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Camille H. Mangiaratti

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**BIG DREAMS AND PYRAMID SCHEMES: THE FTC'S
PATH TO IMPROVING MULTI-LEVEL MARKETING
CONSUMER PROTECTION IN LIGHT OF *AMG CAPITAL
MANAGEMENT* AND THE 2016 HERBALIFE
SETTLEMENT**

*Camille H. Mangiaratti**

[Multi-level marketing] is a mathematical trick played on the unwary. MLM promises significant rewards to those who invest time and money in an MLM program, but delivers losses to all but those at or near the top of a large pyramid (or beginning of the chain) of participants - who profit from the failed investments of those beneath them in the pyramid.

– Jon M. Taylor, *Consumer Awareness Institute*¹

Multi-level marketing, also known as “MLM,” is a type of sales business that relies on both sales to consumers and recruitment of sellers into the company’s tiered commission structure. MLMs are wildly and enduringly popular, especially because they claim to be a flexible and easy source of income for people who need it most.

* J.D. Candidate, Brooklyn Law School, 2022. B.A., Cornell University, 2015. I would like to sincerely thank the members of the *Journal of Law and Policy* for their diligence and guidance in preparing this piece for publication, as well as my friends and family for their kindness and support throughout my time in law school. This Note is dedicated to my parents, Jody and Thomas Mangiaratti, who have given me the world, and to Beeper Mangiaratti, who makes me smile every day.

¹ Jon M. Taylor, *The Case (For and) Against Multi-Level Marketing: The Complete Guide to Understanding the Flaws – and Proving and Countering the Effects – of Endless Chain “Opportunity” Recruitment, or Product-based Pyramid Schemes*, CONSUMER AWARENESS INSTITUTE 7–35 (2012), <https://centerforinquiry.org/wp-content/uploads/sites/33/quackwatch/taylor.pdf> [hereinafter *The Case Against MLM*].

*However, almost everyone who joins an MLM will lose money, and many MLMs are illegal pyramid schemes. Millions of Americans are harmed by MLMs every year. Despite this, the government does very little to punish MLMs who lie to prospective participants about their odds of success. How are MLMs allowed to operate relatively unchecked? MLMs have a powerful political lobby which has ensured that state and federal regulations remain favorable to their operations. Furthermore, the Supreme Court's 2021 decision in *AMG Capital Management, LLC v. Federal Trade Commission* abrogated the FTC's power to pursue financial restitution for consumers harmed by MLMs. To overcome this setback, this Note argues that the FTC must frequently and aggressively use its Sections 5 and 19 powers to reimburse harmed MLM customers and deter further MLM misconduct, without falling into the pitfalls exemplified by its 2016 settlement with Herbalife, a nutrition MLM. The FTC must also require full disclosure of the odds of success in an MLM, obtain proportionate financial punishments against offenders, and more widely publicize the harmful nature of MLMs.*

INTRODUCTION

Multi-level marketing (“MLM”) is a sales business model wherein participants earn income through two major channels: first, by selling products or services via direct, person-to-person sales, often from home or online,² and second, by recruiting others to join the MLM.³ An MLM participant earns commission on their recruit's sales, as well as commission on the sales of anyone their recruit subsequently brings into the company.⁴

MLMs are entrenched in America—they have been popularized and protected, in part, through the support of powerful public

² *Multi-Level Marketing Businesses and Pyramid Schemes*, FED. TRADE COMM'N (May 2021), https://www.consumer.ftc.gov/articles/0065-multi-level-marketing-businesses-and-pyramid-schemes#What_are_MLMs_and_How_Do_They_Work? [hereinafter *FTC Comparison*].

³ *Id.*

⁴ *Id.*

figures, like President Donald Trump⁵ and members of his cabinet.⁶ Unfortunately, MLMs use their political clout to the detriment of the vast majority of their participants, largely because they have a fierce political lobby that helps them dodge federal and state consumer protection regulation.⁷

Despite being promised financial success and personal freedom, most MLM participants lose money⁸ and some find themselves deeply in debt.⁹ MLMs strategically prey on women, immigrants, low-income people, and those whose lifestyles necessitate extra income and flexibility, like stay-at-home parents.¹⁰ The false allure

⁵ See James V. Grimaldi & Mark Maremont, *Donald Trump Made Millions from Multilevel Marketing Firm*, WALL ST. J. (Aug. 13, 2015, 7:37 PM), <https://www.wsj.com/articles/trump-made-millions-from-multilevel-marketing-firm-1439481128> (describing President Donald Trump's involvement with an MLM called ACN).

⁶ Michelle Celarier, *Trump's Great Pyramid*, SLATE (Feb. 21, 2017, 11:06 AM), <https://slate.com/business/2017/02/the-trump-era-will-be-a-boon-for-multilevel-marketing-companies.html>.

⁷ See Matt Stroud, *How Lobbying Dollars Prop up Pyramid Schemes*, THE VERGE (Apr. 8, 2014, 10:30 AM), <https://www.theverge.com/2014/4/8/5590550/alleged-pyramid-schemes-lobbying-ftc>.

⁸ Taylor, *supra* note 1, at Intro-8 (“Based on available company data, approximately 99.7% of all MLM participants lose money.”).

⁹ *FTC Comparison*, *supra* note 2 (“Most people who join legitimate MLMs make little or no money. Some of them lose money. In some cases, people believe they’ve joined a legitimate MLM, but it turns out to be an illegal pyramid scheme that steals everything they invest and leaves them deeply in debt.”); Taylor, *supra* note 1, at Intro-8 (“In some cases, monetary losses from MLM participation lead to heavy indebtedness, bankruptcy, foreclosed mortgages, and failed educational and career pursuits.”).

¹⁰ See Lauren Bell, *Pyramid Dream*, BALTIMORE MAG. (June 2018), <https://www.baltimoremagazine.com/section/businessdevelopment/multi-level-marketing-companies-evolve-with-21st-century/> (using anecdotal evidence to describe how MLMs use lifestyle promises to attract vulnerable participants); see also *Complaint, Belinda Hibbard v. LulaRoe LLC*, 2019-00270087 (Cal. Super. Nov. 27, 2019) (“Defendants targeted women, stay at home mothers, spouses of active military members, and other groups who had working capacity and some access to credit or savings, but also, generally, a lack of formal business or finance training.”); Hector Barreto, *Latino Entrepreneurs Need Federal Protection from Pyramid Schemes*, THE HILL (Feb. 15, 2017, 11:00 AM), <https://thehill.com/blogs/pundits-blog/economy-budget/319625-latino-entrepreneurs-need-federal-protection-from-pyramid>.

of MLMs is especially troubling given the economic downturn stemming from the COVID-19 pandemic—millions of Americans are newly desperate for extra income and MLMs unequivocally promise to deliver.¹¹ While some proponents claim MLMs have spiritual¹² and feminist¹³ upsides, these ideological benefits are far outweighed by the tangible consequences of economic failure,¹⁴ which is all but guaranteed when one gets involved with an MLM.¹⁵

MLMs are regulated at both the state and federal levels.¹⁶ A minority of states regulate MLMs by providing a statutory definition of MLM business operations alongside a companion statute outlawing pyramid schemes.¹⁷ The majority of states, however, provide only anti-pyramid scheme statutes, without defining MLMs.¹⁸ In doing so, these states indirectly regulate MLMs by

¹¹ Johnny Diaz, *F.T.C. Warns 10 Companies About Virus-Related Health and Business Claims*, N.Y. TIMES (Apr. 25, 2020), <https://www.nytimes.com/2020/04/25/us/ftc-mlm-coronavirus-claims.html>.

¹² Peter S. Cahn, *Building Down and Dreaming up: Finding Faith in the Mexican Multilevel Marketer*, 33 AM. ETHNOLOGIST 126, 128 (2006).

¹³ Catherine Dolan & Linda Scott, *Lipstick Evangelism: Avon Trading Circles and Gender Empowerment in South Africa*, 17 GENDER AND DEV. 203, 203 (2009).

¹⁴ Alden Wicker, *Multilevel-Marketing Companies like LuLaRoe are Forcing People into Debt and Psychological Crisis*, QUARTZ (Aug. 6, 2017), <https://qz.com/1039331/mlms-like-avon-and-lularoe-are-sending-people-into-debt-and-psychological-crisis/>.

¹⁵ Taylor, *supra* note 1, at Intro-8.

¹⁶ See Heidi Liu, *The Behavioral Economics of Multilevel Marketing*, 14 HASTINGS BUS. L.J. 109, 115 (2018).

¹⁷ See *Multilevel Marketing Primer – The MLM Startup*, REESE RICHARDS PLLC (Sept. 30, 2019), https://www.mlmlaw.com/law-library/multilevel-marketing-primer-the-mlm-startup#N_4_ (“A sophisticated minority of state laws specifically define and regulate multilevel marketing plans.”); *see also* Clinton D. Howie, *Is It A Pyramid Scheme? Multilevel Marketing and Louisiana’s “New” Anti-Pyramid Statute*, 9 LA. BAR J. 288, 289 (2002) (describing the regulatory framework in Louisiana, a minority jurisdiction. “Louisiana, like a number of other states, enacted a ‘model’ anti-pyramid statute . . . to clearly distinguish between legitimate multilevel marketing plans and illegal pyramid schemes.”).

¹⁸ See REESE RICHARDS PLLC, *supra* note 17 (“The majority of states statutorily regulate multilevel, or more precisely anti-pyramid, activity.”).

ensuring that they do not function like illegal pyramid schemes.¹⁹ The majority approach is the better of the two regulatory models. While the minority approach claims to clearly distinguish between legitimate MLMs and illegal pyramid schemes, in reality, this statutory framework is favorable to MLMs.²⁰ Thanks to pressure from the MLM lobby on lawmakers, the statutes defining MLMs in minority jurisdictions simply describe their business operations and say nothing about how they *should* operate, nor do they provide any guidelines for consumer protection.²¹ Moreover, their companion anti-pyramid statutes are designed to facilitate recruiting, which is favorable for MLMs.²²

On the federal level, the Department of Justice (“DOJ”), Securities and Exchange Commission (“SEC”), and Federal Trade Commission (“FTC”) regulate MLMs through enforcement actions against non-compliant companies.²³ In 2008, the FTC had the chance to impose sweeping consumer protection regulation on the MLM industry through the Business Opportunity Rule, but the powerful MLM lobby convinced the FTC to exempt the industry.²⁴ MLMs continue to operate relatively unchecked.²⁵

¹⁹ *Id.* (“The vast majority of states utilize an indirect approach by defining a ‘pyramid,’ ‘chain distributor scheme’ or ‘endless-chain scheme’ and proscribing such programs.”).

²⁰ *See* Howie, *supra* note 17, at 290 (“Louisiana’s ‘model’ anti-pyramid statute contains a number of express provisions that are likely to provide significant protection for promoters of multilevel marketing plans.”).

²¹ *See* REESE RICHARDS PLLC, *supra* note 17 (noting that “anti-pyramid and multilevel statutes . . . are drafted and interpreted *very broadly*.”).

²² *See* Howie, *supra* note 17, at 289. *See also* Taylor, *supra* note 1, at 2–10 (“Attempting to change the laws is risky, since the MLM lobby (Direct Selling Association) could then influence legislators to pass deceptive ‘anti-pyramid’ laws that are actually favorable to MLM, as they have already done in several states.”).

²³ Liu, *supra* note 16, at 115.

