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Research, education, and advocacy for consumers on selected issues

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ATTN: FTC Staff:

Kathleen Benway, Attorney, Division of Marketing Practices
 Allyson Himelfarb, Investigator, Division of Marketing Practices
 Lois C. Greisman, Associate Director, Division of Marketing Practices
 David Vladeck, Director, Bureau of Consumer Protection

RE: Serious problems with the latest staff report – especially in the light of new information – and a #10,000 challenge, Part 1

In your staff report posted in October on the FTC web site on the proposed Business Opportunity Rule, we find the following incredible statement at the bottom of page 30:

*As explained in supra Section I.B., two key problems emerged with the IPBOR's breadth of coverage. First, the IPBOR would have unintentionally swept in numerous commercial arrangements **where there is little or no evidence that fraud is occurring.**¹*

Little or no evidence? Later, in Footnote 60 on Page 21, we find the following:

*⁶⁰ None of the comments received provided an industry-wide analysis of pyramid schemes masquerading as MLMs. **They ask the Commission to assume widespread fraud in the multi-level marketing industry, but offer no evidence.** Instead, the comments that purported to present evidence that legitimate MLMs were in fact unlawful pyramid schemes provided only anecdotal evidence. CAI-RNPR; Pyramid Watch-RNPR; Aird-RNPR; Durand-RNPR; Johnson-RNPR. As the Commission noted in the RNPR, identifying a pyramid scheme (or, at least, one that attempts to disguise itself as a legitimate business opportunity) entails a complex economic analysis including an in-depth examination of the compensation structure and the actual manner in which compensation flows within an organization. See Vander Nat & Keep, supra note 15, at 149. There is no bright line disclosure that would help consumers identify a fraudulent pyramid from a legitimate MLM."*

For this comment, it is appropriate to set aside the issue of the pyramidal aspects of MLM (multi-level marketing) because, as is suggested, this is a complex issue in itself and requires separate analysis. That issue can be addressed later.

¹ See 73 Fed. Reg. at 16,113-14.

Problems with staff report, page 2

The key issue here is whether or not sufficient evidence has been submitted to prove widespread evidence of fraud in the MLM industry. The staff claims those of us advocating for consumers “offer no evidence.” For the benefit of consumers worldwide, this demonstrably false statement requires further examination, especially in the light of extensive research completed since the last set of comments were submitted.

I may owe the staff an apology for assuming too much in my earlier comments . I had assumed (1) the staff would have or could take the time to go to my web site and to those of other consumer advocates to which I gave reference and objectively evaluate the plentiful evidence there². (2) I also assumed the persons reading the evidence would have sufficient background in accounting and statistics to properly evaluate the significance of the data. And (3) I assumed that (even without public pressure to do so, since victims are persons with little influence) FTC staff would feel a responsibility to carry out the mission of the FTC to protect against “unfair and deceptive practices.”

In prior comments filed in response to the original Business Opportunity Rule (BOR) in 2006 and the revised BOR in 2008, I and others advocating for consumers spent a considerable amount of time and resources to encourage application of the Rule to all business opportunity sellers and to vigorously counter the efforts of the DSA (Direct Selling Association) to gain an exemption for MLMs, which have essentially taken over the DSA to promote their interests – at the expense of consumer protection against what recent research suggests could be the most damaging fraud ever perpetrated against home business opportunity seekers.

The DSA now functions as a cartel to control and promote the dialogue of deception necessary to legitimize flawed endless chain systems that ravage newly-recruited MLM participants of their resources. The DSA has gone from state to state using deceptive strategies to lobby for bills exempting MLMs from prosecution as pyramid schemes, which I witnessed firsthand here in 2006, when the Utah legislature passed a bill exempting MLMs from prosecution as pyramid schemes..

At my own expense, I traveled to DC to testify at the June 2009 FTC-BOR workshop in an apparently vain attempt to stop this train to destruction that the FTC seems determined to board in its eagerness to comply with the wishes of the DSA and its MLM members. Apparently, my comments and those of others caused the FTC to pause just long enough to come out with their staff report just before the 2010 elections, when the Republicans (with their mantra of “deregulation”) would control the House.

Permit me to draw an analogy to help you appreciate the significance of my comments and attachments here. In the last national political campaign season, pollsters were predicting substantial Republican gains in the House, but not the Senate. They were right on target. How could they be so sure? They did not poll every single voter to find out how they would vote. No, they polled what in statistics are called “samples.” By statistically polling representative samples, which were merely a tiny sample of the population, they were able to predict (within an acceptable range of significance – say 2 or 3%) how the whole population would vote. This technique of sampling is used in many statistical analyses, including those I am presenting.

