about MLM’s or chain sellers could expose the stark truth: They are pyramid marketing schemes that enrich the MLM company and TOPP’s (top of the pyramid promoters) at the expense of a multitude of downline victims!*

And legitimate direct selling is disappearing from the American marketplace. Door-to-door selling is next to non-existent, with few exceptions. This is an outgrowth of the emergence of big box stores (Walmart, etc.), Internet sales, and (unfortunately) chain selling.

A waiting period, coupled with encouragement to search the web and other sources for detailed information, would be a great protection.

FTC officials, please don’t allow MLM promoters and the Direct Selling Association (which now represents chain sellers and MLM/pyramid marketing schemes) to discourage you from requiring a reasonable waiting period,

that would allow prospects time to find and read web sites of organizations that present detailed and critical guides for evaluating MLM/pyramid marketing schemes.

I would support a three-day waiting period for any investment exceeding \$50 in any MLM/pyramid marketing scheme, so long as it is coupled with encouragement to do a web-based search for information that would give more than cursory information on these schemes. Such sites include www.mlm-thetruth.com and www.pyramidschemealert.org, both of which provide links to several other informative and helpful sites. Such detailed information about companies and how to evaluate them for potential harm (loss rates correlated with compensation plans, etc.) is not available elsewhere. Only general suggestions are offered on the web sites sponsored by the FTC, state AG or consumer protection offices, or the Better Business Bureau.

Ten referrals should be split between current and ex-participants in MLM programs.

The ten referrals is potentially a problem, as they could be turned into de facto skills, unless a random selection from all participants in an area was made, including from dropouts. At the very least, five of those could be current participants, and *five should be ex-participants*, both as close as possible to the prospect’s area. Referrals to ex-participants are extremely important, since statistics show that the vast majority of new MLM recruits will soon become ex-participants, or victims.

Complaints received by the FTC represent only the tip of the iceberg of actual victims.

Our research shows that statistics and rankings of consumer complaints received by the FTC for abuse by MLM/pyramid marketing schemes represent only a tiny fraction of actual victims. Those of us working with victims find that they rarely file complaints due to self-blame, fear of consequences to or from those still in the chain (often friends or close relatives), and fear of self-incrimination for having deceived other victims in the scheme.

In Utah, where I live, based on available data and consultation with MLM victims, less than one in 10,000 victims (including out-of-state victims of Utah-based schemes) ever files a complaint with Utah’s Div. of Consumer Protection – including persons who have lost tens of thousands of dollars. So while complaints against pyramid marketing companies rank among the top 20 injury categories reported to the Commission, *actual injuries (included the vast majority of injuries, that are not reported) should clearly place it in the #1 position, especially if overseas losses from US-based companies were included.*

The Notice stated that the FTC staff estimated there were 150 MLM companies. I have personally evaluated over 200 MLM programs out of several hundred that are active, with new ones appearing almost daily. *The MLM phenomenon and associated abuse is far greater than regulators have recognized, since much of their data is based on complaints filed.* Careful analysis of the financial reports of publicly traded companies, such as Amway, Nu Skin, Herbalife, USANA, and Prepaid Legal, reveal the number of victims and aggregate losses to be far more extensive than official complaints would suggest.

Only MEANINGFUL disclosure will provide any real protection.

One final point. In 1994, MLM/chain seller Nu Skin Enterprises agreed to an FTC Order for the company and its representative to Cease and Desist misrepresenting earnings of its distributors. In 1997, Nu Skin began publishing disclosure statements of "Actual Average Incomes" of its distributors. But careful examination revealed *20 clever deceptions on this one-page report, actually making the report seem favorable to unsophisticated prospects.* For the full Report of Violations of the FTC Order for Nu Skin to stop its misrepresentations, go to - <http://www.mlm-thetruth.com/ReportVIOLATIONS-2FTC6-3WebFormatted12-4.pdf>

There is a lesson here for FTC officials. *Disclosure may or may not be helpful, and may in fact be misleading – unless the disclosure is honest and meaningful to prospects.* The DSA/MLM lobby has everything to gain by discouraging honest disclosure.

The chief opponents to the new rule – the Direct Selling Association (DSA) and member MLM/chain selling companies – regularly deceive and have a lot to lose from an honest and meaningful disclosure rule.

From extensive research cited above, it can be seen that disclosure of true and meaningful information about MLM/pyramid marketing schemes could have a devastating effect on their recruitment campaigns. As stated earlier, they depend for their survival and growth on a whole set of misrepresentations which mislead and defraud millions of consumers worldwide.

The DSA itself engages in a number of deceptive practices in its communications and lobbying efforts. Merely referring to MLM as "direct selling" is deceptive. The DSA does a decent job of defining what direct selling is – "the sale of a consumer product or service, person-to-person, away from a fixed retail location." But it blatantly fails to explain what legitimate direct selling is NOT – recruitment of an endless chain of participants as primary customers. As such, it would be far more accurate to refer to DSA member firms as "chain sellers" rather than as "direct sellers."

The DSA has initiated extremely clever and deceptive legislation to weaken state statutes, which hitherto protected consumers against pyramid schemes. Using deceptive tactics, they have been successful in several states. The DSA has sought passage of amendments to state Pyramid Scheme statutes exempting MLM's from prosecution as pyramid schemes or removing the requirement for direct selling to non-participants from existing statutes. This belies their claim to represent only legitimate direct sellers. In fact, at the 2006 Utah State legislative hearings, I witnessed the DSA representative blatantly misrepresent the FTC's stance on income from sales to non-participants in the scheme.

In legislative hearings, statistics cited by the DSA to show how successful and well-received are their MLM firms nearly always lump legitimate direct sellers together with

chain sellers – and never including the dropouts in MLM programs, which make up the majority of recruits in any given year.

The DSA engages in the web version of identity theft. As further evidence that the DSA, like the MLM industry that supports it, engages in misrepresentations and deceptive practices to carry off its programs, go to the PSA web site at www.pyramidschemealert.org. When PSA was developed and financed as a non-profit organization, the web site developer was given the option of registering its domain name with the suffix ".org." But as soon as these guidelines were lifted, the DSA registered other domain name suffixes for pyramidschemealert. Try adding ".com" or ".net" and see what happens. Not only has the DSA registered these domain names, but it has advertised them on sponsored sites related to MLM. This identity diversion is the web version of identity theft, but was no surprise to those who knew of the pattern of deceptive marketing practices routinely used by the DSA and by the MLM industry.

Please allow myself and others who have appropriate education and experience and who have conducted research represent consumers in a forum on business opportunity disclosure requirements.

There are so many opinions being expressed on this issue that it would seem to me to be genuinely helpful for the FTC to sponsor a forum examining research and the pros and cons of requiring a meaningful business opportunity disclosure rule, particularly as it relates to MLM or pyramid marketing schemes – which have acquired a dominant position in the field of sales of business opportunities. This is too important an issue to give it superficial treatment.

Since I have performed more research than anyone on the correlation of MLM marketing operations and compensation plans to earnings and/or losses by participants, I would like to be one of those selected to present such research on behalf of consumers. Another person I would recommend would be Robert Fitzpatrick, President of Pyramid Scheme Alert, who will be writing you shortly.

A review of my vita will show that by education, experience, and both experiential and objective research, I have a lot to offer in the field of consumer protection as it relates to all types of business opportunities. This vita can be downloaded at –

<http://www.mlm-thetruth.com/JMTaylorVITA6-6.pdf>

The recommendations below are based on extensive research.

Based on the above-mentioned research and comments, I strongly recommend the following provisions for the Business Opportunity Disclosure Rule:

1. *Somehow separate disclosure for chain selling or MLM/pyramid marketing schemes from all other forms of business opportunity. They are worlds apart, as the "5 Red Flags" report cited about makes clear.* The former depend on recruitment of an endless chain of participants as primary purchasers, while the latter does not.
2. *If the MLM/pyramid marketing scheme presents itself as an "income opportunity" or "business opportunity,"*

Research related to Business Opportunity Rule, R511993, page 5

that must be regarded as making earnings claims, since it implies the possibility of profits, rather than losses – and not just for those at or near the top of their respective pyramids (or hierarchy of participants). This is important because recent research clearly demonstrates that over 99% of participants in these programs lose money – if all recruits are counted and all costs are subtracted. So if MLM promoters claim their program is a “business” or “income opportunity,” and not a pyramid marketing scheme, they should disclose earnings to support that claim.

3. Require at least a 3-day waiting period before purchases or fees in excess of \$50 total are made by prospects in endless chain recruitment schemes, combined with encouragement to search the Internet for information on MLM and on specific companies. Merely referring them to the FTC, the Better Business Bureau, or to state consumer protection agencies is insufficient, since very little information is presented by these organizations about specific companies or how to do a thorough evaluation.

4. To report commissions and bonuses to participants as “earnings” or as “income” without reporting costs, is misleading. If participants pay more in to a company than they receive back, it should not be considered a profitable enterprise. In standard accounting practice, the bottom line is NET income, not total revenue.

At a bare minimum in disclosure documents, MLM companies should report BOTH revenues paid out to participants – and ALL payments made by participants back to the company for ALL products and services. It would be preferable to report actual operating expenses as well, but that would be cumbersome for thousands of participants. However, MLM companies could easily report all moneys paid to participants (in one column), and all moneys paid by participants back to the company for products and services (in another column) – whether such products are consumed, given as samples, stored, or disposed of. If such products and services count for volume or qualification in any way for commissions, discounts, or to advance in the scheme, they should be counted as a cost of doing business for analytical (not necessarily tax) purposes.

5. Some accounting of total recruits for a given year, coupled with the total remaining at the end of the year, would be helpful. At the very least, cancellation and refund requests should be reported. But experience suggests that only a tiny percentage (3½% for one prominent MLM) seek a refund, even though recruited on the basis of numerous deceptions. It usually takes months, or even years, to become deprogrammed or aware of the fact that they have been deceived when they were recruited.

6. Reports of prior business experience is helpful, as is prior litigation, especially anything that would suggest illegal behavior, even if not found guilty.

7. The disclosure document should be in large and readable type and not cluttered with extraneous material.

8. (From the FTC proposal) “The number and percent of all purchasers during the relevant time period who have achieved at least the claimed earnings.” This is good, provided money paid back to the company is reported. Some who apparently earned a lot of money will show a loss after subtracting the money paid to the company for products and

services. Research suggests that purchases by participants is what supports most MLM companies.

9. All misrepresentations should be forbidden, including the prevalent practice of the DSA and MLM adherents of presenting MLM/pyramid marketing schemes as “direct selling programs.” Nearly all MLM’s are chain selling programs, dependent on an endless chain of recruitment of participants as primary customers.

10. The ten referrals could amount to nothing more than skills, unless they were randomly assigned from the area in which the promoter is recruiting. At the very least, five of those referrals should be from ex-participants.

11. Record retention related to participation lists and earnings and purchases of distributors should be retained for at least five years. In the Nu Skin case cited above, when asked about distributors who had dropped out, the CFO responded that this was “information that they did not consider material!” What could be more “material” or relevant to prospects than data regarding retention and past earnings?

12. With all the complaints (in “public comments”) coming in from MLM adherents for having an “undue burden” placed upon them, I hope the Commission will weigh this burden against the much larger burden of losses suffered by victims of MLM/pyramid marketing schemes.

Please note that if it would be helpful to present the extensive research I have done on disclosure issues related to MLM/pyramid marketing schemes, I and other experts associated with Pyramid Scheme Alert would be happy to appear in hearings or in a workshop for FTC officials and consumer advocates. This is too important an issue to give it superficial treatment.

Thank you for reviewing and posting my comments. And I congratulate the Commission for considering this important new rule.

Sincerely,

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

July 13, 2006 (This letter a revision of the July 1 letter)

CAI
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AWARENESS
INSTITUTE

A non-profit corporation
291 Ea. 1850 South
Bountiful, UT 84010
Te/fax (801) 298-2425
jonmtaylor@juno.com
www.mlm-thetruth.com

Jon M. Taylor, Ph.D.,
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Douglas M. Brooks, Esq.
Attorney for Victims
of Pyramid Schemes
Gilman and Pastor, LLP
Saugus, MA 01906

Eric Schiebeler, former
federal auditor, Author:
Merchants of Deception

Andrew S. Kneeter, Pres.
A.S.K. Solutions, L.L.C.
Financial consultant
for hedge funds

Loraine T. Pace, Former
State Representative
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Anthony Martin
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My challenge to 60 leading MLM’s to disclose earnings of participants remains unmet. But the FTC could require disclosure of information to which voluntary organizations would not have access.

In 1999, upon discovering disturbing evidence of widespread misrepresentations on earnings of participants in MLM, I wrote the presidents of 60 of the largest MLM companies and requested data. They were provided a form for them to demonstrate that they are not a pyramid scheme, based more on loss rates than on structure. Though some tried, officials from none of the 60 companies were able or willing to comply. This challenge, called “The Network Marketing Payout Distribution Study,” has been posted on the Internet since 1999, and to this date none of the MLM companies have met the challenge. This is another demonstration of the need for this disclosure rule; government can compel disclosure of critical information for consumers, whereas consumer advocacy groups cannot. The unmet challenge can be downloaded from – <http://www.mlm-thetruth.com/NWMPayoutstudy-6-6.pdf>

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MLM/pyramid marketing schemes are separate and distinct from legitimate business opportunities or legitimate direct selling programs.

Having taught entrepreneurship, sponsored an Income Opportunity Show and income opportunity directory, and initiated over 40 business startups, I can certify that *MLM are not direct selling programs, but chain selling programs, and are separate and distinct from all other types of business opportunities.* As suggested above, research demonstrates that it is no more appropriate to refer to most MLM's as "business opportunities" than it is to place a "Business Opportunity" sign above gaming tables in Las Vegas. *Please note that the vast majority of the "Public Comments" objections to your proposed disclosure rule come from MLM adherents, not from sponsors of legitimate business opportunities. This is because meaningful disclosure about MLM's or chain sellers could expose the stark truth: They are pyramid marketing schemes that enrich the MLM company and TOPP's (top of the pyramid promoters) at the expense of a multitude of downline victims!*

The assumption that multi-level marketing is a legitimate business model does not conform to results of recent research that shows a loss rate far greater than for no-product pyramid schemes. While it is conceivable that a compensation plan could be designed to reward fairly legitimate direct selling to actual customers who are not a part of the network. out of hundreds of MLM programs we have evaluated, no more than a three of them could qualify as legitimate retail-based programs.

And legitimate direct selling is disappearing from the American marketplace. Door-to-door selling is next to non-existent, with few exceptions. This is an outgrowth of the emergence of big box stores (Wal-Mart, etc.), Internet sales, and (unfortunately) chain selling.

Complaints received by the FTC represent only the tip of the iceberg of actual victims of pyramid marketing schemes.

Our research shows that statistics and rankings of consumer complaints received by the FTC for abuse by MLM/pyramid marketing schemes represent only a tiny fraction of actual victims. Those of us who have communicated with thousands of victims find that they rarely file complaints due to self-blame, fear of consequences to or from those still in the chain (often friends or close relatives), and fear or self-incrimination for having unwittingly deceived other victims they recruited into the chain. In order just to recoup recover their initial and ongoing "pay to play" investment, new recruits of necessity must recruit many others. So the

victims become perpetrators until they run out of money and drop out.

In Utah, where I live, based on available data and consultation with MLM victims, less than one in 10,000 victims (including out-of-state victims of Utah-based schemes) ever files a complaint with Utah's Division of Consumer Protection. Of the many victims who have written or called us, even persons who have lost tens of thousands of dollars refuse to file complaints.

The Notice about the Business Opportunity Rule in the Federal Register stated that the FTC staff estimated there were 150 MLM companies. I have personally evaluated over 200 MLM programs out of several hundred that have been active. And new ones seem to be appearing almost daily.

The MLM phenomenon and associated abuse is far greater than regulators have recognized, since much of their data is based on complaints filed. Careful analysis of the financial reports of publicly traded MLM companies, such as Amway, Nu Skin, Herbalife, USANA, and Prepaid Legal, reveal that the loss rates, aggregate losses, and number of victims are far more extensive than official complaints would suggest. So while complaints against pyramid marketing companies rank among the top 20 injury categories reported to the Commission, actual injuries (included the vast majority of victims who fail to report) could easily place pyramid marketing schemes in the #1 position,, especially if overseas losses from US-based companies were included. Annually, the victims of these schemes number in the millions and the losses suffered by victims in the tens of billions of dollars.

A federal level business opportunity disclosure rule is essential for consumer protection.

MLM promoters and DSA lobbyists and sympathizers talk of doing "due diligence" and of the responsibility of consumers to make informed decisions, but this is nearly impossible without availability of true information upon which to make such decisions. This is just as true of business opportunities as it is of investment securities – which have been required to make extensive financial disclosures. And when a company like Enron gives out false information, leading to losses of savings for thousands of investors, victims of the misrepresentations demand action. Why should business opportunity promoters be any more immune from disclosure than investors in securities?

Adequate disclosure could go a long way towards helping to prevent losses by victims in exploitive schemes. And state disclosure rules and other statutes are inadequate because MLM/pyramid marketing schemes by their very nature quickly spread across state lines and become unmanageable by state law enforcement agencies. To those familiar with the abuses, this appears the type of arena for which the FTC should require meaningful disclosure.

Twelve years' research convinces me that MLM is a business dependent on deception. I conclude that three things are required to be successful in a "recruiting MLM" or pyramid marketing scheme: (1) to be deceived, (2) to maintain a high level of self-deception, and (3) to aggressively go about deceiving others. The deceptions far exceed those of recent investment scandals, such as Enron or WorldCom. To view 30 typical misrepresentations engaged in MLM recruitment campaigns, go to – <http://www.mlm-thetruth.com/Misrepresentations-RecruitingMLMs.pdf>

The Nu Skin disclosure case suggests some valuable lessons for FTC personnel considering a business opportunity disclosure rule.

In 1994, the FTC issued an Order for Nu Skin International, Inc., (now Nu Skin Enterprises) to cease and desist misrepresenting earnings of its distributors. In 1997 and 1998, Nu Skin officials did publish an "Average Earnings of Distributors" disclosure statement, but on close inspection, I found at least 20 subtle deceptions on the one-page report, *actually making the report seem favorable to unsophisticated prospects.*

After I submitted a "REPORT OF VIOLATIONS" to FTC officials and filed (through Pyramid Scheme Alert) a petition seeking enforcement of the Order, Nu Skin made some changes, but these could not be considered satisfactory from a consumer protection perspective. The only major change that was positive was that Nu Skin stopped including retail sales that could not be proven to have occurred. Nu Skin also failed to make their new report "Distributor Compensation Summary" available to the general public – a clear violation of the intent of the Order.

A great many lessons can be learned from the Nu Skin case by those at the FTC who are charged with studying the issues and receiving public comments about the proposed Business Opportunity Disclosure Rule. I would strongly recommend that every person who is involved in the decision review the revised REPORT OF VIOLATIONS, especially Appendix G, which includes both the 2004 Nu Skin "Distributor Compensation Summary" and needed corrections. For the full Report of Violations of the FTC Order for Nu Skin to stop its misrepresentations, go to - <http://www.mlm-thetruth.com/ReportVIOLATIONS-2FTC6-3WebFormatted12-4.pdf> (A hard copy of the full report is included with this submission.)

It should be clear from the latter report (especially Appendix G) that Nu Skin officials will do everything they can to avoid disclosing the type of information consumers need to make an informed choice about participation in their program. No intelligent person would join if he or she had the appropriate facts.

The same could be said for any pyramid marketing (chain selling) scheme.

This is why the Direct Selling Assn (DSA), which has been taken over in recent years by companies sponsoring pyramid marketing (or chain selling) schemes, is so adamantly opposed to the new disclosure proposals. They would be even more resistant to more meaningful disclosures, such as money paid participants to the company for products and services as compared to what they receive in commissions and bonuses – and the entire participant population base from which successful participants were drawn in figuring success rates.

Only MEANINGFUL disclosure will provide any real protection.

One of the most important lessons to be drawn from the Nu Skin case is that *disclosure may or may not be helpful, and may in fact be misleading – unless the disclosure is honest and meaningful to prospects.*

Meaningful disclosure needed by prospects would include at least the following items of information:

1. All pyramid marketing schemes (including MLM and all other forms of chain selling) should be required to disclose and document earnings claims. They should not be given the option of claiming an exemption by stating that they are not making earnings claims – when they do lay out the potential for earnings in one way or another.

Explanation: The very fact that an MLM recruiter presents a program as a "business opportunity" or "income opportunity" suggests a positive income, a contradiction if the vast majority of recruits are destined by the design of the compensation plan to lose money. Recent research proves that only a tiny fraction (less than 1%) of participants at the top of a pyramid of participants in a product-based pyramid scheme actually profit after all expenses are subtracted.

2. Income disclosures of multi-level marketing companies must include at least these three items:

a. It must include the average NET (not gross) PAYOUT from the company, to participants in each level. Average net payout is the average of all monies received from the company by participants in each level minus the average of all moneys paid to the company by participants in each level. Expenditures paid to the company include ALL products and services purchased from the company, including license fees, shipping costs, books, audio and video tapes, training, motivation seminars, computer fees, etc. – whether used by participants, sold, stored, or disposed of.

Explanation: If a participant pays more to the company for products and services than he receives in commissions and bonuses, it should not be considered a profitable venture, whether or not the items are tax deductible. Prospects deserve to know whether or not they are likely to come out ahead, regardless of how much the company pays to them.

b. (From the FTC proposal) “The number and percent of all purchasers during the relevant time periods who achieved at least the claimed earnings.” **It is important that purchasers who achieved the designated levels of earnings be compared with a number representing ALL purchasers who signed up to participate during the SAME TIME PERIOD – even if that includes all persons recruited since the inception of the company.**

Explanation: MLM companies that have published earnings of distributors at different levels have been allowed to compare the number of persons who have achieved different levels of earnings since the beginning of the company with only a tiny slice of the population that made the effort during the current time period. This hugely skews the statistics, making success appear far more likely than is actually the case. If all purchasers who achieved a certain level in a ten-year time period are counted, then ALL purchasers who signed up as participants in the scheme should be counted as the population from which the successful group was drawn.

c. The total number of ALL participants who joined in the past year should be reported, not just the so-called "active participants" in one part of a year – and the number of such participants remaining (still buying or selling products) at the end of the year, so that the current percentage of dropouts can be calculated.

Explanation: If prospects knew what percentage of ALL recruits drop out, they would have a better idea whether or not they would be one of them.

“5 Red Flags” of MLM schemes lead to huge losses, which should be disclosed.

IN 2001, I analyzed features of MLM and pyramid schemes and compared them with features of legitimate businesses with which MLM is often compared. After months of comparative analysis and discussions with top experts, *five characteristics became apparent that clearly distinguished chain or pyramid selling schemes from legitimate businesses.* This comparative analysis can be viewed at – <http://www.mlm-thetruth.com/comparisons.htm>

These features, which could be identified in the compensation plans of the MLM programs, clearly contributed to the high loss rates and helped to identify MLM’s that were in violation of laws in most states, as well as FTC guidelines, suggesting that pyramid schemes emphasize income from recruitment, rather than from sales of products to non-participants in the scheme. In fact, wherever I could get the earnings reports of participants in MLM’s (with these “5 Red Flags” in their pay plan), *approximately 99.9% of ALL participants (including dropouts) lost money, after subtracting ALL expenses, including “incentivized purchases”* (applying to

qualification for commissions or bonuses) of goods and services from the company. *The odds of profiting from some gaming tables in Las Vegas are far better. MLM’s even make obviously illegal no-product pyramid schemes look profitable in comparison.* To see these statistics displayed, go to –

<http://www.mlm-thetruth.com/Compare%2010%20MLMs-vsSellingvsNPSvsVegas-2p-barchart-July05.pdf>

For a summary of all my research on these “5 Red Flags of a Product-based Pyramid Scheme, or Recruiting MLM,” which was presented at the 2004 Economic Crime Summit Conference (sponsored by the National White Collar Crime Center), go to –

<http://www.mlm-thetruth.com/5RedFlags2column40pages2Color3-6.pdf>

The presentation itself can be viewed by clicking on the link from Item #8 at the following web address – http://www.mlm-thetruth.com/law_enforcement.htm

My statistical analyses required some debunking of deceptions inherent in much of the MLM reporting, including (1) assuming retail sales that did not occur, (2) counting only “active” participants and ignoring dropouts, and (3) reporting commissions and bonuses as “earnings” without subtracting costs – primarily payments to the company. *Requirements for earnings disclosure for investments and franchises would not allow such skewed reporting of income statistics.*

Robert Fitzpatrick, president of Pyramid Scheme Alert, wrote *“The Myth of Income Opportunity in Multi-level Marketing,”* which *basically confirmed my findings,* except that he used company statistics without any attempt to debug the deceptions in their reporting. He found that even with company-supplied statistics, *the average weekly income of seven MLM’s ranged from \$1.68 to \$16.57 per week.* After subtracting “incentivized purchases” and operating expenses, it can be assumed that nearly all but a few of the TOPP’s would report a loss. His report can be found at -

<http://www.falseprofits.com/MythofMLMIncome.doc.pdf>

Research on income taxes of MLM participants proves need for disclosure.

In 1997, I wrote the book *The Network Marketing Game*, which exposed the ethical problems of exploiting and deceiving others for personal gain. While on a speaking tour promoting the book, *I got feedback from tax accountants who asked why – with all the promises of MLM promoters of “residual income” – they were not seeing profits reported on tax returns of MLM participants.* I decided to interview other tax professionals – almost 300 of them over a period of several years. I also interviewed programmers of tax

software and persons involved in seminars for tax professionals. *With a total of over two million tax returns represented, a clear picture emerged of who was making money in MLM – the TOPP's (top of the pyramid promoters), at the expense of huge downlines of participants/victims who lost money.* This seemed to confirm the findings of Bruce Craig, an Assistant Attorney General for the state of Wisconsin in the 1970's. He discovered that net income on tax returns of the top 1% of Amway dealers in Wisconsin was minus \$900!

My tax study revealed that the profits of MLM companies and of the TOPP's are fed by a revolving door of recruits, an endless chain of participants as primary (and sometimes only) customers. Actual sales to end users not in the network were insignificant. In Utah County, which leads the nation in per capita participation in and sponsorship of MLM's, *one survey showed FOUR MLM distributors for every ONE customer!* The details of these tax studies can be found at the following web address – http://www.mlm-thetruth.com/tax_study.htm (Hard copies of these reports have been supplied to the Commission.)

Based on these tax studies, I would wager that of the thousands of Public Comments already received by FTC officials from MLM adherents that oppose the new disclosure rule, the vast majority did not report a profit on their income taxes from MLM participation – except for those who are TOPP's!

Checking a “No” box for earnings claims presents a contradiction for MLM companies.

The FTC proposal offers the option for promoters of a business opportunity to declare that they are not making earnings claims by checking a “no” box in the Earnings category. *However, it is misleading for MLM promoters to suggest a program is a “business opportunity” or “income opportunity” if in fact it leads to almost certain loss – except for those at or near the top of the pyramid. In the case of MLM/pyramid marketing schemes with the “5 Red Flags” in the compensation plans, recent evidence demonstrates that 99% of participants lose money, after subtracting money paid in to the company for products and services – with even greater losses (99.9%) if operating expenses are subtracted.*

So the option of an MLM not making earnings claims would be a contradiction and would mislead consumers into thinking it is an income opportunity when in fact it will lead to almost certain loss. The only exception should be when the promoters do not label it as any kind of “income opportunity” or “business opportunity,” because such terms strongly suggest that it is a legitimate business and that positive earnings are likely with effort – and not just recruiting effort.

A waiting period, coupled with encouragement to search the web and other sources for detailed information, would be a great protection.

FTC officials, please don't allow MLM promoters and the Direct Selling Association (which now represents chain sellers and MLM/pyramid marketing schemes) to discourage you from requiring a reasonable waiting period, that would allow prospects time to find and read web sites of organizations that present detailed and critical guides for evaluating MLM/pyramid marketing schemes.

I support a three-day waiting period for any investment exceeding \$50 (including “incentivized” product purchases – tied to qualifications for commissions or advancement in the scheme) in any MLM/pyramid marketing scheme, so long as it is coupled with encouragement to do a web-based search for information that would give more than cursory information on these schemes. Such sites include www.mlm-thetruth.com and www.pyramidschemealert.org, both of which provide links to other helpful sites. Such detailed information about companies and how to evaluate the specifics of their programs (loss rates correlated with the “5 Red Flags” in their compensation plans, etc.) is not available elsewhere. Only very generalized suggestions are offered on the web sites sponsored by the FTC, state AG or consumer protection offices, or the Better Business Bureau.

“Ten prior purchasers” should be split between current and ex-participants in MLM programs.

The list of ten prior purchasers is potentially a problem, as they could be turned into de facto shells, unless a random selection from all participants in an area was made, including from dropouts. At the very least, five of those could be current participants, and *five should be ex-participants*, both as close as possible to the prospect's area. Referrals to ex-participants are extremely important, since statistics show that the vast majority of new MLM recruits will soon become ex-participants (dropouts), or victims.

The chief opponents to the new rule – the Direct Selling Association (DSA) and member MLM/chain selling companies – regularly deceive and have a lot to lose from an honest and meaningful disclosure rule.

From extensive research cited above, it can be seen that disclosure of true and meaningful information about MLM/pyramid marketing schemes could have a devastating effect on their recruitment campaigns. They depend for their survival and growth on a whole set of misrepresentations which mislead and defraud millions of victims worldwide.

The DSA itself engages in a number of deceptive practices in its communications and lobbying efforts. Merely referring to MLM as “direct selling” is deceptive. The DSA does a decent job of defining what direct selling is – “the sale of a consumer product or service, person-to-person, away from a fixed retail location.” But it blatantly fails to explain what legitimate direct selling is NOT – recruitment of an endless chain of participants as primary customers. As such, it would be far more accurate to refer to DSA member firms as “chain sellers” rather than as “direct sellers.”

The DSA has initiated extremely clever and deceptive legislation to weaken state statutes, which hitherto protected consumers against pyramid schemes. Using deceptive tactics, they have been successful in several states. The DSA has sought passage of amendments to state Pyramid Scheme statutes exempting MLM’s from prosecution as pyramid schemes or removing the requirement for direct selling to non-participants from existing statutes. This belies their claim to represent only legitimate direct sellers. In fact, at the 2006 Utah State legislative hearings, I witnessed the DSA representative blatantly misrepresent the FTC’s stance on income from sales to non-participants in the scheme.

In legislative hearings, statistics cited by the DSA to show how successful and well-received are their MLM firms nearly always lump legitimate direct sellers together with chain sellers – and never including the dropouts in MLM programs, which make up the majority of recruits in any given year.

The DSA engages in the web version of identity theft. As further evidence that the DSA, like the MLM industry that supports it, engages in misrepresentations and deceptive practices to carry off its programs, go to the PSA web site at www.pyramidschemealert.org. When PSA was developed and financed as a non-profit organization, the web site developer was given the option of registering its domain name with the suffix “.org.” But as soon as these guidelines were lifted, the DSA registered other domain name suffixes for [pyramidschemealert.com](http://www.pyramidschemealert.com) or “.net” and see what happens. Not only has the DSA registered these domain names, but it has advertised them on sponsored sites related to MLM. This identity diversion is the web version of identity theft, but was no surprise to those who knew of the pattern of deceptive marketing practices routinely used by the DSA and by the MLM industry.

Please allow myself and others who have appropriate education and experience and who have conducted extensive research represent consumers in a forum on business opportunity disclosure requirements.

There are so many opinions being expressed on this issue that it would seem to me to be genuinely helpful

for the FTC to sponsor a forum examining research and the pros and cons of requiring a meaningful business opportunity disclosure rule, particularly as it relates to MLM or pyramid marketing schemes – which have acquired a dominant position in the field of sales of business opportunities. This is too important an issue to give it superficial treatment.

Since I have performed more research than anyone on the correlation of MLM marketing operations and compensation plans to earnings and/or losses by participants, I would like to be one of those selected to present such research on behalf of consumers. Another person I would recommend would be Robert Fitzpatrick, President of Pyramid Scheme Alert, who will be writing you shortly.

A review of my vita will show that by education, experience, and both experiential and objective research, I have a lot to offer in the field of consumer protection as it relates to all types of business opportunities. This vita can be downloaded at –

<http://www.mlm-thetruth.com/JMTaylorVITA6-6.pdf>

The recommendations below are based on extensive research.

Based on the above-mentioned research and comments, I strongly recommend the following provisions for the Business Opportunity Disclosure Rule:

1. *Somehow separate disclosure for chain selling or MLM/pyramid marketing schemes from all other forms of business opportunity. They are worlds apart, as the “5 Red Flags” report cited above makes clear.* The former depend on recruitment of an endless chain of participants as primary purchasers, while the latter does not.

2. *If the MLM/pyramid marketing scheme presents itself as an income or “business opportunity,” that in itself must be regarded as making earnings claims, since it implies the possibility of profits, rather than losses – and not just for those at or near the top of their respective pyramids (or hierarchy of participants).* This is important because recent four research studies clearly demonstrate that over 99% of participants in these programs lose money – if all recruits are counted and all costs are subtracted. So if MLM promoters claim their program is a “business” or “income opportunity,” and not a pyramid marketing scheme, they should disclose earnings to support that claim.

3. *Require at least a 3-day waiting period before purchases or fees in excess of \$50 total are made by prospects in endless chain recruitment schemes, combined with encouragement to search the Internet for information on MLM and on specific companies.* Merely referring them to the FTC, the Better Business Bureau, or to state consumer protection agencies is insufficient, since very little information is presented by these organizations about specific companies or how to do a thorough evaluation.

4. To report commissions and bonuses to participants as “earnings” or as “income” without reporting costs, is misleading. *If participants pay more in to a company than they receive back, it should not be considered a profitable enterprise.* In standard accounting practice, the bottom line is NET income, not total revenue.

At a bare minimum in disclosure documents, MLM companies should report BOTH revenues paid out to participants – and ALL payments made by participants back to the company for ALL products and services. It would be preferable to report actual operating expenses as well, but that would be cumbersome for thousands of participants. However, MLM companies could easily report all moneys paid to participants (in one column), and all moneys paid by participants back to the company for products and services (in another column) – whether such products are consumed, given as samples, stored, or disposed of. If such products and services count for volume or qualification in any way for commissions, discounts, or to advance in the scheme, they should be counted as a cost of doing business for analytical (not necessarily tax) purposes.

5. *Some accounting of total recruits for a given year, coupled with the total remaining at the end of the year, would be helpful.* At the very least, cancellation and refund requests should be reported. But experience suggests that only a tiny percentage (approximately 3½% for Nu Skin) seek a refund, even though recruited on the basis of numerous deceptions. It usually takes months, or even years, to become deprogrammed or aware of the fact that they have been deceived when they were recruited.