²⁴ Stroud, *supra* note 7.

²⁵ *But see* FED. TRADE COMM’N, *FTC Sends Warning Letters to Multi-Level Marketers Regarding Health and Earnings Claims They or Their Participants are Making Related to Coronavirus*, FED. TRADE COMM’N (Apr. 24, 2020), <https://www.ftc.gov/news-events/press-releases/2020/04/ftc-sends-warning-letters-multi-level-marketers-regarding-health> (illustrating the FTC’s willingness to warn MLMs against making false claims to attract customers during the COVID-19 pandemic).

Consumer protection advocates regularly decry the predatory nature of MLMs.²⁶ Unfortunately, the lax regulatory landscape²⁷ allows MLMs to operate with near impunity and routinely fails to protect the typical MLM participant, whose optimism, desperation, or ignorance blinds them to their near inevitable failure.²⁸ MLM participants represent a relatively large sector of the American public—“one in thirteen (7.7%) adults 18 years of age and older in the United States have participated in at least one MLM organization during their lifetime,”²⁹ and an estimated 16 to 18 million Americans participate in an MLM every year.³⁰ Essentially, due to apathy, political cowardice, and lack of resources, lawmakers and regulators knowingly allow MLMs to victimize millions of hopeful entrepreneurs every year. Without swift and harsh federal intervention, MLMs will continue to lie to the American public, cheat the legal system, and cause widespread financial ruin.

²⁶ See generally Jon M. Taylor, *Regulatory Capture – The FTC’s Flawed Business Opportunity Rule*, CONSUMER AWARENESS INST. (Aug. 2014), https://centerforinquiry.org/wp-content/uploads/sites/33/quackwatch/MLM/06FTC/business_opportunity/regulatory_capture.pdf (comprising comments by various consumer protection advocates regarding the specific harms caused by MLMs and why they should be included in the Business Opportunity Rule).

²⁷ *Id.* at 13–14 (comments by Attorney Douglas Brooks) (“[w]ith both the FTCA and its state cognates, enforcement of the prohibitions against ‘unfair or deceptive’ acts or practices has been on a case-by-case, post hoc basis. The absence of a private right of action under the FTCA . . . and the finite budgets of the FTC and state regulators, have the effect of allowing a substantial number of multi-level marketing firms to operate ‘below radar level[.]’”).

²⁸ See Liu, *supra* note 16, at 122–35 (describing “how MLM disclosures to consultants exploit the consultants’ underlying behavioral biases, as well as how MLMs target consultants’ identities to exploit those same biases.”). These biases include MLMs’ emphasis on “grit and independence.” *Id.* at 129.

²⁹ MARGUERITE DELIEMA ET AL., AARP STUDY OF MULTILEVEL MARKETING: PROFILING PARTICIPANTS AND THE EXPERIENCE IN DIRECT SALES 3 (2018), https://www.aarp.org/content/dam/aarp/aarp_foundation/2018/pdf/AARP%20Foundation%20MLM%20Research%20Study%20Report%2010.8.18.pdf.

³⁰ Celarier, *supra* note 6 (“[M]ore than 18 million Americans participat[e] in an MLM in a given year.”).

For decades, the MLM industry has used its political influence to guarantee weak consumer protection regulations, which allows many MLMs to harm participants and end-users without repercussions.³¹ But, in 2021, the Supreme Court made matters worse when it unanimously held, in *AMG Capital Management, LLC v. Federal Trade Commission*,³² that the FTC lacked “authority to compel monetary relief” under Section 13(b) of the FTC Act.³³ Going forward, the FTC is limited to mere injunctive relief under

³¹ See Stroud, *supra* note 7 (“MLM lives and has always lived on the strength of its lobbying.”).

³² *AMG Cap. Mgmt., LLC v. Fed. Trade Comm’n*, 141 S. Ct. 1341, 1352 (2021).

³³ Ronald Mann, *Justices Unanimously Reject FTC’s Authority to Compel Monetary Relief*, SCOTUSBLOG (Apr. 23, 2020, 5:16 PM), <https://www.scotusblog.com/2021/04/justices-unanimously-reject-ftcs-authority-to-compel-monetary-relief/>; see also Christopher Cole, *Supreme Court Rolls Back FTC Restitution Power*, LAW360 (Apr. 22, 2021, 11:15 AM), <https://www.law360.com/competition/articles/1377854> (explaining how the decision was devastating to consumer protection efforts because it stripped the FTC of one of its most successful and frequently used judicial remedies) (“The U.S. Supreme Court . . . gutted the Federal Trade Commission’s power to seek federal court orders forcing bad marketplace actors to pay restitution, shutting down a critical tool the FTC uses to recover money from scammers and antitrust violators.”).

Section 13(b)³⁴ and can only obtain monetary relief for aggrieved consumers under Sections 5 and 19 of the FTC Act.³⁵

Therefore, in the wake of *AMG Capital Management*, it is clear that the FTC must rely on its Section 5 and 19 powers to obtain monetary relief for financially harmed MLM participants. Against this backdrop, the FTC's 2016 Section 5 enforcement action against MLM giant Herbalife Nutrition³⁶ provides an instructive case study for future actions of this kind. The action against Herbalife was touted as one of the harsher Section 5 crackdowns on an MLM to date,³⁷ but Herbalife continues to thrive financially and victimize

³⁴ Prior to *AMG Capital Management*, Section 13(b) allowed the FTC to bring suits for monetary restitution and disgorgement directly to federal court, enabling the agency to efficiently repay those harmed by predatory MLMs. See Cole, *supra* note 33. Now, the FTC may only seek restitution "after conducting a full proceeding before an agency in-house administrative law judge," meaning more uncertainty and delays for victimized consumers. *Id.* "By eliminating the possibility of restitution and redress under section 13(b), the decision also eliminates the FTC's ability to obtain associated relief in the form of asset freezes and receiverships imposed in temporary restraining order and preliminary injunction cases, which historically have proved to be potent weapons used by the FTC in enforcement actions, in particular consumer protection cases." Andrew G. Berg, et al., *U.S. Supreme Court Limits the FTC's Authority to Seek Monetary Relief in Deceptive Practices Enforcement Cases*, GREENBERG TRAURIG (Apr. 23, 2021), <https://www.gtlaw.com/en/insights/2021/4/us-supreme-court-limits-ftcs-authority-seek-monetary-relief-deceptive-practices-enforcement-cases>.

³⁵ Mann, *supra* note 33. "[T]he Court pointed to other sections of the FTC Act, notably the administrative procedures contained in section 5 and the consumer redress available under section 19, as the proper legal avenues for the FTC to seek consumer redress and restitution in most cases. The ruling substantially curbs the FTC's ability to obtain consumer redress under section 13(b), the FTC's preferred means of seeking monetary damages due to its administrative efficiency compared to other Commission enforcement authority granted under the FTC Act." Andrew G. Berg, et al., *supra* note 34.

³⁶ See generally *Herbalife Will Restructure Its Multi-Level Marketing Operations and Pay \$200 Million For Consumer Redress to Settle FTC Charges*, FED. TRADE COMM'N (July 15, 2016), <https://www.ftc.gov/news-events/press-releases/2016/07/herbalife-will-restructure-its-multi-level-marketing-operations> [hereinafter *Herbalife Press Release*].

³⁷ See Lois C. Greisman, *A Restructured Herbalife*, FED. TRADE COMM'N (July 15, 2016), <https://www.consumer.ftc.gov/blog/2016/07/restructured-herbalife>.

consumers,³⁸ seemingly unfazed by the FTC's suit. This outcome begs the question: what went wrong?

Despite the recent abrogation of its power to seek monetary relief, the FTC must not be deterred in its pursuit of financial restitution for those harmed by MLMs. The Commission must learn from its Section 5 Herbalife action and finally stand up to the malignant MLM lobby. The FTC must not only consistently pursue illegal MLMs, but also require full disclosure of the odds of success in an MLM, obtain proportionate financial punishments under Section 19, and more widely publicize the harmful nature of MLMs.

Part I of this Note defines MLMs, surveys their history, and provides an example of a typical MLM. Part II discusses how MLMs are currently regulated, while Part III critiques that regulation. Part IV suggests pathways to protect MLM consumers following *AMG Capital Management* and the negative outcome of the FTC's 2016 Herbalife settlement.

I. MULTI-LEVEL MARKETING, ITS HISTORY, AND ITS ENDURING IMPORTANCE

A. What Are MLMs?

Multi-level marketing is a type of direct selling business.³⁹ Direct selling businesses engage in "person-to-person" sales in non-traditional locations, including social media, private homes, or other atypical retail environments.⁴⁰ Participants in MLMs theoretically earn income by selling products through the MLM—after purchasing products from the MLM to subsequently resell to the public—or by recruiting others to join the MLM and earning a commission on their sales.⁴¹ MLMs have a hierarchical structure and

³⁸ Michael Hiltzik, *Why Does the Government Let a Company Like Herbalife Stay in Business?*, L.A. TIMES (Aug. 28, 2020), <https://www.latimes.com/business/story/2020-08-28/herbalife-lawbreaking-companies>.

³⁹ *Business Guidance Concerning Multi-Level Marketing*, FED. TRADE COMM'N (Jan. 2018), <https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing> [hereinafter *Business Guidance*].

⁴⁰ *Id.*

⁴¹ *Id.*

the distinctive “levels” of the MLM model include the original recruiter, their recruits, their recruits’ recruits, and so on.⁴² Each sales network is called a “downline.”⁴³ For instance, an original recruiter will earn commissions from everyone in their downline—their recruits—and whomever their recruits recruit.⁴⁴ The salespeople in an MLM are treated like independent contractors who are not paid a salary and whose income depends entirely on their own revenue and on their downline’s commissions.⁴⁵

A typical example of an MLM is LuLaRoe, an apparel company whose participants, so-called “Independent Fashion Retailers” (“Retailer”), sell colorful leggings and dresses through social media sites, most commonly Facebook.⁴⁶ To join LuLaRoe, a participant must first have a Sponsor,⁴⁷ which LuLaRoe’s website once described as an active member who will “guide, inspire, and train you,” and moreover, be the participant’s “BFF throughout [their] LuLaRoe journey.”⁴⁸ In reality, a Sponsor is simply a recruiter.⁴⁹

After signing on, each new Retailer must purchase an initial inventory of sixty-five pieces for \$499.00⁵⁰ (down from about

⁴² See *FTC Comparison*, *supra* note 2 (describing how MLMs work at a basic level).

⁴³ *Id.*

⁴⁴ See *id.*

⁴⁵ *Business Guidance*, *supra* note 39.

⁴⁶ Darlena Cunha, *Beware of Selling Yoga Pants on Facebook*, ATLANTIC (Apr. 18, 2018), <https://www.theatlantic.com/business/archive/2018/04/multilevel-marketing-yoga-pants-facebook/558296/>.

⁴⁷ If a prospective participant was not recruited per se and would like to join LuLaRoe on their own initiative, they will be matched with a Sponsor by the company. *Join LuLaRoe*, LULAROE (June 8, 2020), <https://www.lularoe.com/join-lularoe> [<https://web.archive.org/web/20200608111439/https://www.lularoe.com/join-lularoe>].

⁴⁸ *Id.*

⁴⁹ See Brittanie Pyper, *How to Choose the Perfect LuLaRoe Sponsor*, SIMPLISTICALLY LIVING, <https://www.simplisticallyliving.com/how-to-choose-perfect-lularoe-sponsor/> (last visited Sept. 18, 2021) (Ms. Pyper, a LuLaRoe blogger, asks “[h]ow successful are their recruits?” to determine whether to join a Sponsor’s team).

