Business Opportunity Rule, R511993

# REBUTTAL TO COMMENTS OF THE DIRECT SELLING ASSOCIATION IN CONNECTION WITH THE REVISED PROPOSED BUSINESS OPPORTUNITY RULE

PART 1 OF 2

Submitted by Gail Aird

DSA Comments:

DSA endorses the FTC's stated intention of narrowing "the scope of the proposed rule to avoid broadly sweeping in sellers of multi-level marketing opportunities,"…In order to avoid any unintended misinterpretation of the proposed Business Opportunity Rule…These comments are provided for the sole purpose of effectuating the intent expressed in the RNPR that the revised rule **not include direct sellers**. DSA's suggestions are made for the exclusive purpose of making clear in the text of the Rule itself what is stated in the RNPR, *i.e.,* that direct sellers are not covered by the Revised rule. Without such modifications, the language of the revised rule might be interpreted in a manner inconsistent with the FTC's stated intent.

Direct selling is defined as the sale of a consumer product or service, person-to-person, away from a fixed retail location. www.dsa.org . Direct selling, as defined by the DSA, would broadly sweep in every form of person-to- person selling that was conducted “away from a fixed retail location”. Direct sellers would include individuals selling any products or services, including work-at-home schemes such as envelope stuffing, as long as the sales were conducted away from a fixed retail location.

After admitting that the FTC proposed to exempt sellers of multi-level marketing opportunities (“MLMs”) , in a concerted effort to gain exemption [from the Rule] for its members, the DSA tries to create the illusion that the FTC’s expressed intent was actually to exempt direct sellers.

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The Revised Rule:

SUPPLEMENTARY INFORMATION: …the revised proposed rule modifies the initial proposal in six significant ways: It narrows the scope of the proposed Rule to avoid broadly sweeping in sellers of multi-level marketing opportunities…

Scope of the Proposed Rule…In addition, the revised proposal does not attempt to cover MLMs.

In order to avoid confusion as to the *expressed intent of the FTC* as to the specific exemption proposed, the FTC provided the criteria under which the MLM exemption would apply.

## Criteria For MLM Exemption As Proposed

Multi-level marketing is one form of direct selling, and refers to a business model in which a company distributes products through a network of distributors who earn income from their own retail sales of the product and from retail sales made by the distributors' direct and indirect recruits. Because they earn a commission from the sales their recruits make, each member in the MLM network has an incentive to continue recruiting additional sales representatives into their "down lines." See Peter J. Vander Nat and William W. Keep, Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes, 21 J. of Pub. Pol'y & Marketing (Spring 2002), ("Vander Nat and Keep") at 140. *Revised Proposed Rule page 15 footnote 34*

The FTC's identified MLM as "one form of direct selling" clearly putting the public and the DSA on notice that the proposed exemption is expressly limited to only the "one form of direct selling" that the FTC identified in the Proposed Revised Rule. The specific form of direct selling that is proposed for exemption "refers to a business model in which a company distributes products through a network of distributors who earn income from their own retail sales of the product and from retail sales made by the distributors' direct and indirect recruits".

To remove any doubt as to the only form of the direct selling model that was proposed for exemption we need look no further then the following.

A. The proposed exemption is expressly limited to the compensation model generally known as MLM.

B. MLM for purposes of the proposed MLM exemption is a business model that provides the payment of earnings to 2 or more individuals (earnings paid to the distributor and her/his direct and indirect recruits as the result of the sale of the MLMs product or services).

C. The exemption is further expressly limited to a MLM compensation model that provides distributors (members of an MLM salesforce) with the opportunity to earn income "from their retail sales" and from the "retail sales made by their direct and indirect recruits".

## ANALYZING THE CRITERIA FOR THE MLM COMPENSATION MODEL

The FTC took great care to design the MLM exemption in strict accordance with its official "Staff Advisory Opinion regarding the Federal Trade Commission's

analysis of pyramid schemes" sent to the DSA on January 14, 2004; as evidenced by the inclusion of the "retail sales" requirement in the MLM exemption criteria. http://www.marketwaveinc.com/FTC_Letter.pdf

As the FTC clearly articulated to the DSA, *The critical question for the FTC is* whether the revenues that primarily support the commissions paid to all participants are generated from purchases of goods and services that **are not** simply incidental to the purchase of the *right to participate in a money-making venture*….*a multi-level compensation system funded primarily by payments made for the right to participate in the venture is an illegal pyramid scheme…*Downline members pay these fees to join the scheme and meet certain prerequisites for obtaining the monetary and other rewards offered by the program…***The most common means employed to achieve this goal is to require a certain level of monthly purchases to qualify for commissions***…* such a plan is little more than a transfer scheme, dooming the vast majority of participants to financial failure. (Emphasis added)

Sales quotas as a condition requisite for commission entitlement are a common component of numerous MLMs. For example, DSA members Pre-Paid Legal; Herbalife; and USANA all require certain dollar amounts of purchases as a condition requisite for commission entitlement.

