



UNITED STATES OF AMERICA
Federal Trade Commission

Keynote of Commissioner Noah Joshua Phillips

Multilevel Marketing: The Consumer Protection Challenge

**The College of New Jersey School of Business
(virtual conference)**

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Thank you Bill for the kind introduction. I am happy to be here, albeit virtually. I wish I could be there in person, especially because my father grew up right across the street, on Pennington Road.

Today I am here to talk about Federal Trade Commission enforcement in the direct selling area and my take on agency cases and guidance. One caveat: the remarks I give today are my own and do not necessarily reflect the views of the Federal Trade Commission or any of my fellow Commissioners.

The goal of today's conference is to bring together expertise from concerned stakeholders, to put our heads together and come up with ways to improve consumer protection and reduce consumer harm within the MLM industry. I am pleased to participate, and I am thrilled that you will get the benefit of the expertise of some of the FTC's finest – both past and present -- Kati Daffan, Andrew Smith, Andrew Stivers and Peter Vander Nat.

For table setting purposes, it might be helpful to define some terms for the purpose of my remarks.

Generally, a multi-level marketer distributes products or services through a network of salespeople who are not employees of the company and do not receive a salary or wage. Instead, members of the company's salesforce usually are treated as independent contractors, who may earn income depending on their own revenues and expenses. Typically, the company does not directly recruit its salesforce, but relies upon its existing salespeople to recruit additional salespeople, which creates multiple levels of "distributors" or "participants" organized in "downlines". A participant's "downline" is the network of his or her recruits, and recruits of those recruits, and so on.

The FTC has historically recognized that multi-level marketing is not monolithic, with various participants employing many different structures and methods of selling to distribute all manner of products. Multi-level marketing may have certain benefits over traditional retailing, because it depends on direct relationships between sellers and consumers, can help companies to reach consumers that they would not otherwise be able to reach, and may allow for sales to consumers or communities who might be underserved by traditional retail. Multi-level marketing also can give consumers the opportunity to try to supplement their income.

Although there may be significant differences in how multi-level marketers sell their products or services, the FTC's work over the last year illustrates the

importance of hewing to the one of the most basic consumer protection principles: tell the truth.

Representations – by MLMs or their distributors – must be truthful, non-misleading, and substantiated. Some of the most shameless violations of this core principle over the last year have come up in the context of companies and distributors taking advantage of the COVID-19 pandemic.

In April and June 2020, the FTC sent warning letters to a number of multi-level marketing companies to remove and address claims that they or their participants were making to tap into consumers' fears about their economic well-being and health during the pandemic.¹ Many distributors – and one company – capitalized on these fears and made clearly suspect and in all likelihood illegal claims about consumers' abilities to earn substantial income. The letters highlighted problematic language and reminded companies that express and implied earnings claims must be truthful and non-misleading to avoid being deceptive, and therefore unlawful under the FTC Act. This means that claims about the potential to achieve a wealthy lifestyle, career-level income, or significant income are false or misleading if business opportunity participants generally do not achieve such results. By generally, I do not mean the average or mean of what

¹ FTC Press Release, FTC Sends Warning Letters to Multi-Level Marketers Regarding Health and Earnings Claims They or Their Participants are Making Related to Coronavirus (Apr. 24, 2020), <https://www.ftc.gov/news-events/press-releases/2020/04/ftc-sends-warning-letters-multi-level-marketers-regarding-health>; FTC Press Release, FTC Sends Second Round of Warning Letters to Multi-Level Marketers Regarding Coronavirus Related Health and Earnings Claims (June 5, 2020), <https://www.ftc.gov/news-events/press-releases/2020/06/second-round-warning-letters-to-mlms-regarding-coronavirus>.

participants in a specific company earn – I mean what the typical distributor earns, which should factor in expenses rather than reflect gross income.

It's worth pausing on the important issue of earnings claims among MLM participants. As many of you know, the Direct Selling Association, or DSA, is a national trade association for companies that market products and services directly to consumers through an independent salesforce, including MLMs. The DSA itself has acknowledged that most MLM participants will not realize more than a very modest income.² And the law says that even truthful testimonials from participants who do manage to earn significant income or more will likely be misleading unless the advertising also makes clear the amount earned or lost by most participants. Again, this would require laying out what the typical participant can expect to earn after expenses – generally very little.

Based on testing done by the Commission, qualifications such as “results not typical” or “results based on experiences of a few people” are not enough to make clear that otherwise truthful statements about significant income are not the typical experience. In fact, after a consumer sees a claim about atypical earnings, it will likely be difficult to correct that consumer's impression with a disclaimer so

² In 2006, when commenting on the FTC's Business Opportunity Rule, the DSA cited a 2002 National Salesforce Survey showing that the majority of direct sellers made less than \$10,000 per year from direct selling, with a median annual gross income of about \$2,400 or only \$200 per month. Direct Selling Ass'n, Comments on the Notice of Proposed Rulemaking for the Business Opportunity Rule at 15 (July 17, 2006), available at https://www.ftc.gov/system/files/documents/public_comments/2006/07/52241812055.pdf. See also Joseph Mariano, Learning and Building on Collective Experience, DSA News (Sept. 1, 2016), available at http://directsellingnews.com/index.php/view/learning_and_building_on_collective_experience (DSA President cautioning that MLMs “must increase [their] efforts to ensure prospective distributors are fully aware...that for most, direct selling can [only] provide supplemental income. Most distributors will not realize replacement income, let alone a lavish lifestyle.”).

