

November 3, 2017

The Honorable Maureen Ohlhausen
Acting Chairman
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

The Honorable Terrell McSweeney
Commissioner
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

RE: Federal Trade Commission Guidance to the Direct Selling Industry

Dear Acting Chairman Ohlhausen and Commissioner McSweeney:

The undersigned consumer protection groups, civil rights organizations and academic leaders urge the Federal Trade Commission (“FTC” or “Commission”) to ensure that any additional guidance it provides to the direct selling industry is consistent with existing case law and previous Commission guidance, addresses the industry’s position regarding internal consumption, and reaffirms the need for income and product claims to be substantiated. Anything less, we fear, will not adequately protect consumers from deceptive multi-level marketing (“MLM”) companies.

The FTC regularly provides guidance to industries it oversees, which helps businesses to better understand their responsibilities and comply with the law. This guidance is provided in a variety of forms, including letters to industry associations by Commissioners and staff, blog postings, remarks provided by Commissioners at industry events, as well as consumer and business guides.

When the Commission’s settlement with Herbalife was announced in July 2016, the former Chairwoman publicly stated that the Commission also intended to provide additional guidance to the direct selling industry.¹ This message was reiterated in remarks to the

Direct Selling Association (“DSA”) in October 2016ⁱⁱ and in a letter to DSA’s President in January 2017.ⁱⁱⁱ

It is with this goal in mind that we seek to provide you with our views regarding what productive, pro-consumer guidance to the direct selling industry would best include.

Specifically, the FTC’s guidance should:

- **Rely on existing case law affirming the primacy of retail sales for purposes of funding distributor compensation.** For more than four decades, the FTC has relied on guidance from the courts to inform its enforcement activities in the context of protecting consumers from pyramid schemes. This case law is based on the FTC Act and the 1975 *Koscot* decision.^{iv} This foundational case law requires that distributor compensation be tied *primarily* to the sale of goods and services to retail customers external to the business opportunity. The primacy of retail sales forms the core of the “*Koscot* test,” which has been upheld consistently by the courts, most recently in the *Vemma*^v and *BurnLounge*^{vi} cases. As such, the Commission’s guidance should re-affirm that “a legitimate MLM should not use targets or thresholds for compensation or any other benefit that can be met by mere product purchases. Rather, business opportunity participants should buy product only in response to actual customer demand.”^{vii}
- **Draw on previous FTC investigations and settlements.** The majority of FTC investigations of pyramid scheme activity in the direct selling industry are resolved by settlements. In such cases, the parties agree to business practice changes and, often, compensation paid directly to victims of allegedly fraudulent behavior. While the facts pertaining to respective settlements are typically unique to each case, the Commission has also communicated that these settlements are meant as guidance for what business activities may violate Section 5 of the FTC Act. For example, the Commission’s settlement with Herbalife required the company to implement

systems that accurately track receipts of sales to retail consumers of the company's product. Such a requirement is a basic business activity that aligns with the Commission's guidance that MLMs should incentivize "profitable and verifiable sales - to real customers - specifically, those outside the MLM network."^{viii}

- **Reiterate that compensation based on internal consumption of products or services should be subject to reasonable and transparent limits.** The direct selling industry has frequently misinterpreted the finding of the *BurnLounge* court regarding the validity of internal consumption of product and services for purposes of determining distributor compensation.^{ix} The appellate court in *BurnLounge* found that internal consumption alone did not constitute consumer demand for purposes of meeting the *Koscot* test.^x Therefore, the Commission's guidance should reiterate its and the courts' well-established skepticism regarding the validity of "internal" or "personal" consumption as a basis for multi-level compensation.
- **Affirm that product and income claims must be substantiated.** The Commission's investigations have often found evidence that fraudulent MLM companies attempt to attract new distributors with income and product claims that cannot be substantiated.^{xi} In addition, research by TruthInAdvertising.org has found that the products sold by a shockingly high percentage of DSA member companies' distributors are marketed with deceptive health claims.^{xii} Given this evidence, the Commission's guidance should make clear that a MLM company must possess substantiation for any of its income and product claims. Public statements made regarding the distribution of rewards (e.g., earnings) to distributors must convey an accurate picture of distributor rewards over time, including the extent to which significant rewards accrue to the same participants from one year to the next. Regarding distributors, MLM companies must not only prohibit any false claims by their distributors but must also monitor distributors to enforce such prohibitions.

Direct selling, at its best, can be an alternative to traditional retail channels. Unfortunately, the potential benefits provided by this industry have been marred by repeated incidents of pyramidal activity that have harmed millions of consumers. As the agency with primary responsibility for policing the direct selling industry, it is imperative that the guidance the Commission provides be clear, unambiguous, and consistent with existing precedents. On behalf of millions of consumers nationwide, our organizations look forward to continuing to work with the Commission as it crafts its guidance.

