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CONSUMER AWARENESS INSTITUTE

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COMMENTS ON FTC'S RPBOR WORKSHOP JUNE 1, 2009: The Revised Business Opportunity Rule Is Invalid and Must be Vacated.

By Jon M. Taylor, MBA, Ph.D.
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What began as a consumer-friendly Business Opportunity Rule (IPBOR) quickly degenerated into a corrupt rulemaking procedure, manipulated by the DSA (Direct Selling Association), a lobbying organization now dominated by MLMs (multi-level marketing companies). As a result, the Revised Rule (RPBOR) is invalid and will provide little consumer protection, thanks to the DSA and complicit FTC officials. Below are some of the reasons for this conclusion:

1. False and misleading statements of material facts

Below is just one crucial and glaring example among many of falsehood with the imprint of the DSA. Either A or B below is true, but not both.

A. In the text of the Federal Register Notice for the Workshop, and for the Revised Rule, the following is noted about the Revised Rule:

1) (RPBOR) narrows the scope of the proposed Rule to avoid broadly sweeping in sellers of multi-level marketing opportunities. (Workshop Notice, Footnote 7)
2) In addition, the revised proposal does not attempt to cover MLMs. (In Section C. Scope of the Proposed Rule – 1st paragraph)
3) The Commission does not believe it is practicable or sufficiently beneficial to consumers to attempt to apply the proposals advanced in this rulemaking against multi-level marketing companies. (In Section C-2 The MLM Industry: Scope of the Proposed Rule)
4) The Commission takes MLM companies out of the ambit of the Rule.
5) 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.*** (Section D-2-d)

B. In stark contrast to the above, the following is found in Footnote 7 on page 3:

The RNPR did not exempt MLMs from coverage of the RPBOR. *Instead, it narrowed the scope of the IPBOR by significantly revising Section 437.1 by redefining the term*

"business opportunity." 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,[MLM]commenters generally agreed that the IPBOR's required disclosures would not help consumers identify a fraudulent pyramid scheme. In the RNPR, the Commission stated its belief that consumer harm flowing from deceptive practices in the MLM industry could be more effectively addressed through the use of Section 5 of the FTC Act. . .

If A (above) is true, the opening statement for B is false. If B is true, A is false. Either way, one or the other is false and misleading to the public.

2. In all of the Rulemaking procedures, from the original IPBOR announcement to the June 1 Workshop, I was struck with how much the FTC has underestimated the scope of and the harm done by MLM schemes, which may (or may not) be excluded from the Rule.

The DSA claims that the vast majority (98.2%) of direct sellers are now using a multi-level pay structure and that there are over 15 million people selling over $30 billion in products and services using a direct selling model[1]. If we assume these DSA figures are correct, and if we use figures on MLM loss rates from analyses from qualified independent analysts of approximately 99%[2], the losses to consumers are staggering. **In the aggregate, millions of MLM participants are losing tens of billions of dollars every year in the U.S. alone. To exempt this leading class of business opportunity fraud from the Business Opportunity Rule is unthinkable to any informed consumer advocate.**

Those familiar with the harm done by MLMs, including DSA members, often ask why law enforcement at both state and federal levels seem unaware of the extent of the losses. My answer from having worked with victims worldwide is not the obvious one often given out – embarrassment at having not succeeded at "making the plan work." Most are not aware that they have been scammed unless and until they have gone through some deprogramming, similar to what is done with victims of cults.

Perhaps the strongest explanation for the lack of law enforcement action against MLMs is that victims of endless chain business opportunity schemes rarely file complaints. This is because nearly every major victim has of necessity become a perpetrator – having recruited some of his close friends and family in the hope of eventually recouping enough in commissions to meet their ongoing purchases necessary to qualify for commissions and/or advancement in the scheme. So they fear going public for fear of consequences from or to those who they recruited or persons who recruited them – often close family or friends.

