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# The Federal Trade Commission and Pyramid Sales Schemes\*

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Pyramid sales schemes that illegally deceive most participants are proliferating across the nation.<sup>1</sup> These sales schemes grow rapidly and affect thousands of people before law enforcement agencies can act. State agencies, consumer self-help remedies, and market forces frequently are inadequate to address the problems created by pyramid sales schemes. This article suggests a legal theory that the Federal Trade Commission (hereinafter referred to as the Commission) can use to curb the deceptions of pyramid sales promoters.

A pyramid sales scheme is a special type of business opportunity. The

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\* The authors are staff attorneys in the Federal Trade Commission's San Francisco Regional Office. The opinions expressed in this article are solely the authors', however, and do not necessarily reflect the view of the FTC or any individual commissioner.

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1. Pyramid sales schemes have been characterized as the major consumer fraud problem in the United States. *Hearings on S. 1939 Before the Subcomm. for Consumers of the Senate Comm. on Commerce*, 93d Cong., 2d Sess. Ser. 90, at 14 (1974) (statement of Sen. Walter F. Mondale). The size of the pyramid sales industry is substantial. In the early 1970s, an estimated 150 pyramid sales schemes were operating in the United States. *See Address by William J. Casey, Chairman of the Securities and Exchange Commission, 55th Annual Conference of the North American Security Administrators* (Sept. 1972), summarized in *Antitrust and Trade Reg. Rep. (BNA)*, No. 580, at A-4 (Sept. 19, 1972). *See also* N.Y. Times, Jan. 13, 1972, at 59, col. 5 (estimating 200 pyramid schemes nationwide). Probably as many pyramid companies operate today, some of which are as large as the major pyramids of the past. Estimating the size of the pyramid sales industry is difficult because no industry statistics are available and because of the transitory nature of the companies in the industry. The authors believe, however, that sales of over \$100 million by 100 firms would be a conservative estimate. Importantly, the cast of firms may change from year to year as old pyramids collapse and new ones are constructed...

primary vice of most business opportunities challenged by the Commission is the deceptive earnings claims made by the promoters of the opportunity. In the traditional business opportunity case, the Commission generally must prove that the promised earnings were not achieved by the typical or average participant.<sup>2</sup> In contrast, proof of actual failure to achieve promised earnings is unnecessary in the case of a pyramid sales scheme because the earnings claims inevitably will prove to be false by the mere operation of the plan. Every participant in a pyramid sales scheme cannot achieve the promised earnings because the geometric increase in participants virtually eliminates any chance of success by later participants.<sup>3</sup> This phenomenon is known as market saturation.

In this article, the authors set forth a legal theory that would permit the Commission to challenge pyramid sales schemes in an effective and summary manner. Specifically, the authors suggest that the Commission challenge the earnings claims made by the promoters that are based upon the pyramiding of new recruits. A challenge to those earnings claims will be effective in curbing the growth of pyramid sales schemes because pyramid promoters will find it impossible to recruit participants without representing an expected level of earnings. First, the Commission definition of a pyramid sales scheme will be discussed, followed by an analysis of the legal theories that the Commission has used in prosecuting pyramid sales schemes.

#### DEFINING A PYRAMID

An illegal pyramid sales scheme was defined by the Commission in *Koscot Interplanetary, Inc.*<sup>4</sup> In that case, the Commission characterized a pyramid sales scheme as a plan in which a participant pays money to the company and in return receives (1) the right to sell products, and (2) the right to earn rewards for recruiting other participants into the scheme that are unrelated to product sales.<sup>5</sup> The second element is nothing more than a

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2. See, e.g., *National Dynamics Corp.*, 82 F.T.C. 488 (1973), *aff'd in part and rev'd in part*, 492 F.2d 1333 (2d Cir.), *cert. denied*, 419 U.S. 993 (1974).

3. It is well established that the tendency and capacity to deceive, and not actual deception resulting in injury, are the criteria by which practices are tested under section 5 of the Federal Trade Commission Act, 15 U.S.C. §45(a)(1)(1982). In *FTC v. Sterling Drug, Inc.*, 317 F.2d 669 (2d Cir. 1963), the court stated:

In order best to implement the prophylactic purpose of the statute, it has been consistently held that advertising falls within its proscription not only when there is proof of actual deception but also when the representations made have a capacity or tendency to deceive, *i.e.*, when there is a likelihood or fair probability that the reader will be misled....

317 F.2d at 674.

4. 86 F.T.C. 1106 (1975), *aff'd mem. sub. nom.*, *Turner v. FTC*, 580 F.2d 701 (D.C. Cir. 1978).

5. 86 F.T.C. 1106, 1180 (1975).

complex chain letter device in which participants are certain to be disappointed.<sup>6</sup> In *Koscot*, the Commission noted that pyramid sales schemes are not commercially feasible ventures because the presence of a profitable right to sell distributorships or franchises encourages participants to pursue this aspect of the scheme, while ignoring the sale of products to consumers.<sup>7</sup> The short-term results may be large profits for pyramid promoters and select, early distributors, but the long-term results will be the disregard of market development, earnings misrepresentations, and insufficient retail sales to support the great number of participants who have been recruited into the scheme.<sup>8</sup>

The incentives for the participant in a legitimate multi-level distribution plan are to make retail sales rather than to build and profit from a pyramid of recruits.<sup>9</sup> The legitimate company enters the marketplace on a long-term, ongoing basis and depends upon continuing retail sales for success. The selected distribution system is designed to emphasize product sales, rather than a continuous sale of distributorships. Sales persons must be given the incentive to sell the product or service.<sup>10</sup> The legitimate company has little incentive to saturate the marketplace with distributorships or sales personnel because saturation would adversely affect retail sales and ultimately, the long-term success of the company.

Conversely, the incentives for the participant in an illegal pyramid are to profit from a pyramid of recruits rather than to make retail sales.<sup>11</sup> Pyramid schemes are dependent upon continual recruitment of new participants. Promoters are interested only in recruiting until the market becomes saturated and the scheme falls apart.<sup>12</sup> The pyramid promoter, therefore, structures the incentives to encourage participants to emphasize recruiting rather than retail sales.<sup>13</sup>

6. *Id.*

7. *Id.* at 1180-81.

8. *Id.* at 1181.

