CONSUMER AWARENESS INSTITUTE

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Research, education, and advocacy for consumers on selected issues

May 24, 2009

Urgent Attn: Kathleen Benway, Staff Member assigned to RPBOR, Federal Trade Commission
cc. Jon Liebowitz, Chairman, Federal Trade Commission
cc: Donald S. Clark, Secretary of the Commission, Federal Trade Commission
cc: John Seeba, Inspector General, Federal Trade Commission

FROM: Jon M. Taylor, MBA, Ph.D.

RE: Presentation at Workshop on RPBOR

It was announced In the April 24 issue of the Federal Register that the Workshop on the Revised Proposed Business Opportunity Rule (RPBOR) would last from 9am to 5pm. In your May 25 telephone call to me, you told me that the Workshop had been cut to four hours, and that three of the four hours would be devoted to the one-page form, and the last hour to "general issues" (Section II) related to RPBOR. You informed me that each of the seven panel participants would be allowed five minutes to express their concerns. As you would expect, I was struck with the seeming determination on the part of some FTC decision-makers to avoid significant discussion of key issues with RPBOR or with the rulemaking process as applied to it, by limiting time for discussion and by concentrating only on the one-page form.

On May 19 you called again, telling me that the number of panelists had been reduced to five, as some had pulled out – presumably because they could see the futility of participating under the aforementioned conditions. You said that with five panelists, the Workshop could be much shorter.

In the light of the foregoing, I am hereby requesting that the Workshop last the full four hours and that the time gained with the reduced number of panelists be constructively utilized to address substantive issues related to the form and with the rulemaking and to assuring that the final rule conform with the FTC's stated objective:

> *"The Federal Trade Commission works for consumers to **prevent fraudulent, deceptive, and unfair business practices and to provide information to help spot, stop, and avoid them.**" (FTC News April 21, 2009 – emphasis mine)*

Since I am the only independent (not financed by interested parties affected by RPBOR) consumer advocate on the panel speaking on behalf of consumers nation-wide – and to which the FTC is pledged to protect, you should have no objection to allowing me thirty (30) minutes to give an uninterrupted presentation on matters related to RPBOR that could have serious impact on consumers.

FTC personnel have given credibility to concerns of one interested party above all others – the Direct Selling Association (DSA), which has recently come to be dominated by MLMs (multi-level marketing companies). At the urging of the DSA and with form letters provided by them and their member MLMs to millions of participants in their respective pyramids of participants, the DSA has responded with about 17,000 comments. Now it is time for consumers who are regularly scammed by them to have their unspoken concerns represented regarding this bias against them in FTC rulemaking .

Below are at least ten concerns that cry out to be addressed on behalf of consumers nation-wide. My presentation at the Workshop will include, but may not be limited to the following:

1. Sufficient notice and time was not provided to parties interested in the Workshop, apparently to limit relevant information from advocates for consumers affected by RPBOR.

The following is noted in the April 24 announcement of the Workshop: "The public Workshop will be held on June 1, 2009, from 9:00 am to 5:00 pm . . ." The short time frame (five weeks) before the Workshop - is highly suspicious. This was to include proposals for – and selection of – Workshop participants and should also have allowed for scheduling of time and travel for participants selected.

When Kathleen Benbow called to invite me to be a panelist, she said the Workshop had been reduced to four hours, three of which were restricted to discussion of the form and only 5 minutes for each panelist to speak on other issues of concern regarding RPBOR. Three hours is more than enough time to consider the one-page form, but five minutes is inadequate time me to explain serious problems with the Rule and with the way in which the rulemaking process was carried out.

All of this adds up to apparent resolve on the part of some FTC officials to limit input on serious problems with RPBOR, occasioned by the apparent collusion by and between certain FTC officials – including the primary initiators and authors of the RPBOR notice –with the DSA in satisfying its desires to keep DSA members outside the ambit of the final Rule.

2. A false and misleading statement was made in the Workshop announcement regarding the MLM exemption in the notice of the Workshop.

In the Workshop announcement, the FTC states: ***"The RNBOR did not exempt MLMs from coverage of the RPBOR. . "*** (April 24 *Fed. Register*, Footnote 7) This statement was apparently inserted to acknowledge serious flaws in RPBOR, but with the hope that as a footnote it would escape notice.

