

ARTFUL DECEPTION:
THE MULTILEVEL MARKETING INDUSTRY’S USE OF SMOKE AND
MIRRORS TO HIDE THEIR PYRAMID-SHAPED TRUTHS

by
Hailey Stauffer-Person*

In the United States, the line between financial fraud and legal business opportunity is blurry at best. Multilevel marketing companies have mastered the art of walking in the gray area while avoiding the majority of government regulators. In 2020, the direct sales industry experienced over \$40 billion in sales and involved over 7 million Americans as distributors. Countless Americans fall victim to multilevel marketing frauds each year and the U.S. government has done little to protect them from the industry’s inherent manipulation. The recent growth of the industry during the COVID-19 pandemic and the defeat of President Donald Trump has recaptured the attention of the Federal Trade Commission (FTC). In October 2021, the FTC issued over 1,000 warning letters to multilevel marketing companies regarding their deceptive recruitment tactics and unsubstantiated health claims. The multilevel marketing industry has not faced aggressive scrutiny from the FTC since the 1970s. This Comment’s goal is to address the gap in scholarship surrounding the multilevel marketing industry’s history and current legal standards, as well as provide a foundation for others to build upon. This will be accomplished through a thorough review of the relevant history and legal decisions, followed by an application of the relevant standards to a modern-day multilevel marketing company.

Introduction	356
I. Evolution of the Pyramid Scheme.....	359
II. Direct Sales and the Creation of the Multilevel Marketing Company....	364
III. Pyramid-Shaped Truths.....	368

* J.D./MBA Candidate, Lewis & Clark Law School, Portland State University, 2024; B.A. International Business, Concordia College-Moorhead, 2017. Hailey would like to thank Professor Samir Parikh for his encouragement, guidance, and feedback on this Comment and for igniting her interest in corporate scandals and financial frauds. Hailey would also like to thank her partner, Sean Stauffer-Person, for his never ending support, insightful comments, and boundless patience.

IV.	Differentiating MLM Models from Pyramid Schemes	371
A.	<i>The Nutrilite Problem</i>	372
B.	<i>Another Win for the FTC with Holiday Magic</i>	375
C.	<i>MLM's Near-Death Experience with Koscot Interplanetary</i>	377
D.	<i>The Amway Bombshell</i>	379
E.	<i>FTC Decisions and Guidance Post-Amway</i>	381
V.	Application of the Legal Standard to the MLM Model	384
VI.	A Case Study—MONAT	387
A.	<i>The Koscot Test</i>	388
B.	<i>Additional FTC Elements</i>	389
C.	<i>Summary</i>	393
	Conclusion.....	393

INTRODUCTION

There is no physical feature that allows one to spot a fraudster. Instead, fraudsters are identified by their greed-based mindset, heartlessness, and arrogance.¹ One of the earliest recorded cases of financial fraud happened in 3rd century B.C. Athens, when Hegestratos and Xenothemis attempted to commit insurance fraud. Hegestratos and Xenothemis took out an insurance policy on their ship and its cargo, intending to leave the cargo behind and sink their ship halfway through the return voyage and collect on the insurance.² Their plan was foiled by the ship's passengers and resulted in Hegestratos drowning.³ Xenothemis was forced to sail the ship back to port and face the Athens' legal system.⁴ While Hegestratos and Xenothemis exact motives were not recorded in history, it is clear that their greedy mindset is what led to their demise.

Hegestratos and Xenothemis were willing to drown all the passengers on their ship in exchange for a payday. This level of heartlessness is still core to the fraudster mindset in the 21st century. Much like legitimate businesses, financial frauds require others to willingly participate. Willing participation requires the individual to believe in the opportunity and either trust in the fraudster, or fall victim to irrational exuberance.⁵ Multilevel marketing (MLM) companies exhibit the power of the

¹ See MARTIN T. BIEGELMAN, *FACES OF FRAUD: CASES AND LESSONS FROM A LIFE FIGHTING FRAUDSTERS* 1–2 (2013).

² Amanda Foreman, *Insuring Against Disaster*, WALL ST. J. (Feb. 20, 2019, 10:41 AM), <https://www.wsj.com/articles/insuring-against-disaster-11550677283>.

³ It is unclear if he jumped overboard or if he was thrown. *Id.*

⁴ REVATHI SUBRAMANIAN, *BANK FRAUD: USING TECHNOLOGY TO COMBAT LOSSES* 1–2 (2014).

⁵ Former Federal Reserve Chairman Alan Greenspan coined the term “irrational exuberance” in describing investors' frenzied state and irrational belief in the high value and low

fraudster's greed-based mindset combined with the public's irrational exuberance.

The Federal Trade Commission's (FTC) 2016 complaint against Herbalife International of America Inc. (Herbalife) exposed the damage that the greed-based mindset can inflict on unknowing participants. The FTC claimed that Herbalife misrepresented the income opportunity to potential distributors, which resulted in significant financial harm.⁶ To settle the claims, Herbalife paid \$200 million to be distributed to the company's victims.⁷ While the efficacy of the FTC's fine is up for debate,⁸ its effect has been felt throughout the industry.⁹ Many have questioned why the FTC—which had a strong case against Herbalife—settled with the international MLM company instead of pushing for the company's dissolution.¹⁰ A thorough examination of MLM companies' influence, structure, history, and legal landscape provides critical insight and understanding into the FTC's decision.

Multilevel marketing is a direct sales structure used by manufacturers to sell products and services directly to consumers. Direct sales has been around since the early 1900s and can take on one of two forms: (1) single-level marketing plans, or (2) multilevel marketing plans.¹¹ Single-level direct sales plans involve distributors

risk profile of an investment, even when presented with evidence to the contrary. This term has since been built upon to refer to an irrational belief held by many that influences a particular decision-making process. See Alan Greenspan, Chairman of the Fed. Rsrv., Remarks at the Annual Dinner and Francis Boyer Lecture of The American Enterprise Institute for Public Policy Research, Washington, D.C. (Dec. 5, 1996), <https://www.federalreserve.gov/boarddocs/speeches/1996/19961205.htm>; MARC PETER RADKE, *EXPLAINING FINANCIAL CRISES: A CYCLICAL APPROACH 3* (2018); ROBERT J. SHILLER, *IRRATIONAL EXUBERANCE*, at xii–xiii (2d ed. 2005).

⁶ Complaint for Permanent Injunction and Other Equitable Relief at 39–41, Fed. Trade Comm'n v. Herbalife Int'l of Am., Inc., No. 2:16-cv-05217 (C.D. Cal. July 15, 2016).

⁷ *FTC Sends Checks to Nearly 350,000 Victims of Herbalife's Multi-Level Marketing Scheme*, FED. TRADE COMM'N (Jan. 10, 2017), <https://www.ftc.gov/news-events/press-releases/2017/01/ftc-sends-checks-nearly-350000-victims-herbalifes-multi-level>; *Herbalife Refunds*, FED. TRADE COMM'N (May 2019), <https://www.ftc.gov/enforcement/cases-proceedings/refunds/herbalife-refunds>.

⁸ See, e.g., Jen Wiczner, *Herbalife Paid a \$200 Million Fine. Then the FTC Screwed It Up*, FORTUNE (Feb. 2, 2017, 6:38 PM), <https://fortune.com/2017/02/02/herbalife-lawsuit-ftc-settlement-payout/>.

⁹ Kevin Grimes, *Lessons in Missing the Point—The MLM Industry Is Now Expressly Targeted by the FTC for Deceptive Income and Product Claims*, THOMPSON BURTON (Aug. 3, 2021), <https://thompsonburton.com/mlmattorney/2021/08/03/lessons-in-missing-the-point-the-mlm-industry-is-now-expressly-targeted-by-the-ftc-for-deceptive-income-and-product-claims>.

¹⁰ See, e.g., Michael Hiltzik, *FTC Moves Against Herbalife, but Leaves a Question: Why Is this Company Still Allowed in Business?*, L.A. TIMES (July 18, 2016, 2:30 PM), <https://www.latimes.com/business/hiltzik/la-fi-hiltzik-herbalife-20160718-snap-story.html>.

¹¹ *Direct Selling Timeline*, DIRECT SELLING J., <https://www.dsa.org/direct-selling-journal/direct-selling-timeline> (last visited Mar. 5, 2023); Stewart Brodie, John Stanworth & Thomas R. Wotruba, *Comparisons of Salespeople in Multilevel vs. Single Level Direct Selling Organizations*, 22 J. PERS. SELLING & SALES MGMT. 67, 67 (2002).

initiating interactions with consumers to sell a product or service.¹² Single-level marketing plans are common in the retail industry where a sales representative will work directly with customers to identify needs and find the right product to support them.¹³ Single-level sales representatives only sell products or services to end users.¹⁴ In MLM companies, distributors sell both the product or service and the opportunity to become a distributor.¹⁵ When a distributor recruits a new participant, that participant becomes part of their “downline.”¹⁶ For every sale made in a distributor’s downline, they will receive a percentage of the sale as compensation for recruiting the downline distributor. While the theoretical structure of MLM schemes does not seem harmful, in practice the structure is predatory and toxic.¹⁷

The Industrial Revolution greatly benefited the direct sales industry; the mass migration of people to urban centers¹⁸ and technological advances made traveling significantly easier than before.¹⁹ These two changes in American society created the perfect environment for the incorporation of direct sales on a national level. Businesspeople and inventors alike discovered the benefits of selling their goods and services through networks of independent contractors instead of selling their products on shelves. Direct sales continued to grow after the Industrial Revolution, with new technology making it easier for distributors to reach more clients.²⁰ The 20th century also saw an increase in swindles and fraud, including Charles Ponzi’s infamous fraud in Massachusetts and the first MLM schemes in California.²¹

There is little academic study on MLM schemes or the devastation they leave behind. This Comment hopes to address that gap and provide a foundation for future scholars to build on. Part I will provide history and context to the development of Ponzi and pyramid schemes. These kinds of frauds are still prevalent in the 21st century, and the legal acceptance of MLM schemes has provided a mask of

¹² Brodie et al., *supra* note 11, at 67.

¹³ *Sales Representative Demographics and Statistics in the US*, ZIPPPIA, <https://www.zipppia.com/sales-representative-jobs/demographics/> (last visited March 27, 2023).

¹⁴ *Id.*

¹⁵ When recruiting, distributors often refer to the prospect of becoming a distributor as a “business opportunity.” See JON M. TAYLOR, CONSUMER AWARENESS INST., THE CASE (FOR AND) AGAINST MULTI-LEVEL MARKETING ch. 7, at 2 (2012), <https://centerforinquiry.org/wp-content/uploads/sites/33/quackwatch/taylor.pdf>.

¹⁶ See, e.g., MONAT GLOB., COMPENSATION PLAN DEFINITIONS: USA 2 (July 2018), https://mymonat.com/uploads/global/US_Compensation_Plan_Definitions_082018.pdf.

¹⁷ See, e.g., *id.* at 4.

¹⁸ JAMES S. OLSON & SHANNON L. KENNY, THE INDUSTRIAL REVOLUTION: KEY THEMES AND DOCUMENTS, at xii (2015).

¹⁹ *Id.*

²⁰ See generally DELOITTE CTR. FOR THE EDGE, THE RETAIL TRANSFORMATION: CULTIVATING CHOICE, EXPERIENCE, AND TRUST (2015).

²¹ TAYLOR, *supra* note 15, ch. 10, at 2–5.

legitimacy for illegal schemes to hide behind. Part II will introduce the company involved in the creation of the MLM scheme, the people responsible for it, and the components that make MLM schemes destructive to participants both financially and personally. Part III identifies the fundamental issues with the MLM structure, and the inherent deception required to successfully maintain it. Part IV provides an introduction to the early legal cases against MLM companies and outlines the key points of legal analysis used in drawing the line between legal and illegal MLM schemes. Parts V and VI will apply the previously identified legal principles to the standard MLM model and to MONAT Global Corp. (MONAT), a currently operating MLM company.

Ultimately the result of this analysis will show that all MLM models are illegal pyramid schemes. The political power and influence that early MLM founders were able to consolidate and wield has kept MLM companies from a blanket judicial finding of the systems' illegality. The FTC has recently taken encouraging steps in the right direction to push back on MLM companies and their deceptions.²² While this is a good sign, any order, case ruling, or law finding the MLM structure illegal on its face, likely will have to come from Congress or the Supreme Court.

I. EVOLUTION OF THE PYRAMID SCHEME

The origin of the pyramid scheme is largely debated, with many erroneously crediting Charles Ponzi with its creation. Charles Ponzi orchestrated a massive fraud in the early 1900s that became so infamous as to be named after him.²³ Generally, Ponzi schemes involve a single person—or small group of people—promoting a short-term investment with unusually high returns.²⁴ In reality, the fraudster uses the money from new investors to pay off the old investors, until the income from new investors is insufficient to maintain the scheme.²⁵ The promoters also consistently skim money off the top for themselves.²⁶

²² See Emily Stewart, *MLMs Might Not be Able to Get Away with Their Shady Promises Much Longer*, VOX (Oct. 22, 2021, 8:30 AM), <https://www.vox.com/the-goods/22732586/ftc-mlm-rohit-chopra-business-opportunity-rule>; *With Omicron Variant on the Rise, FTC Orders More Marketers to Stop Falsely Claiming Their Products Can Effectively Prevent or Treat COVID-19*, FED. TRADE COMM'N (Jan. 19, 2022), <https://www.ftc.gov/news-events/press-releases/2022/01/omicron-variant-rise-ftc-orders-more-marketers-stop-falsely>.

²³ While Charles Ponzi is the namesake of this kind of scheme, he is not the creator. Sarah Howe's company, Ladies' Deposit Company, is the earliest Ponzi scheme of record by many historians. See Rose Eveleth, *The No. 1 Ladies' Defrauding Agency*, LONGREADS (July 2, 2019), <https://longreads.com/2019/07/02/the-no-1-ladies-defrauding-agency/>.

²⁴ Debra A. Valentine, Gen. Couns., Fed. Trade Comm'n, Prepared Statement on "Pyramid Schemes" Presented at the International Monetary Fund's Seminar on Current Legal Issues Affecting Central Banks (May 13, 1998).