⁵⁰ *Join LuLaRoe*, LULAROE, <https://www.lularoe.com/join-lularoe> (last visited Sept. 18, 2021).

\$5,500 for 375 pieces in 2017).⁵¹ Next, a LuLaRoe Sponsor trains the Retailer and provides guidance on “product knowledge, effective sales techniques, customer service and compliance with Company Policies and Procedures.”⁵² When the Retailer makes a sale, she must cede 3% of that income to her Sponsor, provided that her Sponsor also meets her sales targets.⁵³

However, the flow of sales commissions likely does not end with the Retailer and her Sponsor. Sponsors are the second-lowest level on the LuLaRoe recruitment chain, as their status depends only upon recruiting at least one other participant.⁵⁴ In fact, there are six levels of participation within LuLaRoe: Retailer, Sponsor, Trainer, Coach, Mentor, and Ambassador.⁵⁵ Each promotion within the organization earns the participant a one-time payout.⁵⁶ Advancement within the LuLaRoe leadership system is based on increased personal and team sales, as well as number of recruits.⁵⁷

⁵¹ *Top 8 Questions About Becoming a LuLaRoe Consultant – Answered!*, MOMPREENEUR ADVICE (Jan. 13, 2017), <https://www.mompreneuradvice.com/lularoe-consultant/>; Hayley Peterson, *LuLaRoe is Making Some Women Rich, While Thousands Struggle to Make a Profit*, BUS. INSIDER (Mar. 16, 2017, 11:38 AM), <https://www.businessinsider.com/how-much-money-lularoe-consultants-make-2017-3>. Previously, if a Retailer decided to leave the company, she could return her inventory to LuLaRoe in exchange for 90% of the wholesale value. Suzanne Lucas, *LuLaRoe Changes Return Policy, Costing Consultants Thousands*, INC. (Sept. 15, 2017), <https://www.inc.com/238erballi-lucas/lularoe-changes-return-policy-costing-consultants-.html>. However, as of 2021, LuLaRoe provides customers full refunds for products up to thirty days after purchase, and credit or exchange for products up to ninety days after purchase. *Happiness Policy*, LULAROE, <https://www.lularoe.com/happiness-policy> (last visited Sept. 18, 2021). But, “[f]ew understand within a year that they have been scammed . . .” Taylor, *supra* note 1, at 1–10.

⁵² *Restated Policies and Procedures*, LULAROE 1, 22 (Aug. 18, 2021), https://d1lmfvj4ldun6m.cloudfront.net/exigo/llrAdmin/documents/LLR_P%26Ps.pdf.

⁵³ *See Leadership Compensation Plan*, LULAROE 1, 5 (Nov. 23, 2020), https://s3-us-west-2.amazonaws.com/llrprod/exigo/llrAdmin/documents/LLR_Ldr_Bonus_Plan.pdf (last visited Oct. 2, 2021) (most recent plan publicly available).

⁵⁴ *Id.* at 4–5.

⁵⁵ *Id.* at 4.

⁵⁶ *See id.* at 7–18.

⁵⁷ *See id.*

As participants move through the ranking system, they are entitled to commission from their downline's sales.⁵⁸ If the participant fails to maintain the requisite earnings and team size for her rank, she will be demoted.⁵⁹ But, as participants continue to climb the MLM ranking ladder, the payouts for advancement in rank also increase; for example, a LuLaRoe Ambassador who retains that rank for three consecutive months will receive a one-time payment of \$500,000 as well as additional commission on downline retail sales.⁶⁰

LuLaRoe is just one of many MLMs that operate in essentially the same manner. Though at present no official comprehensive list exists,⁶¹ there are an estimated 1,100 operational direct selling companies in the United States, hundreds of which employ the MLM model.⁶² MLM companies—which include Avon, Tupperware, and Mary Kay—have cemented themselves in the popular culture and become household names.⁶³ However, unlike most MLMs, which are allowed to operate with minimal oversight and few consequences, LuLaRoe was sued by the Washington State Attorney General in 2019 for being an unlawful pyramid scheme.⁶⁴ According to the complaint, LuLaRoe makes “misleading income

⁵⁸ *See id.*

⁵⁹ *Id.* (“[T]he rank must be qualified for each month.”).

⁶⁰ *Id.* at 14, 18.

⁶¹ “It is difficult to estimate the number of direct selling companies operating at any given time . . . [since] most states do not require direct selling companies to register as such [and] . . . many direct selling companies . . . have a relatively short life span.” *Frequently Asked Questions*, DIRECT SELLING ASS'N, <https://www.dsa.org/about/faq> (last visited Sept. 18, 2021). Activist organization The Anti-MLM Coalition maintains its own crowd-sourced list of MLMs. *The MLM Master List*, THE ANTI-MLM COAL., <https://mlmtruth.org/master-list/> (last visited Sept. 18, 2021).

⁶² DIRECT SELLING ASS'N, *supra* note 61.

⁶³ Bell, *supra* note 10; Gregory Karp, *The Fine Line Between Legitimate Businesses and Pyramid Schemes*, CHI. TRIB. (Feb. 10, 2013), <https://www.chicagotribune.com/business/ct-xpm-2013-02-10-ct-biz-0210-herbalife-20130210-story.html>.

⁶⁴ Elizabeth Kayser, *Washington State A.G. Sues LuLaRoe for Operating Unlawful Pyramid Scheme*, ABC 33/40 NEWS (Jan. 26, 2019), <https://abc3340.com/news/nation-world/washington-state-ag-sues-lularoe-for-operating-unlawful-pyramid-scheme>.

claims” and pressures consultants to focus on recruitment, rather than retail sales.⁶⁵ On February 2, 2021, it was announced that LuLaRoe would pay \$4.75 million to resolve the suit.⁶⁶

B. *The History of MLMs*

MLM companies have existed in the United States for decades.⁶⁷ While modern recruiters primarily use websites and social media to build their networks and sell products from home, early MLM companies built their sales networks face-to-face through parties and door-to-door sales.⁶⁸

The history of MLMs in the United States is not only long, but it also involves powerful cultural and political figures.⁶⁹ For example, Secretary of State Madeleine Albright lobbied for Herbalife⁷⁰ and President Bill Clinton made a speech extolling Amway,⁷¹ the world’s largest MLM.⁷² President Donald Trump made millions of dollars by heavily promoting ACN Inc., a videophone MLM.⁷³ Since 2018, President Trump and his adult

⁶⁵ Hayley Peterson, *Washington Attorney General Accuses LuLaRoe of Operating an Illegal ‘Pyramid Scheme’ in New LawsUIT*, BUS. INSIDER (Jan 25, 2019, 3:25 PM), <https://www.businessinsider.com/washington-sues-lularoe-and-alleges-its-an-illegal-pyramid-scheme-2019-1>.

⁶⁶ *LuLaRoe to Pay \$4.75 Million to Resolve AG Ferguson’s LawsUIT Over Pyramid Scheme*, WASH. ST. ATT’Y GEN. (Feb. 2, 2021), <https://www.atg.wa.gov/news/news-releases/lularoe-pay-475-million-resolve-ag-ferguson-s-lawsuit-over-pyramid-scheme>. According to the announcement, “LuLaRoe tricked Washingtonians into buying into its pyramid scheme with deceptive claims and false promises . . . [a]s a result, thousands lost money and two individuals made millions from their scheme. Washingtonians deserve fairness and honesty — and accountability for those who don’t play by the rules.” *Id.*

⁶⁷ MLMs have been in the U.S. potentially as early as the turn of the twentieth century, but certainly since the 1930s. Bell, *supra* note 10.

⁶⁸ *Id.*

⁶⁹ See generally Celarier, *supra* note 6.

⁷⁰ Hiltzik, *supra* note 38.

⁷¹ *President Bill Clinton Speech for Amway Osaka*, VIMEO (Feb. 26, 2013), <https://vimeo.com/60530952>.

⁷² Celarier, *supra* note 6.

⁷³ Grimaldi & Maremont, *supra* note 5.

children have been embroiled in a lawsuit over allegations of fraud stemming from their involvement with ACN.⁷⁴ Additionally, members of President Trump’s cabinet have strong ties to the MLM industry: Richard DeVos, father-in-law of former Secretary of Education Betsy DeVos, co-founded Amway, and former Secretary of Housing and Urban Development Ben Carson was once a pitchman for an MLM.⁷⁵ The political strength of the MLM lobby has largely deterred investigations into companies’ business practices and continues to exempt them from meaningful reform.⁷⁶

The Direct Selling Association (“DSA”), the MLM industry’s most powerful lobbying organization,⁷⁷ has spent years pushing campaign donations to members of Congress, thereby discouraging federal intervention.⁷⁸ Most notably, the DSA used its political sway to exempt most MLM distributors from the FTC’s Business Opportunity Rule, which was designed specifically to target “bogus” work-from-home job opportunities.⁷⁹ Promulgated by the FTC in 2006, the Business Opportunity Rule requires companies to produce particular disclosures, including ongoing fraud-based lawsuits, inventory refund policies (including how many refunds had been sought), and documentation supporting income claims.⁸⁰

To ensure that the Business Opportunity Rule would not apply to MLMs, Herbalife spent more than \$800,000 between 2006 and 2008 on lobbying through the DSA, including donating handsomely to MLM-friendly politicians on both sides of the aisle, like Congressman Paul Ryan, Senator Rick Santorum, and a number of

⁷⁴ *Id.*

⁷⁵ Celarier, *supra* note 6.

⁷⁶ Stroud, *supra* note 7 (“MLM lobbying dollars are dangerous — and unfair — because they effectively silence the people who are taken advantage of by companies like Amway and HerbalifeHow is it possible . . . that the FTC has not even imposed disclosure rules on a network of enterprises that pulls as much as \$30 billion a year out of 15 million American households every year . . . ?”).

⁷⁷ Taylor, *supra* note 1, at 7–4 (referring to the DSA as MLM’s “chief lobbyist”).

⁷⁸ *Id.* at 2–5 (“The Direct Selling Association, has in recent years lobbied aggressively for the MLM industry to stop or water down proposed or existing legislation that protects consumers against . . . MLMs.”); *see generally* Stroud, *supra* note 7 (detailing MLM’s “long history of political maneuvering”).

⁷⁹ Stroud, *supra* note 7.

⁸⁰ *Id.*

New York Congressmen.⁸¹ Around the same time, Amway tripled its lobbying dollars to combat the Business Opportunity Rule, and Avon tripled its amount of political contributions.⁸² The DSA also coordinated a targeted campaign in which 17,000 people sent letters to the FTC, criticizing the proposed regulation as oppressive.⁸³ As a result of the DSA's efforts and donations from MLM companies, eighty-one members of Congress (fifty-seven Republicans and twenty-four Democrats) lobbied the FTC to exempt MLMs from the Business Opportunity Rule.⁸⁴ The political onslaught prevailed: the FTC modified the rule to let MLMs skirt the new requirements, and the MLM-friendly law was enacted in 2012.⁸⁵

C. *The Current Importance of MLMs*

The ubiquitous and seemingly impervious nature of MLMs is cause for alarm because MLMs are, by nature and design, harmful to the majority of their participants.⁸⁶ Despite promising wealth and success, MLMs operate at over a 99% loss rate, meaning that for every one hundred MLM participants, at least ninety-nine lose money.⁸⁷ Furthermore, being a successful distributor does not guarantee financial success.⁸⁸ For example, the top 200 Amway distributors across Wisconsin netted on average an annual income of *negative* \$900.⁸⁹ Therefore, even a perfectly legal MLM is “a mathematical trick played on the unwary,”⁹⁰ but it is nonetheless

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ Taylor, *supra* note 1, at Intro-8 (“Based on available company data, approximately 99.7% of all MLM participants lose money.”).