Herbalife and USANA require its distributors to meet monthly purchase quotas as a condition requisite for commission entitlement. In Pre-Paid's case distributors must meet a sales quota every 3 months or purchase [and maintain] a personal membership from the Company. Pre-Paid sales quota is an interesting requirement, given the fact that the overwhelming majority (over 95%) of every

distributor in its history has failed to meet its imposed quota as a requisite for commission entitlement.

I am not alleging that DSA members Herbalife, USANA and Pre-Paid Legal are pyramid schemes. I am just stating the fact that these DSA members engage in the act of requiring a certain level of purchases as a condition requisite for commission entitlement, which act is identified by the FTC as “little more than a transfer scheme, dooming the vast majority of participants to financial failure”.

**Retail Sales Criteria for Proposed MLM exemption.**

Herbalife is a DSA member. Additionally, the following Herbalife executives serve on DSA’s Board of Directors; Committees and Councils.

a. Board of Directors: Brett Chapman and John Venardos
b. Ethics and Self-Regulation Committee: Katie Dixon and Diane Turpin
c. Government Relations Committee: Brett Chapman; Katie Dixon; Paul R Greenberg; and John Venardos
d. Publicly Traded Companies Council: Diane Turpin and John Venardos.

*Note: In the past, Gregory Probert (who recently resigned as President and COO of Herbalife after it was reveled that he lied about his credentials) previously was a member of the DSA Board and a member of its Strategic and Long-Range Planning Committee.*

Based on the above, there can be no dispute as to the fact that Herbalife is not just a DSA member; but rather its executives play an integral role in the operations of the DSA.

Given the FTC’s position on retail sales, it is noteworthy that Herbalife is prohibited, by and thru a contractual agreement with its distributors from selling any products to any member of the public who is not also a distributor;

consequently its distributors are its only customers. Also, Herbalife does not require, either by contractual agreement with its distributors or by any other means whatsoever that its distributors sell any products [purchased from the Company or the distributors' upline] to any member of the retail public. Additionally, Distributors are allowed to sell products purchased from the Company to their downline distributor recruits. In essence, Herbalife has no basis on which it can rely to determine the amount, if any, of products purchased by its distributors from either the Company or the distributors' upline that were sold to the retail public.

**Herbalife's knowledge of the retail sales requirement**: Herbalife admits in its regulatory reports filed with the Securities & Exchange Commission ("SEC") that its marketing program is governing by FTC "Regulations applicable to network marketing" [and that these regulations] "are directed at preventing fraudulent or deceptive schemes, often referred to as "pyramid" or "chain sales" schemes, *by ensuring that product sales ultimately are made to consumers* and that advancement within an organization is based on sales of the organization's products rather than investments in the organization or other ***non-retail*** *sales-related criteria".* (Emphasis added)

## Background

## MULTI-LEVEL COMPENSATION PLANS

Over the past decade the MLM compensation model proved very successful for business opportunity sellers and has fueled, at least in part, the DSA's growing membership base. As the FTC correctly stated it its MLM definition it is "because they [distributors] earn a commission from the sales their recruits make, [that]

each member in the MLM network has an incentive to continue recruiting additional sales representatives into their “down lines”.

The success of the MLM compensation model was also the catalyst for numerous enterprising business opportunity sellers, including those sellers commonly referred to as MLMs; the majority of DSA members; sellers of vending machine routes and sellers of at home schemes such as envelop stuffing and medical billing programs to adopt the MLM compensation model. In today’s market the majority of business opportunity sellers use a MLM compensation model.

Since the threshold MLM exemption is met by the payment of commissions to 2 or more individuals as the result of a sale; it is reasonable to assume that business opportunity sellers that do not currently have an MLM compensation model will adopt same [to gain exemption] before implementation of a final Rule.

DSA Comments:

DSA's mission is "[t]o protect, serve and promote the effectiveness of member companies and the independent business people they represent" and "[t]o **ensure that the marketing by member companies of products and/or the direct sales opportunity is conducted *with the highest level of business ethics***… “DSA…conducts an independently administered code of ethics program that protects both customers and salespeople… (Emphasis added)

(1) Do DSA member companies conduct their business enterprises “with the highest level of business ethics”?

(2) Does the DSA code of ethics provide protection to customers?

It is reasonable to assume that in order to achieve the goal of conducting their business enterprises “with the highest level of business ethics”; DSA members would operate their enterprises in compliance with all applications laws, including without limitation in compliance with all provisions of the FTC Act.

Question: Would DSA members achieve the highest levels of business ethics if they engaged in the unlawful act that the FTC’s law enforcement demonstrated underlies virtually all fraudulent business opportunity schemes?

