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Adeline Clay

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ADELINE CLAY*

INTRODUCTION

In October 2021, the Federal Trade Commission (FTC) issued a statement directed toward multi-level marketing companies, colloquially known as MLMs, which promised to pursue legal action against these companies for violating Section 5 of the Federal Trade Commission Act (FTCA).[1] Section 5 proscribes "unfair or deceptive acts or practices in or affecting commerce,"[2] and the FTC released this statement in conjunction with an unaddressed letter which included "notices" of legal standards and practice guidance for companies which courts analyze when determining whether or not Section 5 is violated.[3] Of note, the FTC stated that misleading or untrue earning projections exist when a court determines that the "net impression" of a company's statement indicates as much.[4] The FTC addressed these letters "to more than 1,100 companies."[5]

The recent attention from various social media platforms and documentaries highlighting the businesses practices of MLMs serves to explain why the FTC has begun to target them for warnings.[6] Not to be

* Adeline Clay is an associate attorney at Frombaugh Law in New London, Ohio. In 2019, she received her Bachelor of Arts in English from the Ohio State University at Mansfield. Afterward, she attended Ohio Northern University College of Law and graduated in 2022. While in law school, she served as Editor-in-Chief of the Ohio Northern University Law Review and was inducted into the prestigious Willis Society.

1. *FTC Puts Businesses on Notice that False Money-Making Claims Could Lead to Big Penalties*, FED. TRADE COMM'N (Oct. 26, 2021), https://www.ftc.gov/news-events/press-releases/2021/10/ftc-puts-businesses-notice-false-money-making-claims-could-lead [hereinafter *FTC Puts Businesses on Notice*]; Letter from Federal Trade Commission (Oct. 26, 2021), https://www.ftc.gov/system/files/attachments/penalty-offenses-concerning-money-making-opportunities/cover-letter-mmo.pdf [hereinafter Letter].

2. 15 U.S.C.A. § 45(a)(1) (West 2006).

3. Letter, *supra* note 1.

4. *Id.* (quoting F.T.C. v. Stefanchik, 559 F.3d 924, 928 (9th Cir. 2009)).

5. *FTC* Puts Businesses on Notice, supra note 1.

6. *See* Kelsey Weekman, *As Multi-Level Marketing Companies Turn Their Attention to Social Media, Young People Are Fighting Back*, IN THE KNOW (May 27, 2021), https://www.intheknow.com/post/anti-mlm-creators-tiktok-youtube/?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAIzPX5meAur-oWAbvN8-OFoeMl454IKcHJHOW5FDxX_T-Yko8b7nY6MTocaMq6_uFZ8MzfRa7Cfexh8cP-AyXpLNrwq9EFMHRyaPniKKQQgy6n0jeQAVFSuiKg_l6X1cnfkN0mUS3S3M0M0gfrVahl8O0X-dCHkMcQP7em34DgYj; Tom Kucher, *4 Documentaries Like*

confused with pyramid schemes, which are illegal, MLMs may provide a legal, dependable source of income for some entrepreneurs.[7] Most of these direct sellers are women,[8] and MLMs often package their products and risky money-making ventures as sure sources of income that allow women to feel independent as business owners and available as mothers and wives.[9] Unfortunately, a 2011 report by the Consumer Awareness Institute asserted that MLMs see nearly all their sellers lose money rather than earn it, and this same report suggests that the illegal and patently fraudulent pyramid schemes actually result in less economic damage to sellers.[10]

Scholars suggest that the FTC could successfully slow or even stymie the debilitating financial and social effects which misrepresentation and false earning projections have on consumers and direct sellers by sending more warning letters to potentially liable multi-level marketing companies and issuing legal threats in connection with these letters.[11] Additional solutions may include subjecting companies to civil liabilities for misrepresentations[12] or restructuring other areas of employment to accommodate working women and their families.[13] While these methods may be effective in curtailing the effects of direct sellers, they do not adequately address an underlying issue with MLMs—that the net the FTC casts for its warnings is still too small, even when 1,100 companies received warning letters.[14] That is, the number of companies receiving FTC warning letters does not accurately reflect the

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'LulaRich' to Stream That Investigate Multi-Level Marketing (MLM) Schemes, DIST. CHRON. (Sept. 28, 2021), https://districtchronicles.com/4-documentaries-like-lularich-to-stream-that-investigate-multi-level-marketing-mlm-schemes/.

7. *Multi-Level Marketing vs Pyramid Schemes*, S.D. CONSUMER PROT, https://consumer.sd.gov/fastfacts/marketing.aspx (last visited Apr. 20, 2022); Gregory Karp & Chicago Tribune Reporter, *The Fine Line Between Legitimate Businesses and Pyramid Schemes*, CHI. TRIB. (Feb. 10, 2012, 12:00 AM), https://www.chicagotribune.com/business/ct-xpm-2013-02-10-ct-biz-0210-herbalife-20130210-story.html.

8. Bridget Read, *Hey Hun! In Women's Joblessness, Multi-Level Marketers Saw Opportunity*, CUT (Feb. 3, 2021), https://www.thecut.com/2021/02/pandemic-unemployment-multi-level-marketing.html ("The Direct Selling Association, a trade organization of MLMs, estimates that 74% of the 16 million Americans involved in direct selling are women . . . .").

9. *Id.*

10. Jon Taylor, *MLM's Abysmal Numbers, in* THE CASE (FOR AND) AGAINST MULTI-LEVEL MARKETING 7-1 (2011), https://www.ftc.gov/sites/default/files/documents/public_comments/trade-regulation-rule-disclosure-requirements-and-prohibitions-concerning-business-opportunities-ftc.r511993-00008%C2%A0/00008-57281.pdf ("MLM as a business model is the epitome of an 'unfair or deceptive acts or practice' that the FTC is pledged to protect against. It is even worse than classic, no-product pyramid schemes (for which the loss rate is only about 90%) and 'pay to play' chain letters.") [hereinafter Taylor, *MLM's Abysmal Numbers*].

11. Christopher Bradley & Hannah Oates, *The Multi-Level Marketing Pandemic*, 89 TN. L. REV. 321, 326 (2022).

12. Rohit Chopra & Samuel Levine, *The Case for Resurrecting the FTC Act's Penalty Offense Authority*, 170 U. PA. L. REV. 71, 79 (2021).

13. Annie Blackman, *Regulating the Reluctant: Policies That Benefit Vulnerable Participants in Multi-Level Marketing*, 25 U. PA. J. L. & SOC. CHANGE 83, 83, 113 (2021).

14. *FTC Puts Businesses on Notice, supra* note 1.

actual amount of multi-level marketing companies that should be receiving warnings regarding their business practices.[15] If this initial number regarding the unlawful activities of MLMs were more accurate, the FTC and other policy- and lawmakers would have a greater ability to target the harms which MLMs cause their direct sellers.

At the outset, this Comment does not propose additional penalties for violations of the FTCA, nor does it suggest how to resolve the harm caused by multi-level marketing companies and pyramid schemes. Instead, this Comment focuses on the fact that the regulatory guidance the FTC provides for "deceptive practices" in relation to multi-level marketing companies is relatively unhelpful in determining the scope of which MLMs violate the FTCA.[16] This assertion is supported by analyses of case law using and extrapolating on the "net impression" standard courts created which the FTC adopted and now proposes.[17] This Comment then suggests that the net impression standard is insufficient to target the majority of harms associated with multi-level marketing companies; while misleading earning projections form the basis of liability under the FTCA for those deceptive practices, it is the structure of MLMs which promote recruitment over sales, an "unfair" practice under the FTCA, that truly mirror pyramid schemes.[18] If a net impression of earning potential is the controlling standard, then MLMs that publish timely income disclosure statements could escape liability although they functionally pose the same threat to the public as pyramid schemes.[19] While the net impression standard is certainly useful in establishing one type of liability under Section 5 of the FTCA, this standard should be accompanied by a scrutinization of the unfair effects a multi-level marketing company's structure has on the public, which could be accomplished through another net impression standard. Under this type of inquiry, more multi-level marketing companies would likely be considered unlawful and likewise subject to civil penalties because many MLM companies engage in the same unfair results, which subject pyramid schemes to liability.

HISTORY AND BACKGROUND

The MLM Business Model—"These Things Sell Themselves"[20]

As a business model, multi-level marketing companies typically provide two sources of income for their distributors—commissions from selling the

15. *Id.*
16. Letter, *supra* note 1.
17. *See infra* text accompanying notes 161-62; Letter, *supra* note 1.
18. *See infra* text accompanying note 64.
19. *See infra* text accompanying notes 64, 66.
20. *The Office: Michael's Birthday* (NBC television broadcast Mar. 30, 2006).

company's product, and commissions for recruiting new distributors.[21] This model differs from "traditional marketing," in which a company makes a product and sends the product to a "wholesaler," which distributes products to retailers, who advertise and sell the product to the ultimate consumers.[22] Instead, MLMs employ network marketing strategies, in which a company makes a product and recruits direct sellers who buy the product in order to have it on-hand to advertise and sell to other consumers.[23] Advertisement may occur through face-to-face parties, in which a seller can access a key group of friends and colleagues to demonstrate a product, or through social media, an avenue which allows the seller to reach an even wider scope of potential customers and fellow direct sellers.[24] In some ways, MLMs may seem more convenient than traditional marketing tactics by cutting out the middleman and providing an accessible and often personal avenue by which consumers can obtain products.[25]

Studies on the network marketing model demonstrate that most direct sellers are women.[26] The reason women dominate this business model stems in part from societal conventions that some women have a greater desire to stay at home to manage their families and simultaneously earn an income or that they want to develop a "community" of business opportunities for other women.[27] For some direct sellers, religious reasons motivate entrance into MLMs;[28] Utah is "the number one state in the union for multi-level marketing companies."[29] In turn, "Mormons are seriously over-represented" in MLMs.[30] The high proportion of religious people is not solely accounted for by geographic convenience—MLMs suggest that community involvement and hustling create the most successful salespeople, and churchgoers often

21. Fed. Trade Comm'n, *Multi-Level Marketing Businesses and Pyramid Schemes* (July 2022), https://consumer.ftc.gov/articles/multi-level-marketing-businesses-pyramid-schemes [hereinafter F.T.C. *Multi-Level Marketing*].

22. Supriya Bajaj, *A Complete Guide of Multi-Level Marketing Business Model*, SOFTWARE SUGGEST, https://www.softwaresuggest.com/blog/understand-multi-level-marketing-business-model/# (last updated Dec. 21, 2021).