⁸⁷ *Id.*

⁸⁸ *See id.* at 1–5 (describing the author's experience of being in the top 1% of all distributors in the MLM Nu Skin but nonetheless losing over \$1,200 a month due to operational costs and inventory).

⁸⁹ *See id.* at 7–3.

⁹⁰ *Id.* at 7–35.

considered “legitimate” by the FTC, so long as it is not a “pyramid scheme.”⁹¹

Worse still, MLMs target those for whom losses on this scale would be particularly ruinous, including low income people, immigrants,⁹² and stay-at-home mothers.⁹³ MLMs engage these demographics by promising extra income through a flexible, socially fulfilling career that allows participants to work from home and spend more time with their children.⁹⁴ A 2016 study conducted by the DSA found that women make up 74% of MLM participants.⁹⁵ Stay-at-home mothers and other individuals experiencing social isolation are particularly vulnerable to MLMs because the companies promise opportunities for social bonding.⁹⁶ MLMs also appear to target those without college degrees and non-native English speakers.⁹⁷ These groups are susceptible to MLMs because while the vast majority of typical corporate employers require higher education for sales positions,⁹⁸ there is practically no barrier

⁹¹ *FTC Comparison*, *supra* note 2 (According to the FTC, an MLM participant “should be able to make money just by selling the product,” and it is considered an illegal pyramid scheme when profits instead come primarily from recruitment.).

⁹² Sheelah Kolhatkar, *Financiers Fight Over the American Dream*, *NEW YORKER* (Feb. 26, 2017), <https://www.newyorker.com/magazine/2017/03/06/financiers-fight-over-the-american-dream>.

⁹³ Bell, *supra* note 10. *See* Complaint, *Belinda Hibbard v. LulaRoe LLC*, 2019-00270087 (Cal. Super. Nov. 27, 2019) (“Defendants targeted women, stay at home mothers, spouses of active military members, and other groups who had working capacity and some access to credit or savings, but also, generally, a lack of formal business or finance training.”); *see also* Mona Bushnell, *MLMs Are Preying on the Dream of Entrepreneurship*, *BUSINESS.COM* (Aug. 22, 2019), <https://www.business.com/articles/mlms-target-women-and-immigrants/> (“Pyramid schemes prey on women, minorities and immigrants.”).

⁹⁴ Bell, *supra* note 10 (“Many MLM companies seem to offer people a way to have it all: a career with flexibility, new friends, a way to stay at home and spend more time with their children, and extra money.”).

⁹⁵ *Id.*

⁹⁶ *See id.* (describing why a stay-at-home mother joined an MLM after feeling isolated and creatively stifled).

⁹⁷ Kolhatkar, *supra* note 92.

⁹⁸ Sammi Caramela, *Is a College Degree Necessary for Success?*, *BUSINESS.COM*, <https://www.business.com/articles/is-college-degree-needed/> (last updated Mar. 13, 2020).

to entry into an MLM.⁹⁹ It has also been suggested that many undocumented immigrants, particularly within Hispanic communities, are attracted to MLMs because they have been popularized as a way to earn income without working papers.¹⁰⁰

MLMs have also attempted to capitalize on the current climate of fear and economic uncertainty stemming from the COVID-19 pandemic.¹⁰¹ For example, in a recent promotional video, one MLM stated that their company was akin to “a great stimulus package,” and members would “earn \$1,730 literally in their first 10 days in the business.”¹⁰² However, at least sixteen MLMs received warnings from the FTC for engaging in this behavior and were told to remove unsubstantiated earnings and coronavirus health claims, including that products will prevent or cure COVID-19.¹⁰³

⁹⁹ For example, to join LuLaRoe, the only requirements are to: (1) be a minimum of eighteen years of age; (2) have a valid Social Security or Federal Tax ID number; (3) submit a properly executed LLR Independent Fashion Consultant Agreement; (4) read and agree to adhere to LLR Policies and Procedures; and (5) purchase an initial inventory of LLR products. LULAROE, *supra* note 52, at 8.

¹⁰⁰ See Michael S. Schmidt et al., *After Big Bet, Hedge Fund Pulls the Levels of Power*, N.Y. TIMES (Mar. 9, 2014), https://www.nytimes.com/2014/03/10/business/staking-1-billion-that-herbalife-will-fail-then-ackman-lobbying-to-bring-it-down.html?hp&_r=2.

¹⁰¹ Emma Penrod, *As the COVID-19 Economic Crisis Deepens, Financially Risky MLMs are Moving in to Fill the Employment Void*, BUS. INSIDER (July 14, 2020), <https://www.insider.com/unemployed-people-turn-to-risky-multi-level-marketing-companies-2020-7>; Jesselyn Cook, *MLMs Are Using Coronavirus Anxiety To Exploit The Quarantined And Unemployed*, HUFFINGTON POST (May 29, 2020), https://www.huffpost.com/entry/mlms-capitalizing-on-coronavirus-anxiety_n_5ecad83ac5b63a8c2095c800; Abby Vesoulis & Eliana Dockterman, *Pandemic Schemes: How Multilevel Marketing Distributors Are Using the Internet – and the Coronavirus – to Grow Their Businesses*, TIME (July 9, 2020), <https://time.com/5864712/multilevel-marketing-schemes-coronavirus/>.

¹⁰² Diaz, *supra* note 11.

¹⁰³ *FTC Sends Warning Letters to Multi-Level Marketers Regarding Health and Earnings Claims They or Their Participants are Making Related to Coronavirus*, FED. TRADE COMM’N (Apr. 24, 2020), <https://www.ftc.gov/news-events/press-releases/2020/04/ftc-sends-warning-letters-multi-level-marketers-regarding-health>; Lisette Voytko, *FTC Warns 16 Multi-Level Marketing Companies About Coronavirus Fraud*, FORBES (June 9, 2020, 6:24 PM), <https://www.forbes.com/sites/lisettevoytko/2020/06/09/ftc-warns-16-multi-level-marketing-companies-about-coronavirus-fraud/#364fdad17b9d>.

Despite their glaring downsides, MLMs have some proponents. One anthropologist has argued that since many MLMs have biblical underpinnings and operate as quasi-religious organizations, low-level distributors have the opportunity to reconnect with their religious faith through this line of work.¹⁰⁴ Additionally, MLMs could be viewed as a vehicle of female empowerment, since MLMs often recognize the professionalism and expertise of participants through dignified job titles like “Beauty Consultant,” which boost confidence.¹⁰⁵ Further, “direct sales of beauty products can offer low risk opportunities for women to become entrepreneurs, and form a potentially promising route to gender-equitable poverty reduction.”¹⁰⁶ These arguments, however, ignore the reality that failure in an MLM is all but guaranteed.¹⁰⁷ More often than not, participants, most of whom are women,¹⁰⁸ end up thousands of dollars in debt.¹⁰⁹

The MLM industry is, objectively, remarkably lucrative, reportedly generating \$35.2 billion in sales in 2019.¹¹⁰ In 2018, Herbalife generated \$4.9 billion in net sales,¹¹¹ and in 2017, LuLaRoe generated \$2.3 billion in sales.¹¹² Even more impressive,

¹⁰⁴ Cahn, *supra* note 12, at 127.

¹⁰⁵ *Id.* at 128.

¹⁰⁶ Dolan & Scott, *supra* note 13, at 203.

¹⁰⁷ See Taylor, *supra* note 1, at Intro-8.

¹⁰⁸ Bell, *supra* note 10.

¹⁰⁹ See generally Wicker, *supra* note 14.

¹¹⁰ *Direct Selling in the United States 2019 Industry Overview*, DIRECT SELLING ASS'N (2019), https://www.dsa.org/docs/default-source/research/growth-outlook/2019-research-overview-fact-sheet-final.pdf?sfvrsn=3bfedda5_2%27. This net sales figure averages out to \$5,176 in retail sales per year, per seller. *Id.*

¹¹¹ *About Herbalife Nutrition*, HERBALIFE (Nov. 6, 2020), <https://company.herbalife.com/> [<https://web.archive.org/web/20201106165414/https://company.herbalife.com/>]; see also *Herbalife Nutrition Reports Fourth Straight Quarter of Year-Over-Year Double-Digit Net Sales Growth*, BUS. WIRE (Aug. 3, 2021), <https://www.businesswire.com/news/home/20210803006072/en/Herbalife-Nutrition-Reports-Fourth-Straight-Quarter-of-Year-Over-Year-Double-Digit-Net-Sales-Growth> (describing Herbalife's 2021 financial results through the second quarter of fiscal year 2021).

¹¹² Hayley Peterson, *LuLaRoe is Facing Mounting Debt, Layoffs, and an Exodus of Top Sellers, and Sources Say the \$2.3 Billion Legging Empire Could be Imploding*, BUS. INSIDER (Nov. 20, 2018),

however, is that in this “legitimate” industry, millions of participants are essentially guaranteed to lose money.¹¹³ This contrast represents an unconscionable failure to protect consumers, particularly during times of economic uncertainty. The FTC must enact sweeping regulation that prevents MLMs from taking advantage of Americans afraid for their health and financial futures.

II. THE CURRENT MLM REGULATORY LANDSCAPE

MLMs are primarily regulated based on their compensation structures; in other words, whether or not they are pyramid schemes.¹¹⁴ The difference between a pyramid scheme and legitimate MLM typically hinges on the presence of a product: in a pyramid scheme, there is no product sold, and participants generate income solely through recruiting others to invest.¹¹⁵ Pyramid scheme operators may try to sidestep regulation by also selling a product, but “in all pyramid schemes, the selling of a product itself is much less important than the recruiting of new investors.”¹¹⁶

While some people knowingly join illegal pyramid schemes hoping to profit, most victims of pyramid schemes are unwitting and believe that they have joined an “investment club” or an organization selling legitimate products or services.¹¹⁷ Pyramid schemes invariably fail once all the investors in a given community have contributed, and the lack of new investment causes the structure to collapse, leaving only a select few atop the pyramid with

<https://www.businessinsider.com/lularoe-legging-empire-mounting-debt-top-sellers-flee-2018-11>.

¹¹³ See Taylor, *supra* note 1, at 7-35 (“The loss rates for MLM participants (averaging at least 99.7% . . .) is far greater than for participants in classic pyramid schemes, which is approximately 90%.”).

¹¹⁴ Liu, *supra* note 16, at 115 (“Enforcement against MLMs with problematic business tactics is primarily triggered through allegations that the MLMs employ pyramid sales schemes.”); see also FED. TRADE COMM’N, *Business Guidance*, *supra* note 39.

¹¹⁵ *Multi-level Marketing vs Pyramid Schemes*, S.D. CONSUMER PROT. OFF. OF THE ATT’Y GEN., <https://consumer.sd.gov/docs/MultilevelVSPyramid.pdf>.

¹¹⁶ *Don’t Get Caught in a Pyramid Scheme*, N.Y. ST. ATT’Y GEN., <https://ag.ny.gov/consumer-frauds/pyramid-schemes> (last visited Sept. 21, 2021).