According to the Original Proposed Business Opportunity Rule [the FTC’s] “law enforcement history demonstrates that the making of earnings claims *underlies virtually all fraudulent business opportunity schemes*….the Commission to date has brought over 140 cases against a multitude of business opportunities and related schemes, each of which lured unsuspecting consumers through false or deceptive earnings representations….In the Commission’s experience, such claims are highly relevant to consumers in making their investment decisions and typically are the single most decisive factor in such decisions”. (Emphasis added)

*Note: Emphasis added by the author of this report. The source document for the following is the FTC’s Notice of Proposed Rulemaking (16 CFR Part 437 Business Opportunity Rule).*

A. @19057: …By far, the most frequent allegations in Commission business opportunity cases pertain to **false or unsubstantiated earnings claims**….

B. @19058: …as the Commission's cases and complaint data demonstrate the con artists who promote fraudulent work-at-home schemes frequently dupe consumers with **false earnings claims**, *a very prevalent practice among fraudulent business opportunity sellers.*

C. @19060**: …**pyramid schemes often deceive consumers with the **promise of large potential incomes.** It is not uncommon for promoters of these schemes to claim potential incomes of thousands of dollars a week or month. Because of the claimed high earnings potential, pyramid schemes are highly successful in attracting prospective investors…**…**

D. @19063 continued on 19064: …The Commission's law enforcement history demonstrates that the making of earnings claims underlies virtually **all** fraudulent business opportunity schemes. As detailed above, the Commission to date has brought *over 140 cases against a multitude of business opportunities and related schemes*, each of which lured unsuspecting consumers through false or deceptive earnings representations….In the Commission's experience, such claims are highly relevant to consumers in making their investment decisions and typically are the single most decisive factor in such decisions.

E. @19074: As noted throughout this NPR, the making of **false earnings claims** *is the most prevalent problem in the offer and sale of business opportunities.*

At this point we have established that the FTC's historical experience demonstrates that the making of False or Deception earnings claims is the most prevalent UNLAWFUL act or practice engaged in by business opportunity sellers.

The FTC states in the Revised Rule [that] in the last ten years the Commission has sued fourteen pyramid schemes **that purported to be legitimate MLM businesses selling products to end-users.** Apart from operating as illegal pyramids, MLMs also could be engaged in making false earnings representations. In the Commission's law enforcement experience, *all of its pyramid cases* against **purportedly legitimate MLMs** alleged that the defendant *made false earnings representations*. Notably, at least one other case the Commission brought against an MLM company alleged false earnings representations. *Earnings claims lie at the heart of business opportunity fraud, and are typically the enticement that persuades consumers to invest their money.* (Emphasis added)

The catalyst to make the false or deceptive earnings representations, which according to the FTC "lure unsuspecting consumers" into joining a business opportunity is the MLM compensation model. But for the fact that a business opportunity seller provides that members of its MLM salesforce can earn commission on sales made by their direct and indirect recruits, the incentive to use false or deceptive earnings claims to lure unsuspecting consumers into joining a business opportunity would be extinguished

Given the FTC's admission that its "law enforcement history demonstrates that the making of earnings claims *underlies virtually all fraudulent business opportunity schemes"* and DSA's reliance on its code of ethics to persuade the FTC to agree to its suggestions, it is essential to analyze the DSA's Code of Ethics in connection with earnings claims.

DSA Code of Ethics is found at http://www.dsa.org/ethics/ .

> ***Code Section 8 Earnings Representations**: "No member company shall misrepresent the actual or potential sales or earnings of its independent salespeople. Any earnings or sales representations that are made by member companies **shall be based on documented facts"**. (Emphasis added)*

The sole DSA requirement is that earnings or sales representation must be "based on document facts". This means that as long as any DSA member can prove that any of its distributors received the "actual" earnings portrayed to the public and that the portrayed "potential sales or earnings" is based on the fact that the stated number of sales would produce the [potential] sales or earnings portrayed, its members are operating in compliance with the DSA Code.

> *"There is ample legal precedent in the form of FTC decisions to afford guidance on the subject of earnings representations. While not controlling, these precedents should be used by the Code Administrator in making determinations as to the substantiation of company earnings claims". (Emphasis added)*

After admitting that "there is ample legal precedent in the form of FTC decisions to afford guidance on the subject of earnings representations the DSA proclaims that these FTC decisions ARE NOT CONTROLLING ON THE CODE ADMINISTRATOR. (Emphasis added)

First and foremost is the fact that the DSA has admitted that its Code Administrator is not controlled [bound] by FTC precedents. In essence, the DSA is telling the FTC that its Code usurps FTC legal precedent.

