

Report:

Direct Selling in Europe in general, and the Netherlands in particular

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(N.B. this version corrects some minor typos.)

The Direct Selling industry in the United States is convulsing with a newly attentive approach to regulation and law enforcement pertaining to the so-called Multi-Level Marketing business, also known as network marketing. A 1979 decision, known as the "Amway '79 Decision" by an inexperienced Administrative Law Judge, James P. Timony, was based on rules drafted by Amway's lawyers (70% inventory sell down, 10 customer rule, and buybacks), and adopted by the FTC under Chair Robert Pitofsky (whose specialty was anti-trust, not pyramid schemes). The ruling created some loopholes whereby the impression was given that an MLM could be (at least conditionally) legal, and not an illegal pyramid scheme. Since then, an MLM "industry" has proliferated, and has gradually infiltrated and taken over the Direct Selling Association (DSA), in an attempt to pass off MLM as Direct Selling. In Europe, the Direct Selling lobby has been extremely effective in weakening the regulatory framework, as was documented in a recent doctoral thesis at the University of Maastricht by Orsolya Tokaji-Nagy, [A Legal and Empirical Investigation into the Direct Selling Advocacy in the EU](#), and her [Direct Selling Corporate Lobbying in the European Union: An Overview](#). Recent developments suggest new attention to this issue may be in order.

The major problems of the American handling of the MLM-phenomenon is that, certainly as of the Amway '79 decision, the expectation was set that MLM could be (conditional upon a set of safeguards that were virtually unenforceable) a legitimate form of direct selling, and the standard approach became one of business regulation, not criminal justice, when the reverse was clearly indicated, as will be demonstrated below. The FTC in effect became a captive regulator to the MLM industry, attending industry events, and eventually even allowing an MLM exemption from its "Revised Business Opportunity Rule," of 2011. Token prosecutions were focused on small companies that were possibly extremely blatant and abusive scams, but in the main, the industry was given credence by the FTC's treatment of it as if it were a legitimate business. The burden of proof was on the FTC and a pyramid scheme prosecution became an unlikely event because it required "fact-intensive" inquiries, in the words of the FTC. The periodic culling of the herd by a token prosecution from time to time served only to make the rest of the industry look more credible.

Since the “protections” from the Amway ’79 Decision were hardly verifiable and enforceable in practice, and placed the burden of proof pretty much on the government regulator (the FTC), the budding ‘MLM-industry’ has extensively exploited these loopholes. Herbalife was one of the most significant companies to launch in the immediate aftermath of that ruling. Soon the industry found it could not just drive the proverbial truck through the loopholes, it drove an entire convoy of trucks through it, resulting in an “industry” of over a thousand companies today, who are fleecing consumers all across America and world-wide as well. These developments were certainly helped along when Timothy Muris, whose law firm had Amway for a client, was made Chair of the FTC from 2001 to 2004, and all MLM-prosecutions ground to a halt. Political contributions by the MLM industry were plentiful. Respectability for MLM seemed to have arrived. Herbalife, on its part, even became public, lending it an aura of legitimacy that has been widely exploited by it, and by the entire industry around it. Obviously, or so the reasoning went, the SEC would not allow a complete scam to become publicly listed. More MLM companies went public, and others were owned by supposedly respectable companies, such as Berkshire-Hathaway, which still owns three MLMs at this writing.

There has been a string of recent American decisions, law enforcement and regulatory actions, starting with the Burnlounge case, followed by the Fortune Hi-Tech Marketing case, and lately culminating in the Vemma (FTC), Herbalife (FTC) and Zeek Rewards (SEC/DOJ) actions, which all highlight the problem in a different way. In particular, the reader should take note of an article by Pyramid Scheme expert Robert L. Fitzpatrick, [Zeek’s Criminal Fraud Case Raises Prospects For More Herbalife Charges](#). It would be fair to say that the recent FTC settlement with Herbalife turns back the clock to before the Amway ’79 decision, for the simple reason that the implication of the settlement is based on a clear operational understanding of why MLMs are covert pyramid schemes, and how they work in practice, in far greater detail than has been done before and correcting the shortcomings of the Amway ’79 findings. In short, Amway itself could not pass muster under the present-day “Herbalife rules,” and may well have to adapt eventually. While the FTC, for better or for worse, avoided the public spectacle that would have resulted from litigating a pyramid scheme allegation that could have taken many years to prosecute, the Commission in fact commonsensically used the opportunity to establish an operational framework which places the burden on the company, in this case Herbalife, but with clear intentions to apply the same standards to the rest of the industry. The “Herbalife rules” are today what the “Amway 79 rules” were to the budding MLM industry of the 80’s and 90’s, and they head off the MLM industry at the pass – or in this case the loopholes created by “Amway 79.”