¹¹⁷ *Id.*

any money.¹¹⁸ Moreover, pyramid schemes exploit the connectivity and trust of communities to drum up participation.¹¹⁹ Ultimately, pyramid schemes are a waste of money and time for nearly all of their participants.¹²⁰ Because of the danger they pose to society, pyramid schemes (and non-compliant MLMs) are regulated at both the state and federal levels.¹²¹

A. The State Level: Amway Exception and the Endless Chain Model

States take one of two regulatory approaches towards MLMs.¹²² A minority of states¹²³ directly regulate MLMs by providing statutory definitions that distinguish between MLMs and illegal pyramid schemes.¹²⁴

Georgia is a minority approach state and has a statute that provides a typical MLM definition.¹²⁵ It defines MLMs as a business entity

which sells, distributes, or supplies for a valuable consideration *goods or services* through independent agents, contractors, or distributors at different levels wherein such participants *may recruit* other participants and wherein commissions, cross-commissions, bonuses, refunds, discounts, dividends, or other considerations in the program are *or may be paid as a result of the sale of such goods*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Multi-level Marketing or Illegal Pyramid Scheme?*, DEP'T OF THE MICH. ATT'Y GEN., https://www.michigan.gov/ag/0,4534,7-359-81903_20942-208400-,00.html (last visited Sept. 21, 2021).

¹²¹ Liu, *supra* note 16, at 115.

¹²² REESE RICHARDS PLLC, *supra* note 17.

¹²³ Alabama, Arizona, Florida, Georgia, Idaho, Illinois, Louisiana, Maryland, Massachusetts, Mississippi, Missouri, New Mexico, North Dakota, Oklahoma, Tennessee, Texas, Utah, and Wyoming, as well as Puerto Rico, take this approach. Howie, *supra* note 17, at 289 n.4.

¹²⁴ *Id.*

¹²⁵ REESE RICHARDS PLLC, *supra* note 17.

or services or the recruitment, actions, or performances of additional participants.¹²⁶

Louisiana, another minority approach state, defines pyramid schemes, on the other hand, as

[a]ny plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived *primarily* from the person's introduction of other persons into a plan or operation rather than from the sale of goods, services, or intangible property by the participant or other persons introduced into the plan or operation.¹²⁷

The minority approach has also been dubbed the “Amway Exception” because it is designed to protect MLMs, like Amway.¹²⁸ A typical minority MLM definition gives no guidelines for compensation, places no limits on recruitment, and only requires that the MLM provide “goods and services.”¹²⁹ Furthermore, its counterpart anti-pyramid scheme statute only outlaws businesses where compensation is derived “*primarily*” from recruitment.¹³⁰ Therefore, a *significant* portion of compensation (in theory, up to 50%) can derive from recruitment, so long as it is not the *primary* source of compensation.¹³¹

Alternatively, the majority of states indirectly regulate MLMs by ensuring they do not function like illegal pyramid schemes.¹³² This approach is sometimes referred to as the “endless chain” model, and it intends to prohibit compensation based on recruitment rather than product sales to consumers.¹³³ For example, California's

¹²⁶ GA. CODE ANN. § 10-1-410 (2021) (emphasis added).

¹²⁷ LA. STAT. ANN. § 51:361 (2021) (emphasis added).

¹²⁸ See Howie, *supra* note 17, at 289 (“The statute contains a number of important provisions that are likely to provide protection for multilevel marketing plan sponsors.”).

¹²⁹ GA. CODE ANN. § 10-1-410 (2021).

¹³⁰ LA. STAT. ANN. § 51:361 (2021).

¹³¹ Howie, *supra* note 17, at 289 (“This provision is significant because it allows multilevel marketing plans to compensate participants for activities that may not be directly related to the sale of products to consumers.”).

¹³² REESE RICHARDS PLLC, *supra* note 17 (“The majority of states statutorily regulate multilevel, or more precisely anti-pyramid, activity.”).

¹³³ *Id.*

endless chain statute prohibits “[a]ny scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme.”¹³⁴

Unlike the Amway Exception, which only outlaws MLMs in which “compensation is derived ‘*primarily*’ from the introduction of new participants,”¹³⁵ endless chain anti-pyramid statutes scrutinize *any compensation not derived from actual sales*, even if it is not the primary source of compensation.¹³⁶ Therefore, endless chain statutes—more so than Amway Exception statutes—discourage MLMs from rewarding participants for recruiting others to join, because compensation from recruitment is more likely to attract regulatory scrutiny.¹³⁷ Furthermore, endless chain anti-pyramid statutes differentiate between product sales between the participants in the MLM and sales to end-users outside the MLM.¹³⁸ Amway Exception statutes, however, do not do the same.¹³⁹ Thus, endless chain statutes, unlike Amway Exception statutes, allow regulators to take action when it is clear that MLM participants are buying products themselves or earning commissions based on sales to their own downline, both of which create problems with participants’ personal debt and excessive stockpiling of inventory.¹⁴⁰

¹³⁴ CAL. PENAL CODE § 327 (2021). North Carolina’s anti-pyramid statute is nearly identical. See N.C. GEN. STAT. § 14-291.2 (2021); REESE RICHARDS PLLC, *supra* note 17.

¹³⁵ Howie, *supra* note 17, at 290 (emphasis added).

¹³⁶ *Id.*

¹³⁷ *See id.*

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *See id.* (explaining that the “payment of commissions based upon the sale of products to downline participants for their own use, which is expressly excluded from coverage under the Louisiana statute, is likely to be actionable under the California statute”).

B. The Federal Level of Regulation

MLMs are regulated at the federal level by the DOJ, the SEC, and the FTC.¹⁴¹

The DOJ's "lottery approach" focuses on "consideration, prize, and chance," or "whether the victim has given funds to the company, how much the company benefits, and how much the victim may benefit from his or her consideration."¹⁴² The DOJ occasionally pursues actions against MLMs on charges of mail order fraud.¹⁴³

The SEC may bring actions against MLMs using securities law, under which an MLM may not make "materially false or misleading statements in connection with a security."¹⁴⁴ These actions typically center around whether an MLM investment contract is in fact a security.¹⁴⁵ And, pursuant to *SEC v. Glenn W. Turner Enterprises*, the individual investor in a business must exert some effort to earn a return on his investment, as opposed to merely relying on the actions of others to make a profit for him; consequently, an MLM participant's profits may not substantially rely on recruitment.¹⁴⁶

The FTC also has the power to enforce consumer protection and competition laws, including against MLMs.¹⁴⁷ There are two main channels for FTC enforcement actions: the administrative process and the judicial process.¹⁴⁸ The FTC has administrative authority

¹⁴¹ Liu, *supra* note 16, at 115.

¹⁴² *Id.*

¹⁴³ *Id.* at 116.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* (citing *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 (9th Cir. 1973) ("[W]e adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.")).

¹⁴⁷ See FED. TRADE COMM'N, *A Brief Overview of the Federal Trade Commission's Investigative, Law Enforcement, and Rulemaking Authority*, FED. TRADE COMM'N, <https://www.ftc.gov/about-ftc/what-we-do/enforcement-authority> (May 2021) (stating that "[f]ollowing an investigation, the Commission may initiate an enforcement action using either an administrative or judicial process if it has 'reason to believe' that the law is being or has been violated. The Commission enforces both consumer protection and antitrust laws.") [hereinafter *FTC Overview*].

¹⁴⁸ *Id.*

under Section 5(b) of the FTC Act.¹⁴⁹ Section 5 allows the FTC to file an administrative complaint against a deceptive or anti-competitive MLM.¹⁵⁰ If successful, an administrative law judge will issue a cease and desist against the MLM.¹⁵¹ Then, Section 19 of the FTC Act allows the Commission to enforce the administrative judgment in a federal district court and obtain monetary relief for injured customers.¹⁵²

The judicial process is governed by Section 13(b) of the FTC Act,¹⁵³ which allows the Commission to go *directly* to federal court to obtain injunctive relief (e.g., a cease and desist order) without first going through administrative proceedings.¹⁵⁴ Prior to *AMG Capital Management*, the FTC frequently¹⁵⁵ used its Section 13(b) authority to obtain monetary awards, particularly in consumer protection

¹⁴⁹ Mann, *supra* note 33.

¹⁵⁰ *FTC Overview*, *supra* note 147 (“Under Section 5(b) of the FTC Act, the Commission may challenge ‘unfair or deceptive act[s] or practice[s],’ ‘unfair methods of competition,’ or violations of other laws enforced through the FTC Act, by instituting an administrative adjudication. When the Commission has ‘reason to believe’ that a law violation has occurred, the Commission may issue a complaint setting forth its charges.”).

¹⁵¹ *Id.* (“Upon conclusion of the hearing, the ALJ issues an ‘initial decision’ . . . recommending either entry of an order to cease and desist or dismissal of the complaint”); *see also* Mann, *supra* note 33.

¹⁵² *FTC Overview*, *supra* note 147 (“[A]fter all judicial review of its order is complete[], the Commission may seek consumer redress from the respondent in federal district court for consumer injury caused by the conduct that was at issue in the administrative proceeding. In such a suit, which lies under Section 19 of the FTC Act, 15 U.S.C. Sec. 57b, the Commission must demonstrate that ‘a reasonable man would have known under the circumstances [that the conduct] was dishonest or fraudulent.”); Mann, *supra* note 33 (“Congress added an enforcement option . . . permitting the commission to go into a federal district court under Section 19 of the act and obtain ‘such relief as the court finds necessary to redress injury to consumers,’ including among other things ‘refund of money.’”).

¹⁵³ *FTC Overview*, *supra* note 147.

¹⁵⁴ *Id.* (“[T]he Commission may seek, and the court may grant, a permanent injunction.”); Mann, *supra* note 33 (“[Section 13(b)] allows the commission to go directly to federal court – without the trouble of conducting administrative proceedings or obtaining a cease-and-desist order.”).

¹⁵⁵ In the most recent fiscal year, the FTC obtained almost four times as many permanent injunctions under Section 13(b) as it issued cease-and-desist orders under Section 5. Mann, *supra* note 33.

cases.¹⁵⁶ However, Justice Breyer, writing for the unanimous Court in *AMG Capital Management*, held that Section 13(b) “does not authorize the Commission to seek, or a court to award, *equitable monetary relief such as restitution or disgorgement.*”¹⁵⁷ Therefore, after *AMG Capital Management*, the FTC may no longer take deceptive or anti-competitive MLMs directly to federal court to reimburse injured consumers.¹⁵⁸ Instead, the FTC must now rely solely on Sections 5 and 19 of the FTC Act to obtain monetary relief for consumers financially harmed by MLMs.¹⁵⁹ That is, the FTC must first seek administrative relief before taking the judgment to the federal district court for monetary redress.¹⁶⁰

According to the FTC, an illegal MLM is “characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to the sale of the product to ultimate users.”¹⁶¹ In particular, the FTC set out a protective standard called the “Amway Safeguards,” which requires MLMs to ensure their participants are selling “70% of [their] inventory to 10 different customers each month” before they can receive a bonus, as well as allowing participants to sell their inventory back to the company.¹⁶² Courts tend to defer to the Amway Safeguards.¹⁶³ Other FTC actions against MLMs focus on whether an MLM pays participants per recruit, or compensates participants based on how much product their own downlines purchase.¹⁶⁴ The FTC decisions provide courts

¹⁵⁶ *See id.*; *see also* *AMG Cap. Mgmt., LLC v. Fed. Trade Comm’n*, 141 S. Ct. 1341, 1347 (2021) (“the Commission presently uses §13(b) to win equitable monetary relief directly in court with great frequency.”).