23. *Id.*

24. *Id.;* Caileen Kehayas Holden, *What Is An MLM + Why Do They Target Women*, CAREER CONTESSA, https://www.careercontessa.com/advice/multilevel-marketing/ (last visited Apr. 3, 2022).

25. Bajaj, *supra* note 22.

26. Blackman, *supra* note 13, at 94; Direct Selling Ass'n, *Direct Selling in the United States*, PERMA (Oct. 25, 2021, 10:54 PM), https://perma.cc/F7XE-B4V9; Holden, *supra* note 24.

27. Blackman, *supra* note 13, at 96.

28. Holden, *supra* note 24.

29. *Id.* (quoting Mette Harrison, *10 Reasons Mormons Dominate Multi-Level Marketing Companies*, RELIGION NEWS (June 20, 2017), https://religionnews.com/2017/06/20/10-reasons-mormons-dominate-multi-level-marketing-companies/).

30. Captain Cassidy, *An Overlapping Venn Diagram: Christianity and Multi-Level Marketing Schemes*, PATHEOS (Feb. 28, 2018), https://www.patheos.com/blogs/rolltodisbelieve/2018/02/28/overlapping-venn-diagram-christianity-mlm/.

have large social networks to which they can outreach.[31] People tend to trust those with shared characteristics, whether gender, ideology, or social class, and the community aspect of MLMs relies on these relationships to recruit sellers and consumers.[32]

Unfortunately, many MLMs advertise financial independence, entrepreneurial opportunities, community values, and women-centered businesses to potential consumers over the quality of the products themselves.[33] For example, the now-controversial clothing retailer LuLaRoe states that it "was created to help others succeed" and was "built on the principles of entrepreneurship, freedom, and service."[34] Avon's "values" do not include mentions of makeup or fashion selections but instead describe the efficacy of its business and the ultimate goal of bettering the world for women.[35] doTERRA promises its sellers a business which "maintain[s] the culture of a small company where everyone has a voice and a place," and it is only after this statement that the company describes the quality of its essential oils products in any great detail.[36] These examples are neither exclusive nor extraordinary when compared to other MLMs.[37]

To recruit direct sellers, MLMs may offer joining options for their website visitors.[38] However, new sellers often join based on testimonials from acquaintances or friends claiming they now run their own businesses, can pay off debts and bills, and have extra spending money for their families.[39] By joining the original seller's "downline," a new direct seller may be able to market to a similar social circle or reach out to their own friends and family members to advertise their products.[40] Direct sellers might pay an upfront cost for initial inventory, as well as continued expenses for

31. Holden, *supra* note 24; Harrison, *supra* note 29.

32. Holden, *supra* note 24; Harrison, *supra* note 29.

33. Blackman, *supra* note 13, at 94-96.

34. *Our Story*, LULAROE, https://www.lularoe.com/our-story (last visited Apr. 29, 2022).

35. *Our Values*, AVON, https://www.avonworldwide.com/about-us/our-values (last visited Apr. 29, 2022).

36. *The doTERRA Vision*, DOTERRA, https://www.doterra.com/US/en/brochures-magazines-welcome-to-doterra-doterra-vision (last visited Apr. 29, 2022).

37. *See also* Blackman, *supra* note 13, at 96 (describing the sales tactics employed by retailers for the company It Works!, in which distributors would "'go into mom groups and look for anyone at [sic] trying to look for friends or who had financial struggles and go after them . . .'") (quoting Sara Silverstein et al., *People Who Sell for Multilevel Marketing Companies Look Wildly Successful on Facebook, But the Reality Is Much More Complicated*, BUS. INSIDER (Aug 6, 2019, 12:11 PM), https://www.businessinsider.com/mlms-use-social-media-facebook-portray-financial-success-2019-7).

38. *See also Join Us*, LULAROE, https://www.lularoe.com/join-lularoe (last visited Apr. 29, 2022).

39. *See* Silverstein et al., *supra* note 37 ("Judging by what people post on social media, it seems like there are a lot of multilevel marketers doing great and making money. But the data tells a different story. . . . Some 94% of all [Young Living] members are at the very bottom rung where the average monthly income is less than $1.").

40. Charity, *What's a Downline? What Is an Upline?*, MLMLEGAL (July 18, 2013), http://mlmlegal.com/MLMBlog/whats-a-downline-what-is-an-upline/.

products.[41] However, they can make sizable commissions by selling some products, recruiting other sellers into their downline, and profiting "upward" in the retail chain by earning a percentage of the income that their downline receives.[42] For those direct sellers who join a multi-level marketing company at its inception, the probability of large bonuses and reliable income is high.[43] Unfortunately, the more direct sellers are recruited, the fewer potential customers remain because those customers already have representatives to sell their product, or they themselves are direct sellers.[44] While those at the top of these direct seller distribution chain benefit from the sales and commissions their downlines receive, those at the bottom of this model expend money to join the company and buy inventory yet are left with no customers to which to advertise.[45]

MLMs provide a product to the ultimate consumer, distinguishing them from pyramid schemes which focus solely on recruitment.[46] While MLMs emphasize business and money-making opportunities to their customers, the products direct sellers sell make MLMs legal.If an MLM did not have a product to market, it would be a pyramid scheme and would therefore be illegal.[47] The FTC also noted that pyramid scheme recruiters often "make extravagant promises about . . . earning potential," and "emphasize recruiting new distributors for your sales network as the real way to make money."[48]

In considering the structure of a multi-level marketing company, the first distributors of a given corporation make the largest income, earned somewhat from their personal sales but primarily from commissions derived from their downline's sales and their downline's recruitment actions.[49] After the first

41. *See* Silverstein et al., *supra* note 37. One former seller for Young Living recounted that '"The investment was $165, which [the company] totally downplayed and made it sound like you could become the CEO of your own company for just 160 bucks."' *Id*. "A study done in 2011 by John Taylor of the Consumer Awareness Institute analyzed the compensation structure for 350 MLMs. *See* Taylor, *MLM's Abysmal Numbers, supra* note 10, at 7-1. Taylor accounted for expenses, including the products that distributors had to buy themselves just to qualify for commissions or bonuses. Taylor also found that over 99% of participants lost money in each of the multilevel marketing companies analyzed.

42. F.T.C. *Multi-Level Marketing*, *supra* note 21; Bajaj, *supra* note 22.

43. *See* Taylor, *MLM's Abysmal Numbers, supra* note 10, at 7-3. Taylor reported that "most of the money goes to TOPPs ["top-of-the-pyramid promoters"] at the expense of a revolving door of unwitting new downline recruits who try an MLM program and quit, only to enrich the TOPPs with commissions from the purchases they made in a vain effort to 'succeed.'"

44. *See id.*

45. *Id.* at 7-4 ("MLM compensation plans assume an infinite market and a virgin market, neither of which exists in the real world." (emphasis omitted)).

46. F.T.C. *Multi-Level Marketing*, *supra* note 21.

47. *Id.*

48. *Id.*

49. *See* Marguerite DeLiema et al., *AARP Study of Multilevel Marketing: Profiling Participants and their Experiences in Direct Sales*, AM. ASS'N OF RETIRED PERSONS, 1, 9 (2018). The AARP's study revealed a correlation between entering a multi-level marketing company early and earning a substantial income.

distributor recruits a distributor, who then branches out their own business and recruits other distributors, the latter of these distributors are all necessarily in the downline of the first distributor.[50] The shape this business structure creates may be better thought of as a triangle or even a pyramid.[51] In considering this shape, however, it must be emphasized that based on current regulations, a MLM would not be considered a pyramid scheme, despite the two business plans having similar marketing structures.[52]

What ultimately separates MLMs from pyramid schemes is "that there is no real product that is sold in a pyramid scheme."[53] Even when a company *does* have a product to sell, the FTC writes that this product may be attributed to a fraudulent marketing scheme, when the company engages in "inventory loading and a lack of retail sales."[54] Inventory loading reflects the amount of product distributors purchase themselves to maintain a position in the company or to have a high enough inventory to sell to consumers.[55] If the companies' distributors have few sales, but loaded inventories, the FTC suggests the company is likely a pyramid scheme, not a legitimate MLM.[56] These factors differ from MLMs, which are required to have a "buyback policy," which "prohibit[s]" retailers from "buying new inventory until retailers have sold 70% and have at least 10 new customers."[57] Finally, the FTC adds that the "hallmarks" of pyramid schemes are the guarantees of high

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> Only three individuals, *half of one percent*, reported profits of $100,000 or more. All of these three individuals worked as direct sellers for the company for more than 5 years (and one person for more than 20 years) and put in between 10 to 40 hours of work per week. One of the individuals reported that he founded the organization.

Id.

50. Bajaj, *supra* note 22.

51. F.T.C. *Multi-Level Marketing*, *supra* note 21.

52. *Id.*

53. *Multi-Level Marketing vs Pyramid Schemes*, *supra* note 7.

54. Debra A. Valentine, General Counselor for the U.S. Federal Trade Commission, Statement at the International Monetary Fund's Seminar on Current Legal Issues Affecting Central Banks: Pyramid Schemes (May 13, 1998), https://factsaboutherbalife.com/wp-content/uploads/2012/12/Valentine-FTC-5-13-98.pdf.

55. *Id.*; *See* Fed. Trade Comm'n, *Business Guidance Concerning Multi-Level Marketing,* https://www.ftc.gov/business-guidance/resources/business-guidance-concerning-multi-level-marketing (last visited Apr. 29, 2022) ("An MLM compensation structure that incentivizes participants to buy product, and to recruit additional participants to buy product, to advance in the marketing program rather than in response to consumer demand in the marketplace, poses particular risks of injury.") [hereinafter F.T.C. *Business Guidance*].

56. Valentine, *supra* note 54 ("A lack of retail sales is also a red flag that a pyramid exists. Many pyramid schemes will claim that their product is selling like hot cakes. However, on closer examination, the sales occur only between people inside the pyramid structure or to new recruits joining the structure, not to consumers out in the general public.").