MLM is perhaps the cleverest con game of all time. The very people who are perpetrators are themselves victims until they run out of money and drop off the vine. And since they don't complain, law enforcement does nothing. So the game goes on.

3. The Revised Rule will apply to no one and will therefore provide no consumer protection against unfair and deceptive practices, which the FTC is pledged to protect.

In her closing comments, Ms. Morrissey applauded the Commission and Staff for narrowing the scope of the proposed Business Opportunity Rule. Other DSA members present were obviously please with this apparent exclusion. (I say apparent advisedly, given #1, above)

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[1] DSA Industry statistics – www.dsa.org

[2] Available for download at www.mlm-thetruth.com and www.pyramidschemealert.org

However, according to the Revised Rule[3], all Business Opportunities that pay commissions to two 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.**

As explained in earlier comments and in FTC announcements regarding both IPBOR and RPBOR, fraudulent practices are common in business opportunity schemes. By exempting virtually all such schemes through RPBOR, the FTC could thereby be complicit in aiding and abetting massive consumer fraud by direct sellers of "business opportunities" -- many of them members of the DSA, which is the lobbying group primarily responsible for the MLM exemption. With RPBOR, the FTC is clearly siding with the DSA in direct contradiction to its responsibility to protect consumers from unfair and deceptive practices.

4. 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 these ex parte communications are included in the Notice of Corruption at the end of these comments. It should also be noted that **no transcript has been provided by the FTC of such ex parte communications where the Business Opportunity Rule was discussed.**

These ex parte communications are just one of many strong pieces of evidence of collusion between certain present and former FTC officials and the DSA. Another revealing example is the attempt to influence the IPBOR by comments on behalf of DSA members from former high level FTC officials, including Timothy Muris, Howard Beales III, and Jodi Bernstein. It is very disturbing to us as consumer advocates to see this radical transformation by these officials we once trusted from consumer protection to fraud protection.

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 procedure 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.**

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[3] Footnote 34 of the RPBOR announcement:

"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.' "[illegible] 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 a;lso rebuttal to DSA Comments, Part 1: www.ftc.gov/os/comments/bizoprevised/rebuttals/535221-00081.pdf

5. Other rulemaking irregularities include refusal to answer one key question at the Workshop, while responding to others.

At the June 1 Workshop, Ms. Benway answered Mr. Hailey's question about the legal action section of the form – and even discussed Tupperware's lead generation system with Ms. Morrissey (to whom was shown great deference and who was allowed to pitch both Tupperware and the DSA), as well as defending her use of the DSA Code of Ethics, but refused to answer my question about the obvious contradiction discussed in #1 above.

6. The cost effectiveness of a Rule promoting transparency – vs. utilizing Section 5 on a case-by-case basis – was ignored in RPBOR. Without hugely 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 showing evidence 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 (Top-of-the-pyramid promoters). 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? – <u>not</u> legitimate multi-level marketing* –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. 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 make them merely 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 tenfold 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 of 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 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 on case-by-case enforcement.

7. 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.

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.

Several panel members at the workshop referred to the issue of the burden of disclosing certain information on a one-page form to those being sold Business Opportunities. However, 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 just one of many put forth by the DSA and its many minions and accepted by the FTC. 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 raising serious questions about the motivation behind such cooperation between certain FTC officials and the DSA/MLM lobby. Two and two do not equal five, even if 17,000 commenters claim it is so.

9. The suggestion in the Workshop announcement that disclosures by MLMs would not help consumers is a manifestly bogus argument – as are other arguments for exempting MLM from the Rule. Two and two do not equal five, even if 17,000 commenters claim it is so.

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[4]. 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

[4] See REPORT OF VIOLATIONS of the FTC Order for Nu Skin to case its misrepresentations of distributor earnings, linked from the Law Enforcement page of my web site – www.mlm-thetruth.com

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, reported by independent analysts, and then conveyed to consumers in print or online. This would not be possible if no data were made available.

Of course, nearly all the DSA/MLM commenters "generally agreed that the IPBOR's 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.