This sentence is manifestly false! The RNBOR did effectively exempt MLMs from coverage of the RPBOR. As stated on page 18 (and elsewhere) of the RPBOR notice:

> *The MLM industry articulated concerns peculiar to its business model, but* ***these provisions would no longer apply to MLM companies inasmuch as these companies, and their representatives, are excluded from the ambit of the RPBOR.*** *(emphasis mine)*

Since the FTC included footnote 7 in the Workshop notice, which contained the false statement that "The RNPR did not exempt MLMs from coverage of the RPBOR," this topic has been noticed and is on record, in the Federal Register, as a topic properly included at the Workshop. And to be clear, I intend to direct questions to FTC personnel in attendance at the Workshop in connection with the aforementioned statement.

3. The FTC may have exceeded its authority in defining "business opportunity" so narrowly by excluding MLM in RPBOR.

In the announcement of the Workshop, the FTC also states: *". . . It [the RNBOR] narrowed the scope of the IPBOR by significantly revising Section 437.1 by redefining the term "business opportunity."* (April 24 *Federal Register*, Footnote 7)

The DSA is a lobbying and trade organization representing direct sellers in the United States, many of whom – especially MLMs – could be classified as business opportunity sellers. In 2007, according to the DSA, 98.2% of all individual sellers in the United States were compensated under an MLM compensation plan, leaving only 1.8% compensated under a single level compensation plan. (http://www.dsa.org/pubs/numbers/07gofactsheet.pdf) And in 2007 the DSA claimed to have 285 MLM

direct sellers whose collective MLM sales forces total 15 million distributors. This would suggest that DSA members comprise by far the largest group of business opportunity sellers in the United States. The FTC notice states: "Business opportunity ventures include vending machine routes, rack display operations, and medical billing ventures." To anyone familiar with the business opportunity market, complaints about these three represent only a tiny percentage of problems needing consumer protection.

There is a real question as to whether or not the FTC even has the authority to define business opportunity so narrowly as to limit the Rule to such a miniscule portion of the marketplace of business opportunities; i.e., non-MLM sellers. This makes about as much sense as a Franchise Rule exempting all food services because requiring them to disclose information might contribute to world hunger

4. The suggestion in the Workshop announcement that disclosures by MLMs would not help consumers is manifestly false.

In the April 24 announcement of the Workshop, the FTC stated in Footnote 7:

> *The RNPR noted that while some MLMs do engage in unfair or deceptive acts or practices, including the operation of pyramid schemes or unsubstantiated earnings claims that cause consumer harm, commenters generally agreed that the IPBORs required disclosures would not help consumers identify a fraudulent pyramid scheme.*

In my comments regarding IPBOR, I suggested that MLMS would attempt to circumvent honest disclosure in such a Rule, such as Nu Skin has done in its compliance with the 1994 Order for Nu Skin to cease its misrepresentations of earnings of distributors. When MLMs do disclose earnings, they do everything they can to report in such a way as to disguise the truth; viz., that it is extremely rare for anyone to realize a net profit from their pay plan. However, I was in no way suggesting that such disclosures could not help any consumers identify a fraudulent scheme. Some sophisticated consumers may understand the statistics. And such data could be analyzed, debunked, and reported by independent analysts and then conveyed on to consumers. This would not be possible if no data were made available.

Of course, nearly all the DSA/MLM commenters "generally agreed that the IPBORs required disclosures would not help consumers identify a fraudulent pyramid scheme." This response from MLM parties should have been expected, as the last thing MLM promoters want is for the truth to be made obvious – that they are unprofitable for all but the founders and a few TOPPs (top-of-the-pyramid promoters). But regardless of the number of MLM proponents who agreed that disclosure would not help consumers, this should not be accepted by the FTC as fact, but recognized for what it is – desire by MLMs to protect their capability to continue defrauding consumers without regulatory scrutiny.

5. The cost effectiveness of a Rule promoting transparency – vs. utilizing Section 5 on a case-by-case basis – was ignored in RPBOR. Without massively increasing the personnel at the FTC, it would be impossible to keep up with the MLMs that are forming every year, many if not most of them violating Section 5.