Sincerely,

Consumer Action

Consumer Federation of America

Consumers Union

Consumer Watchdog

League of United Latin American Citizens

MANA, A National Latina Organization

National Association of Consumer Advocates

National Consumer Law Center (on behalf of its low income clients)

National Consumers League

Public Citizen

U.S. PIRG

William W. Keep, PhD, The College of New Jersey School of Business

Peter J. Vander Nat, PhD, Senior Economist (retired), Federal Trade Commission

cc: The Honorable Richard Blumenthal
The Honorable Shelley Moore Capito
The Honorable Thad Cochran
The Honorable Christopher Coons
The Honorable Rodney Frelinghuysen
The Honorable Tom Graves
The Honorable Bob Latta

The Honorable Patrick Leahy
The Honorable Nita Lowey
The Honorable Mitch McConnell
The Honorable Jerry Moran
The Honorable Bill Nelson
The Honorable Frank Pallone
The Honorable Nancy Pelosi
The Honorable Mike Quigley
The Honorable Paul Ryan
The Honorable Jan Schakowsky
The Honorable Charles Schumer
The Honorable John Thune
The Honorable Greg Walden

ⁱ Comments of FTC Chairman Edith Ramirez. “FEDERAL TRADE COMMISSION: Herbalife Press Conference,” July 15, 2016. (“CHAIRMAN RAMIREZ: We will be providing additional guidance to the MLM industry more generally following this case. I think what we achieved in this case is unprecedented. I think the protections that we have in place here, they’re aimed to ensure that going forward Herbalife operates legitimately. But I do think they provide important guidance to the rest of the MLM industry about what they need to focus on in order to ensure that they are not engaging in unfair deceptive practices. But we do intend to provide further guidance following what we’re doing in this particular case.”) Online:

https://www.ftc.gov/system/files/documents/videos/ftc-press-conference-herbalife/ftc_press_conference_on_herbalife_settlement_7-15-16_-_transcript.pdf

ⁱⁱ Federal Trade Commission. “Keynote Remarks of FTC Chairwoman Ramirez DSA Business & Policy Conference Washington, DC,” October 25, 2016. (“For our part, the FTC will be issuing further guidance for MLMs, but I believe the principles that I have outlined today should provide an important foundation for structuring business practices in the MLM industry in a way that provides consumers with truthful information and helps prevent consumer harm.”) Online:

https://www.ftc.gov/system/files/documents/public_statements/993473/ramirez_-_dsa_speech_10-25-16.pdf

ⁱⁱⁱ Federal Trade Commission. “Letter from Chairwoman Edith Ramirez to Joseph Mariano,” (hereafter “Ramirez letter”) January 19, 2017. (“To date, the Commission has issued substantial guidance detailing the key tenets legitimate MLMs must follow. This guidance includes the 2016 Herbalife enforcement action and consent order, as well as the FTC’s other litigated and settled cases. My October 2016 remarks, which are now posted on the FTC’s website, are also instructive and set forth additional guidance to the MLM industry, describing in detail how industry members can enhance transparency and ensure they stay on the right side of the law. Additionally, in December 2016, we announced the settlement of our action against multi-level marketer Vemma and have published several blogs reiterating and reinforcing the central tenets legitimate MLMs are required to follow.”) Online:

https://www.ftc.gov/system/files/documents/public_statements/1068663/response_to_dsa_letter_ramirez.pdf

^{iv} *In Re Koscot Interplanetary Inc.*, 86 F.T.C. 11106 (1975) Online:

https://www.ftc.gov/sites/default/files/documents/commission_decision_volumes/volume-86/ftc_volume_decision_86_july_-_december_1975pages_1106-1202.pdf

^v Online: <https://www.ftc.gov/enforcement/cases-proceedings/142-3230-x150057/vemma-nutrition-company>

^{vi} Online: <https://www.ftc.gov/enforcement/cases-proceedings/062-3201/burnlounge-inc>

^{vii} Ramirez letter. Pg. 2.

^{viii} *ibid.*

^{ix} *See, e.g.* Mariano, Joseph. "Court ruling clarifies protections regarding pyramid schemes," *The Hill*. June 12, 2014. ("...the Court affirmed that compensation in a multilevel marketing business must be primarily based on the sale of products and services to the ultimate consumer, whether or not that consumer is also a seller of the products.") Online: <http://thehill.com/blogs/congress-blog/judicial/209086-court-ruling-clarifies-protections-regarding-pyramid-schemes>

^x BurnLounge opinion, pg. 19. ("Whether the rewards are related to the sale of products depends on how BurnLounge's bonus structure operated in practice. *See Omnitrition*, 79 F.3d at 781. In practice, the rewards BurnLounge paid for package sales were not tied to the consumer demand for the merchandise in the packages; they were paid to Moguls for recruiting new participants. The fact that the rewards were paid for recruiting is shown by the necessity of recruiting to earn cash rewards and the evidence that the scheme was set up to motivate Moguls through the opportunity to earn cash. Rewards for recruiting were 'unrelated' to sales to ultimate users because BurnLounge incentivized recruiting participants, not product sales.")

^{xi} Federal Trade Commission. "Keynote Remarks of FTC Chairwoman Ramirez DSA Business & Policy Conference Washington, DC," October 25, 2016. ("Unfortunately, however, our law enforcement experience shows that many MLMs continue to misrepresent the amount of money participants are likely to earn. In fact, in all of our cases against multi-level marketers, the FTC has alleged that the defendants made false earnings representations. These misrepresentations cause real harm to consumers, and they need to stop.") Online: https://www.ftc.gov/system/files/documents/public_statements/993473/ramirez_-_dsa_speech_10-25-16.pdf

^{xii} TruthInAdvertising.org "TINA.ORG INVESTIGATION REVEALS MLM INDUSTRY RIFE WITH ILLEGAL HEALTH CLAIMS," Press release. November 7, 2016. Online: <https://www.truthinadvertising.org/tina-org-investigation-reveals-mlm-industry-rife-with-illegal-health-claims/>