9. See *Amway Corporation, Inc.*, 93 F.T.C. 618, 672-73 (1979); see also Senate Report, S. 1939, 93d Cong. 2d Sess. (1974), reprinted in S. Rep. No. 1114, 93d Cong., 2d Sess. 4 (1974), at 6 (Senate Report on proposed Pyramid Sales Act that passed the Senate but died in the House of Representatives upon expiration of the 93d term) [hereinafter referred to as Senate Report]. The authors do not propose that the Commission challenge legitimate multi-level plans using the legal theory set forth in this article. Rather the Commission should continue to treat the legitimate multi-level plan as a traditional business opportunity.

10. *Amway*, for example, enforced rules that served to encourage retail selling and prevent inventory loading. 93 F.T.C. at 716. See generally M. ZOBEL, PRINCIPLES OF MARKETING 263-66 (text ed. 1971).

11. *Koscot Interplanetary, Inc.*, 86 F.T.C. at 1180; *Amway*, 93 F.T.C. at 715.

12. The Commission found the Ger-Ro-Mar pyramid sales scheme deceptive by a mere perusal of the plan as set forth in the sales manual and promotional literature. *Ger-Ro-Mar, Inc.*, 84 F.T.C. 95, 140-50 (1974), *aff'd in part, rev'd in part sub nom.*, *Ger-Ro-Mar v. F.T.C.*, 518 F.2d 33 (2d Cir. 1975).

13. See generally LEFF, SWINDLING AND SELLING 88-111 (1976) (explanation of pyramid sales schemes). The operation of a typical pyramid sales scheme is explained more fully at notes 74-79 and accompanying text, *infra*.

Legitimate multi-level marketing plans or franchises are not inherently deceptive. Although the rapid proliferation of participants is *possible* with multi-level and franchise plans, and may indeed result in participants being deceived about their chances for success,<sup>14</sup> the deception of participants is virtually *inevitable* in pyramid schemes.<sup>15</sup>

In a typical franchise organization, only the franchisor is selling franchises.<sup>16</sup> The franchisor can control the number and location of franchisees to maximize retail sales. Similarly, a legitimate multi-level company has no reason to enroll distributors indiscriminately, but can be expected to enroll the number that will result in the most effective distribution of its product. In a pyramid scheme, however, each franchisee is, in effect, selling additional franchises. Once the pyramid scheme is implemented, the promoter loses control of the plan because the success promised to each participant is dependent on a pyramiding of new participants. The proliferation of participants may result in either a saturation of the market with distributors or an "equilibrium" short of saturation, in which the number of persons dropping out balances the number of new recruits.<sup>17</sup> In either case, *all* participants will be unable to attain the earnings claimed for the selling plan.

#### BACKGROUND OF THE PYRAMID PHENOMENON

In early cases, the Commission applied the antilottery theory to prosecute pyramid sales schemes.<sup>18</sup> The Commission asserted that pyramid sales schemes were in the nature of a lottery and should be unlawful *per se*. The antilottery approach is rooted in a long line of decisions<sup>19</sup> that have

14. See, e.g., *National Dynamics Corp.*, *supra* note 2.

15. See *Ger-Ro-Mar, Inc.*, 84 F.T.C. at 147-48; *Holiday Magic, Inc.*, 84 F.T.C. 748, 1037 (1974); *Koscot Interplanetary, Inc.*, 86 F.T.C. at 1182.

16. Franchisees receive the further protections of the Commission's Trade Regulation Rule, *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, 15 C.F.R. §436 (1983); see Senate Report, *supra* note 9, at 6. See generally G. GLICKMAN, 15 BUSINESS ORGANIZATIONS (Franchising) (1974); C. VAUGHN, FRANCHISING (1974) (explanation of franchise operations).

17. Saturation may never occur. Rather, some sort of equilibrium may be reached where as many drop out as join the scheme. This equilibrium itself is evidence of the failure of the scheme. Those who drop out will themselves fail to achieve the promised earnings and will further cause the failure of preceding generations of distributors whose success depended on continued recruiting by the drop-outs. Equilibrium simply indicates that the pyramid scheme has failed to mature to its full potential for deception, not that deception is absent. See *Ger-Ro-Mar, Inc.*, 84 F.T.C. at 146-47.

18. See, e.g., *Ger-Ro-Mar, Inc.*, 84 F.T.C. at 100; *Holiday Magic, Inc.*, 84 F.T.C. at 755-58; *Koscot Interplanetary, Inc.*, 86 F.T.C. at 1111-14; *Devour Chem. Co.*, 81 F.T.C. 551 (1972); *Int'l. Safe-T-Trac, Inc.*, 79 F.T.C. 318 (1971); *Bestline Products Corp.*, 79 F.T.C. 107 (1971); *Chemical Associates, Inc.*, 77 F.T.C. 1500 (1970); see also Commission advisory opinions 16 C.F.R. §15.155 (1983); 16 C.F.R. §15.241 (1983); 16 C.F.R. §15.404 (1983).

19. See, e.g., *F.T.C. v. R. F. Keppel & Bros., Inc.*, 291 U.S. 304 (1934); *Peerless Products, Inc. v. F.T.C.*, 284 F.2d 825 (7th Cir. 1960), *cert. denied*, 365 U.S. 844 (1961).

held games of chance used in the merchandising of goods to be *per se* violations of section 5 of the Federal Trade Commission Act (hereinafter referred to as FTC Act).<sup>20</sup> Games of chance were considered a type of lottery, and therefore against public policy.<sup>21</sup>

Courts have applied the traditional antilottery approach to pyramid sales schemes by finding that the requisite elements of a lottery are also present in pyramid schemes.<sup>22</sup> A lottery involves three elements: (1) a prize, (2) according to chance, and (3) for a consideration.<sup>23</sup> A participant in the pyramid scheme pays an investment fee or purchases merchandise (consideration) to participate in a chance at a profit (prize) by recruiting others. Chance is considered to be at the core of a pyramid scheme because success is beyond the control of any individual participant. The chance of successfully recruiting other participants is dependent upon the number of participants who have previously participated.