² Including my reports on MLM earnings statistics (at www.mlm-thetruth.com) and the report by Robert FitzPatrick titled “*The Myth of ‘Income Opportunity’ in Multi-level Marketing,*” reporting on income misrepresentations of 11 MLMs, which can be downloaded from – www.pyramidschemealert.org.

Problems with staff report, page 3

Actually, the timing of the staff report could not have been better for me, as I have just completed several months of research and writing of my new e-book entitled: [The Case \(for and\) against Multi-level Marketing](#), which is the most thorough analysis of the legitimacy of MLM ever published. The parenthesis is my way of acknowledging that many of the arguments for MLM would be included, but only secondarily to the arguments against MLM – for a simple reason. I have analyzed the compensation plans of over 350 MLMs, and in every case (that’s 100%) of them (remember statistical sampling and acceptable significance?), they are built on an endless chain of recruitment.

Every MLM (100% of those for which I could obtain a copy of their compensation plan) assumed both infinite and virgin markets, neither of which exists in the real world. They are therefore inherently flawed, uneconomic, and deceptive. In addition, worldwide feedback convinces me and others advocating for consumers in this field that MLMs are extremely viral and predatory, spreading quickly from state to state and then on to vulnerable populations overseas.

Worldwide, tens of millions of consumers are defrauded of tens of billions of dollars every year by MLMs. When I get done with submitting my comments and supporting data, assuming a person with basic understanding of statistics evaluates my research, no one will not be able to say with any objectivity or credibility that we consumer advocates offer no evidence of widespread fraud in the multi-level marketing industry.

My research provides powerful evidence of what was stated in a 1974 ruling, in which **the FTC found in the very structure of “multi-leveling” or “pyramid selling” [now called multi-level marketing, or MLM] “an intolerable potential to deceive.”**³ This warning proved to be powerfully prophetic, as you will see.

Setting aside the issue of “pyramid scheme” labels, MLMs are routinely misrepresented by their promoters. Over 100 misrepresentations are listed in [Chapter 8](#) of my new ebook.

I have gone much further than just analyzing the inherent flaws and deceptions in MLM. In Appendix A of Chapter 7 of my e-book, I reveal the loss rates calculated from the average earnings data of every MLM (that’s 100% of them) for which I was able to obtain average earnings data for levels of participants with percentages at those various levels. This is not rocket science for someone with an elementary background in accounting and statistics. For the sample of 30 MLMs for which I was able to obtain such data, all (that’s 100% of them) showed loss rates exceeding 99%, with an average of 99.6%. And this is using liberal assumptions in their favor.

My recent analyses of 350 MLMs supports this. All 350 MLMs (100% of them) are recruitment-driven and top-weighted. This means the primary rewards are for recruiting a large downline, not selling products, and the payout to distributors escalates as one moves to the top of the pyramid, leaving at least 99% of those below top levels in a loss position, after subtracting necessary purchases and minimal operating expenses. This significant breakeven point for recruitment-driven MLMs is a primary reason for such high loss rates for all but those at or near the top of their respective pyramids of participants.

³ Holiday Magic, Inc., Docket No. 8834, slip op. pp. 11-14 [84 F.T.C. 748 at pp. 1036-1039] (Oct. 15, 1974); Ger-Ro-Mar, Inc., Docket No. 8872, slip op. pp. 8-12 [84 F.T.C. 95, at pp. 145-149] (July 23, 1974), rev'd in part 518 F.2d 33 (2d Cir. 1975).

Problems with staff report, page 4

All of this analysis of the data, and the assumptions upon which it is based (and all analyses must proceed from some assumptions) are carefully presented in my newly released e-book. Any impartial accountant or statistician will immediately see the significance of this analysis. In fact, I am asking some professionals with expertise in accounting and statistics to submit comments validating my research.

Now let's get to the issue at hand. The Business Opportunity Rule was initiated by the FTC to assist in fulfilling its mission to protect against "unfair and deceptive practices" in the marketplace. It was a great idea as initially proposed. But the MLM exemption is clearly a retreat from that mission.