¹⁵⁷ *AMG Cap. Mgmt.*, 141 S. Ct. at 1347.

¹⁵⁸ Mann, *supra* note 33.

¹⁵⁹ *Id.*

¹⁶⁰ *See id.*

¹⁶¹ *Business Guidance*, *supra* note 39 (quoting *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975)).

¹⁶² Liu, *supra* note 16, at 117 (citing *In re Amway Corp., Inc.*, 93 F.T.C. 618 (1979)).

¹⁶³ *Id.*

¹⁶⁴ *Id.* at 117–18.

with a number of factors to balance in MLM litigation, including whether:

1. Products have “no real world marketplace” and the marketing program is a cover for a scam;
2. Products are sold at inflated prices;
3. That there is a substantial “buy-in” qualification, also known as “inventory loading” or “front-loading,” for the membership;
4. That there is an initial cash investment over \$500;
5. That members must purchase ancillary products or services to remain in the program;
6. Whether the MLM has an inventory repurchase policy in the event that the member leaves the MLM;
7. That the emphasis is, or has become, more focused on rewards for recruiting than selling goods or services; and
8. Whether there are misrepresentations related to membership earnings claims or outright misrepresentations related to potential income by the member.¹⁶⁵

Historically, the FTC rarely pursued Section 5 claims against MLMs.¹⁶⁶ The FTC reportedly prosecutes very few MLMs because the Commission does not have the staff or resources to do so.¹⁶⁷ Although MLMs must compensate participants based on product sales to end-users, Section 5 does not require MLMs to retain sales receipts, so if an FTC investigation were to take place, there would be very little documentation available to build a case.¹⁶⁸ Though not particularly persuasive, company policies and attestations of sales could be considered sufficient to satisfy an FTC inquiry of this nature.¹⁶⁹

¹⁶⁵ *Id.* at 118.

¹⁶⁶ Taylor, *supra* note 1, at 7–37 (“[T]he FTC admitted to prosecuting only 14 MLM companies in the preceding ten years.”).

¹⁶⁷ *Id.* at 7-37–38 (“Since virtually all MLMs are violating Section 5, [prosecuting them] would require that the FTC increase its staff at least twenty-fold[.]”).

¹⁶⁸ See FED. TRADE COMM’N, *supra* note 39.

¹⁶⁹ *Id.*

Also, thanks to the MLM lobby,¹⁷⁰ MLMs are not subject to the FTC's Business Opportunity Rule.¹⁷¹ "The Business Opportunity Rule requires business opportunity sellers to give prospective buyers specific information to help them evaluate a business opportunity, thus ensuring that the prospective purchasers have the information they need in order to assess the risks of buying a work-at-home program or any other business opportunity."¹⁷² The FTC applies the Business Opportunity rule on a case-by-case basis to "address bad actors engaged in a specific harm, without directly affecting an entire industry."¹⁷³

Fortunately for the MLM industry, orders from FTC enforcement actions against "bad actors" are not binding on other companies, just those in the particular FTC action.¹⁷⁴ Instead, the FTC notes that "[i]ndustry members may choose voluntarily to follow the provisions in these orders or to consider the provisions in developing their own practices and procedures," and recommends they consider these enforcement actions as "guidance and insights."¹⁷⁵ The FTC insists on the MLM industry mostly regulating itself, since it is an "efficient way to secure consumer benefits and promote a robust and competitive marketplace," though the FTC declared it "can and will bring law enforcement actions against companies that claim to follow self-regulatory guidelines but in practice do not."¹⁷⁶

¹⁷⁰ See Stroud, *supra* note 7.

¹⁷¹ FED. TRADE COMM'N, *supra* note 39 ("As stated in the Business Opportunity Rule's Statement of Basis and Purpose, the Commission crafted the Rule to avoid broadly sweeping in MLMs.").

¹⁷² Business Opportunity Rule, 16 C.F.R. Part 437 (Sept. 28, 2021) (rule summary).

¹⁷³ FED. TRADE COMM'N, *supra* note 39.

¹⁷⁴ *Id.* ("Orders obtained through settlements of FTC law enforcement actions are not binding on the entire industry.").

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

III. CRITIQUES ON CURRENT MLM REGULATION

A. The MLM Lobby

While MLMs certainly have powerful advocates, they also are subject to serious criticism from the consumer protection field. Critics blame the influence of special interests for the persistent failure of the federal government to regulate MLMs.¹⁷⁷ In particular, the FTC's exemption of MLMs from the Business Opportunity Rule was especially damning and demonstrates the "corrupting influence of special interests that affect public policy against the public interest."¹⁷⁸ One consumer protection advocate calls for citizens to undertake grassroots efforts and demand more regulatory scrutiny by electing public servants who will not bow to industry pressure.¹⁷⁹

B. Inadequate Disclosure

It has also been argued that increased disclosure and transparency are much needed within the MLM industry.¹⁸⁰ A consumer protection advocate theorized that the DSA mobilized so strongly against the proposed Business Opportunity Rule because it realized that if

true information about MLMs were disclosed, and if prospects were allowed time to do some research, recruitment could be adversely affected. Persons who understood basic statistics may balk if they knew that less than one out of a thousand recruits earned the income held out to them at opportunity meetings. And if they were provided references and allowed time to call them and to do research on the Internet, only the most unsophisticated would join.¹⁸¹

¹⁷⁷ See Taylor, *supra* note 26, at 3.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* ("[There is a] need for citizens to demand not more – nor less – regulatory scrutiny in protecting citizens, but better regulatory efforts – even if we have to pay more for qualified and courageous public servants who will work for the public good.").

¹⁸⁰ *Id.* at 30.

¹⁸¹ *Id.* at 5.

To that end, consumer protection advocates have suggested many types of mandatory disclosures, including that of pre-sale earnings information,¹⁸² retail-based income averages,¹⁸³ income claim disclosures, total number of participants, and average costs to participate.¹⁸⁴ Any mandatory disclosures should also be clear and easily accessible via the MLM company website.¹⁸⁵

C. *Inherently Deceptive Practices*

Anti-MLM activists have also called for the “outright prohibition” of specific, inherently deceptive aspects of MLMs, including breakaway plans, matrix plans, and minimum purchase requirements.¹⁸⁶ Critics argue that these complex compensation structures are deceptive and harmful to the average MLM participant.

In a breakaway plan, distributors must meet certain sales targets both personally and as part of a group, consisting of the distributor and her entry-level recruits.¹⁸⁷ This group sales target is known as a “group volume.”¹⁸⁸ But, “[a]s entry level recruits advance in the program, they ‘breakaway’ and their purchases no longer count towards their sponsor’s group volume requirements.”¹⁸⁹ However, the sponsor still has the same group volume requirement, and is therefore forced to either recruit new distributors or purchase product herself to meet the group volume requirement.¹⁹⁰

¹⁸² *Id.* at 6 (Aug. 10, 1995 comments by Attorney Douglas Brooks).

¹⁸³ *Id.* at 30–31 (July 7, 2006 comments by consumer advocate Robert FitzPatrick). This metric is important because “[t]he distinguishing feature of an MLM pyramid scam is the lack of profitable retail sales among most participants.” *Id.*

¹⁸⁴ *Id.* Costs to participate include motivational seminar registrations and training materials. *Id.* These costs are significant because when they are factored in, more than 99% of participants lose money. *See also* Taylor, *supra* note 1, at 2–9 (“[A]pproximately 99.6% of ALL participants lose money (after subtracting ALL expenses!)”) (emphasis in original).

¹⁸⁵ *Id.* at 45 (July 15, 2006 comments by Dr. Stephen Barrett).

¹⁸⁶ *See id.* at 6, 13 (comments by Douglas Brooks).

¹⁸⁷ *Id.* at 13.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

“Breakaway plans tend to generate the most lopsided disparities in earnings between distributors at the highest and lowest levels.”¹⁹¹ Notable MLMs which use this model include NuSkin,¹⁹² in which only 19.04% of active U.S. members in 2020 earned any sales commission, and only 0.20% of NuSkin distributors’ commissions were equal to, or greater than, \$37,474.¹⁹³

Matrix plans limit the rank that a distributor’s direct recruits can achieve.¹⁹⁴ Recruits who exceed this cap are placed in lower ranks in the downline, so participants are often assured that their “downlines may be built for them, if distributors in their uplines are active recruiters.”¹⁹⁵ This model reinforces the harmful practice of a distributor meeting the minimum sales requirements and instead relying on passive income from their downline.¹⁹⁶

Under a monthly purchase requirement, an MLM will withhold a distributor’s downline commission unless the distributor herself purchases a certain amount of product.¹⁹⁷ Why should a distributor “have to purchase any set amount of products in order to qualify to receive commissions on his downline’s purchases?”¹⁹⁸ Arguably, this is “simply a device to ensure a large captive market.”¹⁹⁹

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ 2020 Brand Affiliate Sales Compensation Summary (U.S. Market), NUSKIN (2020), https://www.nuskin.com/content/dam/office/n_america/US/en/business_materials/distearnings.pdf. In 2017, only 15.42% of NuFace participants earned any sales commission, and of those, only 1.4% “made more working for NuSkin than they would have working a minimum-wage job.” Rik Worth, *The NuFace of Pyramid Schemes?*, THE OVERTAKE (Dec. 9, 2018), <https://theovertake.com/~beta/vulnerable-people-have-each-lost-tens-thousands-of-pounds-working-for-this-cosmetics-company/>.

¹⁹⁴ See Taylor, *supra* note 26, at 13 (comments by Douglas Brooks).

¹⁹⁵ *Id.*

¹⁹⁶ See *id.*

¹⁹⁷ See *id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

D. Statutory Changes

While the majority of arguments against the current MLM regulatory landscape focus on reforming disclosure rules and compensation structure, others argue for specific statutory changes. The former Assistant Attorney for Wisconsin argues that the FTC should provide an “explicit definition” of a pyramid scheme, and further advocates for the universal adoption of an anti-pyramid statute modeled on California’s that makes it illegal to “contrive[], prepare[], set[] up, propose[], or operate[] any endless chain.”²⁰⁰

Another proposed solution is a mandatory cooling off period during which prospective distributors will have the opportunity to consider an MLM proposal without pressure from the seller.²⁰¹ This period will encourage participants to consult family, friends, and other advisers about their decision to join the MLM, which may ultimately serve as a deterrent.²⁰²

Despite being presented with the foregoing expert opinions during the comment period on the Business Opportunity Rule, the FTC declined to incorporate any of these practicable solutions into the final rule, presumably due to political influence, and excluded MLMs from the scope of the rule altogether.²⁰³

IV. INCORPORATING LESSONS LEARNED FROM THE FTC’S 2016
HERBALIFE SETTLEMENT IN A POST-*AMG CAPITAL*
MANAGEMENT WORLD

In *AMG Capital Management*, the United States Supreme Court held that the FTC may not use FTC Act Section 13(b) “to seek, or a court to award, equitable monetary relief such as restitution or disgorgement,” and therefore may no longer bring suits for monetary relief directly to federal court, effectively hollowing out

²⁰⁰ *Id.* at 32. “[E]ndless chain’ means any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant.” *Id.*

²⁰¹ *Id.* at 40, 45.