The traditional approach to games of chance changed in 1969 when the Commission issued the *Trade Regulation Rule for Games of Chance in the Food Retailing and Gasoline Industries*.<sup>24</sup> The Commission decided to remove the prohibition on games of chance in these two industries and to regulate the games instead. In *Marco Sales Company v. FTC*,<sup>25</sup> the Second Circuit Court of Appeals recognized an anomaly in regulating games of chance in some areas while prohibiting them in others and overruled a Commission order prohibiting a game of chance. In *Marco*, a sales company sent literature through the mail describing merchandise that was sold by push or punch cards.<sup>26</sup> By punching out a disc in the card, a customer learned the cost of the specially priced merchandise that was being offered for sale.<sup>27</sup> The cost of a specific piece of merchandise ranged from zero to thirty-nine cents.<sup>28</sup> The Commission issued an order prohibiting Marco's game because the game was in the nature of a lottery.<sup>29</sup> The *Marco* court struck down the order because of the disparate treatment accorded Marco Sales Company in comparison to the food retailing and

20. 15 U.S.C. section 45 (a)(1) (1982) states: "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."

21. *R. F. Keppel & Bros., Inc.*, 291 U.S. at 313-14; *Dandy Products, Inc. v. FTC*, 332 F.2d 985, 986 (7th Cir. 1964), *cert. denied*, 379 U.S. 961 (1965).

22. See *Frye v. Taylor*, 263 So. 2d 835 (Fla. App. 1972); *State ex rel. Morgan v. Dare To Be Great, Inc.*, 15 N.C. App. 275, 189 S.E.2d 802 (Ct. App. 1972); *State ex rel. Lefkowitz v. I.T.M., Inc.*, 52 Misc. 2d 39, 274 N.Y.S.2d 303 (1966); Comment, *Trade Regulation: Examination of Games of Chance and Referral Selling as Sales Promotional Devices*, 17 U. KAN. L. REV. 668, 669-74 (1969) (critical analysis of the antilottery approach).

23. *FCC v. American Broadcasting Co.*, 347 U.S. 284, 290-91 (1954).

24. 16 C.F.R. §419 (1983).

25. 453 F.2d 1 (2d Cir. 1971).

26. *Id.* at 3.

27. *Id.*

28. *Id.*

29. *Marco Sales Company*, 78 F.T.C. 454, 462-63 (1971).

gasoline industries.<sup>30</sup> The Commission, on the one hand, had only regulated games in the food retailing and gasoline industries while in *Marco*, the Commission had prohibited the game of chance altogether.

The approach of the Commission to pyramid sales schemes has evolved from first treating the schemes as lotteries, to an approach based on an inherent deception theory, as exemplified by *Ger-Ro-Mar, Inc.*,<sup>31</sup> *Holiday Magic, Inc.*,<sup>32</sup> and *Koscot Interplanetary, Inc.*<sup>33</sup> The first pyramid sales case adjudicated by the Commission was *Ger-Ro-Mar*.

*Ger-Ro-Mar* is the *only* Commission case that was tried on the theory that a pyramid sales plan, apart from any specific misrepresentations, is inherently deceptive due to the inevitability of market saturation. Under this *per se* theory, a demonstration of market saturation is unnecessary.<sup>34</sup> In that case, the Commission found that *Ger-Ro-Mar* was engaged in the sale and distribution of "Symbra'ette" brand brassieres, girdles, lingerie, swimwear, and wigs through a multi-level marketing plan. A participant in the marketing plan obtained the right to purchase products at a discount and sell them at retail prices for a profit.<sup>35</sup> The *Ger-Ro-Mar* scheme was challenged at trial in three separate counts, each resting on a different legal theory. Count one was grounded on a traditional antilottery theory,<sup>36</sup> count two was grounded on an inherent deception theory,<sup>37</sup> and count three charged that *Ger-Ro-Mar* had made specific misrepresentations, including false earnings claims in connection with the promotion of the scheme.<sup>38</sup>

The Commission found the *Ger-Ro-Mar* plan unfair and deceptive because the plan presented the opportunity to make money by recruiting others, with the right to recruit passed on to other participants as an inducement for them to join. This type of plan, the Commission concluded, contains the "intolerable potential to deceive."<sup>39</sup> The Commission also found that *Ger-Ro-Mar* had misrepresented the earning potential of the scheme in its promotional materials even though no evidence was introduced showing that the promised earnings were not achieved by the typi-

30. 453 F.2d at 3.

31. 84 F.T.C. 95 (1974), *aff'd in part, rev'd in part sub. nom.*, *Ger-Ro-Mar v. F.T.C.*, 518 F.2d 33 (2d Cir. 1975). Case Comment, 9 SUFFOLK U. L. REV. 1406 (1975). The authors were the complaint counsel in the *Ger-Ro-Mar* case.

32. 84 F.T.C. 748 (1974).

33. 86 F.T.C. 1106 (1975), *aff'd mem. sub nom.*, *Turner v. F.T.C.*, 580 F.2d 701 (D.C. Cir. 1978).

34. 84 F.T.C. at 145-48.

35. *Id.* at 106-07.

36. *Id.* at 100.

37. *Id.* at 100-01.

38. *Id.* at 102. The complaint also charged *Ger-Ro-Mar* with wholesale and retail price fixing and other restrictive practices. *Id.* at 103.

39. *Id.* at 148.

cal or average participant.<sup>40</sup> After analyzing the Ger-Ro-Mar marketing plan as set forth in the sales manual and promotional literature, the Commission concluded that all participants could not possibly succeed in the manner portrayed.<sup>41</sup> Ger-Ro-Mar's pyramid sales scheme, and the earnings representations made to promote it, therefore were found by the Commission to be deceptive.

The Commission did not uphold the finding of the administrative law judge that the Ger-Ro-Mar plan was a type of lottery.<sup>42</sup> The Commission, noting the difficulty of distinguishing the large element of chance contained in Ger-Ro-Mar's plan from that found in many legitimate business opportunities, did not find that chance, an essential element of a lottery, was the sole appeal of the plan.<sup>43</sup> The holding in *Ger-Ro-Mar*, therefore, strikes a death knell for the use of the antilottery approach to pyramid sales schemes, at least in cases brought before the Commission.<sup>44</sup>

On appeal, the Second Circuit reversed<sup>45</sup> the part of the ruling by the Commission proscribing the marketing plan because some evidence of market saturation had not been shown.<sup>46</sup> The court held that the marketing plan could not be found by the Commission to violate section 5 of the FTC Act based solely on a theory or mathematical formula.<sup>47</sup> The court, however, upheld the determination of the Commission that the earnings claims contained in the advertisements promoting Ger-Ro-Mar's pyramid sales schemes—as opposed to the pyramid plan itself—were deceptive, even in the absence of market saturation or evidence that the promised earnings were in fact not achieved by the typical participant.<sup>48</sup>

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40. *Id.* at 149-50. It is well established that the Commission may draw its own inferences from an advertisement. The Commission need not depend on testimony or exhibits introduced into the record. *Carter Products, Inc. v. F.T.C.*, 323 F.2d 523, 528 (5th Cir. 1963); *Zenith Radio Corp. v. F.T.C.*, 143 F.2d 29, 31 (7th Cir. 1944).