I am sufficiently certain of my research showing widespread MLM fraud, causing massive consumer losses, that I am willing to issue the following challenge:

If any official from the FTC or from any other federal or state law enforcement agency, such as the SEC or offices of Attorney General, can identify any class of business or income opportunity that is more unfair and deceptive, and at the same time more viral and predatory (harmful) than MLM⁴, I will withdraw \$10,000 from my limited retirement funds and give it to him or her (The specific requirements for the \$10,000 challenge are laid out in the Appendix at the end of this comment letter). If their agency's rules don't allow them to accept the money, they can designate that the money go to their favorite charity. But a plaintiff attorney who has worked on several MLM cases and who is familiar with my research and with this challenge told me, "You're money will be as safe as the gold in Fort Knox."

Attached is a very revealing chart ([Appendix 7E](#)) comparing the profitability of MLM with legitimate small businesses and direct selling, as well as with gambling and no-product pyramid schemes. All of this is supported by solid research by myself and others. "Bright line disclosures" that clearly separate recruitment-driven MLMs from legitimate businesses will be presented in later comments – also supported by extensive research.

Future comments will include attachments and reference to other chapters and information to support this analysis and the conclusions for this chapter. Of course, you can go to my web site and download the [entire e-book](#), which would be a good thing for all of the FTC staff who wish to be well-informed on the issue of MLM fraud, which I maintain far exceeds all other home or packaged business opportunity fraud combined. The complaints you have received may not show that, but there are reasons that very few victims in endless chain recruitment programs ever file a complaint with law enforcement or with the Better Business Bureau. Based on my work with MLM victims and their families over the past 15 years, I estimate that the complaints you have received from MLM victims represent less than 1% of actual victims, many of whom have lost thousands – or even tens of thousands – of dollars.

⁴ One possible exception is party plans, which assume sales to non-participants. But this is not a blanket exception, as I have not been able to get either average income data nor complete compensation plans for these programs. An analyst would have to have this information showing the rewards to top level participants to do an evaluation.

Problems with staff report, page 5

The reason MLM victims seldom file complaints is simple: In any endless chain recruitment scheme, every major victim is of necessity a perpetrator (recruiter) because to have any hope of recouping their ongoing investments (including “pay to play” product purchases) they must recruit others to do what they have done. Some of their recruits are likely to be their “warm market” – friends and loved ones. They fear consequences from or to those they recruited who are still in the program. They also fear self-incrimination for their unwitting recruitment of victims into their own downline. Also, the MLM promoters teach new recruits to believe that if they don’t “succeed” they have only themselves to blame. And since law enforcement, including the FTC, typically responds to complaints (“The squeaky wheel gets the grease”), rather than proactively preventing fraud, little happens to protect consumers from such endless chains.

If – even after irrefutable evidence of massive MLM fraud – the FTC staff decides to go ahead with a Rule that exempts MLM, I am determined to go on record with my research showing how irresponsible such a move would be. And relying on Section 5 to prosecute literally hundreds of MLMs that are currently and blatantly violating Section 5, appears to me (and will appear to others who are presented this information) to be totally impractical. Here is why:

The FTC has admitted to prosecuting only 17 cases in ten years, which according to the best of my knowledge is at best 1% of the MLMs that are or have been violating Section 5. Can the FTC afford to increase its staff 100 times to take these cases on a case-by-case basis? I think not. A Rule requiring transparency by disclosing average income of participants and other helpful disclosures is far more cost effective – and doable than applying Section 5 case-by-case. Besides, relying on case-by-case enforcement provides almost zero protection against the harm caused – and only a very tiny percentage of losses would be recovered of the tens of billions lost every year by tens of millions of MLM victims. These tens of billions of dollars are touted by the DSA as sales revenues, but they represent losses to 99.6 % of participants.

Also, according to Footnote 97 in the latest FTC Staff report on BOR, we see the following statement, which uncritically parrots the rhetoric of the DSA.

Second, the IPBOR would have imposed greater burdens on the MLM industry than other types of business opportunity sellers without sufficient countervailing benefits to consumers.

Really? Was the writer just reframing the DSA claim that it is too great a burden for MLM recruiters to hand out a single sheet of paper prepared by the company – and that it is not beneficial to consumers (when with minimal resources expended by the FTC the Rule could help to prevent massive consumer losses)?

To exempt MLM from the Business Opportunity Rule is analogous to installing traffic lights to control traffic at a busy intersection, but exempting cars and trucks from having to obey traffic signs. All other vehicles (bicycles, motorcycles, and motorized wheelchairs) would have to comply.

Problems with staff report, page 5

Even though the proposed Business Opportunity Rule provides minimal information, it is better than nothing. Those of us with a solid background in accounting and statistics can debunk many of the deceptions in their reporting and pass it on to those who inquire, as I have done with inquiries about Nu Skin and in my new e-book. But we cannot do that with no disclosure of average income information to draw from.