Other typical DSA arguments that were used to gain an exemption for its member MLM firms (many of which were reiterated by Ms. Morrissey and others at the workshop) include:

- Multi-level marketing is equated to legitimate direct selling. My analysis of over 300 MLM programs reveals that MLMs rarely incentivize direct selling to the public sufficiently to outweigh the enormous incentives to recruit a huge downline, which is where any profits are realized. Participants are primarily incentivized to do pyramid or chain selling, not direct selling.
- MLM is presented as a business with little risk, as the signup fee is small. But this is merely a ruse, as major ongoing incentivized purchases (often $50 to $300 a month) are required in nearly all MLMs in order to qualify for commissions or advancement in the scheme. And those who invest the most tend to lose the most – some many thousands of dollars.
- MLM companies who are members of the DSA are subject to its Code of Ethics. But members who were found guilty of conducting illegal pyramid schemes were members of the DSA in good standing at the time[5]. And it is clear from its Code of Ethics that the DSA allows pyramid or endless chains schemes among its membership.[6]
- Many MLM participants merely work part-time or seasonally to earn enough for Christmas or to meet other temporary needs. Only a person unfamiliar with the compensation plans of MLM companies would accept such a claim. All of the MLMs who are members of the DSA use compensation plans that require enormous full-time and long-term commitment to building and maintaining large downlines before they can realize significant profits. The only way a person could earn enough in commissions to exceed incentivized purchases and minimal operating expenses is if products were priced competitively to make possible sales to the general public. But my studies and those of other independent analysts has shown prices anywhere from two to six times as much as products sold through more standard outlets.

[5] Equinox, Trek Alliance, etc.

[6] **Pyramid Schemes (DSA Code of Ethics #6)** For the purpose of this Code, pyramid or endless chain schemes shall be considered consumer transactions actionable under this Code. **The Code Administrator shall determine whether such pyramid or endless chain schemes constitute a violation of this Code** in accordance with applicable federal, state and/or local law or regulation.

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- For the same reason, the DSA argument that many join one of their MLMs just to get the products at retail just does not hold water. Even at wholesale, the products cannot compete with alternative outlets.

Refer to my previous comments in IPBOR and RPBOR for other weak arguments put forth by the DSA and apparently accepted by the FTC to gain the MLM exemption. FTC personnel had access to all of the information rebutting with irrefutable evidence the fallacy of DSA arguments. If you take away these bogus arguments, there is no justification - for any informed official or analyst not sponsored by the MLM industry - for exempting MLM from the Rule. So this again calls into question the motivation of those FTC personnel who used these bogus arguments as justification for exempting MLM from the ambit of the Rule.

10. 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 IPBOR, RPBOR, the consultant's report on the BOR form, and related materials, one can safely conclude the following:

a) The making of false earnings claims is the most prevalent problem in the offer and sale of business opportunities.
b) The making of false earnings claims underlies virtually all fraudulent business opportunity schemes.
c) Earnings claims lie at the heart of business opportunity fraud, and are typically the enticement that persuades consumers to invest their money.
d) Earnings claims are highly relevant to consumers in making their investment decisions and typically are the single most decisive factor in such decisions.
e) Earnings claims are the most salient feature of sales (and recruiting) presentations made by business opportunity sellers.
f) MLMs as business opportunities, often deceive consumers with the promise of large potential income and are thereby highly successful in attracting prospective investors.
g) By far, the most frequent allegations in business opportunity cases pertain to false or unsubstantiated earnings claims.

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.
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.

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)

As independent analysts, both Robert Fitzpatrick[7] and I[8] have done extensive analyses based on the actual reports of average incomes of participants in MLM programs for which data is

[7] "The Myth of Income Opportunity in Multi-level Marketing" is available for downloading from the web site – www.pyramidschemealert.org.

available to prove that 99-99.9% of participants in their programs lose money. Even promoting such MLMs as income or business opportunities, when the odds of profiting are far greater for gambling in Las Vegas, is deceptive.