57. Adrian Horton, *'It's Very Culty': The Bizarre Billion-Dollar Downfall of Fashion Company LuLaRoe*, GUARDIAN (Sept. 15, 2021, 3:37 PM), https://www.theguardian.com/tv-and-radio/2021/sep/15/lularich-lularoe-amazon-docuseries.

income in comparison to the amount of hours worked by distributors and that when retailers do make money, they make a commission based on recruiting more distributors to the network rather than for selling a product.[58]

The differences between these two business models suggests that multi-level marketing companies would be legitimate and free from fraud.[59] To the network marketing system's credit, the Direct Selling Association (DSA) operates as the "national trade association" designed "to promote, protect and police the direct selling industry while helping direct selling companies and their independent salesforce become more successful;" and those MLMs that are members of the DSA may be less harmful to distributors and consumers because they are subject to regulation.[60] Whether the DSA is particularly successful in its policing efforts is debatable, however, as some companies which have won awards through the association, such as Herbalife,[61] Younique,[62] Amway,[63] Young Living,[64] and Beachbody[65] have either been

58. Valentine, *supra* note 54; *Multi-Level Marketing vs Pyramid Schemes*, *supra* note 7.

59. Bajaj, *supra* note 22.

60. *Who We Are*, DIRECT SELLING ASS'N, https://www.dsa.org/about/association (last visited Apr. 29, 2022).

61. *See* Richard Craver, *RICO Lawsuit vs. Herbalife May Have Reached Settlement*, WINSTON-SALEM J. (Jan. 10, 2022), https://journalnow.com/business/local/rico-lawsuit-vs-herbalife-may-have-reached-settlement/article_94070b56-7252-11ec-ae0a-1790ffd5a80e.html (describing a 2017 class action lawsuit filed against the company after plaintiffs paid to attend "Circle of Success" presentations and allegedly suffered damages as a result); *see* Curt Anderson, *Distributors Who Didn't Get Rich Sue Herbalife Over 'Circle of Success' Events*, INS. J. (Aug. 23, 2018), https://www.insurancejournal.com/news/national/2018/08/23/498937.htm; *see also* Lisette Voytko, *Herbalife's $123 Million Chinese Bribery Settlement Is Latest Legal Trouble for MLM Giant*, FORBES (Aug. 28, 2020, 1:40 PM), https://www.forbes.com/sites/lisettevoytko/2020/08/28/herbalifes-123-million-chinese-bribery-settlement-is-latest-legal-trouble-for-mlm-giant/ (detailing Herbalife's agreement to "pay $123 million in civil and criminal penalties" after being accused of bribing the Chinese government to improve Herbalife business in the country).

62. *See Younique's Original Moodstruck Lashes Settlement*, FIBERLASH SETTLEMENT, http://www.fiberlashessettlement.com (last visited Apr. 29, 2022) (describing how the company entered a settlement agreement after plaintiffs alleged it falsely labeled its false eyelash product).

63. *See* Josh Eidelson, *Amway Sued by 'Independent Business Owner' Claiming Employee Status*, L.A. TIMES (Jan. 10, 2020, 12:30 PM), https://www.latimes.com/business/story/2020-01-10/amway-lawsuit-pay (detailing how a change in California law caused sellers for Amway, previously described as "independent contractors," to file suit to obtain "employee" status in order to receive "better pay and benefits").

64. *See* Erin Shaak, *'No Medicinal Benefit': Young Living Hit with Action Challenging Essential Oil Health Claims [UPDATE]*, CLASS ACTION, https://www.classaction.org/blog/no-medicinal-benefit-young-living-hit-with-class-action-challenging-essential-oil-health-benefit-claims (last updated July 21, 2022); *see also* Nicole Einbinder, *Some Members of Multilevel-Marketing Company Young Living Are Making Questionable Claims About 'Essential Oils' Curing Cancer and Coronavirus*, BUS. INSIDER (July 29, 2020, 6:02 AM), https://www.businessinsider.com/young-living-essential-oils-medical-claims-2020-7 (explaining how the company has been subject to criticism and legal controversy due to potential claims from retailers about the curative qualities of Young Living products).

65. *See* Ally Arcuri & Donna Sarkar, *The Truth about Beachbody*, HEALTH DIG., https://www.healthdigest.com/480585/the-truth-about-beachbody/ (last updated Dec. 13,2022, 9:22 AM). One line of products sold by Beachbody, "Shakeology," has been the subject of controversy due to the company's broad claim it contains various "superfoods" without describing the amount of each ingredient within the

subject to a class action lawsuit or have been embroiled in some other high-profile controversy regarding products or business practices.[66] At any rate, the DSA's existence suggests a strong stride toward keeping MLMs operating as legitimate business model as opposed to pyramid schemes.

This Comment suggests that pyramid schemes and MLMs are nonetheless too similar and that the FTC's regulatory language in Section 5 of the FTCA should reflect that similarity in legal actions against the two types of companies. Although many MLMs claim to pay their distributors based on sales, the reality is that the overwhelming percentage of top-earners in these companies instead earn their high incomes from recruitment.[67] Additionally, testimonials from former MLM representatives suggest that these companies promise large incomes to their distributors encourage their distributors to buy large amounts of products in order to maintain prestige in the company.[68] These facts indicate that the key differences between pyramid schemes and MLMs which the FTC highlights are thin at best and often illusory. As noted earlier, the FTC's current guidance on the potential unlawfulness of MLMs and earning potential estimates is based on the "net impression" created by a company's business practices, but if these practices more closely resemble pyramid schemes, than originally believed, then the net impression standard becomes less helpful because this is not the legal standard the FTC uses to regulate pyramid schemes.[69] In fact, pyramid schemes are hardly afforded such a benefit of the doubt because they are illegal by nature.[70] By briefly discussing the history of MLMs, the legal situations in which courts have previously imposed liability on some companies, and the current controversies surrounding some of the most notable of these companies, the need for better clarification from the FTC

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product. Additionally, Beachbody has made false claims about the disease-preventing and curing powers of its products.

66. *The Direct Selling Association (DSA) Announces 2019 Awards Winners and Highest Performing Companies*, BUS. WIRE (June 5, 2019, 3:35 PM), https://www.businesswire.com/news/home/20190605005897/en/The-Direct-Selling-Association-DSA-Announces-2019-Awards-Winners-and-Highest-Performing-Companies.

67. *But see* Taylor, *MLM's Abysmal Numbers, supra* note 10, at Intro-5. While Taylor notes that "recruiting is not a requirement for individual success in direct selling, and compensation must always [be] based on the sale of products and services," he continues that these sales can be made from one's "own sales or the sales made by [their] recruits." If a retailer cannot form a downline upon entry into a company, the only sales they will be able to make would be their own and a limited number of customers. However, by forming a downline through recruitment, a retailer has a much broader reach of consumers because they can make money off sales without having to advertise or network.

68. *See* Silverstein et al., *supra* note 37.

69. *See* F.T.C. *Business Guidance*, *supra* note 55. *See also infra* text accompanying note 125.

70. Valentine, *supra* note 54 ("Yet, both pyramid and Ponzi schemes are illegal because they inevitably must fall apart.").

regarding MLM's unlawful practices and the harms they inevitably perpetuate becomes more evident.[71]

History of MLMs

The year 1932 saw the birth of the first "network marketing" company, Wachter.[72] The now-defunct company sported a reportedly "lucrative" money-making opportunity for its sellers, while advertising "organic sea products" as nutritional supplements.[73] More popularly, Nutrilite, is credited as beginning the MLM movement following their incorporation in 1939.[74] Sporting itself as "a vitamin, mineral, and dietary supplement brand," the company began as an initiative by its founder, Carl Rehnborg, to incorporate more healthy and organic substances into food and sported itself as "a vitamin, mineral, and dietary supplement brand."[75] While farming in California, Rehnborg developed a multi-vitamin, later coined "DOUBLE X," and brought distributors into Nutrilite the following year.[76] The most noteworthy distributors—Jay Van Andrel and Rich DeVos—left the company after a decade to begin their own network marketing company, Amway.[77] Amway first marketed an organic cleaning product and, by 1968, had developed its own "clean" and "plant-based" makeup line, "Artistry."[78] At Nutrilite, Rehnborg's wife had ventured into the makeup industry a few years prior to Artistry's inception; by 1972, the interpersonal relationships in Amway and Nutrilite and the similar products made Amway's acquisition of Nutrilite seem natural.[79] Through the 1972 acquisition, Amway acquired Nutrilite's products, reputation, and workforce and now makes an annual revenue of over $8 billion.[80]

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71. *See infra* History of MLMs, Legal Background—The Court's Search for Substantive Rule, Controversies Surrounding MLMs.

72. *Product Catalogue and Price List*, WACHTERS', https://www.wachters.com/catalog_print.php (last visited Apr. 29, 2022).

73. *Id.*; Frank Ross, *The Oldest Network Marketing Company*, ALL BUS., https://www.allbusiness.com/the-oldest-network-marketing-company-52948-1.html (last visited Apr. 29, 2022).

74. *Nutrilite History*, NUTRILITE, https://www.nutrilite.com.my/en/history (last visited Apr. 29, 2022).

75. *The Brand Story*, NUTRILITE, https://www.nutrilite.com.my/en/article/the-brand-story (last visited Apr. 29, 2022); *Nutrilite History*, *supra* note 74.

76. *The Brand Story*, *supra* note 75; *Nutrilite History*, *supra* note 74.

77. *Nutrilite History*, *supra* note 74.

78. *Artistry About Us*, AMWAY, https://www.amway.com/artistry/about (last visited Apr. 29, 2022).

79. *Nutrilite History*, *supra* note 74; *Artistry About Us*, *supra* note 78.

80. *Nutrilite History*, *supra* note 74; Carly Hallman, *The Top 25 MLMs By Revenue*, TITLEMAX, https://www.titlemax.com/discovery-center/lifestyle/the-top-25-mlms-by-revenue/ (last visited Apr. 29, 2022).

The Management Study Guide describes the genesis of the downline system in network selling as an "accident[]."[81] Because Nutrilite operated on a network marketing model, salespeople with good social connections or numerous family members interested in the products could naturally make more sales than those without those connections.[82] Perhaps also naturally, other consumers who saw a friend or relative earn an income through Nutrilite wanted to have that same opportunity.[83] As a result, Nutrilite began offering a bonus opportunity to its distributors.[84] This "2 percent bonus" system, available to sellers who could convince others to join as Nutrilite salespeople, proved lucrative for both the company and its salespeople.[85] With a potential bonus for sellers each time a new distributor is added to their downline, the top seller in that downline could earn substantially more money as a recruiter rather than as a door-to-door salesperson[86] The Management Study Guide credits Nutrilite with the introduction of "network selling," with other companies like Amway and Shaklee following suit.[87] Now, the network selling system predominates MLMs, and the Management Study Guide suggests that "94%" of these companies use direct selling to make the majority of their revenues.[88]

Despite the wide usage of direct selling strategies and the amount of income it generates for companies, current statistics regarding MLM bonus payouts paint a tragic scene for most direct sellers, and companies such as Wachter appear to be the exception rather than the "norm."[89] For example, the most successful network marketing company, Forever Living Products, states on its LinkedIn page that the company sees "an annual turnover in excess of $2.6 billion and assets of over $1.5 billion."[90] It also boasts "a network of some 9 million independent distributors."[91] According to the company's Income Disclosure Statement, "89.8%" of direct sellers do "not

81. *Brief History of Multi Level Marketing*, MGMT. STUDY GUIDE, https://www.managementstudyguide.com/multi-level-marketing-history.htm (last visited Apr. 29, 2022).