It should be noted that the FTC settlement with Herbalife likely is the beginning of the end of MLM as we know it, and likely the end of Herbalife itself, unless it can embrace the new model and succeed as a legitimate direct sales company. In practice, Herbalife now faces several potential threats:

1. It should be noted that, while the compensation plan changes (keyed to verifiable, profitable retail sales) only commence in May 2017, HLF and its distributors are enjoined immediately to cease deceptive income claims and are affirmatively obligated to provide "all information material" to a decision to participate before any recruits are enrolled. It could be called to task if it violates the court-ordered settlement. Indications are that there continue to be numerous violations, and the company's management and lead investor Carl Icahn remain in total denial of the significance of the settlement they just entered.
2. The company will have to adjust its financial reporting, and how it deals with certain revenues, a.o. those which were misclassified as retail sales but were in fact found to be conscripted consumption by distributors and thus internal sales, it would appear this will lead to restatements of the financial reports, moreover the legal costs incurred, which they have treated as one-off expenses for four years already, are now becoming an ongoing concern for at least seven more years, even aside from the fact that other lawsuits or prosecutions could follow, so that the companies legal costs will remain significant for the foreseeable future. It should be expected that the SEC will take a keen interest in these matters.
3. As the auditors to Herbalife, Price Waterhouse Coopers has to deal with a client who to all intents and purposes was found to have operated as a pyramid scheme, but, in the words of the FTC, must now start to operate legitimately. Consequently, the auditor has serious exposure if the lies are continued in the financial reporting, and they should expect serious regulatory scrutiny of the financial reports pursuant to the present ruling.

In a more general sense, it should be noted that the FTC's action also put the SEC on notice that Herbalife heretofore was operating illegally, and that should produce a greater interest in stopping MLM companies from being publicly listed. **The upshot is this: since an MLM business can only be promoted by lying to prospects, all of these companies are lying to investors by direct extension.** To understand a pyramid scheme, it can be compared with a Ponzi-scheme to the extent that a Ponzi-scheme is a passive investment, that takes in people's money, and promises a return. Therefore "investors" have a claim on principal plus interest, and Ponzi schemes crash hard once withdrawals overwhelm them. Pyramid schemes pretend to be businesses, and instead of facing hard claims, they tell victims that they did not work the business hard enough, and they generally get away with it, if they authorities let them. As a result, [Pyramid schemes fail slowly and over a long period of time](#), as long as they can continue to find new victims. Ponzi schemes collapse on the instigators, while pyramid schemes make their owners and a small group of founding distributors plenty of money while they take sometimes decades to fail. The consumer losses resulting from a business like Herbalife are incalculable, and certainly a multiple of the value of its annual sales.

Analytically, a pyramid scheme is no more than a Ponzi-scheme on the installment program for people who are not otherwise “qualified investors.” The particularly cruel part of pyramid schemes is that they often get people to go into debt to fund their “own business,” which is merely a license for them to be fleeced by the respective MLM companies, as well as the many purveyors of ancillary services, training, business leads, not to mention travel expenses and so on. **Therefore, if the MLM business is indeed a \$180 billion business world-wide, then consumer losses are a multiple of that, probably at least double, and possibly more. I have met people who have lost thousands, tens of thousands and hundreds of thousands. Collectively, the MLM/pyramid scheme racket is far larger than the Madoff scandal.**

Criminological background

Prior to Amway '79 the understanding that an MLM was merely a form of a pyramid scheme was more or less the norm, although the enthusiasts always tried to pretend otherwise. It is important to understand why MLM is a criminal design.