6. Reports of prior business experience is helpful, as is prior litigation, especially anything that would suggest illegal behavior, even if not found guilty.

7. The disclosure document should be in large and readable type and not cluttered with extraneous material.

8. (From the FTC proposal) “The number and percent of all purchasers during the relevant time period who have achieved at least the claimed earnings.” This is good, but again, provided money paid back to the company is reported. *Some who apparently earned a lot of money will show a loss after subtracting the money paid to the company for products and services. Research suggests that purchases by participants is what supports most MLM companies.*

9. *All misrepresentations should be forbidden, including the prevalent practice of the DSA and MLM adherents of presenting MLM/pyramid marketing schemes as “direct selling programs.” Nearly all MLM’s are chain selling programs, dependent on an endless chain of recruitment of participants as primary customers.*

10. The ten referrals could amount to nothing more than shells, unless they were randomly assigned from the area in which the promoter is recruiting. *At the very least, five of those referrals should be from ex-participants.*

11. Record retention related to participation lists and earnings and purchases of distributors should be retained for at least five years. In the Nu Skin case cited above, when asked about distributors who had dropped out, the CFO responded that this was “information that they did not consider material!” What could be more “material” or relevant to prospects than data regarding retention and past earnings?

12. *With all the complaints (in “public comments”) coming in from MLM adherents for having an “undue burden” placed upon them, I hope the Commission will weigh this burden against the much larger burden of losses suffered by victims of MLM/pyramid marketing schemes. Those who complain about the burden of disclosure should read the details that public stock companies are required to disclose. No one in the field of investment securities insists that such disclosures are not necessary for investors to make informed choices. Even Enron reporting was far more open and honest than most MLM’s in their representations to investors in their programs. Though the investments are in products and services, not securities, it IS an investment deserving of honest and meaningful disclosure.*

Please note that if it would be helpful to present the extensive research I have done on disclosure issues related to MLM/pyramid marketing schemes, I and other experts associated with Pyramid Scheme Alert would be happy to appear in hearings or in a workshop for FTC officials and consumer advocates. I would also be willing to serve the Commission in a consulting capacity in sorting out the complex issues related to disclosure, as I have the broad-based experience and have performed extensive research in this field as an independent analyst – not dependent on income from any MLM or from the DSA. This is too important an issue to give it superficial treatment.

Thank you for reviewing and posting my comments. I firmly believe that the research information supplied by myself (and by Robert Fitzpatrick, President of Pyramid Scheme Alert) can take the disclosure debate out of the realm of mere preferences and opinions and squarely into the realm of facts and realities. And I congratulate the Commission for considering this important new rule.

Sincerely,

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

CONTENTS OF PACKET: Research and analysis applicable to Business Opportunity Rule R511993 –
Submission #2, July 13, 2006 (Submission #1 July 1, 2006)

Nu Skin Enterprises, Inc. – A Case Study in FTC Efforts to Enforce Business Opportunity Disclosure

Submitted by Jon M. Taylor, Consumer Awareness Institute, and Advisor, Pyramid Scheme Alert

✓ Public Comments submitted to FTC (July 13 revision of original comments submitted July 1, 2006)

→
✓ **REPORT OF VIOLATIONS of the 1994 FTC Order for Nu Skin to stop misrepresenting earnings of distributors, including:**

- (1) Copy and analysis of compliance of original Order requiring disclosure
- (2) Four stages of misrepresentation and worldwide damages therefrom
- (3) Primary deceptions that misrepresent earnings
- (4) “5 Red Flags” of a “recruiting MLM,” leading to a 99.9% loss rate
- (5) Motivation and causes of misrepresentations found in MLM generally – and why honest and meaningful disclosure will be fiercely resisted by sponsors
- (6) Reasons for the silence of victims, leading to misperception by law enforcement of the extent of the problem of pyramid marketing schemes
- (7) Petitions submitted by Pyramid Scheme Alert, seeking better disclosure to enforce 1994 Order
- (8) Evidence of recent misrepresentations and failure of implement meaningful disclosure to correct them (Appendix F)
- (9) 2004 “Distribution Compensation Summary” submitted by Nu Skin – followed by content and format corrections, using principles that apply to meaningful disclosure
- (10) Bio and history of Dr. Taylor’s involvement as independent investigator of the 1994 Order

✓ Information on web site that reports on research and consumer guides helpful to consumers and to law enforcement agencies on important issues related to MLM, including disclosure

NU SKIN ENTERPRISES, INC.
2004 DISTRIBUTOR COMPENSATION SUMMARY – CORRECTED
With suggested content and format corrections by Jon M. Taylor, Ph.D., President,
Consumer Awareness Institute, and Advisor, Pyramid Scheme Alert

(Corrections to be printed are in italics)

[Comments to FTC officials (not to be printed) are in brackets, with alphabetical footnotes]

Company Overview

Nu Skin Enterprises, Inc. (together with its affiliates, the "Company") is a global ~~direct~~ *chain-selling*^a company that operates in more than 30 countries throughout North and South America, Asia and Europe. The Company operates in three divisions: (1) the Nu Skin division markets premium quality skin care and personal care products; (2) the Pharmanex division is a science-based developer of nutrition products; and (3) the Big Planet division markets and distributes Internet, technology, telecommunication and other products.

Distributors

The Company markets its products ~~through~~ *primarily to* a network of ~~independent~~ *participants, which it refers to as* "distributors." For purposes of this summary, an "Active Distributor" is a distributor who placed an order for products, promotional materials or services or renewed their distributorship during the ~~quarter~~ *year*. In the United States, the Company had an average of 57,998 Active Distributors ~~each quarter~~ in 2004 *(including some who had been with Nu Skin for many years) each quarter – out of over one million who have joined the program in the U.S. since its founding in 1984. Out of approximately 60,000 distributors that signed up as US distributors since the beginning of the year 2004, approximately 10,000 were still active at the end of the year.*^b

Compensation

There are two fundamental ways in which a distributor can earn compensation:

- Through retail markups on sales of products purchased at wholesale prices; and
- Through commissions (sometimes called bonuses) paid on one's product sales and the sales of other distributors in one's downline sales network.

As with any other sales opportunity, the compensation earned by distributors varies significantly. The cost to become a distributor is very low. People become distributors for various reasons. Many people become distributors simply to enjoy the Company's products at wholesale prices.^c Some join the business to improve their skills or to experience the management of their own business.^d Others become distributors but for various reasons never purchase products from the Company.^e ~~Consequently, many~~ *The vast majority of all new distributors never qualify to receive commissions.*

[^a Nu Skin's program primarily rewards not direct selling, but the recruitment of an endless chain of participants as primary customers. It's breakaway compensation plan is a highly leveraged pyramid marketing scheme. Most of the direct selling is to participants in the scheme (and immediate family members), rather than to non-participating (retail) customers.]

[^b These numbers are guesses – but illustrate information that should be supplied to prospects.]

[^c And many people are pressured into becoming distributors to help a friend or relative to qualify for commissions or to advance to higher levels in the pay plan. Most of these purchases are at wholesale prices to meet qualifications for commissions or for advancement to higher levels in the pay plan.]

[^d Highly unlikely. This wording appears to make the scheme seem more legitimate.]

[^e Those distributors who do not buy products from the Company lose only the distributor fee and are the least hurt by participation in the program.]

Nu Skin Enterprises, Inc, Distributor Compensation Summary – Corrected, Page 2

Generating ~~meaningful~~ compensation as a distributor *in excess of expenses* requires considerable time, *recruitment* effort, commitment, and the *willingness to misrepresent both the products and the opportunity.*^f This is not a get rich quickly program.^g There are no guarantees of financial success.^h

Retail Markups

Distributors can buy Nu Skin, Pharmanex and Big Planet products from the Company at wholesale prices for resale to customers or for personal consumption. Some Big Planet products are services, such as Internet access, on which there is no retail mark-up earned by distributors. In addition, some Big Planet products are lower margin products offered through Internet mall affiliates. Consequently lower levels of commissions are paid on the sale of such products. The Company's suggested retail markup is 43% on most of its personal care and nutrition products.ⁱ

However, distributors are free to set their own selling price and may personally consume some of the products they purchase.^j ~~As a result,~~ The Company currently neither provides an estimate of average income from retail sales nor includes distributor retail income in its average commission information.^k

Commissions

Distributors ~~can also~~ *primarily* earn commissions based on the sale of products ~~by to~~ a distributor and his/her downline of sponsored distributors in all markets where the Company does business. The Company also sells promotional materials that do not generate commissions to distributors.

In 2004 the *Nu Skin's total global revenue was over \$1.1 billion*^l – *most of it from new recruits and cooperating family members.* *Of this amount the Company rebated to the its network of distributors paid* approximately \$487 million^m in commissions and sales compensation globally. In the same period, *out of \$146 million the Company received from markets in North America (mostly in the U.S.) the Company paid rebated* approximately \$77 million in commissions to distributors residing in the United States.

[^f In contrast to legitimate businesses, the more time, effort, commitment, and money participants invest in Nu Skin (or any highly leveraged chain selling scheme), the more they are likely to lose. The notable exceptions are those who rise to a payout level at or near the top of a pyramid of participants. To achieve these high levels in the compensation plan requires a high degree of self-deception and aggressive recruitment of a downline of thousands of participants on the basis of many misrepresentations. Nu Skin has been charged by the FTC and state agencies on multiple occasions with misrepresentations related to products and distributor earnings. A list of 30 typical misrepresentations that are used in every recruitment campaign of “recruiting MLM’s” (those that depend on recruitment of a downline for income) is available online at – <http://www.mlm-thetruth.com/Misrepresentations-RecruitingMLMs.pdf>]

[^g In fact, evidence points to Nu Skin as a “get poor quickly” program.]

[^h Based on analysis of Nu Skin’s own reports, about 99% of participants experience financial loss. It is also well to note that if this disclosure is honestly presented, many who would otherwise join Nu Skin as distributors would not join. Recruitment – so crucial to realizing any profits – may become so difficult that all investing recruits would lose money. Also, the Company, which is dependent on a revolving door of new recruits who buy the products on the basis of these misrepresentations, may collapse.]

[ⁱ Because wholesale prices are much higher than retail prices for comparable products at alternative outlets, most sales are made at wholesale prices to participants and cooperating family members in order for participants to meet quotas to qualify for commissions or to advance in the scheme. This was observed first-hand by the author in his one-year test of the Nu Skin program.]

[^j Hyper-consumption of products is common in order to meet requirements for commissions or advancement, as are sample giveaways, storage of products, and disposal of products at termination.]

[^k Validated retail sales to legitimate costumers outside the network of participants is relatively rare.]

[^l From Nu Skin financial reports, as is the North American sales figure that follows.]

[^m Rounding the numbers to millions more clearly shows where the money is coming from and where it is going.]

Nu Skin Enterprises, Inc, Distributor Compensation Summary – Corrected, Page 3

[NOTE: The next paragraph – and the table on the next page – had to be entirely re-written.]

The table on the following page shows the average percentage and number of total Distributors that qualified to receive commissions at each of the various levels of the Company's sales compensation plan ~~at~~ by the end of 2004ⁿ, the average annualized^p commissions paid in 2004 to U.S. distributors, average purchases of goods and services from Nu Skin by distributors at these levels^p, and average gross profit, without subtracting operating expenses^q. These figures do not include retail markup income.^r

The average annualized commission paid to U.S. “Active” Distributors [in 2004] ~~quarter~~ was ~~\$326.55 or \$1,306.20 on an annualized basis~~. The average amount of moneys paid by Active distributors to Nu Skin for products and services was \$2,000^s, for an average loss of \$693.80. This loss would be much greater if operating expenses were subtracted, such as travel, telephone and Internet fees, advertising and promotional expenses, meeting room rentals, and miscellaneous expenses. The average [annualized] commissions paid to U.S. Active Distributors who qualified for commissions in 2004 was \$9,194.00 (annualized). Most of the commissions and bonuses paid by Nu Skin to its distributors is paid to Blue Diamond Executives. So after subtracting purchases from the Company, and before even subtracting operating expenses, a net loss was experienced by over 99% of distributors.

[Clearly, a distributor must recruit aggressively with the aim of becoming a Blue Diamond if he/she expects to profit from the Nu Skin program. Income from selling to persons without the aim of recruiting them would only divert them from their potential profits.] Note that these figures do not represent a distributor's profit, as they do not consider expenses incurred by a distributor in promotion of his/her business and do not include retail markup income. An average of 14.28%^t of U.S. Active Distributors qualified for commissions in 2004 – probably less than 1% of all distributors who had been recruited into the program since Nu Skin's inception. Active Distributors represented an average of 41.56% of Total Distributors, less than 2% of all distributors who had been recruited into the program since its inception.^u

Note that equivalent titles of Executive-and-above distributors vary between the Nu Skin Personal Care, Pharmanex and Big Planet divisions.

[ⁿIncludes some distributors who had been with the company since close to its founding in 1984. For statistical consistency, this time period for the population base should be used throughout the report.]

[^o Figures showing quarterly commissions are irrelevant for opportunity seekers (though common on reports to investors). The quarterly commission column in the original report may have been inserted to limit room for meaningful business opportunity disclosure items, such as purchases from the company.]

[^p Disclosure of all purchases from the Company are crucial for determining whether or not distributors are likely to come out ahead financially. Some purchases are required to qualify for commissions or advancement to higher levels in the pay plan, and others, such as training and sales materials, are necessary for full participation. These are estimates, that at the lower four levels are based on personal experience by the author in his one-year test of the Nu Skin program.]

[^q Operating expenses for successful recruiters can be many thousands of dollars, and recruitment prospects should be encouraged to factor in estimated expenses when estimating potential profits. Such operating expenses include travel, telephone and Internet costs, advertising and promotional expenses, rental of meeting rooms, company sponsored training programs, sales materials, and miscellaneous expenses. Subtracting operating expenses would mean only those near the top would profit.]

[^r Documented retail markup income rarely occurs.]

[^s These numbers are merely estimates and are given to illustrate information that should be supplied.]

[^t This number is calculated by adding the average percentage numbers for each level of Active Distributors in the above table.]

[^u **IMPORTANT NOTE:** The “since its inception” is used for the total population to be statistically consistent with the practice of counting all distributors who achieved the various levels – also since the Company's inception.]

Nu Skin Enterprises, Inc, Distributor Compensation Summary – Corrected, Page 4

Title (level in the compensation plan)	Percentage of total distributors * recruited during applicable time period ¹	Total number of distributors, many of which were recruited during the time period represented in the left column (total – over 1 million in U.S. A.) ²	Average quarterly commission Incomes - IRRELEVANT FOR OPPORTUNITY SEEKERS ¹²	Average annual commissions per distributor for each income level	Average Total purchases * of goods and services from Nu Skin (some on behalf of others) ³	Average net profit/loss ³ per distributor
Blue Diamond	.14 0.007% ¹	81 ²	N/A	\$552,348	\$20,000 ³	\$532,358 ³
Diamond	.07 0.0035	41	N/A	126,824	15,000	111,824
Emerald	.07 0.0035	41	N/A	71,627	10,000	61,627
Ruby	.15 0.0075	87	N/A	35,634	8,000	27,634
Lapis	.46 0.023	267	N/A	15,960	6,000	9,960
Gold	.79 0.0395	458	N/A	7,981	5,000	2,981
Executive	2.96 0.145	1717	N/A	3,955	5,000	(1,045)
Qualifying Exec.	1.24 0.062	719	N/A	1,320	5,000	(3,680)
Distributors who qualify for commissions	8.40 0.42	4,872	N/A	507	2,500	(1,993)
All distributors who did not qualify for commissions during applicable time period	85.72 99.289	991,717	N/A	0	200	(200)

If you have any questions concerning this information, please contact Distributor Support at (800) 487-1000.

¹ These percentages are calculated by dividing the number of distributors in the various levels at the end of 2004 by the total number of distributors recruited during the same time period as the period covered by those included in the various payout levels. ~~adding the average percentage of total Active Distributors at each level. at the end of the quarter for each quarter of 2004 and dividing by four.~~

² ~~These numbers are calculated by taking the quarterly average commissions and multiplying by four.~~

² "Total Distributors" includes all U.S. distributors who either signed an agreement or renewed their distributorship during 2004 irrespective of their purchasing products, promotional materials or services or earning commissions – *except for the bottom row, which includes those who dropped out or terminated their distributorships, which is over 99% of participants who signed up since the inception of the company.*

³ These numbers are merely estimates and are given to illustrate information that should be included in the report.

IMPORTANT NOTE TO FTC OFFICIALS: If the Company objects to counting all distributors recruited since the inception of the company (to be consistent with length of activity of those who achieved certain levels), the time period could be shortened to five or ten years, etc. But in that case only those participants who started during the same time period and who achieved the various levels during that same time period should be counted. The most honest and statistically correct way to report this would be to take ALL recruits for a given year and follow them for one or more years and report how many achieved the various levels, and how many became inactive or terminated.

NU SKIN ENTERPRISES, INC. DISTRIBUTOR COMPENSATION SUMMARY

Company Overview

Nu Skin Enterprises, Inc. (together with its affiliates, the "Company") is a global direct selling company that operates in more than 30 countries throughout North and South America, Asia and Europe. The Company operates in three divisions: (1) the Nu Skin division markets premium quality skin care and personal care products; (2) the Pharmanex division is a science-based developer of nutrition products; and (3) the Big Planet division markets and distributes Internet, technology, telecommunication and other products.

Distributors

The Company markets its products through a network of independent distributors. For purposes of this summary, an "Active Distributor" is a distributor who placed an order for products, promotional materials or services or renewed their distributorship during the quarter. In the United States, the Company had an average of 57,998 Active Distributors each quarter in 2004.

Compensation

There are two fundamental ways in which a distributor can earn compensation:

- Through retail markups on sales of products purchased at wholesale prices; and
- Through commissions (sometimes called bonuses) paid on one's product sales and the sales of other distributors in one's downline sales network.

As with any other sales opportunity, the compensation earned by distributors varies significantly. The cost to become a distributor is very low. People become distributors for various reasons. Many people become distributors simply to enjoy the Company's products at wholesale prices. Some join the business to improve their skills or to experience the management of their own business. Others become distributors but for various reasons never purchase products from the Company. Consequently, many distributors never qualify to receive commissions.

Generating meaningful compensation as a distributor requires considerable time, effort, and commitment. This is not a get rich quickly program. There are no guarantees of financial success.

Retail Markups

Distributors can buy Nu Skin, Pharmanex and Big Planet products from the Company at wholesale prices for resale to customers or for personal consumption. Some Big Planet products are services, such as Internet access, on which there is no retail mark-up earned by distributors. In addition, some Big Planet products are lower margin products offered through Internet mall affiliates. Consequently lower levels of commissions are paid on the sale of such products. The Company's suggested retail markup is 43% on most of its personal care and nutrition products. However, distributors are free to set their own selling price and may personally consume some of the products they purchase. As a result, the Company currently neither provides an estimate of average income from retail sales nor includes distributor retail income in its average commission information.

Commissions

Distributors can also earn commissions based on the sale of products by a distributor and his/her downline of sponsored distributors in all markets where the Company does business. The Company also sells promotional materials that do not generate commissions to distributors.

In 2004 the Company paid approximately \$487,631,000 in commissions and sales compensation globally. In the same period, the Company paid approximately \$77,329,163 in commissions to distributors residing in the United States.

The following table shows the average quarterly commissions paid in 2004 to U.S. distributors at the various levels of the Company's sales compensation plan at the end of each quarter, the average percentage of total Active Distributors and the average percentage of Executive-and-above distributors that qualified to receive commissions at each level at the end of each quarter. These figures do not include retail markup income

Title	Quarterly Average Commission Income at Each Level for 2004	Annualized Commissions ²	Average Percentage of Active Distributors ¹	Average Percentage of Executive-and-above level distributors
Active Distributor Qualifying for Check (Non-Executive)	126.75	507.00	8.40%	N/A%
-Qualifying Executive	330.00	1,320.00	1.24	N/A
Executive	988.75	3,955.00	2.96	64
Gold Executive	1,995.25	7,981.00	.79	17
Lapis Executive	3,990.00	15,960.00	.46	10
Ruby Executive	8,908.50	35,634.00	.15	3
Emerald Executive	17,906.75	71,627.00	.07	2
Diamond Executive	31,706.00	126,824.00	.07	2
Blue Diamond Executive	138,087.00	552,348.00	.14	3

The average commission paid to U.S. Active Distributors each quarter was \$326.55 or \$1,306.20 on an annualized basis. The average commission paid to U.S. Active Distributors who qualified for commissions in 2004 was \$9,194.00 (annualized). Note that these figures do not represent a distributor's profit, as they do not consider expenses incurred by a distributor in promotion of his/her business and do not include retail markup income. An average of 14.28% of U.S. Active Distributors qualified for commissions in 2004³ Active Distributors represented an average of 41.56% of Total Distributors.⁴

Note that equivalent titles of Executive-and-above distributors vary between the Nu Skin Personal Care, Pharmanex and Big Planet divisions.

If you have any questions concerning this information, please contact Distributor Support at (800) 487-1000.

¹These percentages are calculated by adding the average percentage of total Active Distributors at each level at the end of the quarter for each quarter of 2004 and dividing by four.

²These numbers are calculated by taking the quarterly average commissions and multiplying by four.

³This number is calculated by adding the average percentage numbers for each level of distributors in the above table.

⁴"Total Distributors" includes all U.S. distributors who either signed an agreement or renewed their distributorship during 2004 irrespective of their purchasing products, promotional materials or services or earning commissions.

—WEB SITE NOTICE—

For Law Enforcement Agencies And Consumer Advocates

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

The web site, www.mlm-thetruth.com, features research on MLM (multi-level or network marketing) legitimacy – and evaluates MLM programs against the criteria of the “5 red flags of a recruiting MLM,” or product-based pyramid scheme – based on 10 years of investigative research on MLM/network marketing and other chain selling schemes. Better alternatives (than MLM) for earning income are presented.

Based on extensive research on MLM compensation plans, the “5 Red Flags” for evaluating MLM programs were developed. To evaluate MLM’s go to – http://www.mlm-thetruth.com/mlm_evaluations.htm Do your own evaluation, and then see how (in our analyses) dozens of prominent MLM’s (MLM programs” stack up against these criteria, which were developed during ten years of research on the harm done by some of the more exploitive programs – “recruiting MLM’s” (which reward recruitment of a large downline more than legitimate sales to consumers outside the network). Then read of better ways of earning an income.

For well-researched reports on the MLM/network marketing industry, go to www.mlm-thetruth.com, where are posted research and consumer guides regarding MLM prepared over a period of ten years by Dr. Jon Taylor, president of the Consumer Awareness Institute, with the assistance of other top experts in the field. Opinions in publications and on web sites vary widely on the legitimacy of network marketing.

What is different about this site is that you will find objective research upon which to base analyses of MLM compensation plans and how they relate to success, loss rates, legality, etc. In other words, consumers will have an objective basis for deciding whether or not to participate in a particular MLM – or any MLM – or to seek an alternate income source.

Questions answered on the site include:

- Who if anyone is actually profiting from these schemes?
- How can a person determine if an MLM program is legitimate – and if such exists?
- What – if anything – are federal and state officials doing to regulate MLM’s? How can victims recover losses from MLM participation?

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- “5-STEP DO-IT-YOURSELF EVALUATION” section for judging the profitability of specific MLM programs. Compare with our EVALUATIONS of over 200 MLM companies
- “1,357 Ways to Make a LOT More Money than in MLM-Network Marketing” – proves that MLM is not the only game in town
- (for LDS members) “Answers to Questions for LDS Church Leaders and Members Regarding Multi-level Endless Chain Recruitment Schemes”

- “Top Ten Things I Learned from Ten Years’ Research on MLM/Network Marketing” – by Dr. Taylor
- “Survey of Tax Preparers” – Tax professionals as a group know who is and who is not making any money in MLM/network marketing programs.
- MLM STATISTICS –The odds of success in MLM, compared with gambling & no-product pyramid schemes
- “The FIVE RED FLAGS of a Recruiting MLM, or Product-based Pyramid Scheme”
- “TWELVE TESTS for Evaluating a Network Marketing (MLM) “Opportunity” – quoted by both pro and anti-MLM advocates and by consumer protection agencies
- Reports on LAW ENFORCEMENT and LEGISLATION as it relates to MLM
- “Answer Cards” and “Pass-along Bulletins” to warn friends and family of the risks of chain selling
- CARTOONS poking fun at MLM/network marketing.
- ACTIONS MLM victims can take to recover losses
- HISTORY of MLM/network marketing and the status of regulatory efforts

These reports are based on extensive research, including:



- Comparative research on MLM compensation plans and alternative business models to clarify differences
- Interviews with and feedback from thousands of MLM distributors and ex-distributors in a wide variety of MLM programs
- Interviews with the top experts in the field
- Interviews with regulators seeking to curb pyramid scheme abuse
- First-hand experience with a variety of MLM programs.
- Internal documents from MLM company officials
- Surveys of hundreds of tax professionals, representing thousands of MLM tax returns
- Court records in MLM cases – including IRS income tax records of top distributors in one state
- Household consumer surveys of MLM participation and reactions to being approached by MLM recruiters
- Surveys of leading MLM company presidents
- Private and public financial disclosures by MLM firms
- Communications with law enforcement officials at all levels
- Direct experience with prominent MLM companies
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Questions? E-mail Jon M. Taylor, Ph.D., Consumer Awareness Institute at – jonmtaylor@juno.com

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Nu Skin Enterprises: An important case study for FTC officials on past efforts to implement business opportunity disclosure

REPORT OF VIOLATIONS

of the FTC Order for Nu Skin to stop
misrepresenting earnings of distributors –
and the need for FTC action to redress damages
and to prevent further world wide consumer losses –
including Addenda with evidence of recent misrepresentations
and failure to implement meaningful disclosure to correct them

By Jon M. Taylor, Ph.D., President, Consumer Awareness Institute, and Advisor, Pyramid Scheme Alert – Petition first submitted September 4, 2000 (Revised 7-13-06)

- ▶ The content, appropriateness, and importance of the 1994 consent order for Nu Skin to cease and desist misrepresenting earnings of distributors
- ▶ The four stages of violations of the Order by Nu Skin Enterprises, Inc. (current name), and the billions of dollars in cost to consumers worldwide as a result of said violations
- ▶ Three primary deceptions underlying said violations, including the attempt by Nu Skin to position itself as primarily a direct sales company, and the resulting distorted picture of “the Nu Skin opportunity”
- ▶ Five red flags that clearly identify Nu Skin’s compensation system as an exploitive product-based pyramid scheme, or recruiting MLM.
- ▶ The motivation for misrepresentations by Nu Skin – their highly leveraged breakaway compensation system, leading to in an abnormally high loss rate and the need to continue their deceptions in order to survive and grow
- ▶ Worldwide Ponzi/pyramid fraud resulting from Nu Skin’s de facto market saturation and misrepresentations about moving from the market in one country to fresh markets elsewhere
- ▶ Nu Skin’s efforts to buy credibility for its fraudulent program through worthy and visible donations, Olympic sponsorships, famous speakers at its conventions, notables on its board of directors, and other associations
- ▶ The need for prompt action by the FTC to fulfill its mission to protect consumers and fair trade – by finding Nu Skin in violation of the Order and by enforcing it with appropriate sanctions
- ▶ How failure to take enforcement action in the case of the 1994 Order for the protection of consumers (small investors) from Nu Skin (and similar programs affected by it) is analogous to the failure of the SEC to protect large investors in the Enron/Worldcom debacle – both resulting from earnings misrepresentations

INDEX AND SUMMARY OF KEY POINTS

NOTE: In the interest of time, the reader can review the key points here and focus on those items of greatest interest.

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(6) The cause of misrepresentation in recruiting MLM’s like Nu Skin – their exploitive and complicated compensation systems – are either avoided or not adequately addressed by consumer protection agencies and the courts. Instead, attention is given to complaints about exaggerated product and income claims, etc.	35
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A. The 1994 FTC Order for Nu Skin to stop misrepresenting earnings of its distributors was clear, appropriate, and important in fulfilling the mission of the FTC to protect consumers and to promote fair trade.

There should be no cause for confusion or question about the intent and content of the 1994 Order, as can be seen in Exhibit 1, below. **The Order was appropriate because Nu Skin International, Inc. (now Nu Skin Enterprises, Inc.), would tout huge earnings of top distributors, often stating that such earnings exceed those of all others in the industry. And Nu Skin still does this. (See B [Stage 3] below, and Appendix B.) For these reasons, and in spite of the protests of Nu Skin officials, the FTC was not in error in singling out Nu Skin for enforcement.** For the FTC to issue such an Order and not enforce it would seem to undermine the integrity and efficacy of the FTC in fulfilling its mandate to protect consumers against unfair, deceptive, or fraudulent practices.

B. Nu Skin has flagrantly violated both the letter and the spirit of the Order from 1994 to the present in four stages of misrepresentation:

STAGE 1: Period prior to the Order, when unsubstantiated huge earnings claims were being made, which led to the original FTC investigation and the Order

STAGE 2: From 1994 to 2000, during which time the company finally made official distributor earnings reports available to prospects. The intent of these reports was to substantiate earnings, but they are full of deceptions, that flagrantly misrepresent earnings and odds of “success.” This was particularly transparent after debunking the deceptions in its 1997 and 1998 reports of “Actual Average Incomes” of distributors.

STAGE 3: From late 2000 (when reporting was challenged) to the present, the company went back to allowing promoters to quote huge extraordinary distributor earnings, without including the actual percentages of participants at the various payout levels. Eventually

On September 4, 2000, I submitted a complaint regarding Nu Skin’s non-compliance with the Order

to the FTC. Then on December 4, 2000, essentially the same complaint was filed with the FTC Enforcement Division as a petition filed by Pyramid Scheme Alert (PSA), a non-profit corporation organized to expose, study and prevent illegal pyramid schemes.

The PSA petition detailed the violations of the 1994 Order, based on the 1998 report of “Actual Average Incomes” of distributors, which Nu Skin officials made available until that time to persons who were recruited into their programs. **This report was intended to support the income claims of Nu Skin promoters, but in fact was full of deceptions – 20 on a single page.** (See Appendix A, which has been condensed for this report, and Table 1 – *Debunking the Deceptions.*)

The author made a FOIA request for correspondence between Nu Skin officials and FTC officials, but was turned down, citing confidentiality concerns and discretion in favor of Nu Skin. Out of a file of some 60 pages, only one public document was released – which the author already had. The author also wrote Senator John McCain, who was over the FTC oversight committee to see if something could be done to improve FTC enforcement of the 1994 Order. An FTC communication representative informed Sen. McCain that the Nu Skin investigation was essentially closed. **Senator McCain admonished the FTC to “keep an eye on Nu Skin.”**

STAGE 4: Nu Skin began making “Distributor Compensation Summary” reports available to distributors, but only on a restricted basis – apparently to keep them out of the hands of independent investigators like us. However, through inquiries to us by persons considering Nu Skin as a possible income opportunity, we were able to obtain these reports. On close examination, it was clear that **most of the deceptions in their reporting remained.** A couple of irrelevant columns were added, apparently to deflect attention from the missing items – primarily a column for average amounts distributors paid back to Nu Skin for goods and services – essential information for opportunity seekers. (See Appendix G.)

When the aforementioned petition by Pyramid Scheme Alert was published on the World Wide Web and passed on to FTC officials, Nu Skin stopped issuing such reports, apparently fearing further scrutiny. But little action has been taken to date. Reports are now again being made available on a restricted bases, but many glaring misrepresentations remain and new ones are added. (See Appendix G.)

**Exhibit 1: Excerpts from the agreement between the Federal Trade
Commission and Nu Skin International, Inc.,
containing CONSENT ORDER TO CEASE AND DESIST**

Dated May 21, 1993 (File No. 912 3071) and finalized in April 1994

In the Matter of: Nu Skin International, Inc. (now Nu Skin Enterprises, Inc.), CJM, Inc. CST Management, Inc., and CK & C, Inc., corporations and Clara McDermott, individually and as an officer and director of CJM, Inc., Craig Tillotson, individually and as an officer and director of CST Management, Inc., and Craig Bryson, individually and as an officer and director of CK & C, Inc.

IT IS ORDERED that respondents Nu Skin, CJM, Inc., CST Management, Inc., and CK & C, Inc., corporations, their successors and assigns, and their officers; Clara McDermott, individually and as an officer and director of CJM, Inc.; Craig Tillotson, individually and as an officer and director of CST Management, Inc.; Craig Bryson, individually and as an officer and director of CK & C, Inc., and respondents' agents, representatives and employees, directly or through any partnership, corporation, subsidiary, division, or other device, in connection with inducing or seeking to induce the participation of any person in any distribution, sales, or marketing plan, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith **cease and desist** from:

A. Misrepresenting, in any manner, the past, present, or future profits, earnings, income, or sales from such participation; and

B. Representing, in any manner, directly or by implication, by use of hypothetical examples or otherwise, that distributors earn or achieve from such participation any stated amount of profits, earnings, income, or sales in excess of the average profits, earnings, income, or sales of all distributors in any time period respondents may select, unless in conjunction therewith such average profits, earnings, income, or sales are clearly and conspicuously disclosed, and the percent of all distributors who actually achieved such stated profits, earnings, income, or sales in such time period is clearly and conspicuously disclosed.

Finally, the Order prohibits the respondents from:

1. **Misrepresenting** the past, present, or future profits, earnings, income, or sales of any person in any distribution, sales or marketing plan; and

2. **Representing** that distributors earn or achieve any stated amount of profits, earnings, income, or sales in excess of the average profits, earnings, income, or sales of **all** distributors unless in conjunction therewith the average profits, earnings, income, or sales are clearly and conspicuously disclosed, and the percent of **all** distributors who actually achieved such stated profits, earnings, income, or sales is clearly and conspicuously disclosed.

The proposed Consent Order also prohibits the proposed respondents from,

(1) **misrepresenting**, in any manner, the past, present, or future profits, earnings, income, or sales from participation of any person in any distribution, sales, or marketing plan; and

(2) **representing**, in any manner, directly or by implication, by use of hypothetical examples or otherwise, that distributors earn or achieve from participation in any distribution, sales, or marketing plan any stated amount of profits, earnings, income, or sales in excess of the average profits, earnings, income, or sales of **all** distributors, unless in conjunction therewith such average profits, earnings, income, or sales are clearly and conspicuously disclosed, and the percent of **all** distributors who actually achieved such stated profits, earnings, income, or sales in such time period is clearly and conspicuously disclosed.

This case against Nu Skin is not based solely on the 1998 report. Nu Skin had made reports available by “fax on demand” prior to that time, but they were long and difficult to decipher. But the 1997 and 1998 reports were particularly important to enforcement of the Order because they were easy to interpret and on official company-wide reports, and the deceptions could readily be debunked by a qualified analyst.