82. *Id*.

83. *Id*.

84. *Id*.

85. *Id*.

86. *Brief History of Multi Level Marketing*, *supra* note 81.

87. *See id. See also Shaklee. Where Health Meets Science Meets Nature*, SHAKLEE, https://us.shaklee.com/about-us (last visited Apr. 29, 2022); DSN Staff, *Beyond Testimonials . . . to Science,* DIRECT SELLING NEWS (Mar. 1, 2012), https://www.directsellingnews.com/beyond-testimonials-to-science/. Shaklee is the invention of Dr. Forrest Shaklee. As Andrel and DeVos did with Amway, he worked for Nutrilite before leaving in 1956 to start Shaklee, which first sold supplements before branching into cleaning products and other meal supplements.

88. *Brief History of Multi Level Marketing*, *supra* note 81.

89. DeLiema et al., *supra* note 49, at 9.

90. *Forever - The Aloe Vera Company*, LUSHA, https://www.lusha.com/business/a21f9d7c74f41468/ (last visited Apr. 6, 2023).

91. *Id.*

receive any meaningful compensation or earnings" through this business opportunity, meaning that nearly 8 million of these direct sellers either lose money or make very little income.[92] Of the sellers who do make money through Forever Living, the largest percentage of earners, promised to "be [their] own boss[es]," would make sixty-nine cents an hour if their monthly earnings were converted into a forty-hour week.[93]

Legal Background—The Court's Search for Substantive Rule

The FTCA, Briefly

As previously noted, Section 5 of the FTCA provides the legal backdrop for FTC suits against multi-level marketing companies or pyramid schemes.[94] Under this Act, those companies which engage in "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce" are considered to be unlawful.[95] When the FTC suspects a violation of this section and the FTC believes "a proceeding by it in respect [to the violation] would be to the interest of the public, it shall issue . . . a complaint stating its charges in that respect and containing a notice of a hearing . . . ."[96] Along with subsection (b)'s instructions for FTC action in suspected violations, which expressly mention a public interest component, subsection (n) likewise notes that how a business impacts the public is relevant when determining the lawfulness of a company's actions.[97]

Regarding the factors of illegal practices, deception or unfair trade, courts find an action deceptive "(1) if it is likely to mislead consumers acting reasonably under the circumstances (2) in a way that is material."[98] Addressing unfair practices, the Act states:

> The Commission shall have no authority under [the FTCA] to declare unlawful an act or practice on the grounds that such act or practice is unfair *unless* the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers

92. *Income Disclosure Statement*, FOREVER LIVING, https://foreverliving.com/usa/en-us/income-disclosure (last visited Apr. 29, 2022).

93. *The Forever Opportunity*, FOREVER LIVING, https://joinnow.foreverliving.com/usa/en-us/your-opportunity (last visited Apr. 29, 2022); *see Income Disclosure Statement*, *supra* note 92.

94. *See supra* Introduction.

95. 15 U.S.C.A. § 45(a)(1) (West 2022).

96. 15 U.S.C.A. § 45(b) (West 2022).

97. 15 U.S.C.A. §§ 45(b), (n) (West 2022).

98. F.T.C. v. Cyberspace.Com LLC, 453 F.3d 1196, 1199 (9th Cir. 2006).

> themselves and not outweighed by countervailing benefits to consumers or to competition.[99]

It concludes by noting that "public policies" are relevant but not dispositive to the FTC's declaration that a specific company has violated the FTC.[100] Under the FTCA, then, only those unfair acts accompanied by an unavoidable potential or actual harm to the public, that was more harmful than helpful, are actionable.[101]

Koscot: The Endless Chain Fallacy and the 2-Part Test

The first definite rule addressing pyramid schemes arose from the FTC's complaint against Koscot Interplanetary and Glenn W. Turner Enterprises.[102] In *In re Koscot Interplanetary, Inc.*, the court considered the business dealings of the "cosmetics" and "toiletries" companies and how their actions allegedly violated the FTCA.[103] While the company purported to operate as a legal multi-level marketing company, its distributors could join Koscot and immediately receive more commissions than an entry-level "retailer" by "investing $2000" to qualify as a "supervisor."[104] Moreover, a new supervisor could become a "director" and receive a high discount on products and a bonus on all their downline's purchases and sales by investing an "additional $3000" and recruiting someone else as a supervisor.[105]

These two allegations made against Koscot—that the company rewarded those sellers who invested a sizable amount of money into the company and who recruited other sellers and paid an even higher amount—are still symptomatic of many MLMs, and they likewise highlight the concerning similarities between MLMs and pyramid schemes.[106] A small, initial enrollment fee for distributors to break into the selling market is not

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99. 15 U.S.C.A. § 45(n) (West 2022).
100. *Id.*
101. *Id.*
102. In re Koscot Interplanetary, Inc., 86 F.T.C. 1106, 1106-07 (1975).
103. *Id.* at 1107.
104. *Id.* at 1108.
105. *Id.*
106. *See* Jon Taylor, *MLM Definitions and Legitimacy: What MLM Is—And Is Not, in* THE CASE (FOR AND) AGAINST MULTI-LEVEL MARKETING 2-1, https://www.ftc.gov/sites/default/files/documents/publiccomments/trade-regulation-rule-disclosure-requirements-and-prohibitions-concerning-business-opportunities-ftc.r511993-00014%C2%A0/00014-57319.pdf [hereinafter Taylor, *What MLM Is*].

> There are inherent flaws in any MLM, assuming an endless chain of recruitment and a pay plan that is recruitment-driven, top-weighted, and financed primarily by incentivized purchases of the participants themselves. I have looked for exceptions to this generalization in the 350 MLMs I have analyzed, but have found none.

Id. at 2-1. Dr. Taylor likens "recruitment-driven MLMs" to "product-based pyramid schemes" and suggests that "retail-focused MLMs" are only "hypothetical" in nature. *See id*. at 2-9, 2-10.

concerning—this startup cost could be attributed to training, product samples and inventory, or rights to sell products.[107] However, when a participant invests money into a network marketing company in order to achieve a particular rank or title in the company, such an action is a high indicator of participation in a pyramid scheme because "the percentage of purchases accounted for by participants' personal consumption . . . has become a litmus test for determining if an MLM is an illegal pyramid scheme."[108] In other words, should this allegation be proven by a plaintiff, a court would likely view the company as masquerading itself as a multi-level marketing company when it was instead a pyramid scheme, especially when a distributor's large investments result in inventory loading.[109]

The FTC's second allegation, that one is recruiting another direct seller and investing even more money into Koscot would result in another promotion, is another problematic facet of multi-level marketing companies, one which is perhaps more worrisome than the first because even now, courts view this second charge as conditionally legal.[110] Courts may still find that a pyramid scheme could be inferred from this business model when a company primarily encourages recruitment rather than sales.[111] However, so long as a company's "sales volume" is relatively low and the company engages in some preventative measures to avoid inventory loading, such as preventing commissions based on personal purchases, courts will not view these companies as operating as a pyramid scheme.[112]

In *Koscot*, the FTC alleged that Koscot and Glenn W. Turner Enterprises violated the FTCA because they made false earning projections for their retailers and understated how much work was required in order for retailers to make a sizable income,[113] fixed product prices, and placed limits on the

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107. Doris Wood, *Understanding MLM Compensation Plans*, IMATRIX SOFTWARE (last visited Apr. 29, 2022), https://www.imatrixsoftware.com/understanding-mlm-compensation-plans/. *See also* Whole Living, Inc. v. Tolman, 344 F.Supp.2d 739, 746 (2004) ("B]eyond the relatively small qualifying amount of $100 to $200 a month, no larger amount of purchases will increase a distributor's commission rate, therefore there is no incentive for a distributor to purchase large amounts of non-refundable product to obtain large commissions.").

108. Taylor, *What MLM Is*, *supra* note 106, at 2-15.

109. *See* Valentine, *supra* note 54.

110. *Koscot*, 86 F.T.C. at 1108-09.

111. *See Tolman*, 344 F.Supp.2d at 746. *See also* Webster v. Omnitrition Int'l., 79 F.3d 776, 782-83 (1996) ("Where, as here, a distribution program appears to meet the *Koscot* definition of a pyramid scheme, there must be evidence that the program's safeguards are enforced and actually serve to deter inventory loading and encourage retail sales.") (holding that a program with multiple distributor levels based on the total amount of money invested into the company, primarily achieved through recruitment and personal investments, creates the appearance of a pyramid scheme).

112. *See Tolman*, 344 F.Supp.2d at 742, 745-46. The court held that a company offering commissions through a seller's downline was not a pyramid scheme because distributors were not encouraged to buy large amounts of product to receive a commission because an upline's personal purchases did not qualify for the commission, even when the downline personally purchased products.

113. *Koscot*, 86 F.T.C. at 1110, 1112-13.

number of sellers and purchasers to whom distributors could approach regarding products.[114] The FTC also alleged that the companies created a sort-of "monopoly" by engaging in "discrimination in net price" against those retailers who buy from other distributors as opposed to those able to buy directly from Koscot.[115] Finally, an allegation was made that the companies perpetuated "unfair" trade practices by failing to facilitate a company in which distributors could earn back their initial investments through sales.[116]

Here, the judge agreed with the FTC and found that Koscot and Glenn W. Turner Enterprises were, in fact, operating as a pyramid scheme and selling "an impossible dream and a virtual financial nightmare."[117] By considering the business model, in which distributors were incentivized more to recruit other distributors into a downline than to make sales on products, the judge noted that Koscot relied on an "endless chain" idea, or a "fallacy" in which distributors would eventually run out of potential recruitment candidates because, if Koscot's money-earning system was so lucrative, everyone would want to join as a distributor.[118] If everyone joined as a distributor, someone inevitably must serve as the bottom of the downline who would necessarily receive no commission based on anyone else's sales and would not even have a consumer-base with which to sell products.[119] Additionally, Koscot's earning projections for distributors were quite different than what actually occurred,[120] and the turnover rate for distributors was high.[121] Ultimately, the judge noted,

> The Koscot program was organized and operated in such a manner that the realization of profit by any participant was predicated upon the exploitation of others, most of whom had virtually no chance of receiving a return on their investment and all of whom had been

114. *Id.* at 1114-15.
115. *Id.* at 1115.
116. *Id.* at 1116.
117. *Id.* at 1129.
118. *Koscot*, 86 F.T.C. at 1132.
119. *Id.*

> The fallacy in the 'endless chain' aspect of the Koscot marketing program . . . is that it involves a geometric progression which, carried through to its ultimate result, would mean that in 18 months the entire United States population (203 million in 1970) would be involved in the plan. Aside from the mathematical fallacy inherent in the Koscot plan, an endless chain scheme must, in any event, ultimately fail to provide returns to all participants. Such a scheme must cease when it exhausts the number of people willing to invest in it (citation omitted).