that you leave him or her with a truthful net impression. It all depends on the details, but it may be a difficult task to pull off. This is why the FTC advises that “it’s unwise for MLMs to make earnings claims – expressly or by implication – that don’t reflect what typical participants achieve.”³

Now, back to the warning letters. In addition to earnings claims, the marketplace was also rife with claims about certain products’ ability to treat or prevent COVID-19. That is dangerous stuff. Warning letters we sent cautioned these MLMs that it is unlawful under the FTC Act for them – or their distributors – to advertise that a product can prevent, treat, or cure COVID-19 unless they possess competent and reliable scientific evidence. This includes, when appropriate, well-controlled human clinical studies, substantiating that the claims are true at the time they are made. For COVID-19, no such studies existed for any of the products at issue. The FTC warned the letter recipients immediately to cease making the unsupported COVID-19 claims.

These letters also set forth another important reminder: companies are responsible for the claims of their business opportunity participants and representatives. The compensation structure of a multi-level marketing entity may create incentives for its participants to make certain representations to current or prospective participants. The FTC has cautioned MLMs that they are therefore

³ See FTC Blog Post, Redress checks and compliance checks: Lessons from the FTC’s Herbalife and Vemma cases (Jan. 10, 2017), <https://www.ftc.gov/news-events/blogs/business-blog/2017/01/redress-checks-compliance-checks-lessons-ftcs-herbalife?page=1>; FTC Press Release, FTC alleges Neora, formerly known as Nerium, operates an illegal pyramid scheme (Nov. 4, 2019), <https://www.ftc.gov/news-events/blogs/business-blog/2019/11/ftc-alleges-neora-formerly-known-nerium-operates-illegal>.

obliged not only to *instruct* their participants not to make false, misleading, or unsubstantiated representations but also to *monitor* their participants so they do not make such misrepresentations.

I am pleased that others – in particular, the BBB’s Direct Selling Self-Regulatory Council and the DSA – recognize the importance of reiterating these same messages to members of the direct selling industry. Last year, they cautioned direct selling companies and their salesforce members to ensure that all claims made about health-related products are accurate.⁴ I commend both organizations for reinforcing the important message that, because claims made by salesforce members are attributable to direct selling companies themselves, it is incumbent upon selling companies to educate their individual sellers about best practices with respect to product and earnings claims.

As I mentioned earlier, multi-level marketing – done correctly – can benefit distributors and consumers. But an overemphasis on recruiting can easily turn a multilevel marketing company into a pyramid scheme. A pyramid encourages recruitment of new participants into the business opportunity, without regard to whether those new participants have a meaningful retail sales opportunity, and rewards participants for recruiting rather than for real sales made to real customers.

⁴ Press Release, BBB National Programs’ Direct Selling Self-Regulatory Council and Direct Selling Association Urge Caution Regarding Health-Related Product Claims (Apr. 7, 2020), <https://bbbprograms.org/media-center/press-releases-details/bbb-national-programs-direct-selling-self-regulatory-council-and-direct-selling-association-urge-caution-regarding-health-related-product-claims>.

Recently, several cases filed by the FTC have alleged illegal pyramid schemes, along with deceptive earnings claims. Even though some of these cases are currently in litigation, highlighting some of the facts alleged can be useful in identifying some of the “red flags” of pyramid schemes and deceptive earnings claims.

I will start with one of our most notable settlements that demonstrates the FTC’s commitment to addressing consumer harm in this arena. In October 2019, the FTC announced settlements with AdvoCare International, its former chief executive officer, as well as two of its top promoters.⁵ In the three-count complaint, the FTC alleged that defendants operated an illegal pyramid scheme, made income misrepresentations, and provided the means and instrumentalities for its distributors to do the same.

As set forth in the complaint, under the AdvoCare compensation plan, participants were charged \$59 to become a distributor, making them eligible to receive discounts on products, and to sell products to the public. To earn meaningful compensation, however, participants had to become “advisors,” which typically required them to spend between \$1,200 and \$2,400 purchasing AdvoCare products, and accumulate thousands of dollars of product purchase volume each year, according to the complaint. The income of AdvoCare advisors allegedly was based on their success at recruiting, with the highest rewards going to those who recruited the most advisors and generated the most purchase volume from their downline.

⁵ FTC Press Release, Multi-Level Marketer AdvoCare Will Pay \$150 Million To Settle FTC Charges it Operated an Illegal Pyramid Scheme (Oct. 2, 2019), <https://www.ftc.gov/news-events/press-releases/2019/10/multi-level-marketer-advocare-will-pay-150-million-settle-ftc>.