The reason for the original Order in 1994, following Stage 1, was widespread misrepresentation by distributors. The misrepresentations during Stage 2 (discussed in the petition) were found in official company reports, especially the 1997 and 1998 reports of “Actual Average Incomes” of distributors. (Note that the 1997 report and analysis follows 1998 as an addendum on page 10 of Appendix A.) The 1997 report displayed the same primary deceptions (See section D below) as was used for 1998, and in 1994 to 1996 Nu Skin used similar devices to deceive prospects.

Stage 3 was in essence a return to Stage 1. On February 8, 2001, a call was made by this researcher to the number which was previously given out to verify income of distributors, and the answer that was given was “That report is temporarily unavailable.” Several months later, an intercept indicated that the number was disconnected. Several calls were made to distributor relations at Nu Skin, but the answer finally given was “that information is no longer available.”

Reports came by e-mail to PSA from distributors worldwide that Nu Skin promoters continued to claim the highest earnings for its top level (Blue Diamond) distributors in the MLM (multi-level marketing) industry, but without giving out data supporting such claims. See Appendix B for the form in which these earnings were compared to other MLM companies – with my comments on problems with these reports.

Note that the report was from an outside business school, which allows Nu Skin promoters to quote them, rather than make the claims themselves. But there is no question about the source of the information – which begs for the qualifications suggested here.

Nu Skin promoters never explained that the odds of achieving Blue Diamond status was less than one in 12,500 – and that to be “successful” in the Nu Skin program, participants needed to become Blue Diamonds. This is because Blue Diamond distributors received about 58.6% (63% in 1997) of the payout – out of thousands of their respective downline participants (including commissions that “roll up” from dropouts).

In Provo, Utah, where Nu Skin is headquartered, “Blue Diamond University” weekend rallies have

been held recently, implying that anyone who put forth the effort (and paid out extensive moneys for products and services) could become a Blue Diamond distributor. But never were recruits told that their chances of becoming a Blue Diamond were less than one in 12,500.

Further evidence of misrepresentations during Stages 3 and 4 are discussed in the Addendum in Appendixes F and G.

Exhibit 2: Meeting with Nu Skin officials challenging my analysis

On March 30, 2001, at their request, I agreed to meet with Max Pinegar, formerly Nu Skin general manager, and Corey Lindley, then Nu Skin’s CFO.

Mr. Lindley attempted to discredit my finding in the PSA petition that the U.S. retail sales statistics implied by the “Actual Average Incomes” report differed sharply with those required by the SEC in their annual report. Mr. Lindley explained the juggling back and forth of sales figures in 1998 due to international inter-corporate transfers and restructuring, and other factors.

However, even under the most liberal of interpretations, the numbers reported for U.S. sales revenues to the SEC do not come anywhere near those reported to the FTC in 1998. And Mr. Lindley’s justifications did not explain the same three deceptions underlying other reports from 1994 to 1997, nor the reports of average incomes of top distributors given out since 1998 – which avoided any substantiation of income figures. Let us examine this further.

Obviously, Nu Skin’s CFO had the advantage in that he held the U.S. sales figures close to his vest and was not very open about disclosing them. **But Mr. Lindley would have to do some serious number stretching to get U.S. retail sales up to the \$353.8 million in 1998, 1999 or any year – as projected from the “Actual Average Incomes” report required by the FTC when large incomes were touted, triggering the need for statistics to back up claims of Nu Skin promoters.**

However, the 2000 Annual Report (page 36) does reveal revenues from North American operations (of which 95% was in the U.S.) of \$72.7 M, \$117.9 M, and \$155.8 M in 1998, 1999, and 2000, respectively. For 2001 the figure was \$155.9 million. It never exceeded \$160 million for any year during the years 1997 to 2001 – not even half that projected in the “Actual Average Incomes” supplied to prospects who made investment decisions based on these misleading statistics.

So my conclusions, based on conflicting information between reports to the FTC and SEC, are

indisputable. In fact, after subtracting starter kits and minimum qualifying purchases by distributors for Executive qualification, retail sales are far lower than what I estimated.

It should also be noted that the 1997 report of "Actual Average Incomes" followed the same format as for 1998, and used the same three basic deceptions to misrepresent earnings – which will be explained in Section D, below. And the excuse of inter-corporate transfers cannot be used to the same degree for 1997. Distributor income reports prior to 1997 were more difficult to decipher, but careful analysis suggests similar deceptions were used as in other years.

When I pressed Nu Skin's CFO on the matter of not counting distributors who invested in the program and then dropped out (a crucial statistic for prospective recruits), he stated, "We've never deemed that to be material." When pressed further on the matter, he finally admitted to me (with a witness present) that **the company purges the records of ex-distributors on a regular basis. Thus perhaps the most damaging of evidence which could be used against Nu Skin on this vital issue in court, is destroyed and kept from the knowledge of regulators now and in the future.**

When I kept pressing these gentlemen about the numbers in their report, Mr. Lindley responded, "People don't pay any attention to those numbers." Why would Nu Skin officials want to bring it up? If true numbers were provided prospects in a form that they could understand, no rational person would join.

Apparently, Nu Skin's response to the findings in the PSA petition was to stop publishing the report at all. (See Complaint and supporting documentation in Appendix A.) Mr. Lindley used as an excuse that SEC requirements limit public disclosure of information for the protection of investors. But investors make their decisions on the assumption that the business is honest in its reporting. It seems that Nu Skin officials fail or do not wish to acknowledge that the key to their business – the participation of new recruits – is predicated on honest reporting of average earnings to these recruits.

In other words, **Nu Skin officials use SEC rules to defy the FTC Order. Instead of releasing true and adequate information, Nu Skin gives out misleading or inadequate information and uses the SEC as an excuse to avoid telling the whole truth (which would discourage anyone from signing up). So prospects are told they can become a Blue Diamond and make this enormous income without being told how close to zero are their odds of doing so.** (See Tables 1 and 4.)

Investors are deceived as much as are Nu Skin recruits by being told Nu Skin is a direct selling opportunity, rather than a chain selling scheme; i. e., a highly leveraged and exploitive

product-based pyramid scheme. (See Section F, below.) Few would invest if they were given true information. So the SEC and investors are both misled.

Following my meeting with Mr. Lindley and Mr. Pinegar, I wrote my response to their challenges and sent copies to founder Blake M. Roney, Chairman of the Board, and Steven J. Lund, President and Chief Executive Officer of Nu Skin. They both wrote me back, expressing the view that Nu Skin offers quality products and a fine income opportunity, that not everyone succeeds at this business, as is the case with any business, etc., etc. (For more on the meeting, see Primary Deception #1. below.)

Overall, the responses of Nu Skin officials to my challenges reminds me of a child caught with his hand in the cookie jar, who cannot come up with a satisfactory explanation and so invents an excuse – "My brother made me do it," etc. NS officials dramatically display the "cognitive dissonance" expounded by the psychologist Leon Festinger, which explains this denial and rationalizing behavior.

Mr. Lindley often boasted that Nu Skin reporting practices followed GAAP (generally accepted accounting principles). Since the revelations of Enron, Arthur Anderson, and others, the GAAP cover quickly evaporates. As explained below, Nu Skin could be the Enron of small investors. All it takes to unravel the deceptions is someone who is skilled at long division and some basic algebra and statistics.

It should be explained here that many of the official apologists for Nu Skin have never been distributors for the company, so they have a limited understanding of the dynamics and extent of the misrepresentation that routinely goes on in the recruiting process. **It would be better if the founding distributors – who created the compensation plan and profit from it – answered these charges.**

In my opinion, if the founding distributors were investigated or cross-examined in their claims by a capable and knowledgeable prosecutor, they could be easily tripped up. So to protect themselves from searching cross-examination, they hire willing support staff (which includes the CFO, corporate attorney, and other managers of the infrastructure who parrot the answers they are taught.

I believe it is no accident that both the last CEO (Steven J. Lund) and present CEO (M. Truman Hunt) are both attorneys.

(end of Exhibit 2)

C. During all four stages, the resulting consumer damages have been significant. Millions of participants have been defrauded of billions of dollars worldwide.

Nu Skin's whole business is predicated on representations made to prospects that it is a legitimate business and that it will be profitable for them to participate. When those representations mislead, people are defrauded of the money they invest (usually in the form of products and services from Nu Skin).

Careful study leads to the conclusion that the degree (though not the total amount) of misrepresentation by Nu Skin exceeds that of Enron, Worldcom, and other major corporations, which have recently received much recent media attention. The agency responsible for regulating the securities market failed to protect investors from misrepresentation. As a result, SEC Director Lindsey, was replaced in December of 2002.

But with Nu Skin, instead of investors losing assets because of earnings misrepresentations of the companies, participants in the "Nu Skin opportunity" lost money in the form of investments in products and services from Nu Skin, based on significant misrepresentations in claims of average earnings of distributors. As a result, about 99.94% of Nu Skin recruits lost money – never to be recovered.

Nu Skin counters these losses with the argument that their distributor contract includes a one-year buy back policy for unused merchandise. But this presents one of the challenges for distributors – the time it takes to discover the validity of the Nu Skin program. None of the ex-distributors I interviewed became fully aware within a year of the misrepresentations that had been the cornerstone of their signing up as a distributor.

After leaving Nu Skin following a one-year test of their system, it took me several years to fully decipher the deceptions that I reported in the PSA petition. And I have a Ph.D., with considerable experience as an entrepreneur and evaluator of small business opportunities. Investigators tend to underestimate the cleverness of the compensation systems of product-based pyramid schemes. **Without understanding the five red flags of recruiting MLM's (Appendix D), it is very difficult to see through the deceptions.**

Unfortunately, **few filed complaints because Nu Skin indoctrinates recruits into believing that any blame for failure is the distributor's, rather**

than a highly leveraged compensation system favoring those at the top of the pyramidal hierarchy. Also, interviews with many victims of the Nu Skin program also make it clear that **a primary reason for their failure to file complaints is fear – fear of consequences from or to those in their upline or downline who are still in the program and might be affected by their disclosures, which could be close friends or relatives.**

In fact, this seems to be true of all endless chain recruitment programs. Fear of self-incrimination is also a major factor, since every major victim of a chain selling scheme is of necessity a perpetrator. If he/she is to have any hope of recouping the money they have invested, they must recruit many others into the programs, who themselves become victims – who in turn become perpetrators, ad infinitum, in an endless chain of recruitment.

Since Nu Skin's inception, **millions of participants have been defrauded of billions of dollars world-wide, due in large part to its misrepresentations** in promoting its programs. Hundreds of thousands of additional recruits (mostly in Asia) have been defrauded of hundreds of billions of dollars since the original filing of the PSA petition in December 6, 2000.

The actual amount of losses can be estimated by referring to the total revenues published by Nu Skin. Since this analysis leads to the conclusion that 99.94% of participants lost money (after subtracting product purchases and operating expenses), the revenues reported to the company was obtained by defrauding the 99.94% of downline participants who could be considered victims of the scheme. Total revenues since the Order have exceeded ten billion dollars, so **damages to participants could exceed six or seven billion dollars. And the total number of victims worldwide is in the millions.**

Table 1

DEBUNKING THE DECEPTIONS

**Percent of participants who succeeded in earning a profit
and percent who lost money in Nu Skin Enterprises, Inc. –
BEFORE and AFTER the author debunked the deceptions in
Nu Skin’s “1998 Actual Average Incomes” report of distributors’ incomes**

BEFORE debunking Nu Skin’s numbers:

Percent of Nu Skin distributors who are made to appear to have made money (profited), assuming reasonable effort, **before** debunking Nu Skin’s “Actual Average Incomes” report of distributors’ incomes — **100%**

Percent of distributors who would have lost money, who “really tried” to make the program work for them — **0%**

Nu Skin’s “Actual Average Incomes” report left the impression that nearly everyone who diligently works at the Nu Skin program earns a profit.

AFTER debunking Nu Skin’s numbers:

Percent of Nu Skin distributors who actually profited, **after** debunking Nu Skin’s “Actual Average Incomes” report of distributors’ incomes — **0.06%**

Percent of Nu Skin distributors who lost money, including some who put forth great effort to make the program work for them — 99.94%

A closer look suggests that only about one in 3,838 Nu Skin distributors made a profit, after subtracting all expenses (including “incentivized” or “pay to play” product purchases). The vast majority lost money; some lost substantial investments – all to enrich Nu Skin’s coffers and its top recruiters at the top of its hierarchy of distributors. (Actually a megapyramid of participants – See Item E and F below.)

CAN A MORE STRIKING CONTRAST BE IMAGINED BETWEEN THE TRUTH AND WHAT WAS REPRESENTED BY NU SKIN OFFICIALS?

rate – is undermined by purging and minimizing the denominator in the equation for calculating the ratio of success against the entire population of those who attempt the Nu Skin “business opportunity.” In a sense, the whole premise of Nu Skin’s business is built on this statistic, but instead is replaced with “active distributors,” a misleading statistic. In effect, Mr. Lindley was admitting (in the presence of three witnesses) that Nu Skin routinely destroys crucial evidence of its misrepresentations.

Finally, realizing I sensed his evasiveness, Mr. Lindley offered that “in any given year, 200,000 to 300,000 distributors are recruited world-wide.” This makes my estimates for recent years very conservative. At one time, the number of distributors in the U.S. was much higher than overseas, and since the report deals with U.S. distributors, my conclusions on terminations and inactive distributors still holds, even though Nu Skin avoids tracking or giving out accurate totals.

Mr. Lindley pointed out that “active distributor” counts are defined in many ways. Never does Nu Skin count all who sign up as distributors to be the distributor population for statistical purposes. Yet it is inconceivable that over 95% of recruits who sign up and pay to become Nu Skin distributors have no intention of becoming distributors – unless they were “dummy distributors” to satisfy “pay to play” or head count requirements.

Mr. Lindley claimed that the practice of using a narrow base of “active distributors” in figuring the odds of success for an MLM was in keeping with an “industry standard.” He was no doubt referring to the DSA (Direct Selling Association), which has become a spokesman for (pyramid scheme) chain sellers, or the MLM industry. But accepting this practice is no better than Enron, Worldcom, and other corporations failing to expense executive options in calculating earnings upon which investor decisions are based. The effect is the same – exaggerated claims of success upon which decisions are made to participate in the Nu Skin program – or earnings upon which investment decisions are based.

To eliminate in the report the distributors who terminate or become inactive after signing on would be like saying to prospects, “Your odds – after eliminating 95% of you investors, who will become deadbeats, anyway – is 1 in 192! Or, 1 in 3,838 will earn a profit if we include everyone, including those of you who remain active and those of you who will eventually be losers, which is the vast majority of you!” It should be disclosed that less than one in

12,500 are likely to make the income of Blue Diamond distributors – who pocket most of the commissions and bonuses paid by Nu Skin. If they did this, they would at least be honest – but then no one would join the Nu Skin program. This should be a good thing for them, if not for Nu Skin.

When the numbers become clear to victims, they are outraged at the misrepresentations. As Louis S., a former New Jersey distributor for IDN (Interior Design Nutritionals, a division replaced by Nu Skin’s Pharmanex Division), put it after losing not only his money but nearly losing his wife and family:

Congratulations on your efforts to spare other individuals from the misfortune these callous miscreants heave upon an unsuspecting public. . . As an IDN executive, unfortunately, I disregarded my gut feeling that the numbers didn’t equate to the pitch I received from my male sponsor and his female upline. I was swayed by her beauty and sincerity, I nearly lost it all. I gave control of my trucking business to my son, separated from my wife and went on in an attempt to prove my family wrong and was going to make this work by doing it fulltime . . . I’ve never seen so many divorces caused by a business as with N.S.!

I even went to the conferences in Utah for a couple of years fooling myself into believing I would turn this around. Fortunately my wife of now 36 years did not give up hope that I would see I was being hoodwinked and forgave my foolishness, I’ve steered clear of any other MLM pitches and try to convince others to do the same.

Misrepresentations in Asia:

Recently, Nu Skin promoters have recruited aggressively in Asian countries. Since the company there is outside of the U.S. and the scrutiny of the FTC, income claims are made without discussing the odds of achieving such incomes. I asked Asian correspondents there if it was true that Nu Skin recruiters compared the average incomes of Nu Skin’s top distributors (Blue Diamonds) with top earners of other companies (see Appendix B) without giving out the odds or likelihood of achieving those levels? A correspondent named Susan from Malaysia answered:

Yes, we were given the numbers and the chart showing the astronomical difference

[between top distributors' earnings for Nu Skin versus those at other leading MLM companies]. We were also told that's the reason why companies like Amway and Cosway are losing members rapidly. The most hyped member, earns about USD 15,000 every day or about USD 400,000 a month.

She was later asked, "Were you told that less than one in 625 (U.S. figures – one in 300 in Hong Kong) currently "active distributors" are Blue Diamonds?" [- and that distributors who dropped out were not counted in the statistics, which would make the odds far worse – **less than one in 12,500? The one in 625 or one in 300 is a huge deception.**]

Answer: No, [citing] statistics are a rarity. We were shown successful distributors pictures and lots of blue diamonds from Japan.

Jerome Pang from Singapore observed:

There was the usual presentation of potential income up to Sing 75,000 dollars but **there was no show of what percentage of persons/distributors who achieved or were able to achieve these incomes or what percentages were successful [in Nu Skin] in Hong Kong or the US.** The following were always illustrated during the "business opportunity meetings"

If 2 distributors became executives you could earn S\$2000 pm. [per month]

If 4 distributors became executives you could earn S\$5000 pm.

If 6 distributors became executives you could earn S\$9000 pm.

If 8 distributors became executives you could earn S\$22,000 pm.

If 12 distributors became executives you could earn S\$75,000 pm.

PRIMARY DECEPTION #2: Expenses, including "pay to play" purchases, were not subtracted when figuring income, ignoring breakeven and hugely distorting income averages.

The importance of subtracting "incentivized" or "pay to play" purchases (purchases to meet volume quotas required to qualify for commissions or advancement) is explained in my separate report entitled *Five Defining Characteristics [now the "5*

Red Flags"] of Product-Based Pyramid Schemes, or Recruiting MLM's. (See summary in Appendix D.) I will not elaborate on it here, but it should be studied carefully to clarify what are some vital (though thorny) issues regarding compensation systems of recruiting MLM's. But suffice it to say that **in other businesses, any expenses required to qualify to conduct the business is considered a business expense.**

In my one-year test of the Nu Skin system, I found it necessary to spend an average of \$1,543 per month on products, training, and all operating expenses in order to advance in the scheme. My commissions finally rose to about \$246 a month, for a loss of \$1,297 per month – in spite of my being in the top 1% of all Nu Skin distributors in its pyramidal hierarchy!

Add to qualifying expenses the operating expenses of travel, supplies, telephone services, etc., and the costs can be substantial. Yet these are never quoted at Nu Skin opportunity meetings. **Subtracting purchases of products and services from Nu Skin, as well as operating expenses, raises the breakeven bar to the point that only a tiny percentage of Nu Skin participants actually realize a profit.** In the case of recruiting MLM's such as Nu Skin [See F below – and Appendix A] this analysis leads to the conclusion that **approximately 1/30 of 1% of participants actually realize a net profit – far less than the "Actual Average Incomes" report would suggest.**

In recruiting meetings in Singapore and Malaysia during the years 2001 and 2002, product and operating costs are not mentioned as a significant factor in estimating income. I asked a distributor in Malaysia (who requested she not be named) this question: "Were you reminded that purchases and operating costs of recruiting enough persons to have a profitable downline could be very expensive and even wipe out all profits?"

Answer: "No, none were mentioned. It was made to be a low cost, high benefits business. All we have to do is to show them to friends and acquaintances, the products would sell by themselves."

Neither the cost of required purchases to "play the game" or of necessary operating costs to be successful were mentioned.

Henry and Liza, a couple from Singapore (henry_liza@hotmail.com) wrote:

First of all, I really hope you can take time to reply to my query as we (my wife and I) are about to start into this “business” as recommended by a very close friend. We, in fact, already paid our distributor's fee and bought an executive pack of products from Nu Skin. **All these are necessary as this is the 'system' defined by our uplines. Now, we are 'encouraged' to buy a '5-pack' , i.e., 5 executive packs, which they say will start to fast track our becoming executives, hoping that our recruits or downlines will 'duplicate' this system. By the way, this executive pack and 5-pack kind of system is proven [or so they had been led to believe] to earn thousands of dollars per month, as confirmed by our uplines.**

We haven't started getting our recruits yet. This is simply because we still have some hesitations about the 'system' and of course Nu Skin, in general. Nu Skin products are the first products launched in a country after which they will then launch Pharmanex, Big Planet, and so on. Have you heard of such names? Are these MLM and how are they different from Amway, etc.? *[They are divisions of Nu Skin, which apparently was not disclosed to them.]*

Please help.

Later they wrote:

Thanks for sending us this information. It had helped us so much to make a decision to stop and be further involved in this “business opportunity”.

We [had] signed up and already bought the advanced-500 pack. We're asked to buy 5 more packs to accelerate the process of being an executive. We declined and started researching about this thing.

Its true – many recruits hesitate at this point during training as to whether to launch their business with the 5 packs or not. Some start to get serious and do more checking just like this couple. Many attend even more trainings and recruits are encouraged to attend the “Blue Diamond University” mostly conducted by George Calligeros himself who is a GREAT TRAINER and PRESENTER and some end up “taking up the 5 packs” to launch the business.

Essentially, the 5 packs are returnable within 365 days for 90 per cent and within 60 days for 100 per cent. However, the leadership's

argument is that “stocking up” is part of the SYSTEM and its been Nathan Ricks specially designed system that has allowed him to build his great fortune etc. Nathan himself supports this and says that “people suddenly see more prospects” once they commit to the 5 packs! (its true because they are all stressed up to move the packs or fail and be seen returning them). . . .

It's a “mental paradigm shift” for most people to accept that a) they have to give profit to their upline partners and b) they allow their uplines to earn these points. However, if one is serious, it's the way it has to work because in this recruitment model, there is no other way you can move that fast without sponsoring products downline and earning your points that way. **They always say “pay once and earn it back 5 times”. [How could the “pay to play” feature of a product-based pyramid scheme be better articulated than that?]**

NOTE: Using simple algebra, I figure about \$1,751 US dollars for the 5-pack mentioned above, or a total of about \$2,251 that Henry and Liza were expected to invest to “play the game.” This corresponds roughly to amounts often invested by victims of the Nu Skin program in this country.

David Kwok Chong, a correspondent from Singapore (kwok_chongdavid_mun@baxter.com), identified what he calls “VICARIOUS MISREPRESENTATION,” or the penalty for not recruiting and buying a sufficient quota of products:

This is where the MAJOR “CRIME” is committed – the Independent Distributors, in particular the BLUE DIAMOND LEADERS and their teams will mostly do anything TO SUCK OTHERS IN and they do this because they would otherwise LOSE WHATEVER THEY HAVE BUILT !

George Calligeros always said “The fear of loss is the greatest motivator” in his [Nu Skin] presentations and training and he knows and works on this. His modus operandi is to get recruits on the “path of Executiveship” so that they appear to themselves to be “on track to Blue Diamond” and the “Fear of Loss” will keep them maintaining their Executiveships even if they BREAK THEIR BANKS AND CREDIT CARDS in the process!

From experience, observations, and worldwide correspondence, it is clear that Nu Skin's primary source of revenues is not retail sales, but purchases from a huge network of middlemen disguised as distributors.

PRIMARY DECEPTION #3: Nu Skin promotes its program as a "direct sales opportunity," a major misrepresentation – which becomes evident when its compensation system is understood and its "Actual Average Incomes" reports debunked. Based on bogus survey statistics, sales at full retail prices were assumed that had seldom occurred, except for new recruits paying full retail prices for "pay to play" purchases. Thirteen proofs, taken together, provide solid evidence of no significant retail market.

In spite of Nu Skin's claim that most products purchased by participants are sold directly to end users at the listed retail price, evidence that Nu Skin "distributors" seldom sell products to persons outside its network is plentiful:

(1) In Nu Skin's compensation system, the rewards for recruiting far outweigh rewards for retailing. Using a simple principle of differential rewards, when the odds are stacked over 1,000 to one in favor of those who recruit their way to the top as compared to those who attempt to make money retailing, participants will see it is to their advantage to concentrate on recruiting, especially with such high priced products. It becomes clear in the way the scheme is promoted that recruiting – not retailing – is where the money is.

(2) Retail list prices for Nu Skin's products are too high to be competitive on the retail market – so that only in well-to-do neighborhoods could a distributor be successful in selling products at the suggested retail price. For example, a couple with two teen-age children taking LifePak would pay about \$200 a month wholesale for basic nutritional supplements. If in addition they buy skin care products and/or computer services, that figure could easily rise to twice that amount. And if you add 43% retail markup, they could be up to \$572 a month – before even buying groceries for the family!

Nu Skin officials counter that the products are high priced because they are superior to other

products on the market. But experts I have consulted in the fields of skin care, nutritional supplements, and computer services have emphasized that Nu Skin's products are not top-of-the-line in their respective categories – at least not sufficient to justify their high prices.

(3) Little or no viable retail market remains after Nu Skin has recruited in an area and moved on. This is apparent to anyone who has followed their movements from one market to another, a process I call "re-pyramiding" – making such chain selling schemes de facto Ponzi schemes! So Nu Skin promoters have engaged in re-pyramiding from country to country and from one product division to another in order to keep the income stream going for both the company and for Blue Diamond distributors. This suggests that **products sold at retail were primarily sold to those in the network as "pay to play" purchases. So the sellers are the buyers, and the buyers are the sellers – to themselves and their families.**

(4) Determined to prove whether the Nu Skin program was a genuine opportunity or a scam, I performed a one-year experiential test of the Nu Skin program, attending over 60 opportunity meetings and conversing with "distributors" at all levels, including Blue Diamonds. Out of over 200 distributors I had contact with, I recall only one person who focused on selling Nu Skin products at full retail price. This was a woman who lived in a well-to-do neighborhood.

It was my observation that **when products were sold at the listed retail price, it was generally only to new distributor recruits who were willing to pay such inflated prices to qualify to "play the game."** Nu Skin's retail rules (minimum of five retail customers, 80% of products sold or used, etc.) were just cosmetic to satisfy the FTC and state agencies. They were merely winked at and not enforced. **All ex-distributors I have spoken with agree on this point. These rules simply do not work. Without addressing the underlying compensation system, exculpatory rules merely offer an easy way to feign legitimacy by appearing to comply.**

(5) Surveys of distributors cited by Nu Skin in its "Average Actual Incomes" include a finding that "55.7% of personal sales volume was sold at retail to end consumers." If true, this would indicate substantial retail sales in the aggregate. However, ex-distributors I consulted agreed with me that the 55.7% retail figure is a bogus statistic and that sales of products by Nu Skin to end users at full retail price is the exception and not the rule.

This statistic is misleading and does not square with experience or observation or incentives in the compensation system. And it is invalid because of the company's strongly worded warning in their "Policies and Procedures" directives, in which it is made clear that violating these "rules" could cause loss of commissions – a severe sanction against survey respondents' telling the truth. One must conclude that the above-mentioned survey is spurious and that respondents are telling what they **should be doing, not what they are doing.**

NOTE to FTC officials:

One positive change has occurred in Nu Skin's reporting. This phony retail statistic has since been dropped, as reflected in its 2003 and 2004 "Distributor Compensation Summary" reports – and the assumption of retail income for lower level distributors. See (13)

(6) I would ask anyone reading this, **"When were you last sold products by a Nu Skin distributor without the 'business opportunity' pitch?"** Since Nu Skin has probably signed up over two total million distributors in this country since 1984, and assuming their products are as outstanding as Nu Skin promoters claim, one would expect that a lot of ongoing sales to retail customers would continue to be made to retail customers (as has been the case with Avon, at least until they changed their program) outside of distributors' networks. Such is not the case.

No, Nu Skin sells primarily to participating distributors and their families – who generally stop buying from Nu Skin when they leave the program. **Their claim to any significant ongoing retail customer base in this country is a sham.**

In fact, most participators are not "distributors" at all, but participating investors who make a lot of purchases to meet quotas and to advance in the scheme. **To be successful, participants must also recruit aggressively and encourage their downline participants likewise to recruit and buy products. So when the recruiting dries up in an area, the retailing vanishes.**

(7) Extensions of "incentivized" or "pay to play" purchase requirements of participants at the various payout levels severely limits the amount of retailing possible within actual or reported sales – as reported to the SEC and to investors.

(8) From my discussions with ex-distributors, I found that **when they terminated their distributorships, their spending on Nu Skin products generally dropped 80% to 100%.** In my case, purchases of Nu Skin products dropped from about \$500 a month to zero after quitting. For example, we replaced the flagship "LifePak" nutritionals, costing about \$150 a month retail for my wife and me, with quality supplements from a retail store that cost less than \$30 a month. My total purchases from Nu Skin dropped from an average of \$450 a month to zero. This was typical of ex-distributors I spoke with.

(9) **Another telling statistic is total Nu Skin revenues, which grow with aggressive recruiting, but languish when recruiting markets thin out.** In the early years of the company, when recruiting spread rapidly in the U.S., revenues likewise grew. Promoters at Nu Skin opportunity meetings spoke of NS being a "billion dollar company." Even though total recruits had numbered in the millions, revenues languished when de facto saturation became apparent in this country. Revenues in 1994 were only \$330 million. Sales were also affected by legal actions against Nu Skin.

Then company officials and Blue Diamond recruiters began developing markets for recruiting in Japan, Korea and other Asian markets in the mid-nineties. Revenues soared as recruiting took hold, peaking at \$953.4 million in 1997. De facto saturation for direct sales set in among populations in these areas, distributors terminated, and revenues leveled off. Then NS officials worked to open new markets in the Philippines, Singapore, and Malaysia to replace the dropouts. Hundreds of thousands of new recruits came on board, but revenues did not increase because the recruiting markets in these countries were limited, and new recruits barely kept pace with the dropouts.

The point here is **direct sales have not been sufficient to sustain any given market.** When the recruiting stops, sales drop sharply (except for sales made by churning new recruits to replace those that drop out), until new recruiting markets can be opened up and new recruits can be induced to buy products at full retail price to "play the game." **Nu Skin is not a "direct selling" company, but a chain selling company.**

(10) **Dummy distributors and counterfeit "customers" pump up the numbers.**

Since Nu Skin's compensation system is so heavily weighted to the "back end" (top-level Blue Diamond Distributors) of the plan, there is enormous incentive to inflate the head count of "executives"

and qualified distributors to advance up the levels in the hierarchy to whom the bulk of the payout from Nu Skin is made.

From my test of the Nu Skin system and from numerous interviews with ex-distributors, I found a pattern that is very common in the network of upwardly striving distributors. They would ask a friend or relative to take the role of distributor and then buy products in that person's name. They would also get trusted persons to act as "customers," in case they were ever challenged on whether or not they had met the company's minimum customer rule to "document retail sales to at least five retail customers." While this rule may have made sense to company officials, outside observers, and enforcement investigators, it seems ludicrous to those who have been actively involved in the system.

(11) But an even stronger argument against Nu Skin's claim to be retailing products is an intuitive one. **Why would anyone pay inflated "retail" prices when they can get products wholesale from other participants – who are highly motivated to meet their qualification and/or advancement requirements for purchases (supposedly for resale), even if it meant selling wholesale to do so?**

(12) **The retail "proof is in the pudding." The fallacy of MLM promoters' oft-repeated boast that MLM is "the wave of the future" is made transparent by the fact that MLM remains an insignificant factor in the retail marketplace.** Recent total U.S. retail sales have exceeded \$3 trillion per year. While estimates vary widely, it seems that collective sales of all MLM companies together has never reached even ½ of 1% of total U.S. retail sales in any given year – after 30 years of claiming to making huge inroads in the marketplace.

(13) **Nu Skin's published reports contradict one another. The numbers simply do not add up. When one correlates the 1998 Average Annual Incomes report with figures in Nu Skin's annual report, obvious discrepancies emerge, proving again the falsity of the claim that distributors are retailing to any significant degree outside of their distributor network.** The following calculations are quoted from the PSA 2000 petition:

If 55.7% of purchases were sold for at a retail markup of 43%, then the reported average income of \$1,555.23 to distributors who did not receive commissions would represent an average wholesale cost of \$3,616.81. And this supposedly represents 55.7% of personal sales volume.

Divide \$3,616.81 by .557 and you get \$6,493.38 total purchases. Multiply this in turn by 54,487 distributors who did not qualify for commissions, and you get wholesale purchases of \$353,804,796.10 – or **\$353.8 million** (probably well over \$400 million if purchases by commissioned distributors are included). But based on Nu Skin's annual report required by the SEC, \$88.3 million revenue was reported for markets outside Asia in 1998.

In 1999 North America generated 84 % of revenue of the "Other Markets." If a ratio even close to this were applied to 1998, the total revenue for North America would be only about **\$74.2 million**. The validity of the aforementioned "1998 survey of active distributors' retail sales" is discredited.

Again, the huge discrepancy between 1998 U.S. sales revenue figures given to the FTC and Nu Skin recruits (about \$74.2 million) and those given to the SEC and investors in Nu Skin stock (\$353.8 million) confirms the above conclusions regarding retailing. The same underlying deceptions applied as well to reports for 1997 and other years.

Nu Skin begins its 2000 Annual Report with a large headline stating: "We are direct selling entrepreneurs." **Nu Skin officials thus mislead not only recruits, but also investors in its company by affirming that it is a direct sales business, rather than a chain selling business (recruiting MLM, or product-based pyramid scheme. See sections E and F below.) – wherein the vast majority of sales of its products are to its distributors.** It is a study in deception that Nu Skin has not only avoided the label of "pyramid scheme," but also "MLM" or "multi-level marketing." **A pig is a pig, no matter how many dollars are spent positioning it as a horse.**

It should be noted that China has agreed to allow Nu Skin to establish retail centers, a marked departure from its resistance to allowing MLM in the country. This does not represent a change in Nu Skin's fundamental policies, but an effort to provide a foot-in-the-door into a huge Chinese market for top distributors from other Asian countries, whose local markets for recruiting are reaching de facto saturation.

In terms of Nu Skin's basic highly leveraged compensation program, China represents a dead end for a program that depends on recruitment for growth. It is absurd to imagine retail Nu Skin shops for each of the hundreds of thousands of distributors who have been recruited in other countries.

Assumptions of retail sales by Nu Skin are greatly exaggerated, especially since they are virtually non-existent outside of China. Retail products are priced too high to be competitive, and the compensation system is heavily stacked in favor of recruiting, so there is little incentive to sell at retail. **Essentially, the sellers are the buyers, and the buyers are the sellers – to themselves and their families!**

Not only is the reporting of Nu Skin full of misrepresentations, but the stated mission in its reporting and actual business practices clearly contradict one another. In all of its annual reports and releases to the media and to prospects, company officials present the company as a direct sales company. For example, in the 2000 Annual Report to stockholders, the opening title boldly proclaims: “We are direct selling entrepreneurs.”