In the April 24 announcement of the Workshop, the FTC also stated in Footnote 7:

> *In the RPBOR, the Commission stated its belief that consumer harm flowing form deceptive practices in the MLM industry could be more effectively addressed through the use of Section 5 of the FTC Act.*

As a business model predicated upon infinite expansion (endless chain of recruitment) in a finite marketplace, MLMs are inherently flawed, uneconomic, and fraudulent. In spite of this mathematical reality, the FTC admitted in the RPGOR announcement that the FTC had used Section 5 in actions against only 14 MLMs in the past ten years. However, FTC officials were in a position to know of the research I

cited in my comments proving that at least 250 MLMs (out of over 1,000 extant, according to some industry observers), are currently violating Section 5 and that at least 81 of these are members of the DSA, which has so vigorously objected to a rule requiring their members to provide greater transparency to protect consumers against unfair and deceptive practices.

Extensive research I and others have performed (reported on mlm-thetruth.com) has demonstrated that the compensation plan of an MLM can determine the extent to which a program depends upon aggressive recruitment by new recruits of a large downline of self-consuming participants in order to profit from the scheme. When this is the case, the MLM is merely a money transfer scheme. (See FTC Staff Advisory letter dated January 14, 2004, from James Kohm to DSA president Neil H. Offen). In other words, they are structured to transfer money from those at the bottom to founders and TOPPs. They accomplish this by using purchases of (usually overpriced) products to disguise or launder their investments in a product-based pyramid scheme.

Such emphasis on revenues from "internal consumption" is positive proof that an MLM is conducting an unfair and deceptive practice in violation of Section 5. Please review the speech on "Pyramid Schemes" by Debra Valentine, General Counsel of the FTC, delivered May 13, 1998, sponsored by the International Monetary Fund. Note the section titled: "What is a Pyramid Scheme and What is Legitimate Marketing?" *Note that she asked what is legitimate marketing? – not legitimate multi-level marketing* – essentially an oxymoron to those who understand how sales and recruiting are incentivized in typical MLMs.

In every MLM for which I could obtain the compensation plan, I found five causative and defining characteristics of a recruiting MLM, or product-based pyramid scheme. Please read my *"5 Red Flags: Five Causative and Defining Characteristics of Recruiting MLMs, or Product-based Pyramid Schemes"* on my web site – mlm-thetruth.com. This report is a summary of literally thousands of pages of research and feedback from all over the world. In every case where data was available on MLMs with these five red flags, the percentage of people losing money was about 99%. Robert Fitzpatrick of Pyramid Scheme Alert found essentially the same thing in his report *"The Myth of 'Income Opportunity' in Multi-level Marketing" (pyramidschemealert.org).* The FTC is in possession of this information as recorded in prior comments by myself and Mr. Fitzpatrick.

Since nearly every MLM I have studied (by now over 300) has these five characteristics, it can be assumed that the vast majority of all MLMs will also have these characteristics, making them likewise unfair and deceptive practices. Doug Firebaugh lists 585 MLMs at - www.passionfire.com/article10.html. Army Diller lists over 1,000 past and present MLMs at - www.armydiller.com/financial-scam/links.htm#complaintsmlm

Even if we assume that the number of MLMs with compensation plans that suggest they are mere money transfer schemes – or product-based pyramid schemes – totaled only 500, with at least 50 new schemes originating every year (I personally encounter about one new MLM every week), it would be impossible for the FTC to keep up with them using Section 5 on a case-by-case basis. At the rate of 14 cases every ten years, **applying Section 5 would require 357 years for the FTC to act against the existing base of MLMs, and the FTC would have to increase its staff at least twentyfold just to keep up with fraudulent new MLMs forming every year. The DSA recognizes that it is in its members' best interest to get the FTC to exclude them from having to make meaningful disclosures, and to instead fall back on Section 5, since it would make the threat that any their many members (violating Section 5) would have to deal with FTC regulation rare to non-existent. By the time the FTC finally got around to investigating any given MLM using Section 5, all the principals would likely be long dead.**

The Business Opportunity Rule requiring meaningful disclosure by ALL sellers of business opportunities would be far more cost effective than exempting MLMs from the Rule – and instead relying upon section 5 to protect against unfair and deceptive practices. I would seriously doubt that had the Commissioners been informed of this reality, they would have voted 4-0 in favor of RPBOR. The exemption of MLMs is not consistent with the FTC's practice of using industry-wide rules to more efficiently discourage unfair and deceptive practices than relying just on case-by-case enforcement.