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.

11. If the Revised Rule (RPBOR) were enacted, consumers would be misled into believing that the FTC's Business Opportunity Rule provides protection against fraudulent, unfair, and deceptive practices, when in fact it will do just the opposite.

Since any business opportunity seller can easily qualify as an MLM and thereby gain exemption from the Rule, they will likely do so, leaving virtually no business opportunity sellers covered by the Rule. Also, it is not difficult to envision MLM promoters emboldened in their deceptive recruiting practices and saying to prospective recruits: "Our MLM is a legitimate business model. If it were not, it would certainly come under scrutiny by the FTC or other regulatory agencies set up to protect against unfair and deceptive practices."

While a Business Opportunity is certainly needed, this Revised Rule is not the answer, but could have extremely harmful unintended consequences for consumers. It would be far better for the FTC to scrap the Rule altogether than to let it go forward with the MLM exemption.

This is one of those cases in which **no rule is better than a bad rule.**

12. Considering the above, the Workshop was 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), 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

[8] Several reports on MLM loss rates are linked from the Statistics page on my web site – www.mlm-thetruth.com.

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 that MLMs be excluded from the RPBOR? Their motivation must be examined.

It is my hope that the FTC will stop 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.

IMPORTANT NOTE TO FTC STAFF:

Inasmuch as the transcript of the Workshop was not made available until one working day before this June 15 deadline, I reserve the right to comment further after more thoroughly analyzing the transcript.

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NOTICE OF CORRUPTION
of the Proposed Business Opportunity Rule

By Jon M. Taylor, MBA, Ph.D., Consumer Awareness Institute, and Advisor, Pyramid Scheme Alert

In April, 2006, in an effort to curtail false earnings representations and other abuses of business opportunity sellers, the FTC proposed a Business Opportunity Rule and invited comments from the public. However, a serious corruption of the rule-making process has occurred with respect to the original and a Revised Business Opportunity Rule[9], as outlined below.

1. The initial Proposed Business Opportunity Rule led to *over 17,000 comment letters*, the vast majority of them from MLMs (multi-level marketing companies) and participants in MLM/pyramid/chain selling schemes. They claimed the rule would threaten their livelihood. This is not surprising, since extensive research shows that *99% of participants in such schemes lose money*, and disclosure of meaningful information such as average earnings (or losses) of participants, would discourage prospective recruits from joining and buying into their programs. *It could dash any hope by participants in these schemes of recovering their investments and of eventually reaping a profit.*

2. *Yielding to extraordinary pressure*[10], in March, 2008, the FTC altered the proposed Rule to a Revised Business Opportunity Rule (RBOR) that would exempt MLMs[11]. To

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[9] In a press release posted on the FTC web site in April 2006, the FTC proposed –

. . . a rule to protect consumers from bogus business opportunities and further enhance law enforcement efforts in this area. The rule would cover business opportunities commonly touted by fraudsters, while minimizing compliance costs for legitimate businesses. Currently, the FTC brings law enforcement actions against fraudulent business opportunities under two laws, the Franchise Rule and the FTC Act. Neither is specifically designed for the unique scams that occur frequently with business opportunities. . .

The FTC concluded its press release by asserting its mission: "*The FTC works for the consumer to prevent fraudulent, deceptive, and unfair business practices in the marketplace and to provide information to help consumers spot, stop, and avoid them.*"

[10] *At least three of these letters came from former high level FTC officials who at one time worked in important position related to consumer protection.* To those of us advocating on behalf of consumers, *this turnabout from consumer protection to fraud protection is incredible, since MLM clearly is at the forefront of a business model which is clearly an unfair and deceptive trade practice (Section 5), costing tens of millions of victims worldwide tens of billions of dollars in losses every year.*