Since, as conclusively demonstrated above, Nu Skin does not engage significantly in direct sales to the public, but instead its sales are primarily “pay to play” purchases by participants seeking advancement in the scheme, this is another major area of misrepresentation. Investors would be upset to find they are buying a piece of the infrastructure of a product-based pyramid scheme.

Those who are fully informed on these issues find it misleading for Nu Skin promoters to even refer to their recruits as “distributors.” They are **participants** in the scheme who buy a lot of products, ostensibly for consumption, but actually to meet qualification and advancement quotas. They aggressively recruit to build their downlines and to fill group volume requirements to qualify for commissions and bonuses.

False assumptions in the report of sales at retail prices greatly skew income figures upward, especially of lower level distributors, since their stated incomes depend on retail sales. It would be much more valid to report only average payout to distributors from Nu Skin without making any assumptions about retail sales. It would then be seen that very few distributors make any money at all, especially after subtracting incentivized purchases and operating expenses.

Thus, Nu Skin’s assumptions of retail sales are grossly exaggerated and mislead prospects. Products cost too much, and there is little incentive to sell. Recruiting – not retailing – is where the money is.

Nu Skin is not a direct sales company any more than a pig is a horse. More accurately, it is a recruiting MLM, and more specifically a product-

based pyramid scheme with a highly leveraged breakaway compensation system. Nearly all participants become unwitting victims defrauded by the scheme. Rather than expanding market share, Nu Skin is continuously replacing a collapsing pyramid.

Also, since the income of Nu Skin participants is derived primarily from recruiting rather than from retailing products, Nu Skin’s extreme breakaway compensation system satisfies the legal definition of a pyramid scheme. The products are purchased primarily to qualify to participate and advance in the scheme. Properly understood, seemingly legitimate product sales thereby become an extremely clever means of laundering investments in one of the most highly leveraged, and exploitive types of pyramid schemes ever concocted. (See Item E and F below.)

E. Nu Skin’s abnormally high loss rate is due to its highly leveraged breakaway compensation system, which pays huge rewards to top Blue Diamonds at the expense of thousands of downline participants (victims).

Again, Nu Skin uses what is called a “breakaway” compensation system. While qualification requirements for commissions and bonuses vary somewhat from division to division and country to country, some common elements stand out. There are requirements for group and personal sales volume within certain time frames, and for customer and front line distributor head counts. When these requirements are met, specified commission rates are paid out on personal sales and on sales by groups of distributors in one’s downline.

While much is made of commissions (a nominal 5% to 15%) that can be made from sales in one’s “circle group” (those who have not yet become an “executive”), it soon becomes clear to recruits that the real money is in developing breakaway executive groups. These are groups of participants under an executive sponsor, each of whom is led by a qualified upline executive. For example, in one executive qualification program, a “distributor” would qualify by having distributors under him, each of whom purchased (supposedly for resale) at least \$100 worth of products per month.

Let’s say a woman was recruited by a male friend who was a Nu Skin executive distributor. If she signed a letter of intent, maintained “qualified”

active distributors under her (at a quota of \$100/month each in product purchases), and purchased (supposedly for resale) personal sales volume of \$500 a month and group sales volume from her downline of \$1,000 the first month, \$1,500 the second month, and \$2,000 the third month, she then would qualify as an “executive.”

[NOTE: These minimums have recently been modified, partly due to legal restrictions in some countries. Since head count requirements have been reduced, it appears that “front-end loading” is more common. Participants may be buying unneeded products in the names of dummy distributors to meet qualifications.]

As an Executive, the woman’s group “breaks away.” Her upline sponsor no longer gets commissions from her as a member of his circle group. He instead receives bonuses of 2½-5% on the sales of her entire group, assuming he meets his minimum Executive quota (which has been \$3,000/month to qualify for the full 5% bonus).

While the 5% bonus may not sound like much, the sponsor gets 5% from her entire group. So these breakaway groups are then treated as units, and this is where the leverage comes in. The number of qualified “executives” the sponsor has directly under him on his first level determines his distributor payout level, which in turn determines the number of levels of breakaway groups from which he can collect bonuses, as shown in Appendix C. Blue Diamonds can collect on six breakaway levels.

“Nu Skin’s Blue Diamonds Cash in on a Megapramid of Downline Victims.” Appendix E at the end of this report) shows the huge number of participants in a hypothetical downline and illustrates the extreme leverage enjoyed by a Blue Diamond at the top, who collects about 60% (63% in 1997, 59.6% in 1998) of the total payout by Nu Skin to thousands of persons in the network. So a relative handful of Blue Diamonds reap the harvest from the losses of their collective downline of hundreds of thousands of recruits. The people they are supposedly helping to “succeed” are in effect being victimized by their upline Blue Diamonds.

(Nu Skin may have hundreds of Blue Diamonds (BD’s), but that is a very tiny percentage out of many millions who have tried the program. And even the huge average income of BD’s hides the fact that the top persons in the hierarchy of BD’s earn far more than newer BD’s.)

[NOTE: Appendix E is illustrative of the extreme leverage of Nu Skin’s breakaway system. However, The downline for each Blue Diamond distributor would be different, since recruitment

success varies for each participant, and since so many drop out and overrides from their downlines “roll up” to the person above him/her.]

It is revealing to extend the average payout and percentage of active distributors who are at the various income levels. According to the 1998 report (the latest released) **about 102 Blue Diamond distributors in the U.S. got at least 58.6%** (higher if you subtract assumed retail sales that did not occur) **of the total payout to distributors.** The other 41.4% was split among approximately 63,418 distributors – or probably well over a million, if all past and present U. S. distributors are included in the statistics, as they should be. (See Appendix A and Section D(1) below.)

I once saw a photostatic copy of a monthly check for one of the founding distributors totaling over \$400,000. That’s about \$5 million a year! Another ex-distributor reported seeing a check to a Blue Diamond distributor in the amount of \$875,000 for a single month. Where did that much money come from? The majority of the payout was in the form of overrides from the purchases of tens of thousands of downline distributors beneath him, the vast majority of whom lost money for pursuing the Nu Skin “opportunity.” These were incentivized purchases made primarily for advancement in the scheme. Therefore, I would argue that most were not bona fide purchases at all, but disguised investments in a product-based pyramid scheme.

So the huge incomes reported for Blue Diamond distributors comes from unwitting downline distributors who become, in effect, victims of the scheme. They may spend many thousands of dollars and invest months or even years working feverishly to realize the promised rewards. But sooner or later, all but a tiny percentage “fail” and terminate their distributorship or just drop out. But their upline does not lose by their dropping out, because of the “roll up” feature in Nu Skin’s highly leveraged scheme. Any override commissions or bonuses from their downline automatically “rolls up” to the next qualified upline executive.

F. Nu Skin’s program shows all FIVE RED FLAGS of a “recruiting MLM” – or an exploitive product-based pyramid scheme:

Psychologists have proven from decades of experimentation that behavior that is rewarded tends to be reinforced and repeated. That is to say, you get

the behavior you reward. For example, if carpenters were paid ten times as much per hour to build sheds as to build fences, you would find many carpenters building sheds and few building fences.

This same principle applies to business practices. If a multi-level program offered ten or 100 times as much in financial rewards (payout) for recruiting as for retailing products, the emphasis would be on recruiting. **So it is the compensation system, along with the associated marketing plan used to implement it, that regulators should scrutinize most carefully.** These compensation systems are often complex, so investigators from consumer protection agencies tend to avoid them. However, I have found that with a solid understanding of marketing principles and of acceptable business practices, and with the math skills necessary to decipher the deceptions and effects of the underlying compensation systems, it can be accomplished.

I spent several months comparing alternative business models to which MLM is often compared, including direct sales, franchises, distributorships, sales of insurance and securities, and other small business models. I was then able to identify some unmistakable characteristics, which clearly differentiate pyramid schemes, chain letters, and product-based pyramid schemes (usually disguised as “MLM” or “network marketing”) from legitimate businesses. It is interesting to note that **these defining characteristics are also the causal factors that account for consumer harm, in terms of high loss rate and other deleterious effects.**

Nu Skin displays all five of the red flags of a recruiting MLM, or highly leveraged product-based pyramid scheme. These are as itemized below.

(For more elaboration on the five red flags, see Appendix D, *Five Red Flags for Identifying Product-based Pyramid Schemes, or Recruiting MLM's*, which was prepared for the FTC for consumer education purposes. For a more complete analysis, read my report: *Five Causal and Defining Characteristics of Product-Based Pyramid Schemes, or Recruiting MLM's*.)

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

Nu Skin recruits are encouraged to immediately recruit five more to qualify as an “Executive.” To become a “Blue Diamond” (those who get most of

the payout from Nu Skin), they must recruit a total of twelve of these qualified Executives who likewise qualify, each of whom have recruited five qualified (in terms of purchases) distributors, etc. It is impossible for this to continue indefinitely, but unwitting recruits are not informed of the ultimate futility of the scheme.

So a mathematical trick is being paid on the unwary. Nu Skin promoters counter persuasively that saturation has never happened in network marketing. However, it can be demonstrated that de facto saturation – perception among prospects that the opportunity is diminishing – is very real. (See Section I below.)

Since de facto saturation is inevitable in any given area, recruits are promised the impending opening of giant markets in other countries, such as Indonesia and China. No one asks what interplanetary markets are planned for grand openings when the major earth markets are effectively saturated.

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

Advancement is by self-appointment through recruitment to ascending payout levels in the distributor hierarchy. Since the only way a person can profit significantly in the Nu Skin scheme is through recruiting to advance to higher payout levels, and since “pay to play” purchases are disguised pyramid investments [See Red Flag #3, below], this strongly suggests that Nu Skin satisfies the legal definition of a pyramid scheme.

Red Flag # 3: “Pay to play” requirements are satisfied by ongoing “incentivized purchases**.”

Recruits are informed that they only need to pay a nominal amount for a distributorship, but at the same time they are told that if they are serious about “building the business” they will buy an “Executive Pack,” (about 500 US dollars), or better yet, five of these (over \$1,500 US dollars) to qualify each of their recruits to become an Executive very quickly. So at large opportunity rallies, huge quantities of products are often ordered.

This “pay to play” feature of a pyramid scheme is augmented by powerful incentives to continue buying products to move quickly up the ladder of

ever-increasing bonus levels. Some distributors hyper-consume many thousands of dollars of products they don't need, except to advance in the scheme. Nu Skin has rules against stockpiling products – window-dressing for regulators – when in fact, incentives in the pay plan encourage over-consumption. A major part of the purchases are just disguised pyramid investments.

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

Nu Skin uses a breakaway compensation system, which pays the same bonus percentage to breakaway organizations six levels down. A breakaway is a pyramidal organization topped by an “executive” distributor, who has five “qualified distributors” under him or her. This breakaway system creates enormous leverage, with those at the top receiving huge commission checks, at the expense of a whole multitude of downline investors in the scheme. And the company benefits enormously from all this artificial consumption.

This also means that since a person one or two breakaway levels above the person selling the product gets the same bonus as a person five or six levels up, there is not sufficient payout from Nu Skin to make it worthwhile for front-line distributors to focus on retailing products. **Nu Skin's compensation and marketing system effectively destroys any significant retail market.** New recruits soon learn that they must themselves also recruit a huge downline to make the kind of money touted at opportunity meetings. After recruiting, there is not enough time left to sell products – and insufficient rewards for doing so, as explained further in Red Flag #5, below.

Red Flag #5: Company payout per sale for each upline participant equals or exceeds that for the person selling the product, creating inadequate incentive to retail and excessive incentive to recruit – and an extreme concentration of income at the top.

Nu Skin's compensation system pays overrides on six levels of breakaway organizations. This often means that a **Blue Diamond distributor may have many thousands of downline participants on whom they can collect override bonuses.** This is amplified by a “roll-up” feature, which transfers

bonuses from dropouts (which eventually includes nearly everyone) to the next qualifying Executive upline.

So when you look at the downline structure of a Nu Skin Blue Diamond distributor, you see what I call a mega-pyramid made up of many poly-pyramids. (Again, see *Nu Skin's Blue Diamonds Cash in on a Mega-pyramid of Downline Victims*, Appendix E.) It is far more leveraged or extreme in its pyramidal structure than a naked, no-product pyramid scheme – which would be illegal in almost all jurisdictions. And it can be demonstrated that with this, combined with the other factors here, the loss rate is inevitably much higher.

As explained below, based on available data, when these five characteristics are all found in an MLM, the loss rate is so low that 99.9% of participants lose money. Nu Skin's compensation system incorporates all five to the maximum degree.

Each “Executive” must recruit twelve separate pyramid-shaped “organizations” to qualify as a Blue Diamond distributor and collect overrides on whole clusters (I call them “poly-pyramids”) of “executive organizations” (or multi-pyramids) six levels deep, all of which yield enormous “leveraged income” to the builders of what I call “mega-pyramids,” hailed by all participants as “Blue Diamonds.” (Again, see the *Blue Diamond distributor* chart and Appendix C.) **These Blue Diamonds receive overrides of tens or even hundreds of thousands of dollars every month.**

The highest level in the Nu Skin hierarchy is Hawaiian Blue Diamond, requiring 15 breakaways on the front level. Nu Skin does not publish the average income of Hawaiian BD's. One can only imagine what their average income would be, especially that of the founding distributors, one of whom was praised in an opportunity meeting for having made \$20 million (which of course came from his downline, probably 99.9 % of whom lost money in the scheme). This was in 1995. His cumulative take would by now be far greater than that, as would the aggregate losses of his downline.

Also, if the income of the founding and Hawaiian distributors were removed from the calculations, the average Blue Diamond income would be much smaller. So it is a program with the deck heavily stacked in favor of those on the top of the pyramidal hierarchy – even more than with a no-product pyramid scheme.

NOTE to FTC personnel – VanderNat model used in other cases:

Peter VanderNat, economist for the FTC, used another, more complex, model (“ARC”) in a recent declaration, using Equinox International as a test case in April of 2000, which was settled out of court. A similar analysis was used in the Skybiz.com case in May of 2001. Though it is outside the purposes and analytical framework for this report, I believe his model would also show that Nu Skin is not structured mathematically to support primary emphasis on retail selling and therefore technically meets the definition of a pyramid selling scheme used by the FTC and most states.

G. Where data has become available, the loss rate for such highly leveraged recruiting MLM programs is about 99.9%. Nu Skin’s is at least 99.94%. Participants have a far better chance of profiting from a no-product pyramid scheme or from a single bet in craps or roulette at gambling casinos.

What is significant (where valid data is available) is that when the five red flags discussed above exist in an MLM compensation system, approximately 99.9% of participants lose money. The loss rate for Nu Skin, is at least 99.94%. These odds are worse than is the case for recent, no product pyramid schemes, in which the loss rate is generally 93.3%. Even games of chance at gambling casinos have better odds of success. (See Table 2: *The Winners and the Losers.*)

NS promoters sell the idea that anyone can become a Blue Diamond if they work hard enough at it. Some promoters have even staged weekend events called “Blue Diamond University” in Provo, Utah, the company’s headquarters. The assumption is that by applying the information taught at the sessions, one can become a Blue Diamond. No one is told that the probability of anyone becoming a Blue Diamond is less than one in 12,500. This is another major misrepresentation which misleads investors in the Nu Skin program into believing it is something it is not.

By now, it should be clear to the reader that the primary villain in the Nu Skin program is not the

products or the people involved, but an **inherently fraudulent compensation system.**

At Nu Skin opportunity meetings, one of the big sales pitches is that by building a downline, one can develop a “permanent income” – as opposed to a “temporary income” in the form of salaries or wages which the rest of the hapless world receives for their daily labors. Prospects are offered the dream of “time freedom,” or the freedom from having to report to work and put in one’s time. Some recruits give up their jobs and some even sacrifice professional careers to build a Nu Skin downline that they are led to expect will give them the freedom to work or not work, as they choose.

The misrepresentation here is that it rarely happens, and when it does, it happens at the expense of thousands of downline recruits who have to be fed the same line and be led to believe that it is true. The winners – the Blue Diamonds and founders – win big at the expense of the losers – who (in the aggregate) lose big. (Table 3: *Who Got What and from Whom in Nu Skin*)

So what is done with all that money? According to *Utah Valley Magazine* (Jan./Feb. 2003), Nedra Roney, one of the founders, owns homes in Malibu, Cayman Islands, Mapleton (Utah), Las Vegas, Lake Powell, and a multi-million dollar home in Jackson Hole, Wyoming. She owns a Gulfstream II jet, a Porsche and a Mercedes. And there’s plenty left over for her favorite charities.

Success Magazine (Dec. ‘95) reported that a Blue Diamond distributor, Dr. John Pfeifer, acquired not just one Rolls Royce, but a whole fleet of them – and not from his medical practice, but primarily from Nu Skin/IDN earnings. Many who have attended Nu Skin opportunity meetings have noticed the Hummers owned by Blue Diamonds lined up in the parking lot. And huge ranches and other properties of founders and top Blue Diamonds are legendary.

These are just a few examples of the profligate lifestyles of founders and Blue Diamonds – while 99.94% of investors in the Nu Skin MLM scheme lost money, based on the data in Exhibit A and related information. This loss rate is worse than for no-product pyramid schemes, which would be discovered and prosecuted for violation of statutes against such pyramid schemes. In spite of the extreme pyramidal leverage in its compensation system, Nu Skin has cleverly managed to escape serious prosecution as a pyramid scheme.

H. The motivation for promoters of a recruiting MLM like Nu Skin to so blatantly misrepresent earnings of distributors is that such deception is essential for the company to survive and grow. If the truth about its rates of success were told, few would join Nu Skin's program. By enforcing the Order, the FTC will be efficacious in this arena.

The abnormally low rate of success for the Nu Skin "opportunity" explains the motivation of company officials and promoters in flagrantly misrepresenting earnings of distributors. They are in a tight spot. If prospects for the Nu Skin program knew that at least 99.94% of participants would lose money, most would likely choose not to participate, and since the program is dependant on income from new recruits, Nu Skin would soon collapse. If in fact Nu Skin's program was merely a scam, it's demise would be a good thing for consumers. The same would be true for similar recruiting MLM's

Anyone questioning these conclusions should take the time to review the calculation in the analysis and charts in the PSA Petition in Appendix A – also Tables 1, 2, and 3, which were extracted from the PSA Petition. The math is not overly difficult – some long division and basic algebra and statistics.

The relationship between misrepresentation and high loss rates inherent in highly leveraged product-based pyramid schemes offers an important tool for the FTC and for consumer protection agencies. Since the FTC ruled in 1979 that Amway was not a pyramid scheme (based on limited available data at the time and what may seem in retrospect to have been rather weak arguments), they have been very reluctant to bring pyramid charges against established MLM's like Amway and Nu Skin. What actions have been brought have been against easier targets. This seems to be the case since 1979, even though it can now be shown that loss rates and aggregate losses are much greater for product-based pyramid schemes than for no-product schemes.

By focusing on misrepresentation, agencies can have a basis for action against product-based schemes, without addressing the pyramid issue. And since pyramid schemes of all types depend on deception to survive and grow, they will always be highly vulnerable to charges of misrepresentation, assuming qualified and determined investigators are assigned to such cases. **(PSA has been accepting petitions for a disclosure rule that would make**

transparent the extremely low success rate of most MLM's – at least recruiting MLM's.)

This is why I believe the FTC would be doing itself and consumers a great disservice by failing to take vigorous action against Nu Skin's flagrant violations of the 1994 Order, as detailed in this report. The case is laid out for FTC enforcement personnel, with many years of research invested in this report. This may be the FTC's golden opportunity to prove its efficacy in this arena.

I. As with other product-based pyramid schemes, Nu Skin has evolved into a worldwide Ponzi scheme. De facto market saturation is reached very quickly with Nu Skin's compensation and marketing system, requiring re-pyramiding elsewhere. Nu Skin misleads consumers about re-pyramiding from division to division and from country to country. With the aid of these misrepresentations, Nu Skin has been victimizing millions of unsuspecting consumers in Asia.

Promoters of multi-level marketing attempt to defuse the argument of the ultimate saturation of endless chain marketing schemes by pointing to the fact that such saturation has never occurred. Amway has been around for decades, they say, yet only a tiny segment of the population has become Amway distributors. But **while actual saturation may never be realized, perceived market (or de facto) saturation is reached very early for product-based pyramid schemes.**

Why would a town of 10,000 people need 10,000 distributors? This would be absurd. But when a dozen persons are selling to the townspeople, the perceived opportunity for each new distributor will drop with each new dozen added. De facto or market saturation in a town of 1,000 population may be reached with from 10 to 100 distributors.

With a product-based pyramid scheme, when an area becomes increasingly saturated, the drop in enthusiasm for the "opportunity" leads to collapse – unless the promoters undertake recruiting for new downlines elsewhere. This is a process I call "re-pyramiding" or a de facto Ponzi scheme. As American consumers come to perceive MLM opportunities as diminishing, it is becoming prevalent for such MLM's to recruit overseas from more vulnerable populations, particularly in Asia.

Table 2: THE WINNERS AND THE LOSERS –

Who gets the money paid out by recruiting MLM's – and where does it come from? (Mostly from participants who LOSE money)

	Average annual income of top-level distributors ⁹	Approximate percent of participants who lose money ¹⁰
Amway (1999)	\$997,334	99.99%
Arbonne (2004)	\$82,629	99.92%
Cyberwize (2004)	\$1,414,709	99.94%
FreeLife Int'l (2004)	\$549,662	99.69%
Herbalife (2004)	\$585,117	99.94%
Melaleuca (1998)	\$138,375	99.87%
Nikken (c. 2002)	\$1,200,000(est.)	99.98%
Nu Skin (2004)	\$552,348	99.98%
Reliv (2003)	158,129	99.90%
Symmetry (2003)	\$104,792	99.96%
RTTP *	\$1,080,000	99.91%
A telcom MLM ** (now defunct)	\$240,000	99.92%

*RTTP = Renaissance—the Tax People (shut down as an illegal pyramid scheme¹¹)

**The telcom company was bought by a legitimate telecommunications company that is taking aggressive legal steps to prevent its name from being associated with network marketing in any way, so it could not be identified by name.

The others are prominent MLM's still operating.

For comparison:

	<u>Loss rate</u>
Recent no-product pyramid schemes, including gifting schemes	93.3%
Single bet on snake eyes in a game of craps at Caesar's Palace in Las Vegas	96.77%

Therefore, assuming a 99.9% loss rate for recruiting MLM's, a person has at least 67 times as great a chance of earning a profit in a classic, no-product pyramid scheme as from signing up as a distributor for a recruiting MLM – and 32 times as great a chance of profiting by betting on snake eyes with a single roll of the dice in a game of craps! The odds for Roulette are also better than for recruiting MLM's.

CONCLUSION: In recruiting MLM's, most of the money paid out to “distributors” goes to participants at the top levels in the distributor hierarchy (pyramid) at the expense of a multitude of downline hopefuls, who make “pay to play” purchases which far exceed any sales revenues. As a result, approximately 99.9% of them lose money – much worse odds than no-product pyramid schemes and even some casino games of chance. RECRUITING MLM'S, SUCH AS NU SKIN, ARE NOT HARMLESS! OF ALL THE TYPES OF PYRAMID SCHEMES, THEY CAUSE THE GREATEST CONSUMER LOSSES.

* Income figures for all but Renaissance are based on a report widely circulated by Nu Skin at opportunity meetings, entitled “Network Marketing: Portrait of an industry and its Top Earners” by the Fielding Institute, November 1996, conducted by Dr. W. J. Burns of Iowa and Dr. C. Miller, American Graduate School of International Management, Thunderbird University. Data for Renaissance – the Tax People (RTTP) is based on the author's research on behalf the Attorney General's office for the state of Kansas.

**Amway, Nu Skin, Melaleuca, Excel, and Nikken are prominent recruiting MLM companies still operating. (For reference notes, refer to chart “Which Does the Greater Harm,” available from the author.) Renaissance – the Tax People (RTTP) was shut down in 2001 by a Kansas district court as an illegal pyramid scheme.

Table 3

WHO GOT WHAT AND FROM WHOM* IN NU SKIN ENTERPRISES, INC.?

Who got the money paid by the company?

58.6% went to the “Blue Diamonds,” which is 1 in 12,500 distributors.

In 1998 (reported to recruitment prospects until 2001), the average paid by Nu Skin in commissions and bonuses to Blue Diamond distributors was \$480,404/year.

The average payout per year to all other distributors was \$27 per year.

Where did the money come from?

The source of the revenue flow was primarily from downline participants, 99.94% of whom lost money, becoming victims. These downline participants can be broken down into two categories, (1) those who qualified for commissions through “pay to play” purchases (“for re-sale”), and (2) those invested in products, but who did not purchase enough to qualify.

MINIMUM purchases of \$1,200 per year was the “pay to play” requirement to qualify for commissions. Some paid FAR MORE.

For those distributors who “sold” (purchased) enough products to qualify for commissions:
The average commission income from Nu Skin for all “active distributors” who qualified (excluding Blue Diamonds) was \$43/year

For the distributors who did not qualify for commissions—

Actual payout of commissions and bonuses from Nu Skin was zero.

“Pay to play” purchases, intended to “build the business,” actually represented losses for these participants, regardless of amount.

**Figures compiled by Jon M. Taylor, Ph.D. All figures are based on 1998 company reports and following removal of major statistical misrepresentations.*

Since a Blue Diamond must have 12 “Executive distributors” beneath him or her, each with their own downlines, **the assumption that “anyone can do it” becomes highly questionable, if not absurd. Total saturation of the entire world population would be reached very quickly, and that is assuming everyone buys into the program.**

With Nu Skin’s highly leveraged compensation system (see Appendix C), market (de facto) saturation is certain. At opportunity meetings, recruits are told that they, too, can become a Blue Diamond. For example, I witnessed Blue Diamond Nathan Ricks speak at several Nu Skin opportunity meetings of his success at recruiting a Blue Diamond, who then recruited another BD, who also recruited a BD, who in turn recruited a final BD – and implied that if he could do it, anyone could.

Since Blue Diamonds receive most of the rewards from Nu Skin, for a participant to strive for anything less than that only contributes to Nu Skin’s coffers and to one’s Blue Diamond upline. So let’s assume one must be a Blue Diamond to be successful at Nu Skin. Even actual saturation of the entire galaxy might be reached in four levels of successful Blue Diamonds:

Level 1 Blue Diamonds: 12 Executive distributors on first level x 5 distributors under each = 60 distributors x estimated minimal average of 5 under each = 300 distributors. Using very conservative assumptions, 300+60 distributors in the first level of Executive organizations = 360, the minimum number of distributors per Level 1 Blue Diamond distributor. All of these must be “active.”

Actually, most successful Blue Diamond distributors have a downline that numbers in the thousands, since not every distributor is a “producer.” Some have tens of thousands in their downline. For our purposes, we will assume a minimum of 1,000 downline participants per Blue Diamond distributor. Remember that to be successful in the Nu Skin program, one needs to be a Blue Diamond.

Level 2 Blue Diamonds: 1,000 x 1,000 Blue Diamonds = 1 million Blue Diamonds

Level 3 Blue Diamonds: 1 million x 1,000 Blue Diamonds = 1 billion Blue Diamonds

Level 4 Blue Diamonds: 1 billion x 1,000 Blue Diamonds = **1 trillion Blue Diamonds, the minimum number of Blue Diamond distributors per Level 4 Blue Diamond distributor – or 163 times the total number of persons on the earth, with a total population of approximately 6.15 billion persons!**

NOTE to FTC Personnel regarding Ponzi-style growth in Asia:

Though overseas expansion of the Nu Skin program may seem irrelevant to enforcement in the US, it is instructive (and saddening) to observe how highly leveraged product-based pyramid schemes like Nu Skin quickly transcend borders and undertake aggressive recruitment from country to country, leaving multitudes of recruits as victims in their wake. And since this report was first prepared, we have received reports of Nu Skin’s recruitment in many countries outside Asia, with the same results.

Because its compensation system is so highly leveraged, **Nu Skin has reached de facto saturation (which requires far fewer participants) rather quickly in each of the areas where Blue Diamond promoters have recruited.** It soon becomes obvious to Nu Skin promoters that the opportunity to build a downline diminishes as the excitement wanes from de facto saturation in a given country – so NS recruiters move on to another country. This has been happening in Asia for several years. I call this process “re-pyramiding” – the MLM version of a Ponzi scheme. **So Blue Diamond recruiters hopscotch from country to country in Asia, building mega-pyramids as they go. This export of exploitation may come back to haunt U. S. relations there.**

Having passed their peak in countries like Japan, Korea, and Hong Kong, Nu Skin flooded the market in Singapore and then entered Malaysia with the same sensational splash. But according to e-mail feedback we received from people who were recruited there, **these people were told at huge rallies that by getting in at that time, they could be among the first to build a downline in Indonesia in 2002 (apparently thwarted since), and possibly in China in 2003.**

The Chinese have some problems, but they have been wiser than us Americans in banning MLM’s – until now. Unfortunately for the Chinese people, a Pandora’s box is about to be opened there when (and if) China lifts its ban on “direct selling” (which Nu Skin is trying to equate with MLM) – thanks in part to some U. S. trade representatives that I understand have come under tremendous pressure from such companies as Amway and Nu Skin. **MLM’s are being promoted as “the wave of the future” or “the way we do business**

in America.” These Asian countries, and ultimately we as exporters of MLM, could pay a heavy price for such exploitation.

Nu Skin’s promise (to recruits in Singapore and Malaysia) of income derived from “those other markets” should be another obvious tip-off that retailing is not a serious income option. The real income comes from recruiting, and since de facto saturation happens fairly quickly in the smaller countries, the real money is to be made from recruiting in other countries.

Many of these people will have invested the last of their lifetime savings in hopes that they will be relieved from their poverty. Nu Skin leaves a trail of dashed hopes and diminished pocketbooks. What will that do for their opinion about Americans who introduced this curse to their country? Is this type of exploitation what we want to project to the world at this very sensitive time? This should be of grave concern to U.S. officials, especially with the anti-American sentiment in countries with predominantly Muslim populations.

It may not be a problem if Nu Skin recruiters told the truth about their supposed “business opportunity.” But reports we have received out of Singapore and Malaysia indicate that convention halls have been filled with prospects at opportunity meetings where hope is held out to all that they can become a Blue Diamond.

As one promoter put it, “It’s up to you. You can make as much as the people who first came in and ran the company.” I realize that not all of these promoters are from the U.S. Some from Hong Kong (and other parts of Asia) are trying vigorously to act on the tip-off of their uplines when they invested in the Nu Skin scheme – that the real opportunity was in Singapore, then Malaysia, etc.

In section D(3)9, it was explained that growth or decline in total revenues corresponds roughly to recruiting activity, not sales to non-participants. New recruits merely replace those who inevitably drop out. This is another evidence that the Nu Skin program quickly evolves into a Ponzi scheme as recruiting in a given area reaches de facto saturation.

Other MLM companies are aggressively entering these Asian markets and following the lead set by Nu Skin and Amway/Quixtar. If you include China, which the DSA/MLM lobby is trying to enter with a multi-level (chain) selling model, potential aggregate consumer losses in the Orient could number in the tens of billions of dollars! We can and should stop this export of exploitation. In the case of Nu Skin, enforcing the Order could go a long way towards accomplishing this.

Since Nu Skin’s compensation system rewards recruiting handsomely and direct selling (to non-participating customers) pitifully, the program’s growth is limited in any given area. As we have seen, as soon as prospects see the opportunity to recruit prospects dwindle with increasing market saturation, promoters must move on to another area. This has been the history of Nu Skin and every other recruiting MLM. **So Nu Skin has become, in effect, a giant Ponzi scheme in which the only way early investors can be paid off is for Nu Skin to open new markets for recruiting new investors in the scheme, who in turn will get paid from investments by recruiting investors in other areas, etc.**

Alternatively, Nu Skin has started new product divisions so new downlines can be recruited, while still proclaiming a seamless global compensation system. So there are continuing efforts by the company to find vulnerable new markets for recruiting, since stable and continuing retail markets are virtually non-existent and cannot support the leveraged payout inherent in the compensation system. Incentives are heavily stacked in favor of recruiting, not direct selling to end users.

In summary, when Nu Skin ran into legal challenges in the U.S. and when market saturation became apparent (and since sales to non-network end users did not support the distributors), the heavy hitters – Blue Diamonds – went to Asia to recruit new downlines and expand those they had. For several years these promoters have recruited heavily in Asia, primarily in Japan, South Korea, Taiwan, the Philippines, Singapore, Malaysia, and Indonesia. According to feedback we received from Asian correspondents, when recruiting began to dry up in one country, Nu Skin promoters would promise recruits that they would make big money by recruiting in the next country to open up.

In e-mails to us by participants and observers in Singapore, Nu Skin was described as “the hottest thing in town” in December, 2000, with over 7,000 people attending the grand opening at a major convention center.

Patsy Chan said, “I was skeptical as to whether they are running a pyramid selling scheme.”

David Leong () stated,

The motivation is in the compensation system, which promises rich rewards if we recruit distributors into our downline. We have been repeatedly encouraged to attend training sessions, business opportunity meetings and meetings to

meet our “uplines” to be charged up. Both I and my wife somehow felt uncomfortable with the way things are conducted – bordering on the practices of a potential cult.

Jerome Pang (jeromep@pacific.net.sg) reported, “I join Nu Skin in June this year and as usual there was hope of making . . . a secure future for my family.” Then, after mentioning how informative articles from PSA and others had “really opened my eyes,” he said,

This whole thing about MLM is really a scam and I am really disappointed too with the whole Nu Skin thing. . . . **Recently our government amended the law to include MLM as a legitimate business apart from pyramid schemes. After reading your report, I felt they have not understood the whole story about MLM’s.**

Nu Skin has exploded here. With a population of 3.2 million people on our tiny island, the whole thing is going to be saturated very soon. . . .

I must admit they have quite OK products, but retailing is next to impossible because of the high price. So what they do next is to get distributors to join, so that they will buy and we can get our points. The only way you can achieve your points is to recruit people, and this . . . is the big scam of Nu Skin!!!

I feel really bad for bringing in friends and family . . . What we are doing is benefiting the uplines, especially the top guys. A bunch of them came from Australia, Taiwan, and Hong Kong. I believe they are seeing their incomes drop and coming here to open lines to support themselves.

Several others wrote of the rapid market penetration by Nu Skin in Singapore before moving on to Malaysia. For example (I don’t know how to address him, so will use the whole address lines):

From: kwok_chongdavid_mun@baxter.com
To: info@pyramidschemealert.org
Date: Tue, 17 Jul 2001 18:26:54 +0800
Subject: Nu Skin in Singapore

This is the hottest thing in town right now and it’s spreading to Malaysia very soon! Everyone is talking about it.