> *The DSA's follow-up statement: "these precedents should be used by the Code Administrator in making determinations as to the substantiation of company earnings claims"*

The above is meaningless because the “substantiation” of DSA members’ earnings claims are isolated to substantiating that a distributor received the specific earning presented.

Does the DSA knowingly and willingly allows its members to engage in unlawful acts in direct violation of Section 5 (false and deceptive earnings claims)?

A. **According to FTC case law:** A false or unsubstantiated earnings or lifestyle claim is a statement of earnings or lifestyle presented to the public that (even if representative of the earnings or lifestyle achieved by the maker of the statement) is not representative of the earnings or lifestyle the person to whom the claim is made can reasonably be expected to achieve *based on the historical earnings of distributors* of a company.

B. **According to the DSA:** A false or unsubstantiated earnings or lifestyle claim is ***only*** false or unsubstantiated if a DSA member cannot find ***even one*** distributor who has made the earnings or achieved the lifestyle presented as the result of being a member of the DSA members’ salesforce.

The DSA www.dsa.org

> Every DSA member company has gone through a rigorous one-year application process. All companies must abide by DSA's Code of Ethics in order to retain membership in the Association. Find out more about the Code of Ethics at http://www.dsa.org/ethics/

**HERBALIFE**

HERBALIFE HIGH LEVEL DISTRIBUTORS
LESLIE STANFORD;
SUSAN PETERSON AND JOHN TARTOL

*Notes: Share Holdings (shares owned/controlled). Value of shares as of June 12, 2008. Dividends received since December 14, 2007. SEC filings at http://www.herbalife.com/global/investor_relations_frset.jsp?irhome&*

| Name | Share Holdings | Value | Dividends |
|---|---|---|---|
| Leslie Stanford | 779,465 | $28.271 million | $467,679 |
| Susan Peterson | 37,778 | $1.370 million | $ 22,667 |
| John Tartol | 231,716 | $ 8.404 million | $139,030 |
| Collective total: | 1.049 million | $38.046 million | $629,376 |

All three (3) of the above are, as a matter of federal securities law, insiders of Herbalife and report their insider holdings to the SEC. Their insider designations as well as their substantial holdings in Herbalife creates a substantial conflict of interest (which conflict is not disclosed to distributors or potential recruits). All three receive a direct financial benefit (a percent of every purchase made by their direct and indirect downline recruits) and a direct financial benefit if the price of Herbalife shares increase (higher recruiting means higher revenue=higher share price). All of these individuals are members of Herbalife's Chairman's Club and are Herbalife approved world trainers. http://media.herbalife.com/myHbl/cc/cc.html and http://www.myherbalifeww.com/za/pdf/01_2007%20FC%20and%20CC%20Global%20Tour%20(20%20Aug%2007).pdf

The following recruiting video is presented by John Tartol (current member of Herbalife's Board of Directors) and Leslie Stanford (former member of Herbalife's Board of Directors). Both Tartol and Stanford are Herbalife authorized world trainers.

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## TARTOL AND STANFORD RECRUITING VIDEO

ODDS OF BECOMING A MILLION IN HERBALIFE:
http://www.youtube.com/watch?v=K1l6TiqGpac
AT ABOUT 3 MINUTES 25 SECONDS

Distributor 1 in 13,000
Supervisor 1 in 1700
Word Team member 1 in 500
Global Expansion Team 1 in 100
Millionaire Team Member 1 in 28
Presidents Club 1 in 9

*Notes: Herbalife's earnings disclosure is sent to distributors after they have purchased Herbalife's business opportunity and joined its MLM salesforce. This document discloses that the average annual earnings of Supervisors (**representing 87.5%** of what the Company describes as "Active Leaders") was $549 in 2006.* *http://www.herbalife.com/US/en/pdf/AverageGrossCompensation_EN.pdf* .

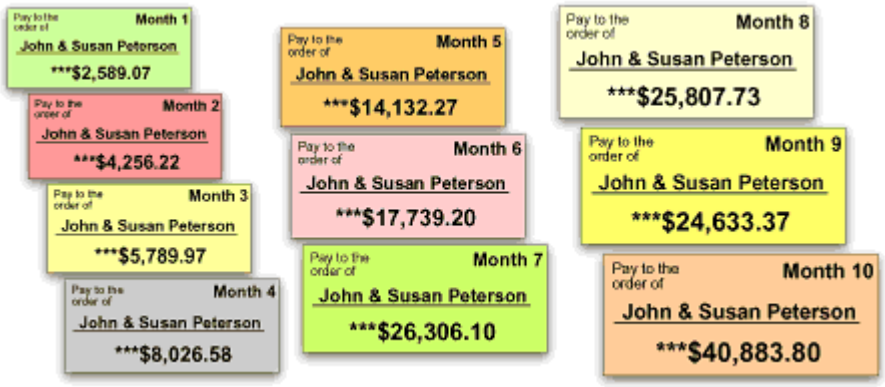
### SUSAN PETERSON

Peterson is President of Work From Home, Inc. Susan Peterson's Work from Home websites engages in both egregious earnings claims (without any disclaimers whatsoever) and adds another element of fraud to her bag of tricks. Specifically, she engages in the ole "Bait and Switch" by removing any mention whatsoever of the name Herbalife (or any statement that would reveal the opportunity her distributors are promoting is Herbalife).

