PROGRAM MATERIALS
Program #3289
May 18, 2022

Multi-level Marketing Companies and Pyramid Schemes

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Multi-Level Marketing Companies and Pyramid Schemes

May 18, 2022| Presented by: Nicole McNeil Donecker, CPA, CVA, CAMS

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Objectives

- Discuss the business strategies that differentiate a Multi-level Marketing company from a pyramid scheme and how a pyramid scheme is closely related to a Ponzi scheme.
- Identify the red flags of pyramid and Ponzi schemes.
- Discuss the flow of funds in an MLM and a pyramid scheme.
- Discuss government actions involving MLMs.

Multi-Level Marketing v. Pyramid v. Ponzi

- Multi-Level Marketing Companies, Pyramid Schemes and Ponzi Schemes are very similar in structure, where as each builds upon a new layer of participants.
- MLMs are similar in structure to pyramid and Ponzi schemes, but with the essential difference that an MLM is considered a legitimate business enterprise and pyramid and Ponzi schemes are created to defraud.
- A pyramid scheme relies on the constant inflow of money from new investors finding its way to the top of the pyramid, which makes it, essentially, a Ponzi scheme.
- All three are shaped similar to a triangle, or a pyramid.

Well known MLMs and Pyramid Schemes

- Many MLMs are household names:
  - Amway
  - Avon
  - Herbalife
  - Tupperware
  - Young Living
  - Arbonne International
  - Cutco/Vector Marketing
  - Mary Kay
  - Rodan + Fields
  - LuLaRoe
  - Norwex
  - Pampered Chef
- Some of the most famous pyramid schemes in history:
  - Koscot Interplanetary
  - Holiday Magic
  - Metabolife
  - United Sciences of America
  - Equinox International
  - BurnLounge
  - Fortune Hi-Tech Marketing
  - WakeUpNow
  - MonaVie
  - Solavei
  - Herbalife

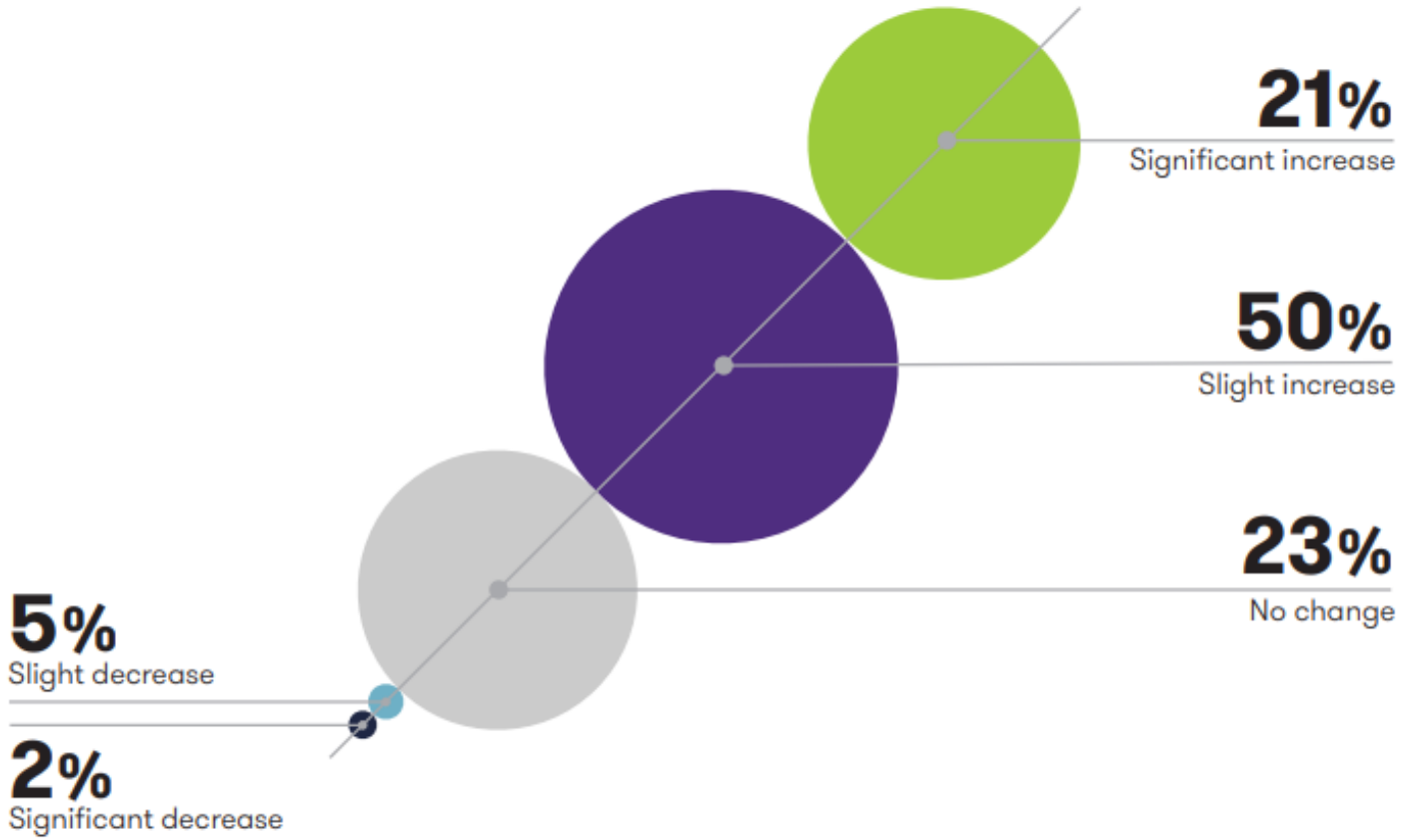
Association of Certified Fraud Examiners

- The ACFE prepared a series of reports *"To illuminate the global pandemic's impact on the fight against fraud, the ACFE is undertaking a series of benchmarking surveys exploring how fraud risks and anti-fraud programs are changing in the current environment."*
  - Fraud in the Wake of COVID-19: Benchmarking Report, June 2020 Edition
  - Fraud in the Wake of COVID-19: Benchmarking Report, September 2020 Edition
  - Fraud in the Wake of COVID-19: Benchmarking Report, December 2020 Edition
  - The Next Normal: Preparing for a Post-Pandemic Fraud Landscape

https://legacy.acfe.com/report-to-the-nations/2022/?_ga=2.83034966.1509986174.1651950898-824944158.1571745384

“The Next Normal: Preparing for a Post-Pandemic Fraud Landscape” – Prepared by the ACFE

FIG. 3 Expected change in the overall level of fraud impacting organizations



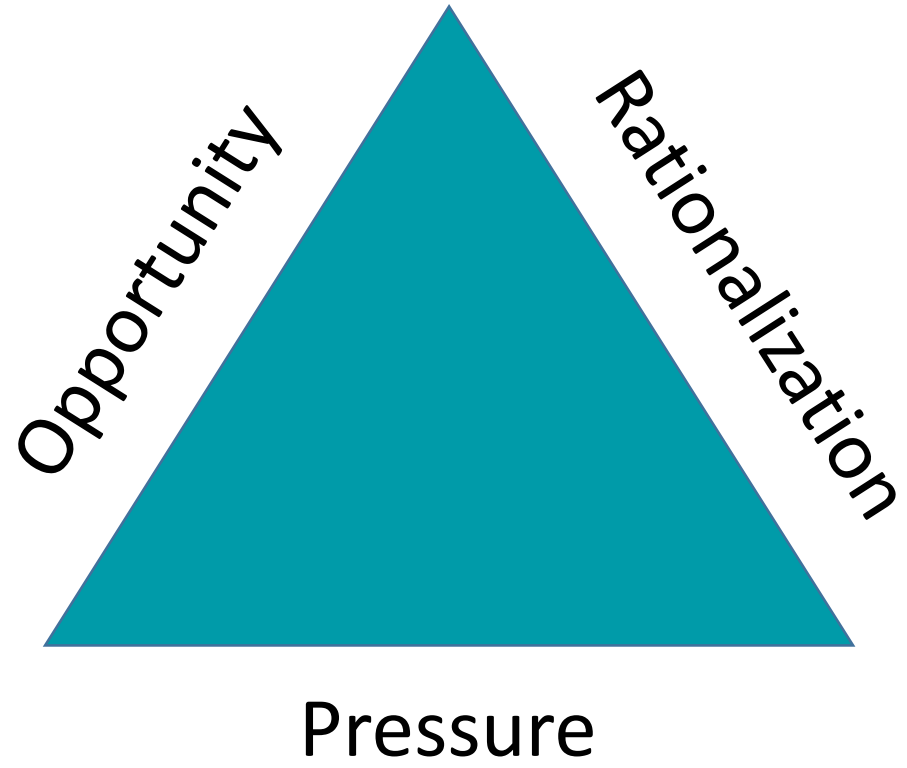
COVID-19's Influence on MLMs

- The pandemic and the recession that followed did not slow down MLMs and pyramid schemes.
- At the beginning of the pandemic, with many people laid off from their jobs and large segments of the workforce sent home to work, MLMs seemed ideal.
- In March 2020, the Direct Selling Association (DSA) began surveying its members about how the COVID-19 pandemic impacted company revenue in the United States, with the last update on July 23, 2021.
- According to more than half of the respondents, comprised of direct selling companies, the pandemic had a positive impact on company revenue.
- A 2020 industry overview infographic prepared by the DSA shows the number of direct sellers in the United States grew by 7.7 million, a 13.2% increase from 2019.
- The pandemic created a prime opportunity for pyramid schemes to prey on people who suddenly found themselves out of work.

Sources: https://www.dsa.org/docs/default-source/research/dsa-industry-overview-fact-sheetd601b69c41746fcd88eaff000002c0f4.pdf?Status=Temp&sfvrsn=6e75d9a5_2%27

https://www.dsa.org/statistics-insights/coronavirus-impact---quickpulse

The Fraud Triangle



The Fraud Triangle was developed by Dr. Donald Cressey in 1953.

- Rationalization
  - *"I deserve it"*
  - *"I will pay it back"*
- Pressure
  - Financial pressures
  - Addiction
  - Sales Targets
- Opportunity
  - Weak controls
  - Lack of oversight

Ponzi Schemes

- Ponzi Schemes are named for Charles Ponzi who defrauded investors in the 1920's with a postage stamp speculation scheme.
- A Ponzi scheme is an investment fraud that uses newly invested funds from investors to pay prior investors.
- High returns with little risk is often offered.
- The money received from the investors is not invested, but instead is used to pay other investors.
- A Ponzi scheme requires constant cash flow and new money to survive.
- There are two events that can collapse a Ponzi scheme:
  - Inability to recruit new investors or
  - Large number of investors cashing out.

Source: https://www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme

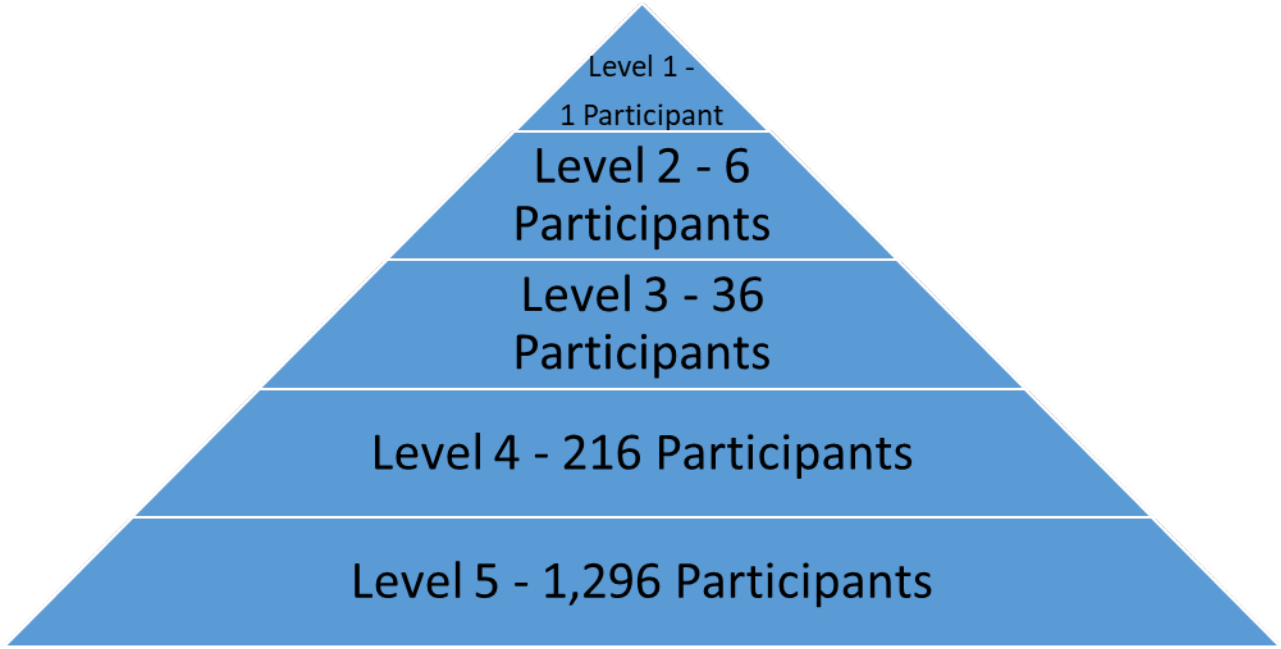
Ponzi Scheme Red Flags

- High returns with little or no risk.
  - Investments generally carry some degree of risk.
  - High yield investments generally involve more risk.
  - Investors should be skeptical of guaranteed returns.
- Overly consistent returns.
  - Investments tend to go up and down over time.
  - The investment produces returns regardless of market conditions.
- Unregistered investments.
  - The investments that are not registered with the SEC or state regulators.
  - Without registration, there is no regulations or access to background information on the company's management, products, services, and finances.
- Unlicensed sellers.
  - Federal and state regulators require licensure of the seller.
- Secretive and complex strategies.
  - Ponzi schemes use investments that are designed so the investor cannot understand them or get information on them
- Issues with paperwork.
  - Account statements with errors or statements are not provided timely.
- Difficulty receiving payments.
  - Payments are not received timely or the investor is dissuaded from cashing out.
  - The promoter of the Ponzi scheme will offer higher returns to not cash out.

Source: https://www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme

Pyramid Schemes

- In the classic pyramid scheme, participants attempt to make money solely by recruiting new participants.
- Pyramid schemes are designed to collapse. If each person on each level recruits 6 new people, by level 11 the number of participants (362,797,056) would exceed the U.S. population.



Source: https://www.investor.gov/protect-your-investments/fraud/types-fraud/pyramid-schemes

Characteristics of a Pyramid Scheme

- Emphasis on recruiting.
  - Focus is recruiting more participants.
  - New participants must pay a fee to join
  - More compensation is received for recruitment than sales.
- No genuine product or service is sold.
  - Products being sold are hard to value.
  - The products are often “tech services”, mass-licensed e-books, or advertising on low traffic websites.
  - To make it harder to prove the company is a pyramid scheme, the “products” are given fancy names.
- Promise of high returns in a short period of time.
  - There is a promise of fast cash.
  - Fast cash could mean commissions on recruitment rather than sales

Source: https://www.investor.gov/protect-your-investments/fraud/types-fraud/pyramid-schemes
https://www.investor.gov/introduction-investing/investing-basics/glossary/pyramid-schemes

Characteristics of a Pyramid Scheme

- Easy money or passive income.
  - Offered compensation for doing little work.
  - The little bit of work entails making payments, recruiting others, or advertising on obscure websites.
- No demonstrated revenue from retail sales.
  - Ask to see audited financial statements to identify the source of revenue.
  - A legitimate MLM derives its revenue from selling products, not recruitment.
- Buy-in required for new participants.
- Complex commission structure.
  - Commissions are based on recruitment no sales.
  - The payment structure is complex and difficult to understand.

Source: https://www.investor.gov/protect-your-investments/fraud/types-fraud/pyramid-schemes
https://www.investor.gov/introduction-investing/investing-basics/glossary/pyramid-schemes

Federal Trade Commission Red Flags

The FTC describes several red flags found in pyramid schemes that differentiate them from MLMs:

- Promoters (those trying to recruit new participants) make extravagant promises about the money the participant can earn.
- The promoter encourages the new participant to recruit more people and expand their network since this is key to making money.
- Promoters play on emotions and use high-pressure sales tactics to persuade participants to sign on: “You’ll lose the opportunity if you don’t act now!”
- The new participant is encouraged to buy more inventory than they will ever be able to sell. Inventory purchases keep participants active or qualify them for bonuses and rewards.

Source: https://consumer.ftc.gov/articles/multi-level-marketing-businesses-pyramid-schemes

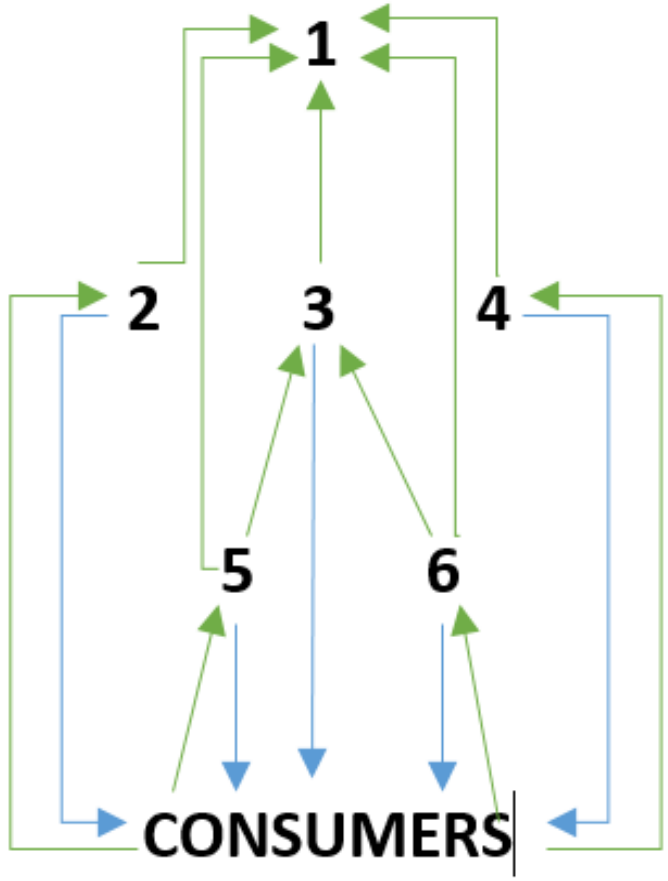
Multi-Level Marketing Companies

- Multilevel marketing is a strategy used by some direct sales companies encouraging existing participants to promote and sell their products and services to other individuals and bring new recruits into the business.
- MLMs provide products and services to consumers through direct sales channels. Under the pyramid structure of an MLM, participants both sell the product or service and recruit new members to the sales team.
- Recruits, the people they recruit, and so on, become the participant's sales network, or “downline.”
- In an MLM program, the company may refer to you as an independent “distributor,” “participant,” or “contractor.”
- If the MLM is not a pyramid scheme, it will pay you based on your sales to retail customers, without having to recruit new distributors.
- Most people who join legitimate MLMs make little or no money. Some of them lose money.

Source: https://consumer.ftc.gov/articles/multi-level-marketing-businesses-pyramid-schemes

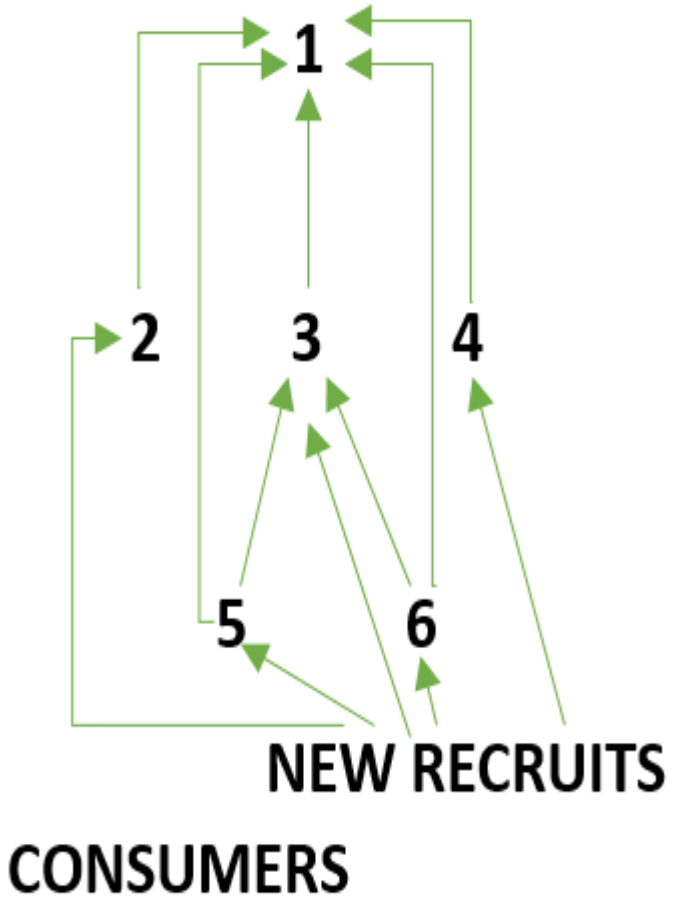
How does the money flow in an MLM?

- According to the FTC, participants in an MLM are selling products to a consumer, with earnings and commissions based on the participants' sales. Earnings and commissions can also be based on recruiting new participants and the sales those new participants make to consumers.
- Think of this in levels. Imagine that participant 1 recruits participants 2, 3 and 4, and then participant 3 recruits participants 5 and 6. Each participant earns commission on their own sales (blue arrows), plus participant 1 receives commission on the sales made by 2, 3, 4, 5 and 6, and participant 3 receives commission from the sales made by 5 and 6 (green arrows).



How does the money flow in a Pyramid Scheme?

- With pyramid schemes, earnings and commissions do not necessarily come from sales to consumers. If participants 1 through 6 were in a pyramid scheme, all participants would earn commission from their own sales, if any, to consumers. The difference is that participant 1 will earn commission from the initial buy-in and inventory purchases made by recruits 2 through 6 in order to become participants.
- Likewise, participant 3 will earn commission from the initial buy-in and inventory purchases of participants 5 and 6. This structure leaves participants 5 and 6 with only earnings from sales to consumers, if any, and they will need to constantly reinvest those earnings to buy more inventory. For participants 5 and 6 to increase their commissions, they will need to recruit more participants under them to buy into the scheme and purchase inventory to sell to consumers.



MLMs and Pyramids

- The first MLMs existed in the 1920's and 1930's. For example, the California Vitamin Company and the California Perfume Company, which later became Nutrilite and Avon, respectively, were early MLMs.
- In re Koscot Interplanetary, Inc. was an early case where the FTC found that Koscot was operating an "entrepreneurial chain marketing system." In the FTC's decision, paragraph 33 stated *"Koscot's distribution method has come to be known as multileveling or pyramid selling…Such a system has been condemned as unlawful by the Commission, as well as numerous courts."*
- In the 1970's Senator Walter Mondale sponsored an anti-pyramiding bill that passed the Senate twice but never became law.
- In 1975 the FTC filed a complaint against Amway. In 1979, the FTC determined that Amway was not a pyramid scheme, but instead a legitimate multi-level marketing company.

Amway Decision

In the opinion section of the ruling, Commissioner Robert Pitofsky stated:

- *Two other Amway rules serve to prevent inventory loading and encourage the sale of Amway products to consumers. The "70 percent rule" provides that "[every] distributor must sell at wholesale and/or retail at least 70% of the total amount of products he bought during a given month in order to receive the Performance Bonus due on all products bought…." This rule prevents the accumulation of inventory at any level. The "10 customer" rule states that "[i]n order to obtain the right to earn Performance Bonuses on the volume of products sold by him to his sponsored distributors during a given month, a sponsoring distributor must make not less than one sale at retail to each of ten different customers that month and produce proof of such sales to his sponsor and Direct Distributor." This rule makes retail selling an essential part of being a distributor. The ALJ found that the buyback rule, the 70-percent rule, and the ten-customer rule are enforced, and that they serve to prevent inventory loading and encourage retailing.*
- 93 F.T.C. 618: Opinion, page 716

State of Washington v. LuLaRoe

- LLR LuLaRoe Inc. is a company famous for selling leggings on Facebook and other social media platforms.
- LuLaRoe used “levels” for its participants that ranged from “sponsors,” the lowest tier, to “mentors,” the fourth and highest tier.
- On Jan. 23, 2019, Robert W. Ferguson, the attorney general of Washington, filed a complaint for injunctive relief and other relief on behalf of the plaintiff, the state of Washington, against LuLaRoe and other defendants, including company founders Mark A. Stidham and Deanne S. Brady Stidham and her son, Jordan K. Brady. The complaint alleged that LuLaRoe operated an unlawful pyramid scheme.
- The complaint alleged that prior to July 1, 2017, LuLaRoe’s bonus package was based on recruitment of new participants (consultants) and the inventory purchased by those consultants, not the product sold by the consultants.

State of Washington v. LuLaRoe

Additional evidence for the allegation that LuLaRoe was a pyramid scheme included:

- The claim that participants could “make a full-time income doing part-time work.”
- The practice of “inventory loading” by encouraging participants to purchase and maintain sizeable inventories to stay active and eligible for bonuses.
- A complicated refund and return policy for participants.

State of Washington v. LuLaRoe

As stated in the complaint, prior to July 1, 2017, LuLaRoe's bonus program was based on recruitment and inventory purchases by consultants. The bonus program was subsequently changed to bonuses based on sales, rather than inventory purchases. This resulted in a large decline in commissions for participants. The large bonus checks that once ranged from tens to hundreds of thousands of dollars ended. The complaint includes statements by Defendant Jordan Brady during an Oct. 27, 2016, webinar, in which he explained the rationale for the change in policy:

- "We need to get away from being a pyramid scheme. OK!"
- "So, the way we get away from a pyramid scheme and incentivize you as leaders is we change it."

State of Washington v. LuLaRoe

- In February, Ferguson announced a resolution with LuLaRoe agreeing to pay $4.75 million.
- Four million of that total was to be paid in restitution to LuLaRoe consultants who were residents of Washington state.
- In addition to the monetary payment, LuLaRoe was required to publish income disclosures, calculate bonuses on retail sales by consultants, conduct random and targeted audits to verify sales to actual consumers, and modify its return and refund policy.

Herbalife

- On July 15, 2016 the Federal Trade Commission filed a complaint for permanent injunction and other equitable relief against Herbalife International of America, Inc. in the Central District of California, Case No. 2:16-cv-05217.
- The complaint alleged:
  - Misleading Income Representations
  - Misleading Representations Regarding Income from Retail Sales
  - Defendants' Business Opportunity is Based on Recruitment
  - Defendants' Compensation Plan Incentivizes Recruiting
  - Defendants' Compensation Plan Incentivizes Wholesale Product Purchases
  - Product Purchases are Required to Advance to Higher Levels
  - Product Purchases are Required to Requalify for Status Levels
  - Monthly Product Purchases are Required to Qualify for Reward Checks

Herbalife

- The FTC did not conclude that Herbalife was a pyramid scheme.
- The decision did require changes to Herbalife's business practices including, but not limited to:
  - Compensation to the participants
  - Collection of retail sales information
  - Verification of retails sales and preferred customer sales
  - Limitations on rewardable personal consumption
  - Limitations on thresholds, targets, and requirements
  - Refund policies
  - Required training for business opportunity participants
- The FTC also required compliance monitoring by the defendants and an independent compliance auditor.
- Herbalife was ordered to pay the FTC $200 million that was deposited into a fund administered by the FTC.

A Belgian Court found Herbalife to be a Pyramid Scheme in 2011

In a December 16, 2011 press release, Herbalife stated:

- *"Herbalife (NYSE:HLF) plans to appeal a recent Belgian Commercial Court judgment in a case brought by local consumer organization Test-Aankoop in 2004. The ruling states that Herbalife's sales method violates current Belgian law on unfair commercial practices. It includes a maximum fine of 250,000 euros, should a court determine that any modifications the company makes to its business practices are inadequate to clarify compliance with the judgment."*
- *"Herbalife believes the judgment contains factual errors and is based on misinterpretations of the law and its direct-selling sales model. Herbalife remains committed to its multi-level direct-selling sales model and is confident that, with clarifications in certain aspects of its business, there will be no doubt as to its compliance with all applicable Belgian laws."*

The Decision was overturned in the Belgian Appeals Court

In a December 3, 2013 press release, Herbalife stated:

- *"Global nutrition company Herbalife (NYSE: HLF), welcomes the judgment by a Belgian Appeal Court that states the company's sales model is in full compliance with Belgian law. This judgment overturns a previous ruling by the lower court, in response to claims brought by Belgian consumer organization Test-Aankoop, that Herbalife was operating a pyramid scheme."*
- *"Herbalife always believed that the first judgment contained factual errors and was based on misinterpretations of its direct-selling sales method, and was confident that the original judgment would be overturned on appeal."*

Words From the Wise

In a Time article from July 2020, Carl Daikeler, CEO of Beachbody, offered this view to those considering an MLM:

"This is not something you jump into and instantly make a lot of money. I will literally say, 'Are you sure? And do you have money saved? Because this is starting your own business, and starting your own business is very hard. Most new businesses that start, fail.'"

For more information, contact:

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Legal Intelligencer

https://www.law.com/thelegalintelligencer/2022/02/25/multi-level-marketing-companies-and-pyramid-schemes/

Nicole McNeil Donecker of Marcum.

COMMENTARY

MLMs are similar in structure to pyramid schemes, but with the essential difference that an MLM is considered a legitimate business enterprise and a pyramid is a scheme to defraud. Understanding this difference is paramount for investors.

February 25, 2022 at 11:31 AM

I am sure you have heard of Avon and Tupperware, and you may even have their products in your home. Both of these companies are referred to as multilevel marketing companies, or MLMs. Multilevel marketing is a strategy used by some direct sales companies encouraging existing participants to promote and sell their products and services to other individuals and bring new recruits into the business. MLMs are similar in structure to pyramid schemes, but with the essential difference that an MLM

is considered a legitimate business enterprise and a pyramid is a scheme to defraud. Understanding this difference is paramount for investors.

MLMs provide products and services to consumers through direct sales channels. Under the pyramid structure of an MLM, participants both sell the product or service and recruit new members to the sales team. As each participant in the MLM expands their team, each level below continues to expand—from one person on level one to three people on level two and then nine people on level three.

Pyramid schemes are, appropriately, also shaped like pyramids. However, pyramid schemes are illegal and often collapse. A pyramid scheme generally does not involve selling products or services. Instead, it relies on the constant inflow of money from new investors finding its way to the top of the pyramid, which makes it, essentially, a Ponzi scheme. The Securities and Exchange Commission (SEC) defines a Ponzi scheme as an investment fraud that pays existing investors with funds collected from new investors. Essentially it is a pyramid scheme as an investment fraud in which new participants' fees are typically used to pay existing participants for recruiting new members.

How to Differentiate Between an MLM and a Pyramid Scheme

The FTC describes several red flags found in pyramid schemes that differentiate them from MLMs.

- Promoters (those trying to recruit new participants) make extravagant promises about the money the participant can earn.
- The promoter encourages the new participant to recruit more people and expand their network since this is key to making money.

- Promoters play on emotions and use high-pressure sales tactics to persuade participants to sign on: “You’ll lose the opportunity if you don’t act now!”
- The new participant is encouraged to buy more inventory than they will ever be able to sell. Inventory purchases keep participants active or qualify them for bonuses and rewards.

The SEC provides additional pyramid scheme red flags:

- In some instances, no real products or services are offered for sale.
- There is a promise of high returns quickly and easily.
- Buy-in is required to participate.
- There is a complex commission structure.

When does an MLM cross the line to become a pyramid scheme? Two distinctions between an MLM and a pyramid scheme are the recruitment of new participants and the composition of commissions. According to the FTC, participants in an MLM are selling products to a consumer, with earnings and commissions based on the participants’ sales. Earnings and commissions can also be based on recruiting new participants and the sales those new participants make to consumers.

Think of this in levels. Imagine that participant 1 recruits participants 2, 3 and 4, and then participant 3 recruits participants 5 and 6. Each participant earns commission on their own sales, plus participant 1 receives commission on the sales made by 2, 3, 4, 5 and 6, and participant 3 receives commission from the sales made by 5 and 6.

With pyramid schemes, earnings and commissions do not necessarily come from sales to consumers. If participants 1 through 6 above were in a pyramid scheme, all participants would earn commission from their own sales to consumers. The difference is that participant 1 will earn commission from the initial buy-in and inventory purchases made by recruits 2 through 6 in order to become participants. Likewise, participant 3 will earn commission from

the initial buy-in and inventory purchases of participants 5 and 6. This structure leaves participants 5 and 6 with only earnings from sales to consumers and they will need to constantly reinvest those earnings to buy more inventory. For participants 5 and 6 to increase their commissions, they will need to recruit more participants under them to buy into the scheme and purchase inventory to sell to consumers.

How the Pandemic Affected MLMs and Pyramid Schemes

The pandemic and the recession that followed did not slow down MLMs and pyramid schemes. At the beginning of the pandemic, with many people laid off from their jobs and large segments of the workforce sent home to work, MLMs seemed ideal. Pyramid schemes were also on the rise during the pandemic, like so many other frauds. In the Association of Certified Fraud Examiner's report "The Next Normal: Preparing for a Post-Pandemic Fraud Landscape," 51% of responding organizations uncovered more fraud since the beginning of the pandemic and 71% expect an increase over the next 12 months in the levels of fraud impacting organizations.

In March 2020, the Direct Selling Association (DSA) began surveying its members about how the COVID-19 pandemic impacted company revenue in the United States, with the last update on July 23, 2021. According to more than half of the respondents, comprised of direct selling companies, the pandemic had a positive impact on company revenue. A 2020 industry overview infographic prepared by the DSA shows the number of direct sellers in the United States grew by 7.7 million, a 13.2% increase from 2019. In other words, the pandemic created a prime opportunity for pyramid schemes to prey on people who suddenly found themselves out of work.

‘Washington v. LuLaRoe’

LLR LuLaRoe Inc. is a company famous for selling leggings on Facebook and other social media platforms. LuLaRoe used “levels” for its participants that ranged from “sponsors,” the lowest tier, to “mentors,” the fourth and highest tier. On Jan. 23, 2019, Robert W. Ferguson, the attorney general of Washington, filed a complaint for injunctive relief and other relief on behalf of the plaintiff, the state of Washington, against LuLaRoe and other defendants, including company founders Mark A. Stidham and Deanne S. Brady Stidham and her son, Jordan K. Brady. The complaint alleged that LuLaRoe operated an unlawful pyramid scheme. The complaint alleged that prior to July 1, 2017, LuLaRoe’s bonus package was based on recruitment of new participants (consultants) and the inventory purchased by those consultants, not the product sold by the consultants.

Additional evidence for the allegation that LuLaRoe was a pyramid scheme included:

- The claim that participants could “make a full-time income doing part-time work.”
- The practice of “inventory loading” by encouraging participants to purchase and maintain sizeable inventories to stay active and eligible for bonuses.
- A complicated refund and return policy for participants.

As stated in the complaint, prior to July 1, 2017, LuLaRoe’s bonus program was based on recruitment and inventory purchases by consultants. The bonus program was subsequently changed to bonuses based on sales, rather than inventory purchases. This resulted in a large decline in commissions for participants. The large bonus checks that once ranged from tens to hundreds of thousands of dollars ended. The complaint includes statements by Defendant Jordan Brady during an Oct. 27, 2016, webinar, in which he explained the rationale for the change in policy:

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In February, Ferguson announced a resolution with LuLaRoe agreeing to pay $4.75 million. Four million of that total was to be paid in restitution to LuLaRoe consultants who were residents of Washington state. In addition to the monetary payment, LuLaRoe was required to publish income disclosures, calculate bonuses on retail sales by consultants, conduct random and targeted audits to verify sales to actual consumers, and modify its return and refund policy.

Words From the Wise

While the promise of quick money, working from home, and owning your own business might seem very tempting at first, a 2018 AARP study of MLMs showed that nearly 75% of participants either lost money or broke even. In a Time article from July 2020, Carl Daikeler, CEO of Beachbody, offered this view to those considering an MLM: "This is not something you jump into and instantly make a lot of money. I will literally say, 'Are you sure? And do you have money saved? Because this is starting your own business, and starting your own business is very hard. Most new businesses that start, fail.'"

Nicole McNeil Donecker *is a senior manager in the valuation & litigation support services group of Marcum's Philadelphia office. A forensic accounting specialist, she provides investigative accounting and litigation support services to attorneys, insurance companies, financial institutions and governmental entities. Contact her at Nicole.donecker@marcumllp.com.*

December 16, 2011

Herbalife statement regarding Belgian Commercial Court Ruling

LOS ANGELES--(BUSINESS WIRE)-- Herbalife (NYSE:HLF) plans to appeal a recent Belgian Commercial Court judgment in a case brought by local consumer organization Test-Aankoop in 2004. The ruling states that Herbalife's sales method violates current Belgian law on unfair commercial practices. It includes a maximum fine of 250,000 euros, should a court determine that any modifications the company makes to its business practices are inadequate to clarify compliance with the judgment.

While the Belgian market represents less than 0.65 percent of the company's worldwide net sales, Herbalife remains fully committed to supporting its Belgian independent distributors and the large customer base they have built over the many years Herbalife has been in Belgium. The company firmly believes its sales method is in compliance with all applicable Belgian laws.

Herbalife believes the judgment contains factual errors and is based on misinterpretations of the law and its direct-selling sales model. Herbalife remains committed to its multi-level direct-selling sales model and is confident that, with clarifications in certain aspects of its business, there will be no doubt as to its compliance with all applicable Belgian laws.

Herbalife has always been a strong campaigner and supporter for legislation to protect consumers against unscrupulous business practices wherever it does business. As part of its commitment to furthering industry best practice and safeguarding consumers around the world, Herbalife plays an active role in, and adheres to the Codes of Conduct of, a large number of industry trade organizations, including The World Federation of Direct Selling Associations, SELDIA – the European Direct Selling Association and more than 40 national Direct Selling Associations.

About Herbalife Ltd.

Herbalife Ltd. (NYSE:HLF) is a global nutrition company that sells weight-management, nutrition, and personal care products intended to support a healthy lifestyle. Herbalife products are sold in 79 countries through a network of approximately 2.5 million independent distributors. The company supports the Herbalife Family Foundation and its Casa Herbalife program to help bring good nutrition to children. For more information, www.herbalife.com.

Herbalife Ltd.
George Fischer, 213-745-0519
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Source: Herbalife Ltd.

December 3, 2013

Herbalife Statement Regarding Belgian Appeal Court Ruling

LOS ANGELES--(BUSINESS WIRE)-- Global nutrition company Herbalife (NYSE: HLF), welcomes the judgment by a Belgian Appeal Court that states the company's sales model is in full compliance with Belgian law. This judgment overturns a previous ruling by the lower court, in response to claims brought by Belgian consumer organization Test-Aankoop, that Herbalife was operating a pyramid scheme.

Herbalife always believed that the first judgment contained factual errors and was based on misinterpretations of its direct-selling sales method, and was confident that the original judgment would be overturned on appeal.

Herbalife continues to focus on supporting its independent distributors and their customers in Belgium, and the company remains committed to an open and transparent relationship with those distributors and customers, as well as regulatory authorities and all other stakeholders.

About Herbalife Ltd.

Herbalife Ltd. (NYSE:HLF) is a global nutrition company that sells weight-management, nutrition and personal care products intended to support a healthy lifestyle. Herbalife products are sold in more than 90 countries to and through a network of independent distributors. The company supports the Herbalife Family Foundation and its Casa Herbalife program to help bring good nutrition to children. Herbalife's website contains financial and other information about Herbalife at www.herbalife.com.

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Source: Herbalife Ltd.

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UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

HERBALIFE INTERNATIONAL OF AMERICA, INC., a corporation;

HERBALIFE INTERNATIONAL, INC., a corporation; and

Case No. 2:16-cv-05217

STIPULATION TO ENTRY OF ORDER FOR PERMANENT INJUNCTION AND MONETARY JUDGMENT

HERBALIFE, LTD., a corporation,

Defendants.

Plaintiff, the Federal Trade Commission ("Commission"), filed its Complaint for Permanent Injunction and Other Equitable Relief ("Complaint") in this matter, pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b). The Commission and Defendants stipulate to entry of a Stipulated Order for Permanent Injunction and Monetary Judgment ("Order"), lodged concurrently with this Stipulation, with the following terms and provisions:

THEREFORE, IT IS ORDERED as follows:

FINDINGS

Plaintiff and Defendants stipulate to the following findings:

1. This Court has jurisdiction over this matter.

2. The Complaint charges that Defendants participated in unfair and deceptive acts or practices in violation of Section 5 of the FTC Act, 15 U.S.C. § 45, by: promoting participation in a multi-level marketing program with a compensation structure that causes or is likely to cause harm to participants; making false or misleading income representations; making unsubstantiated claims regarding the retail sales income earned by participants in Defendants' program; and providing participants in Defendants' program with the means and instrumentalities to engage in deceptive acts and practices.

3. Defendants neither admit nor deny any of the allegations in the Complaint, except as specifically stated in this Order. Only for purposes of this action, Defendants admit the facts necessary to establish jurisdiction.

4. Defendants waive any claim that they may have under the Equal Access to Justice Act, 28 U.S.C. § 2412, concerning the prosecution of this action through the date of this Order, and agree to bear their own costs and attorney fees.

5. Defendants waive all rights to appeal or otherwise challenge or

contest the validity of this Order.

DEFINITIONS

For the purpose of this Order, the following definitions apply:

A. "**Business Opportunity Participant**" or "**Participant**" means any individual who is participating in a Multi-Level Marketing Program. "Business Opportunity Participant" or "Participant" does not include Preferred Customers.

B. "**Business Venture**" means any written or oral business arrangement, however denominated, whether or not covered by 16 C.F.R. Part 437, that consists of the payment of any consideration for the right or means to offer, sell, or distribute goods or services (whether or not identified by a trademark, service mark, trade name, advertising or other commercial symbol). The definition of "Business Venture" includes Multi-Level Marketing Programs.

C. "**Defendants**" means all of the Defendants and their successors and assigns, individually, collectively, or in any combination.

D. "**Downline**" refers to the collection of all Business Opportunity Participants whom a Business Opportunity Participant has personally recruited or sponsored (first level), all Participants and Preferred Customers recruited or sponsored by first level Participants (second level), all Participants and Preferred Customers recruited or sponsored by second level Participants (third level), and so forth, however denominated (including, but not limited to, "downline," "tree," "cooperative," or "income center"), whose activities are the basis, in whole or part, for any payment or compensation from Defendants to the Business Opportunity Participant.

E. "**Multi-Level Compensation**" means any payment or compensation (including, but not limited to, "wholesale profit," "commissions," "royalties," "overrides," and "bonuses") in a Multi-Level Marketing

Program from Defendants to a Business Opportunity Participant that is based, in whole or in part, on the activities of the Participant's Preferred Customers and the Participant's Downline.

F. "**Multi-Level Marketing Program**" or "**Program**" means any marketing program in which Business Opportunity Participants have the right to (1) sell goods or services; (2) recruit others into the Program; and (3) receive payment or other compensation that is based, in whole or in part, upon the Product purchases, sales, or other activities of the Participant's Downline.

G. "**Net Rewardable Sales**" for Defendants means the annual total of

1. Net Sales generated by Preferred Customer Sales and Product sales that result in Profitable Retail Sales; and
2. Net Sales generated by Rewardable Personal Consumption, determined pursuant to Subsection I.E.

Provided, however, that if the total of G.2 would exceed one-third of the combined total of G.1 and G.2, then Net Rewardable Sales shall equal one-and-a-half times the total of G.1.

H. "**Net Sales**" means gross Product sales in the United States by Defendants, including packaging and handling, freight recovery, and surcharges, and net of any returns, refunds, Product Discounts, and allowances, including Wholesale Commissions.

I. "**Preferred Customer**" means an individual who joins or registers with a Multi-Level Marketing Program as a customer only, and who does not have the right to (1) sell goods or services; (2) recruit others into the Program; or (3) receive Multi-Level Compensation.

J. "**Preferred Customer Sales**" or "**Sales to Preferred Customers**" means sales of Products made directly from Defendants to Preferred Customers.

K. "**Product**" means any good sold by Defendants that can potentially generate Multi-Level Compensation pursuant to Defendants' compensation plan.

L. "**Product Discount**" refers to the difference between Defendants' suggested retail price for a Product and the Product price charged by Defendants to the purchaser in a purchase made directly from Defendants.

M. "**Profitable Retail Sale**" means a sale of Product by a Business Opportunity Participant to a Retail Customer or a Preferred Customer that is a genuine sale made at a price above the Business Opportunity Participant's average wholesale cost over the preceding twelve (12) months for the items sold (including tax and the actual or approximate cost of shipping, handling, and any similar fees) and for which retail sale information is collected and maintained by Defendants.

N. "**Retail Customer**" means a purchaser of Products sold through a Multi-Level Marketing Program who is not a Business Opportunity Participant or a Preferred Customer, is not registered with the Program, and is not otherwise participating in the Program.

O. "**Rewardable Personal Consumption**" means sales of Product by Defendants to a Business Opportunity Participant, for his own or his household's use, that can potentially be used to generate Multi-Level Compensation as set forth in Subsection I.E.

P. "**Total Net Sales**" for Defendants means the total of Net Sales in a fiscal year.

Q. "**Wholesale Commissions**" means Multi-Level Compensation generated by a Product purchase from Defendants that, in total for the transaction, equals the difference between the purchaser's Product Discount and the lesser of either the maximum Product Discount for the Product under Defendants' compensation plan or 50% of the suggested retail price of the Product, and is paid by Defendants to Participants whose Product Discount is greater than that of the purchaser and who have such purchaser either in their Downline or as a Preferred Customer whom they recruited or sponsored.

ORDER

I.

PROHIBITED BUSINESS PRACTICES

IT IS ORDERED that Defendants, Defendants' officers, agents, employees, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, are permanently restrained and enjoined from advertising, marketing, promoting, or offering any Multi-Level Marketing Program unless such program has the following characteristics:

A. **Limitations on Multi-Level Compensation.** The program shall include, and Defendants shall enforce, the following provisions:

1. Any Multi-Level Compensation paid to a Participant for a given period shall be generated solely by the following categories of transactions ("Rewardable Transactions") occurring in the same period or, during such Participant's first six months as a Business Opportunity Participant, the three months prior to that period:
    a. Sales to Preferred Customers whom the Participant has personally recruited or sponsored;
    b. Sales to Preferred Customers in the Participant's Downline;
    c. Profitable Retail Sales of the Participant's Downline, as calculated by Defendants using the information collected pursuant to Subsection I.C; and
    d. All or a portion of Rewardable Personal Consumption transactions, determined pursuant to Subsection I.E., of the Participant's Downline; *provided that* the Rewardable Personal Consumption transactions included in a Participant's Rewardable Transactions shall be limited such that no more than one-third of the total value of the Participant's Multi-Level

Compensation may be attributable to or generated by such transactions.

2. If a Participant has transactions that are not Rewardable Transactions ("Non-Rewardable Transactions") in his or her Downline, the amount of any Multi-Level Compensation that the Participant may receive shall not vary from the amount of Multi-Level Compensation that the Participant would be entitled to receive if such Non-Rewardable Transactions were not in his or her Downline; *i.e.,* the total amount of a Participant's Multi-Level Compensation shall not be increased because the Non-Rewardable Transactions were in the Participant's Downline rather than in any other Participant's Downline.
3. Any point system or other method used to measure Rewardable Transactions shall assign the same value to a given Product regardless of whether the Product was sold to a Preferred Customer, to a Retail Customer, or to a Business Opportunity Participant. Any system that calculates Multi-Level Compensation shall not vary the compensation for a Rewardable Transaction based on whether the Product was sold to a Preferred Customer, to a Retail Customer, or to a Business Opportunity Participant for personal consumption.
4. For any fiscal year, if the total of Net Rewardable Sales is less than 80% of Total Net Sales, the sum of Multi-Level Compensation payments excluding Wholesale Commissions by Defendants to Participants may not exceed forty-one point seven five percent (41.75%) of the amount of Net Rewardable Sales, which reflects a ten-percent (10%) increase over the percentage of Multi-Level Compensation excluding Wholesale Commissions paid by Defendants in fiscal year 2015.
5. No compensation shall be paid solely for enrolling or recruiting a

Participant or a Preferred Customer into the Program.

B. **Preferred Customer Category.** The program shall differentiate between Preferred Customers and Business Opportunity Participants, including through the following requirements:

1. A Preferred Customer's classification cannot change to Business Opportunity Participant except upon the Preferred Customer's written request or application or other written expression of intent made directly to and approved by Defendants.
2. A Business Opportunity Participant's classification cannot change to Preferred Customer except upon the Participant's written request or application or other written expression of intent made directly to and approved by Defendants.
3. A Preferred Customer who becomes a Business Opportunity Participant may not receive any benefit or status that depends in any way on that individual's activity as a Preferred Customer, except that any discount that the individual obtained as a Preferred Customer may continue to be used to purchase Product that is designated, at the time of purchase, as being for the individual's own or household use.
4. All individuals who are registered with or participating in the Program as of the Effective Date of this Section and who have not affirmatively elected to be classified as Preferred Customers pursuant to Subsection I.B.2, above, shall be classified as Business Opportunity Participants.

C. **Collection of Retail Sales Information.** Defendants shall collect from Business Opportunity Participants and maintain in a standardized format the following information for any claimed Profitable Retail Sale:

1. the method of payment;
2. the Products and quantities sold;
3. the date;

4. the price paid by the purchaser;
5. the first and last name of the purchaser;
6. contact information for the purchaser, including at least two of the following: telephone number, address or e-mail address; and
7. for any paper receipt submitted to Defendants, the signature of the Retail Customer or Preferred Customer.

D. **Verification of Retail Sales and Preferred Customer Sales.** The following requirements shall apply regarding Profitable Retail Sales and Preferred Customer Sales:

1. Defendants shall take all reasonable steps, including both random and targeted audits, to monitor Profitable Retail Sales and Preferred Customer Sales in order to ensure that they are genuine sales of Products, rather than an attempt to manipulate the Program's compensation plan.
2. Defendants shall take all reasonable steps, including both random and targeted audits, to monitor Profitable Retail Sales in order to ensure that they in fact occurred as reported in the information collected and maintained pursuant to Subsection I.C.
3. If the total amount of Product claimed by any Business Opportunity Participant as Profitable Retail Sales exceeds the total amount of Product purchased by the Participant subsequent to the Effective Date of this Section, less any amount designated at the time of purchase as being for the Participant's own or household use, Defendants shall not pay any Multi-Level Compensation on the excess amount of claimed Profitable Retail Sales.

E. **Limitations on Rewardable Personal Consumption.** The Rewardable Personal Consumption of a Business Opportunity Participant in a given period shall be limited to purchases in that period that are designated by the

Business Opportunity Participant at the time of purchase as being for the Business Opportunity Participant's own or household use. Rewardable Personal Consumption shall also be subject to the following additional limitations:

1. For the first twelve (12) months following the date this Subsection becomes effective, an individual Business Opportunity Participant's own purchases in a given month may be Rewardable Personal Consumption in an amount not to exceed $200 of wholesale Product expenditures (including tax and actual or approximate shipping, handling, and similar fees).
2. Beginning twelve (12) months after the date this Subsection becomes effective, an individual Business Opportunity Participant's own purchases (including tax and actual or approximate shipping, handling, and similar fees) in a given month may be Rewardable Personal Consumption in an amount not to exceed the greater of:
    a. $125 in wholesale Product expenditures; or
    b. the 75th percentile of average monthly wholesale Product expenditures among Preferred Customers over the prior twelve (12) months (the "measurement window"). The population of Preferred Customers from which the 75th percentile shall be computed shall consist exclusively of all Preferred Customers who had the status of Preferred Customer for at least six (6) months of the measurement window and who purchased product directly from Defendants at least once during each of the calendar quarters in which they had the status of Preferred Customer during the measurement window. Each Preferred Customer's "average monthly wholesale Product expenditure" shall be calculated by summing up all Product expenditures

(including tax and shipping, handling, and similar fees) made by the Preferred Customer directly from Defendants during the measurement window and made while he or she had the status of Preferred Customer, and dividing that sum by the total number of months in the measurement window for which he or she had the status of Preferred Customer, regardless of whether he or she made purchases in any of those months. This latter limit option shall be available only if the population of Preferred Customers being ranked consists of not less than 20,000 individuals.

3. The limitation of Subsection I.E.2 shall be re-set annually, based on the prior twelve (12) months of activity, through the procedure set forth in that Subsection.

F. **Limitations on Thresholds, Targets, and Requirements.** The Program shall include, and Defendants shall enforce, the following policies:

1. Business Opportunity Participants shall not be required to purchase a minimum quantity of products, except that Defendants may require Business Opportunity Participants to purchase an initial start-up package or its equivalent, provided that no Multi-Level Compensation is generated or paid on the purchase.

2. To the extent the Program requires that a Participant meet a threshold or target in order to (a) obtain or maintain a level or designation necessary to receive any particular type or amount of Multi-Level Compensation; (b) qualify or become eligible to receive Multi-Level Compensation; (c) otherwise increase the Participant's amount of Multi-Level Compensation; or (d) obtain, maintain, increase, or qualify for a discount or rebate on Product purchased for resale; such threshold or target shall be met exclusively through Profitable Retail

Sales and Sales to Preferred Customers.

3. Business Opportunity Participants are prohibited from participating in any auto-shipment program or any similar program involving standing orders of product.

G. **Refund Policies.** The program shall include, and Defendants shall enforce, the following policies related to product refunds or buybacks:

1. For at least the first twelve (12) months after becoming a Business Opportunity Participant, Participants are entitled to a full refund from Defendants of the cost of any start-up package or its equivalent. If Defendants require, as part of their refund procedure, that any part of the start-up package or its equivalent be returned, Defendants will pay for any shipping costs associated with such return.
2. Business Opportunity Participants are entitled to a full refund from Defendants of the cost, including tax and any fees, of any unopened products purchased from Defendants within the previous twelve (12) months. If Defendants require, as part of their refund procedure, that refundable products be returned, Defendants will pay for any shipping costs associated with such return.
3. Defendants shall take effective steps to notify Participants of both (i) the right to return unopened product for a full refund and (ii) contact information, including a telephone number, that may be used to promptly initiate a product return for refund. Such steps shall include, at a minimum, providing clear and conspicuous notice of the same on the following:
    a. Every product purchase invoice or receipt sent from Defendants to a Participant;
    b. Any websites maintained by Defendants that promote or otherwise provide information about the Program;

c. Any application to join the Program as a Business Opportunity Participant; and

d. Any of Defendants' booklets, brochures, or similar printed materials promoting the Program.

4. Preferred Customers are entitled to product refunds on terms and through procedures that are at least as generous as those for Retail Customers.

H. **Required Training for Business Opportunity Participants.** Defendants shall not pay Multi-Level Compensation to any Participant, and shall prohibit and prevent such Participant from recruiting or sponsoring other Participants, until such Participant has successfully completed a training course conducted by Defendants that is focused on the following topics: (a) the importance of purchasing only the amount of product that the Participant expects to sell in the near future; (b) how to document retail sales; (c) prohibitions on and consequences for falsifying retail sales documentation; (d) how to identify and account for business-related expenses and calculate profit or loss; (e) how to create a business budget and manage income and expenses; (f) prohibited and permissible representations to Participants and potential Participants; (g) how to receive a refund or buyback for unwanted product; and (h) how to submit a complaint about the business opportunity to Defendants and to law enforcement.

I. **Policies Relating to Leased or Purchased Business Locations.** The program shall include, and Defendants shall enforce, the following policies relating to leased or purchased business locations:

1. Participants are prohibited from entering into any lease, sublease, or purchase of a physical location or a portion of a physical location (other than their homes or dwellings) for their Program-related businesses until they have:

a. been Business Opportunity Participants for at least twelve (12) consecutive months;

b. successfully completed a training course conducted by Defendants that focuses on the following topics as related to the operation of a leased or purchased business location: (i) how to identify and account for all business-related expenses and calculate profit or loss; (ii) how to create a budget and manage income and expenses; (iii) how to learn about and comply with local laws that may affect the Participant's business; and (iv) how to create a business plan meeting the requirements set forth in Subsection I.I.c, below; and

c. prepared a written business plan that such Participant must retain and make available to Defendants or to the Independent Compliance Auditor upon request, and that (i) identifies the facilities and equipment that will be used for business operations and the costs of acquiring such facilities and equipment; (ii) identifies applicable city, county, and state regulations and the steps and costs necessary for the Participant to operate in compliance therewith; (iii) estimates start-up costs and identifies the source of funding for such costs; (iv) presents a promotional plan for attracting customers to the location; (v) estimates the monthly and annual volume of customers and sales necessary for the Participant's retail business to operate profitably; and (vi) forecasts income, overhead, and operating expenses by month for the first two years of operation.

II.

PROHIBITED MISREPRESENTATIONS

IT IS FURTHER ORDERED that Defendants, Defendants' officers,

agents, and employees, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, in connection with the advertising, marketing, promoting, or offering of any Business Venture, are permanently restrained and enjoined from misrepresenting or assisting others in misrepresenting, including by providing others with the means and instrumentalities with which to misrepresent, expressly or by implication:

A. That participants will or are likely to earn substantial income;

B. The amount of revenue, income, or profit a participant actually earned or can likely earn;

C. The reasons participants do not earn significant income, including but not limited to representations that participants fail to devote substantial or sufficient effort; and

D. Any other fact material to participants concerning the Business Venture, such as: the total costs to participate, including trainings, brochures, and sales aids; any material restrictions, limitations, or conditions on operating the Business Venture; or any material aspect of its performance, efficacy, nature, or central characteristics.

III.

PROHIBITED LIFESTYLE REPRESENTATIONS

IT IS FURTHER ORDERED that Defendants, Defendants' officers, agents, and employees, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, in connection with the advertising, marketing, promoting, or offering of any Business Venture, are permanently restrained and enjoined from representing that participation in the Business Venture is likely to result in a lavish lifestyle, and from using images or descriptions to represent or imply that participation in the Business Venture is likely to result in a lavish lifestyle. For the purposes of this

Section, the following are examples of prohibited claims when made to a general audience of prospective or current participants:

A. Statements that participants can "quit your job," "be set for life," "earn millions of dollars," "make more money than they ever have imagined or thought possible," "realize unlimited income," or any substantially similar representations; and

B. Descriptions or images of opulent mansions, private helicopters, private jets, yachts, exotic automobiles, or any substantially similar representations.

IV.

PROHIBITION AGAINST MATERIAL OMISSIONS AND UNSUBSTANTIATED INCOME REPRESENTATIONS

IT IS FURTHER ORDERED that Defendants, Defendants' officers, agents, and employees, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, in connection with advertising, marketing, promoting, or offering any Business Venture, are permanently restrained and enjoined from:

A. Failing to disclose, clearly and conspicuously, before any potential participant pays any money to Defendants, all information material to the decision of whether to participate in the Business Venture, including, but not limited to whether Defendants have a refund or buyback policy and if so, all material terms and conditions of the refund or buyback policy, including the specific steps consumers must follow to obtain a refund or buyback; and

B. Making any representation, expressly or by implication, regarding the amount or level of income, including full-time or part-time income, that a participant can reasonably expect to earn unless the representation is non-misleading and, at the time such representation is made, Defendants possess and rely upon competent and reliable evidence sufficient to substantiate that the representation is true. Implied representations regarding the amount or

level of income that a participant reasonably can expect to earn include but are not limited to representations involving and images used to show an improved lifestyle.

V.

COMPLIANCE MONITORING BY DEFENDANTS

IT IS FURTHER ORDERED that Defendants, Defendants' officers, agents, employees, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, in connection with advertising, marketing, promoting, or offering any Multi-Level Marketing Program, are hereby permanently restrained and enjoined from:

A. Failing to take all reasonable steps necessary to monitor and ensure that Defendants' agents, representatives, employees, and independent contractors act in compliance with the requirements of Sections I–IV of this Order. For purposes of this Subsection, an individual's status as a Business Opportunity Participant alone does not render him or her an agent, representative, employee, or independent contractor of Defendants.

B. Failing to take all reasonable steps necessary to monitor and ensure that Business Opportunity Participants and Preferred Customers act in compliance with the requirements of Sections II–IV of this Order.

C. Providing any monetary compensation to any Business Opportunity Participant when Defendants know or should know that such monetary compensation is or would be based on claimed transactions that are not in accordance with the requirements of Section I.

D. Failing to claw back any monetary compensation to any Business Opportunity Participant when Defendants learn or should have learned that such monetary compensation was based on claimed transactions that were not in accordance with the requirements of Section I.

E. Failing to implement and maintain a corrective action program that deters and corrects behaviors of Business Opportunity Participants and Preferred Customers that are not in compliance with the requirements of this Order.

F. Failing to promptly and thoroughly investigate any complaint received by Defendants relating to compliance with this Order and to notify the complainant of the resolution of the complaint and the reason therefor, unless legitimate business reasons exist not to notify the complainant.

VI.

INDEPENDENT COMPLIANCE AUDITOR

IT IS FURTHER ORDERED that an Independent Compliance Auditor ("ICA") shall be appointed to further ensure compliance with Section I.A–F and I.I of this Order, as set forth below. The ICA shall be an independent third party, not an employee or agent of the Commission or of Defendants, and no attorney-client or other professional relationship shall be formed between the ICA and Defendants. No later than sixty (60) days after the entry of this Order, Commission staff and Defendants shall select the ICA by mutual agreement. If the parties are unable to agree on an ICA who is willing and able to perform the ICA's duties under this Order, they shall submit the matter to the Court for determination. Defendants shall consent to the following terms and conditions regarding the ICA:

A. The ICA shall serve, without bond or other security, at the expense of Defendants. Defendants shall execute an agreement that, subject to the prior approval of Commission staff, confers upon the ICA all the rights and powers necessary to permit the ICA to perform its duties and responsibilities pursuant to and in accordance with the provisions of this Order. Any individual who serves as ICA or performs duties at the ICA's direction shall agree not to be retained by the Commission or Defendants for a period of two years after the conclusion of the engagement.

B. Beginning at the Effective Date applicable to Section I of this Order, the

ICA shall have the duty and responsibility to diligently and competently review, assess, and evaluate Defendants' compliance with the following requirements of Section I of this Order, namely the requirements that:

1. Defendants are paying Multi-Level Compensation only in accordance with Subsection I.A, and subject to the limitations set forth in Subsections I.D., I.E, I.F, and I.H;
2. Defendants are differentiating between Preferred Customers and Business Opportunity Participants as required by Subsection I.B;
3. Defendants are collecting and maintaining retail sales information as required by Subsection I.C;
4. Defendants are taking all reasonable steps necessary to monitor and ensure that Profitable Retail Sales and Preferred Customer Purchases are genuine sales of Products, rather than an attempt to manipulate the program's compensation plan, as required by Subsection I.D.1;
5. Defendants are taking all reasonable steps necessary to monitor and ensure that Profitable Retail Sales in fact occurred as reported in the information collected and maintained pursuant to Subsection I.D.2;
6. Defendants are complying with the requirements and limitations relating to claimed Profitable Retail Sales set forth in Subsection I.D.3;
7. Defendants are complying with the requirements and limitations relating to Rewardable Personal Consumption set forth in Subsection I.E;
8. Defendants are complying with the limitations on thresholds, targets, and requirements set forth in Subsection I.F;
9. Defendants are complying with and enforcing the requirements and limitations on leased or purchased business locations set forth in Subsection I.I.

C. Subject to the terms of this Order, the ICA shall have authority to engage professional staff, at the expense of Defendants, to assist the ICA in carrying out the ICA's duties and responsibilities.

D. Except for information protected by any demonstrated legally-recognized privilege, the ICA shall have full and complete access to all reasonably available information in the possession, custody, or control of Defendants that is relevant to accomplishing the ICA's duties and responsibilities described in Section VI. Defendants may consult with the ICA concerning the ICA's work, including but not limited to the ICA's findings and recommendations, as appropriate.

E. The ICA, and any staff engaged to assist the ICA in carrying out the ICA's duties and responsibilities, shall maintain the confidentiality of any of Defendants' information obtained in accordance with this Order, and shall not disclose such information to any other person except in accordance with this Order; *except that*, upon request, the ICA shall share records and information with Commission staff. Nothing in this Section shall affect or impair the Commission's ability to obtain records and information pursuant to Section XII.

F. Defendants may require the ICA, and any staff engaged to assist the ICA in carrying out the ICA's duties and responsibilities, to sign a customary confidentiality agreement; *provided, however,* that such agreement shall not restrict the ICA (and its representatives) from providing any information to Commission staff.

G. Commission staff may require the ICA, and any staff engaged to assist the ICA in carrying out the ICA's duties and responsibilities, to sign an appropriate confidentiality agreement related to Commission materials and information received in connection with the performance of the ICA's duties, and to take other appropriate steps to protect the confidentiality of the

same.

H. The ICA shall serve for seven (7) years after the Effective Date applicable to Section I of this Order.

I. The ICA shall periodically report in writing to Commission staff and to Defendants on Defendants' compliance with each of the subsections of Section I. For the first three (3) years, the ICA shall make such reports every six (6) months, beginning six months following the Effective Date applicable to Section I. After the first three (3) years, the frequency of such reports shall be decreased to annually.

J. If, at any time, the ICA determines that Defendants are not in substantial compliance with Section I.A–F or I.I of this Order, the ICA shall so notify Commission staff and consult with Defendants. Defendants may at any time submit to Commission staff and to the ICA a written response to the ICA's notification.

K. The ICA shall prepare a budget and work plan as follows:

1. No later than ninety (90) days prior to the Effective Date applicable to Section I of this Order, the ICA shall, in consultation with Commission staff and Defendants, prepare and present to Commission staff and Defendants an annual budget and work plan (the "ICA Budget") describing the scope of work to be performed and the fees and expenses of the ICA and any professional staff to be incurred during the first year following the Effective Date of Section I of this Order.
2. The scope of work, fees, and expenses to be incurred by the ICA and any professional staff shall be reasonable and not excessive, in light of the ICA's defined duties, responsibilities, and powers prescribed in this Order.
3. The ICA shall prepare and submit to Defendants and to Commission

staff an annual ICA Budget no later than ninety (90) days prior to the beginning of each subsequent year of the ICA's term. If Defendants and Commission staff both approve the ICA Budget, the ICA shall adhere to and shall not exceed the approved ICA Budget, unless such deviations are authorized by agreement of the parties or order of the Court.

4. Within 21 days of receipt of any ICA Budget, either Commission staff or Defendants may serve an objection to the ICA, who, within 21 days of such objection, shall provide to Commission staff and Defendants a revised ICA Budget or a notice that no such revision will be made.
5. Following the ICA's response to an objection provided in accordance with Subsection VI.K.3, either Commission staff or Defendants may apply to the Court to modify the ICA Budget.
6. Pending the Court's decision concerning any application pursuant to Subsection VI.K.4, the ICA shall continue to perform its duties and implement the ICA Budget as prepared by the ICA.

L. Defendants shall indemnify the ICA and hold the ICA harmless against all losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the ICA's duties, including all reasonable fees of counsel and other reasonable expenses incurred in connection with the preparations for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from gross negligence, willful or wanton acts, or bad faith by the ICA.

M. In the event Commission staff determines that the ICA has ceased to act or failed to act consistently with the terms of this Subsection, Commission staff may relieve the ICA of its duties.

N. If the ICA has been relieved of its duties, or if the ICA is no longer willing

or able to continue to serve, Commission staff and Defendants shall mutually agree on a replacement ICA. If the parties are unable to agree on a replacement ICA within thirty (30) days, they shall submit the matter to the Court for determination. If more than three (3) months elapse without an ICA in place, the overall term of the ICA set forth in Subsection VI.H shall be extended for a commensurate period.

O. Not later than ten (10) days after the appointment of the replacement ICA, Defendants shall execute an agreement that, subject to the prior approval of Commission staff, confers upon the replacement ICA all the rights and powers necessary to permit the replacement ICA to perform its duties and responsibilities pursuant to this Order.

VII.

MONETARY JUDGMENT

IT IS FURTHER ORDERED that:

A. Judgment in the amount of Two Hundred Million Dollars ($200,000,000) is entered in favor of the Commission against Defendants, jointly and severally, as equitable monetary relief.

B. Defendant Herbalife International of America, Inc. is ordered to pay to the Commission Two Hundred Million Dollars ($200,000,000), within 7 days of entry of this Order by electronic fund transfer in accordance with instructions previously provided by a representative of the Commission.

C. Defendants relinquish dominion and all legal and equitable right, title, and interest in all assets transferred pursuant to this Order and may not seek the return of any assets.

D. The facts alleged in the Complaint will be taken as true, without further proof, in any subsequent civil litigation by or on behalf of the Commission in a proceeding to enforce its rights to any payment or monetary judgment pursuant to this Order, such as a nondischargeability complaint in any

bankruptcy case.

E. The facts alleged in the Complaint establish all elements necessary to sustain an action by the Commission pursuant to Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. § 523(a)(2)(A), and this Order will have collateral estoppel effect for such purposes.

F. Defendants acknowledge that their Taxpayer Identification Numbers or Employer Identification Numbers, which Defendants must submit to the Commission, may be used for collecting and reporting on any delinquent amount arising out of this Order, in accordance with 31 U.S.C. § 7701.

G. All money paid to the Commission pursuant to this Order may be deposited into a fund administered by the Commission or its designee to be used for equitable relief, including consumer redress and any attendant expenses for the administration of any redress fund. If a representative of the Commission decides that direct redress to consumers is wholly or partially impracticable or money remains after redress is completed, the Commission may apply any remaining money for such other equitable relief (including consumer information remedies) as it determines to be reasonably related to Defendants' practices alleged in the Complaint. Any money not used for such equitable relief is to be deposited to the U.S. Treasury as disgorgement. Defendants have no right to challenge any actions the Commission or its representatives may take pursuant to this Subsection.

VIII.

CUSTOMER INFORMATION

IT IS FURTHER ORDERED that Defendants, Defendants' officers, agents, and employees, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, are permanently restrained and enjoined from directly or indirectly failing to provide sufficient customer information to enable the Commission to efficiently administer consumer redress.

Defendants represent that they have provided this redress information to the Commission. If a representative of the Commission requests in writing any information related to redress, Defendants must provide it, in the form prescribed by the Commission, within 14 days.

IX.

ORDER ACKNOWLEDGMENTS

IT IS FURTHER ORDERED that Defendants obtain acknowledgments of receipt of this Order:

A. Each Defendant, within 7 days of entry of this Order, must submit to the Commission an acknowledgment of receipt of this Order sworn under penalty of perjury.

B. For ten (10) years after entry of this Order, Defendants must deliver a copy of this Order to: (1) all principals, officers, directors, and LLC managers and members, including Participants who serve as principals, officers, directors, and LLC managers and members; (2) all employees, agents, and representatives having managerial responsibilities concerning conduct covered by Sections I–IV of this Order; (3) Business Opportunity Participants who are members of the Founder's Circle or Chairman's Club or any group with similar stature under the marketing plan; (4) any business entity resulting from any change in structure as set forth in the Section titled Compliance Reporting. Delivery must occur within 7 days of entry of this Order for current personnel. For all others, delivery must occur before they assume their responsibilities.

C. From each individual or entity to which a Defendant delivered a copy of this Order, that Defendant must obtain, within 30 days, a signed and dated acknowledgment of receipt of this Order.

X.

COMPLIANCE REPORTING

IT IS FURTHER ORDERED that Defendants make timely submissions to the Commission:

A. One year after entry of this Order, each Defendant must submit a compliance report, sworn under penalty of perjury. Each Defendant must:

1. Identify the primary physical, postal, and email address and telephone number, as designated points of contact, which representatives of the Commission may use to communicate with Defendant;
2. Identify all of that Defendant's businesses by all of their names, telephone numbers, and physical, postal, email, and Internet addresses;
3. Describe the activities of each business, including the goods and services offered, the means of advertising, marketing, and sales, and the involvement of any other Defendant;
4. Describe in detail whether and how that Defendant is in compliance with each Section of this Order; and
5. Provide a copy of each Order Acknowledgment obtained pursuant to this Order, unless previously submitted to the Commission.

B. For nine (9) years after entry of this Order, each Defendant must submit a compliance notice, sworn under penalty of perjury, within 14 days of any change in the following:

1. Any designated point of contact; or
2. The structure of Defendant or any entity that Defendant has any ownership interest in or controls directly or indirectly that may affect compliance obligations arising under this Order, including: creation, merger, sale, or dissolution of the entity or any subsidiary, parent, or affiliate that engages in any acts or practices subject to this Order.

C. Each Defendant must submit to the Commission notice of the filing of any bankruptcy petition, insolvency proceeding, or similar proceeding by or against such Defendant within 14 days of its filing.

D. Any submission to the Commission required by this Order to be sworn under penalty of perjury must be true and accurate and comply with 28 U.S.C. § 1746, such as by concluding: "I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on: _____" and supplying the date, signatory's full name, title (if applicable), and signature.

E. Unless otherwise directed by a Commission representative in writing, all submissions to the Commission pursuant to this Order must be emailed to DEbrief@ftc.gov or sent by overnight courier (not the U.S. Postal Service) to: Associate Director for Enforcement, Bureau of Consumer Protection, Federal Trade Commission, 600 Pennsylvania Avenue NW, Washington, DC 20580. The subject line must begin: FTC v. Herbalife, Ltd., *et al*.

XI.

RECORDKEEPING

IT IS FURTHER ORDERED that Defendants must create certain records for nine (9) years after entry of the Order, and retain each such record for five (5) years. Specifically, Defendants must create and retain the following records:

A. Accounting records showing the revenues from all goods or services sold to participants in a Business Venture;

B. Personnel records showing, for each person providing services, whether as an employee or otherwise, that person's name; addresses; telephone numbers; job title or position; dates of service; and (if applicable) the reason for termination;

C. Records accurately reflecting current Preferred Customers' and Participants' name, address, telephone number, and e-mail address, and former Preferred

Customers' and Participants' name and last known address, telephone number, and e-mail address;

D. Records of all consumer complaints and refund requests, whether received directly or indirectly, such as through a third party, and any response;

E. All records necessary to demonstrate full compliance with each provision of this Order, including all submissions to the Commission;

F. A copy of each unique advertisement or other marketing material used or disseminated by Defendants to consumers, Preferred Customers, or Participants;

G. A copy of each unique training material used or disseminated by Defendants to Preferred Customers or Participants; and

H. Copies of all contracts or agreements entered into between Defendants and any participant in Defendants' Business Venture.

XII.

COMPLIANCE MONITORING

IT IS FURTHER ORDERED that for the purpose of monitoring Defendants' compliance with this Order and any failure to transfer any assets as required by this Order:

A. Within 14 days of receipt of a written request from a representative of the Commission each Defendant must: submit additional compliance reports or other requested information, which must be sworn under penalty of perjury; appear for depositions; and produce documents for inspection and copying. The Commission is also authorized to obtain discovery, without further leave of court, using any of the procedures prescribed by Federal Rules of Civil Procedure 29, 30 (including telephonic depositions), 31, 33, 34, 36, 45, and 69.

B. For matters concerning this Order, the Commission is authorized to communicate with each Defendant through its counsel. Defendant must

permit representatives of the Commission to interview any employee or other person affiliated with any Defendant who has agreed to such an interview. The person interviewed may have counsel present.

C. The Commission may use all other lawful means, including posing through its representatives as consumers, suppliers, or other individuals or entities, to Defendants or any individual or entity affiliated with Defendants, without the necessity of identification or prior notice. Nothing in this Order limits the Commission's lawful use of compulsory process, pursuant to Sections 9 and 20 of the FTC Act, 15 U.S.C. §§ 49, 57b-1.

XIII.

EFFECTIVE DATE

IT IS FURTHER ORDERED that this Order shall become effective upon entry, except that Section I shall become effective ten (10) months after entry of the Order.

XIV.

RETENTION OF JURISDICTION

IT IS FURTHER ORDERED that this Court retains jurisdiction of this matter for purposes of construction, modification, and enforcement of this Order.

SO STIPULATED AND AGREED:

FOR PLAINTIFF FEDERAL TRADE COMMISSION

Date: 7/15/16

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FOR DEFENDANTS HERBALIFE INTERNATIONAL OF AMERICA, INC., HERBALIFE INTERNATIONAL, INC., AND HERBALIFE, LTD.

Date: 7/14/16

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FOR DEFENDANTS HERBALIFE INTERNATIONAL OF AMERICA, INC., HERBALIFE INTERNATIONAL, INC., AND HERBALIFE, LTD.

Date: 7/14/2016

MARK J. FRIEDMAN, as an officer of Herbalife International of America, Inc.

Date: 7/14/2016

MARK J. FRIEDMAN, as an officer of Herbalife International, Inc.

Date: 7/14/2016

MARK J. FRIEDMAN, as an officer of Herbalife, Ltd.

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

HERBALIFE INTERNATIONAL OF AMERICA, INC., a corporation,

Case No. 2:16-cv-05217

COMPLAINT FOR PERMANENT INJUNCTION AND OTHER EQUITABLE RELIEF

HERBALIFE INTERNATIONAL, INC., a corporation, and

HERBALIFE LTD., a corporation,

Defendants.

Plaintiff, the Federal Trade Commission ("FTC" or "the Commission"), for its Complaint alleges:

1. The FTC brings this action under Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), to obtain permanent injunctive relief, rescission or reformation of contracts, restitution, the refund of monies paid, disgorgement of ill-gotten monies, and other equitable relief for Defendants' acts or practices in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), in connection with the advertising, marketing, promotion, and sale of a multi-level marketing business opportunity.

JURISDICTION AND VENUE

2. This Court has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1331, 1337(a), and 1345, and 15 U.S.C. §§ 45(a) and 53(b).

3. Venue is proper in this district under 28 U.S.C. §§ 1391(b)(2) and (c)(2) and 15 U.S.C. § 53(b).

PLAINTIFF

4. The FTC is an independent agency of the United States Government created by statute. 15 U.S.C. §§ 41–58.

5. The FTC enforces Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), which prohibits unfair or deceptive acts or practices in or affecting commerce.

6. The FTC is authorized to initiate federal district court proceedings, by its own designated attorneys, to enjoin violations of the FTC Act and to secure such equitable relief as may be appropriate in each case, including rescission or

reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies. 15 U.S.C. § 53(b).

DEFENDANTS

7. Defendant Herbalife International of America, Inc. is a Nevada corporation with its principal place of business at 800 W. Olympic Boulevard, Los Angeles, California. Defendant Herbalife International of America, Inc. is a wholly-owned subsidiary of Herbalife International, Inc. and an indirectly wholly-owned subsidiary of Herbalife Ltd., and is employed by those entities to conduct their U.S. operations. Herbalife International of America, Inc. transacts or has transacted business in this district and throughout the United States.

8. Defendant Herbalife International, Inc. is a Nevada corporation with its principal place of business at 800 W. Olympic Boulevard, Los Angeles, California. Herbalife International, Inc. is an indirect wholly-owned subsidiary of Herbalife Ltd. Herbalife Ltd. employs Herbalife International, Inc. to manage its global marketing company. Herbalife International, Inc. transacts or has transacted business in this district and throughout the United States.