Since the fundamental economic proposition is completely counter-factual, an MLM can only be promoted by misrepresentations, and the appearance of direct sales is merely the front for the pyramid scheme itself. Hence some of the commentators have spoken of product-masked pyramid schemes. The larger incentive in MLM compensation plans, by a wide margin, is always recruiting, not selling, and retail sales margins come under pressure from oversupply in the market, and eventually product is given away and the wholesale cost of the product becomes a cost of doing business. The best example of this issue was the \$ 8 million “charitable donation” of Herbalife product: a way to become “garage qualified” without even the need for a garage to store it all: just give it away to “charity,” and deduct it from your taxes.

In summary, the functional decomposition and the effects of an MLM are:

- The “front” or cover operation is a direct sales business, which is what is being advertised to keep the public unaware of the scheme, and keep the regulators at bay. This direct sales component provides the appearance of legality.
- The pyramid scheme is hidden behind the façade of the product sales, in the compensation plan. The compensation structure places the greater incentive on recruiting than selling, and hence people will recruit, not sell, putting margin pressure on any naïve “distributors,” who make the mistake of trying to sell the product.
- To avoid detection by law enforcement, there are no rewards paid for recruiting directly, but they are laundered through markups on the products of the presumed direct sales company. Thus the direct sales “front” is the money laundering operation for the illegal pyramid scheme back-end.

- Since the appearance of a Direct Selling business must always be maintained in order to escape prosecution, the business can only be promoted by misrepresentation, rendering it a criminal fraud by definition.
- If selling the Brooklyn Bridge is a criminal fraud, fraud-in-the-inducement in MLM happens thousands of times a day, world-wide: if the proposition is a lie, it can only be sold by lying.
- In the main it seems as if fraud on an industrial scale becomes a business, and a vindication of the concept that a lie, repeated often enough, becomes true – the old story of the big lie. “Working with regulators,” now fosters the appearance of legitimacy, and captive regulators inadvertently serve to sanction the industry.
- To sum it up: **an MLM is a pyramid scheme disguised as a direct sales business, and conversely an MLM minus the pyramid scheme elements is a direct sales business, which the FTC, at a new height of obfuscation, calls a “legitimate MLM.”** It would seem unlikely that the companies that are indeed operating as legitimate direct sales businesses, like real-estate or insurance sales, would ever want to use the term MLM for themselves.
- The FTC’s settlement with Herbalife excised the pyramid scheme elements out of Herbalife’s compensation plan with surgical precision, demonstrating the previous point in practice.

Ergo, MLM is not a business in need of regulatory oversight, but a criminal fraud disguised as a business, and some countries have started to understand, such as the [Kingdom of Bahrain](#), which has banned the practice completely to the point of even making facilities rental to pyramid schemes illegal. MLM is certainly [unlawful under Sharia law](#). In theory, MLM is banned in China, but companies have found a way around it, led by Amway, in that case embarrassingly aided and abetted by none other than Harvard University. India seemed to make an overture to clean up the industry when it twice [arrested the President of Amway India](#), but since then appears to have backed away from the confrontation – yet another unfortunate consequence of inconsistencies in American law enforcement in this area, as pointed out by British MLM-critic David Brear on his priceless blog: [‘MLM’ The American Dream Made Nightmare](#).

Other aspects of the criminality of the pyramid scheme industry have been developed in great detail by Prof. Robert Blakey, pursuant to his expert testimony in the 1985 Amway trial with Procter & Gamble, where he developed the legal theory [why MLM should be regarded as a RICO-conspiracy](#), which has since then been put to the test several times in private RICO lawsuits, but as of yet the Eliot Ness of MLM has not emerged in the US, and provided the FTC proceeds to reform the entire industry after the model of the Herbalife settlement, it may never come to that. Blakey also cites the fascinating 1985 Ph.D. thesis of Carol Juth-Gavasso, on the Amway Corporation: [Organizational Deviance in the Direct Selling Industry](#). In his coverage on the L.A.