²⁰² *Id.* at 45.

²⁰³ *See id.* at 1.

the FTC's consumer protection enforcement authority.²⁰⁴ For decades, these actions were the Commission's most direct and consistent mode of obtaining payment for financially harmed consumers.²⁰⁵ And, "in the most recent fiscal year the FTC obtained almost four times as many permanent injunctions under Section 13(b) as it issued cease-and-desist orders under Section 5."²⁰⁶ Therefore, without Section 13(b) at its disposal, the FTC must promulgate widespread regulations to reform MLMs, and, in the meantime, aggressively exercise its power to pursue financial restitution from MLMs under Sections 5 and 19 of the FTC Act.

AMG Capital Management undeniably delivered a blow to the FTC's consumer protection capabilities.²⁰⁷ However, "Section 13(b) is not the FTC's only tool."²⁰⁸ On June 14, 2021, shortly after the *AMG Capital Management* decision, the FTC announced its intention to review the Business Opportunity Rule, which requires disclosure of "specific information to help [a consumer] evaluate a business opportunity."²⁰⁹ In his statement regarding the upcoming review, FTC Commissioner Rohit Chopra noted that

This rule was intended to ensure that would-be entrepreneurs are not cheated through *deceptive earnings claims* and other forms of fraud, and it allows the Commission to seek *civil penalties, damages, and other relief* against violators. However, *prior Commissioners voted to exempt multilevel marketers* from the rule's requirements.²¹⁰

²⁰⁴ Mann, *supra* note 33.

²⁰⁵ *See id.*

²⁰⁶ *Id.*

²⁰⁷ *See id.*

²⁰⁸ *Statement of Commissioner Rohit Chopra Regarding the Business Opportunity Rule*, FED. TRADE COMM'N (June 14, 2021), https://www.ftc.gov/system/files/documents/public_statements/1591046/statement_of_commissioner_rohit_chopra_regarding_the_business_opportunity_rule.pdf [hereinafter *Chopra Statement*].

²⁰⁹ *FTC Schedules Review of Business Opportunity Rule*, FED. TRADE COMM'N (June 14, 2021), <https://www.ftc.gov/news-events/press-releases/2021/06/ftc-schedules-review-business-opportunity-rule>.

²¹⁰ *Chopra Statement*, *supra* note 208, at 1.

Although Commissioner Chopra implied an intention to include MLMs in the revised Business Opportunity Rule, it is imperative that the FTC do so. By including MLMs in the Business Opportunity Rule, the FTC will once again be able to efficiently obtain monetary relief for harmed MLM participants, even without Section 13(b) at its disposal.

In the meantime, millions of Americans continue to be harmed daily by MLMs,²¹¹ so the FTC must aggressively pursue Section 5 claims against them. Since the FTC is relatively less likely to prevail on Section 5 claims compared to Section 13(b) claims, and obtaining monetary relief through Section 19 is slower and more uncertain,²¹² the FTC must be even more aggressive in its pursuit of these cases and remedies. One of the FTC's most notable recent Section 5 actions against an MLM was its Herbalife suit in 2016,²¹³ and the outcome of the case highlights some of the pitfalls of these actions that the FTC must avoid in the future.

A. The Herbalife Settlement

On July 15, 2016, the FTC proudly announced a “historic settlement” with Herbalife,²¹⁴ a highly profitable nutrition MLM

²¹¹ See Celarier, *supra* note 6 (“[M]ore than 18 million Americans participat[e] in an MLM in a given year.”); Gregory Karp, *The Fine Line Between Legitimate Businesses and Pyramid Schemes*, CHICAGO TRIBUNE (Feb. 10, 2013), <https://www.chicagotribune.com/business/ct-xpm-2013-02-10-ct-biz-0210-herbalife-20130210-story.html> (“MLMs have annual sales of about \$30 billion, with about 16 million people in the United States selling their products . . .”).

²¹² To obtain monetary rewards, the FTC must first pursue administrative relief through Section 5, and then, if successful, seek enforcement of that administrative ruling in federal court through Section 19. Instead of obtaining swift and reliable monetary relief directly from federal courts under Section 13(b), aggrieved consumers must now wait for their claims to ascend through, and succeed in, the administrative system, which includes winning any appeals from the administrative process. This introduces delay and uncertainty into the restitution process. See Mann, *supra* note 33; see also *FTC Overview*, *supra* note 147.

²¹³ Greisman, *supra* note 37.

²¹⁴ *Id.*

founded in 1980,²¹⁵ that would result in a significant restructuring of the company and a \$200 million fine to repay those who lost money (including those who might lose money in the future).²¹⁶ The FTC brought suit under Section 5 of the FTC Act and determined that Herbalife “deceived consumers into believing they could earn substantial money selling diet, nutritional supplement, and personal care products,” and that Herbalife’s compensation structure was “unfair,” since it “reward[ed] distributors for recruiting others to join and purchase products in order to advance in the marketing program, rather than in response to actual retail demand for the product[.]”²¹⁷ According to the FTC, “[c]onsumers have suffered and will continue to suffer substantial monetary loss as a result of [Herbalife’s] violations of Section 5(a) of the FTC Act.”²¹⁸

In a blog post covering the settlement, the FTC noted that readers “might know Herbalife through its extensive marketing in English and Spanish,” as well as its ubiquitous promotions and “glowing testimonials.”²¹⁹ For decades prior to FTC intervention, Herbalife promised participants earnings of at least \$500 per month, as well as a luxurious lifestyle for those who opted to work for the company full-time.²²⁰ Hundreds of thousands of people took the Herbalife bait, but in fact, half of Herbalife’s “sales leaders” earned, on average, less than \$5 a month from selling Herbalife products, and the average Herbalife distributor received under \$300 in 2014 from product sales and recruitment commissions combined.²²¹ Moreover, “[o]f the more than 680,000 distributors counted by Herbalife in 2014, only 205, or 0.03%, earned more than \$600,000.”²²² The very few Herbalife distributors who managed to

²¹⁵ *About Herbalife Nutrition*, HERBALIFE, <https://iamherbalifenutrition.com/who-we-are/> (last visited Sept. 22, 2021).

²¹⁶ Greisman, *supra* note 37.

²¹⁷ *Herbalife Press Release*, *supra* note 36.

²¹⁸ Hiltzik, *supra* note 38.

²¹⁹ Greisman, *supra* note 37.

²²⁰ *Statement of the Federal Trade Commission FTC v. Herbalife International of America, Inc.*, FED. TRADE COMM’N (July 15, 2016), https://www.ftc.gov/system/files/documents/public_statements/971213/160715herbalifestatement.pdf [hereinafter *Herbalife Statement*].

²²¹ *Herbalife Press Release*, *supra* note 36; Greisman, *supra* note 37.

²²² Hiltzik, *supra* note 38.

profit did so by recruiting a downline of distributors to buy products at wholesale.²²³ Whether or not their downlines were able to re-sell the product was immaterial to the recruiter's income, so many recruiters pressured their downlines to purchase products regardless of market demand, consequently leaving their downlines with a large leftover product inventory they would be unable to sell.²²⁴

The FTC settlement required Herbalife to overhaul its compensation system to reward retail sales to end-users instead of income derived primarily from recruitment, as well as ensure participants are selling their products to an end-user, instead of buying the products themselves.²²⁵ Herbalife must also retain an Independent Compliance Auditor to monitor their adherence to the FTC order, and Herbalife is further prevented from misrepresenting distributors' potential or likely earnings, particularly through claims that members can "quit their job or otherwise enjoy a lavish lifestyle."²²⁶ The FTC claims this settlement "serves as an important reminder to multi-level marketing firms," who should ensure their "income representations are not false or misleading, and that compensation structures do not incentivize recruitment and wholesale purchases unrelated to retail demand."²²⁷

According to the FTC, the settlement was a win against the powerful MLM: the \$200 million payout and restructuring mandate were widely publicized,²²⁸ and the national media described the

²²³ *Herbalife Statement*, *supra* note 220.

²²⁴ *Id.*

²²⁵ *Herbalife Press Release*, *supra* note 36.

²²⁶ *Id.*

²²⁷ *Herbalife Statement*, *supra* note 220.

²²⁸ *See id.*; *see generally* Jim Zarroli, *Herbalife Agrees To Pay \$200 Million To Settle Complaints It Deceived Consumers*, NPR (July 15, 2016, 6:42 PM), <https://www.npr.org/sections/thetwo-way/2016/07/15/486174340/herbalife-agrees-to-pay-200-million-to-settle-complaints-it-deceived-consumers>; Matthew Goldstein & Alexandra Stevenson, *Herbalife Settlement With F.T.C. Ends Billionaires' Battle*, N.Y. TIMES (July 15, 2016), <https://www.nytimes.com/2016/07/16/business/dealbook/herbalife-ftc-inquiry-settlement-william-ackman.html>; Sam Thielman, *Herbalife Dodges 'Pyramid Scheme' Label and Agrees to Pay \$200M Fine*, THE GUARDIAN (July 15, 2016, 13:13 EDT), <https://www.theguardian.com/business/2016/jul/15/herbalife-ftc-fine-200-million-pyramid-scheme-label>.

outcome as “harsh.”²²⁹ In reality, the settlement was not harsh enough, and it illuminates the many flaws in the FTC’s approach to consumer protection actions against major MLMs. Nonetheless, the settlement is a helpful case study for future Section 5 enforcement actions and substantive reforms because it illustrates the ways MLMs continue to skirt justice. Learning from the Herbalife settlement, especially after *AMG Capital Management*, the FTC must adequately protect consumers and use its Sections 5 and 19 powers to enforce harsh judgements against MLMs, immediately promulgate rules to enact stricter income disclosure requirements, and punish violators financially and reputationally.

B. Prioritizing Enforcement under Section 5 of the FTC Act

Despite Herbalife’s decades-long history of wrongdoing, the FTC did not take any action against the company until 2016.²³⁰ Herbalife first garnered negative attention from federal regulators (particularly, the Food and Drug Administration) in 1982 for false claims about its products’ effectiveness against treating certain diseases, including claims that the products “dissolv[ed]” tumors.²³¹ Since then, Herbalife has faced extensive regulatory scrutiny and lawsuits,²³² including a 2013 class action alleging the company violated California’s Endless Chain Scheme Law²³³ and a 2002 class action alleging RICO violations from December 1999 onwards,²³⁴ both of which settled.²³⁵ Further, according to a January 2012 FOIA

²²⁹ Zarroli, *supra* note 228.

²³⁰ Stephen Barrett, *Herbalife’s Early Days (1980-1986)*, MLM WATCH (Dec. 17, 2004), <https://quackwatch.org/mlm/c/Herbalife/herbalife01/>.

²³¹ *Id.*

²³² *Id.*

²³³ Complaint at 2, *Bostick v. Herbalife Int’l of America, Inc.*, No. CV13-02488 (C.D. Cal. Apr. 8, 2013), <https://centerforinquiry.org/wp-content/uploads/sites/33/quackwatch/casewatch/civil/herbalife/bostick/complaint.pdf>.

²³⁴ Complaint at 35, *Jacobs v. Herbalife Int’l, Inc.*, (C.D. Cal. Feb. 15, 2002), <https://centerforinquiry.org/wp-content/uploads/sites/33/quackwatch/MLM/04C/Herbalife/classaction/suit.pdf>.