I’m in it and has now made the decision to get out . . . through friends and also through PSA which has given me a better understanding of

MLM. Firstly, they present to people that they are not the illegal pyramid by comparing the characteristics of the company vs. a illegal one. Currently, they are “emphasizing” the goodness of the products using their philosophy “All of the good and none of the bad” and speeches by overseas Blue diamond achievers to camouflage the scheme. **Basically their approach is to present to the “prospects” 2 options i.e.**

1. to be just a distributor doing retailing selling products and earn that bit of money as recurring income [NOTE: Few outsiders understand that this is merely a come-on. Understanding the compensation system unmarks this lie – the payoff to recruit is so far superior to the rewards for direct selling to end users that few would seriously attempt to retail products. (See section D above – Primary Deception #3)]

2. make it big by building the organization through recruitment of distributors who have unfulfilled “dreams”

In this way, they don’t take any accountability or responsibility which option the “prospect” will take. And obviously, many people will choose option # 2 because of greed and the “promise”.

It is disheartening to see people being deceived by this scheme. I don’t know how much the government knows about the underlying scheme. Can you advise how I can warn or educate people about this harmful scheme in Singapore?

Immediately following the September 11, 2001 tragedy in the U.S., a woman named Christina Koh (“Christina Koh” christina_kohhp@hotmail.com) wrote:

I am now at a crossroad as to whether to join Nu Skin. There are 3 million people in Singapore and 50,000 Nu Skin distributors (I was informed). Nu Skin is opening the Malaysia Market in one month’s time and I feel the urgency to make the decision now. I would greatly appreciate your advice.

Thank you.

Best Regards,
Chris

PS. my condolences for the recent tragedy in US

NOTE: 50,000 distributors selling to a small island of 3 million people! Is not this market (de facto) saturation?

It occurred to me then that as the U.S. was under attack by Muslim fundamentalists who hate Americans to the point of plotting to kill us, we ought to be doubly careful about exploiting or ravaging their countries for selfish purposes. And here was Nu Skin, exporting MLM pyramidism and profiting from blatant misrepresentation in predominantly Muslim countries such as Malaysia and Indonesia. What would these vulnerable people conclude about Americans when they finally came to understand that they had been scammed of hundreds of millions (even billions) of dollars?

It was then that I decided to intensify my efforts to convince them to stop the misrepresentations making possible the onward march of Nu Skin and other MLM companies in their Ponzi re-pyramiding from country to country. At the very least, the FTC could act on Nu Skin's breach of the 1994 Consent Order to Desist misrepresenting earnings of distributors.

True to form, when market saturation led to a sharp decline in recruiting success in Singapore, Nu Skin promoters moved next to Malaysia.

According to a woman I shall call Susan (real name withheld by request, for fear of retaliation by her upline),

Nu Skin opened [Malaysia] with great fanfare on November 10, 2001. There were at least 5,000 signups in two days. . .

At the upper middle income areas of Kuala Lumpur, Nu Skin is doing a roaring business. Their office is very busy with distributors lugging away tons of cosmetics, other signing up everyone they know.

Is this phenomena sustainable? Malaysia is the 13th most successful markets for MLMs in the world. We are quite vulnerable and easily convinced with burning toners and pH tests (used to sell skin care products).

We have 22 million people in Malaysia. What are the chances of our making it to Blue Diamonds?"

Susan and others had been encouraged by Nu Skin promoters to plan on achieving Blue Diamond status, but without any mention of the abysmal odds of achieving it. They were shown the charts displayed in Appendix B.

Then Susan spells out her Nu Skin recruiter's plan for her to buy an expensive kit and get five friends to do the same, then the next month do the same and encourage those she recruited to do the same, etc. She goes on, "We are led to believe that we would be earning RM 10,000 a

month if we follow their formula and train all our business minded downlines to duplicate the same."

Nu Skin often defends their push to get new recruits to buy products with their 90% refund policy. But Karin says, "The problem with this '500 kit' is that, if we use or sell some of the items, we can't return for a 90% refund from Nu Skin on the unsold products. To return the remaining products, we have to buy (back) enough to make a complete set."

So where does Nu Skin go after Malaysia? Susan later wrote,

Before Nu Skin opened in November 2001, we were led to dream about expanding our markets to Indonesia (predicted opening in 2002) by our Hong Kong/Singaporean Blue Diamond uplines and China in 2002-2003.

We were informed that with our multilingual abilities (English, Chinese and Malay), penetrating Indonesia and China would be easy. If we work hard at the "ground start-up" and achieve our executive status, we would be able to achieve levels only dreamed of by others. **China's 1 billion population would be a mountain of treasure for those who dare to dream.**

A few other quotes from Susan's letters are interesting for the light they shed on the problem of misrepresentations in Singapore:

Singaporeans were shown that Malaysia in particular and then China and later India was going to open and if they participated, they would be able to enjoy tremendous "residual income." Little is said to them that the Taiwanese and Hong Kong people are better located and experienced in dealing with China. Now, with the China announcements that I have given you, it appears that the China dream is a "bitter lemon" for the people who have not made it big yet (those who cannot attain Blue Diamondship and Hawaiian Blue Diamond status by December 2002) . . .

(China) is now a "limited opportunity" skewed in preference of the "Team Elite Members" (Hawaiian Blue Diamonds) and Executives are now being compelled to attend at Salt Lake City's convention before they can participate in China. This alone has been a huge VICARIOUS misrepresentation by Blue Diamonds on behalf of the company but they (the company) will always deny it because even on their website, they have structured the information that China is a "market under construction" and that they are

negotiating and so on without commitments to the distributor publicly. **The company is very smart on this matter.**

[NOTE: Since this was first written, China authorities wisely decided to allow single-level direct selling only – not MLM! This was a huge setback for distributors in other Asian countries who were counting on building downlines in China.]

Quite often, in BOM [business opportunity meetings], it is stressed that because of the “breakaway sidestairway plan” [sic – I think he meant staircase breakaway.] YOU CAN BUILD BETTER AND BIGGER THAN YOUR SPONSOR AND THOSE BEFORE YOU especially NOW THAT THE BIGGEST MARKETS IN THE WORLD ARE OPENING – CHINA AND AFTER THAT INDIA ! This is the LURE!

[Our upline] insists that the 500 kit pack is essential if we want to start as business builders (meaning executives and above). They even go to the extent that if we don't buy the 500 pack, we cannot attend their Win-Win Club Leaders Training. Of course, everyone (including myself) who wanted to know what win-win club leader training means ended up buying a 500 pack each. The 500 packs sold like hotcakes from Nov 9-Nov 15. When the individual products were launched on November 23, Malaysian's distributors bought individual products to meet their 500 points quota.

We were told that if we work hard, we can become blue diamond in 5 years. Jackie Phua, a blue diamond from Singapore, would boast every time she trains, that she became a blue diamond in 6 months and both her uplines are blue diamonds.

I asked Jerome Pang some questions to get more specific:

Question: Did any Nu Skin distributors try to sell you Nu Skin products without making any mention of Nu Skin as a “sales opportunity” or “business opportunity?”

Answer: **You see if you did not mentioned the “business opportunity” part you would stand to loose from that part of the income which is [six] “levels deep.” The main gist of the whole thing is to get as many people under you in order to get that “big” income. It mainly plays on people's**

greed. The more you get people into this “business opportunity” the better your income would be. Your downlines would also have their own downlines and go many levels deep.

Question: About how much of an investment were you expected to make? (If you have already answered this question, just ignore it.)

Now this is the interesting part. They used this line which I remember so clearly because you were supposed to “duplicate” this to your downlines." you don't have to get the pack and it isn't a requirement but we found that this is the fastest way to get started on the program"

Then they would say that it would be for you to try the products and if you have a downline they would follow what you have done. There would be sort of no excuse for the downlines not to get the pack [buy the Executive starter pack].

The main idea for this is so that you would add to the upline's monthly GSV (Group Sales Volume) and to your own PSV (Personal Sales Volume) So that's the reason why they were so intent on new recruits to get the “started kit” It cost Sing 1350 !

I would like to add another point. There was also no explanation at the business brief of how you would achieve Executive level; i.e., how many points would be needed for each month of the qualifying period until you signed up for the LOI. This would be explained only at the LOI training. I experience some quiet disbelief and some shock from some of my downlines!

The fastest way to achieve your monthly GSV was to get your downlines to get the pack at Sing 1350! when they join the program. It's no wonder they say that this is the fastest way! (see above)

This was deliberate because if you had told people about this requirement I think many people would not have joined in the beginning!

You could also do it the other way.

Now instead to getting the "recruits" to buy the S\$1350 pack at 500 GSV (you would need 4- 5 packs per month per LOI month of 4 months program, you're exempted for the 2nd month) you could also sell approx. 237 bottles at retail price) of one of their shampoo each month!!! A typical 250ml bottle last for 3-4 months. Interesting!!!

Now to add to your GSV you were also encourage to get the LifePak at Sing 136 wholesale price (S\$166 Preferred Shopper price ; S\$195 at

Retail Price !!!) at your LOI training and you would encourage your downlines to do the same! (duplicate)

An average family of 4 would spend Sing 544 monthly excluding groceries etc!!! This is big money for families here with the current economic situation. In fact, they were so aggressive at the LOI training that they fill up your order (for 6 or up to 18 months of order, Automatic Delivery Program) form there and then!

Luckily for me and my downlines which I "trained" I did not submit my or their form but just bought one pack just to try. I felt it was pressure buying. I haven't finished the pack yet!

They also said that Pharmanex would bring in more products into the market but that has not happened either. Only a few more new Nu Skin products. I think Pharmanex is also part of the game plan and should also be looked into. Big Planet has also not come into [this] market!

The whole experience has left a bitter taste in my mouth about MLMs' or network marketing and their products although I did not lose any money.

You also really had to work full-time to achieve those goals touted because it also involved looking after your downlines. You had

to see that they also succeeded because if they failed you would have little income too!

I've become more careful when approached about MLMs and have warned those wanting to strike out with MLMs to be careful. It is not as it seems to be.

I also asked Susan (and other Asian correspondents) some questions, such as, "Were you given the odds (or probability or likelihood) of achieving those various levels, or were you shown the success rate for distributors in other countries? Answer: "No, none were mentioned."

I pressed the issue of income misrepresentation further:

Question: Were you informed that probably less than 1 in 10,000 (or whatever the figure in Asian countries – certainly less than 1 in 5,000, based on experience in the U.S.) of all who sign a distributor agreement ever become Blue Diamonds?

Answer: No, it was presented in a way that blue diamond is relatively easy to achieve. The number game of 5 multiples were used even though it was banned in a suit in the US. This is reproduced for your reference: [See Table 4 below.]

Table 4: Sales Organization Growth
via 5 x 5 x 5 x 5 x 5 "duplication:"

	1 Mo.	2 Mo.	3 Mo.	4 Mo.	5 Mo.
No. of Distributors:	5	25	125	625	3125

or about 4000 total "salespeople" in their downline.

Worst Case Attrition:

75% (4000 x .25) = 1000 distributors remaining

Worst Case Sales

\$100/Mo. x 1000 Sales People = \$100,000 monthly volume

14% Commission x \$100,000 Volume = \$14,000/Mo.

\$14,000 Per Month x 12 months = **\$168,000 Per Year!**

Other Asian correspondents have also shared the "Sales Organization Growth" chart that is often cited by promoters in opportunity meetings, but which is clearly in violation of the FTC Order. (Exhibit 1). **These Nu Skin Blue Diamond promoters were projecting \$168,000 in commission per year as a worst case scenario! Based on all that is known from other information in this report, wherever such projections are posted, it would be blatant misrepresentation.**

Of course, these projections sound very appealing and even somewhat logical to an unsophisticated prospect. The math works if you buy the assumptions. But no solid statistics on success rates are disclosed, and if they were – based on Nu Skin’s published “1998 Actual Average Incomes” report, which has been found to contain about 20 misrepresentations on a single page, how could anyone have any faith in Nu Skin’s numbers?

Question: Was it made clear to you that you really need to be a Blue Diamond to make a significant amount of money? [Since Blue Diamonds get over 58% of Nu Skin’s payout to distributors]

Yes, that is why we have to recruit as many downlines as possible and to become an executive in the shortest period and to qualify for Blue diamond within a year.

Question: A person in Singapore told me that the Nu Skin promoters said, “It’s up to you!” They claimed openly that “you can make as much money as the people who first came in and ran the company?” Was anything like that said to you?

Answer: Yes, we were told that we would be better off coming in now, as China has not opened, our potential to earn would greatly exceed those who were before us. . .

Question: I think you wrote earlier that at opportunity meetings prospects were told that if they get in now, they may be able to capitalize on markets soon to open up in Indonesia (probably in 2002) and then China in 2003? Have I got that right?

Answer: Yes, all the time, we were hyped about the huge, unlimited potential of marketing in China. Malaysia is seen as a small training ground. The actual gold mine is China. We were told that 50 cities would simultaneously launch Nu Skin Products, [and] that is why we have to establish our base in Malaysia to enable us to tackle China.

Question: What were you expected to pay up front to be fully active in the Nu Skin program?

Answer from David and Liza (henry_liza@hotmail.com) *in Singapore:* We paid our Advanced 500 Pack at a retail price of S\$1285 when in fact we could have bought that for S\$900 at wholesale being a distributor ourselves. We are, however, told that

distributors need to buy the Advanced 500 Pack, otherwise no training (or coaching on 'how to invite') shall be given to us.

This, therefore means that the 500 RSV, products worth US\$500, was credited to the upline who sold us the Advanced 500 Pack. In our case, this upline is not our immediate upline (who is in Philippines) but is actually a blue diamond executive.

It should be noted that when Nu Skin breaks into another country with a new pyramidal recruiting organization, it does whatever is necessary to adapt to the laws of that country, even if it means altering its compensation system. For example, in Singapore GSV (gross sales volume) can be equated with legs in the downline, so Nu Skin had to allow for that. But that created unprofitable and “unstable” organizations, a problem for Nu Skin. As Susan reported:

Another strong point is that if we achieve Blue Diamond status, we will stand to make commission 57% of the total sales by our downlines, so our Nu Skin products purchases (100 psv p.mth) would almost be free with tens of thousands of dollars of income per month. Our Singapore blue diamond is reportedly making S\$50,000 a month (S\$1 approx = C\$)

Blue Diamonds wherever they come from do make a lot of money provided they have built a strong and matured organisation.

There are also “Blue Diamonds” particularly from Singapore because they have new unstable organisations.

The current Singaporean Nu Skin distributor can become a blue diamond without 12 legs (executives as front lines) directly below them.

Quite a few S’pore Blue Diamonds build their titles with 2-3 legs only but because the rules here allow them to equate gsv volumes with legs e.g. if you do s\$36,000 for two months, they recognise and award you the blue diamond title because the gsv volume is calculated on gsv 3,000 x 12 executives even if you only have one or two front line executive group breakaway in Singapore.

If you look at the number of S’pore Blue Diamond’s, this is quite disproportionate to the population of only 4 mill. people. I understand that this variation of the rule in favour of Singaporeans is because of the hard stand of the government authorities when Nu Skin was discussing with them prior to entry into the Singapore market.

Recently, I have heard that the company is wanting to change this “recognition of titles” to make Singapore the same as the rest of the world. Perhaps, the payout in Singapore is higher than the company likes and that is why they want to change this – their profits is based on “BREAKAGES” [breakaways] – commissions provided for in the compensation plan that is not earned.

In Singapore, especially where products are purchased and returned and initial euphoria is achieved and commissions paid out, it is possible that the company profitability is less than expected especially when returns as demanded by law is huge and relentless.

The China “opportunity”: As best I can determine, authorities in Indonesia balked at admitting Nu Skin. China has agreed to admit Nu Skin, but with very stringent restrictions, since China has in the past outlawed multi-level marketing.

As explained by Nu Skin in an internal memo:

Team Elite China Retail Store Incentive Plan Tri-fold Content (includes legal’s and Corey Lindley’s modifications. Draft 6: 4-12-02)

The Opportunity

Never before has Nu Skin Enterprises (Nu Skin) embarked upon an international journey so great as the one before us today. China is home to over one-sixth of the world’s population, yet its economy and infrastructure are less developed than many markets in which we operate. As such, government practices necessarily incorporate strict guidelines; which currently prohibit several proactive forms of commerce including direct sales and network marketing.

Nu Skin, which has invested \$65 million to date in a modest infrastructure in China, has worked exhaustively with local and state gov’t officials to begin aggressively expanding its presence through an additional \$15 million dollar investment in its retail structure and manufacturing operations. In doing so, the company is proud to present Phase 1 of this exciting venture: The Team Elite China Retail Store Incentive Plan.

The Team Elite China Retail Store Incentive Plan incorporates several innovative strategies that allows Nu Skin Enterprises to involve its leaders in the further expansion efforts of the market while operating within parameters agreed upon between Nu Skin Enterprises and government authorities. The opportunity for

distributor leaders to work with Nu Skin Enterprises to expand the China Market is the first of its kind in China and in the world of network marketing, offering distributor leadership the opportunity to help expand and drive sales at Nu Skin stores and receive a percentage of such sales as a commission bonus.

Beginning January, 2003, Shanghai Nu Skin (the name of the official Nu Skin subsidiary company in China) will officially open up to one hundred additional retail stores in five provinces throughout south-east China: Jiangsu, Shanghai, Zhejiang, Fujian, Guangdong.

While Nu Skin’s China Retail Store Incentive Plan may seem an improvement, considering all that has been said about Nu Skin not having a bone fide retail or even a direct sales operation, **the China Plan is actually a dead end for Nu Skin’s recent recruits hoping to recoup their investments and earn the handsome fortunes promised to them. In effect, you have over 300,000 distributors competing for a tiny piece of 100-200 retail stores. But as before, distributors who entered the scheme earlier have the edge.** On April 28, we received from a distributor in Singapore this plea for help – and asking to be included in the Petition to the FTC regarding Nu Skin’s misrepresentations:

Dear Sirs,

I am writing to add more information about this horrible company.

Many of us were recruited because:

1) **The compensation plan allows us to grow bigger than our sponsor etc – that’s what they tell us.**

2) **There is this great China Opportunity that is represented to us by our sponsors at the point of recruitment - just attend any of the Business Opportunity Meetings that had been run for the last 12 months in Singapore and other parts of the world and perhaps in the USA.**

Now, the company (notwithstanding the fact that they have to comply with China's laws and authorities) have come up with a draft proposal to its Big Hitters (the Blue Diamonds) amongst its hundreds of thousands of distributors worldwide.

Sure, between now and December 2002, we can all compete to qualify for the "Big China Opportunity".

The major and critical difference is that some of us are starting now from near ground zero while many are up at Diamond and Blue Diamonds with huge organisations already standing.

It would not take more than a child to tell you that the race to "make it for China" will have the big hitters at the top of the "pyramid"! The rest of the [us] distributors will be surviving if we can on the "crumbs of China!"

IS THERE A CAUSE HERE FOR FTC INTERVENTION?

HELP!

Thank You,

Dato Lim Kok Peng (datolimkp@yahoo.com),
Malaysia (Some information is also available on this at

<http://www.NuSkin.com> (select China) but not much, as the pasted document here is an internal one.)

J. A few supporters of the PSA petition are representative of millions of silent victims worldwide. (See separate listing of petitioners). Reasons that relatively few complaints are filed and limited actions are taken against Nu Skin include the following:

(1) Participants are led to blame themselves for their "failure," rather than a compensation system that guarantees an extraordinarily high loss rate. So few complaints are filed.

With all recruiting MLM's, it is unfortunately the case that many good people are drawn into its web, even highly educated and moral persons. These participants develop a blind spot in their perception of truth and error. This phenomenon was well described by the psychologist Leon Festinger in his theory of cognitive dissonance. When a person's behavior sharply contradicts his/her belief system, that person may find it easier to resolve the dissonance by justifying or altering the belief system than by altering the behavior. Nowhere have I seen such rationalizing more evident than in recruiting MLM's.

Prospects are tricked into participating in a system that depends for its existence on deception. As with other product-based pyramid schemes, success requires that new distributors first be deceived, then maintain a high degree of self-deception, and finally go about deceiving others. Victims become perpetrators. So some fear self-incrimination – if they complained, they may implicate themselves.

This is another explanation for the few instances of ex-distributors coming forth with complaints about even the worst MLM scams. Not only have they been taught that failure is the fault of the distributor, but they have convinced themselves that the business was legitimate. They don't want to admit to themselves, and certainly not to the persons they recruited, that it was essentially a scam. Thus, the paucity of complaints may mask the fact that a multitude has kept quiet. One complaint may be representative of 1,000 or even 10,000 victims.

So a recruiting MLM like Nu Skin is the perfect con game. The very persons who are being victimized become the program's promoters and defenders. They have had it drummed into them that anyone can succeed if only they will try hard enough to "work the system." They work diligently to "build a downline" until they run out of money and drop out – only to further enrich the persons at the top who promote and profit from the fraud.

Dropouts are ashamed at having "failed," so they hesitate to complain to anyone and may even apologize to their upline for their failure. They don't know until carefully deprogrammed that the probability was 99.9% that they would fail, based on the experience of others, many of whom put forth great effort. Only by buying into and promoting the misrepresentations to thousands of others could they succeed.

After all (they reason – or have been told by promoters), if the program – were an illegal pyramid scheme engaging in misrepresentation, it would have been stopped by authorities long ago.

(2) Sales literature and other communications focus on the ruse of direct selling of well-researched quality products, rather than an actual emphasis on recruiting. (See D(3) above.)

(3) Nu Skin builds its credibility by well-placed donations to worthy and highly visible causes, such as the Para-Olympics, college (BYU) athletics, environmental protection, Stanford University dermatology research, starvation assistance, etc.

Recognizing its vulnerability operating on the edge of legality (or over the edge, depending on the sophistication of investigators), Nu Skin officials have bent over backwards to make very visible contributions to worthy causes. This has not been difficult, since Nu Skin has been awash with cash from its ill-gotten gains

partner in the Marriott School's Leadership Alliance. All of this has helped to give the company tremendous credibility and influence in the local community and helped to provide a stable full-time and part-time work force for NuSkin, with many of its management drawn from the ranks of former BYU staff.

In the ultimate PR coup for Nu Skin, a series of programs called "Conversation with the Governor" appeared recently on Channel 11, BYU's TV station. And who was the sponsor? Nu Skin! A trailer touted the great products sold by Nu Skin's "direct sales" force to bless the lives of consumers. And of course, Nu Skin's donations to worthy causes was also mentioned. So this was a program produced by BYU, featuring the popular governor of the State of Utah, Michael Leavitt, sponsored by a recruiting MLM. It was funded by Nu Skin – with a compensation system that makes it one of the most extreme pyramid schemes ever devised!

(4) Nu Skin hires notables to its board of directors and as speakers for its worldwide conventions. It has also donated to politicians who have authority to regulate it.

To further enhance its credibility, Nu Skin places on its Board of Directors persons of influence and stellar reputation. These include retired Senators E.J. "Jake" Garn from Utah and Paula F. Hawkins from Florida.

Over the years, Nu Skin has paid to secure such prestigious speakers at its worldwide conventions as Gerald Ford, Ronald Reagan, Colin Powell, Lee Iacoca, and Margaret Thatcher. Would these individuals have agreed to associate their names with Nu Skin if they had any idea of the fraudulent system providing the funding for all that Nu Skin does, including their speaking fees?

As mentioned in #3 above, Utah's popular Governor Michael Leavitt has appeared on a program sponsored by Nu Skin! In the trailer that follows, Nu Skin is touted as a "direct sales company" offering quality products and as a force for good in the world. One wonders if the governor or BYU officials would have agreed to Nu Skin's sponsorship had they understood the misrepresentation underpinning the source of Nu Skin's funds.

We might note that a review of Utah state election records revealed that Nu Skin's officers and the Nu Skin PAC donated 93% of their reported 1995-96 political contributions for state offices towards the campaign of Jan Graham, who was then state Attorney General (though of an opposing political party from Nu Skin officials – as above-named invited speakers

would suggest), which could be responsible for possible state action against them.

Credit Nu Skin with well-placed donations. We should also note that Amway (later Alticore), another recruiting MLM, leads the way in MLM influence peddling, was recently reported as one of the largest contributors to the Republican Party!

Nu Skin has worked hard to come across as a "good corporate citizen." But do these impressive donations put Nu Skin Enterprises, Inc., above the law? This report calls the motivation for all this into question.

Could it be that Nu Skin is buying legitimacy, at least among the locals, with all this largesse so that consumers and regulators will merely wink at the numbers, when they should be wincing?

(5) Nu Skin used the credibility it had built up among local politicians and law enforcement to weaken Utah's Pyramid Scheme Act.

In the 2005 and 2006 Utah legislative sessions, Nu Skin used its influence and credibility to lobby for bills to weaken the statute against pyramid schemes. In 2006, Senate Bill 182, that cleverly removes the requirement that participants sell to persons outside the network of participants, passed with the aid of testimony from Utah's Attorney General Mark Shurtleff, on whom legislators depended for legal advice. However, Mr. Shurtleff failed to disclose was that for years his top corporate contributors were product-based pyramid schemes, such as Nu Skin and Pre-paid Legal.

So at the 2005 and 2006 legislative hearings, I witnessed the specter of Utah's top law enforcement officer lobbying for arguably Utah's top lawbreaker!

One of the tired arguments put forth by Nu Skin, and repeated by the local Chamber of Commerce, was that Nu Skin is a "good corporate citizen," donating to many worthy causes locally.

Though effective in gaining the legislator's respect, the logic of Nu Skin's lobbyists is absurd. If one steals \$1 million from a bank and then donates \$200,000 of that to charity, does that legitimize the theft?

(6) The cause of misrepresentation in recruiting MLM's like Nu Skin – their exploitive and complicated compensation systems – are either avoided or not adequately addressed by consumer protection agencies and the courts. Instead,

attention is given to complaints about exaggerated product and income claims, background of founders, etc.

When one understands the fraud and misrepresentation inherent in recruiting MLM's, it becomes apparent that in order to assess the harm to participants, one must address critical elements in the compensation system (See Appendix C and D). **Unfortunately, many of these pay plans are so complex that few investigators are able or willing to do an adequate job of analyzing them. Many lack the background in statistics and familiarity with the marketing models and compensation systems in other settings to make qualified comparisons between legitimate businesses and recruiting MLM's, or product-based pyramid schemes. Consequently, well-financed and skillful MLM lobbyists and legal teams have overwhelmed the resources of consumer protection agencies. Those who are trying to protect consumers against exploitive MLM's are simply outgunned and outfoxed by MLM protagonists.**

Because of the complexity of the compensation plans, cases filed against MLM's typically focus on less relevant issues, such as exaggerated product claims or background of the founders. Generally, agencies only respond to the few complaints that are filed by victims who understand enough to know that they have been scammed. Consumer activists have learned that in enforcement, the squeaky wheel gets the grease. But with MLM, the vast majority of victims do not complain.

(7) Nu Skin and other recruiting MLM's have succeeded in establishing precedents of getting away with misrepresentation for many years. Thus, Nu Skin promoters have been emboldened to continue their misrepresentations, apparently confident they can get away with it, as they have since the 1994 Order.

As mentioned in A (above), the 1994 Order was clear, appropriate, and important to the FTC in fulfilling its mission to protect consumers and to promote fair trade. It is with great frustration and sadness that this analyst observes such flagrant violation of the Order continuing to this day, even though most of this evidence was presented to FTC officials in December of 2000. All knowledgeable and objective persons to whom I have presented this

information have agreed that the evidence of violations is both compelling and conclusive.

I have performed arduous research at an extreme disadvantage. Nu Skin officials have repeatedly refused to supply the data I requested, while accusing me of "torturing the data." (See L below.) So I have had to use information from public documents, such as those detailed in Appendix A. And my efforts to get the FTC to release its file of about 60 pages on Nu Skin, using the FOIA (Freedom of Information Act) was met by their releasing just one page. The FTC's FOIA office had its reasons, but the information could have facilitated my investigation.

For two years Nu Skin has been aware of the efforts of myself and others to debunk their deceptions. And because Nu Skin has not yet officially been found in violation of the Order, and because no penalties or corrective actions have been assessed or publicly reported, misrepresentations continue unabated. Officials at Nu Skin (and similar MLM's) are emboldened by the lack of enforcement action. It is hoped that this clear presentation of these facts and analysis will lead to appropriate and vigorous enforcement without further delay.

People in other countries are interested in what enforcement action has occurred in this country. In an e-mail message dated 12/26/01, Lim Choon Kiong wrote:

Dear Sirs,

I am from Singapore and come across your web page highlighting fraudulent MLMs. Interesting read!

May I know, is Nu Skin currently under some kind of investigation recently over at the States? Sorry to ask you this, since you know I can't get this info from their website! Over in S'pore [Singapore], **Nu Skin is the predominant player here.** There is an MLM Amended Act enforced in our country [wef 1/1/2002].

K. With competent and objective investigation, using the information in this report and petition, Nu Skin will be found to be in material breach of the CONSENT ORDER TO CEASE AND DESIST misrepresenting earnings of its distributors. Prompt action by the FTC with appropriate sanctions and without further delay is important to protect consumers and fair trade – and vital to the FTC in fulfilling its own mission.

I believe sufficient evidence has been presented to find the 1997 and 1998 reports of "Actual Average Incomes" of distributors in violation of both the letter and the spirit of the 1994 Order for Nu Skin to stop misrepresenting earnings of distributors – and that such misrepresentation has continued in one form or another since the Consent Order was finalized in 1994. The fact that Nu Skin's compensation system constitutes a recruiting MLM, or product-based pyramid scheme, may not be at issue, but it helps to understand the motivation behind the misrepresentation. The misrepresentation and deception that such a system inevitably leads to should not be allowed to continue without FTC action – especially when there is an Order in place to stop it!

In separate correspondence (dated May 13, 2002) to Robert Frisby of the FTC's Enforcement Division, I have proposed reporting disclosures that would be more truthful and fair to consumers. **PSA has also received many e-mails from supporters of a petition for the FTC to require adequate disclosure of average earnings of distributors for all MLM's. This is one of the most constructive steps the FTC could take to protect consumers. However, it is anticipated that the MLM's lobbying organization, the Direct Selling Association, would fight it vigorously, as it would make transparent the fraud inherent in most of these programs.**

Robert Fitzpatrick in his book *Pyramid Nation* states, "Nu Skin is the only company in the country to be fined over one million dollars on two occasions by the FTC for making false and misleading claims about its products and the incomes of distributors." (p. 56)

Perhaps a million dollars is too insignificant a penalty to effect any change in Nu Skin's exploitive breakaway compensation system. To Nu Skin officials, it is merely a small budget item – like another donation to charity.

NOTE TO FTC PERSONNEL:

The 1994 Order is a good one – one of the best actions the FTC has ever taken in this field. American consumers are deserving to know if the FTC is enforcing its own orders on their behalf. Based on my understanding of the Congressional mandate under which the FTC operates, enforcement of the 1994 Order is highly appropriate and timely. Further delay, on the other hand, will facilitate ongoing exploitation in U.S. and foreign markets, and the perception of ineffectiveness of an agency charged with the responsibility of protecting consumers and fair trade.

L. Nu Skin's only defense against these charges is to discredit the whistleblower, with comments which reveal significant self-deception even among responsible top officials.

The research that has gone into this report has been very thorough and performed over a period of many years. Having been heavily recruited by Nu Skin, as well as other MLM recruiters, I finally decided to test the program for a year as a practicing distributor, determined to prove whether or not Nu Skin (and other MLM's) were what their promoters represented themselves to be. Many of the insights and evidence collected for this report would not have been possible without this direct involvement.

To be fair, I have challenged Nu Skin's officers to provide refutation of the analyses on four occasions, both by mail and in person. In each case, they declined to do so, other than the CFO's dismal attempts to dismiss the charges without offering any substantive evidence or rationale to refute my conclusions.

Nu Skin has taken the approach of discrediting the whistleblower. But should this be any surprise? Like a child caught with his hand in the cookie jar, it is human nature to make rationalizations. Please read my separate report, *Nu Skin Discredits the Whistleblower*, which begins with a statement furnished by Nu Skin to at least one editor who asked about my research, with my itemized rebuttal and own detailed account of how I got involved in this arena of consumer awareness.

Appendix A

**Petition submitted to FTC Enforcement Division
by Pyramid Scheme Alert (PSA) December 4, 2000**

**COMPLAINT OF VIOLATION BY NU SKIN
of the 1993 [finalized in 1994] FTC Order for Nu Skin and Its Distributors to Stop
Misrepresenting Past, Present, and Future Earnings of Distributors**

- Since 1991, Nu Skin Enterprises has been investigated, subject to cease and desist orders and/or other enforcement actions related to its business practices by the Federal Trade Commission (FTC) and the Attorneys General of Michigan, Georgia, Pennsylvania, Florida, Illinois, Ohio, Connecticut, Texas, and Utah.
- In 1993, Nu Skin International, Inc. (now Nu Skin Enterprises, Inc.) and associates were ordered by the Federal Trade Commission to stop misrepresenting in any manner past, present, and future profits, earnings, income, or sales from participation in its marketing plan.
- Since that time, Nu Skin has published and made available to prospects who inquire an annual report entitled *Actual Average Incomes*.
- This report includes faulty assumptions and survey results, omissions of costs and other important data, and statistical distortions that -- taken together -- significantly mislead and misrepresent earnings to potential distributors who are recruited into its plans. For example, sales at retail price are assumed at far greater rate than actually occurs, and odds of success are calculated without considering the vast majority of participants who quit the Nu Skin program after losing their investment.
- In particular, a person reading the report may conclude that 100% of those who make an effort to apply the Nu Skin program as distributors (the "actively participating distributors") earn at least some profit. But careful study by qualified analysts, who are intimately familiar with the report and with Nu Skin's recruiting practices and compensation system, have concluded that less than 1/10 of 1% of all distributors who have signed a distributor agreement have earned a profit after subtracting all expenses, including both operating expenses and products purchased from Nu Skin.
- As a result, hundreds of thousands of persons who joined the Nu Skin program since 1993, and who based their decision to participate partly on the verity of this report, may have been defrauded collectively of as much as hundreds of millions of dollars.

We therefore request the Federal Trade Commission to examine whether Nu Skin's Actual Average Incomes document is a violation of the 1994 Order for Nu Skin and its distributors to stop misrepresenting past, present, and future earnings of distributors.

SUPPORTING DOCUMENTATION

for the Complaint of Violation by Nu Skin of the 1994 FTC Cease and Desist Order for Nu Skin and its Distributors To Stop Misrepresenting Past, Present, and Future Earnings of Distributors

PART 1: Summary and notations on Nu Skin's report "1998 Actual Average Incomes"

In supporting the petition for the Federal Trade Commission to determine if in fact Nu Skin International, Inc. (now Nu Skin Enterprises, Inc.), and associated parties are in violation of the Agreement Containing Consent Order to Cease and Desist (misrepresenting earnings of distributors, etc.), dated May 21, 1993 (File No. 912 3071), the following supporting information is presented.