Times pieces about Herbalife, David Brear appropriately raises [the issue of the RICO act](#) all over again. Last, not least, the reader should be referred to Robert FitzPatrick's article on the Zeek case, cited above, to note that intrinsically Herbalife and Zeek were not different enough to explain why one should merit a regulatory "settlement," while the other brought a full-fledged criminal prosecution down upon itself.

Developments in the Netherlands and Europe in general

The Netherlands, and the EU in general, have been sold a bill of goods, just [like Botswana has, as recently reported by David Brear](#). Herbalife has its EMEA presence in the Netherlands, and there are numerous potential issues that have come to light, even besides the overall point that an evident pyramid scheme, even if it was not adjudicated as such for technical reasons, is continuing to operate there. These include the existence of potential issues around import duties, that have been identified in an article by Christine Richard, on Seeking Alpha, titled: [Did Herbalife Ship Millions of Canisters of Formula-1 to Lebanon?](#) Also, the very opaque reporting of the operations of the Herbalife Foundation in Holland calls into question if there are not similar issues going on as were just [disclosed by the Los Angeles Times](#) about an \$8 million set of orders by one distributor that was donated to charity. In the Dutch case, there seems to be an absolutely mysterious relationship with the KNZB, (the Koninklijke Nederlandse Zwembond, Royal Dutch Swimming Federation), about which nothing can be learned from the opaque reporting by the Herbalife Foundation. In an earlier article, the Los Angeles Times justifiably asked [why Herbalife was allowed to stay in business](#).

It should be noted that Belgium botched a prosecution of Herbalife as a pyramid scheme in recent years, by completely failing to do a forensic accounting assessment that should have incontrovertibly demonstrated that it is one. Italy has been quicker to act, and specifically tagged Vemma as a pyramid scheme even before the FTC did. This whole history can be found on the website of Truth in Advertising, they have a repository of [FTC-Vemma Pyramid Lawsuit Documents](#). Numerous former Herbalifers, starting with Anthony Powell, had defected from Herbalife and moved to Vemma, just as subsequently part of team Vemma moved on in part to Jeunesse and in part to Xango in large numbers, after Vemma shut down in Europe pursuant to the FTC action in the US, as was recently reported by Het Financieel Dagblad, "[Omstreden wondersap Xango werft student-verkopers](#)." Most notably, Italy has paid attention to the issue of "pay to play," or "conscripted consumption" (a.k.a. autoship), which is the entry fee to the pyramid compensation in MLM and the guarantee that at all times more people lose money than make money. In both the Vemma and Xango prosecutions it was clear that the Italian prosecutors understood this issue. In the meantime it now appears that [Xango is on the radar of the FTC](#), and [Jeunesse is facing a private RICO lawsuit](#).

Austria, and Switzerland (and Australia) have had their issues with Lyonesse, and there might be other cases. It pains one to see Rombouts coffee in Belgium getting caught up in one of these schemes, and I was shocked recently to discover that AEGON of the Netherlands owns WFG, World Financial Group, a Primerica clone, that has [all the problems of Primerica](#), and is now facing new consumer protection legislation in the form of a fiduciary rule from the Dept. of Labor, which is likely to cause it serious problems because it addresses conflicts of interest that are almost endemic in the MLM business model. A recent SeekingAlpha article titled "[Ackman targeted the wrong MLM: Primerica will collapse before Herbalife](#)," sums it up extremely well, including why Primerica, and, by extension, World Financial Group, may fail sooner than Herbalife itself, because of the combined effects of the new DOL rules on fiduciary responsibility and the "Herbalife rules."

In short, **it appears to be high time to reconsider if MLM should continue to be treated as a business method to be regulated, or rather as a criminal fraud disguised as a direct sales business.** The fundamental issue is not only about consumer deception, but unfair competition to any businesses that practice legitimate direct selling. Illegal enterprises always falsify the competitive landscape, and legal inaction in this area is very costly to the economy as a whole.