6. The Revised Rule will apply to essentially no business opportunity seller, and will provide no significant consumer protection. Given this fact, discussion of the options for the final form discussed in this Workshop is irrelevant.

According to the Revised Rule[1], all Business Opportunities that pay commissions to 2 or more individuals as the result of a sale of the company's products or services are MLMs for purposes of the proposed MLM exemption. Given the facts that (1) there are few, if any, business opportunities sellers ("direct sellers") that do not currently engage in this practice and that (2) the minuscule number of sellers that do not engage in same will do so to gain exemption from the ambit of a final Rule, **the end result, if the MLM exemption is included in a final rule, will be a Business Opportunity Rule that will exclude virtually every single business opportunity in the US from the ambit of the Rule. The FTC could thereby be complicit in aiding and abetting massive consumer fraud by direct sellers.**

7. The RPBOR and the whole rulemaking process for a Business Opportunity Rule have been corrupted by ex parte communications between FTC officials and the DSA.

After the comment period closed for RPBOR, I and other parties sought to give additional input to correct facts regarding interpretation of prior comments. Such communications were refused on the grounds that they would be ex parte communications. However, in a DSA revenue generating event after the close of the comment period, certain FTC officials met with DSA members on October 23-24, 2008, in Alexandria, Virginia. Details of this ex parte communications are included in the Notice of Corruption supplied with this letter.

This ex parte communication is just one more strong piece of evidence of collusion between certain present and former FTC officials and the DSA. This is added to the attempts to influence the IPBOR by comments from former high level FTC officials, including Timothy Muris, Howard Beales III, and Jodi Bernstein. This also raises the question of what direct or implied enticements DSA members have offered to current officials for supporting the MLM exemption in promises of lucrative consulting jobs, etc., following FTC employment. This and related corruption of the rulemaking process deserve Congressional investigation. At the very least, the Commissioners should be asking how it is that certain FTC officials have allowed the DSA to roam so unbridled over the rulemaking process.

8. The acceptance of the "too great a burden" argument against a one-page disclosure form by MLMs is such an obvious absurdity that only FTC officials partial to the DSA/MLM lobby or those unaware of other disclosure requirements, such as franchises or securities, would have accepted it.

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[1] Footnote 34 at bottom of page 15:

"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. Policy & Marketing (Spring 2002), ("Vander Nat and Keep") at 140. See rebuttal to DSA Comments part 1:
http://www.ftc.gov/os/comments/bizoprevised/rebuttals/535221-00081.pdf

The FTC requires a Franchise Disclosure Document by franchisors be supplied to prospective franchisees that can be hundreds of pages in length. The IPBOR would have required only a single page disclosure form (plus any supporting information of average earnings, etc.) be provided by business opportunity sellers. But the DSA/MLM and their minions protested it would be "too great a burden" to supply each prospect with only a couple pieces of paper provided by the company. This makes about as much sense as the FTC not requiring franchisors to provide a Franchise Disclosure Document – or the SEC exempting all private corporations from having to publish annual and quarterly reports because it would place "too great a burden" on them to comply.

The "too great a burden" argument is so absurd as to not require further comment, yet the RPBOR clearly shows FTC officials accepting it, again suggesting collusion between certain FTC officials and the DSA/MLM lobby.

9. For the RPBOR form, the most important disclosure a business opportunity seller can provide is breakdown of earnings of participants. False earnings claims are typical of MLM sellers, so MLMs must not be excluded from the Rule.

After reading FTC IPBOR, RPBOR, and related materials, one can safely conclude the following:

1. The making of false earnings claims is the most prevalent problem in the offer and sale of business opportunities.
2. The making of false earnings claims underlies virtually all fraudulent business opportunity schemes.
3. Earnings claims lie at the heart of business opportunity fraud, and are typically the enticement that persuades consumers to invest their money.
4. Earnings claims are highly relevant to consumers in making their investment decisions and typically are the single most decisive factor in such decisions.
5. Earnings claims are the most salient feature of sales (and recruiting) presentations made by business opportunity sellers.
6. Pyramidal business opportunities, or MLMs, often deceive consumers with the promise of large potential income and are thereby highly successful in attracting prospective investors.
7. By far, the most frequent allegations in business opportunity cases pertain to false or unsubstantiated earnings claims.
8. The FTC has brought over 140 cases against a multitude of business opportunities and related schemes (including MLMs and pyramid schemes), each of which lured unsuspecting consumers through false or deceptive earnings representations.
9. Narrowing the definition of "earnings claims" could weaken protections regarding the most salient feature of the sales presentation by allowing sellers to avoid disclosing the average incomes of participants at ascending levels in the pay plan.
10. For MLMs, the impetus for making false income claims is the compensation plan which incentivizes promising whatever will entice prospects to join one's downline.

According to the FTC, the catalyst for making false earnings claims is the MLM compensation model "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." (Revised Rule, p. 15)

This all adds up to the necessity, not just advisability, to include MLMs in the Rule, primarily to assure meaningful disclosure of average earnings of participants at the different levels in the pay plan. This is essential to protect against unfair and deceptive practices, especially false earnings claims.

10. Considering the above, the Workshop is a sham, and the form is irrelevant. In exempting MLM from the Rule to satisfy the DSA, the FTC is abandoning its mission to protect consumers from unfair and deceptive practices.

As an analyst and advocate for the tens of thousands of victims and their families who have visited my web site (www.mlm-thetruth.com, as well as www.pyramidschemealert.org – for which I am an advisor), I understand that there is ample reason for the DSA to so vigorously object to requiring transparency among its members. Those reasons are all tied to the FTCs role to "prevent fraudulent, deceptive, and unfair business practices and to provide information to help spot, stop, and avoid them." The DSA thereby presents a direct challenge to all that the FTC is about.

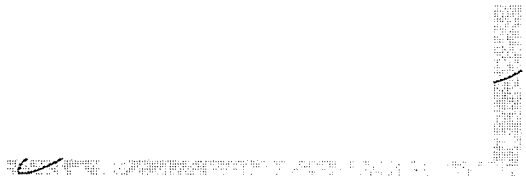
As one who has by now studied the compensation plans of over 300 MLMs, I can testify that **virtually all MLMs employ a business model that assumes infinite expansion in finite markets, which makes them inherently flawed, uneconomic, and fraudulent**. What should surprise FTC officials is that there were only 17,000 comments out of approximately 30 million participants (according to the DSA) in several hundred MLMs, some with gigantic pyramids of participants – all hoping to eventually earn a profit, but with less than 1% ever receiving enough to exceed their expenses; i.e., meeting quotas of product purchases, training costs, and minimal operating expenses. In other words, for those MLMs for which reliable data is available, approximately 99 out of every 100 participants lose money. And yet these same MLMs are promoted by sellers as the answer to consumers' financial woes. **MLM is almost by definition (infinite expansion within finite markets) an unfair and deceptive practice**, and in addition is both **viral** (all are built up by an endless chain of aggressive recruitment) and **predatory** – taking advantage of the most vulnerable populations among us. If FTC staff were to attend (unannounced) very many MLM recruitment rallies, as I have, they would see the truth of all that I am saying – and reporting on my web site. With 99% doomed to financial loss, why would FTC officials cave to the DSA's demand to be excluded from the RPBOR? Their motivation must be examined.

In summary, the purpose of my presentation would be to prevent the FTC from pursuing a disastrous course in abandoning its mission to protect consumers by yielding to the enormous pressure placed upon certain FTC officials by the DSA. Relying on Section 5, rather than the Rule for MLMs would be allowing consumers to be victimized by endless chains of MLM recruiters, and then left like sheep wandering without protection in an enclosure full of wolves.

Please respond to my request for 30 minutes of presentation time by Wednesday afternoon at 4:00 pm EST, so that I can be properly prepared. It would also be helpful to know if you can make available a computer projector to project a Power Point presentation.

Considering that the final Rule could have a major impact on the mission and reputation of the FTC, I respectfully request that Commission Chairman Jon Liebowitz attend – at least my presentation. And considering the possible violations of rulemaking procedure and ethics by certain FTC employees, I would request that Inspector General John Seeba be there as well. Also, considering the magnitude of these issues, I respectively request that you make this letter part of the rulemaking record for RPBOR. Thank you for your attention to this matter.

Sincerely,



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