9. Defendant Herbalife Ltd. is a corporation organized under the laws of the Cayman Islands with its principal place of business at P.O. Box 309GT, Ugland House, South Church Street, Grand Cayman, Cayman Islands. Herbalife Ltd. transacts or has transacted business in this district and throughout the United States.

10. This Complaint refers to Herbalife International of America, Inc., Herbalife International, Inc., and Herbalife Ltd. collectively as "Herbalife" or "Defendants."

11. At all times material to this Complaint, acting alone or in concert with others, Defendants have advertised, marketed, distributed, or sold the business opportunity at issue in this Complaint to consumers throughout the United States.

COMMON ENTERPRISE

12. Defendants have operated as a common enterprise while engaging in the deceptive and unlawful acts and practices alleged herein. Defendants have conducted the business practices described below through interrelated companies that have common ownership, officers, directors, and office locations. Because Defendants have operated as a common enterprise, each entity is jointly and severally liable for the acts and practices alleged below.

COMMERCE

13. At all times material to this Complaint, Defendants have maintained a substantial course of trade in or affecting commerce, as "commerce" is defined in Section 4 of the FTC Act, 15 U.S.C. § 44.

DEFENDANTS' BUSINESS PRACTICES

14. Defendants promote Herbalife as a multi-level marketing business opportunity through which participants may earn compensation by selling weight management, nutritional supplement, and personal care products and by recruiting new participants into the organization.

15. Individuals who participate in Defendants' business opportunity are called "Distributors" (also referred to herein as "participants"). In 2013, Defendants began calling participants "Members" rather than "Distributors." The change in terminology, however, was not accompanied by any substantive change to the nature of the business opportunity available to Herbalife participants.

16. Defendants represent, expressly or by implication, that Herbalife Distributors are likely to earn substantial income, including significant full-time or part-time income, from pursuing a retail-based business opportunity.

17. In reality, however, Defendants' program does not offer participants a viable retail-based business opportunity. Defendants' compensation program incentivizes not retail sales, but the recruiting of additional participants who will fuel the enterprise by making wholesale purchases of product.

18. The retail sale of Herbalife product is not profitable or is so insufficiently profitable that any retail sales tend only to mitigate the costs to participate in the Herbalife business opportunity.

19. As a consequence, the small minority of Distributors who receive substantial income through Herbalife are primarily compensated for successfully recruiting large numbers of business opportunity participants who purchase Herbalife product.

20. The overwhelming majority of Herbalife Distributors who pursue the business opportunity make little or no money, and a substantial percentage lose money.

Defendants' Promotional and Marketing Activities Are Misleading

21. Defendants promote their business opportunity in both English and Spanish through a variety of channels, including videos, live presentations, and print materials. Through each of these channels, Defendants represent, expressly or by implication, that consumers who become Herbalife Distributors are likely to earn substantial income, including significant full-time or part-time income by purchasing and re-selling Herbalife products.

22. In some but not all instances, Defendants accompany their misleading income representations with purported "disclaimers." These purported disclaimers, which often appear in small print, do not alter the net impression created by Defendants' misleading representations, namely, that Distributors are likely to earn substantial income. (See, for example, the graphic illustration at Paragraph 37, which contains the following disclaimer: "Incomes applicable to the individuals (or examples) depicted and not average. For average financial performance data, see the Statement of Average Gross Compensation of U.S. Supervisors at Herbalife.com and MyHerbalife.com.")

23. As in the example at Paragraph 37, Defendants' purported disclaimers typically reference a separate document, the "Statement of Average Gross

Compensation," that supposedly presents "realistic expectations of the possible income you can earn." The Statement of Average Gross Compensation does not provide clarity or realistic expectations, but instead obfuscates through a dense maze of verbiage and numbers. Neither the reference to nor the Statement of Average Gross Compensation itself alters the net impression created by Defendants' misleading representations.

Misleading Income Representations

24. Defendants use videos to promote their business, making them available to Distributors through Herbalife's websites, including myherbalife.com and video.herbalife.com. Defendants have at times also included videos in the starter packs that all new Distributors must purchase. Many of the videos are disseminated in both English and Spanish.

25. Defendants' videos include representations that Distributors are likely to earn substantial income through Defendants' business opportunity; images of expensive houses, luxury automobiles, and exotic vacations; and income testimonials.

26. For example, a promotional video available through February 2016 on myherbalife.com portrays a "Mini-HOM (Herbalife Opportunity Meeting)" at which various Herbalife Distributors take turns giving income testimonials. The video includes the following income representations:

a. I made $4,100 my second month. . . . And I retired from corporate America. . . . Last month it was $7,300.

b. I average an extra $1,500 a month part-time, around a 60-hour workweek [working in corporate finance], so you can really build this around whatever you're doing.

c. I've been a coach on the team for a year and a half. . . . Fast forward maybe a year and five months later, that's when I hit six figures in the company. . . . Couple of months later, I make

over $13,000 a month now.

d. My income ended up getting to $4,000 a month, part time, at Herbalife. . . . It's been five years, my income got up to $10,000 a month a couple years ago. It's more than double that now.

27. Another video, "Design Your Life," was included in every new Distributor's starter pack until January 2013 and was available on video.herbalife.com until October 2014. Because Defendants intended the "Design Your Life" video to be given to potential recruits, ten copies of the DVD were included in the starter pack. In addition to images of expensive cars and opulent mansions the video includes the following testimonials:

a. About a year and a half into the business, still part-time, I was making $2,500 a month.

b. First month in the business, without having a clue . . . first month it was unbelievable, actually, our income was $1,500.

c. A year exactly after I started the business, my checks that month were $5,468.28. Two months later my check went up to $7,080—and that was the month I went on vacation, and came back, and got that $7,000 check! So, it's been amazing.

d. You know, the royalties grew five times in five months, and last month, we hit about $16,000.

e. When I got to ten thousand, I thought, well that wasn't so hard after all, maybe I can get to fifteen, and I went from fifteen, to twenty, and then to thirty, and then even up to forty thousand dollars a month.

f. The first nine months of really getting going, I had made a quarter of a million dollars.

28. The "Design Your Life" video also includes the following:

> There are basically three types of people Herbalife is looking for. What you need to do next is get back to the person who gave you this video and let them know what you are. Just tell them A, B, or C . . . Category A is someone who might be saying . . . I don't need any extra income but the products sound great . . . I want to get started on the products right away.
>
> Category B is someone who might be saying, you know, the products sound great, and I'd like to start a small business to earn an extra $500 to $1,500 a month part-time . . . .
>
> Category C, you might be saying, wow, everything sounds great. I like the products and would like to start a big business that could generate a career level income or more. $2,500 to $10,000 a month. . . .
>
> You make the choice. Are you A, B or C?

29. In addition, from at least January 2009 through August 2013, a DVD called "Getting Started" was included in the starter packs that all Distributors must purchase. The most recent version of "Getting Started" included the testimonials of Distributors "Glenn" and "Jennifer":

a. Glenn explains that he was a bartender, "broke" and "struggling to pay [his] bills," before becoming an Herbalife Distributor. Although he "didn't have any formal education" or "any business background," he quickly succeeded with Herbalife and was able to make enough money to quit his job and work full-time as an Herbalife Distributor. Now "I'm able to live in a beautiful home, drive whatever I want, and there's nothing else I'd rather do than work from home, be able to set my own schedule, and be my own boss."

b. Before Herbalife, Jennifer wanted to be a stay-at-home mom for

> her son. However, she had to put her son in daycare and work long hours while her husband worked eighty-hour weeks. After just four months as an Herbalife Distributor, she "went full-time, took [her] son out of daycare, and [] became that stay-at-home mom." Today, she and her husband are both stay-at-home parents, "we travel the world, we have a six-figure income, and this company and the products have totally changed my life."

30. Defendants also sponsor numerous events for Distributors in both English and Spanish. Many of these events include live presentations at which speakers boast about the high incomes they earn as Herbalife Distributors. These events have names such as "Extravaganzas," "Leadership Development Weekends," and "Success Training Seminars."

31. Defendants strongly encourage Distributors to attend these events, which often require Distributors to pay an attendance fee and/or purchase a minimum amount of product from Herbalife. Defendants craft the agendas and select the speakers who present at these events. Speakers are usually chosen from among the very small percentage of Herbalife participants who have reached the highest status levels of the Herbalife organization. The presentations made by the selected top Distributors repeatedly emphasize that Distributors are likely to earn substantial income through Herbalife, and that Distributors' income potential is limited only by their own efforts.

32. For example, speakers giving live presentations at Defendants' events have made the following statements:

a. [H]ow many of you would like to make at least a million dollars a year in income? I gotta tell ya, every extra million dollars, I find, comes in handy. OK? You know? Then you get 2 million, 5 million, you know, and with the increases of

20%, 25%—

Even now, you can put into your mind—like, if you made a hundred thousand dollars last year, and your income went up proportionately, an extra twenty thousand dollars? That's pretty cool, huh? Couple thousand a month? You make five hundred thousand dollars, would an extra hundred thousand dollars come in handy? And we're gonna go through how to make it happen.

[Herbalife Chairman's Club member John Tartol, 2012 President's Summit, Los Angeles]

b. . . . I can remember when I was new, and I didn't know anything, I didn't know anybody, didn't have any sales or marketing experience, I didn't know, how was I ever gonna get successful? . . .

And make no mistake about it, 'cause it happened for me, I'm living proof that it can happen, and all the people down here in this floor here, and the people behind you, all of us are, you know—I'm a multi-millionaire, but, you know, all of us are getting groomed to become multi-millionaires. That is an awesome opportunity.

Now, you can take advantage of it, or you may only want to make sixty thousand, a hundred thousand, a couple hundred thousand.

[Herbalife Founder's Circle member Geri Cvitanovich, 2010 Herbalife Extravaganza, Los Angeles]

c. [translated from Spanish] It has been 15 years since we arrived here in the United States searching for the American Dream . . . . In '95, we came from Mexico to the United

> States . . . . I lasted 7 years in a cleaning company, 7 years earning $2,000 a month. We started the business doing it part time, the income started coming, it was something incredible, our lifestyle started to change spectacularly. . . . In the last three months the company has paid us more than $45,000. Welcome to Herbalife!
>
> [Raul Sánchez, Herbalife President's Team member, 2009 Herbalife Extravaganza Latina, Atlanta]

33. In addition to the spoken content, the live presentations at Defendants' events often involve images of expensive houses, luxury automobiles, and exotic vacations.

34. Defendants have recorded many of the live presentations given at Defendants' sponsored events and have formally integrated the presentations into their own resources, making the recordings available to Distributors through Herbalife's websites, including myherbalife.com and video.herbalife.com.

35. Like Defendants' videos and sponsored-events, Defendants' print publications include representations that Distributors are likely to earn substantial income through Defendants' business opportunity.

36. Defendants' print publications include, for example, "Your Business Basics," which is available in both English and Spanish and is provided to all new Distributors. From 2014 through at least December 2015, "Your Business Basics" included the following representations:

a. Earn extra money each month. \ Be your own boss. \ Have the time and money to enjoy the finer things in life.

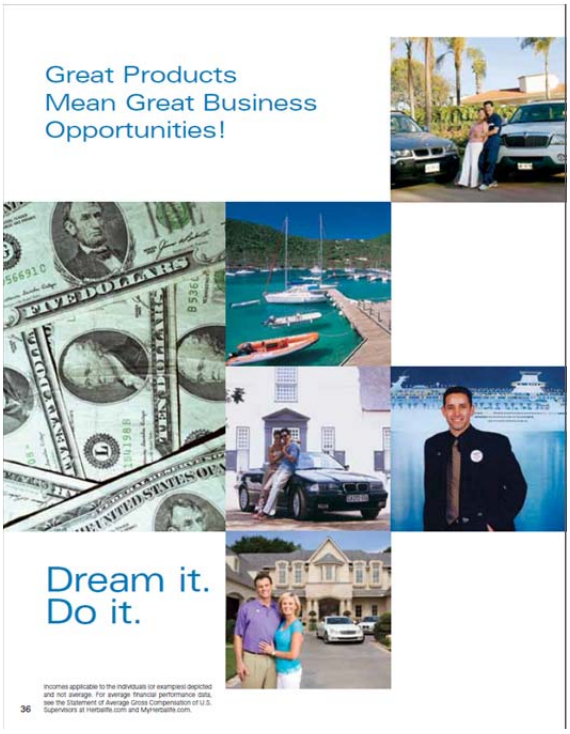
b. Regardless of your background and job experience, you can succeed because we have people just like you who started where you are and are now earning substantial incomes.

c. Your income and lifestyle potential with Herbalife are yours to

determine. Thousands of others like you have achieved success with Herbalife. You can do it!

d. From nutrition to the business opportunity, you'll see there's no limit to your personal or financial potential, and others just like you have tapped into this incredible opportunity.

37. The "Presentation Book" is another of Defendants' publications that is available in both English and Spanish and that is provided to all new Distributors. It is designed to be shown to potential recruits. The English-language version of the Presentation Book that was included in the starter pack from 2012 through 2014 stated that Herbalife offers "[t]he opportunity to earn more than you ever thought possible and make your dreams come true!" That publication, a page of which is shown below, included pictures of big houses, fancy cars, cash, and boats alongside the text "Great Products Mean Great Business Opportunities! Dream it. Do it."



38. Other versions of the Presentation Book have also included Distributor income testimonials:

a. . . . I started my Herbalife business with the goal of quitting my job as a collection specialist within a year. Just 13 months later, I realized that dream! . . . And with my $6,500-a-month income, we've been able to move into a new house and renovate.

b. Now, while earning $25,000 a month with Herbalife, I get to do all the things I love: play music and ride my motorcycle!

c. We went from bankruptcy to being set for life!

39. From 2012 through 2013, the Spanish-language version of Presentation Book offered similar income testimonials (translated here into English):

a. The days when I would earn a living cleaning houses are behind me because now we are fully dedicated to our prosperous Herbalife business.

b. When we worked in factories our earnings could only pay for basic needs, but now we can take our 12 grandkids on vacations. These are the best years of our lives.

c. Before Herbalife I worked on a ranch tending cattle, but when my sister showed me her royalty check she convinced me then and there. Today, at 22 years old, I'm economically independent.

d. We figured out that if we worked hard with our independent Herbalife business, we could achieve anything: health, wealth, and financial liberty. And that's exactly what we've done!

40. Similar representations regularly appear in the Defendants' magazine, "Herbalife Today," which is available in both English and Spanish and is provided online to Distributors through myherbalife.com. The March 2013 issue of "Herbalife Today," for example, includes the following testimonials:

a. Now I have the freedom to do what I like. I can travel the world and help others change their lives wherever I go.

b. Today, as Independent Distributors, they're able to work from home, take vacations and have a flexible schedule.

c. Now, Dan and Orlyn feel they have found financial stability and take pride in helping others find better nutrition and financial success.

41. To help Distributors recruit new participants, Defendants have provided Distributors with several tools and training materials, including the videos and print materials discussed above. Defendants encourage Distributors to use these materials in attempting to recruit new participants.

Misleading Representations Regarding Income from Retail Sales

42. Many of Defendants' representations that Herbalife participants are likely to earn substantial income expressly or impliedly represent that Herbalife participants earn significant full-time or part-time income from selling Herbalife products at retail.

43. Defendants' promotional materials often focus on the growth of the weight-loss industry as a result of the worldwide "obesity epidemic," and claim or imply that this industry growth translates into the potential for making large amounts of money from the retail sale of Herbalife weight management products. For example, the "Ready To Go" video, available through February 2016 on video.herbalife.com, begins by portraying a bleak picture of the current state of the economy ("rising unemployment," "layoffs," "salary reductions," "reduced benefits") and urges the viewer to "take control of your . . . situation / financial future / life" and "join the emerging megatrend of wellness." The video cites estimates that the global weight loss market will reach $672 billion by 2015 and explains, "[t]hat spells growth / opportunity / the answer you've been looking for." The video makes the following invitation: "Get in on the opportunity / the health

and wellness megatrend / the premier nutrition and wellness company in the world. Get in on Herbalife."

44. In 2013, Defendants created and made available to Distributors a PowerPoint presentation to show prospective and newly-recruited Distributors. The presentation, which was still in use in 2015, claims that "total revenue in the fitness industry reached $21.8 billion in 2012," and that "statistics show a rise in consumer spending for body image concerns." The presentation goes on to portray Herbalife as "the brand leader" in the meal replacement category, noting that in 2012 the company had "over $6.4 billion [in] suggested retail sales." The presentation claims that through offering "great products" and a "great business," Herbalife "allows you to earn Member discounts and profits instantly by retailing products."

45. Similarly, the "Getting Started" video mentioned above at Paragraph 29, which was included in the starter pack for new Distributors from at least January 2009 through August 2013, claims that the 3 trillion dollar weight-loss industry "has surpassed the GNP of all major European countries." The video goes on to claim that Herbalife, "with more than 2.5 billion dollars in sales generated by a team of over one million distributors throughout the world," is a leader in this industry, which "has become the newest financial powerhouse in the world." Herbalife is described as a "great business opportunity": "You have the opportunity for financial independence and freedom; you can do it with helping people change their lives, by getting them in a better nutritional mode, by getting them healthier."

46. The "Mini-HOM (Herbalife Opportunity Meeting)" promotional video available through February 2016 on myherbalife.com presents testimonials that expressly or impliedly represent the full-time or part-time income that participants earn from selling Herbalife products at retail, by emphasizing how much money participants can make immediately (presumably before they have

had a chance to build an organization that would generate recruiting-reward payments):

a. In my first three weeks, I made an extra $1,200 around my full-time nursing schedule. So this is really part-time, doing this super part-time, and I just saw the potential with this . . . .

b. I started as a client, I was actually the CFO of an entertainment finance company . . . . So, you know, had the career down . . . . Went to a volleyball tournament that I was already gonna play in. Everyone on the beach, you guys, was like, what are you doing, you look better than you did when you were at UCLA, like, hook me up, like, help me, basically!

. . . You know, my three days on the beach at a beach volleyball tournament, I made $2,100. And I wasn't actively looking for extra money, but I wasn't gonna give it back.

c. [I]n my first month, I made an extra 500 bucks around . . . a crazy corporate job.

47. In the "Design Your Life" video, available on video.herbalife.com until October 2014, one of the speakers states that Herbalife's "great consumable products that people want and need [are] why we have an incredible financial opportunity." A speaker later states that as an "Herbalife Distributor you can develop a successful retail base to help put money in your pocket every day and every month." A voiceover additionally states that "[w]ith just ten customers, each spending a hundred dollars a month, you can take in a thousand dollars in retail sales, and make up to $420 in profit."

48. The "Design Your Life" video also presents numerous testimonials that expressly or impliedly represent the full-time or part-time income that participants earn from selling Herbalife products at retail:

a. My first week in the business, part-time, just learning what to

do, I earned $1,000! . . . [M]y first month, part-time, I earned over $5,000!

b. I earned $420 in my first ten days. . . . working this business part-time. I was able to fire my boss, and I've never had a real boss since.

c. When I got started on these products, I got such great results that I made a thousand extra dollars my first month. . . . And so I kept working my business part-time . . . while I was still [working as a nurse] full-time . . .

d. When I got started, my first day I actually earned $420 . . . .

e. [I]n the month of August I had retail sales of $3,700.

49. Print materials included in the starter packs that all new Distributors must purchase also portray an opportunity to earn significant income through retail sales of Herbalife products. For example, from 2014 through at least December 2015, the "Sales & Marketing Plan and Business Rules" book, which is included in the starter pack for new Distributors, discussed the opportunity for Distributors to make "Immediate Retail Profit" from direct sales to customers and states that retailing is an important "key to success" as an Herbalife Distributor.

50. From 2014 through at least December 2015, the book "Building Your Business," which is also included in the starter pack for new Distributors, represented that "a satisfied customer base can provide you with regular, long-term income."

51. Similarly, through at least December 2015, a pamphlet that is also included in the starter pack for new Distributors, "Your First 72 Hours: Making Your First Sale," provides instruction on "making your first sale in 5 easy steps."

Defendants Do Not Offer a Viable Retail-Based Business Opportunity

52. Although Defendants represent, expressly or impliedly, that Distributors will be able to sell Herbalife products at a profit, Defendants do not

track either the existence or profitability of Distributor attempts to retail Herbalife products.

53. The overwhelming majority of Herbalife Distributors who pursue the business opportunity do not make anything approaching full-time or even part-time minimum wage because the promised retail sales to customers simply are not there.

54. Even according to Defendants' own survey, sales to customers outside the Herbalife network account for only 39% of Herbalife's product sales each year; the remaining approximately 60% is simply Herbalife selling to its own Distributors. [Herbalife Press Release, July 22, 2014]

55. Analysis of Defendants' own Distributor purchase data shows that, even under favorable assumptions about Distributors' market reach and sales price, the overwhelming majority of Herbalife Distributors who pursue the business opportunity make little or no money from retail sales. Under these assumptions, and assuming no costs other than an individual's total payments to Herbalife, half of Distributors whom the Defendants designate as "Sales Leaders"[1] average less than $5 per month in net profit from retail alone, and half of these Distributors lose money.[2]

56. As a direct-selling company, Defendants encourage Distributors to sell product face-to-face to family and friends, and to customers with whom they are supposed to develop personal relationships. Distributors are taught to follow three key steps in retailing the product: use the product themselves, wear a button

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[1] "Sales Leaders" are defined by Defendants as Distributors who have reached status levels of "Supervisor" and above. Approximately $3,000 in product purchases are required to reach the lowest level of "Sales Leader." "Sales Leaders" may purchase products from the Defendants at a 50% discount, which is the largest discount available to Distributors. *See* ¶¶ 111–18.

[2] This figure is based on analysis of Distributors who joined in 2009–11 and were designated as "Sales Leaders." It assumes that they sold 75% of the product they purchased, at the full suggested retail price, and incurred no expenses other than the monies they paid to Herbalife.

advertising Herbalife, and talk to people ("use, wear, talk").

57. In order to restrict sales to the direct-selling channel, Defendants have adopted rules that effectively prevent Distributors from being able to sell to a larger customer base. Defendants' rules prohibit the sale of product in retail stores and impose many restrictions on online selling. Nonetheless, Defendants foster an illusion that Distributors can make significant full-time or part-time income from retail sales. One way in which Defendants accomplish this is by promoting the concept of the "Nutrition Club." The Nutrition Club model was developed from an idea that started in Mexico and, according to Defendants, has particular appeal for members of the U.S. Latino community.

58. According to Defendants, the Nutrition Club is supposed to be a neighborhood gathering place to promote health and wellness, and to provide income for the Nutrition Club owner. In practice, Nutrition Clubs operate primarily as a tool for recruiting new members rather than as a method for profitably retailing Herbalife products.

59. Defendants encourage Distributors to lease a commercial space (or use space in their homes) to operate a business similar to a juice bar, in which the Distributor will work on a daily basis as the owner and sole employee. [Herbalife Rule of Conduct 8.1.3]

60. Customers who come to the club pay a daily "membership fee" of a few dollars that entitles them to consume certain Herbalife products that are prepared on the premises. Visitors typically receive one serving of soy protein powder mixed with water and ice (referred to as a "shake"), herbal tea, and aloe. This method of operating an Herbalife business is often referred to as "daily consumption."

61. To find customers, Nutrition Club operators are encouraged to pass out flyers to potential customers on the street, at their children's school, or other locations, inviting them to visit the "club."

62. While only a small percentage of the roughly half-million U.S. Herbalife Distributors report operating Nutrition Clubs, Defendants claim that club owners purchase a disproportionate amount of volume of Herbalife product. In 2012, Defendants estimated that there were 3,700 commercial Nutrition Clubs in the North America region (consisting primarily of the United States); Defendants also claimed that Nutrition Clubs were driving 30–35% of the overall volume of product purchased in the United States. [Herbalife Second Quarter 2012 Earnings Conference Call]

63. Although Nutrition Clubs would appear to be retail establishments, Defendants' rules provide that Nutrition Clubs are not retail stores or outlets, nor are they restaurants or carry-out establishments. Nutrition Clubs are not intended to attract "walk-in" traffic; Defendants' rules prohibit signs that state or suggest that Herbalife products are available for retail purchase on the premises. Club owners are not permitted to post signs indicating whether the club is open or closed, and the interior of the club must not be visible to persons outside. [Herbalife Rules of Conduct 8.3.3, 8.4.3, 8.4.4]

64. Club operators may not post, list, or charge prices for servings of prepared products such as shakes, teas, or aloe. The only permissible charge in connection with the provision of these products is the "membership fee." [Herbalife Rules of Conduct 8.2.1, 8.2.8] Provision of the shake, tea, and aloe generally costs a Distributor a few dollars, leaving little of the "membership fee" to cover the various operational expenses associated with the club.

65. Although Defendants create the impression that Nutrition Club owners will make significant full-time or part-time income from retailing Herbalife products to customers at their clubs, many Distributors find it all but impossible to make enough money from retail sales of product to cover the overhead of the club and also generate income for the owner.

66. Many club owners incur thousands of dollars in expenses—including

but not limited to product purchases, rent, utilities, supplies, and licensing fees—that they are unable to recover through the operation of their clubs, and end up losing money.

67. In fact, Defendants' own telephone survey of 433 current and 69 former Nutrition Club owners in February 2013 paints a discouraging picture of the experience of many Nutrition Club owners. Fifty-seven percent of Nutrition Club owners reported that their clubs made no profit or lost money. Club owners reported spending an average of about $8,500 to open their club.

68. Some Nutrition Club owners continue to operate their clubs for little or no profit—or at a loss—for years, in the hope that things will turn around and their investment will eventually pay off. However, the promised retail-based business opportunity is simply not there.

69. Because Nutrition Clubs are expressly not retail establishments and are often unprofitable, they are principally of value to a small minority of financially successful Herbalife Distributors as a location from which they can recruit new participants.

70. As one top Distributor explained in a PowerPoint presentation:

> [Nutrition Club] Operators need to realize that the end goal is not how many $4.00 services they sell each day as that is not the way for them to achieve their financial goals. Rather, it's upgrading a Consumer to become a Customer and eventually a Distributor and ultimately having Distributors become Operators who will duplicate the Nutrition Club method.
>
> ["Financial Success System" presentation dated March 24, 2010]

71. "Successful" Nutrition Club owners make money not from retailing product, but from recruiting other participants who are encouraged to open their own clubs, buy more product, and recruit more participants. When recruited participants purchase product to sell at their clubs, these purchases generate

recruiting rewards for the sponsor, even if the clubs themselves lose money. These recruiting rewards are the only pathway to achieve the high incomes touted in Defendants' promotional materials.

72. Regardless of whether Distributors operate a Nutrition Club, Distributors experience difficulty in selling product to customers outside the network. Nevertheless, Defendants' compensation structure puts pressure on Distributors to purchase large quantities of product in order to qualify for greater wholesale discounts and recruiting-based rewards (*see* discussion below at ¶¶ 135–44).

73. As a result, many Distributors buy product that they find difficult to sell. Although Defendants have a buy-back policy, in order to take advantage of the policy, a Distributor must resign his distributorship. Many Distributors have been unaware of the policy or, for various reasons, have been reluctant to attempt to use it.

74. Distributors dispose of excess product purchases in numerous ways. At the simplest level, when Distributors are left with product they are unable to sell they may give it to friends, throw it away, or gradually consume it themselves. Such self-consumption is not driven by genuine demand for the product, but is the easiest and most convenient way for a Distributor to get some benefit from product that the Distributor would not have bought absent his or her participation in the business opportunity. In other instances Distributors attempt to sell their excess inventory at a discount on auction websites or at flea markets, although such efforts to mitigate their losses are prohibited by Defendants' rules. [Herbalife Rules of Conduct 4.1.1, 7.3]

75. The overwhelming majority of Distributors who attempt to retail the product make little or no net income, or even lose money, from retailing the product.

Distributors Abandon the Business Opportunity in Large Numbers

76. In light of their poor financial results, many Distributors either stop buying product or leave the organization altogether, resulting in a high turnover rate.

77. Despite Defendants' efforts to promote retention of Distributors whom it characterizes as "Sales Leaders," in 2014 nearly 60% of first-time Sales Leaders did not purchase sufficient product to requalify as Sales Leaders. [Statement of Average Gross Compensation Paid by Herbalife to U.S. Members in 2014]

78. Retention for non-Sales Leaders, many of whom are pursuing the business opportunity, is even worse. An analysis of Defendants' data shows that the majority of Distributors stop ordering Herbalife products within their first year, and nearly 50% of the entire Herbalife U.S. Distributor base quits in any given year. Roughly half of all Herbalife Distributors at any given time are in their first 12 months of membership, and roughly 40% of the volume of Herbalife products sold by Defendants each year is sold to participants in their first year.

79. During 2009–13, an annual average of approximately 242,000 new Distributors signed up in the United States. On average, 89% of those newly-recruited Distributors, however, simply replaced U.S. Distributors who left that same year, with an annual average of approximately 216,000 Distributors leaving during this time period.

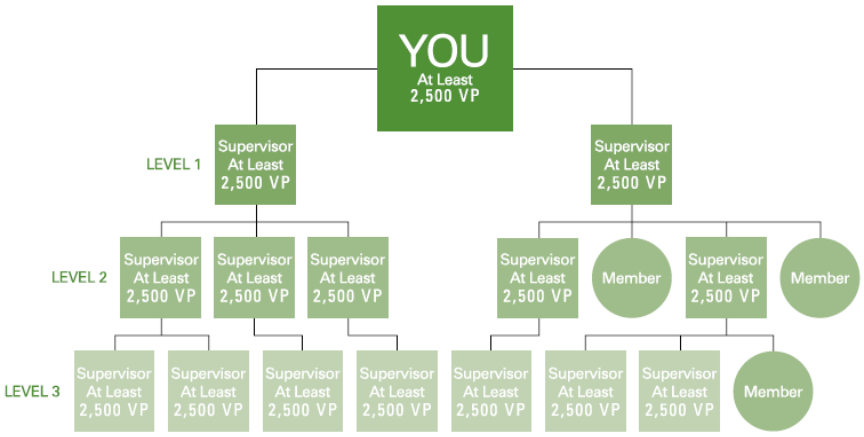
80. For example, while approximately 277,000 new Distributors joined Herbalife in the U.S. in 2013 (from a base of approximately 520,000 Distributors at the end of 2012), approximately 256,000 existing Distributors left that year.

Defendants' Business Opportunity is Based on Recruitment

81. Notwithstanding Defendants' express and implied representations that Herbalife offers a retail-based business opportunity, in truth the only way to achieve wealth from the Herbalife business opportunity is to recruit other

Distributors. Purchases by these recruited Distributors, referred to as a "downline," generate rewards for the sponsoring Distributor. (*See* ¶ 119.) Through a variety of channels, Defendants admit, expressly or by implication, that recruiting is the key to financial success.

82. Defendants' print materials emphasize the importance of recruiting new Herbalife participants. For example, through at least December 2015 the book "Building Your Business," which is included in the starter kit that every Distributor must purchase, discussed "the power of duplication" and illustrated "what you can achieve" if "you recruit and retain two active Supervisors." In the illustration, the Distributor purchases a certain quantity of product (costing over $1,000) each month and recruits two new participants who also purchase that quantity each month. Those two participants then recruit a total of twelve additional participants in two additional levels below them. For each month that the Distributor and the fourteen recruits purchase the specified quantity of product, the Distributor will earn $1,750.



83. The English-language version of the 2012-2014 Presentation Book also includes examples of how recruiting two or three new participants can translate into $2,450 to $8,775 per month for the recruiter, assuming that the new participants make substantial wholesale product purchases and themselves recruit

new participants who also make substantial wholesale product purchases.

84. The Spanish-language version of the 2012-2013 Presentation Book similarly discusses "the power of duplication" that can result when "you bring in 3 people to the business, who each bring 3 people, who in turn bring 3 people . . . ." (translated from Spanish).

85. Speakers giving live presentations at Defendants' events also make representations concerning the importance of recruiting in Herbalife's compensation program:

a. It's wonderful that we have everybody consuming and we have everybody doing the different methods of retail . . . but you got to think about it, guys, the name of the game here is royalty . . . and you don't get paid royalty off of customers. You get paid royalties off of distributors that you help to become successful to become supervisors. [Herbalife Founder's Circle member Susan Peterson, 2009 Herbalife Extravaganza, Atlanta]

b. [translated from Spanish] The only way to scale the ladder of success is through sponsorship. [Herbalife President's Team member Dalia González, 2009 Herbalife Extravaganza Latina, Atlanta]

c. The key to royalty growth[:] New distributors qualifying as Supervisor every month. [Herbalife Chairman's Club member Kurt O'Connell, "Building Your Royalties" Presentation, 2011 Herbalife Extravaganza, Las Vegas]

86. Savvy Distributors have figured out ways to use the recruiting reward structure to reap rewards, even without profitable retail sales. For example, during the years 2009–14, one top Distributor paid over $8 million for product (with a total Suggested Retail Price of over $16 million) which the Distributor purchased in the names of various downline members, thereby generating additional rewards

and qualifying for higher payments from Defendants. This Distributor then donated all of this product to charity, rather than attempting to sell it. The Distributor generated enough rewards through these purchases to make a net profit, without even selling the products.

87. Similarly, other Distributors have used unprofitable retail sales of product to generate large reward payments. These Distributors have created specialized websites offering products at discounts of up to 50% with no tax and free shipping. Although the net profit earned from these online retail sales has been *de minimis*, by manipulating Herbalife's compensation system, these Distributors have generated significant "recruiting" reward payments from the large volume of product purchases made by their purported downlines.

Few Business Opportunity Participants Earn Recruiting Rewards

88. Although recruiting is the only path to a high income, very few Herbalife participants earn income from recruiting.

89. Most Distributors (80%) do not successfully recruit any new participants, and therefore receive no recruiting rewards.

90. Even among those who do recruit, a substantial percentage receive no reward payments. For example, as of December 31, 2014, more than 111,000 U.S. Distributors had recruited a downline, but approximately 43% of them (47,714) received no reward payments from Defendants. [Statement of Average Gross Compensation Paid by Herbalife to U.S. Members in 2014]

91. Income from recruiting is low even for many in the top 13% of all Distributors—those who reached the status of "Sales Leaders with a downline." In 2014, more than half (57.6%) of the Distributors in this elite group received average gross reward payments from Defendants of under $300 *for the year*. [*Id*.]

92. Rewards are highly concentrated among a small number of Distributors. In contrast to the experience of the vast majority of Distributors who

make little or no money from recruitment-based rewards, the top 0.03% of U.S. Distributors (205 individuals) received average gross reward payments of over $600,000 per year. [Statement of Average Gross Compensation Paid by Herbalife to U.S. Members in 2014]

93. For the fewer than 1% of Distributors who receive substantial income through Defendants' business opportunity, their compensation for recruiting large numbers of new business opportunity participants dwarfs whatever they might make from retail sales of the product.

94. The overwhelming majority of Herbalife Distributors who pursue the business opportunity earn little or lose money, while those few Distributors who do make a living from their Herbalife business do so by recruiting other business opportunity participants who purchase product, not by retailing the product.

To Confuse Participants and the Public About Distributors' Poor Financial Outcomes, Defendants Understate the Percentage of Distributors Who Are Pursuing the Business Opportunity

95. Although Defendants heavily promote their business opportunity, in recent years Defendants have begun to claim that most consumers who sign up to be Distributors are merely customers who purchase the product only for their own consumption and are not interested in pursuing the Herbalife business opportunity.

96. Defendants do not offer a separate "customer" or "discount buyer" status for consumers who are uninterested in pursuing a business opportunity and thus do not systematically track or distinguish Distributors who might be "discount buyers" from Distributors who are pursuing a business opportunity.

97. Defendants' rules provide that all consumers who sign up with Herbalife must enter into an agreement that includes the business opportunity. The 2015 version of that agreement consists of seven pages of small print and includes a number of provisions that would be inapplicable to a "discount buyer," such as a requirement that the participant indemnify, defend, and hold harmless Herbalife

from any cost or liability arising from the participant's breach of the agreement or the conduct of his or her Herbalife business.

98. Since 2013 Defendants have publicly claimed or implied that a mere 27% of their Distributors are pursuing the business opportunity either full-time or part-time, and that a "substantial majority" (73%) are simply interested in buying Herbalife products for their own personal consumption.

99. Defendants' express or implied claim that a "substantial majority" of their Distributors are not pursuing the business opportunity is based not on Distributor behavior, but on surveys commissioned by Defendants beginning in July 2012 that are flawed and unreliable. For example, many survey participants who were included in the category of Distributors who purportedly "joined Herbalife primarily as discount customers" themselves reported that they quit Herbalife because "finding new customers was too difficult and/or time consuming," or the "business was harder than [they] originally believed."

100. Based on such survey results, even some Distributors who reach "President's Team" (the highest status level in Herbalife) and earn over $100,000 in recruiting rewards annually from the business opportunity have been categorized in Defendants' representations as merely "discount buyers."

101. When observable Distributor behavior from Defendants' data is analyzed, the percentage of Distributors who are attempting to earn income from the Herbalife business opportunity readily exceeds the 27% in Defendants' claims. Such behaviors include, for example, purchasing promotional literature and sales and recruiting aids from Defendants.

102. Furthermore, many Distributors interested in the business opportunity may make some effort to earn income and fail, without engaging in the type of measureable and overt behaviors that would make their pursuit of the business opportunity readily apparent.

103. In short, many of the Distributors whom Defendants would expressly

or impliedly characterize as solely "discount buyers" are, in fact, pursuing the business opportunity.

104. Regardless of the number of so-called "discount buyers," it is clear that collectively they could account for only a small percentage of the volume of Defendants' products sold in the United States. Even using a grossly overstated measure of "discount buyers"—that is, counting as "discount buyers" the roughly 80% of participants who are not "Sales Leaders"—such Distributors collectively account for less than 25% of the volume of Defendants' products sold in the United States. The remainder, over 75%, is purchased by Distributors at the "Sales Leader" level, who are clearly pursuing a business opportunity.

Overview of Defendants' Compensation Plan

105. The amount of compensation a Distributor receives from Defendants is not based on retail sales of Herbalife products, but rather is based on the volume of product purchased by the Distributor's recruits, and by their recruits, and so on.

106. Thus, the compensation plan contains incentives for Distributors to recruit participants and to persuade them to buy as much product as they can.

107. To become a Distributor, an individual must pay either $59.50 or $92.25, plus tax and shipping, to purchase a starter pack called an "International Business Pack,"[3] the contents of which have varied over time but which have included an Herbalife tote bag; samples of various Herbalife products; literature about Herbalife's products; sales aids (such as a "Presentation Book" and buttons the distributor is supposed to wear to advertise Herbalife); DVDs about the business opportunity such as "Design Your Life"; multiple publications concerning the Herbalife business opportunity, including the pamphlet "Your First 72 Hours: Making Your First Sale" and the books "Your Business Basics," "Using &

[3] In 2013, Defendants began calling the pack required for all new participants the "Herbalife Member Pack" rather than the "International Business Pack."

Retailing Your Products," "Building Your Business," and "Sales & Marketing Plan and Business Rules"; and a single receipt form that can be given to a customer in the event of a single sale of product.

108. Defendants' rules provide that participants must enter into an "Agreement of Distributorship" either online or, if the pack is not purchased online, in hardcopy form. (In 2013, Defendants began calling the agreement an "Herbalife Membership Application and Agreement" rather than an "Agreement of Distributorship." The change in terminology, however, was not accompanied by any substantive change to the nature of the business opportunity available to Herbalife participants.) Upon purchasing the International Business Pack and submitting the Agreement to Defendants, a participant is assigned an Herbalife ID number and becomes an official Distributor.

109. The details of Defendants' compensation program are complex and convoluted, and involve specialized terminology and concepts. These details, terminology, and concepts are laid out in a book included in the International Business Pack entitled "Sales & Marketing Plan and Business Rules." The 2014 version of the "Sales & Marketing Plan and Business Rules" has 114 pages and consists of more than 58,000 words. The book is difficult to read and understand and many participants rely upon their sponsors to explain the program.

110. The core concepts of Defendants' compensation program are as follows:

a. Participants advance to higher status levels in the organization and qualify for reward payments based on product purchases (not product sales); and

b. The only way to reach the highest levels of compensation is to recruit more participants.

A simplified version of the compensation plan is set forth below.

111. New recruits start at the lowest level, called "Distributor" (or, since

2013, "Member"). A Distributor can purchase product from Defendants at a discount of 25% off the "earn base" (a dollar value that Defendants assign to each product that is generally slightly less than the value that Defendants assign as the Suggested Retail Price for that product). The only way a participant at this level can make money is to buy product from Herbalife and sell it to a customer for more than his total cost, with the difference representing the participant's "Retail Profit." "Retail Profit" is also the only form of compensation available to those Distributors who have not recruited other Distributors.

112. The vast majority of Herbalife participants never progress higher than the Distributor level, and most stop purchasing product within a year and do not renew their memberships.

113. Higher status levels are obtained by meeting threshold requirements of "Volume Points," which are accumulated by purchasing greater quantities of products. (The "Volume Point" is a unit created by Defendants to measure the value of product purchases across currencies. A product with a Suggested Retail Price of $100 generates roughly 100 Volume Points.) The Sales and Marketing Plan contains complicated rules regarding how much of the threshold Volume Point requirement must be volume that is personally purchased by the Distributor, and how much may be volume purchased by other Distributors whom he recruits.

114. A Distributor can advance to the status level of "Senior Consultant," which allows him to purchase product at a 35% discount, by accumulating at least 500 Volume Points in one month.

115. A Distributor who purchases 1,000 Volume Points in a single order obtains the status of "Success Builder" and is entitled to a 42% discount for that month.

116. A Distributor who accumulates a total of 2,500 Volume Points over one to three months obtains the status of "Qualified Producer" and is entitled to a 42% discount through the following year.

117. The maximum discount, for those at the "Supervisor" status level and above, is 50% off the "earn base." A Distributor who accumulates a total of 4,000 Volume Points obtains "Supervisor" status and is entitled to a 50% discount through the following year.

118. If a Distributor makes it to the Supervisor level, there are numerous higher levels that offer additional rewards that are based on recruiting. Herbalife refers to Distributors who reach the Supervisor level or above as "Sales Leaders."

119. The essential requirement for moving up to the highest status levels is recruiting a large "downline." A given participant's "downline" is comprised of all those whom the participant has personally recruited (Level One), all those recruited by his Level One participants (Level Two), and so forth, down to as many levels as have been created by recruitment.

Defendants' Compensation Plan Incentivizes Recruiting

120. Defendants' compensation plan gives participants a powerful incentive to recruit more participants, because recruiting a downline entitles a participant to receive multiple different types of payments directly from Defendants.

121. One such type of payment is called "Wholesale Profit" (or "Commissions"). An Herbalife participant may receive "Wholesale Profit" based on purchases made by participants he has recruited who are at a lower discount rate. For example, if a participant at the "Supervisor" status level (50% discount rate) recruited a participant at the "Senior Consultant" status level (35% discount rate) who then ordered product with a Suggested Retail Price of $100, the participant at the "Supervisor" level would receive a commission check from Defendants of approximately $15, representing the 15 percentage point difference between the two participants' discount rates.

122. An additional type of payment based on downline purchases, available to participants who are at or above the status level of "Supervisor" and who have

recruited a downline, is called "Royalty Overrides." To understand how Royalty Overrides work, it is necessary to understand two "volume" concepts in Defendants' Sales & Marketing Plan: "Total Volume" and "Organizational Volume."

123. "Total Volume" is a total of the Volume Points associated with a participant's own product purchases, plus the Volume Points associated with the product purchases made by certain members of the participant's downline. Specifically, the "Total Volume" of Participant A would include the product purchases of Participant A's downline members who (i) have a status level lower than "Supervisor," and (ii) do not have any participants who have a status level of "Supervisor" or higher in the chain of participants between them and Participant A.

124. In simplified form, "Organizational Volume" refers to the Total Volume of a participant's first three levels of "Supervisors" who are active in a given month.

125. "Royalty Overrides" are payments ranging from 1% to 5% of a participant's "Organizational Volume." The amount of the "Royalty Override" percentage that a given participant earns each month depends on the participant's "Total Volume" for that month. Thus, 500 Total Volume points entitles the participant to a 1% Royalty Override; 1,000 Total Volume points earns a 2% Royalty Override; and so on, up to 2,500 Total Volume points which earns a maximum 5% Royalty Override.

126. Participants are eligible to earn Royalty Overrides only if they have (i) obtained a status level of "Supervisor" or above (*i.e.*, "Sales Leaders") and (ii) recruited a downline.

127. As of December 31, 2014, only about 13% of all U.S. Distributors fell into the category of "Sales Leaders" who had recruited a downline. Even among this group, most receive little or nothing in compensation from Defendants. In 2014, approximately 57.6% of this group received an average gross annual

payment from Herbalife of about $299, and approximately 14.3% received nothing. [Statement of Average Gross Compensation Paid by Herbalife to U.S. Members in 2014]

128. The participants who receive the highest gross compensation from Defendants are at the top three status levels of the compensation system: "Global Expansion Team," "Millionaire Team," and "President's Team," called collectively "TAB Team" ("Top Achievers Business Team").

129. At the "TAB Team" status levels, participants may be eligible to receive three different types of income based on their downlines' purchases: Wholesale Profits, Royalty Overrides, and a third category of income called "Production Bonuses." A Production Bonus is a monthly payment of 2% to 7% of the product purchases of the participant's entire downline, on all levels infinitely deep.

130. Participants at the "TAB Team" status levels may also qualify to receive the "Mark Hughes Bonus Award," which is a payment based on a percentage of Herbalife's worldwide sales.

131. It is only at the "TAB Team" status levels that a small number of participants begin to see the rewards promised by Defendants, although even at this level, the majority of participants are hardly receiving lavish income from Defendants. For example, in 2011—the last year in which Defendants publicly released income data by participant level—the median annual compensation that participants at the "Global Expansion Team" status level received from Defendants was $19,417. In comparison, the U.S. Census Bureau's 2011 poverty threshold for a family of two with no children was $14,657.

132. Rewards are concentrated at the very highest levels. Participants at the top level, "President's Team," accounted for only about 0.05% of all Distributors in 2011 but their median annual gross income from Defendants was $336,901.

133. In 2011, the top U.S. Distributor received over $7 million from Defendants, broken down as follows:

Wholesale Profits	$2,847
Royalty Overrides	$944,058
Production Bonuses	$4,256,817
Mark Hughes Bonus	$2,000,000
Total	$7,203,722

These reward payments were not based on retail sales to consumers, but on wholesale purchases made by downline Distributors in his worldwide organization.

134. The only way to reach the "TAB Team" status levels is to recruit a large organization of participants at the "Supervisor" status level who purchase thousands of "Volume Points" worth of product. Thus, for example, to reach the top level, "President's Team," a participant must recruit an organization of Supervisors who generate at least 10,000 Royalty Override points each month for three consecutive months. Because the maximum Royalty Override percentage is 5%, this means that the first three levels of Supervisors must collectively generate a minimum total of 200,000 Volume Points of product purchases each month, for a total of 600,000 Volume Points of product purchases over the three months.

Defendants' Compensation Plan Incentivizes Wholesale Product Purchases

135. Defendants' compensation plan requires large wholesale purchases of products in order for a participant to advance to a higher status level and to make money from rewards. As explained below, participants must purchase product from Defendants, or convince others to join and purchase product from Defendants, in order to (i) qualify to move up to a higher status level; (ii) requalify for those status levels and prevent being demoted; and (iii) qualify to receive "Royalty Override" and "Production Bonus" payments from Defendants. These product purchases are made as payments to participate in the Herbalife operation

rather than in response to actual retail demand for Herbalife products.

Product Purchases Are Required to Advance to Higher Levels

136. To advance from the lowest status level, "Distributor," to any of the status levels providing a higher discount, an Herbalife participant must make substantial wholesale product purchases from Defendants and/or recruit downline participants who will make substantial wholesale product purchases from Defendants.

137. For example, reaching the status of "Supervisor" requires wholesale product purchases totaling a minimum of 4,000 Volume Points. An order totaling 4,000 Volume Points costs roughly $3,000 and would entail a large amount of Herbalife product. As an example, the following would represent a 4,000 Volume Point order sufficient to qualify a participant as a "Supervisor":

SKU	Description	Qty	Volume Points Each	Volume Point Total
3106	Formula 1 shake mix canister (30 servings)	16	32.75	524.00
0365	Protein bar deluxe (14 bars)	32 boxes	13.22	423.04
1188	Herbal aloe concentrate (half gallon)	8	92.55	740.40
0106	Herbal tea concentrate (3.5 oz.)	16	34.95	559.20
3115	Formula 2 multivitamin (90 tablets)	16	19.95	319.20
3123	Formula 3 Cell Activator (60 tablets)	16	21.95	351.20
3277	Lift-Off (30 tablets)	16	47.70	763.20
1415	Herbalife 24 – Prolong canister (37 oz.)	8	41.60	332.80
	TOTAL			4,013.04

138. It is impossible to reach the highest status levels of Defendants' compensation program—"Global Expansion Team," "Millionaire Team," and "President's Team"—without recruiting new participants who collectively purchase large quantities of product. Under Defendants' compensation plan, recruitment is required to reach these status levels.

Product Purchases Are Required to Requalify for Status Levels

139. Participants who obtain a particular status level must annually "requalify" to retain that level or be demoted. Requalification is based on the volume of wholesale product purchases by the participant and/or his organization. To requalify as a Supervisor and retain his or her downline, for example, a participant must accumulate another 4,000 or 10,000 Volume Points, depending on the method of requalification.

Monthly Product Purchases Are Required to Qualify for Reward Checks

140. Participants who are eligible to receive "Royalty Overrides" or "Production Bonuses" must also accumulate, on a monthly basis, specific volumes of product purchases to "qualify" to receive those reward payments. An eligible participant "qualifies" to receive "Royalty Override" and "Production Bonus" reward payments for a given month by accumulating in that month a threshold amount of "Total Volume" ranging from 2,500 Volume Points to 5,000 Volume Points.

141. All of these volume requirements are based on wholesale *purchases* of product from Defendants. Defendants do not track what happens to the product after a participant purchases it.

142. Higher-level Distributors who are eligible to receive reward payments frequently buy Herbalife products in order to meet the thresholds for obtaining these rewards, rather than to satisfy consumer demand. For example, analysis of Defendants' purchasing data reflects that, in the months in which participants at the "TAB Team" levels—the highest levels in the Herbalife marketing plan—received

"Royalty Override" payments, they frequently purchased almost precisely the amount of product necessary to qualify for the payment.

143. These participants at the highest status levels who must make monthly product purchases in order to earn recruiting rewards are the most robust wholesale purchasers of Herbalife products. In the time period from January 2009 through March 2014, such high-level participants purchased on average almost eight times as much product per person as participants at the lowest level of "Sales Leaders" (Supervisors), who by and large were ineligible for such recruiting rewards.

144. This purchasing behavior reflects an excessive emphasis on purchasing product for the purpose of qualifying for recruitment rewards.

CONCLUSION

145. In sum, Defendants' compensation structure incentivizes Distributors to purchase thousands of dollars of product to receive recruiting-based rewards and to recruit new participants who will do the same.

146. This results in the over-recruitment of participants and the over-supply of Defendants' products and exacerbates participants' difficulty in selling Herbalife products for a profit.

147. Participants in a business opportunity should have some reasonable prospect of earning profits from reselling products to customers. However, most Herbalife participants earn little or no profit, or even lose money, from retailing Herbalife products.

148. In the absence of a viable retail-based business opportunity, recruiting, rather than retail sales, is the natural focus of successful participants in Defendants' business opportunity.

149. Thus, participants' wholesale purchases from Herbalife are primarily a payment to participate in a business opportunity that rewards recruiting at the expense of retail sales.

VIOLATIONS OF THE FTC ACT

150. Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), prohibits "unfair or deceptive acts or practices in or affecting commerce."

151. Misrepresentations or deceptive omissions of material fact constitute deceptive acts or practices prohibited by Section 5(a) of the FTC Act.

152. Acts or practices are unfair under Section 5 of the FTC Act if they cause or are likely to cause substantial injury to consumers that consumers cannot reasonably avoid themselves and that is not outweighed by countervailing benefits to consumers or competition. 15 U.S.C. § 45(n).

COUNT I

Unfair Practices

153. As alleged above, Defendants promote participation in Herbalife, a multi-level marketing program, which has a compensation structure that incentivizes business opportunity participants to purchase product, and to recruit new business opportunity participants to purchase product, in order to advance in the marketing program rather than in response to actual retail demand.

154. Defendants' actions cause or are likely to cause substantial injury to consumers that consumers cannot reasonably avoid themselves and that is not outweighed by countervailing benefits to consumers or competition.

155. Therefore, Defendants' practices as described in Paragraph 153 above constitute unfair acts or practices in violation of Section 5 of the FTC Act, 15 U.S.C. §§ 45(a) and 45(n).

COUNT II

Income Misrepresentations

156. In numerous instances in connection with the advertising, marketing, promotion, offering for sale, or sale of the right to participate in the Herbalife program, Defendants have represented, directly or indirectly, expressly or by implication, that consumers who become Herbalife Distributors are likely to earn

substantial income.

157. In truth and in fact, in numerous instances in which Defendants have made the representations set forth in Paragraph 156 of this Complaint, consumers who become Herbalife Distributors are not likely to earn substantial income.

158. Therefore, Defendants' representations are false or misleading and constitute deceptive acts or practices in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

COUNT III

False or Unsubstantiated Claims of Income from Retail Sales

159. In numerous instances, in connection with the advertising, marketing, promotion, or offering for sale of the Herbalife business opportunity, Defendants have represented, expressly or by implication, that consumers who become Herbalife Distributors are likely to earn significant full-time or part-time income from selling Herbalife products at retail.

160. In numerous of these instances, the representations set forth in Paragraph 159 are false or were not substantiated at the time the representations were made. Therefore, the making of the representations set forth in Paragraph 159, above, constitutes a deceptive act or practice, in or affecting commerce, in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

COUNT IV

Means and Instrumentalities

161. By furnishing Herbalife Distributors with promotional materials to be used in recruiting new participants that contain false and misleading representations, Defendants have provided the means and instrumentalities for the commission of deceptive acts and practices.

162. Therefore, Defendants' practices, as described in Paragraph 161 of this Complaint, constitute a deceptive act and practice in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

CONSUMER INJURY

163. Consumers have suffered and will continue to suffer substantial monetary loss as a result of Defendants' violations of Section 5(a) of the FTC Act. In addition, Defendants have been unjustly enriched as a result of their unlawful acts and practices. Absent injunctive relief by this Court, Defendants are likely to continue to injure consumers, reap unjust enrichment, and harm the public interest.

THIS COURT'S POWER TO GRANT RELIEF

164. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), empowers this Court to grant injunctive and such other relief as the Court may deem appropriate to halt and redress violations of any provision of law enforced by the FTC. The Court, in the exercise of its equitable jurisdiction, may award ancillary relief, including rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies, to prevent and remedy any violation of any provision of law enforced by the FTC.

PRAYER FOR RELIEF

Wherefore, Plaintiff FTC, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and the Court's own equitable powers, requests that the Court:

A. Enter a permanent injunction to prevent future violations of the FTC Act by Defendants;

B. Award such relief as the Court finds necessary to redress injury to consumers resulting from Defendants' violations of the FTC Act, including but not limited to, rescission or reformation of contracts, restitution, the refund of monies paid, and the disgorgement of ill-gotten monies; and

C. Award Plaintiff the costs of bringing this action, as well as such other and additional relief as the Court may determine to be just and proper.

Respectfully submitted,

DAVID C. SHONKA
Acting General Counsel

Dated: July 15, 2016

/s/
JANET AMMERMAN
CHRISTINE M. TODARO
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LAURA SOLIS

Attorneys for Plaintiff
FEDERAL TRADE COMMISSION

ACFE
Association of Certified Fraud Examiners

Grant Thornton

THE NEXT NORMAL: PREPARING FOR A POST-PANDEMIC FRAUD LANDSCAPE

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INTRODUCTION

With COVID-19 vaccinations being administered as quickly as possible and countries beginning to lift restrictions put into place to limit the virus's spread, many organizations around the world are starting to prepare for a post-pandemic reality. However, shifts in business operations, economic impacts, and changes in consumer behavior due to the pandemic will likely remain significant factors affecting entities—and their fraud risks and anti-fraud programs—going forward. To assess how organizations are preparing for the "next" normal, the Association of Certified Fraud Examiners (ACFE), in collaboration with Grant Thornton, surveyed anti-fraud professionals around the globe regarding the current and expected effects of COVID-19 on the fraud landscape.

KEY FINDINGS

51% of organizations have **uncovered more fraud** since the onset of the pandemic

71% expect the **level of fraud** impacting their organizations to **increase** over the next year

38% of organizations increased their budget for **anti-fraud technology** for fiscal year 2021, making this the most common area for **increased investment** within anti-fraud programs

More than **80%** of organizations have already implemented **one or more changes** to their **anti-fraud programs** in response to the pandemic

Technological challenges are expected to affect an increasing number of organizations' anti-fraud programs

Shifts in **business operations** and **changing consumer behaviors** are the **top two risk factors** expected to impact the fraud risk landscape in the coming year

The most common **pandemic-related challenges** facing anti-fraud programs are changes to **investigative processes** and changes in the **control/operating environment**

HOW HAVE THE LEVELS OF FRAUD AND FRAUD AWARENESS CHANGED DURING THE PANDEMIC?

More than half of survey respondents (51%) indicated that their organization has uncovered more fraud than usual since the onset of the pandemic, with one-fifth indicating a significant increase in the amount of fraud detected. In contrast, only 14% of respondents' organizations have uncovered less fraud during this time.

ACFE research in the early months of the pandemic indicated that organizations knew an increased wave of fraud was likely. In the first *Fraud in the Wake of COVID-19* survey conducted in May 2020, 93% of respondents expected an increase in the overall level of fraud during the coming year.[1]

The level of fraud awareness has also risen notably since the onset of the pandemic. More than 60% of respondents have observed a significant or slight increase in their organizations' fraud awareness, and only 7% indicated that the level of fraud awareness has decreased. While some of this change is likely due to increased efforts on behalf of anti-fraud professionals and more internal conversations around fraud risks, heightened press coverage of pandemic-related fraud schemes might also have contributed to the increase in fraud awareness.

More than half of organizations (51%) have uncovered more fraud than usual since the onset of the pandemic.

[1] The May 2020 ACFE survey asked respondents about expected changes in the overall level of fraud in general, not about the level of fraud specifically at their organizations. Consequently, the responses to these two areas of inquiry are not directly comparable. However, examining these results in juxtaposition provides some interesting insight into the expected and detected fraud levels during the May 2020–May 2021 time frame.

FIG. 1 Change in the amount of fraud uncovered

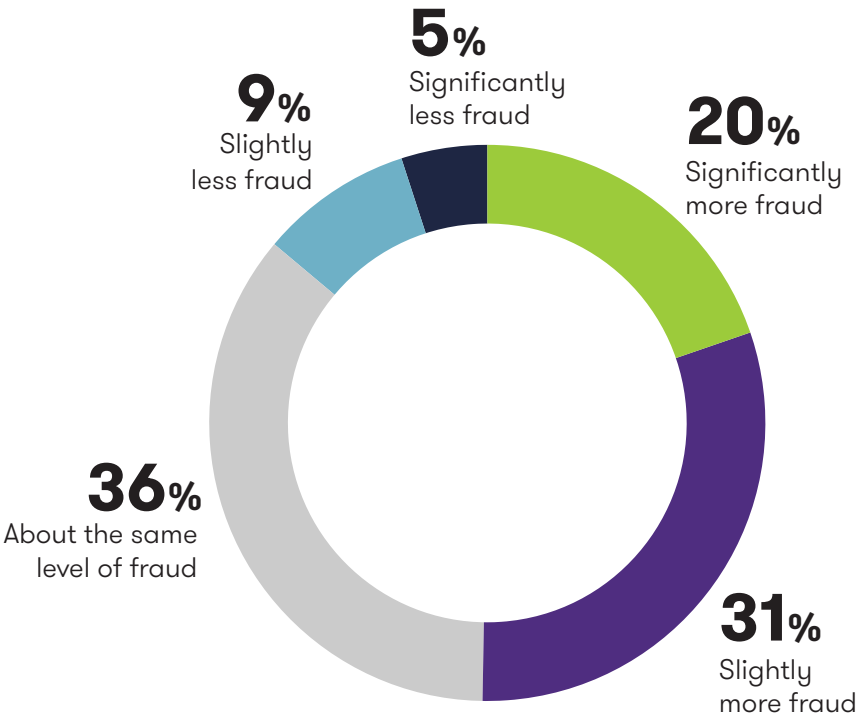
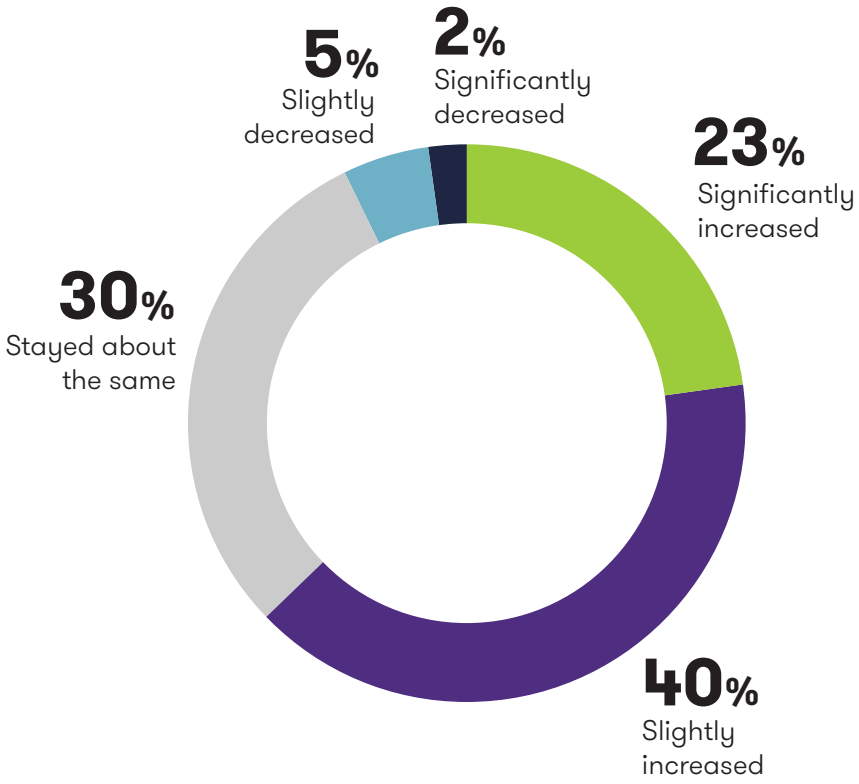


FIG. 2 Change in the level of fraud awareness



HOW IS THE OVERALL LEVEL OF FRAUD EXPECTED TO CHANGE POST-PANDEMIC?

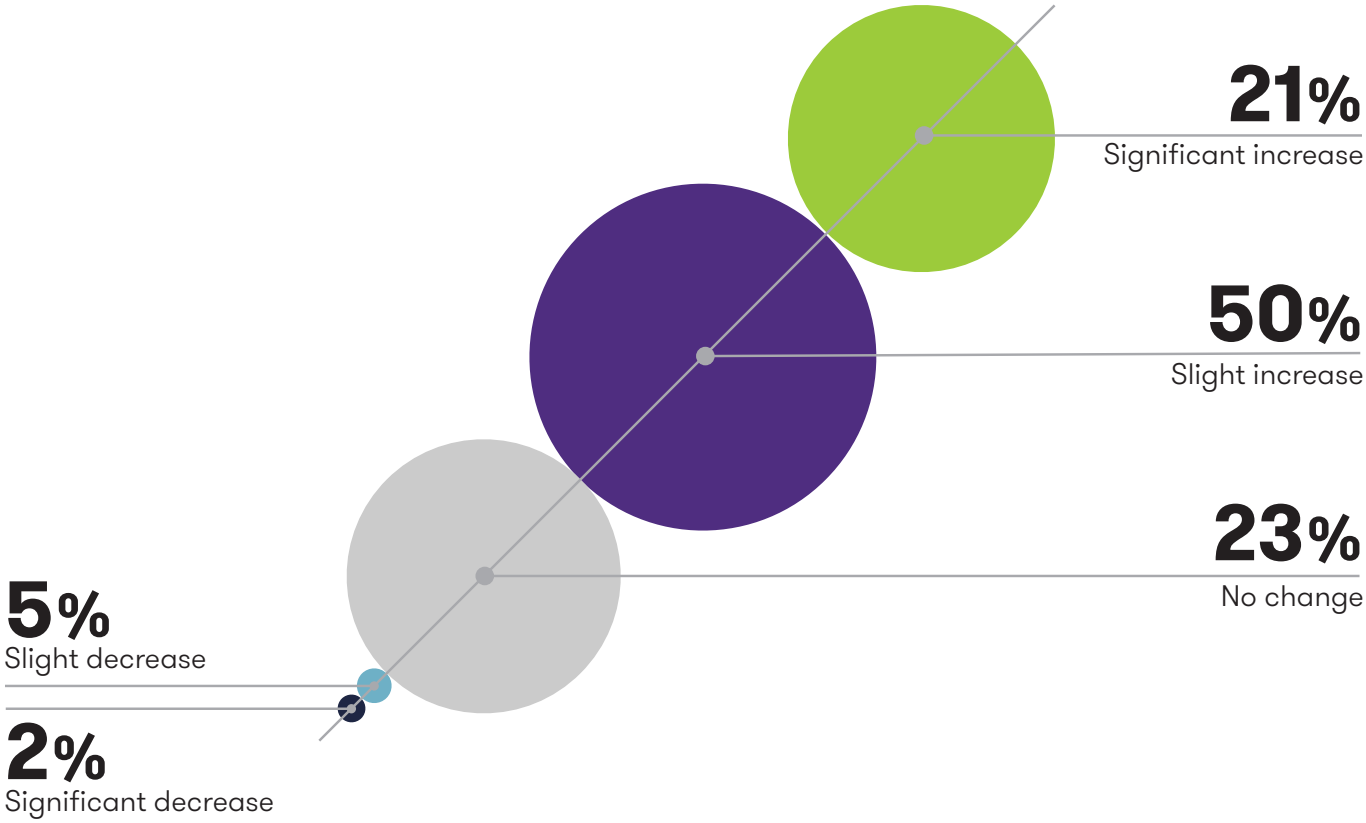
When asked how they expect the level of fraud impacting their organizations to change over the next 12 months, 71% of respondents answered that they expect it to increase, with 21% expecting a significant increase. This is substantially higher than the 51% of survey respondents whose organizations have already uncovered an increased amount of fraud since the onset of the pandemic (see Figure 1), indicating that more organizations are likely to be affected by an increased wave of fraud over the coming year than have already been affected.

In contrast, 30% of survey respondents expect either no change or a decrease in the level of fraud impacting their organizations over the next 12 months. Comparing this to prior ACFE studies highlights some reason for optimism; in the December 2020 *Fraud in the Wake of COVID-19: Benchmarking Report*, only 10% of respondents expected the overall level of fraud to stay the same or decrease during 2021.[2]

71% of respondents expect the level of fraud impacting their organizations to increase over the next 12 months.

[2] The December 2020 study focused on changes in the overall level of fraud in general, while our current study asked about fraud specifically impacting the respondents' organizations. Consequently, these findings are not directly parallel. However, they do reveal an interesting perspective and possible shift in the view of overall fraud risk as we move into the post-pandemic landscape.

FIG. 3 Expected change in the overall level of fraud impacting organizations

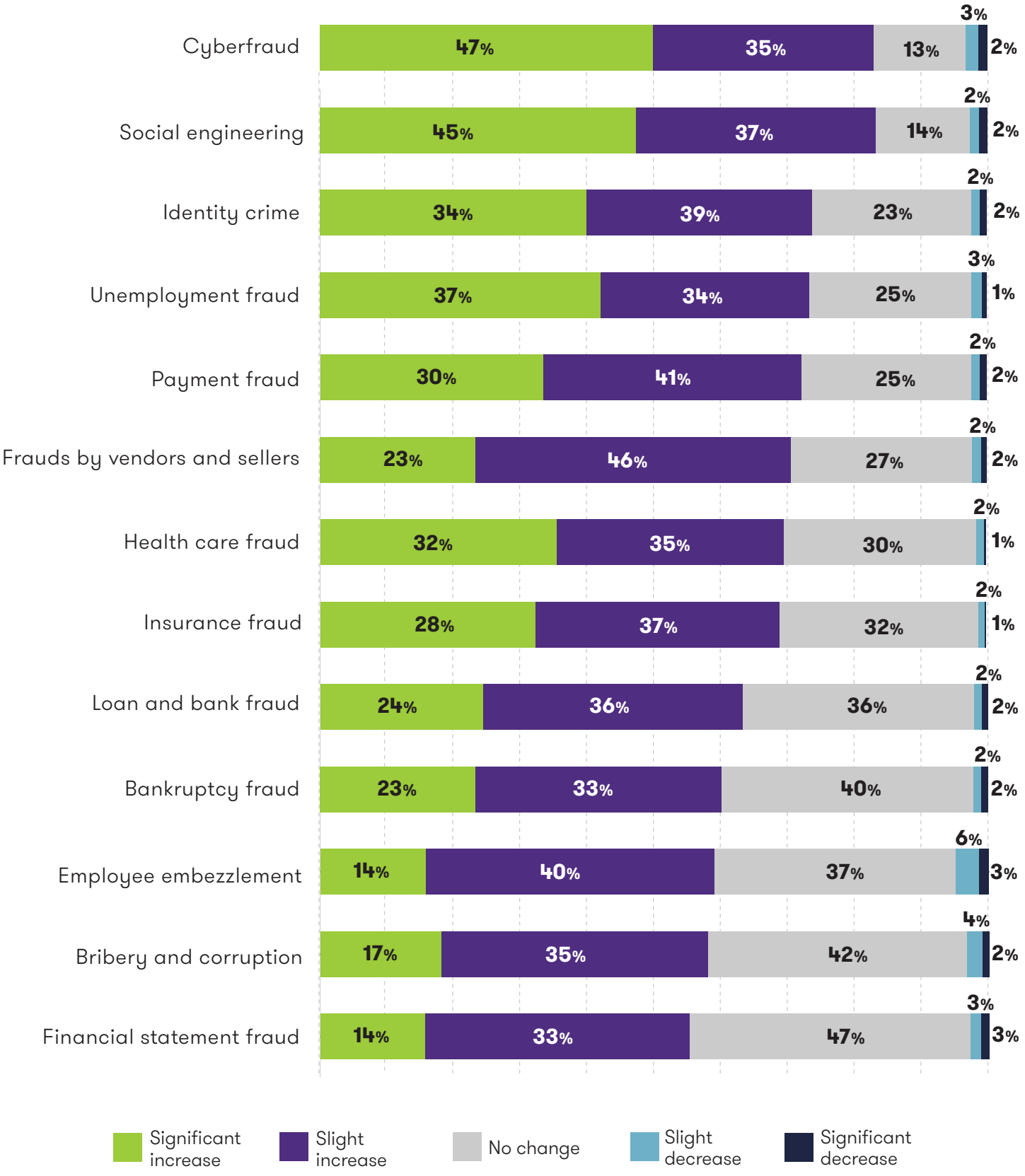


HOW ARE FRAUD RISKS EXPECTED TO CHANGE POST-PANDEMIC?

To determine how specific fraud risks affecting organizations might change over the next 12 months, we asked respondents about their expectations for 13 categories of fraud risks. The results indicate that most anti-fraud professionals expect increases in all types of fraud risks; more than half of respondents expect to see increases in every category except one (financial statement fraud). Cyberfraud (e.g., business email compromise, hacking, ransomware, and malware) and social engineering (e.g., phishing, brandjacking, and baiting) are the categories most expected to increase, with more than 80% of respondents anticipating growth in these two risk areas. Other risks projected to see large increases include identity crime (e.g., identity theft, synthetic identity schemes, and account takeovers), unemployment fraud, and payment fraud (e.g., credit card fraud and fraudulent mobile payments). In contrast, the three categories with the lowest percentage of respondents expecting an increase are the three primary categories of internal or occupational fraud: employee embezzlement (54%), bribery and corruption (52%), and financial statement fraud (47%).

Most anti-fraud professionals expect increases in all types of fraud risks; more than half of respondents expect to see increases in every category except one (financial statement fraud).

FIG. 4 Expected change in specific fraud risks over the next 12 months



HOW ARE ANTI-FRAUD BUDGETS CHANGING?

Financial resources available to anti-fraud teams and programs can significantly influence how effectively they can detect or prevent fraud. Furthermore, budgetary and staffing support can be especially critical in times when organizations are experiencing or expect to experience increases in fraud. To explore how the pandemic is affecting these areas, we asked survey participants about current and expected changes to the budgets for their overall anti-fraud program, as well as specific components of their programs.

For fiscal year 2021, most respondents' organizations (86%) increased or maintained the overall budget for their anti-fraud programs, and more than 60% of organizations kept the budget for the various program components at the same level or higher than in pre-pandemic years. Additionally, 38% of respondents' organizations increased their budgets for anti-fraud technology, making this the most common area for increased investment. The hardest-hit budget area for fiscal year 2021 was travel for anti-fraud staff, with 39% of respondents' organizations cutting funding (22% significantly so), which should come as no surprise given the travel restrictions that resulted from the pandemic. This category was also the only area in which more organizations decreased their budget than increased it for 2021.

When asked about expected changes to anti-fraud budgets for fiscal year 2022 compared to 2021, 43% of respondents indicated that their organizations expect to increase their overall anti-fraud program budgets, and 48% expect their budgets to remain about the same. For each of the specific budgetary areas, more organizations are expecting increases—and fewer are expecting decreases—than were noted for fiscal year 2021, indicating a continued investment in anti-fraud programs.

38% of organizations increased their budgets for anti-fraud technology, making this the most common area for increased investment.

FIG. 5A Budgets for fiscal year 2021 compared to pre-pandemic years

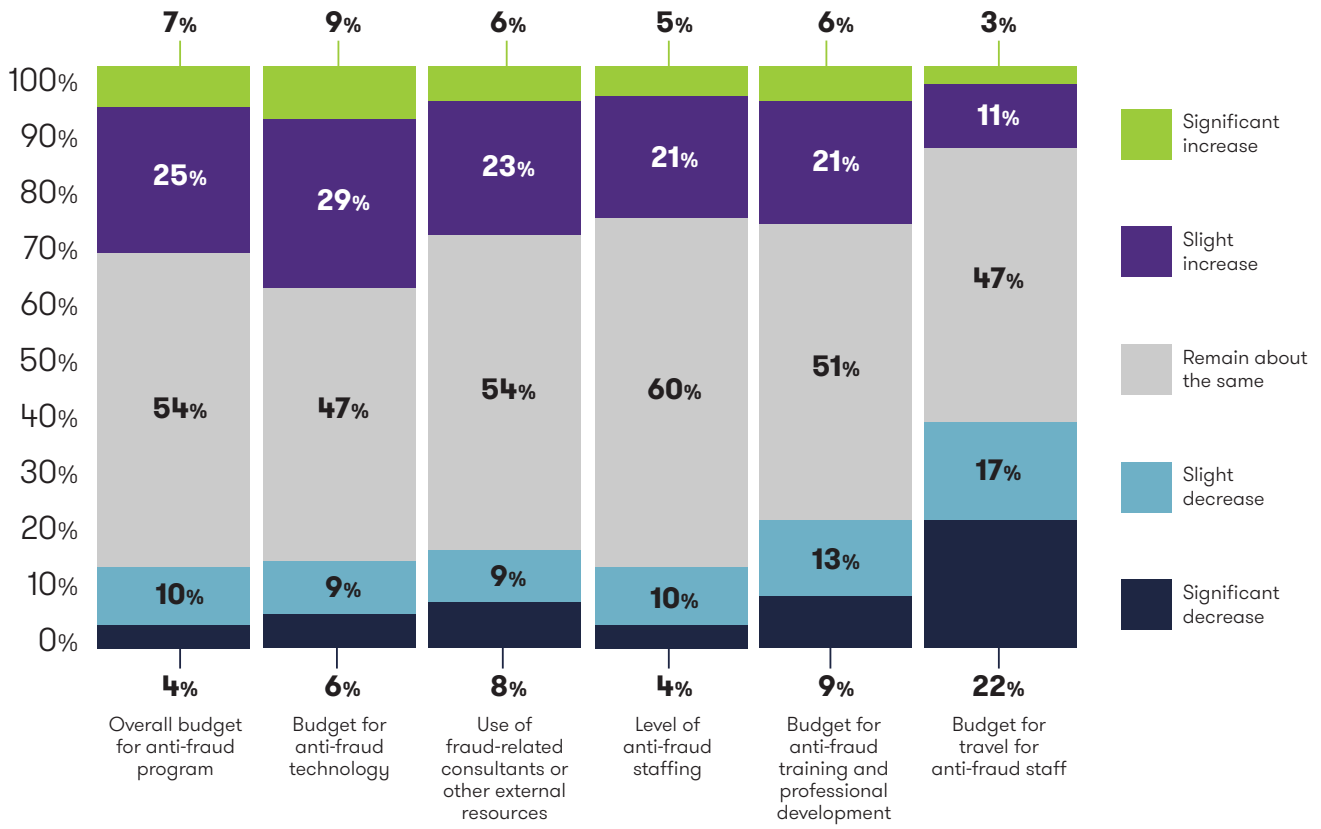
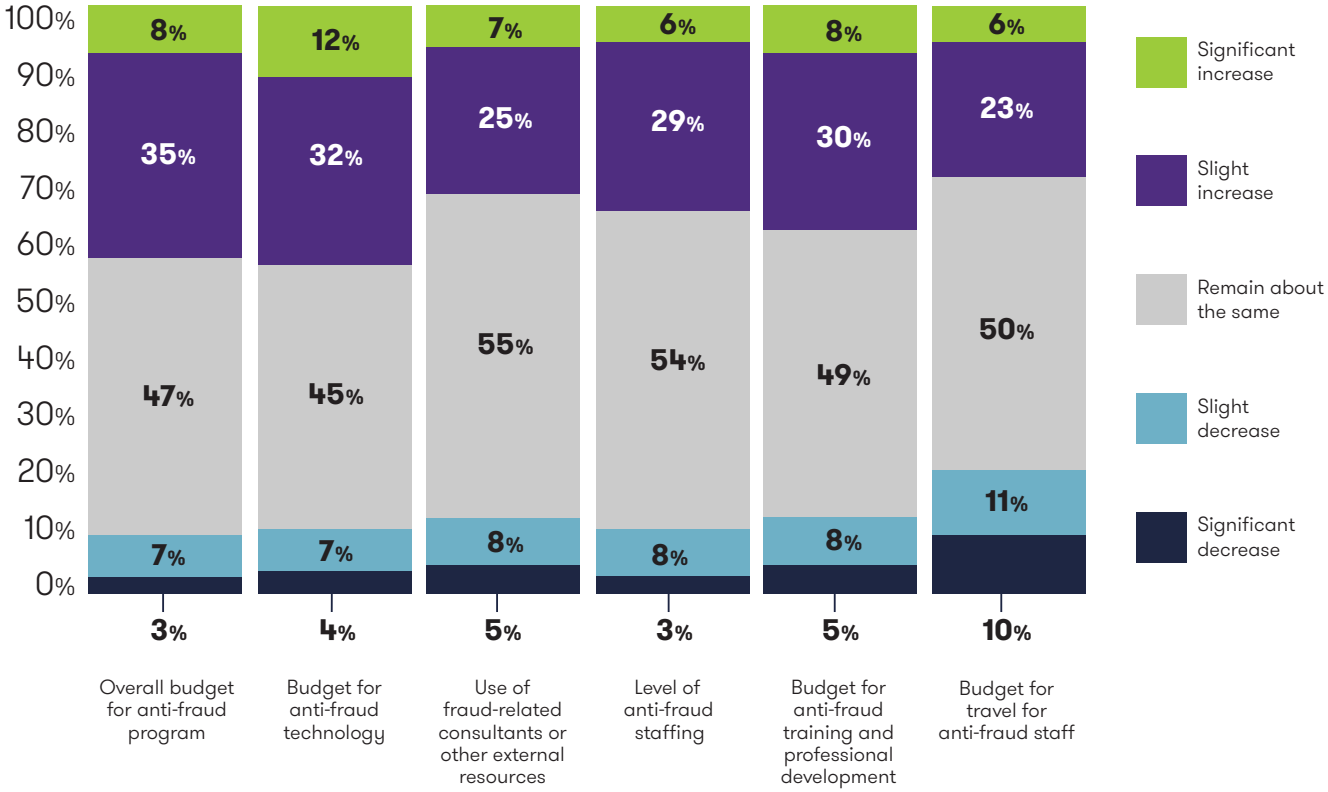


FIG. 5B Budgets for fiscal year 2022 compared to 2021



WHAT FACTORS ARE IMPACTING FRAUD RISK DURING AND POST-PANDEMIC?

