PYRAMID SCHEME ALERT
International Association to Expose, Study and Prevent Pyramid Schemes

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Members of the United States Federal Trade Commission:
William E. Kovacic, Chairman
Pamela Jones Harbour, Commissioner
Jon Leibowitz, Commissioner
J. Thomas Rosch, Commissioner
600 Pennsylvania Avenue, NW
Washington, DC 20580

An Open Letter to the Members of the United States Federal Trade Commission

Re: Decision to Exempt "Multi-Level Marketing" from Proposed Rule to Combat Fraud in "Business Opportunity" Schemes.

Dear Commissioners:

This letter supports my submitted comment that the proposed businesses opportunity rule – which effectively excludes multi-level marketing (MLM) schemes – is meaningless, a waste of tax money, and useless in its stated purpose of protecting consumers. Whatever value such a rule would have provided the public was eradicated by the Commissioners' decision to exempt multi-level marketing schemes from its coverage (http://www.ftc.gov/opa/2008/03/busrule.shtm).

MLM is, by every measure, the largest and most pervasive of all the types of business opportunity schemes. The remaining types that the proposed rule would cover – envelope stuffing, vending machine routes, etc, –are insignificant, uncommon, and have little financial impact. The exclusion of MLM serves to bolster and protect the worst and most common type of business opportunity fraud. Rather than protecting the public, the revised rule literally provides a safe haven for business opportunity schemes. It may even drive those scams that use other models to now adopt a MLM pay plan in order to gain protection under the rule.

The Commission stated that MLMs will be covered by Section 5 of the FTC Act governing "unfair and deceptive practices." It is to this point – the Commissioners' record and willingness to enforce Section 5 in cases of MLM fraud – that the rest of this letter is addressed.

When confronting widespread and persistent crimes, frauds, or other anti-social conditions, experience may force citizens to make a critical decision. They may decide to no longer alert and seek the support of proper regulatory agencies. Instead, they may be forced to raise awareness about the negligence and complicity of regulatory agencies themselves in allowing the frauds to continue. Persistent failure of a duly appointed regulatory agency to protect consumers makes the pubic even more vulnerable and emboldens and aids perpetrators of fraud.

This point in time has been reached with the FTC regarding the Commissioners' failure – and apparent refusal – to enforce the law against the most common and pernicious form of business opportunity fraud: the use of the "endless chain" in selling business opportunities as "multi-level marketing." In an era when millions of people are forced to seek new income opportunities through self-employment or independent sales, this type of fraud is insidious and tragic. That it is protected by the Commission through refusal to enforce Section 5 of the FTC act is indefensible.

While the FTC has many dedicated and knowledgeable staff on whom the public can still rely, the policies and actions of you, the Commissioners, make you a party to the escalating fraud now being inflicted on the American public and worldwide in "MLM- business opportunity" frauds.

The reality which led to this position can be stated briefly:

1. The "endless chain" is the most common and most harmful form of fraud facing consumers today when they seek new business or income opportunities. There is hardly an American household today that does not have a member who has been solicited or who has lost money and time in a multi-level marketing scheme that turned out to be an endless chain recruiting/investment scam.
2. Multi-level marketing is overwhelmingly – almost exclusively – the primary disguise used for the epidemic of endless chain frauds. The scale of losses is in the billions each year.
3. In the MLM scams, a closed system of money transfer is disguised as "direct selling;" participants are authorized as independent sales representatives, but in fact, the nature of the products, their high prices, the top loaded and recruitment-based pay plans and other market conditions make actual "direct selling" unfeasible; the "consideration" paid by investors to participate is laundered through required inventory purchases and other "fees"; rewards are tied to endless chain recruiting of new participants, not retailing; the perpetrators conceal key information about the flawed model and the extent of losses it has caused.
4. Few people can discern the true nature of such scams. This public vulnerability is exacerbated when the frauds are allowed to operate openly, without regulation, and the public sees no government interest in investigating them. In that circumstance, the government serves as endorser and supporter of these known scams. The perpetrators repeatedly point to the regulators' inaction as evidence of the schemes' "legality."

5. In the mid-to late 1990's, the FTC was systematically prosecuting MLMs that operated as pyramid scheme frauds. It had gained experience in analysis; developed a proven method for distinguishing such scams from legitimate sales companies; had the legal foundation of three federal court rulings to support prosecution of MLM scams in which there is little actual retailing of goods and recruiting new participants is the primary means to recoup investments and gain promised profits.
6. Since 2001 the FTC virtually stopped all investigations and prosecution of MLM endless chain scams; it moved key personnel out of this area of investigation; and the FTC has ignored repeated consumer requests for investigations of these schemes (e.g. http://www.ftc.gov/os/comments/businessopprule/522418-70047.pdf)
7. The timing of this abrupt change in policy coincides with the 2001 FTC Chairmanship appointment by President Bush of Timothy Muris, an attorney whose law firm at that time represented the largest of all multi-level marketing companies, Amway. Though Mr. Muris has left the FTC, the endless chain safe haven policies have continued.
8. With nearly seven years of government protection, endless chain schemes have proliferated; consumers are now harassed or sued who dare to question their legitimacy; with great risk and at their own expense, consumers have battled these scams with publicity, research and lawsuits.
9. In 2008, the FTC went beyond providing endless chain sales scheme immunity from investigation. It voted to exclude these types of schemes from a proposed rule aimed at combating business opportunity fraud. This action reinforces the protection provided to fraud. It renders whatever rule may be finally adopted meaningless and useless, since the largest form of business opportunity fraud is specifically excluded.