41. 84 F.T.C. at 150.

42. *Id.* at 153-55.

43. *Id.*

44. See *Holiday Magic, Inc.*, 84 F.T.C. at 1038 n.7 (Commission vacated portions of Initial Decision and Order dealing with lottery count); *Koscot Interplanetary, Inc.*, 86 F.T.C. at 1160 (lottery count dismissed). In the authors' opinion, this is a wise decision because the antilottery theory was designed for unsophisticated games of chance, and not for clever schemes disguised as commercially feasible business opportunities. See LEFF, SWINDLING AND SELLING 109-11 (1976).

45. *Ger-Ro-Mar, Inc. v. FTC*, 518 F.2d 33 (2d Cir. 1975).

46. The court stated:

[W]e have no study or analysis in the record which would realistically establish that some recruiting saturation exists which would make the entry of additional distributors and the recruitment of others potentially impossible in any practical sense.

*Id.* at 37. See also *U.S. v. Bestline Products Corp.*, 412 F. Supp. 754, 777 (N.D. Cal. 1976).

47. 518 F.2d at 37-38.

48. *Ger-Ro-Mar*, 518 F.2d at 38-39. The seemingly inconsistent result reached by the court in *Ger-Ro-Mar* cannot be fully explained. The court found the promotion of the pyramid plan to be deceptive and in doing so may have applied an inherent deception standard. The court points to evidence in the record to support the finding of deception. *Id.* at 39. However, the court did not indicate the exact evidence it relied upon and stated no legal standard for the finding.

Three possible explanations exist for the result reached by the *Ger-Ro-Mar* Court.



Shortly after the Commission issued the *Ger-Ro-Mar* opinion, but prior to the decision of the court of appeals in *Ger-Ro-Mar*, the Commission decided the case of *Holiday Magic, Inc.*<sup>49</sup> Holiday Magic was engaged in the sale and distribution of cosmetics, toiletries, and cleaning products through a multi-level distribution program. A participant could buy into the program at different levels, and each level required a different initial investment. Participants in the program obtained the right to purchase products at discount and sell them at retail for a profit. In addition, the Holiday Magic program emphasized the large earnings that could be achieved by a participant through commissions paid for sponsoring new distributors. Participants could also earn commissions and overrides on the products that the new distributors sold.<sup>50</sup> In *Holiday Magic*, complaint counsel demonstrated actual market saturation. The Commission, however, citing its own opinion in *Ger-Ro-Mar*, indicated that an order prescribing the Holiday Magic plan would have been issued even in the absence of proof of market saturation because the potential for deception would have remained.<sup>51</sup> The Commission continued to favor the summary approach to pyramid schemes enunciated in *Ger-Ro-Mar*.<sup>52</sup>

After the *Holiday Magic* decision, and after the Second Circuit Court of Appeals decided *Ger-Ro-Mar*, the Commission rendered its opinion in

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First, the only evidence in the record was the promotional literature used by Ger-Ro-Mar. The record did not contain evidence of actual earnings achieved by participants. Therefore, the court apparently applied an inherent deception standard to the *representations*, the very standard it had specifically rejected earlier as to the *plan* itself. Second, the opposite conclusion could also be reached by a reasonable reading of the decision of the court. The opinion infers that the court relied upon evidence in addition to the promotional literature to support the finding that the representations were misleading. Any other reading produces an apparent inconsistency between the treatment of the plan and the treatment of the representations. Finally, the best explanation for the seemingly inconsistent decision of the court is that the respondents had, in effect, conceded the misrepresentation issue in their reply brief.

We further note that the petitioners, in their reply brief, have conceded that "[I]f there be any questionable conduct on the part of Symbra'ette, it must be in the alleged misrepresentation in its advertising. The ends of justice will be met and any misconduct will be obviated by merely prohibiting misrepresentations in the advertising." We are inclined to agree and affirm and enforce paragraphs 3, 4, 5, 6, 7 and 8 of the final order.

*Id.* Thus, the *Ger-Ro-Mar* court never decided the issue of whether earnings claims based upon the pyramiding of new recruits are inherently deceptive.

49. 84 F.T.C. 748 (1974).

50. *Id.* at 1035-38.

51. *Id.* at 1037.

52. *Id.* In this regard, the Commission stated: "Indeed, a tragic aspect of this case is that the challenged marketing plan was not obliterated in its infancy, before the seed of deception ripened into the poisonous fruit of fraud and oppression." *Id.* Complaint counsel in *Holiday Magic* also demonstrated that the typical distributor actually failed to make the promised earnings. The opinion of the Commission, however, clearly indicates that this type of proof was not necessary to support the conclusion that the earnings representations were deceptive. 84 F.T.C. at 1032-38. The Commission also found that Holiday Magic had engaged in price discrimination in violation of subsection (a) of section 2 of the Clayton Act, as amended by the Robinson-Patman Act, 15 U.S.C. section 13(a)(1982) and engaged in illegal price fixing and other restrictive practices in violation of section 5 of the FTC Act. *Id.* at 1049-60.

the case of *Koscot Interplanetary, Inc.*<sup>53</sup> Koscot was engaged in the sale and distribution of cosmetics and toiletries through a multi-level distribution program that resembled the plan in *Holiday Magic*.<sup>54</sup> The Commission, in apparent disregard of the *Ger-Ro-Mar* court, cited its earlier decisions in *Ger-Ro-Mar* and *Holiday Magic* and continued to adhere to the application of an inherent deception standard to both the marketing plan and the earnings misrepresentations. Although complaint counsel demonstrated market saturation, the opinion of the Commission makes clear that the decision rested on the deception inherent in the plan, and not on any actual injury suffered as a result of market saturation.<sup>55</sup>

In *Koscot*, the administrative law judge found that Koscot misrepresented the earnings potential of the plan. This finding was based on two independent theories:<sup>56</sup> (1) actual proof of the falsity of the representation, and (2) the “mathematical fallacy” inherent in the plan. The Commission adopted these findings of the judge and issued an order proscribing the deceptive earnings claims.<sup>57</sup>