The pandemic has fundamentally changed the way many businesses operate and how consumers behave, while also prompting actions by governments worldwide to address the pandemic's impact through regulatory changes and stimulus programs. These and other factors related to the COVID-19 pandemic have in turn affected the fraud risks affecting organizations. We asked respondents about the extent to which several pandemic-related risk factors have altered their organizations' fraud risk landscape or fraud risk management programs. The two risk factors that have had the greatest effect so far are shifts in business operations (e.g., the shift to remote work) and changing consumer behavior (e.g., virtual retail/online transactions). More than two-thirds of respondents indicated that both of these factors have had a significant or moderate influence on their organization's fraud risk landscape and/or fraud risk management program.

We also asked participants how they expect the same fraud risk factors to impact their organizations over the next 12 months. Shifts in business operations and changing consumer behavior remain the top two risk factors expected to affect respondents' organizations in the coming year, highlighting the lasting repercussions of these changes. However, there was a slight decrease in the proportion of respondents expecting a significant or moderate effect for most of the risk factors, possibly suggesting either an improved ability to navigate these changes or an expectation that these factors might soon return to pre-pandemic levels.

Shifts in business operations and changing consumer behavior remain the top two fraud risk factors.

FIG. 6A Fraud risk factors since the onset of the pandemic

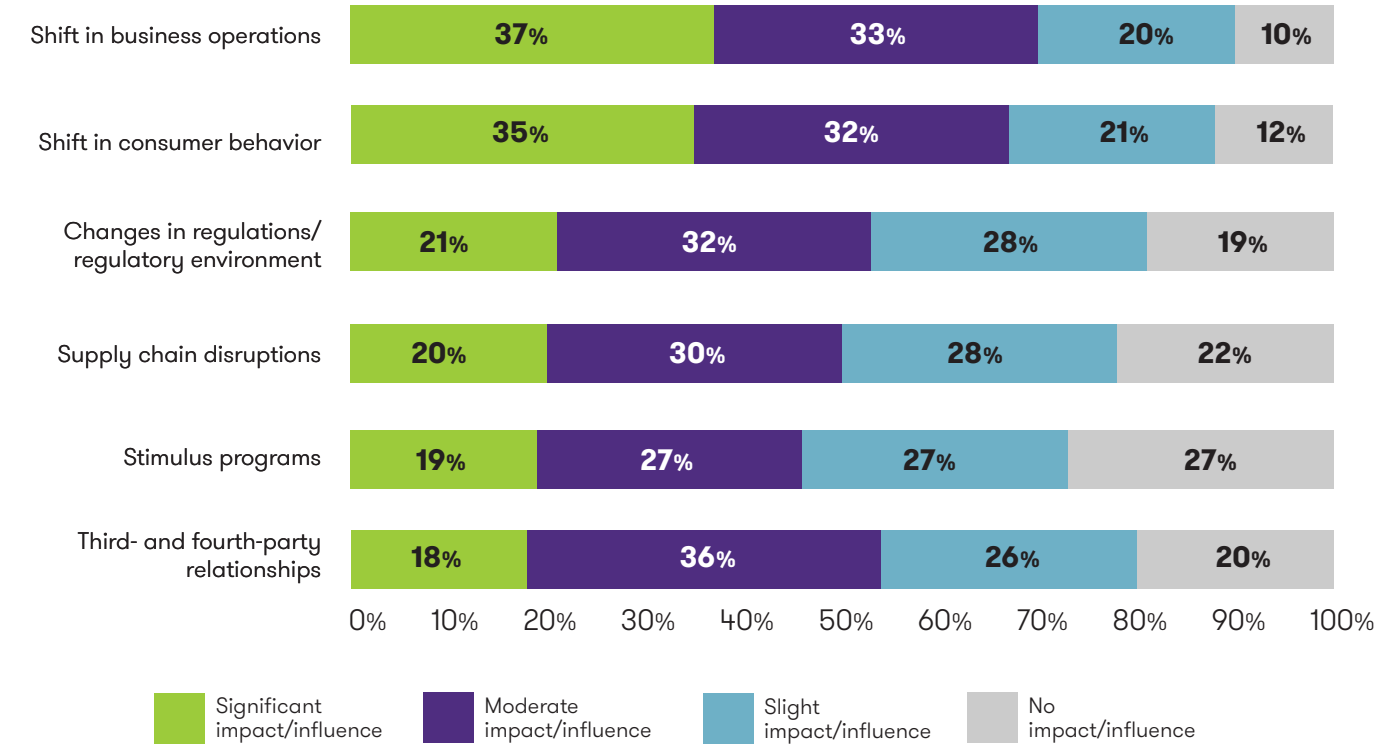
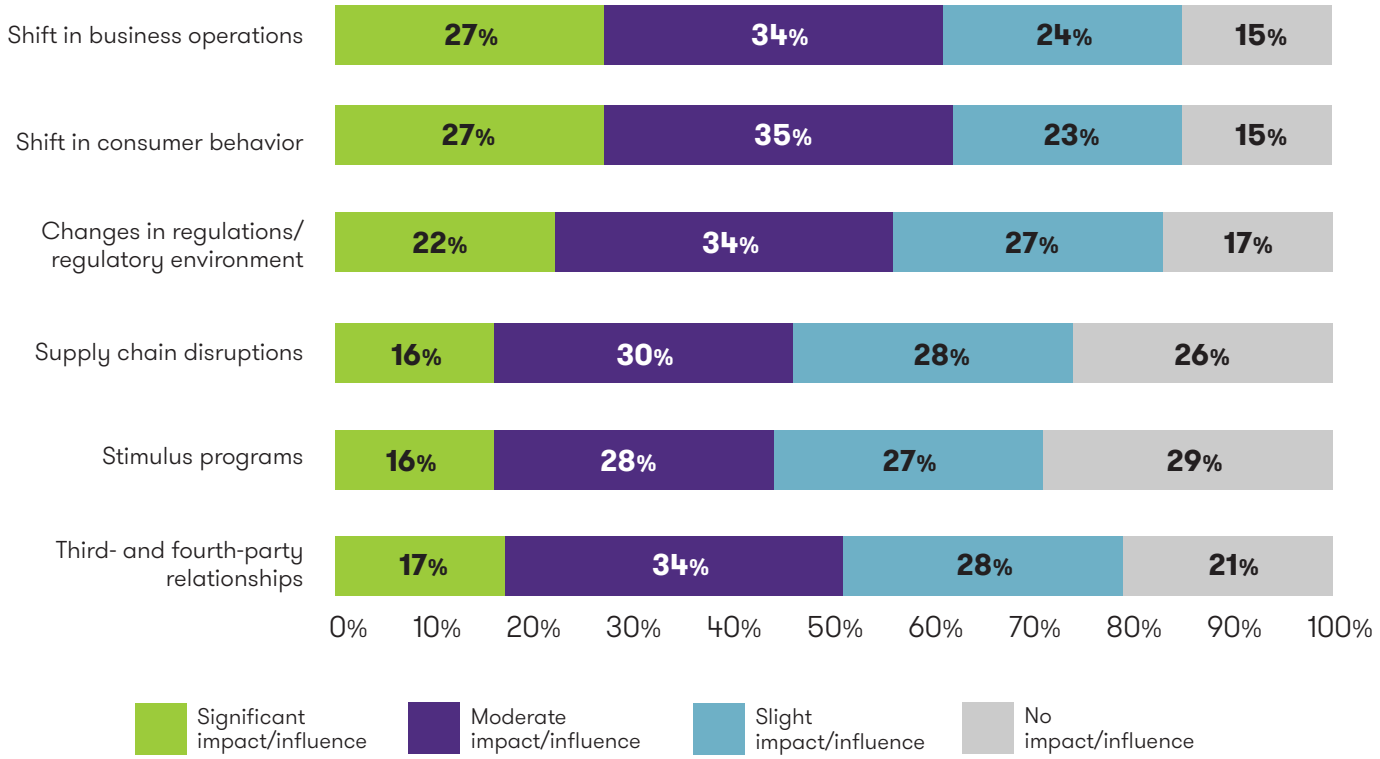


FIG. 6B Fraud risk factors expected over the next 12 months

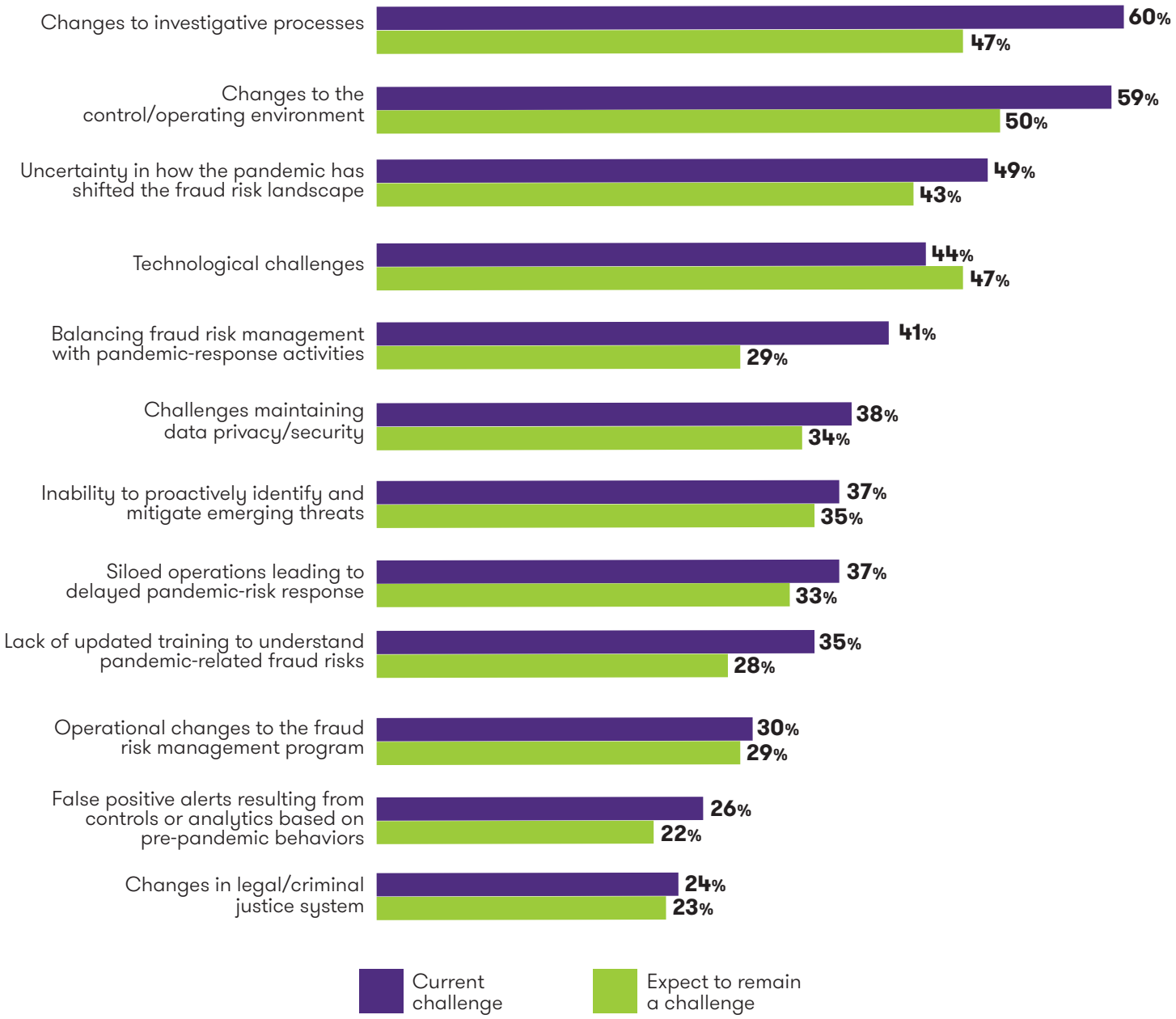


WHAT ARE THE PRIMARY CHALLENGES FACING ANTI-FRAUD PROGRAMS?

Survey participants provided insights about the current and expected challenges facing their anti-fraud programs due to the pandemic. According to respondents, changes to investigative processes (e.g., challenges in gaining access to evidence or conducting remote interviews, inability to travel) and to the control/operating environment (e.g., process/control exceptions, changes in controls/processes due to shift to remote work, staffing changes/reductions) have presented the greatest challenge to organizations, with 60% and 59% of respondents, respectively, noting these as current obstacles. These two factors are also expected to remain challenges for the greatest number of respondents in the post-pandemic environment. Additionally, while most challenges are expected to begin easing as we look forward, technological challenges are projected to grow slightly post-pandemic; 44% of respondents see technology as a current challenge, while 47% anticipate challenges in this area going forward.

Top challenges facing anti-fraud programs include changes to investigative processes and changes to the control/operating environment.

FIG. 7 Challenges facing anti-fraud programs

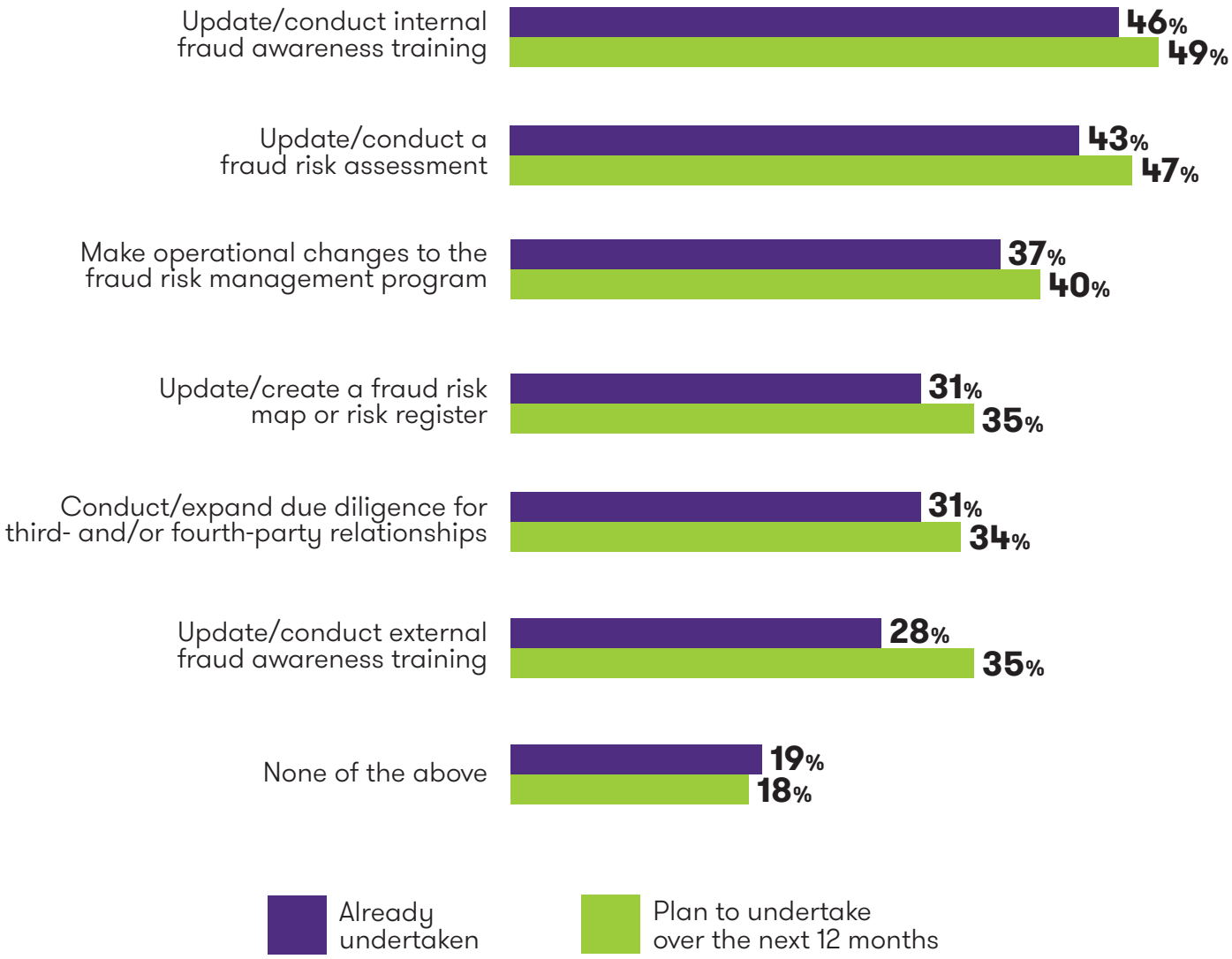


HOW ARE ANTI-FRAUD PROGRAMS BEING ADJUSTED FOR PANDEMIC-RELATED RISKS?

To understand how anti-fraud programs have changed in response to risks and circumstances surrounding the pandemic, we asked participants about what, if any, anti-fraud program changes their organizations have undertaken or plan to undertake over the next year. More than 80% of organizations have already implemented one or more changes to their anti-fraud programs, with updating or conducting internal fraud awareness training (46%) and updating or conducting a fraud risk assessment (43%) being the two most common initiatives. Both of these changes are also the most anticipated adjustments that organizations plan to make over the next 12 months; however, for every category, more organizations expect to implement changes in the coming year than have already undertaken the relevant change.

More than 80% of organizations have already implemented one or more changes to their anti-fraud programs in response to the pandemic.

FIG. 8 Changes to anti-fraud programs to address pandemic-related risks

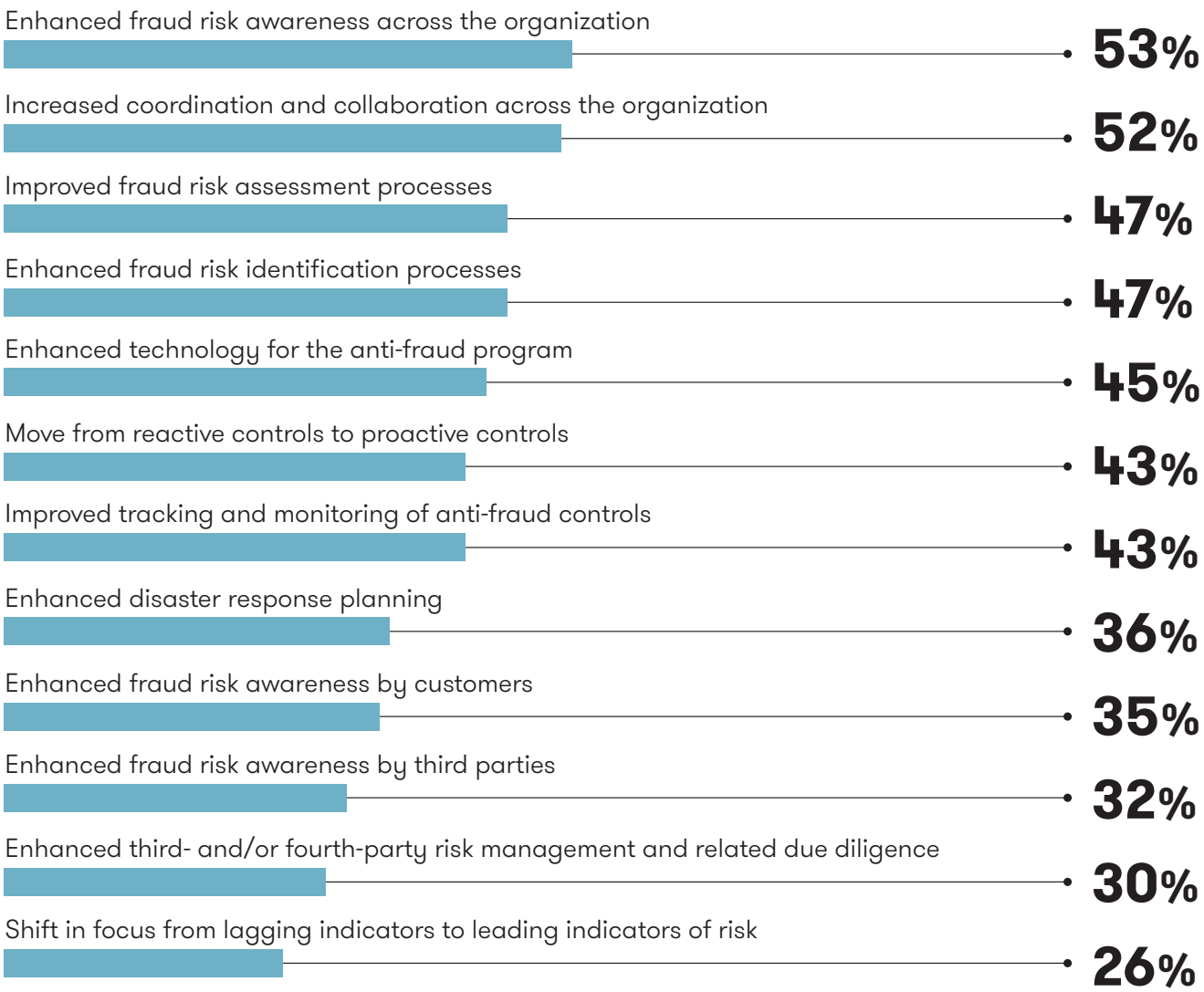


WHAT LESSONS HAVE WE LEARNED TO MOVE ANTI-FRAUD PROGRAMS FORWARD POST-PANDEMIC?

We asked respondents about 12 potential areas for enhancement in their organizations' anti-fraud programs—specifically, whether the pandemic revealed that improvements in these areas were needed for their anti-fraud programs to be effective. Our results indicate that there are strong opportunities for improvement across organizations. More than half of respondents believe that enhanced fraud risk awareness and increased collaboration across the organization are necessary to be more effective post-pandemic (53% and 52%, respectively). Only three areas—fraud risk awareness by third parties, third- and fourth-party risk management and due diligence, and a shift in focus from lagging to leading indicators of risk—were identified as necessary areas of improvement by less than one-third of respondents. These results suggest that there are common areas of many organizations' anti-fraud programs that require improvement to be more effective in the post-pandemic fraud landscape.

More than half of respondents believe that enhanced fraud risk awareness and increased collaboration across the organization are necessary to be more effective post-pandemic.

FIG. 9 Changes needed to make anti-fraud programs more effective going forward



METHODOLOGY AND DEMOGRAPHICS

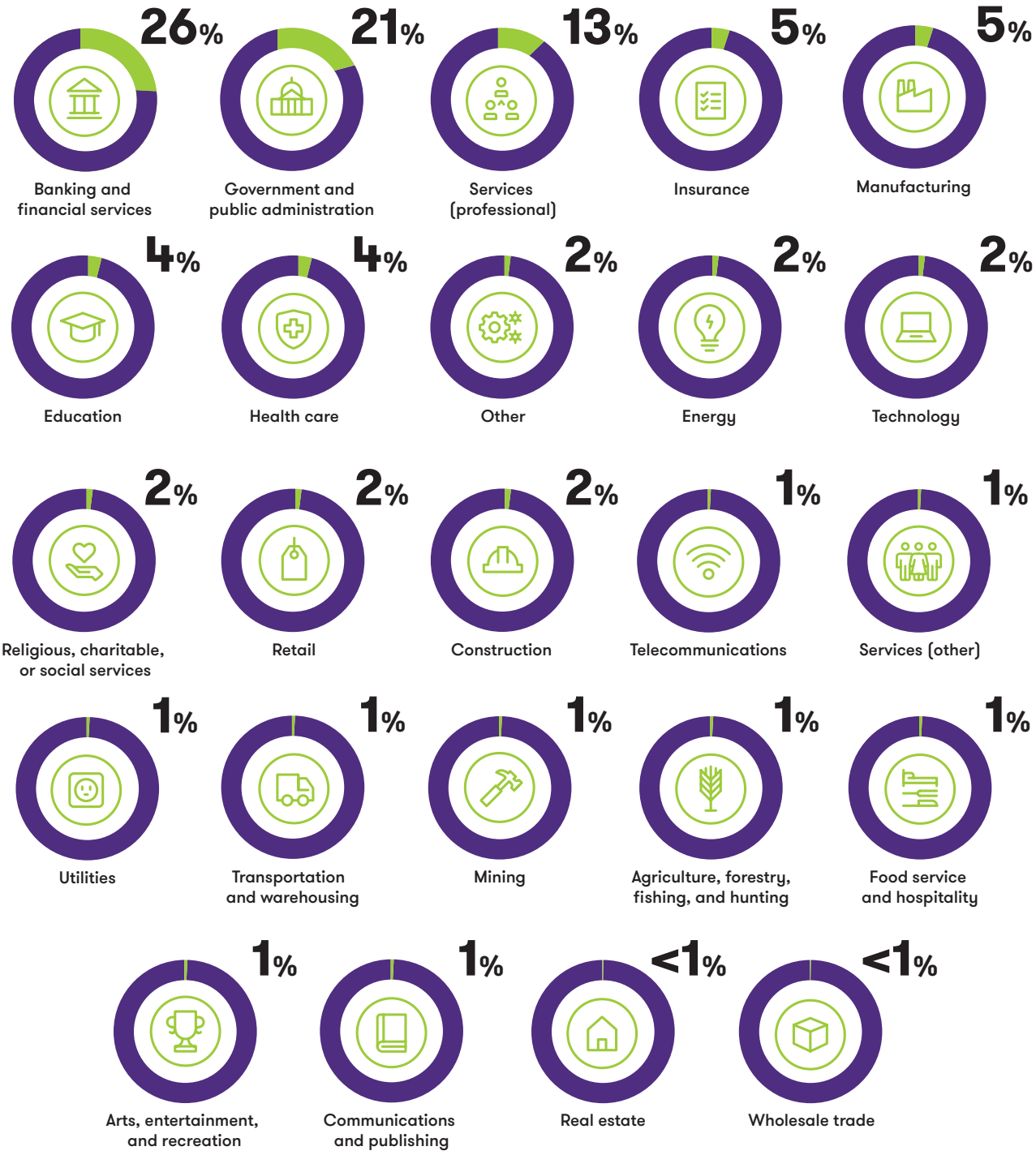
In late March and early April 2021, we invited 83,677 ACFE members to participate in a 15-question survey. Survey responses were collected anonymously. We received 1,539 survey responses that were usable for purposes of this report; all findings presented herein are based on these responses.

The sum of percentages in some figures throughout the report might not be exactly 100% due to rounding of individual category data.

INDUSTRY

More than one-quarter of survey respondents work in the banking and financial services industry, 21% are in the government and public administration sector, and 13% work in professional services. The remaining 40% of respondents are distributed across a variety of other industries.

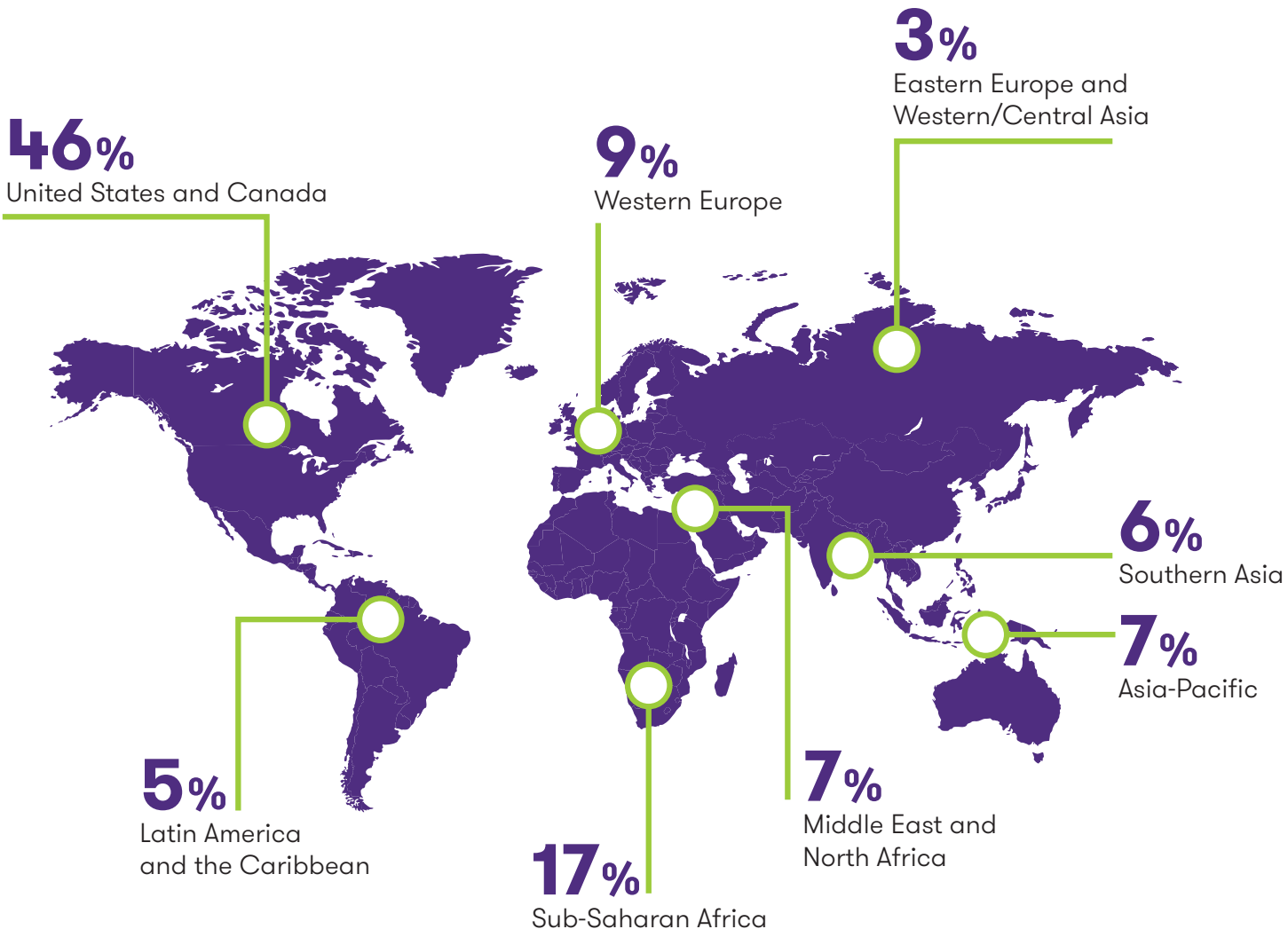
FIG. 10 Industry of respondents' organizations



REGION

Our survey respondents reside in more than 100 countries around the world, providing a truly global view into the post-pandemic fraud landscape. Nearly half (46%) of respondents live in the United States and Canada; 17% live in Sub-Saharan Africa; 9% live in Western Europe; 7% each live in the Asia-Pacific region and the Middle East and North Africa; 6% live in Southern Asia; 5% live in Latin America and the Caribbean; and 3% live in Eastern Europe and Western/Central Asia.

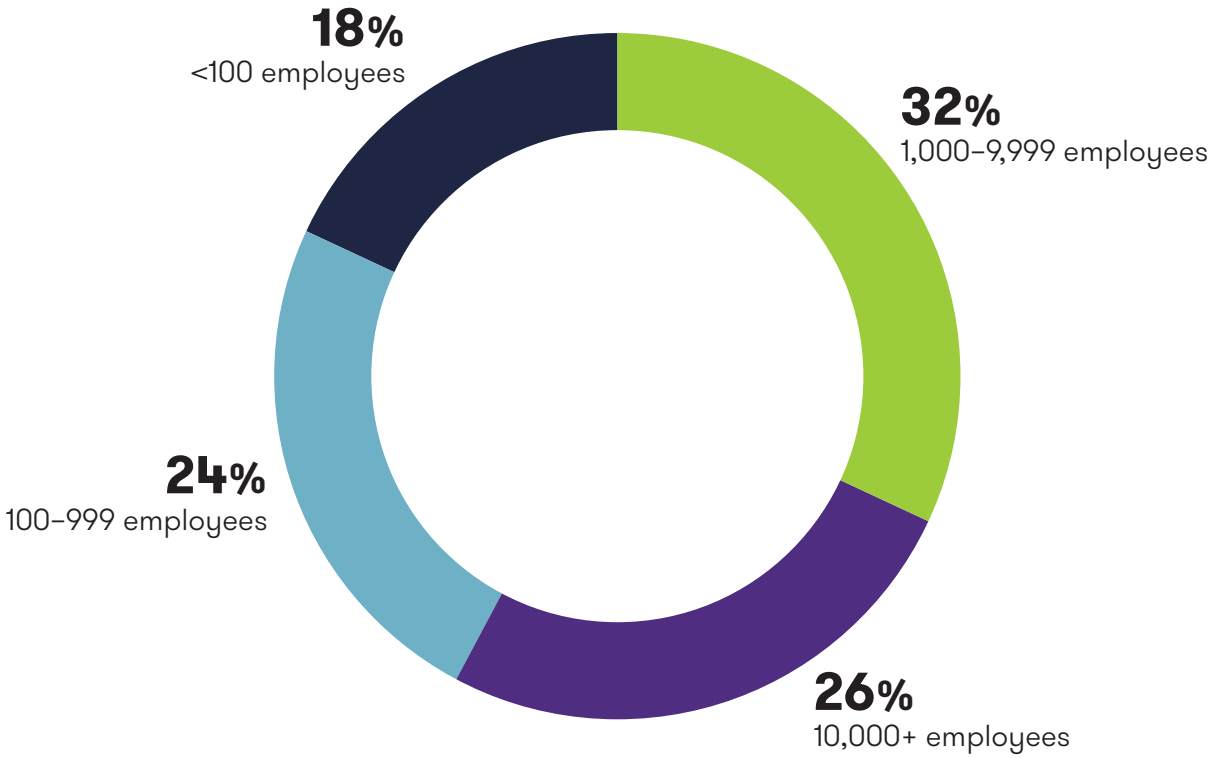
FIG. 11 Region of respondents' organizations



ORGANIZATION SIZE

We asked respondents about the size of their employing organizations. As shown in Figure 12, nearly one-third of respondents work for an organization with 1,000–9,999 employees, approximately one-quarter each work for organizations with 100–999 employees and with more than 10,000 employees, and 18% work for smaller organizations that employ fewer than 100 individuals.

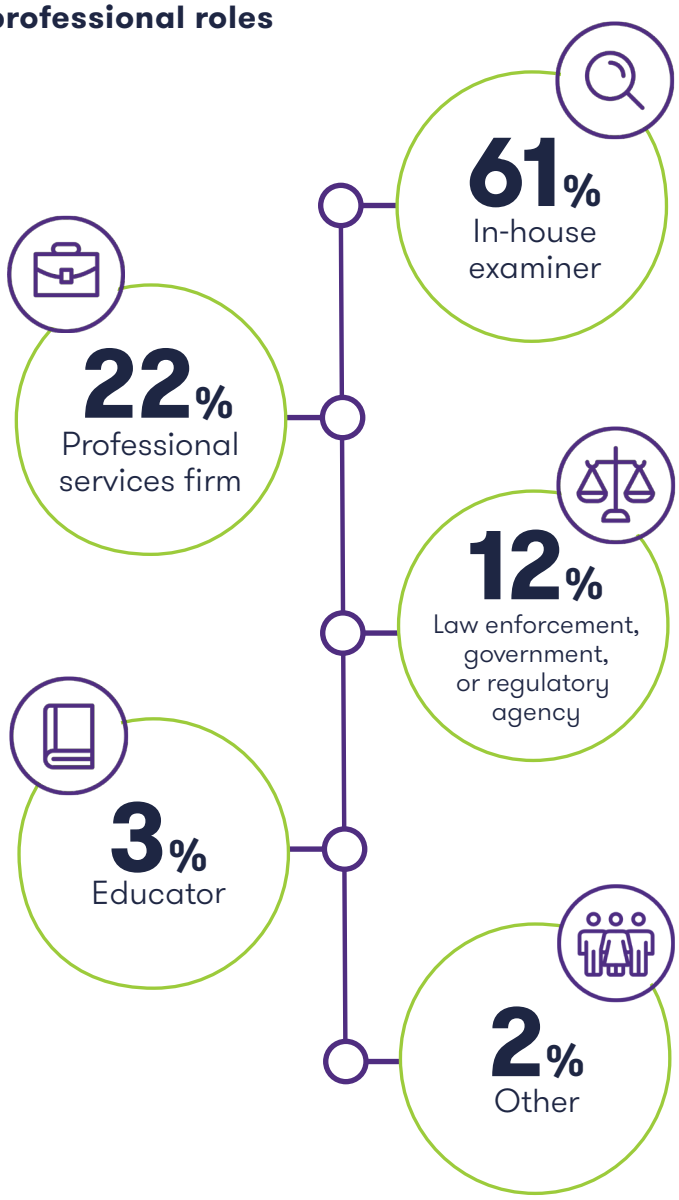
FIG. 12 Size of respondents' organizations



PROFESSIONAL ROLE

The majority of survey respondents (61%) work as in-house fraud examiners, conducting fraud-related engagements within a single company or agency. Another 22% work for professional services firms that conduct fraud-related engagements on behalf of client organizations, while 12% work for law enforcement, government, or regulatory agencies that conduct fraud-related engagements for other parties under their employing agency's authority.

FIG. 13 Respondents' professional roles



CONCLUSION

The pandemic has changed much about the business environment and operations, and anti-fraud programs must evolve along with them. The ACFE and Grant Thornton are deeply grateful to all survey respondents who took the time to share their experience and expertise as part of our study. We hope the survey results provided in this report help anti-fraud professionals, organizational leaders, and the general public understand and better prepare for the post-pandemic fraud landscape.

Organizations and anti-fraud professionals who want to learn more about how to strengthen their defenses against fraud can find the ACFE/Grant Thornton *Anti-Fraud Playbook*, a publication that provides easy-to-use, actionable guidance for managing fraud risks, along with a library of other fraud risk management tools and resources at ACFE.com/fraudrisktools-playbook or at http://www.grantthornton.com/fraudplaybook.

ABOUT THE ACFE

Founded in 1988 by Dr. Joseph T. Wells, CFE, CPA, the ACFE is the world's largest anti-fraud organization and premier provider of anti-fraud training and education. Together with nearly 90,000 members in more than 180 countries, the ACFE is reducing business fraud worldwide and providing the training and resources needed to fight fraud more effectively.

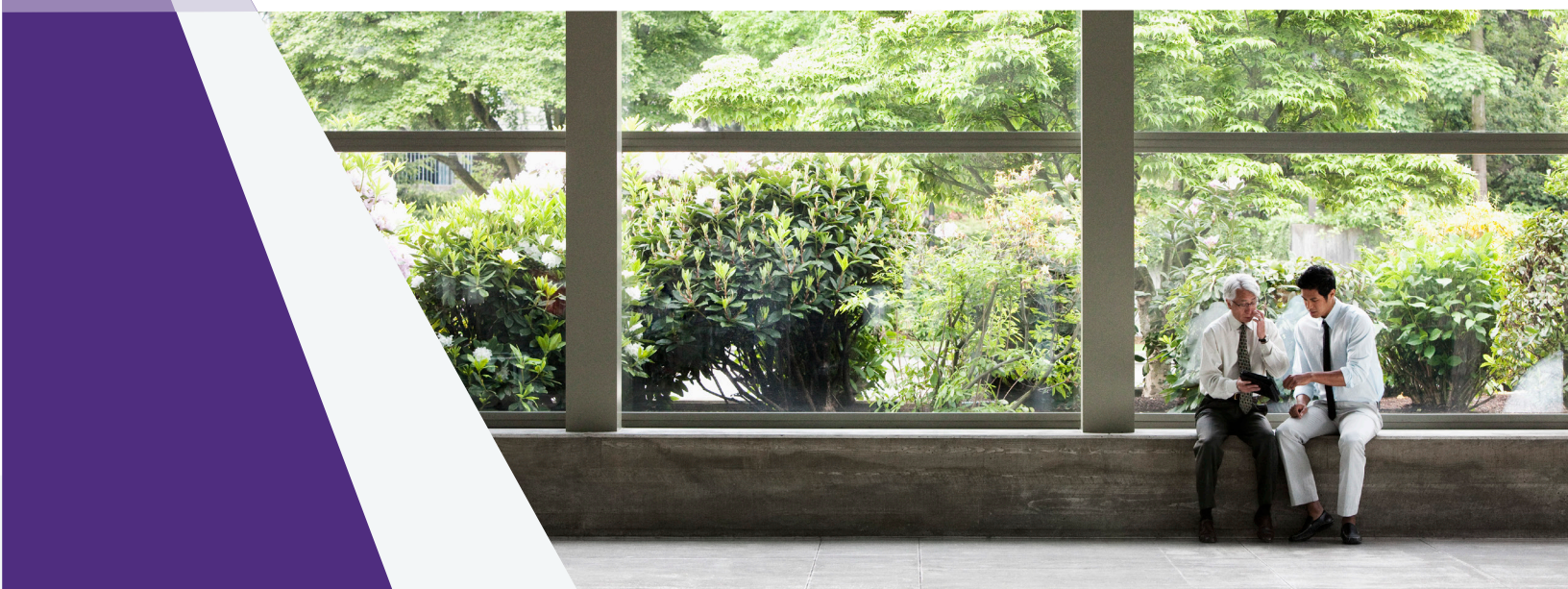
The positive effects of anti-fraud training are far-reaching. Clearly, the best way to combat fraud is to educate anyone engaged in fighting fraud on how to effectively prevent, detect and investigate it. By educating, uniting and supporting the global anti-fraud community with the tools to fight fraud more effectively, the ACFE is reducing business fraud worldwide and inspiring public confidence in the integrity and objectivity of the profession. The ACFE offers its members the opportunity for professional certification. The Certified Fraud Examiner (CFE) credential is preferred by businesses and government entities around the world and indicates expertise in fraud prevention and detection.

ABOUT GRANT THORNTON LLP

Founded in Chicago in 1924, Grant Thornton LLP (Grant Thornton) is the U.S. member firm of Grant Thornton International Ltd, one of the world's leading organizations of independent audit, tax and advisory firms. Grant Thornton, which has revenues of $1.92 billion and operates more than 50 offices, works with a broad range of dynamic publicly and privately held companies, government agencies, financial institutions, and civic and religious organizations.

ACFE
Association of Certified Fraud Examiners

Grant Thornton



IN THE MATTER OF

AMWAY CORPORATION, INC., ET AL.

FINAL ORDER, OPINION, ETC., IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT

Docket 9023. Complaint, March 25, 1975 — Final Order, May 8, 1979

This order, among other things, requires two Michigan corporations engaged in the door-to-door marketing of various household products, and two corporate officers, to cease allocating customers among their distributors; fixing wholesale and retail prices for their products; taking retaliatory action against recalcitrants; and disseminating price-listing data which fail to advise that price adherence is not obligatory. Respondents are additionally prohibited from misrepresenting potential earnings and other relevants to prospective distributors.

Appearances

For the Commission: *Joseph S. Brownman, D. Stuart Cameron, Mary Lou Steptoe, B. Milele Archibald* and *Michael Goldenberg.*

For the respondents: *Lee Loevinger, Philip C. Larson* and *Robert J. Kenney, Jr., Hogan & Hartson,* Washington, D.C. and *John E. Stephen,* Ada, Mich.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act (15 U.S.C. 41, *et seq.*) and by virtue of the authority vested in it by said Act, the Federal Trade Commission having reason to believe that the parties listed in the caption hereof and more particularly described and referred to hereinafter as respondents, have violated the provisions of Section 5 of the Federal Trade Commission Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the interest of the public, hereby issues its complaint, stating its charges as follows:

PARAGRAPH 1. Respondent Amway Corporation, Inc. is a corporation organized on or about September 6, 1949, under the name Ja-Ri Corporation, Inc. Its name was formally changed to Amway Corporation in November 1963. On or about January 1, 1964, Amway Sales Corporation, Amway Services Corporation and Amway Manufacturing Corporation, all of which were Michigan corporations, were merged into Amway Corporation, Inc. Respondent corporation maintains its home office and principal place of business at 7575 East Fulton Rd., Ada, Michigan. [2]

PAR. 2. Respondent Amway Distributors Association of the United

States is an association of Amway distributors and dealers, which maintains its home office and principal place of business at 7575 East Fulton Rd., Ada, Michigan. Among the functions and duties of the Amway Distributors Association are to make recommendations to respondent corporation with respect to the standing, termination or suspension of individual distributors or dealers, and to recommend changes or other action on various restrictions upon distributors or dealers.

PAR. 3. Respondent Jay Van Andel is Chairman of the Board of Directors of respondent corporation, and was one of its founders. Together with others, respondent Van Andel instituted the Amway marketing plan and distribution policies, and has been and continues to be responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondent. Mr. Van Andel's office address is the same as that of respondent corporation.

PAR. 4. Respondent Richard M. DeVos is President of respondent corporation, and was one of its founders. Together with others, respondent DeVos instituted the Amway marketing plan and distribution policies, and has been and continues to be responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondent. Mr. DeVos' office address is the same as that of respondent corporation.

PAR. 5. Respondent corporation is engaged in the manufacture, distribution, offering for sale and sale of more than 150 kinds of home-care, car-care and personal-care products, as well as vitamins and food supplements, under its own labels and trademarks, to distributors and dealers located throughout the United States. In addition, respondent corporation sells over 300 products manufactured by and bearing the name and label of other manufacturers. These products are of a wide variety including clothing, household appliances, furnishings, tools, luggage, watches, cameras and other items. Sales of products by the respondent corporation is more than $150,000,000 at retail levels, and over 200,000 persons are actively engaged in the resale of Amway products throughout the United States. [3]

PAR. 6. In the course and conduct of its business of manufacturing and distributing its products, respondent corporation ships or causes such products to be shipped from the state in which they are manufactured and warehoused to distributors or dealers located in various other States throughout the United States. These distributors in turn resell to other distributors, dealers or to members of the general public. There is now and has been for several years last past a constant, substantial, and increasing flow of such products in or

affecting "commerce" as that term is defined in the Federal Trade Commission Act.

PAR. 7. Except to the extent that actual and potential competition has been lessened, hampered, restricted and restrained by reason of the practices hereinafter alleged, respondent corporation's distributors and dealers, in the course and conduct of their business of distributing, offering for sale, and selling their products are in substantial actual competition or potential competition in commerce with one another, and corporate respondent is in substantial actual or potential competition in commerce with other persons or firms engaged in the manufacture, sale and distribution of similar merchandise.

PAR. 8. Respondents have formulated a distribution system which has been published in various manuals, bulletins, pamphlets and other literature and material. To effectuate and carry out the policies of this distribution system, corporate respondent has entered into contracts, agreements, combinations or common understandings with its distributors and dealers; and has adopted, placed into effect, enforced and carried out, by various methods and means, said distribution system, which hinders, frustrates, restrains, suppresses and eliminates competition in the offering for sale, distribution and sale of its various products.

PAR. 9. Distributors and dealers of respondent corporation are independent contractors who sell or attempt to sell at retail to members of the consuming public, and at wholesale to other distributors and dealers recruited and/or sponsored into their respective sales organizations. Except for "Direct Distributors," distributors or dealers generally purchase their product needs directly from their sponsors. [4]

Distributors buying directly from respondent corporation are denoted "Direct Distributors," of which there are approximately fifteen hundred (1500) throughout the United States. Other distributors or dealers may purchase directly from Amway Corporation after meeting certain conditions.

In concert and combination with their network of distributors and dealers, respondents police, enforce and carry out the various rules, regulations and policies, including those alleged hereinafter as unfair methods of competition and unfair or deceptive acts or practices.

COUNT I

Paragraphs One through Nine are incorporated by reference herein as if fully set forth verbatim.

PAR. 10. The acts, practices and methods of competition engaged in, followed, pursued or adopted by respondents, and the combination, conspiracy, agreement or common understanding entered into or reached between and among the respondents, respondent corporation's distributors or dealers, or others not parties hereto tend to, and do, fix, maintain, control or tamper with the resale prices at which respondent corporation's products are or may be sold.

PAR. 11. For example, distributors and dealers have entered into contracts, agreements, combinations or understandings with respondents, or have been and continue to be required and coerced by respondents to sell to other distributors or dealers at other wholesale levels of distribution at the same prices which they paid for their products from other distributors or dealers or from respondent Amway Corporation. Distributors or dealers must thereafter rely upon the implementation of and adherence to respondents' purchase volume refund schedule for wholesale profits.

Under this purchase volume refund plan, refunds are paid by respondent Amway Corporation to its direct buying "Direct Distributors" on a monthly basis at the rate of 25% of the monthly dollar volume of purchases figured at the retail price. These sponsoring distributors, in turn, pay rebates to their wholesale customers of from 0 to 25%, based upon their own monthly dollar volume of purchases, and so on, to all wholesale levels of distribution. [5]

PAR. 12. By way of further example, distributors and dealers have also agreed to sell to church, service, civic or charitable selling organizations at specified prices, and to in turn request these organizations to adhere to these same retail prices when selling to the ultimate consumer. Thereafter the distributor or dealer will pay the selling organization a sum of money which will become its gross income on the aforesaid sales.

Said acts, practices and methods of competition, and the adverse competitive effects resulting therefrom, constitute unreasonable restraints of trade and unfair methods of competition in commerce within the intent and meaning of Section 5 of the Federal Trade Commission Act, as amended.

COUNT II

Paragraphs One through Nine are incorporated by reference herein as if fully set forth verbatim.

PAR. 13. The acts, practices and methods of competition engaged in, followed, pursued or adopted by respondents, and the combination, conspiracy, agreements or common understandings entered into or reached between and among the respondents, respondent

corporation's distributors or dealers, or others not parties hereto tend to, and do, restrict the customers to whom respondent corporation's distributors or dealers may resell their products; restrict distributors and dealers as to the source of their product needs; restrict the retail outlets through which distributors and dealers may resell their products; and allocate retail customers between and among the various distributors or dealers.

PAR. 14. Distributors and dealers have entered into contracts, agreements, combinations or understandings with respondents, or have been and continue to be required and coerced by respondents to adhere to practices whereby absent prior approval to the contrary, purchases of product needs must be made either directly from respondent corporation or from the distributor or dealer who recruited and/or [6] sponsored the would-be purchasing distributor or dealer. Distributors and dealers may not resell their products at wholesale except to those other distributors or dealers they had recruited and/or sponsored, and who are recognized as such by respondents. Distributors or dealers who drop out of the program are replaced in the chain of distribution by other distributors or dealers to whom the former had previously been selling.

PAR. 15. Distributors and dealers have also entered into contracts, agreements, combinations or understandings with respondents, or have been and continue to be required and coerced by respondents to refrain from selling from or through any business office, retail store, military store, ship's store, service station, barber shop, beauty salon, show booth, fair or the like, and to refrain from selling to proprietors of such establishments for resale at the retail level.

PAR. 16. Distributors and dealers have also entered into contracts, agreements, combinations or understandings with respondents, or have been required and coerced by respondents to refrain from soliciting the business of retail customers and commercial accounts of other distributors or dealers.

Said acts, practices and methods of competition, and the adverse competitive effects resulting therefrom, constitute unreasonable restraints of trade and unfair methods of competition in commerce within the intent and meaning of Section 5 of the Federal Trade Commission Act, as amended.

COUNT III

Paragraphs One through Nine are incorporated by reference herein as if fully set forth verbatim.

PAR. 17. The acts, practices and methods of competition engaged in, followed, pursued or adopted by respondents, and the combina-

tion, conspiracy, agreements or common understandings entered into or reached between and among the respondents, respondent corporation's distributors or dealers, or others not parties hereto tend to, and do, restrict the advertising and promotional activities in which distributors and dealers may or would otherwise engage. [7]

PAR. 18. Distributors and dealers have entered into contracts, agreements, combinations or understandings with respondents, or have been required and coerced by respondents to refrain from engaging in or limiting advertising activities as follows:

1. Distributors and dealers may not display literature or merchandise in the locations from which retail sales activities are prohibited.

2. "Direct Distributors" only may display the "Amway" tradename, tradmarks or logos on the exterior of their places of business; provided that in addition thereto the place of business is a commercial type building, the place of business is an exclusively Amway business, no displays appear in any show windows, a view from the outside looking in is obscured, and "Wholesale Only" must appear on the door leading in.

3. Distributors and dealers other than "Direct Distributors" must obtain the permission of the Direct Distributors from whose chain of distribution they purchase merchandise before the Amway logo may be displayed on business vehicles.

4. "Direct Distributors," with prior permission, may advertise in the "white pages" of the telephone directory under the "Amway" tradename, whereas other distributors or dealers may not.

5. Distributors and dealers may not utilize display ads in "yellow pages" telephone directories wherein it is indicated that the distributor or dealer deals in Amway merchandise.

6. Distributors and dealers may not set up displays at fairs, home shows or other special events unless they do so in concert, and under the direction of a "Direct Distributor." [8]

7. "Direct Distributors" only may utilize roadside advertising.

8. Distributors and dealers other than "Direct Distributors" may not advertise in newspapers, magazines or on the radio or television.

9. Distributors and dealers may only place recruiting ads which do not mention the name "Amway."

10. Distributors and dealers may not advertise specific Amway products in the media.

Said acts, practices and methods of competition, and the adverse competitive effects resulting therefrom, constitute unreasonable restraints of trade and unfair methods of competition in commerce

within the intent and meaning of Section 5 of the Federal Trade Commission Act, as amended.

COUNT IV

Paragraphs One through Nine are incorporated by reference herein as if fully set forth verbatim.

PAR. 19. By and through the use of written or oral representations, respondents or their representatives represent and have represented, directly or by implication that:

1. Substantial income or profit as a result of wholesale or retail sales activities from "multiplication," "duplication" or geometrical increases in the number of distributors at lower functional levels of distribution is likely.

2. Substantial income or profit as a result of wholesale or retail sales activities from unlimited recruiting activities or endless chain recruiting activities is likely. [9]

PAR. 20. In truth and in fact the distributors and dealers are not long likely to recruit other distributors in multiplication, duplication, geometrically increasing, unlimited or endless chain fashion, or to profit from sales to other distributors at lower functional levels in geometrically increasing, unlimited, or endless chain fashion because:

(a) The participants may be, and in a substantial number of instances will be, unable to find additional participants, by the time they enter respondents' marketing program. As to each of the individual participants, recruitment of additional participants must of necessity ultimately collapse when the number of persons theretofore recruited has so saturated the area with distributors or dealers as to render it virtually impossible to recruit others.

(b) Profits resulting from respondents' recruitment program must of necessity ultimately collapse when the number of potentially available persons who can be recruited to serve a particular area is exhausted. The greater the number of distributors or dealers previously recruited, the lower the chances of a profitable distributorship or dealership operation.

(c) Regardless of the number of distributors or dealers previously recruited to serve in a particular market area, profits and therefore recruitment must of necessity ultimately collapse when distributors or dealers at lower functional levels of distribution are unable to operate their wholesale businesses at a profit by selling to lower functional levels at prices greater than paid for. The greater the

number of levels of distribution, the more inefficient the distribution system becomes, and the less profitable it is likely to be at the lower levels. [10]

For the foregoing reasons and others, respondents' representations that substantial income or profit may be predicated through multiplication, duplication, and geometrical, unlimited or endless chain increases in the number of distributors or dealers recruited, either at the same or lower functional levels of distribution, in connection with the manufacture, sale and distribution of their merchandise, was and is false, misleading and deceptive, and was and is an unfair method of competition and an unfair act and practice within the intent and meaning of Section 5 of the Federal Trade Commission Act, as amended.

COUNT V

Paragraphs One through Nine and Paragraphs Nineteen and Twenty are incorporated by reference herein as if fully set forth verbatim.

PAR. 21. In the course and conduct of their business, and for the purpose of inducing the purchase of their products and the participation of persons as dealers or distributors of respondents' products, the respondents and their representatives or agents have made and are continuing to make oral and written statements and representations to distributors, dealers and prospective participants regarding the sale of their merchandise, the profitability of a dealership or distributorship and the recruitment of still additional participants. Typical and illustrative of said statements and representations, but not all inclusive thereof, are the following (with emphasis omitted):

1. Sponsoring is profitable, regardless of whether you do it on a limited basis as a part-time distributor, or "all-out" as a full-time distributor.

2. Sponsoring is easy! Recruiting new Amway Distributors is not difficult, just as selling Amway products is not difficult. . . .When you have learned to sponsor one, then you simply repeat the process and sponsor two. . . .From that point on, it is just simple multiplication!

3. . . .[T]here is no known limit to how big your business can grow when you sponsor other distributors, who in turn sell products and sponsor still other distributors.

4. With the proven Amway Opportunity success will be yours. . .act now. . . .

5. To build a big business you, plus your 10 distributors-each sponsoring 4 people (total 51 distributors) with everyone selling one hour per day you will earn. . .your total monthly profit $1,368.00. Excellent income for one hour per day. [11]

6. To build a larger business. . .you simply sponsor 10 distributors who work. . .one hour per day. . .You will earn. . .Your total monthly profit. . .$264.00. Great income for one hour per day.

7. By working just one hour per day and making 2 average sales of $4.00 PV each, . . . your total monthly profit . . . .$52.80. Good extra income for one hour per day."

8. How much can I earn? As much as you desire.

9. Amway six year plan for financial independence. Step 1 - become a direct distributor. . . Step 2 - develop one direct distributor per year. . . Annual income after 6 years $24,300.00.

10. Assuming that you become a Direct Distributor within a year's time and that you develop a Direct Distributor each year for the next five years, at the end of six years you can be earning in Direct Distributor bonuses $225 x 5, or a total of $1,125 a month. . . .The $1,069 a month which you receive on your personal group and the 3% refund bonuses of $1,125 on the 5 Direct Distributors whom you personally sponsor will amount to $2,194 a month or a total of $26,328 a year. This is gross income for managing a business of your own. This can be your six-year plan for financial independence.

11. You can realize the achievement of your dreams through the Amway Opportunity. The Amway Opportunity is broad enough for you to achieve whatever your goal is.

12. An Amway pattern for success. . .duplicate yourself. You sponsor 1 distributor each month . . . each of your personally sponsored distributors sponsor 1 distributor each month - up to 6 . . . . at the end of one year. . . . Your personal group would consist of 64 distributors.

13. To build a still bigger business. . . .You, plus your 6 distributors each sponsoring 4 people (total 31 distributors) with everyone selling $5.00 PV per day. . .you will earn. . .your total monthly income. . . . $408. Excellent income for only a few hours per day.

14. With Amway, you start earning money right away with no large inventory investment.

15. The market potential for Amway products is spectacular.

16. Let's say that six of your personally sponsored distributors sponsor four distributors each, and that everyone makes a sale a day. . . . [12]

17. Let's say you have sponsored six distributors. . . . Your distributor organization can look like this:

Your Sponsor
1
You $200 (Retailing)
1
A $300
B $100
C $150
D $50
E $200
F $100

Your total group PV $1,100.00
Total monthly gross income $157.50

As your business continues to grow and as you train and motivate your personally sponsored distributors to retail and to duplicate themselves by sponsoring new distributors, here is how your total PV and income can increase:

Your Sponsor
1
You $200 (Retailing)
1
Dist A and his group $600
Dist B and his group $300
Dist C and his group $200
Dist D and his group $250
Dist E and his group $300
Dist F and his group $400

Your total group PV $2,250.00
Total monthly gross income: $270.00

At this point, your business has started to bring you good returns. Although you should have sponsored additional distributors in the meantime, for the purposes of simplication, we will show only six distributors personally sponsored by you. Your part-time business can expand rapidly from this point onward.

. . .Your income picture for the month can now look like this:

Your Sponsor
1
You $200 (Retailing)
1
Dist A and his group $1,000
Dist B and his group $1,500
Dist C and his group $800
Dist D and his group $500
Dist E and his group $300
Dist F and his group $800

Your total group PV $5,100.00
Total monthly gross income $594.00

[13] 18. The income picture! Let's take a look at your income picture for the month. . . . Immediate income on your personal sales of $200. . . . $60. Income on refund:. . . . $114. Total earnings $174.

If you save $174 a month for six months, you'd have a total of $1,044 toward a Carribean or a South Seas vacation. . . . So for example, five of your distributors sponsor four distributors who each sell $200 for the month. Now the total of your group has grown to 26, and your monthly purchase volume is $5,200. . . . However, your earnings picture for the month can now look like this: Immediate income on your personal sales $60. Refund income . . . $492. Total earnings $552. Thus, you now have an attractive part-time income, and yet this is just the beginning.

PAR. 22. By and through the use of the above quoted statements and representations, as well as other oral and written statements and representations as found in various promotional materials not expressly set out herein, respondents and their representatives or agents represent, and have represented, directly or by implication, to distributors, dealers and prospective participants, that:

1. It is easy for distributors or dealers to recruit and/or retain

persons to participate in the program as distributors, dealers or sales personnel.

2. Distributors or dealers in the program can anticipate receiving or will receive substantial profits or earnings.

PAR. 23. In truth and in fact:

1. It is not as easy as respondents represent for distributors or dealers to recruit and/or retain as distributors, dealers or sales personnel persons who will participate in the sales program.

2. Distributors or dealers in the sales program do not receive nor are likely to receive the substantial profits or earnings that respondents represent that they will receive or are likely to receive. [14]

PAR. 24. The following statements constitute material facts with respect to the making of claims or representations regarding the potential for recruitment of prospective distributors or dealers and/or the profitability of a distributorship or dealership:

1. There is a substantial turnover or dropout rate of distributors, dealers, wholesale and retail sales personnel, and a constant recruitment effort must be made simply to maintain a constant number of sub-distributors, sub-dealers, or sales personnel.

2. There are substantial business expenses associated with an active Amway distributorship or dealership.

PAR. 25. The statements and representations contained in Paragraph Twenty-One, along with other statements and representations not expressly referred to therein, contain claims regarding the potential for recruitment of prospective distributors, dealers or sales personnel and the profitability of a distributorship or dealership; but fail to disclose the material facts set forth in Paragraph Twenty-Four.

The dissemination by respondents of the aforesaid statements and representations, and others, has had, and continues to have, the capacity and tendency to mislead distributors, dealers and prospective participants into the erroneous and mistaken belief that:

1. There is no substantial turnover of distributors, dealers or sales personnel.

2. The turnover of distributors, dealers or sales personnel is not as substantial as they would otherwise have been led to believe.

3. There are no substantial business expenses incurred by distributors or dealers.

4. The business expenses of distributors or dealers are not as substantial as they would otherwise have been led to believe. [15]

PAR. 26. For all of the foregoing reasons, and others, respondents' statements and representations as set forth in Paragraph Twenty-One, as well as others not expressly referred to therein, in connection with the manufacture, sale and distribution of their merchandise, are false, misleading and deceptive, and were and are unfair methods of competition and unfair or deceptive acts or practices within the intent and meaning of Section 5 of the Federal Trade Commission Act, as amended.

INITIAL DECISION BY JAMES P. TIMONY, ADMINISTRATIVE LAW JUDGE

JUNE 23, 1978

PRELIMINARY STATEMENT

By a Federal Trade Commission complaint issued on March 25, 1975, respondents Amway Corporation ("Amway"), Amway Distributors Association of the United States ("ADA"), Jay Van Andel and Richard M. DeVos are charged in five counts with violations of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45. [2]

Respondent Amway is a corporation organized less than twenty years ago by respondents Van Andel and DeVos. Amway manufactures, distributes and sells with its own trademarks over 150 products, including primarily cleaning and personal care products, and food supplements. While Amway started with soap and other cleaning products, it now sells a wide variety of low cost consumer products, including catalog sales of over 300 products manufactured by and bearing the names of other manufacturers, such as clothing, household appliances, furnishings, tools, luggage, watches and cameras. Amway sells such products through more than 300,000 independent distributors throughout the country. These distributors engage in direct, house-to-house sales to consumers, with total sales amounting to over $200 million in fiscal 1976. The distributors also seek new distributors to build a sales organization. As an incentive to the distributors' sales, Amway offers, *inter alia,* volume discounts based on the total sales of a distributor's sales organization, ranging from 3% on monthly sales over $100 to 25% on sales of about $8,500 and over. Once the distributors reach the top discount bracket, they become "Direct Distributors," receiving such benefits as dealing directly with Amway (rather than through the distributors which

sponsored them), and voting membership in the distributors' association, ADA.

The ADA is an association of about 2,500 Amway Direct Distributors, acting as a consultant to Amway on proposed changes in basic sales policies of Amway and as a board of arbitration in disputes between and among distributors and as an appeal board with respect to action by Amway which may affect the rights of distributors.

Amway has a distribution plan published in various manuals, bulletins, pamphlets and other literature and material. This plan, known as the Amway Sales and Marketing Plan, imposes certain limitations upon the distributors' resale of products purchased from Amway and upon the method of recruiting new distributors. The complaint in this case attacks these limitations. Count I of the complaint alleges that respondents engage in resale price maintenance. [3] Count II alleges that respondents allocate customers among distributors and restrict the distributors' source of supply as well as the retail outlets through which they may resell. Count III alleges that respondents restrict the distributors' advertising. Count IV alleges that respondents misrepresent that substantial income may be obtained from geometrical increases in the number of distributors in the chain recruiting operation of the Amway distribution plan. Count V alleges that respondents misrepresent the profitability of a distributorship and the potential for recruiting new distributors and fail to disclose the substantial business expense involved and the high turnover of distributors.

By an answer filed on August 28, 1975, respondents admitted in part and denied in part the various allegations of the complaint. Respondents moved to dismiss the complaint on the grounds that: (1) evidence was improperly obtained by the staff during the course of the pre-complaint investigation, and (2) respondents were not afforded an opportunity to negotiate a settlement prior to the issuance of the complaint. The motion was certified to the Commission by an order dated September 16, 1975; the motion was denied. By an order dated April 12, 1976, I was substituted as administrative law judge because of the heavy workload of the former administrative law judge. An active motion practice ensued, with some thirty contested pretrail orders being issued on a number of procedural question.[1] [4]

Discovery was extensive, involving depositions, interrogatories, requests for admission, and pretrial subpoenas. Counsel filed lists of

[1] Many of respondents' allegations of procedural misconduct were repeated by respondents' counsel on the first day of the trial and are the subject of an additional order, recently entered herein, denying respondents' motion to dismiss.

witnesses and narrative statements of their proposed testimony and exchanged documents to be offered in evidence. The parties filed written statements of relevancy and opposition concerning the offer of hundreds of proposed Commission exhibits. Complaint counsel filed an extensive pretrial statement and proposed findings. The parties filed pretrial briefs.

Hearings started May 16, 1977. The case-in-chief ended on June 7, 1977. The defense started June 28, 1977, and concluded on July 29, 1977. Complaint counsel had a rebuttal case on October 4, 1977. About 150 witnesses testified and the record consists of almost seven thousand pages of transcript and over one thousand exhibits.

Since the last witness testified, the parties have resumed the motion practice, with about thirty additional post-trial contested motions. One of the contested issues involved twenty-three tape recordings received as exhibits during the trial on condition that transcripts be prepared and offered as exhibits. The parties were long at issue over the content of the transcripts of the tapes. The transcripts, when completed, made a pile "two or three feet high." Six full transcripts and seventeen partial transcripts of the tape recordings eventually were offered and received as exhibits.[2] [5]

The post-trial briefs and proposed findings amounted to about 1600 pages. Oral argument was heard on June 6, 1978.

The findings of fact include references to the principal supporting evidence in the record. Such references are intended to serve as convenient guides to the testimony and exhibits supporting the findings of fact, but do not necessarily represent complete summaries of the evidence considered in arriving at such findings. The following abbreviations have been used:

CX - Commission's Exhibit, followed by number of exhibit being referenced.
RX - Respondents' Exhibit, followed by number of exhibit being referenced.
Tr. - Transcript, preceded by the name of the witness, followed by the page number.
CPF - Proposed Finding submitted by Complaint Counsel.
CB - Complaint Counsel's Brief.
CRB - Complaint Counsel's Reply Brief.
RPF - Respondents' Proposed Findings.

[2] Another reason for the delay in closing the record involved the condition of the record. Numerous exhibits were lost or misplaced. At least sixty exhibits had to be replaced with substitutes. The transcript of testimony had numerous errors. Almost all of the changes were stipulated by the parties. The reporter is submitting corrected pages of the transcript during the time that this decision is being prepared, too late for reference herein. Eleven orders were entered concerning this subject, *e.g.*, orders dated March 16, 1978, and June 15, 1978 (denying motion to dismiss of June 6, 1978).

RB – Respondents' Brief. [6]

FINDINGS OF FACT

Respondents

1. Respondent Amway Corporation (Amway) is a corporation organized and existing under the laws of the State of Michigan, with its home office and principal place of business at 7575 East Fulton Rd., Ada, Michigan. (Answer, p. 5)

2. Amway currently manufactures and sells more than 150 kinds of home care, car care and personal care products, as well as vitamins and food supplements, all of which are sold under its own labels and trademarks. (Answer, p. 4)

3. The products which Amway sells to its distributors may be grouped into seven major categories as follows: home care and cleaning products; personal care products (such as cosmetics); food supplements; cookware and cutlery; commercial and agricultural products; catalog sales (a wide variety of products); and safety products (such as smoke detectors and fire extinguishers). Soap and detergents account for 41.2% of Amway's 1974 sales; polishes and sanitation goods 20%; and toilet preparations 6.5%. (RX 405)

4. Through its Personal Shoppers Catalog, Amway sells over 300 products manufactured by and bearing the name of other manufacturers. These products include clothes, household appliances, furnishings, tools, luggage, watches, and cameras. (CX 640)

5. Amway distributes its products in the United States through direct selling by authorized independent distributors, which in 1977 numbered approximately 360,000. (RX 383) [7]

6. Amway's dollar volume in sales to distributors in fiscal 1976 was approximately $169 million in the United States and $205 million worldwide. (RX 448; RX 431; Halliday, Tr. 6103, 6105–16)

7. Respondents Jay Van Andel and Richard M. DeVos are co-founders and, together with their wives, are principal owners of Amway. (Van Andel, Tr. 1672, 1781)

8. Mr. Van Andel is Chairman of the Board of Amway. (Van Andel, Tr. 1671)

9. Mr. DeVos is President of Amway. (Complaint, ¶4; Answer, p. 4)

10. Amway's Board of Directors consists of Mr. Van Andel, Mr. DeVos, and William J. Halliday, Jr. (Van Andel, Tr. 1781–82)

11. Respondent Amway Distributors Association of the United States (ADA) is a trade association of Amway distributors organized and existing as a non-profit corporation under Michigan Law.

(Halliday, Tr. 6091–92, 6171–73) ADA maintains its home office and principal place of business at 7575 East Fulton Road, Ada, Michigan. (Complaint, ¶2; Answer)

12. Each new Amway distributor may choose to become a member of the ADA. (Halliday, Tr. 6195–96)

13. An Amway distributor who, through sales volume and other requirements, becomes a "Direct Distributor" may qualify as a voting member of the ADA. (Halliday, Tr. 6196–97) [8]

14. There currently are about 2500 voting members of the ADA. (Halliday, Tr. 6555–56)

15. Voting members of the ADA elect nine members of the eleven-member ADA Board of Directors and Amway appoints two members. Mr. Van Andel and Mr. DeVos represent Amway on the Board. (Halliday Tr. 6194)

16. The ADA Board performs three principal functions: (a) it acts as a representative of the distributor association; (b) it acts as an advisory board to Amway; and (c) it acts as an arbitration board in disputes between distributors or between Amway and a distributor. (Halliday, Tr. 6175–83)

Organization History

17. Mr. Van Andel and Mr. DeVos have been involved in direct selling since 1949, beginning as distributors of Nutrilite food supplements, through a corporation they organized for this purpose—the Ja-Ri Corporation. (Van Andel, Tr. 1672–73, 1676, 1908–10)

18. Direct selling is the distribution of products and related services to consumers in their homes through person-to-person selling. (Van Andel, Tr. 1691–92; Granfield, Tr. 2917–18)

19. In 1959, Mr. Van Andel and Mr. DeVos and other distributors had trouble with their suppliers of food supplements, Nutrilite Products Company, Inc., and Mytinger & Castleberry, Inc. A small group of distributors was appointed, with Mr. Van Andel as the chairman, to try to work out an arrangement with the suppliers. The negotiations culminated in an offer by one of the suppliers to Mr. Van Andel to become president of the company. Mr. Van Andel and Mr. DeVos concluded that the inherent problems were with the people who owned those companies and that those problems would continue regardless of who managed them. Mr. Van Andel refused the offer. (Van Andel, Tr. 1672–73) [9]

20. Mr. Van Andel and Mr. DeVos decided that their suppliers were in great danger of collapsing and that they should go into the business themselves, producing their own products and selling them through the Ja-Ri sales organization which had more than 2000

distributors as members. (Van Andel, Tr. 1674; 1679; Hansen, Tr. 3302; CX 904)

21. Mr. Van Andel and Mr. DeVos then put together an organization of distributors called the American Way Association, the name of which was later changed to the Amway Distributors Association. The primary purpose of this organization was to allow Mr. Van Andel and Mr. DeVos to communicate with their Nutrilite distributors in the Ja-Ri organization and to hold the business together until Mr. Van Andel and Mr. DeVos could develop their own manufacturing operation. (Van Andel, Tr. 1674–75)

22. Mr. Van Andel and Mr. DeVos had to be very careful in changing their distributor organization, with its allegiance to Nutrilite food supplement products. Since the distributors were independent, they might quit. It was therefore necessary for Mr. Van Andel and Mr. DeVos to have these distributors concur in their plans to set up a product distribution and manufacturing operation; and they discussed the type of products they intended to produce with the distributors' association. (Van Andel, Tr. 1674–76) Many of the distributors in the organization of Mr. Van Andel and Mr. DeVos joined the American Way Association, and began distributing products sold to them by Amway as well as Nutrilite products. In 1972, Amway acquired 51% of Nutrilite. (Van Andel, Tr. 1679–80, 1684–85)

23. Mr. Van Andel and Mr. DeVos decided to look for products which were readily consumable, relatively low-priced, different from those found in retail stores, and which would lead to repeat sales. They chose soap and detergents because they felt it would be the easiest market to train distributors to sell in. With that type of product, it is a matter of which one to use rather than whether to use it at all. (Halliday, Tr. 6541; Van Andel, Tr. 1680–81) **[10]**

24. At about the same time that the American Way Association was formed, Mr. Van Andel and Mr. DeVos began distributing through the Ja-Ri organization a liquid detergent called "Frisk" which they renamed "LOC" (liquid organic compound) and which is still one of the principal Amway products. This product was manufactured by Eckle Company, a small supplier in Detroit, Michigan, and it was one of the only biodegradable liquid detergents available at that time. Mr. Van Andel and Mr. DeVos, through Ja-Ri Corporation, acquired the company, moved the assets to Ada, Michigan, and changed its name to Amway Manufacturing Company. A few months later they introduced SA8, a biodegradable powder detergent. (Van Andel, Tr. 1673–78; Halliday, Tr. 6153, 6541)

25. In November 1959, Mr. Van Andel and Mr. DeVos organized

Amway Sales Corporation and Amway Services Corporation. (Van Andel, Tr. 1677) In November 1963 the name of Ja-Ri Corporation, Inc., was changed to Amway Corporation; and on January 1, 1964, Amway Sales Corporation, Amway Service Corporation, and Amway Manufacturing Corporation were merged into Amway. (Answer, p. 3)

Amway Distribution System

Amway Distributors

26. The Amway Sales and Marketing Plan is designed to move products manufactured by or for Amway through a network of distributors to retail customers. (Halliday, Tr. 6198) Amway imposes several restraints upon distributors as part of this system. The restraints, which are the subject of this litigation, are found in Amway's "Code of Ethics and Rules of Conduct." (RX 331, pp. 13–B through 25–B) The Amway system of recruiting, sponsoring and selling basically is the same as the Nutrilite system which began operating in 1946. (Van Andel, Tr. 1702, 1905–08) [11]

27. The Amway Sales and Marketing plan involves person-to-person retail selling. Amway distributors are urged to sell at retail to persons they know or are referred to, rather than going from door-to-door. (Van Andel, Tr. 1757–58)

28. In the Amway Sales and Marketing Plan, products are sold by Amway distributors, all of whom are independent contractors. (Halliday, Tr. 6261–62)

29. All new Amway distributors enter the business with the same rights and obligations. (Halliday, Tr. 6208; Lemier, Tr. 210–11)

30. Each Amway distributor has the right to sell Amway products to consumers and to sponsor new Amway distributors and to sell products to his sponsored distributors. (Van Andel, Tr. 1708)

31. Any Amway distributor may become a "Direct Distributor" by qualifying on the basis of sales volume. The principal requirement for qualification as a Direct Distributor is that the distributor must have a sales volume of about $8500 per month. (RX 331, p. 8–D

32. Amway sells its products to Direct Distributors, who sel Amway products to consumers and to their sponsored distributo for resale. (S. Bryant, Tr. 4033–34) Other distributors normally bu from their sponsor. (RX 331, p. 1–E) Those distributors ("Warehou Order Distributors"), living more than 25 miles from their source supply or doing a large volume, are authorized to buy directly fr Amway. (RX 331, p. 1–E) [12]

33. In order to become a duly authorized Amway distributo person must (a) be sponsored by an Amway distributor, and (b)

an application with Amway for the right to sell Amway products. (Van Andel, Tr. 1696–97; RX 331, p. 14–B)

34. A new Amway distributor is not required to buy inventory. The distributor need only buy a $15.60 "Sales Kit" containing product information and sales aids and literature. (RX 331, p. 15–B; Halliday, Tr. 6615)

35. A new distributor may also purchase an optional "Product Kit" for $25.65, containing sample Amway products for demonstration use. (Halliday, Tr. 6126, 6588; RX 433)

36. Neither Amway nor sponsoring distributors make a profit on the Sales Kits. (Van Andel, Tr. 1863, 1937; Max, Tr. 5996; Garmon, Tr. 3515)

37. A distributor who decides to leave the business may receive a refund on the price of the Sales Kit and Product Kit. (Halliday, Tr. 6615)

38. Most new Amway distributors have had no selling or business experience. (CX 1000–K; Van Andel, Tr. 1695)

39. The vast majority of Amway distributors, including Direct Distributors, conduct the Amway business on a part-time basis, and have another full-time occupation. (Halliday, Tr. 6235; RX 329) [13]

40. Anyone who has become an Amway distributor prior to August 31 of any year or who has continued his distributorship for that year must renew his distributorship authorization for the next year by December 31. (Halliday, Tr. 6484)

41. The number of active distributors since 1972 has remained relatively constant, fluctuating around 300,000, climbing in 1977 to about 360,000. (RX 383)

42. The average annual turnover of Amway distributors is about 50%. The turnover rate for Amway distributors during their first year is almost 75% and thereafter about 25% a year. (CX 909; RX 83)

43. Currently about half of all Amway distributors were sponsored by a Direct Distributor or by a distributor sponsored by a rect Distributor. More than 70% were within three positions of a rect Distributor and 99% were within seven positions. (RX 423)

4. If distributors leave Amway, any distributors whom they may e sponsored move up the line of sponsorship to the next qualified ributor. (RX 331, p. 17–B)

. In order to receive the benefits of sponsoring, Amway ibutors must train their sponsored distributors and stock ıtory to supply them. (RX 331, pp. 17–B to 18–B)

The distributors sponsored by an Amway distributor become ers of that distributor's "personal group." The sponsored

distributors may then sponsor other distributors, thereby forming their own personal groups and enlarging the personal group of the first sponsoring distributor. (CS 1096, p. 2–B) [14]

47. When distributors qualify as Direct Distributors, they "break off" from the personal group of their sponsor, thereafter dealing directly with Amway. (RX 331, p. 8–B)

48. The Amway Sales and Marketing Plan provides communication with distributors through literature published by Amway and by meetings. About 10 or 15 times a year sales rallies consisting of several thousand distributors are held around the country, to which any distributor in the area is invited. An afternoon meeting for high volume distributors only (with no guests allowed) is followed by an evening sales rally for all distributors and their guests. (Van Andel, Tr. 1761–63) These evening sales rallies involve presentation of sales awards with impromptu speeches by the recipients and motivational speeches by other successful distributors and celebrities. "Amway officials are present to offer helpful advice to both new and experienced distributors alike." (*Id.;* CX 62–Z–42 - 43) Area meetings are produced independently by Direct Distributors for their groups or for a combination of Direct Distributor groups. They provide information and inspiration for the distributors. (CX 62–Z–43)

49. About five thousand distributor-operated meetings are held each week. These local meetings help sponsors "build enthusiasm within their group through weekly meetings in their homes or offices for the purpose of training, motivating and sponsoring." (CX 62–Z–43)

Compensation

50. Amway distributors earn income from retail sales through the "basic discount" (the difference between the price paid by the distributor for the product and the price charged by the distributor at retail). A distributor does not make money directly by selling products to his sponsored distributors "because he sells them for the same price he paid for them; the distributor cost." (RX 331, p. 3–B) Instead, distributors receive a [15] "performance bonus" which is paid by Amway through sponsoring distributors and is based on the distributor's total monthly sales volume. The "Basic Discount" and "Performance Bonus" are defined as (RX 331, p. 4–B):

> Basic Discount: When you personally sell Amway products you earn income in two ways . . . the first of these is your "basic discount." You buy products from your sponsor at the wholesale price, and sell them to customers at retail. The basic discount on most home-size products is 35%, with some at 15% or 25%. That percentage is your

immediate income — your "basic discount" — which you get as soon as you are paid by your customers. Most distributors average 30% of Business Volume as income.

