MARTLAND & BROOKS, LLP
ATTORNEYS AT LAW
63 ATLANTIC AVENUE
3RD FLOOR
BOSTON, MA 02110

TELEPHONE: (617) 742-9720
FACSIMILE: (617) 742-9701

JOHN C. MARTLAND
DOUGLAS M. BROOKS

January 18, 2011

Jon Leibowitz, Chairman
Julie Brill, Commissioner
William E. Kovacic, Commissioner
Edith Ramirez, Commissioner
J. Thomas Rosch, Commissioner

Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

Comment on Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule (16 CFR Part 437) and Request to Reopen the Record

Dear Commissioners:

Please accept this comment on the Staff Report on the proposed Business Opportunity Rule issued on October 28, 2010, and my request that the Commission reopen the record for the reasons set forth below.

The Staff Report urges the Commission to take the final step in its slow, sad capitulation to the multi-level marketing ("MLM") industry. If adopted, the proposed Final Business Opportunity Rule ("FBOR") will exempt MLM firms from making the basic, simplified disclosures which other business opportunity sellers will be required to make. There is no basis for the MLM exemption; no basis for giving purchasers of MLM business opportunities less protection than purchasers of other types of business opportunities. The MLM industry has proven incapable of regulating itself, is rife with

fraudulent and deceptive earnings claims and has caused – and will continue to cause – untold financial harm and misery to the poorest and most vulnerable of the consumers which the Commission was formed to protect. It is painfully ironic that the business opportunity industry which is probably causing the worst public harm is the only one which has managed to exempt itself from the FBOR.

The Staff Report's assertion that the Commission's enforcement authority under Section constitutes "an effective tool to challenge unfair or deceptive acts in the MLM industry" (Staff Report at 21) is flatly contradicted by the Commission's own record of prosecuting MLM firms, all of which took place only after substantial numbers of consumers had been victimized and resulted in, at best, recovery of a small fraction of consumer losses. The Staff Report's assertion that the disclosures mandated by the FBOR will not enable consumers to differentiate between a legitimate MLM and a pyramid scheme (Staff Report at 20-21) is a *non sequitur* – the real issue is whether MLM firms, whether "legitimate" or otherwise, should be required to make the same sorts of disclosures that other business opportunity sellers are required to make. The Staff Report's assertion that "a uniform, industry-wide standard for providing earnings information" is not "feasible (Staff Report at 21 n.59) betrays an agenda which seeks to find justification for the MLM exemption, rather than an effort to find creative solutions to protect consumers from deceptive MLM earnings claims.

I urge the Commission to reject the FBOR and to reopen the regulatory record for the purpose of obtaining evidence concerning the feasibility of requiring MLM sellers to refrain from making fraudulent and deceptive earnings claims. Adopting the FBOR in its current form would be an exercise in futility, and – incidentally – a waste of the tremendous resources which the Commission has expended on its decades-long effort to regulate the business opportunity industry.

Statement of Interest, Background and Experience

I am an attorney in private practice in the Commonwealth of Massachusetts since 1982. I am a member of the Forum on Franchising of the American Bar Association. I have represented hundreds of franchisees and distributors in litigation involving traditional franchising and distribution businesses.

For the past 18 years I have devoted a substantial portion of my practice to representing the victims of deceptive MLM schemes. I have represented MLM distributors in putative and certified class actions in a number of cases, including *Webster v. Omnitrition International, Inc.*, 79 F.3d 776, 782 (9th Cir. 1996), *cert. den.* 519 U.S. 865 (1996); *Capone v. Nu Skin Canada, Inc.* Case No. 93-C-2855 (D.Utah); *Rhodes v. Consumers' Buyline, Inc.*, 868 F.Supp. 368 (D.Mass. 1993) ; *Jacobs v. Herbalife International, Inc.*, Case No. CV 02-01431 (C.D.Cal.); and *Minton v. Herbalife International, Inc.*, Case

No. BC 338305 (Cal.Super.Ct., Los Angeles Cty). In the course of my practice I have interviewed or deposed hundreds of participants in MLM schemes, reviewed tens of thousands of documents which were produced by MLM firms subject to confidentiality orders, and studied the compensation plans of scores of MLM companies.

I have worked *pro bono* for a number of non-profit organizations involved in the effort to educate and protect consumers from deceptive and fraudulent MLM schemes, including Pyramid Scheme Alert (www.pyramidschemealert.org), the Consumer Awareness Institute (www.MLM-thetruth.com), Quackwatch (www.quackwatch.com and www.mlmwatch.org), MLM Survivor (www.mlmsurvivor.com) and the Rick Ross Institute for the Study of Destructive Cults, Controversial Groups and Movements (www.rickross.com). Since 1995 my *pro bono* work has included a number of submissions to the Commission in its rule-making proceedings involving the Franchise Rule and proposed Business Opportunity Rule, in which I have argued for disclosure and conduct regulation of the MLM industry. I have not received any compensation for these efforts.