Other Avenues for Combating Pyramid Schemes

Besides the plain and simple treatment of MLM as criminal fraud, as was in evidence in the Zeek case, there are a number of corollary issues that potentially deserve attention:

- **Corruption.** An extensive network of political corruption and influence buying is par for the course, exemplified in the hiring of large numbers of former federal regulators by Herbalife, and how it escaped prosecution as a pyramid scheme, while its smaller competitor Zeek got the full criminal treatment. For evidence look no further than the speaking fees commanded by the Bush presidents at MLM conventions, and the fact that all of [Donald Trump, Jeb Bush, Bill Clinton, Ben Carson](#), and many other politicians all were involved to one degree or another, and [Michelle van Etten of Youngevity](#) even spoke at the Republican National Convention recently.
- **Promoting tax evasion.** Statistically, any business with a [near 100% failure rate](#) should be treated as a form of illegal gambling, which is what pyramid schemes are under many legal regimes. If Enron sold off its losing transactions to SPVs and forgot to account for the buyback provisions, in MLM the losses are brilliantly pawned off on the commons, specifically taxpayers in general, as prospects are being told they are buying into a business and they can deduct the expenses: MLM entrepreneurs "buy" the marketing costs (losses) from the parent company, and the cost is almost infinitely large, depending on the level of brainwashing of the victims.

It should be noted that the income disclosures MLMs provide generally also misstate the

facts, even if they do not technically do so, simply because they use yearly numbers, and retention at the top is far greater over many years than at the bottom where turnover can be 50% a year or more. In the Herbalife case turnover is two million a year. Mostly the same people make the money at the top from year to year and ever changing hordes of people lose money at the bottom. As a result, the new entrant faces a nearly 100% certainty of failure. In short, **disallowing tax deductions for MLM could be an effective way to control the problem.**

As a direct consequence, companies promoting the tax-deductibility of the expenses of MLM distributorships, would be promoting tax-evasion, and could be held accountable accordingly. In this context, it should also be noted that the US SBA (Small Business Administration), has had a long standing policy of not lending to MLM distributors.

In terms of direct tax deductions, the most egregious case of all time may have been the \$8 million order cited above, which proves for all time that not only do retail margins go to zero, the product itself tends to become a cost of doing business as recruiting takes over more and more in saturating markets. There seems to be ample US precedent of Tax Court rejection of MLM losses, as reported in Forbes [here](#), and [here](#). [In earlier research, the same author, Peter J. Reilly, CPA](#), sums up all cases he could find for Amway distributors, and they generally always lose in tax court, finding that their claims are being relegated to "hobby losses." At least from a taxation point of view it makes sense that voluntarily and predictably losing money on a pointless venture should be a hobby, not a business.

- Another tax-related issue, but also a labor issue, is whether or not the extremely burdensome contracts of MLM constitute valid independent distributorships, but should not rather be construed as employment contracts.
- **Evasion of labor laws.** In general, in MLM there is the question raised above under tax evasion, if an MLM contract could even be construed as an "independent" distributorship, as most are so restrictive they practically constitute indentured servant contracts. In the case of Herbalife, this issue may yet have repercussions in respect of the nutrition clubs, where free labor seems to be the word of the day, all under the guise of "training," along with the fact that the name "Success University," is a protected term, which potentially could cause problems.

Postscript

Common sense has been absent from this area. To make things practical, Slate just produced a simulated MLM, so anybody can experience why people lose so much money in these scams: [An Exciting New Business Opportunity From Your Friends at Slate!](#) This is the kind of common sense tool that makes one wonder why four out of five chamber maids know a pyramid scheme when they see one, and so does [Judge Judy](#). One of the more colorful commentators on Herbalife, Salty Droid, delivered a fitting punch line, [Herbalife – Death To America](#), where he makes the point

many people know a pyramid scheme when they see one, and it makes no sense why regulators and law enforcement have had such a difficult time dealing with this particular fraud.