Performance Bonus: The second way you earn income is through your monthly Performance Bonus on Amway products you purchase for resale. In addition to your immediate basic discount, you earn a Performance Bonus each month based on total Point Value and BV of all products purchased by you during the month. This is a percentage Bonus which varies from 3% to 25% depending on your total monthly Point Value, according to the schedule below.

PERFORMANCE

BONUS SCHEDULE

Performance Bonuses are paid in addition to the basic discount, which averages 30%.

IF YOUR TOTAL MONTHLY POINT VALUE* IS:	YOUR PERFORMANCE BONUS IS:
7,500 or more points	25% of your Business Volume
6,000 to 7,499 points	23% of your Business Volume
4,000 to 5,999 points	21% of your Business Volume
2,500 to 3,999 points	18% of your Business Volume
1,500 to 2,499 points	15% of your Business Volume
1,000 to 1,499 points	12% of your Business Volume [16]
600 to 999 points	9% of your Business Volume
300 to 599 points	6% of your Business Volume
100 to 299 points	3% of your Business Volume
Less than 100 points	0% of your Business Volume

* Total monthly PV includes both personal PV and PV of others you sponsor.

51. The performance bonus schedule was previously based on monthly dollar purchase volume. (CX 61, p. 4–B) In 1975, in order to adjust for inflation, each product was assigned a "point value" which remains constant regardless of changes in the price of the product. (CX 680–A)

52. Each Amway product is also assigned a dollar value for the purpose of calculating "business volume" ("BV"), corresponding approximately to the suggested resale price of the product, less a warehouse charge. (RX 331, p. 4–B)

53. The performance bonus system provides an incentive to sponsoring distributors to provide training, motivation and supply to sponsored distributors, since they receive income based on the accumulated total sales of all of the distributors in their personal group. (Van Andel, Tr. 1863–64) This payment has been termed "overwrite," "bonus," and "refund," and since 1975 "performance

bonus." (CPF 199) It corresponds to the compensation paid by manufacturers to wholesalers. (Cady, Tr. 5776-78)

54. Under the Amway Sales and Marketing Plan it is the Direct Distributors' duty to see that performance bonuses, which they receive monthly from Amway, are promptly distributed to sponsored distributors and redistributed in that month to all distributors in the Direct Distributor's personal organizations who earned the performance bonus. (RX 331, p. 19-B) Amway enforces its refund policy. (CPF 204) The ADA arbitrates disputes concerning the refund policy. (CPF 205) [17]

Sponsoring

55. The sponsoring distributors earn income on the basis of the total sales volume of their personal distributor group, as well as their own personal retail sales. (RX 331, p. 5-B) Sponsoring distributors must supply and train distributors they sponsor. (RX 331, p. 17-B)

56. Distributors are urged to sponsor new distributors in order to "earn on what others sell" (RX 331, p. 5-B), but the Amway Sales and Marketing Plan stresses that combined retail selling and sponsoring are equally essential to the distributor's success. (RX 331, p. 1-B)

57. About 25% of Amway distributors sponsor new distributors. (RX 415; Van Andel, Tr. 1828; Max, Tr. 6023)

58. Recruiting distributors occurs primarily at an "Opportunity Meeting" which each distributor is urged to hold at least once a week. (CX 68-D) Amway encourages that recruiting be done individually rather than at mass meetings. (CX 638-H) Recruiting new distributors through the presentation of the Amway Sales and Marketing Plan involves (1) introducing the company and products, (2) appealing to the financial goals of the prospective distributors, and (3) explaining the compensation of a distributor through retail and wholesale sales. (RX 331, Section D)

59. The Amway Career Manual for distributors explains how to recruit distributors by appealing to the financial goals of prospects. (RX 331, pp. 1-D to 3-D). The suggested presentation provides that the distributor should: [18]

> Announce to your guests that you would like to tell them about an exciting opportunity to be in business for themselves and to develop an income of as much as $1,000 per month. Explain that it is an opportunity that grows as they share it with others.
>
> Ask if they are as successful as they would like to be. If not, would they be interested in a chance to realize their dreams through a business of their own that

they can build on a part time basis — and, with such a modest initial expenditure? An opportunity does exist that will give them such a chance.

* * * * * * *

[The distributor is then advised to give a short history of the company and to describe some of the products and sales literature.]

* * * * * * *

What does all this mean to you? It means you can become a part of a dynamic growing organization. It means that this opportunity can mean the realization of your dreams.

(Ask questions to find out what the goals and dreams of each prospective distributor may be.)

What are some of your dreams?

Do you want a new car, a new house, college education for your children?

Do you want retirement income that will afford you a comfortable standard of living?

What income do you want six years from now?

Are you willing to work hard to get this?

How much extra money per month do you need for that new car? [19]

$100 a month or more?

What kind would you like — a Chevrolet, Pontiac, Oldsmobile?

How much money per month do you need for that new house?

What kind of home do you want — a three-bedroom ranch — with a price tag of $35,000 - $40,000?

How much will you need for monthly payments — $250, $300 a month?

How much will it take to send the youngsters through college — $2,500 to $3,000 a year for each youngster?

If you could earn an extra $250 a month, you would have an additional $3,000 a year. This might be sufficient to send one youngster through one year of college.

How much would you like as a continuing income — $1,000 a month?

Would you work for your goal?

Would you be interested if I could show you a way you can make your dreams come true?

Would you be interested in a way to achieve this on a part-time basis?

What would you be willing to give up to get this?

You can realize the achievement of your dreams through the Amway Sales and Marketing Plan. It is broad enough for you to achieve whatever your goal is. First of all, you start like everyone else — you are sponsored by another Amway distributor. You are in business *for* yourself, but not *by* yourself. You buy Amway products at wholesale from your sponsor, and you sell them at retail to your customers. (Emphasis in original.) [20]

60. The Amway Career Manual for distributors explains the nature of retail and wholesale compensation provided in the Amway Sales and Marketing Plan. (RX 331, pp. 5–B through 7–B): [21]

HOW MUCH CAN YOU EARN?

PUT IT THIS WAY . . .

for a small business of your own . . . **EXAMPLE 1:** by making only two average sales of $5.00 each per day, working less than an hour in each of 20 days per month, you can sell $200.00 BV per month.

Your 30% average immediate income on $200.00 sales (at BV) . . . . . = $60.00

Plus . . . 3% Performance Bonus on $200.00 in BV provided your monthly Point Value is 100 points or more . . . . . = 6.00

EQUALS . . .

YOUR TOTAL MONTHLY INCOME . . . $66.00

GROUP SPONSORSHIP

HOW YOU EARN ON WHAT OTHERS SELL

You have seen how you earn an immediate basic discount on each Amway product you sell and how you receive a monthly Performance Bonus based on the total Point Value and BV of all Amway products you sell. Here is still another Amway Career Opportunity: becoming a sponsor.

Every Amway distributor may sponsor other distributors. When you sponsor a new distributor, you become his wholesale supplier, just as your sponsor wholesales to you. Your income from sponsorship comes in the form of a greater monthly Performance Bonus percentage. Your total Point Value and BV include your personal Point Value and BV plus that of those whom you sponsor . . . when all the sales are added together you will probably be in a higher Performance Bonus percentage bracket, and thus earn a larger Performance Bonus. Out of this, you pay the distributor you sponsor his own earned Performance Bonus, but because your total Point Value and BV are greater than that of any of the distributors you sponsor, you will usually earn a larger Performance Bonus than you pay out. You not only earn income on the BV of the distributors in your personal group, but will usually also earn a higher Performance Bonus percentage on your own personal BV.

And you earn in the same way on the new distributors that you sponsor . . . and on those they sponsor . . . and so on. You form a growing group of distributors, and every dollar of BV generated by those in your personal group is a dollar of additional BV for you.

When you're a sponsor, you're building income for your family today, potential income for your retirement, and income that may become part of your estate. That's why Amway is not "employment," but rather, a real career: a growing, repeat business of your own!

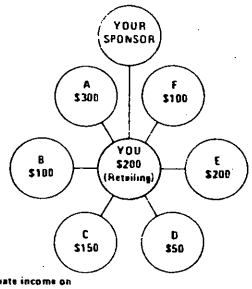
EXAMPLE 2:

Let's assume that your sponsor two other distributors and that each of the three of you sell exactly $200 (at BV) in a month, or $600 (at BV). If the Point Value of these products is at least 600 points, you will receive a $54 Performance Bonus. Out of this, you pay Performance Bonuses of $6.00 to each of your personally sponsored distributors, a total of $12, leaving you $42. This plus your $60 in basic discount gives you a total income of $102 in that month.

In order to retain the right to earn Performance Bonuses on your group BV, you yourself must make not less than one sale at retail to each of six different customers each month and produce proof of such sales to your sponsor and Direct Distributor. This provision assists you in maintaining the balance between sponsoring and retail selling which is essential to a successful distributorship.

EXAMPLE 3:

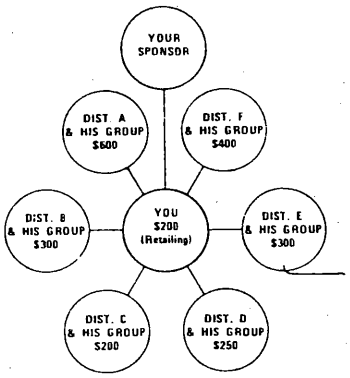
Let's say you have sponsored six distributors. The amount of BV which each will generate will probably vary depending on the length of time they have been distributors and the amount of time they have available for developing their business. The following is an example of how your organization can look:



Immediate income on personal sales $200 (at BV)			$ 60.00
Your total group BV:	$1,100.00		
Performance Bonuses you receive (12%, assuming a Point Value of at least 1,000 points)		$132.00	
Performance Bonuses you pay out (assuming necessary Point Values have been achieved by each distributor)			
Distributor A (6%)	$18.00		
B (3%)	3.00		
C (3%)	4.50		
D (0%)	.00		
E (3%)	6.00		
F (3%)	3.00	-$ 34.50	
Performance Bonus you keep:			$ 97.50
Total monthly gross income.			$157.50

EXAMPLE 4:

As your business continues to grow and as you train and motivate your personally sponsored distributors to retail and to duplicate themselves by sponsoring new distributors, here is how your total BV and income can increase.

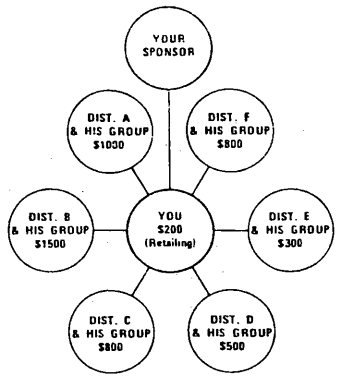


Immediate income on personal sales $200 (at BV)		$ 60.00
Your total group BV: $2,250.00		
Performance Bonuses you receive (15%, assuming Point Value of at least 1500 points)	$337.50	
Performance Bonuses you pay out (assuming necessary Point Values have been achieved by each distributor)		
Distributor A (9%) $54.00		
B (6%) 18.00		
C (3%) 6.00		
D (3%) 7.50		
E (6%) 18.00		
F (6%) 24.00		
Total paid out	−$127.50	
(Distributors A, B, C, D, E, and F will, of course, be responsible for paying Performance Bonuses to their distributors.)		
Performance Bonus you keep		$210.00
Total monthly gross income:		$270.00

EXAMPLE 5:

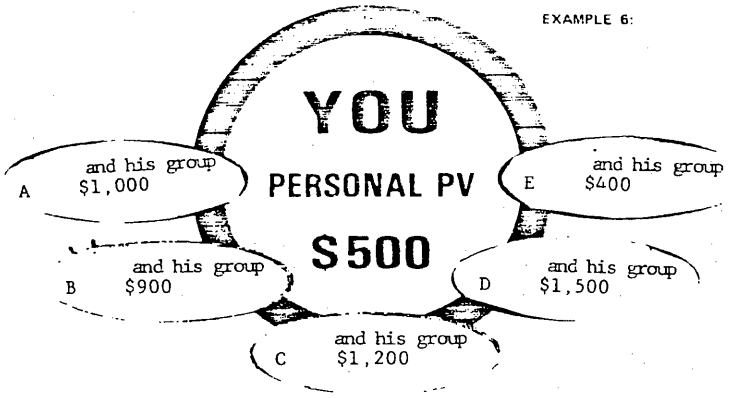
At this point, your business has started to bring you good returns. Although you should have sponsored additional distributors in the meantime, for the purposes of simplification, we will show only six distributors personally sponsored by you. Your part-time business can expand rapidly from this point onward.

As your distributors' BV grows, so does yours. Your income picture for the month can now look like this:



Immediate income on personal sales $200 (at BV)		$ 60.00
Your total group BV: $5,100.00		
Performance Bonuses you receive (21%, assuming Point Value of at least 4000 points)	$1,071.00	
Performance Bonuses you pay out (assuming necessary Point Values have been achieved by each distributor)		
Distributor A (12%) $120.00		
B (15%) 225.00		
C (9%) 72.00		
D (6%) 30.00		
E (6%) 18.00		
F (9%) 72.00		
Total paid out	−$ 537.00	
(Distributors A, B, C, D, E, and F will, of course, be responsible for paying Performance Bonuses to their distributors.)		
Performance Bonus you keep		$534.00
Total monthly gross income:		$594.00

FULL TIME SPONSORSHIP INCOME



BUILDING TOWARD A DIRECT DISTRIBUTORSHIP

If you work consistently toward building a Sales Group of distributors and increasing your own volume of retail sales, your monthly volume can look like this. See Chart below for income breakdown. Assume that you are selling to a larger personal customer clientele who makes purchases from you totaling $500 BV of Amway products monthly. Assume the distributors you sponsor have increased their retail sales and have sponsored distributors of their own so that together they contribute an additional $5,000 to your total BV. Now you are in the 21% Performance Bonus bracket, provided you have monthly total Point Value of at least 4,000 points . . . you get your basic discount on your personal BV PLUS 21% Performance Bonus on your personal BV. In addition, you will earn between 21% and the percentage Performance Bonus earned by each of your distributors on his BV. You now earn $711.

Distribution of Performance Bonus on $5,500 Total Group BV – 21%
Performance Bonus $1,155.00 (provided you have monthly total Point Value of at least 4,000 points.)

INDIVIDUAL BV	INDIVIDUAL PERFORMANCE BONUS %*	INDIVIDUAL PERFORMANCE BONUS	% PERFORMANCE BONUS LEFT FOR SPONSOR	$ PERFORMANCE BONUS LEFT FOR SPONSOR
A $1,000	12%	$120	9%	$ 90
B $ 900	9%	$ 81	12%	$108
C $1,200	12%	$144	9%	$108
D $1,500	15%	$225	6%	$ 90
E $ 400	6%	$ 24	15%	$ 60
YOU $ 500			21%	$105
TOTAL PERFORMANCE BONUS: $1,155. PAID OUT: $594			YOU KEEP	$561
			YOUR AVERAGE BASIC DISCOUNT	$150
			YOUR AVERAGE TOTAL EARNINGS	$771

Note: A, B, C, D & E also have distributors under them helping to make total – From here it is only a short step to Direct Distributor

*Assuming necessary Point Values have been achieved by each distributor

61. Amway distributorships are not for sale and sponsoring distributors receive no profit from the act of sponsoring. It is only after the sponsored distributor begins to buy products that the sponsoring distributor will receive income. (S. Bryant, Tr. 4063)

Direct Distributors

62. A distributor may qualify as a Direct Distributor with at least 8,500 BV in a single month (assuming a point value of at least 7500 points), and with a personal group point value of at least 7500 points or more for the following two consecutive months, with a gross profit of at least $800 for each of the three consecutive months. (RX 331, p. 8-D)

63. A Direct Distributor becomes eligible for voting membership in the Amway Distributors Association and qualifies for the 3% Direct Distributor Bonus, and Sales Training Bonus, and the Profit Sharing Bonus. (RX 331, pp. 8 and 9-B)

64. Direct Distributors receive 3% of the personal group Business Volume of the Direct Distributors whom they sponsor. At that level both the sponsoring and the sponsored distributors are in the same performance bonus bracket—25%. Therefore, in order to provide the sponsoring distributor with an incentive to continue to motivate and train such a sponsored distributor, the extra 3% Direct Distributor Bonus is provided. To receive the 3% bonus, distributors must be qualified Direct Distributors, by having a qualifying personal group Business Volume excluding the Business Volume of Direct Distributors whom they have sponsored. (RX 331, pp. 8-B to 9-B) If the sponsor of the Direct Distributor does not qualify, then the 3% bonus goes to the next upline sponsor who meets the requirements. (S. Bryant, Tr. 4067-68) [25]

65. Amway pays a sales training bonus to Direct Distributors who sponsor three Direct Distributors for any six months in a year. (RX 331, p. 9-B)

66. Amway has each year paid a "profit sharing distribution" in the form of debenture bonds to all voting members of the Amway Distributors Association. (RX 331, p. 9-B; Halliday, Tr. 6212-13)

67. Amway supplies, trains and compensates Director Distributors. (Van Andel, Tr. 1710, 1850)

68. Direct Distributors supply, train and compensate distributors. They maintain a stock of merchandise and literature, have regular office hours, train distributors through sales meetings and advice, and enforce the Amway Rules of Conduct, including the requirement that monthly performance bonuses be distributed to all distributors in their organization. (RX 331, p. 19-B)

69. Direct Distributors are required to requalify annually on the basis of their sales volume. (RX 331, p. 19–B)

70. The number of Amway Direct Distributors in the United States has grown from about 3000 in 1972 to about 4000 in 1977. (Van Andel, Tr. 1695–96; CX 896) About half of the Direct Distributors started with Amway in the last five years. (RX 434)

71. Distributors who fail to requalify as Direct Distributors generally continue as distributors. Between 1960 and 1976, 3070 Direct Distributors failed to requalify as Direct Distributors, and at the end of that period 75% were still Amway distributors. (RX 434) [26]

Pyramid Rules

72. Amway, the Direct Distributor or the sponsoring distributor will buy back any unused marketable products from a distributor whose inventory is not moving or who wishes to leave the business. (RX 331, p. 17–B to 18–B; CX 847; CX 1076) The buy-back rule has been in existence since Amway started. (CX 1041–J) Amway enforces the buy-back rule. (CX 847; Brown, Tr. 5012–13; Bortnem, Tr. 686, 690; Soukup, Tr. 913)

73. To ensure that distributors do not attempt to secure the performance bonus solely on the basis of purchases, Amway requires that, to receive a performance bonus, distributors must resell at least 70% of the products they have purchased each month. (RX 331, pp. 16–B to 17–B) The 70% rule has been in existence since the beginning of Amway. (S. Bryant, Tr. 4086) Amway enforces the 70% rule. (Lemier, Tr. 192–93; S. Bryant, Tr. 4056–59; Halliday, Tr. 6497)

74. Amway's "ten-customer" rule provides that distributors may not receive a performance bonus unless they prove a sale to each of ten different retail customers during each month. (RX 331, pp. 1–B and 17–B) The Direct Distributors have the primary responsibility for enforcing the ten-customer rule in their own group. (S. Bryant, Tr. 4061–62) The ten-customer rule was started by Amway about 1970. Prior to that, there was a 25 sales rule which required the distributor to make 25 retail sales a month without regard to the number of customers. (S. Bryant, Tr. 4085–86) The ten-customer rule is enforced by Amway and the Direct Distributors. (CX 823; Case, Tr. 3414–15; Medina, Tr. 4197; Zizic, Tr. 4138–43; Lincecum, Tr. 1266)

75. The buy-back rule, the 70% rule, and the ten-customer rule encourage retail sales to consumers. (Van Andel, Tr. 1999–2000, 2010; Halliday, Tr. 6231–33; Lemier, Tr. 176; Cady, Tr. 5795–97) [27]

Operation of the ADA

76. The voting members of the ADA meet once a year for a one day meeting. They elect the Board members of the ADA and receive reports concerning the Amway business. (Halliday, Tr. 6174–75)

77. The ADA Board meets four times a year, usually for two days at a time. (Bass, Tr. 42)

78. Amway uses the ADA Board to receive recommendations concerning the business. Amway presents proposals for changes of rules to the Board for information and advice, and for reaction from the field. (Halliday, Tr. 6612–13)

79. Amway consults with the Amway Distributors Association, through the Board of Directors, in setting up discount and refund schedules, bonuses, and retail prices. (CX 22–B) In its 1975 annual report to the state of its incorporation, the ADA reported that its purpose was (CX 3–A): "To act as a trade ass'n for the purpose of setting policies with the company from whom purchases are made and the pricing of all products sold direct to the consumers." (*Also see* CX 4–A – B for 1971 report.) The Board of the ADA has in fact consulted with Amway about retail prices, *e.g.,* discussing in 1973 price cutting on a cookware promotion. (CX 376–B)

80. The ADA Board also acts as a board of arbitration in disputes among distributors and as an appeal board when Amway has terminated or disciplined a distributor. The ADA Board conducts formal hearings through a hearing committee of three members. Participants may attend the hearing in person and may be represented by an attorney. The hearing committee receives witness testimony and other evidence, and a transcript of the hearing is made if a participant requests it. The committee then makes a recommendation to the Board. The Board considers about 5 or 6 cases each time it meets and in about 20% of the cases the Board disagrees with Amway. Amway always has acceded to the Board's decision. (RPF 243, 244) [28]

Vertical Restrictions

Cross-Group Selling Rule

81. Amway distributors agree to sell at wholesale only to distributors they have sponsored, and to buy only from their sponsor. This restriction is known as the "cross-group selling rule": "*Rule 3. No distributor shall engage in cross-group selling.* A distributor in one line of sponsorship must buy all of his Amway products and literature supplies from or through his supplier." (RX 331, p. 15–B)

82. The cross-group selling rule provides Amway distributors with an incentive to recruit distributors and to train and motivate

them to sell Amway products, since the sponsoring distributor receives income on the sponsored distributors' sales volume. (Patty, Tr. 3111-13; Halliday, Tr. 6237-39; Van Andel, Tr. 1751) Effective sponsoring distributors keep inventory of Amway products, hold sales meetings, run contests and conduct other promotional and training activities. (RPF 159)

83. Amway distributors may transfer from one sponsor to another after being terminated or remaining inactive for six months. Amway also approves about 100 transfers of distributorships a year for other reasons. (RX 331, pp. 18-B and 19-B; Halliday, Tr. 6507-09)

84. A distributor must train and supply his sponsored distributor. If they are in different geographic locations, however, the sponsor may arrange, through his Direct Distributor, to have the sponsored distributor trained and supplied by a Direct Distributor living in the sponsored distributor's area. (RX 331, p. 17-B) In these private servicing arrangements, the two Direct Distributors determine the compensation for this service. (Van Andel, Tr. 1739-41) [29]

Retail Store Rule

85. Amway distributors agree not to sell in retail stores (RX 331, p. 16-B):

> RULE 6. No distributor shall permit Amway products to be sold or displayed in retail stores, PX's, ships or military stores; nor shall he permit any product displays to appear in such locations, even if the products themselves are not for sale. No Amway literature shall be displayed in retail establishments.
>
> A distributor who works in or owns a retail store must operate his or her Amway business separate and apart from the retail store. Such distributors must secure customers and deliver products to them in the same manner as Amway distributors who have no connection with a store. Other types of retail establishments, which are not technically stores, such as barber shops, beauty shops, etc., likewise may not be used to display Amway products.

86. Amway prohibits distributors from setting up displays or booths at fairs, home shows, or other similar special events. (RX 331, p. 23-B)

87. Amway restricts its distributors in their sales of Amway products in fund-raising drives carried on by churches, and other civic or charitable organizations, limiting the manner and time of the sales and the products to be sold. (RX 331, p. 15-B; CX 277-M - N)

88. The retail store rule gives an incentive to Amway distributors to provide services to consumers. Amway distributors go to the consumer's home, demonstrate and explain the products, help with cleaning problems "on site," and deliver the products to the consumer's home at the customer's convenience. These services are

typically unavailable from a retail store. (Schroeder, Tr. 5355–56; Bryant, Tr. 4396; Halliday, Tr. 6240–43; Max, Tr. 5893–94) [30]

89. In the absence of massive advertising to create demand, sales of Amway products in retail stores would fail. Retail stores might be willing to stock Amway products in the short run because of existing demand created by personal direct selling by Amway distributors. (Cady, Tr. 5785–86) Distributors would quit or switch their attention from consumers to stores. (Cady, Tr. 5786) Demand would therefore slow and when demand slows down there is no longer shelf space available in the store. (Van Andel, Tr. 1810–12) If Amway were to sell through retail stores, "they would destroy their direct selling capability." (Diassi, Tr. 5537–38)

Customer-Protection Rule

90. The Amway Sales and Marketing Plan formerly had a "customer protection rule," providing that, upon making a sale to a retail customer, a distributor established an exclusive right to resell to that customer for a specified period of time. (CX 60–Z–5)

RULE 1. *A distributor who completes a sale to a retail customer and registers such sale thereby establishes the exclusive right for a period of the next 30 days to re-sell that customer.*

An Amway distributor, upon completing a sale to a retail customer, thereby establishes the exclusive right to re-sell Amway products to that customer, provided he has "registered" such sale by sending a copy of the sales receipt to his Direct Distributor or *to such sponsor as the Direct Distributor may designate.* The distributor must sell the retail customer an Amway product and register that customer each 30 days in order to retain his exclusive right on a continuous basis.

In the case of a commercial account, a distributor may retain an exclusive right to his customer in the same manner except that the exclusive right shall be effective for a period of 90 days. [31]

If the 30 or 90-day exclusive period is permitted to expire because of a failure to make and register a sale, then the next distributor to complete a sale and register the customer thereby establishes a new exclusive right period during which such exclusive right shall remain in effect in accordance with the terms outlined above.

Whenever a distributor approaches a new prospective customer, he shall ask whether that prospective customer is presently being sold regularly by an Amway distributor. If the customer is being sold regularly, then the distributor shall make no further attempt to sell that customer, but shall refer the customer to his or her regular distributor. (Emphasis in original.)

This rule was carried over to Amway from the Nutrilite sales plan. (Van Andel, Tr. 2047–48)

91. The Amway Sales and Marketing Plan formerly provided

that a distributor had an exclusive right to sponsor his own customer as a distributor. (CX 60-Z-5)

92. In January 1972, effective March 1, 1972, Amway abolished the "customer protection" rule and the rule giving a distributor the exclusive right to sponsor his customer as a distributor. (CX 284; CX 293)

93. Amway continues to support the principle of the customer protection rule. In June of 1974, Mr. Halliday, one of the three top officials at Amway, spoke at a New Direct Distributors' meeting. He pointed out that, while legal, it was unethical to "go in cutting out another Amway distributor" by taking his commercial account: "[S]ometimes there's a—something above and beyond the law that you have to think about in terms of ethics." (CX 1041-I) [32]

Advertising Regulation

94. Only Amway Direct Distributors are permitted to display the Amway name on the exterior of their distributor office, and that office must be for wholesale only. (RX 331, p. 20-B)

95. Amway controls the display of the Amway name and logo on distributors' business vehicles by approving their use only if the distributor meets specific instructions involving the display of the Amway trademark, trade name, logo, design or symbol, and the condition of the vehicle. (RX 331, p. 21-B)

96. Amway restricts the use by distributors of the Amway name in telephone directories. For example, only Direct Distributors may appear under the Amway or Nutrilite names in the white pages. Other Amway distributors are allowed to use the designation "Amway Distributor" in the white pages, as long as they are listed under their surname. (RX 331, pp. 21-B - 22-B) In the yellow pages, upon prior written approval by Amway, a distributor may list under three specified categories, ("cleaning products," "cosmetics," and/or "vitamins") using the designation "Amway Home Products Distributors." (RX 331, p. 22-B)

97. Only upon prior Amway written approval, may distributors use outdoor advertising on billboards or signs. (RX 331, p. 23-B)

98. Amway distributors may not use the Amway trade name or logo on checks except to describe themselves as Amway distributors. (RX 331, p. 23-B) [33]

99. Direct Distributors may contract for local advertising of Amway products on radio, television, or in newspapers only by using advertising mats and scripts obtained from Amway. (RX 331, p. 23-B)

100. If Amway distributors use the Amway name in classified

recruiting advertisements, the advertisements must follow the exact, word-for-word copy of one of seventeen formats provided by Amway. For example: "Local Amway Distributor is helping many persons earn money working two to four hours a day. We can help you. For interview, call ————————————." (RX 331, p. 24–B)

101. All Amway printed material is copyrighted and may not be reproduced by distributors without permission. (RX 331, p. 24–B)

102. Amway restricts the advertising of its distributors in order to keep a consistent market position, among other reasons. (Cady, Tr. 5815)

103. People inexperienced in direct sales tend to overestimate the effectiveness of advertising which may increase their expenses and hasten their exit from the market. (Cady, Tr. 5813–15) The Amway direct sales system is based on the plan that personal contact is more effective than advertising in selling Amway products and recruiting distributors. (Van Andel, Tr. 1857–58)

104. By its regulation of distributors' advertising, Amway attempts to assure that its marketing plan is explained and represented by experienced distributors. (Halliday, Tr. 6244–46; CX 960) [34]

105. With the high turnover rate typical of direct sales organizations, Amway attempts to control the distributors' advertising in order to avoid the negative impact on consumers responding to ads placed by distributors who have gone out of business. (Halliday, Tr. 6244–46; Cady, Tr. 5812–16)

106. Amway uses and has registered 125 trademarks and servicemarks. (RX 336)

107. Amway has controlled the use of its trademarks, servicemarks, and trade names in order to prevent misrepresentations by some distributors. One distributor in Alton, Illinois, ran recruiting ads implying that he was offering employment. A similar incident occurred in New York City. Amway terminated both distributors. (Halliday, Tr. 6246–49) Some Amway distributors in Kansas City falsely represented that Amway cookware was the same as cookware costing twice as much. Amway took disciplinary action against the distributors. (Halliday, Tr. 6253–54) A distributor in Arkansas produced cassette tapes and literature which misrepresented the Amway Sales and Marketing Plan and Amway products. Amway brought suit and injunctive relief was obtained prohibiting the production and distribution of the materials. (Halliday, Tr. 6254–56) Several distributors in Minnesota produced their own literature advertising several Amway cleaning products including a germicide The literature did not give the proper instructions. Relying on the brochure, a distributor recommended to the owner of a goat farm

that the product could be used to sanitize a goat before milking. The literature failed to give proper instructions, and the goatman applied the germicide at full strength and burned several goats severely. Amway located and destroyed all copies of the unauthorized literature. (Halliday, Tr. 6250–51) [35]

108. Amway also controls the use of its trademarks, servicemarks and trade names to avoid possible liability for the contents of advertising by the distributors. (Van Andel, Tr. 2055) Improper use of its logo on vehicles operated by distributors might imply an employment relationship attaching liability in the event those vehicles are involved in an accident. (Halliday, Tr. 6252–53)

Price Fixing

109. Amway has fixed the prices at which its products are to be sold to distributors and to consumers. One of the "Rules of Conduct" of the Amway Sales Plan published in 1963 was that (CX 53–Z–31):

> No distributor shall sell products sold under the Amway label for less than the specified retail price, when making sales to persons who are not distributors, except where commercial discounts are authorized to be given. No distributor shall give a greater discount than that authorized in the appropriate Amway Product Sales Manual.

Those who signed the application to become Amway distributors at that time agreed to comply with those distributor requirements and "to observe the spirit as well as the letter of the Code of Ethics and Rules of Conduct of Amway Distributors." (CX 53–Z–62) Amway had 30,000 distributors in 1963. (CX 53–H)

110. Amway fixed the charge for freight to be collected by the distributors. In 1963, Amway sold its products to distributors FOB regional warehouse. Amway provided that, since the Direct Distributor picked up the products from the warehouse and incurred freight costs in delivering the products to the ordering distributor: "[The Direct Distributor] may assess a freight charge of 1% of [purchase volume] of each invoice to [36] help offset some of this cost. Each sponsor is authorized to pass this charge down the line . . . ." (CX 53–Z–37 – 38) In a few areas that were long distances from the nearest warehouse, Amway's policy was that "it is permissible to add certain additional freight costs to the retail prices, and to increase retail prices." (CX 53–Z–40)

111. Amway still indicates the price that distributors are to charge at wholesale. The 1963 Amway Sales Plan explained wholesale prices (the prices paid in sales from one distributor to another) (CX 53–Z–15):

When a sponsor buys Amway products from his sponsor or Direct Distributor, and resells them to a distributor whom he sponsors, he both buys and sells at the basic discount. Thus products sold between distributors are always sold at the same price, with no profit made on the immediate transaction. The profit is made later on the refund percentage . . . .

(*See also* CX 88-E - 1968) The 1975 Amway Career Manual for distributors explained wholesale prices (RX 331, p. 3-B):

In Amway, a sponsor does not succeed unless his sponsored distributors succeed. He cannot make money by simply selling products to his sponsored distributors because he sells them for the same price he paid for them: the distributor cost. Instead he makes money on the Performance Bonuses they generate on their Business Volume, which in turn is based on their retail sales. . . . [37]

112. Respondents have fixed the prices at which its products may be sold through fund raising drives.

(a) In the Career Manual for Amway distributors published in 1968, Amway specified the products that distributors could sell through fund-raising drives by schools, churches and clubs, and stated that the distributor should (CX 57-Z-152):

See that standard retail prices are observed. Do not permit cut-rate selling. Cut-rate selling during a fund-raising campaign could hurt your own regular selling of these items.

(*Also see* CX 54-Z-128 - for 1965.)

(b) In the Rules of Conduct published November 1, 1969, Amway stated that the Amway Fund-Raising Plan was that (CX 277-"N"):

The selling organization will buy the products from the distributor at retail and will sell them at retail. Selling organizations will be requested to adhere to the suggested retail prices.

The Amway Plan also specified that (*ibid.*): "The distributor will pay the selling organization a *profit* of not more than *the difference between the retail price and the distributor cost* . . . ." (Emphasis in original.) This part of the rule fixing the amount to be paid to the selling organization by the distributor was recommended by the ADA. (CX 338-B)

(c) The current Amway Rule of Conduct for fund-raising drives specifies the six products which may be sold and states that (RX 38 p. 15-B):

Members of the selling organization will only take orders for the products. S orders will be turned over to the sponsoring distributor, and he, or distributors in organization, will deliver the products to the customer and collect the purchase p [38]

113. The 1965 price list for distributors specified the "retail" price for Amway products. (CX 587) The 1970 price lists specified the the "retail prices (for sales tax purposes)." (CX 593; CX 615) Amway price lists since 1972 have specified "suggested retail for sales tax" (CX 597 - 1972; CX 620 - 1973), or "retail sales comp. base" (CX 598 - 1973; CX 605 - 1976). The current order form states that the price of the Amway products is "suggested retail." (RX 456, RX 460)

114. Amway has a policy of advising distributors not to sell Amway products at discount to commercial accounts. Amway sells training and motivational cassette tapes to distributors for use at sales meetings. Among the "proven ideas from successful distributors" spoken on the tapes is the advice not to grant discounts (CX 1031-I - Transcript of tape sold in 1976, CX 605-M):

> (Don Mumford speaking) So, so anyway, he says, "Don, do you, what kind of a deal do you give? If we order 50 barrels from you, what type of a deal do you give?" They have the same philosophy as Amway. Whether if you buy one case or a thousand cases, it's all the same price. There's no deals. That's what I told him. We don't have any deals. It's all the same price. If it's worth $95 a drum, then 50 drums is still worth $95. I, I'm just telling you this, don't give deals. I don't, it's just not worth it, it's just not worth it. (applause) But anyway, he gave me a blanket order for 50 barrels.

Commercial sales are where price competition among Amway Distributors is most likely to occur. (Halliday, CX 1040-K; CX 485) [39]

115. Amway threatens termination of the distributorship to discourage retail price cutting. In Dallas, Texas, in 1971, Mr. DeVos talked to Direct Distributors and was asked what could be done about price cutting by distributors (CX 1037-E - G):

> Question:] Are you as Amway going to do anything to distributors who are selling roducts at wholesale to retail customers? [DeVos:] If you have a distributor who is elling Amway products at wholesale to a customer, our action has got to be first of all get a complaint on it and find out who the distributor is that's doing it. Our next ove has got to be to work on his removal, but this isn't an easy problem, because if is person wishes to sell to anybody on the street at whatever price he wants to, re getting into some touchy areas on price fixing. Now the only thing you can nt out is that sooner or later the distributor is going to go broke — because you 't go on selling the product at what you paid for it and survive in the business. . . .

DeVos gave the Direct Distributors further advice on how to to the price cutting distributor. After warning the Direct ributors that price fixing is a serious matter "that the federal le and the FTC watch like a hawk" (CX 1037-G):

> do a sales job on the guy and pointing out that if he's going to continue that he's to destroy his own business, he's gonna work at a non-profit situation, he'll tely not be able to recruit distributors, because they can't make any money and

what he's doing is destroying himself, and therefore in most cases where you have it happen it disappears quite rapidly.

[40] 116. Amway combines with distributors who report price cutting and with Direct Distributors so that pressure may be applied to stop distributors who are retailing Amway products at less than the suggested price. In a tape recording of a new Direct Distributor seminar conducted in 1971, by Mr. Halliday, an official of Amway, and one of the three members of the Board of Directors of the company, told the distributors that, in the event that another distributor sells products at a reduced price, they should approach that distributor's Direct Distributor (CX 1040–J):

[Question:] We have had some people who would, uh, sell products at a reduced price, for example, last week we had a fair booth and, um, I knew some of this was going on, once in a while people would come up and I'd just ask them, I'd say, "Say, what, uh, what are you selling shoe spray for in your area?" And, some of the prices that I got were, uh, very staggering to the imagination. What can we do about this?

[Halliday:] Well, again, I think the only thing you can do about it as an individual is to go to talk to the Direct Distributor of that organization, explain to him what he's doing, as far as the image of all Amway distributors, uh, the fact that they're confusing customers — the potential customers, that the reason that the price — you have to get that retail price is if you're rendering the service that you're rendering that's the only way that you're going to be adequately compensated for it. You're gonna have to work with him on an informal basis. As far as our being able to write him and saying "You can't do it." we cannot.

[41] *See also* the testimony of Lawrence Lemier, an Amway Area Coordinator until October of 1973, who had handled complaints from distributors. Occasionally, a distributor would complain that some other distributor was selling products at less than retail price to retail customers. Mr. Lemier would tell both the Direct Distributor of the complaining distributor and the Direct Distributor of the price cutter that (Lemier, Tr. 179):

[T]here was not much Amway could do in a case like that. We couldn't control prices, but I would let them know that studies were made and that products at the retail, the suggested retail price, those were fair prices to the retail customer and a fair margir of profit to the distributor.

117. This record contains examples of the success of Amway' policy of combination and communication to stop price cutting. I 1972, Lorraine Cooke, an Amway distributor from Gun Lak Michigan, distributed flyers featuring Amway products at belc suggested retail prices. Other distributors reported this to Amw and Lorraine Cooke received the following letter dated June 8, 19 from Ann Penrose, an Amway Administrative Legal Assistant (831–A - C):

Amway Corporation will not tolerate the use of the Amway name, logo, or its products in any manner in privately developed promotional literature. We, therefore, must instruct you to immediately cease and desist the dissemination of both flyers and to destroy any remaining quantities which you may have in your possession.

* * * * * * *

One of your flyers also indicates that you are apparently selling Amway products at a price below Amway's suggested retail prices in a "package special." [42]

As you will note from the SA-13 Wholesale Price List, Amway publishes a suggested retail price list for sales tax purposes. Amway, however, cannot impose a fixed price schedule upon its distributors. Under the Amway Sales and Marketing Plan, each Amway distributor is an independent businessman who purchases products from Amway for cash. Title to these products actually passes from the company to the distributor (and later from distributor to distributor or from distributor to retail customer) under a purchase and sales agreement. At each sale, title passes to the buyer immediately upon purchase. Thus, in essence, each buyer has latitude in determining what price he will charge for the product when he subsequently sells the same.

There are certain built in features about the Amway Sales and Marketing Plan which tend to discourage unreasonable and unrealistic price variances. Perhaps the most important of these is that any price reduction results in less net income to the distributor. The product line manufactured by Amway Corporation is relatively stable, with several new products being added each year, and several products being removed from the line. Generally speaking, the product line remains essentially constant, particularly compared with some other direct selling companies, such as Avon, which have a calculated policy of conducting "sales" every several weeks in order to generate consumer interest and which ties into their constantly changing line of products and packaging.

A policy of "sales" is not consistent with a stable product line, since customers would become confused concerning why there would be a "sale" one month and not during the next. They would lose confidence in the stability of the distributor with whom they are dealing, at least from the standpoint of individual pricing policies. [43]

Then, again, the Amway products, because of their concentrated nature, and the ıanner in which they perform, compete effectively with other products designed ıbstantially for the same purpose and which are available in retail stores. Because of ır advantageous competitive position, the practice of "sales" is not, and would not be, a similar benefit, or would not produce the same results in increasing volume, as is pected by a grocer or supermarket when it embarks upon the same practice.

We are usually able to point out to a distributor that it is to his financial advantage naximize his profits by selling Amway products at the suggested retail price for s tax purposes. Because of certain intricacies of federal law, and those of some es, it is not possible for Amway Corporation to dictate to independent Amway ibutors the prices at which they should sell an Amway product. It has never been ssary for Amway to take any position such as that for the reason that the vast rity of Amway distributors, which means almost 100% of all Amway distributors, ware of the principle stated in this letter and are thus more than content to

realize the greatest maximum profit on their sales of Amway products. Therefore, we would certainly discourage any such "sale."

Lorraine Cooke wrote back to Ann Penrose, stating that she had "complied with all your demands" (CX 1008):

I have always through the course of my lifetime—and in my experience as a Girl Scout Leader—preached and tried to practice Fair Play. . . .I cannot tell you how dreadful this has been to me. I am a new distributor—this has been a good lesson to me. . . .and needless to say, I have CAREFULLY re-read my manual and now understand them (sic) more fully. [44]

If I have hurt anyone, in my ambitions to get started in the Amway world, please advise how I may further correct my mistakes. They were certainly. . . .not intended to hurt, please believe me.[3]

Steven A. Bryant, Amway's Chief Attorney, wrote to Mrs. Cooke shortly afterward, when another distributor alleged that Mrs. Cooke had told customers that the area in which she sold was her "territory." Mr. Bryant warned that because of the complaints [including the price cutting episode] concerning her, Mrs. Cooke was in danger of losing her distributorship. He sent a carbon copy of his letter to Mrs. Cooke's sponsors, requesting that they "educate this distributor as she was causing considerable disturbance in the field." (CX 1017)

118. Amway warns against writing letters to distributors concerning price cutting, to prevent the Federal Trade Commission from obtaining them. (DeVos, CX 1037-G, I)

119. Amway's policy is that distributors who advertise Amway products at discount in the newspaper can have their distributorships terminated. (DeVos, CX 1037-I)

120. One of Amway's Rules of Conduct requires distributors to buy back from a sponsored distributor who is leaving the business any marketable products, literature or sales aids, with a 5% discount for handling. (RX 331, pp. 17-B to 17-C) If the distributors do not buy back the products or promotional material, Amway will. (CX 406-C) [45] There are two reasons for the buy-back policy: (1) to prevent inventory-loading, and (2) to avoid discount sales by distributors who may choose to leave the business. (CX 406-D)

121. An example of the execution of the buy-back rule to stop price cutting involved Russell Bortnem, an airplane pilot who had been an Amway distributor for five years. He had sponsored 20 to 30 distributors and had between 75 and 100 in his organization. (Tr. 684) Since his sponsor had moved away, he was authorized to buy

[3] See also Holdridge, Tr. 781-82 and CX 833 for a similar episode.

directly from Amway and service his distributors from the inventory he kept. He built up too much inventory and Amway would not buy back certain products which had been discontinued or the size of which had been changed. Russell Bortnem and three other distributors placed an ad in the Fort Lauderdale newspaper on October 26, 1975, advertising Amway products "Below Wholesale! 'Our loss, your gain'." Mr. Bortnem testified (Tr. 689):

Q. You placed the ad approximately in October, '75, October 26, '75?

A. Yes. I think it ran probably three days throughout a week or a week and a half period.

Q. Did you receive any response from that ad, you personally?

A. Yes. We sold quite a few things but also most of the response was from other direct distributors in the Fort Lauderdale area.

Q. What did direct distributors respond?

A. They were threatening us that, "You can't do this and we are going the [sic] report you to Amway," and everything. . . .

[46] In a few days he received a call from an Amway employee who asked him to remove the ad from the paper and who agreed to buy the inventory. (CX 1049, CX 1050) Mr. Bortnem had indicated previously that he would resign his Amway distributorship if that was what was required to be able to return the Amway products (RX 10). The buy-back agreement prepared by Amway provided that in return for the reimbursement, Mr. Bortnem agreed to relinquish his Amway distributorship. (CX 1050)

122. Amway urges distributors to buy back products even if the products are no longer marketable so that they will not be sold at discount. (Halliday, CX 1040-N, CX 1042-D - E)

123. Amway instructs its distributors that when Amway products are in the possession of shipping companies, salvage stores or freight recovery stores, which acquired the products by paying off insurance claims on damaged freight, the distributor should repurchase the products or notify Amway so that Amway can repurchase them. The reason for this policy is to prevent salvage stores from discounting the products. (CPF 227)

124. Amway collects retail sales taxes at the time of sale to Amway Direct Distributors and pays the state governments. This system was started at the request of state taxing authorities. (Van Andel, Tr. 1782-83; Fisher, Tr. 3201-04) Amway refunds the prepaid sales tax to distributors who request refunds because the products were not sold at the suggested retail price. (Van Andel, Tr. 1817; RX

328) Part of these refunds undoubtedly go to distributors who have consumed the products rather than having resold them. (Van Andel, Tr. 1994) [47]

125. On commercial sales, the distributor can buy the products from Amway and resell to the commercial account, or the distributor can request that Amway finance the sale. If the distributor cannot afford to buy the products, he can send the order to Amway, and if Amway decides the commercial account has a satisfactory credit rating the products will be shipped directly to the customer; Amway will bill the customer and when payment is received the distributor will receive compensation less 3% for this billing and service. Until at least 1972, the Amway instructions for commercial sales to be financed by Amway instructed the distributor to: "3. Indicate price quoted and whether to be shipped prepaid or collect. If freight collect, price quoted should be PV. If freight prepaid, price quoted should be suggested retail . . . ." (CX 61-Z-60)[4] Amway does not currently specify that the purchase price should include freight collect or prepaid. (RX 331, pp. 8-E to 9-E)

126. Amway distributors take title, dominion and risk of loss over Amway products, except for commericial sales where the distributors ask Amway to provide credit. (CX 831)

127. The vast majority of Amway distributors do not cut the retail price for Amway products. (CX 831-B - C) The number of reports annually received by Amway of price cutting by distributors is usually less than a dozen. (Halliday, CX 1040-H; DeVos, CX 1037-D) [48]

Misrepresentations and Failure To Disclose

128. Amway instructs its distributors to make "only such claims as are sanctioned in official Amway literature." (RX 331, p. 14-B) Amway disciplines, by termination or censure, distributors who misrepresent the Amway Sales and Marketing Plan. (Halliday, Tr. 6262-65, 6488-97; Van Andel, Tr. 1847)

129. Amway literature emphasizes that retail selling is an essential part of the Amway Sales and Marketing Plan and that a distributor cannot succeed merely by sponsoring new distributors. (RX 331, pp. 5-A, 8-D through 10-D)

130. Amway emphasizes that hard work is necessary to succeed as a distributor. Amway tells the distributor:

You have to work to build your business. You have to do the succeeding yourself. Not

[4] "PV" meant purchase volume. (CX 61-T) (See CX 615-C.) Since 1975 this has been called "BV" or "business volume." (Finding 52) (See CX 605-F) The name was changed to avoid confusion with "point value" added in that year. (Finding 51)

us. Not your sponsor. Not your group. You. All we can do is urge you on, support your efforts, ship the products, send the Performance Bonuses.

(RX 331, p. 5–A; see also pp. 3–A, 8–D, 9–D; DeVos, CX 1045–G - 1970; Van Andel, CX 999–J; CX 85–X)

131. Amway literature currently states that distributors should not "quote dollar incomes on specific individuals even though you may want to use their stories about the homes in which they live, the cars they drive, or the airplanes they fly." (RX 331, p. 9–D) [49]

132. Amway representatives have stated specific dollar incomes which may be possible to achieve as an Amway distributor. For example, Mr. DeVos attended an Amway rally in Mobile, Alabama, on February 8, 1973, and in a sales inspirational speech stated that the distributors have "unlimited income potential" because how much they made depended on how much they sold and that:

. . .[Y]ou can start out by trying to make $50 and when you start climbing and working with the plan you can make $100,000 in the same plan. (CX 1007–N)

And, he said:

You ought to open up your mind right now to thinking in terms of making $100,000 a year because you can do it and you ought to think that way. (applause) Listen—That won't happen tomorrow, and it won't happen the next day. But if [you] were to work at any other job you've got 40 years ahead of you. And there are going to be people in this room and in this country who by the time they are 40 starting even part time building gradually, they're going to arrive at a point where they are going to have that kind of income only because you dared think about it. (CX 1007–O)

This statement, in context, meant that only some hard workers would achieve this level of success. It was directed to the "young people in their twenties" in the audience. The story preceding it was of a distributor who was finally able to buy her children a new pair of shoes for school. And Mr. Devos said "there aren't many hundred thousand dollar deals in real estate either." (CX 1007–H) [50]

133. Some Amway distributors do make substantial gross incomes from their Amway business. In fiscal 1971, there were 291 Amway distributors who had a purchase volume of $100,000 or more. About 11% of the Direct Distributors in the years 1972–74 did that well. A few sell $300,000 or more. About 28% of the Direct Distributors have an annual purchase volume of $50,000 or more. (CX 917–A - B) In 1974, about 39% of the Direct Distributors received performance bonuses of $10,000 or more. (CX 918–A - B) Well balanced distributors, according to Amway, keep about one-half of the performance bonus. (RX 401, p. 10) In 1974, about twenty distributors received 3% Direct Distributor bonuses of more than

$20,000, ten received more than $30,000, three received more than $40,000 and one got $56,178.92. (CPF 524) (See RX 401, p. 10.)

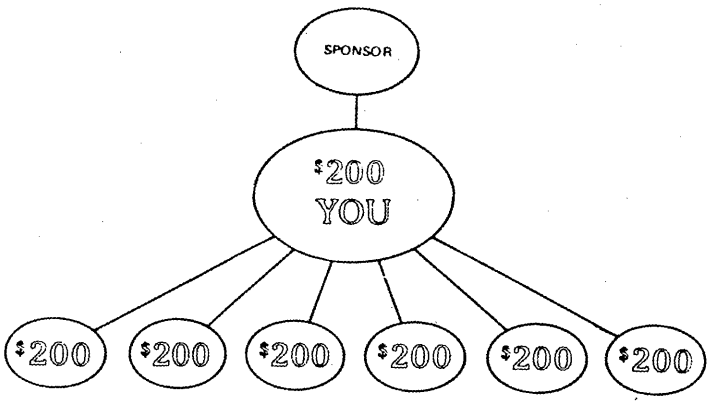
134. Until 1973, Amway explained to new distributors the potential income from retail selling by the representation that (CX 85–T): "By making just one average sale of $5.00 per day, you can sell $100.00 worth of products a month." Later Amway increased the distributors' potential "average gross income" to $200 a month. (RX 331, p. 3–D):

> You can make retail sales that will average $200 BV every month by making "Two sales a day, the Amway Way!" On your $200 in BV, you receive an immediate income of about 30% or $60. (You buy Amway products from your sponsor at varying discounts from 15% to 35%; this averages out at about 30%.) The term "Business Volume" (or BV for short) is used to describe the amount of products that you purchase from your sponsor for your personal customer needs, your own use, and that of the distributors whom you personally sponsor.
>
> You also receive a second income, or a Performance Bonus on your Business Volume (BV), when you have a monthly Point Value of at least 100 points. On $200 BV, your Performance Bonus is 3%, or $6, provided you have Point Value of at least 100 points that month. This means your gross income for the month is $66—a good part-time income for making two sales a day, the Amway way. [51]
>
> ON YOUR $200 IN BV
>
> YOUR AVERAGE GROSS
>
> INCOME IS
>
> $60.00
>
> YOU ALSO RECEIVE A
>
> PERFORMANCE BONUS OF 3% OF $200 BV
>
> OR
>
> $6.00
>
> TOTAL GROSS INCOME
>
> FROM YOUR OWN RETAIL
>
> BUSINESS IS
>
> $66.00

135. Amway instructs its distributors to explain the potential income to be made by sponsoring by "drawing circles." These diagrams are based on Amway's representations that a distributor's potential "average gross income" is a particular amount. Until 1973, Amway used $100 for the amount. (CX 61–Z–31 to Z–35) By 1975,

Amway had increased that amount to $200 BV (RX 331, p. 5–D through 7–D): [52]

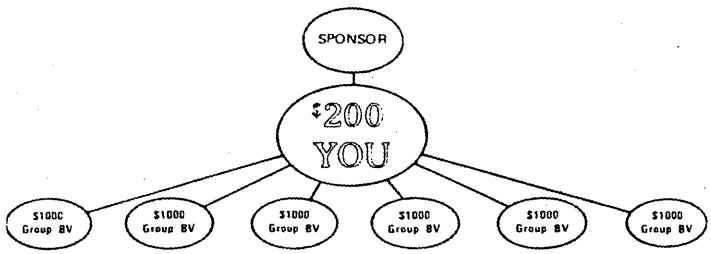
FOR DISCUSSION PURPOSES, LET'S ROUND OUT THE NUMBERS TO $200.00. I'M SURE YOU REALIZE THAT SOME WILL DO MUCH LESS AND SOME MORE. BUT, IF THEY MAKE TWO SALES A DAY, THEY SHOULD SELL AT LEAST $200 (AT BV) PER MONTH.



Immediate income on Personal Sales of $200 (at BV)		$ 60.00
Your total Group BV:		
$200 in BV x 7	$1400	
12% Performance Bonus on $1400 (assuming Point Value of at least 1,000 points)	$ 168	
Less Six 3% Performance Bonuses on $200 to your distributors (assuming necessary Point Values have been achieved by each distributor)	— $ 36 Performance Bonus you pay	
	$ 132 Performance Bonus you keep	$132.00
Total gross income from your business		$192.00

YOUR BUSINESS CAN BUILD EVEN LARGER AS YOU TRAIN AND INSPIRE YOUR PERSONALLY SPONSORED DISTRIBUTORS TO DUPLICATE THEMSELVES BY SPONSORING NEW DISTRIBUTORS. LET'S SAY THAT SIX OF YOUR PERSONALLY SPONSORED DISTRIBUTORS SPONSOR FOUR DISTRIBUTORS EACH AND THAT EVERYONE MAKES TWO SALES A DAY, WITH EACH ONE SELLING $200 (AT BV) A MONTH.

YOUR INCOME PICTURE FOR THE MONTH WOULD LOOK LIKE THIS: (HERE AGAIN FOR THE SAKE OF SIMPLICITY, WE HAVE ROUNDED OUT THE NUMBERS TO $200.)

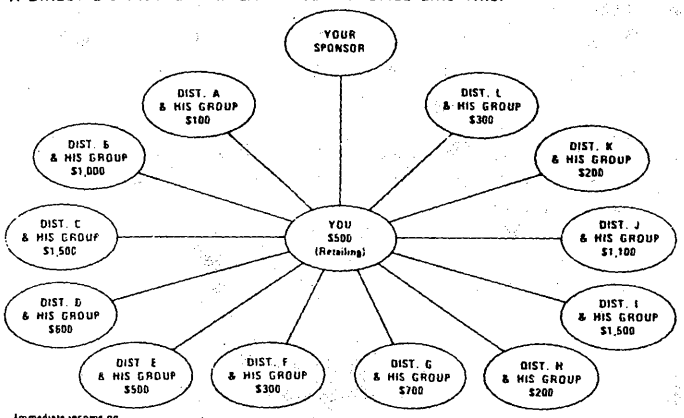


Immediate income on personal sales of $200 BV			$ 60.00
Your total Group BV:			
$200 in BV x 31 or 6 groups of 5 distributors plus your own sales	$6,200		
23% Performance Bonus on $6,200 (assuming Point Value of at least 6,000 points)	$1,426		
Less six 12% Performance Bonuses on $1000 to your distributors (assuming necessary Point Values have been achieved by each distributor) who in turn pay Performance Bonuses to their distributors	– $ 720	Performance Bonus you pay	
	$ 706	Performance Bonus you keep	$706.00
Total gross income from your business			$766.00

THE GROWTH OF YOUR PART-TIME BUSINESS FROM THIS POINT ONWARD CAN ONLY BE DESCRIBED BY THE PHRASE – IT EXPANDS RAPIDLY. THE OPPORTUNITY IS THERE FOR YOU TO CONTINUE TO BUILD YOUR SALES ORGANIZATION IN THE SAME WAY UNTIL YOU ATTAIN A MONTHLY POINT VALUE OF 7,500 OR MORE POINTS. IT WILL, OF COURSE, REQUIRE MORE TIME AND MORE EFFORT, BUT IT CAN BE DONE AS A PART-TIME BUSINESS.

THE DISTRIBUTORS SPONSORED BY YOUR PERSONALLY SPONSORED DISTRIBUTORS SPONSOR OTHER DISTRIBUTORS, AND THUS YOUR GROWTH EXPANDS EVEN MORE.

A DIRECT DISTRIBUTORSHIP CAN HAVE A PROFILE LIKE THIS:



Immediate income on personal sales $500 (at BV)			$ 150.00
Your total group BV	$8,500		
Performance Bonus you receive (25%, assuming Point Value of at least 7,500 points)		$2,125.00	
Performance Bonuses you pay out (assuming necessary Point Values have been achieved by each distributor)			
Distributor A (3%)	$ 3.00		
B (12%)	120.00		
C (15%)	225.00		
D (9%)	54.00		
E (6%)	30.00		
F (6%)	18.00		
G (9%)	63.00		
H (3%)	6.00		
I (15%)	225.00		
J (12%)	132.00		
K (3%)	6.00		
L (6%)	18.00		
TOTAL PAID OUT		-$ 900.00	
(Distributors A, B, C, D, E, F, G, H, I, J, K, and L will, of course, be responsible for paying Performance Bonuses to their distributors.)		$1,225.00	
Performance Bonus you keep:			$1,226.00
Total monthly gross income			$1,375.00

7-D

[55] Amway distributors use this technique in recruiting new distributors. (Yager, CX 1040-U; Trozera, CX 1031-E; Cliett, Tr. 3758-59) In 1977, Amway raised the basic amount to be used in the circles to $250. (RX 401, pp. 7-8)

136. In speaking to a new Direct Distributors meeting in June of 1974, Mr. Van Andel explained the reasons for specifying a particular sum to represent the amount of the distributors' sales in the circles drawn to show the plan (CX 1041-T):

> What is my personal opinion with regard to the $200 circles versus the $100 circles? Well, we think that the $200 circle concept raises the, the vision of people, and we have found through experience, as you have I'm sure, that people tend to do that which you ask them to do. If you had $50 circles, they'd probably do $50. If you have a hundred they do a hundred, and if you do $200 they probably do $200. Now, there's a limit to that, and, er, you know, you can follow that through and say let's make 'em $5,000 circles — well, it doesn't quite work out that way. But I think the general consensus, and we discussed this widely with Direct Distributors, Diamond Direct Distributors, with the ADA Board, was that the $100 figure was too low. And that by raising it to $200, it would result in a general upgrading of the potential of a great many distributors, which would be good for them and good for you. And that's, I think, about the way it's worked out for most people. . . .

137. The average monthly BV of Amway distributors in fiscal 1969-70 was about $20 a month. In fiscal 1973-74 the average BV for each distributor was about $33 a month. (CX 517-F, Z-95) Much of this amount is consumed by the distributors themselves rather than resold. The distributors obtain Amway products with about a 30% discount off the retail price. Many of them consume large amounts of the products every month. (Cook - $75, Tr. 4742; Marshall - $35 to $45, Tr. 4761; Woodworth - $60, Tr. 4787; Wespinter - $75 to $100, Tr. 4884; Rivett - $60, Tr. 4971; Nieman - $75 to $100, Tr. 5081; Hendrickson - $150, Tr. 5181; Gregory - $40, Tr. 5209; Williams, $125-$150, Tr. 5325; Evans - [56] $70-$80, Tr. 5300-01; Wakeman - $30-$40, Tr. 5446; Burgess - $25-$40, Tr. 5460; DeJean - $30-$40, Tr. 5501; Wong - $80-$100, Tr. 5650; Wolfe - $100, Tr. 5664)

138. Amway instructs new distributors to recruit additional distributors by the following method. After making a list of friends, relatives and neighbors, the new distributor is instructed (RX 331, p. 1-D):

> Give these friends, relatives and neighbors the benefit of a full presentation of the Amway Sales and Marketing Plan. Don't try to explain over the phone. Encourage them to attend the meeting by telling them that this is an opportunity to be in business for themselves on a part time basis with no investment in inventory necessary. Tell them they may build a business earning as much as $1000 or more a month. Mention that you have started your own independent business on a part time basis and that you would like to tell them about it.

Amway distributors use this technique in recruiting new distributors. (Dirksen, Tr. 423; Holdridge, Tr. 743, 819; Bernard, Tr. 1364–65, 1376–77; Johnson, Tr. 1439; Rovena, Tr. 1633–34; Blinko, CX 1041–Y; Johnson, CX 1115–B; Williams, CX 990–Z–30; Eldridge, CX 999–V)

139. Amway recruiting literature used in 1964 stated that: "Sponsoring is easy!" The 29 page single spaced manual continued, however, to outline the method used in sponsoring, referring to several other Amway manuals, and concluding: "After your first reading this manual may seem a bit confusing to you. If (sic) may seem like there are a tremendous number of things to remember and learn. Don't try to remember all the details now. Start with the first step . . . ." (CX 89) (1964) More recent recruiting literature is even more detailed. (CX 91) (1975) [57]

140. Amway literature explaining the Sales and Marketing Plan cautions that distributors incur expenses in the operation of the distributorship, such as automobile, telephone, stationery, literature, utility and other operating expenses. (CX 88, p. 10, RX 401, p. 10, CX 87, CX 62–Z–18, CX 60–Z–19, CX 61–Z–18, CX 91–H, CX 1096, pp. 2–H and 3–H, CX 793, p. 10) Distributors are also told at meetings to watch expenses. (DeVos, CX 1045–B)

141. Amway has warned its distributors that it is realistic to expect a new distributor to drop out in only one week. (CPF 505) In 1970, Mr. DeVos told new Direct Distributors that "about half the people who sign up the first time sign up the second year." (CX 1045–B) Amway teaches its distributors to expect newly sponsored distributors to quit the business and to be prepared for the let down. (CX 1000–W) [58]

Pyramid Sales

142. "Pyramid" sales plans involve compensation for recruiting regardless of consumer sales. In such schemes, participants receive rewards for recruiting in the form of "headhunting fees" or commissions on mandatory inventory purchases by the recruits known as "inventory loading." (Van Andel, Tr. 1820–21; Patty, Tr. 3147, 3091–92; Cady, Tr. 5778–79)

143. "Pyramid" sales plans based on inventory loading or headhunting fees create an incentive for recruiting rather than selling products to consumers. This potentially results in the number of recruits outgrowing the market for products being sold to consumers. (Granfield, Tr. 2996–97)

144. The Amway Sales and Marketing Plan provides incentives for sponsoring which are based on sales of products to consumers.

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(Van Andel, Tr. 1823-24; Granfield, Tr. 2951-52; Patty, Tr. 3092-95; Cady, Tr. 5779-81; Max, Tr. 5995-97) It is not a pyramid sales plan.

145. Amway's buy-back rule deters inventory loading by sponsoring distributors. (Van Andel, Tr. 1999-2000; Halliday, Tr. 6231-32; S. Bryant, Tr. 4062-63)

146. Amway's 70% rule deters inventory loading by sponsoring distributors. (Cady, Tr. 5795-97; Halliday, Tr. 6231; Lemier, Tr. 176)

147. Amway's ten customer rule deters inventory loading by sponsoring distributors. (Max, Tr. 5996-97) [59]

Saturation

148. Distributors have come into the Amway business in the United States as follows (RX 381):

Year	*New Distributors*
1972	255,000
1973	231,000
1974	213,000
1975	237,000
1976	280,000

Each Amway distributor who wants to continue as an authorized Amway distributor (except those recruited after August 31 of that year) must notify Amway. At the end of the calendar year the files are cleared of the names of distributors who elected not to continue. The number of distributors at the beginning of the year therefore is close to the number of active distributors. (Halliday, Tr. 6483-87) The turnover rate for all Amway distributors (including international) is as follows (RX 383):

Year	*Number at the End of Prior Year*	*Number at beginning of Year*	*Turnover*
1972	646,633	320,738	50.4%
1973	655,310	306,002	53.3%
1974	546,328	298,561	45.4%
1975	518,583	294,328	43.2%
1976	549,516	315,187	42.6%
1977	610,059	359,470	41%

149. Amway distributors from various parts of the country gave credible testimony that they have found that in recent years it has become easier to sponsor new distributors. (Hansen - Grand Rapids, Michigan, Tr. 3271-72; Cliett - Fairfax Station, Va., Tr. 3747; Zizic - Timonium, Maryland, Tr. 4113-14; Hunt - Holly Pond, Alabama, Tr. 4412; Wespinter - Portage, Michigan, Tr. 4883-84; Evans - Wray,

Colorado, Tr. 5263–64; Lamb - Missoula, Montana, Tr. 5607; Case - Phoenix, Arizona, Tr. 3401–02) [60]

150. The Amway Sales and Marketing Plan, not being a "pyramid" plan, has not led to any significant difficulty in recruiting new distributors.

a. Some witnesses, called in support of the complaint, testified to their difficulty in sponsoring new distributors in their areas of the country. Other evidence, however shows that the opportunity to sponsor new Amway distributors has continued in those areas:

Baton Rouge, Louisiana - The new distributors increased from 332 in 1975 to 547 in 1976. (RX 372) The population increased 45,000 from 1970 to 1976. (RX 354)

Charlotte, North Carolina - The new distributors increased from 688 in 1975 to 1014 in 1976. (RX 375) The population increased 65,000 from 1970 to 1976. (RX 357)

Conway, South Carolina - The time period for which there was testimony about difficulty in sponsoring (1973–1976) shows a slight drop in new distributors in 1973 from 326 to 307 in 1976; the total number of distributors increased from 536 in 1973 to 678 in 1976. (RX 376) The population increased 22,000 from 1970 to 1976. (RX 358)

Florida counties - Although the total number of distributors has declined from 1971 through 1976, there have been an average of over 2,000 new distributors added each year during this time. (CX 898–A, RX 378, RX 379, RX 380) The population has increased 620,000 from 1970 to 1976. (RX 361–63)

Dallas/Ft. Worth, Texas - Although there was a 64% decrease in the number of new distributors recruited from 1971 to 1973, the number increased by 56% from 1973 to 1976. (RX 377) The population increased 175,000 from 1970 to 1976. (RX 359) [61]

Kalamazoo, Michigan - The population increased 13,000 from 1970 to 1976 (RX 355) and there were an average of 775 new distributors in each year from 1972 to 1976. (RX 373)

b. Other witnesses whom I heard and find credible were called by respondents and testified that in several of these areas they had no difficulty sponsoring new distributors during the relevant time. (Rivett - Baton Rouge, Tr. 4943–44; Gregory - Dallas/Ft. Worth, Tr. 5200–01; Wespinter - Kalamazoo, Tr. 4882–84; Brown - Florida counties, Tr. 4997–5001)

151. It is relatively unlikely that the available supply of potential Amway distributors will be exhausted in any particular area. It is predominently a part-time activity. The population of the country continues to grow. Former Amway distributors sometimes come back in the business. (Max, Tr. 5950–52; RX 381) Twenty-five percent of the population move every year. (Van Andel, Tr. 1829–30, 1916) Only one-fourth of all Amway distributors engage in sponsoring (Van Andel, Tr. 1828–30), and there has been no decline in the percentage of Amway distributors who sponsor over the last five or six years. (Max, Tr. 5958–59, 5965–69; RX 415) Amway's sales trend has shown almost uninterrupted growth (RX 448) in each state as well as nationally. (RX 432) Average monthly income for Amway distributors has been increasing. (Cady, Tr. 5818) Average sales per distributor have been increasing. (Max, Tr. 5965–69) There has been an increase in the number of Direct Distributors. (CX 896)

152. Amway has had a rule against distributors misrepresenting the Amway Sales and Marketing Plan as involving only sponsoring. Amway enforces this rule by terminating distributorships or by censure, impounding bonuses and reorientation. (Halliday, Tr. 6488–97) [62]

Direct Selling

153. Direct selling companies distribute their products through independent salespersons who sell to consumers person-to-person on a commission basis, typically demonstrating the effectiveness of the products in the homes or places of business of the customers. Some direct selling companies are "multi-level," with independent distributors acting as wholesalers as well as retailers. Others are integrated down to the wholesale level, with only the retail sales to consumers being made by independent salespersons. (Van Andel, Tr. 1691–95; Granfield, Tr. 2917–18)

154. There are in the United States more than 2000 companies engaged in direct selling. (Van Andel, Tr. 1812, 1693–95; RX 403) There are about 30 to 40 major direct selling companies in the United States. (Patty, Tr. 3067) Direct selling industry sales annually amount to between ten and fifteen billion dollars, about one or two percent of all retail sales. (Patty, Tr. 3068) This does not include companies selling such products as insurance, real estate, milk or newspapers. (*Ibid.*) Direct selling companies hire about two million people. (Patty, Tr. 3069) Avon is the largest direct selling company with annual sales of $1.25 billion. (Van Andel, Tr. 1693) Many direct selling companies have been acquired by large companies not previously engaged in direct selling. Some of these acquired compa-

nies include Tupperware, Electrolux and Fuller Brush. (Patty, Tr. 3146)

155. Direct selling often starts with the salesperson calling on friends and relatives but to build a business eventually requires calling on strangers. (Patty, Tr. 3088) Door-to-door selling is direct selling by knocking on strangers' doors, although the term has a broader definition meaning direct selling of all types. Amway advises its distributors to sell to friends, relatives, neighbors or persons referred by a customer. This gives the distributor an introduction to the prospect. (Van Andel, Tr. 1757–58) [63]

156. Direct selling companies usually sell high quality products, in order to recruit salespersons and to induce homeowners to allow sales persons into the privacy of their homes. The products typically are high priced items such as encyclopedias and vacuum cleaners (where the salesperson can make up for demonstrating lost sales through the high price of products sold) or low priced, frequently purchased items where the salesperson is trying to develop a regular clientele. (Patty, Tr. 3080–81) Some companies sell an expensive high quality line of products through direct sales and a different inexpensive line through retail stores. (Patty, Tr. 3102) One encyclopedia company (World Book) tried selling through a department store but found very few people would pay for the books without personal selling and demonstration afforded by direct selling. (Patty, Tr. 3102–03)

157. Direct selling provides convenience for consumers who have to travel long distances to shop or who may be confined to their homes by age or health or a number of small children. It provides product demonstration not available in retail stores. Direct selling also provides supplemental income for many people working part-time. (Patty, Tr. 3075–77) It also allows the salespersons to be their own bosses. (Patty, Tr. 3090)

158. Direct selling can provide a manufacturer with distribution of a new product without heavy media advertising and promotion costs. (Granfield, Tr. 2944–45; Patty, Tr. 3069–75)

159. Selling through independent distributors avoids fixed costs incurred by selling through employees, such as social security, unemployment compensation and employment salaries. (Granfield, Tr. 2932) [64]

160. Successful direct selling usually requires:

(a) Dependable, quality products. (Granfield, Tr. 2950; Patty, Tr. 3083) A quality product makes it easier to recruit distributors. (Cady, Tr. 5765–66);

(b) Money-back guarantee. (Granfield, Tr. 2950) An unconditional guarantee helps recruit distributors by assuring them of the quality of the product and encourages consumers to try a new product. (Cady, Tr. 5769–70);

(c) Ability to recruit, retain, train, and motivate a sales force. (Granfield, Tr. 2938–41; Cady, Tr. 5773–74; Patty, Tr. 3081).