Id.

120. *See id.* at 1135 ("Whereas Koscot depicted a distributor's annual product sales as ranging from $50,000 to more than $200,000, the actual annual average or mean sales of distributors in those States in 1971 were reported in hundreds of dollars, not thousands.") (citation omitted).
121. *Id.*

> induced to participate by inherent misrepresentations as to potential earnings.[122]

As a result, Koscot's business model was deemed illegal.[123]

Of note, the judge expressed distaste for most multi-level marketing companies and pyramid schemes due to the "inevitably deceptive representation" present when a company implements a buyback policy or a no-risk investment policy but does not adequately honor it.[124] In fact, the judge writes, "[t]hat these schemes so often do not allow recovery of investments by means of retail sales either merely points up that there is very little positive value to be lost by not allowing such schemes to get started in the first place."[125]

What emerged from *Koscot* was the widely accepted rule regarding pyramid schemes and when they were illegal.[126] While the judge in *Koscot* might have suggested that all companies operating under this scheme could be *per se* unlawful because deceptive practices were inherently embedded in their policies, the FTC adopted the *Koscot* test to suggest that pyramid schemes and multi-level marketing companies are unlawful when a company requires a retailer to invest in: "(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 sale of the product to ultimate users."[127] As of 2018, this test is still the one used by the FTC in regulating direct selling companies.[128]

Leading the Amway: MLMs and the Legitimate Business Model

If a company qualifies as a pyramid scheme, courts hold that it is "per se" illegal because it violates the FTCA.[129] However, multi-level marketing companies are not illegal unless a claimant can show that the company misrepresented how much money a direct seller would make.[130] Nonetheless, legal issues surrounding even the most popular and successful MLMs are not uncommon, as shown by the previous discussions.[131] In fact, the seminal case regarding the legality of MLMs centered on Amway's business practices.[132]

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122. *Id.* at 1157.
123. *Koscot*, 86 F.T.C. at 1157.
124. *Id.* at 1181.
125. *Id.*
126. *Id.* at 1180.
127. *Id.*; *see* Valentine, *supra* note 54.
128. *See supra* note 55 and accompanying text.
129. Webster v. Omnitrition Int'l., 79 F.3d 776, 788 (1996); F.T.C. v. Cyberspace.Com LLC, 453 F.3d 1196, 1200 (9th Cir. 2006).
130. *See generally supra* text accompanying note 1.
131. *See* discussion *supra* History of MLMs.
132. In re Amway Corp., Inc., 93 F.T.C. 618, 622 (1979).

As in *Koscot,* in *In re Amway*, the FTC brought a complaint against Amway for various alleged violations of Section 5 of the Federal Trade Commission Act, specifically that, (1) Amway limited its distributors through "resale price maintenance," or an agreement in which "resellers" "will sell product or products at certain prices at or above price floor (minimum RPM) or at or below price ceiling (maximum RPM)";[133] (2) Amway hurt its distributors by limiting how many products they could purchase to sell and to whom they could sell their products;[134] (3) Amway "restrict[ed] the distributors' advertising";[135] (4) Amway did not disclose how much money a distributor could earn by forming a greater downline;[136] and (5) Amway overstated how profitable selling through Amway could be, especially because distributors could struggle to find other potential distributors to work under them and would have to pay a sizable amount of money to join Amway as a distributor.[137]

When considering the legality of Amway's actions, the judge noted that the "sales literature" the company provided seemingly promised potential distributors the ability to purchase "a new car, a new house, college education for [their] children . . . [, and a] retirement income," by stating that a distributor could "realize the achievement of [their] dreams through the Amway Sales and Marketing Plan."[138] This promise was offset by the somewhat confusing structure of Amway's compensation plan; the company offered its retailers income based on "performance" rather than purely on sales—that is, Amway distributors received a "discount" on their purchases from Amway, and they received additional bonuses based on the total amount of sales, including purchases made from other distributors in one's downline.[139] In an attempt to safeguard against distributors' buying products in bulk and then returning the product through Amway's buyback policy, Amway required distributors to "resell at least 70% of the products they have purchased each month" before Amway would repurchase unsold products.[140] Additionally, to prevent retailers' using the volume of purchases to earn a performance bonus, the company required its distributors to sell products to "prove a sale to each of ten different retail customers."[141] Distributors could

133. *Id.*; Krystyna Blokhina Gilkis, *Resale Price Maintenance Agreements*, CORNELL L. SCH. LEGAL INFO. INST., https://www.law.cornell.edu/wex/resale_price_maintenance_agreements (last updated March 2020).
134. *Amway*, 93 F.T.C. at 630.
135. *Id.*
136. *Id.*
137. *Id.*
138. *Id.* at 640-41.
139. *Amway*, 93 F.T.C. at 637-38.
140. *Id.* at 646.
141. *Id*.

not sell products in retail stores or at public events,[142] they could not advertise products in any manner not sanctioned by Amway,[143] and they could not change the price of products in any way.[144] The FTC alleged, therefore, that these "vertical restrictions" in Amway supported a finding that Amway acted unlawfully when it would fix its prices and "pyramid distributors."[145]

In considering these restraints on Amway distributors, the judge found that Amway's self-regulatory actions were lawful and reasonable.[146] Despite the somewhat strict restrictions Amway placed on its distributors considering price-fixing and purchasing agreements, the court held that Amway reasonably needed these restrictions because of the inaccessibility of the cleaning supplies market.[147] Specifically, the judge wrote, Amway's "control of the distributors' marketing practices is no broader than necessary to achieve the main purpose of direct selling in an oligopolistic market."[148] Additionally, the direct selling structure of the company increased and maintained consumer demand, whereas Amway risked losing customers if they sold their products in retail stores alongside other popular cleaning products.[149]

Regarding the payment plan Amway implemented, the court again found that Amway acted lawfully.[150] While the FTC conceded that Amway's bonus system would not always result in financial losses to distributors, the company nonetheless misrepresented to potential distributors how much money they would earn by joining.[151] Instead, the judge noted, "This rule of *per se* illegality for pyramid plans has not yet been accepted by the courts" and that the *Koscot* ruling on pyramid schemes only applied when both elements were met.[152] Here, unlike in *Koscot*, Amway distributors only had to purchase a relatively cheap informational package to begin selling through the company, and sales were required in order for distributors to receive bonuses.[153] While the court agreed that pyramid schemes were in and of themselves harmful, even without economic loss to distributors, Amway had

142. *Id.* at 648.
143. *Id.* at 650.
144. *Amway*, 93 F.T.C. at 652.
145. *Id.* at 691, 692, 698. Regarding vertical restrictions, the judge wrote that these restraints on distributors "must be analyzed under the rule of reason," or that the FTC would have to prove that these restrictions have a "demonstrative economic effect," using a "preponderance" evidentiary standard, on distributors before a court would find any unlawful activity.
146. *Id.* at 691, 693.
147. *Id.* at 692-93.
148. *Id.* at 693.
149. *Amway*, 93 F.T.C. at 693.
150. *Id.* at 695-96.
151. *Id.* at 698.
152. *Id.* at 699.
153. *Id.* at 699-700.

not been operating one because it "avoided the abuses of pyramid schemes."[154] Finally, the court concluded that Amway did not engage in the misrepresentations and failures to disclose typically found in pyramid schemes because the company emphasized that payments and bonuses for distributors could only be achieved through sales and not just through recruitment and that the turnover rate for distributors was not unusually high.[155] Therefore, despite the difficulty involved in making a sizable income through the company, Amway was not operating as a pyramid scheme and was instead a "substantial manufacturing company" with "an efficient distribution system."[156]

A Bad First "Net Impression"

While *In re Amway* held that Amway was a legally operating MLM rather than a pyramid scheme, recognizing the point when a MLM becomes legally actionable as an undercover pyramid scheme can be difficult. When is Section 5 of the FTCA violated in such a manner that a direct selling company is deemed not only illegal but *per se* illegal? That is, when is a business model so potentially harmful to its participants that its very existence is prohibited? Under current case law, the extent to which multi-level companies are subjected to liability under the FTCA results when these companies create a "net impression" that earnings projections are "mislead[ing]."[157]

The phrase "net impression," used as an inquiry for courts in determining whether a company engaged in deceptive business practices, originated from *F.T.C. v. Cyberspace.Com, LLC.*[158] In that case, the FTC brought suit against Internet providers who solicited business by mailing potential customers checks with a small amount of money payable to the recipient.[159] The "back of the check . . . contained small-print disclosures" to inform recipients that once cashed, the check would form a contract between the customer and the Internet providers.[160] The providers sent an invoice and "advertising insert" along with the checks, but none of the materials contained obvious or highly visible language to indicate the formation of a contract between the parties.[161] After more than "225,000 small businesses and individuals" formed contracts

154. *Amway*, 93 F.T.C. at 700. The court notes that these abuses are "(1) not having a 'headhunting' fee; (2) making product sales a precondition to receiving the performance bonus; (3) buying back excessive inventory; and (4) requiring that products be sold to consumers."
155. *Id.* at 706.
156. *Id*.
157. *See generally* Letter, *supra* note 1.
158. F.T.C. v. Cyberspace.Com LLC, 453 F.3d 1196, 1200 (9th Cir. 2006).
159. *Id*. at 1198.
160. *Id*.
161. *Id*. at 1198-99.

with the providers as a result of cashing the checks, complaints arose in which some customers claimed they did not realize receiving the money would result in a contractual relationship.[162]