²⁵ *Id.*

²⁶ *Id.*

Ponzi schemes can often be difficult to detect, as they can appear to be legitimate investment opportunities. In the case of Charles Ponzi, he convinced members of his community that he could provide a 50% return on their investment through the exchange of International Reply Coupons (IRCs).²⁷ In 1906, the International Universal Postal Union created the IRC as a way to pay for international postage.²⁸ Member countries signed a treaty agreeing to accept IRCs from other member countries as sufficient payment to send an international letter.²⁹ The exchange rate of IRCs was set in the international treaty.³⁰ After World War I, Ponzi saw the rapid fluctuation of international currency and came up with an idea. If he could buy an IRC in a low-cost country and then exchange the IRC in a high-cost country, he could make a substantial profit.³¹ Ponzi was attempting to take advantage of an arbitrage—an opportunity for an investor to buy a commodity in one place at a low price, then sell it in another where it is worth more therefore taking advantage of price differences across markets.³² Unfortunately for Ponzi, IRC's could not be returned or redeemed for cash.³³ Instead, Ponzi claimed he had a vast network of individuals buying IRC's across Europe who would purchase and send IRC's to the United States, where they were exchanged for United States stamps and then resold.³⁴

Ponzi's plan was simple enough for people to understand, though some questioned how he was able to convert the IRCs back to cash. Ponzi refused to tell anyone how he converted the coupons, citing a fear that others would copy him.³⁵ While investors were intrigued by Ponzi's plan, they were blown away at his promise of a 50% return on their investment within 45 days or 100% return within 90 days.³⁶ After the first round of investors saw their returns, irrational exuberance overcame the community and everyone rushed to invest their money with Ponzi.

Irrational exuberance is the key element of a Ponzi scheme. Ponzi schemes

²⁷ Mary Darby, *In Ponzi We Trust*, SMITHSONIAN MAG. (Dec. 1998), <https://www.smithsonianmag.com/history/in-ponzi-we-trust-64016168/>.

²⁸ *Behind the Badge Exhibition: Ponzi Scheme*, SMITHSONIAN NAT'L POSTAL MUSEUM, <https://postalmuseum.si.edu/exhibition/behind-the-badge-case-histories-scams-and-schemes/ponzi-scheme> (last visited Apr. 20, 2023).

²⁹ *Id.*; Universal Postal Convention, Protocol, art. 11, ¶ 2, May 26, 1906, 35 Stat. 1639.

³⁰ Darby, *supra* note 27; Universal Postal Convention, *supra* note 29, at 1652.

³¹ Darby, *supra* note 27.

³² Anna-Louise Jackson, *Understanding Arbitrage*, FORBES ADVISOR, <https://www.forbes.com/advisor/investing/what-is-arbitrage/> (Dec. 16, 2022).

³³ Universal Postal Convention, Detailed Regulations, art. VII, May 26, 1906, 35 Stat. 1639.

³⁴ Darby, *supra* note 27.

³⁵ Steve Weisman, *The History of Ponzi Schemes Goes Deeper than the Man Who Gave Them His Name*, TIME (Aug. 12, 2020, 9:30 AM), <https://time.com/5877434/first-ponzi-scheme/>.

³⁶ *Id.*

require a constant influx of money, or they collapse.³⁷ The irrational exuberance exhibited by investors is what infects and attracts new investors. Once the first investors receive their return, the community is infected with the idea of making money, blatantly ignoring all warning signs. In theory, a Ponzi scheme can continue forever, but in reality, they eventually run out of new investors, which triggers their collapse. Charles Ponzi caused his own demise when he offered to open his books to the government and to stop taking on new investments during the investigation.³⁸ This led to a mass panic among investors who feared Ponzi was about to pack up and leave town. Investors rushed to collect their investment funds.³⁹ Ponzi was unable to pay back all the clients, and his fraud came to a crashing end.⁴⁰

Charles Ponzi likely receives credit for the creation of the pyramid scheme due to the similarity in structure to the Ponzi scheme. Like Ponzi schemes, pyramid schemes rely on the influx of new capital, or they collapse.⁴¹ Unlike Ponzi schemes, pyramid schemes usually sell a product, rather than an investment.⁴² Pyramid schemes require the recruitment of new investors by those already in the scheme.⁴³ The recruitment makes a hierarchy of investors, with early investors at the top of the pyramid and the latest investors at the bottom, with no concrete way to join those at the top.⁴⁴

To maintain a constant inflow of investments, the scheme incentivizes current members to recruit. These incentives are usually monetary in nature and can include large one-time bonuses, a percentage cut of new investors' sales, and an increase in one's commission rate.⁴⁵ The constant recruitment eventually leads to market saturation, which makes recruiting and selling extremely difficult; at this point all recruits stuck at the bottom of the scheme are unable to recoup their loss.⁴⁶

³⁷ U.S. Sec. & Exch. Comm'n, *Ponzi Schemes*, INVESTOR.GOV, <https://www.investor.gov/introduction-investing/investing-basics/glossary/ponzi-schemes> (last visited Apr. 20, 2023).

³⁸ *Behind the Badge Exhibition: Ponzi Scheme*, *supra* note 28.

³⁹ *Id.*; Weisman, *supra* note 35.

⁴⁰ *Behind the Badge Exhibition: Ponzi Scheme*, *supra* note 28.

⁴¹ Valentine, *supra* note 24.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ Stacie Bosley & Maggie Knorr, *Pyramids, Ponzis and Fraud Prevention: Lessons from a Case Study*, 25 J. FIN. CRIME 81, 82 (2018).

⁴⁵ *Pyramid Schemes*, WASH. OFF. OF THE ATT'Y GEN., <https://www.atg.wa.gov/pyramid-schemes> (last visited Apr. 20, 2023).

⁴⁶ TAYLOR, *supra* note 15, ch. 10, at 2–3; *see, e.g.*, David Enscoe, *Pyramid Scheme Takes Off Thousands Invest in 'Plane Game'*, S. FLA. SUN-SENTINEL (March 26, 1987), https://web.archive.org/web/20170719055557/http://articles.sun-sentinel.com/1987-03-26/news/8701190859_1_pyramid-game-pilot-passengers.

Pyramid schemes often have a required buy-in for new investors.⁴⁷ In the MLM context, this payment is often marketed as a minimal or important investment in one's future.⁴⁸ The concept of a pyramid scheme and the language surrounding its recruitment strategies are exemplified in the infamous 1980s Airplane Game that swept across the country, leaving countless victims.⁴⁹ The origin of the Airplane Game is unknown, though the game is comparable to a chain letter—an old-fashioned version of the pyramid scheme involving the sending of money and letters to those one knows.⁵⁰ The Airplane Game took inspiration from a traditional flight crew with one pilot, two copilots, four crew members and eight passengers.⁵¹ Each copilot was responsible for two crew members and four passengers. New participants entered into the role of passengers, with a required buy-in of \$1,500 to \$2,500 a player.⁵² Passengers were the only participants who paid any fee. Passengers paid their entry fee to the pilot, who would then proceed to “retire.” Pilots reportedly took home between \$12,000 to \$20,000 on average, with some papers reporting earnings up to \$40,000.⁵³

Upon the pilot's “retirement,” they would promote their crew, creating two new planes in the process. Each copilot would become the pilot of their own plane, with their crew becoming their copilots and the passengers becoming the crew.⁵⁴ The new airplanes then recruited eight new passengers, and the game would continue until the recruitment of new passengers was impossible.⁵⁵ In the early rounds of the Airplane Game, many players would play multiple times, only paying \$1,200 to \$1,500 to participate, and walking away with over \$12,000.⁵⁶ The wild success of the game died down quickly as recruiting passengers became harder and harder.⁵⁷ For those who were recruited but did not have many friends, reaching the status of pilot and recovering one's investment was difficult. These participants, and those

⁴⁷ Valentine, *supra* note 24. See generally ROBERT L. FITZPATRICK, *PONZINOMICS: THE UNTOLD STORY OF MULTI-LEVEL MARKETING* (2020).

⁴⁸ The Dream, *Yes, I Would Like to Swim in Cash*, LITTLE EVERYWHERE & WITNESS DOCS, at 10:45 (Oct. 1, 2018) (downloaded using Spotify); *2020 Consumer Attitudes & Entrepreneurship Study*, DIRECT SELLING ASS'N (2020), <https://www.dsa.org/docs/default-source/research/dsa-ipsos-2020-consumerattitudesinfographic2-27.pdf>.

⁴⁹ In Boston alone, there were 7 people who faced criminal charges and 33 under court order to stop playing. Associated Press, *Airplane Game Crashes*, N.Y. TIMES, Dec. 6, 1987, at 75.

⁵⁰ Lawrence Kilman, *Newest Illegal Pyramid Scheme Going Up and Up, but Not Away*, AP NEWS (Mar. 23, 1987), <https://apnews.com/article/7894d03521da555b7ea45e6f78323fbb>.

⁵¹ Elizabeth Neuffer, ‘Airplane’: High-Stakes Chain Letter, N.Y. TIMES, Apr. 7, 1987, at B7.

⁵² *Id.*

⁵³ See, e.g., Neuffer, *supra* note 51; Enscoe, *supra* note 46.

⁵⁴ Neuffer, *supra* note 51.

⁵⁵ The Dream, *supra* note 48, at 7:00.

⁵⁶ *Id.* at 14:00.

⁵⁷ *Id.* at 15:30.

they recruited, would pay for the wins of the previous pilots. Established planes would also falter when those who participated got scared off by federal investigations, grew bored, or wanted to get out while they were ahead.⁵⁸ The sheer mass of people participating in the pyramid scheme is what attracted the attention of law enforcement, who eventually investigated and arrested high profile participants in states across the country. By the end, most participants were left poorer than when they began.⁵⁹

Pyramid schemes cause more damage to their victims than other kinds of money schemes.⁶⁰ They target specific market segments and prey on the communities' trust in each other to gain a foothold.⁶¹ Pyramid schemes seek out—and thrive in—female, religious, minority, desperate, and fringe communities.⁶² Herbalife, which the FTC accused of targeting the Spanish speaking community,⁶³ and NXIVM, which targeted people seeking a strong family-like community and enlightenment, are examples of schemes that specifically targeted a marginalized group.⁶⁴ These schemes use investors' friends and familial relationships to recruit participants, counting on the trust inherent in their bonds to disguise the numerous red flags.⁶⁵ These relationships, paired with the manipulative recruitment tactics used by investors, encourage the irrational exuberance of new recruits who are willing to follow without asking questions.⁶⁶ In turn, the irrational exuberance, constant pressure, and “mentorship” causes many victims to inventory load and take on debt or other personally harmful burdens to support the scheme.⁶⁷ Victims often remain in the scheme until they no longer have any value to provide, whether such lack of

⁵⁸ *Id.*

⁵⁹ See Jerry Belcher, *Police Clip Wings of 'Airplane Game': Arrest Four Alleged Promoters of Version of Pyramid Scheme*, L.A. TIMES (Mar. 19, 1987, 12:00 AM), <https://www.latimes.com/archives/la-xpm-1987-03-19-mn-14141-story.html>; Enscoe, *supra* note 46.

⁶⁰ See Bosley & Knorr, *supra* note 44, at 83.

⁶¹ *Id.* at 82; The Dream, *Women's Work*, LITTLE EVERYWHERE & WITNESS DOCS, at 19:50 (Sept. 24, 2018) (downloaded using Spotify).

⁶² Bosley & Knorr, *supra* note 44, at 82–83; *Direct Selling in the United States: 2020 Industry Overview*, DIRECT SELLING ASS'N (2021), <https://www.dsa.org/docs/default-source/research/dsa-industry-overview-fact-sheet.pdf>.

⁶³ See Complaint for Permanent Injunction and Other Equitable Relief, *supra* note 6, at 5–12.

⁶⁴ Escaping NXIVM, *The Epiphany*, CBC PODCASTS, at 4:50 (Sept. 3, 2018) (downloaded using Spotify).

⁶⁵ The Dream, *How a Dream Becomes a Nightmare*, LITTLE EVERYWHERE & WITNESS DOCS, at 11:05 (Oct. 2018) (downloaded from Spotify).

⁶⁶ Casey Bond, *How MLMs and Cults Use the Same Mind Control Techniques*, HUFFPOST, https://www.huffpost.com/entry/multilevel-marketing-companies-mlms-cults-similarities_1_5d49f8c2e4b09e72973df3d3 (Jan. 8, 2021).

⁶⁷ See The Dream, *supra* note 65, at 15:10; *LuLaRich: Toe Up*, at 5:54 (Amazon Video Sept. 9, 2021).

value results from an inability to meet sales and recruitment goals, new familial obligations, or health issues that consume their time.⁶⁸ The community then starts to ostracize the victim and removes them from the social sphere.⁶⁹ Exile breaks victims' irrational exuberance and allows them to see the unfortunate pyramid-shaped truth.

II. DIRECT SALES AND THE CREATION OF THE MULTILEVEL MARKETING COMPANY

Direct selling has been a cornerstone of the American economy since the 17th century. What started out as individuals traveling across the country in wagons, buying goods from one community and selling them to another, slowly transformed into centralized businesses with many agents throughout the country.⁷⁰ The life of the 19th century peddler was lonely and dangerous, as the business model required them to be constantly on the road, carrying valuable goods, and possibly traveling alone.⁷¹ The end of the 18th century and beginning of the 19th century saw the industrial revolution change American society forever. The sudden increase in technology and the mass migration of people to cities offered a new opportunity to the individual peddler.⁷² Communication, transportation, and news now traveled across the country in ways previously unimaginable. Businesses could send items to customers outside their community, facilitating an increase in their market presence. National chain stores became more prevalent,⁷³ while smaller brands pushed to be featured on their shelves.⁷⁴

The California Perfume Company (CPC), now known as Avon, formed in 1886. Its business model was unprecedented.⁷⁵ CPC only hired women to sell their

⁶⁸ See *LuLaRich: Toe Up*, *supra* note 67, at 10:15.

⁶⁹ See Bond, *supra* note 66.

⁷⁰ Jessica K. Burch, Dissertation Summary, "Soap and Hope": *Direct Sales and the Culture of Work and Capitalism in Postwar America*, 17 ENTER. & SOC'Y 741, 741 (2016); *Direct Selling Timeline*, *supra* note 11.

⁷¹ RICHARDSON WRIGHT, HAWKERS & WALKERS IN EARLY AMERICA; STROLLING PEDDLERS, PREACHERS, LAWYERS, DOCTORS, PLAYERS, AND OTHERS, FROM THE BEGINNING TO THE CIVIL WAR 21 (1927).