161. Direct selling provides a channel of distribution for a relatively small or new company which has new, good products but does not have the financial resources to sell in traditional retail stores, with the high advertising and other expenditures entailed by that method. Lack of financial strength in such circumstances leads to the small innovative company being acquired by larger companies. (Patty, Tr. 3074)

162. Annual turnover of salespersons for companies engaged in direct selling of lower priced products averages about 100%. (Granfield, Tr. 2942–43; Patty, Tr. 3106) A direct selling company with less than a 60% turnover rate is doing a relatively good job of recruiting and retaining salespeople. (Patty, Tr. 3106–07)

163. Amway's annual turnover rate has usually been in the 50% to 60% range. (RX 383) [65]

164. Because of the relatively high rate of turnover among salespersons, direct selling companies continually recruit new salespersons. (Patty, Tr. 3103–04; Cady, Tr. 5778) Recruiting is essential to a direct selling company. (Patty, Tr. 3103)

165. Some direct selling companies use employees to do most of the recruiting of new salespersons. Independent contractors do the selling, and may be paid a small reward for referring a new recruit. Avon, Electrolux and greeting card companies use this system in the United States, although overseas Avon and Fuller Brush use the same system of recruiting as Amway. (Patty, Tr. 3153; Van Andel, Tr. 1695, 1889; Granfield, Tr. 2959–60)

166. Amway pays about 60% of its sales dollar to distributors in payment for the distribution of Amway products. (Halliday, Tr. 6213–14) Distributors for other direct selling companies do not get paid any more money, if they get as much. (Halliday, Tr. 6191–93)

167. "Multilevel direct selling" refers to a firm which has a number of levels of supervision, which involve independent contractors who are not employees of the company. They are compensated on the basis of margin rather than a commission or salary. Several direct selling companies are multilevel, including most encyclopedia companies. (Patty, Tr. 3130–32; Van Andel, Tr. 1694–95)

168. Some multilevel direct selling companies have engaged in

"pyramid selling," involving "inventory loading" and "headhunting" fees. These companies have a large inventory requirement for a new distributor, and reward distributors for bringing into the business a new distributor. The result emphasizes recruiting of new distributors rather than selling the products to consumers. Typically, these pyramid companies require new recruits to buy $2000 to $5000 in inventory, with as much as half of that amount going to the recruiting distributor. (Patty, Tr. 3091–92) **[66]**

Amway's Product Markets

169. Amway started in the business of manufacturing and distributing soap and detergents, and this still is its primary activity. (Van Andel, Tr. 1680–81) Soap and detergents accounted for more than 40% of Amway's 1974 sales; polishes and sanitation goods accounted for 20%; and toilet preparations accounted for about 7%. (RX 405) Amway's 1974 sales of soap and detergents amounted to $57.9 million, accounting for 1.7% of the total sales of soap and detergents in this country. (RX 404; RX 406)

170. The market for soap and detergents in the United States includes laundry detergent, dishwashing detergent (either of which may be liquid or powder), bar soap, and a small volume of speciality products such as laundry aids and scouring cleansers. (Diassi, Tr. 5517, 5558)

171. The manufacturing and distribution of soap and detergents is highly concentrated, with the largest firm, Procter & Gamble Company, accounting for half the sales. Procter & Gamble, Colgate-Palmolive Company and Lever Brothers account for 82% of industry sales. The fourth largest firm, Purex Corporation, has 4% of sales. (RX 407; Diassi, Tr. 5516–17; Robbins, Tr. 6744) Market shares in the laundry detergent industry, in pounds produced in 1973 and 1975 were (CX 561-G):

	1973 % of Market	*1975 % of Market*
Procter & Gamble		
Tide	26.0	28.0
Cheer	8.5	8.5
Bold	4.5	4.5
ERA		4.5
Six Others	14.0	10.0
Total P & G	53.0	55.5

[67] Lever		
All-Liquid	1.1	1.5
All-Powder	6.5	6.5
Wisk	5.1	6.0
Breeze	2.4	2.4
Three Others	6.9	5.2
Total Lever	22.0	21.6
Colgate		
Fab	5.5	4.8
Cold Power	4.0	4.0
Ajax	3.0	3.0
Dynamo	0.7	2.0
Two Others	2.0	1.9
Total Colgate	15.2	15.7
Others	9.8	7.2
Total	100.0	100.0

Amway's leading product, SA8 Plus, accounted for .78% of this market. (CX 561-F)

172. The personal care products market is also concentrated. The largest firm, Procter & Gamble, has 24% of total sales. The next three, Lever Brothers, Colgate-Palmolive and Gillette, account for 25%. (RX 408)

173. Procter & Gamble Company has been in the soap business since 1837 and had 1976 sales of about $6.5 billion. Colgate-Palmolive Company started in the soap business in 1864 and had 1976 sales of about $3.5 billion. Unilever Ltd., known as "Lever Brothers" in the United States, started in the soap business in 1894 and had 1976 sales of 8.7 billion pounds sterling. (RPF 50) Two other companies manufacture and distribute some of their brands of soap and detergents nationally, Purex Corporation and Church and Dwight Company (using the "Arm & Hammer" label). (Robbins, Tr. 6718-19; Diassi, Tr. 5571-72) [68]

174. Private label soap and detergents are manufactured by a few relatively small companies and are sold by retail stores under their own brand names. Total national private label sales amount to about 5% of the detergent market. (Diassi, Tr. 5519-20, 5548)

175. The three largest manufacturers in the soap and detergents industry spent over a half a billion dollars in advertising and sales promotion in 1975. (RX 410-13) Procter & Gamble, the nation's

largest advertiser, spent over $360 million in product promotion in 1975. (RX 413) Amway spent less than a million dollars in that year for institutional (non-product) advertising. (Teska, Tr. 2751–52; RX 413)

176. Most Amway products are of the kind sold through chain food stores. (Cady, Tr. 5758) Over 95% of the retail sales of soap and detergents in this country is by grocery stores. (Diassi, Tr. 5576; Cady, Tr. 5758) Obtaining retail shelf space is critical for successful entry into the soap and detergents market. (Cox, Tr. 3819) Retail grocery stores are reluctant to add a new product unless it promises to sell quickly. (Diassi, Tr. 5535) The successful marketing of a national brand of detergent through retail stores requires that the product be available in almost every retail outlet where detergents are sold. (Diassi, Tr. 5525–26) Retail grocery chain stores are becoming increasingly concentrated. (RX 449, pp. 9–11)

177. Attempted new entry into the soap and detergents market has faced substantial increased promotional and advertising spending by Procter & Gamble. (Max, Tr. 5930–32; Robbins, Tr. 6728–30; Dunlap, Tr. 6683) Procter & Gamble also counters attempted introduction of a new brand of detergent with introduction of its own new brand. (Robbins, Tr. 6731–32; Cox, Tr. 3854–55) By producing many brands, Procter & Gamble has succeeded in occupying a great deal of grocery shelf space. (Cox, Tr. 3819) **[69]**

178. The three largest manufacturers of soap and detergents at first resisted the demand for non-phosphate detergents during the early 1970's, brought about by concern with the environmental impact of phosphate detergents. (RX 353) Several companies attempted to make and sell a non-phosphate detergent. (Cox, Tr. 3806–07) Armour & Company, established in 1863 with 1976 sales of $2.7 billion, and an established firm in the bar soap industry, attempted to enter the laundry detergent market with a concentrated non-phosphate product called "Triumph." Despite considerable promotion, the attempt was a failure. (Diassi, Tr. 5527–30) Church & Dwight ("Arm & Hammer") entered the market with a non-phosphate laundry detergent and gained about 4% of the market and was the only successful entrant with a non-phosphate detergent. Church & Dwight is one hundred years old and was already in grocery stores with an established brand of washing soda and baking soda. (Diassi, Tr. 5571–73) Following this entry, and following ecology legislation by several state and local governments, the major soap companies started selling non-phosphate detergents. (Diassi, Tr. 5570)

179. Purex Corporation started manufacturing household bleach in 1927. Purex started manufacturing dishwashing detergent in 1947

and laundry detergent in 1952. Since then, Purex has been able to sell several of its soap and detergent products nationally, using established trademarks gained through acquisition ("Old Dutch Cleanser," "Brillo," "Sweetheart" soap), some national advertising, its own sales force, and prices about 20% below those of the major soap and detergent companies. (Robbins, Tr. 6696, *et seq.*)

180. Los Angeles Soap Company has been marketing soap through retail stores for 116 years, and has been using the "White King" tradename since the turn of the century. It sells regionally in 18 western states, where it has 2% of the market, and prices low enough to allow the grocer to double and sometimes triple the profit he would make selling national brands. (Dunlap, Tr. 6640–42, 6653–54, 6670) In the early 1960's, Los Angeles Soap Company tried to enter the eastern market with a plant at Framingham, Massachusetts. The expansion failed and the plant was sold as scrap. (Dunlap, Tr. 6671–72) [70]

181. Except for the non-phosphate detergents, there has been virtually no new successful entry in the national market for sales of soap and detergents through retail stores in the last thirty years. (Cox, Tr. 3799, 3805; Diassi, Tr. 5523–33; 5571–72; Granfield, Tr. 2936–37; Dunlap, Tr. 6670–72, 6676–77) The market has been increasing at a rate of about 4% a year since 1954. (Cox, Tr. 3807)

182. Amway's laundry detergent sells at retail for slightly more per use than the detergents of the major soap and detergents companies, and slightly less if Amway's large size product is purchased. (Max, Tr. 6038–45) On a cost per use basis, in 1967, SA8 was less than 3¢ and Tide was about 7¢. At this time, SA8 use direction was 5/32 cup per washload and Tide was 1.75 cup. The cost per use drew close in 1968 when the use direction was changed: SA8 1/4 cup and Tide 1.25 cup. In 1972, Tide again changed its use direction to 1 cup per washload, in response to "phosphate down the drain" legislation. (CX 561–Z–11 - 12) Since then SA8 has cost about 1¢ to 2¢ per use more than Tide and the other leading laundry detergents. Sold in the large size (100 lbs.), however, SA8 has a lower per use cost than any laundry detergent. (CX 561–Z–14) In 1973, Amway introduced SA8 Plus, selling at retail for about the same as SA8, but apparently superior in cleaning power to either SA8 or Tide. (CX 561–Z, Z–3 to Z–4) And, unlike detergent purchased at the grocery store, Amway's products are delivered to the consumer's home. (Max, Tr. 6045)

Amway Is a Substantial Industrial Company

183. Amway's United States sales have grown from $4.3 million

in 1963 to $169.1 million in 1976. Worldwide sales of Amway products in 1976 amounted to about $205 million. (RX 431, RX 448) [71]

184. Amway employed over 1,500 persons in 1976 at its plant in Ada, Michigan, with an annual payroll of $19 million. The plant represents a capital investment of $56 million. In 1976, Amway paid over $60 million to its distributors, over $41 million for raw materials, and $11 million to third parties for transportation of Amway products. (RPF 248)

185. All but a few of the regular-line products sold under the Amway name are manufactured by Amway or its subsidiary, Nutrilite Products, Inc. (Van Andel, Tr. 1805) Amway's plant and equipment are modern and efficient. (RX 68 to RX 277) Amway follows recognized industry standards of good manufacturing practice. (RPF 90) It has a substantial research and development operation and expends generally as much per sales dollar as larger competitors in the personal care products field. (RPF 86)

186. Amway's products have very high consumer acceptance. A market study in the record shows that of 37 brands of laundry detergent, Amway's product, with only a very small market share and no national advertising, was third in brand loyalty. (Cady, Tr. 5823) Amway's dishwashing liquid soap led all 16 brands surveyed in consumer acceptance. (Cady, Tr. 5819–22) In each of the markets for automatic dishwasher detergents, detergents for fine clothing, bleaches, rug cleaners, and laundry additives, Amway's products were second in brand loyalty. (Cady, Tr. 5822) Professor Cady, a marketing specialist from the Harvard Graduate School of Business Administration, testified that (Tr. 5823):

> What this means overall is that consumers are obviously well served by the products that Amway supplies them with. In fact, they are so well-served, in the face of a large number of available substitutes, they purchase Amway products to a degree which is almost unknown to other brands in the market.

[72] Amway has achieved this consumer acceptance for its products while having no more than 1.7% of any market in which it competes (RX 406) and while spending a total of about two million dollars for advertising and sales promotion for the years 1972 through 1975, while its top five competitors were spending about 2.3 billion dollars for that purpose. (RX 410 to RX 413)

187. Amway, through its distributors, provides services to consumers not readily available when products are purchased at a retail store. Amway has a 100% money-back guarantee which permits a customer who is not satisfied with an Amway product to return it with the choice of replacement, repair, credit, or refund of full

purchase price (RPF 93, 94, 98) Distributors provide the service of home or commercial delivery at the time convenient to the customer, including weekends and evenings. (RPF 98(a)) Amway ditributors demonstrate and explain product use. (RPF 98(b) and (c)) Distributors perform water hardness tests and recommend the use of a dishwashing detergent for hard or soft water. (RPF 98(d)) Amway and its distributors provide advice for safe product use. (RPF 98(e), 98(i)) Distributors leave sample products with customers for trial use before purchase. (RPF 98(f)) Distributors install Amway products when necessary, such as smoke detectors, and deliver to the laundry room 100 lb. and 85 lb. boxes of detergent. (RPF 98(m)) [73]

DISCUSSION

The following discussion is intended to summarize and supplement the foregoing findings of fact and to present conclusions of law derived from the facts as found.

Summary

Amway was founded in 1959 by Jay Van Andel and Richard M. DeVos, who continue as its principal executives and stockholders. Prior to that time, they sold Nutrilite food supplements door-to-door and headed a large group of distributors. They began having supply problems and started looking for different products to sell. They looked for readily consumable, low-priced, repeat sale products which would be different than those found in retail stores.

Mr. Van Andel and Mr. DeVos started distributing a liquid biodegradable detergent[5] which they named "LOC." A few months later, they acquired the small manufacturer of LOC, moved the assets to Ada, Michigan, and started manufacturing their own products under the Amway label. Amway's second product, also biodegradable, was a powder laundry detergent, SA8. Amway continued to introduce new products and now manufactures and sells more than 150, but its main product market continues to be soap and detergents, accounting for more than 40% of sales. [74]

Amway's principal products are of the kind that are sold in chain food stores. These markets are dominated by a few large manufacturers, of which the largest is Procter & Gamble. Procter & Gamble sells about half of all of the soap and detergents sold in this country, and one-fourth of the personal care products. The three largest firms

[5] Synthetic detergents have largely replaced soap for laundry and dishwashing purposes in the last 30 years, being chemically different and much more effective. (Diassi, Tr. 5573-74) "Biodegradable" means that the ingredients of the detergent are broken down by natural biological action, helping to eliminate foaming problems in lakes and streams. (Halliday, Tr. 6095, 6154)

in the soap and detergents market sell over 80% of total market sales and this dominance existed prior to Amway's origin. *FTC* v. *Procter & Gamble Co.,* 386 U.S. 568, 572–73 (1967). Entry into this market has been blocked for thirty years by the major soap companies by product differentiation achieved through advertising, by retaliatory pricing and promotions, and by brand proliferation.[6]

Amway entered the market with biodegradable detergents. Mr. Halliday, an officer of Amway, was asked (Tr. 6154):

Q. At the time of introduction of LOC and SA-8 by Amway, do you know whether other detergents were then biogradeable [sic]?

A. I know that none of the detergents marketed by the big three soapers were or did contain biodegradeable ingredients at that time.

Q. How long afterward did the detergent industry essentially go biodegradeable?

A. It was up to 10 years afterwards.[7]

[75] Amway marketed its products by selling directly to consumers in their homes through a large number of salespeople. These independent distributors find the customer, and explain, demonstrate and deliver the products. Most of them work part-time. Three out of four quit after the first year.[8]

Some promoters posing as direct selling companies have rewarded recruiting itself in "pyramid" plans, involving "headhunting" and "inventory loading." Recruits earn money by securing further recruits, and there are few product sales to consumers. In order to recruit an effective sales force, Amway encourages its distributors to sponsor new distributors. This is not, however, a pyramid plan. In the Amway system, the incentive to recruit comes from the commission distributors receive on product sales by sponsored distributors in their organizations. But, by several rules, Amway requires that commissions are not paid unless the products are sold to consumers. Distributors must each sell to ten retail customers every month; the distributors must certify that 70% of the products purchased by them during the month have been resold; and inventory loading is further deterred by a rule requiring distributors

[6] To some extent the effect of these practices on consumers has been mitigated by the growing concentration and power of food chains and their tendency of using soap and detergents as loss leaders. (Diassi, Tr. 5534; Finding 176)

[7] In typical oligopolistic conduct, the major soap companies were slow to react to public demand for non-phosphate detergents in the early 1970's, allowing successful entry by at least one manufacturer selling through food stores. (Finding 178)

[8] Amway's turnover rate among distributors is better than most direct selling companies. (Findings 148, 162–163)

to buy back the inventory of any of their sponsored distributors leaving the business.

Amway has successfully entered the soap and detergents market because its distributors sell directly to consumers in their homes or businesses, rather than through retail grocery stores. Amway has achieved this method of distribution through several restraints on its distributors, including the retail store rule, the cross-group selling rule, and regulation of its distributors' advertising. These are reasonable vertical restraints. However, respondents went too far in controlling intrabrand competition while promoting interbrand competition. In addition to the beneficial restraints, respondents also stopped Amway distributors from competing among themselves for customers and fixed the prices at which Amway products are sold among distributors and to consumers. [76]

Distributor Restraints Are Vertically Imposed

The theory of the complaint anchors on the alleged horizontal nature of restrictions imposed on Amway distributors. Complaint counsel argue that the Amway Distributors Association is:

> [R]un by a clique of the most successful Amway Distributors. It exists for the sole purpose of protecting the interests of the successful from the hoards of competitors and newcomers who enter the distribution stream daily. Its mission is protection and its clout is termination. The Association is the root cause of all of the Section 5 violations, including the very existence of the Amway Sales and Marketing Plan. (CB, p. 3)

Complaint counsel state that about 35 Nutrilite distributors, including Mr. Van Andel and Mr. DeVos, decided collectively (1) that they needed a product, found one called "Frisk," and (2) that the "Marketing Plan" with its restrictions should be imposed on distributors. The uncontradicted testimony of Mr. Van Andel tells a different story. He testified that the Nutrilite distributors started having problems with their suppliers in 1959. (Van Andel, Tr. 1673–76):

> At that time, in order to attempt to bring this intramural fight to a conclusion and arbitrated, if you wish, a small group of distributors were appointed, of which I became the chairman, to try to work with both companies and try to work out an arrangement that would bring peace and tranquility back. [77]

> The arrangement to do this was not entirely successful. I met many times with the principals of both companies and this arrangement culminated in an offer by one of the companies to me to become president of their company. Mr. DeVos and I discussed this in some detail and we realized that the inherent problems were not being solved because it appeared to us the inherent problems were with the people who owned

those companies and that those problems would continue regardless of who managed them.

It appeared to us therefore the Nutra-Lite [sic] structure, the companies behind the Nutra-Lite distributing organization were in great danger of collapsing, that the time and effort they were putting into fighting amongst themselves instead of competing in marketplace would eventually destroy the company. Therefore it appeared to us if we were going to survive in business, if we were going to be able to continue and have some return on our 10 years of effort, it would be best if we would go into business ourselves, producing our own products and selling them through our own sales organization and controlling the entire distribution and manufacturing operation.

This then necessitated a very careful change in the distributor organization that we had built, which had been very strongly built with an allegience to Nutra-Lite food supplement as a product to sell. The Nutra-Lite organization as well as the Amway organization is built entirely of volunteers, people who voluntarily are distributors and it is very important if you are going to go into a different direction that the volunteers follow. They don't have to. They could all quit. [78]

So it was very necessary for us, we felt, to get their concurrence that our plans were good ones and that they would continue with us.

In order to do this, we felt we had to communicate with them very closely, and that at that time we put together a structure which I think you are familiar with, called Amway Distributor Association.

That association at that time was called the American Way Association; its name was changed later.

Its primary purpose was to attempt to communicate and hold together what business we had until we could shift gears and develop our own manufacturing operation, develop our own products and continue on.

This was basically the genesis of the Amway Corporation and we began with one or two products and continued on until where we are today.

Q. Did the American Way Association, when it was formed, have any particular products to distribute through the organizations of its members?

A. The American Way Association was never developed to be a product distributing structure. Rather it was in the nature of an association of independent contract or [sic] business people whereby they would have a means of formalized communication with Mr. DeVos and myself who proposed to set up the product distribution and manufacturing operation.

We developed a system whereby a board of directors of the association could be elected, a system whereby we could meet with them from time to time and discuss our plans and communicate with them and hopefully get them to agree to continue with us. [79]

Q. Did the association or did the association members determine a particular product that would be distributed through its organizations?

A. The association members were polled by us and asked by us if they were interested in having us supply certain products.

Q. "Us," meaning yourself, Mr. DeVos?

A. By "us" I should say, Amway Corporation, Mr. DeVos and myself and the company that we built behind that.

Two of the 35 former Nutrilite distributors who became Amway distributors were called as witnesses. Walter Bass, the first president of the ADA, acknowledged that Mr. Van Andel and Mr. DeVos created Amway. He was asked about the formation of Amway and the ADA. (Bass, Tr. 70–71):

Q. Were Richard DeVos and J. Andel [sic] some of the key people involved?

A. They were the key people.

Q. They were more key than any other persons, that is what you are saying?

A. It was their idea.

Q. Were they doing business under the name Ja-Ri Corporation?

A. Yes.

Q. For what reason, if you know, did these key people, yourself included, get together to form this association?

A. We foresaw some problems in the Nutra-Lite organization that alarmed us and rather than to allow is [sic] to just go out of existence, the idea of Amway was developed.

[80] Mr. Bass could name only 6 of the 35 Nutrilite distributors who allegedly started Amway. (Bass, Tr. 68–69) Bernice Hansen, also one of the 35 Nutrilite distributors who became Amway distributors, was called. She too identified Mr. Van Andel and Mr. DeVos as the persons who "started Amway." (Hansen, Tr. 3301–02)

The impetus for the restrictions imposed on distributors in this case clearly came from above. Mr. Van Andel and Mr. DeVos started Amway, not the 35 Nutrilite distributors. Mr. Van Andel and Mr. DeVos used the association of distributors to communicate and control the distribution of the products they were to make, but the thrust to build the Amway organization as it now stands came from those two individuals, not from a committee. (Findings 19–25)

Here the dealers do not control the manufacturer, as in *United States* v. *Topco Assoc., Inc.*, 405 U.S. 596 (1972) and *United States* v. *Sealy, Inc.*, 388 U.S. 350 (1967). Nor did the dealers here prevail upon the manufacturer to impose the restrictions. *United States* v. *General Motors Corp.*, 384 U.S. 127 (1966). Mr. Van Andel and Mr.

DeVos initiated and orchestrated the scheme, and notwithstanding the willing participation of the distributors, Amway is the dominant partner. *Newberry* v. *Washington Post Co.,* 438 F. Supp. 470, 474 n.5 (1977).

When Amway was created, Mr. Van Andel and Mr. DeVos, through the Ja-Ri Corporation, were distributors as well as manufacturers. (CX 53-J) But in replacing the previous suppliers in the Nutrilite organization, and adopting the distribution system from that organization, they were acting essentially alone.[9] The restraints are not, therefore, "primarily 'horizontal.' " *The Coca-Cola Company,* Dkt. 8855, Commission Opinion p. 8 (Decided April 7, 1978). [81] "[O]nly by ignoring the essential relationships which exist" between Amway and the distributors might it be concluded that the restraints are horizontal. (*Ibid.*)

Horizontal Cooperation by ADA

Complaint counsel argue that respondents are engaged in an unlawful group boycott because the ADA is the "final arbiter of disputes and interpretations of the Code of Ethics and Rules of Conduct." (CB, p. 5)

The Amway Distributors Association of the United States is a voluntary association of independent Amway distributors. (Findings 11-12) Voting membership in this trade association is open to qualified Direct Distributors. (Finding 13) Voting members may attend annual meetings to receive reports concerning Amway and elect ADA Board members. (Finding 76)

The ADA Board meets four times a year. Amway seeks advice from the ADA Board concerning any changes in Amway rules. (Finding 78) Rather than an agreement among equals, this aspect of the ADA is a means by which Amway controls the distribution of its products through independent salespersons by convincing them—not coercing them—to accept changes in the Amway Sales and Marketing Plan. Mr. Halliday testified that (Tr. 6612-13): [82]

> As a matter of policy, Amway Corporation presents the proposals for changes of rules to the board for educational purposes, instructional purposes, for feedback from the board as representative of the distributor organization as to the kind of reaction to the change, as to the timeliness of implementing the rule changes; it is an opportunity to sell the board so that they and their distributors in their organizations wil enthusiastically support the notion of moving ahead in that direction. Again, we ar talking about a group of volunteers.

[9] There is some evidence that one of the distributors suggested to Mr. Van Andel and Mr. DeVos that t product "Frisk" be distributed. (Halliday, Tr. 6541) The preponderance of the evidence, however, supports t finding that the genesis of Amway was vertically imposed. *Cf. Sandura Company* v. *FTC,* 339 F.2d 847, 857-58 ((Cir. 1964).

You just don't say tomorrow we are going to propose a new rule and bang this is the rule, or tomorrow we are going to change a rule and bang this is the rule. What we try to do is to present it to the board and the distributor organization [so] that when the date of implementation occurs, which we determine, that it is accepted with full enthusiasm and that people move ahead voluntarily, then, to act in accordance with those changes.

The ADA Board of Directors also acts as an arbitration panel for disputes in which Amway decides to discipline a distributor for a rule violation. If Amway decides not to impose sanctions for a violation of a rule, the ADA has no authority to recommend the sanction. (Van Andel, Tr. 1838–39) If Amway does impose a sanction, the distributor may bring the matter before the ADA Board. (Finding 80) Amway has bound itself by the decision of the Board on these arbitration cases. (Halliday, Tr. 6180)

Group boycotts are *per se* unlawful. In *Fashion Originators' Guild* v. *FTC,* 312 U.S. 457 (1941), a group of "original designers" agreed to refuse to sell their creations to retailers who had been selling copies of original designs. [83] The purpose of the agreement was to prevent style piracy, and the Court held that it was an unlawful group boycott and upheld the Commission's refusal to hear evidence on the reasonableness of the methods pursued by the combination. The issue involving the ADA, then, is whether the self-regulation is an unlawful group boycott like the *Fashion Originators'* case or whether it is pro-competitive.

Self-regulation by an industry has been allowed by the courts where:

(1) There is a legislative mandate for self-regulation. *Gordon* v. *New York Stock Exchange,* 422 U.S. 659 (1975).

(2) The collective action

(a) is intended to accomplish an end consistent with the policy justifying self-regulation
(b) is reasonably related to that goal, and
(c) is no more extensive than necessary.

Denver Rockets v. *All-Pro Management, Inc.,* 325 F. Supp. 1049, 1064 (D. Cal. 1971).

The association provides procedural safeguards which assure that restraints are not arbitrary and which furnish a basis for judicial review. *McCreery Angus Farms* v. *American Angus Ass'n.* 379 F. Supp. 1008, 1018 (S.D. Ill. 1974), *aff'd,* 506 F.2d 1404 (7th Cir.); *Silver* v. *NYSE,* 348 F. Supp. 1185 (S.D.N.Y. 1972).

The main purpose of the self-regulation by the respondents meets this test. (Findings 22, 78 and 80) [84]

"In an industry which necessarily requires some interdependence and cooperation, the *per se* rule should not be applied indiscriminately." *Hatley* v. *American Quarter Horse Ass'n,* 552 F.2d 646, 652 (5th Cir. 1977). In the direct selling of soap and detergents, "a few rules are essential to survivial." (*Ibid.*) Participation by the ADA as an arbitration panel does not by itself, without consideration of the specific rules involved, amount to a naked restraint of trade. An analysis of each rule alleged to violate the law is necessary to understand fully whether it is anticompetitive.

Discontinuance and Remote Evidence

Respondents argue generally that a substantial number of the exhibits relied on by complaint counsel are dated six years or more before the issuance of the complaint, and specifically that the customer protection rule, alleged to be evidence of retail price fixing, was dropped by Amway at the beginning of 1972.

Respondents rely primarily on *New Standard Pub. Co.* v. *FTC,* 194 F.2d 181 (4th Cir. 1952). In that case, the Commission issued an order six years after the last evidence was taken and the circuit court reversed and remanded. The court did not hold that the case was moot, but sent it back for more recent evidence. Respondents also rely on *Oregon-Washington Plywood Co.* v. *FTC,* 194 F.2d 48 (9th Cir. 1952). That case involved two groups which allegedly conspired to commit trade restraints. The respondents admitted the restraints had occurred up until seven years before the complaint issued and denied any further violation after that time. Complaint counsel did not put on any evidence, and the Commission issued an order based on the pleadings, relying upon a rule that a conspiracy once shown to exist is presumed to continue until abandonment is shown. The circuit court reversed, holding that the answers to the complaint denying the conspiracy put the matter in issue [85] and since complaint counsel did not put on any evidence and there was no such presumption, the complaint should have been dismissed. The court also held that there was nothing to show that the discontinued practices would be resumed and that discontinued practices do no provide a basis for an order.

The two issues here involve (1) the alleged discontinuance as defense, and (2) the age of the evidence.

The case law is clear that discontinuance of an illegal practice do not of itself render inappropriate the entry of a cease and des order. *Oregon-Washington Plywood Co.* v. *FTC,* 194 F.2d at 50-

The propriety of such an order in any particular case must depend on a consideration of all the surrounding facts and circumstances; and where the activities charged have been discontinued, the elements of time, volition and general attitude of the respondents in respect of the cessation are necessarily factors of prime importance. Parties who have abandoned their challenged practices only after proceedings are brought against them are in no position to complain of a cease and desist order. In such a case the discontinuance can hardly be thought voluntary.

And the cases have clearly held that discontinuance after the investigation has begun will not be held voluntary. *Giant Food, Inc.* v. *FTC,* 322 F.2d 977, 986–87 (D.C. Cir. 1963); *Cotherman* v. *FTC,* 417 F.2d 587, 594–95 (5th Cir. 1969); *Coro, Inc.* v. *FTC,* 338 F.2d 149, 153 (1st Cir. 1964), *cert. denied,* 380 U.S. 954 (1965). Here, Amway officially discontinued the customer protection rule in 1972 (although Amway has continued to urge distributors that such competition is "unethical"). (Findings 90–93) [86] Mr. DeVos told Direct Distributors in Dallas in 1971 the reason that the customer protection rule was goind to have to go (DeVos, CX 1037–E):

And I must be very frank with you—I think that the rule will have to go and it'll have to go probably in the not too far distant future. And the reason it'll have to go is that I don't think we can live with it any longer, I don't think we are consistent in our philosophy and I don't think the governmental people are gonna look at it favorably. They've already looked at it and they say that's a restraint of trade type thing, you see.[10]

The record shows that Amway knew of the Federal Trade Commission investigation in this case before January of 1970. (CX 345–E) The discontinuance of the customer protection rule by Amway was not the kind of abandonment of an illegal practice which gives assurance that it will not be repeated in the future. *Holiday Magic, Inc.,* 84 F.T.C. 748, 1050 (1974).

Some of the evidence relating to price fixing and customer restraints in this case goes back to the 1960's. Such evidence is relevant to show a continuing effort to fix prices and restrain competition. See *FTC* v. *Cement Institute,* 333 U.S. 683, 703–05 (1948), where the Court held that the Commission had properly regarded evidence as far back as 1902 in the price fixing case. And in *P.F. Collier & Son Corp.* v. *FTC,* 427 F.2d 261, 275 (6th Cir. 1970) the respondent had argued that the evidence was cold and stale, but the court upheld the Commission's order, stating that the fact that the evidence may be old does not mean that an order issued upon it is stated. The court held that where an illegal trade practice is capable of being perpetuated or resumed, it may be presumed to

opping a practice after a visit by government investigators does not show permanent abandonment. *United Parke, Davis & Co.,* 362 U.S. 29, 47–48 (1960).

have been continued, [87] and an order may issue to prevent it, even upon a showing that it has been discontinued or abandoned.[11] Here, Amway had an explicit policy of retail price fixing in the middle 1960's, and, until 1972, a written policy of preventing distributors from competing with each other. This evidence raised a presumption that these policies have continued or could be resumed.

Count I—Price Fixing

The Rules of Conduct of the Amway Sales Plan published in 1963 required that distributors sell Amway products to consumers at the specified resale price. (Finding 109) It also provided that no unauthorized discount be given on sales to other distributors, and fixed the resale charge for freight. (Finding 109–111) The record does not show when Amway stopped using this sales manual or whether distributors were ever clearly notified that it does not express Amway's policy.[12] Such resale price maintenance is *per se* unlawful. *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911). [88]

The Career Manual for Amway distributors published in 1968 specified that distributors should not cut the retail price in fund-raising drives. The fund-raising drive policy was changed in 1969, upon the recommendation of the ADA, so that the retail sales now are made by the distributor rather than by the fund-raising organization. (Finding 112) By implication at least, this change was made with the intent to control resale prices. While the policy requiring the distributor rather than the fund-raising organization to make the retail sales might be reasonable in itself, when coupled with unlawful intent it became an unreasonable restraint of trade. *United States* v. *Columbia Steel Co.*, 334 U.S. 495, 522 (1948).

While much of the evidence of price fixing agreements is relatively old, it raises a presumption of continuity which respondents have not rebutted.[13] After express contracts were no longer used, the other vertical restraints on advertising, selection of customers and source of supply controlled price competition. The customer protection rule alone stopped all competition for a retail customer for 30 days after a distributor made a sale to that customer. (Finding 90) The purpose

[11] The court in *P.F. Collier* specifically declined to follow *Bearings, Inc.*, 64 F.T.C. 373 (1964), relied on by respondents. 427 F.2d at 275 n.13.

[12] On retail sales, Amway's price lists obliquely refer to "suggested retail for sales tax" or "retail sale computation base." (Finding 113) The record does not show that Amway has ever clearly told its distributors they are free to set their own prices on sales to other distributors or to consumers.

[13] *Holiday Magic, Inc.*, 84 F.T.C. 748, 1050 (1974). Amway was able to produce distributors who do use competitively to obtain wholesale and retail sales. (RPF 223–229) Considering the number of distributors of Amway products, this is not surprising. Furthermore, evidence of price competition conflicts with state Amway officers who say that very little price cutting occurs. (Finding 127)

the customer protection role was "to prevent cut throat competition" between distributors. (Halliday, CX 486)[14] [89] Amway officially discontinued the rule only after Federal Trade Commission investigators looked at it and said it was a restraint of trade. (DeVos, CX 1037-E) Amway continues to support the principle of the customer protection rule by calling such competition "unethical." (Finding 93) One of the distributors testified to the effect of the customer protection rule in her organization. Mrs. Joan Spradley was asked by some of the distributors in her group if they could discount retail prices. She said "no." Mrs. Spradley testified that (Tr. 1340):

> It was our understanding that the retail price was a set thing, and that we did not compete with one another for customers. In other words, we understood when a Amway distributor made a contact, for instance, if I came to you and sold you Amway products, then you became my customer and under our ethics, another Amway distributor would not go and try to sell to you or undercut my price or anything like that. I would sell to you at the retail price and they would leave you alone and go get their own customers.

The customer protection rule has been used to support and continue the unlawful price fixing found herein and must be prohibited. "A practice which lessens price competition touches the core of the free enterprise system." *The Coca-Cola Company, et al.,* FTC Dkt. 8855 (Final Order dated April 7, 1978), at p. 89.

Amway threatens to terminate the distributorship of distributors who cut the retail price of Amway products. (Findings, 115, 117, 119) And where the price cutting distributor is not buying directly from Amway, the threat is made in combination with Direct Distributors. (Findings 115–117) Amway also encourages Direct Distributors to do a "sales job" on price cutting distributors, pointing out the reckessness of this conduct (Finding 115), and Amway urges that this hould be done through a combination of Direct Distributors. 'inding 116) [90]

Amway distributors promote the policy of discouraging price tting through their combined efforts with Amway. Price cutters ' quickly reproached by other distributors, and it is not long until \way applies pressure directly and through Direct Distributors to) the "disturbance in the field." (Findings 117, 121) Many Amway ributors are inexperienced in business (Van Andel, Tr. 1814–15) it does not take much pressure to stop price cutting. They ly comply with the demands of Amway and other distributors p cutting retail prices. (Finding 117) *Holiday Magic, Inc.,* 84 748, 1049 (1974). While only a few distributors were actually

[14] Amway market study in 1970 warned that lifting the customer protection rule could lead to "excessive g" by distributors. (CX 522-Z-215)

coerced on this record (Findings 117, 121), price fixing agreements are unlawful *per se* regardless of enforcement. *Holiday Magic, Inc.*, 84 F.T.C. 748, 1049 (1974). And where the unlawful intent to fix prices is coupled with a single instance of coercion, even the Sherman Act will be violated. *Newberry* v. *Washington Post Co.*, 438 F. Supp. 470, 480–82, 485 (D.D.C. 1977). Here, the action by Amway in combination with Direct Distributors and other distributors to achieve uniform prices for Amway products would probably violate the Sherman Act, *United States* v. *Parke, Davis & Co.*, 362 U.S. 29, 45–46 (1960), and clearly violates Section 5 of the Federal Trade Commission Act which was intended by Congress to stop such conduct before it amounts to "full blown" violations of the Sherman Act. *FTC* v. *Brown Shoe Co.*, 384 U.S. 316, 320–22 (1966)

Amway quickly admonishes distributors who advertise Amway products at discount prices. (Findings 117, 119, 121) For example, Roger Laverty, an Amway distributor from Pompano Beach, Florida, had prepared sales literature using the Amway trademark, featuring price comparisons on Amway and competing products. An Amway Administrative Legal Assistant wrote to Laverty stating Amway's view of the law (CX 989–B): "[C]ost comparisons themselves are now strictly 'taboo,' are not used by Amway and should not be used by Amway distributors." On the contrary, however, the law protects price competition by truthful advertising. See *Sunbeam Corp.* v. *Payless Drug Stores*, 113 F. Supp. 31, 44 (N.D. Cal. 1953), citing *Prestonettes, Inc.* v. *Coty*, 264 U.S., 359, 368 (1924) (Mr. Justice Holmes): [91]

> A trade mark only gives the right to prohibit the use of it so far as to protect the owner's good will against the sale of another's product as his. . . . When the mark is used in a way that does not deceive the public we see no such sanctity in the word as to prevent its being used to tell the truth. It is not taboo.

Amway completes its control of retail prices by extending the bu back rule beyond its legitimate purpose—to prevent invento loading. Amway urges its distributors not to allow freight damag Amway products to reach the hands of salvage stores or if they dc buy them up before consumers can get to them. (Findings 122, 1

According to the Amway Career Manual published in 1968, Board of Directors of the association "meets at least three tim year to act on approval of product classifications for distrib under the Amway name, sales policies, pricing policies, discoun refund schedules . . . ." (CX 59–J) The record does not shov this policy has been discontinued. In fact, the ADA has cor

with Amway in setting retail prices and has recommended changes and agreed with Amway on retail pricing policy. (Findings 79, 112(b))

Generally, a manufacturer who sells through independent wholesalers and retailers would prefer the lowest retail price possible, since that usually means increased sales and higher manufacturer revenues. *Continental T.V., Inc.* v. *GTC Sylvania, Inc.*, 433 U.S. 36, 56 n.24 (1977). Here, however, Amway's self-interest in preventing price cutting was indicated by Mr. Van Andel who reported in 1970 that a market test of Amway catalog products proved that the same products sold for a higher price led to 50% more sales, since the direct selling [92] distributors worked harder to obtain the higher margin. (CX 638-H) Since the higher price encourages distributors to do more selling, Amway does not sponsor special sales by granting extra discounts, and Amway sets the retail price of its catalog goods "competitive with the average department store level—without the specials." (*Ibid.*)[15]

The number of reports of distributors cutting the retail price of Amway products usually is something less than a dozen. (Halliday, CX 1040-H; DeVos, CX 1037-D). The "methods" employed by Amway and its distributors are "as effective as agreements in producing the result that 'all who would deal in the company's products are constrained to sell at the suggested prices.' " *United States* v. *Parke, Davis & Co.*, 362 U.S. 29, 42 (1960) (quoting *FTC* v. *Beech-Nut Packing Co.*, 257 U.S. 441, 455 (1922).

Empirical studies show that resale price maintenance does raise ...etail prices above what they would otherwise be. *Hearings on S.408 ...fore the Subcommittee on Antitrust and Monopoly of the Senate ...diciary Committee*, 94th Cong., 1st Sess., p. 174 (1975). Such evidence ... Congress to repeal the Miller-Tydings and McGuire Acts, which ...mitted states to enact "fair trade" laws authorizing sellers to ...blish resale prices for branded commodities. 15 U.S.C. 1, 45 ...ective March 11, 1976). "Price is the 'central nervous [93] system of ...conomy.' " *Nat'l. Soc. of Prof. Engineers* v. *United States*, 435 U.S. ... 1978-1 Trade Cases ¶61,990 at 74,225 (decided April 25, 1978). ...ndents regularly treat the subject of resale prices, however, in a ...r and informal manner.[16] "Price is too critical, too sensitive a

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...68, an Amway employee reported that retail prices on Amway products "are in most instances ... higher than comparable items in conventional retail outlets." (CX 558-B) Customer complaints about ...t prices (CX 700-J) may have changed Amway's pricing policy. In 1970, retail prices set for most ...og products were set below the prices for comparable items sold in department stores but above prices ...scount stores. (CX 522-Z-176 to 177)

...Vos' advice to Direct Distributors on how to handle price cutting distributors exhibits a lack of ...nsistent with the sensitive nature of the subject. He incoherently mixes warnings of price fixings ...erminate the distributor or to badger, threaten and otherwise "do a sales job on the guy" because ...d against anything that's dog eat dog." (CX 1037-E to I)

control to allow it to be used even in an informal manner to restrain competition." *United States* v. *Container Corp. of America,* 393 U.S. 333, 338 (1969). **[94]**

Counts II and III of the Complaint

Count II of the complaint alleges that respondents unlawfully allocate the Amway distributors' customers and source of supply. This allegation deals primarily with two rules of the Amway Sales and Marketing Plan: (1) the retail store rule requiring distributors not to allow Amway products to be sold through retail stores (Finding 85), and (2) the cross-group selling rule requiring distributors to sell Amway products only to distributors they have recruited and to buy Amway products only from their sponsor. (Finding 81)[17]

Count III of the complaint alleges that Amway restricts the advertising and promotional activities of the distributors. This allegation deals with the detailed regulation of its distributors' advertising. (Findings 94–108)

These rules are vertical in nature. Vertical customer allocations and requirements contracts are not the kind of "agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Northern Pac. R. Co.* v. *United States,* 356 U.S. 1, 5 (1958). The vertical restrictions here must be analyzed under the rule of reason. *Continental T.V., Inc.* v. *GTE Sylvania, Inc.,* 537 F.2d 980 (9th Cir. 1976), *aff'd,* 433 U.S. 36 (1977). **[95]** The *Sylvania* case involved location restrictions imposed on dealers by a small manufacturer competing in an oligopolistic market. 537 F.2d at 1001. The Court held that some vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain marketing efficiencies in the distribution of its products. Among these "redeeming virtues," the Court found that established manufacturers may use them to induce retailers to provide services necessary to the efficient marketing of the products and that new manufacturers may use them to induce competent and aggressive retailers to do the work necessary to distribute products unknown to consumers. 433 U.S. p. 55. The Court overruled the vertical *per se* rule stated in *United States* v. *Arnold, Schwinn & Co.,* 388 U.S. 365 (1967) and, while foreclosing the possibility that particular applications of vertical restrictions might justify *per se* prohibitions, the Court clearly that departure from the rule of reason standard must be based

[17] The customer protection rule has been considered a part of the unlawful price fixing combination, 88–89.

demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing. 433 U.S. at 59. No such economic effect has been proved here and the restrictions should not be treated under the *per se* rule.

Complaint counsel argue that: "Restrictions such as these should not be individually analyzed, for they work their toll on competition collectively." (CRB, p. 37) Nothing in the record compels the conclusion, however, that the restrictive provisions were employed in combination in an effort to eliminate or restrain competition to the detriment of consumers. *Snap-On-Tools Corp.* v. *FTC,* 321 F.2d 825, 830 (7th Cir. 1963):

> Except for the fact that the provisions are all found in one document, there is no evidence, let alone substantial, to show that these provisions were designed to be, or were employed as a *unitary device* to foster practices violative of Section 5 of the Act. (Emphasis by court.)

[96] Each restraint therefore must be analyzed individually to determine whether the preponderence of the evidence shows the prohibited purpose or effect.

The Amway Sales and Marketing Plan has involved wholesale and retail price fixing. If other restrictive practices were "ancillary" to this price fixing, or "part of a scheme involving price fixing," the result would be a *per se* violation of law. *United States* v. *Arnold, Schwinn & Co.,* 388 U.S. 365, 373 (1967); *White Motor Co.* v. *United States,* 372 U.S. 253, 260 (1963).[18] Here, however, no such finding can be made on this record. Here, the price fixing is ancillary and incidental to the other vertical restraints, to which respondents have spent most of their efforts. The other vertical restraints should therefore be judged independently from the price fixing. *United States* v. *Sealy, Inc.,* 388 U.S. 350, 351-52 (1967); *United States* v. *Arnold, Schwinn & Co.,* 388 U.S. 365, 373 (1967); *White Motor Co.* v. *United States,* 372 U.S. 253, 260, 263 (1963). [97]

Applying the rule of reason standard to vertically imposed territorial restraints, the Commission in *The Coca-Cola Company, et* FTC Dkt. 8855 (Final Order dated April 7, 1978) [91 F.T.C. 517], d that the vertical restraints involving nonrefillable bottles were roader scope than reasonably necessary[19] to achieve marketing

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n those cases, price fixing allegations in the complaints "accompanied" the allegations of other vertical ts, but the Court did not rely on that fact in deciding whether the *per se* rule should be used. The test is not price fixing allegations "accompany" allegations of other vertical restraints but whether the main and effect of all of the vertical restraints show a justifiable business reason, or whether they are mainly t fixing prices for which there is no acceptable economic basis. *(Ibid.)* The Commission referred to, but did p, this issue in the letter explaining the acceptance of a consent order in *Performance Sailcraft Inc.*, File . 2922] (Commission action dated May 2, 1978) [91 F.T.C. 869].

e the courts have split on adopting this part of the ancillary restraints doctrine (see dissenting opinion ioner Clanton in *Cola-Cola, supra,* at pp. 11-12), it was relied on in part of *Schwinn,* not reversed by

(Continued)

efficiencies by inducing capital investment, local advertising and promotional and service activities by the supplier's customers; and that intrabrand competition would be likely to invigorate price competition. The restrictions as to sales of the soft drinks in refillable bottles were, however, held reasonable because of practical marketing difficulties and consumer benefits associated with that product.

On this record, Amway's cross-group and retail store rules and its regulation of advertising, are reasonable and have provided entry to a marketplace[20] which would not otherwise have been available. (Dunlap, Tr. 6676–77) While this defense may not be a "perpetual license to operate in restraint of trade," *Siegel* v. *Chicken Delight, Inc.*, 448 F.2d 43, 51 (9th Cir. 1971), respondents' control of the distributors' marketing practices is no broader than necessary to achieve the main purpose of direct selling in an oligopolistic market.[21] [98] Furthermore, the restrictions here are not an "industrywide practice"[22] involving a "dominant brand" by an "established giant in the industry." (*Coca-Cola Co., supra,* at pp. 35, 47 and 51)

The Retail Store Rule

The Amway Sales and Marketing Plan requires that Amway products be sold directly to consumers and not through retail stores.[23] (Finding 85) Based upon evidence adduced through expert witnesses, Amway executives and numerous Amway distributors, it is apparent that the rule has preserved Amway's direct selling organization and consumer demand, and provided an incentive to distributors to furnish services to consumers.

Marketing experts gave credible testimony in this proceeding that if Amway products were sold in retail stores, distributors would lose interest in calling on consumers' homes, demonstrating and explaining products to create a demand which could be satisfied —perhaps at a lower price— at a retail store. (Finding 89) Without a demand for the products, retail stores would soon lose interest in Amway

Sylvania. The Court held that where Schwinn retained indicia of ownership it could, under the rule of reason, confine sales to franchised retailers for the reason, *inter alia,* that the restraint "was justified by, and *went no further* than required by, competitive pressures." 388 U.S. at 382. (Emphasis added.)

[20] While Amway sells a variety of products, its main business is still "selling soap." (RX 331, p. 4–A)

[21] Unlike some other direct selling companies, Amway does not prohibit distributors from selling competing products. (RX 331, p. 15-B; Bortnem - W.T. Raleigh, Tr. 697-99; Cooke - Avon Lady, Tr. 735–36; Laverty - Fuller Brush, W.T. Raleigh, Tr. 838–39). And, unlike Avon, the largest direct selling company, Amway does not assign sales territories to its distributors. (Cooke - Avon, Tr. 735; Halliday, Tr. 6192–93)

[22] Direct selling companies generally do not, however, sell their products through retail stores. (Patty, Tr. 3099–3103)

[23] Amway also prohibits distributors from selling or displaying Amway merchandise at flea markets and similar events (Finding 86) and regulates their sales through fund-raising drives. (Finding 87). The rationale for these restrictions is the same as the retail store rule and they have the same economic impact as that rule.

products. Amway would then be faced with the necessity of creating demand in the traditional way of advertising expenditures and [99] otherwise doing battle in the retail grocery stores, in a hostile oligopolistic marketplace. (Findings 171–181) Vertical restrictions on intrabrand competition may be used to allow a company to compete in an oligopolistic market. *Sylvania, supra.*[24]

The retail store rule gives Amway distributors an incentive to provide services to consumers and to create a consumer demand which would dissipate if Amway products were sold in retail stores. Amway distributors demonstrate and explain Amway products and deliver to the consumer's home. These services are typically unavailable from retail stores. (Finding 88) Because some Amway products are more concentrated than products sold in retail stores, demonstration and explanation are essential to consumer demand. (Diassi, Tr. 5529; Schroeder, Tr. 5355–56)

Vertical restraints which induce retailers to engage in promotional activities and to provide services help stir interbrand competition and should be encouraged. *Sylvania, supra; Snap-On Tools, supra,* 321 F.2d at 828–29. The retail store rule is such a vertical restraint and is lawful under the rule of reason. [100]

Cross-Group Selling Rule

The cross-group selling rule requires Amway distributors to buy Amway products only through their sponsor. (Finding 81) The distributors, in effect, promise to buy their "requirements" of Amway products from one supplier. There has been no showing on this record of any probable immediate or future market pre-emption which might substantially lessen competition. *Tampa Electric Co.* v. *Nashville Coal Co.,* 365 U.S. 320, 329 (1961).

The cross-group selling rule also provides that distributors shall sell at wholesale only to their sponsored distributors. This aspect of the rule has the same economic justification as the retail store rule.[25]

The cross-group selling rule is the basis for the Amway Sales and Marketing Plan. It provides the structure by which products, information and compensation flow from Amway to the Direct Distributors and down to the distributors engaged in making the retail sale. It provides lines of communication and responsibility insuring that distributors are properly trained and motivated and that consumers receive services provided under the Amway system

[24] Sylvania's market share was 5%, 433 U.S. 46–47 n.12, almost triple Amway's 1.7% of the soap and detergents market. (RX 406, RX 407)

[25] Amway also restricts distributors from selling non-Amway products to Amway distributors they have not sponsored. (RX 331, p. 15–B) The business reason for this restriction is to prevent a "conflict of interest." (Van Andel, Tr. 1896) The record does not show the market impact, if any, of this provision.

of distribution. (Finding 82) Used in conjunction with the performance bonus system, the cross-group selling rule gives sponsoring distributors an incentive to recruit, train, motivate and supply other distributors in order to gain a reward based on the sponsored distributors' sales volume. If sponsored distributors could buy Amway products from someone other than their sponsor, that incentive would not exist. The cross-group selling rule thus provides an alternative to payment of a "headhunting" fee as an incentive for recruiting. (Patty, Tr. 3111–13) [101]

Amway's Market Concept

Amway's marketing image was summarized well by one of respondents' expert witnesses (Diassi, Tr. 5542–43):

> I would think that it is based a great deal on the form of the product, that is, it is a concentrated product for the consumer. It is one that she has to use very little of per washload and therefore economical to use. I think that they have built in one other feeling for it and that is the idea that it is delivered directly to the home. There is a service portion that is built into the, into that product itself.
>
> I think to a certain degree that there is some exclusivity built into it, too, that you can only buy it from an Amway distributor. It is not a product that everyone can get ahold of, although I am sure Amway would like to have everyone buy the product. But I think those are the ingredients that go into it. It is a very high quality sophisticated product that almost requires somebody to tell you how to use it as opposed to something that is in a supermarket that you just go out and kind of dump into the machine.

The concept of which market a company like Amway wants to compete in has been protected by the courts which have upheld rules, more restrictive than those involved here, because they were necessary to maintain that concept. In *Evans* v. *S.S. Kresge Co.*, 544 F.2d 1184 (3d Cir. 1976), *cert. denied,* 433 U.S. 908 (1977), a department store chain licensed the use of the K-Mart service trademark and a "one stop shopping" concept to various independent food stores. The resulting retail outlet was comprised of the independent food store and the chain department store under one roof with one K-Mart sign appearing outside. The department store chain was interested in drawing on customers making frequent food purchases [102] at the grocery stores. In order to retain its reputation and market concept for high volume and low prices, Kresge required the grocery stores, *inter alia,* to agree to set prices on their non-food items (2%–5% of their volume) at prices no higher than the prices charged by the department store for the same items. The Third Circuit Court of Appeals upheld the summary judgment

for Kresge, holding that there was no violation of the Sherman Act (544 F.2d at 1193):

> . . .[T]he challenged restraint enabled Kresge to add a food component to its discount operation without causing customer confusion or threatening the low-price "K-Mart" discounting image upon which the success of K-Mart (including K-Mart Food) would depend. Therefore, far from attempting to stifle competition, the restraints had as their purpose the stimulation of business and efficiency for both the department store and the supermarket: they (the restraints) would assure that the overall operation would compete effectively in both the discount and food markets vis-a-vis other department store and food discounters. The restraints thus serve a legitimate business purpose.

The trademark licensor's market concept was also upheld in *Weight Watchers of the Rocky Mountain Region, Inc.* v. *Weight Watchers Int'l, Inc.*, 1976-2 Trade Cas. §61, 157 (E.D.N.Y. 1976). There, Weight Watchers International had licensed its trademarks and system of weight control to over 100 independent franchisees. The franchise agreement prohibited the franchise from offering "front loading" or "prepayment" plans whereby the members were asked to prepay their fees for weight control classes to be held in the future in return for which they received discounts and some meetings without charge. Weight Watchers International prohibited prepayment plans because other weight loss clubs had engaged in fraudulent practices in connection with such arrangements. The plaintiff franchisee [103] nevertheless required prepayment, arguing that it put pressure on members to attend weight classes. Weight Watchers International argued that its marketing concept was that no commitment by the member was central to its weight plan. The court held that the rule was consistent with the antitrust laws and that the franchisee had interfered with the defendant's central marketing concept (at p. 70, 226): "[Weight Watchers International's] limitation on price policy is . . . an integral part of its method. Any modification of it might do serious damage to the good will of International."

The market concept by which Amway has, in less than 20 years, successfully added a new competitive presence to the oligopolistic soap and detergents market, among others, depends on the vertical restraints imposed on the distributors such as the retail store rule and the cross-group selling rule. Any modification of these rules might well do serious damage to this marketing concept and Amway's goodwill.

Trademark and Servicemark Protection

Amway argues that it has established several rules, including the

retail store rule and those regulating distributors' advertising, in order to protect its goodwill and trademarks and servicemarks.

The owner of a mark must prevent third parties from misusing a mark or will be deemed to have abandoned it. *Dawn Donut Co.* v. *Hart's Food Stores, Inc.*, 267 F.2d 358, 366 (2d Cir. 1959).[26] [104] This means that a trademark owner has the right to supervise to some extent the quality of goods and services offered by licensees under that mark. *Siegel* v. *Chicken Delight, Inc.*, 448 F.2d 43, 51 (9th Cir. 1971), *cert. denied*, 405 U.S. 43; *Denison Mattress Factory* v. *Spring-Air Co.*, 308 F.2d 403, 409 (5th Cir. 1962). It does not mean, however, that merely because restrictive provisions are part of a trademark licensing arrangement those provisions are immunized from the antitrust laws, where their central purpose is to restrain trade. *Timkin Roller Bearing Co.* v. *United States*, 341 U.S. 593, 598–99 (1951). Specifically, a manufacturer cannot maintain resale prices under the theory that discount prices will interfere with trademark rights. *Sunbeam Corp.* v. *Payless Drug Stores*, 113 F. Supp. 31, 44 (N.D. Cal. 1953). Protection of the goodwill embodied in a trademark may, however, justify an otherwise invalid trade restraint such as a tying arrangement. *Susser* v. *Carvel Corp.*, 332 F.2d 505, 512 (2d Cir. 1964). And the worth of the trademark will be assessed in determining the reasonableness of requirements contracts, *Denison Mattress Factory* v. *Spring-Air Co., supra*, at p. 410, and customer limitations, *Perma Life Mufflers, Inc.* v. *International Parts Corp.*, 392 U.S. 134, 136 n.4 (1968).

It is apparent, therefore, that the protection of Amway's trademarks and servicemarks carry weight in the determination of the legality of the vertical restraints it has imposed on the distributors.

Amway meticulously regulates advertising by its distributors. (Findings 94–108) Except for Amway's control of price advertising, *supra*, this control of advertising has adequate legal support. Amway has an "affirmative duty to itself and to the public to invoke some kind of control and restraint" in order to guard against misuse of its marks. *Denison Mattress Factory* v. *Spring-Air Co., supra*, at p. 409. The trademark licensor may properly regulate advertising or promotional materials in connection with the licensing of trademarks. [105] *Weight Watchers of the Rocky Mountain Region, Inc.* v. *Weight Watchers Int'l, Inc.*, 1976-2 Trade Cas. ¶ 61,157, at p. 70,225 (E.D.N.Y. 1976). And Amway had the right to regulate its distributors' advertising to stop infringement of its marks by unauthorized

[26] The rights of servicemark owners in this respect are the same as owners of trademarks. *Pro. Golfers Ass'n* v. *Bankers Life & Cas. Co.*, 514 F.2d 665, 668 (5th Cir. 1975)

publication in sales literature. *Amway Corp.* v. *International Sales Aids, Inc.,* 187 U.S.P.Q. 15, 21–22 (E.D. Ark. 1974).

Complaint counsel raise as a collateral issue the validity of three servicemarks. (CRB, p. 64) They argue that Amway distributors do not in fact perform services not normally connected with the sale of a particular type of product, and that a servicemark should not have been issued. Amway distributors do, however, perform valuable services for their sponsored distributors. (Finding 82) And Amway distributors provide valuable services to consumers, demonstrating and explaining products and delivering the products to the customer's home or place of business. (Finding 88)

Complaint counsel further attack the validity of the servicemarks, alleging "something highly improper" (CRB, p. 71 footnote) in an affidavit filed in support of the application for the servicemark. Although complaint counsel do not cite the record in this regard, they apparently refer to an error made in the application which referred to "trademark" rather than "servicemark." (Price, Tr. 2881) The context of the entire application shows that it involves a request for protection for a trademark for services.

Complaint counsel also argue that the application filed in support of the mark stated that it was for "door-to-door retail merchandising engaged in by the distributors," whereas respondents have discouraged "door-to-door" selling. (CRB, p. 72) The term "door-to-door" selling has a generic sense meaning "direct selling" as opposed to selling to retail stores. Amway advises its distributors to try to get an introduction from a neighbor, customer or friend before knocking on someone's door, although door-to-door canvassing is used by Amway distributors and it is "optional with them." (Van Andel, Tr. 1757–58) **[106]**

Counts IV and V of the Complaint

Counts IV and V of the complaint allege that respondents' system of distribution is unfair and involves misrepresentations concerning the nature of the system and the income distributors may gain from recruiting and fails to disclose distributors' substantial expenses and turnover.

Pyramid

Complaint counsel argue that the Amway Sales and Marketing Plan is inherently unlawful because it is "a scheme to pyramid distributors upon ever increasing numbers of other distributors." They argue that the Amway Plan, even without actual proof of

economic failure, is "doomed to failure" and contains an "intolerable potential to deceive." (CB, p. 32)

This rule of *per se* illegality for pyramid plans has not yet been accepted by the courts. *Ger-Ro-Mar, Inc.*, 84 F.T.C. 95 (1974), *rev'd in part, Ger-Ro-Mar, Inc.* v. *FTC*, 518 F.2d 33, 37 (2d Cir. 1975); *United States* v. *Bestline Products Corp.*, 412 F. Supp. 754, 777 (N.D. Cal. 1976). The Commission defined such unlawful "entrepreneurial chains" in *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180 (1975):

> 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 the 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. (Emphasis in original.)

[107] Participants in the Koscot marketing plan paid an initial amount up to $5,000 to the company for inventory and the right to recruit others. The distributors who recruited others received $2,650 of the recruit's $5,000 payment. 86 F.T.C. at 1179. The only way a Koscot distributor could get the payment back was to recruit more distributors. 86 F.T.C. at 1131. Koscot and its distributors were primarily in the business of selling distributorships. 86 F.T.C. at 1140.

Participants in the *Ger-Ro-Mar, Inc.* marketing plan bought non-returnable inventory for up to $1,950. 84 F.T.C. at 108–10. Recruiters received compensation based on the fact of recruiting regardless of whether products were sold to the consumers. 84 F.T.C. at 148.

The pyramid marketing program in *Holiday Magic, Inc.*, 84 F.T.C. 748 (1974) required distributors to buy in at various levels for up to $4,500. At the highest level, distributors received $2,500 of the $4,500 for recruiting another distributor at the same level. 84 F.T.C. at 1032. The inventory purchased in this manner was non-returnable and the company paid little attention to consumers. 84 F.T.C. at 1035.

There is little doubt that a pyramid distribution scheme should now be condemned even without the demonstration of its economic consequences. The Commission has studied the effects of such "entrepreneurial chains" and seen the damage they do and a *per se* rule should be used. *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180–82 (1975). Such a rule would be based on demonstrated economic effect in these cases, rather than formalistic line drawing. *Continental T.V. Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 59 (1977). In such cases, the fact that some retail sales occur does not mitigate the unlawful nature of the method of recruiting. *Ger-Ro-Mar, Inc.*, 84 F.T.C. 95, 148–49 (1974), *rev'd on other grounds*, 518 F.2d 33 (2d Cir.

1975). Here, however, the Amway system does not involve an "investment" in inventory by a new distributor. (Finding 61) A kit of sales literature costing only $15.60 is the only requisite. (Finding 34) And that amount will be returned if the distributor decides to leave Amway. (Finding 37) [108]

The Amway system is based on retail sales to consumers. (Findings 72–75, 144) Respondents have avoided the abuses of pyramid schemes by (1) not having a "headhunting" fee; (2) making product sales a precondition to receiving the performance bonus; (3) buying back excessive inventory; and (4) requiring that products be sold to consumers. (Patty, Tr. 3092–94). Amway's buy-back, 70% and ten customer rules deter unlawful inventory loading. (Findings 145–47)[27] Amway is not in business to sell distributorships and is not a pyramid distriubtion scheme. (Findings 142–44)

Saturation

The complaint alleges that distributors are not long likely to recruit other distributors because "recruitment of additional participants must of necessity ultimately collapse when the number of persons theretofore recruited has so saturated the area with distributors or dealers as to render it virtually impossible to recruit others." (Complaint, p. 9)

The term "saturation" as used in the complaint and by complaint counsel is one of the legitimate proofs in a case involving a pyramid distribution scheme. *Koscot,* 86 F.T.C. at 1135; *Holiday Magic,* 84 F.T.C. at 979; *Ger-Ro-Mar,* 84 F.T.C. at 119. Since Amway is not such a pyramid, the concept is immaterial here. [109]

Irrespective of the materiality of the concept, the facts in this record do not show that Amway distributors in any market were unable to recruit new distributors or to sell Amway products because of any inherent defect in the Amway Sales and Marketing Plan.[28] Products are consumed or wear out. (Patty, Tr. 3110) The population of the country continues to grow and to move about. Only one in four Amway distributors engage in recruiting, and there has been no decline in that percentage in recent years. The sales trend for Amway has shown almost uninterrupted growth. (Finding 151) The markets for Amway products and distributors, in short, are not static.

The preponderence of the evidence in the record does not support

[27] While the ten customer rule has a reasonable basis in preventing an unlawful pyramid, the distributors' monthly reports showing such sales need not specify the prices at which the sales were made. Such a requirement could be used to monitor unlawful resale price fixing.

[28] According to a market study conducted in 1973, only 4% of the distributors who did not renew their distributorship left because there were too many other Amway distributors in their area. (CX 521-E)

the allegation of "saturation." (Findings 148–52) From my observation of the demeanor, inconsistencies and uncertainties in the testimony of the witnesses called in support of the complaint in this regard, I believe the reason for their failure was more accurately described by a marketing expert who testified about this subject (Patty, Tr. 3109): "I think generally speaking when a salesman tells you that a market is saturated, he has become discouraged for some reason, usually he is simply not making the sales effort that is required." [110]

Misrepresentations and Failure to Disclose

The complaint alleges that respondents falsely represent that it is easy to recruit distributors and that distributors will receive substantial earnings. The complaint also alleges that respondents fail to disclose that there is substantial turnover among Amway distributors, and that substantial expenses are incurred in the business of being an Amway distributor. (Complaint, pp. 13–14) Misrepresenting to potential salespersons the nature of the position offered and the amount of compensation that will be received violates the Federal Trade Commission Act. *Encyclopedia Britannica, Inc.*, 87 F.T.C. 421, 488 (Initial Decision adopted by the Commission 1976).

Misrepresentations

The complaint alleges that respondents unlawfully represent that sponsoring is easy and profitable. (Complaint, pp. 10, 13) While words such as "easy" and "profitable" are relative, they can be the basis for a proper charge of unlawful misrepresentation. *Tashof* v. *FTC,* 437 F.2d 707, 712 (D.C. Cir. 1970); *Goodman* v. *FTC,* 244 F.2d 584, 597 (9th Cir. 1957); *Steelco Stainless Steel, Inc.* v. *FTC,* 187 F.2d 693, 697 (7th Cir. 1951); *contra, Carlay Co.* v. *FTC,* 153 F.2d 493, 496 (7th Cir. 1946). The facts, however, show that no unlawful misrepresentation has occurred.

Amway has represented that: "Sponsoring is easy!" Such isolated statements are found in detailed literature about the Amway Sales and Marketing Plan which must be read in context in assessing the nature of the statement. (Finding 139) Furthermore, Amway lets distributors know that the Amway Sales and Marketing Plan involves work. (Finding 130) In the introduction to the Career Manual for Amway Distributors, Mr. DeVos tells new distributors [111] that they are getting into the business on the "ground floor," starting "at the bottom," and that the Amway plan is an opportunity

for all "who are willing to pay the price for success" and that the "person who thinks he can get big without working has no place here." (RX 331, p. 3-A)

In support of the allegation complaint counsel have proposed only the finding that three out of four distributors do not recruit. (CPF 525) This has little to do with the ease of recruiting because there has been no showing that all distributors are interested in recruiting rather than retail selling. Moreover, complaint counsel seem to admit that Amway has had no trouble recruiting distributors. (CB, p. 10).[29]

There is no doubt that the Amway Sales and Marketing Plan is designed to catch the interest of a prospective recruit by appealing to material interests. (Findings 59, 138) One approach is the "dream" sheet. Prospects are asked to describe their goals and dreams such as "a new car, a new home, college education for your children." They are, however, also asked: "Are you willing to work hard to get this?" (Finding 59)[30] [112]

Amway literature and speeches made at rallies by Amway representatives describe luxuries that may be available to Amway distributors. (DeVos, CX 1000-Z-3; Findings 59, 131) Guides for presenting the sales and marketing plan instruct the distributor to tell prospects (CX 190-J):

> For *you* the Amway Sales and Marketing Plan can mean the kind of life you've always dreamed of living, a new car, a new home, security . . . the things you want most out of life can be yours! Amway can be the means by which you achieve those things you've always dreamed of, but never thought you could afford. Amway can offer you an opportunity for true independence. Freedom from time clocks and freedom to travel *when* you want to. . . . [F]reedom from allowing someone else to decide your financial progress. (Emphasis in original.)

But the Amway plan also makes clear the idea that work will be involved, and that the material rewards to be gained will directly depend on the amount and quality of work done. (Finding 130) Complaint counsel argue that appealing to financial and material goals of salespersons is "emotionally exploitative." No applicable

[29] They argue that Amway has too many distributors and that Amway has "saturated" the market for distributors.

[30] Complaint counsel object to the "curiosity approach" that distributors have used when attempting to interest recruits. This involves getting the prospect to attend a meeting by a statement such as "we're in the business of helping professional people . . . start their own business," without mentioning the name "Amway." (Williams, CX 1116-S - T) At the meeting the full details of the Amway Sales and Marketing Plan are then explained. This approach was used primarily in the early 1970's because of the adverse publicity about pyramid plans unconnected with Amway. (CX 519-Z-49)

Amway distributors are not required to seek new distributors only by first announcing to prospects that they want to take their leisure hours away in a sales job. One distributor said that if this approach is used and ". . . you're talking to the guy that just came home from a factory maybe after ten hours, and is perspiring and looking at you and saying, 'Lady, you are one big dingaling if you think I'm gonna go out and do some more work after that.' " (Blinco, CX 1041-Z-3)

precendent was cited or found that would hold such conduct unfair. [113]

Amway literature urges recruiters not to "quote dollar incomes on specific individuals even though you may want to use their stories about the homes in which they live, the cars they drive, or the airplanes they fly." (Finding 131)[31] Amway officers and other representatives have, however, orally stated specific dollar incomes which are attributed to Amway distributors. (Finding 132) These statements are typically made in mass sales rallies which are primarily for persons who are already Amway distributors. (Finding 48; CX 57-Z-118) The context of the sales talk is inspirational and it is to a knowledgeable crowd already aware of the details of the Amway Sales and Marketing Plan,[32] and in this motivational context the statements are obviously meant and understood to be feasible goals and not guaranteed average income for the listeners.[33] [114]

Amway recommends that distributors explain the Sales and Marketing Plan by using specific dollar amounts representing hypothetical retail and wholesale sales. (Findings 60, 134, 135) This method explains visually how to receive income by recruiting new distributors. It is frequently referred to as "drawing the circles" (CX 116-I) and shows expanding organizations of distributors in four or five examples, culminating in a hypothetical organization showing the sponsoring distributor receiving hundreds of dollars in monthly gross income. The diagrams start with a specific amount for the sponsoring distributor's hypothetical retail sales. From 1973 until 1977 this amount was $200 B.V.[34] Until recently Amway's circle diagrams showed the sponsored distributors' hypothetical sales also as $200 B.V. In 1977 recruiting literature, Amway changed these to more realistic varying amounts. (RX 401, pp. 7-9)

The circle diagrams have been qualified in the Amway literature to show that the illustration is hypothetical. (CX 162-G):

> For example, let's say you begin by sponsoring six new distributors. Just to illustrate the way the Amway Sales Plan operates, and not to suggest that there is any predictable level that any individual will ordinarily achieve, let us assume that each of the six sells an order a day . . . $5 a day . . . $100 per month . . . though actual sales will vary. . . .

[31] Specific examples of amounts paid to Amway distributors are well qualified in the literature to show that they are maximum amounts, not average. (RX 401, p. 10)

[32] Amway urges that recruiting be done individually rather than at mass meetings. (CX 638-H)

[33] For example, while urging distributors to open their minds to thinking in terms of making $100,000 a year, Mr. DeVos predicted that "there are going to be *some people* in the room" who were going to have that kind of income. (Finding 132) (Emphasis added.) This statement does not indicate that the average distributor can expect to make that amount. Examples cited in complaint counsel's proposed findings, when put in context, similarly show that the speakers are offering the specific amounts as goals not as representations of average incomes. (See the text surrounding the dollar amounts referred to in CPF 457, for example CX 990-Z, CX 992-H, CX 992-J.)

[34] Before 1973 it was $100; in 1977 it was raised to $250. (Finding 134; RX 401, pp. 7-9).

NOTE: Volume figures and earnings shown in this session are meant for *example* only. In actuality, distributors may show a variety of different volumes and earnings. Growth of an Amway group is not likely to work out in just this way.[35] (Emphasis in original.)

[115] The average Amway distributor sells far less than $200 a month. (Finding 137) The vast majority of Amway distributors are in the business part-time. Only one in four sponsors other distributors, and many apparently are distributors in order to buy Amway products—at about a 30% discount—which they consume. (Finding 137) For a dollar figure representing average sales by distributors engaged in active retailing of Amway products, however, the $200 is reasonable. (Cliett, Tr. 3759; Bryan, Tr. 4521)

Mr. Van Andel's reason for using the $200 figure is to act as a goal to motivate the distributors' sales. (Finding 136)[36] One of complaint counsel's [116] witnesses, Jack Wayne Hearne, a former Amway distributor, testified that he understood the $200 figure was a goal, not an average (Tr. 632–33):

Q. I believe you said that at the first meeting [the prospective distributors] were told that part of the plan was that everyone should try to sell $200 worth of products a month, that is correct?

A. Yes, and I asked why, and [the Amway distributor] said this is the basic thing that we work for. You are not required. If you do fine, if you don't fine, whatever. That was the goal you kind of worked toward.

The Amway literature stresses that retail selling is essential, and that sponsoring new distributors brings the responsibilities of training, motivating and supplying. The literature also warns the distributor never to give the imprssion that a business can be built only by sponsoring new distributors and not to quote dollar incomes by specific distributors or otherwise to imply that the plan is for anyone "who is unwilling to work hard." (RX 331, pp. 8–D, 9–D) In this context, it is clear that drawing the circles to show the Amway plan is not an attempt to deceive prospects into believing that such earnings are "typical" for Amway distributors, *Goodman* v. *FTC*, 244 F.2d 584, 595–96 (9th Cir. 1957), or that distributors "will obtain" the

[35] And distributors were warned: "In reality, some of your distributors will probably sell more than $200 P.V. while others may sell less; but just to make it easy to understand, we'll stick to the figure of $200 P.V. for purposes of this example." (CX 190–G; CX 201–G)

And Amway literature advises that: "As with retailing, depending on their own goals, initiative, and available time, and the retail sales of those they sponsor will vary." (CX 205–G; CX 208–F)

[36] The audience at opportunity meetings includes persons who are already distributors as well as prospective distributors. (CX 204–G) The "drawing circles" technique is used to teach these distributors the wholesale side of the Amway Sales and Marketing Plan and to set goals for these distributors, as well as to introduce prospective distributors to the plan.

amount specified. *Tractor Training Service* v. *FTC,* 227 F.2d 420, 425 (9th Cir. 1955), *affirming,* 50 F.T.C. 762, 769, 774.

For the same reason, there is no law violation in Amway's use of the $1000 figure as the earnings of a business which a distributor "may build." (Finding 138) There is no doubt that some Amway distributors earn that amount. (Finding 133) [117] It is used to entice prospects to an opportunity meeting where the details of the Amway Sales and Marketing Plan can be explained. In the context of the plan, it is clear that the amount is not meant to represent the average or typical earnings of an Amway distributor.[37]

Amway is not a "modern-day version of the chain letter." *Holiday Magic, Inc.,* 84 F.T.C. 748, 1035 (1974) The Amway system does not create the potential for massive deception present in a pyramid distribution scheme which relies primarily on the profits to be made from recruiting new distributors rather than from ultimate sales to consumers. (*Id.* at 1036) Unlike the pyramid companies, Amway and its distributors do not make money unless products are sold to consumers. The inherent potential for deception is not present in the Amway plan. In the full context of the plan, it does not have an unlawful capacity to deceive. [118]

Failure to Disclose

Respondents have not misrepresented the potential expenses incurred in running an Amway distributorship. Amway literature describes normal business expenses involved in conducting a distributorship, even assuming the distributors were not already aware of the existence of such expenses. (Finding 140)

The complaint also alleges that Amway has failed to disclose that there is a substantial turnover of persons recruited as Amway distributors.

Amway experienced a decline in the number of distributors recruited into its system starting about 1971. This lasted for a few years and was caused primarily by bad publicity concerning pyramid distribution companies. (CX 519-G, U) In recent years, the total number of Amway distributors has been increasing gradually and the rate of turnover has been falling. (Finding 148)

Direct selling companies typically have a high turnover among their independent salespersons. (Finding 162)[38] The rate of turnover

[37] In any event, prospective Amway distributors do not believe that they will make $1000 a month. On the application form for an Amway distributor, the applicants are asked to state their expected earnings. About 90% expect to earn less than $10,000 a year. About 75% expect less than $5,000, and more than half expect less than $2,000 a year. (CX 516-U)

[38] *Compare, Snap-On-Tools Corp.* v. *FTC,* 321 F.2d 825, 829 (7th Cir. 1963). Of 900 dealers of industrial tools, Snap-On had a turnover of from 35% to 700 in one and one-half years.

among Amway distributors has been lower than average among direct selling companies. (Findings 148, 162, 163) Furthermore, Amway warns its distributors that newly sponsored distributors can be expected to leave the business. (Finding 141) [119]

CONCLUSIONS

The Amway Sales and Marketing Plan is not a pyramid plan. In less than 20 years, the respondents have built a substantial manufacturing company and an efficient distribution system, which has brought new products into the market, notably into the highly oligopolistic soap and detergents market. Consumers are benefited by this new source of supply, and have responded by remarkable brand loyalty to Amway products. (Finding 186) The vertical restraints by which Amway has achieved this entry—avoiding conventional retailing through grocery stores by direct selling—are reasonable. Respondents' restraints on price competition, however, must be prohibited.

I therefore conclude that:

1. The Federal Trade Commission has jurisdiction over respondents and the subject matter of this proceeding.
2. This proceeding is in the public interest.
3. Respondents have agreed, combined and conspired with each other and Amway distributors to fix resale prices for Amway products, on sales between Amway distributors and to consumers, in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45.
4. The attached order to cease and desist against respondents is appropriate, supported by the findings of fact, reasonably related to the offenses found, and necessary for the protection of the public interest.
5. The record does not support the allegations of Counts II, III, IV and V. Accordingly, those counts must be dismissed. [120]

Remedy

The order in this case should prohibit respondents in the future from controlling the prices charged for Amway products in sales between distributors and to consumers. And since the customer protection rule had that purpose and effect, the order must cover allocation of retail consumers.

As long as they obey the other rules herein found to be reasonable,

distributors should have the right to advertise and sell Amway products, which they have purchased, at whatever price they wish.[39] "[W]here consumers have the benefit of price advertising, retail prices often are dramatically lower than they would be without advertising." *Bates* v. *State of Arizona,* 433 U.S. 350, 1977-2 Trade Cases, ¶ 61,573, at p. 72,330. [121]

ORDER

I

It is ordered, That respondents Amway Corporation and Amway Distributors Association of the United States, their officers, agents, representatives, employees, successors and assigns, and respondents Jay Van Andel and Richard M. DeVos, individually, and their agents, representatives and employees, directly or indirectly, or through any corporate or other device, in connection with the offering for sale, sale or distribution of any product, whether by combination, agreement, conspiracy or coercion, shall forthwith cease and desist from:

1. Fixing the price at which any distributor may advertise, promote, offer for sale or sell any product at retail.
2. Fixing the price at which any distributor may sell any product to any other distributor.
3. Requesting or obtaining any assurance to comply with, continuing, enforcing, or announcing any contract, agreement, [122] understanding, or arrangement with any distributor or prospective distributor which fixes the price at which any product is sold or advertised by such distributor or prospective distributor.
4. Threatening to withhold or withholding bonus payments or profit sharing payments from any distributor because of the price at which said distributor advertises or sells any product.
5. Requiring or requesting distributors to report the price at which products are resold, or to report the identity of any other distributor because of the retail price at which such distributor is advertising or selling any product; or acting on any reports or information about such retail prices by threatening, intimidating, coercing, terminating or contacting in any way the said distributor because of those reports or information. [123]
6. Terminating or taking any other action to prevent or limit the sale of any product by any distributor because of the retail price at

[39] Mr. Price, Amway's trademark attorney, testified that distributors can properly advertise that they are selling Amway products. (Tr. 2900-01)

which the distributor is advertising or selling any product, whether or not in conjunction with any of the Amway trademarks or servicemarks.

7. Publishing or distributing, directly or indirectly any wholesale or retail price list, order form, promotional material or any other document which employs resale prices for products sold by respondents without stating clearly and conspicuously in conjunction therewith the following: "The prices stated herein are suggested prices only. Distributors are not obligated in any way to adhere to any suggested prices. Distributors may determine for themselves the prices at which their product may be sold to other distributors or to consumers."

8. Allocating retail customers of distributors. [124]

II

Nothing in this order shall affect:

1. Respondents' rights in law and equity respecting the protection of respondents' trademarks or servicemarks in conjunction with the offer for sale or advertising of any product.

2. Respondents' rights to enforce the rules of the Amway Sales and Marketing Plan found reasonable in this decision.

III

It is further ordered, That respondent Amway Corporation, or its officers, agents, representatives, employees, successors or assigns, shall:

1. Within thirty (30) days from the effective date of this order, deliver a copy of this order to cease and desist to all present Amway Direct Distributors and distributors. From each Direct Distributor, a signed statement acknowledging receipt of this order shall also be obtained. [125]

2. Deliver a copy of this order to all future Amway distributors on the date of their participation.

3. Within thirty (30) days of the effective date of this order, make written offers of distributorships of equivalent value to the distributorship of any distributor who was terminated or suspended solely for the violation of rules, or policies which contravene any of the provisions of this order.

IV

It is further ordered, That respondents and their successors and

assigns notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents such as dissolution, assignment or sale resulting in the emergence of successor corporations, the creation or dissolution of subsidiaries or any other change in the corporations or in the Amway Sales and Marketing Plan which may affect compliance obligations arising out of the order. [126]

V

It is further ordered, That the individual respondents promptly notify the Commission of any change of their present business relationship or employment. Such notice shall include respondents' business address and a statement as to the nature of change of business or employment as well as a description of their duties and responsibilities.

VI

It is further ordered, That the respondents herein shall within sixty (60) days from the effective date of this order, file with the Commission a report in writing setting forth in detail the manner and form in which they have complied with this order.