In summary, it can be demonstrated that Nu Skin is violating the order by: Misrepresenting the past, present, and future profits, earnings, income, and sales from participation by distributors in Nu Skin's marketing plan, based on reported earnings of existing distributors.

This formal complaint is supported by the following – some in the report of "Actual Average Incomes," some in the analysis and appendices of Part 2:

- A careful review of the "1998 Actual Average Incomes" report currently provided by Nu Skin for prospects and the FTC. (See Exhibit A.) Reports for other years follow the same format.
- Data from 1998 and 1999 Form 10-K (Annual Report) required by the SEC
- Spreadsheet analysis of Nu Skin's report of "1998 Actual Average Incomes"
- Reports from observation of ex-distributors (free from sanctions by Nu Skin)
- Analysis of incentives built into the Nu Skin Compensation System
- Excerpts from the order itself
- Qualifications of this analyst (separate sheet)

Based on the "1998 Actual Average Incomes" provided by Nu Skin, it appears that 100% of Nu Skin distributors who put forth some effort (as "active distributors") earn at least some profit. This encouraging statistic is at least part of the justification for new distributors' choice to participate in the Nu Skin program. While this 100% success rate is certainly desirable for seekers of business opportunities, **the true odds of earning a net profit for all new distributors are probably less than 1/10 of 1%, or 1 in 1,000.** The

rate could even be closer to 1 in 3,838 – if all relevant data were included—assuming a minimum 95% dropout rate and using figures adjusted for misleading statistics reported by Nu Skin and not detected by the FTC's Division of Enforcement.

The difference between the odds of success inferred from Nu Skin's report that is provided to prospective recruits, and the actual odds of success, is sufficient to make a material difference in a prospect's decision whether or not to participate. Hundreds of thousands of persons who joined the Nu Skin program, based on the numbers and the report form apparently approved by the FTC, were thus defrauded.

Many of these errors could have been detected by a statistician or market analyst who understood basic principles of marketing and statistics, who had sales or entrepreneurial experience, and who was willing to challenge the validity of Nu Skin's claims. Some would be difficult to identify without direct involvement with the Nu Skin compensation system, such as I have had.

To show how extensive are the misrepresentations in the report entitled "1998 Actual Average Incomes," I have included a copy of the report, with notations for the misleading statements and statistics. (See report on the next page and the notes following.) Nu Skin would of course not accept these corrections, because only persons with no ability to understand basic statistics would then want to participate. It would be obvious that Nu Skin's "business opportunity" is in reality no opportunity at all. Both the FTC and the public it should be protecting, have thus been defrauded.

NOTE to FTC personnel:

Please study carefully the report to follow and see how the one-page report is full of misrepresentations and omissions. Those who understand the issues will find at least 20 of them. See notes and documentation following the report.

NOTES on “1998 Actual Average Incomes” report

- (1) It is highly unlikely that any profits will result from part-time effort, contrary to promises of recruiters. Extreme effort and the willingness to deceive many recruits may be required to “succeed.” What is not said here is what is deceptive.
- (2) The vast majority of active distributors (85.8%) do not qualify for any commissions. It is quite possible that over 90% of all U.S. distributors who have participated in the Nu Skin program have not qualified for commissions. And remember, commissions are not net income.
- (3) These are not earnings, but assumed earnings. They include bogus retail sales figures, and averages skewed by the inclusion of a few founding and early Blue Diamond distributors, who receive a majority of the payout.
- (4) Since retail figures have been proven to be fallacious (See Part 2), they should not be included. This column should include only actual average payout by Nu Skin and be labeled as such. Also, the payout to the founding and earliest Blue Diamond distributors is so extreme that it skews any averages. They should either be eliminated from the averages or given a separate designation.
- (5) After subtracting operating expenses and purchases from the company, actual net income for all but the top distributors, is usually zero or a net loss.
- (6) A column of purchases from Nu Skin should be included here as a prime expense of doing business.
- (7) Net payout, after subtracting purchases from Nu Skin as a cost of doing business, gives a more realistic picture of net income. If actual operating expenses were also subtracted, most would show losses, except for top distributors. But this information would be difficult to obtain unless distributors were willing to voluntarily release information from their income tax returns. It is doubtful they would do so without a court order. Ex-distributors may be more willing.
- (8) These percentages would be reduced by over 95% if all distributors (including inactives and those who quit or were terminated) were included.
- (9) Could be over a million if all distributors, past and present, were included for computing odds of success.
- (10) Because (1) Nu Skin was experiencing regulatory action, (2) the perception of saturation swept the U.S., and (3) its top distributors wanted to establish profitable “organizations” (pyramids) overseas, most of Nu Skin’s business is now in Asia, where laws against pyramid schemes are weak and populations vulnerable. There are over 60,000 active distributors in the U.S., but about 500,000 worldwide, mostly in Asia.
- Millions of participants have lost money, become discouraged, and quit.
- (11) This number of distributors who have achieved each level since the founding of the company is compared against a monthly average of “actively participating distributors”—an apples and oranges comparison. This statistical distortion lies at the root of many of Nu Skin’s misleading earnings claims.
- (12) This greatly limits the number of distributors who figure in any calculations of the odds of success.
- (13) This number is false, as it assumes sales at retail prices, most of which was sold at wholesale prices, if sold at all.
- (14) Again, only rarely do distributors sell at a markup of 43%. Most are sold at wholesale, though taxed at retail.
- (15) This survey is invalid. Distributors who told the truth could lose their distributorships.
- (16) End consumers are generally the distributors and their families. The sellers are the buyers, and the buyers are the sellers—to themselves. This is generally true of product-based pyramid schemes. Retailing outside of their network is rare. Some Nu Skin promoters have been telling distributors they only need to sell to their downline.
- (17) A totally bogus figure. The average income for these distributors was approximately zero, or a loss—if they bought any products at all.
- (18) A column should also be added for the distributor to estimate operating expenses, before projecting what net income will be. Based on the experience of ex-distributors, it would be safe to say that minimum operating expenses for serious Nu Skin recruiters in the U.S. would exceed \$7,500 a year, or ½ of total payout by Nu Skin, whichever is greater.
- (19) It should be revealed that over half of the total payout by Nu Skin goes to a tiny percentage of Blue Diamond distributors at the top of Nu Skin’s pyramidal hierarchy—typical of a highly leveraged, back end weighted pyramid scheme. In fact, it can be demonstrated that Nu Skin’s breakaway compensation system is a mega-pyramid, one of the most extreme forms of a pyramid scheme.
- (20) It would only be fair to reveal that the vast majority of all “actively participating distributors” who receive commission checks experience losses, some of them major losses. It is often the case that those who invest the most and try the hardest, lose the most. It would also be advisable to reveal that the actual odds of “success” (if showing a tiny profit could be considered a success) is less than one in 10,000—or worse, depending on a number of factors and on statistics which Nu Skin is understandably reluctant to make public

SUPPORTING DOCUMENTATION, PART 2: Detailed Analysis – Major reporting inconsistencies

Nu Skin's "1998 Actual Average Incomes" report states: "This average annual income includes retail profit based on a 43% retail markup price. A survey of active distributors' retail sales from January-December 1998 revealed that an average of 55.7% of personal sales volume was sold at retail to end consumers."

Anyone who is familiar with Nu Skin's products knows that retail list prices are so high that only in well-to-do neighborhoods could a distributor be consistently successful in selling products at the suggested retail price. For example, a couple with two teen-age children taking LifePak would have to pay over \$200 a month wholesale just for LifePak supplements. If they buy other supplements and a few skin care products that figure could easily rise to twice that amount. And if you add 43% to that you could be up to \$572 a month—and the family hasn't even bought basic groceries yet!

Ex-distributors who have sold Nu Skin's products, agree that the vast majority of products are sold at wholesale, and most are bought more to meet minimum purchase requirements to qualify for commissions and bonuses than for actual need. The distributors are the buyers, and the buyers are the sellers—primarily to themselves and family members—some consumed, some stored, and some given away. Distributors are urged to "be a product of the products." In any event, only an insignificant portion of the total of Nu Skin's reported product sales are consumed by end users outside of Nu Skin's immediate family and network of distributors.

One would have to conclude that the above-mentioned survey is an in-house one and that respondents are telling what they **should** be doing, not what they **are** doing. After all, violating the "rules" could result in forfeiting their distributorship.

False assumptions in the report of sales at retail prices greatly skew income figures upward, especially of lower level distributors, since their stated incomes depend on retail sales. **It would be much more valid to report only average payout to distributors from Nu Skin without making any assumptions about retail sales. It would then be seen that very few distributors make any net income, even without subtracting expenses.**

Also, when one correlates the 1998 Average Annual Incomes report with figures in Nu Skin's annual report, obvious discrepancies emerge, calling into question again the claim that distributors are retailing to any significant degree outside of their distributor network.

Let's look at the numbers. If 55.7% of purchases were sold at a retail markup of 43%, then the average income of \$1,555.23 (See chart below) to distributors who did not receive commissions would represent an average wholesale cost for those assumed sales of

\$3,616.81. And this supposedly represents 55.7% of personal sales volume.

Divide \$3,616.81 by .557 and you get \$6,493.38 total purchases. Multiply this in turn by 54,487 distributors who did not qualify for commissions, and you get wholesale purchases of \$353,804,796.10—or **\$353.8 million** (much higher if purchases by commissioned distributors are included). But based on Nu Skin's annual report (Form 10K, required by the SEC), \$88.3 million revenue was reported for markets outside Asia in 1998. In 1999 North America generated 84 % of revenue of the "Other Markets." If a ratio even close to this were applied to 1998, the **total revenue for all of North America would be only about \$74.2 million. Oops!** The validity of the aforementioned "1998 survey of active distributors' retail sales" comes very much into question.

Not only do the numbers not add up, but the numbers furnished leave little room for retail sales outside Nu Skin's network of distributors. Blue Diamond distributors are getting a lot of money – not from retail sales, but from purchases by their respective downlines – mainly from recruitment activities in Asia.

While it is not the purpose of this complaint to charge Nu Skin with conducting a pyramid scheme, it is helpful to observe that pyramidal elements in Nu Skin's compensation system contribute to the falsification of this report. Even in Utah (where laws against product-based pyramid schemes are weaker than in some other states), if a company's multi-level marketing participants get their money primarily from recruiting rather than from the sale of products, it is considered a pyramid scheme. This may be another reason Nu Skin publishes this misleading report, making it appear that far more retailing is occurring than is actually the case.

Only rarely would prospective distributors have the sophistication to extract and identify these contradictory statistics, **and they are thus misled by these extremely misleading statistics.**

Faulty assumptions based on spurious survey

One would have to conclude that the above-mentioned survey is an in-house one and that respondents are telling what they **should** be doing, not what they **are** doing. **In their "Policies and Procedures" directives it is made clear that violating these "rules" could cause loss of one's distributorship – a severe sanction against telling the truth.**

Nu Skin's reported "survey of active distributors' retail sales from Jan.-Dec.1998" is thus invalid and should not be accepted by the FTC as evidence that "an average of 55.7% of personal sales volume was sold at retail to end consumers." As has been

mentioned, reports of retail sales are greatly exaggerated. Such a survey to be valid would have to be given by an independent research firm with no hint of any connection to Nu Skin. Distributors otherwise fear that their license could be revoked for not obeying the “rules against stockpiling products.” It would be far more valid to survey ex-distributors who have nothing to lose.

Given Nu Skin’s proclivity to exaggerate or fabricate retail sales (as demonstrated here), all sales transactions purported to be sold at retail prices should be documented and monitored frequently by independent audit—or not accepted as reported. Buyers should certify on separate signed sales receipts for each transaction (1) the actual price paid and (2) whether or not said buyers are outside of the distributor’s immediate family or downline.

So it is not surprising that ex-distributors I have interviewed report that retailing to end consumers at retail prices was a rarity for Nu Skin’s network of distributors. **Products were purchased on a “pay to play” basis, with many products stockpiled or generously given away to family members or friends, and some bought in the name of “dummy distributors.”** This is done to meet minimum recruitment requirements in order to advance to ever ascending levels in the distributor hierarchy.

I doubt that these products would have been purchased had not the participants been enrolled as Nu Skin distributors. Sales to end consumers outside of the network of distributors (and their families) are insignificant, especially at full retail markup.

The column in Nu Skin’s report entitled “Average Annual Income at each level for 1998” is therefore incorrect and should be replaced with **actual payout by Nu Skin**, not including any assumed retail sales, since such figures can be shown (based on these reports) to be invalid. Income for “Distributors” from retail markup is actually close to zero – more likely in the loss column.

After a careful analysis of Nu Skin’s compensation plan and purported average incomes for top distributors, it is inconceivable that many distributor would choose to expend significant effort to sell products at retail when the rewards touted by promoters are infinitely greater (by hundreds – even thousands – of times) to recruit a downline for the same expenditure of effort.

Based on the foregoing, I believe it is safe to say that Nu Skin’s assumptions of retail sales are faulty and misleading. Products cost too much, and there is little incentive to sell. Recruiting—not retailing—is where the money is. With few exceptions, the sellers are the buyers, and the buyers are the sellers—to themselves and their families!

Omission of costs of products and other purchases from the company as expenses

As previously mentioned, products purchased by distributors are not sold but are generally used, stored,

or given away, and such purchases represent a “pay to play” contribution to Nu Skin and the top upline distributors. They could be referred to as “incentivized” or “pay to play” purchases because they are tied to qualifications to participate or to advance in the scheme.

In my one-year test of Nu Skin’s system, I was obliged to buy products to meet minimum requirements for commissions and bonuses, to offer as samples to prospects, and to “be a product of the products” – as our upline recommended.

When product purchases are incentivized to satisfy volume requirements to advance up to higher levels in the hierarchy of distributors, they should be counted as a cost of doing business, even if they are consumed. Interviews with ex-distributors confirms my own observations that consumption of Nu Skin products drops sharply when a participant leaves the scheme. They find more reasonably priced products elsewhere. What was seen as normal consumptions while in the system now is recognized as hyper-consumption of expensive products for reasons other than real need.

The fact that these products would not likely have been purchased or sold without this connection can be demonstrated by asking ex-distributors and their families how much of the products they continue purchasing after terminating their Nu Skin distributorship. Based on my observations and experience, the drop is usually from 80% to 100%, as seems to be the case with all MLM programs.

So purchases from any MLM company like Nu Skin should be subtracted from any income averages as a cost of doing business. The resultant net income figures then show that relatively few distributors ever realize a net profit.

This can be demonstrated by requiring an additional column in the report, showing the average total purchases for each level of distributors and another column showing net average payout for each level (commissions less products from Nu Skin). Prospects would then have a more realistic picture of the odds of netting any profit from participation.

Omission of operating costs in reporting “actual average incomes”

Nowhere in the report is any indication given of costs, not only of products, but also of **operating expenses**, which should be subtracted from revenues to produce actual net income. This may seem obvious to experienced business persons, but I observed that this

point was entirely overlooked at every opportunity meeting or publication of “actual average incomes.”

If one subtracts expenses that distributors incur, the odds of earning a profit become much worse than the report suggests.

My one-year test proved that success required significant operating expenses, such as large telephone bills for continual recruiting; travel to meetings, conventions, and prospects’ homes; purchases of cassettes and other sales materials supplied by Nu Skin, fees for Nu Skin conventions and training, printing and duplication of articles and other materials; postage and shipping of promotional materials to prospects, and supplies.

Also, after exhausting my “warm list” of friends, relatives, and acquaintances, I found it necessary to turn to advertising to obtain additional prospects. **The notion that this is a no-cost or low cost business was found to be totally misleading, at least for those seeking “success.”**

One year of expenses included (purchases from Nu Skin in bold face type):

Money paid to Nu Skin

Nu Skin products	\$5,416.75
VIP services (by Nu Skin)	102.21
Nu Skin training, conferences	755.00
Nu Skin Publications & tapes	459.98
Total amount paid to Nu Skin	<u>\$6,733.94</u>

Operating expenses

Advertising	1,457.81
Supplies	586.30
Printing & duplication	418.99
Telecommunications services	3,496.15
Postage & shipping	329.85
Travel & mileage	5,277.12
Miscellaneous	<u>216.76</u>
Total operating expenses – not paid to Nu Skin	<u>\$11,782.98</u>

Total expenses \$18,516.92

If one is working with more vulnerable populations, such as in the Orient, where perceived saturation is not as high as in the U.S., some expenses may not be so high. Person-to-person recruiting may be more effective. But even if advertising, business use of the home, and rental of meeting spaces (necessary for higher level distributors) are all excluded from the calculations, **a minimum figure of \$15,000 total expenses for products and operating expenses seems reasonable for a person seeking to advance in the system.** Distributors who did not qualify for commissions were not as aggressive in their recruiting.

I can attest that in my experience with Nu Skin, expenses necessary to ascend the ladder of payout levels in order to qualify as an “executive distributor” exceeded

\$15,000 per year. My observations and those of others was that it would be far greater for those at higher levels.

While Nu Skin may argue that if network marketing is done properly, little in the way of promotional expense is necessary, I found that to be false, at least in the U.S. Nu Skin is a tough sell, as is any multi-level marketing (MLM) program in the U.S., where consumers have been bombarded by MLM propositions and are less gullible than in years past.

But even if one cuts expenses in half to \$7,500 per year – or even to nothing (the impression given in many opportunity meetings, where operating costs are not mentioned at all), **the odds of success are such that one’s efforts will likely come to naught, and it would be misleading to suggest otherwise.** (See Chart below.)

Nu Skin’s report of “Actual Average Incomes” should include a statement such as the following:

“Expenses of operating a distributorship, including cost of products purchased from Nu Skin and all operating expenses, can be very significant. It is not unusual for total costs of products and operating expenses to exceed payout from the company for all but the top two or three levels of distributors.”

It would be even more honest to report the following: “It would be extremely rare for a profit to be reported for tax purposes by any distributors, with the exception of Blue Diamond or Diamond distributors.” It would also be helpful if prospects knew that **well over half of the payout from Nu Skin goes to relatively few Blue Diamond distributors – about 100 Blue Diamonds out of over a million past and present US distributors who have attempted the Nu Skin “business opportunity.” In fact, in the light of this data and analysis it is misleading to refer to a Nu Skin distributorship as a “business opportunity” at all.**

Statistical distortions

In the “Title” column of the Average Incomes report are listed the distributor titles. These are distributors who have risen to certain levels, many of whom have been with the company for many years, especially the Blue Diamonds. The founding distributors and some of their participating relatives have been with Nu Skin since the beginning, or close to it.

The column “Percentage of the Active Distributors” compares the **cumulative** totals of distributors who have achieved and maintained certain payout levels since the founding of the company with the **average** of 63,520 “actively participating U.S. Nu Skin and IDN distributors per month.” **So a cumulative statistic – those who have achieved certain levels over the years of Nu Skin’s existence – is compared with a point-in-time measure of a**

fluctuating statistic—average “actively participating distributors” in an average month. This is an apples and orange comparison, a ratio no qualified statistician would consider acceptable. To be a valid comparison, all distributors who ever signed up must be included in comparisons with all who achieved said levels. It is unlikely that Nu Skin would have maintained the number of total distributor signups, as such a statistic would be irrefutable evidence of a bogus “business opportunity.”

But even the latter comparison would not be valid for a multi-level marketing (MLM) program like Nu Skin. This is because it is in the nature of MLM’s (like all pyramid schemes) for early entrants into the scheme to have a huge advantage over later entrants. After all, one of the most forceful appeals of Nu Skin promoters is the concept of “permanent income” derived from the downline one recruits. So we can assume that the upline positions of founding distributors tend to be locked in, and no one thereafter has a comparable opportunity to make such large amounts of money.

I knew of one Nu Skin founding distributor who had made over \$20 million up to 1995, and I saw a photocopy of a monthly check of another for over \$400,000. The monthly check of a third Blue Diamond was for over \$850,000! Given the structure of their pyramidal compensation system, other Blue Diamond distributors could never make as much as they could. **Therefore, including the ultimate upline distributors (especially the founding distributors), in any averages hugely skews such statistics.**

So an objective analyst could conclude that a more valid measure of success for new distributors is to compare distributors who qualified for a certain level in a given year – minus those who lost qualification for that level – with the total number of new distributors who signed up as distributors (whether they “succeeded” or not) during that same year. You would then have a more current and valid statistic. As this report suggests, it would be abysmally low. With such honest reporting, Nu Skin would be seen as a bogus business opportunity. **It would then be misleading to claim that a person has a significant likelihood of making money as a Nu Skin distributor. This would be illegal and a violation of the Order to stop misrepresenting earnings.**

As well might a gaming table in Las Vegas post a sign above it saying “BUSINESS OPPORTUNITY” as for Nu Skin to suggest its program is a legitimate business opportunity. In fact, the odds of success are considerably better at nearly all of the slot machines and gaming tables in Las Vegas. (I checked with the Nevada State Gaming Control Board.)

Why all these deceptions? Extreme pyramidal compensation system

One might ask: Why do such deceptions seem to run rampant in MLM’s, and why would Nu Skin (and other MLM’s) so frequently resort to such tactics? In my opinion, **MLM’s deceptive sales practices, including misleading product and earnings claims, cannot adequately be understood without a solid understanding of the structure and dynamics of product-based pyramid schemes.** In fact, I firmly believe that **the over-emphasis on recruiting and the associated deceptive sales practices are the resulting effects, and not the cause of the manifest problems.**

Combined effects of deceptions in Nu Skin program

So – **the 100% odds of earning a significant profit (using “active distributors” as the population), which the 1998 Nu Skin report suggests, on close inspection drops to an infinitesimal number – possibly even less than 1/100 of 1%.** [To be on the safe side, a more conservative figure of 1/10 of 1% was used in the petition statement.] I estimate that if you subtract assumed retail sales, include a realistic estimate of operating expenses and products purchased from Nu Skin, and if you include all distributors who ever attempted a Nu Skin distributorship in the statistical population, and subtract the top distributors whose positions tend to be locked in, **the odds of earning a profit may be as low as 1 in 15,152. One in 23,810 would earn over \$10/hour! But even leaving the founding distributors in the statistical population (as in chart below), odds of 1 in 3,838 (assuming 95% dropout rate since Nu Skin’s beginning) of earning any profit at all is an unacceptable success rate for anyone considering participation.**

Hundreds of thousands (if not millions) of persons who joined the Nu Skin program, based on the numbers and the report form apparently approved by the FTC, were thus defrauded. The Enforcement Division of the FTC was blatantly deceived, as well as Nu Skin participants.

Based on the foregoing, I believe the case should be reopened and Nu Skin charged at the very least with misrepresenting earnings in violation of the 1994 Order – if not with also conducting an illegal pyramid scheme. The effects of the fraudulence are so consequential that both corrective and punitive action seems appropriate.

ANALYSIS OF NU SKIN'S REPORT, ENTITLED "1998 ACTUAL AVERAGE INCOMES"

LEVEL	Average annual income per distributor * (should be payout)	% of active distributors - plus non-paid distributors*	Total no. of distributors (estim.)	Total average revenues per distributor level (estim.)	% of total distributor revenues (estim)	Minimum average annual product costs & operating expenses per distributor ** (est.)	Maximum average profits per distributor (estim)	Approx. average annual earnings if paid a minimum wage	Average earnings per distributor - above minimum wage (est.)
Blue Diamond	\$480,404	0.16	102	\$48,824,416	58.7	\$240,202	\$240,202	\$12,240	\$227,962
Diamond	\$154,582	0.09	57	\$8,837,126	10.6	\$77,291	\$77,291	\$12,240	\$65,051
Emerald	\$53,422	0.08	51	\$2,714,713	3.3	\$26,711	\$26,711	\$12,240	\$14,471
Ruby	\$27,071	0.19	121	\$3,267,134	3.9	\$15,000	\$12,071	\$12,240	(\$169)
Lapis	\$12,409	0.66	419	\$5,202,246	6.2	\$15,000	(\$2,591)	\$12,240	(\$14,831)
Gold	\$6,611	1.11	705	\$4,661,541	5.6	\$15,000	(\$8,389)	\$12,240	(\$20,629)
Executive	\$4,622	2.66	1,690	\$7,809,530	9.4	\$15,000	(\$10,378)	\$12,240	(\$22,618)
Qual. exec's*	\$598	0.46	292	\$174,731	0.2	\$15,000	(\$14,402)	\$12,240	(\$26,642)
Distributor *	\$311	8.8	5,590	\$1,738,415	2.1	\$1,200	(\$934.00)	\$12,240	(\$13,174)
Distributors who did NOT receive commissions*	\$0	85.78	54,487	\$0	0	\$200	(\$200)	\$12,240	(\$12,440)
Calculated totals		99.99	63,514	\$83,229,852	100.0				

Reported total*

63,520 – average number of “actively participating distributors” per month.

For the purposes of this report, the minimum total of U.S. distributors since Nu Skin's founding is **1,270,400**—assuming a minimum cumulative dropout rate of 95%, including all inactive & terminated distributors since the companies founding.

At least 58.6% of total revenues went to Blue Diamonds (48,424,416/83,229,852), making up only 0.00008 of all distributors since Nu Skin's founding, or **1 for every 12,500 total distributors!** (102/1,270,400) This is characteristic of pyramid schemes – most of the income goes to a tiny percentage of the top distributors.

In 1998, less than 0.52% of all US Nu Skin distributors earned a profit. That's one in 192 (63,520/331)—much less if inactive and terminated distributors were counted. **Assuming 95% of distributors have dropped out since Nu Skin's founding, only 1 out of at least 3,838 total distributors would have earned a profit!** (1,270,400/331)

In 1998, less than 0.33% earned a minimum wage (assuming \$6/hour). That's one in 303! (63,520/210)—much less if inactive and terminated distributors were counted. **With a 95% dropout rate, only 1 out of at least 6,050 total distributors would have earned a minimum wage!** (1,270,400/210)

* 1998 Actual Average Incomes - data furnished by calling (801) 345-9599 (U.S. only) These two columns are reported by Nu Skin, except that reported income has been reduced to 20% of that reported for distributors and qualifying executives - to more closely represent actual sales. No attempt is made to estimate retail sales at higher levels. **Distributors who didn't earn commissions are not likely to have sold at retail prices, so their income is 0 - actually a loss if product purchases are subtracted.**

** Includes product purchases from the company, supplies, printing & duplicating, telephone services, postage & shipping, publications & tapes, travel & mileage, sales materials, training, and misc. business expenses. Minimum average annual product costs & operating expenses per distributor are roughly estimated at \$15,000 total per year, or 1/2 of commissions, whichever is greater. (Exception: For distributors who are not serious recruiters, purchases as an expense item are based on “pay to play” and minimal signup and sample costs.) Use of home and advertising are not included. Minimum product purchases – and estimated operating expenses for executive distributors and above – are conservatively based on a one-year test of the Nu Skin program by Jon M. Taylor, Ph.D., and on discussions with other Nu Skin distributors.

ANALYSIS OF NU SKIN'S REPORT, ENTITLED "1997 ACTUAL AVERAGE INCOMES"

LEVEL	Average annual income per distributor * (should be payout)	% of active distributors - plus non-paid distributors*	Total no. of distributors (estim.)	Total average revenues per distributor level (estim.)	% of total distributor or revenues (estim)	Minimum average annual product costs & operating expenses per distributor ** (est.)	Maximum average profits per distributor (estim)	Approx. average annual earnings if paid a minimum wage	Average earnings per distributor - above minimum wage (est.)
Blue Diamond	\$649,550	0.24	103	\$67,197,262	63.0	\$324,775	\$324,775	\$12,240	\$312,535
Diamond	\$152,099	0.13	56	\$8,523,084	8.0	\$76,049	\$76,049	\$12,240	\$63,809
Emerald	\$63,668	0.13	56	\$3,567,758	3.3	\$31,834	\$31,834	\$12,240	\$19,594
Ruby	\$32,817	0.29	125	\$4,102,256	3.8	\$16,408	\$16,408	\$12,240	\$4,168
Lapis	\$14,995	0.95	409	\$6,140,403	5.8	\$15,000	(\$5)	\$12,240	(\$12,245)
Gold	\$7,849	1.61	694	\$5,447,173	5.1	\$15,000	(\$7,151)	\$12,240	(\$19,391)
Executive	\$4,726	4.81	2,073	\$9,799,006	9.2	\$15,000	(\$10,274)	\$12,240	(\$22,513)
Qual. exec's*	\$598	0.53	228	\$136,617	0.13	\$15,000	(\$14,402)	\$12,240	(\$26,642)
Distributor*	\$221	18.50	7,974	\$1,763,895	1.65	\$1,245	(\$1,024)	\$12,240	(\$13,264)
Distributors who did NOT receive commissions *	\$0	82.81	31,385	\$0	0	\$200	(\$200)	\$12,240	(\$12,440)
Calculated totals		100.00	43,105	\$106,667,455	100.00				

Reported total*

43,105 – average number of “actively participating distributors” per month.

For the purposes of this report, the minimum total of U.S. distributors since Nu Skin's founding is 862,100 – assuming a minimum cumulative dropout rate of 95%, including all inactive & terminated distributors since the companies founding.

At least 62.99% of total revenues went to Blue Diamonds (67,197,262/106,667,455), making up only 0.00012 of all distributors since Nu Skin's founding, or 1 for every 8,370 total distributors! (103/862,100 – even worse in 1998) This is characteristic of pyramid schemes – most of the income goes to a tiny percentage of the top distributors.

In 1997, less than 0.79% of all US Nu Skin distributors earned a profit. That's one in 127 (43,105/340)—much less if inactive and terminated distributors were counted. Assuming 95% of distributors have dropped out since Nu Skin's founding, only 1 out of at least 2,605 total distributors would have earned a profit! (862,100 /331).

In 1997, the percentages of all US Nu Skin distributors who earned a minimum wage (assuming \$6/hour) were the same as for those who earned a profit (previous paragraph).

* 1997 Actual Average Incomes - data furnished by calling (801) 345-9599 (U.S. only) These two columns are reported by Nu Skin, except that reported income has been reduced to 20% of that reported for distributors and qualifying executives - to more closely represent actual sales. No attempt is made to estimate retail sales at higher levels. Distributors who didn't earn commissions are not likely to have sold at retail prices, so their income is 0 - actually a loss if product purchases are subtracted.

** Includes product purchases from the company, supplies, printing & duplicating, telephone services, postage & shipping, publications & tapes, travel & mileage, sales materials, training, and misc. business expenses. Minimum average annual product costs & operating expenses per distributor are roughly estimated at \$15,000 total per year, or 1/2 of commissions, whichever is greater. (Exception: For distributors who are not serious recruiters, purchases as an expense item are based on “pay to play” and minimal signup and sample costs.) Use of home and advertising are not included. Minimum product purchases – and estimated operating expenses for executive distributors and above – are conservatively based on a one-year test of the Nu Skin program by Jon M. Taylor, Ph.D., and on discussions with other Nu Skin distributors.

Appendix B: What Nu Skin promoters are saying and displaying at opportunity meetings

MARKET SURVEY* RESULTS – TOP 10 DIRECT SALES COMPANIES

Aim of Study:

To resolve conflicting claims regarding incomes among companies in the network marketing industry.

Summary of Results for Top Ten (US\$)

Company	Average Income	Equity Price	Top Earners	Founded	Annual Revenue
Nu Skin Int	\$747,063	\$7,478,843	520	1984	\$1.0 Billion
Body Wise	\$439,000	\$4,492,546	15	1989	\$65 Million
Primerica	\$288,550	\$3,034,955	42	1977	\$1.4 Billion
Shaklee	\$244,000	\$2,440,138	100	1956	\$700 Million
Excel	\$240,000	\$2,524,154	86	1989	\$506 Million
Mary Kay	\$231,000	\$2,301,610	100	1963	\$950 Million
Amway	\$137,000	\$1,310,912	1000	1959	\$6.3 Billion
Melaleuca	\$121,000	\$1,248,173	150	1985	\$266 Million
NSA	\$108,000	\$1,006,242	324	1970	\$108 Million
Discovery Toys	\$100,000	\$ 925,570	7	1978	\$ 93 Million

CONCLUSIONS (PER NU SKIN PROMOTERS)

- Network Marketing is a viable, lucrative business.
- In all companies it took an average of 6 years to reach the top.
- Nu Skin International is fueling fast growth with a new equity reward for serious executives.
- Nu Skin International gives the best return for the same amount of work.

MY COMMENTS ON THE ABOVE

As unlikely as it may seem, there are “experts” who can be found, even at universities who provide fodder for schemes such as Nu Skin’s. It would be very difficult to find experts at universities who would have the courage to challenge the MLM industry – especially those receiving donations from such companies. A recent *Atlantic Monthly* article entitled “The Kept University” underscores this problem. This is why independent analysts such as myself, not depending on the MLM industry for funds, feel the need to speak out vigorously against consumer abuses. It would not be necessary if enforcement agencies were up for the task.

- We should also note that when an MLM company like Nu Skin can get an independent source to mislead prospects, they need not do it themselves. Very convenient in court.

- Note the title: “TOP 10 DIRECT SALES COMPANIES.” The authors of the study, or its institution may have received funds from the Direct Selling Assn. (now the voice of MLM) – or from the companies themselves. I have taken great pains to demonstrate in this report that if there is anything Nu Skin is not, it is a “direct sales” company. And the same is true for most of the others on the above list.
- The top earners at Nu Skin are, of course, the Blue Diamonds. But if you were to look at the average income of all distributors, you would get a completely different picture. Average income for Nu Skin distributors may be close to the bottom, after ALL distributors are averaged, including the “failures” or those who failed to “work the system.” But of course, we cannot know that because Nu Skin’s CFO said the management team “never deemed that to be

material,” so they purged the records of the distributors who were not “active.”

- Hopefully, this report will belie the myth in the first statement: “Network Marketing is a viable, lucrative business.” It may be for a tiny percentage, but the vast majority (about 99.9%, based on available data) lose money.
- In the second statement: “In all companies it took an average of 6 years to reach the top,” the implication is that a new distributor can expect to take that long to reach that level. And since Blue Diamonds get over 58% of company payout to distributors, participants rightly want to become Blue Diamonds. Again, no mention is made of the infinitesimal odds of getting to Blue Diamond status – less than one in 12,500!
- The “equity price” suggests that when one has achieved a given level (by “building the business”), the distributorship can be valued as an equity. In fact, the third statement suggests that an “equity” is created. – another misrepresentation for a recruiting MLM. Can anyone who carefully reads this report see that as a viable conclusion? For most, it becomes a liability. And if it were deemed an equity, should not a distributorship be treated as a security? This would place Nu Skin in violation of securities laws, at least in the U.S.