The FTC also received letters from 85 Congressmen, who had been successfully lobbied by MLMs to object to the inclusion of MLM in the proposed business opportunity rule. I have not checked their records of campaign contributions to see how much was donated to their campaigns by MLMs and the DSA (Direct Selling Association), *the organization that has aggressively lobbied for the weakening of statutes that protect consumers against pyramid schemes*. This happened in Utah, where I live, when DSA member firms donated extensively to key political figures to assure exemption of MLM from prosecution as pyramid schemes. *Whether or not they paid money to these Congressmen to*

independent consumer advocates who are aware of the research (not funded by MLM), this is ludicrous, since non-MLM business opportunity promoters that would be covered are relatively insignificant in comparison, and they do not have the reputation for massive fraud that is characteristic of the hundreds of MLM programs now operating.

3. The FTC proposed instead to use Section 5 to prosecute MLMs on a case-by-case basis. Based on prior experience with FTC inaction against hundreds of product-based pyramid schemes, we see this as totally unworkable. I have personally analyzed over 250 MLM programs and can assert that *virtually all of them are violating Section 5.* The FTC only has sufficient personnel to go after a small sample (less than 1-2%) of them, as in the past. To take one at a time would not only be impractical, but would facilitate the defrauding of millions of persons while waiting for the FTC to get to all the programs. In the meantime, hundreds of additional MLMs would have sprung up, as they are now doing, and millions of additional consumers would be victimized in the interim. No rule would be better than a bad rule, such as this one.

4. After the comment period for rebuttals of comments on RBOR) was closed, I twice emailed Monica Vaca at the FTC, who was at that time administering RBOR. I expressed some concerns about FTC interpretations of my earlier comments and about some unjustified attacks against me personally by an MLM proponent in his comments. Ms. Vaca responded by saying "*it would be inappropriate for staff to consider material that is not part of the rulemaking record."* My letters are quoted as Appendix A, and her letter is quoted as Appendix B.

5. An informant alerted me to an ex parte communication with at a "Legal Issues of the Day" seminar sponsored October 23-24 in Alexandria, Virginia – by the DSA[12]. One of the presenters was Lois Greisman, Associate Director of the Division of Marketing Practices at the FTC. Another was Lem Dowdy, FTC Attorney. As indicated in the DSA press release (Appendix C), this was not merely a one-way presentation. Note the following statement:

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assure their support, because of their huge numbers of participants in their endless chains of recruitment, their promises of jobs and votes can be very compelling.

[11] After intense lobbying by the DSA (which claims to have 285 MLM members and 13.3 million MLM distributors) to have MLM exempted from the Rule, the FTC proposed a Revised Business Opportunity Rule. In a press release posted on the FTC web site in April 2006, these changes were noted:

After evaluating the comments received on the April 2006 notice, the Commission has decided to issue an RNPR [Revised Notice of Proposed Rulemaking] that is more narrowly focused than the April 2006 proposal. As proposed now, the Business Opportunity Rule would still cover those schemes currently covered by the interim Business Opportunity Rule, and it would expand coverage to include work-at-home schemes. The revised proposal, however, would not reach multi-level marketing companies or certain companies that may have been swept inadvertently into scope of the April 2006 proposal.

[12] **DSA press release, program, and registration costs and restrictions.** See Appendix A for the DSA press release confirming the above. For the official announcement on the DSA web site, go to – http://www.dsa.org/press/press_releases/index.cfm?fuseaction=show_release&Document_id=1928
The full program can be accessed at –
http://www.dsa.org/press/misc/index.cfm?documentID=1808
Registration information can be accessed at –
http://www.dsa.org/forms/meeting/MeetingFormPublic/view?id=2C1DD00000076

" Attendees will have the opportunity to ask questions and engage in an open dialogue with these representatives, encouraging understanding between our industry and this important government regulator."