Opinion of the Commission

By Pitofsky, *Commissioner:*

I. Introduction

In March 1975 the Federal Trade Commission issued a complaint charging respondents Amway Corporation ("Amway"), Amway Distributors Association ("ADA"), Jay VanAndel (Chairman of the Board of Amway and one of its two principal owners), and Richard M. DeVos (President of Amway and the other principal owner), with various violations of Section 5 of the Federal Trade Commission Act, 15 U.S.C. 45. The alleged violations involve the distribution network that has been built up to market the consumer products Amway manufactures. [2]

After extensive discovery, hearings began in May 1977 and were concluded in October 1977. In an Initial Decision rendered June 23, 1978, the presiding administrative law judge (the "ALJ") found that FTC counsel supporting the complaint ("complaint counsel") had established that respondents had engaged in illegal resale price maintenance, but had failed to establish that respondents had committed other violations of Section 5. We affirm the ALJ's

decision with respect to resale price maintenance and, in addition, find that respondents have made false and misleading earnings claims in attempting to recruit persons to serve as distributors of Amway products. We also agree with the conclusion reached in the Initial Decision, that complaint counsel have failed to prove the other allegations made against Amway of unfair methods of competition and unfair or deceptive acts and practices. Specifically, we have determined that the Amway Sales and Marketing Plan is not an illegal "pyramid scheme"; that the non-price-related rules Amway has imposed on the distributors of its products, to control the way the products flow to consumers, do not constitute unreasonable restraints of trade or unfair methods of competition; and that, with the exception of certain earnings claims, respondents have not made false, misleading, or deceptive claims about Amway's business or the opportunities it presents to a person who becomes a part of it.

Amway has a highly unusual distribution system, and therefore a fairly extended description of Amway's business and marketing techniques is necessary as a prologue to the application of the relevant legal principles.

A. The Nature of Amway's Business

Amway was formed in 1959 by VanAndel and DeVos. It manufactures over 150 products, most of which are cleaning and personal care products. Soaps and detergents constitute 41 percent of sales; polishes, sanitation goods, and other cleaners 20 percent; toilet preparations 6.5 percent; pharmaceutical preparations 6 percent; and a variety of other consumer goods account for the rest. Amway's total sales topped $200 million in 1976, but Amway is still a small competitor compared to the giants that dominate the market in which it operates. The three largest firms in the soap and detergent market—Procter & Gamble, Lever Bros., and Colgate-Palmolive—account for over 80 percent of the total sales in that market. Procter & Gamble alone has about half these sales; in addition, it has about one-fourth of the total sales of personal care products. There are formidable barriers to entry into the market in which Amway operates; generally, a new competitor cannot enter at all unless it has very large amounts of money to spend on [3] advertising and promotion.[1] Amway skirted these near-insurmountable barriers and interjected a vigorous new competitive presence into this highly

[1] The three soap-and-detergent manufacturers mentioned above spent over $500 million in advertising and sales promotion in 1975. (Compare Amway's $200 million in sales.) Procter & Gamble alone—the largest advertiser in the United States—spent over $360 million in product promotion in 1975. Amway, by contrast, spent less than $1 million for advertising in 1975. Initial Decision, p. 68, Finding 175.

concentrated market by developing what is known as a "direct selling" distribution network.

B. Amway's Direct Selling Operation

Amway's products are the type usually sold in retail stores, especially in supermarkets. But Amway has totally avoided traditional retail outlets.[2] It retails its products directly to consumers on a "house-to-house" basis, using a sales force of about 360,000 independent distributors. Actually, Amway describes its retail marketing program as "person-to-person", since it encourages its distributors to seek out regular, repeat customers whom the distributors may service on an ongoing basis.

The advantages claimed for a direct selling operation include home delivery, explanation and demonstration of product characteristics and use, explanation of product guarantees, and other similar services. Amway has shown that these advantages can be considerable, as it has grown from sales of $4.3 million in 1963 to sales of over $200 million in 1976. One of the reasons for this rapid growth is that Amway's products have very high consumer acceptance. A marketing specialist called to testify at the hearings stated that Amway's laundry detergent, which has a very small market share and no national advertising, ranks third out of thirty-seven brands in brand loyalty. Other Amway products, including its automatic dishwasher detergent, detergent for fine clothing, bleach, rug cleaner, and laundry additives, each rank second in brand loyalty. Amway's liquid dishwashing soap led all sixteen brands surveyed in brand loyalty. [4]

C. Amway's Multilevel Distributor System

Each of the 360,000 Amway distributors is an independent businessperson. These distributors are governed in their relations with each other, with Amway, and, to some extent, with consumers, by the Amway Sales and Marketing Plan (the "Amway Plan").[3]

[2] Amway actually has a rule (in what is known as its "Rules of Conduct") which states that no Amway distributor shall permit Amway products to be distributed through any retail outlet. This rule, known as the "retail store rule," is discussed in greater detail at pages 21–23, *infra*.

[3] Generally speaking, the Amway Plan is a highly structured organizational outline, developed by VanAndel and DeVos to control the manner in which Amway products move through the distributor network to consumers. It is based on the "Code of Ethics and Rules of Conduct for Amway Distributors." The Amway Plan and the Code of Ethics and Rules of Conduct are set out in a manual, which Amway republishes every two to five years. The 1977 edition of the manual, which was current at the time of the hearings and is therefore frequently referred to herein is called the Amway Career Manual; some earlier editions, also referred to herein, were called the Amway Sale Plan.

Under the Amway Plan, a select few distributors known as Direct Distributors[4] purchase products at wholesale directly from Amway and resell the products both at retail to consumers and at wholesale to the distributors they personally "sponsored" (that is, the distributors they recruited). Each second-level distributor resells the products both at retail to consumers and at wholesale to the distributors he personally sponsored. The third-level distributors perform the same two functions. This multilevel wholesaling network ends with those distributors who have not sponsored any new distributors, and who make purchases from their sponsors solely for their own use or for resale to consumers. Thus there is beneath each Direct Distributor a "field" of distributors, each of whom receives products which have flowed through each level between himself and the Direct Distributor.[5] Amway directs that these [5] products, regardless of how many levels they pass through, are to be sold between distributors at the same prices the Direct Distributor paid for them.[6]

All distributors are encouraged to make retail sales and to sponsor new distributors who will themselves make retail sales; distributors earn money for successfully engaging in either of these activities. The way a distributor makes money on a retail sale is simple. Each time he makes such a sale, he keeps the difference between the retail price at which he sold the product and the wholesale price at which he bought it. The way a distributor earns money from sponsoring new distributors is more difficult to understand and requires a more lengthy explanation.

Under the Amway Plan, each distributor is eligible to receive a monthly "Performance Bonus" which is based on the total amount of Amway products he purchased that month for resale, both to consumers and to his sponsored distributors. This Bonus is basically a volume-based refund. The exact amount of the Bonus to be paid to a particular distributor is determined as follows. Each Amway product is assigned a "Point Value" (roughly corresponding to its wholesale cost) and a "retail value" (based on Amway's "suggested retail price" for that product). At the end of each month, a distributor adds up separately the total Point Value and the total retail value (referred to as his "Business Volume") for all the products he purchased that month from his sponsor (or, in the case of

[4] There were approximately 4000 Direct Distributors in 1977.

[5] Apparently some Direct Distributors have lines of sponsorship which are twenty to twenty-five levels deep. But of February 1977, approximately one-half of all Amway distributors either had a Direct Distributor as their sponsor were sponsored by a distributor who had a Direct Distributor as his sponsor. Over 70 percent of all distributors were the first three positions; over 85 percent were in the first four positions; over 93 percent were in the first five sitions; and roughly 99 percent were in the first seven positions.

[6] This restriction on wholesale pricing is discussed in greater detail at pages 12-13, *infra*.

a Direct Distributor, from Amway). He then computes the actual amount of his Performance Bonus by referring to the following "Performance Bonus Schedule," published by Amway:

IF YOUR TOTAL MONTHLY POINT VALUE IS:	YOUR PERFORMANCE BONUS IS:
7,500 or more points	25% of Your Business Volume
6,000 to 7,499 points	23% of Your Business Volume
4,000 to 5,999 points	21% of Your Business Volume
2,500 to 3,999 points	18% of Your Business Volume
1,500 ot 2,499 points	15% of Your Business Volume
1,000 to 1,499 points	12% of Your Business Volume
600 to 999 points	9% of Your Business Volume
300 to 599 points	6% of Your Business Volume
100 to 299 points	3% of Your Business Volume
less than 100 points	0% of Your Business Volume

[6] The Performance Bonuses are paid, in the first instance, by Amway to the Direct Distributors. Each Direct Distributor figures his Point Value and Business Volume for the month — both of which will include all the purchases he made from Amway to supply his own retail customers and to filter wholesale supplies down through the levels beneath him in his field or sponsorship — and is paid by Amway whatever percentage of his Business Volume he is entitled to. Each Direct Distributor is then responsible for paying out Performance Bonuses, from the amount he received from Amway, to the second-level distributors he sponsored.

The Direct Distributor usually will pay out less than he received from Amway, because these second-level distributors will each have a lower Point Value than he has, and they will therefore receive a lower percentage of their respective Business Volume amounts. For example, if five second-level distributors had each purchased a large enough volume of products in a month to be entitled to a 15 percent Performance Bonus, their Direct Distributor — in supplying their product needs as well as his own — would have purchased enough products from Amway to be entitled to a 25 percent Performance Bonus. The Direct Distributor would therefore be paid 25¢ by Amway on each dollar of his Business Volume, but he would only pay out 15¢ to his second-level distributors on each dollar of their respective Business Volumes. So the Direct Distributor would net a 25¢ Bonus on each dollar of Business Volume representing retail sales made by him to consumers, and a 10¢ Bonus on each dollar of Business Volume representing wholesale sales made by him to his sponsored distributors.

Each second-level distributor is then responsible for paying out

Performance Bonuses, from the amount the Direct Distributor pays to him, to the third-level distributors he sponsored. The second-level distributors will make money on the Business Volume generated by their sponsored distributors in the same way the Direct Distributors made money on the Business Volume generated by the second-level distributors; and so on, down through the successive levels of distributors.

This distribution hierarchy is not static, however, as any regular distributor, regardless of how many levels he may be below his Direct Distributor, may himself become a Direct Distributor by reaching a specified, high volume of purchases three months in a row.[7] When a regular distributor [7] qualifies as a Direct Distributor, he breaks out of the field of sponsorship he was in up to that time and begins to make his wholesale purchases directly from Amway. When a new Direct Distributor breaks out of his old position like this, he takes with him all those distributors he sponsored, all the distributors those persons sponsored, etc.[8]

D. Amway Distributors Association

The ADA is a trade association of Amway distributors.[9] Every Amway distributor is entitled to join the ADA, but only Direct Distributors may qualify as voting members. The voting members of the ADA meet once a year for a one-day meeting at which they elect nine of the eleven directors on the ADA Board. The other two directors — VanAndel and DeVos — are appointed by Amway. The Board performs three principal functions: it acts as a representative of the distributor association; it acts as an advisory board to Amway; and it acts as an arbitration board in disputes between distributors, or between Amway and a distributor.

II. The Alleged Violations

Complaint counsel have charged respondents with violations which fall into three categories. First, it is alleged that the Amway Sales and Marketing Plan is inherently deceptive, as it holds out the promise of "substantial income . . . as a result of . . . sales activities from . . . endless chain recruiting activities"; this is essentially a way of saying that the Amway Plan is an illegal pyramid scheme.

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[7] *See* Initial Decision, p. 24, Finding 62, for a more exact statement of what is required.

[8] When a newly qualified Direct Distributor — who is by definition a very high volume performer — breaks out of his old place, it represents a great loss to the "old" Direct Distributor who previously funneled products to him. The old Direct Distributor is compensated by Amway for this loss by an additional monthly Performance Bonus consisting of 3 percent of the Business Volume of the new Direct Distributor.

[9] *See* Initial Decision, pp. 8-10, Findings 17-25, for a discussion of the history and origins of the ADA, and its relationship with Amway.

Second, it is alleged that various restrictions governing the sales, recruiting, and advertising activities of Amway distributors constitute unreasonable restraints of trade. Finally, respondents are charged with misrepresenting the profitability of a distributorship and the potential for recruiting and keeping new distributors. These charges will be taken up and discussed in order. [8]

A. Allegations That the Amway Plan Is a Pyramid Scheme

Complaint counsel argue that respondents have represented to prospective distributors that under the Amway Plan a distributor is likely to earn substantial income through a process of "multiplication" or "duplication", by recruiting others into the program who will themselves engage in recruiting, etc. Complaint counsel characterize the Amway Plan as "a scheme to pyramid by geometric growth layers of distributors." They state that "the Plan, by itself, is false, misleading and deceptive", because it leads to distributor saturation — that is, to such heavy concentration of Amway distributors that there is no one left to be recruited. The ALJ found that the record does not support these charges, and we agree.

The Commission had described the essential features of an illegal pyramid scheme:

> 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.* . . . As is apparent, the presence of this second element, recruitment with rewards unrelated to product sales, is nothing more than an elaborate chain letter device in which individuals who pay a valuable consideration with the expectation of recouping it to some degree via recruitment are bound to be disappointed. *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180 (1975) (emphasis added), *aff'd mem., sub nom. Turner* v. *FTC* 580 F.2d 701 (D.C. Cir. 1978).

See also In re Ger-Ro-Mar, 84 F.T.C. 95 (1974), *aff'd in part, rev'd in part sub nom. Ger-Ro-Mar* v. *F.T.C.,* 518 F.2d 33 (2d Cir. 1975); *In re Holiday Magic, Inc.,* 84 F.T.C. 748 (1974). The Amway Plan does not contain the essential features described above, and therefore it is not a scheme which is inherently false, misleading, or deceptive.

The *Koscot, Ger-Ro-Mar,* and *Holiday Magic* cases all involved "marketing" plans which required a person seeking to become a distributor to pay a large sum of money, either as an entry fee (usually called a "headhunting" fee) or for the purchase of a large amount of nonreturnable inventory (a practice known as "inventory loading"). In exchange, the new distributor obtained the right to recruit others who would themselves have to pay a large sum of

money — some of which would go to the recruiting distributor — to join the organization. [9]

By contrast, a person is not required to pay a headhunting fee or buy a large amount of inventory to become an Amway distributor. The only purchase a new distributor is required to make is a $15.60 Sales Kit, which contains Amway literature and sales aids; no profit is made in the sale of this Kit, and the purchase price may be refunded if the distributor decides to leave the business. Initial Decision, p. 12, Findings 34–37. Thus a sponsoring distributor receives nothing from the mere act of sponsoring. It is only when the newly recruited distributor begins to make wholesale purchases from his sponsor and sales to consumers, that the sponsor begins to earn money from his recruit's efforts. And Amway has prevented inventory loading at this point with its "buy-back rule," which states that a sponsoring distributor shall "[p]urchase back from any of his personally sponsored distributors leaving the business, upon his request, any unused, currently marketable products. . . ." By this rule, a sponsoring distributor is inhibited from pushing unrealistically large amounts of inventory onto his sponsored distributors in order to increase his Point Value and Business Volume, and thereby increase his Bonus.

Two other Amway rules serve to prevent inventory loading and encourage the sale of Amway products to consumers. The "70 percent rule" provides that "[every] distributor must sell at wholesale and/or retail at least 70% of the total amount of products he bought during a given month in order to receive the Performance Bonus due on all products bought . . . ." This rule prevents the accumulation of inventory at any level. The "10 customer" rule states that "[i]n order to obtain the right to earn Performance Bonuses on the volume of products sold by him to his sponsored distributors during a given month, a sponsoring distributor must make not less than one sale at retail to each of ten different customers that month and produce proof of such sales to his sponsor and Direct Distributor." This rule makes retail selling an essential part of being a distributor.

The ALJ found that the buy-back rule, the 70 percent rule, and the ten customer rule are enforced, and that they serve to prevent inventory loading and encourage retailing. Initial Decision, p. 26, findings 72–75, and p. 58, Findings 145–47. Given these facts, the Amway plan is significantly different from the pyramid plans condemned in *Koscot, Ger-Ro-Mar,* and *Holiday Magic.* Specifically, the Amway Plan is not a plan where participants purchase the right

to earn profits by recruiting other participants, who themselves are interested in recruitment fees rather than the sale of products. [10]

B. Distributor Restrictions

1. Direct Price-Related Restrictions

The ALJ found that Amway engaged in illegal resale price maintenance at both the wholesale and retail levels. Respondents argue before us that Amway merely suggests retail and wholesale prices. They argue there is no evidence in the record of current explicit agreements between Amway and its distributors, or of Amway enforcing its suggested prices through coercion of its distributors. What evidence of such conduct there is, they say, relates to acts and practices long since discontinued; and since there is no cognizable danger of a recurrence of these acts, they continue, an order prohibiting such acts is unwarranted. We reject respondents' arguments regarding Amway's wholesale and retail pricing practices, and affirm the ALJ's finding that Amway has engaged in illegal resale price maintenance.

As will be discussed below, evidence in the record conclusively demonstrates that Amway entered into explicit agreements with its distributors, in the past, regarding wholesale and retail pricing. And though Amway has discontinued the use of explicit agreements with respect to retail pricing, it still has explicit agreements with its distributors regarding wholesale pricing. Such explicit agreements to maintain resale prices are, of course, illegal per se. *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911); *United States* v. *A. Schrader's Son, Inc.*, 252 U.S. 85 (1920); *cf. Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384, 386 (1951). After it discontinued the use of explicit agreements regarding retail pricing, Amway started out merely suggesting a retail price; but it then engaged in acts which secured adherence to its plan and thereby produced a "combination" or implied agreement, which had a direct and substantial effect on retail prices. *United States* v. *Parke-Davis Co.*, 362 U.S. 29 (1960); *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968); *In re Holiday Magic, Inc.*, 84 F.T.C. 748 (1974). Finally, Amway required its distributors to agree to certain other rules regulating the distribution and advertising of its products, which serve to bolster and effectuate its retail price maintenance scheme.

As to the practices it has relied on in the retail pricing area since it discontinued the use of explicit agreements, Amway seeks to rely on the *Colgate* doctrine. In *United States* v. *Colgate & Co.*, 250 U.S. 300, 307 (1919), the Supreme Court said: [11]

[T]he [Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell.

This language was interpreted to mean, as respondents state, in their Appeal Brief, at 12, that "a manufacturer [may] suggest resale prices for its products and independently . . . decline to do business with persons who resell the products at prices other than those suggested by the manufacturer." But cases decided since *Colgate* make it clear that the quoted language from that case was intended to create an exceedingly narrow exception. For example, in *United States* v. *Parke-Davis, supra,* the Supreme Court said:

An unlawful combination is not just such as arises from a price maintenance *agreement,* express or implied; such a combination is also organized if the producer secures adherence to his suggested prices by means which go beyond his mere declination to sell to a customer who will not observe his announced policy. 362 U.S. at 43.

Eight years later, in *Albrecht* v. *Herald Co., supra,* the Supreme Court raised the suspicions of many that *Colgate* was a dead letter when it stated that the *Colgate* exception might be exceeded if the sole evidence of a combination or conspiracy was that wholesalers and retailers, against whom a price maintenance plan was directed and enforced, had acquiesced in the plan. 390 U.S. at 150 n.6.

As will be developed in detail below, the evidence in this case establishes that Amway, in its efforts to secure adherence to its retail pricing plan, went far beyond the type of conduct that even a liberal reading of *Colgate* would allow. Specifically, Amway enlisted its distributors in a program designed to insure adherence to its stated pricing plan, and it structured certain of its Rules of Conduct so as to inhibit any kind of retail price competition among its distributors. Viewed against the background of the explicit agreements which Amway entered into in earlier years, these actions amply support a finding of illegal resale price maintenance. [12]

a. *Wholesale Prices*

Amway has illegally sought, and still seeks, to maintain its wholesale pricing policy through explicit agreement with its distributors. In a chapter of the 1975 Amway Career Manual[10] titled "The Amway Sales and Marketing Plan", Amway states: "[A distributor]

[10] *See* footnote 3 at page 4, *supra,* for a description of the Amway Career Manual.

cannot make money by simply selling products to his sponsored distributors because he sells them for the same price he paid for them: the distributor cost.[11]

Amway then converts this statement into a contractual provision by requiring a person seeking to become an Amway distributor to sign an application form which contains the following language:

> I agree to comply with the Amway Sales and Marketing Plan as set forth in official Amway Literature and manuals and to observe the spirit as well as the letters of the Amway Code of Ethics and Rules of Conduct . . . . I understand that my distriubtorship may be revoked if I fail to comply with the above provisions.[12]

[13] These explicit agreements are illegal *per se*.[13] *Dr. Miles Medical Co.* v. *John D. Park & Sons Co., supra.*

In addition, the "Distributor Order Form" (called an "SA-1"), which is published and circulated by Amway, instructs distributors to "consult the SA-13" for prices; an SA-13 is an Amway Wholesale Price List. Similarly, the 1975 Career Manual instructs distributors as follows: "Place your own order with your sponsor using the SA-1 Order Form. Use the Wholesale Price List to compute . . . Distributor Cost . . . for all items you have listed on the SA-1." Nowhere on any of these documents does it state that Amway's listed wholesale prices are "suggested" or "optional".

b. *Retail Prices*

In the retail pricing area, Amway originally used explicit agreements to prevent distributors from selling at less than Amway's specified retail price. In the 1963 Amway Sales Plan, the Rules of Conduct included the following rule: "No distributor shall sell

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[11] Though worded differently at different times, the message has been the same down through the years. The 1963 Amway Sales Plan said: "[P]roducts sold between distributors are always sold at the same price, with no profit made on the immediate transaction. The profit is made later on the refund percentage." The 1968 Career Manual stated: "You sell Amway products to the distributor you sponsor at the same [price] at which you buy from your sponsor, and at which he buys from his sponsor."

[12] In the Career Manual itself, on the page facing the page containing the statement above about selling at distributor cost, Amway states:

> "[T]here is . . . . a binding contractual arrangement between Amway and its distributors, and that contractual arrangement is spelled out in detail not in a single printed document, but in a group of documents. Amway has always considered itself bound by a contract consisting of the following: . . . the Career Manual. . . ."

[13] As noted at page 5, *supra*, Amway does indicate in a " Performance Bonus Schedule" the percentage of a distributor's monthly Business Volume that he is to receive as a Bonus from his sponsor. If there were an agreement between Amway and its distributors at various levels that the distributors would adhere to this Schedule in paying out Performance Bonuses to the distributors they sponsored, it arguably would be an agreement with a substantial and direct effect on wholesale prices and would be illegal *per se*. *Cf. United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 221 (1940). But there is no evidence that Amway or its distributors regard the Schedule as binding with respect to specific percentages. There is also no evidence that Amway enforces adherence to the percentages set out in the Schedule, nor even that most distributors do in fact adhere to those percentages. Findings 54 and 68 of the Initial Decision, at pp. 16, 25, indicate only that Amway enforces its rule that the Performance Bonuses it pays out to the Direct Distributors must be filtered through the distributor network, but not that the percentages Amway sets out are binding.

products sold under the Amway label for less than the specified retail price . . . ." Also included in this manual was a copy of the application a prospective distributor must fill out; each applicant was required to sign on the application underneath the following pledge: "I agree to observe the spirit as well as the letter of the Code of Ethics and Rules of Conduct of Amway Distributors." [14]

Respondents claim that the rule requiring adherence to Amway's retail prices was abolished in 1965. But as the ALJ pointed out, the record does not show that Amway has ever clearly told its distributors that they are free to set their own prices on retail sales to consumers.[14] Initial Decision, p. 87 n.12. Rather, it has signaled in several ways that it continues to regard fixed resale prices as being in everyone's mutual interest.[15]

Evidence presented at the hearing indicates that Amway has continued its efforts to secure compliance with its retail pricing policy long after it deleted the inculpatory language from its Rules of Conduct; in so doing, it has stepped well outside the protective parameters of *Colgate*. Specifically, it has invited its distributors to participate in a general scheme to detect and deter price cutting. For example, in a 1971 speech to a meeting of Direct Distributors,[16] DeVos was asked several questions by persons in the audience about what could be done with price cutters. He stated: [15]

> If you have a distributor who is selling Amway products at wholesale to a customer, our action has got to be first of all to get a complaint on it and find out who the distributor is that's doing it. Our next move has got to be to work on his removal, but this isn't an easy problem, because if this person wishes to sell to anybody on the street at whatever price he wants to, you're getting into some touchy areas on price-fixing. . . . Now you can try all the devious things you want to, to prevent this indiscriminate guy from price cutting . . . . [Y]ou can go ahead and delay shipments to him, you can berate him, you can lecture him. . . . Say [to him], "if you want to play price cutting game with your customers just let me know who they are because I make 25% and I'll go in and cut you right off. See, if its price cutting you want I'll show you how to play the game. Because I've got more money to play with than you have, haven't I?" [17]

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[14] Amway sends to distributors retail price lists for Amway products. The 1965 price list referred to the prices thereon as "retail". The 1970 price list used the phrase "retail prices (for sales tax purposes)". The current price list states that the prices listed are "suggested retail".

[15] In a 1970 copy of "The Amway Amagram" (a newspaper-like publication sent by Amway to its distributors), an article contained statements made by VanAndel to a meeting of Direct Distributors. He told them that Amway had conducted a test, in which it had divided the country into half, with prices set at normal levels in one half and at very high levels in the other half. He continued:

> "We wanted to see how much difference price would make in our marketing system. Actually, the sales volume per distriubtor in the higher price area was considerably higher than that in the other. I don't mean just 5% or 10%, I think it was over 50%. We concluded that higher price encouraged distributors to do more selling so he could make extra profit."

[16] This speech, along with several others, was tape-recorded live; the tapes of these speeches were admitted as evidence at the hearings.

[17] During this speech DeVos also said in regard to price cutting: "I can't do much about it. And I don't think you can do much about it." He added: "[Y]ou don't stand a legal chance of doing anything about it . . . . I can't

(Continued)

He went on in the same speech to caution the Direct Distributors to "guard against anything that's dog eat dog." He warned them that "price fixing is one of the things that the federal people and the FTC watch like a hawk," and advised them to talk to price cutters but not to write to them, because "when the FTC grabs that letter they'll say you're . . . price fixing." To say the least, the tactics recommended in this speech "go beyond mere announcement of [a] policy and [a] simple refusal to deal," and constitute "other means which effect adherence to [specified] resale prices." *United States* v. *Parke-Davis & Co., supra,* 362 U.S. at 44.

Similarly, Mr. Halliday — Amway's Executive Vice President and one of its three directors — told a meeting of Direct Distributors that if they learned of a distributor cutting prices, they should go to talk to that person's Direct Distributor and seek to persuade the price cutter to [16] stop. He added: "You're gonna have to work with him on an informal basis. As far as our being able to write him and saying 'You can't do it,' we cannot." This sounds far more like the invitation to acquiesce which the Supreme Court found unacceptable in *Parke-Davis* than the unilateral refusal to deal which might have some remaining vitality under *Colgate.*[18]

Amway has taken additional steps, beyond counseling Direct Distributors on how to deal with price cutters, to insure that price competition among distributors is thwarted. The clearest example of Amway's additional efforts to support its general price maintenance scheme is the "customer protection rule." This rule, which was included as one of the Rules of Conduct up until 1972, provides that each time an Amway distributor makes a sale to a retail customer, he obtains an exclusive right to re-sell to that customer for a thirty day period; if the distributor does make another sale to the customer within that period, he extends his exclusive right for another thirty days.

The ALJ found that the purpose and effect of the customer protection rule was to prevent price competition. Initial Decision, p. 89. This finding is supported by the obvious effect of the rule, and by Amway Vice President Halliday's statement that the purpose of the

take any action on it without endangering everybody in a federal restraint of trade activity." But these statements, essentially recognizing the dangerous legal problems that can arise from resale price maintenance and recommending caution in efforts at coercion, do not offset the clear meaning and effect of the other statements quoted above.

[18] Respondents rely heavily on *Knutson* v. *Daily Review, Inc.,* 548 F.2d 795 (9th Cir. 1976), *cert. denied,* 433 U.S. 910 (1977), for the proposition that where an explicit agreement is abandoned and is succeeded by strong recommendations of resale price maintenance, those recommendations do not constitute a "combination" in the absence of evidence of special coercion. But *Knutson* is not applicable here because Amway has gone far beyond "recommending": it has induced other distributors to assist in its program of detecting and deterring price cutting, and it has attempted to extract agreement and acquiesence from its distributors. *See* Initial Decision, pp. 39, 41–44, Findings 115, 117.

rule is "to prevent cut-throat competition" between distributors. Initial Decision, p. 88.

Respondents point to the fact that this rule was deleted from the Rules of Conduct in 1972; they claim this is evidence of discontinuance. However, in a speech to a meeting of Direct Distributors in 1974, Halliday reminded his listeners that the Golden Rule is the first rule in the Amway Code of Ethics[19] and then stated: [17]

> To what extent do you want to go in cutting out another Amway distributor? You have the absolute right to do it — the law says . . . there is no protection of customer under those circumstances. But you see, sometimes there's a — something above and beyond the law that you have to think about in terms of ethics.

Also, in the "Know-How Success Course", a training booklet used through 1974, sponsors are taught to test their recruits' knowledge of Amway policy with a quiz, which contains the following two questions (with their respective "right" answers):

> 9. Before you complete a sale to a new customer, is it important to ask if that customer is presently being serviced by another Amway distributor? YES or NO.
>
> - YES
>
> 10. As long as one distributor maintains exclusive right to resell a customer, no other Amway Distributor may sponsor that customer. TRUE or FALSE.
>
> - TRUE

These statements, coming as they did on top of an explicit rule in the recent past, undercut any argument of discontinuance.

In addition, Amway has tailored some of its otherwise reasonable Rules of Conduct to detect and prevent retail price cutting among distributors. An example is the ten customer rule (discussed at page 9, *supra*), which provides that a distributor must produce proof of retail sales to at least ten customers each month before he can receive his Performance Bonus. This rule has the reasonable purpose and effect of tying compensation to the retail sale of products. But it also serves as a detection device with regard to price cutting, because the "proof" a distributor must produce is a copy of the retail sales slip, which, by another rule, must "state the price charged". This aspect of the ten customer rule also has an obvious *in terrorem* effect on distributors who might be inclined to sell at less than Amway's "suggested" retail price. [18]

Two other rules currently included in the Rules of Conduct have had the effect of "shoring up" Amway's retail price fixing scheme.

[19] This literally is true, as the first provision of the Code reads: "I will make the 'Golden Rule' my basic principal of doing business. I will always endeavor to 'do unto others as I would have them do unto me.' "

The buy-back rule (discussed at page 9, *supra*) provides that a sponsoring distributor must buy back any products he sold to a sponsored distributor who has decided to go out of business. A 1973 Amway Legal Bulletin explained that one of the reasons for this rule is to insure that a distributor who is leaving the business does not "attempt to sell the products at a discount." *See* Initial Decision, pp. 44–46, Findings 120–23. The "fund-raising rule" provides that a distributor may sell certain Amway products in fund-raising drives held by church, service, civic or charitable organizations "provided such sales are made in accordance with the Amway Fund-Raising Plan." Under this plan (as it is described in the 1975 Career Manual), the selling organization only takes orders for the products; the orders are then turned over to an Amway distributor, who delivers the products, collects the purchase price, and pays an agreed-upon profit to the selling organization. Amway argues that the reason an Amway distributor is sent to deliver the product and pick up the purchase price is to allow the distributor to initiate contact with the purchaser. This argument might be convincing were it not for the history of this rule. The 1968 Amway Career Manual — which was distributed at a time when the charitable organization took sole responsibility for delivering the product and collecting the purchase price — gave the following advice to distributors supplying a fund-raising organization: "See that standard retail prices are observed. Do not permit cut-rate selling. Cut-rate selling during a fund-raising campaign could hurt your own regular selling of these items."

We do not say that the ten customer rule, the buy-back rule, and the fund raising rule are illegal in their entirety in this case. We do say that certain aspects of these rules, discussed above, as implemented here — with the plain purpose and effect of assisting in a program of illegal resale price maintenance — are illegal under Section 5 in that they contribute to a resale price maintenance program, *cf. National Society of Professional Engineers* v. *United States,* 435 U.S. 679, 692–93 (1978), and also that they are evidence of a purpose on the part of Amway to maintain an overall price maintenance program.[20] Initial Decision, p. 37, Finding 112. [19]

In a further effort to deter price competition, Amway has sought to prevent its distributors from advertising prices for Amway products.[21] Initial Decision, pp. 43–45, Findings 117, 119, 121. It has done

[20] The portions of the Final Order relating to rules (Order Paragraphs I.4, I.7, and I.8) are aimed solely at preventing their use in connection with the maintenance of retail prices; the Order does not otherwise disturb their operation.

[21] *See* pages 23–24, *infra,* for a detailed discussion of the advertising restrictions Amway has imposed on its distributors.

this by converting a series of restrictive advertising rules contained in its Rules of Conduct into contractual provisions,[22] and by terminating, or threatening to terminate, distributors who advertise Amway products at discount prices.[23] Besides contributing to Amway's overall scheme to control resale prices, this elimination of price advertising is a *per se* violation of Section 5. *See, United States* v. *Gasoline Retailers Asso., Inc.,* 285 F.2d 688, 691 (7th Cir. 1961); *United States* v. *The House of Seagram,* 1965 Trade Cases (CCH) ¶71,517, p. 81,275 (S.D. Fla. 1965); *cf. National Society of Professional Engineers* v. *United States,* 435 U.S. 679, 692–93 (1978). Moreover, this restriction on price advertising is evidence, along with the other price-related rules and practices discussed already, of Amway's intent to eliminate price competition in the retail sale of Amway products.

Finally, there is an additional, slightly different reason why Amway's retail pricing policy is illegal. This is not a situation, like *Colgate,* where a manufacturer is imposing its retail pricing policy on a corps of resistant, or even neutral, wholesalers and retailers. Rather, there is evidence that the ADA Board of Directors — which is the representative of Amway's distributors — agrees in advance with Amway on what the retail price of particular products is going to be. *See* Initial Decision, p. 27, Finding 79. In its Non-Profit Corporation Annual Report filed with the state of Michigan in 1975, the ADA stated that the "Purpose of the Corporation" was: "To act as a trade association for the purpose of setting policies with the company from whom purchases are made *and the pricing of all products sold direct to the consumer*" (emphasis added). Respondents have attempted to characterize this language as "inaccurate boilerplate". We find this characterization unpersuasive. [20]

c. *Respondents' Claims That Price Competition Does Exist*

Respondents argue that distributors do, in fact, demonstrate considerable independence and flexibility in wholesale and retail pricing. And several distributors (mostly Direct Distributors) who testified at the hearings were asked whether they were required by Amway to resell Amway products at a certain price, and answered "No". In addition, some of these distributors testified that they occasionally do sell for less than "suggested" retail or wholesale. However, as the ALJ observed, it is not surprising that out of a group

[22] *See* page 12, *supra,* for a discussion of how Amway converts the Rules of Conduct into a contract between Amway and each distributor.

[23] *See* Initial Decision, pp. 41–46, Findings 117, 119, 121, and p. 90. Also, Amway advises its distributors, in the Career Manual, that when a distributor violates one of the Rules of Conduct his Direct Distributor "may take such corrective action as he deems necessary, even terminating the violator's distributorship."

of 360,000 distributors, a few could be found who do "discount". Initial Decision, p. 88 n.13. The ALJ still found that the record showed that the vast majority of Amway distributors do not cut the retail price of Amway products. Initial Decision, p. 47, Finding 127. We agree with this finding.

Respondents also claim that substantial retail discounting is evidenced by the retail sales tax refunds Amway pays out to distributors. Amway collects retail sales tax, based on its suggested retail prices, from the Direct Distributors at the time it sells products to them wholesale; this is done at the request of state taxing authorities. *See* Initial Decision, p. 46, Finding 124. This sales tax is passed along in each wholesale sale of products, and is ultimately recouped at the time a product is sold at retail. Respondents point to the fact that a distributor may apply for a refund of some or all of this amount if he sells a product at less than Amway's suggested retail price. And in fact, respondents state, a large amount of money is refunded each month from Amway's sales tax collections. But complaint counsel point out that there are many reasons why a distributor could be entitled to a refund of some or all of the retail sales tax he paid, including: sales across state lines with different tax structures, sales to tax exempt organizations, and, most importantly, distributor home consumption.[24] Indeed, this "request-for-refund" policy could itself be ancillary to Amway's price maintenance plan if it were used as a means of learning which distributors have made sales at less than "suggested" retail. [21]

We conclude on the record that Amway has illegally sought to enforce its resale price policies, and, judging by market effects, has enforced them successfully throughout most of its distributor network.[25]

2. Other Challenged Distribution Restrictions

Complaint counsel also allege that two other Amway rules and restrictions — the "cross-group selling rule" and the "retail store rule" — violate Section 5 as unreasonable restraints of trade. The prohibition on cross-group selling, sanctified in Amway's Rules of Conduct, provides that a distributor must buy all his products from

[24] The ALJ found that home consumption of Amway products by distributors accounts for a significant amount of Amway's sales. *See* Initial Decision, pp. 55–56, Finding 137.

[25] Where a finding of resale price maintenance has been made, we routinely include in the order a provision prohibiting the use of suggested prices for some time after entry of the order. But in this case there are highly unusual circumstances which make the use of suggested resale prices not anti-competitive. Specifically, Amway has an unusual distribution system which relies on the sales efforts of hundreds of thousands of distributors, many of whom distribute Amway products part-time and are inexperienced in business matters generally. It is not unreasonable under these circumstances to give distributors some guidance in setting prices on the 150 products they try to sell.

his sponsor; by implication, a distributor may not sell Amway products to a person sponsored by someone else. The retail store rule — also one of the Rules of Conduct — provides that no distributor shall permit Amway products to be sold or displayed in "retail stores" or "other types of retail establishments, which are not technically stores, such as barber shops, beauty shops, etc."

Complaint counsel have characterized these restrictions as *per se* violations of Section 5, either as part of a plan to maintain prices, or as market division schemes horizontally imposed. We reject both these contentions. As to the price fixing charge, we have already found that Amway has entered into a series of express agreements and/or implied combinations with its distributors fixing wholesale and retail prices. There is no evidence on this record that the retail store rule or the cross-group selling rule were adopted to implement those vertical price fixing agreements, or that they contributed to that effect. If Amway's direct efforts at resale price maintenance are elimiated — as they should be through the order imposed here — there is no reason to believe resale price maintenance would persist as a reult of these two rules. [22]

If the restraints embodied in the cross-group selling and retail store rules were horizontally agreed to or induced, rather than vertically imposed by Amway on its distributors, the agreements would probably be illegal *per se* as horizontal divisions of market. *See United States* v. *Topco Associates, Inc.,* 405 U.S. 596 (1972); *United States* v. *Addyston Pipe & Steel Co.,* 85 F. 271 (6th Cir. 1898), *aff'd.,* 175 U.S. 211 (1899). Complaint Counsel claim that the ADA was formed before Amway, and that therefore the ADA must have been the source of all distributor restrictions. We do not find this approach conclusive on this question. Furthermore, the ALJ found that VanAndel and DeVos formed the ADA, at a time when they were distributing another manufacturer's products through a direct selling organization, in anticipation of starting their own manufacturing company. Initial Decision, pp. 8–10, Findings 17–25. Complaint counsel established that there is a constant dialogue between Amway and the ADA Board regarding the nature and consequences of the Amway Plan. But it does not follow that Amway is obligated to adopt, or does adopt, the recommendations or requests of the ADA Board when Amway is otherwise inclined to take different action or to take no action at all. It is likely that the dialogue exists primarily for the purpose of making the distributors — especially the Direct Distributors, who are linchpins in the Amway Plan — feel that they are an important part of the Amway organization and that their views and opinions are highly regarded. *See* Initial Decision, pp. 81–

82. Complaint counsel also point to the fact that VanAndel and DeVos, the two principal owners of Amway, are themselves the joint heads of a Direct Distributor organization. However, other than stating in their Appeal Brief, at 43, that the two men have "one of the largest Amway Direct Distributorships in the country," complaint counsel have provided no information or evidence on this point. All in all, we feel there is not sufficient evidence to support a finding that the Amway Rules of Conduct are not "essentially" vertical. Therefore they will be analyzed individually under the rule of reason. *Cf. Continental T.V., Inc.* v. *GTE Sylvania, Inc.,* 433 U.S. 36 (1977).

The cross-group selling rule, which applies only to distributors' wholesaling functions, was found by the ALJ to be "the basis for the Amway Sales and Marketing Plan":

> It provides the structure by which products, information and compensation flow from Amway to the Direct Distributors and down to the distributors engaged in making the retail sale. It provides lines of communication and responsibility insuring that distributors are properly trained and [23] motivated and that consumers receive services provided under the Amway system of distribution. Used in conjunction with the performance bonus system, the cross-group selling rule gives sponsoring distributors an incentive to recruit, train, motivate and supply other distributors in order to gain a reward based on the sponsored distributors' sales volume. If sponsored distributors could buy Amway products from someone other than their sponsor, that incentive would not exist. Initial Decision, p. 100 (citations omitted).

We endorse this finding and conclude that the vertically imposed cross-group selling rule is reasonably ancillary to compensation, efficient distribution, and training. Given the large number of existing and potential distributors of Amway products, Amway's small size compared to its major competitors, and the direct relationship between the limitation on cross-group selling and the achievement of efficiencies within Amway's unique distribution system, we agree with the ALJ that the restriction is reasonable. *Continental T.V. Inc.* v. *GTE Sylvania, supra.*

The ALJ found that the retail store rule preserves Amway's direct-selling operation and consumer demand for Amway products, and provides an incentive to distributors to furnish special services to consumers:

> Marketing experts gave credible testimony in this proceeding that if Amway products were sold in retail stores, distributors would lose interest in calling on consumers' homes, demonstrating and explaining products to create a demand which could be satisfied — perhaps at a lower price — at a retail store. Without a demand for the products, retail stores would soon lose interest in Amway products. Amway would then be faced with the necessity of creating demand in the traditional way of advertising expenditures and otherwise doing battle in the retail grocery stores, in a

hostile oligopolistic marketplace. . . . The retail store rule gives Amway distributors an incentive to provide services to consumers and to create a consumer demand which would dissipate if Amway products were sold in retail stores. Amway distributors demonstrate and explain Amway products [24] and deliver to the consumer's home. These services are typically unavailable from retail stores. Because some Amway products are more concentrated than products sold in retail stores, demonstration and explanation are essential to consumer demand. Initial Decision, pp. 98–99 (citations omitted).

We endorse this finding as well. Since neither Amway nor any of its distributors can sell through retail outlets, this is not an instance where existing competition between different distributors or classes of distributors is being curtailed. Given Amway's small size (compared to its competitors), the plausible business reasons for the restrictions (relating mainly to Amway's ability to recruit distributors and induce them to provide special services), the absence of evidence that retail stores are excluded principally because of a belief that they would be price cutters, and the armies of distributors seeking to sell Amway products to all who wish to purchase them — we agree that complaint counsel has failed to show that this restriction is unreasonable.

3. Advertising Restrictions

Amway exercises a strong control over advertising by its distributors. It has placed especially severe restrictions on product advertising. One of the Rules of Conduct states: "No Amway distributor may produce or procure, from any source other than Amway, any literature relating to the Amway Sales and Marketing Plan or any Amway product." Thus the first rule on product advertising is that Amway has total control over what is actually said. Amway insists this restriction is necessary to protect its 125 registered trademarks and servicemarks, and to insure that its products are intelligently and consistently described.

Another rule provides that only Direct Distributors may advertise on radio, television, or in newspapers, and then only if they use ad mats and scripts obtained from Amway. Thus a distributor who is not a Direct Distributor may not advertise Amway products by any means other than hand- or mail-delivery of Amway sales aids and promotional materials. Amway claims it is reasonable to deny regular distributors the right to advertise products on radio, television, and in newspapers, because most distributors are inexperienced in business and tend to overestimate the effectiveness of advertising; if they were turned loose to advertise as much [25] and by whatever means they chose, many of them would unjustifiably

increase their expenses to the point where they were driven from the market. In addition, respondents say, there is rapid turnover among distributors, and it would have a negative impact on Amway's image if consumers responded to ads placed by distributors who had since gone out of business.

The ALJ found these restrictions reasonable. Initial Decision, pp. 104–05. We concur in this finding, except that we find one aspect of Amway's restrictions on product advertising unnecessarily restrictive and ancillary to Amway's price maintenance scheme. Specifically, none of the Amway-designed sales aids, promotional literature, ad mats, or ad scripts provides a place for the advertising distributor to list his own retail price for the products advertised. And since no distributor may advertise Amway products other than by using the advertising materials designed and distributed by Amway, it follows that price advertising is effectively prohibited. To protect its servicemarkets and trademarks, Amway may — in reasonable ways that are not anticompetitive — prescribe the means by which distributors advertise products and the words they use; but Amway may not foreclose distributors from advertising product prices. *United States* v. *Gasoline Retailers Asso., Inc.,* 285 F.2d 688, 691, (7th Cir. 1961); *United States* v. *The House of Seagram,* 1965 Trade Cases (CCH) ¶71,517, p. 81,275 (S.D. Fla. 1965); *cf. National Society of Professional Engineers* v. *United States,* 435 U.S. 679 (1978).

Amway also restricts the use by distributors of the Amway name and logo on the exteriors of wholesale offices and automobiles, on checks, and in telephone directories. It restricts outdoor advertising on billboards or signs, and allows distributors to use the Amway name in classified recruiting advertisements only if the ads follow word-for-word one of seventeen formats provided by Amway. Finally, all Amway printed material is copyrighted and may not be reproduced by distributors without permission. The ALJ found these reasonable. *See* Initial Decision, pp. 32–35, Findings 94–108, and pp. 104–05. We question whether some of these restrictions are reasonably related to Amway's legitimate business needs; but we agree that complaint counsel have offered no plausible evidence from which we might conclude that the purpose or effect of these various restrictions is anticompetitive. [26]

C. Misrepresentations

Respondents were charged in the complaint with making false, misleading, and deceptive statements concerning the profitability of a distributorship. Specifically, complaint counsel claim respondents have affirmatively misrepresented distributors' earnings and re-

cruiting potential, and have omitted material facts about business expenses and turnover among recruited distributors. Together, it is charged, these misrepresentations and omissions have the capacity to deceive distributors and potential distributors.

The different kinds of alleged misrepresentations involved are discussed in detail in the Initial Decision at pages 17–23 and 48–57. Most come from the 1975 edition of the Amway Career Manual, from the section advising a would-be sponsor on how to go about recruiting a new distributor. The method employed consists of explaining the Amway plan and appealing to the financial goals of the recruit. The ALJ found that, viewed in context, none of the statements challenged constitutes an illegal misrepresentation. Initial Decision, pp. 110–18. With the exception of those statements which make unrealistic earnings or sales claims, we affirm this finding.

The "non-earnings" claims made by Amway — which generally consist of vague references to the achievement of one's dreams, having everything one always wanted, etc. — are phrased in terms of "opportunity" or "possibility" or "chance"; and they are surrounded by warnings that hard work is required. We believe that these claims are primarily inspirational and motivational; to the extent that they dangle the likelihood of financial security and material success before the potential distributor, they constitute vague "puffs" which few people, if any, would take literally; and in any event, they are accompanied by appropriate qualifiers.

The same cannot be said, though, for certain statements and claims which contain references to specific dollar amounts which distributors are likely to earn. For example, in the 1975 Career Manual, Amway advises recruiting distributors to announce to persons they are trying to recruit that Amway offers an opportunity to "develop an income of as much as $1,000 per month." Amway also advises recruiting distributors to ask questions like the following:

> How much money per month do you need for that new car? $100 a month or more?
>
> What kind of home do you want — a three-bedroom ranch — with a price tag of $35,000–$40,000? [27]
>
> How much will it take to send the youngsters through college — $2,500 to $3,000 a year for each younster? If you could earn an extra $250 a month, you would have an additional $3,000 a year. This might be sufficient to send one youngster through one year of college.
>
> How much would you like as a continuing income — $100 a month?

But not all of Amway's recommended recruiting claims are so

generalized. At one point in the Career Manual it states: "If you make 'two sales a day . . . the Amway way' on each of 20 days per month, your retail sales can easily amount to $200.00 per month even though you work less than an hour per day." The Manual uses this $200 figure again when it instructs a recruiting distributor on how to "draw the circles" — a device used to explain the way a distributor earns a Performance Bonus off the purchases made from him by the distributors he has sponsored. He is advised to state: "Let's say, for example, that you sponsor six distributors and that each one of these distributors starts his own retail business selling $200 a month." He then draws a big circle, representing the sponsor, and six smaller circles, each of which represents a sponsored distributor. The figure $200 is written into each of these six smaller circles to indicate that each sponsored distributor has a Business Volume of $200 per month. The recruiting distributor then does a series of calculations showing the Performance Bonus the sponsor will earn as a result of having six sponsored distributors with individual monthly Business Volumes of $200. In the example of this diagram included in the Career Manual, the following language is placed above the circles: "For discussion purposes, let's round out the numbers to $200.00. I'm sure you realize that some will do much less and some more. But, if they make two sales a day, they should sell at least $200 (at BV) per month." But in spite of this prominent disclaimer, the impression is created that $200 is a typical or average monthly Business Volume.[26] [28]

In fact, the record shows that in 1969–70 the average monthly Business Volume of Amway distributors was about $20, and in 1973–74 it was about $33.[27] Initial Decision, pp. 55–56, Finding 137. And while some Direct Distributors do have annual Business Volumes in the thousands of dollars, they are less than 1 percent of Amway's 360,000 distributors. Initial Decision, p. 50, Finding 133. Thus the claims of incomes of $100 to $1,000 per month and the use of the $200 figure in such a way as to imply that it is a typical monthly retail sales figure, constitute misstatements of the amount of money a distributor is likely to earn. The $200 Business Volume figure

[26] "What impression is made by a given practice is a question of fact for the Commission to determine . . . ." *Benrus Watch Co.* v. *FTC*, 352, F.2d 313, 318 (8th Cir. 1965), *cert. denied*, 384 U.S. 939 (1966); *accord Niresk Industries, Inc.* v. *FTC*, 278 F.2d 337, 342 (7th Cir.), *cert. denied*, 364 U.S. 883 (1960); *Kalwajtys* v. *FTC*, 237 F.2d 654, 656 (7th Cir. 1956), *cert. denied*, 352 U.S. 1025 (1957).

[27] We note that this figure is not "retail sales", but Business Volume — that is, the retail value of the products purchased for resale to consumers and sponsored distributors, and for distributor home consumption, which was stated before, constitutes a large portion of all sales of Amway products. *See* Initial Decision, pp. 55–56, Finding 137.

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overstates the true average Business Volume by more than 500 percent.[28] And the often unqualified claims regarding actual income are even more removed from reality, at least as reality exists for the vast majority of Amway distributors.

The Commission previously addressed issues concerning unrepresentative earnings claims in *National Dynamics Corp.*, 82 F.T.C. 488 (1973), *aff'd in part and rev'd. in part,* 492 F.2d 1333 (2d Cir.), *cert. denied,* 419 U.S. 993 (1974). In *National Dynamics,* respondents were manufacturers of a battery additive which they marketed through 12,000 distributors. In attempting to recruit new distributors, respondents made generalized earnings claims like, "You can earn $12,000 a year. . . .", and "What do you want to make of your life? . . . An income of $15,000 to $50,000 per year?" They also quoted the following earnings for named individuals: "$1,554 one week", "$148 one day", "$2,316.96 one week", "$1,028 one month". The Commission opinion noted that of the 12,000 [29] distributors selling for respondents in 1969, not more than sixty, or one-half of 1 percent of the total number of distributors, made profits in excess of $10,000. *Id.* at 563. Based on this fact, the Commission found the generalized earnings claims to be misleading and deceptive because they "far exceed[ed] the earnings normally received by dealers." *Id.* at 565. The specific earnings claims for named individuals were also found to be misleading and deceptive because they had "the capacity and tendency to lead members of the public to believe that a substantial number of distributors will regularly earn such amounts." *Id.* at 564.

Amway's specific earnings and sales claims are similar to the claims in *National Dynamics:*[29] they far exceed the amounts normally received by distributors, and, in their cumulative impact, they have the capacity and tendency to lead potential distributors to believe that a substantial number of distributors really do receive such amounts. Therefore, they constitute illegal misrepresentations under Section 5.[30]

Finally, the ALJ found, contrary to complaint counsel's charges, that Amway has not misrepresented distributors' recruiting poten-

[28] In a speech given to Direct Distributors in 1974, DeVos stated that the reason for using a figure as large as $200 is to raise distributors' "vision" of their own potential. *See* Initial Decision, p. 55, Finding 136. But this does not change the fact that the $200 figure overstates the true average Business Volume amount; and a statement need not be intended to deceive in order to have the capacity to deceive.

[29] It should be noted, though, that Amway has not advertised specific earnings of named individuals. In fact, the 1975 Amway Career Manual states: "Don't quote dollar incomes on specific individuals even though you may want to use their stories about the homes in which they live, the cars they drive, or the airplanes they fly."

[30] We note here that complaint counsel have attacked earnings claims made to potential distributors and to persons who already were Amway distributors. We restrict our finding of a violation to those earnings misrepresentations made to potential distributors. We believe that experienced distributors can be expected to be aware of the opportunities, or lack of opportunities, open to them under the Amway Plan. Statements of the kind discussed in the Initial Decision, at p. 49, Finding 132, when made to persons who already are distributors, can be considered "inspirational" in nature.

tial, and that it has not failed to disclose that distributors incur expenses in operating their distributorship, or that there has been a high rate of turnover among newly recruited distributors. *See* Initial Decision, p. 57, Findings 140–41. We affirm this finding. [30]

III. Procedural Issues

Respondents claim that numerous procedural errors and irregularities occurred, to their prejudice, during this proceeding and the investigation which preceded it. First, they claim that no cease and desist order can be entered against them because part or all of the evidence supporting the complaint may have been acquired by unlawful means. Respondents moved to dismiss the complaint on the same grounds in April 1975. The Commission denied that motion but stated that its ruling was without prejudice to any attempts by respondents to move the ALJ to suppress evidence they claim was improperly obtained. The ALJ thereafter took steps to monitor the source of witnesses and exhibits complaint counsel proposed to call or introduce at the hearings. We find, upon review, that the steps taken by the ALJ were adequate and effective.

Next, respondents claim they were prejudiced by the ALJ's denial of their request for discovery from the files in *Colgate-Palmolive, et al.*, Commission File No. 741–0048 (relating to a non-public FTC investigation). Respondents argue that the discovery sought from that file relates to entry barriers and concentration in the soap and detergent industry, and that it could provide proof of the reasonableness of the vertical restrictions in the Amway Plan. We reject respondents' argument that they were entitled to discovery from this file and affirm the ALJ's order denying discovery.[31]

Respondents further state that a series of procedural errors and irregularities are set forth in a motion to dismiss read into the record on the first day of trial. Though that motion was denied by the ALJ in a June 15, 1978 Order, respondents state that they continue to assert the positions set forth in the motion. Without describing the alleged errors and irregularities, they add: "The bases for those positions are set forth in respondents' motion and do not require repetition here." We have considered the motion set forth in the transcript, and we affirm the ALJ's decision to deny. [31]

Finally, respondents assert that the transcript of testimony given at the hearings is full of errors, and that the record must either be

[31] We note that all of the vertical restrictions challenged have been found to be reasonable, except as they were ancillary to Amway's illegal resale price maintenance plan. We also note that these findings were based on our view that the product markets in which Amway competes are indeed concentrated, and that Amway's presence has had some procompetitive consequences.

reopened to allow correction of these errors or the complaint must be dismissed. Respondents filed a veritable blizzard of papers on this matter with the ALJ, who issued more than ten Orders in response. A brief description of the events leading to respondents' objection is appropriate.

Soon after the hearings ended, respondents objected to about 2000 pages of the transcript, claiming they contained errors. Complaint counsel objected to additional pages, and the parties filed with the ALJ a stipulation of corrections involving over 2000 pages of the transcript. In Orders issued on December 6 and December 30, 1977, and January 6, 1978, the ALJ noted that almost all these stipulated changes involved typographical or spelling errors, and ordered the parties to specify the errors affecting substance. This was to insure compliance with Section 3.44(b) of the FTC Rules of Practice, which says that "[c]orrections of the official transcript may be made only when they involve errors affecting substance . . . ." After considerable maneuvering by the parties with respect to what constitutes an error of substance, the ALJ issued an order on January 24, 1978 stating:

> Respondents submit that there should be changes made on almost 2000 pages of the transcript in this case . . . . Respondents argue that errors in spelling of some of the key words in the transcript must be corrected for the purpose of accuracy in their computer retrieval system. This is a convincing argument. I therefore hold that the pages of the transcript enclosed with this order shall be corrected by the official reporter pursuant to Rule 3.44(b).

By letter of March 13, 1978, the official reporter responded, stating that all the requested changes had been made and characterizing them as "errors in spelling" and "changes in grammer or syntax, post-hearing selections of synonyms deemed more appropriate, expressions of parentheticals in the form of commas, and in some instances complete changes in the sentence structure which reflects the desire of witnesses, after the fact, to communicate their thoughts in clearer fashion." [32]

Still not satisfied, respondents moved, during an oral argument on the merits of the case, to dismiss the complaint on the grounds that not all the ordered corrections had been accomplished.[32] In reply, complaint counsel informed the ALJ that they had learned from the official reporter that no one had arranged to have the transcript put into computer readable form such that it could be utilized in a computerized information retrieval service. This led the ALJ to remark, in his June 15, 1978 Order denying the motion to dismiss,

[32] Respondents assert on appeal that ordered corrections have still not been made on 350 pages, and that there are 35 "garbled or omitted portions of the transcript".

that the 2000 pages previously ordered corrected "need not, therefore, have been retyped pursuant to Rule 3.44(b)." The ALJ continued: "[R]espondents have not been able to point to one proposed finding which might be affected by any of the errors in the transcript they allege." The ALJ noted that the parties were in agreement as to every correction ordered, and therefore instructed complaint counsel to have the stipulation of changes — which consists of hand corrected copies of the transcript pages in question — inserted in the record. Complaint counsel did so, and the hand-marked pages are included in the record as "ALJ Exhibit A". We interpret the ALJ's statement above — that none of the remaining "errors" affects any proposed finding — to mean that none of those errors affect substance. Therefore, no further corrections of the record need be made (if, indeed, any ever did need to be made).

IV. Conclusions

We conclude that respondents have agreed and combined with each other and/or with Amway distributors to fix the resale prices of Amway products, at both the wholesale and retail levels, in violation of Section 5 of the Federal Trade Commission Act. Respondents have also made earnings and sales claims which have the capacity to deceive the potential distributors to whom they have been made; this too, is in violation of Section 5. We have decided that it is appropriate and necessary to order respondents to cease and desist from these violations, and from certain offenses reasonably related to them.

The Commission has also concluded that complaint counsel have failed to establish that respondents have engaged in the other alleged violations of Section 5. Therefore those charges against respondents are dismissed.

Final Order

This matter having been heard by the Commission upon the cross-appeals of respondents and complaint counsel from the Initial Decision, and upon briefs and oral argument in support thereof and opposition thereto, and the Commission for the reasons stated in the accompanying Opinion having determined to affirm in part and reverse in part the Initial Decision:

It is ordered, That the Initial Decision of the administrative law judge be adopted as the Findings of Fact and Conclusions of Law of the Commission, except to the extent inconsistent with the accompanying Opinion.

Other Findings of Fact and Conclusions of Law of the Commission are contained in the accompanying Opinion.

It is further ordered, That the following Order to Cease and Desist be, and it hereby is entered: [2]

I

It is ordered, That respondents Amway Corporation and Amway Distributors Association, and their officers, agents, employees, representatives, members, successors and assigns, and respondents Jay VanAndel and Richard M. DeVos, individually, and their agents, employees, and representatives, directly or indirectly through any corporate or other device, in connection with the offering for sale, sale, or distribution of cleaning or personal care products, or any other products or goods in commerce, as "commerce" is defined in the Federal Trade Commission Act, shall forthwith cease and desist from:

1. Fixing, establishing, or maintaining, or attempting to fix, establish, or maintain, the price at which any distributor sells or offers for sale any product at wholesale or retail.

2. Stating that distributors are required to, or do, charge a particular price in wholesale or retail sales of any product.

3. Entering into any contract, agreement, understanding, or arrangement with any distributor which fixes, establishes, or maintains the price at which that distributor sells or offers for sale any product at wholesale or retail.

4. Taking any action, or counseling any distributor to take any action, designed to detect the price at which any distributor sells or offers for sale any product at wholesale or retail, including but not limited to: requiring distributors, in proving that they made retail sales to ten different persons in a month, to disclose the price at which they made such sales; directing or requesting any distributor to report to his Direct Distributor, to Amway, or to any other person or entity, knowledge he or she has of another distributor selling products at a price different from Amway's suggested wholesale or retail price; or allowing the price information submitted by any distributor seeking a full or partial refund of amounts paid by him or her for state retail sales tax, to be seen by any person other than those responsible for paying out such refunds, or to be used for any purpose other than paying out such refunds.

Provided, however, it shall not be a violation of this order for Amway to receive information about the price a distributor charged in a particular retail sale if such information is received by Amway solely as a result of such [3] sale being one of the following types: (1)

a sale wherein the purchaser used a bank credit card in making the purchase; (2) a sale of catalog merchandise wherein the purchaser paid by personal check payable to Amway; or (3) a sale to a commercial account wherein Amway financed the purchase.

5. Taking any action, or counseling any distributor to take any action, designed to deter distributors from selling or offering for sale products at a price different from Amway's suggested wholesale or retail prices, including but not limited to: addressing communications regarding price to any individual distributor, rather than to distributors as a class; delaying, or threatening to delay, the shipment of products to any distributor; withholding, or threatening to withhold, any distributor's Performance Bonus, if such distributor is otherwise entitled to such Bonus; underselling, or threatening to undersell, any distributor in retaliation for such distributor having sold or offered to sell products at a price different from Amway's suggested wholesale or retail prices.

6. Preventing or discouraging, or attempting to prevent or discourage, any distributor from selling or offering for sale products at retail to any person or entity, on the grounds that such person or entity is the customer of another distributor.

7. Requiring a distributor who is terminating his relationship with Amway to sell his remaining products back to Amway or to another distributor; *provided, however,* it shall not be a violation of this order to give a distributor who is terminating his relationship with Amway the opportunity to sell his remaining products back to Amway or another distributor.

8. Preventing, or attempting to prevent, a fund raising organization from selling or offering for sale products at a price different from Amway's suggested retail price.

9. Preventing, or attempting to prevent, distributors from advertising the prices at which they are selling or offering for sale products, including but not limited to, failing to include a place for distributors to disclose price in any existing or future sales aids, promotional literature, advertising mats, advertising scripts, etc., used by distributors in advertising Amway products. [4]

10. Publishing or distributing, directly or indirectly, any wholesale or retail price list, order form, promotional material, or any other document which lists resale prices for products without stating clearly and conspicuously thereon: "The prices stated here are suggested prices only. Distributors are not obligated to charge these prices. Each distributor is entitled to determine independently the prices at which products may be sold to other distributors or to consumers."

II

It is further ordered, That the aforesaid respondents and their officers, agents, employees, representatives, members, successors, and assigns, directly or indirectly, in connection with inducing or seeking to induce the participation of any person in any distribution, sales, or marketing plan, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Misrepresenting in any manner the past, present, or future profits, earnings, or sales from such participation.

2. Representing, by implication, by use of hypothetical examples, or otherwise, that distributors earn or achieve from such participation any stated amount of profits, earnings, or sales in excess of the average profits, earnings, or sales of all distributors in any recent year respondents may select, unless in conjunction therewith such average profits, earnings, or sales is clearly and conspicuously disclosed, or the percent of all distributors who actually achieved such stated profits, earnings, or sales in such year is clearly and conspicuously disclosed.

III

It is further ordered, That respondent Amway Corporation or its officers, agents, representatives, employees, successors or assigns shall, within thirty (30) days from the effective date of this order, deliver a copy of this order to all persons who are currently Amway distributors.

IV

It is further ordered, That respondents and their successors and assigns notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents such as dissolution, assignment or sale resulting in the emergence of successor corporations, the creation or dissolution of subsidiaries, or any other change in the corporations or in the Amway Sales and Marketing Plan which may affect compliance obligations arising out of the order. [5]

V

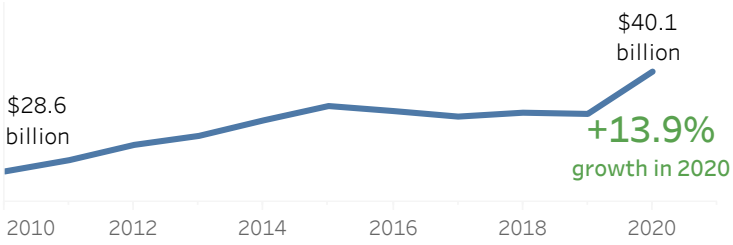
It is further ordered, That the respondents herein shall within sixty (60) days from the effective date of this order, file with the Commission a report in writing setting forth in detail the manner and form in which they have complied with this order.

Direct Selling in the United States

2020 Industry Overview

Direct selling in the United States achieved record highs in 2020 for retail sales ($40.1 billion), sellers (7.7 million), and customers (more than 41.6 million) during 2020. By dividing the $40.1 billion in sales by the 7.7 million direct sellers, direct sellers averaged $5,208 in retail sales in 2020. (Hover your mouse over the charts below to see exact figures)

Direct Retail Sales

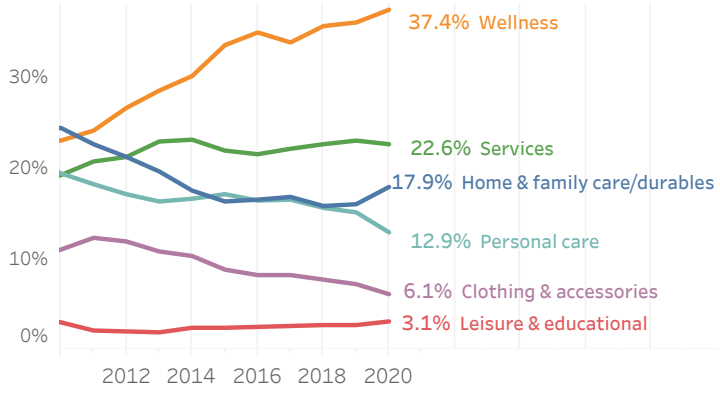


7.7 Million Direct Sellers

7.7 million direct sellers (a 13.2% increase over 2019) built a business full-time (30 or more hours/week) or part-time (fewer than 30 hours/week) . These people sell products/services to consumers and may sponsor people to join their team.

Full-time	Part-time
0.9 million	6.8 million

Sales by Product Category



41.6 Million Preferred Customers and Discount Buyers

This total figure represents a 12.7% increase over 2019. (And, this figure excludes those who have not signed an agreement with a direct selling company).

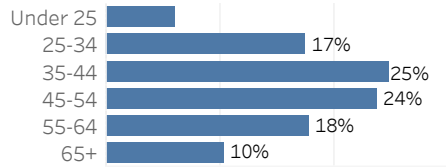
Preferred Customers	Discount Buyers
32.6 million	9.0 million

Demographic Breakdowns

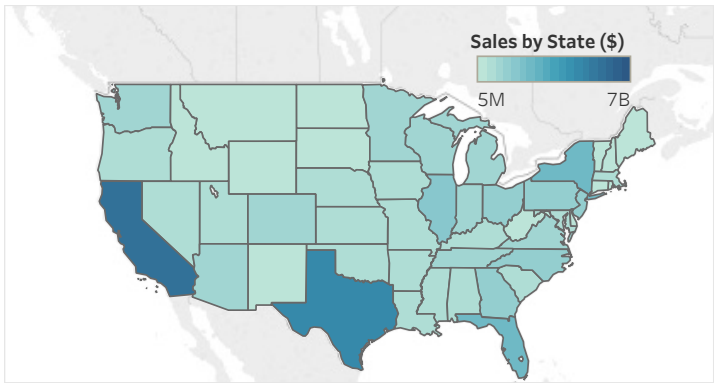
(Demographics include both direct sellers and discount buyers)

Gender

Age



Sales by State

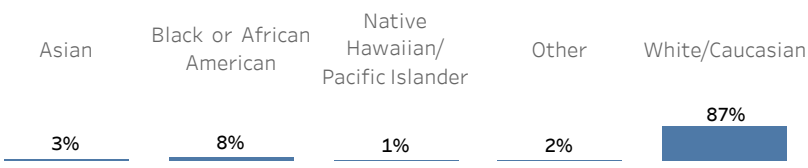


Hispanic Ethnicity:

22% Hispanic

Note: U.S. Census Bureau reports Hispanic Ethnicity and Race separately, and so does DSA.

Race



Source: DSA 2021 Growth & Outlook Study; For further information visit www.dsa.org/benefits/research

Definitions

Direct selling: A business model that provides entrepreneurial opportunities to individuals as independent contractors to market and/or sell products and services, typically outside of a fixed retail establishment, through one-to-one selling, in-home product demonstrations or online. Compensation is ultimately based on sales and may be earned based on personal sales and/or the sales of others in their sales team.

Direct sellers build a business full-time (30 or more hours/week) or part-time (fewer than 30 hours/week) and sell products/services to consumers and may sponsor people to join their team.

Discount buyers are eligible to purchase, sell, & sponsor, but are product lovers, only purchasing products /services they personally enjoy and use at a discount.

Preferred customers have signed a preferred customer agreement with a direct selling company where they may be eligible to pay wholesales prices for products/services. They are not eligible to sell products/services to others, and they are not eligible to earn.

Note: Figures above may not sum to 100% due to rounding.

Appearances

For the Commission: *Harold E. Kirtz, Karen G. Bokat* and *Charles W. Corddry, III.*

For the respondent: *Michael J. Henke, Vinson, Elkins, Searls, Connolly & Smith*, Wash., D.C.

ORDER DENYING MOTION FOR RECONSIDERATION

Respondent American General Insurance Company and intervenor Fidelity and Deposit Company of Maryland move for reconsideration of an order by the Commission, dated Dec. 5, 1972 [81 F.T.C. 1052], vacating the administrative law judge's initial decision and remanding the case for further proceedings. The administrative law judge filed an initial decision sustaining the complaint in this matter on Aug. 7, 1975.

Respondent and intervenor have failed to make a sufficient showing why the Commission should grant their motion for reconsideration, especially after the lapse of almost three years from the date of issuance of the order they seek to challenge. Accordingly,

It is ordered, That the aforesaid motion for reconsideration be, and it hereby is, denied.

IN THE MATTER OF

KOSCOT INTERPLANETARY, INC., ET AL.

ORDER, OPINION ETC., IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 2 OF THE CLAYTON ACT

Docket 8888. Complaint, May 24, 1972-Final Order, Nov. 18, 1975

Order requiring an Orlando, Fla., seller and distributor, of cosmetics and cosmetic distributorships, among other things to cease using its open-ended, multilevel marketing plan; engaging in illegal price fixing and price discrimination and imposing selling and purchasing restrictions on its distributors; and to cease making exaggerated earnings claims and other misrepresentations in an effort to recruit distributors.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act and the Clayton Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission, having reason to believe that Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, and Glenn W. Turner, Terrell Jones, Malcolm Julian, Ben

Bunting, Michael Delaney, Hobart Wilder, and Raleigh P. Mann, individually and as former officers, officers, or directors of said corporations, hereinafter referred to as respondents, have violated the provisions of said Acts, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., are corporations organized, existing and doing business under and by virtue of the laws of the State of Florida, with their principal office and place of business located at 4805 Sand Lake Rd., Orlando, Fla.

Respondent Glenn W. Turner is chairman of the board of directors of Koscot Interplanetary, Inc., and is the sole stockholder of Glenn W. Turner Enterprises, Inc. Mr. Turner was the founder of Koscot Interplanetary, Inc., and instituted the marketing plan and distribution policies. He, with others named herein, has been and is responsible for establishing, supervising, directing and controlling the business activities and practices of corporate respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., including the acts and practices hereinafter set forth. Mr. Turner's address is the same as that of the corporate respondents.

Respondents Terrell Jones, Malcolm Julian, Ben Bunting, Michael Delaney, Hobart Wilder, and Raleigh P. Mann are officers, or directors of said corporate respondents. Together with others, said respondents have been and are responsible for the formulation, control and direction of the acts and practices hereinafter set forth. Their address is the same as that of the corporate respondents.

The aforementioned respondents cooperate and act together in carrying out the acts and practices hereinafter set forth.

PAR. 2. In the conduct of their business, at all times mentioned herein, respondents have been in substantial competition in commerce with corporations, firms and individuals in the sale of cosmetics, toiletries and associated items of the same general kind and nature as those sold by respondents.

PAR. 3. Respondents are now, and for some time last past have, engaged in the advertising, offering for sale, sale and distribution of cosmetics, toiletries and associated items and distributorships and franchises to the public, and are inducing, and have induced, persons to invest substantial sums of money in respondents' multilevel marketing program as hereinafter more fully described.

PAR. 4. In the course and conduct of their business, respondents now cause, and for some time last past have caused, their products, when

sold, to be shipped from their places of business in various States to purchasers thereof located in various States of the United States other than the State of origination, and maintain, and at all times mentioned herein have maintained, a substantial course of trade in said products in commerce, as "commerce" is defined in the Federal Trade Commission Act and the Clayton Act.

PAR. 5. In the course and conduct of their business, respondents have used a multilevel marketing program having four levels of distributors and are presently using a multilevel marketing program which allows the potential participant to enter at any one of three levels, *i.e.*, beauty advisor, supervisor or director. All participants are designated as independent contractors and except for the beauty advisors who sell primarily at retail through party plans and door-to-door methods, are permitted to, and do, sell or attempt to sell at both wholesale and retail. A description of these levels, in order of ascendency, follows:

1. Beauty advisor (retailer)—The beauty advisor purchases products from her sponsor (who may be a supervisor or director) at a 40 percent discount, for sale to the consuming public. The beauty advisor receives a refund bonus from her sponsor each month, based on the total retail volume ordered during the month. Entrant qualifies by investing $10 for a starter kit.

2. Supervisor (sub-distributor)—The supervisor purchases products from the company at a 55 percent discount for distribution to his beauty advisors and direct sales to the consuming public. The supervisor receives a special commission for each new supervisor order he creates, $500 or 25 percent of the $2000 paid for the initial order. An entrant qualifies as a supervisor in any one of these ways:

a. By investing $2000 immediately;

b. By purchasing $5400 in Koscot cosmetics (at retail value) from his sponsor;

c. By selling a portion of the required $5400 volume through his organization and purchasing the balance in one lump sum.

3. Director (distributor)—The director purchases products from the company at a 65 percent discount for distribution to his direct distributors (supervisors and beauty advisors) and for direct sales to the consuming public. The director is entitled to a 10 percent special commission on all of his supervisor's purchases. He receives $500 for each supervisor order that he sells. The director sponsoring a new director is also entitled to a 65 percent commission ($1,950) on the $3,000 additional inventory which the new director is required to purchase. An entrant qualifies as a director by: a) becoming a supervisor, purchasing the additional $3000 director inventory and selling a new supervisor order in order to replace himself in his

sponsoring director's organization; or b) by initially investing $5000 and becoming known as an apprentice director until he fulfills all the necessary aforementioned requirements.

These positions are described more fully to the prospective investors at "Opportunity Meetings" held weekly in various locations across the country. At such a meeting, a movie is shown and speeches are made which concentrate upon the unlimited potential to earn large sums of money in a relatively short time by recruiting others into the Koscot program. In most instances, the opportunity meeting will closely follow the script provided by respondents as found in the distributor's training manual. This meeting is run in such a manner as to excite those attending and to induce them into making an emotional decision to invest in the program.

PAR. 6. In the course and conduct of their business as aforesaid, respondents have done and performed and are doing and performing the following:

1. Respondent Koscot Interplanetary, Inc. has entered into contracts, agreements, combinations, or understandings with its distributors whereby said distributors agree to maintain the resale prices established and set forth by respondent corporation, notwithstanding that some of such distributors are located in States which do not have Fair Trade laws.

2. Respondent Koscot Interplanetary, Inc. has entered into contracts, agreements, combinations, or understandings with its distributors whereby said distributors agree to maintain the discounts, overrides, rebates, bonus schedules, finder's fees and release fees, between and among all other distributors, as established and set forth by respondent corporation.

3. Respondent Koscot Interplanetary, Inc. has entered into contracts, agreements, combinations, or understandings with its distributors whereby said distributors understand that a violation of any company rule or regulation is reason for immediate termination of their status as distributors by the company board of directors.

4. Respondent Koscot Interplanetary, Inc. has instituted certain rules and regulations, among which are those set out below, whereby its distributors:

(a) Agree to purchase merchandise only from respondent or his sponsor in accordance with Koscot's marketing program,

(b) agree that all purchases of merchandise from respondent corporation or his sponsor constitutes a nonrefundable sale,

(c) agree not to engage in the sale of a competitive line of products or individual products which would be considered competitive to respondent corporation,

(d) agree never to make any consignment of merchandise to anyone without receiving written notice of approval by Koscot Interplanetary, Inc.,

(e) agree to restrict retail sales and display of cosmetics to home service routes and beauty forums, and to certain categories of retail outlets specified by respondent but only with Koscot's approval,

(f) agree to obtain prior written approval from Koscot for any promotion or advertising of Koscot products or his distributorship,

(g) agree to maintain a record of the names and addresses of all his customers and to provide Koscot with such information through his supervisor or director,

(h) agree not to transfer to another organization without prior written consent of all distributors above him in his organization, including respondent corporation,

(i) agree to have a financial interest in only one Koscot distributorship at a time and that he cannot be part of two separate distributorships,

(j) agree not to enter into any agreement with a distributor in another Koscot organization to make a division of profits, assets, or new recruits in violation of the "Koscot Marketing Koncept."

5. Respondent Koscot Interplanetary, Inc. has entered into contracts, agreements, combinations or understandings with its distributors whereby respondent:

(a) Prohibits a corporation from becoming a Koscot distributor,

(b) requires that the organization of a distributor, who quits or loses his status as a distributor, becomes a part of the organization of the distributor immediately preceding him on Koscot's organizational chart.

6. Respondent Koscot Interplanetary, Inc. discriminates in price, directly or indirectly, between different purchasers of its products of like grade and quality by selling said products at lower prices to some purchasers than to other purchasers, many of whom have been and now are in competition with the purchasers paying the higher price. For example, director-distributor purchases his products directly from respondent corporation at approximately: (a) 22.2 percent discount as compared with the cost to a supervisor-distributor, (b) 41.7 percent discount as compared with the cost to a beauty advisor.

There are approximately 7,988 director-distributors and approximately 10,726 supervisor-distributors in the program.

The supervisor-distributor who purchases his products directly or indirectly from respondent corporation, purchases at approximately a 25 percent discount as compared with the cost to a beauty advisor.

In addition, respondent corporation has agreed to pay the director-distributor a 2 percent override on the purchases of the entire

organization of each supervisor-distributor recruited by said director-distributor when such supervisor-distributor works up or buys in and becomes a director himself. Thereafter, although both director-distributors buy from respondent corporation, only the first will receive the 2 percent override from respondent corporation.

COUNT I

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One through Six hereof are incorporated by reference in Count I with respect to respondents, as if fully set forth herein.

PAR. 7. Respondents make various oral and written statements to prospective investors regarding the sale of their cosmetics, toiletries and associated items and the recruitment of additional participants in their marketing program. Typical and illustrative of said statements and representations, but not all inclusive thereof, are the following:

1. To become a Director a Supervisor * * * must go out, create a new Supervisor's initial order, and bring this order to *you*, the Director, before you *release* this Supervisor to become a Director * * *. When this new Supervisor entered the program, he ordered $2000 in retail products. This Supervisor created the order, so he receives the 25% commission on products. But *you* are the Director, so *you* earn the 10% Director's commission of $200.