Proof Herbalife knows that Peterson is President of Work from Home can be found on page 18 of the 13D at Http://www.secinfo.com/dsvrn.u1uf.htm .

**A picture is worth a thousand words!**

http://www.lifebeauty.net/




You'll find outrageous earnings claims on Ms. Peterson's Work From Home Herbalife distributor websites; but you won't find any income disclosures whatsoever or even a hint that the website is the website of a Herbalife distributor.

http://www1.homeriches.net/wfhLandForm/WFHDomainLand.cfm?&PID=%21%2ABN%22%0A&ADID=0&v=WFH&s=&bid=offline&domainname=homeriches.net&tid=&language_id=ENUS&showpop=0&preview=0

**John & Susan Peterson**

We were broke when we first started. After learning the Work From Home System, we made $14,132 our 5th month! Today we have a villa in Mexico, a home in the mountains and a ranch in Wyoming all paid for."

All you have to do is follow our Proven System…

Ms. Peterson is a Herbalife authorized world trainer; Herbalife knows she created and runs the Work from Home sites for her downline distributors; Herbalife senior executives watch Ms. Peterson on stage at national and international conventions as she presents her earnings claims. And, adding insult to injury, Herbalife includes Ms. Peterson's earning claims in the video on its corporate website. Based on these facts, Herbalife cannot claim that Tartol; Peterson and Stanford's false and deceptive earnings claims are not made under its direction and control.

## Pre-Paid Legal Services, Inc

Pre-Paid Legal is another DSA member that, while violating Section 5 of the FTC Act (False or Deceptive earnings claims) meets the requirement of DSA *Code Section 8 (*Earnings Representations*)*.

Pre-Paid Legal submitted a Comment letter on the Original Proposed Rule. On September 29, 2006, Attorney Hal Neier submitted a Rebuttal to Pre-Paid's Comment letter. **http://www.ftc.gov/os/comments/businessopprule/rebuttal/522418-13247.pdf**

On page 6 Mr. Neier presents the following chart (compiled from disclosures in Pre-Paid's regulatory reports filed with the Securities & Exchange Commission).

| | | Percentage of Vested Associates who failed to sell: | |
|---|---|---|---|
| **Year** | **Vested Associates** | **A single membership** | **More than 10 memberships** |
| 2005 | 468,365 | 78% | 97.6% |
| 2004 | 343,696 | 77% | 97% |
| 2003 | 329,600 | 74% | 97% |
| 2002 | 341,116 | 70% | 96% |
| 2001 | 286,488 | 72% | 95% |

On page 8 Mr. Neier presents his position on Pre-Paid false or deceptive earnings claims, including but not necessarily limited to, the following.

Even a cursory review of Pre-Paid's earnings claims reveals that Pre-Paid engages in precisely the sort of misleading disclosure that the Proposed Rule is designed to eliminate…. For example, on its website, Pre-Paid states that "if you market just 5 memberships per week, you'll receive $500 per week! An accompanying chart projects this weekly commission to a total of $26,000 annually. Another entry on Pre-Paid's website goes even further, stating: If only 30 individuals within your Organization sold just one membership per week, assuming a one-year commission advance with no chargebacks that would mean $975 per WEEK! What if THEY each marketed three a week? What if they marketed ONE **A DAY? TWO A DAY? THREE A DAY**? Of course, not everyone reaches this level but think of what could happen if you did!

Pre-Paid's disclaimer that "not everyone" reaches the advertised level of sales may charitably be described as an understatement. In fact, as noted (in the chart) above, fewer than 2.5% of Pre-Paid's Associates sold even one plan per *month* in 2005, never mind the "5 memberships per week" or "THREE A DAY" cited in the above promotions.

The second representation is even more misleading when one considers that, in order to reach the level of income posited by Pre-Paid's website, a single associate would have had to recruit into his "Organization" thirty other Associates, all of whom would have to fall within whatever tiny fraction of the 2.5% is made up of Associates who manage to achieve one sale per week. In short, the chance of an Associate achieving an income anywhere near the levels

touted on Pre-Paid's website is, for all practical purposes, zero. *End of Neier Rebuttal excerpts.*

The information in Mr. Neier's Rebuttal letter paints the picture of an MLM member of the DSA whose earnings representations are in direct violation of Section 5 of the FTC act; yet comply (I will acknowledge that Pre-Paid can find at least one distributor that accomplished the selling and recruiting goals presented to the public) with the DSA's Code.