As a result of these complaints, the FTC brought suit against the providers under Section 5 of the FTCA.[163] The Ninth Circuit Court of Appeals ultimately held that the Internet providers had violated the FTCA by affirming the lower court's summary judgment ruling in favor of the FTC.[164] Conversely, the Internet providers argued that their solicitations were not misleading because of the information contained on the backs of the products which would have informed recipients that cashing the check would form a contractual relationship.[165] The court instead held, "A solicitation may be likely to mislead by virtue of the net impression it creates even though the solicitation also contains truthful disclosures."[166] Here, the appearance of the checks and the lack of clear contractual language on the fronts of them created the net impression that these items were indeed checks and not contracts.[167] In making its determination, the court considered the large number of individuals who fell prey to this solicitation device—225,000 customers—against the number of individuals who "attempted to use" the providers' Internet—"less than one percent."[168] Finally, the court found that the checks represented a "material" misrepresentation because most people who receive an apparent check would subsequently cash it and unknowingly contract themselves to a service agreement.[169]

An example of the net impression standard being used in a multi-level marketing context can be found in *Federal Trade Commission v. Vemma Nutrition Company*.[170] The FTC brought suit against a multi-level marketing company, Vemma, which specialized in "nutrition and energy drink" sales, under the FTCA.[171] Specifically, the Commission argued that the deceptive practices at issue arose from Vemma's solicitation of direct sellers, or "[a]ffiliates."[172] Notably, the company did not require its sellers to purchase products to join the company, but they were "strongly encourage[d]" to invest $600 in merchandise in order to receive sales bonuses, as well as to enroll in a "monthly auto-delivery of two cases of product to maintain eligibility for

162. *Id*. at 1199.
163. *Cyberspace.Com, LLC*, 453 F.3d at 1199.
164. *Id*. at 1201.
165. *Id*. at 1200.
166. *Id*.
167. *Id*. at 1200-01.
168. *Cyberspace.Com, LLC*, 453 F.3d at 1201.
169. *Id*.
170. F.T.C. v. Vemma Nutrition Co. No. CV-15-01578-PHX-JJT, 2015-WL-11118111 (D.Ariz., Sept. 18, 2015).
171. *Id.* at *1-2.
172. *Id.*

bonuses."[173] The FTC accused Vemma of operating as a pyramid scheme because the company sold significantly more product to its own retailers than to outside consumers.[174]

In *Vemma Nutrition Company*, the court examined Vemma's practices and found that it both operated as a pyramid scheme and violated the FTCA because the company published "print, web, audio, video, and live presentation of exorbitant Affiliate earnings," even though "93% of Affiliates earned less than $6,200."[175] Additionally, encouraging salespeople to buy into the company before joining as a direct seller satisfied the first part of the Koscot test.[176] The court likewise found the second element satisfied because "the bonuses Affiliates earn are primarily for recruitment of other Affiliates, not the sale of products."[177] For the Section Five claim, the court used the net impression test to find that large earning projections with weak disclaimers were still misleading because consumers would likely assume that the stated estimates were more usual than the outliers.[178] As a result, Vemma had violated the FTCA, and because it was a pyramid scheme, its operations were inherently illegal.[179]

What the net impression test demonstrates is that when a company produces materials or makes claims with results different than a reasonable consumer or seller would infer from the representations, the company has violated Section 5 of the FTCA.[180] Such a fact is true even when the company produces disclaimers if such disclaimers do not effectively dispel the misrepresentations.[181] The *Vemma Nutrition Company* court even described this test as one of "common-sense," yet MLMs continue to face controversies resulting from deceptive and unfair business practices.[182] While one might think that a settled test such as this might alleviate the harms caused by MLMs, the net impression test only addresses the deceptive practices in

173. *Id.*
174. *Id.*
175. *Vemma*, 2015-WL-11118111 at *5.
176. *Id.* at *4.
177. *Id.*
178. *Id.* at *6.
179. *Id.* at *12.
180. *Vemma*, 2015-WL-11118111 at *7.
181. *Id.* at *6 ("Thus, representations may be misleading despite the use of a disclaimer such as 'results may vary' if the consumer may reasonably believe that a statement of unusual earning potential represents typical earnings.").
182. *Id.* (quoting FTC v. Minuteman Press, 53 F. Supp. 2d 248, 262 (E.D.N.Y. 1998). *See also* O'Shaughnessy v. Young Living Essential Oils, L.C., 810 Fed.Apx. 308, 312 (2020). While this case only details Young Living's motion to compel arbitration, the plaintiff's claim alleged that Young Living was acting as a pyramid scheme. *O'Shaughnessy*, 810 Fed.Apx. at 310. Additionally, the court declined to compel arbitration, even though courts generally view arbitration agreements favorably, because the agreement between the parties did not represent a "meeting of the minds." *Id*. at 312.

which multi-level marketing companies engage.[183] As a discussion on personal accounts relating to controversial companies will illuminate, the unfair practices supposedly proscribed by Section 5 of the FTCA need greater attention.[184]

Controversies Surrounding MLMs

LuLaRich—A Lesson on Leggings

In recent years, documentarians have spotlighted the controversial business practices which MLMs conduct. Most recently, the company LuLaRoe received almost instantaneous and unanimous Internet backlash with the release of *LuLaRich*, a four-part breakdown of the founding, rise, and legal ramifications of this fashion retailer.[185] The documentary provided interviews from former and current salespeople, as well as former corporate employees and even the founders themselves, Mark and Deanne Stidham.[186] Throughout the series, viewers learned that LuLaRoe, like any typical network marketing company, started as a one-woman enterprise, with one product sold—skirts.[187] According to Deanna Stidham, she began in the retail business by selling dresses for another dressmaker and was able to make a commission based off her sales of his products.[188] When her daughter needed a skirt, she sewed one together, and others in her community soon wanted similar products.[189] With her own product to sell, Stidham was able to focus on her business and hosted parties in which she would sell merchandise to attendees.[190]

As Stidham's consumer base increased, so too did her product line, the most popular of which were her leggings, as well as her need for more distributors.[191] The company grew quickly and dramatically, but its downfall from public favor was nearly as breakneck.[192] Greater increase and high demand of popular products saw a decrease in quality, originality, and availability.[193] Those looking to join the company as salespeople were put

183. *See* Letter, *supra* note 1.
184. *See* discussion *infra* Controversies Surrounding MLMs.
185. *LuLaRich* (Amazon Prime Video Sept. 10, 2021).
186. *Id*.
187. *Id.*
188. Stephanie McNeal, *Millennial Women Made LuLaRoe Billions. Then They Paid the Price*, BUZZFEED NEWS (Feb. 22, 2020, 10:32 PM), https://www.buzzfeednews.com/article/stephaniemcneal/lularoe-millennial-women-entrepreneurship-lawsuits.
189. *LuLaRich* (Amazon Prime Video Sept. 10, 2021).
190. *Id*.
191. *Id.*
192. *Id.*
193. *See id.* This assertion is somewhat of an understatement. Testimonials from former salespeople describe receiving wet and moldy clothing, clothing that tore easily, or unflattering and even inappropriate patterns on clothing.

on a waitlist for "onboarding" with the company and could have been asked to pay over $5,000 to receive inventory to begin selling.[194] Because many wanted to join LuLaRoe as distributors after seeing friends and family members receive commissions based off sales and recruitments, the company's decisions to make membership exclusive, to raise the price of joining the company, and to limit the availability of products and styles due to the large demand are somewhat understandable.[195] However, LuLaRoe had also changed its commission policy in 2017, from rewarding distributors based on how many products their downline bought to how many products their downline sold.[196] Additionally, the company replaced its 100-percent buyback policy with a stricter 90-percent return policy.[197] As a result of these changes and other issues with LuLaRoe's products themselves, the company faced a number of class-action lawsuits, the most notable of which alleged that the company was really a pyramid scheme disguised as a multi-level marketing company.[198] After settling lawsuits and dodging heavy criticism, LuLaRoe has a much lower number of distributors, though it still operates as a resilient company.[199]

LuLaRich employs a sympathetic tone for those former distributors who lost relationships because of heavy advertisement of LuLaRoe products, those who bought too much product to continue receiving commissions and other company benefits, even if they lost money in the process, and those who initially received sizable commissions for impressively large downlines but who later lost that income due to commission cutbacks and the volatility of the network marketing system.[200] In short, the documentary portrays those

194. *See* Rachel Hunt, *'LulaRich': We Researched the LulaRoe Onboarding Package 2021 So You Don't Have To*, CHEATSHEET (Sept. 14, 2021), https://www.cheatsheet.com/entertainment/lularich-research-lularoe-onboarding-package-2021.html/. This number is a rough estimate of a startup cost. Some interviewees in *LuLaRich* claimed that distributors were asked to pay as much as $10,000 to start up their business with the company, though onboarding with LuLaRoe now costs distributors $499 (this cost also represents a much smaller amount of inventory a distributor will receive in their startup package).

195. *LuLaRich* (Amazon Prime Video Sept. 10, 2021).

196. McNeal, *supra* note 188. While this commission change may have been an effort by the Stidhams to meet FTC guidelines, the sharp drop in earning potential was certainly detrimental to retailers who had become accustomed to the former commission structure.

197. Ginger Rough, *LuLaRoe Abruptly Changes Return Policy; Consultants Say They Are Owed Thousands*, USA TODAY (Sept. 14, 2017, 11:33 AM), https://www.usatoday.com/story/life/allthemoms/news/2017/09/14/lularoe-return-policy-changes-outrage/34915297/. This return policy now only allowed returns on unopened clothing purchased directly from LuLaRoe within the previous year. As with the commission changes, this change of policy is not inherently harmful; in fact, it was "the original policy" implemented by LuLaRoe. However, encouraging distributors to buy copious amounts of product in order to sell more product to a waning consumer base without warning these distributors that they can no longer return all unwanted merchandise would understandably result in criticism and skepticism of the company's business practices.

198. McNeal, *supra* note 188.

199. *See* Joey Keogh, *Is LulaRoe Still in Business?*, THE LIST (Jan. 12, 2022, 11:57 AM), https://www.thelist.com/731732/is-lularoe-still-in-business/.

