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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 6

In your staff report posted in October on the FTC web site on the proposed Business Opportunity Rule, we find the following incredible statement in footnote 60 on of page 21:

60 None of the comments received provided an industry-wide analysis of pyramid schemes masquerading [sic] 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.

This statement is packed with misconceptions. Let's take them one at a time, beginning with the final statement at the end, which assumes that legitimate MLMs exist. Anyone with an open mind who has read my prior comments and the applicable chapters (which were attached) from my new e-book *The Case (for and) against Multi-level Marketing* would have to question that assumption. An MLM could only be legitimate if it departed in some major ways from the traditional MLM model so much so that it could hardly be said to be MLM at all. A hypothetical "good MLM" is described in Chapter 2 ("MLM definitions and legitimacy"), which is attached.

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In all of the compensation plans for the 350 MLMs I analyzed, they incentivized an endless chain of participants, all of whom had to meet minimum purchase requirements to qualify for commissions or advancement in the scheme – which wind up being the major source of revenues for the company. All of these compensation plans are built on the assumption of infinite markets and virgin markets, neither of which exist in the real world.

Just like chain letters, these recruitment-driven MLMs are therefore inherently flawed, deceptive, and profitable primarily for the first ones in and those at the top of the hierarchy (pyramid) of participants – who are often the same people. My research, as reported in Chapter 7 of my new e-book (in my comments under Part 1) supports this. This means that less than one percent of participants are profiting at the expense of at least 99% of participants who are losing money. **MLM is the epitome of an unfair and deceptive practice, which the FTC is pledged to protect against.**

So while there may be “no bright line disclosure that would help consumers identify a fraudulent pyramid from a legitimate MLM,” **there is (based on comparative research in Exhibit 2F) clearly a bright line disclosure that (if they are made aware of it) helps consumers distinguish between a recruitment-driven MLM and a legitimate sales or business opportunity.** These are presented in my research-based 5-step do-it-yourself MLM evaluation on my web site – and is also spelled out in Chapter 2 (attached) of my e-book.

This analysis was pointed out in earlier comments, but apparently missed by the staff. These four (and usually five) causative and defining characteristics (“red flags”) have since been tested on over 350 MLMs and found to lead to a loss rate exceeding 99% in every case where data on average earnings was available. That is very compelling evidence – and not just “anecdotal evidence.”

It really does not matter what you choose to call such MLMs – entrepreneurial chains, product-based pyramid schemes, or recruitment-driven MLMs. The effect is the same. They defraud 99% of participants of their investments in “pay-to-play” and other purchases from the company, to say nothing of minimal operating expenses and a great deal of time and effort.

When the FTC’s Dr. Vander Nat suggested that “identifying a pyramid scheme 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,” **he of course did not know at the time that I would by now have been doing that for over 15 years and that the process would have been tested and refined in analyzing over 350 MLMs, with a consistent result in every case. This makes generalizations possible and greatly simplifies the whole process.**

With all this research behind me, I can (without a fact-intensive behavioral analysis) predict with near 100% certainty the approximate loss rate of any MLM, based on a simple analysis their compensation plan; i.e., based on basic structural analysis. In every case the loss rate has been at least 99% in the hundreds of MLMs I have analyzed. So in actuality, a “good MLM” is an oxymoron.

But again, this is not just about indentifying a pyramid scheme, but about protecting consumers against unfair and deceptive practices, which the Rule is intended to help accomplish – whatever label you put on these product-based schemes. Since at least 99% of participants in all (100%) of the sample of 30 MLMs (for which I was able to obtain sufficient data) lost money, it is safe to generalize and label MLMs¹ as an industry as an unfair and deceptive practice – to be avoided, or at the very least to be warned against. And a good Rule requiring disclosure of average earnings would be a good start. If prospects knew that 99.6% of participants lose money, they may hesitate to join – to their benefit. Billions in losses suffered by millions of potential recruits could be prevented.

Now let's look at the first sentence of the paragraph quoted at the beginning of this submission; *"None of the comments received provided an industry-wide analysis of pyramid schemes masquarading [correct spelling is „masquerading"] as MLMs."*

This is a straw man argument and again assumes that MLMs are legitimate and not simply product-based pyramid schemes. The addition of products does not automatically give legitimacy to an endless chain recruitment scheme, entrepreneurial chain, or "pyramid scheme" (whatever you choose to call it) – any more than a "pay-to-play" chain letter. As I pointed out in Part 4 of my comments, 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."**² *The mission of the FTC is not to merely assign labels, but to protect against unfair and deceptive practices, which clearly has to include MLMs – if it includes any class of business.*

However, if a "brite line disclosure" definition of MLM is needed, and it is, the only research-based definition is found in Chapter 2 of my new e-book. I say research-based for all the reasons explained in Chapter 1 ("*MLM under the Microscope*") of my e-book. And again, chapter 2 not only includes a realistic definition, but a model that clearly separates legitimate direct selling from fraudulent endless chain sales schemes, or recruitment-driven MLMs. The DSA won't agree with this rather unflattering definition, but then the FTC does not exist to protect the DSA – or does it? My understanding – from the FTC's own web site – is that the FTC's role in consumer protection is to protect consumers against unfair and deceptive practices. You are welcome to correct me if I am wrong on that point.

Former Assistant Bruce Craig, who has worked on this issue for 30 years, including some landmark MLM/pyramid cases, and who has forwarded extensive input to the FTC over the years, has stressed that **"The premise of "multi-level vs. pyramid" marketing may well represent a distinction without a difference."**³

¹ The only possible exceptions are retail-focused in-home demonstration plans ("party plans") which allow hostesses to profit from sales to non-participants. But even then, one must examine the higher levels of the compensation plan to make a determination as to what extent it is recruitment-driven and top-weighted. Sponsors of these party plans have not generally been willing to disclose either their full compensation plans or statements of average earnings or payout to participants at the various levels. This is why as a group I have not performed an analysis of them.

² *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).

³ Letter from Bruce Craig to Chairman Robert Pitofsky, February 25, 2000

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We could argue this issue of definitions until the cows come home, but as is clearly pointed out in Chapter 2 and in other chapters in my new e-book, MLM is a flawed system that deceives and defrauds 99% of its participants of their money with promises of income that is found to be fictitious, except for a few at the top of the hierarchy (or pyramid or whatever you call it) of participants. To exempt MLMs from having to disclose what other business opportunity sellers have to disclose is not only unfair; but to any informed consumer advocate, it is absurd.

Sincerely,



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