Common sense suggests the solution should be easy, but the almost incredible fact is that it has taken the US nearly four years since Bill Ackman rang the bell with a billion dollar short position in Herbalife at the end of 2012. Some of the most comprehensive information on Herbalife can still be found on the Pershing Square website about Herbalife, www.factsaboutherbalife.com. It should be expected that the rest of the world will now start catching up to save their citizenry from this kind of exploitation. Carol Juth spoke of Corporate Deviance, David Brear speaks of a criminogenic environment. These terms are apt. A collateral dimension of false MLM income claims are the frequent false product claims, which in the US could be either an FTC or FDA matter. These issues are rampant in an industry where lying is the norm. It is time to treat MLM as what it is, a criminal fraud masquerading as a direct selling business, and not a business that should be regulated. Enough is enough.

Personal Postscript

I was first exposed to MLM while I was finishing up my degree in economics at Fairfield University, and for a while I considered doing a paper on it. I gave that up, as I could not find enough research on the topic. I had been exposed to NuSkin via my accountant, who had a client who supposedly made lots of money in that company. I turned it down. Then a good friend pitched me on Amway, and I did extensive due diligence, and turned it down – if nothing else, they were routinely teaching people to issue false affidavits to circumvent the “Amway 79” rules. During the period, I got to know a lot of people, including MLM-consultant Rod Cook, and attorneys Jeff Babener, and Gerry Nehra, and I thought the legal framework of MLM became clear to me. Later I dabbled in MLM a few times, with companies who were “not like Amway,” but I always quickly got a bad taste in my mouth.

In the mid-nineties I met a relative, one Harry van Asselt, who had become a partner in one company, Amerivox, and I advised him that unfortunately, he would lose his entire investment, based on what I had learned about the owners. Six months later he did – I estimate it was at least a million dollars. Some of the principals had already previously been barred from the MLM-industry by the FTC, because of their involvement in a.o. Best Line products, but that hardly concerned them. Still, I remained stuck in the notion that MLM could be legal, in part because of the official stance of FTC and SEC. In the late nineties, I developed an MLM business plan for a nutritional company where I worked as a consultant, but fortunately it was never launched. I still did not fully understand why MLM is always a pyramid scheme.

In 2011 I signed on with a company called North American Power (NAP), which appeared innocuous to me – they promoted green energy, something near and dear to my heart, and since they did not charge a fee to join, it seemed to be a harmless free referral program. Later it dawned on me that it was a pyramid scheme nevertheless, and by August of 2014 I withdrew my

name, and I presented the owners with a list of 20 reasons why they could be found to be a pyramid scheme. They claimed that four law firms had approved of their business plan, and I suggested that maybe none of the four law firms had the requisite subject matter expertise. The President of the company validated my guess, and told me not one of the four law firms had any comprehension of the marketing plan. The company then hired a fifth law firm, who confirmed that my 20 points of concern were valid, and the management began to make changes, forcing the company to become more of a direct selling company and less of a recruiting company. This did not sit well with the hard core MLM-ers, and by January 13th, 2015 the company shut down its network marketing operations.

I had begun to [write on Herbalife in May of 2013](#), predicting at the time that Carl Icahn would lose his investment. At that time, although convinced that Herbalife was a pyramid scheme, I still thought MLM could be legal, however, due to my experience with NAP, I came to realize that any MLM is like a car without brakes, and cannot ever be street-legal. The more I focused on the pure economics, the clearer it became that **if the incentive is to recruit, people will recruit, and the onslaught of recruiting will force retail margins towards zero as the network grows, and eventually this will lead to product being given away as free samples.** As I put it in one of my articles: if recruiting drives the bus, retailers get thrown under the bus. In short, **MLM is never a business, or a business method, but simply a criminal fraud disguised to look like a business.** Former FTC Commissioner Paul Rand Dixon said it best in one of the MLM cases he presided over as an Administrative Law Judge: MLM has "... an intolerable potential to deceive." Unfortunately, some of his successors were not so clear-headed, but the tide has now started to turn.