⁷² Elizabeth Yuko, *How the Industrial Revolution Fueled the Growth of Cities*, HISTORY (Nov. 18, 2021), <https://www.history.com/news/industrial-revolution-cities#:~:text=%E2%80%9CCities%20grew%20because%20industrial%20factories,life%20in%20the%20United%20States.%E2%80%9D>; see KATINA MANKO, DING DONG! AVON CALLING! THE WOMEN AND MEN OF AVON PRODUCTS, INCORPORATED 77 (2021).

⁷³ See generally Lucia Foster, John Haltiwanger, Shawn Klimek, CJ Krizan & Scott Ohlmacher, *The Evolution of National Retail Chains: How We Got Here* (U.S. Census Bureau, Ctr. for Econ. Stud., Working Paper, CES 15-10, 2015).

⁷⁴ See, e.g., Madam C.J. Walker, The Crown Drug Store Order Letters, in MADAM C.J. WALKER PAPERS ADDITION, 1911–2005, M1250, box 4, folder 5 (Ind. Hist. Soc'y 2019) (1954).

⁷⁵ See MANKO, *supra* note 72 at 1–2.

product directly to their target market.⁷⁶ CPC structured itself in the standard single-level direct sales structure, with salespeople reporting to regional managers and regional managers reporting to corporate. CPC targeted middle-class white housewives to sell their cosmetics. Women were the target market of Avon products, and women were able to enter clients' homes to sell Avon's products without scandal. Avon created two kinds of sales representatives: the traveling representative and the door-to-door saleswoman.⁷⁷ The traveling saleswomen group was composed of the best saleswomen in the company and focused on breaking into new markets with recruitment, training, and mentoring. Since Avon recruited their representatives, Avon was able to regulate its sales force and prevent market oversaturation. Avon would remain a single-level direct sales company until 2005, when transitioned to an MLM model in hopes of staying competitive in the direct sales market.⁷⁸

Avon opened the doors for many white women to earn money in a time when finding employment outside the home was extremely difficult. Avon's "exclusive" culture purposefully excluded minority women.⁷⁹ Avon's purposeful exclusion of black women allowed Madam C.J. Walker to enter, and thrive in, the direct selling market. Walker was the first black female millionaire in the United States.⁸⁰ She built her fortune off a direct-selling haircare company that made products specifically for black women in a time where there was little to nothing marketed specifically for them.⁸¹

Walker was able to harness the power of direct sales in a way Avon had not cared to. She was able to educate and embolden her community of sales agents with the goal of selling and instigating social change. Walker trained her agents to be "beauty culturists," whose job was to educate their communities on her system.⁸² As her sales force grew, so did their needs. In 1908, Walker opened a beauty school near her factory in Pennsylvania to train sales agents and hair stylists.⁸³ Agents paid to attend the school, though there were many scholarship options available.⁸⁴ By 1919, Walker had over 20,000 agents.⁸⁵

⁷⁶ The Dream, *supra* note 61, at 28:40.

⁷⁷ MANKO, *supra* note 75, at 2–6.

⁷⁸ See AVON, 2005 ANNUAL REPORT (2006), https://s23.q4cdn.com/756130224/files/doc_financials/annual/1500057616.pdf.

⁷⁹ MANKO, *supra* note 77, at 5, 53–55.

⁸⁰ *Madam C.J. Walker*, HISTORY.COM, <https://www.history.com/topics/black-history/madam-c-j-walker> (Mar. 15, 2022).

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ Robin Spevacek, *Madam C.J. Walker*, CRICKET, Feb. 2017, at 34.

⁸⁵ *Id.*

To elicit loyalty from her sales force, Walker created the Benevolent Association of Madam C.J. Walker Agents.⁸⁶ This national organization allowed the agents to belong to a society based on their geographic region. Much like other organizations and societies, the Benevolent Association of Madam C.J. Walker Agents was organized into chapters. Walker assigned each chapter an elite saleswoman, who was not only effective at her job but also emulated Walker's social views.⁸⁷ Walker provided extra compensation to this select group of women in addition to their sales with the directive to "treat, teach, and organize, [and] delive[r] lectures. . . ."⁸⁸

By the time Walker died in 1919, there were many roles at varying levels for agents. Agents could be members of the elite team, charter presidents, owner-operators, or salon promoters.⁸⁹ Agents' promotions were based on their leadership potential and ability to grow the business.⁹⁰ Walker used the pyramid structure of leadership with her sales agents to motivate, support, mentor, and create culture. Madam C.J. Walker Manufacturing Company managed to find the perfect balance among leadership pyramids, profit, and culture—without taking advantage of its agents.

Direct sales increased in popularity during the 20th century, culminating in the creation of the first multilevel marketing company—Nutrilite Products Inc. (Nutrilite). Carl Rehnberg hoped to profit from the irrational exuberance—or "vit-*amania*"⁹¹—tearing through American society during the 1930s.⁹² Rehnberg's life was spent chasing wealth and failing each time.⁹³ After a failed venture in China, Rehnberg returned home to California and started Nutrilite, hoping to finally make it big.⁹⁴ Nutrilite struggled to gain market share in the early years and did not achieve true success until Rehnberg signed an exclusive distribution deal with William Casselberry—a psychologist with a segment on a popular radio show—and Lee

⁸⁶ Letter from Madam C.J. Walker to F.B. Ransom (Apr. 10, 1916), in MADAM C.J. WALKER PAPERS, 1910–1980, M0399, box 1, folder 4 (Ind. Hist. Soc'y 2019) (1916).

⁸⁷ Gary Hoover, *Madam C. J. Walker: The Ultimate Self-Made Woman*, AM. BUS. HIST. CTR. (Oct. 31, 2017), <https://americanbusinesshistory.org/madam-c-j-walker-the-ultimate-self-made-woman/>.

⁸⁸ Letter from Madam C.J. Walker to F.B. Ransom (Apr. 17, 1916), in MADAM C.J. WALKER PAPERS, 1910–1980, *supra* note 86.

⁸⁹ See Tyrone McKinley Freeman & Katie Smith Milway, *How Madam C.J. Walker Built Racial Equity into Her Business*, HARV. BUS. REV. (Dec. 9, 2020), <https://hbr.org/2020/12/how-madam-c-j-walker-built-racial-equity-into-her-business>.

⁹⁰ Hoover, *supra* note 87.

⁹¹ University of Wisconsin-Madison Professor Rima Apple coined the term "vit-*amania*" in 1996. See RIMA D. APPLE, VITAMANIA: VITAMINS IN AMERICAN CULTURE (1996).

⁹² FITZPATRICK, *supra* note 47, at 31–33.

⁹³ *Id.* at 28–30.

⁹⁴ *Id.* at 29–33, 36.

Mytinger—a successful veteran cemetery plot salesman.⁹⁵

At first, Casselberry and Mytinger did not contribute much to Nutrilite. One day, sometime between 1943 and 1945, Casselberry and Mytinger were discussing Mytinger's growing frustration over his company promoting salesmen whom he had trained, instead of promoting him.⁹⁶ This conversation led the two men to create a new business model, one that would eventually be known as the multilevel marketing scheme. Mytinger's contribution to the plan was its structure. He hated seeing young recruits outpacing their teachers, and as such he suggested removing promotional criteria based on sales and marketability.⁹⁷ This structure would allow salespeople to build their own distribution chains, limited only by the distributor's ability to recruit.⁹⁸ This would allow distributors to continually profit from their "downline," making their downline's success their success. The company favorites would then be those with the largest distribution networks, rather than those who individually sold the most.⁹⁹ Mytinger's plan severed compensation from the market's supply and demand. Instead, distributors were financially incentivized to recruit others into the chain.¹⁰⁰ While Mytinger devised the structure of the new system, Casselberry's addition would make the MLM structure infamous. Casselberry used his understanding of human psychology to establish the rules, values, and culture that would transform this structure from a simple business into a way of life.¹⁰¹ Casselberry infused MLM culture with the same psychological recruitment and retention methods found in cults and added a splash of theatrics.¹⁰² The perfect marriage of Mytinger's structure and Casselberry's psychological influence have made MLM schemes increasingly prevalent and incredibly destructive.

Nutrilite remained a top retailer of vitamins and supplements throughout its life. In 1956, Nutrilite's total sales approximated \$26 million.¹⁰³ The success of Nutrilite prompted the launch of another infamous MLM company, Amway International Corp. (Amway). Richard DeVos and Jay Van Andel started out as Nutrilite

⁹⁵ *Id.* at 47, 52–62.

⁹⁶ *Id.* at 63.

⁹⁷ *Id.* at 63–66.

⁹⁸ *Id.* at 64.

⁹⁹ *Id.* at 65–67.

¹⁰⁰ *Id.* at 70.

¹⁰¹ *Id.* at 65–67.

¹⁰² *Id.* at 53; see Claudia Groß & Dirk Vriens, *The Role of the Distributor Network in the Persistence of Legal and Ethical Problems of Multi-Level Marketing Companies*, 156 J. BUS. ETHICS 333, 340 (2019); Denise Sutherland, *Multi-Level Menace*, SKEPTICAL INQUIRER, Sept.–Oct. 2018, at 44, 45; see also Last Week Tonight, *Multilevel Marketing: Last Week Tonight with John Oliver* (HBO), YOUTUBE (Nov. 7, 2016), <https://www.youtube.com/watch?v=s6MwGeOm8iI> (revealing undercover footage of an MLM recruiter explaining the theatrics of the model).

¹⁰³ Mytinger & Casselberry, Inc., 57 F.T.C. 717, 718 (1960).

salesmen before going into business for themselves.¹⁰⁴ In 1972, they reached out to Rehnborg in hopes of finding a way to sell Nutrilite through their Amway distribution network.¹⁰⁵ They were successful and Rehnborg sold them controlling interest in Nutrilite. Rehnborg passed away soon after, at the age of 86. His family remained involved with the company until 1994 when they sold their remaining interest to Amway.¹⁰⁶

III. PYRAMID-SHAPED TRUTHS

Mytinger's and Casselberry's innovative sales structure was advantageous for early adopters but presented a plethora of issues for both the long-term success of the business and its distributors. The MLM model's resemblance to pyramid schemes provided an air of legitimacy that allowed illegal pyramid schemes to masquerade as lawful businesses while deceiving countless victims.¹⁰⁷ MLM companies often claim that they present a "business opportunity" to earn some extra money while working part-time.¹⁰⁸ These recruitment tactics disguise the three main truths of the MLM structure: (1) the endless chain of recruitment is impossible; (2) relentless recruiting leads to harmful market saturation; and (3) commissions are primarily based on the recruitment of new distributors.

The core tenet of recruitment affects the businesses in multiple ways. First, MLM schemes sell the idea of the endless recruitment chain where everyone can continuously recruit and make money.¹⁰⁹ The endless chain theory is problematic in the rate the scheme consumes the world's population. This scenario makes many faulty assumptions; for example, it assumes that every human has equal access to every other human, and every human would participate.¹¹⁰ In a pyramid where every person is expected to recruit three more people, the scheme would include more

¹⁰⁴ *Amway in the 1970s: Nutrilite Joins the Amway Family*, AMWAY CONNECTIONS (May 9, 2019), <https://www.amwayconnections.com/amway-celebrates-60-years/amway-1970s-nutrilite-joins-amway-family/>.

¹⁰⁵ *Id.*; *Amway: Rising to the Top*, DIRECT SELLING NEWS (Sept. 2, 2014), <https://www.directsellingnews.com/amway-rising-to-the-top/>.

¹⁰⁶ *Amway: Rising to the Top*, *supra* note 105; Shandra Martinez, *78-Year-Old Nutrilite 'Lab Rat' Tells Story of Amway's Best-Selling Product*, MLIVE (Oct. 7, 2014, 6:15 PM), https://www.mlive.com/business/west-michigan/2014/10/78-year-old_nutrilite_lab_rat.html.

¹⁰⁷ See Dan McCrum, Opinion, *BurnLounge Is a Pyramid Scheme, While 9th Circuit Leaves Herbalife Debate Unresolved*, FIN. TIMES (June 3, 2014), <https://www.ft.com/content/f9e24c19-2270-3552-bc0e-f956b458a960>; Jayne O'Donnell, *Federal, State Regulators Shut Down Fortune Hi-Tech*, USA TODAY (Jan. 28, 2013, 6:31 PM), <https://www.usatoday.com/story/money/personalfinance/2013/01/28/fhhtm-shut-down-pyramid-scheme/1870527/>.

¹⁰⁸ TAYLOR, *supra* note 15, ch. 8, at 9.

¹⁰⁹ *Id.* ch. 3, at 1; FITZPATRICK, *supra* note 47, at 104–05.

¹¹⁰ Last Week Tonight, *supra* note 102, at 2:00 (providing undercover footage of an MLM recruiter explaining the endless chain concept).

people than are currently on the planet by the 22nd level.¹¹¹ MLM schemes not only rely on the faulty endless chain theory, but they also mandate it. MLM companies aggressively compensate their distributors for the successful downline expansion. The standard MLM model offers distributors a percentage of their downline's sales, bonuses for hitting a combined market volume, a portion of the new recruits' entry fee, and one-time bonuses for each successfully enrolled new recruit.¹¹²

FIGURE 1.¹¹³

Level	Number of People
1	1
2	4
3	12
4	36
5	108
6	324
7	972
8	2,916
9	8,748
10	26,244
11	78,732
12	236,196
13	708,588
14	2,125,764
15	6,377,292
16	19,131,876
17	57,395,628
18	172,186,884
19	516,560,652
20	1,549,681,956
21	4,649,045,868

¹¹¹ This hypothetical scheme starts with one person at the first level and expands to four people at the second level, 12 people at the third level, 36 people at the fourth level, and so on until there are 4,649,045,868 people at the 22nd level.

¹¹² See, e.g., MONAT, USA COMPENSATION PLAN AT A GLANCE (2021), https://monatglobal.com/wp-content/uploads/2021/03/US_Compensation-Plan.pdf [hereinafter MONAT COMPENSATION PLAN]; see also HERBALIFE, MARKETING PLAN: INTRODUCTION AND FUNDAMENTALS 2, 5–6 (2011), https://www.myherbalife.com/content/en-us/pdf/toolsandtraining/business/marketingplan/110917_marketingplanintofundamentals_p2.pdf; ARBONNE, SUCCESS PLAN: U.S. 3–15 (Jan. 2021), <https://embed.widencdn.net/pdf/view/arbonne/njgallivi6/SuccessPlan+as+of+January+1st+2021>.