Additionally, it is difficult not to notice that the FTC has been in receipt of Mr. Neier's information since September 2006 and the FTC has yet to investigate these serious allegations of Pre-Paid's violation of Section 5 of the FTC Act.

Question: Given the compelling evidence that Herbalife and Pre-Paid's earnings claims violate Section 5, why would DSA allow Herbalife and Pre-Paid to remain DSA members?

Answer: Because the DSA does not require its members to operate their MLM enterprises in compliance with the FTC Act, including without limited Section 5 (False or Deceptive earnings claims).

- *Would the FTC either bring a formal action or begin a formal investigation if the identical practices (engaged in by Herbalife and Pre-Paid Legal as described herein) were engaged in by a business opportunity that was not a DSA member and sold an "Envelope Stuffing" business opportunity?*

**Undaunted by the obstacles presented by some provisions of the Revised Rule the DSA has found a solution that, regardless of any provisions in a final Rule, will guarantee exemption [from the Rule] for all of its members.**

DSA COMMENTS

Throughout these comments, DSA will refer to its members and others that engage in direct selling activities as "direct sellers." …the FTC refers to these types of businesses as "multi-level marketing" opportunities…. The term "direct sellers" may be more accurate, in that many direct sellers do not have multiple tiers of marketing or compensation activities, and there may be different interpretations of what "multi-level marketing" entails. For clarity, DSA will simply refer to this industry and its members as "direct sellers." Direct sellers are defined specifically and precisely under federal law, see 26 U.S.C. §3508.

DSA statement: Direct sellers are defined specifically and precisely under federal law, see 26 U.S.C. §3508.

In truth and in fact 26 U.S.C. §3508 applies to the IRS definition of statutory non-, a/k/a IRS form 1099 independent contractors for federal tax purposes.

The DSA solution is simple and will accomplish its purpose of guaranteeing exemption for all of its members. The DSA's solution will also wreck havoc on the FTC because its solution will exempt every entity, of any form or nature whatsoever, whose salesforce qualify as independent contractors (under 26 U.S.C. §3508) from a Final Rule.

The DSA admitted its knowledge of the above in its Comment to the FTC in connection to the Can-Spam Act Rulemaking project; stating “Individual direct sellers are independent contractors and in a business-to-business relationship with the direct selling company. Individual direct sellers are statutory non-employees for federal tax purposes”, citing 26 U.S.C. § 3508 (2001) in support of its statement. http://www.ftc.gov/os/comments/canspam/OL-105343.pdf

The Revised Rule agreed (Traditional Product Distribution Arrangements and Others) with commenters that the Rule, as originally proposed, “Would have regulated a wide range of legitimate and traditional product distribution arrangements that are not associated with the types of fraud that business opportunity laws are designed to remedy”.

In support of its position the FTC cited numerous traditional arrangements for distributors of various products and services that the original Rule would have improperly covered; including “even the relationship between newspapers and **independent carriers”** (26 U.S.C. § 3508 statutory non-employees for federal tax purposes). In addition, the Revised Rule lists numerous traditional product distribution arrangements, many of which are commonly known to utilize a salesforce of independent contractors (26 U.S.C. § 3508 statutory non-employees) that are not intended to be covered under the ambit of the Revised Rule.

If the FTC agrees to change the proposed exemption (from MLMs) to direct sellers using the DSA’s absurd (and self serving) interpretation, i.e., as defined in 26 U.S.C. § 3508; such revision would literally cause every entity in the US that uses independent contractors to market its products or services to gain exemption from a Final Rule.

Notwithstanding the power over [and access to the] FTC enjoyed by the DSA and its lobbyists, I don't believe that even the DSA thought its proposed 26 U.S.C. §3508 exemption would pass the smell test.

DSA Comments

DSA is the national trade association of the leading companies that manufacture and distribute goods and services sold directly to consumers by personal presentation and demonstration, primarily in the home.

In addition to being the national association for direct sellers and MLMs, the DSA is the largest lobbying group for the direct selling and MLM industry in the US. Therefore, as a matter of law the DSA could not meet the legal requirements set forth by federal law to qualify as the Self Regulatory Organization ("SRO") of the direct selling or MLM industry.

I applaud the FTC for letting the requests of DSA members that because they are members of the DSA they should gain exemption from the Rule fall on deaf ears.

At first blush It seems that the FTC's Revised Rule was crafted in a concerted effort to specifically provide exemption for DSA members. However when viewed in light of the facts that (1) the FTC provided the retail sales criteria for purposes of the proposed MLM exemption and (2) the FTC included other provisions (which will be addressed later) that would bring DSA members under the ambit of the Rule, the casting of the FTC as an agency that has fallen prey to the demands of the DSA and its lobbyists may be premature.