Note: *The ex parte meeting was a revenue-generating event for the DSA. Specifically, the DSA charged Active DSA members $575, Direct Selling Non-Members $2,975, and Supplier Non-Members $2,600. In an effort to ensure that individuals or entities that opposed the DSA position (in connection with the Rule) from gaining access to this event, the DSA did not allow the media or the public to attend the event.*

6. I wrote Monica Vaca, protesting this ex parte communication – which is clearly forbidden – as indicated in her July 23 letter to me (and as outlined in U.S.C. Title 5, governing, among other things, the conduct of employees of federal agencies to protect against abuses of the rule-making process such as this). My letter is in Appendix D and is followed by Ms. Vaca's response in Appendix E.

7. In addition, based on personal information and belief, other individuals advocating for consumers were told they could not communicate with FTC personnel about this matter pending the rule's promulgation. Therefore, apparently *the FTC gave preferential treatment, to the exclusion of other interested parties, to the DSA by the FTC's participation in the DSA ex parte meetings.*

8. In her response, Ms. Vaca attempted to persuade me that the DSA ex parte meeting (which she admitted was attended by Ms. Greisman) was "consistent with our [FTC] rule making procedures." In an attempt to further convince me that the DSA ex parte meeting was appropriate (in compliance with applicable law), Ms. Vaca stated that "FTC staff regularly speaks with . . . trade organizations . . . to provide information about activities going on at the agency that may be of interest to such groups, including our (FTC) regulatory initiates."[13]

CONCLUSIONS

The FTC had information at least four months before it participated in the DSA ex parte meeting that would have caused a reasonable person, not intent on protecting the DSA's 285 MLM members and their 13.3 million MLM distributors, to question the legality of the practices of DSA member firms.

By participating in the ex parte meeting with DSA members, FTC employees have corrupted the Rule and compromised the integrity and mission of the Federal Trade Commission. As you are well aware, as a matter of law, once a rulemaking process has been corrupted, any final Rule will be invalid.

There are individuals who believe that the FTC abandoned its duty to consumers – in favor of protecting the financial interests of the DSA and its members – because of substantial donations DSA member firms

have given to Republican lawmakers; including Republican lawmakers who wrote letters to the FTC in support of the DSA position in connection with the Rule. Others believe that Chairman Kovacic, who was appointed to his post by President Bush, allowed the FTC to abandon its duty to consumers as the ultimate "thank you" to the DSA and its members for their financial support of Republican lawmakers.

Whether these beliefs are real or perceived, the significant amount of contributions to Republican lawmakers, at the very least, gives rise to the appearance that these contributions have influenced the decision of the FTC in connection with the Rule – to the great detriment of consumers.

I have no basis on which to rely that Chairman Kovacic, Secretary Clark, or the Commissioners will take the appropriate action to Notice the public that the rulemaking process (in connection with the Rule) has been terminated for the reasons that gave rise to this event; i.e., corruption of the rulemaking process. If the Commission attempts to enact a rule under these circumstances, this information – along with additional information withheld from this writing – will be transmitted to certain interested individuals who have the power and authority to address this issue, with a view to protecting consumers; as opposed to protecting the financial interests of the DSA and its members.

Appendix A: Letter from Jon Taylor to Monica Vaca

From: jonmtaylor@juno.com [mailto:jonmtaylor@juno.com]
Sent: Wednesday, July 23, 2008 2:21 PM
To: Vaca, Monica E.
Subject: My July 21 email to you

Ms. Vaca -

Did you receive the email I sent July 21? If is repeated below in case you missed it. Please confirm that you received it.

BTW, you probably noticed that the 89% of the rebuttal comments on the RPBOR were from MLM victims or consumer advocates who believe a rule exempting MLM would be a great disservice to consumers, providing MLM fraudsters with the cover of assumed MLM legitimacy. RPBOR as proposed would certainly aid and abet MLM fraud by providing an opening to all scams to go with an MLM model to avoid honest disclosure that would protect consumers but hurt the scammers.

- Jon M. Taylor, MBA, Ph.D., President, Consumer Awareness Institute
and Advisor, Pyramid Scheme Alert

E-mail: jonmtaylor@juno.com

Web site for MLM research and guides - www.mlm-thetruth.com

July 21, 2008

Ms. Vaca -

By now you should be returned from your vacation - and to a mountain of emails!