Pre-Sale Disclosures by Sellers of MLM Business Opportunities are Essential

As the Staff Report notes, "fraud in the sale of business opportunities is not only prevalent but persistent." (Staff Report at 5). This is not news; in the rule-making proceedings during the 1970's which led to the Franchise Rule, the Commission "found that franchise and business opportunity fraud was widespread, causing serious economic harm to consumers." (April 12, 2006 Notice of Proposed Rulemaking, 71 Fed.Reg. at 19055 ("NPR")). In the NPR the Commission noted that between 1997 and 2005 it had received 17,588 complaints concerning pyramid schemes, amount to over $46 million in aggregate losses. (NPR, 71 Fed.Reg. at 19061). These losses grossly understate the actual losses suffered by consumers since, in light of the Commission's own survey, only 1.4% of victims of any scheme report their losses, and victims of pyramid schemes are less likely to complain than victims of other types of consumer fraud. *See* FED. TRADE COMM'N, CONSUMER FRAUD IN THE UNITED STATES: AN FTC SURVEY 14 (2004), *available at* http://www.ftc.gov/reports/consumerfraud/040805confraudrpt.pdf, at 81.[1]

Several of the consumer advocates who have submitted comments in this rulemaking proceeding have demonstrated the existence of substantial consumer losses caused by the MLM industry, notably

[1] I would respectfully suggest that the next time the Commission conducts a consumer survey it should include a series of questions designed to determine how many consumers who purchase goods or services from an MLM distributor are not themselves also participants or prospective participants in that MLM. This information is key to determine whether MLM is a legitimate industry. My prediction is that the volume of MLM purchases by non-participants is very, very low.

those by Robert Fitzpatrick of Pyramid Scheme Alert and Dr. Jon Taylor of the Consumer Awareness Institute. Most recently, in his submissions responding to the Staff Report, Dr. Taylor has submitted his analysis of a large number of prominent MLM compensation plans, all of which suggest that over 99% of participants in such plans will lose their investments. MLM industry representatives discounted these analyses as "unsubstantiated" or "unverifiable." *See, e.g.,* Comments of Christine Varney. The Staff Report buys into this canard and asserts that

> None of the comments received provided an industry-wide analysis of pyramid schemes masquarading as MLMs. They ask the Commission to assume widespread fraud in the multi-level marketing industry, but offer no evidence. Instead, the comments that purported to present evidence that legitimate MLMs were in fact unlawful pyramid schemes provided only anecdotal evidence. CAI-RNPR; Pyramid Watch-RNPR; Aird-RNPR; Durand-RNPR; Johnson-RNPR. As the Commission noted in the RNPR, identifying a pyramid scheme (or, at least, one that attempts to disguise itself as a legitimate business opportunity) entails a complex economic analysis including an in-depth examination of the compensation structure and the actual manner in which compensation flows within an organization. See Vander Nat & Keep, supra note 15, at 149. There is no bright line disclosure that would help consumers identify a fraudulent pyramid from a legitimate MLM.

(Staff Report at 21 n.60).

These criticisms are unfair and disingenuous, when one considers that the very industry that accuses Dr. Taylor and Mr. Fitzpatrick of not including enough information in their reports is the industry with access to that information and it is the industry that is aggressively trying to keep that information hidden. If the industry would allow complete disclosure and transparency, then the actual results could be verified. Dr. Taylor and Mr. Fitzpatrick should be commended for their efforts to uncover the truth behind MLM earnings claims; they have attempted to fill the void left by the Commission's inability or unwillingness to act. It is within the power of the Commission to require MLM sellers, including the many who have submitted comments in these rulemaking proceedings, to produce actual, verifiable data concerning the earnings and losses of their distributors, especially since all of them make substantial earnings claims to prospective participants in their MLM systems. *See generally*, Pareja, Sergio, Sales Gone Wild: Will the FTC's Business Opportunity Rule Put an End to Pyramid Marketing Schemes?, 39 McGeorge L.Rev. 83 (2008).

The Staff Report's criticism of the consumer advocates' analysis of the losses caused by the MLM industry also muddies the waters by shifting the focus of the discussion from whether MLM firms are making deceptive earnings claims to whether MLM firms are operating as unlawful pyramid schemes. These are two distinct issues. The issue of whether a particular MLM firm constitutes a pyramid scheme may indeed entail a "complex economic analysis" which may not be susceptible to the simplified disclosure document contemplated by the proposed rule. But the record is clear that MLM firms represent themselves as selling "business opportunities," and all of them make representations concerning

the incomes which participants can expect to achieve. As business opportunity sellers, MLM firms should be subject to the same rules that govern other business opportunity sellers, including the requirement that their earnings claims should have some basis in reality. By arguing that Dr. Taylor, Mr. Fitzpatrick and the other consumer advocates have not established that all MLM firms are unlawful pyramid schemes – a straw man if there ever was one - the Staff Report sidesteps the issue as to whether deceptive earnings claims are endemic in the MLM industry. The record is crystal clear that they are. (NPR at 19060-61).