¹¹³ Figure 1 depicts the number of people needed for a pyramid scheme started by one person, with three recruits per each new member.

As distributors climb in rank within MLMs, their profit percentage of their personal sales rarely increases. Instead, distributors can earn an increasingly higher percentage of their downline's sales.¹¹⁴ Compensation structures like this take the money spent and earned by distributors at the bottom and redirect it to distributors at the top.

This kind of recruiting can lead to other problems, such as market saturation. Market saturation occurs when there are no more customers available in the market.¹¹⁵ When distributors are incentivized to recruit, with almost guaranteed acceptance of new recruits, there is no limit to the number of distributors that can be in one geographic market. For example, in a market of 200 people, all of whom use one bottle of shampoo a month, the market size for the year would be 2,400 bottles and the recruitment market would consist of 200 people. If 50% of the market is devoted to their current shampoo brand, the available market shrinks to 1,200 bottles a year, and 100 people. The new distributors must share the available 50% of the market with other shampoo brands available in the region. One or two distributors would likely saturate the available market quickly. The market for recruiting distributors would be even smaller than the shampoo market; a 2018 AARP study found that approximately 8% of Americans have taken part in an MLM.¹¹⁶ Considering the increase in participation in MLMs since 2018,¹¹⁷ even doubling that percentage to 16% does not improve the outcome in a 200-person market. The first distributor into the market will work hard to recruit others to join and will likely succeed in recruiting more than one other person. If the distributors were successful in recruiting 16% of the available market, they would have 16 distributors in a market of 100 people. That leaves about six customers per distributor. If the average shampoo costs \$10 and every person goes through a bottle a month, each distributor will sell \$720 a year. Assuming they make a 20% commission on their sales, they would make \$144 per year. The company, on the other hand, would sell \$72,000 worth of shampoo each year. The MLM approach to market saturation is one of the problematic ways they differ from single-level direct sales companies.

Once market saturation has occurred, the MLM model will start to collapse. An MLM scheme can breakdown in one of two ways: (1) they can fold and cease to exist, or (2) they can enter into a pattern of continual collapse.¹¹⁸ Continual collapse occurs when the MLM company is able to survive by "recycling a stream of new

¹¹⁴ See, e.g., MONAT COMPENSATION PLAN, *supra* note 112, at 1; HERBALIFE, *supra* note 112, at 6; ARBONNE, *supra* note 112, at 2.

¹¹⁵ TAYLOR, *supra* note 15, ch. 2, app. at 35.

¹¹⁶ MARGUERITE DELIEMA, DOUG SHADEL, AMY NOFZIGER & KARLA PAK, AARP FOUND., AARP STUDY OF MULTILEVEL MARKETING: PROFILING PARTICIPANTS AND THEIR EXPERIENCES IN DIRECT SALES 3 (2018).

¹¹⁷ *Direct Selling in the United States*, *supra* note 62.

¹¹⁸ TAYLOR, *supra* note 15, ch. 3, at 1–4.

recruits through new markets and new products.”¹¹⁹ As such, each individual market for any product is in a constant state of growth and then collapse. The MLM company keeps consumers and distributors engaged through the constant influx of new products targeting new market segments.

MLM schemes—as they currently operate—thrive off the same principles as pyramid schemes. They need a constant influx of new distributors who bring in significant money through their personal purchases and enrollment fees, they ignore the cost of market saturation, and they use the income gained from new recruits to compensate those higher up in the scheme.¹²⁰

IV. DIFFERENTIATING MLM MODELS FROM PYRAMID SCHEMES

Identifying and regulating illegal transactions can be difficult because the business of selling and the business of financial fraud require almost identical inputs. In any successful transaction the seller—or fraudster—must convince the buyer of (1) the benefit of the transaction,¹²¹ and (2) the value or necessity of conducting the transaction together instead of with other parties.¹²² Meeting these criteria is significantly easier with legitimate transactions, though the methods used by the seller are identical to those used by fraudsters to perpetrate the fraud.

Most legal transactions fulfill these two elements easily. Buyers are convinced of the transaction’s benefit through the buyer’s own want or need for the good or service. For most daily transactions, the consumer is already aware of the value provided by the seller. Grocery stores and gas stations do not have to convince consumers of the value they provide; the customers simply walk in and purchase the desired items. When consumers show up at the location ready to purchase their item, the seller has then met the second element. The value they provide to the transaction may be their location, convenience, reputation, or staff. Regardless, when the consumer walks in the door, sellers have already established their value.

Illegal transactions, such as pyramid schemes, often must prove these two elements to their targeted consumer, or “mark.” Fraudsters usually avoid mainstream marketing, out of fear of attracting federal scrutiny. Instead, financial frauds—especially pyramid or Ponzi schemes—rely on investors to market the product.¹²³ The participants are trained to target their mark’s insecurities or desires, such as wealth,

¹¹⁹ *Id.* ch. 3, at 4.

¹²⁰ See Bosley & Knorr, *supra* note 44, at 82; see also FITZPATRICK, *supra* note 47, at 104.

¹²¹ ARTHUR ALLEN LEFF, SWINDLING AND SELLING 12 (1976).

¹²² *Id.* at 16.

¹²³ Peter J. Vander Nat & William W. Keep, *Marketing Fraud: An Approach for Differentiating Multilevel Marketing from Pyramid Schemes*, 21 J. PUB. POL’Y & MKTG. 139, 140 (2002).

desperation, or desire to belong to a community.¹²⁴ Fraudsters use manipulation to prove the value and necessity of both parties to the transaction.¹²⁵ Since the seller holds an exclusive key to the business, if the mark does not want to miss out, the mark must act through the seller.¹²⁶

As Professor Arthur Leff said in his book *Swindling and Selling*, not all selling is swindling, but “all swindling is selling.”¹²⁷ Congress has failed to write laws that specifically target financial frauds like Ponzi and pyramid schemes due to the difficulty in differentiating transactions. Instead, Congress passed the Federal Trade Commission Act (FTCA),¹²⁸ the Clayton Act¹²⁹ and the Food, Drug, and Cosmetic Act (FDCA).¹³⁰ This hodgepodge of applicable law, Congress’ lack of statutory guidance for common financial frauds, and the thin line separating legal and illegal transactions have led to conflicting and ineffective judicial rulings. Early success by government agencies in prosecuting pyramid schemes morphed into consistent failure and eventual abandonment.

A. *The Nutrilite Problem*

In 1945, the future Rehnborg had planned for Nutrilite was quickly seeming out of reach. A recent advertising consultation had failed to produce new customers, and Nutrilite had yet to differentiate itself from the multitude of other vitamin companies.¹³¹ Casselberry and Mytinger saw their opportunity to present their multi-level marketing plan to Rehnborg and, with a slight twist, a way to become wealthy

¹²⁴ Sutherland, *supra* note 102, at 45–46; Jo Irigoyen, *Handling OBJECTIONS & How to OVERCOME Them*, YOUTUBE, at 22:35 (June 18, 2020), <https://www.youtube.com/watch?v=0nq9MpUjevww>.

¹²⁵ LEFF, *supra* note 121, at 28.

¹²⁶ *Id.*

¹²⁷ *Id.* at 111.

¹²⁸ Federal Trade Commission Act, ch. 311, 38 Stat. 717 (1914). Section 5 of the FTCA prohibits unfair methods of competition and unfair or deceptive practices involving commerce. 15 U.S.C. § 45.

¹²⁹ Clayton Act, ch. 323, 38 Stat. 730 (1914). The Clayton Act is a part of the foundation of U.S. antitrust law. See *The Antitrust Laws*, FED. TRADE COMM’N, <https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/antitrust-laws> (last visited Mar. 6, 2023). Pyramid schemes are often caught up in the Act’s ban on price discrimination, exclusive dealings, and product tying. See 15 U.S.C. §§ 13, 14.

¹³⁰ Federal Food, Drug, and Cosmetic Act, ch. 675, 52 Stat. 1040 (1938). The FDCA forbids the altering or misbranding of food, drugs, devices, tobacco, or cosmetic products involved in interstate commerce. 21 U.S.C. § 331(b). Many MLM companies traffic in these kinds of goods and can be sanctioned for the mismarketing of their products. See Groß & Vriens, *supra* note 102, at 333, 335 tbl.1.

¹³¹ FITZPATRICK, *supra* note 47, at 43.

in the process. Their offer to Rehnberg required Nutrilite to sign an exclusive distribution agreement with Mytinger & Casselberry, Inc. (M&C).¹³² This new company would promote, organize, and run the new MLM business. Rehnberg reluctantly agreed, and in September 1945, M&C took control of distribution for Nutrilite.¹³³ The new model was wildly successful and launched Nutrilite onto the national stage, simultaneously attracting the attention of the federal government.

In October 1948, the Food and Drug Administration (FDA) seized significant quantities of Nutrilite's marketing materials and inventory.¹³⁴ The FDA accused Nutrilite of misbranding under § 502(a) of the FDCA.¹³⁵ M&C wrote, published, and distributed a booklet called *How To Get Well and Stay Well*, which the FDA claimed made significant, unsubstantiated claims related to health.¹³⁶ The 58-page booklet provided information on the relationship between vitamins, nutrition, and disease, while making claims that Nutrilite could cure everything from minor ailments to cancer and Parkinson's Disease.¹³⁷ The lengthy litigation that ensued included ten misbranding cases and a FDCA enforcement action brought against M&C and Nutrilite.¹³⁸ In addition, M&C brought suit in the District of Columbia to enjoin the United States government from prosecuting M&C's misbranding allegations and test the constitutionality of the FDCA.¹³⁹ M&C's case went all the way to the Supreme Court, where they lost.¹⁴⁰ In April 1951, the litigation ended with the entry of a consent decree requiring Nutrilite and its distributors to include accurate labels on their products, remake their marketing materials, and refrain from making unsubstantiated health claims.¹⁴¹

In 1957 the FTC filed a complaint targeting M&C's direct sales structure.¹⁴² The FTC found M&C in violation of § 5 of the FTCA for "unfair methods of

¹³² *Id.* at 47, 123.

¹³³ *Id.* at 123; Mytinger & Casselberry, Inc., [1951] D.D.N.J. (Fed. Sec. Agency) No. 3383, at 354, 366 (S.D. Cal. 1949) (complaint to enjoin and restrain interstate shipment of Nutrilite Food Supplement).

¹³⁴ FITZPATRICK, *supra* note 47, at 47; Mytinger & Casselberry, Inc. v. Ewing, 87 F. Supp. 650, 655 (D.D.C. 1949); *Court Validates Seizure of Drugs*, N.Y. TIMES, May 30, 1950, at L25.

¹³⁵ 21 U.S.C. § 352(a); Mytinger & Casselberry, Inc., [1951] D.D.N.J. (Fed. Sec. Agency) No. 3383, at 368.

¹³⁶ Mytinger & Casselberry, Inc., [1951] D.D.N.J. (Fed. Sec. Agency) No. 3383, at 356, 361–65.

¹³⁷ *Id.* at 357, 361, 363–65.

¹³⁸ Mytinger & Casselberry, Inc., [1951] D.D.N.J. (Fed. Sec. Agency) No. 3381; Mytinger & Casselberry, Inc., [1951] D.D.N.J. (Fed. Sec. Agency) No. 3383.

¹³⁹ Mytinger & Casselberry, Inc., [1951] D.D.N.J. (Fed. Sec. Agency) No. 3382.

¹⁴⁰ *See* Ewing v. Mytinger & Casselberry, Inc., 339 U.S. 594 (1950).

¹⁴¹ Mytinger & Casselberry, Inc., [1951] D.D.N.J. (Fed. Sec. Agency) No. 3383, at 356, 369–71 (consent decree granting injunction).

¹⁴² Mytinger & Casselberry, Inc., 57 F.T.C. 717 (1960).

competition and unfair acts and practices,” and § 3 of the Clayton Act for business practices that “substantially lessen competition in the line of commerce.”¹⁴³ The administrative law judge (ALJ), the FTC, and the U.S. Court of Appeals for the District of Columbia Circuit all agreed that M&C violated both Acts.¹⁴⁴

M&C’s business practices were found to substantially lessen industry competition through restrictive contracts with their distributors. The M&C distributor application had a clause providing that applicants would “not sell, give away, or otherwise distribute any other vitamin and/or mineral products” while distributing Nutrilite, and would not “use or disclose . . . any information . . . concerning the names and/or addresses of Nutrilite customers, or any other trade secrets, nor . . . solicit or . . . induce Nutrilite customers to purchase any other vitamin . . . product or to cease using Nutrilite” for two years after termination of their association with M&C.¹⁴⁵ The ALJ found that, under the Supreme Court ruling in *Standard Oil Co. of California v. United States*,¹⁴⁶ business organizations who “enjoy[] a powerful, though clearly not dominant, position in the trade,” and use contractual provisions to maintain their power and market share are in violation of the exclusive dealing prohibition under § 3 of the Clayton Act.¹⁴⁷

Finding the actions that violated § 3 of the Clayton Act to also violate § 5 of the FTCA would be easily understandable. Instead, the ALJ looked past the restrictive contracts and reviewed M&C’s methods of enforcing the agreements.¹⁴⁸ M&C testified that they enforced the exclusivity clause of their contracts through various forms of intimidation and litigation.¹⁴⁹ The ALJ found that M&C’s intimidation and litigation tactics were detrimental to competitors; obstructed, hindered, and prevented competition in the market; and rendered distributors’ interest secondary to M&C’s interest. M&C’s zealous enforcement of the exclusivity clause led the judge to find them in violation of § 5 of the FTCA.¹⁵⁰

While M&C appealed the ALJ’s decision, in 1962 the U.S. Court of Appeals for the District of Columbia Circuit upheld the final order.¹⁵¹ The FDA and FTC saw the danger a company like Nutrilite posed to legal businesses and targeted the

¹⁴³ *Id.* at 728–29 (first citing 15 U.S.C. § 45; and then citing 15 U.S.C. § 14).

¹⁴⁴ *Id.* at 728–29, 741–42; *Mytinger & Casselberry, Inc. v. Fed. Trade Comm’n*, 301 F.2d 534 (D.C. Cir. 1962).