As soon as this Supervisor's initial order is received by the company, the company sends *you* the 65% commission on this $3000 additional inventory. This is $1,950! You now have earned a total of $2,850!

Create this volume once a month and at the end of the year you will have earned over $34,000.

2. As a Director with one Supervisor in your organization, your job is to help this Supervisor become successful. See that he and his retail manager are thoroughly trained and make certain he fully understands the program. When he is ready to enjoy additional benefits, help him create a new Supervisor's initial order for kosmetics and he will become a Director.

Continue to help the one Supervisor you will always have. Help him sell only one Supervisor's order per month for your organization and you will earn over $26,000 per year! But work with your Supervisor full-time to make him a success! Do this twice a month and your income will exceed $52,000 per year!

3. Let's assume you decide to recruit girls to be trained as Beauty Advisors * * * Let's look at your third month in the business. Again sponsor only eight girls who produce the part-time volume of only $300 a month. This new group will produce $2,400 their first 30 days. The last group you sponsored has learned the benefits of our incentive plan. They have learned that by increasing their efforts and continuing to service their customers they can produce a monthly volume of $900 each. When this occurs, this group will give you an additional $7,200 in volume.

Your first group of girls may have increased their volume even *more*, but suppose they are producing only $900 each per month or $7,200 for the group. Then your total monthly volume is $16,800!

At this point you will *certainly* want to become a Director and enjoy the benefits of a 65% discount! You continue to sponsor eight girls a month and train them to produce the

necessary volume, and you will be giving yourself an $1,800 a month *raise* in income every month.

PAR. 8. Respondents' multilevel marketing program, as represented by the above-quoted statements, contemplates an endless recruiting of participants since each person entering the program must bring in other distributors to achieve the represented earnings. The demand for prospective participants thus increases in geometric progression whereas the number of potential investors available in a given community or geographical area remains relatively constant. Consequently, a person coming into the program at a later stage will be unable, in a substantial number of instances, to find additional investors because the recruiting of participants into the program at an earlier stage by others has exhausted the number of prospective participants. It is self-evident that respondents' marketing program must of necessity fail when the market for potential distributors has become saturated.

Although some participants in respondents' multilevel merchandising program may realize a profit, all participants do not have the income potentiality represented by respondents, such as described in Paragraph Seven through recruiting other participants and the resultant finder's fees, commissions, overrides, rebates and other compensation arising out of the sale of respondents' products. In reality, some participants in the program will receive little or no return on their investment.

Respondents' multilevel merchandising program is organized and operated in such a manner that the realization of profit by any participant is predicated upon the exploitation of others who have virtually no chance of receiving a return on their investment and who had been induced to participate by misrepresentations as to potential earnings. Therefore, the use by respondents of the aforesaid program in connection with the sale of their merchandise was and is an unfair act and practice, and was and is false, misleading and deceptive.

PAR. 9. In the course and conduct of their business as aforesaid, and for the purpose of inducing the purchase of their products, and the purchase of distributorships and participation in their multilevel marketing program, the respondents have made, and are now making numerous statements and representations in certain promotional materials, including, but not limited to, film strips, newsletters, information manuals, marketing plan booklets, meeting scripts, and other materials.

Typical and illustrative of said statements and representations, but not all inclusive thereof, are those set out below, as well as those in the distributor's training manual.

1. The world's largest kosmetic company sponsors over 200,000 girls a year. Knowing

this, with a full-time effort in our program, don't you believe you can sponsor 2 girls a week?

2. There are ordinary men and women in KOSCOT like you and me who are earning five and even ten thousand dollars per month!

3. Ladies and gentlemen, this is over $50,000 a year and now *we are* talking about a great deal of money aren't we? Do you know what excites me about this figure? Many KOSCOT Distributors are presently earning this kind of money and more! The point you should consider is this: When we can do so much, surely you can do as well or even better when you exert the necessary effort.

PAR. 10. By and through the use of the above-quoted statements and representations, as well as the exposition of the "Koscot Marketing Koncept," as found in the distributor's business manual, and other statements and representations of similar import and meaning, but not expressly set out herein, respondents and their agents and representatives, represent, and have represented, directly or by implication, to prospective participants, that:

1. It is not difficult for participants in the Koscot program to recruit and retain distributors and sales personnel to work home routes and sell respondents' products door-to-door enabling said participants to recoup their investment and to earn the represented profits set forth herein.

2. Participants in the Koscot marketing program have the potentiality and reasonable expectancy of receiving large profits or earnings.

3. The Koscot marketing program is commercially feasible for all participants and the supply of available entrants and investors is virtually inexhaustible.

PAR. 11. In truth and in fact:

1. It is difficult for participants in the Koscot program to recruit and retain distributors and sales personnel to work home routes and sell respondents' products door-to-door, hence, many participants cannot even recoup their investment, much less earn the represented profits set forth herein.

2. Participants in respondents' marketing program do not have the potentiality and reasonable expectancy of receiving large profits or earnings (for the reasons hereinbefore set forth).

3. The Koscot marketing program is not commercially feasible for all participants and its operation exhausts the supply of available entrants and investors as hereinbefore explained.

Therefore, the statements and representations as set forth in Paragraphs Nine and Ten have been and are, false, misleading and deceptive.

PAR. 12. Respondents' merchandising program is in the nature of a lottery in that participants are induced to invest substantial sums of money on the possibility that by the activities and efforts of others, over whom they exercise no control or direction, they will receive the

profits described in Paragraphs Seven and Nine herein. The realization of such financial gain is not dependent on the skill and effort of the individual participant, but is the result of elements of chance including the number of prior participants and the degree of saturation of the market which exists when the participant is induced to make his investment.

The use by respondents of a multilevel marketing program, which is in the nature of a lottery, is contrary to the public policy of the United States and is an unfair act and practice and an act of unfair competition within the intent and meaning of Section 5 of the Federal Trade Commission Act.

PAR. 13. The use by the respondents of the aforesaid false, misleading and deceptive statements, representations and practices has had, and now has, the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that said statements and representations were and are true and into the investment of substantial sums of money to participate in the respondents' multilevel marketing program and the purchase of substantial quantities of respondents' products by reason of said erroneous and mistaken belief.

PAR. 14. The aforesaid acts and practices of the respondents, as herein alleged, were and are all to the prejudice and injury of the public and of respondents' competitors in commerce and unfair methods and deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act.

COUNT II

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One through Fourteen hereof are incorporated by reference in Count II as if fully set forth herein.

PAR. 15. The acts and practices, courses of conduct and methods of competition engaged in, followed, pursued or adopted by respondents, as alleged hereinabove, have had and continue to have the purpose and effect of substantially lessening, restraining, preventing and excluding free and open competition by, between, and among respondents' distributors in the marketing, sale and distribution of respondents' products throughout the United States in the following manner:

a. By fixing, maintaining and otherwise controlling the prices at which respondents' products are resold in both the wholesale and retail markets.

b. By fixing, maintaining or otherwise controlling the various fees, bonuses, rebates, or overrides required to be paid by one distributor or class of distributors.

c. By restricting the sellers from whom respondents' distributors

may purchase their products and the customers to whom they may sell their products.

d. By restricting their distributors to reselling respondent corporation's products only in certain categories of retail outlets.

e. By unreasonably restricting the freedom of respondents' distributors to market their products in the manner of their own choosing.

Said acts, practices, courses of conduct and methods of competition are prejudicial and injurious to the public; have a tendency to hinder and prevent competition and have actually hindered and restrained competition, and constitute unfair acts or practices and unfair methods of competition in commerce within the meaning and intent of Section 5 of the Federal Trade Commission Act.

COUNT III

Alleging violation of Section 2(a) of the Clayton Act, the allegations of Paragraphs One through Five and subparagraph (6) of Paragraph Six hereof are incorporated by reference in Count III as if fully set forth herein.

PAR. 16. The difference in net cost among the various distributors of respondents' products, each of whom is in competition with other distributors of respondents' products, results in substantial discrimination in the net prices for products sold to the nonfavored customers, who are both direct purchasers and indirect purchasers of respondents' products.

In addition, the various fees, overrides, or other payments result in discriminations among the direct and indirect purchasing distributors who are in competition with one another. These monies are direct and indirect payments by respondent Koscot Interplanetary, Inc. and are in effect discriminations in the net price of products to the various distributors.

The effect of respondent Koscot Interplanetary, Inc.'s discrimination in net price as alleged herein may be substantially to lessen competition or tend to create a monopoly in the line of commerce in which its favored purchaser is engaged, or to injure, destroy, or prevent competition between the favored and nonfavored purchasers or with the customers of either of them, except to the extent that competition has been lessened by the acts and practices alleged in Counts I and II hereof.

The aforesaid acts and practices of respondents constitute violations of the provisions of Section 2(a) of the Clayton Act as amended.

COUNT IV

Alleging violation of Section 5 of the Federal Trade Commission Act, the allegations of Paragraphs One through Fourteen hereof are incorporated by reference in Count IV with respect to respondents, as if fully set forth herein:

PAR. 17. In the course and conduct of their business as aforesaid, respondents' multilevel merchandising program is organized and operated in a manner that results in the recruitment of many participants who have virtually no chance to recover their investments of substantial sums of money in respondents' program and who have been induced to participate by misrepresentations as to potential earnings. Respondents have received the said sums and have failed to offer to refund and refused to refund such money to participants that were unable to recover their investment.

The use by the respondents of the aforesaid program and their continued retention of the said sums, as aforesaid, is an unfair act and practice and an act of unfair competition within the intent and meaning of Section 5 of the Federal Trade Commission Act.

PAR. 18. The aforesaid acts and practices of the respondents, as herein alleged, were and are all to the prejudice and injury of the public and of respondents' competitors in commerce and are unfair acts and practices and unfair methods of competition in commerce, in violation of Section 5 of the Federal Trade Commission Act.

Appearances

For the Commission: *Quentin P. McColgin* and *David C. Keehn.*

For the respondents: *Jerris Leonard* and *Kenneth Michael Robinson, Leonard, Cohen & Gettings*, Wash., D. C. for Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Malcolm Julian, Ben Bunting and Hobart Wilder.[1]

INITIAL DECISION BY DONALD R. MOORE, ADMINISTRATIVE LAW JUDGE

MARCH 20, 1975

CONTENTS

[1] A supplemental memorandum of law was submitted on behalf of Koscot Interplanetary, Inc., by Levy, Levy & Ruback, New York, N. Y., as special bankruptcy counsel. Various other counsel participated at earlier stages of the proceeding but subsequently withdrew. Regarding respondents Terrell Jones, Michael Delaney, and Raleigh P. Mann, see *infra*, pp. 3-4, 15[pp. 1119, 1127, herein].

PRELIMINARY STATEMENT

The complaint in this proceeding, charging violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and of Section 2(a) of the Clayton Act, 15 U.S.C. § 13, was issued on May 24, 1972, and was thereafter duly served on all respondents except Terrell Jones (see *infra*). The complaint, containing four counts, charges as unlawful certain of respondents' practices in connection with the sale and distribution of toiletries and cosmetics and the recruitment of distributor-investors.

Count I of the complaint charges that respondents' "multi-level marketing program" was not only inherently deceptive and unfair but also involved numerous misrepresentations. Count II alleges that agreements between respondent Koscot and its distributors were in unlawful restraint of trade. Count III alleges that respondents discriminated in price among various classes of customers, in violation of the Clayton Act as amended. Count IV charges in effect that

respondents' retention of funds obtained through misrepresentation constituted an unfair practice.

Respondents filed answers on Aug. 22, 1972, and on Sept. 7, 1972, which put in issue most of the material allegations of the complaint.[2]

After extensive prehearing procedures, including several prehearing conferences, hearings were held between July 30, 1973, and Oct. 18, 1974, in Washington, D.C., New York City, Kansas City, Mo., and Orlando, Fla. At these hearings, testimony and other evidence were offered in support of and in opposition to the allegations of the complaint. The testimony and evidence presented—aggregating 5224 pages of transcript and thousands of pages of documentary exhibits—have been duly recorded and filed.

Forty-one witnesses were called to testify in support of the allegations of the complaint, including the seven individual respondents, one additional former officer of respondent Koscot, two officials of Avon Products, Inc., three expert witnesses (marketing and economics), and 28 distributors or former distributors of respondent Koscot.

Four of the individual respondents—Glenn W. Turner, Malcolm Julian, Ben Bunting, and Hobart Wilder—were excused from testifying after each pleaded his constitutional right to remain silent on the ground that answers to questions propounded or proposed on the subject matter of this proceeding might tend to incriminate him. These Fifth Amendment pleas were made in the light of a pending criminal proceeding in the United States District Court for the Middle District of Florida (*Koscot Interplanetary Incorporated, et al.*, Criminal No. 73-71). (See Tr. 912-91).

Respondents called no witnesses in defense but offered some documentary evidence, primarily relating to the status of respondent Koscot as a result of its petition for an arrangement under Chapter 11 of the Federal Bankruptcy Act.

Hearings were in recess from October 1973 until August 1974, because certain witnesses whose testimony was required to complete the case-in-chief in support of the complaint were prohibited from testifying by protective orders issued on Oct. 17, 1973, by the Honorable Gerald B. Tjoflat, United States District Judge for the Middle District of Florida, in connection with the criminal case styled *United States* v. *Koscot Interplanetary, Inc., et al.*, No. 73-71-Orl-Cr. On Aug. 1, 1974, such protective orders were modified so as to permit the testimony in question, and hearings in support of the complaint were resumed on Aug. 19, 1974, and concluded on Aug. 22, 1974. After

[2] The answer filed on Aug. 22, 1972, on behalf of the corporate respondents and respondents Turner, Julian, and Wilder was later amended to reflect that it was also the answer of respondent Michael Delaney (order granting motion to amend answer, Sept. 11, 1972).

further proceedings, including the submission of documentary exhibits on behalf of respondents, the evidentiary record was closed on Oct. 18, 1974.

The parties were represented by counsel and were afforded full opportunity to be heard, to examine and to cross-examine witnesses, and to introduce evidence bearing on the issues.[3] Also, although respondent Raleigh P. Mann was afforded a full opportunity to participate in the trial, he was not represented by counsel during the hearings and did not participate other than to appear as a witness subpoenaed by complaint counsel and to make a statement under oath on his own behalf at the conclusion of his testimony (Tr. 4814-15). He filed no exceptions or other response to the proposed findings, etc., submitted by complaint counsel. However, on Sept. 26, 1974, he filed *pro se* a motion to dismiss the case as to him on grounds that there had been failure of proof. The motion was taken under advisement for determination as part of the initial decision herein.

After the presentation of evidence, proposed findings of fact and conclusions of law and a proposed form of order were filed by counsel supporting the complaint, together with a supporting brief. (Certain errors in complaint counsel's proposed findings of fact, etc., as originally filed, were corrected by a "Notice of Corrections" filed on Jan. 2, 1975.)

Counsel for respondents filed a brief in opposition to the submittals of complaint counsel, and complaint counsel filed a reply brief.

In their brief, all respondents except Mann have consented to the issuance of the order proposed by complaint counsel except that part (Section V) which requires that restitution be made by the corporate respondents and by three of the individual respondents. As to the proposed findings of fact submitted by complaint counsel, respondents' exceptions are directed only to those that are intended to provide a factual predicate for the restitution order. Their brief states:

> Counsel strongly disagrees with the opening language used in complaint counsel's brief whereby *Koscot, et al.* are described as inherently deceptive and fraudulent. However, in view of the recognized fact that none of these respondents are presently participating in such illegal marketing deceptions and frauds we do not take issue with the proposed order except for the proposed findings which deal with restitution. [Footnote omitted.]
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> * * * * * * *
>
> * * * [W]e do not intend to respond or object to the proposed findings of fact and conclusions of law except for those parts regarding restitution. In not objecting to the language of the proposed order which deals with "pyramiding" and fraudulent practices,

[3] Terrell Jones, although cited in the complaint, was not a party since he was not served with a copy of the complaint (Tr. 4835-37). (He was later located and was called as a witness by complaint counsel.)

we do not wish for anyone to interpret our silence as a stipulation that such did occur. We simply reaffirm our proffer that the interests of justice can best be served in this case by the issuance of an order which enjoins that conduct which complaint counsel argues existed. If such conduct and practice did exist in the context as complaint counsel argues them then respondents are the first to agree that such activity should be forever stopped.

* * * * * * *

* * * [I]t is respectfully submitted that the remedies requested by complaint counsel as regards restitution be denied and that all other injunctive relief be ordered and noted as not objected to by respondents. (RB, pp. 1, 8, 19; see also pp. 17-18).

In view of these concessions by the principal respondents, most of the essential facts are virtually undisputed, and most of the provisions of the proposed order may be entered as "not objected to." Accordingly, despite the size of the record and the volume of counsel's submittals, the administrative law judge has made relatively brief findings of ultimate facts. The proposed findings of complaint counsel are meticulously detailed, with extensive citations to the record. Since, for the most part, respondents have not challenged these proposed findings, they are incorporated by reference as subsidiary findings that support the findings of ultimate fact constituting this initial decision.[4] Respondents' exceptions are essentially limited to those proposed findings that underlie complaint counsel's plea for a restitution order. These exceptions have been carefully considered and are discussed in greater detail than those matters that respondents have not specifically contested. As requested (RB, p. 8), the undersigned has carefully reviewed the testimony, particularly the cross-examination, of Messrs. Delaney, Edwards, Mann, and Jones.

FINDINGS OF FACT

I. *Respondents and Their Business*

A. The Corporate Respondents

1. Koscot Interplanetary, Inc. ("Koscot")[5] is a corporation existing and doing business under and by virtue of the laws of the State of Florida, with its principal office and place of business located at 4805

[4] Where references are made to proposed findings submitted by the parties, such references are intended to include their citations to the record unless otherwise indicated. Citations to the record, as well as to the proposed findings, are intended to serve as convenient guides to the testimony and to the exhibits supporting the findings of fact, but they do not necessarily represent complete summaries of the evidence considered in arriving at such findings. The proposed findings of the parties not adopted, either in the form proposed or in substance, have been rejected as lacking support in the record or as involving immaterial matters.

[5] The name "Koscot" is an acronym for the term "Kosmetics for the Communities of Tomorrow." Spelling cosmetics with a "k" was designed to call attention to the product (CX 11, p. 3). Later, Turner spelled the word "cash" with a "k" in a company called "Kash Is Best," which involved a discount for cash payments (Jones 4896).

Sand Lake Rd., Orlando, Fla. It was organized on or about Aug. 21, 1967 (complaint, ¶ 1; answer of Koscot, et al., ¶ 2; CX 29 C).

2. Glenn W. Turner Enterprises, Inc. ("Turner Enterprises") is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Florida, with its principal office and place of business located at 4805 Sand Lake Rd., Orlando, Fla. It was originally organized prior to October 1970 under the name of Dare To Be Big, Inc. (complaint, ¶ 1; answer of Koscot, et al., ¶ 2; CX 30 B).

3. Koscot was founded by respondent Glenn W. Turner, who, directly or indirectly owned the controlling interest in Koscot until August 1973. He was its sole stockholder from December 1970 until August 1971, when Koscot became a wholly-owned subsidiary of Glenn W. Turner Enterprises, Inc., which had previously been a subsidiary of Koscot. Turner was the sole stockholder in Turner Enterprises. Turner Enterprises held 100 percent of the voting stock of Koscot until August 1973, when all of the outstanding capital stock of Koscot was sold by Turner Enterprises to Max Morris for the sum of $15,000 (complaint, ¶ 1; answer of Koscot, et al., ¶¶ 2-3; CX 1 A-C; CX 13 A; CX 27 F; CXs 29-30; CX 190 C-D; CX 357 H, CX 358 H; CX 362 G; CX 759 A; Tr. 5210-11). This stock sale took place about a month after Koscot filed a petition for an "arrangement" with its creditors under Chapter XI of the Federal Bankruptcy Act. A plan of arrangement has been submitted by Koscot, and further proceedings were scheduled in early 1975 (RXs 12 A-Z-102, 16, 17 A).

In this decision, references to the record are made in parentheses, and certain abbreviations are used as follows:

CPF - Complaint counsel's proposed findings—"Proposed Findings of Fact, Conclusions of Law, and Order."

CB - Complaint counsel's "Brief in Support of Proposed Findings of Fact, Conclusions of Law and Order."

CRB - "Complaint Counsel's Reply Brief and Other Submissions."

CX - Commission exhibit.

RB - Respondents' brief—"Brief in Opposition to Commission's Brief in Support of Proposed Findings of Fact and Conclusions of Law, and Order."

RPF - Respondents' proposed findings, as contained in RB (pp. 1-7).

RX - Respondents' exhibit.

Tr. - Transcript. (References to testimony sometimes cite the name of the witness and the transcript page number without the abbreviation "Tr."—for example, Jones 4868.)

References to the proposed findings of counsel are to paragraph numbers, while citations to the briefs are to page numbers.

Having heard and observed the witnesses and having careful

reviewed the entire record in this proceeding, together with the proposed findings and briefs filed by the parties, the administrative law judge makes the following findings of fact, enters his resulting conclusions, and issues an appropriate order.

4. For most of the period 1971 until August 1973, Turner Enterprises controlled and directed the affairs of Koscot (CXs 358 H, 362 G; CXs 271-73, 275 A, 279 A-B, 291 A, 568 B; Mann 4403-06, 4494) and derived most of its income from Koscot. From September 1971 to August 1973, Koscot was required to make weekly transfers of funds to Turner Enterprises amounting to 10 percent of all revenues, net of commissions paid out (CXs 291 A, 358 Q, 362 Q). For the 11-month period ending June 30, 1972, more than one-half of the total income of Turner Enterprises came from Koscot (CXs 179 E, 330 C). Money was transferred regularly between Turner Enterprises and Koscot, as well as between other subsidiaries and affiliates, foreign and domestic, of Turner Enterprises (CX 758 A-B; Jones 4899). As of July 1972, Turner Enterprises had investments in and advances to foreign corporations in excess of $2 million. These foreign corporations included the following:

Koscot of Australia Pty. Ltd.
Fashcot of Australia Pty. Ltd.
Dare To Be Great of Australia Pty. Ltd.
Koscot Interplanetary of Canada (1971) Limited
Koscot GmbH
Dare To Be Great GmbH
Koscot Hellas L.L.C.
Koscot Italia S.R.L.
Koscot Interplanetaria De Mexico, S.A.
Koscot A.G.
Koscot Interplanetary (U.K.) Ltd.
Koscot De Venezuela S.A.

5. During January 1973, all of the outstanding capital stock of one or more of the companies listed in ¶ 4, *supra*, was sold by Turner Enterprises to Ariarnes, a corporation (not otherwise identified), for an amount ranging between $10,000 and $100,000 (CXs 758 A, 759 B-C; Tr. 210-11).

6. As of July 31, 1972, Koscot had total assets of $22.5 million, but as of July 1973, its total assets had dwindled to $11.7 million (CX 758 A; CX 12 Z-70-71, 76-77, 91).

B. The Individual Respondents

7. *Glenn W. Turner*—Glenn W. Turner was the founder of Koscot[6] and instituted its marketing plan and its distribution policies. He owned a controlling interest, directly or indirectly, in each of the corporate respondents. He was president of Koscot from August 1967 to January 1968 and chairman of its board of directors from January 1968 until at least March 1972. He was also chairman of the board of directors of Turner Enterprises from February 1971 until March 1972 (see ¶3, *supra*).

8. Each of the two corporate respondents was, in essence, the alter ego of Turner. He was primarily responsible for establishing, supervising, directing, and controlling the policies, business activities, and practices of each of the corporate respondents. Despite ostensible changes in corporate officers, as well as the establishment of a voting trust for Koscot, both corporations operated under his ultimate control and domination. He appointed and removed corporate officers and directors. The two corporations had many officers and directors in common and, with other Turner-controlled companies, essentially operated as a single enterprise. Turner controlled the corporate funds and used them for such purposes as he saw fit, borrowing and otherwise using corporate funds as his own.

9. Although there is evidence that Turner resigned as a corporate officer of Turner Enterprises in March 1972,[7] a document submitted by respondents as Appendix I of their brief shows that in October 1974, he signed a stipulation of settlement in a class action suit pending in the United States District Court for the Western District of Pennsylvania as president of Turner Enterprises, as president of Dare To Be Great, Inc., and also on behalf of Koscot (capacity not designated).

(Record references: Complaint, ¶ 1; answer of Koscot et al., ¶¶ 2, 3; Edwards 1129-32; Mann 4375-85, 4391-92, 4399-4403, 4488, 4494, 4592-4612, 4660-64, 4699-4709, 4719; Jones 4880-83, 4888-89, 4899, 5000-01; CXs 1 A-C, 5, 13 A, 27 F, 29-30, 43-49, 190 D, 192, 195 A, 221, 223, 226, 229, 244, 292, 357 H & J, 358 H & L, 362 G & K, 490 A-C, 568 A-B, 618-19, 759 A; Tr. 5210-11; RX 12 Z-98.)

10. Although Turner retained ultimate veto power over corporate operations, he necessarily delegated authority to others. Those who shared with him the responsibility for the formulation, control, and

[6] Turner established Koscot in August 1967 with $5,000 in borrowed money. He supposedly had no other capital despite the fact that he claimed to have earned $30,000 to $35,000 a month as a "General" in Holiday Magic, with which he had been associated since late 1966. (Jones 4847-48, 4853), and Koscot literature portrayed him as having earned $250,000 in cosmetics in "twelve short months" (CX 11, pp. 19, 34) before he founded Koscot.

[7] Turner resigned as chairman of the board of Turner Enterprises on Mar. 13, 1972, but announced he would serv as a consultant. He requested $250,000 a month for such consulting services, and other financial considerations were t be negotiated (CX 292).

direction of the acts and practices of the corporate respondents included the following respondents:

Ben Bunting
Hobart Wilder
Malcolm Julian
Raleigh P. Mann

The role of each may be outlined as follows:

11. *Ben Bunting*—Respondent Ben U. Bunting played a key role in Koscot operations from 1969 until mid-1971 and was a well-paid "consultant" thereafter. As the "right hand man for Turner" during most of this period, he virtually had total control of Koscot operations. Beginning as a Koscot distributor, he later held the following corporate offices in Koscot:

National director—November 1968-January 1969;
president—January-June 1969;
corporate president[8]—June 1969-July 1970;
member and chairman of voting trust—April-December 1970; and
international corporate president—July 1970-July 1971.

In addition, Bunting was involved in Turner Enterprises, as assistant to the chairman of the board (July 1970-February 1971) and as vice chairman of the board (February-July 1971). Thereafter, he became a consultant to Turner Enterprises while apparently continuing to serve as a director of Turner Enterprises (Mann 4387-88, 4391-92, 4488; Jones 4904-06, 4970, 4991; CXs 2 D-U, 3 A, 5, 13 J, 46 F, 211, 223, 245, 252 A, 253, 279, 490 A, 568 A, 574 A-B, 614 C).

12. On July 8, 1971, Bunting resigned from the boards of directors of all companies except Turner Enterprises and was designated to be in charge of all monies for that corporation (CX 574 A-B). About this same time, Bunting and Turner entered into a contract providing that 3 percent of the gross receipts of Turner Enterprises and its subsidiaries, including Koscot, were to be paid to Bunting for consulting services (Mann 4577-78). Meanwhile, using a loan of $250,000 from Turner, Bunting acquired a foreign "shell corporation," Candida Holdings, NV ("Candida") (Mann 4574-4577, 4580; CX 611 A). In November 1971, Candida became a publicly-held company, but Bunting continued to hold in excess of 50 percent of its stock (CX 611 A; Mann 4577, 4584). Shortly thereafter, Bunting assigned his consulting contract to Candida CX 611 A; Mann 4578).

13. Bunting continued to meet regularly with Turner and often attended the board meetings of Turner Enterprises in 1971-72 (CX 279 -B; CX 285; CX 291 A; Mann 4571).

[8] The distinction between "President" and "Corporate President" is not altogether clear, but it appears that, at least in theory, the corporate president was superior to the president of the corporation (CX 13 J).

14. In a contract dated Aug. 25, 1971 (CX 279 C), Turner and Turner Enterprises retained Candida for management and sales consultation services.[9] Turner Enterprises agreed to pay Candida 3 percent of its gross sales, and Turner individually agreed to cause other corporations that he controlled to pay the same amount. In addition, all expenses for services to Turner corporations were to be reimbursed, and office facilities were to be made available to Candida on request. Although adjustments might be made in the percentage fee, the minimum fee was stated to be 3 percent plus expenses. The arrangement was to continue for five years. The contract was signed by Turner as chairman of the board of Turner Enterprises and as an individual and was accepted by Bunting as managing director of Candida. Candida was to provide "complete management and sales consultation services" (CX 279 C) and "to structure and develop new sales and marketing plans and programs * * *" (CX 611 B).

15. As of Apr. 1, 1972, the contract between Turner Enterprises and Candida was terminated (CX 612 B; Mann 4571, 4581). As a result of the operation of the contract and the agreed settlement for its premature termination, Candida received nearly $2 million, comprising the following:

(a) $475,020, representing 3 percent of the gross sales of Turner Enterprises and its subsidiaries for the months of September, October and November 1971 (CX 611 A).

(b) $666,503, representing 3 percent of the gross sales of Turner Enterprises from Dec. 1, 1971, until the original contract was terminated (CX 612 A).

(c) $270,912, representing one percent of the gross sales of Turner Enterprises from Apr. 1, 1972, until Aug. 31, 1972 (CX 612 A).[10]

(d) $183,375, representing a lump sum payment for the termination of the original contract with Turner Enterprises (CX 612 A-B).

(e) Approximately $400,000 representing notes from F. Lee Bailey and Enstrom Helicopter Corporation transferred from Turner Enterprises upon termination of the original contract between Turner Enterprises and Candida (Mann 4579).[11]

16. *Hobart Wilder*—Respondent Hobart Wilder likewise played a significant role in the operations of Koscot and Turner Enterprises. Beginning as a distributor and advancing to the position of state director, he then held the following offices in Koscot: National director

[9] A report to Candida's shareholders dated Feb. 4, 1972, shows the contract date as Dec. 1, 1971 (CX 611 A).

[10] Whether Candida has continued to collect one percent of the gross sales of Turner Enterprises is not clear from the record. A report to Candida shareholders states that "Candida has received a lump sum settlement of $183,375, and a fee of 1 percent of Turner Enterprises' gross sales for the remainder of the original contract period which ends Dec. 1, 1976" (CX 612 B).

[11] The directors placed a value of $40,000 on the notes receivable assigned to Candida (CX 612 B).

of field operations—July-October 1970; president—October 1970-February 1971; and corporate president—February-July 1971.

Wilder was also active in Turner Enterprises, serving as international corporate president from July 1971 until March 1972, when he became chairman of the board. He ultimately replaced Bunting as the No. 2 man in the Turner operation. He apparently left the Turner organization between July 1972 and July 1973 (Delaney 874-75; Mann 4390-93, 4403-04, 4488, 4554-55, 4562-64; Jones 4906-07; CXs 234 A, 237 A, 270 A, 279 A, 292, 490 A, 560, 567 A, 568 A, 574 A, 605, 606, 614 D).

17. Wilder received a salary many times greater than Bunting, Julian, and Mann—$102,300 in 1972 (CX 322), compared to a range of $16,000 to $37,000 for such other officials (CXs 297, 299, 300, 307, 309, 324, 326). In May 1973, he also received a loan from Koscot of $161,000, which had not been repaid as of July 1973 (RX 12 Z-74).

18. *Malcolm Julian*—Respondent Malcolm Julian was another top official of Koscot. He served twice as president of Koscot (June 1969-July 1970 and September-December 1971). He was also a member of the voting trust (April-August 1970) and served as international corporate vice-president from July 1970 to September 1971. He was also a member of the board of directors of Turner Enterprises, resigning in December 1972. He subsequently became a consultant to Koscot (Delaney 1044; Mann 4442; CXs 2 D, 5, 13 J, 223, 235, 245 A, 262 A, 271, 279 A, 286, 287, 490, 502 C).

19. *Raleigh P. Mann*—Respondent Raleigh P. Mann also held important positions in Koscot. After joining Koscot as a distributor in June 1968, he later moved to Canada and in early 1969 became president of Koscot's Canadian affiliate. He then served as president of Koscot (July-October 1970), a member of the voting trust (August-December 1970), and international president (October 1970-July 1971). He resigned all offices and directorships in all Turner corporations in July 1971 but was retained as a Koscot consultant until October 1971 (Mann 4347-52, 4358-60, 4386, 4397-4400; CXs 5, 6, 85, 258, 262 A, 490 A, 559, 560, 566, 568 A, 573).

20. As a consultant, Mann initially prepared a memorandum recommending to Turner in effect that Koscot get out of the "wholesale promotion business" and become a real cosmetics marketing company independent of Turner Enterprises (CX 575 A-C; Tr. 4556-57, 4563-65). His later consulting work was unrelated to Koscot (Tr. 4567-70). Meanwhile, Mann had become associated with Bunting as a stockholder and as a consultant in Candida (*supra*) and engaged in consulting work unrelated to Turner Enterprises until August 1972 (Tr. 4570).

21. Mann testified that his salary from Koscot in the course of approximately two and one-half years (including his consulting fees)

amounted to approximately $90,000, while his income from Candida was approximately $60,000 (Tr. 4614-16). Koscot had advanced him $51,000 for a downpayment on his home, but this note was paid off when the house was sold (Tr. 4614-15). Mann initially had 10,000 shares of Candida stock (at $1 a share), which later increased to 100,000 shares as a result of a stock split. He later sold 82,475 shares for approximately $23,000 and retained 17,525 shares, which he characterized as worthless (Tr. 4582-83).

22. Although he was unemployed for most of 1973 because of the "Turner stigma," he was then employed by a drapery and carpet company owned by his wife (Tr. 4617-20). As of August 1974, Mann described his financial condition as "broke." He was living in a rented house, owned one car, and had a minimal bank balance. He concluded: "We have our personal belongings; we have our furnishings; we have our clothing. We have no trust funds, trust accounts, hidden assets or anything else." (Tr. 4619; see also Tr. 4814-15).

23. In November 1974, Mann's address was Route 3, Box 281 (Jacaranda), Orlando, Fla. (attachment to motion to correct the official transcript, filed Nov. 22, 1974).

24. The business address of all the individual respondents was the same as that of the corporate respondents.

25. Respondents Bunting, Wilder, Julian and Mann were responsible, along with Turner and others, for the formulation, direction, and control of the acts and practices of Koscot and Turner Enterprises. They participated actively and knowingly in such acts and practices, as outlined more fully *infra*, ¶¶ 132-39.

26. In summary, respondents Koscot, Turner Enterprises, Turner, Julian, Bunting, Wilder, and Mann cooperated and acted together in carrying out the acts and practices herein found.

27. On the basis of the foregoing facts, as well as those developed *infra* on the record as a whole, the motions to dismiss for failure of proof that were entered by respondent Mann (*pro se* on Sept. 26, 1974) and by counsel for Julian (Tr. 5054-57) are hereby denied.

28. Two other individuals were cited in the complaint but are being dismissed as respondents:

(a) *Terrell Jones*—Although Terrell Jones, whose address in August 1974 was in Indian Hills, Colo., was named as a respondent in the complaint and played a significant part in Koscot's operations, he was never served with a copy of the complaint and thus is not a party to this proceeding. As proposed by complaint counsel (CPF 25), the complaint is being dismissed as to Jones, without prejudice, however, to the right of the Commission to bring further proceedings against him if the public interest so warrants. (See Tr. 4835-37.)

(b) *Michael Delaney*—Respondent Michael Delaney is an individual who was residing in August 1974 at 241 Timberlane Trace, Longwood, Fla. He was associated with Koscot from September 1969 to February 1971 in the following capacities: Assistant director of manufacturing—September-December 1969; director of manufacturing—December 1969-September 1970; voting trust member—April-December 1970; and executive vice-president—December 1970-February 1971.

Thereafter he engaged in various administrative duties until he resigned in July 1973. Since then he has been a Koscot consultant (Delaney 792-98; CXs 2 D-U, 245 A, 269 A, 273 B).

At the conclusion of the hearings, counsel for Delaney (Kenneth Michael Robinson) renewed a previous motion that the complaint be dismissed as to Delaney for failure of proof. Complaint counsel joined in the motion, and it was accordingly granted by the administrative law judge. (Tr. 5041-54) The reasons for this action are essentially summarized in the argument of defense counsel (Tr. 5041-52) and on the basis of the following record references: Delaney 792-910, 994-1120; Mann 4624, 4651-60, 4683, 4709-16, 4720-21, 4753, 4764-65; Jones 4929, 4957, 4962, 4964, 4974.

(Unless otherwise indicated, the term "respondents" as used herein is not intended to refer to Jones or Delaney. The term "Koscot" may sometimes be used to refer to all respondents collectively.)

C. Jurisdictional Findings

29. For several years the respondents have been engaged in the advertising, offering for sale, and sale of distributorships and franchises and of various products and services, including a line of cosmetics, toiletries, and associated items sold and distributed under the trade name Koscot. In so doing, respondents have caused their products to be shipped from their places of business in various States to purchasers located in various States other than the State of origination and have maintained a substantial course of trade in such products in commerce, as "commerce" is defined in the Federal Trade Commission Act and in the Clayton Act (complaint, ¶¶ 3-4; answer of Koscot, et al., ¶¶ 7-9; RPF 9; CXs 29 F, 69 A-S, 72 A-D, 103 A-F, 105 A-J, 110 A-113 V, 120 A-123 K).

30. Respondents have been in substantial competition in commerce with corporations, firms, and individuals in the sale of cosmetics, toiletries, and associated items of the same general kind and nature as those sold by respondents (complaint, ¶ 2; answer of Koscot, et al., ¶ 6; RPF 9).

II. *Unfair and Deceptive Practices*

A. Introduction

31. Glenn Turner had an "impossible dream" (Tr. 5003). And, for a time, the dream became a sort of reality for him, for some of his associates, and for those relatively few who got in on the ground floor. But for thousands of others, it remained an impossible dream and a virtual financial nightmare. The impossible dream was the creation of a distribution network for the sale of cosmetics that was represented as offering an opportunity for untold riches for those who became involved in an "endless chain" of recruiting distributors for this business and in selling Koscot products. The Koscot plan is somewhat complicated to explain, but it was made to appear deceptively simple at "golden opportunity" meetings.

32. Koscot offered a plan that was ostensibly designed to sell cosmetics but that actually operated as a scheme to defraud the gullible—and even the not-so-gullible. To those who were victimized, the description of Turner as a "share-cropper on his way to harvest the world" (CX 11, preface) has an ironic twist.

33. Koscot's distribution method has come to be known as multileveling or pyramid selling (Westing 1197; Darling 1444; Nelson 2057). Such a system has been condemned as unlawful by the Commission, as well as by numerous courts.[12]

34. Cosmetics were to be sold, not through shops, but by direct selling, that is, by sales effected by individuals in the homes of the purchasers. There was a hierarchy of individuals involved, and those at the higher levels had to pay Koscot substantial sums for their so-called franchises (although the term "franchise" does not seem to have been used). The attraction was that the higher level participants received substantial commissions if they or those under them recruited new members to such upper levels. Through this method, a sales force in something of the shape of a pyramid was built up, with Koscot at the top and with two or more levels of individuals beneath, with the bottom level supposedly being the most numerous, and each level being connected with the others by a system of commissions whereby the higher levels profited from the activities of the lower levels.

35. The primary vice under attack in this proceeding is that this system of paying commissions on recruitment has the same appeal and the same ultimate result as a "chain letter."

36. Although, initially, Koscot had no cosmetics to sell, it began an operation ostensibly designed to sell cosmetics in the manner described

[12] *Holiday Magic, Inc.*, Dkt. 8834, Final Order, Oct. 15, 1974, (slip opinion pp. 11-14 [84 F.T.C. 748, at pp. 1036-1039]); *Ger-O-Mar, Inc.*, Dkt. 8872, Final Order, July 23, 1974 (slip opinion, pp. 8-12 [84 F.T.C. 95, at pp. 145-149]).

in ¶ 34, *supra*. Koscot set up a hierarchy of individuals through whom sales were to be made. At the lowest level, there were beauty advisors, who were to sell Koscot products directly to members of the public through door-to-door selling or through "party plans", involving group selling. These beauty advisors were appointed by supervisors or subdistributors, who were the next rung on the Koscot distribution ladder. The supervisors, in turn, were appointed by the top rung (other than Koscot), who were called distributors or directors. The rights that went with the position of a distributor or supervisor might be analogized to a franchise. Koscot products were to be sold through distributors at a discount of 65 percent off retail price; supervisors in turn were to enjoy a 55 percent discount; and beauty advisers were to have a 40 percent discount.

37. However, product sales were by no means to be the only source of revenue, either for Koscot or for the distributors and supervisors. Each distributor was required to pay to Koscot a stated amount, ranging up to $5,000, for his position, for his initial inventory, and for the right to recruit supervisors and other distributors. If he had been introduced by another distributor, that other distributor received a commission of $2,650, with Koscot keeping the balance of $2,350. A supervisor had to pay Koscot $2,000 for his position. If he had been introduced by a distributor, the distributor got a commission of $700, the balance of $1,300 remaining with Koscot. If the new supervisor had been recruited by another supervisor, the same commission of $700 was payable, but the supervisor who found the new recruit got only $500, with the remaining $200 going to that supervisor's distributor. If a supervisor advanced to distributor, he was required to pay Koscot an additional $3,000, of which $1,950 was paid to the distributor who had sponsored him. He was also required to recruit another supervisor to replace himself, a transaction on which both he and his sponsoring distributor received the fees listed *supra*.

38. This was Koscot's basic "dual level" program, as outlined essentially in CXs 11 and 13. There were earlier and later variations, with different commission and discount figures, including a "single level" plan in which there was no supervisor or subdistributor (CXs 8 A-Z-23, 9, 10, 14, 15, 98 A-J). Many of the changes were made to meet legal objections raised in particular States. The variations are set forth in detail in CPF 116-62.

39. In their literature, and in their presentations in opportunity meetings and on GO-Tours, respondents held out the promise of big profits for all in an "endless chain" of recruiting, supplemented by fat commissions on subsequent sales of cosmetics.

40. A cardinal feature of the Koscot plan was that, irrespective of

any sales of cosmetics to consumers, a distributor or supervisor who had paid his entry fee could supposedly get it back, and more, by means of recruiting further distributors or supervisors, each of whom paid similar sums to Koscot. The one certainty was that Koscot received substantial sums on each appointment. Whether those who recruited the new distributors or the new supervisors got some or all of their money back, or made any profit, depended on the number of new appointments.

41. The beauty advisors, on the bottom rung, were outside these commission arrangements, and their compensation was based on the 40 percent spread between their acquisition cost of product and the retail price at which they sold.

42. It is readily apparent that there existed a strong financial incentive for distributors and supervisors to recruit others to these positions. Whereas the recruitment of beauty advisers merely facilitated increased earnings on sales, the recruitment of other distributors or supervisors, brought immediate and substantial commissions. A distributor who paid $5,000 for his position would get his money back, and more, if he recruited two distributors or eight supervisors, while a supervisor got his money back if he recruited four supervisors. For so-called franchise holders, the commissions on any recruitment above these numbers were all profit. Additionally, apart from any commissions earned by a distributor by his own efforts, there was always a possibility that one of his supervisors would recruit another supervisor and thus bring the distributor $200 without any effort on his part.

43. Stated another way, the system had financial attractions in that both in the franchise structure and in the sales structure, there were rewards not only for work done by the participant himself but also for work done by others, through a system of overriding commissions on sales made by others.

44. This does not purport to describe the system in all its details, nor all of the variations that Koscot instituted. However, this sufficiently describes the essentials of the plan to indicate its nature.

45. The record supports findings that for approximately a year following the establishment of Koscot and the institution of its marketing plan, respondents were engaged solely in the marketing of distributorships; that, thereafter, the sale of cosmetics was merely incidental to the marketing of distributorships; that except for a relatively few distributorships in the early stages of the program, the distributorships conferred few, if any, effective legal rights upon the holders and were virtually worthless; that members of the public were induced to purchase distributorships by a variety of misrepresentations as to their value and as to the income likely to be realized; and that

distributors were encouraged to recoup their losses and to make profits by recruiting others by deceptive means. There follows a more detailed examination of the massive deception involved in the Koscot operation.

B. "Endless Chain"

46. The Koscot marketing program clearly contemplated an "endless chain" in that it involved the continual recruitment of additional participants, since each person entering the program had to bring in other distributors to achieve the specified earnings. The demand for prospective participants thus increased in geometric progression while the number of potential investors available in a given community or geographical area remained relatively constant (Westing 1271-72, 1278; Nelson 1718-19; Darling 1445).

47. The fallacy in the "endless chain" aspect of the Koscot marketing program, with each distributor supposedly recruiting successively two other distributors a month, is that it involves a geometric progression which, carried through to its ultimate result, would mean that in 18 months the entire United States population (203 million in 1970) would be involved in the plan (CX 536; Westing 1273; Darling 1445-48).

48. Aside from the mathematical fallacy inherent in the Koscot plan, an endless chain scheme must, in any event, ultimately fail to provide returns to all participants. Such a scheme must cease when it exhausts the number of people willing to invest in it. The exhaustion of prospects results from over-saturation, leading potential purchasers to realize that their chance for success is limited in view of the numbers already recruited; lack of funds on the part of otherwise potential purchasers; or a negative reaction on the part of potential purchasers for any number of other reasons. Recruiting must always cease, and those recruited into the program at or near its conclusion must lose (Westing 1271, 1273; Nelson 1729-30). And the fact is that most Koscot distributors lost by relying on the endless chain aspect of the Koscot marketing program (CPF 225).

49. Respondents' defense to the endless chain charge (complaint, ¶ 8) is that because of "self-imposed" quotas on the number of distributorships, sales of distributorships "would not be like a chain letter, hence not deceptive or unfair to the investor," so that "Turner believed that if the quota was followed then there could be no misrepresentations involved about it." Respondents state that Turner's original quota of one distributor per 4,000 population was changed in 1969 to one per 7,000 upon the advice of counsel and a marketing consultant. On the basis that the population in 1972 was 207 million, they contend that Koscot complied with its self-imposed quota when it

stopped selling franchises in mid-1972 with just under 30,000 distributorships (RPF 12, 25).

50. This defense is rejected. First, the facts are contrary to the defense claims. Actually, the purported quota of one per 7,000, which had been instituted in February 1970 (CX 233 A), was discontinued in September 1971 in favor of the earlier quota of one per 4,000 population (CX 239), so that the so-called quota nationally was 51,000 distributors. Second, the purported quotas were on a State basis rather than on a national basis (Mann 4623). Third, the quotas were not always "self-imposed;" in several States, a quota was imposed as the result of legal action by State authorities (Westing 1278-79; Jones 4892-93). Fourth, the quotas were deliberately ignored and circumvented by respondents. Among other things, Koscot classified numerous distributors as "inactive" and thus not chargeable against the quota. Other devices were encouraged and permitted to evade the so-called quota. (CPF 173, 178-89) Fifth, distributors were either not told of the quota or of its specific impact (CPF 172), or, if they were, it was "used as a high pressure tactic" to enroll the prospect before it was too late (Jones 4893).

51. In addition, even where there was ostensible compliance with the quota as far as Koscot sales were concerned, respondents established additional companies operating on a similar basis and allowed Koscot distributors to participate in them and thus continue the chain of recruitment (CPF 191-216). The fact that respondents deliberately provided distributors with the opportunity to continue recruiting when enforcement of the so-called quota might otherwise have stopped such activity is sufficient to show their intent to operate an endless chain recruitment scheme.

52. Finally, even if the quota had been adhered to, the theory that this would defeat any chain letter aspect and prevent the Koscot program from being deceptive or unfair will not withstand scrutiny. First, even with the purported limitations of one Koscot distributor for each 7,000 people, this would involve the recruitment of 29,000 distributors within ten months; and if the limitation were one distributor for each 4,000 people, this would involve the recruitment of nearly 51,000 distributors, or a saturation point likewise reached within ten months (CX 536; Westing 1273; Darling 1445-48). Second, the imposition of an inappropriate statewide quota did not negate the endless chain representation, nor did it prevent the chain from soon reaching the saturation point in numerous local areas. This was largely because, with rare exceptions, distributors naturally tended to recruit in their own circumscribed local areas, and the chain soon ended in such an area before a statewide quota was breached (CPF 174-77).

53. In summary, the imposition of quotas that ostensibly limited the number of distributors within each State did not really affect the endless chain aspect of the Koscot program. Respondents continued to recruit distributors by portraying the program as an endless chain; they devised numerous means to circumvent the quotas; and they established and promoted numerous other companies whose distributorships could be sold by Koscot distributors (CPF 172-216). Meanwhile, distributors learned to their sorrow that the chain was not endless but that all too soon it reached its inevitable end in their communities.

C. Other Misrepresentations

Distributor Earnings

54. The deception inherent in the endless chain aspect of Koscot's marketing plan is but one of numerous misrepresentations made by respondents. This basic deception necessarily involved, of course, gross misrepresentations of the income to be made through recruitment.

55. The earnings claims varied with the various programs. Again using CX 11 as typical, we find Koscot claiming that a distributor could readily sell a minimum of 12 distributorships a year or, with a little more effort, 24 distributorships a year. Depending on how many were directly recruited as distributors and how many were "promoted" from the supervisor level, the annual income was represented as ranging from $26,000 to $52,000 (CX 11, pp. 12-13; CXs 531, 532; Darling 1309-13). These claims were scaled down from those in an earlier manual, which had portrayed earnings ranging from $33,000 to $175,000 (CX 15, pp. 21-22). The falsity of such representations as applied to virtually all of Koscot's distributors has already been demonstrated *supra* (¶¶ 47-53). None of the typical distributors who testified even approached such figures.

56. In addition to gross misrepresentation of the earnings from recruitment, respondents also made numerous misrepresentations concerning the status of Koscot and the opportunities for success and wealth in selling Koscot cosmetics.

57. To begin with, respondents misrepresented the ease with which beauty advisors could be recruited and retained; the volume of initial orders that could be realized; and the extent of repeat business. Contrary to respondents' representations, it was difficult to recruit beauty advisors and, for the relatively few recruited by most distributors or subdistributors, it was even more difficult to keep them working (CPF 242-47).

58. Then, using a gross misstatement of the retail market for

cosmetics—average family purchases of $17.82 per month (CX 11, p. 3), when the correct figure was $8.33 (Nelson 1581)—respondents persisted in presenting a totally false and misleading picture of the volume of sales and the profits that could be made by beauty advisors, by subdistributors, and by distributors (CPF 247-71).

59. The falsity of respondents' representations concerning anticipated retail sales is demonstrated not only by mathematical analysis of the market in the light of the representations made but also by Koscot's records and by the actual experience of those who testified in this proceeding.

60. Koscot painted a picture of 400,000 beauty advisors (CX 13 B), each earning over $8,000 a year in commissions on an annual volume (at retail prices) of $21,600 (CX 11, p. 4; Darling 1299-1300). This multiplies out to annual retail sales for Koscot of $8.6 billion, when total retail sales by all companies of the type of products sold by Koscot amounted to only $5.1 billion in 1970 (CX 21; Nelson 1573-79). Similarly, Koscot represented earnings of $50,000 a year by a distributor through sales made by his beauty advisors (CX 11, p. 9). This would necessitate retail sales of over $200,000 for each distributor. With 40,000 distributors (CX 13 B), Koscot's total retail sales would have to be $8.1 billion—again, far in excess of the total market for Koscot-type products. Even if we were to cut in half the represented sales of a distributor's retail organization, this would contemplate an 80 percent saturation of the market by Koscot.

61. However, it is not necessary to rely on mathematical theory. Analysis of Koscot's records shows that in Illinois, Kansas, and New Jersey, average or mean sales per distributor were only a fraction of the figures represented by Koscot. Whereas Koscot depicted a distributor's annual product sales as ranging from $50,000 to more than $200,000 (CX 11, pp. 8-9; Darling 1302-06), the actual annual average or mean sales of distributors in those States in 1971 were reported in hundreds of dollars, not thousands. The national distributor averages were $1125 in 1970, $1733 in 1971, and $938 in 1972. (CPF 270; see also CPF 267-69)

62. Distributors and subdistributors having the greatest volume of sales in New Jersey had retail sales ranging only from $8,507 to $24,384, while in Illinois, the range was from $8,160 to $22,760 (CPF 271).

63. In summary, the average distributor found it difficult to recruit beauty advisors and even more difficult to retain them. Contrary to Koscot's claims, he wound up with just a few, and even fewer stayed on the job for more than three months. For the most part, their sales were minimal, and most distributors wound up trying to sell directly themselves or relying on their wives or other family members (CX 609

A; CPF 246). The claimed volume of sales simply did not materialize, and, of course, neither did the promised profits (Jones 4979-81). Thus, Koscot's representations concerning the earnings of distributors, supervisors, and beauty advisors were vastly overstated, contrary to what might reasonably be expected, and without basis in fact (CPF 239-71).

64. The lack of success at retail by Koscot's distributors was amply demonstrated by Koscot's own books and records, but that did not deter respondents from continuing to make their grossly deceptive claims of huge retail sales with resulting huge profits for distributors, supervisors, and beauty advisers. As a matter of fact, at a meeting attended by Turner, Bunting, and Julian, the suggestion that Koscot literature be revised to reflect the actual retail sales experience of Koscot distributors was rejected by Turner because "the figures weren't high enough to arouse the enthusiasm that he wanted" (Jones 4892).

Status of Koscot

65. Koscot made grandiose claims concerning its status as a seller of cosmetics and its prospects of surpassing within a year or two Avon Products, Inc., as the leading seller of cosmetics—of becoming "Number One in '71" (CX 11, pp. 3, 20, 34-35; CX 3 A; Mann 4450; CPF 272-79).

66. Illustrative of misrepresentations concerning the status of Koscot and its operations is the following:

> KOSCOT was begun with an investment of $5,000. During its first month in operation, it sold $67,000 in retail kosmetics. One year later, its sales were exceeding one million dollars per month, and seven months after that the retail sales were in excess of four million dollars per month (CX 11, p. 20).

67. Contrary to such representations, there was no product for many months after Koscot was launched in August 1967, and total product revenues in 1968 totalled only $255,000 (CX 29 E). During the first year of its operations, Koscot was engaged almost exclusively in the sale of distributorships and devoted almost no effort to providing a basis for future retail sales. Koscot had a minuscule share of the market throughout its history—considerably less than one percent (Mann 4450-51, 4740; CPF 282), and it could not reasonably be expected to become the leading seller of cosmetics for at least ten years (Delaney 1057; Mann 4451, CPF 282-97).

Opportunity Meetings and GO-Tours

68. Distributorship sales were generally accomplished by high-

pressure sales methods applied at golden opportunity meetings and on golden opportunity tours (GO-Tours). The opportunity meetings were carefully contrived and scripted to create a highly-charged emotional atmosphere in which prospects were persuaded that Koscot offered a fantastic opportunity to "achieve financial success beyond [their] greatest expectations" (CX 11, p. 1). Koscot was presented as an opportunity for "ordinary men and women" to earn from $5,000 to $20,000 a month (CX 15, p. 13; CX 11, p. 5; CPF 70, 76, 82). Scripts were generally followed, but even the exaggerated figures that they contained would sometimes be further exaggerated by overly enthusiastic distributors (CPF 71-72).

69. Koscot literature outlined in detail various techniques designed to "close" the prospect (CX 15, pp. 40-51, 55-58, CPF 58, 80-81). Success stories of named individuals were frequently grossly exaggerated or almost entirely fabricated (CPF 83).

70. To create an impression that affiliation with Koscot was the pathway to success and wealth, hundred dollar bills and thousand dollar bills, as well as Koscot checks for large sums of money—some of them fakes—were ostentatiously displayed (Jones 4856, 4861-62; CPF 84).

71. Through its literature, and particularly through its opportunity meetings and GO-Tours, Koscot represented that there was a virtually unlimited potential to earn large sums of money in a relatively short time by affiliating with Koscot (CPF 67-70, 80). None of the witnesses could fully articulate the atmosphere of the opportunity meetings, but it is apparent that they were generally conducted in such a manner as to excite most of those attending and to induce them to make an emotional decision to invest in the program (CPF 62, 66). Opportunity meetings took on the charged atmosphere of an old-fashioned revival meeting, except that the god was Mammon. For example, there "was a 'money hum,' where the crowd would hum 'money' and then shout it loudly" (Jones 4909). Another widely-favored chant was "Get that check; get that check" (*ibid.*).

72. Anyone who had or could get the amount of the enrollment fee was a prospect (CPF 59). Under the extreme psychological and emotional pressures established at opportunity meetings and on GO-Tours, individuals were sold on the idea that anyone could succeed in the Koscot program. For those who had reservations about their qualifications, Koscot promised to provide the necessary training.[13]

73. One former Koscot official described the "extremely high pressure" tactics used by respondent Hobart Wilder to "get that check" from a prospect:

[13] See *infra*, p. 35 [p. 1145, herein].

things like grabbing people's lapels, pulling their ties off, hitting them on the back, yelling in their ear, * * * any bizarre, odd things that could change a person's state of consciousness so much that he would just unthinkingly invest in the company, on the spot sometimes (Jones 4908-09).

74. Opportunity meetings were supplemented periodically with GO-Tours. A GO-Tour was a trip by bus or plane to a Koscot facility, climaxed by an opportunity meeting. With a captive audience of distributors and prospective distributors, the GO-Tour presented an extended opportunity for Koscot to use all its high-pressure recruitment techniques. The technique was to "keep everyone enthused, vibrating. You had to keep them excited until you got the money * * *. This was the whole thing, constant sing, shout, holler, go, go, go." (Tell 3887-88; CPF 85-96)

One GO-Tour participant reported:

When I got back home I didn't sleep for five nights after this, neither did my wife. The guy got us so jacked up, in thousands, I was ready to sell the Brooklyn Bridge to Eisenhower. (Vaz 2476)

Company Support of Retail Sales

75. The failure of distributors and their so-called sales organizations (subdistributors and beauty advisors) to achieve any substantial consumer sales was due in major part to Koscot's failure to make good on its representations as to company support of retail sales.[14] Respondents concede that the "promises attached to the sale of Koscot distributorships" included commitments (1) to provide product availability—initial inventory and a distribution system for the delivery of products; (2) to provide free training with respect to both recruitment and retail selling; and (3) to provide advertising (RPF 26). Respondents have put in issue the question whether or not Koscot lived up to those commitments. They have proposed numerous findings that purportedly "rebut much of the evidence complaint counsel sought to adduce" respecting product, training, and advertising, as well as other subjects (RB, p. 8). Respondents claim too much. Many of their proposed findings lack record support or are actually contrary to the record, and others are irrelevant to the issues presented. Each of these aspects of the Koscot operation will be examined in turn.

Product Availability

76. It is undisputed that ready availability of product is necessary for a successful retail operation. In recognition of this truism, Koscot promised ready availability of product to its distributors and their

[14] See *infra*, p. 41 [pp. 1149-50, herein].

retail sales organizations. Respondents argue that they met their commitments with regard to provision of product and that therefore no fraud occurred with respect to this aspect of the Koscot marketing program. Respondents' proposed findings regarding product may be summarized as follows:

1. Koscot did better in providing product than did Holiday Magic (RPF 14, 16, 18, 31).

2. Events beyond the control of Koscot or Turner caused whatever shortages occurred (RPF 19, 21, 32, 34, 40).

3. Koscot and Turner actually desired to have product (RPF 23, 33, 39).

4. Koscot took actions to obtain product (RPF 27, 35-38).

5. Koscot provided an effective product distribution system (RPF 30).

6. Koscot provided adequate product availability from late 1968 on (RPF 40).

77. A comparison of the foregoing summary with complaint counsel's contentions (CRB, pp. 4-5) shows that the principal dispute relates to the question of product availability and distribution methods after 1968, with subsidiary questions relating to the reasons for the lack of product in 1967-1968 and Turner's intent respecting retail operations.

78. Respondents concede that product "was not readily available in 1967 and most of 1968" but they blame this situation on factors "beyond Koscot's control" and contend that by the end of 1968 "product was beginning to pour into Koscot and thereafter product was always plentiful" (RPF 40). Thus, the acknowledged fact is that for more than a year after Koscot was organized and began recruiting and making claims of product availability, neither Koscot nor any of its distributors had any product available for immediate sale (Edwards 1132-36, 1163; Mann 4349, 4639, 4648; Jones 4921-24, 4928-29, 4952-54; CXs 196 A, 198). It is by no means clear that this initial lack of product was due to factors beyond Koscot's control. And, in any event, such a circumstance does not justify the continuing misrepresentations as to product availability.

79. It is true that cosmetics worth millions of dollars were produced or purchased by Koscot thereafter (Jones 4952). The record establishes, however, that even after the first year, Koscot was consistently unable to fill immediately its distributors' orders with the products desired, particularly the most popular products. There were significant lags in obtaining product necessary to fill completely the orders of distributors. (CXs 275 A, 277 A, 609 A; Jones 4876-77, 4989; CPF 334-35)

80. Some of the production and distribution problems encountered

by Koscot, particularly in the first year or so, might be rationalized as simply the growing pains of a new company, complicated by mismanagement due to the lack of qualified personnel, as well as certain other factors. Actually, the factors allegedly beyond Koscot's control which respondents cite to excuse their initial failure to deliver product apply only to the first year of Koscot's operation. Respondents blame the incompetence of the personnel assigned to get product (RPF 19, 21, 32, 34).

81. This excuse must be assessed against the fact that no one with any experience in cosmetics was brought into the company in its early days and that officials were selected on the basis of their ability to sell distributorships rather than skill in managing a cosmetics sales operation (Delaney 1084-86, 1090, 4452, 4468; Mann 4792; Jones 4902-03, 4962). Thus, by selecting personnel unqualified to successfully obtain product, Koscot and Turner took actions whose predictable consequence was the shortages of product they experienced, particularly in the early history of Koscot.

82. Respondents also refer to a glass industry strike in 1968 (RPF 34), but the record fails to establish sufficient details concerning the date or the duration of the strike or its actual impact on Koscot operations (Delaney 1051-53; Edwards 1163; Mann 4639).

83. It is true, moreover, that efforts were ultimately made to develop good products and to employ some personnel knowledgeable in the field of cosmetics production and marketing. Nevertheless, this record establishes that product sales were constantly subordinated to recruitment. Koscot and its distributors were primarily in the business of selling distributorships (Westing 1214-16; Nelson 1726). The extent and nature of Koscot's product inventories demonstrated its expectation of limited product sales (Westing 1237-39).

84. That the principal activity of Koscot was the sale of distributorships is shown by financial records reflecting that during the period 1967-1972 distributorship sales accounted for the bulk of its revenues. The breakdown is as follows:

Period	*Total Revenues**	*Recruitment Revenues**	*% of Total*	*Product Revenues**	*% of Total*
1967	143	143	100%	255	8.7%
1968	2,932	2,676	91.3%	1,474	10.8%
1969	13,658	11,400	83.5%	9,516	42%
1970	22,716	13,200	58%	19,504	35%
1971	56,204	36,700	65%	8,772	19%
1971**	46,135	37,363	81%	7,677	39.4%
1972	19,485	11,807	60.6%		

* In thousands of dollars. Figures have been rounded.

** For 11 months ended June 30, 1971; see *infra*.

Notes: The figures are drawn primarily from CPF 464 and the sources there listed (by "Notice of Corrections"), except that the figures for the fiscal years 1970 and 1971 have been inserted from CXs 357 G-H and 358 F, I. Although the Koscot financial records from which this analysis was drawn are not models of clarity, and there are a few discrepancies, they appear to be the best information available. Some explanation is required as to methodology.

CX 29 E, a Koscot report to the Commission, is the source for the 1967 and 1968 figures. For the fiscal year ended July 31, 1969, the total revenues figure is found at CX 26 F; the recruitment figure at CX 26 G. For fiscal 1969, product revenues were derived by subtracting the recruitment revenues from total revenues and then adjusting that figure by subtracting revenues for sales aides, newspaper income, and trucking, as shown on CX 26 Q. Here there are two discrepancies: (1) CX 26 G cites distributor revenues of $11.4 million, "of which $9,816,000 is included in revenue;" and (2) CX 26 Q shows "Cosmetic sales" of $9.7 million. If the $9.8 million figure were used instead of $11.4 million, the percentage figures would be 71 percent and 29 percent respectively. As a further complication, CX 29 E presents another set of figures, showing "gross sales" of $13.03 million, distributorship revenues of $8.9 million, and product revenues of $4 million. These figures would result in percentages of 69 percent and 31 percent respectively.

The 1970 figures, shown in CPF 464 as not available, were derived from CX 357 G-H for the fiscal year ended July 31, 1970. Product revenues were obtained by subtracting the recruitment revenues from total revenues.

The first set of 1971 figures (for the fiscal year ended July 31, 1971) was similarly derived from CX 358 I (but see 358 F). The second set of 1971 figures, taken from CPF 464, is for the eleven months ended June 30, 1971. The total revenues figure was arrived at by adding "Receipts from New Contracts" (CX 168 B) to "Receipts—Product Sales" (CX 168 B), except that this product figure has been adjusted to reflect net prices by subtracting the "Territory Override." (Since the year-to-date override entry on CX 168 B is illegible, it was arrived at by using the year-to-date figure on CX 167 D and adding to it the June 1971 figure shown on CX 168 B.) The substantial variance between the 1971 figures has not been explained. Presumably, complaint counsel considered CX 168 more reliable than CX 358.

The figures for the fiscal year ended July 31, 1972, were derived from CX 180 D. Recruitment revenues represent the sum of the "New contracts" figure plus "GO Tour" revenue. The product revenue figures represents the "Product sales" figure from which the "Territory override" was subtracted to reflect net prices. (See also Westing 1214-16 and Nelson 1727-38.)

85. Whatever the shortcomings of the data in ¶ 84, there nevertheless is no doubt that during the period covered, distributorship sales accounted for most of Koscot's revenues (Edwards 1173; Westing 1216; Nelson 1728).[14a]

86. Respondents also plead good intentions on the part of Turner and his associates (RPF 23, 33, 39). The evidence tends to show that Turner initially wanted to establish a successful company to sell cosmetics at retail, but there are also indications that this desire may have changed in the face of the constant need of the Turner empire for more cash, which could be more quickly realized through recruiting activities than through cosmetic sales (Delaney 1057, 1089-91; Edwards 1152-56, 1160-61, 1173; Mann 4564-65, 4589-91, 4650-55, 4670-75, 4695-99, 4794-95, 4802-05; Jones 4875, 4926-36, 4949-50, 4990-94, 4998, 5001-03).

87. Regardless of respondents' intentions, the fact remains that from the inception of Koscot, there were serious misrepresentations regarding retail operations—(1) the availability of product; (2) the extent and nature of supporting advertising; (3) the training offered with respect to retail operations; as well as (4) the likelihood of success and the amount of income to be realized through retailing of Koscot products (*supra*). And these were knowing misrepresentations.

88. Until early 1969, the only method used by Koscot to distribute its products was by direct factory shipment to distributors. All initial inventories, less out-of-stock items, were shipped direct to the distributors. These initial inventories consisted of an assortment of products chosen by Koscot. All reorders for product had to be made in case lots direct from Koscot (CPF 315).

89. Beginning in March 1969, distributors, with Koscot's advice and assistance, began establishing local cooperative warehouses ("co-ops") in which their inventories were stored. The idea was that such co-ops would provide immediate product availability on a local basis by establishing a larger inventory assortment than would have been available to a distributor under the direct factory shipment method. Although distributors could continue to get direct factory shipment, they were strongly discouraged from doing so and encouraged, instead, to join in the co-op warehouse (CPF 316-17).

90. To establish a co-op, existing distributors put in the inventory which they already possessed, while new distributors either received their initial inventory direct from Koscot and placed it in the co-op or Koscot simply credited the co-op account with the amount of product due a new distributor (CPF 318).

91. Distributors were required to maintain a minimum inventory account at the co-op. A distributor could withdraw products without

[14a] From August 1967 until July 1972, Koscot netted $14.1 million after paying recruiting fees (CPF 226-228).

additional charge only so long as his inventory value exceeded this minimum. The co-ops soon encountered difficulties in re-stocking (CPF 319-20).

92. Within a few months, Koscot acquired control of the co-ops and their inventory and converted them to "satellite warehouses" and also opened additional satellites. By June 1970, there were 350 satellite warehouses in operation (CPF 321) Koscot obtained control of existing inventories of the co-ops and assumed their liability to distributors for their inventory accounts. As new distributors were recruited, Koscot established for them an inventory account at the nearest satellite. There were restrictions on withdrawal of inventory. Distributors had to maintain a minimum inventory value at the satellite and paid immediately for all product withdrawn once this minimum was reached (CPF 322-23).

93. In 1971, Koscot began closing down the local satellites and replaced them with five regional mail-order satellites. These mail-order satellites assumed the obligations of the local satellites and were operated in the same manner as the local satellites with respect to the crediting of distributor inventory and the withdrawal of product by distributors or their sales organization. (CPF 325-27). The mail-order satellites disadvantaged, rather than helped, retail sales (CPF 344). There are indications that the mail-order satellites were later closed and that all orders thereafter were shipped from Orlando, Fla. (Bennett 3709).

94. Thus, Koscot's successive modifications of its distribution system, so that a distributor's initial inventory was not physically delivered to him, meant that Koscot was receiving payment for product that it did not actually deliver. As a matter of fact, between July 1969 and July 1973, Koscot had less finished goods inventory on hand than the amount for which it already had been paid by its distributors. During this period, Koscot steadily reduced the amount of finished goods that it had on hand, in comparison to the initial inventories for which it had been paid by distributors but had not furnished. The table prepared by complaint counsel from respondents' own records tells the story as follows:

Fiscal Year	*Koscot's Finished Goods Inventory*	*Cost of Product Due Distributors*	*Percentage Relationship**
1969	$995,000	$1,155,000	86
1970	2,579,000	4,291,000	60
1971	5,557,000	10,362,000	54
1972	4,793,592	9,693,000	49
1973	1,400,000	9,693,000**	14.4

* Finished inventory as a percentage of product due distributors.

** Assuming no change from 1972.

Sources: CXs 26 E, H; 357 F, I; 358 E, K; 758 A-B; RX 12 Z-71; Nelson 1713-15; CPF 336-37.

95. Such a practice allowed funds paid for product to be diverted to other uses (Westing 1237-39; Darling 1459-60).

96. The weakness in respondents' defense is pointed up by the fact that they are driven to claim that Koscot did better in providing product than did Turner's "alma mater," Holiday Magic (RPF 14, 16, 18, 31). Complaint counsel concede that Koscot supplied a better and more extensive line of cosmetics than did Holiday Magic. But this is irrelevant, as is the disputed claim of respondents that Koscot provided its distributors a greater availability of product than Holiday Magic. Even if we accept respondents' contention that Holiday Magic had "little product" and was "not interested in the retail cosmetics business" (RPF 31), this would merely show that Koscot, in its failure to provide what it promised, may not have been as derelict as another firm that the Commission has found to have engaged in a fraudulent operation (*Holiday Magic, Inc., supra*).

97. As a matter of fact, the Koscot plan was adopted from the Holiday Magic plan. Turner quit Holiday Magic and established Koscot when Holiday Magic curtailed the opportunity to earn large commissions on recruiting by imposing certain requirements for retail sales. Koscot's manuals were based on those of Holiday Magic, and Turner's instructions were to out-magic Holiday Magic by raising the ante on the earnings claims (Jones 4851-53, 4860-61). Although there is some testimony that does tend to introduce some ameliorating factors and to suggest some "honorable parts of Koscot's history" different from the Holiday Magic scheme" (RB, p. 8), the undersigned has not made a detailed comparative study of the two plans, and he sees no occasion to do so. To predicate a defense on the theory that Koscot's offenses were not as bad as those of a similar operation (Holiday Magic) already found to have been fraudulent is to confess the bankruptcy of the defense. Degrees of fraud are somewhat akin to degrees of pregnancy.

98. However anomalous it may seem for Koscot to operate in a manner apparently designed to discourage consumer sales of its products, that was the effect of its supply and distribution policies and practices (CPF 338-41, 344; see *infra*, p. 41 [p.1149, herein]). Whatever the cause of its failure to provide ready availability of product for resale, Koscot plainly did not make good on its representations in that regard.

Training

99. Because of the lure of the money to be made through

recruitment, many Koscot distributors sold distributorships to others whom they knew or believed to be unqualified (Hatcher 3115; Brown 3390-91; Tell 3883-86; Fletcher 3977). So long as it was possible to "get that check," anybody with a "pulse and two legs" (Vaz 2465) or "anyone that was breathing" (Tell 3883) was a prospect by Koscot standards (Mann 4475-76; CPF 97-98, 100, 104).

100. Many persons who purchased Koscot distributorships were unqualified to operate a cosmetics selling business by reason of their age, lack of education and training, or lack of business, administrative, or sales experience. Koscot's recruitment methods tended to result in the enrollment of persons without any special qualifications, including frequently the credulous, who in turn tended to recruit others with similar profiles. By reason of their limited education and modest backgrounds, such persons tended to have a limited degree of sophistication in financial and business matters. (CPF 100, 103, 106-09, 111, 304-06, 310-11) They were particularly vulnerable to the misrepresentations and the high-pressure enrollment techniques used at opportunity meetings and on GO-Tours (*supra*, p. 26 [p.1137, herein]).

101. Consistent with the Turner philosophy, respondents represented that anyone could achieve success by becoming a seller of Koscot cosmetics-that no special qualifications or experience were necessary (CX 11, pp. 5, 34; CPF 100, 305-06. To those who expressed doubts on this score, Koscot promised to provide training that would overcome any such shortcomings (CPF 307, 345-47, 349). This record demonstrates that Koscot's representations of this nature were false and misleading (CPF 310-11, 350-354a).

102. Koscot deliberately chose a method of recruitment that enrolled distributors who, for the most part, did not know how to set up and manage a wholesale or retail business and then, to compound the offense, used the promise of its training program to overcome objections by potential distributors that they were not qualified (CPF 104-11, 348-49).

103. Because of certain terminology used in the findings that follow, it is important to understand that in the operation of the Koscot plan, the sale of distributorships for compensation was known as "wholesale," while the sale of cosmetics, whether at wholesale or at retail, was known as "retail." In theory, and to a very limited extent in practice, a Koscot distributor performed a traditional wholesale function in supplying products to others (supervisors (or subdistributors) and beauty advisors) for eventual sale at retail to consumers. To avoid the possible confusion that may result in referring to the sale of distributorships as "wholesale," the undersigned has usually referred to the sale of distributorships in those words or by the use of the terms

"recruitment" or "recruiting" (see CPF 128). However, in this section, "wholesale training" refers to salesmanship and motivation training designed to teach distributors to recruit others into the Koscot program. As used by counsel and witnesses, "retail training" primarily means business training respecting the establishment and operation of a distributorship for the sale of cosmetics, etc., although the term was also loosely used sometimes to include the training of beauty advisors for retail selling. To avoid confusion, the term "business training" will be used herein except when quoting.

104. Respondents do not dispute that Koscot promised its distributors "free training—both wholesale and retail"[15] (RPF 26). In contending that respondents met this commitment, defense counsel have proposed the following findings:

> Glenn Turner created Koscot with the idea that he would get better product and training to his distributors than Ben Patrick gave his with Holiday Magic. * * * The training was superior. (RPF 14)
>
> Glenn Turner gave Miss Jeri Jacobus 5 percent of Koscot to be in charge of retail training. She was knowledgeable and her judgment was valued. * * * Miss Jacobus did provide training programs for the beauty advisors. In excess of $20,000 per month was spent on such training alone as early as 1968. (RPF 15) Jeri Jacobus provided free, expert training in the early days for Koscot retailers * * * and thereafter, Jerry McLaughlin headed a substantial (perhaps a 100) husband and wife retail training teams. * * * In excess of $35,000 per month was spent by Koscot on salaries and travel expenses for the retail training teams while Mann was president of Koscot. * * * In 1968, Koscot had spent in excess of $20,000 per month for training while Mr. Edwards was president. (RPF 28)

105. The difficulty with such proposed findings is that they fail to meet the issues posed by complaint counsel's proposed findings (CPF 345-354a). And, although the record citations tend to support respondents' proposed findings on the general subject of training, the testimony relied on is principally concerned with "wholesale" training and training of beauty advisors. Complaint counsel concede that respondents provided free training, both "wholesale and retail," and that such training was superior to that offered by Holiday Magic (CRB, pp. 14-15). Complaint counsel also concede that respondents spent considerable sums on training Koscot distributors how to recruit and that this phase of the training was effective (*ibid.*). However, the allegation is that Koscot falsely promised business training—to teach its distributors and subdistributors how to set up and manage a cosmetics business—a wholesale-retail operation. Respondents' proposed findings simply fail to meet the record evidence in support of this allegation. The testimony relied on by respondents relates almost exclusively to "wholesale" training and to the training of beauty

[15] See ¶ 103, *supra*.

advisors. At most, the cited testimony (Edwards 1157; Mann 4631-34; Jones 4918-19) simply demonstrates that there was some "retail" training and that this involved the expenditure of Koscot funds (see Mann 4452, 4470, 4473-74, 4773-80; Jones 4952-53, 4982, 4997). The figures cited by respondents in RPF 15 and 28 are not figures for business training but cover wholesale training and beauty advisor training (Edwards 1157; Mann 4635, 4684, 4773-77). As a matter of fact, although Koscot represented that $300 of each distributorship fee went for training, company records indicate that out of $2 million earmarked for training in the fiscal year ended July 31, 1969, Koscot spent only $1.4 million (CXs 13 D-E, 26 Q).

106. The business training that was provided did not qualify distributors to operate a cosmetics business (CPF 353). No training in record-keeping or cost accounting was provided (CPF 353a), although such subject matter was necessary to enable distributors to operate any business successfully (CPF 348).

107. Although Koscot recognized the need for business training and promised to provide it, it actually discouraged distributors from taking it, so that they could be trained instead in recruitment (CPF 353). Frequently, Koscot's so-called business training sessions were devoted in large part to "wholesale" and to motivational aspects or to product description and application and the recruitment, control, and maintenance of beauty advisors (CPF 350, 353b).

108. The former Koscot officials who, according to respondents (RB, p. 17), were "highly complimentary" of the retail training program failed to support the claim of effective business training for distributors as each testified that he was unfamiliar with the nature of such training (Edwards 1174; Mann 4780; Jones 4982, 4997). Even so, one of them, a former president of Koscot, testified that in 1971, the retail training program for distributors "needed a tremendous amount of improvement" (Mann 4473).

109. In summary, Koscot promised to teach its distributors how to set up and manage a business, and it did not do so, regardless of how much money it may have spent.