The dismal history of deceptive MLM marketing claims and substantial consumer losses should, at a minimum, be sufficient to justify requiring sellers of MLM business opportunities to provide the simplified pre-sale disclosures which the FBOR will impose on other business opportunity sellers. As the Staff Report notes:

> Like the Franchise Rule and the Interim Business Opportunity Rule, the RPBOR was posited on the notion that a fully informed consumer is in a better position to determine whether a particular offering is in his or her best interest. The proposed disclosure document would have provided prospective purchasers with information that is critical to making an informed purchasing decision. The RPBOR would not have regulated, nor was it intended to, the substantive terms of a business opportunity contract. Rather, it was designed to prevent fraud by prohibiting sellers from failing to disclose material information to prospective buyers. *It is beyond dispute that consumers should be protected against receiving inaccurate information and self-serving unsubstantiated claims from business opportunity sellers.*

(Staff Report at 20, emphasis supplied). I agree with the Staff Report on this point: purchasers of MLM business opportunities should receive critical information concerning the sellers and the opportunity being offered, and should be protected from receiving unsubstantiated and inaccurate earnings claims. Why then does the Staff Report and the Commission advocate exempting the MLM industry from the FBOR?

The Purported Justifications for the MLM Exemption Are Inadequate

My prior submissions, as well as those by Mr. Fitzpatrick, Dr. Taylor and others have addressed the sophisticated and expensive lobbying campaign waged by the MLM industry against the proposed business opportunity rule.[2] I will address here the purported justifications for the MLM exemption.

In support of the MLM exemption, the Staff Report recites the following:

---

[2] The Staff Report alludes to this effort, including the thousands of form letters submitted by participants in various MLM operations. (Staff Report at 7 n.16). Interestingly, "[o]nly one comment received [in response to the Revised Notice of Proposed Rule-Making] was from a non-MLM business opportunity seller" (Staff Report at 14). Given the burdens that the proposed rule will impose on business opportunity sellers, the fact that the other forms of business opportunities did not mount a similar attack on the proposed rule attests to their small size and lack of significance relative to the MLM industry.

> [T]he Commission acknowledged that some MLMs engage in unfair or deceptive acts and practices, including the operation of pyramid schemes and the making of false and unsubstantiated earnings claims. However, the Commission concluded, and we agree, that neither the earnings disclosure provided by the proposed Rule, nor alternatives proposed by commenters, would enable potential recruits to differentiate between a legitimate MLM and a pyramid scheme, or to inform consumers adequately about likely earnings. …
>
> While we take very seriously the commenters' concerns about pyramid schemes posing as legitimate MLMs, we are not persuaded that subjecting all MLMs to the Rule would allow consumers to differentiate between unlawful pyramid schemes and legitimate companies using an MLM business model.

(Staff Report at 20-21). In a footnote, the Staff Report adds:

> The Commission determined that in view of the differences in the structure of MLM programs, it might not be possible to prescribe a feasible, uniform, industry-wide standard for providing earnings information. 73 Fed. Reg. at 16,120. Furthermore, identification of the true earnings of participants is undermined by the incentives in many MLMs for participants to report manufactured sales in order to retain a favorable commission level. Id. It further determined that other disclosures required by the proposed Rule, such as prior recruits, are not likely to help potential recruits evaluate the risk of participating, because all participants in the MLM have a financial incentive to enlist new recruits. Id.

(Staff Report at 21 n.59). Accordingly, the Staff Report identifies three purported justifications for the MLM exemption:

1. The proposed disclosures would not enable prospective purchasers to distinguish between "legitimate" MLM operations and unlawful pyramid schemes.
2. Earnings disclosures by MLM firms would not be feasible.
3. The proposed rule's requirement for identifying existing participants whom prospective recruits could contact would backfire.

None of these reasons holds water.

As to the first justification, the difficulty in distinguishing between legitimate MLMs and pyramids is a *non-sequitur*. The proposed rule does not seek to dictate the terms of any business opportunity contract. Presumably if it did, it would outlaw forms of MLM which constitute pyramid schemes. The proposed rule has a more limited objective, which is to provide disclosures to prospective purchasers of business opportunities. The fact – if true - that the proposed disclosures will not enable consumers to identify potential pyramid schemes masquerading as legitimate MLM operations is beside the point. Accurate disclosures will enable consumers to make informed decisions about MLM business opportunities. If the "legitimate" MLM turns out to be a pyramid scheme, the Commission will still have its Section 5 remedy. *See also* Pareja, *supra*, 39 McGeorge L.Rev. at 116-17 (advocating for anti-pyramid scheme filings in addition to earnings disclosures by MLM firms). But the Staff Report's

reasoning would permit "legitimate" MLMs to make deceptive earnings claims merely because some MLMs turn out to be pyramid schemes.