The improper influence of an appointment to the FTC Chair of an individual from a law firm that represented the world's largest multi-level marketing company might be disconnected from the FTC's immediate moratorium on prosecutions of MLMs, except that other facts also make the political influence-buying connection impossible to ignore.

- The subsequent appointment by Mr. Muris of David Scheffman as the FTC's Chief Economist. When the large and notorious multi-level marketing company, Equinox International, was prosecuted and shut down by the FTC in the late 1990's, David Scheffman testified as a consultant/expert for Equinox *against the FTC*. He argued that the Equinox business model – based on recruiting, not retailing – was legitimate, not a pyramid scheme. His claim was largely based on the assertion that Equinox operated just like Amway.
- The "soft money" donation of $2.5 million from the Amway Corporation to the Republican Party in 1994.
- Amway's and affiliated donors' soft money contributions to the Republican National Committee totaling $4,147,000 between January 1, 1991 and June 30, 1999, according to the consumer watchdog group Common Cause,
- Amway's 1996 donation of $1.3 million to San Diego's host committee "to defer convention costs" for the Republican Party's national convention.

- The 1997 gift of $1 million to the Republican Party, one of the largest single donations on record from an individual, by Amway founder, Richard DeVos, a former finance chairman of the Republican National Committee.
- The campaign status with the Bush/Cheney campaign of Betsy DeVos, daughter-in-law of the Amway co-founder Richard DeVos, as a "Pioneer" after raising $100,000 for the Bush/Cheney campaign.
- Contributions of $2 million each from Amway founders Richard DeVos and Jay Van Andel in 2004 the to the Republican "527" *Progress for America*.
- The use of the Amway yacht in Philadelphia and New York at the 2000 and 2004 Republican Conventions to host parties for lobbyists and insiders.
- The use of the DeVos family yacht in 1999 by the "Republican Majority Issues Committee" (RMIC), for its inaugural fundraising event. RMIC is a "527" organization founded by Rep. Tom DeLay (R-Texas).

Every day, our organization receives the same basic questions from consumers worldwide. They ask whether one of the hundreds of US-based MLMs is a fraud due to their programs of endless chain recruiting and lack of retail sales; and, from those who have already been harmed, they ask why the FTC is not prosecuting or at least formally investigating the schemes.

Part of this consumer confusion is attributed to the FTC's near 30-year policy of identifying "non-retailing" MLMs as inherent frauds. The sudden reversal of that policy in 2001 toward allowing such scams to operate is inexplicable to many Americans.

Secondly, the FTC's own double-speak on the matter has confused citizens. On your own website (http://www.ftc.gov/bcp/conline/pubs/alerts/pyrdalrt.shtm), the FTC warns consumers away from endless chain schemes, which it identifies as "illegal", while it takes no action to prosecute them.
The FTC website states:

> "However, others (MLMs) are illegal pyramid schemes. In pyramids, commissions are based on the number of distributors recruited. Most of the product sales are made to these distributors – not to consumers in general. The underlying goods and services, which vary from vitamins to car leases, serve only to make the schemes look legitimate."

This "FTC Alert" shows that the FTC is fully aware of the fraudulence of an MLM that operates as a closed system ("Most of the product sales are made to these distributors - not to consumers in general… commissions are based on the number of distributors recruited.") The FTC even lists, in question form, the key factors that identify MLM frauds:

- Does it sell products to the public-at-large?
- Is the product competitively priced?
- Is it likely to appeal to a large customer base?
- Is there a minimum monthly sales commitment to earn a commission?
- Will you be required to recruit new distributors to earn your commission?

Most of the largest and best known MLMs fail this questionnaire.

- The products are ultimately purchased almost exclusively by the salespeople, not the public at large. A recent class action suit brought against the largest MLM, Amway, by a group of its top insider sales people, asserts that only 4% of Amway's goods are ever retailed. Amway itself has admitted that less than 20% of its product are ever sold to the "public-at-large."
- The products are exorbitantly priced, sometimes 3 to 10 times the price of similar products. Recent reports in the *Wall Street Journal* reported the extraordinary pricing of a large MLM, Usana Health Sciences, and a recent government prosecution of Amway in England also confirmed the absurdly uncompetitive prices of Amway goods.
- Detached from their "income proposition" MLM products have little or no market value and the great majority of all who do purchase them stop doing so within a year. Recent controversies about the MLM, Herbalife, revealed that 80% of all Herbalife "sales people" quit the scheme within a year and stop buying the goods. Many of MLM product are for sale on EBay at fractions of their so called wholesale prices.
- To earn a commission each new recruit must continue to purchase goods at a specified level. The monthly "auto order", employed by Usana, Amway, Nuskin, and others in which the purchases are automatically charged to the consumer's credit card is a standard in the MLM business.
- MLM payments are based on recruiting new distributors and the pay plans escalate payment rates the higher one moves up the recruiting chain. In nearly every MLM studied, more than 50% of all payments are transferred to the top 1% of the sales chain and 99% of all sales people earn less than their costs. Recruiting is the only viable way to earn a profit and in the closed systems, profit from recruiting is mathematically limited to a tiny few at the top of the chain.
- The extraordinary consumer losses that the MLM endless chain system requires and inflicts are concealed or denied by the perpetrators.

On it website, the FTC admonishes consumers about their liability in joining a fraudulent MLM scheme and urges "common sense." It remains silent about its own responsibilities to enforce the law against the schemes and its own liability for not doing so.

The time has come for consumers to no longer ask the FTC to investigate MLM frauds, but rather to ask Congress to investigate the FTC for politically protecting them.

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