*Amway Corporation, Inc.*<sup>58</sup> is the most recent Commission statement about pyramid sales schemes. Amway was engaged in the manufacture, sale, and distribution of cleaning and personal care products through a multi-level distribution plan. The Commission found that the Amway distribution plan was not illegal because the plan emphasized sales to ultimate consumers rather than the recruitment of new distributors. The Amway plan ensured that a participant’s success must be based on retail sales. First, the plan enforced a “seventy percent” rule whereby each distributor was required to sell at least seventy percent of the total amount of products he bought during a month to receive bonuses on total products purchased.<sup>59</sup> Second, the “ten customer” rule required at least one sale at retail to ten different customers in a month to be eligible for bonuses.<sup>60</sup> In addition, the Amway plan included a “buy-back” rule, stating that a sponsoring distributor shall “[p]urchase back from any of his personally sponsored distributors leaving the business, upon his request, any unused, currently marketable products. . . .”<sup>61</sup> The Commission noted that this “buy-back” rule prevented a sponsoring distributor from loading an unrealistically large amount of inventory onto his sponsored distributors, a

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53. 86 F.T.C. 1106 (1975), *aff’d mem. sub nom.*, *Turner v. F.T.C.*, 580 F.2d 701 (D.C. Cir. 1978).

54. 86 F.T.C. at 1178-82.

55. *Id.* at 1180-82.

56. 86 F.T.C. at 1132-35.

57. The Commission also found that Koscot, like *Holiday Magic*, had engaged in price discrimination, in illegal price fixing and other restrictive practices. *See supra* note 52.

58. 93 F.T.C. 618 (1979).

59. *Id.* at 716.

60. *Id.*

61. *Id.*

major problem in *Holiday Magic* and *Koscot*. The “seventy percent” rule, the “ten customer” rule, and the “buy-back” rule, the Commission concluded, served to encourage retail sales and prevent inventory loading. The incentives for the participant were to make retail sales rather than to build a pyramid of recruits. These features of the Amway plan made it significantly different from the plans condemned by the Commission in *Ger-Ro-Mar*, *Holiday Magic*, and *Koscot*.<sup>62</sup>

The complaint counsel in *Amway* introduced evidence that the typical Amway distributor did not earn the monies promised. The earnings claims made by Amway, however, were not based upon the pyramiding of new recruits. Instead, Amway had made generalized earnings claims that held out the possibility of earning at least \$12,000 per year.<sup>63</sup> The evidence showed, however, that only one-half of one percent of the total number of Amway distributors made more than \$10,000 in profits.<sup>64</sup> The Commission, therefore, issued an order prohibiting these earnings claims.<sup>65</sup> The Commission cited *National Dynamics Corp.*,<sup>66</sup> a traditional business opportunity case, for the proposition that Amway had misrepresented earnings claims concerning the profitability of a distributorship and therefore, had made an illegal misrepresentation in violation of section 5 of the FTC Act.<sup>67</sup> Nonetheless, the Commission clearly indicated that *Amway* was not a pyramid case because the Amway plan did not contain the essential features of an illegal pyramid scheme.<sup>68</sup> Specifically, the Amway plan was *not* a scheme in which participants purchased the right to earn profits by recruiting other participants, who themselves were interested in recruitment bonuses rather than the sale of products.<sup>69</sup>

The *Ger-Ro-Mar*, *Holiday Magic*, *Koscot*, and *Amway* cases are clear Commission precedent for the legal proposition that both a pyramid plan itself, as well as the earnings claims based upon pyramided recruitment, are inherently deceptive and thus illegal under section 5 of the FTC Act.<sup>70</sup> Although the decision of the court in *Ger-Ro-Mar* precludes the application of an inherent deception standard to the pyramid plan itself, the standard may still be applied to earnings misrepresentations used to promote the plan. The decisions of the Federal Trade Commission and the Second Circuit Court of Appeals, however, have not articulated a uniform ap-

62. *Id.* at 716-17.

63. The earnings claims stated: “What do you want to make of your life? . . . An income of \$15,000 to \$50,000 per year?” and “You can earn \$12,000 a year.” *Id.* at 732.

64. *Id.*

65. *Id.* at 738. In addition, the Commission found that Amway engaged in illegal resale price maintenance at both the wholesale and retail levels. *Id.* at 717-28.

66. 82 F.T.C. 488 (1973).

67. 93 F.T.C. at 732.

68. *Id.* at 715.

69. *Id.* at 716-17.

70. *See supra* notes 49-66.

proach to pyramid sales cases. The remainder of this article, therefore, will suggest a method for effectively challenging pyramid sales schemes.

### A PROPOSED LEGAL APPROACH

The authors of this article suggest that the Commission should continue to apply the inherent deception standard to the earnings claims made by pyramid promoters. Only this approach will stop pyramid schemes in their infancy.<sup>71</sup> Confining a pyramid challenge to earnings misrepresentations alone, using a summary approach, will be more effective than challenging the entire marketing plan. In the traditional business opportunity case, the complainants must prove that the promised earnings were not earned by the average or typical participant. Under the inherent deception approach, the deception is apparent from a mere perusal of the pyramid plan and therefore, proof of actual failure to achieve the promised earnings is unnecessary. Challenging only the earnings claims will be as effective in correcting the deception perpetrated on prospective participants as will challenging the pyramid plan itself. Promoters of pyramid plans will find the recruitment of participants very difficult without representing an expected level of earnings,<sup>72</sup> particularly when selling to prospects who believe that they are being offered a commercially feasible business opportunity. Furthermore, this approach to challenging pyramid schemes is in consonance with the decision of the court in *Ger-Ro-Mar*, which struck down the application of an inherent deception standard to a pyramid sales plan but not to earnings claims based upon pyramided recruitment.<sup>73</sup> In the following sections, this article will describe the theories of inherently deceptive earnings claims and inevitable injury to participants that should be used in prosecuting a pyramid sales scheme under the inherent deception approach.

#### *A. Deceptive Earnings Claims Made In The Promotion Of A Pyramid Sales Scheme*

Earnings claims typically made in connection with the promotion of a pyramid sales scheme illustrate the inherent deception present in the claims. A typical pyramid company, ABC Pyramid Company (hereinaf-

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71. See *supra* note 52.

72. Various types of earnings claims are presented by promoters to induce enthusiasm at promotional meetings. See, e.g., *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 479 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973) (promoters dressed in expensive clothes throwing sums of cash about); *Kugler v. Koscot Interplanetary, Inc.*, 20 N.J. Super. 216, 229, 293 A.2d 682, 689 (Super. Ct. 1972) (a "money hum" used to induce enthusiasm).