¹⁴⁵ *Mytinger & Casselberry, Inc.*, 57 F.T.C. at 722.

¹⁴⁶ *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 301, 302 (1949).

¹⁴⁷ *Mytinger & Casselberry, Inc.*, 57 F.T.C. at 728 (quoting *Dictograph Prods., Inc. v. Fed. Trade Comm’n*, 217 F.2d 821, 827 (2d Cir. 1954)).

¹⁴⁸ *Id.* at 729.

¹⁴⁹ *Id.* at 724.

¹⁵⁰ *Id.* at 729.

¹⁵¹ *Mytinger & Casselberry, Inc. v. Fed. Trade Comm’n*, 301 F.2d 534 (D.C. Cir. 1962).

crucial components of the new venture. Case law now addressed the anticompetition and misleading marketing trends that were integral to Nutrilite's success.

B. Another Win for the FTC with Holiday Magic

The direct selling industry grew by over a million dollars during the Nutrilite litigation.¹⁵² Nutrilite's early success with the MLM model highlighted the ease of which founders and early adopters of the structure could make money. The FTC's victory gave the government a blueprint for bringing the predatory businesses into line and potentially ending the model for good. Holiday Magic, Inc. (Holiday Magic), based out of California, would give the FTC a chance to prove that MLM models are pyramid schemes. On January 18, 1971, the FTC filed a complaint against the company, the chairman of the board (who was the company's founder, William Penn Patrick), the president, and the vice president, alleging unfair trade practices for "operating a marketing plan in the nature of a lottery, price discrimination, marketing and price control, deception, and misrepresentations."¹⁵³ The complaint took six months to write between the investigation and copious feedback from within the agency.¹⁵⁴ The hearings took around 75 days, scattered over two years, producing over 10,000 pages of transcripts and over 900 exhibits.¹⁵⁵ The initial decision would go on to take up over 200 pages in the *Federal Trade Commission Decisions* volume.¹⁵⁶

When William Penn Patrick founded Holiday Magic, he used Nutrilite's MLM model but took it a step further. Distributors for Holiday Magic were able recruit new distributors into positions below them, at the same level or potentially above them. Holiday Magic had four levels of distributors: base level, second level, third level, and top.¹⁵⁷ The first level's purpose was to buy products from their up-line and sell them to the consumer.¹⁵⁸ This level of distributor could not recruit other distributors, nor could it buy directly from Holiday Magic. The price at which each level bought the product, and the price the product sold for, was preset by Holiday Magic.¹⁵⁹ The second level could sell product to end-users or first-level

¹⁵² U.S. BUREAU OF THE CENSUS, 1948 CENSUS OF BUS. vol. 1, pt. 1, at 18 (1948); U.S. BUREAU OF THE CENSUS, 1954 CENSUS OF BUS. vol. 1, pt. 1, at 18.

¹⁵³ Holiday Magic, Inc., 84 F.T.C. 748, 763 (1974); *F.T.C. Alleges Deception by a Cosmetics Concern*, N.Y. TIMES, July 3, 1970, at L25.

¹⁵⁴ The Dream, *Lazy, Stupid, Greedy or Dead*, LITTLE EVERYWHERE & WITNESS DOCS, at 9:30 (Oct. 2018) (downloaded using Spotify).

¹⁵⁵ *Holiday Magic Inc.*, 84 F.T.C. at 763.

¹⁵⁶ See generally *id.*

¹⁵⁷ *Id.* at 751, 774.

¹⁵⁸ *Id.* at 774.

¹⁵⁹ *Id.* at 808–09.

distributors *that they recruited*.¹⁶⁰ Second and third level distributors could recruit people into the first, second or third level of the pyramid.¹⁶¹ Recruits continually bought their product from their recruiters, creating a profitable upline, until they reached the top level and were able to break away. To break away from one's upline, third-level participants had to pay a fee to the distributor who recruited them and *recruit a third-level participant to replace them*.¹⁶²

The ALJ determined that this model was "a device calculated to appeal to the gambling instinct" of consumers.¹⁶³ Gambling does not violate 15 U.S.C. § 45 but running a lottery does.¹⁶⁴ The administrative court analyzed the three elements that separate a lottery from a game of chance: prize, consideration, and chance.¹⁶⁵ The findings for prize and consideration were obvious. Distributors received more money in commissions and bonuses the higher a position they obtained, and with each position they had to pay fees or purchase product. Further, the ALJ found that the "element of chance is present in abundance in the Holiday Magic scheme."¹⁶⁶ The prizes of higher commissions and bonuses were outside the control of the distributors; therefore, a distributor likely could not join the scheme for the opportunity of entering into the cosmetic selling business.¹⁶⁷ Distributors instead were signing up with the motivation of trying to win the lottery.

On October 15, 1974, the FTC adopted the ALJ's opinion with few changes.¹⁶⁸ Holiday Magic's attorneys heavily objected to the ALJ's finding that their marketing plan was "inherently' deceptive."¹⁶⁹ The FTC admonished Holiday Magic, finding that the marketing plan had a foreseeable and "intolerable potential to deceive" distributors, and asserting "[t]o say that [the marketing plan] is 'inherently' deceptive is to say no more than that it contains this intolerable potential to deceive, and on those grounds as well the plan requires condemnation."¹⁷⁰ The FTC's belief in the inherent deception of the marketing plan and Holiday Magic's responsibility for it led them to add an additional order that would devastate the

¹⁶⁰ *Id.* at 776.

¹⁶¹ *Id.* at 774, 776.

¹⁶² *Id.* at 783–85.

¹⁶³ *Id.* at 968.

¹⁶⁴ *See id.* at 967–68; *Hofeller v. Fed. Trade Comm'n*, 82 F.2d 647, 649–50 (7th Cir. 1936); *Maltz v. Sax*, 134 F.2d 2, 4 (7th Cir. 1943).

¹⁶⁵ *Holiday Magic Inc.*, 84 F.T.C. at 968–69.

¹⁶⁶ *Id.* at 769.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 1065.

¹⁶⁹ *Id.* at 1037.

¹⁷⁰ *Id.*

company. They banned Holiday Magic, as well as the president and vice president,¹⁷¹ from ever being involved, directly or indirectly, with any MLM scheme.¹⁷²

By the end of 1974, the FTC had taken down two of the largest MLM companies in the United States. FTC attorneys had gained valuable precedent and insight into MLM schemes' deceptive structure, market-suppressing tendencies, and deceitful marketing and recruitment tactics. Holiday Magic and high-ranking officers of the company faced actions by state governments, consumers, and the U.S. Securities and Exchange Commission, leading the company to eventually file for bankruptcy.¹⁷³ Bankruptcy would not end the impact Holiday Magic had on the MLM industry, as many distributors had discovered the profitability of the MLM structure and would strike out on their own. The direct sales industry grew by almost 60% between 1967 and 1972,¹⁷⁴ but the FTC's win with Holiday Magic would soon take effect.

C. *MLM's Near-Death Experience with Koscot Interplanetary*

Glenn Turner started out as a distributor with Holiday Magic before founding Koscot Interplanetary, Inc. (Koscot) in 1967.¹⁷⁵ Koscot, a Florida company, manufactured and distributed mink-oil-based makeup through an MLM system.¹⁷⁶ Turner became a national icon through the operation of Koscot and his other MLM company, Dare to Be Great. He was known for helping the less fortunate and creating jobs for differently-abled individuals.¹⁷⁷ Koscot's structure was remarkably similar to Holiday Magic's, including a model in which recruits were able to buy in to higher levels of distribution. On May 24, 1972, the FTC filed a complaint against Koscot,¹⁷⁸ and in August 1972, Florida law enforcement arrested Turner for criminal violations of Florida's securities law.¹⁷⁹

The ALJ reprimanded Koscot and its officers for the operation of an MLM

¹⁷¹ Founder and chairman of the board, William Penn Patrick, died shortly before the hearing on this decision in a small plane crash near his California property. *William Patrick Is Killed in California Air Crash*, N.Y. TIMES, June 10, 1973, at L22.

¹⁷² *Holiday Magic Inc.*, 84 F.T.C. at 1065–66; *U.S. Order Restrains Holiday Magic on Pyramiding*, N.Y. TIMES, Apr. 3, 1974, at L62.

¹⁷³ Arnold H. Lubasch, *4 in Holiday Magic Inc. Indicted in Alleged Fraud*, N.Y. TIMES, July 2, 1976, at D3.

¹⁷⁴ U.S. BUREAU OF THE CENSUS, 1972 CENSUS OF RETAIL TRADE, vol. I, at 70–71 tbl.9 (1976).

¹⁷⁵ Wayne King, *Glenn Turner: A Franchiser with Flamboyance*, N.Y. TIMES, Jan. 13, 1972, at L59; Harry M. Cochran, Jr., *Dare to Be Great, Inc!: A Case Study of Pyramid Sales Plan Regulation*, 33 OHIO ST. L.J. 676, 704 (1972).

¹⁷⁶ King, *supra* note 175, at L59.

¹⁷⁷ Thomas Thompson, *The Dare-to-Be-Great Man*, LIFE, May 28, 1971, at 68, 73–74.

¹⁷⁸ *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106 (1975).

¹⁷⁹ Associated Press, *Florida Arrests Glenn Turner*, N.Y. TIMES, Aug. 31, 1972, at L45.

company and highlighted the FTC's view that all MLM schemes were illegal.¹⁸⁰ In its subsequent opinion, the FTC went on to articulate the elements of these illegal MLM schemes, writing:

Such schemes are characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users. In general such recruitment is facilitated by promising all participants the same "lucrative" rights to recruit.¹⁸¹

The FTC took particular issue with the promise of never-ending recruitment when it is mathematically impossible. At some point a market would become saturated, and recruits would be unable to discern how saturated it was until they bought into the fraud. Market saturation is easily predictable and controllable, yet Koscot refused to inform distributors or prevent the saturation. In fact, Koscot rewarded participants for recruitment regardless of a distributor's sales of the product to an end user.¹⁸² The FTC took issue with this deceptive practice, stating that the MLM structure led to the inevitably deceptive practice of promising recruits the ability to "recoup [their] investment by means of inducing others to invest," because "these schemes . . . do not allow recovery of investments by means of retail sales . . . [and show] that there is very little positive value to be lost by not allowing such schemes to get started in the first place."¹⁸³

During the hearings, the FTC attorneys showed that Turner was not only deceptive, but also that he was aware of the illegality of the MLM system. In depositions of participants close to Turner, they recalled his strategy to continuously open up new MLM schemes "faster than the [g]overnment could shut [them] down."¹⁸⁴ Turner made this promise to distributors who feared losing money in the prosecution of the scheme. Turner also structured his ownership to try to protect himself and facilitate the creation of new MLMs. Turner created a parent company, Glenn W. Turner Enterprises, Inc., to own both Koscot and Dare to be Great.¹⁸⁵ In the end, all three of Turner's companies were tied up in significant litigation by both the federal and state governments.¹⁸⁶

¹⁸⁰ *Koscot Interplanetary, Inc.*, 86 F.T.C. at 1129 (citing *Holiday Magic, Inc.*, 84 F.T.C. 748, 1036-39 (1974)).

¹⁸¹ *Id.* at 1180 (emphasis omitted).

¹⁸² *Id.* at 1180-81.

¹⁸³ *Id.* at 1181.

¹⁸⁴ *Id.* at 1152.

¹⁸⁵ King, *supra* note 175, at 59.

¹⁸⁶ Associated Press, *Koscot Creditors Rebuffed by Order*, N.Y. TIMES, June 12, 1975, at L6; Associated Press, *Koscot and Turner Cited in Complaint Filed by the S.E.C.*, N.Y. TIMES (Sept. 14, 1972), <https://www.nytimes.com/1972/09/14/archives/koscot-and-turner-cited-in-complaint-filed>

Today, the FTC still points to the *Koscot* opinion as the basic test for determining if an MLM is legal.¹⁸⁷ While the law has changed little since the *Koscot* opinion, this decision changed the history of direct selling. Between 1972 and 1977, the direct sales industry plummeted by over a billion dollars.¹⁸⁸ The U.S. GDP, on the other hand, increased by over 60%,¹⁸⁹ showing that MLM companies are not integral to the success of the economy. MLM schemes do not create legitimate new business; instead, they just move money from the bottom of the pyramid to the top.

D. *The Amway Bombshell*

The FTC had been moving from success to success since taking on Nutrilite in the late 1940s and 1950s. With its victories against Holiday Magic and Koscot, which ultimately led the companies to file for bankruptcy, the FTC felt confident that they could finally take down the biggest MLM company in the United States—Amway.¹⁹⁰ Amway originated as the American Way Foundation in 1959 when Richard DeVos and Jay Van Andel decided to diversify their Nutrilite distribution network due to concern surrounding Nutrilite’s legal troubles.¹⁹¹ Their plan quickly took off, and in the 1970s they opened distribution networks in Australia, the United Kingdom, Germany, and China.¹⁹² On March 25, 1975, the FTC filed a complaint alleging that Amway and its founders were in violation of § 5 of the FTCA.¹⁹³ The FTC believed Amway to be engaging in price fixing, unfair trade practices related to the distribution of product, unfair trade practices related to restrictive marketing, and misrepresentations related to the “business opportunity” and its profitability.¹⁹⁴ The final order in this matter was not issued until May

by-the-sec.html; Associated Press, *supra* note 179, at L55; Joseph F. Sullivan, ‘*Dare to Be Great’ Losers Are Reimbursed in Jersey*, N.Y. TIMES (Mar. 14, 1973), <https://www.nytimes.com/1973/03/14/archives/-dare-to-be-great-losers-are-reimbursed-in-jersey.html>.

¹⁸⁷ See *Business Guidance Concerning Multi-Level Marketing*, FED. TRADE COMM’N (Jan. 2018), <https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing>.

¹⁸⁸ U.S. BUREAU OF THE CENSUS, *supra* note 174, at 70 tbl.9 (1976); U.S. BUREAU OF THE CENSUS, 1982 CENSUS OF RETAIL TRADE, vol. 1, at 6 tbl.2 (1984) [hereinafter 1982 CENSUS OF RETAIL TRADE].

¹⁸⁹ GDP (Current US\$)—United States, WORLD BANK, <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=1977&locations=US&start=1972> (last visited Apr. 23, 2023).