200. *LuLaRich* (Amazon Prime Video Sept. 10, 2021).

direct sellers, even the ones still supportive of LuLaRoe, as victims (if not unaware victims), and the founders as predators.[201]

For those unaccustomed to the MLM structure and its sales tactics, *LuLaRich* presents a shocking introduction to this system. If all the testimonials regarding the impropriety, poor product quality, and nepotism shown in the corporate makeup are unnerving, then the stories of distributors forced into bankruptcy and the later lawsuits lobbed at LuLaRoe, which detail sellers' financial and emotional losses as a result of selling for this company are devastating.[202]

Two key takeaways from *LuLaRich*, however, demonstrate the timeliness and relevance of this Comment—first, that LuLaRoe is neither unique nor incredibly egregious in comparison to other top MLM companies[203]; second, that while LuLaRoe faced a lawsuit alleging that the company was a pyramid scheme veiling itself as an MLM, finally settling the lawsuit for $5 million, neither of the founders or other top officials has been convicted of fraud or any other crime which would suggest that the company is legally a pyramid scheme.[204] Based on current legal standards, LuLaRoe is, for all intents and purposes, a typical MLM which lawfully recruits direct sellers with overstated promises of financial freedom and empowering entrepreneurialism.[205] But a company which is technically legal yet overwhelmingly harmful in terms of its effect on the public deserves a higher degree of scrutiny than the FTC currently grants it.

Essential (Snake) Oils, Financial Foibles, and Online Discourse

As noted, *LuLaRich* is not the only documentary developed to expose the harmfulness of the MLM industry.[206] Both the first episode of *(Un)well*[207] and the documentary *Betting on Zero*[208] tackle the health and wellness side of MLMs and the false claims, victimization of women, and large financial investments, often with zero returns, perpetuated by these companies.[209]

201. *Id.*
202. *Id.*
203. *See* Alden Wicker, *Multilevel-Marketing Companies Like LuLaRoe Are Forcing People into Debt and Psychological Crisis*, QUARTZ (Aug. 10, 2017), https://qz.com/1039331/mlms-like-avon-and-lularoe-are-sending-people-into-debt-and-psychological-crisis/ (noting that although "LuLaRoe is queen" among the "MLMs masquerading as women's empowerment," its notoriety derives from the popularity of the brand rather than any unique business practices).
204. Stephanie McNeal, *LuLaRoe Is Paying More than $4 Million to Settle a Lawsuit That Claimed It Was Running a Pyramid Scheme*, BUZZFEED NEWS (Feb. 2, 2021, 1:32 PM), https://www.buzzfeednews.com/article/stephaniemcneal/lularoe-settles-washington-state-pyramid-scheme-lawsuit.
205. F.T.C. *Multi-Level Marketing*, *supra* note 21.
206. *LuLaRich* (Amazon Prime Video Sept. 10, 2021).
207. *(Un)well: Essential Oils* (Netflix Original Programming Aug. 12, 2020).
208. BETTING ON ZERO (Zipper Brothers Films 2016).
209. *See* Kucher, *supra* note 6.

Perhaps most unsettling, research on these wellness-focused MLMs show that these companies or their distributors have made misleading and even harmful claims relating to the curative attributes of their products, which could lead users of these products to delay seeking medical attention and treatment.[210] With the devastating medical and financial effects of COVID-19, some MLMs have used this emergency to market their products as agents "to treat or prevent coronavirus, or about the money people can earn if they've recently lost income."[211] The FTC, aware of the network marketing opportunity available with the pandemic, warned MLMs in 2020 against touting their products as coronavirus preventatives or against making false earning projections for joining MLMs.[212]

Despite the fact that multiple resources exist detailing the harmful effects of MLMs,[213] financial[214] or otherwise,[215] participation in these companies is still high, and MLMs remain a formidable market.[216] A report from the

210. Einbinder, *supra* note 64. According to this article, companies selling essential oils have been reprimanded by the USFDA for "selling products that claim to cure of prevent coronavirus." Additionally, the company Young Living has been criticized for promoting a culture that resulted in "loved ones [of essential oils users] delaying medical care because of their belief in the healing benefits of the oils."

211. Megan Graham, *FTC Warns Multilevel Marketing Company Sellers*, CNBC (Apr. 27, 2020, 3:18 PM), https://www.cnbc.com/2020/04/27/ftc-warns-doterra-rodan-fields-other-mlm-sellers-on-covid-claims.html.

212. *Id.;* Fed. Trade Comm'n, *FTC Sends Warning Letters* (Apr. 24, 2020), https://www.ftc.gov/news-events/press-releases/2020/04/ftc-sends-warning-letters-multi-level-marketers-regarding-health.

213. In addition to documentaries, popular Internet figures, such as former LuLaRoe salesperson Roberta Blevins, have taken to social media and podcasts to highlight the dangers of joining MLMs. Roberta Belvin, *Life After MLM*, APPLE PODCASTS (Feb. 14, 2021), https://podcasts.apple.com/us/podcast/life-after-mlm/id1553784236. YouTube and TikTok users have dedicated channels or video series to speak against companies that use direct sellers and network marketing tactics. *See also* münecat, YOUTUBE, https://www.youtube.com/c/münecat/playlists.

214. An interview from an anonymous former Young Living retailer details her negative experience selling the essential oils, that she spent more money on buying inventory and trying to recruit friends and family and did not make enough income to generate a living. *See (Un)well: Essential Oils* (Netflix Original Programming Aug. 12, 2020). Further input revealed that Young Living retailers had to spend $100 a month to qualify for a commission, even if they were not able to sell the product, and that "94%" of the Young Living distributors made "less than $1 a month."

215. *See id.* MLMs occupying the essential oils industry, specifically doTERRA and Young Living, suggest that aromatherapy may prove more effective in treating serious health issues, such as chronic illnesses or cancers, than modern Western medicine can. However, Dr. E. Joy Bowles suggested that while essential oils may legitimately treat users with anxiety and other mental problems and could be effective as a placebo, the science behind the helpfulness of essential oils is simply incomplete, and there is no clinical evidence to show that essential oils can cure the diseases their proponents suggest they can. Additionally, a biographical snippet about the founder of Young Living, Gary Young, deftly demonstrated the conflicting evidence of aromatherapy—lemongrass may have cured Young's paralysis, but vitamin C may have nearly killed one of his patients.

216. The reasons for increased participation in MLMs can be attributed to financial problems increasing during the pandemic, businesses moving remote or shutting down, and even products being promoted as "cure-alls" of the coronavirus. *See also* Abby Vesoulis & Eliana Dockterman, *Pandemic Schemes: How Multilevel Marketing Distributors Are Using the Internet*, TIME (July 9, 2020, 6:29 AM). *See also* Graham, *supra* note 211; Áine Cain, *Utah's Governor Highlighted a Controversial Essential-Oil*

AARP noted that in 2018, "about one in thirteen (7.7%) adults 18 years of age or older in the United States have participated in at least one MLM organization during their lifetime."[217] Accordingly, the "2020 Industry Overview" published by the DSA records the number of direct sellers as "7.3 million," including "0.5 million" sellers who would describe their work as "full-time."[218] Testimonies from *LuLaRich* and *(Un)Well* demonstrate the pitfalls of MLMs which this Comment has previously addressed—that while the founders and top retailers in a network marketing company make a sizable income, those retailers on the bottom of a downline invest thousands of dollars into a dream of self-made success yet ultimately lose money in the process.[219]

PROPOSAL—SATISFYING SECTION 45(N) WITH A REPURPOSED NET IMPRESSION TEST

Personal testimonies from former direct sellers, expert opinions from those informed on multi-level marketing companies, and even caselaw point to a sobering conclusion—that the inherently harmful effects of MLMs do not stem from unrealistic earning projections.[220] Instead, it is the structure of the MLM, unfair in its nature and designed in such a way that direct sellers will eventually run out of potential downline candidates, that both creates the disparity in pay between the top sellers and the entry-level downline and reflects the similarities between these companies and pyramid schemes.[221] The FTC suggests that pyramid schemes are per se "illegal because they inevitably must fall apart" due to the recruitment system.[222] If multi-level companies, like pyramid schemes, offer commissions for recruitment, and if a retailer's sales goals can be achieved by purchases her downline makes, then all consumers would reasonably be incentivized to join multi-level

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MLM, BUS. INSIDER (Sept. 28, 2021, 12:28 PM), https://www.businessinsider.com/doterra-utah-governor-cox-mlm-essential-oils-school-covid-19-2021-9.

217. DeLiema et al., *supra* note 49, at 3.

218. *Industry Fact Sheets,* DIRECT SELLING ASS'N, https://www.dsa.org/statistics-insights/factsheets (last visited Apr. 29, 2022).

219. *See LuLaRich* (Amazon Prime Video Sept. 10, 2021); *see (Un)well: Essential Oils* (Netflix Original Programming Aug. 12, 2020).

220. *See supra* The MLM Business Model, Legal Background, Controversies Surrounding MLMs.

221. *See* Taylor, *MLM's Abysmal Numbers, supra* note 10, at 7-4, 7-5.

> From analyses of the compensation plans of hundreds of MLMs, I have found a consistent pattern of pay plans that are recruitment-driven and top-weighted, meaning they are driven by incentives to recruit, with company payout of commissions going primarily to founders and a select few . . . who are usually those who were positioned at the beginning of the recruitment chain.

Id.

222. Valentine, *supra* note 54.

marketing companies. Whether a product is available in an MLM as opposed to a pyramid scheme is irrelevant when the ultimate result and the characteristic which legitimizes pyramid schemes—that uplines will eventually extinguish potential downline recruits—are virtually the same.[223]

Despite these considerations, discussions on the legalities of MLMs or lack thereof center on the deceptive practices of these companies.[224] However, the FTCA specifically provides a subsection on unfair practices.[225] To oversimplify the subsection, an unfair practice is only actionable under the FTCA when it creates harm to the public which consumers themselves cannot avoid.[226] The harms caused by unfair practices also do not possess any mitigating factors which would make the injurious effects less serious.[227] Additionally, the statute specifically carves out public policy considerations for the FTC.[228]

As previously noted, the FTC has brought suit under the FTCA against various multi-level marketing companies for allegedly deceptive practices.[229] But how can the FTCA be more effective in curtailing the unfair practices perpetuated by these companies? The method this Comment proposes is by bringing suit for allegedly unfair practices. As case law regarding this prong of the FTCA suggests, "unfairness" is a "flexible concept with evolving content."[230] Indeed, finding a definite standard by which to judge unfairness is difficult, though courts have noted that the "plain meaning" of the word is helpful in such an inquiry.[231] Additionally, previous findings of unfairness by courts and the FTC are not only non-exhaustive, but the same practices which are actionable for deceptiveness could also be actionable for unfairness.[232]

To inform an administrative or judicial body as to what practices are unfair, the Supreme Court apparently implicitly adopted three bases for unfairness the FTC proposed, otherwise known as the "S & H criteria":[233]

> (1) whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established

223. McNeal *supra* note 188; F.T.C. *Multi-Level Marketing*, *supra* note 21.
224. F.T.C. v. Cyberspace.Com LLC, 453 F.3d 1196, 1200 (9th Cir. 2006).
225. 15 U.S.C.A § 45(n) (West 2022).
226. *Id.*
227. *Id.*
228. *Id.*
229. *See*, *e.g.,* In re Koscot Interplanetary, Inc., 86 F.T.C. 1106, 1132 (1975).
230. *See* FTC v. Wyndham Worldwide Corp., 799 F.3d 236, 243 (2015) (quoting Federal Trade Commission v. Bunte Bros., 312 U.S. 349, 353 (1941).
231. *Wyndham,* 799 F.3d at 244-45 (finding that unfair acts need not rise to "unscrupulous or unethical behavior," and consumers need not actually suffer severe injury before such acts are violative of the FTCA).
232. *Id.* at 245.
233. In re International Harvester Co., 104 F.T.C. 949, 1073-74, 1076 (1984).