73. See *supra* note 48 and accompanying text.

ter referred to as "ABC"), requires each new participant to purchase a sales kit that includes a sales manual. The sales manual describes the multi-level program in the following manner:

\* \* \* \*

If you sign up ten people and each in turn does the same for three levels, see what happens:

Level	Members	Your Commission	
		Purchase Volume	(10%)
1	10	\$200	\$20
2	100	\$2,000	\$200
3	1,000	\$20,000	<u>\$2,000</u>
			\$2,220

That's \$2,220 *per month!* Go down ten levels and see what happens!<sup>74</sup>

\* \* \* \*

Using these types of statements, the promoters of ABC represent that the typical or average participant in the program can expect to earn at least \$2,220 per month. The earnings claim is deceptive because only a very limited number of early participants have an opportunity to earn \$2,220, or any other significant amount. Using the assumption made by ABC that each member would be able to recruit ten new members, one million members would be at the sixth level and only the initial participant and the participants at the first, second, and third level, would have earned as much as \$2,220. The program would have to continue to the ninth level for each of the one million participants to earn the promised amount, at which point one billion people would be members of the ABC pyramid sales scheme.<sup>75</sup> The large numbers of distributors projected by ABC could never be reached by ABC or by any other pyramid sales scheme. *The projected numbers could never be reached despite ABC promises to each potential participant of an opportunity that only the pro-*

74. Cf. *Ger-Ro-Mar, Inc.*, 84 F.T.C. at 112-15.

75. The formula for the calculation of the number of members in any level "n" is the simple  $n = x^i$ , where "x" is the number of recruits per participant per level (in this case  $x = 10$ ) and "i" is the level (in this case  $i = 9$ ). Thus,  $n = 10^9 = 1$  billion. Actually, the number of members in the program by the time the plan reached nine levels would be higher (1,111,111,110) since all previous levels would, on these assumptions, still be "in" the program. Thus,  $10^9$  gives only the number brought in at level nine. For present purposes, of course, 100 million participants more or less make very little difference. Cf. *Ger-Ro-Mar, Inc. v. FTC*, 518 F.2d at 37 n.3.

*jected numbers could fulfill.*

Law enforcement agencies should not assume that a plan must lead to saturation to be deceptive. The inherent vice of pyramid sales schemes is not the high number of participants that the schemes must achieve to be successful, but the inexorable rate of growth that the schemes must maintain if even early participants are to succeed. If pyramid sales schemes are to succeed at all, growth must be exponential. The chance that any subsequent participant's success will be equal to the success of any prior or contemporary participant will always diminish in accordance with the success of previous participants. Later participants, therefore, will always have a lesser probability of success than earlier participants. Because the same program with the same literature is used unchanged during the course of a pyramid sales scheme, every later participant must have more difficulty finding and convincing others to join the program. If an initial participant had a one-in-ten chance of recruiting five new sponsorees, then a later participant has a chance that is less than one-in-ten, a chance decreased precisely by the success of the first participant and his contemporaries.

The odds need not increase at a strict exponential rate, however, for a pyramid sales scheme to be inherently deceptive. Even if the rate of growth is less than exponential, not all participants will drop out or fail to recruit. The success of the remaining participants decreases the opportunity for success of those who subsequently join the plan. (Persons who drop out are effectively removed from the pool of potential recruits). Persons who join later, however, are still offered the same proposition as those who joined earlier. Participants are thus deceived before any theoretical "saturation" of the market occurs.<sup>76</sup>

In effect, a participant in a pyramid sales scheme exchanges money and effort for (1) the right to purchase or sell goods, and (2) the right to profit by recruiting other participants to purchase or sell the goods. The promise of success conveyed to one distributor is the same promise the distributor then conveys to the next generation of distributors, *ad infinitum*. The chance of finding other recruits must decrease as a direct function of the number of people already in the program. Each subsequent purchaser, therefore, is in the position of being asked to join a program in which the odds against finding new participants have necessarily shifted against him. If this fact is not concealed, only an imprudent person would join the program. Consequently, if the program is to succeed, new entrants must be deceived by the pyramid promoter and the initial distributors.

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76. See *supra* note 17.

## B. Inevitable Injury To Participants

Promoters of pyramid sales schemes present the program as a commercially feasible business opportunity. Most business opportunities require a large investment of money and business acumen. A pyramid sales scheme, on the other hand, promises the average person the opportunity to earn large profits as an independent business person by investing time and labor instead of a large amount of money. The pyramid sales scheme often appeals to the unsophisticated person<sup>77</sup> and is especially attractive during times of economic uncertainty.<sup>78</sup>

Some early participants may join out of greed, knowing that profits will be gained at the expense of later participants. The great majority of participants in pyramid sales schemes, however, joined what they thought was a legitimate business opportunity. The unique strength of the pyramid sales scheme is the power to attract participants to the plan. Participants are recruited into the program by promises of (1) goods to buy or sell at a promised savings or profit, and (2) a chance, made attractive by reference to the power of pyramided recruitments, to earn substantial additional compensation.<sup>79</sup> The participants are thus lured into the program and induced to make a commitment to sales and recruitment by materially misleading promises of success. The participants lose their financial investment as well as alternative opportunities for the use of their time and labor.

Experience demonstrates that the operation of a pyramid sales scheme inevitably results in consumer injury. Nonetheless, *some* participants will be able to make *some* money. The chance that most participants in these schemes will achieve any substantial amounts of earnings are slim to begin with, however, and decrease exponentially as the program continues.

### ALTERNATIVE REMEDIES

Commission action is only one of several responses that may remedy the problems of pyramid sales schemes. Other available means include: (1) the operation of market forces, (2) action by state consumer protection agencies, and (3) self-help remedies by injured participants. In this sec-

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77. *Kugler v. Koscot Interplanetary, Inc.*, 120 N.J. Super. 216, 235, 293 A.2d 682 (Super. Ct. 1972) (program calculated to persuade gullible individuals to purchase distributorships); 16 C.F.R. §15.155(d) (1983) (marketing plan was not "designed as an offer to knowledgeable businessmen competent to weigh and evaluate commercial risks").