- The fourth statement is simply false for anyone who has done any amount of honest work to which “the Nu Skin opportunity” can be compared.

**Reference for the above report supplied at Nu Skin “opportunity” meetings:*

“Network Marketing: Portrait of an industry and its Top Earners” by the Fielding Institute, November 1996. Conducted by Dr. W. J. Burns of Iowa and Dr. C. Miller, American Graduate School of International Management, Thunderbird University.

NOTE to FTC personnel:

This type of comparative report demonstrates the need for meaningful disclosure. Stating income of top earners without disclosing the total base of participants from which these persons were drawn and without subtracting costs of participation can lead prospects to think that their odds of success were greater than was actually the case.

Appendix C

Incomes by Distributor Levels for Nu Skin's Breakaway Compensation System

Distributor level	No. of downline breakaway organizations on first level	No. of levels deep of downline breakaway organizations from which commission overrides can be collected	Approx. total no. of downline distributors from which commissions on purchases can be collected	Likelihood of realizing any profit
Distributors not qualified for commissions (over 95% of participants)	0	0	Few, if any	ALL lose money
Distributors qualified for commissions	0	0	A few	Probably all lose money
Gold	1	1	Dozens	Probably all lose money
Lapis	2	2	Low hundreds	Almost all lose money
Ruby	4	3	High hundreds	Most lose money
Emerald	6	4	Low thousands	Many lose money
Diamond	8	5	High thousands	Some may lose money
Blue Diamonds	12	6	Tens of thousands	Receive lion's share of payout by Nu Skin - average \$552,348/yr.

Blue diamonds, only a tiny percentage of all distributors, get most of the commission payout paid by Nu Skin. More specifically, though there was only about one Blue Diamonds for every 12,500 distributors, they got about 60% of Nu Skin's total payout to distributors See Table 3.

* Figures for these two columns are based on observations, interviews, and analysis of a limited amount of published data. They are rough estimates only.

Several things (itemized below) should be noted to assess the harm done to the vast majority of participants by such a compensation system:

► **Blue diamonds, constituting 0.00008 (less than 1/100 of 1%) or less than one out of every 12,500 distributors, harvest 58% of the money paid out by Nu Skin to their entire distributor downline network. At opportunity meetings, prospects are told that anyone can become a Blue Diamond. They are NOT told that Blue Diamonds get over 58% of the payout at the expense of their own downlines. They are NOT told that 99.94% of recruits will lose money, after subtracting all expenses, including "pay to play" purchases.**

► When discussing number of levels for payout, we are not talking about levels of individuals, but of **whole groups of participants**. So payout to a Blue Diamond distributor could be not just six, but over a dozen levels of participants in some downline "genealogies" – a clear red flag of a recruiting MLM.

► As the number of qualified executives on one's front line increases, the breakaway bonuses skyrocket in exponential fashion. A blue diamond's income may increase tenfold over what was paid out as a diamond. This places enormous pressure on participants to move up to the next level to avoid "leaving money on the table." It also explains why retailing becomes a waste of time – recruiting is so much more profitable. In effect, participants moving up the hierarchy of titles are penalized severely for NOT placing their emphasis on recruiting.

► Because the downline of an executive with executives under him/her consists of whole groups of distributors, the number of downline distributors can easily number in the thousands. Many Blue Diamond executives have tens of thousands of downline distributors from whom they collect breakaway bonuses. See the attached chart illustrating how numerous (and lucrative) a downline for a Blue Diamond can be.

► Analysis of the 1998 “Actual Average Incomes” report demonstrates that at least 58.6% of Nu Skin’s payout in distributor incentives goes to the Blue Diamond distributors – even where a Blue Diamond may have tens of thousands of persons in his downline. Prospects are not told this.

► When distributors terminate, bonuses for those they have recruited then “roll up” to the upline person immediately above them. Since the vast majority of distributors lose money and drop out, bonuses accrue eventually to Blue Diamonds at the top of the hierarchy. In this way, the persons at the top of the pyramid profit from those beneath, whether they succeed or fail.

► While extremely profitable for the top distributors, this reverse gravitational flow of income to blue Diamonds impoverishes those beneath them. This helps to explain the extremely high loss rate – over 99.94%!

► A careful reading of my report on “*The 5 Red Flags: Five Causal and Defining Characteristics of Product-Based Pyramid Schemes, or Recruiting MLM’s*” leads to the inescapable conclusion that Nu Skin is clearly a recruiting MLM, or cleverly disguised product-based pyramid scheme dependent on an endless chain of recruitment of participants as primary customers.

► Nu Skin’s highly leveraged breakaway compensation system makes it not only a pyramid scheme of people, but of whole groups of people. It is, in effect, a mega-pyramid of many downline poly-pyramids – perhaps the most extreme and exploitive type of pyramid scheme ever created.

► Since Blue Diamonds harvest most of the payout from Nu Skin, participants strive to achieve Blue Diamond status. To be fair, such achievement would have to be available to all. But if even a high percentage achieved this goal, world saturation would be reached very quickly.

Appendix D

FIVE RED FLAGS

for Identifying Exploitive Product-based Pyramid Schemes, or Recruiting MLM's*

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

Recruiting MLM's require extensive recruiting before realizing genuine profits. In such programs, retailing is not significant. Recruiting MLM's typically display five features:

1. Recruiting of participants is unlimited in an endless chain of empowered and motivated recruiters recruiting recruiters. Ask: Is unlimited recruiting allowed, and are those who are recruited empowered and spurred on by incentives (such as overrides from downline purchases, advancement, etc.) to recruit additional recruiters, who are likewise empowered and motivated to recruit still more recruiters, etc. – so that the effect is an endless chain of recruiters recruiting recruiters? This leads to a perception that a given market is saturated, and the program must move on to another location or introduce new products or divisions to continue. The opportunity for each new person to make money becomes less and less as the programs expands.

2. Advancement in a hierarchy of multiple levels of "distributors" is achieved by recruitment, rather than by appointment. Ask: Does a participating "distributor" advance his/her position (and potential income) in a hierarchy of multiple levels of "distributors" by recruiting other "distributors" under him/her, who in turn advance by recruiting distributors under them, etc.? If so, the result is self-appointment through recruitment to ascending payout levels in the distributor hierarchy. If the only way a person can profit significantly in the scheme is through recruiting to advance to higher payout levels, this strongly indicates a pyramid scheme.

3. "Pay to play" requirements are satisfied by ongoing "incentivized purchases."** Ask: Are participating "distributors" who are recruited presented with significant "pay to play" options? That is, are they encouraged to make sizable investments in "incentivized purchases**" in order to take advantage of the "business opportunity," and later to continue qualifying for advancement in – or payout in overrides and bonuses from – the MLM company? Watch out for minimum quantity purchases of products or services over time – where you must "pay to play" the game –

in order to qualify for commissions or advancement. Be particularly wary when you are asked to sign up for continuing product purchases on auto-ship through an automatic bank draft, rather than making occasional purchases as needed. Such "pay to play" or "incentivized" purchase requirements may be disguised investments in a product-based pyramid scheme, or a clever system of laundering pyramid investments in the form of product purchases.

4. The company pays commissions and/or bonuses to more than five levels of "distributors." Ask: Does the company pay overrides to distributors in a hierarchy of more levels than are functionally justified; i.e., more than five levels?" Even in major corporations, the entire world marketplace can be covered in five levels of sales management – branch, district, regional, national, and international sales managers. Paying overrides and bonuses on more than five levels in an MLM program primarily enriches those at the top at the expense of those at the bottom. You would be wise to avoid any program that pays overrides on more than five levels. **Breakaway compensation systems are particularly exploitive**, as payments are on a hierarchy of "breakaway" organizations of whole groups of participants, not just individuals – creating an extraordinarily high loss rate, except for those at the top of a "mega-pyramid of pyramids."

5. Company payout per sale for each upline participant equals or exceeds that for the person selling the product, creating inadequate incentive to retail and excessive incentive to recruit – and an extreme concentration of income at the top. Ask: Would a "distributor" purchasing products "for resale" receive about the same total payout (in commissions, bonuses, etc.) from the MLM company as participants several levels above who had nothing to do with the sale? If so, the company's payments to the person retailing the product would be pitifully small, while those at the top in his upline can compound the small commission per sale by the sales of hundreds or even thousands of downline distributors. This is great for that upline person, but lousy for those attempting retail sales. Avoid any MLM company which pays less than

half of all distributor payout to the person actually selling the products to customers outside the network.

You should not accept income projections of retail sales at full retail prices, especially for products that are overpriced and not competitive in the marketplace. Also be wary when an MLM promoter asks you to choose between two options or “tracks” – one for those who want to “retail” the products and another track for those who are serious about “building the business.” If the incentives are heavily weighted towards recruiting, this is a moot question.

While no one of these red flags in and of themselves constitutes an exploitive pyramid scheme, taken together they create enormous leverage, enriching those at the top of the pyramid at the expense of a huge downline of unwitting victims of the scheme. Where valid data has become available, recent research has demonstrated that **when all five of these red flags are found in an MLM, the percentage of participants who lose money is approximately 99.9%** – even worse than the 93.3% loss rate for classic, no-product pyramid schemes and for many games of chance in Las Vegas. For the full report, go to –
<http://www.mlm-thetruth.com/5RedFlags2column40pages2Color3-6.pdf>

* a.k.a. multi-level marketing, network marketing, consumer direct marketing, etc. Recruiting MLM’s can be distinguished from retail MLM’s, in which the company pays generously for retailing products without recruiting large downlines.

** “Incentivized purchases” are purchases of goods and services from the MLM company that are tied to qualifications to participate in commissions or to advance through ascending levels in the distributor hierarchy. If they constitute a required cost of participating in the “business opportunity,” then whether they are used, sold, given away, or stored is irrelevant – they should be considered a cost of doing business.

Note to FTC personnel:

The full 40-page report is important to anyone seeking to understand the factors in a pyramid marketing (or chain selling) scheme, that define and differentiate them from other business models, how the compensation plans lead to such high loss rates, and what type of disclosure is needed to protect consumers. For the full report, go to –
<http://www.mlm-thetruth.com/5RedFlags2column40pages2Color3-6.pdf>
And for related research, go to -
http://www.mlm-thetruth.com/mlm_research.htm

Appendix E: Nu Skin's Blue Diamonds cash in on a mega-pyramid of downline victims

Nu Skin's program can be described as a MEGA-PYRAMID, that uses a highly leveraged breakaway compensation plan that enriches top Blue Diamond distributors at the expense of as many as tens of thousands of downline victim-participants. These become in effect, a revolving door of new recruits, each of whom join and buy products in hopes of reaching the coveted Blue Diamond status. However, no one informs them of the infinitesimal odds of achieving this elusive goal.

To qualify as a Blue Diamond, one must recruit twelve separate pyramids of participants (which they call "organizations"), headed up by qualified Executive distributors on the Blue Diamond's first level of distributors, each of whom must meet volume quotas, from which the Blue Diamond can collect override bonuses, along with their respective downlines.

Nu Skin can be viewed as an extreme product-based pyramid scheme with a whole constellation of multiple pyramids (or poly-pyramids) nested within a downline of one grand pyramid, or more accurately mega-pyramid made up of numerous smaller pyramids – each pyramid counting as a unit headed by a qualified executive.

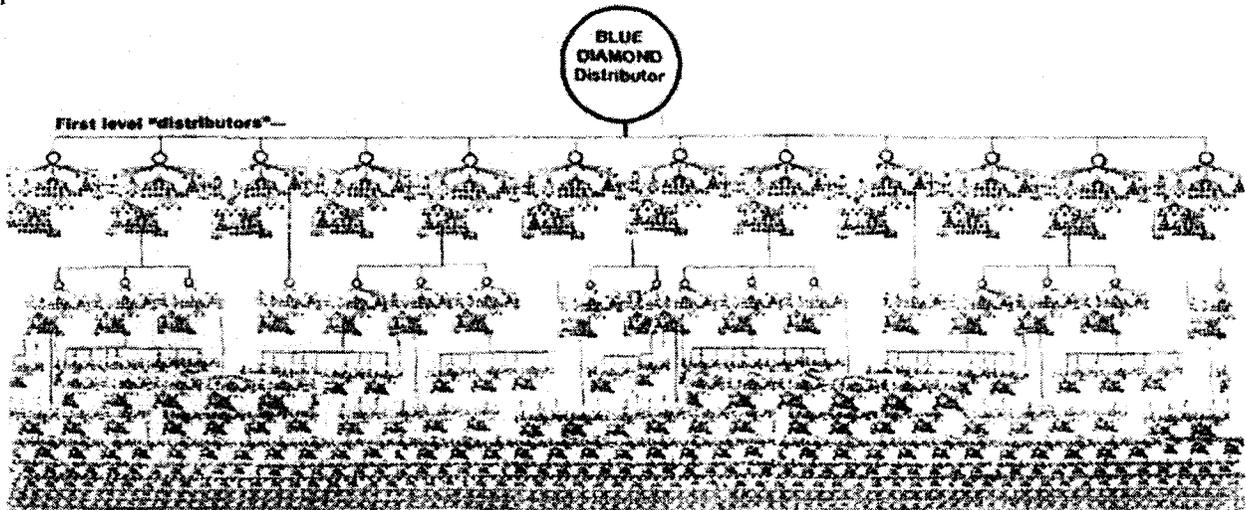
In comparison with product-based pyramid schemes, the harmful effects of no-product pyramid schemes are mild in comparison – with a loss rate of no more than 93.3% and aggregate losses and number of

victims only a tiny fraction of those in product-based schemes. In fact, the odd of profiting from a no-product pyramid scheme is many times that of profiting as a Nu Skin distributor. (To learn more about product-based pyramid schemes, or recruiting MLM's, read "The 5 Red Flags: Five Causal and Defining Characteristics of a Recruiting MLM, or Product-based Pyramid Scheme." It can be downloaded at – <http://www.mlm-thetruth.com/5RedFlags2column40pages2Color3-6.pdf>

A Blue Diamond Executive distributor sits atop and collects commissions of the purchases of a downline of thousands of hopeful distributors, all of whom have been led to believe that they too could profit from their recruitment efforts. However, about 60% of Nu Skin's payout to distributors goes to the Blue Diamonds. The remaining 40% is divided up among tens of thousands of downline participants. Few participants get enough commission income to exceed "pay to play" or incentivized purchases and other expenses. Analyses of reports of distributor incomes from 1997 to 2004 suggest that about 99.9% of Nu Skin distributors lose money, after all expenses are subtracted. This would not be as big a problem if the truth about Nu Skin's odds of "success" were disclosed, but it is not.

Exhibit 3: Nu Skin's Mega-pyramid Structure

Blue Diamond Executive distributors get about 60% of the payout from Nu Skin in a mega-pyramid of tens of thousands of downline participants – who as a group receive the other 40%. This means that few distributors receive enough in commissions to cover their costs. Approximately 99.9% lose money – only to enrich the Blue Diamond at the top.



Appendix F: ADDENDUM (Prepared June 7, 2003)

Recent Activities and Misrepresentations by U. S. Nu Skin Recruiters in its Big Planet and Pharmanex Divisions

Recent feedback from current Nu Skin distributors and ex-distributors, who had terminated their Nu Skin distributor licenses, reveals a continuing pattern of misrepresentation by Nu Skin promoters and officials, in order to recruit more people to enrich top distributors and to maintain cash flow for the company. In fact, Nu Skin's promoters seem determined to promise whatever would entice new recruits to join up and buy their products and services.

While the ex-distributors quoted in this Addendum are from Utah, where this researcher is located, similar reports could be gathered from at least 30 states throughout the U.S, where Nu Skin promoters are recruiting. These would include Alabama, California, Colorado, Connecticut, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Minnesota, Missouri, Montana, Nevada, New York, North Carolina, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, Wash. D.C., and Wisconsin. Canada and Puerto Rico are also targets.

Although Nu Skin promoters tout the company's strategy of adding new divisions for promoting explosive growth, company revenues have not grown significantly during the past decade. In 1994, Nu Skin promoters spoke of the company as a "billion dollar company," and they are still doing so today – quoting sales as "nearly a billion dollars." Still, promoters were telling prospects last year that "when China opens up" they could anticipate sales of "\$5-6 billion by 2005."

The addition of new divisions by Nu Skin is not so much a growth strategy as a replacement strategy to survive, as each division dries up in a given area. Since the rewards in Nu Skin's compensation system are much greater for recruiting than are the rewards for direct selling to end users, no real direct sales market survives after recruiting has achieved de facto saturation in a given area. In the U.S., powerful evidence of this is seen in the fact that there exists no significant ongoing direct sales market for Nu Skin personal care products, which were Nu Skin's premier product line up until the early nineties when Nu Skin went to Japan to build volume through recruitment.

As this report demonstrates, Nu Skin's recruiting and resultant revenues have in the past several years been concentrated in Asia, going from one country to another as de facto saturation sets in. In recent years,

approximately 80% of Nu Skin's revenues have come from Asia. However, new divisions established in the U.S. have opened new recruiting opportunities for Blue Diamonds here – IDN (Interior Design Nutritionals) in the mid-nineties, Pharmanex and Big Planet in 1978 and 1999.

In some areas, recruitment meetings consist of "tri-division opportunity" meetings, where prospects are told they can participate in a seamless global strategy of buying and recruiting worldwide in any of the three divisions – Nu Skin, Big Planet, and Pharmanex. Purchases (supposedly for resale) in any division count towards qualifications for advancement to or maintenance of Executive status or other levels in the distributor hierarchy. But in most areas, the meetings seem to concentrate on one product division.

Misrepresentation of Distributor Earnings Continues

Recruiters have continued to show charts of average incomes of the top levels of distributors and are led to believe that anyone can become one of the Blue Diamond distributors, who average about \$½ million a year. However, prospects are not shown the abysmal odds of achieving this level – less than one in 12,500. Also, the fact that Blue Diamonds get most of the commissions paid out by Nu Skin, and that 99.94% of participants lose money, is not disclosed.

Harley Bradbury, of West Jordan, Utah, recalls Nu Skin promoters flashing the 1998 "Actual Average Incomes of Distributors" report (challenged in the petition). "It was so misleading it was pathetic," he said.

Big Planet's Big Misrepresentations

In 1998, Nu Skin introduced its Big Planet division, which was a new opportunity to get new recruits excited enough to join up and "pay to play" the game by buying an products and services from Big Planet. As is the case each time Nu Skin introduces a new division or opens a new area, recruits were told they were getting in just ahead of the "bubble" or "wave of opportunity." "We were told that Big Planet would be the largest Internet provider ever," said Ryan Taylor of Salt Lake City.

In 1999, Nu Skin promoters somehow managed to get former Chrysler chairman Lee Iacocca to see

Nu Skin's Big Planet division as an inexpensive and expeditious way to promote energy efficient vehicles, futuristic household equipment, and other items with which he had become associated. Big Planet was being paired with a program called Planet Electric for an array of exciting new technology that could be sold by Big Planet distributors.

Iacocca was featured in a 1999 Big Planet recruiting video, in which recruits were told that Big Planet's networking model was cheaper than conventional advertising and distribution for promoting these progressive new products. Energy efficient electric golf carts, snowmobiles, jet skis, and electric cars, dubbed e-cars, were to be released within months, following a tentative schedule that was discussed at the meetings. A folding e-bike was already available.

In the video, Chaz Haba, CEO and Director of Planet Electric, demonstrated his folding e-bike and discussed products his compact new lithium battery pack would make possible that will "truly make a difference" and that "change the world." He promised,

"We're gonna give you a lot of products . . . We're gonna start out with sports/recreational vehicles. That's why we feel that Big Planet and Planet Electric are going to be unique products for the world. No one else is going to have this product [offering]."

Iacocca criticized traditional franchising and auto dealership models as expensive and cumbersome. "With your progressive marketing and our progressive products, we're gonna change the world," declared Iacocca. "I can't get into a new industry with new product awareness, unless I come to you [Big Planet] people – 'cause you've got the right formula."

The person narrating the video laid out an exciting opportunity for new recruits to Big Planet, which would provide "multiple sources of residual income," including: Internet service, paging, long distance, wireless cell phone and Internet access, Internet devices, calling cards and pagers, web hosting, Big Planet DSL, unified messaging, and even unique energy offerings in the field of electricity and natural gas. (See "Pennsylvania Settlement with Nu Skin to Prevent Further Misrepresentations," below.) "They were talking about a whole electric community," recalls Stella Powell, of Murray, Utah.

Big Planet was to have an exclusive network marketing relationship with "Planet Electric – the advanced electric technology company." Recruits who saw this video were led to believe that this was an opportunity too good to miss!

Prospects were told that if they "sign up now" they could be one of the first to sell one of these vehicles. In the meantime, at about \$1,395 each, new recruits were buying large quantities of folding electric bicycles, or e-bikes. Eager recruits were excited by the apparent Iacocca-Big Planet connection.

Recruits were assured that they would earn commissions not only on what they bought, but on what their customers bought, and on sales by "each person you enrolled to assist you in building your business." These were to be "high-tech products and services that generate a residual income that can change your life." The appeal was electric!

Big Planet promoters urged recruits to sign up for their Internet service on 3-year contracts at \$29.95 a month, for a minimum investment of \$1,078.20 (a "pay-to-play" way of getting thousands of new recruits to invest millions of dollars). Recruits were also encouraged to buy at least \$100 a month in products and services to qualify for commissions. The more ambitious were enticed to eventually make purchases of \$2,000 a month (supposedly for resale) to maintain Executive status. Some spent thousands of dollars to purchase in the names of children or friends to qualify.

The recruits also received "I-phones," fancy telephones priced at \$395, that served as answering machines and could be used for e-mail, as long as the person was signed up for Big Planet Internet service. The I-phones were free as long as the three-year Big Planet contract was fulfilled.

Calling cards and pagers were also sold through Big Planet, but the calling cards soon fizzled. Participants were told they could promote products through an Internet mall, so long as they went through Big Planet, which was promising to offer over 30 million products over the web. However, as stated by Rhonda Leigh of West Jordan, Utah, "a lot of promises were made, but nothing was ready as promised."

Recruits were led to believe that the e-bikes and e-cars were going to be unique to Big Planet participants, who would be the first to have them for resale. However, they discovered that Iacocca was selling the e-bikes through other outlets and became disillusioned from that point on. A golf cart was reported to have caught fire and was pulled from the web listings. Promoters stopped talking about the e-cars. Since then, E-bikes are periodically sold off at fire sale prices. The electric cars, golf carts, snowmobiles, and jet skis did not become available as promised.

Big Planet recruits were led to believe that solar cell batteries were exclusive to Big Planet. They later discovered they were not exclusive. "All of this was just a ploy, or smokescreen, to recruit new people," said Kim Wolfey, a frustrated ex-distributor from Ogden, Utah. He said the use of Iacocca's name in recruiting was very effective. "I assumed that someone with Iacocca's stature would not want to be associated with a scam."

The I-phone worked for many people, but some called it a "piece of junk." Some failed to last a year. Refunds of 90% were given under strict conditions if applied for within a year, but many participants did not become aware that Big Planet was not what they were led to believe until the year had expired.

Many people bought into Big Planet not only for themselves, but also for friends and family members in order to qualify to advance in the system ("Pay to play" – See page 17). Some lost thousands when they finally decided to get out – having to buy out the contracts of those for whom they were buying products and services.

Iacocca's name was used to promote Nu Skin via the "Feed the Children" program, in which a percent of every sale goes to help starving populations. "We were led to believe that Iacocca was part of us," said Carol Loveland, another ex-distributor from Ogden, who figures she lost over \$250,000 with Nu Skin (including lost work time) while she traveled and promoted Big Planet 14 hours a day for about 18 months.

Ms. Loveland said she would not have joined Big Planet if she had known at the start that it was actually Nu Skin and not really a separate company. It was promoted as Big Planet, and the name Nu Skin was not introduced until later. She feels sorry for the hundreds of people she recruited. "We were flat lied to," she said.

Some older recruits used what little savings they had set aside to enhance their retirement by participating in Big Planet. After buying enough Big Planet contracts for his children to qualify to participate and advance in the scheme, Dick Knudsen from Holladay, Utah, finally dropped out after losing \$6,600 to live on his "pittance from Social Security." He said he got involved because of representations by Big Planet recruiters. "I needed an I-phone like I needed a hole in my head," said Knudsen.

A disappointed recruit from Salt Lake City, Ron Bulgamore, said, "the whole thing was based on signing up new people." He had planned to retire, based on promises by Nu Skin recruiters. He was told, that if he signed up enough people, he would have enough to retire. "Now I can't retire," he laments.

Jim Waite, from Ogden, was told an electric car would be available by 2003. "Nu Skin lied to us totally," he said. "They buy big names." (Lee Iacocca, Olympics and BYU athletics as sponsors, Utah Jazz as users of LifePak, etc.). "They suck a lot of blood out of people."

Big Planet is now currently receiving relatively little attention by Nu Skin. While until last year it was a major thrust in recruiting meetings, according to one distributor, it may now be getting 5% of the attention. So in the U.S., Big Planet seems to be going the way of the Nu Skin personal care line and IDN (Interior Design Nutritionals) – replaced by another division to bolster recruiting opportunities.

Pennsylvania Settles with Nu Skin to Prevent Further Misrepresentations

An alert team of regulators at the office of Pennsylvania Attorney General Mike Fisher accused Nu-Skin of operating a pyramid scheme to sell energy and technology services such as electricity, cable television, and Internet services through independent distributors. Distributors paid \$350 to join the program and were offered financial incentives to recruit new members. The Attorney General alleged that during the recruitment period, Nu-Skin wasn't even able to sell the services that its distributors were to promote.

As part of an Assurance of Voluntary Compliance that Nu-Skin entered into with the state on August 3, 1998, Nu Skin agreed to donate \$1,000 to the National Fraud Information Center (NFIC). Nu-Skin also agreed not to make any representations about resale of electric service until it has contracts in place to provide it. Nu Skin offered refunds to Pennsylvania consumers who paid to join the marketing plan and reimbursed the state \$34,000 for the costs of investigation.

"Electric deregulation and competition opens a whole new area for fraudulent money-making schemes," noted Susan Grant, director of the NFIC.

Pharmanex Misrepresents by Using its BioPhotonic Scanner to Sell Supplements

Interior Design Nutritionals was the major thrust in the U.S. during the mid-nineties until it passed its peak. Then in 1998, Nu Skin acquired Pharmanex as a wholly owned subsidiary. Now Pharmanex is the name of the division promoting nutritional supplements.

The Pharmanex division of Nu Skin has come up with its "Pharmanex BioPhotonic (laser) Scanner,"

developed at a top U.S. research university. The scanner uses reflectance Raman spectroscopy to measure carotenoids in the skin. It is being widely promoted by Pharmanex distributors – who have little or no background as health practitioners – to detect anti-oxidant deficiencies, which in turn are used to help sell nutritional supplements. At this writing, about 60 scanners are used at Pharmanex opportunity meetings in at least 17 states.

However, research indicates that carotenoids, as measured by the scanner, are only a contributor to the overall antioxidant status and that it is an unjustified leap to assume that the scanner also measures overall anti-oxidant levels. A research paper on the use of this technology concludes with this statement:

The non-invasive method shows promise in assessing skin cancer risk. Further work is needed to understand the relative contributions of dietary and supplemental carotenoids on skin carotenoid concentration as well as the possible correlation with human cutaneous pathology. – *“Non-invasive Raman Spectroscopic detection of Carotenoids in Human Skin,”* by researchers Hata, Scholz, Ermakov, McClane, Khachik, Gellermann, and Pershing (*Journal of Investigative Dermatology*, 115:441-448, 2000)

While the scanner may help in assessing total carotenoids and their association with skin cancer, the technology measures only total carotenoids, not individual carotenoids, which have varying importance in determining anti-oxidant status of the skin.

No proof exists that the scanner measures vitamin C, vitamin E, or glutathione concentrations in the skin, which are also important to anti-oxidant status. And as the above-mentioned paper makes clear, whether nutritional supplements actually alter the carotenoid concentrations in the skin remains to be evaluated.

In summary, the use of the Pharmanex BioPhotonic Scanner to diagnose anti-oxidant deficiencies and to help sell anti-oxidant nutritional supplements is one more example of misrepresentation by Nu Skin.

Misrepresentations to U.S. Recruits Regarding “the China Opportunity”

Many recruits in the U.S. were promised that China would soon be opening up and that Nu Skin would be one of the first multi-level companies in there, and Nu Skin retail “storefronts” were gaining a foothold in 2002 and 2003. They were told to

anticipate a \$5-6 billion market in China by 2005. But a knowledgeable Executive distributor who had over 300 participants in his downline, reports that “there is nothing there,” and that “the whole China thing is a crap shoot.”

Kim Chen, a Nu Skin distributor from Hong Kong living in Utah, spoke of a whole menu of strict rules for doing business in China. The first distributors who entered China had the overwhelming advantage – they could make money, while those who came later, could not. He said that “tons of people,” many from Canada, went there in June and July of 2000, prior to his taking his group there to work for three months, which cost them a considerable amount of money.

Kim said Nu Skin made it hard for new people like him who tried to build a downline in China. He said he and his group were not told in recruiting presentations that they could not recruit in China.

After qualification, it was very difficult under the Nu Skin rules for Kim to maintain the \$2,000 a month minimum volume requirements to maintain his status of executive distributor. So what business he did generate in China “rolled up” to his upline. He said he felt the Blue Diamonds were just waiting for their downline to fail, so that they could profit from the business they generated.

Kim appealed to Nu Skin officials and his upline for help with marketing and PR to promote business in China, but was rebuffed. “Nu Skin made me a liar to the people in my downline,” he said.

How could China accommodate over 300,000 distributors (from various hopefuls in Asia and the U.S.), each of whom would need a retail store in China to realize the promises of huge commissions they were promised by achieving Blue Diamond status? The vision of a Nu Skin retail store on every corner in China to satisfy quotas of participants from other Asian nations becomes ludicrous in the extreme. At this writing, informants claim there were only about 30 storefronts operating in China.

R. Taylor, of Salt Lake City, said Big Planet’s big pitch in 2000 was their upcoming launch in Asia. The launch there didn’t happen as promised. “A lot of people were hurt with Big Planet,” he said. “They recruited very aggressively.” This confirms the disappointing experiences of Nu Skin victims in Asia, especially from Singapore and Malaysia.

Misrepresentations about the Nature of Nu Skin’s Primary Business

As explained in the body of this report, Nu Skin is not now, nor has it ever been, in the business of direct sales, except very tangentially. It satisfies all of

the characteristics of a recruiting MLM, or product-based pyramid scheme. Nu Skin's compensation system is so heavily weighted towards recruiting at the expense of direct sales to end users, that there is little incentive to sell at suggested (and expensive) retail prices.

Almost all of Nu Skin's revenues come from "pay to play" purchases of new recruits and collaborating family members, many of whom allow the recruit to use their name under which to buy products, so that the recruit can qualify for commissions and advancement. When recruiters reach de facto saturation in a given area, they hold out hope that new recruits can build a downline in the next area to open up. So Nu Skin's volume is maintained, not by ongoing sales, but by the Ponzi-like investments of new recruits to replace the failing investments of earlier recruits.

Also, when recruiting with a recruiting MLM like Nu Skin slows down in a given area, direct sales slow down with it. What sales did occur were primarily tied to recruitment incentives. Little or no direct sales market remains.

Yet Nu Skin positions itself on its reports to the SEC, to investors, and to recruiting prospects, as a direct sales company. Nu Skin's 2000 Annual Report began with a full-page headline: "We are direct selling entrepreneurs," This is misleading. A pig is not a horse, no matter how much money is spent positioning it as a horse.

Nu Skin officials often refer to the company's membership in the Direct Selling Association as proof that it is a direct sales company. This is analogous to leading a pig into a stable full of horses and saying, "There, you can see that it is a horse because it is in the horse stable."

Besides, the DSA has been virtually hijacked by the MLM industry, with MLM companies now making up about 80% of its membership. The DSA has become a front for MLM interests to lobby for legislation that legitimizes MLM. If currently promoted legislation is passed, MLM's will be exempt from laws against pyramid schemes, so long as trademarked products are offered.

Since this author has demonstrated that recruiting MLM's, or product-based pyramid schemes, are the most damaging of all pyramid schemes (See "Which Does the Greater Harm?" – available from the author), the DSA legislation would be very damaging to consumers. Nu Skin supports the DSA position.

Summary of Recent Misrepresentations by Nu Skin Recruiters in the U.S.

1. As has been the case world-wide, potential earnings continued to be displayed and misrepresented by Nu Skin recruiters, who touted huge earnings of top distributors (\$½ million a year) but failed to disclose the abysmal odds of achieving this – less than one in 12,500.
2. The connection of retired Chrysler chairman Lee Iacocca with Nu Skin's Big Planet division was overstated and misleading.
3. Nu Skin recruiters also continue to promote connections between Nu Skin divisions and other big names, such as the Olympics, the Utah Jazz, Stanford University, Brigham Young University, and support of numerous charities to give the company credibility that is unjustified and misleading (see also main report, page 29).
4. An array of products that were to be offered through Big Planet were not delivered or made available as promised.
5. Participants were led to believe that e-bikes and other products heavily promoted to recruits would be exclusive to Big Planet distributors, and they were not.
6. Some recruits were not informed of Nu Skin's tight connection with Big Planet until they were well into the program. Some who knew of Nu Skin's questionable dealings would not have joined, had recruiters been up front about this.
7. The promise of a "China opportunity" was overstated and misleading.
8. The Pharmanex BioPhotonic Scanner has been used as a device to help sell anti-oxidant supplements in a way that overstates the scanner's capabilities and is misleading.
9. The portrayal of Nu Skin recruits entering "ahead of the wave" of an explosive growth opportunity follows a long-standing pattern of overstatement and misrepresentation.
10. The touting of a divisional and country-to-country growth strategy is misleading, since Nu Skin is merely replacing lost volume from de facto saturation in one area or division with recruitment in another (see also main report, page 22). The sharp company-wide growth from launching new divisions or entries into new countries, which has been promised year after year, has not happened with any lasting significance for ten years.

11. Nu Skin's promoters and recruiters continue to refer to Nu Skin as a "direct sales" company. This misleads consumers, investors, and recruiting prospects who are considering investing in its program. In this report, the analysis of Nu Skin's compensation system leads to the conclusion that it is clearly a recruiting MLM, or product-based pyramid scheme. Its compensation system is weighted too heavily towards recruiting, and its direct sales activity too tied to recruiting, to be taken seriously as a direct sales company.

Conclusions

Nu Skin's continuing misrepresentations are not surprising, since they are inevitable fruits of extreme leverage in what Salt Lake City ex-distributor K. Thompson called Nu Skin's "brutal compensation system." Participants seeking "success" must advance to the top in the Nu Skin hierarchy, or Blue Diamond status, because Blue Diamonds receive most of the commissions paid by Nu Skin. But as shown in this report, the odds of achieving Blue Diamond status were one in 12,500 at best! So recruiters are in the position of having to misrepresent these abysmal odds to succeed in their recruiting.