The second justification is that MLM earnings disclosures would not be feasible. The Staff Report refers to two factors supporting this supposed lack of feasibility: (a) the differences among MLM programs and (b) the possibility that participants will "report manufactured sales in order to achieve favorable commission levels." (Staff Report at 21 n.59). Neither of these constitutes an obstacle to requiring MLM firms to have a reasonable basis for their earnings claims. The Staff Report's reliance on these factors suggests either an unwillingness to analyze MLM compensation plans or an agenda to look for excuses to avoid regulating the MLM industry. Differences in how franchise relationships are structured have not proven to be an obstacle to effective implementation and enforcement of the Franchise Rule, including its provisions governing earnings claims. Differences in how rack display, vending machine and other non-MLM business opportunities are structured are not anticipated to be an obstacle to the FBOR. Other than the conclusory, self-serving and highly suspect statements by MLM participants and apologists, there is no actual evidence in the record that supports a finding of lack of feasibility. If the objective of the Commission is to truly to provide consumers with the critical information they need in order to evaluate MLM business opportunities, and to protect them from deceptive earnings claims, then creative solutions exist and have been proposed, most notably by the submissions of Mr. Fitzpatrick and Dr. Taylor. *See also* Pareja, *supra*, 39 McGeorge L.Rev. at 115-16 (suggesting format for MLM earnings claim disclosure). Moreover, the original rule as proposed in the NPR did not attempt to shoe-horn all MLM firms into one rigid earnings claim format.

> The proposed Rule does not specify any particular format or formula for an earnings claim. Consistent with the Franchise Rule, the proposed Rule allows flexibility in presenting earnings information in the manner that is appropriate for each opportunity, provided that any such claim have a reasonable basis and that there be written substantiation for the claim at the time it is made, as noted above.

(NPR at 19072). This original, far-sighted approach by the Commission should have been a sufficient answer to industry claims that earnings disclosures were not "feasible."

As noted above, the Staff Report also asserts that the "manufactured sales" issue makes earnings disclosures unfeasible. This is a flimsy excuse. First of all, the only motivation for a MLM distributor to "manufacture" sales is to comply with the MLM firm's retail selling requirements. Second, the record is devoid of any evidence that such manufactured sales have any impact on actual earnings of MLM distributors. MLM firms studiously avoid collecting any information from their distributors concerning actual retail sales, probably because they do not want to know the truth – retail profits by their distributors

are non-existent. The Commission should not follow this head-in-the-sand approach. Rather, it should obtain information on the actual earnings of MLM participants, including what percentage of their incomes are derived from retail sales as opposed to commissions or bonuses based on sales to their downlines.

Finally, the Commission and the Staff Report accepted the argument by MLM firms that they should not have to disclose prior recruits to prospective purchasers because "all participants in the MLM have a financial incentive to enlist new recruits." (Staff Report at 21 n.59). This is utter nonsense, for two reasons. First, existing MLM participants have an incentive to recruit additional participants *only if the new participants will become part of their downline*. Second, given the person-to-person nature of MLM recruitment, a prospective recruit who has received the disclosure document *has already been recruited.* If the recruit decides to join the MLM, he or she will become part of the downline of the participant who recruited them. The "ownership" of new recruits by the participant who recruits them is treated as "sacred" by every MLM with which I am familiar. The typical MLM distributor agreement identifies the participant who recruited or "sponsored" the distributor, and the agreement usually contains a provision governing how any change in the distributor's "upline" may occur. Given the importance of recruiting to the income of MLM distributors it could hardly be otherwise. The "risk" identified by the Staff Report is non-existent and betrays a dismal lack of understanding of how MLMs work in the real world.

Conclusion and Request to Reopen the Record

The Commission has been attempting to provide some form of pre-sale disclosure for prospective purchasers of business opportunities since the adoption of the Franchise Rule in 1978. Sellers of MLM business opportunities have generally been able to avoid having to comply with the Franchise Rule, primarily because of the $500 minimum payment provision. The regulatory process to require disclosure from MLM firms began again in 1995 as part of a review of the Franchise Rule. I submitted a comment to the Commission at that time, urging some form of disclosure regulation of MLM. Now, after fifteen years of rulemaking proceedings, the MLM industry has apparently dodged a bullet, and will continue to evade public scrutiny of its deceptive recruitment practices. I urge the Commission to reconsider its adoption of the MLM exemption and to reopen the record for the purpose of determining the feasibility of requiring MLM earnings claims disclosures.

Respectfully submitted,

Douglas M. Brooks