With respect to earnings claims, the complaint describes how the defendants told consumers that they could realize large incomes by promoting AdvoCare and that their earning capacity was limited only by their effort. However, the reality was quite different. As detailed in the complaint, in 2016, 72.3 percent of distributors did not earn any compensation from AdvoCare; another 18 percent earned between one cent and \$250; and another 6 percent earned between \$250 and \$1,000. The annual earnings distribution was nearly identical for 2012 through 2015. It's important to note that none of these calculations factored in the expenses distributors incurred from participating in AdvoCare.

AdvoCare and its former CEO agreed to pay \$150 million and be banned from the multi-level marketing business. Two of its top distributors also settled charges that they promoted the illegal pyramid scheme and misled consumers about their income potential, also agreeing to an MLM ban and a judgment of \$4 million that was suspended when they surrendered substantial assets.

I think the messages from these settlements are pretty clear – when an MLM is an illegal pyramid, defendants – including senior management, promoters and distributors – may be named personally, face bans, and be required to turn over money they have taken from consumers. I think a case like this also shows the incredible amount of effort that the FTC staff is willing to put into bringing illegal pyramid cases, and the resolve at the Commission level. Ours is sometimes a fractious commission, but the AdvoCare votes were unanimous.

In November 2019, again unanimously, the FTC filed a five-count complaint against Neora, LLC, formerly known as Nerium International, LLC, and its chief executive officer, Jeffrey Olson.⁶ Neora is an MLM that sells supplements, skin creams, and other products through a network of “brand partners.” Our complaint alleges that Neora’s compensation scheme emphasizes recruiting new “brand partners” over the retail sale of products to consumers. The complaint also alleges that the defendants made false earnings claims that consumers who become Neora brand partners are likely to earn substantial income. However, rather than making substantial income, the complaint describes how Neora’s business model makes it unlikely that brand partners can earn money by selling product to outside consumers in response to genuine demand—most make little or no money, and a substantial percentage lose money. Instead, purchases by brand partners and fees paid by brand partners accounted for more than half of all company revenues.

As we saw more recently with MLMs that took advantage of the COVID-19 crisis, in addition to the illegal pyramid scheme and false earnings claims, the defendants also are charged with deceptively promoting their supplements. Here the FTC alleges that defendants deceptively claim their products are an antidote to concussions and chronic traumatic encephalopathy, as well as Alzheimer’s disease and Parkinson’s disease, and misrepresent that they had scientific proof. Because Neora provided its brand partners with promotional materials that contained deceptive representations about the supplements, the complaint also charges them

⁶ FTC Press Release, FTC Sues Multi-Level Marketer Neora, formerly known as Nerium, Alleging it Operates as an Illegal Pyramid Scheme (Nov. 1, 2019), <https://www.ftc.gov/news-events/press-releases/2019/11/ftc-sues-multi-level-marketer-neora-formerly-known-nerium>.

with providing their brand partners with the “means and instrumentalities” to deceive others.

This case is currently in litigation and the court has not ruled on the merits. However, the language of the FTC complaint is a useful tool to illustrate some of the types of acts and practices that the FTC is likely to find problematic. For example, the complaint alleges that Neora incentivizes recruits to make a substantial upfront investment in Neora products and then commit to additional product purchases each month. The complaint alleges that according to Neora’s own recent reporting, less than 5% of brand partners in the United States earn more from Neora than they pay in fees and product purchases. That allegation raises an important compliance point: providing a truthful and substantiated income claim requires that an MLM will need to know – and be able to show – that the outcome it or its distributors are claiming is the generally expected achievement of distributors after taking into account expenses.

The complaint is also illustrative of another fact: when the FTC investigates, it does a thorough job in uncovering and pleading deceptive acts and practices. Not only could defendants be on the hook for an illegal pyramid scheme and deceptive earning claims, other advertising and marketing practices will come under the microscope as well. For example, does the product actually do what it is claimed to do, and do the defendants have the substantiation to support the marketing claims that they are making? If defendants offer a refund policy or a guarantee, do they stand by it?

Sometimes, in addition to filing a complaint, the FTC asks for immediate relief. In January 2020, a federal court granted the FTC's request to temporarily shut down an alleged pyramid scheme known as "Success By Health," appoint a receiver for the company, and freeze the assets of the company and its executives.⁷ "Success By Health" sold coffee, tea, and dietary supplements through a network of independent distributors, called "Affiliates." In a separate action, we also allege that individual Jay Noland, along with two other Success By Health executives, should be held in contempt for violating a 2002 court order against Noland related to another pyramid scheme against which the FTC took action, known as BigSmart.

As you can see, the FTC is fully engaged in this area and is determined to protect hard-working consumers from losing money to illegal pyramid schemes or other business opportunities that make deceptive earnings claims. This is a top enforcement priority for me, and I hope the agency. This conference's mission is very important and I look forward to seeing the fruits of your discussions.

And with that, I'll end. Thanks very much for your time today.

⁷ FTC Press Release, FTC Acts to Shut Down 'Success by Health' Instant Coffee Pyramid Scheme (Jan. 16, 2020), <https://www.ftc.gov/news-events/press-releases/2020/01/ftc-acts-shut-down-success-health-instant-coffee-pyramid-scheme>.