> by statutes, the common law, or otherwise—whether, in other words, it is within at least the penumbra of some common-law, statutory, or other established concept of unfairness; (2) whether it is immoral, unethical, oppressive, or unscrupulous; (3) whether it causes substantial injury to consumers (or competitors or other businessmen).[234]

While the second criterion cannot be the determinative factor in finding unfairness of a particular practice, courts have noted that the last criterion "is the primary focus of the FTC Act, and . . . . [b]y itself . . . can be sufficient to warrant a finding of unfairness."[235]

Accordingly, injury to consumers and unfair acts motivated the FTC to add (n) to the FTCA.[236] And it is this very text of the FTCA which provides what this Comment suggests is a workable rubric for analyses of unfair practices within the multi-level marketing community.[237] Because the net impression standard in deceptive practices analyses appeared to be a judicially created standard, courts too could promote utility and uniformity (while still following Congressionally codified rules) between analyses of unfair and deceptive practices by adopting a version of the net impression standard for unfair practices analyses. That is, a multi-level marketing company engages in unfair practices in violation of Section 5 of the FTCA when, based on a net impression of the company's actions, it promotes recruitment over sales in distributing commissions and bonuses.[238] As with the net impression test and disclaimers, a company could still be found in violation of the Act even when it does not wholly reward bonuses based on recruitment if a seller would reasonably infer that the company significantly promoted recruitment over sales.[239]

With this test, the net impression of unfair practice would be based on the three considerations presented in (n) of Section 5 of the FTCA.[240] A court would first determine whether a specific company's recruitment-based incentives resulted in, or would result in, a serious injury to direct sellers and consumers. If such a finding is not present, the inquiry will end. If, however, a "substantial injury" occurred, then the question of whether the injury was

234. F.T.C. v. Sperry & Hutchinson Co., 405 U.S. 233, 244 n.5 (quoting 29 Fed. Reg. 8355 (July 2, 1964)).

235. *See Wyndham*, 799 F.3d at 244; *International Harvester Co.*, 104 F.T.C. at *248.

236. *Wyndham*, 799 F.3d at 244; Federal Trade Commission Act Amendments of 1994, Pub. L. No. 103-312 § 9, 108 Stat. 1691, 1695 (1994).

237. 15 U.S.C.A § 45(n) (West 2022).

238. *See id*.

239. *See id.*

240. *Id.*

"reasonably avoidable by consumers themselves."[241] Again, a negative answer to this question would result in a finding of no violation of the Act. Conversely, the last question of the analysis would be whether the injury is "outweighed by countervailing benefits to consumers or to competition."[242] If a court found that all three elements were met, at least to some degree, it could then balance the findings to determine whether a net impression of unfair practices is created and whether Section 5 of the FTCA is therefore violated.[243]

In practice, an analysis under this proposed net impression test would include empirical information detailing losses, economic and otherwise, resulting from the recruitment-based structure of multi-level marketing companies.[244] Existing information suggests the unfair practice requirements could be easily satisfied by many MLMs.[245] In the case of MLMs, the injurious effects of the companies are prevalent. Generally, "99%" of direct sellers lose money after joining an MLM.[246] While other losses associated with MLMs, such as social and emotional losses, may be present, economic losses would likely be the most helpful loss to prove unfair practices.[247] Statistics regarding losses attributable to a specific MLM would vary, but the overwhelming truth is that a "substantial injury" is likely to occur from an MLM promoting recruitments over sales.[248]

The question of whether a consumer may be able to avoid the harms caused by these companies on their own is somewhat more challenging—certainly, consumers could choose not to engage with MLMs, but not every MLM identifies itself as such. A consumer might also begin purchasing products from a friend without realizing that they will soon be asked to join a company in order to receive more benefits and products at higher discounts.[249] Additionally, companies oversaturate social media with advertisements from the company itself and through direct sellers about earning opportunities and life-changing products, and a consumer might

241. *Id.*

242. 15 U.S.C.A § 45(n) (West 2022).

243. *Id.*

244. *See* F.T.C. *Business Guidance*, *supra* note 55. This proposal would be consistent with current practices, as the FTC uses a case-by-case analysis in making determinations such as whether the "Business Opportunity Rule" applies to MLMs.

245. Taylor, *MLM's Abysmal Numbers, supra* note 10, at 7-1. "Our studies, along with those done by other independent analysts . . . clearly prove that MLM as a business model — with its endless chain of recruitment of participants as primary customers —is flawed, *unfair*, and deceptive" (emphasis added).

246. *Id.*

247. This assumption is derived from the fact that this would be an evaluation under the FTCA, an act designed to regulate trade practices.

248. 15 U.S.C.A § 45(n) (West 2022).

249. *See* Silverstein et al., *supra* note 37. A former retailer for a multi-level marketing company described the process as targeting "a friend offering them this thing that they needed."

reasonably believe that there is little risk to joining a company and purchasing products if their return will be high.[250]

Lastly, courts would have to examine a company for its specific contribution to consumers or to the market in which it operates to determine whether the injury caused by the company is mitigated. A particular MLM might be a relatively low-risk investment, it might have a successful buy-back policy, or it might have a product to distribute in a market inaccessible to traditional sales models. This new net impression standard would not impose liability on every multi-level marketing company simply for promoting recruitment over sales; it would, however, impose liability when this tactic results in unavoidable harm to a consumer when the company fails to alleviate the injury or contributes to the market in a beneficial manner.

The benefit of this test is that it would not upset the existing precedent regarding the legality of multi-level marketing companies. For example, if one were to consider *In re Amway* under this new net impression standard, Amway would still be considered a legally operating MLM.[251] In that case, the court pointed toward multiple factors which indicated that Amway was not a pyramid scheme and had not violated the FTCA.[252] First, any injury caused by the recruitment system in Amway was not significant due to the low cost of entry into the company.[253] While this fact could end a net impression inquiry, any injuries attributed to Amway's sales plan were reasonably avoidable by consumers and sellers because Amway had implemented a policy in which direct sellers had to affirmatively inform the company of their intent to remain as sellers in the company every year or they would be released from the company.[254] Therefore, Amway had not employed more direct sellers than available consumers.[255] Finally, the benefit Amway provided to the market outweighed any harm caused by its practices.[256] For example, its buyback policy "deter[red] inventory loading,"[257] and it had a smaller turnover than most other multi-level marketing companies.[258] Perhaps most importantly for this part of the analysis, Amway had entered a market in which "chain food store[]" competition was fierce, and the market was nearly inaccessible.[259] By

250. *See id.* (stating that according to retailers, "[a] curated and positive social media feed is a must").
251. In re Amway Corp., Inc., 93 F.T.C. 618, 706 (1979).
252. *Id.*
253. *Id.* at 715-16.
254. *Id*. at 668.
255. *Id.* at 700.
256. *Amway*, 93 F.T.C. at 706.
257. *Id.* at 668.
258. *Id.* at 672.
259. *Id.* at 675-76.

employing a direct-selling model, Amway could enter the market in an unconventional manner and sell products with positive customer response that it otherwise would not have been able to do.[260]

Based on these observations, Amway would not have been found to be in violation of the FTCA, even under a new net impressions test. It is possible that this test would not achieve any more effective results than the current net impressions test for deceptive practices. However, providing courts and the FTC another avenue by which to conduct analyses could serve as a deterrent for unfair business practices if multi-level marketing companies knew that they could be found to be liable for unfair recruitment systems that do not provide safeguards to protect their sellers and consumers.

CONCLUSION

Section 5 of the FTCA provides workable guidelines by which the FTC and courts can review the business and trade practices of a given company to determine if the Act has been violated.[261] This section is particularly helpful in investigations of multi-level marketing companies because the difference between a legal MLM and an illegal pyramid scheme is often difficult to ascertain.[262] Unfortunately, current analyses and scholarship on Section 5 claims highlight the possible deceptive practices of MLMs without recognizing the inherently unfair practices these companies employ when they reward bonuses based on recruitment over sales.[263] This Comment first addressed this issue by discussing the history of multi-level marketing companies and the accompanying legal framework.[264] While the *Koscot* test provided a two-part test to determine when a company is a pyramid scheme, *In re Amway* complicated analyses by suggesting that safeguards, put in place to prevent the effects of pyramid schemes, could allow a company to operate legally as an MLM.[265]

However, as the current issues surrounding many MLMs and the net impressions test for deceptive practices demonstrate, ineffective safeguards and disclaimers will not curtail the harmful effects multi-level marketing companies have on their distributors. The net impressions test, though helpful, did not effectively spotlight the larger issue revolving around MLMs—if courts and the FTC only focus on the effects of misleading earning projections in Section 5 claims, then they will ignore the fact that these projections can only exist because these companies consist of uplines and

260. *Id.* at 677-78.
261. 15 U.S.C.A § 45(n) (West 2022).
262. *See Multi-Level Marketing vs Pyramid Schemes*, *supra* note 7.
263. Letter, *supra* note 1.
264. *See supra* notes 67-89 and accompanying text.
265. In re Koscot Interplanetary, Inc., 86 F.T.C. 1106, 1180 (1975); *Amway*, 93 F.T.C. at 680, 706.

downlines which create the pay disparities. In response to this gap in Section 5 analyses, this Comment suggested a new standard to accompany the existing one, a net impression standard based on the unfair practices present in many MLMs.[266] Under the considerations presented by this new standard, the FTC could flag more multi-level marketing companies as violative of Section 5 of the FTCA, and greater regulation of these companies could result in more effective network marketing companies by minimizing recruitment and promoting more equitable distributions of income to retailers.

266. *See supra* notes 212-16 and accompanying text.