Many of the above observations are anecdotal, but they can be generalized to any cross-section of ex-distributors of Nu Skin, Big Planet, and Pharmanex. Combined with a history of legal actions against Nu Skin, they reveal a consistent pattern of deception.

It would be helpful if Nu Skin still made available company-wide earnings statistics that could be debunked by qualified analysis, as was the case until December of 2000 when the PSA petition for the FTC to enforce its Order regarding Nu Skin's misrepresentations. Officials found that they could no longer get away with such misleading reports. Now the company is repeating what it was doing prior to the 1994 Order, when individual promoters were each misrepresenting to facilitate their own recruitment.

So misrepresentations were not on official company-wide reports before 1993 and have not been since December 2000. This is why FTC recognition of violations of the Order in the 1997 and 1998 reports is so important. The misrepresentations were system-wide and on official company documents. Nu Skin should not be permitted to escape FTC sanctions for its actions in defiance of the Order.

As this report makes clear, the success rate for highly leveraged MLM compensations systems, such as for Nu Skin, is so low as to be virtually nil. For five recruiting MLM companies for which data has

become available, the loss rate is 99.9% - which rounds to 100% loss rate for the nearest whole percent.

Nu Skin Blue Diamond recruiters, who get most of the commissions paid by the company, are in a difficult position. Since Nu Skin leaves behind little or no ongoing sales activity after the initial recruiting in a given area has peaked, it must rely on sales to new recruits in new areas or divisions who make "pay to play" purchases to keep the money coming in.

Some Blue Diamond distributors engage in what could be considered predatory recruiting practices - continually on the lookout for new recruits to exploit. Also, they must get the company to sponsor hot new products. The more exciting the promises the better, regardless of how true or false those promises may be.

In Nu Skin, as in all recruiting MLM's, recruiters must and do misrepresent if they are to be successful in building and maintaining their downlines. If recruiters told the truth about the odds of success or average distributor earnings, their downline participants would quit the program. Few prospects who understand basic math would sign up, and since revenues are derived from sales to new recruits, the whole program would collapse like a house of cards. Bad for Nu Skin, but good for consumers - and millions of would-be victims over the next few years. Scams are not needed in our society, even if they employ thousands and even if a portion of their proceeds go to worthy causes.

Also, Nu Skin thrives on misrepresentations in order to survive and grow as a company. Even company officers and employees, who provide the infrastructure for the network of "distributors," must uphold the misrepresentations, or they would soon be out of a job.

NOTE to FTC personnel:

The recent misrepresentations by Nu Skin illustrate an important point about product-based pyramid schemes. It does not matter what the company does to change or improve its marketing materials or product offerings, its management, or even its name to signify a new division or product category. It is the compensation plan itself that is the root of the problems, especially the unjust enrichment of a few at the top of the pyramid at the expense of a multitude of downline victims, who have purchased goods and services on the basis of a whole set of misrepresentations.

**Appendix G: ADDENDUM #2 (prepared for “public comments” on Business Opportunity Disclosure rule – submitted July 13, 2006)
2004 DISTRIBUTOR COMPENSATION SUMMARY as submitted by Nu Skin
– then corrected, using reasonable disclosure principles**

**NU SKIN ENTERPRISES, INC.
DISTRIBUTOR COMPENSATION SUMMARY**

Company Overview

Nu Skin Enterprises (together with its affiliates, the “Company”) is a global direct selling company that operates in more than 30 countries throughout North and South America, Asia and Europe. The Company operates in three divisions: (1) the Nu Skin division markets premium quality skin care and personal care products; (2) the Pharmanex division is a science-based developer of nutrition products; and (3) the Big Planet division markets and distributes Internet, technology, telecommunications and other products.

Distributors

The Company markets its products through a network of independent distributors. For purposes of this summary, an “Active Distributor” is a distributor who placed an order for products, promotional materials or services or renewed their distributorship during the quarter. In the United States, the Company had an average of 57,998 Active Distributors each quarter in 2004.

Compensation

There are two fundamental ways in which a distributor can earn compensation:

- Through retail markups on sales of products purchased at wholesale prices; and
- Through commissions (sometimes called bonuses) paid on one's product sales and the sales of other distributors in one's downline sales network.

As with any other sales opportunity, the compensation earned by distributors varies significantly. The cost to become a distributor is very low. People become distributors for various reasons. Many people become distributors simply to enjoy the Company's products at wholesale prices. Some join the business to improve their skills or to experience the management of their own business. Others become distributors but for various reasons never purchase products from the Company. Consequently, many distributors never qualify to receive commissions.

Generating meaningful compensation as a distributor requires considerable time, effort, and commitment. This is not a get rich quickly program. There are no guarantees of financial success.

Retail Markups

Distributors can buy Nu Skin, Pharmanex and Big Planet products from the Company at wholesale prices for resale to customers or for personal consumption. Some Big Planet products are services, such as Internet access, on which there is no retail mark-up earned by distributors. In addition, some Big Planet products are lower margin products offered through Internet mall affiliates. Consequently lower levels of commissions are paid on the sale of such products. The Company's suggested retail markup is 43% on most of its personal care and nutrition products. However, distributors are free to set their own selling price and may personally consume some of the products they purchase. As a result, the Company currently neither provides an estimate of average income from retail sales nor includes distributor retail income in its average commission information.

NU SKIN ENTERPRISES, INC.

2004 DISTRIBUTOR COMPENSATION SUMMARY – *CORRECTED*

Followed by content and format corrections using principles applying to meaningful disclosure
By Jon M. Taylor, Ph.D., President, Consumer Awareness Institute, and Advisor, Pyramid Scheme Alert

(Corrections to be printed are in italics)

[Comments to FTC officials (not to be printed) are in brackets, with alphabetical footnotes]

Company Overview

Nu Skin Enterprises, Inc. (together with its affiliates, the "Company") is a global ~~direct~~ *chain-selling*^a company that operates in more than 30 countries throughout North and South America, Asia and Europe. The Company operates in three divisions: (1) the Nu Skin division markets premium quality skin care and personal care products; (2) the Pharmanex division is a science-based developer of nutrition products; and (3) the Big Planet division markets and distributes Internet, technology, telecommunication and other products.

Distributors

The Company markets its products ~~through~~ *primarily* to a network of ~~independent participants,~~ *which it refers to as "distributors."* For purposes of this summary, an "Active Distributor" is a distributor who placed an order for products, promotional materials or services or renewed their distributorship during the ~~quarter~~ *year*. In the United States, the Company had an average of 57,998 Active Distributors ~~each quarter~~ in 2004 *(including some who had been with Nu Skin for many years) each quarter* – *out of over one million who have joined the program in the U.S. since its founding in 1984. Out*

of approximately 60,000 distributors that signed up as US distributors since the beginning of the year 2004, approximately 10,000 were still active at the end of the year.^b

Compensation

There are two fundamental ways in which a distributor can earn compensation:

- Through retail markups on sales of products purchased at wholesale prices; and
- Through commissions (sometimes called bonuses) paid on one's product sales and the sales of other distributors in one's downline sales network.

As with any other sales opportunity, the compensation earned by distributors varies significantly. The cost to become a distributor is very low. People become distributors for various reasons. Many people become distributors simply to enjoy the Company's products at wholesale prices.^c Some join the business to improve their skills or to experience the management of their own business.^d Others become distributors but for various reasons never purchase products from the Company.^e ~~Consequently,~~ *many* The vast majority of all new distributors never qualify to receive commissions.

[^a Nu Skin's program primarily rewards not direct selling, but the recruitment of an endless chain of participants as primary customers. It's breakaway compensation plan is a highly leveraged pyramid marketing scheme. Most of the direct selling is to participants in the scheme (and immediate family members), rather than to non-participating (retail) customers.]

[^b These numbers are guesses – but illustrate information that should be supplied to prospects.]

[^c And many people are pressured into becoming distributors to help a friend or relative to qualify for commissions or to advance to higher levels in the pay plan. Most of these

purchases are at wholesale prices to meet qualifications for commissions or for advancement to higher levels in the pay plan.]

[^d Highly unlikely. This wording appears to make the scheme seem more legitimate.]

[^e Those distributors who do not buy products from the Company lose only the distributor fee and are the least hurt by participation in the program.]

Nu Skin Enterprises, Inc, Distributor Compensation Summary – Corrected, Page 2

Generating ~~meaningful~~ compensation as a distributor *in excess of expenses* requires considerable time, *recruitment* effort, commitment, and the *willingness to misrepresent both the products and the opportunity.*^f This is not a get rich quickly program.^g There are no guarantees of financial success.^h

Retail Markups

Distributors can buy Nu Skin, Pharmanex and Big Planet products from the Company at wholesale prices for resale to customers or for personal consumption. Some Big Planet products are services, such as Internet access, on which there is no retail mark-up earned by distributors. In addition, some Big Planet products are lower margin products offered through Internet mall affiliates. Consequently lower levels of commissions are paid on the sale of such products. The Company's suggested retail markup is 43% on most of its personal care and nutrition products.ⁱ

However, distributors are free to set their own selling price and may personally consume some of the products they purchase.^j As a result, The Company currently neither provides an estimate of average

income from retail sales nor includes distributor retail income in its average commission information.^k

Commissions

Distributors ~~can also~~ *primarily* earn commissions based on the sale of products ~~by to~~ a distributor and his/her downline of sponsored distributors in all markets where the Company does business. The Company also sells promotional materials that do not generate commissions to distributors.

In 2004 the *Nu Skin's total global revenue was over \$1.1 billion*^l – *most of it from new recruits and cooperating family members.* Of this amount the Company ~~rebated to~~ *the its network of distributors paid* approximately \$487 million^m in commissions and sales compensation globally. In the same period, *out of \$146 million the Company received from markets in North America (mostly in the U.S.) the Company paid rebated* approximately \$77 million in commissions to distributors residing in the United States.

^f In contrast to legitimate businesses, the more time, effort, commitment, and money participants invest in Nu Skin (or any highly leveraged chain selling scheme), the more they are likely to lose. The notable exceptions are those who rise to a payout level at or near the top of a pyramid of participants. To achieve these high levels in the compensation plan requires a high degree of self-deception and aggressive recruitment of a downline of thousands of participants on the basis of many misrepresentations. Nu Skin has been charged by the FTC and state agencies on multiple occasions with misrepresentations related to products and distributor earnings. A list of 30 typical misrepresentations that are used in every recruitment campaign of “recruiting MLM’s” (those that depend on recruitment of a downline for income) is available online at – <http://www.mlm-thetruth.com/Misrepresentations-RecruitingMLMs.pdf>]

^g In fact, evidence points to Nu Skin as a “get poor quickly” program.]

^h Based on analysis of Nu Skin’s own reports, about 99% of participants experience financial loss. It is also well to note that if this disclosure is honestly presented, many who would otherwise join Nu Skin as distributors would not join. Recruitment – so

crucial to realizing any profits – may become so difficult that all investing recruits would lose money. Also, the Company, which is dependent on a revolving door of new recruits who buy the products on the basis of these misrepresentations, may collapse.]

[ⁱ Because wholesale prices are much higher than retail prices for comparable products at alternative outlets, most sales are made at wholesale prices to participants and cooperating family members in order for participants to meet quotas to qualify for commissions or to advance in the scheme. This was observed first-hand by the author in his one-year test of the Nu Skin program.]

[^j Hyper-consumption of products is common in order to meet requirements for commissions or advancement, as are sample giveaways, storage of products, and disposal of products at termination.]

[^k Validated retail sales to legitimate costumers outside the network of participants is relatively rare.]

[^l From Nu Skin financial reports, as is the North American sales figure that follows.]

[^m Rounding the numbers to millions more clearly shows where the money is coming from and where it is going.]

Nu Skin Enterprises, Inc, Distributor Compensation Summary – Corrected, Page 3

[NOTE: The next paragraph – and the table on the next page – had to be entirely re-written.]

The table on the following page shows the average percentage and number of total Distributors that qualified to receive commissions at each of the various levels of the Company's sales compensation plan at-by the end of 2004ⁿ, the average annualized^p commissions paid in 2004 to U.S. distributors, average purchases of goods and services from Nu Skin by distributors at these levels^p, and average gross profit, without subtracting operating expenses^q. These figures do not include retail markup income.^r

The average annualized commission paid to U.S. "Active" Distributors [in 2004] quarter was ~~\$326.55~~ or \$1,306.20 on an annualized basis. The average amount of moneys paid by Active distributors to Nu Skin for products and services was \$2,000^s, for an average loss of \$693.80. This loss would be much greater if operating expenses were subtracted, such as travel, telephone and Internet fees, advertising and promotional expenses, meeting room rentals, and miscellaneous expenses. The average [annualized] commissions paid to U.S. Active Distributors who qualified for commissions in 2004 was \$9,194.00 (annualized). Most of the commissions and bonuses

paid by Nu Skin to its distributors is paid to Blue Diamond Executives. So after subtracting purchases from the Company, and before even subtracting operating expenses, a net loss was experienced by over 99% of distributors.

[Clearly, a distributor must recruit aggressively with the aim of becoming a Blue Diamond if he/she expects to profit from the Nu Skin program. Income from selling to persons without the aim of recruiting them would only divert them from their potential profits.] Note that these figures do not represent a distributor's profit, as they do not consider expenses incurred by a distributor in promotion of his/her business and do not include retail markup income. An average of 14.28%^t of U.S. Active Distributors qualified for commissions in 2004 – probably less than 1% of all distributors who had been recruited into the program since Nu Skin's inception. Active Distributors represented an average of 41.56% of Total Distributors, less than 2% of all distributors who had been recruited into the program since its inception.^u

Note that equivalent titles of Executive-and-above distributors vary between the Nu Skin Personal Care, Pharmanex and Big Planet divisions.

[ⁿIncludes some distributors who had been with the company since close to its founding in 1984. For statistical consistency, this time period for the population base should be used throughout the report.]

[^o Figures showing quarterly commissions are irrelevant for opportunity seekers (though common on reports to investors). The quarterly commission column in the original report may have been inserted to limit room for meaningful business opportunity disclosure items, such as purchases from the company.]

[^p Disclosure of all purchases from the Company are crucial for determining whether or not distributors are likely to come out ahead financially. Some purchases are required to qualify for commissions or advancement to higher levels in the pay plan, and others, such as training and sales materials, are necessary for full participation. These are estimates, that at the lower four levels are based on personal experience by the author in his one-year test of the Nu Skin program.]

[^q Operating expenses for successful recruiters can be many thousands of dollars, and recruitment prospects should be encouraged to factor in

estimated expenses when estimating potential profits. Such operating expenses include travel, telephone and Internet costs, advertising and promotional expenses, rental of meeting rooms, company sponsored training programs, sales materials, and miscellaneous expenses. Subtracting operating expenses would mean only those near the top would profit.]

[^r Documented retail markup income rarely occurs.]

[^s These numbers are merely estimates and are given to illustrate information that should be supplied.]

[^t This number is calculated by adding the average percentage numbers for each level of Active Distributors in the above table.]

[^u NOTE: The "since its inception" is used for the total population to be statistically consistent with the practice of counting all distributors who achieved the various levels – since the Company's inception. See "IMPORTANT NOTE TO FTC OFFICIALS" on the next page.]

Nu Skin Enterprises, Inc, Distributor Compensation Summary – Corrected, Page 4

Title (level in the compensation plan)	Percentage of total distributors * recruited during applicable time period ¹	Total number of dsitr's ,many of which were recruited during the time period represented in the left column (total – over 1 million in U.S. A.) ²	Average quarterly commission Incomes - IRRELEVANT FOR OPPORTUNITY SEEKERS ¹²	Average annual commissions per distributor for each income level	Average Total purchases * of goods and services from Nu Skin (some on behalf of others) ³	Average net profit/loss ³ per distributor
Blue Diamond	.14 0.007% ¹	81 ²	N/A	\$552,348	\$20,000 ³	\$532,358 ³
Diamond	.07 0.0035	41	N/A	126,824	15,000	111,824
Emerald	.07 0.0035	41	N/A	71,627	10,000	61,627
Ruby	.15 0.0075	87	N/A	35,634	8,000	27,634
Lapis	.46 0.023	267	N/A	15,960	6,000	9,960
Gold	.79 0.0395	458	N/A	7,981	5,000	2,981
Executive	2.96 0.145	1717	N/A	3,955	5,000	(1,045)
Qualifying Exec.	1.24 0.062	719	N/A	1,320	5,000	(3,680)
Distributors who qualify for commissions	8.40 0.42	4,872	N/A	507	2,500	(1,993)
All distributors who did not qualify for commissions during applicable time period	85.72 99.289	991,717	N/A	0	200	(200)

If you have any questions concerning this information, please contact Distributor Support at (800) 487-1000.

¹ These percentages are calculated by *dividing the number of distributors in the various levels at the end of 2004 by the total number of distributors recruited during the same time period as the period covered by those included in the various payout levels. adding the average percentage of total Active Distributors at each level. at the end of the quarter for each quarter of 2004 and dividing by four.*

² These numbers are calculated by taking the quarterly average commissions and multiplying by four.

² "Total Distributors" includes all U.S. distributors who either signed an agreement or renewed their distributorship during 2004 irrespective of their purchasing products, promotional materials or services or earning commissions – *except for the bottom row, which includes those who dropped out or terminated their distributorships, which is over 99% of participants who signed up since the inception of the company.*

³ These numbers are merely estimates and are given

to illustrate information that should be included.

NOTE to FTC personnel:

If the Company objects to counting all distributors recruited since the inception of the company (to be consistent with length of activity of those who achieved certain levels), the time period could be shortened to five or ten years, etc. But in that case only those participants who started during the same time period and who achieved the various levels during that same time period should be counted. The most honest and statistically correct way to report this would be to take ALL recruits for a given year and follow them for one or more years and report how many achieved the various levels, and how many became inactive or terminated.

<p>However, there are hundreds of thousands of others who continue to appreciate the opportunity to achieve their goals, whether they be earning a little extra pocket money each month or they seek the freedom to quit the traditional corporate world and own their own business.</p>	<p>Those who do “achieve their goals” do so at the expense of a multitude of unwitting downline victims. And the notion of a part-time income for Nu Skin’s highly leveraged compensation system is a huge misrepresentation, especially if all expenses are subtracted from revenues – for a net (loss) figure. See Appendix A in the <i>Report of Violations</i> report and my own story below.</p>
<p>Background: Jon M. Taylor is a self-appointed crusader opposed to the network marketing industry, particularly Nu Skin Enterprises</p>	<p>No one appoints a genuine crusader to anything, much less a whistleblower. Does the writer expect that Nu Skin would appoint a crusader against its own program or against the MLM industry?</p>
<p>He has formed a non-profit corporation in Kaysville, Utah called the Consumer Awareness Institute. Dr. Taylor was an Interior Design Nutritionals (IDN, the precursor of Pharmanex) distributor for a short time. He claims to have been “very successful” during his year with Nu Skin. However, in the forward of one of his books he writes of changing from an “outspoken critic of network marketing to an enthusiastic convert” before his dream soured and his wife persuaded him to give up the pursuit of wealth.</p>	<p>My “conversion” and subsequent disillusionment is an important part my story – which follows. In fact, it would not have been possible to fully decipher the deceptions in the Nu Skin program without having at one time been a committed participant. It became apparent after having made it to the top 1% of all distributors, while receiving checks of only \$246 a month against expenses exceeding \$1500 a month, the “opportunity” was very different from what was represented. Extensive research showed that it was rare for anyone to make a profit. The more I researched the topic, the more my conclusions were confirmed.</p>
<p>Dr. Taylor is fond of acquiring public data about Nu Skin and then “torturing” it until it suits his purposes.</p>	<p>One attorney with years of MLM litigation experience laughed at the idea of my “torturing” the data. Who tortured the data? Nu Skin was given at least four opportunities to rebut my analyses with valid numbers. They failed to do so all four times.</p>
<p>He has challenged the way the company reports average distributor incomes – despite its being in the prescribed format required by the Federal Trade Commission</p>	<p>The “prescribed format” allowed by the FTC has been challenged in correspondence with the Enforcement Division officials, who now have better format input. The FTC has been petitioned by numerous petitioners for better disclosure by MLM companies. And if the format is “required by the FTC,” why did NuSkin cease publishing the report – about the time I challenged its validity?</p>
<p>– as well as the structure of the network marketing model, the pricing of products, the ethics of the industry,</p>	<p>Read <i>The 5 Red Flags (cited above)</i>, and then evaluate the structure, product pricing, and ethics of the typical network marketing model. We see shades of Enron – except that it is small investors that are being stiffed by recruiting MLM’s like Nu Skin.</p>
<p>and even the company's philanthropy.</p>	<p>There they go again on the philanthropy-credibility connection. Would anyone who read the <i>Report of Violations</i> still buy into that?</p>
<p>Dr. Taylor forgets that salespersons in any organization have the same motivation: to earn money. He labels that desire “greed” and condemns it in network marketing. In traditional businesses national sales managers motivate regional ones, who motivate district ones, who motivate the salesmen, etc. The same is true in retail where the store manager motivates the assistant store manager, who motivates the department managers, who motivate the salesmen because they all get bonuses from the sales of those below them in the organization.</p>	<p>It is safe to say that the writer of this statement (most likely someone on staff who has neither been a distributor nor a direct sales person) has not had a fraction of the sales and marketing experience I have had – nor a wall full of awards for successful performance. I know the difference between legitimate selling and a scam. See Section D-3 and Appendix D in the above-mentioned <i>Complaint of Violations</i> report – and my more extensive report on defining characteristics of recruiting MLM’s [op cit]. The latter makes a clear distinction between compensation systems in a recruiting MLM and legitimate retail or direct sales operations.</p>
<p>He says that network marketing companies claim distributors can make millions. Laws prohibit network marketing companies and distributors from making earnings claims. In Nu Skin, distributors are penalized or terminated if found violating this stricture.</p>	<p>The writer of this statement should attend some Nu Skin recruitment or opportunity meetings. And it would be good if while he was there he would open his eyes and ears to observe what goes on.</p>

MY UNIQUE BACKGROUND AND EXPERIENCE WITH NU SKIN AND WITH MLM

Statement by Jon M. Taylor, Ph.D., President, Consumer Awareness Institute,
and Director, Pyramid Scheme Alert

My motives, and the credentials which qualify me to make the claims in this report, deserve scrutiny. So here goes:

My education included an MBA from Brigham Young University, and a Ph.D. in Applied Psychology from the University of Utah. An inveterate entrepreneur and communicator, I have over 35 years of sales, marketing, and entrepreneurial experience, having personally started or assisted in the creation of over 40 businesses.

I have served on the administrative staff for two universities; taught college classes and seminars in business management, entrepreneurship, personal finance, and business ethics; sponsored income opportunity shows and other trade shows; written and published on consumer and business topics; and provided career and entrepreneurial consulting services. I believe I am in an excellent position by temperament, training, and experience to evaluate sales and business opportunities.

In the past, when asked for my opinion about multi-level marketing (a.k.a., "MLM" or "network marketing"), I would insist that MLM's were in fact pyramid schemes, in which only a few made money at the expense of the many who lost money.

My "conversion" to MLM – and to Nu Skin

My outlook gradually changed in 1994 when I was aggressively recruited by persons I respected, who insisted I was wrong and should take a more objective look at MLM. They maintained that, like it or not, MLM was the "wave of the future." They provided me with extensive industry material. Being both an entrepreneur and a researcher, I was curious enough to prove for myself once and for all whether or not MLM was a legitimate business – by trying it myself. Then I would tell the world the truth, whatever I discovered.

As a first step, I went to Utah's Division of Consumer Protection and was furnished a pamphlet from the Direct Selling Education Foundation (which I later learned was written and financed by the MLM industry) entitled *Pyramid Schemes: Not What They Seem!* It claimed most MLM's are legitimate income opportunities. I noticed it was "prepared in cooperation with the Federal Trade Commission [FTC]." Should be OK, I thought.

Then, like a good investigating consumer, I checked with the Better Business Bureau, who provided a flyer entitled "*Tips on . . . Multi-level Marketing (How to Tell a Legitimate Opportunity from a Pyramid Scheme.)*" In it, reputable MLM's were distinguished from illegal pyramid

schemes. Guidelines and checklists were given, but most any MLM program could pass, as long as products and services were offered – in lieu of recruiting people to pay fees for the right to sell products.

Richard Poe's favorable outlook for the MLM industry in his best-selling book *Wave 3: the New Era in Network Marketing*¹¹ impressed me. Having served on the editorial staff of *Success Magazine*, he seemed credible. I met him personally and learned that he had never been an MLM distributor, but was acting as an "objective reporter" of the MLM phenomenon.

I then read numerous articles on MLM and spoke with several MLM participants I knew and trusted, each of whom helped ease my concerns and even led me to believe that there could be a tremendous future in this industry and that I should get on board. Meanwhile, some very persistent recruiters from Nu Skin and other MLM's kept after me to join their programs.

I finally decided to sign up with Nu Skin, which seemed to have a sterling reputation and excellent products – supplements from its new Interior Design Nutritionals (IDN) division. Nu Skin promoters boasted of having numerous Blue Diamond distributors (many of whom I met), whose average income at that time exceeded \$700,000 a year. I figured that with my background, contacts, and determination, I could become a Blue Diamond distributor if anyone could.

I did everything my company and upline recommended – bought the "IDN 500" starter kit of nutritional products and sales materials totaling over \$1,500, subscribed to monthly "LifePak" supplements (via autoship by automatic bank withdrawal), tried other Nu Skin products, recruited people around the clock, attended all the training and opportunity meetings, and used my best efforts to train and motivate my recruits. I dropped my other business interests, dedicated more than full time effort to the enterprise, and drove my wife crazy with my single-minded dedication to MLM recruiting.

Reality check – Nu Skin a losing proposition

After several months of more money going out than coming in, my wife began asking questions. She also did not like the changes that were occurring in me as a person – neglecting the family and seeing everyone as a prospect, even our most treasured friends and family members. Fortunately, as a researcher I had kept detailed notes of my experiences and observations with MLM and was still in an investigative mode.

I often reviewed my financial progress – a reality check of what was actually happening. At the end of a year I had fallen way behind financially, partly because of all the products I had purchased and given away to meet minimum requirements to qualify for commissions and to advance to a higher bonus level, partly because of all the other expenses of running the operation, and also because my full-time MLM efforts ruled out other work.

Though my upline told me that success in Nu Skin could be accomplished part-time, I found that to be false. Full-time effort was essential to earn a profit, and it would take great effort to earn more than even a minimum wage. This may not have been true for the first distributors in the program.

In summary, I had to sell at wholesale and give away a lot of products to satisfy requirements for Executive status. Only then could any appreciable commissions be earned. Significant money was to be made not from retailing, but from recruiting a downline of many thousands of distributors. This required considerable expense and enormous time and effort.

I did not fail at Nu Skin – I made the top 1% and quit!

I finally achieved Executive status – probably in the top 1% of distributors, if all who originally signed up as distributors were included in the calculations. But just being in the top 1% was very much a losing proposition, after subtracting all expenses, which were not mentioned at opportunity meetings.

It became apparent that to be honest with myself, expenses would have to include product purchases. Our family's purchases of nutritional supplements and skin care products jumped from about \$50 a month to over \$450 a month, all of course from Nu Skin. This was not unusual for Nu Skin distributors, who were urged to be a "product of the products."

After leaving Nu Skin/IDN, our purchases of supplements and skin care products dropped back down to below \$50 a month. Nu Skin buyers are sellers – primarily to themselves and their families. Meeting purchase quotas is how they "pay to play" the game! This is how investments in the pyramid scheme are cleverly disguised or laundered to appear legitimate.

Another facet of MLM's like Nu Skin concerned me even more than the money. As a former teacher of ethics and one who considers himself an honest person, I discovered a whole range of ethical conflicts that made MLM an unacceptable way of conducting a business. Also, my psychology background was invaluable in identifying the motivational factors and self-deception that seemed endemic among MLM participants.

Before I quit Nu Skin after a year of concentrated effort, I could see clearly what I would have to do to earn over \$700,000 a year as a Blue Diamond. I would

have to deceive hundreds, even thousands of downline distributors (like I had been deceived), into believing that they too could achieve what I had achieved – and then maintaining required monthly volumes and downline head counts. It simply was not worth it – and not moral. For me to receive that much income, thousands would have to lose their investment – the money would have to come from somewhere. It certainly does not come in any significant amount from actual sales to non-distributors.

Most MLM's not much better than Nu Skin

I had organized a non-profit corporation – The Consumer Awareness Institute – and used it to spearhead research and to unravel deceptions such as those inherent in MLM's. Seeing so many people affected by MLM's, I did extensive research and wrote a book entitled *The Network Marketing Game*. It included my experiences at Nu Skin and those of persons exposed to dozens of other MLM programs, persons willing to share their experiences – mostly negative. The book generated a great deal of publicity and positive feedback – and some hate mail!

But in my book, care was taken not to mention Nu Skin or other MLM's by name. I was more interested in generalities and guidelines that could be applied to the whole range of MLM's. There was also some fear of retaliation for identifying Nu Skin by name. So the pseudonym WealthPlus was used when referring to my experience with Nu Skin.

Later, I spoke to a few students at a local university and was quoted in the student paper about the problems inherent in MLM's. Nu Skin's legal counsel chastised the university administration for allowing the newspaper to speak negatively about them and MLM – after all they had contributed to the university! I decided it was time to refer to Nu Skin by name.

Some critics of my reports see them as a "sour grapes" response to my "failure" at Nu Skin. But in becoming an "Executive" I did not fail. Readers may be fortunate that (unlike millions of others who quit MLM with feelings of failure) I was willing to publish what I learned – fulfilling my initial pledge to myself to make public whatever I learned from my research and experiences with MLM – good or bad. So I really did succeed at Nu Skin – in unraveling the deceptions for the benefit of others.

MLM enthusiasts suggested I try another company, saying, "This one is different." But my time and resources were too precious to experience more losses. Being more cost effective, I conducted a telephone survey of hundreds of persons who had experienced a wide assortment of MLM programs and compensation systems – breakaway, binary, matrix, etc. My generalities held up, with only a handful of exceptions – in what I call "retail MLM's." (See "5 Red Flags," referenced below.)

I found Nu Skin to be just a pyramid scheme after all.

I concluded that my original views regarding MLM were correct. Even modest success (say, a minimum wage for the time spent) was extremely rare. The vast majority lose time and money. Though legitimate products are offered and recruiting fees for participation are disguised, it became apparent that most MLM's are as pyramidal as any illegal pyramid scheme that could be conceived. That point is supported in my other reports.

To have succeeded with Nu Skin, I would have had to insist that Nu Skin was a legitimate business and not a pyramid scheme. But I now knew better. I had good evidence that Nu Skin is in fact a pyramid scheme – a most extreme one at that.

I began sharing my research in speeches to groups, and the feedback was interesting. One tax accountant said he had worked for H&R Block as one of the principals in northern Utah for many years, during which time his group had completed about 15,000 tax returns, hundreds of whom were MLM distributors. He said that in all that time *he could remember only one of the MLM distributors who had reported a net profit on his return – and he was bankrupt within a year!*

This observation caught my attention. So I surveyed other tax accountants, financial planners, bankers, and other professionals who had access to people's financial records. Their responses were very similar – actual profits resulting from MLM participation were extremely rare. If in fact less than one in 1000 distributors earns a profit from an MLM, that could be further evidence that the MLM program is a scam – masked as a legitimate system for marketing products.

I recorded my conclusions in *The Network Marketing Payout Distribution Study* and sent it to the presidents of 60 of the largest MLM companies, inviting them to "Prove me wrong." They were each provided a form for disproving my conclusions with available data. While some tried, none were able or willing to do so. Nu Skin's communications official offered to comply but was refused by top executives. In order to prove the company was not a pyramid scheme and misrepresenting earnings of its distributors, officials would have had to contradict the data in Nu Skin's own published reports.

I then prepared the report, *Network Marketing – the Ultimate Pyramid Scheme*, sent it to the FTC, and made it available to the Attorneys General of the 50 states. A later report, *Product-based Pyramid Schemes*, introduced analytical tools and terminology that addressed the issues. A consumer guide was also prepared, entitled "*Twelve Tests in Evaluating a Network Marketing "Opportunity."*"

I joined others in a non-profit corporation – Pyramid Scheme Alert – to inform and warn consumers against pyramid schemes. We got so many requests for help evaluating MLM programs on our web site that I prepared an interactive tool for consumers and regulators entitled

"Do-it-yourself Evaluation of Multi-level Marketing Programs and Suspected Pyramid Schemes." (Go to www.pyramidschemealert.org, click on "Resources," then "Analytical Tools.")

My recent research has focused on differentiating MLM from alternative business models with which it is often compared. Having had extensive experience in direct sales, insurance, and numerous small business startups of many kinds, along with a research background, I believed I was in an excellent position to do this analysis.

What became clear after extensive comparative analyses was that there were five key differences between what I call "recruiting MLM's" (those with compensation systems that make recruiting essential for the success of participants and of the company itself) and legitimate forms of business enterprise. For those programs for which data was available, the loss rate for companies displaying these five red flags was 99.9%. These are found in my report entitled *5 Red Flags: Five Causal and Defining Characteristics of Product-Based Pyramid Schemes, or Recruiting MLM's*, – a summary of which was included among the white papers for the 2002 Economic Crime Summit conference, sponsored by the National White Collar Crime Center. A one-page summary of the *Five Red Flags* was also prepared and submitted to the FTC for use in consumer awareness. Later surveys of tax preparers confirmed these findings.

Some assume that regulators would have enforced the anti-pyramid laws if they were violated, such as with Nu Skin. However, my research convinces me that deciphering the many deceptions inherent in these highly leveraged schemes requires not only special skills, but also a lot of inside information on the workings of these programs. The underlying compensation plans are often too complex to yield to quick outside analysis. I firmly believe that the information and analyses in my reports could not have come about without a careful look from inside as a practicing distributor.

But further interaction with law enforcement on the state and national level convinces me that the primary reason law enforcement fails to act against these schemes is that it is extremely rare for victims to file official complaints with the appropriate agencies. MLM participants have been conditioned to blame themselves for their "failure," they fear consequences from or to their upline or downline (often close friends or relatives), and they fear self-incrimination for having unwitting recruited victims themselves.

To download current reports prepared by Dr. Taylor, go to — www.mlm-thetruth.com — where you will find analytical reports, including: *Surveys of Tax Preparers* (why MLM's don't show income), the full *REPORT OF VIOLATIONS* of the FTC Order for Nu Skin to stop its misrepresentations, and *The 5 RED FLAGS of a Recruiting MLM, or Product-based Pyramid Scheme* –and more!