Now that the comment period is closed, I feel a couple of comments are timely. On July 9, Len Clements of MarketWave, Inc., requested an extension of an additional two weeks for rebuttal comments. From other sources, I learned that he just overlooked the deadline and is looking for a chance to undertake a smear campaign to those of us who are advocating for consumers - as he has been doing for some time on the web. He can't directly challenge our research, as it is solid and based on the actual statistics and financial data provided by the MLM companies. So he attacks us personally - and often irrationally, calling us "anti-MLM zealots." We donate our time warning consumers against the worst scams partly because the incidence of such fraud is far beyond what law enforcement can cope with.

As for difficulty getting through to the FTC's page for submitting comments, the web address hasn't changed, and to my knowledge no one but him had difficulty getting through. And the fact that only a

small number of comments were registered is reflective of the victory of the DSA in getting MLM exempted from the Revised Rule. The millions of people in the DSA members' recruitment pyramids and chains of participants have no reason to file comments now.

However, as I explained in my rebuttal comments, those of us advocating for consumers are very concerned. The RPBOR without MLM will only encourage the worst scams to modify their programs to come under the MLM exemption. The inevitable result would be the proliferation of hundreds of the worst scams in history, with the FTC unable to keep up with the abuse - powerless to stop it on a case-by-case basis using Section 5. Both RPBOR and Section 5 could be rendered ineffective, especially if the FTC yields to DSA wording.

The FTC exempted MLM from the Rule, at least partly due to 17,000 comments from participants who claimed it would threaten their livelihood. But I would bet you or anyone $1,000 that if an independent

auditor took a random sample of 20 of the 17,000 MLM participants who submitted comments, even half could produce tax returns from 2007 showing a profit from MLM. These people who were encouraged to write in from templates provided them are nearly all hoping to some day gain enough in commissions to exceed their expenses. It is extremely rare for lower-level participants to ever report a profit on their taxes – nearly all lose money. This is substantiated by extensive research, as reported on my web site and that of Robert Fitzpatrick or Pyramid Scheme Alert.

One more thing. On page 20 of the FTC's "NOTICE OF REVISED PROPOSED BUSINESS OPPORTUNITY RULE" (RPBOR), I was quoted as saying that "although MLMs should be covered, the disclosures the Commission proposed in the IPBOR would be inadequate to remedy deceptive earnings claims."

I never suggested that average earnings should not be disclosed. I was merely referring to our experience with Nu Skin that even when an MLM company discloses information, it will do so in a deceptive manner. That said, it still needs to be disclosed so that persons who investigate them will have data to work from. We did that with Nu Skin and reported the results to the FTC and anyone else who was interested.

Again, MLMs have everything to gain by avoiding disclosure and should not be allowed to get away with it. And having a Business Opportunity Rule that excludes MLM would represent a terrible abrogation by the FTC of its responsibility to protect consumers and promote fair trade. Better to scrap the Rule altogether for now - pending further research - and a change to a more consumer-friendly administration.

- Jon M. Taylor, MBA, Ph.D., President, Consumer Awareness Institute
and Advisor, Pyramid Scheme Alert

E-mail: jonmtaylor@juno.com
Web site for MLM research and guides - www.mlm-thetruth.com

Appendix B: Email from Monica Vaca of the FTC to Jon Taylor

From:"Vaca, Monica E." <MVACA@ftc.gov>

To: <jonmtaylor@juno.com>

RE: My July 21 email to you

Wed, Jul 23, 2008 01:37 PM

Dr. Taylor,

I have received your emails. While I appreciate your input, please note that it would be inappropriate for staff to consider material (including emails) that is not part of the rulemaking record. We have received the comments and rebuttal comments that you submitted (and can be found on the web site), and these are on the rulemaking record. However, the comment and rebuttal periods have now closed.