¹⁹⁰ The Dream, *supra* note 154, at 24:32.

¹⁹¹ *Amway in the 1970s*, *supra* note 104; Robert FitzPatrick, *Myth of Direct Selling Blinds the Bulls and Believers at Herbalife*, NASDAQ (Dec. 1, 2014, 1:03 AM), <https://www.nasdaq.com/articles/myth-direct-selling-blinds-bulls-and-believers-herbalife-2014-12-01>.

¹⁹² Stefania Palmisano & Nicola Pannofino, *It Isn’t Just About the Money: The Implicit Religion of Amway Corporation*, 16 IMPLICIT RELIGION 27, 30 (2013).

¹⁹³ Amway Corp., 93 F.T.C. 618, 618–29 (1979); 15 U.S.C. § 45.

¹⁹⁴ Amway Corp., 93 F.T.C., at 620–29.

1979.¹⁹⁵

Amway's compensation plan was set up similarly to those of Koscot and Holiday Magic. Distributors at the top of their respective chains would deal directly with Amway, while their downlines would order through them. The FTC used the logic developed in *Koscot* and *Holiday Magic*, stating that the MLM structure "has had, and continues to have, the capacity and tendency to mislead distributors, dealers and prospective participants" and is therefore illegal.¹⁹⁶ The ALJ disagreed with the FTC's interpretation of *Koscot* and *Holiday Magic*, instead finding that "entrepreneurial chains" are illegal and problematic when the company is "in the business of selling distributorships."¹⁹⁷

What makes a company "in the business of selling distributorships" remains unclear. Each time the FTC raised an argument in support of Amway's malfeasance, Amway responded with a company policy that negated the illegal effect of a pyramid scheme. In response to the allegation of distributors profiting off recruit's entry fees, Amway said it did not require a large investment to become a distributor, but rather only a small purchase of \$15.60.¹⁹⁸ In response to the accusation that there were minimal sales of inventory to those outside the company, Amway cited its "ten-customer" rule. Distributors could not receive any bonus until they sold product to at least 10 different non-distributor customers.¹⁹⁹ When pressured on inventory loading, Amway countered with its buyback policy for unsold and unopened inventory, and its requirement that distributors sell at least 70% of their inventory before they can place another order.²⁰⁰ While Amway offered these policies as support for it not being an illegal MLM scheme, it did not offer any evidence that these policies were effective or enforced. The ALJ took Amway's word at face value when deciding this matter.²⁰¹

Many have questioned how this decision was reached when it is in complete opposition to FTC precedent. The primary theory is that Amway's founders were able to politically pressure the FTC.²⁰² At the time of the decision, DeVos was the national finance chair of the GOP and Van Andel was the chairman of the chamber of commerce.²⁰³ DeVos was a staunch supporter of President Ronald Reagan and

¹⁹⁵ *Id.* at 735.

¹⁹⁶ *Id.* at 628.

¹⁹⁷ *Id.* at 699 (citing *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1140, 1180 (1975)).

¹⁹⁸ *Id.* at 700. Today this amount would equal around \$82.

¹⁹⁹ *Id.* at 646.

²⁰⁰ *Id.* at 679–80.

²⁰¹ The Dream, *supra* note 154, at 41:55.

²⁰² See FITZPATRICK, *supra* note 47, at 149.

²⁰³ *Id.*

was responsible for raising \$46.5 million for the 1980 election cycle.²⁰⁴ Since winning the case, DeVos and Van Andel have pushed for MLM companies and their leadership to get involved in politics.²⁰⁵ In January 1984, after giving the State of the Union address to Congress, President Reagan flew to Atlanta, Georgia, to speak at an Amway convention that was hastily rebranded as a “Spirit of America—Salute to Free Enterprise” rally.²⁰⁶

While President Reagan would speak highly of the Amway distributors at the conference, Amway’s win against the FTC gave MLM companies the legitimacy they needed to gain a true foothold in the United States. The industry boomed and sales increased by 42% between 1977 and 1982.²⁰⁷ The decision made protecting the public from MLM schemes difficult for the FTC, regardless of their predatory tactics. The difficulty in prosecuting MLM companies has become a recruiting tactic for distributors, with them being the first to point out that pyramid schemes are illegal.²⁰⁸ They quickly follow this statement with the condition that since MLM companies are still in operation, then they must be legitimate businesses.²⁰⁹ The legacy of the *Amway* decision would be its bolstering of the mask of legitimacy that MLM schemes already hide behind.

E. *FTC Decisions and Guidance Post-Amway*

The *Amway* decision left the FTC without a clear path forward. While the *Koscot* test is still valid law, the *Amway* exceptions muddied the water. Prior to *Amway*, the *Koscot* test was fairly easy and straightforward; now the FTC also must show that the MLM scheme in question does not qualify for any *Amway* exceptions.²¹⁰ The FTC did not file another complaint against an MLM company until 1996,

²⁰⁴ *Id.*

²⁰⁵ The Dream, *The American Way*, LITTLE EVERYWHERE & WITNESS DOCS, at 2:50 (Nov. 2018) (downloaded using Spotify).

²⁰⁶ Dale Russakoff & Juan Williams, *Rearranging ‘Amway Event’ for Reagan*, WASH. POST (Jan. 22, 1984), <https://www.washingtonpost.com/archive/politics/1984/01/22/rearranging-amway-event-for-reagan/b3e74482-5ce0-4d20-9f98-ebdc9b4d4918/>; Reagan Foundation, *President Reagan’s Remarks at a Spirit of America Rally in Atlanta, Georgia – 1/26/84*, YOUTUBE (June 15, 2010), https://www.youtube.com/watch?v=IzazVguX_1I.

²⁰⁷ 1982 CENSUS OF RETAIL TRADE, *supra* note 188, at 6 tbl.2.

²⁰⁸ Casey Bond, *9 Signs that Exciting New Job Opportunity Is Really an MLM Scam*, HUFFPOST, https://www.huffpost.com/entry/job-opportunity-mlm-scam-pyramid-scheme_l_5e30c62ec5b6e8375f647a5e (Dec. 16, 2021).

²⁰⁹ *Id.*

²¹⁰ *See, e.g.*, *Bostick v. Herbalife Int’l of Am. Inc.*, No. CV 13-02488, 2013 WL 12131732, at *4 (C.D. Cal. Oct. 11, 2013).

when it went after Fortuna Alliance, LLC.²¹¹ Since then, the FTC has filed 31 complaints against MLM companies.²¹² Only a handful of these cases went to trial, while the rest settled fairly quickly.²¹³

The FTC's guidance to MLM companies and consumers has not changed much since the *Amway* decision. In 2004, the Direct Selling Association—the lobbying body of the MLM industry—requested that the FTC issue an advisory opinion clarifying the role of internal consumption within MLM companies.²¹⁴ Many cases leading up to 2004 had focused on the lack of product movement to the general public, accusing companies of hiding sales within the umbrella of “internal consumption.”²¹⁵ The FTC clarified that the problem with the MLM companies targeted by recent FTC actions was that the majority of product consumption happened by distributors, not the public. Most products ended up with the distributor who bought it; therefore, those who profit are doing so because of those “who are themselves making payments in order to obtain their own profit.”²¹⁶ This kind of gain would not qualify as a legitimate business under the *Amway* exception, as the distributor's profit is not from the sale of merchandise to end users.

In 2018, after settlements with Herbalife, Vemma Nutrition Co., and Fortune Hi-Tech Marketing, Inc.,²¹⁷ the FTC issued business guidance for MLM companies.²¹⁸ The FTC reminded businesses that the *Koscot* test was still the prevailing law used to determine if an MLM company is operating illegally.²¹⁹ It stressed that the most important aspect of legal MLM models is that “compensation . . . is based on actual sales to real customers, rather than based on mere wholesale purchases or other payments by its participants.”²²⁰ The FTC also provided guidance on how to

²¹¹ See *FTC Pyramid Cases Post-Amway*, TRUTH IN ADVERT., <https://www.truthinadvertising.org/ftc-pyramid-cases-by-the-numbers/> (June 2, 2022).

²¹² *Id.*

²¹³ *Id.*

²¹⁴ Letter from James A. Kohm, Acting Dir. Mktg. Pracs., Fed. Trade Comm'n, to Neil H. Offen, President, Direct Selling Ass'n (Jan. 14, 2004), available at https://www.ftc.gov/system/files/documents/advisory_opinions/staff-advisory-opinion-pyramid-scheme-analysis/040114_bizopp-pyramid.pdf.

²¹⁵ *Id.*

²¹⁶ *Id.*

²¹⁷ *FTC Sends Checks to Nearly 350,000 Victims of Herbalife's Multi-Level Marketing Scheme*, *supra* note 7; *Vemma Agrees to Ban on Pyramid Scheme Practices to Settle FTC Charges*, FED. TRADE COMM'N (Dec. 15, 2016), <https://www.ftc.gov/news-events/news/press-releases/2016/12/vemma-agrees-ban-pyramid-scheme-practices-settle-ftc-charges>; *FTC Settlement Bans Pyramid Scheme Operators from Multi-Level Marketing*, FED. TRADE COMM'N (May 13, 2014), <https://www.ftc.gov/news-events/news/press-releases/2014/05/ftc-settlement-bans-pyramid-scheme-operators-multi-level-marketing>.

²¹⁸ *Business Guidance Concerning Multi-Level Marketing*, *supra* note 187.

²¹⁹ *Id.*

²²⁰ *Id.*

prevent deceptive representations by stating that “[a] company must have a reasonable basis for the claims it makes or disseminates” and a company should avoid the use of hypotheticals that are not supported by the company’s data.²²¹

The FTC has also maintained a page titled “Multi-Level Marketing Businesses and Pyramid Schemes” designed to help the average person determine if an MLM company is the right opportunity for them. The defining fact the FTC uses to separate illegal MLM schemes from legal ones is “[i]f the MLM is not a pyramid scheme, it will pay you based on your sales to retail customers, without having to recruit new distributors.”²²² The page warns potential recruits to look for four warning signs: (1) extravagant promises about earning potential, (2) an emphasis on recruiting new distributors, (3) emotional manipulation and high-pressure sales tactics, and (4) inventory loading by current distributors.²²³

The FTC’s ability to effectively prosecute MLM companies took a hit in 2021 with the Supreme Court decision in *AMG Capital Management*.²²⁴ In 1973, Congress amended the FTCA to include § 13(b) which granted the FTC the ability to seek injunctive relief in federal court when the FTC has reason to believe that “any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission.”²²⁵ Courts quickly interpreted this to mean the FTC could seek other kinds of equitable relief to “redress injury resulting from consumer frauds.”²²⁶ Since the late 1970s, § 13(b) has been the FTC’s primary form of litigation and it has allowed them to be part of multidistrict litigation efforts,²²⁷ as well as skip the administrative adjudication process, which often leads back to federal court.²²⁸ Of the 31 complaints the FTC filed against MLM companies since 1996, 30 of them were filed in federal court under their

²²¹ *Id.*

²²² *Multi-Level Marketing Businesses and Pyramid Schemes*, FED. TRADE COMM’N CONSUMER ADVICE (May 2021), <https://consumer.ftc.gov/articles/multi-level-marketing-businesses-pyramid-schemes>.

²²³ *Id.*

²²⁴ *AMG Cap. Mgmt., L.L.C. v. Fed. Trade Comm’n*, 141 S. Ct. 1341, 1352 (2021).

²²⁵ Act of Nov. 16, 1973, Pub. L. No. 93-153, sec. 408(f), § 13(b), 87 Stat. 576, 592 (codified as amended at 15 U.S.C. § 53(b)).

²²⁶ David M. FitzGerald, *The Genesis of Consumer Protection Remedies Under Section 13(b) of the FTC Act*, Paper at the FTC 90th Anniversary Symp., at 1–2 (Sept. 23, 2004); see, e.g., *Fed. Trade Comm’n v. Think Achievement Corp.*, 312 F.3d 259, 262 (7th Cir. 2002); *Fed. Trade Comm’n v. Va. Homes Mfg. Corp.*, 509 F. Supp. 51, 59 (D. Md. 1981).

²²⁷ See, e.g., Federal Trade Commission’s Final Status Report on Consumer Compensation, *In re Volkswagen “Clean Diesel” Mktg., Sales Pracs. & Prod. Liab. Litig.*, M.D.L. No. 2672 (N.D. Cal. July 27, 2020); see also *Stipulated Order for Permanent Injunction and Monetary Judgment at 12–27*, *Fed. Trade Comm’n v. Equifax Inc.*, No. 1:19-cv-03297 (N.D. Ga. July 23, 2019).

²²⁸ See FitzGerald, *supra* note 226, at 2–3.

§ 13(b) power.²²⁹ The outlying complaint was filed in an administrative proceeding.²³⁰ The removal of this strategy going forward will severely cripple the FTC's ability to pressure MLM companies into effective settlement agreements. ALJs will be forced to grapple with the confusing and contradictory *Koscot* and *Amway* decisions, which will likely lead to more confusing and complex case law. It is doubtful that MLM companies will feel the pressure to settle when faced with an administrative adjudication, as they garner less national press coverage and can take years to reach a final decision.²³¹ In addition to these factors, the FTC only has approximately 1,120 full-time equivalent employees (FTEs),²³² with only five FTEs assigned to the Office of Administrative Law Judges.²³³ These employees are stretched thin, as the FTC is tasked with the enforcement of over 70 laws.²³⁴

Case law post-*Amway* has not produced notable changes. Instead, the FTC has been pursuing small-to-medium sized MLM companies that possess obvious, stereotypical pyramid scheme tropes. Each MLM investigation takes considerable time to research and prepare, as each MLM scheme must be individually evaluated.²³⁵ The FTC has used the smaller cases to clarify the *Amway* decision and chart a path forward. While the *Koscot* test is still the gold standard of conduct that will draw the attention of the FTC, the FTC has indicated that it will also examine three additional areas: (1) the end purchaser of the product, (2) the compensation structure, and (3) the participant experience.²³⁶

V. APPLICATION OF THE LEGAL STANDARD TO THE MLM MODEL

One of the reasons the MLM model is so popular with direct selling companies is its adaptability. Each company can choose (1) how to compensate their distributors, (2) at what rates, and (3) how to incentivize them to sell. The ability of these

²²⁹ See *id.* at 2; *FTC Pyramid Cases Post-Amway*, *supra* note 211.