DSA Comments

DSA notes that definitions in the RPBOR may inadvertently encompass some direct seller activities. *While the FTC has made clear that direct sellers are outside the scope of the RPBOR* in its RNPR commentary, it is important to modify the definitions set forth in §437.1 of the proposed rule to avoid any possible ambiguity. (Emphasis added)

**Note to the DSA**: The FTC did not propose, suggest or even allude to the proposition that direct sellers are outside the scope of the RPBOR.

DSA Comments

Of paramount concern to DSA is the possibility that "required payment" might be construed inappropriately to include payments for the purchase of certain materials on a not-for-profit basis…. Direct sellers routinely purchase - on a not-for-profit basis certain materials for demonstration… or otherwise to be used to [in connection with] the sale of products to consumers. The not for-profit sale by the company of these materials is another feature that distinguishes direct selling from business opportunities and business opportunity frauds…the exclusion…should be amended to also include payments for the purchase of business materials on a not-for-profit basis… (Emphasis added)

Notes: The items the DSA refers to as “Business Material” are commonly referred to as sales and marketing tools.

**SALES & MARKETING TOOLS PURCHASED ON A NOT-FOR-PROFIT BASIS**

The DSA correctly states that the sale of sales & marketing tools on a for-profit basis is a practice engaged in by **“business opportunity frauds”.**

UNDERSTANDING THE NOT-FOR-PROFIT RULE:

1. Sales & marketing tools sold by MLMs and Direct Sellers cannot be purchased by any member of the public who is not also a member of the company's salesforce. This practice is commonly referred to as Distributor-To-Distributor sales.

2. The practice of selling sales & marketing tools to distributors at a price in excess of the Company's cost, defined as the Company's actual out-of-pocket cost to purchase or produce the items that created the revenue, plus its out-of-pocket shipping and handlings costs is generally considered to be the act of a pyramid scheme (or using DSA's definition the practice of a business opportunity fraud).

3. Additionally, the payment of a commission on the sale of any product or service that cannot be sold to members of the general public (sales & marketing tools) is also generally considered to be the act of a pyramid scheme. (or using DSA's definition the practice of a business opportunity fraud).

The reasoning behind the Not-For-Profit Rule is to prevent the practices engaged in by pyramid schemes and business opportunities sellers (admitted by the DSA to be Business Opportunity frauds) in the past, i.e., creating profits from their sale of sales & marketing tools to distributors; as opposed to the sale of products and services to the retail public.

## HERBALIFE

Herbalife's sale of sales & marketing tools are identified in its regulatory reports filed with the "SEC" as "literature, promotional and other".

According to its 2007 Annual Report filed with the SEC (1) members of its MLM salesforce purchased a total of **$110.7 million** in sales & marketing tools; (2) the Company paid $18.8 Million commissions to its distributors who sold these items to their downline recruits; and (3) after expensing distributor commissions and its cost of goods (determined by calculations in its income statement in regulatory reports filed with the SEC) the Company received net profit on its sale of sales & marketing tools to members of its MLM salesforce of **$69.760 million** in 2007.

**Note to DSA:** You admitted that for-profit sales of Business Materials (a/k/a sales & marketing tools) is the practice of a business opportunity fraud and according to financial measures and data in Herbalife's SEC filings it engages in this practice. If there is a prohibition in your Code of Ethics that prevents business opportunity frauds from retaining membership, you might want to reconsider Herbalife's membership in the DSA.

The DSA's request IS SPECIFICALLY for exclusion of payments made by distributors on any **not-for-profit** purchases. If the FTC granted DSA's request, would the DSA enforce (upon all its members, including Herbalife) the not-for-profit clause on the sale of sales & marketing tools? **Obviously, the answer is a resounding NO**. The DSA would allows its members regardless of whether they complied with or violated the not-for-profit rule (just as the DSA allows its members to violate Section 5 of the FTC Act) to keep doing what they have

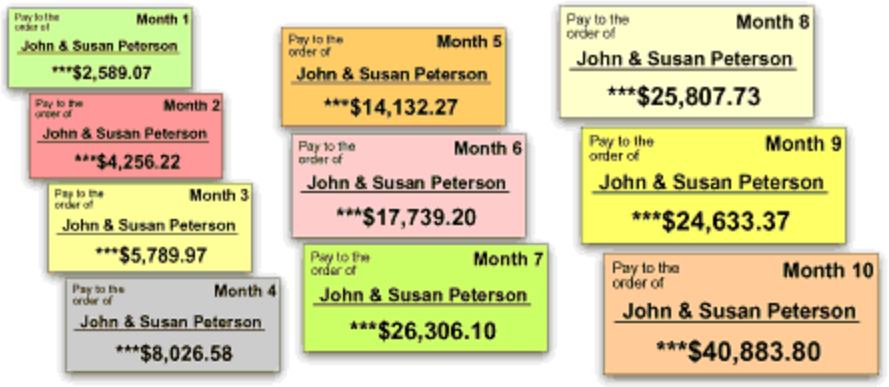
always done, which is to snub their noses at the FTC and engage in business as usual.