One more point. By now it should be obvious to the staff reading this why the DSA and its MLM members lobbied so vigorously against having to disclose information that MLM prospects deserve to have before they would make a decision on whether or not to sign up. If it were disclosed to prospects that 99.6% of participants (or 99.99% of all new recruits) lose money, only those who don't understand percentages would sign up. The MLMs would all fold like a house of cards, and the DSA would see a drop-off in membership. But consumers would benefit greatly – as opposed to the false assertion by the staff that there would not be “sufficient countervailing benefits to consumers.” This assertion shows blatant disregard of the facts.

This is not old information from prior comments, but analysis of new data and conclusions – that also reinforces what I said earlier. And the actions of the FTC in this matter will be included in the final edition of my book, as well as in communications to Congressional overseers, state AG offices, Better Business Bureaus, consumer advocates, the media, and anyone else who is interested in consumer protection, which the FTC appears to be abandoning in regards to tens of millions of MLM victims worldwide every year. Just because 17,000 DSA/MLM minions (commenters objecting to including MLM in the original BOR proposal) say the earth is flat does not make it so.

Finally, I know that you as FTC officials face some tough challenges, including intense DSA/MLM lobbying. But I am pleading with you to do the responsible thing. In the light of this new information, either require that all business opportunity sellers, including MLMs, comply with the Rule – or scrap the Rule altogether.

If you go ahead with the Rule exempting MLM, this will only be an incentive for MLMs to be more brazen in claiming they are legitimate direct sellers, and it will encourage all business opportunity sellers to convert to a multi-level compensation plan, thus corrupting the entire field of packaged or home business opportunities and causing even more massive losses for consumers. This unintended but predictable consequence would be a tragic outcome for consumers – and would sully the reputation of the FTC – and it's efficacy in protecting against unfair and deceptive practices in the marketplace.

Sincerely,

Jon M. Taylor, MBA, Ph.D.
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Appendix:**The \$10,000 “unfair and deceptive practices”⁵ challenge**

By Jon M. Taylor, MBA, Ph.D.

President, Consumer Awareness Institute – web site: mlm-thetruth.com

According to the web site for the FTC (Federal Trade Commission):

“The Federal Trade Commission is the nation's consumer protection agency. The FTC's Bureau of Consumer Protection works for the Consumer to prevent fraud, deception, and unfair business practices in the marketplace.”⁶

Having gathered decades of research, experience, and worldwide feedback on problems related to multi-level marketing (MLM), I am prepared to issue a challenge. I have pledged \$10,000 of my limited retirement to be paid to the first official from the FTC, SEC, U.S. Postal Services Office of Inspector General, U.S. Dept. of Justice, or offices of Attorneys General of all 50 states, that can identify any class of packaged “business opportunity,” “work from home,” or “income opportunity” that – as an industry based on a unique business model or practice – is verifiably more unfair and deceptive, more viral and predatory, and causing losses to more victims and more aggregate harm to participants – than is MLM.

Below are the requirements and criteria for the reward:

To qualify, you must read my articulation of the problem of MLM fraud in my book ***The Case (for and) against Multi-level Marketing***, which summarizes thousands of pages of research and worldwide feedback. It can be downloaded for free from my web site – mlm-thetruth.com. The website offers numerous other reports that will aid you in your basic understanding of this flawed business model and in clearing up any questions you may have about MLM industry practices and effects. You will also find much useful information at the web site – pyramidschemealert.org.

Based on meticulous research and the resulting conclusions about MLM in the aforementioned book, the minimum criteria in Table 1 (next page) would have to be met.

After reading my book, if you can identify any class of “work from home” or “business opportunity” that is more unfair and deceptive, more viral and predatory, and causes more aggregate harm to participants – than recruitment-driven MLMs⁷, based on the criteria in Table 1, please send details to Dr. Jon Taylor at the following email address: jonmtaylor@juno.com.

This challenge is in effect until July 1, 2011, and may be extended if Dr. Taylor so decides. If the challenge is not met by then, those of us advocating for consumers are justified in concluding that MLM as a business model and all⁸ of the hundreds of MLMs that make up the industry are in violation of FTC Section 5.

⁵ Section 5 of the Federal Trade Commission Act (FTC Act) declares that unfair or deceptive trade practices are illegal. See 15 USC §45(a) (FTC Act Section 5).