Addendum: A summary from Robert L. FitzPatrick

The following is a recap of the state of affairs regarding MLM, and how the DSA in America and Direct Selling organizations around the world are dealing with the fallout from the FTC's new "Herbalife rules," from the President of the Pyramid Scheme Alert, Robert L. FitzPatrick, quoted here by his permission:

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I and others here have wrestled with this question of "legal MLM" and "pyramid scheme." We eventually abandoned the word game and just took MLM apart to examine what its defining characteristics are, as manifested almost universally here. After doing that, we could see that its elements — as practiced and in operation — constitute the definition of a pyramid scheme.

First, a pyramid scheme is fairly obvious. Essentially, it is the same as a Ponzi except that the investors whose new money is transferred to earlier ones are found by the investors themselves. A pyramid scheme may be seen as a collection of Ponzis strung together into one long chain. People pay money to join (pay to play); new investors must constantly be

found (mandated recruiting); the number of new people found to fund earlier ones must equal or exceed existing ones to continue (endless expansion); and the money obtained must be transferred to earlier one (internal money transfer, from later to earlier investors). This is obviously not sustainable; financially dooms the last ones in; is not a real business where value is exchanged; and must be disguised and employ deception. Seeing this as a fraud does not require a Ph.D in Economics.

As for “MLM” we found several key characteristics universal and within each scheme we studied, counting into the hundreds.

1. An endless chain usually with from at least 4 paid levels to infinity. The overall chain is “endless” and the proposition on which the recruiting is based makes no provision for mathematical limits or market saturation.
2. Pay to play. Each person must pay money to join and pay more to remain qualified. This is usually done with purchase quotas. Buying products is required and “products” become a form of currency. Usually the purchases are translated to “points”, like Las Vegas chips, that are redeemable for hard cash.
3. Recruiting is the only viable means of gaining income. This is spelled out in the pay plan with rebates, royalties, bonuses, etc, all predicated on having a downline. The larger the downline, the greater the income. Without recruiting, the largest rewards are not available at all. The recruiting mandate expands the chain but the network in which the money is generated and is transferred always remains “closed”. Most of the money available for rewards is the closed network’s members’ own money, making “profit for all” impossible.
4. Concentrated transfer to the top. Even with a large downline, the ultimate source of funds is always the recruits themselves (product purchase quotas) and the majority of recruits are always at the bottom. All MLMs have pay plans in which the largest proportion of rewards, per transaction, go to the upper levels. This transfer formula in the pay plan terms is exacerbated by the resulting pattern of “breakage.” With the imposition of constant payments, the mandate of recruiting a large downline, and the paucity of rewards allowed to the lower ranks, most people abandon the MLM plan within the year or so. As they leave, whatever rewards they may have built up with recruiting are transferred upward. The net result is that more than 50% of total rewards, excluding retail margins, goes to the top 1%. Often the percentage gained each year by that group is 80%.

So, endless chain, pay to play, mandated recruiting of new investors whose funds are the main source of rewards, and transfer of most rewards directly to the top — those are the elements of MLM and those are also the elements of a classic pyramid scheme.

This is clearly a financial trap, well designed, cleverly disguised and carefully executed. The essential pervasive element for success at every level is deception. The inevitable

result of the plan is harm. We studied MLM after MLM where income disclosure data were available. In every case less than a few percent were ever profitable, each year. The profitable people are generally the same year after year. The losers come and go, year after year. Churn rates were 50-80% per year. So, when all participating were counted over a 5-year period, for example, the actual people who made money among of all who had participated in that time frame was a small percentage of one percent.

This is called “legal MLM.” It became legal, by diversion and disguise. Disguising the transactions with product purchases is one key element; a complex pay plan that is incomprehensible is another; offering the chance to gain income from retail selling and then not documenting the retail selling activity, so as to make it an unknown is also crucial. Overlaying all this flame-flam is the pseudo-language of business, marketing, “commissions”, sales, managers, etc., including the official-sounding term “multi-level marketing”.