²³⁰ See Complaint, *In re Schmidt*, No. C-3834 (Fed. Trade Comm'n July 14, 1998), <https://www.ftc.gov/system/files/documents/cases/980714kalvinschmidtcmpt.pdf>.

²³¹ Both *Koscot* and *Amway* took multiple years to adjudicate. *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106 (1975) (over three years); *Amway Corp.*, 93 F.T.C. 618 (1979) (over four years).

²³² While FTE means there may be more individual employees, in 2021, the employees worked the number hours equivalent to 1,123 full time employees in total. The FTC has not had more than 1,200 FTE employees since 1985. *FTC Appropriation and Full-Time Equivalent (FTE) History*, FED. TRADE COMM'N, <https://www.ftc.gov/about-ftc/bureaus-offices/office-executive-director/financial-management-office/ftc-appropriation> (last visited Apr. 20, 2023).

²³³ FED. TRADE COMM'N, FISCAL YEAR 2021 CONGRESSIONAL BUDGET JUSTIFICATION 143 (2022).

²³⁴ *Enforcement*, FED. TRADE COMM'N, <https://www.ftc.gov/enforcement> (last visited Apr. 20, 2023).

²³⁵ *Business Guidance Concerning Multi-Level Marketing*, *supra* note 187.

²³⁶ *Id.*

companies to customize the model also makes the litigation of MLM schemes exceptionally time consuming and difficult. While each MLM may be slightly different in operation, there are five core elements that are always present: (1) MLM schemes have a product or service they sell through independent distributors; (2) distributors can sell the product and recruit other distributors; (3) distributors are organized into multiple “levels” and receive compensation based on their level; (4) distributors have to pay-to-play, with the initiation payment often including the purchase of product; and (5) there is no limit to the number of people a distributor can recruit.²³⁷ These five elements make it impossible for any MLM scheme to be legal under the *Koscot* test and the more recent FTC guidance.

The MLM model meets the requirements of the *Koscot* test. To enter the scheme, participants usually must order a starter pack of product to sell.²³⁸ The purchase of the starter pack or payment of any entry fee in exchange for the right to sell the company’s products meets the first element of the *Koscot* test. MLM schemes use the “levels” of their distributors to determine the amount of compensation they will receive. Distributors may receive one-time achievement bonuses, higher percentage earnings, rank advancement bonuses, generational bonuses, and a percentage of the sales from their downline.²³⁹ Under the second element of the *Koscot* test, any compensation received that is not directly attributable to the sale of merchandise—including one-time bonuses—are program rewards clearly not based on the sale of product to ultimate users. As the ALJ in *Koscot* determined, the MLM model meets the elements of an illegal pyramid recruitment scheme.²⁴⁰

In analyzing the *Amway* exceptions of internal consumption, compensation structure, participant experience, and overall operation, the MLM model fails here as well. MLM and pyramid schemes require the constant influx of new participants to remain active. MLM schemes thus promote recruitment as the primary way to earn income. Since every market has a finite number of customers, distributors are logically going to start recruiting the customers they sell to because customers are familiar with and like the product. For each end user recruited to join the scheme, more of the MLM product is consumed internally. This high quantity of internal consumption means that less of the product is reaching the public, and distributors at the bottom of the pyramid are paying those at the top. This leads to a massive redistribution of wealth from those at the bottom of the pyramid to those at the top, violating the *Amway* exceptions.²⁴¹

²³⁷ TAYLOR, *supra* note 15, ch. 2, at 26 tbl.1.

²³⁸ *Things to Know Before Joining a Multilevel Marketing Business*, RINCKER L. (Aug. 1, 2021), <https://rinckerlaw.com/things-to-know-before-joining-a-multilevel-marketing-business/>.

²³⁹ See, e.g., MONAT COMPENSATION PLAN, *supra* note 112, at 1; HERBALIFE, *supra* note 112, at 1; ARBONNE, *supra* note 112, at 2.

²⁴⁰ *Koscot Interplanetary, Inc.*, 86 F.T.C. at 1179.

²⁴¹ FITZPATRICK, *supra* note 47, at 106–07.

While internal consumption is part of the problem, the entirety of the compensation structure is problematic. If distributors could make the most amount of money by strictly selling product, the MLM scheme would quickly fall apart, as they would not receive the influx of new participants needed to maintain the scheme.²⁴² To promote recruitment, distributors must be compensated in a manner that outperforms their personal sales ability.²⁴³ If the compensation of distributors for their recruiting efforts is only a percentage of the sales of their downline, then their compensation would still be tied directly to the sale of a product and not contradict the *Amway* exception. Distributors would likely not find a small percentage cut of one's downline's sales to be adequate incentive for constant recruitment. Instead, upline distributors receive a multitude of bonuses upon recruitment of new distributors, including one-time bonuses, group volume bonuses, and status items such as cars.²⁴⁴

The ALJ in *Koscot* identified the main issue with the participant experience in the MLM model as “the inevitably deceptive representation (conveyed by their mere existence) that any individual can recoup his or her investment by means of inducing others to invest.”²⁴⁵ The ALJ saw that the recruiting practices sustaining the MLM structure would lead to the inevitable promise of wealth, even after market saturation had been reached. This is one of the few charges that Amway could not defeat. The ALJ ordered Amway to cease and desist from making misrepresentations regarding the earning potential of distributors.²⁴⁶ The need to make misrepresentations regarding the earning potential of distributors is an inherent flaw in the MLM structure that will always lead to violations of the FTCA and is the one of the quintessential elements to proving that MLM schemes are pyramid schemes. Recruiting new distributors with the promise of losing money or just breaking even would be practically impossible. Thus, nearly all distributors lose money in the MLM transaction.²⁴⁷ The only way to recruit distributors is to overpromise and use high pressure selling tactics. These tactics prey on the insecurities of the target by offering

²⁴² See, e.g., Enscoe, *supra* note 46.

²⁴³ Yaniv Reingewertz, *An Economic Model of Multi-Level Marketing*, PLOS ONE, July 20, 2021, at 1, 13, Doc. No. e0253700.

²⁴⁴ *Multi-Level Marketing Businesses and Pyramid Schemes*, *supra* note 222.

²⁴⁵ *Koscot Interplanetary, Inc.*, 86 F.T.C. at 1181.

²⁴⁶ *Amway Corp.*, 93 F.T.C. 618, 738 (1979). The FTC recently reminded over 1,000 companies of this matter in a letter sent out in October 2021. FED. TRADE COMM'N, LIST OF OCTOBER 2021 RECIPIENTS OF THE FTC'S NOTICES OF PENALTY OFFENSES CONCERNING MONEY-MAKING OPPORTUNITIES AND CONCERNING DECEPTIVE OR UNFAIR CONDUCT AROUND ENDORSEMENTS AND TESTIMONIALS (2021), https://www.ftc.gov/system/files/attachments/penalty-offenses-concerning-money-making-opportunities/list-recipients-mmo_notice_0.pdf.

²⁴⁷ Gaby Del Valle, *Multilevel Marketing Companies Say They Can Make You Rich. Here's How Much 7 Sellers Actually Earned*, VOX (Oct. 22, 2018, 2:56 PM), <https://www.vox.com/the->

more than just a “business opportunity”—they offer community, wealth, and a way to better themselves.²⁴⁸

While participation in MLM schemes often results in significant monetary loss, the psychological damage can be even greater and harder to find justice for. Once a new distributor has been successfully recruited, they are subject to the manipulation of the organization. The relationship usually starts with “love bombing”²⁴⁹ from fellow distributors to “welcome” the new recruit. The short-lived welcome is closely followed by application of the BITE model: Behavior control, Information control, Thought control, and Emotional control.²⁵⁰ These four controls permeate the lives of MLM distributors and make leaving the MLM company extremely difficult and personally damaging. When distributors finally leave the scheme, they find that the scheme alienated them from friends and family who did not support the MLM scheme, and the community they created inside the MLM network has exiled them.²⁵¹ The cost can be evaluated in the emerging anti-MLM movement.²⁵² Interviews with previous distributors are often emotional and full of feelings of betrayal and manipulation.²⁵³ While the financial loss may set victims back years, the psychological cost can take even longer to heal.

VI. A CASE STUDY—MONAT

MONAT—a combination of Modern Nature—is a hair and skin care company that started in 2014 and has been especially popular among millennials and generation Z.²⁵⁴ Since its inception, MONAT has launched a wellness line of sup-

goods/2018/10/15/17971410/lularoe-lipsense-amway-itworks-mary-kay-mlm-multilevel-marketing (citing TAYLOR, *supra* note 15, ch. 7, at 1).

²⁴⁸ Groß & Vriens, *supra* note 102, at 337–39; Escaping NXIVM, *supra* note 64, at 4:50.

²⁴⁹ The term “love bombing,” reportedly invented by the Unification Church, “has evolved today to mean a type of toxic, manipulative affection.” Bond, *supra* note 66.

²⁵⁰ *Id.*

²⁵¹ *LuLaRich*, *supra* note 67, at 18:12; BETTING ON ZERO (Biltmore Films & Zipper Bros Films 2017); Amanda Garrity, *Inside the “Toxic” World of Women Selling You Everything from Supplements to Skincare on Social Media*, GOOD HOUSEKEEPING (May 24, 2021), <https://www.goodhousekeeping.com/life/a34933110/mlm-companies-distributor-experience/>; Escaping NXIVM, *The Suppressives*, at 7:39 (Sept. 2018) (downloaded using Spotify); Illegal Tender, *This Can Happen To Anyone*, YAHOO FIN., at 24:30 (Oct. 29, 2020) (downloaded using Apple Podcasts).

²⁵² See *Breaking Up with MLM*, ANTI-MLM COAL. (June 18, 2020), <https://mlmtruth.org/2020/06/18/breaking-up-with-your-mlm/>.

²⁵³ Garrity, *supra* note 251; Escaping NXIVM, *supra* note 251, at 17:27.

²⁵⁴ See Beth Douglass Silcox, *MONAT Global: Re-Imagining Together*, DIRECT SELLING NEWS (Feb. 1, 2021), <https://www.directsellingnews.com/monat-global-re-imagining-together/>.

plements and a pet care line. In 2018, MONAT received Leaping Bunny certification as a cruelty-free brand.²⁵⁵

MONAT has not been without its fair share of legal troubles. In 2015, a slew of class-action lawsuits were filed against MONAT claiming that the products led to hair loss, balding, itching, sores, and skin lesions.²⁵⁶ These complaints led to a 2018 FDA investigation, which found that MONAT's products contained "harsh chemicals" and became "contaminated with filth" during production.²⁵⁷ The litigation is still ongoing, though MONAT entered into a voluntary compliance agreement with the Florida Office of the Attorney General agreeing that MONAT and its distributors would refrain from making unsubstantiated claims about the products.²⁵⁸

A. *The Koscot Test*

Koscot provided that illegal MLMs are organizations where participants' pay the company in return for "(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."²⁵⁹ MONAT has five requirements to become an entry level distributor: (1) be the age of majority of the distributor's state, (2) live in a state and country where MONAT operates, (3) have a valid social security number or federal tax ID number, (4) purchase a MONAT Starter Kit, and (5) submit a completed Market Partner Application and Agreement.²⁶⁰

MONAT has four starter packs that distributors can choose from. They range in price from \$99 to \$649.²⁶¹ MONAT makes the purchase of a starter pack a requirement for all U.S. distributors—except for residents of North Dakota.²⁶² For

²⁵⁵ *MONAT*, LEAPING BUNNY PROGRAM, <https://www.leapingbunny.org/brand/monat> (last visited Apr. 20, 2023).

²⁵⁶ See, e.g., *In re Monat Hair Care Prods. Mktg., Sales Pracs., & Prods. Liab. Litig.*, MDL No. 2841, 2019 WL 5423457, at *2 (S.D. Fla. Oct. 23, 2019).

²⁵⁷ *Id.* at *1, *2; *The Controversy Behind Popular MLM Hair Care Brand Monat*, BETTER GOODS (Mar. 19, 2022), <https://bettergoods.org/monat/>.

²⁵⁸ Assurance of Voluntary Compliance at 9–15, *In re Monat Glob. Corp.*, No. L18-3-1232 (Fla. Att'y Gen. Aug. 13, 2020), [http://www.myfloridalegal.com/EC_Edoc.nsf/0/3D7B7AEF1647AAC8852585C90058D975/\\$file/L18-3-1232+AVC+Monat+Global.pdf](http://www.myfloridalegal.com/EC_Edoc.nsf/0/3D7B7AEF1647AAC8852585C90058D975/$file/L18-3-1232+AVC+Monat+Global.pdf); Darcy Spears, *Attorney General Cracks Down on Monat Hair Care Claims in Wake of 13 Investigation*, KTNV LAS VEGAS, <https://www.ktnv.com/13-investigates/attorney-general-cracks-down-on-monat-hair-care-claims-in-wake-of-13-investigation> (Sept. 25, 2020, 2:11 PM).

²⁵⁹ *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180 (1975) (emphasis omitted).

²⁶⁰ *MONAT GLOB. U.S., POLICIES AND PROCEDURES* § 2.1, at 3 (2017).

²⁶¹ *MONAT, PRODUCT PACKS* (May 2018), https://monatglobal.com/wp-content/uploads/2018/05/Updated-Product-Packs_May-2018.pdf.

²⁶² See *MONAT GLOB. U.S.*, *supra* note 260, § 2.1, at 3. North Dakota state law prohibits "pyramid promotional schemes," which are defined as:

each starter pack sold, distributors earn a commission between \$50 and \$350.²⁶³ MONAT allows distributors to recruit from day one.²⁶⁴ MONAT encourages new entry-level distributors to recruit three distributors and 12 preferred customers in the first three months of business.²⁶⁵ MONAT characterizes a grouping of one distributor and four preferred customers as a block and awards a \$150 bonus for each block established.²⁶⁶ If a distributor creates three blocks during their first three months, they receive a \$500 bonus.²⁶⁷

Under this analysis, MONAT has met the *Koscot* test of (1) receiving money from participants in return for (2) the right to sell the product and (3) the right to receive money for recruiting other participants unrelated to the sales of the product to end users.