78. In *Koscot*, the Commission noted the "staggering human toll" exacted by the Koscot pyramid sales scheme in money borrowed, jobs quit, homes mortgaged, and even bankruptcy. 86 F.T.C. at 1179. See also 33 OHIO ST. L.J. 676, 686-87 (1972) (description of one investor's experience with the Dare To Be Great pyramid sales scheme).

79. See *supra* notes 68-69 and accompanying text.

tion, these alternative remedies will be discussed, and an explanation will be given why Commission intervention can be an efficient and effective way to protect the public from the inherent deception of pyramid sales schemes.

#### A. Operation of Market Forces

A consumer ordinarily protects himself in the marketplace by choosing among alternative products or among alternative uses of his money, time, and labor. For this decision to be meaningful, however, it must be based on full and accurate knowledge of the alternatives.<sup>80</sup> Pyramid promoters undermine this process by misrepresenting the earnings potential of their distribution programs,<sup>81</sup> thus making informed comparisons by prospective participants very difficult. A pyramid promoter has no incentive to provide accurate information because the financial success of the scheme is dependent upon these false promises.

The market will ordinarily accurately evaluate the worth of any business opportunity, but the success of the pyramid promoter is predicated on a taking of profits before the market evaluates the sales plan. Accurate information about an opportunity will be slowly disseminated to the market only after disgruntled participants both fail to achieve the promised earnings and make their dissatisfaction known to other potential participants. In the interim, new recruits, deceived by the promotion, will continue to enter the scheme. Pyramid sales schemes are designed to exploit the information failure of market forces by moving in and out of the market quickly. Consequently, Commission action proves to be a more effective means to combat pyramid sales schemes.

#### B. State Action

Pyramid sales schemes are proliferating across the country and state law enforcement agencies are not always able to cope with the problem alone. Laws under which pyramid promoters are prosecuted vary among the states, making a uniform or simultaneous state response difficult.<sup>82</sup> The budgetary constraints placed upon many state consumer protection

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80. See generally Pridgen & Preston, *Enhancing the Flow of Information in the Marketplace: From Caveat Emptor to Virginia Pharmacy and Beyond at the Federal Trade Commission*, 14 GA. L. REV. 635 (1980); Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661 (1977).

81. See, e.g., *Ger-Ro-Mar, Inc.*, 84 F.T.C. at 149-50; *Holiday Magic, Inc.*, 84 F.T.C. at 1032-35.

82. See Note, *Pyramid Schemes: Dare to be Regulated*, 61 GA. L.J. 1257 (1973), for a discussion of the various state enforcement approaches to pyramid sales schemes. See generally 54 A.L.R.3d 217 (1973).



agencies also hinder the states in curbing pyramid sales schemes. State action, therefore, does not always effectively curb pyramid companies. A challenged company can simply move from one state to another, leaving its distributors to face state law enforcement officials. A well-publicized Commission order of nationwide scope is preferable to multifarious and limited state responses.

### *C. Self-Help Remedies By Injured Participants*

The cost and difficulty of bringing individual lawsuits against an out-of-state corporation will prevent most injured consumers from pursuing individual remedies. Furthermore, the sponsoring distributor is often a friend or relative<sup>83</sup> and therefore, is unlikely to be sued. Preventive measures are preferable to individual or group attempts to recover lost money that may have been secreted by the promoters.<sup>84</sup> Individual action is often impractical because of the relatively large expense of recovering a moderate financial loss. Even a class action by participants suffers from the disadvantage of requiring certification<sup>85</sup> and the expense of notification,<sup>86</sup> in addition to the actual litigation costs. Commission challenges to the earnings claims made by pyramid scheme promoters, as presented in this article, would best minimize consumer harm caused by the pyramid company and deter similar illegal conduct by others.

### *D. Commission Action*

The authors believe that Commission action, utilizing the inherent deception approach suggested in this article, would be the most effective and efficient method of achieving a nationwide, uniform response to the very serious problem presented by pyramid sales schemes. The Commission has a number of available remedial tools,<sup>87</sup> including: (1) civil penalties from respondents, (2) civil penalties from nonrespondents, (3) consumer redress after trial, and (4) temporary and permanent injunctions. Each of these remedial options is discussed below.

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83. *Kugler v. Koscot Interplanetary, Inc.*, 120 N.J. Super. 216, 233-35, 293 A.2d 682, 691-92 (Super Ct. 1972).

84. In *Koscot*, the Commission noted that \$44 million had been taken from consumers and only a fraction of the money had been accounted for. 86 F.T.C. at 1181.

85. FED. R. CIV. P. 23 (c)(1).

86. *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 178-79 (1974).

87. See Federal Trade Commission *Operating Manual*, Ch. 11 (the procedures and criteria regarding judicial action) [hereinafter referred to as *Operating Manual*].

### 1. Civil Penalties From Respondents

A pyramid sales company that violates a final order of the Commission is liable for civil penalties.<sup>88</sup> A continuing violation is considered to be a separate offense for each day the violation continues.<sup>89</sup> Furthermore, federal district courts are authorized to issue injunctions and other equitable relief to enforce Commission orders.<sup>90</sup>

### 2. Civil Penalties From Nonrespondents

Under section 205 of the FTC Act, the Commission can seek civil penalties against a nonrespondent<sup>91</sup> when: (1) a person engages in acts or practices that the Commission has held to be unlawful under the FTC Act by issuing a cease and desist order, and (2) the person had actual knowledge of the unlawfulness of the acts set forth in the previous order.<sup>92</sup> Once the Commission finds that a pyramid sales company has violated section 5 of the FTC Act by making earnings misrepresentations based upon pyramid recruiting, a copy of the final order against that company can be mailed to companies making similar earnings claims.<sup>93</sup> Mailing of the order satisfies the actual knowledge requirement.<sup>94</sup> If the other pyramid companies then fail to cease making the earnings misrepresentations, the Commission can seek civil penalties against those companies in federal district court.

### 3. Consumer Redress After Trial

Under section 19(a)(2) of the FTC Act,<sup>95</sup> the Commission can seek con-

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88. 15 U.S.C. §45(1) (1982); *see, e.g.*, U.S. v. Bestline Products Corp., 412 F. Supp. 754 (N.D. Cal. 1976). The Bestline pyramid sales scheme and its founder, William E. Bailey were found to be in non-compliance with a Commission consent order. The Court ultimately assessed Bailey \$1,036,000 in civil penalties. San Francisco Chronicle, June 19, 1976, at 10.

89. 15 U.S.C. §45(a)(1) (1982).