Gradually, the elements of the MLM pyramid are being revealed without having to “prove” they add up to a pyramid scheme which is pointless anyway since it is the elements themselves that are illegal, not the label. MLMs have made “pyramid scheme” a straw man, which has distracted from the elements of deception and the net result of harm. They have created false definitions of “pyramid scheme”, such as a scheme where no product is involved. Or a scheme in which direct payments are made for recruiting, or a scheme that is not a business, or where no one buys a “real” product, or one that “inevitably collapses”, etc. The factor of retail selling has been a major diversion. MLMs used it as a claim of viable income beyond recruiting, but also kept it unverified in quantity, so it operates only as a theoretical defense, but a defense nevertheless. In fact, lack of retail selling is not a cause of MLM being a fraud, but a consequence of the other fundamental elements. Mandated recruiting that constantly grow the number of “retailers”, greater rewards for recruiting over retailing, the open-need and enticing offer to all to get the wholesale price and possibly rewards as well and mandated internal purchases — all make “retailing” impossible.

Thus, the MLM can say: we have real products; people do buy products. We are “direct selling” because people can – if they wish to – retail the goods; or we are a chartered corporation; or we have been in business 20 years (not collapsed); or no one is “required to make purchases”; or no one is “paid for recruiting.” These are all diversions.

To explain away the massive loss rates, MLMs have recently claimed that most people who join and sign sales contracts only want to buy the products, not make money. They never discuss how it is impossible for any but a few, under the structure and plan, to make money, regardless of how many “want” to make an income.

They obscure the lack of actual direct selling and retail sales by claiming wholesale purchase inside the sales chain are actually retail purchases, ignoring the requirements and incentives that surround these purchases.

Now that the FTC has exposed a bedrock member of the DSA here and one of the largest MLMs in the world and determined that it is fundamentally deceptive, engages in pay to play to gain its revenue, has no retail sales market, and is causing massive consumer harm, the DSA is struggling to maintain its old ruses, diversions, rationalizations and claims that have served it well up until now.
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Sources:

Besides the references that are accessible in the electronic copy of this document, available on Scribd, here: <https://www.scribd.com/document/319740451/MLM-Summary-for-EU-Post-FTC-Herbalife?>, here are other major sources of intelligence about the pyramid scheme business:

- Pyramid Scheme Alert: <http://pyramidschemealert.org>, website of MLM expert Robert L. FitzPatrick.
- MLM-The Truth: <http://pyramidschemealert.org>, website of long term MLM expert Jon M. Taylor, Ph.D.
- Facts About Herbalife: <http://www.factsaboutherbalife.com>, Pershing Square Capital Management's Herbalife website.
- Truth in Advertising: <https://www.truthinadvertising.org>
- FTC: <https://www.ftc.gov/news-events/press-releases/2016/07/herbalife-will-restructure-its-multi-level-marketing-operations> Note that much of the FTC's information and guidance on the issue has been very deceptive and protective of the MLM industry, but it appears we may be turning the corner, as evidenced in this entry: <https://www.ftc.gov/news-events/blogs/business-blog/2016/07/its-no-longer-business-usual-herbalife-inside-look-200>
- SEC: The SEC information about MLM and pyramid schemes continues to be utterly confusing, if not outright deceptive to this day. As of this writing it still sounds as though MLM's are legal if only they provide "real products."
- Investment website Seeking Alpha has become the central locus of the debate around these issues, for Herbalife as well as other MLMs, or MLM in general, here is the link for Herbalife: <http://seekingalpha.com/symbol/HLF>. My own 50+ articles on the issue appeared mostly on this site.
- Tin Promises: <http://www.realscam.com/f9/tin-promises-how-mlm-can-tear-lives-apart-roger-willco-3013/> The real-life story of one whose domestic partner lost \$250,000 over 10 years in four different MLMs.

- The book "Downline: an intolerable potential to deceive," by E. Robert Smith, is a fun read, and explains the whole sordid history of the failures of law enforcement and regulation to deal with MLM.
- The book "False Profits," by Robert L. FitzPatrick and Joyce K. Reynolds is also a classic introduction to the subject.
- The website of cult expert of Steve Hassan, <https://www.freedomofmind.com>, which documents in great detail why MLMs are cults that engage in a dangerous form of brainwashing.