B. *Additional FTC Elements*

Outside of the *Koscot* test, the FTC also looks at (1) the end purchaser of the product, (2) the compensation structure, and (3) the participant experience.²⁶⁸ It is likely that MONAT fails on all three of these elements. With MONAT's 5 to 1 distributor to customer ratio, its internal consumption is likely dangerously high.²⁶⁹ MONAT has 11 levels in its compensation structure, as well as a preferred customer sign-up.²⁷⁰ Preferred customers get 15% off retail prices, plus exclusive discounts in return for signing up for automatic shipments of their desired products.²⁷¹ MONAT does not require distributors to hold any product on hand; instead, distributors

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

N.D. CENT. CODE §§ 51-16.1-01(3)–1-02(1) (2021). This law is responsible for the common exemption to MLMs mandatory starter pack rules.

²⁶³ MONAT COMPENSATION PLAN, *supra* note 112, at 2.

²⁶⁴ MONAT Global, *Smart Start Explained*, VIMEO, at 0:26 (July 7, 2017), <https://vimeo.com/224646048>.

²⁶⁵ *Id.* at 3:49.

²⁶⁶ When a new distributor earns a block bonus, their recruiter gets a \$75 bonus. MONAT COMPENSATION PLAN, *supra* note 112, at 2.

²⁶⁷ *Id.*

²⁶⁸ *Business Guidance Concerning Multi-Level Marketing*, *supra* note 187.

²⁶⁹ Douglass Silcox, *supra* note 254.

²⁷⁰ MONAT COMPENSATION PLAN, *supra* note 112, at 1.

²⁷¹ MONAT GLOB. U.S., VIP CUSTOMER AGREEMENT 2–3 (2022), <https://monatglobal.com/wp-content/uploads/2022/08/USA-VIP-Customer-Program-FAQ-September-2022.pdf>.

place an order directly with MONAT on behalf of their customer.²⁷² MONAT then ships the order directly to the customer from a company warehouse.²⁷³

The government does not require privately held companies to report their internal metrics.²⁷⁴ The majority of MLM companies, like MONAT, choose to remain private so they can keep their data to themselves. As such, this information can be difficult to find and evaluate. While detailed financial statements are not available for MONAT, the company has provided financial information and metrics in interviews that can be compiled, estimated, and evaluated.

Each year, *Direct Selling News* publishes its Global 100 List. The purpose of this list is to recognize direct selling companies who exceed \$100 million in annual sales revenue. While the companies submit their own information, each company must have the CEO and another qualified agent sign off on its submission.²⁷⁵ MONAT reported its sales revenue for 2020 at \$804 million, making MONAT the 23rd largest direct selling company on the list.²⁷⁶ In an interview with *Direct Selling News* published in February 2021, Stuart MacMillian, MONAT's president, stated that MONAT had 400,000 distributors and almost 2 million customers worldwide.²⁷⁷

Distributors will always be MONAT's best customers, in part because distributors are bombarded with messaging telling them to sell what they use and love.²⁷⁸ MONAT's marketplace provides a list of its 20 bestselling products, which includes skincare products, hair treatment products, hair styling products, shampoos, and conditioners.²⁷⁹ This list does not include any products from MONAT's wellness

²⁷² *Join as a Market Partner*, MONAT GLOB., <https://corp.mymonat.com/the-monat-opportunity/> (last visited Mar. 8, 2023).

²⁷³ *Id.*

²⁷⁴ Evan Tarver, *Are Private Companies Required to Publish Financial Statements?*, INVESTOPEDIA (Oct. 30, 2022), <https://www.investopedia.com/ask/answers/062415/private-company-required-disclose-financial-information-public.asp>.

²⁷⁵ *Global 100 List*, DIRECT SELLING NEWS, <https://www.directsellingnews.com/achievements/global-100-list/> (last visited Mar. 8, 2023).

²⁷⁶ *Global 100 List: Top Direct Selling Companies in the World*, DIRECT SELLING NEWS, <https://dsnnewprd.wpengine.com/global-100-lists/> (choose "2021" from list) (last visited Apr. 20, 2023).

²⁷⁷ Douglass Silcox, *supra* note 254.

²⁷⁸ *See, e.g.*, MONAT (@MONATOfficial), TWITTER (Oct. 1, 2020, 8:00 AM), <https://twitter.com/monatofficial/status/1311682413467250696>; *see also* Elisabeth Rumley, *Why I Started Social Selling with MONAT*, ELISABETH RUMLEY (July 2, 2019), <https://elisabethrumley.com/2019/07/02/social-selling/>.

²⁷⁹ *Best Sellers*, MONAT, <https://corp.mymonat.com/shop/t/categories/best-sellers> (last visited Mar. 8, 2023).

or pet lines. The shampoos on the best seller list cost around \$45 and the conditioners cost around \$52.²⁸⁰ The average costs of a bestselling styling product and treatment product are \$80 and \$43, respectively. The average cost of a wellness product is \$65. MONAT's skincare line has four steps, with the basic packages costing between \$218 and \$302.²⁸¹ An unofficial MONAT study showed that its shampoo lasts approximately 75 washings, or four-and-a-half months.²⁸²

If a distributor goes through three bottles of shampoo and conditioner a year (~\$135 & \$156 each), as well as two styling products (~\$88), two treatment products (~\$162), one large skincare kit (\$302), one replacement cleanser (~\$50), and a year's supply of a wellness product (~\$780), the yearly retail price of their purchases would be \$1,673. MONAT gives their distributors a 30% discount on their purchases, which would then bring a distributor's yearly purchase amount to \$1,171. At 400,000 distributors, MONAT would be looking at an internal consumption rate around 58% for 2020. In the unlikely event that each distributor only purchased their shampoo and conditioner from MONAT, MONAT's internal consumption rate would be approximately 14.5%. The sales revenue number MONAT reported to *Direct Selling News* also includes its revenue relating to new distributor kits purchased. MONAT's income disclosure states that 46% of their distributors in the United States were inactive in 2020.²⁸³ This number is in line with AARP's study which found that at least 50% of MLM participants drop out after one year.²⁸⁴

²⁸⁰ While the company does offer some shampoo and conditioners that are cheaper, the majority of MONAT's products sell for the same price as its best sellers. See *All Products*, MONAT, <https://corp.mymonat.com/shop/t/categories/all-products> (last visited Mar. 8, 2023).

²⁸¹ *Be Gentle Routine*, MONAT, <https://monatglobal.com/be-gentle-routine/> (last visited Mar. 8, 2023); *Be Balanced Routine*, MONAT, <https://monatglobal.com/be-balanced-routine/> (last visited Mar. 8, 2023).

²⁸² Amy Earle is a director for MONAT, meaning she is in one of the top three compensation tiers, and claims that, if using a nickel size amount of product and washing twice, a bottle of MONAT shampoo will last for 108 washings. See Amy Earle (@lifewithamyearle), INSTAGRAM (Sept. 5, 2020), <https://www.instagram.com/reel/CExF8xCFx7M/>. MONAT recommends consumers use a quarter-sized amount of the product. *Top Hair-Washing Hacks!*, STYLE BY MONAT (Aug. 26, 2021), <https://monatglobal.com/top-hair-washing-hacks/>. A quarter is approximately 108.922 mm² or 30% more surface area than a nickel. See *Coin Specifications*, UNITED STATES MINT, <https://www.usmint.gov/learn/coin-and-medal-programs/coin-specifications> (Apr. 28, 2022). Thus, if using a quarter-sized amount of product, a bottle would last around 75 washings. Assuming that users wash their every other day, each distributor would go through about three bottles of shampoo a year.

²⁸³ *MONAT USA 2020 Income Disclosure Statement*, MONAT (Sept. 11, 2021), <https://sequenceinc.com/fraudfiles/wp-content/uploads/2020/08/monat2020.pdf> (MONAT defines inactive distributors as those who "did not earn any amount of commissions in the 2020 calendar year."). Under MONAT's policies, Market Partners must renew their membership each year for \$49.99. MONAT GLOB. U. S., *supra* note 260, at 4. We can therefore understand that inactive market partners are likely still participating by purchasing products for themselves.

²⁸⁴ DELIEMA, ET AL., *supra* note 116.

This means in order to keep growing its active recruiter number, MONAT would have to recruit more distributors than it loses. The average price of the MONAT starter kit is around \$300.²⁸⁵ If MONAT recruited just 20% of its distributors in 2020, it would have earned approximately \$24 million in sales revenue for 2020, which would add another 3% to its internal consumption. Bringing MONAT's estimated internal consumption rate up to around 61%. While MONAT has set a goal to have a 10 to 1 customer-to-distributor mix,²⁸⁶ it is unlikely that it will ever be able to maintain such a rate while operating with its MLM model.

The compensation plan shows that the more individuals distributors recruit, and the higher level of sales they achieve, the more a they will profit off their downline.²⁸⁷ MONAT calls the sales percentage earned off a distributor's downline the "uni-level bonus."²⁸⁸ The seven top distributor levels can earn 12% off the sales of distributors one step below them, 7% off the sales of those two steps below them, 5% off the sales of those three steps below them, and 3% of the sales of those four steps below them.²⁸⁹ To reach these levels, a distributor must: (1) sell at least \$500 in personal volume a month, (2) have a minimum of four active lines below them that achieve group volume sales of at least \$5,000, and (3) two of the downline distributors must be at least second-level distributors, with two active lines below them and \$1,200 in group volume sales.²⁹⁰

As for the participant experience of MONAT, the company has already been investigated for using deceptive marketing tactics relating to their products.²⁹¹ There have been other accusations that MONAT has bullied and threatened individuals, including previous distributors, who have tried to talk out against them.²⁹² MONAT's *Policy and Procedures* bans distributors from talking to the media about the MONAT company.²⁹³ Videos posted by high-ranking members of the company

²⁸⁵ MONAT offers six kits priced at \$99, \$199, \$249, \$400 and \$650. *Join as a Market Partner Today!*, MONAT, https://monat-global.mymonat.com/pyr_core/v2_workflows/6165f7270741e151393a135c/v2_enrollments/6424ea9e2fd0ca5768e8a5c8/step?step=PRODUCT+PACK+SELECTION (last visited Mar. 30, 2023).

²⁸⁶ Douglass Silcox, *supra* note 254.

²⁸⁷ MONAT COMPENSATION PLAN, *supra* note 112.

²⁸⁸ MONAT GLOB., *supra* note 16, at 4.

²⁸⁹ MONAT COMPENSATION PLAN, *supra* note 112, at 1. Under this compensation structure, the distributor who sells the product will earn a 15% commission and their upline will earn 27% commission.

²⁹⁰ *Id.*

²⁹¹ See Assurance of Voluntary Compliance, *supra* note 258.

²⁹² Darcy Spears, *Monat Hair Care Company Accused of Using Strong-Arm Legal Tactics to Silence Critics*, KTNV LAS VEGAS, <https://www.ktnv.com/news/contact-13/monat-hair-care-company-accused-of-using-strong-arm-legal-tactics-to-silence-critics> (Nov. 21, 2018).

²⁹³ MONAT GLOB. U.S., *supra* note 260, § 3.2.5, at 8.

promote the same aggressive recruiting tactics standard of the industry.²⁹⁴ In October 2021, the FTC sent a letter to over 1,000 MLM companies reminding them of the penalty for making deceptive or unfair claims related to the profitability of the business.²⁹⁵ MONAT was one of the businesses to receive the letter.²⁹⁶ While finding explicit evidence of pressuring recruits to sign up for MONAT is difficult, MONAT distributors nonetheless might pressure others into joining.

C. Summary

MONAT, like many MLM companies, remains privately held. It can elect to keep its data out of the public sphere, which makes MONAT even harder to monitor and catch. While MONAT obviously meets the *Koscot* test, proving the other FTC elements may require the FTC to conduct a more in-depth investigation. Fortunately, the factors in question are inherent to the MLM structure. The need for intensive investigations to prove if an MLM business is a pyramid scheme has led to a small number of enforcement cases by the FTC and state officials. Without a clear test and judicial stance on the MLM structure, MLM schemes will remain an active sales model.

CONCLUSION

Mytinger and Casselberry's creation of the MLM company is potentially one of the longest running financial frauds in history. The MLM scheme is likely the only financial fraud structure that has been legalized as an acceptable business structure in the United States. As early case law determined, illegal pyramid schemes are those where participants pay money for (1) the right to sell a product and, (2) the right to recruit others. MLM businesses cannot operate without these two *Koscot* elements. The additional factors analyzed by the FTC after the *Amway* decision, including internal consumption, compensation structure, and participant experience, also fail in relation to the MLM structure. Millions of Americans have been involved in some manner with MLM schemes, and thousands have lost money and relationships over these toxic companies.

The complexity and difficulty of prosecuting MLMs is part of the reason the FTC settled with Herbalife in 2016. The FTC was able to extract multiple concessions out of the company to protect the public and avoid a prolonged and complicated litigation. Outside of the \$200 million fine, Herbalife agreed to restructure its

²⁹⁴ See Irigoyen, *supra* note 124.

²⁹⁵ Press Release, Fed. Trade Comm'n, *FTC Puts Businesses on Notice that False Money-Making Claims Could Lead to Big Penalties*, (Oct. 26, 2021), <https://www.ftc.gov/news-events/news/press-releases/2021/10/ftc-puts-businesses-notice-false-money-making-claims-could-lead-big-penalties>.

²⁹⁶ FED. TRADE COMM'N, *supra* note 246.

business model, maintain more thorough records, change its compensation plan, create a fair refund policy, implement required training for all distributors, and provide funds for an independent compliance monitor.²⁹⁷ Herbalife would pay the compliance monitor, whose job was to thoroughly investigate and ensure Herbalife's compliance with the settlement.²⁹⁸ The monitor would also provide periodic written reports to the FTC.

While the Herbalife settlement was a crucial step in holding MLM companies accountable, it did not shift the legal precedent. Holding MLM companies accountable for the damage they cause to their participants is still complex and difficult. Judicial clarity is unlikely to be found without federal legislation making the use of the MLM structure illegal. Legislation that explicitly makes the MLM structure an illegal pyramid scheme could save millions of Americans from significant monetary loss and would require the direct sales industry to operate legitimately.

²⁹⁷ Stipulation to Entry of Order for Permanent Injunction and Monetary Judgment at 6–27, Fed. Trade Comm'n v. Herbalife Int'l of Am., Inc., No. 2:16-cv-05217 (C.D. Cal. July 15, 2016).

²⁹⁸ *Id.* at 18–19.