⁶ “According to “A Brief Overview of the Federal Trade Commission's Investigative And Law Enforcement Authority” (Rev. July 2008), “The basic consumer protection statute enforced by the Commission is Section 5(a) of the FTC Act, which provides that “**unfair or deceptive acts or practices** in or affecting commerce...are...declared unlawful.” (15 U.S.C. Sec. 45(a)(1)). . . “Unfair” practices are defined as those that “cause[] or [are] likely to cause **substantial injury** to consumers which is **not reasonably avoidable** by consumers themselves and **not outweighed by countervailing benefits** to consumers or to competition” (15 U.S.C. Sec. 45(n)). Posted on FTC web site – www.ftc.gov

⁷ This includes virtually all MLMs, with the possible exception of rare retail-focused MLMs, like some in-home demonstration (party) plans

⁸ See Footnote 7

Table 1: Criteria that would have to be exceeded to meet the \$10,000 MLM “unfair and deceptive business practices”⁹ challenge

I read the book “ <i>The Case (for and) against Multi-level Marketing.</i> ” Yes ___ No ___ (Must read to qualify)		
Please check (√) “Yes” or “No” to the left of each item below. See footnotes for explanations, such as how MLM satisfies each criteria. If “Yes” is checked for all of the criteria below, be prepared to provide detailed evidence. Please specify the type of “work from home” business or business opportunity to which you are referring here:		
Yes	No	For a “work from home” business or business opportunity as an industry to be more unfair, deceptive, viral, predatory, and causing more aggregate harm to participants than MLM, it would have to meet the following criteria:
		1. As a fundamental business model, it would be <i>inherently <u>flawed, unfair, and deceptive</u> – based on common reason or logic.</i> ¹⁰
		2. It would be <i>more <u>fraudulent, unfair, and deceptive</u> than MLM in that at least 99% of participants lose money and at most 1% profit, even though promoters from companies in this industry would tout it as a great income or business opportunity.</i> ¹¹ Those entering at the beginning would profit hugely at the expense of those coming in later.
		3. It would be <i>so full of <u>deception</u> that over 100 typical misrepresentations</i> would be used in promoting and defending it. ¹²
		4. It would be <i>so <u>recruitment-driven</u> – and therefore <u>viral</u> – that participants could not prove that more than 70% of sales volume (in dollars) was accounted for by sales to customers outside the network of participants.</i> ¹³
		5. It would also be <i>so <u>viral</u> that a given company in the industry would spread quickly from state to state and country to country, and specific companies in the industry would have numbered in the thousands over a ten-year period.</i> ¹⁴
		6. It would be <i>so <u>harmful</u> that over ten million victims of such companies would suffer aggregate losses exceeding \$10 billion per year in the U.S. alone, with far more victims and far greater aggregate losses suffered by victims overseas.</i> ¹⁵
		7. It would be <i>so <u>predatory</u> that although almost every new recruit loses money, the number of participants would sometimes increase during times of economic downturn, and it would take advantage of vulnerable markets overseas – by using <u>deceptive promises of relief from financial hardship.</u></i> ¹⁶
		8. Companies making up its industry would be combined into a cartel-like organization such as the Direct Selling Association (DSA) to refine and publicize the <i>dialogue of deception</i> that enables them to effectively lobby states and federal agencies like the FTC to weaken or prevent laws, rulings, or actions that could adversely affect them – to the detriment of consumers. ¹⁷

⁹ The primary mission of the Consumer Protection Div. of the FTC is to protect against “unfair and deceptive trade practices.”

¹⁰ Owing primarily to its endless chain of recruitment and continual turnover of participants, MLM compensation plans assume infinite and virgin markets, neither of which exists. By simple deduction, this would make MLM inherently flawed, unfair, and deceptive. See Chapter 2, 3, and 6 of my book *The Case (for and) against Multi-level Marketing.*

¹¹ See Chapters 4 through 7 to see how I calculated that a minimum of 99% of MLM participants lose money.

¹² See Chapter 8 for over 100 typical MLM misrepresentations used by MLM promoters and defenders.

¹³ See Chapter 5.

¹⁴ Viral growth in itself is not a bad thing, but when it is fraudulent, viral growth can dramatically increase the harm.

¹⁵ See Chapter 7.

¹⁶ See DSA and MLM company web sites for claims that MLM thrives during economic downturns and provides a good option for struggling people seeking relief.

¹⁷ See FTC web site (ftc.gov) for the exemption to the proposed Business Opportunity Rule brought about through intense DSA lobbying, using many of the misrepresentations specified in Chapter 8