90. *Id.*

91. A respondent, as used here, means a company or individual who is under a Commission order for having engaged in unlawful acts or practices. A nonrespondent is a company or individual not under Commission order but is engaging in the same unlawful acts or practices as the respondent.

92. 15 U.S.C. §45(m)(1)(B) (1982). *See generally* 1 S. KANWIT, FEDERAL TRADE COMMISSION §§10.07.09 (1979).

93. *See Operating Manual, supra* note 87, Ch. 11, §2.2 (Commission's section 205 procedures).

94. *See Operating Manual, supra* note 87, Ch. 11, §2.2.4; 1 S. KANWIT, FEDERAL TRADE COMMISSION §10.09 (1979). In a civil penalty action against a nonrespondent, all issues of fact in that action must be tried *de novo* in the federal district court. 15 U.S.C. §45(m)(2) (1982).

95. 15 U.S.C. §57b (a)(2) (1982). *See F.T.C. v. Glenn W. Turner Enterprises, Inc.*, 446 F. Supp. 1113 (M.D. Fla. 1978) (for the first judicial interpretation of the consumer re-

sumer redress in federal district court or in any state court of competent jurisdiction against a person who is subject to a final cease and desist order. The challenged act or practice must be one that under the circumstances, a "reasonable man" would have known was dishonest or fraudulent<sup>96</sup> — a standard more stringent than that required in an administrative proceeding to enforce section 5.<sup>97</sup> The challenged act or practice must also have occurred within three years prior to the date the Commission complaint is issued.<sup>98</sup>

Given the decision of the court in *Ger-Ro-Mar*, the authors doubt that the Commission will authorize the use of section 19 until a clear precedent is established. Whether a pyramid recruiting scheme can meet the required "dishonest or fraudulent" standard is also undecided. Persuasive arguments support the proposition, however, that a pyramid promoter who makes earnings claims based upon the pyramiding of new recruits acts dishonestly and is subject to redress under section 19.<sup>99</sup>

#### 4. Injunctions

Under section 13(b) of the FTC Act, the Commission can seek an injunction in federal district court whenever it has reason to believe that a law enforced by the Commission will be violated and action by the Commission is in the public interest.<sup>100</sup> Under section 13(b), a temporary restraining order or preliminary injunction is authorized upon a showing that granting relief would be in the public interest, based upon a balancing of the equities and the ultimate likelihood of success of the Commission.<sup>101</sup> If a Commission complaint is not filed within twenty days after is-

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dress statute). See generally 2 S. KANWIT, FEDERAL TRADE COMMISSION §§21.03-.06 (1979).

96. 15 U.S.C. §57b (a)(2) (1982).

97. In a section 5 administrative proceeding, absence of knowledge of falsity is not a defense. See, e.g., *Gimbel Bros., Inc. v. FTC*, 116 F.2d 578, 579 (2d Cir. 1941).

98. 15 U.S.C. §57b (d) (1982).

99. See *FTC v. Glenn W. Turner* [1983-1 Trade Cas. (CCH) ¶65,224] No. 79-474-ORL-R (M.D. Fla. December 29, 1982). In granting the FTC's motion for partial summary judgment, the court found Turner liable for redress to consumers who purchased distributorships in his pyramid sales scheme because his actions were of a nature that a "reasonable man would have known under the circumstances were dishonest and fraudulent," and which were "reasonably calculated to deceive persons of ordinary prudence and comprehension." *Id.* at 69,451. The court ordered Turner to refund \$29,299,384 plus interest to 25,000 distributors. *Regulatory and Legal Developments*, No. 200, at A-24 (Oct. 14, 1983). See also *FTC v. Mac Millan, Inc.*, [1983-2 Trade Cas. (CCH) ¶65,553] No. 81 C 6053 (N.D. Ill. August 3, 1983). The court indicated that for the purpose of obtaining consumer redress under section 19, the acts and practices should fall at least within the mail fraud statute, 18 U.S.C. section 1341 (1982). The acts need only be reasonably calculated to deceive persons of ordinary prudence and comprehension. *Id.* at 68,756. Section 19 does not require proof of a defendant's actual intent to defraud consumers. *Id.* at 68,759.

100. 15 U.S.C. §53(b) (1982). See generally 1 S. KANWIT, FEDERAL TRADE COMMISSION §10.04 (1979) (explanation of injunction-granting process).

101. *F.T.C. v. Virginia Homes Manufacturing Co.*, 509 F. Supp. 51 (D. Md.), *aff'd*, 661 F.2d 920 (4th Cir. 1981).

suance, however, the order or injunction is dissolved.<sup>102</sup> Section 13(b) also gives the federal district court authority to grant permanent injunctions in *routine cases* even though the Commission does not contemplate any administrative proceedings.<sup>103</sup>

The authors have concluded in this article that Commission precedent exists for the legal proposition that earnings claims based upon pyramided recruitment are inherently deceptive and violate section 5 of the FTC Act. Consequently, a section 13(b) injunction action seems to be an appropriate remedy. The decision of the court in *Ger-Ro-Mar*, however, creates doubt about the current viability of this theory. A federal district court judge may not view the law as sufficiently settled to grant an injunction. Given this uncertainty, the authors believe that an administrative case-by-case approach is more prudent. Once the inherent deception standard is applied to the earnings claims of a pyramid sales scheme in an FTC order, a section 13(b) injunction action or a section 205 approach might well become the most effective and efficient remedy.

### CONCLUSION

Pyramid sales schemes are promoted as commercially feasible business opportunities in which participants are all promised an opportunity to earn profits by selling products *and* a chance, made attractive by reference to pyramided recruitments, to earn substantial, additional earnings. The chance that all or even most of the participants will achieve any large amounts of earnings is very small. Pyramid schemes tend to appeal to unsophisticated persons and are especially alluring during economically uncertain periods.

The natural operation of the marketplace, private legal action, and action by state agencies are not always effective in curbing the vice inherent in pyramid sales schemes. Commission action, however, can be an effective and efficient way to protect the public against pyramid promoters. By applying the inherent deception standard set forth in this article to the earnings misrepresentations, the Commission can quickly stop a pyramid sales scheme before thousands of participants are injured. A Commission challenge to the earnings claims can be effective because a pyramid promoter will find the recruitment of participants impossible without representing an expected level of earnings.

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102. 15 U.S.C. §53(b) (1982).

103. See *F.T.C. v. H.N. Singer, Inc.*, 668 F.2d 1107 (9th Cir. 1982).