²³⁵ *Index to Information about Herbalife International*, MLM WATCH (Sept. 28, 2020), <https://quackwatch.org/mlm/c/herbalife/herbalife00/>.

request, the FTC had 717 pages of records detailing 188 complaints against Herbalife, many of which involved deceptive earnings claims.²³⁶ However, the FTC only began its investigation in March 2014 after a private individual launched a public attack against Herbalife, bringing renewed national attention to the company.²³⁷

According to the FTC, “hundreds of thousands” of consumers lost money to Herbalife’s false earnings claims.²³⁸ However, the FTC fails to admit its own culpability for this harm. Like so many other MLMs,²³⁹ Herbalife likely spent years operating in violation of Section 5 of the FTC Act, and the settlement reveals the devastation that the FTC’s “blind eye” approach caused the American public: \$200 million worth of financial damage to unwitting consumers.²⁴⁰ If not for the media’s attention on the organization, it is likely that Herbalife would have continued its deceptive practices. It should not take intense public pressure for the FTC to enforce its own regulations. Therefore, to protect consumers from predatory MLMs, the FTC must first prioritize enforcement actions against these companies. Tens of millions of Americans will be scammed by MLMs every year,²⁴¹ and the FTC must reallocate the funds and staff necessary to insulate these individuals from

²³⁶ *Analysis of FTC’s Complaints Against Herbalife*, BEHIND MLM (Feb. 5, 2013), <https://behindmlm.com/companies/analysis-of-ftcs-complaints-against-herbalife/>.

²³⁷ In particular, Mr. Ackman gave a fiery 342-slide public presentation accusing Herbalife of being a “predatory pyramid scheme” that would inevitably fail. GuruFocus, *Bill Ackman Ends 5-Year Battle Against Herbalife*, FORBES (Feb. 28, 2018 6:17 PM), <https://www.forbes.com/sites/gurufocus/2018/02/28/bill-ackman-ends-5-year-battle-against-herbalife/?sh=9572b4619838>; *Herbalife Slammed with \$200 Million Penalty for MLM Scheme*, MLM REP. (July 15, 2016), <https://www.mlmnewsreport.com/herbalife-slammed-200-million-penalty/>.

²³⁸ Greisman, *supra* note 37.

²³⁹ Taylor, *supra* note 1, at 7-38 (“[V]irtually all MLMs are violating Section 5 . . .”).

²⁴⁰ *See id.*; Greisman, *supra* note 37.

²⁴¹ *See* Celarier, *supra* note 6 (“[M]ore than 18 million Americans participat[e] in an MLM in a given year.”); Karp, *supra* note 63 (“MLMs have annual sales of about \$30 billion, with about 16 million people in the United States selling their products . . .”). Assuming, *arguendo*, that 17 million Americans participate in an MLM annually, and 99% of them are destined to lose money, then at least 16.9 million Americans will be harmed by MLM yearly. *See* Taylor, *supra* note 1, at Intro-8.

harm. Currently, MLMs face little pressure to abide by the law: between the rarity of FTC enforcement actions²⁴² and the FTC's insistence that the MLM industry self-regulate,²⁴³ as well as the industry's powerful lobby²⁴⁴ and political connections,²⁴⁵ MLMs operate with relative impunity, harming essentially every single one of their participants.²⁴⁶ If the FTC continues to turn a blind eye to illegal MLMs, millions more Americans will inevitably be harmed.

C. Increased Disclosure Requirements

The Herbalife settlement also reveals the need for increased MLM disclosure requirements. When announcing the Herbalife settlement, FTC Chairwoman Edith Ramirez stated, "Herbalife is going to have to start operating legitimately, making only truthful claims about how much money its members are likely to make."²⁴⁷ Chairwoman Ramirez's statement is not entirely accurate. Under the Herbalife settlement, Herbalife participants are prohibited from representing that "participation in [Herbalife] is likely to result in a *lavish lifestyle*."²⁴⁸ Examples of prohibited claims include statements that a participant can, "'quit your job,' 'be set for life,' 'earn millions of dollars,' 'make more money than they ever have imagined or thought possible,' 'realize unlimited income,' . . . and [d]escriptions or images of opulent mansions, private helicopters, private jets, yachts, [and] exotic automobiles . . ."²⁴⁹ However, prohibiting promises of a "lavish" lifestyle is neither a complete nor adequate solution to the large swathes of the population who lose money to MLMs, and the FTC settlement enables Herbalife to continue to lie to consumers.

²⁴² See Taylor, *supra* note 1, at 7-37.

²⁴³ *Business Guidance*, *supra* note 39.

²⁴⁴ Stroud, *supra* note 7.

²⁴⁵ Celarier, *supra* note 6.

²⁴⁶ Taylor, *supra* note 1, at Intro-8.

²⁴⁷ *Herbalife Press Release*, *supra* note 36.

²⁴⁸ Stipulation and Entry of Order for Permanent Injunction and Monetary Judgment at 15, *Federal Trade Comm'n v. Herbalife Int'l of America, Inc.*, No. 2:16-cv-05217 (C.D. Cal. July 15, 2016), <https://www.ftc.gov/system/files/documents/cases/160715herbalife-stip.pdf> (emphasis added).

²⁴⁹ *Id.* at 16.

While Herbalife distributors may not be able to promise mansions and private jets, under the FTC settlement, they can seemingly promise anything short of that.²⁵⁰ This weak disclosure requirement fails to protect consumers because it does not make them aware of the actual risk of joining an MLM. Not only are MLM participants unlikely to earn enough money to live a lavish lifestyle, at least 99% will *lose* money.²⁵¹ If the actual odds of success were revealed, “[p]ersons who understood basic statistics” would likely decline to enroll, and “only the most unsophisticated would join.”²⁵² To prevent harm to those seeking even a modest extra income, or even those who expect to profit at all, the FTC must require MLMs to disclose the true likelihood of success, that is, next to none.²⁵³ Complete and honest disclosure of a typical MLM participant’s failure rate is especially important in the current economic climate, where millions of low-income Americans, who are particularly vulnerable to MLMs,²⁵⁴ are disproportionately facing joblessness.²⁵⁵ As the Herbalife settlement currently stands, future Herbalife consumers (as well as participants in the myriad of MLMs who have yet to face FTC crackdowns), are still vulnerable to MLM income claims, and may stand to lose money in the midst of a global pandemic. However, if MLMs were required to disclose the actual odds of success during the participant on-boarding process, the number of consumers harmed by MLMs would sharply decrease, since most would decline to join in the first place.

²⁵⁰ *See id.* at 15–16.

²⁵¹ Taylor, *supra* note 1, at Intro-8.

²⁵² Taylor, *supra* note 26, at 5.

²⁵³ Taylor, *supra* note 1, at Intro-8.

²⁵⁴ Bell, *supra* note 10.

²⁵⁵ Kim Parker et al., *Economic Fallout from COVID-19 Continues to Hit Lower-Income Americans the Hardest*, PEW RSCH. CTR. (Sept. 24, 2020), <https://www.pewsocialtrends.org/2020/09/24/economic-fallout-from-covid-19-continues-to-hit-lower-income-americans-the-hardest/>.

D. Proportionate Financial and Reputational Punishments

Although the FTC painted the Herbalife settlement as a victory,²⁵⁶ in reality, the settlement was a win for the MLM.²⁵⁷ The FTC characterized the \$200 million fine as “one of the largest redress distributions the agency has made in any consumer protection action to date.”²⁵⁸ While this may be true, the amount had no lasting negative impact on the multi-billion dollar company’s financial health.²⁵⁹ In fact, it may have been considered a boon, as “the stock market treated the \$200-million settlement as a triumph for the company, sending its shares up nearly 10% . . . after the FTC settlement,” and up another 9% “after the company disclosed the pending penalty in a quarterly report.”²⁶⁰ The market seemingly realized that a \$200 million fine was an obvious drop-in-the-bucket to Herbalife’s billions and that Herbalife would likely be free from further investigation. Although it has been argued that Herbalife has become “too rich to shut down,”²⁶¹ the FTC must use its Section 19 power to obtain significantly higher monetary damages to deter future misconduct, rather than invite it by delivering a mere slap on the wrist. The FTC’s settlements should not perversely reward companies who have defrauded hundreds of thousands of consumers.

Finally, the FTC never officially dubbed Herbalife a “pyramid scheme,” instead allowing it to retain its “multilevel marketing” moniker.²⁶² This was a deliberate move by Herbalife, who agreed to

²⁵⁶ See Greisman, *supra* note 37.

²⁵⁷ Zarroli, *supra* note 228 (“[F]ederal officials stopped short of calling the company a pyramid scheme and allowed it to keep operating. That was seen as a victory for the company on Wall Street . . .”).

²⁵⁸ *FTC Sends Checks to Nearly 350,000 Victims of Herbalife’s Multi-Level Marketing Scheme*, FED. TRADE COMM’N (Jan. 10, 2017), <https://www.ftc.gov/news-events/press-releases/2017/01/ftc-sends-checks-nearly-350000-victims-herbalifes-multi-level>.

²⁵⁹ Hiltzik, *supra* note 38.

²⁶⁰ Michael Hiltzik, *FTC Moves against Herbalife, but leaves a question: Why is this company still allowed in business?* L.A. TIMES (July 18, 2016), <https://www.latimes.com/business/hiltzik/la-fi-hiltzik-herbalife-20160718-snap-story.html>.

²⁶¹ *Id.*

²⁶² Gurufocus, *supra* note 237.

restructure and pay the settlement in exchange for the FTC's agreement to end its investigations into the company and "refrain from classifying the company as a pyramid scheme."²⁶³ "Herbalife negotiated away the words 'pyramid scheme' from the settlement agreement"²⁶⁴ in part because of the MLM industry's political connections.²⁶⁵ Herbalife is in fact a pyramid scheme: participants who profited generated income solely through recruiting others to invest, and not through product sales.²⁶⁶

Members of the public are well aware that pyramid schemes are illegal, and while some people knowingly join illegal pyramid schemes hoping to profit, most victims of pyramid schemes are unwitting.²⁶⁷ Therefore, by bowing to the MLM lobby and failing to accurately characterize Herbalife as a pyramid scheme, the FTC has yet again failed the American public because Herbalife still has a veneer of legitimacy. If the FTC determines that an MLM is actually a pyramid scheme, it must withstand political pressure and publicize this finding. Then, consumers will be able to compare the operations of the "pyramid scheme" to other "legitimate" MLMs and realize they are essentially the same. Without giving the public this critical reference point, the FTC is continuing to allow unwitting consumers to join pyramid schemes, including Herbalife, and is setting them up for failure.

CONCLUSION

If the FTC intends to actually protect millions of consumers from being duped by MLMs without the benefit of Section 13(b) monetary relief or widespread reform, it must stand up to the MLM lobby and earnestly pursue and punish illegal MLMs through its Section 5 power. MLMs must be required to make fully accurate income claims, and those MLMs who fail to do so should face real financial consequences and a blow to their reputation. Otherwise, MLMs will continue to harm the American public, whose

²⁶³ MLM REPORT, *supra* note 237.

²⁶⁴ Gurufocus, *supra* note 237.

²⁶⁵ See Hiltzik, *supra* note 38.

²⁶⁶ S.D. CONSUMER PROT. OFF. OF THE ATT'Y GEN., *supra* note 115.

²⁶⁷ See N.Y. ST. ATT'Y GEN., *supra* note 116.

desperation is only heightened by the current economic downturn from the COVID-19 pandemic.