DSA Comments:

…some direct selling companies offer optional business tools to individual direct sellers. These tools include website templates or links to corporate websites and are intended to maintain brand uniformity and promote effective customer service.

Contrary to the DSA's position that distributor websites "are intended to maintain brand uniformity and promote effective customer service"; Short and simple--distributor websites are used to recruit consumers into MLM business opportunities.

Remember Susan Peterson's website (presented earlier in this letter)?
To refresh your memory, here it is http://www.lifebeauty.net/




The argument of MLMs is that they cannot control the websites of their "independent distributors"; therefore, cannot be held liable. Of course if they just did a google search (as I did) they would discover the earning claims made by

their distributors (in direct violation of Section 5 of the FTC Act). Also, the fact that the DSA could easily discover, as I did, the Section 5 violations of its members, casts doubt as to the validity of its missions to protect consumers.

INCOME CLAIMS ON HERBALIFE DISTRIBUTOR WEBSITES:

The websites I visited include the following and were representative of numerous other distributor websites visited.

http://www.earnextra.com/

http://www.mynewincome.com/testimonials.php

http://www.mynewincome.com/

Excerpts of income claims made on the above websites:

- The couple's gross earnings average $7,000 a month..
- I'm already averaging $7,000 a month.
- Our average monthly earnings are approximately $11,000 a month.
- We earn $8,000 a month on a full-time basis!
- Today, my business brings in about $7,000 a month-and I've only just begun!
- In our first 30 days we earned over $1,000!

So much for DSA's [false] statement that the purpose of distributor websites are to "maintain *brand uniformity and promote effective customer service.* The above makes me wonder what the DSA did in the year it used to analyze its member applicants business practices before being allowed the privileges of DSA membership.

DSA Comments:

DSA suggests a minor revision…regarding representations on the buyback of materials…The inclusion of "provides"…expands this definition too broadly and might cause confusion about its meaning. If "or provides" were struck from the

buy back provision, that element of the business opportunity definition could not be *misconstrued to inappropriately include direct sellers* who agree to buy back inventory…Clearly, this provision was not intended *to nor should it apply* to the repurchase of products from individuals who elect to end their direct selling activities and take advantage of this consumer/salesperson protection…

The DSA refers to this provision as being "misconstrued to inappropriately include direct sellers" (perhaps the author really meant misconstrued to inappropriately include 26 U.S.C. § 3508 statutory non-employees). A provision cannot be misconstrued to inappropriately include a category of business opportunity sellers that are not proposed for exemption from the Rule.

It is essential, for the protection of consumers, that the inclusion of "provides" remain in a final Rule. The FTC has no basis on which to rely (other then DSA's statement that it imposes a buy-back policy on its members) that the DSA even causes its members to buy-back material from distributors. DSA members are not scrutinized as to their compliance, or lack thereof, to the DSA Code. All the DSA requires of its members is that they "pledge" to abide by its code and standards.

DSA Closing Comments

DSA has proposed several amendments to the proposed rule…DSA has provided these brief comments and suggested modifications in an effort to continue our productive dialogue with the **FTC on how best to protect the American public without inadvertently burdening legitimate direct selling companies.** (Emphasis added)

DSA's arrogance and hubris was in full bloom was it stated that it is the entity that will guide **the FTC on how best to protect the American public without inadvertently burdening legitimate direct selling companies.**

Note to DSA: How could any provision of a final Rule burden legitimate direct selling companies given the fact that the FTC did not propose an exemption for direct selling companies (or for 26 U.S.C. § 3508 statutory non-employees)?

Since the DSA has set itself up as the arbiter of how the FTC can best protect the American public, I respectfully request that the FTC include in the Final Rule a mandate that all business opportunity sellers; direct sellers; MLMs and DSA members provide potential distributor recruits with the identical information the DSA requests of its members in connection with the number and turnover rate of their respect salesforce. http://vovici.com/wsb.dll/s/32ebg323d6

The DSA comments in connection with the original proposed rule made it sound like providing salesforce turnover data was an insurmountable task. Funny how when DSA needs the same data, it comes up with a simple 4 step calculation.

Number eligible to submit an order on January 1st

1) Plus: number recruited/added during year
2) Less: number dropped during year
3) Equals: number eligible to submit an order on Dec. 31st/ Jan 1st.

CONTINUED IN PART 2