Sincerely,

Monica E. Vaca

Attorney

Federal Trade Commission

Division of Marketing Practices

600 Pennsylvania Ave., NW

Mailstop H-238

Washington, DC 20580

202-326-2245

Appendix C: Announcement of FTC presentation at DSA's Direct Selling Seminar, at which the FTC's Proposed "Business Opportunity Rule" would be discussed

FOR IMMEDIATE RELEASE

FTC to Attend Direct Selling Legal Seminar

Senior staff members of the Federal Trade Commission (FTC), the all-important regulatory agency charged with consumer protection and marketplace oversight, will be in attendance at the Direct Selling Association's 2008 Legal Issues of the Day Seminar, being held October 23-24 in Alexandria, Va.

Lois Greisman, Associate Director of the Division of Marketing Practices at the FTC, and Lem Dowdy, Attorney, will be present at the seminar and will provide presentations to attendees on subjects including: the FTC's role related to direct selling, its most recent Business Opportunity Rule, the Commission's definition of a pyramid scheme, the "cooling-off" rule and more.

Attendees will have the opportunity to ask questions and engage in an open dialogue with these representatives, encouraging understanding between our industry and this important government regulator.

Members interested in attending this Seminar should visit www.dsa.org/2008legal/ for registration information.

Appendix D: Email from Jon Taylor regarding ex parte meeting between FTC and an interested party, the Direct Selling Association

From: jonmtaylor@juno.com [mailto:jonmtaylor@juno.com]
Sent: Monday, October 27, 2008 9:07 PM
To: Vaca, Monica E.
Subject: Please explain a contradiction - ASAP

Ms. Vaca –

Please explain something to me. Below is a press release from the Direct Selling Association announcing an ex parte meeting in which representatives from the FTC were presenting information and taking questions about the Proposed Business Opportunity Rule in a seminar closed to the media and to non-paying parties last week. The agenda is described in detail on the DSA website. Click here for the link.

You may recall my writing you on July 21 (see below) to correct some if what I felt to be a misinterpretation of my comments by the FTC in its proposal for a revised rule - and also to correct misleading information posted by one of those making comments.

You responded (complete email below) on July 23 as follows:

"I have received your emails. While I appreciate your input, please note that it would be inappropriate for staff to consider material (including emails) that is not part of the rulemaking record. We have received the comments and rebuttal comments that you submitted (and can be found on the web site), and these are on the rulemaking record. However, the comment and rebuttal periods have now closed."

This seems strangely contradictory to me. While the FTC is willing to engage in free exchange during a seminar on the subject of the RPBOR with a very interested party who has in interest in protecting its member firms from making full and honest disclosure, those of us working to warn and protect consumers from such questionable schemes are excluded from further input. How can you justify this?

Also, is the FTC and the DSA providing full and complete transcript and recording of the proceeding so that those of us advocating for consumers can provide rebuttal on their behalf? Is the proceedings and contents of the ex parte meeting (seminar) being entered into the Federal Register? And will these comments at the seminar - and rebuttal comments - be posted and publicly advertised so that others may comment and rebut?

Please respond ASAP.

- Jon M. Taylor, MBA, Ph.D., President, Consumer Awareness Institute
and Advisor, Pyramid Scheme Alert

Appendix E: Response by Monica Vaca of the FTC regarding ex parte meeting

10-28-8

Hello Dr. Taylor,

FTC staff regularly speaks with bar associations, consumer groups, and trade organizations, among others, to provide information about activities going on at the agency that may be of interest to such groups, including our regulatory initiatives. Such outreach is consistent with our rule making procedures. The Associate Director for Marketing Practices, Lois Greisman, did speak last week to DSA. If you have questions or concerns about her remarks, please feel free to call her at: 202-326-3402.

Also, please note that I am no longer the contact person on the Business Opportunity Rule. I have moved to another office, but the Division of Marketing Practices continues to work on the rule.

Sincerely,

Monica Vaca