Advertising

110. Respondents have offered a simplistic defense to the proposed findings of complaint counsel on the subject of advertising. They contend that Koscot promised to spend $75 per distributor for advertising and that Koscot spent from 1968 to 1972, an amount greater than that commitment (RPF 26, 29). These proposed findings of respondents must be rejected as irrelevant and as contrary to the record. First, although there was apparently a contractual commitment

in Koscot's early days to spend $75 per distributor on advertising (Edwards 1143, 1159; Mann 4635-37), Koscot's representations as to advertising were far broader than that narrow commitment. The issue is not whether the contractual commitment was met, but whether Koscot provided the advertising it promised in its manuals, in opportunity meetings, and otherwise. But, second, even if we were to adopt respondents' test, the record fails to support the claim that Koscot spent on advertising $2.25 million between 1968 and 1972. Respondents arrived at this figure by multiplying the supposed number of Koscot distributors (30,000) by the $75 figure and then asking a former president of Koscot whether that amount was indeed spent on advertising. It is true that an affirmative answer was given (Mann 4636), but it is entitled to scant weight when considered in the light of the whole record, including Koscot's own records.

111. Mann's testimony does not demonstrate any basis for his knowing Koscot's advertising expenditures for the period 1968-72, or even having an informed opinion. Moreover, some of his other answers materially detract from his estimate (Tr. 4452-67, 4628-30, 4664-68, and 4672-73). Mann testified that advertising expenditures while he was international president of Koscot totalled $450,000 for October 1970-February 1971 and that he knew of no other period where such an amount was spent for advertising (Tr. 4460-61). He contrasted it with an advertising budget of $60,000 for the last six months of 1971 (Tr. 4461; CXs 570-72).

112. Above and beyond its contractual commitment to spend on advertising $75 per distributor, Koscot promised that it would be spending millions of dollars on advertising within a year or two to create a consumer demand and to make Koscot the leading firm in the cosmetics industry ("No. 1 in '71"). Koscot promised to place effective advertising on network television and radio and in magazines and newspapers (CPF 355-56, 369).

113. Koscot's promises concerning advertising demonstrated recognition by its officials, as well as by its distributors, that extensive advertising would be necessary for a new firm selling cosmetics door-to-door in competition with one or more firms already firmly entrenched in the industry (Mann 4451-52, 4751-52; CPF 355e, 357-59). Yet Koscot's advertising effort was far overshadowed by that of the industry leader, Avon Products, Inc. (CPF 364).

114. Koscot announced its intention "to reach the greatest heights in product recognition—to become the *one* product everyone thinks of when kosmetics are mentioned!" This was said to be a "fantastic idea" but "one that is fast becoming a reality!" (CX 11, p. 3).

115. The "reality" was that more than once Turner disapproved of

advertising expenditures to reach such a goal (Edwards 1141-42; Jones 4875). Jeri Jacobus favored "massive advertising to get product recognition" (Jones 4929-30), but Turner "always said that most of the money was coming out of the wholesale[16] side, and he thought that most of the money should be devoted to that end" (Jones 4875).

116. Thus, the substantial advertising promised by Koscot did not materialize. Advertising was "minimal" in 1968 (Edwards 1140). Later, there were periods when nothing was spent on advertising and other periods when a "good bit" was spent (Edwards 1143-44, 1159-60; Jones 4929-30, 4953-54). Such advertising as Koscot did sponsor was too little and too late, and the glowing promises regarding product recognition were never fulfilled (CPF 369, 371-72). There were some limited local TV commercials, many in other than prime time, and a few magazine and newspaper advertisements (CPF 365, 367).

117. Contrary to respondents' dubious estimate that at least $2.2 million was spent for advertising[17] between 1968 and 1972 (RPF 29), the fact is that only about half of this amount was spent for advertising. As developed from Koscot's own records, its advertising expenditures were as follows:

Year	*Total Amount*	*Media*	*Production*
1967-1968	$ 24,446*		
1969	$110,512	$ 99,871	$10,641
1970	$311,302	$287,511	$23,791
1971	$317,263	$273,246	$44,017
1972	$370,459	$332,993	$37,466
Total	$1,133,982	$993,621	$115,915

* Includes some expenditures made through 3/14/69.

From CPF 360. Sources: CXs 625, 651, 652, 699 A-B, 743 A-B, 756 A-K (see Tr. 4339-41).

118. Some of these advertising expenditures were forced upon Koscot in the light of legal proceedings instituted or threatened. For example, as a result of negotiations with the attorney general of New York, $100,000 was spent in a single campaign in that State (Mann 4465). Although Koscot designated certain funds for advertising in its financial records, actual advertising expenditures were substantially below the funds so earmarked (Edwards 1143, 1159-60; CPF 362). As a matter of fact, as of July 31, 1972, Koscot had a book entry reflecting $1,876,989 designated for advertising expenses but unspent (CX 758 B).

119. Despite the conceded quality of Koscot cosmetics, they remained largely unknown to the consuming public, and lack of

[16] See ¶ 103, *supra*.

[17] "Sales aids" were included in respondents' estimate, but Koscot *sold* these items to its distributors at a profit (CPF 378).

advertising was a significant factor leading to this negative result. Koscot failed to make good on its representations concerning the nature and scope of its advertising.

D. "Wholesale v. Retail"[18]

120. Koscot's emphasis on the "get-rich-quick" aspect of its endless chain recruitment had predictable results. Koscot raked in millions of dollars, and a few early birds also realized huge profits before the bubble burst. Meanwhile, the sale of "kosmetics" to the public languished, and Koscot's representations about this phase of its business turned out to be just as false and misleading as those concerning recruiting. Koscot's initial glowing promises about the retailing of cosmetics were at best highly dubious. But the preoccupation of Turner and his cohorts with the "big money" to be made through recruitment virtually ensured the failure of the retail operation.

121. That is one of the saddest and most ironical aspects of this case. There is evidence indicating that Koscot did indeed have a potential for success as a seller of cosmetics. As a matter of fact, now that it is out of the business of selling distributorships, Koscot may yet emerge as a viable cosmetics company. According to most of the distributors and subdistributors who testified, the Koscot products had merit and might have achieved considerable consumer acceptance with proper promotion and advertising. Some of the company officials saw this potential, particularly Delaney, Mann and Julian, and many distributors made prodigious efforts to succeed in the retail sale of the product. However, the steps necessary for success in the sale of cosmetics were almost invariably subordinated to the promotion of the sale of distributorships. Company officials who tried to change the emphasis to retailing either quit in disgust or were forced out of the company or into subordinate positions.

122. The Koscot marketing program was structured so as to maximize recruitment earnings even at the expense of retail earnings. Distributors were encouraged to devote their energies to recruiting by virtue of the apparent opportunity to make big money fast. No real effort was made to obtain distributors interested in or qualified for the operation of a retail business. The incentives in the Koscot marketing program were so structured that recruitment provided the possibility of large immediate rewards. In contrast, the work of building a retail sales organization was very difficult, initial rewards were small, and it took time to develop and build a retail sales organization. Koscot's former president recognized the difficulty of getting distributors to

[18] See ¶ 103, *supra*.

concentrate their efforts on retail when it appeared that the rewards from recruiting were faster and more substantial (Mann 4473).

123. By encouraging the recruitment of any person who had or who could get sufficient money to buy into the program, regardless of their qualifications or their location in reference to other distributors, the Koscot program virtually foredoomed the retail effort to failure.

124. The result was an inadequate and unbalanced distribution network, with too many distributors serving certain areas and too few serving other areas. Distributors were not evenly distributed in any State in proportion to the relative population of the various marketing areas. Instead, distributors were concentrated in certain marketing areas in numbers greatly disproportionate to the population of those marketing areas. (CXs 537-39)

125. One of complaint counsel's expert witnesses expressed it this way:

> If a manufacturer selects his own distributors, he will look at them very hard headedly in terms of how knowledgeable they are, how financially secure they are, how experienced they are, and so on. He also will strive to put together an organization that covers the territory of the country that he wants to cultivate in an even and balanced manner.
>
> If an organization is put together by other distributors whose primary inducement is the profit they can make from recruiting, they are likely to pay primary attention to whether the prospect can pay the investment. That would be the primary concern because that is going to be the source of their profit.
>
> Secondly, they will tend to recruit from among the people who[m] they have access to, which means that the proximity will be an important consideration and the consequences of this is likely to be an over-development of an organization in certain territories and a scarcity of distributors in other territories. (Westing 1210-11.)

126. The rationalization that the emphasis on recruitment was designed to establish a distribution network as quickly as possible (Mann 4802-05; Jones 4936; CX 13 B) will not withstand analysis. Whether the quota was 30,000 distributors or 40,000 distributors, this was an excessive number for the amount of retail business that was being done or that could reasonably be expected (CPF 385-87, 389-92). Although perhaps not conclusive, a comparison with Avon as a successful company in the field tends to show that there was no necessity for the number of distributors being sought by Koscot other than as a means of realizing a rapid and substantial cash intake. In 1969, Avon had 1,566 district managers to recruit and supervise its retail sales representatives. By 1971, this number had increased to 1,841 district managers, pursuant to the Avon formula of one district manager to 100,000 population (Speer 2121-22).

127. The compensation of Koscot's State directors and their assistants was "based on receipts from new contracts" (CX 164 E).

Understandably, this method of compensation provided an incentive for such officials to favor recruitment over retail. And the record demonstrates their natural reaction to such an incentive: The Illinois State director told a scheduled "business meeting" of distributors: "I don't care about retail. I am here to sell wholesale."[19] (Gittings 3286; CPF 417).

128. Despite his ostensible interest in building a cosmetics company, Turner devoted most of his time to recruitment activity and problems; he promoted officials and employees who emphasized the recruitment aspect of Koscot, to the detriment of those who tried to build up the cosmetics-selling end of the business (CPF 419-26, 431-34, 438-447). At a time when recruiting had to be halted in several States because of legal restrictions or because the so-called quota had been reached, Turner was urged to make a tour designed to encourage retail activity, but he rejected this proposal and elected to devote his time to the promotion of Dare-To-Be-Great as a substitute pyramid plan (CPF 435-37).

129. To the extent that the application of quota limitations or the institution or threat of legal action by State authorities raised questions about the continued sale of Koscot distributorships, distributors were constantly reassured that "there will always be wholesale"[20] —that Turner would create new companies in which distributorships could be sold (CPF 192-193). For example, Turner established in 1969, a corporation called Dare To Be Great, Inc. ("DTBG") which used a marketing plan similar to that of Koscot except that the "product" comprised texts and manuals presenting an attitude course. Koscot distributors were authorized to sell distributorships in DTBG. The purpose was made clear:

> Glenn Turner said they will try to stop me with Koscot but we will just go on with Dare to be Great (Palamara 2572).

Turner "decided that we could start many, many pyramid companies and we could start them faster than the Government could shut us down. And, he stated that he * * * intended to be the pyramid king of the world." (Jones 4896). Several other companies using the same type of marketing program were also established by Turner (CPF 192-216).

130. Dissension developed within Koscot, not only in its Orlando headquarters, but also in the field, between those who wanted to continue to reap the harvest of distributorship sales through "wholesaling" (see ¶ 103, *supra*) and those who wanted Koscot to sell cosmetics. It is not necessary for the purposes of this proceeding to

[19] See ¶ 103, *supra*.

[20] See § 103, *supra*.

detail the infighting that ensued. It is sufficient to note that in mid-1971 the "wholesalers," led by Wilder, prevailed with Turner's blessing, and "retailing" was further deemphasized (CPF 433-447, 454-61). However, Glenn Turner's "impossible dream" ended in July 1972, when Koscot petitioned for reorganization under the Federal Bankruptcy Act (RX 12). Koscot finally became a marketer of cosmetics instead of the promoter of a fraudulent scheme.

E. Liability of Individual Respondents

131. Although the previous findings (¶¶ 7-26) are sufficient to demonstrate the need for a cease-and-desist order against the individual respondents (except Delaney and Jones), brief additional findings may be desirable with respect to the order of restitution being entered against Turner, Bunting and Wilder. (Obviously, any restitution order should be directed to the corporate respondents.)

132. Turner was the alter ego of the corporate respondents and the "architect and prime mover"[21] of Koscot's marketing scheme. He bears primary responsibility for the unlawful practices herein found. Additionally, he was the primary beneficiary of the income realized from Koscot's operations, manipulating and using corporate funds as his own. (¶¶ 7-9, *supra*)

133. It is possible, though almost incredible, that at the outset, Turner may have been sincere in his intentions and may have believed the representations made by him and by Koscot. Although he may have been shielded, or may have shielded himself, from some of the harsh realities of what was happening to Koscot's distributors, subdistributors, and beauty advisors (Jones 4903-04, 4968-70, 4986, 4989-94, 5002-03) he is nevertheless chargeable with knowledge that the Koscot operation was based on deception and fraud. If he did not know—and the finding here is to the contrary—he should have known. Although defense counsel pleads that Koscot's operation was superior to that of Holiday Magic, the fact is that there exists a deadly parallel between the two (¶ 97, *supra*). Turner professed to want to establish a successful cosmetics operation, but when there had to be a choice between "retailing" of cosmetics and "wholesaling" ("head-hunting" for a profit), he opted to invest time, effort, and funds in the latter. This he did with full knowledge of the fraud and deceit involved.

134. Despite exhortations that "honesty" was necessary for success in Koscot (CX 10, p. 2; CX 88), Turner operated on the theory that "it was okay to lie as long as it was for the benefit of the person that you were lying to" (Jones 4858). Turner's idea of benefitting people was for

[21] *Holiday Magic, Inc., supra*, at 24.

them "to give up everything they had and go * * * deeply in debt, because he felt like if they had everything to lose they would make it" (Jones 4914).

135. The record is replete with stories of the adverse impact on the finances and the careers of those who took that advice and invested in Koscot. Many borrowed the money,[22] and others quit their jobs to work full time as Koscot distributors. In many instances, net losses were substantial, and some distributors wound up in debt even to the point of bankruptcy or in financial circumstances requiring them to sell their homes (CPF 381-83).

136. Bunting and Wilder each occupied the position of Koscot's chief operations officer for a significant period of time (¶¶ 11, 16, *supra*). Although Bunting's salary was less than one-third of Wilder's (CXs 307, 309, 322), he continued to reap rich financial rewards from Koscot's operations even after he resigned (¶¶ 12-15, *supra*). Wilder not only was high-salaried but also received a substantial loan from Koscot (¶ 17, *supra*). The full extent of their enrichment is not shown by this record, but enough is known to warrant a restitution order against them.

137. There is no question that Bunting and Wilder knowingly and actively directed and participated in the corporate activities. They were familiar with the nature of Koscot's marketing plan, the representations made, and the falsity of such representations. Each had operated as a Koscot distributor, and each had been engaged in field operations (primarily the sale of distributorships) as paid employees before becoming corporate officers. As corporate officers, each participated in opportunity meetings and GO-Tours. Each was aware of the failure of Koscot to deliver the goods (literally and figuratively) to its distributors. Each was actively engaged in day-to-day operations and had available to them computer print-outs showing the facts that contradicted the misrepresentations being made (CPF 538).

138. Under their leadership, high-pressure recruitment methods were intensified through the increasing use of GO-Tours; the method of product distribution was successively modified for the benefit of Koscot and to the detriment of the retail operation; and advertising was not delivered as promised. In addition, plans were made and carried out to avoid the so-called quota restrictions on the continued recruitment of distributors (CPF 539).

139. Wilder occupied a special niche. Next to Turner, he was the chief promoter of recruitment activities. He was ruthless in seeking to "get that check;" he "would do anything to get money" (Jones 4993). He

[22] Koscot encouraged prospective distributors to borrow the money if necessary and furnished a blueprint that in effect encouraged prospects to mislead a bank in applying for such a loan (CX 96 A-D; CPF 105).

and Turner were the prime movers in subordinating cosmetic sales to recruitment activities. (CPF 552-57)

140. In recommending that Julian and Mann be excepted from the restitution order, complaint counsel state:

"These two individuals occupied lesser positions of authority in the direction and implementation of the Koscot marketing plan and received no large financial rewards as a result of their position[s] as officers" of Koscot and Turner Enterprises (CB, p. 62).

The undersigned concurs. Despite the identity of some of the corporate positions held by Bunting, Wilder, Julian, and Mann, the record supports a finding that Bunting and Wilder were more dominant figures and played more significant roles in the operations of the corporate respondents. Moreover, the efforts of Mann and Julian to convert Koscot into a legitimate seller of cosmetics may have been among the factors that led complaint counsel to recommend that these respondents be omitted from that part of the order requiring restitution. Finally, Mann's uncontradicted testimony was that, despite a good income from Koscot, he was now "broke" and without hidden assets (¶ 22, *supra*).

III. *Restraints of Trade*

A. Price Fixing and Other Restrictive Practices

141. In addition to its deceptive nature, the Koscot marketing plan also involved unlawful restraints of trade and unlawful price discriminations. As to these matters, the undersigned finds as follows:

142. Koscot distributors entered into contracts with Koscot whereby they agreed to abide by certain published rules and regulations, including provisions that the distributors would sell only at Koscot's suggested retail prices. These agreements, as reinforced by various written and oral representations made by Koscot, constituted contracts, agreements, combinations, and understandings to fix prices. (CPF 482-87) It is so well established that such fixing of prices is illegal per se[23] that the customary case citations are omitted (but see CB, pp. 21-22).

143. Through other provisions in its rules and regulations which were similarly agreed to by Koscot distributors, Koscot established and maintained contracts, agreements, combinations and understandings which (1) provided for exclusive dealing in that a distributor might purchase merchandise only from Koscot or from his sponsor; (2) limited the customers or categories of customers to whom distributors might sell Koscot products; and (3) required Koscot's approval for consign-

[23] Although respondents did not rely on any exemption provided by so-called Fair Trade laws in certain States, the order provides recognition for any such exemptions.

ment selling. As a means of enforcing these provisions, Koscot required distributors to maintain a record of customers and to make it available to Koscot (CPF 482-83, 488-93; CB, pp. 23-26).

144. On the authority of *Holiday Magic, Inc.*, (slip opinion, pp. 32-35 [*supra*, at pp. 1052-1055]), it is found that these restrictions are unreasonable and anti-competitive.[24] Restraints on the right of a distributor to resell products he has purchased are illegal per se, *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365, 382 (1967).

B. Price Discrimination

145. The facts as to the price discrimination charge (complaint, Count III) may be briefly stated.

(a) Koscot discriminated in price between competing purchasers of its products. To distributors Koscot sold at 65 percent off the retail price, while to supervisors or subdistributors (hereinafter "subdistributors") it sold at 55 percent off retail price.[25] (¶ 36, *supra*) Since both distributors and subdistributors sold to beauty advisors at 40 percent off the retail price, the distributor's gross margin on such sales was 25 percent, while that of a subdistributor on such sales was 15 percent. On direct sales to consumers, distributors enjoyed a gross margin 10 percentage points above that of subdistributors.

(b) The products involved were of like grade and quality.

(c) Distributors and subdistributors performed the same function in the sale and distribution of Koscot products. Both classes of customers purchased directly from Koscot and resold to consumers, either directly or through beauty advisors.

(d) There was competition between distributors and subdistributors, not only in direct sales to consumers, but also in the recruitment of beauty advisors and in sales to beauty advisors.

(e) There is evidence of actual or potential injury to competition as a result of the discriminations. Irrespective of such evidence, however, the magnitude of the discrimination was such as to warrant an inference that the effect may be to substantially lessen competition.

(f) There was no showing by Koscot that the price discriminations were justified on any of the grounds specified by the applicable statute (CPF 494-508).

146. Accordingly, such discriminations in price were in violation of Section 2(a) of the Clayton Act, as amended.

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[24] Unlike the respondents in *Holiday Magic*, respondents here have not sought to offer any business justification for these restrictions.

[25] The fact that during part of the relevant time period, these discounts were actually reduced by virtue of the imposition of a 5 percent bookkeeping fee applicable to both classes of customers is immaterial (CPF 503-505).

CONCLUSIONS

1. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of all the respondents except Terrell Jones.

2. The complaint states a cause of action, and this proceeding is in the public interest.

3. The Koscot program was organized and operated in such a manner that the realization of profit by any participant was predicated upon the exploitation of others, most of whom had virtually no chance of receiving a return on their investment and all of whom had been induced to participate by inherent misrepresentations as to potential earnings. Therefore, the Koscot marketing plan was false, misleading, and deceptive, and its use by respondents constituted an unfair and deceptive act and practice and an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act.

4. In the course of promoting, selling, and offering for sale distributorships, respondents made and caused to be made various statements and representations which were false, misleading, and deceptive, and which respondents knew to be false, misleading, and deceptive. Many persons, in reliance upon such statements and representations, purchased respondents' distributorships, together with cosmetics and related products, and suffered substantial injury thereby. Therefore, the acts and practices of respondents constituted false, misleading and deceptive acts and practices in violation of Section 5 of the Federal Trade Commission Act. In addition, such acts and practices by respondents constituted fraud.

5. The use by respondents of such false, misleading and deceptive statements, representations, and practices, as herein found, has had the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that such statements and representations were true and into the investment of substantial sums of money to participate in respondents' marketing program and the purchase of substantial quantities of respondents' products by reason of such erroneous and mistaken belief.

6. Such acts and practices of the respondents, as herein found, were all to the prejudice and injury of the public and of respondents' competitors and constituted unfair methods of competition and unfair and deceptive acts and practices in commerce in violation of Section 5 of the Federal Trade Commission Act.

7. The failure of the corporate respondents, Glenn W. Turner Enterprises, Inc., and Koscot Interplanetary, Inc., and the individual respondents, Glenn W. Turner, Ben Bunting, and Hobart Wilder to

refund to persons who acted in reliance upon the statements and misrepresentations, as herein found, all monies paid to Koscot Interplanetary, Inc., by such persons was and is inherently and unconscionably unfair and deceptive. The retention of funds obtained pursuant to the unlawful and fraudulent acts and practices disclosed by this record constitutes a violation of Section 5 of the Federal Trade Commission Act.

8. The acts, practices, and methods of competition engaged in, followed, pursued, or adopted by respondents, and the combinations, conspiracies, agreements, or common understandings entered into or reached between and among the respondents and others not parties hereto were unfair methods of competition and were to the prejudice of the public because of their dangerous tendency toward, and the actual practice of, fixing, maintaining, or otherwise controlling the prices at which Koscot's products were resold, in both the wholesale and retail markets, and fixing, maintaining, or otherwise controlling the various fees, bonuses, rebates, or overrides required to be paid by one distributor or class of distributors to another distributor or class of distributors. Such acts, practices, and methods of competition constituted an unreasonable restraint of trade and an unfair method of competition in commerce in violation of Section 5 of the Federal Trade Commission Act.

9. The acts, practices, and methods of competition engaged in, followed, pursued, or adopted by respondents, and the combinations, conspiracies, agreements, or common understandings entered into or reached between and among the respondents and their distributors constituted unfair methods of competition in that they resulted in, or had a dangerous tendency, toward restricting the customers to whom Koscot's distributors might resell their products; restricting the source of supply from which distributors might purchase their products; and restricting their distributors to reselling their products through specified channels. Such acts, practices, and methods of competition constituted an unreasonable restraint of trade and an unfair method of competition in commerce within the intent and meaning of Section 5 of the Federal Trade Commission Act.

10. The effect of the price discriminations found herein has been and may be substantially to lessen competition or to tend to create a monopoly in the line of commerce in which the favored purchaser is engaged or to injure, destroy, or prevent competition between the favored and nonfavored customers or with the customers of either of them. Such discriminations constituted violations of the provisions of Section 2(a) of the Clayton Act as amended.

11. It is in the public interest to issue a cease and desist order

against the respondents Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, respectively, in their individual capacities, as well as against the corporate respondents, Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc.

12. It is in the public interest to issue an order of restitution against the corporate respondents, Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., and against respondents Glenn W. Turner, Ben Bunting, and Hobart Wilder.

13. The complaint must be dismissed as to Terrell Jones for want of jurisdiction and as to Michael Delaney for failure of proof.

Rationale of the Order

Introduction

Although respondents do not concede that they engaged in "pyramiding" or other "fraudulent practices" (RB, p. 8), they do not challenge, for the most part, the proposed findings of complaint counsel, and they also do not object to the entry of the proposed order except for that part dealing with restitution. They do, however, take exception to the description of the Koscot operation as "inherently deceptive and fraudulent" (RB, p. 1) and seek to overcome the cited evidence underlying complaint counsel's proposed findings in that regard.

Thus, the only controverted issues are (1) whether an order of restitution should be issued against the corporate respondents and three of the individual respondents (Turner, Bunting, and Wilder) and (2) whether an order of any kind should be issued against respondent Raleigh P. Mann. The restitution issue may be further subdivided into issues of law and fact as follows: (1) whether the Federal Trade Commission is empowered to issue such an order and (2) whether, assuming such power, the facts and circumstances disclosed by this record warrant the issuance of a restitution order. As reflected in the conclusions, *supra*, all these questions have been answered in the affirmative.

In this state of the record, these remains only the necessity to articulate the basis for such rulings. However, there is no occasion for any lengthy discussion respecting either the basic violations found or the controlling law, except as they may relate to restitution. The findings of fact essentially speak for themselves, and there is no need to rehash them here.

Before dealing with the restitution issue, it may be desirable to comment briefly on the other sections of the order.

The order contained in this initial decision is essentially adapted from that proposed by complaint counsel. Some changes were made,

primarily of an editorial nature. It should be noted that the order differs in many respects from the notice order contained in the complaint, although reflecting the substance and intent thereof. It appears that complaint counsel revised the notice order so as to conform, where applicable, to the order entered in the *Holiday Magic* case, *supra*. Almost without exception, the corresponding order provisions herein are either identical or substantially similar to the *Holiday Magic* provisions.

Although Paragraph Twelve of the complaint challenged respondents' merchandising program as "in the nature of a lottery" and thus an unfair practice in violation of Section 5, complaint counsel have not proposed any findings or conclusions with respect to this allegation, and it is being dismissed pursuant to the Commission's rulings in the *Holiday Magic* case, *supra*, at 14 [p. 1039], and in Ger-Ro-Mar, Inc., [*supra*, (slip opinion, pp. 17-21 [*supra*, at pp. 153-155]).

Restitution Provisions

Respondents have presented a three-pronged objection to the entry of any order of restitution:

First, they challenge the authority of the Commission to enter such an order, relying on the case of *Heater* v. *FTC*, 503 F.2d 321 (9th Cir. 1974);

Second, assuming *arguendo* that the Commission has such authority, they contend that complaint counsel have failed to prove fraud or any other factual basis to support a restitution order; and

Third, they deny that there has been a sufficient showing of the retention by these respondents, particularly the individual respondents, of any fraudulently obtained funds or any funds that are properly the subject of a restitution order.

These questions will be considered *seriatim*.

It should be noted first, however, that additionally, respondents offered several affirmative defenses against restitution: (1) That the illegal practices have been discontinued; (2) that the corporate respondents have either ceased to exist or have become inactive; (3) that the individual respondents have severed their relationship with the corporate respondents; and (4) that the issue of restitution in this proceeding has become moot by virtue of actions in progress in other forums. These defenses will be considered after the basic questions stated above are disposed of.

At this level the question of the Commission's authority to issue a restitution order must be answered in the affirmative. The Commission has ruled that it has such authority: *Holiday Magic, Inc.*, (slip opinion, p. 23 [*supra*, at p. 1046]); *Universal Credit Acceptance Corp.*, 82 F.T.C.

570 (1973), *rev'd in part sub nom Heater* v. *F.T.C.* (refund provisions set aside), 503 F.2d 321 (9th Cir. 1974); *Curtis Publishing Co.*, 78 F.T.C. 1472 (1971); *cf. Windsor Distributing Co.*, 77 F.T.C. 204, 222-23 (1969), *aff'd*, 437 F.2d 443, 444 (3rd Cir. 1971).

In ordering restitution in *Holiday Magic, supra*, the Commission said it was "fully aware of the decision by the Ninth Circuit Court of Appeals declaring that it may not order restitution of retained monies obtained as a result of violations of the FTC Act occurring prior to the entry of a cease-and-desist order." However, "[w]ith all due respect for the court," the Commission expressed its belief that the *Heater* decision is "incorrect" and announced its intention to seek Supreme Court review (slip opinion, p. 23, n. 11 [p. 1046]). Subsequently, the Commission determined not to seek Supreme Court review of the *Heater* decision and, in recognition of the pendency of the *Holiday Magic* appeal in the Ninth Circuit, reopened the *Holiday Magic* case and vacated the restitution order. In so doing, the Commission stated that "this determination should not be construed to signify a change in the view of the Commission regarding the correctness of the *Heater* decision" (order reopening proceeding and modifying final order (Jan. 21, 1975), p. 2 [85 F.T.C. at 89]).

Since the Commission has maintained its position that it has restitution authority despite the *Heater* case, the undersigned considers himself bound by this determination.

Accordingly, on the basis that the Commission does have such authority, the undersigned has determined to enter the restitution order proposed by complaint counsel. However, it should be noted that it is possible that, like *Holiday Magic*, these respondents may seek review of such an order in the Ninth Circuit. Whether this circumstance calls for a disposition of the restitution issue in this case similar to that ordered in *Holiday Magic* is for the Commission to determine.

In any event, and in recognition that the Commission might want to utilize in this case the restitution provisions of the recently approved amendments to the Federal Trade Commission Act, the undersigned has made findings relevant to the issue of restitution and has considered the opposing contentions of counsel with respect thereto. In that connection, it should be noted that although the notice order* in the complaint contained no restitution provisions, the Commission was careful to reserve its right to enter such an order if the record so warranted. It stated (complaint, p. 16):

> If * * * the Commission should conclude from record facts developed in any adjudicative proceeding in this matter that the proposed order provisions may be inadequate to protect the consuming public and respondents' competitors, the Commis-

* Notice order not reported herein.

sion may order such other relief as it finds necessary or appropriate, including, but not limited to, an order of restitution for the losses suffered by past and present participants.

Moreover, Count IV of the complaint alleged as follows:

* * * [R]espondents' multi-level-merchandising program is organized and operated in a manner that results in the recruitment of many participants who have virtually no chance to recover their investments of substantial sums of money in respondents' program and who have been induced to participate by misrepresentations as to potential earnings. Respondents have received the said sums and have failed to offer to refund and refused to refund such money to participants that were unable to recover their investment.

The use by the respondents of the aforesaid program and their continued retention of the said sums, as aforesaid, is an unfair act and practice and an act of unfair competition within the intent and meaning of Section 5 of the Federal Trade Commission Act.

On the basis of this record, and the *Holiday Magic* decision, *supra*, the undersigned has concluded that the allegations of Count IV have been established and that an order of restitution should be issued. The facts here meet the standards for restitution established in *Holiday Magic* and the other cases cited *supra*.

As to the substantiality of the evidence supporting the findings, respondents contend that the testimony of 28 "victim" witnesses[26] "should have the impact of a fly in a hurricane when one considers that 30,000 people invested in Koscot" (RB, pp. 14-15). This contention must be discounted in light of the fact that the number of so-called victim witnesses was limited by the administrative law judge in response to respondents' motion urging that additional witnesses would be merely cumulative (Tr. 2918-52). In a battle of metaphors, complaint counsel argue that the consumer testimony should be regarded "as the tip of an iceberg rather than as 'a fly in a hurricane' " (CRB, p. 39).

Relying on a dictum in the *Heater* case suggesting that salaries and loans from a corporation were not properly subject to a restitutionary order, respondents argue that restitution is inappropriate here as to the three individual respondents (Turner, Wilder, and Bunting) because the evidence indicates that they received nothing other than salaries and loans from the corporate respondents.

The undersigned agrees with complaint counsel that on the basis of the evidence now in this record, and in light of the refusal of Turner, Wilder, and Bunting to testify, the burden has shifted to the individual respondents to show that they did not receive or that they do not now retain funds or other assets from the corporate respondents.

As the record stands, it has been proved that the corporate

[26] Counsel for both sides have overstated the number of consumer witnesses. Complaint counsel referred to 39 distributors or former distributors of Koscot (CPF, p. 2), and respondents' counsel rounded this figure to 40 (RB, p. 14). Actually, there were 28 such witnesses.

respondents received funds from the victims of an illegal and fraudulent scheme; that a significant portion of such funds are no longer in the possession of the corporate respondents; and that the individual respondents were in such a position of control as to permit them to withdraw funds or other assets from the corporate respondents. In this state of the record, the burden of proof is properly shifted to the individual respondents to show that they did not obtain or do not now possess any fruits of the illegal activities engaged in by the corporate and individual respondents. The facts with regard to this issue lie peculiarly within the knowledge of each individual respondent, and it is well established that in these circumstances, the burden of proof may be properly shifted.

The evidence shows that from August 1967 until July 1972, Koscot retained more than $44 million from the initial fees paid by distributors who enrolled in its marketing program, over and above any recruiting fees remitted to the participants (p. 31, *supra*, n. 14a [p. 1142, herein]); that as of July 1972, Koscot's total assets were only $22.5 million and by July 1973 had been further diminished to only $11.7 million (¶ 6[27]); that Turner Enterprises received millions of dollars directly from Koscot during this period (¶¶ 4-5); and that Turner, Bunting, and Wilder were each in control of those corporate respondents and in a position to withdraw funds from them during a significant portion of this period (¶¶ 7-16).

On June 28, 1974, respondents filed a series of motions designed to settle this case on the basis of a consent order as to all issues except that of restitution; and, as to the question of restitution, to provide a factual record on the question of the existence of assets in the hands of respondents available for any restitution that might be ordered (motion to recess proceedings, etc., and motion for an order withdrawing this case from the adjudication process).

Thereafter, in a conference on July 8, 1974, defense counsel proffered to produce as witnesses on the question of assets respondents Turner, Wilder, Bunting, and others (Tr. 4252, 4280-81).

The administrative law judge then entered an order on July 10, 1974 providing, among other things, that "following the completion of the case-in-chief in support of the complaint, defense hearings shall be held for the purpose of determining respondents' assets available for restitution * * *." See also notice of hearing filed on Aug. 1, 1974.

However, on Aug. 21, 1974, in Orlando, Fla., defense counsel announced that, with the exception of Delaney, none of the respondents or other individuals previously listed would testify on the subject

[27] Paragraph numbers refer to the findings of fact, *supra*.

matter of respondents' assets (Tr. 4818-27). At that time, defense counsel made the following statement:

> * * * [W]e recognize that since we were the ones that initiated having these hearings, if we don't come forward now, then that rests the matter on assets. We don't have another day to try to prove it. We recognize that, and I've explained it to the Respondents and they understand. And so, it's now or never. We understand that. (Tr. 4825-26; see also Tr. 4525-38 and Tr. 5062-65)

As to respondents' affirmative defenses, their brief summarizes them this way:

> There has been no substantial public harm done by these respondents since the filing of the FTC complaint and any public harm which may have [preceded] the instant complaint has been provided for [by] the class action stipulated settlement and the Chapter 11 proceedings (RB, p. 12).

However, this defense will not withstand scrutiny.

The fact that the record contains no evidence that these respondents have engaged since mid-1972 in any of the practices challenged by the complaint (RPF 1-6) does not negate the need for an order to cease and desist or for an order of restitution. It is well settled that discontinuance of an unlawful practice does not preclude the entry of an order against its resumption, particularly when, as here, the discontinuance was after issuance of the complaint. In any event, the burden was on respondents to show affirmative discontinuance, and this burden they have not met. Respondents have cited no record evidence in support of their claim that they discontinued the challenged practices about June 1972 or shortly thereafter, and the undersigned is aware of none.

For example, respondents state that "no distributorship has been sold by Koscot since mid-1972" (RPF 8), but the sole record citation (Delaney Tr. 880) fails to support this claim. Moreover, it was not until August 1974 that the referee in bankruptcy specifically prohibited Koscot from selling any franchises or distributorships (RB, Appendix II). As to the contention that there is no evidence that Turner Enterprises is even in existence (RPF 8; see also RPF 2), Turner Enterprises was a signatory to a stipulation of settlement in a class action suit (RB, Appendix I). And, although Turner resigned from Turner Enterprises in March 1972 (RPF 3; CX 292), he stayed on as a consultant. Moreover, Turner signed the stipulation as president of Turner Enterprises and also on behalf of Koscot.

Having established that violations occurred, complaint counsel is not required to show them continuing after the issuance of the complaint. Moreover, it is fairly apparent that any such discontinuance that may have occurred was not necessarily voluntary. Whatever the facts may be as to discontinuance, this record demonstrates the necessity for an

order designed to prevent as fully as possible any likelihood that respondents will resume the activities complained of.

The collateral litigation that, according to respondents, obviates the need for a restitutionary order in this case is as follows:

1. Proceedings for an arrangement under Chapter XI of the Federal Bankruptcy Act filed by Koscot on June 3, 1973, in the United States District Court for the Middle District of Florida (No. 73-179-Orl-P). See RXs 12 and 13.

2. A Stipulation of Settlement proffered on Oct. 7, 1974, in the consolidated class action proceeding *Glenn W. Turner Enterprises Litigation*, MDL Docket No. 109, in the United States District Court for Pennsylvania (No. Misc. 5670) (see Appendix I attached to respondents' brief).

3. A criminal proceeding against Koscot and others, pending in the United States District Court for the Middle District of Florida (Criminal No. 73-71), which resulted in a mistrial (jury unable to agree on a verdict) on May 30, 1974, and which is now scheduled for a new trial.

The reference to the criminal proceeding may be summarily dismissed as irrelevant to the issue of restitution.

As for the stipulation of settlement and the bankruptcy proceeding, both are still in a pending status and thus offer no assurance that they will achieve to any degree the purpose of the proposed restitution order.

Moreover, neither proceeding appears to satisfy the Commission's standards for omission of a restitution order in a case of this kind. In rejecting a pretrial offer of settlement that would have involved the entry of the notice order in the complaint but that would have precluded any provision for restitution, the Commission, in language still applicable to respondents' present arguments, stated:

> The proposed settlements in the pending litigation do not purport to require all of the respondents to disburse to their customers all funds retained by them as a result of alleged violations of Section 5 of the Federal Trade Commission Act. Until there is a clear showing that respondents have accomplished disbursement of all such funds, it is premature at this time to determine that no provision for restitution should be included in any Commission order. (82 F.T.C. 1464, 1466 (1973))

Additional language in that same opinion also effectively refutes respondents' present contentions. The Commission pointed out:

> The violation for which restitution in some instances is an appropriate corrective action occurs when the seller's retention of its customers' money or property is an unfair trade practice, in and of itself, in violation of the Federal Trade Commission Act. [citations omitted] If the private parties involved agree to an approved settlement, they will be bound by its terms, but this does not bar a restitution provision in a cease and

desist order by the Commission if one is issued. An effective remedy may require complete disbursement of such funds to the victims of the unlawful practices up to the amount of their actual payments, and the possibility that this may result in some parties receiving funds in addition to amounts they have received in settlement of their claims does not prevent such restitution. The public policy expressed in the Federal Trade Commission Act is, of course, paramount. (*id.*, at 1466-67)

Thus, there "is no conflict between the Court litigation and the proceeding before the Commission. The Court action is to vindicate private individual rights; the Commission proceeding is to enforce the Federal Trade Commission Act." (*id.*, at 1466).

So here, once the class action suit is disposed of the Commission will have an opportunity to determine whether such disposition would provide for "effective disgorgement" by the respondents of "all unlawfully retained monies" (*Holiday Magic, supra*, at 26 [p. 1048]).

As matters now stand, neither the class action suit nor the bankruptcy proceeding provides for complete disbursement. Moreover, neither proceeding appears to contemplate any definitive determination as to assets held by the respondents proposed to be covered by a restitution order. The proposal is for a maximum payment of $3 million to distributor-claimants (RX 17 A; RB, Appendix I, pp. 8-9). This amount is to be contrasted with some $44 million in enrollment fees unlawfully received and retained by respondents (p. 31, *supra*, n. 14a).

The pending plan of settlement in the bankruptcy proceeding does not make moot the question of restitution in this proceeding. First, the plan of arrangement may or may not be approved, and, second, the Commission's restitution claim may be excepted from discharge even if the plan of arrangement is confirmed.[28] Until these two questions are resolved, it cannot be said that the bankruptcy proceeding is a barrier to any order of restitution by the Commission.

Complaint counsel have advanced other arguments designed to refute respondents' contention, but these need not be explored at this time.

The principal question relating to restitution is whether there remain reachable funds in the hands of the respondents to whom the restitution order is proposed to be directed. Among other things, the Internal Revenue Service has tax liens of $5.7 million against Turner Enterprises and Koscot and $928,980 against Turner (RB p. 12, n. 2; Appendix I, p. 4). These, of course, are priority claims. Nevertheless,

[28] Acting on a motion by complaint counsel that was certified by the administrative law judge, the Commission, on Jan. 7, 1975, entered an order to its General Counsel to "take such action as is necessary and appropriate for the protection of the public interest in any restitutionary claim or any other claim for consumer redress which may arise" out of this proceeding. In entering the order, the Commission noted the report in complaint counsel's motion that respondent Koscot "is in bankruptcy proceedings wherein a settlement is pending which could foreclose any claim in restitution which might arise out of this action" and held that such a foreclosure "would be contrary to the public interest."

further inquiry appears to be appropriate before any determination is made as to the availability of funds for restitution.

Respecting the restitution provisions of the order (Section V), the administrative law judge has adopted the proposals of complaint counsel, even though he has some reservations regarding the practicability of administering such proposals. However, he has not undertaken to tailor an alternative procedure for the following reasons: (1) the plan proposed by complaint counsel, as representatives of the Bureau of Consumer Protection, which presumably will be involved in enforcing the order, is entitled to due deference in what is almost a matter of first impression; and (2) the mechanics of the refund plan may be academic because (a) the order may be subject to review in the United States Court of Appeals for the Ninth Circuit, a circumstance that led the Commission to withdraw the restitution order in *Holiday Magic*, *supra*, in view of that court's ruling that the Commission lacked power to order restitution, and because (b) the Commission may elect, in the light of such circumstance, or for other reasons, to avail itself of the provisions of the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act, Pub. Law 93-637, approved Jan. 4, 1975, § 206(a)(b), 88 Stat. 2201-02, 15 U.S.C. § 57 b. Moreover, developments in collateral litigation described *supra* may inject factors requiring alteration of the refund plan.

In view of the somewhat nebulous status of restitution as applied to this proceeding, the undersigned gave consideration to omitting any detailed provisions with respect thereto while making findings and conclusions dealing with the subject matter. However, he concluded that, whatever deficiencies there may be in the present restitution provisions, they at least provide a basis for appeal by the respondents and for appropriate consideration by the Commission.

On the basis of the foregoing findings and conclusions, the following order is entered:

ORDER

Definitions: For the purposes of this order, the following definitions shall apply:

(a) The term "distributorship" means any continuing commercial relationship created by written agreement or understanding where: (1) the participant is granted the right or is permitted to offer, sell, or distribute goods or commodities manufactured, processed, or distributed by the respondents; or (2) the participant is granted the right or is permitted to offer or sell services established, organized, approved, or directed by the respondents.

(b) "Participant" means any person to whom a distributorship is granted.

(c) "Person" means any individual, group, association, limited or general partnership, corporation, or any other business entity.

(d) "Business day" means any day other than Saturday, Sunday, or the following holidays: New Year's Day, Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans' Day, Thanksgiving, and Christmas.

(e) "Koscot" means Koscot Interplanetary, Inc., and its successors or assigns.

(f) The term "distributor," as used in Section V of this order shall mean any person who paid Koscot $500 or more in exchange for which such person received, *inter alia*, the right to resell Koscot products.

I

It is ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly, through any corporate or other device, in connection with the advertising, offering for sale, or sale of products, services, franchises, or distributorships, or in connection with the seeking to induce or inducing the participation of persons, firms, or corporations therein, or in connection with any merchandising, marketing, or sales promotion program, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Offering, operating, or participating in, directly or indirectly, any marketing or sales plan or program wherein the financial gains to participants during their first year in the plan or program are, or are represented to be, based in any manner or to any degree upon their recruiting of other participants into the plan or program whereby such participants obtain the right to recruit yet other participants.

2. Offering, operating, or participating in, any marketing or sales plan or program wherein a participant gives or agrees to give a valuable consideration in return (1) for the opportunity to receive compensation in return for inducing other persons to become participants in the plan or program, or (2) for the opportunity to receive something of value when a person induced by the participant induces a new participant to give such valuable consideration, *Provided*, That the term "compensation," as used in this paragraph only, does not mean any payment based on actually consummated sales of goods or services to

persons who are not participants in the plan or program and who do not purchase such goods or services in order to participate in the plan or program.

3. Requiring or suggesting that a prospective participant or a participant in any merchandising, marketing, or sales promotion program purchase any product or services or pay any other consideration, either to respondents or to any other person, in order to participate in said program, other than payment for the actual cost to respondents, as determined by generally accepted accounting principles, of those items respondents deem to be reasonably necessary sales materials in order to participate in any manner therein; *Provided*, That necessary sales material shall not include any product inventory.

II

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly, through any corporate or other device, in connection with the advertising, offering for sale, or sale of products, franchises, or distributorships, or in connection with the seeking to induce or inducing the participation of persons, firms, or corporations in any merchandising, marketing, or sales promotion program, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Representing, directly or by implication, including the use of hypothetical examples, that participants in any merchandising, marketing, or sales promotion program, will earn or receive, or have the potential or reasonable expectancy of earning or receiving, any stated or gross or net amount, or representing in any manner the past earnings of participants, unless in fact the earnings represented are those of a substantial number of participants in the community or geographic area in which such representations are made, and the representation clearly indicates the amount of time required by such past participants to achieve the earnings represented, and failing to maintain adequate records which disclose the facts upon which any claims of the type referred to in this paragraph of the order [II(1)] are based; and from which the validity of any such claim can be determined.

2. Misrepresenting the ease of recruiting or retaining participants in any merchandising, marketing, or sales promotion programs, as distributors or as sales personnel.

3. Representing, directly or by implication, that any participant in

any merchandising, marketing, or sales promotion program can attain financial success.

4. Misrepresenting the supply or availability of potential participants or customers in any merchandising, marketing, or sales promotion program in any given community or geographical area.

5. Misrepresenting that participants can expect to remain active in business for any length of time, or misrepresenting in any manner the longevity or tenure of past or current participants, as, for example, by using a hypothetical illustration of how a marketing program operates, which has the tendency or capacity to imply that participants remain active for a given period, when in fact such period is more than the average length of time for which such participants do remain active.

6. Misrepresenting the reasonably necessary and anticipated costs of doing business for prospective distributors, dealers, sales personnel, or franchisees.

7. Representing, directly or by implication, that products will be or have been advertised, either locally or nationally, or in the geographic area in which such representations are made, without clearly and truthfully representing the manner, mode, extent, and amount of the advertising.

8. Representing that a training program will be or is being offered without clearly and truthfully representing the specific type and nature of the training, the number of hours or days of instruction, and the cost to the participant, if any.

9. Misrepresenting the availability of product in any manner, including, but not limited to, misrepresenting the amount of inventory available, the extent to which an order can be filled at a given time, the length of time necessary to replenish items out of stock, and the length of time necessary to deliver an order to a participant.

10. Misrepresenting, directly or by implication, the extent of respondents' sales of products and services, the nature of such sales, including what proportion were derived from the sale of franchises or distributorships, or the market position of respondents in any market.

III

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their successors or assigns, and respondents Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann incident to selling any franchise or distributorship, shall:

1. Inform orally all persons to whom solicitations are made, and provide in writing in all applications and contracts, in at least ten-point bold type, that the application or contract may be cancelled for any

reason by notification to respondents in writing within at least seven (7) business days from the date of execution.

2. Refund immediately all monies to participants who:

(a) Cancel their contracts in accordance with paragraph 1 of this Section III; or

(b) show that respondents' contract solicitations or performance were attended by or involved violation of any of the provisions of this order.

3. Provide to a prospective franchisee or distributor at least fifteen (15) business days prior to the execution by the prospective franchisee or distributor of any franchise or distributorship agreement or any other binding obligation, or the payment by the prospective franchisee or distributor of any consideration in connection with the sale or proposed sale of a franchise:

(a) A certified balance sheet for the most recent year; a certified profit and loss statement for the most recent three-year period; and a statement of any material changes in the financial soundness of the franchisor since the date of such financial statements.

(b) A copy of Federal Trade Commission Consumer Bulletin No. 4, "ADVICE FOR PERSONS WHO ARE CONSIDERING AN INVESTMENT IN A FRANCHISE BUSINESS."

(c) A statement disclosing (a) the number of franchises or distributorships, whether active or inactive, already sold at the end of the last calendar year, and (b) the number of franchises or distributorships, whether active or inactive, already present in the market area in which the prospective franchisee or distributor plans to operate.

IV

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly through any corporate or other device, in connection with the offering for sale, or distribution of goods or commodities in commerce, as "commerce" is defined in the Federal Trade Commission Act and in the Clayton Act, shall forthwith cease and desist from:

1. Entering into, maintaining, promoting, or enforcing any contract, agreement, understanding, marketing system, or course of conduct with any dealer or distributor of such goods or commodities to do or perform or attempt to do or perform any of the following acts practices, or things:

(a) Fix, establish, or maintain the prices, discounts, rebate

overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be resold; *Provided*, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

(b) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct which fixes, establishes, or maintains the prices, discounts, rebates, overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be resold; *Provided*, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

(c) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct requiring, inducing, or coercing any distributor to refrain from selling any merchandise in any quantity to or through any specified person, class of persons, business, or class of businesses.

(d) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct which discriminates, directly or indirectly, in the net price of any merchandise of like grade and quality by selling to any purchaser at net prices higher than the net prices charged to any other purchaser who in fact competes in the resale or distribution of such merchandise with the purchaser paying the higher price.

2. Discriminating, directly or indirectly, in the net price, or terms or conditions of sale of any merchandise of like grade and quality by selling to any purchaser at net prices, or upon terms or conditions of sale, less favorable than the net prices or terms or conditions of sale upon which such products are sold to any other purchaser to the extent such other purchaser competes in the resale of any such products with the purchaser who is afforded less favorable net price or terms or conditions of sale, or with a customer of the purchaser afforded the less favorable net price or terms or conditions of sale.

3. Preventing distributors from entering into consignment agreements or selling their business to another individual.

4. Engaging, either as part of any contract, agreement, understanding, or course of conduct with any distributor or dealer of any goods or ommodities, or individually and unilaterally, in the practice of:

(a) Publishing or distributing, directly or indirectly, any resale price, roduct price list, order form, report form, or promotional material hich employs resale prices for goods or commodities without stating early and visibly in conjunction therewith the following statement:

The prices quoted herein are suggested prices only. Distributors are free to determine themselves their own resale prices.

(b) Publishing or distributing, directly or indirectly, any schedule of discounts, rebates, commissions, overrides, or other bonuses to be paid by one distributor or class of distributors to any other distributors or class of distributors, without stating clearly and visibly in conjunction therewith the following:

The discounts [rebates, commissions, etc.] quoted herein are suggested only. Distributors are free to determine for themselves any amounts to be paid.

Provided, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

5. Requiring any distributor or dealer or other participant in any merchandising program to obtain the prior approval of respondents for any product advertising or promotion, or proposed product advertising or promotion, unless any selling prices and names of any selling outlets are required to be deleted from such proposed advertising or promotion prior to submission for prior approval.

V

It is further ordered, That the corporate respondents, Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., their successors or assigns, and the individual respondents, Glenn W. Turner, Ben Bunting, and Hobart Wilder shall jointly and severally be obligated and required to refund all sums of money paid by any distributor to Koscot; *Provided*, That such refund shall be reduced by:

(a) Any amount of money paid by the corporate respondents to each such distributor, including any refund made either voluntarily or pursuant to settlement or court order; and

(b) the difference between the wholesale value of initial inventory purchased and the wholesale value of inventory presently due to any distributor as reflected by the books and records of Koscot. Such wholesale value shall be calculated at thirty-five percent (35%) of the retail value as shown by the retail prices of Koscot that were in effect on Mar. 24, 1972.

It is further ordered, That such refunds shall be accomplished in the following manner:

1. Within thirty (30) days from the effective date of this order, respondents Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder shall each prepare and shall deliver to the Federal Trade Commission and to each of the other respondents named in this Section V a certified statemen designating all sums of money and other assets they retain as of th effective date of this order and such other assets which they expect t subsequently receive that are directly or indirectly attributable to the

association with Koscot, Glenn W. Turner Enterprises, Inc., Glenn W. Turner, or their agents, successors, subsidiaries, or assigns and shall specify with regard to each asset designated:

(a) The present form of the asset, *i.e.*, cash, stocks, real property, etc.;

(b) the date the asset was received or is expected to be received, the person from whom the asset was received, or is expected to be received, and the form of the asset on the date it was received or is expected to be received;

(c) the current market value of each asset and the market value of the asset on the date it was received; and

(d) any judgment, court orders, or other legal encumbrance on such assets.

2. Within thirty (30) days from the effective date of this order, respondent Koscot shall compile from its books and records a list of all distributors entitled to a refund pursuant to the provisions of this order and shall specify, with regard to each such distributor:

(a) The full name and last known address of each distributor;

(b) the full amount paid by each distributor;

(c) any set-offs which respondents are entitled to deduct from the amount paid by each distributor pursuant to the terms of this order; and

(d) the net amount that respondents would thereby be obligated to refund to each distributor.

A copy of the foregoing statement shall be filed with the secretary of the Federal Trade Commission within thirty (30) days after the effective date of this order, with copies thereof also delivered to respondents Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder.

3. Simultaneously with the filing of the statement described in ¶ 2, above, Koscot shall mail the notice set out below which includes in such notice the calculations provided for therein to each distributor identified in such statement. A copy of such notice, together with a copy of this order, an acceptance card, and a preaddressed envelope as described below, shall be mailed in an envelope which together with the name and address of the distributor shall contain the following legend in 16-point, boldface type "IMPORTANT REFUND NOTICE." The notice itself shall be confined to the following language which shall appear in 12-point, boldface type:

IMPORTANT NOTICE

Pursuant to the Order of the Federal Trade Commission which is attached to this notice, you are entitled to a refund of all sums of money paid to Koscot Interplanetary, Inc., in exchange for the right to participate in the Koscot marketing program less (1) all amounts paid to you by Koscot or by Glenn W. Turner Enterprises, Inc., including any

refund made either voluntarily or pursuant to a private settlement or court judgment, and (2) the wholesale value of any product that you actually received from your initial inventory. According to the books and records of Koscot Interplanetary, Inc., the net refund to which you are entitled is as follows:

[Supply name of participant]

	[To be calculated from Koscot's books and records]
Total Investment:	_____
Set-offs for:	
(1) All money payments:	_____
(2) Wholesale value of initial inventory that you actually received:	_____
Total amount of set-offs:	
Refund (total investment less set-offs)	_____

If you accept this offer, you will receive the amount of refund listed above *unless the total amount of funds available for the purpose of making refunds is insufficient to satisfy the claims of all participants entitled to a refund who accept this offer.* If the total amount of funds is insufficient, then each claim will be reduced on a pro-rata basis.

If you accept this offer, then sign the enclosed acceptance card and return it to Koscot Interplanetary, Inc., within sixty (60) days of the date of this letter. If such card is not returned or is postmarked within sixty (60) days after the date of this letter, you will forfeit all rights to any refund under the provisions of this proffer.

If you believe there are any material discrepancies between the amounts listed above and the amount to which you are entitled under the formula set forth in the attached order, then indicate the reasons for this on the card or on an attached statement to the card.

IMPORTANT NOTICE

In order to have your claim included, it must be postmarked and returned within sixty (60) days of the date of this Notice.

Dated: [to be inserted]

_____

Koscot Interplanetary, Inc.
4805 Sand Lake Road
Orlando, Florida 32809

The acceptance cards shall be approximately 5 x 7 inches in area and contain the following language:

I hereby accept the offer of refund which Koscot Interplanetary, Inc., has proffered to me pursuant to the Order of the Federal Trade Commission.

_____

(Signature)

_____

(Address)

4. Within one hundred twenty (120) days after the date of the filing

of the notice provided for in ¶ 3, *supra*, Koscot shall submit a report to Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder and to the Federal Trade Commission which sets forth a list of the distributors who have indicated their agreement to participate in the arrangement for refunds provided for in this order. Such reports shall identify the claimants by their names and addresses, shall reflect the amounts to which each such claimant is entitled under the provisions of this order and shall reflect the aggregate amounts of such claims. In determining the amounts of such claims, respondent Koscot shall make a good-faith effort to correct any errors which may exist in their books and records which were brought to its attention by such claimants.

5. Within fifteen (15) days of the submission of the report to the Federal Trade Commission provided for in ¶ 4, *supra*, Koscot, Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder shall submit to the Federal Trade Commission for its approval a plan for the disbursement of funds required by this order. Such plan shall contain at least:

(a) The total amount of assets available for payment of the amount due under this order;

(b) the proportionate contribution from each respondent subject to the provision of Part V of this order if their aggregate assets available for payment exceed the amount due under this order;

(c) the procedures to be used to liquidate immediately the assets required to provide for payment of the amount due under this order;

(d) the procedures to be used in the disposition of funds required by this order.

6. Upon approval of such plan as provided for in ¶5, *supra*, Koscot, Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder shall within thirty (30) days thereafter implement all provisions of such plan, including the refund to claimants of the amounts provided for in this order.

VI

It is further ordered, That respondents Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, Hobart Wilder, their successors and assigns shall forthwith deliver a copy of Section II of this order to cease and desist to all present and future salespeople, franchisees, distributors, participants, or other persons engaged in the sale of franchises, distributorships, products, or services on behalf of respondents, and secure from each such person a signed statement acknowledging receipt thereof.

VII

It is further ordered, That the corporate respondents and their successors and assigns shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents, such as dissolution, assignment, or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporations which may affect compliance obligations arising out of this order.

VIII

It is further ordered, That respondents Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann shall each promptly notify the Commission of his present business address and a statement as to the nature of his business or employment and shall each promptly notify the Commission of the discontinuance of his present business or employment, including in such notice his new business address and a statement of the nature of his new business or employment and a description of his duties and responsibilities therewith.

IX

It is further ordered, That each of the respondents herein and their successors and assigns shall, within sixty (60) days after service upon them of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which they have complied with the provisions of this order. Thereafter, within two hundred and ten (210) days after service upon them of this order and every one hundred twenty (120) days thereafter until the provisions of Section V of this order have been satisfied, respondents Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, and Hobart Wilder shall file with the Commission a further report in writing, setting forth in detail the manner and form in which they have complied with Section V of this order.

X

It is further ordered, That the complaint herein be, and it hereby is, dismissed as to Michael Delaney and Terrell Jones; *Provided, however*, That the dismissal as to Terrell Jones is without prejudice to the right of the Commission to institute further proceedings against him if the public interest so warrants.

OPINION OF THE COMMISSION BY DIXON, *Commissioner*

Complaint in this matter was issued on May 24, 1972, charging respondents with numerous violations of Section 5 of the Federal Trade Commission Act (15 U.S.C. § 45) and Section 2(a) of the Clayton Act (15 U.S.C. § 13(a)) in connection with their operation of a multilevel marketing program involving the sale of cosmetics and cosmetics distributorships. Hearings were held, not without interruption, before Administrative Law Judge Donald Moore, who issued his initial decision on Mar. 20, 1975. The law judge recommended entry of a lengthy order prohibiting numerous unfair and deceptive practices and requiring Koscot and individual respondents Turner, Wilder, and Bunting to make restitution to purchasers of distributorships.

Both sides have appealed. There appears to be little disagreement among them as to the form which the Commission's final order should take, although much disagreement as to the reasons for this result. Respondents have not disputed the findings of fact of the administrative law judge, except in conclusory terms, and we shall adopt them as those of the Commission. Respondents have also raised no objections to those parts of the order which enjoin future conduct,[1] reserving their attack for the requirement of restitution. Complaint counsel have suggested that the Commission withdraw order provisions relating to restitution, and reserve the option to consider use of the provisions of Section 19 of the Federal Trade Commission Act (15 U.S.C. § 57b) to obtain consumer redress at a later date. Complaint counsel also suggest certain minor modifications in the order, and urge the Commission to elaborate on the rationale of the administrative law judge in holding respondents' use of a multilevel pyramid type marketing plan to be inherently deceptive and unfair.

Background

Respondents operated a multilevel marketing plan which individuals might enter at one of several levels. At the lowest level, that of "beauty advisor," one could purchase cosmetics at a 40 percent discount for resale to consumers. "Supervisors" received a 55 percent discount and

[1] In briefing the question of relief before the administrative law judge, respondents raised no objections to the non-restitutionary relief proposed by complaint counsel, which the law judge adopted. In their appeal brief before the Commission respondents indicated certain objections to the order language. At oral argument, however, counsel for respondents indicated that his reservations about the order language had been resolved (Transcript of Oral Argument, pp. 3-4, Oct. 2, 1975).

appointed and supplied beauty advisors, while "distributors" received a 65 percent discount and sold to those below them (I.D. 36).[2] The big money, however, derived not from the sale of cosmetics to consumers, but from the act of recruiting other participants into the marketing program. Distributors were required to pay Koscot an amount ranging up to $5000 for initial inventory and the right to recruit others. A distributor who recruited another would receive $2650 of the recruit's $5000 payment. Supervisors paid $2000 for their position, of which a distributor who recruited the supervisor received $700. If one supervisor recruited another, $500 of the $700 commission would go to the recruiting supervisor, and $200 to the distributor who had recruited the recruiting supervisor (I.D. 37). Variations on this scheme are set forth in the initial decision and incorporated findings (I.D. 38). In general, respondents' plan extracted large sums of money from individual participants by offering the promise that they could recoup these sums and more by inducing others to make similar payments (I.D. 40).

To some degree, and particularly at the lowest level, individuals were also induced to participate by the prospect of making money via the sale of cosmetics to consumers. The record indicates, however, that respondents' devotion to this facet of their business frequently fell short of what one would expect from an organization seriously committed to the retailing of cosmetics (I.D. 76-98). Implementation of the Koscot marketing plan was attended by a wide variety of specific misrepresentations and high pressure sales tactics, chronicled by the law judge at I.D. 54-119. The record also reveals a staggering human toll—money borrowed, jobs quit, homes mortgaged, and even personal bankruptcy for some who dared to be great (Tr. 2249, 2343, 2345-46, 2460, 2491, 2483-84, 2491, 2564, 2737, 2769, 3027-28, 3286-87, 3312, 3352-53, 3373, 3480-81, 3485, 3503-04, 3555-57, 3571, 3626-27, 3668-69, 3754-55, 3759-60, 3872, 3893, 3896, 4065).

Illegality of Entrepreneurial Chain Marketing System

Awash amidst evidence of deception and overreaching, the administrative law judge had no difficulty concluding that respondents' practices violated Section 5. He based his conclusions on the actual deception which was proven to have occurred, and on the inherent capacity of respondents' multilevel marketing plan to deceive (I.D. p. 51 [p. 1157, herein]). On appeal, complaint counsel urge that the

[2] The following abbreviations are used herein:
I.D.—Initial Decision (Finding No.)
I.D. p.—Initial Decision (Page No.)
Tr.—Transcript of Testimony (Page No.)

Commission enlarge the reasoning upon which the administrative law judge based his finding that respondents' plan was inherently unlawful. Complaint counsel proposed adoption of an alternative finding of law to the effect that:

> Respondents' marketing plan contemplates upon the payment of consideration, participants would thereby acquire the right to engage in two income-producing activities, one of which contemplated the sale of similar rights to others for which substantial compensation would be paid, while the other contemplated the sale of products or services. Since implicit in the holding out of such rights is the representation that substantial rewards would be gained therefrom, and since the operation of such plan due to its very structure precludes the realization of such rewards to most of those who invest therein, such plan is inherently deceptive. Furthermore, such plan is contrary to established public policy in that it is generally considered to be unfair and unlawful and is by its very nature immoral, unethical, oppressive, unscrupulous, and exploitative. Therefore, such plan was and is inherently unfair and the operation of the Koscot marketing plan by respondents, having caused substantial injury to the participants therein as well as to other members of the public, constitutes an unfair and deceptive act and practice and an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act.

The Commission has previously condemned so-called "entrepreneurial chains" as possessing an intolerable capacity to mislead. *Holiday Magic, Inc.*, Docket No. 8834, slip op. pp. 11-14 [84 F.T.C. 748 at pp. 1036-1039] (Oct. 15, 1974); *Ger-Ro-Mar, Inc.*, Docket No. 8872, slip op. pp. 8-12 [84 F.T.C. 95, at pp. 145-149] (July 23, 1974), *rev'd in part* 518 F.2d 33(2d Cir. 1975). 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.

As is apparent, the presence of this second element, recruitment with rewards unrelated to product sales, is nothing more than an elaborate chain letter device in which individuals who pay a valuable consideration with the expectation of recouping it to some degree via recruitment are bound to be disappointed. Cf. *Twentieth Century Co.* v. *Quilling*, 130 Wis. 318, 110 N.W. 173, 176 (1907). Indeed, even where rewards are based upon sales to consumers, a scheme which represents indiscriminately to all comers that they can recoup their investments by virtue of the product sales of their *recruits* must end up disappointing those at the bottom who can find no recruits capable of making retail sales.[3]

Complaint counsel argue, in a keen analysis, that the right to sell

[3] The presence of a quota for distributors is not likely to eliminate the inherently deceptive nature of an

(*Continued*)

product in an entrepreneurial chain is also likely to prove worthless for many participants, by virtue of the very nature of the plan as opposed to any particular dishonest machinations of its perpetrators. That is so, argue counsel, because the mere presence of a lucrative right to sell franchises will encourage both a company and its distributors to pursue that side of the business, to the neglect or exclusion of retail selling. The short-term result may be high recruiting profits for the company and select distributors, but the ultimate outcome will be neglect of market development, earnings misrepresentations, and insufficient sales for the insupportably large number of distributors whose recruitment the system encourages. Certainly the facts of this case and of *Holiday Magic, supra*, as well as expert testimony in the record (Tr. 1195 ff 1691 ff), bear out complaint counsel's contentions. At the very least we would conclude that a company which offers its distributors substantial rewards for recruiting other distributors, and charges them substantial amounts for this right, creates overwhelming barriers to the development of a sound retail distribution network and resultant meaningful retail sales opportunities for participants.

What compels the categorical condemnation of entrepreneurial chains under Section 5 is, however, 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. That these schemes so often do not allow recovery of investments by means of retail sales either merely points up that there is very little positive value to be lost by not allowing such schemes to get started in the first place.

A discussion of "inherent" illegality and capacity to deceive may seem pointless given the more than 4000 pages of transcript detailing the actual deception and injury in which the Koscot plan resulted. Nothing could be further from the truth. It is regrettably clear that responsible authorities, including this Commission, have acted far too slowly to protect consumers from the manipulations of respondents and others like them. As this is written the corporate respondent, Koscot, is in Chapter XI reorganization proceedings, while the individual respondents plead poverty. The administrative law judge estimated that $44 million was taken from consumers (I.D. p. 59 [p. 1163, herein]), and no more than a fraction of that is presently accounted for. Whether

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entrepreneurial chain, unless realistic quotas are imposed by *market area* rather than by arbitrary geographical unit. In this case, for example, it appears that while statewide quotas were announced and occasionally enforced, this did not prevent saturation of local markets within States (with most of the State's quota being exhausted within an area too small to accommodate so many distributors). In addition, there are strong disincentives for recruiters to disclose honestly the existence of a quota and the extent to which it is being approached, since this will alert prospective recruits to the imminent disappearance of further opportunities for profiting by recruitment and render them less likely to participate.

more than a small fraction of the consumer loss will ever be recovered is open to serious doubt. These particular individual respondents may not, under the watchful eyes of federal authorities, repeat their misdeeds, but once has clearly been too much.

We think that failure to act more promptly can be traced to the previous inability of relevant authorities to obtain *summary* relief against the practices involved. The necessity to prove that a marketing plan, manifestly deceptive on its face, has in fact resulted in injury to numerous consumers, is a lengthy process. Only where the law condemns the mere institution of such a plan, without the necessity to demonstrate its consequences, is meaningful relief likely to be obtained. In the years since Koscot's heyday, many States have enacted laws which categorically proscribe entrepreneurial chain methods of selling. Similarly, the Commission has held that the Federal Trade Commission Act forbids such tactics, and has announced that it will henceforth not hesitate to seek recently-authorized injunctive relief should it seem warranted, *Holiday Magic, Inc., supra*, page 14 [84 F.T.C. 748, at 1038]. The viability of a Federal remedy, however, will depend, if not upon congressional enactment, then upon the willingness of courts to recognize the serious potential hazards of entrepreneurial chains and to permit summary excision of their inherently deceptive elements, without the time-consuming necessity to show occurrence of the very injury which justice should prevent. To require too large an evidentiary burden to condemn these schemes can only ensure that future generations of self-made commercial messiahs will dare to be great and dare anyone to stop them.

Restitution and Consumer Redress

Both sides have recommended that the Commission delete those portions of the administrative law judge's order requiring respondents to make restitution. Counsel for respondents argues that the Commission lacks authority to include a provision requiring restitution in an order to cease and desist. Complaint counsel argue that while the Commission does have such authority, it should rely instead upon its power to obtain redress for consumers pursuant to §206 of the Magnuson-Moss-Warranty—Federal Trade Commission Improvements Act of 1975 (adding Section 19 of the Federal Trade Commission Act).

We agree with complaint counsel that under the circumstances of this case any further efforts by the Commission to obtain compensation for consumers should be made pursuant to the provisions of Section 19 of the Federal Trade Commission Act. We have no doubt that the statutory prerequisites for consumer redress have been made out here. Respondents were apprised in the notice order of the complaint that

recompense for consumers would be sought. And succeeding adjudication has revealed that practices which respondents knew or should have known to be fraudulent or dishonest led to consumers' loss of substantial amounts of money.

As matters now stand, the respondent Koscot is in an arrangement proceeding, pursuant to Chapter XI of the Bankruptcy Act. Whether any further restitutionary action by the Commission as to Koscot will be possible or desirable remains in doubt. Vacation of the administrative law judge's proposed order regarding restitution will remove that as a source of contention in the arrangement proceedings. The Commission's action is, however, taken without prejudice to the institution of such action against corporate respondents as may in the future seem appropriate pursuant to Section 19 of the Federal Trade Commission Act.

With respect to individual respondents Turner, Wilder, and Bunting, there have been intimations from their counsel at various points in these proceedings that pursuit of restitution is a futile gesture because they are in dire financial straits. Respondents have, however, previously refused to provide a verified accounting of their assets, claiming that to do so would abridge their Fifth Amendment rights because of simultaneously pending criminal proceedings. It appears, however, that these proceedings have now ended as to respondents. Therefore, upon the conclusion of this adjudication, the Commission will endeavor to ascertain the financial status of these individuals in order to determine whether Section 19 proceedings as to them would serve a purpose. We can hardly quarrel with respondents' claim that the Commission should not beat a dead horse, but in view of the enormity of the abuses in this case, the Commission has a solemn duty to assure itself that the analogy is a valid one.

Miscellaneous

Complaint counsel urge that Paragraph I(2) of the law judge's proposed order be reformulated so as to prevent in all cases the use of bounty-seeking "headhunters," individuals who would receive compensation based upon the number of others they could induce to participate in respondents' sales program. As now formulated, the law judge's order would permit respondents to enlist certain individuals as headhunters, provided they were not required to pay a valuable consideration for that right. The revised order would still permit payment of compensation to headhunters provided it was based upon actually consummated retail sales by recruits.

Respondents have not objected to this change and we believe it is warranted under the circumstances. As complaint counsel point out,

while the order prevents respondents from requiring an initial payment for participation in a plan, it does not prevent participants from making initial inventory purchases if they so desire. Thus there remain incentives for indiscriminate recruitment by headhunters, and incentives for headhunters in any program to ignore other requirements of the order designed to ensure that recruitment is undertaken honestly. By requiring that compensation for recruitment be based in all cases upon retail sales by those recruited, the order provides a readily monitored means to ensure that recruitment of distributors is based on market demand, which is the goal of any legitimate business enterprise.[4]

Complaint counsel have also urged the Commission to supplement the administrative law judge's conclusions of law with respect to the Robinson-Patman charges in the complaint. Counsel's proposals are hereby adopted.[5]

On its own motion the Commission has broadened those portions of the order relating to Section 5 violations to proscribe covered conduct "affecting" commerce, inasmuch as the Commission's authority has been broadened in that respect. We have placed the Robinson-Patman prohibitions of the law judge's order in a separate section (V) applicable only to activities "in commerce." Provisions of the law judge's Section V concerning restitution have been deleted, along with corresponding provisions in the definitions section and compliance paragraph (IX). Finally the Commission has modified the wording of paragraph I(1) to conform to the language used in *Holiday Magic.*

An appropriate order is appended.

FINAL ORDER

This matter having been heard by the Commission upon the cross-appeals of complaint counsel and respondents' counsel from the initial decision and upon briefs and oral argument in support thereof and opposition thereto, and the Commission, for the reasons stated in the accompanying opinion, having granted the appeals in part:

It is ordered, That pages 1-65 [p. 1117-1167, herein] of the initial decision of the administrative law judge be, and they hereby are, adopted as the findings of fact and conclusions of law of the

[4] Of course we do not construe the order as modified to prevent respondents from paying an individual a fixed salary in return for performing recruitment functions.

[5] "10. Koscot Interplanetary, Inc., a Florida corporation, whose principal office and place of business is located at 4805 Sand Lake Road, Orlando, Florida, sells and distributes in commerce, as commerce is defined in the Clayton Act, as amended, a line of cosmetics, toiletries, and associated items, sold under the trade name of Koscot.

11. Koscot Interplanetary, Inc., in the sale and distribution of its line of cosmetics, toiletries, and associated items was and is in substantial competition with other distributors and sellers of identical or similar cosmetics and toiletries.

12. Many of the distributors to whom Koscot Interplanetary, Inc., sold or sells one or some or all of the items in its product line are in substantial competition with each other in the resale of Koscot products to their customers."

Commission, with the following exceptions: conclusion of law 12, page 53 [p. 1159, herein]; those portions of pages 53-65 [p. 1159-1167, herein] ("Rationale of the Order") which are inconsistent with the opinion of the Commission herein.

Other findings of fact and conclusions of law of the Commission are contained in the accompanying opinion.

It is further ordered, That the following order to cease and desist be, and it hereby is, entered:

ORDER

Definitions: For the purposes of this order, the following definitions shall apply:

(a) The term "distributorship" means any continuing commercial relationship created by written agreement or by understanding in which:

(1) The participant is granted the right or is permitted to offer, sell, or distribute goods or commodities manufactured, processed, or distributed by the respondents; or (2) the participant is granted the right or is permitted to offer or sell services established, organized, approved, or directed by the respondents.

(b) "Participant" means any person to whom a distributorship is granted.

(c) "Person" means any individual, group, association, limited or general partnership, corporation, or any other business entity.

(d) "Koscot" means Koscot Interplanetary, Inc., and its successors or assigns.

I

It is ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly, through any corporate or other device, in connection with the advertising, offering for sale, or sale of products, services, franchises, or distributorships, or in connection with the seeking to induce or inducing the participation of persons, firms, or corporations therein, or in connection with any merchandising, marketing, or sales promotion program, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Offering, operating, or participating in, directly or indirectly, any

marketing or sales plan or program wherein the financial gains to participants are or are represented to be based in any manner or to any degree upon their recruiting of other participants who obtain the right under the plan or program to recruit yet other participants whose function in the program includes during their first year of participation the recruitment of participants.

2. Offering, operating, or participating in, any marketing or sales plan or program wherein a participant is given or promised compensation (1) for inducing another person to become a participant in the plan or program, or (2) when a person induced by the participant induces another person to become a participant in the plan or program; *Provided*, That the term "compensation," as used in this paragraph only, does not mean any payment based on actually consummated sales of goods or services to persons who are not participants in the plan or program and who do not purchase such goods or services in order to resell them.

3. Requiring or suggesting that a prospective participant or a participant in any merchandising, marketing, or sales promotion program purchase any product or services or pay any other consideration, either to respondents or to any person, in order to participate in said program, other than payment for the actual cost to respondents, as determined by generally accepted accounting principles, of those items respondents deem to be reasonably necessary sales materials in order to participate in any manner therein; *Provided*, That necessary sales material shall not include any product inventory.

II

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly, through any corporate or other device, in connection with the advertising, offering for sale, or sale of products, franchises, or distributorships, or in connection with the seeking to induce or inducing the participation of persons, firms, or corporations in any merchandising, marketing, or sales promotion program, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Representing, directly or by implication, including the use of hypothetical examples, that participants in any merchandising, marketing, or sales promotion program, will earn or receive, or have the potential or reasonable expectancy of earning or receiving, any stated

or gross or net amount, or representing in any manner the past earnings of participants, unless in fact the earnings represented are those of a substantial number of participants in the community or geographic area in which such representations are made, and the representation clearly indicates the amount of time required by such past participants to achieve the earnings represented, and failing to maintain adequate records which disclose the facts upon which any claims of the type referred to in this paragraph of the order [II(1)] are based; and from which the validity of any such claim can be determined.

2. Misrepresenting the ease of recruiting or retaining participants in any merchandising, marketing, or sales promotion programs, as distributors or as sales personnel.

3. Representing, directly or by implication, that any participant in any merchandising, marketing, or sales promotion program can attain financial success.

4. Misrepresenting the supply or availability of potential participants or customers in any merchandising, marketing, or sales promotion program in any given community or geographical area.

5. Misrepresenting that participants can expect to remain active in business for any length of time, or misrepresenting in any manner the longevity or tenure of past or current participants, as, for example, by using a hypothetical illustration of how a marketing program operates, which has the tendency or capacity to imply that participants remain active for a given period, when in fact such period is more than the average length of time for which such participants do remain active.

6. Misrepresenting the reasonably necessary and anticipated costs of doing business for prospective distributors, dealers, sales personnel, or franchisees.

7. Representing, directly or by implication, that products will be or have been advertised, either locally or nationally, or in the geographic area in which such representations are made, without clearly and truthfully representing the manner, mode, extent, and amount of the advertising.

8. Representing that a training program will be or is being offered without clearly and truthfully representing the specific type and nature of the training, the number of hours or days of instruction, and the cost to the participant, if any.

9. Misrepresenting the availability of product, in any manner, including, but not limited to, misrepresenting the amount of inventory available, the extent to which an order can be filled at a given time, the length of time necessary to replenish items out of stock, and the length of time necessary to deliver an order to a participant.

10. Misrepresenting, directly or by implication, the extent of

respondents' sales of products and services, the nature of such sales, including what proportion were derived from the sale of franchises or distributorships, or the market position of respondents in any market.

III

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their successors or assigns, and respondents Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann incident to selling any franchise or distributorship, shall:

1. Inform orally all persons to whom solicitations are made, and provide in writing in all applications and contracts, in at least ten-point bold type, that the application or contract may be cancelled for any reason by notification to respondents in writing within at least seven (7) business days from the date of execution.

2. Refund immediately all monies to participants who:

(a) Cancel their contracts in accordance with paragraph 1 of this Section III; or

(b) show that respondents' contract solicitations or performance were attended by or involved violation of any of the provisions of this order.

3. Provide to a prospective franchisee or distributor at least fifteen (15) business days prior to the execution by the prospective franchisee or distributor of any franchise or distributorship agreement or any other binding obligation, or the payment by the prospective franchisee or distributor of any consideration in connection with the sale or proposed sale of a franchise:

(a) A certified balance sheet for the most recent year; a certified profit and loss statement for the most recent three-year period; and a statement of any material changes in the financial soundness of the franchisor since the date of such financial statements.

(b) A copy of Federal Trade Commission Consumer Bulletin No. 4, "ADVICE FOR PERSONS WHO ARE CONSIDERING AN INVESTMENT IN A FRANCHISE BUSINESS."

(c) A statement disclosing (a) the number of franchises or distributorships, whether active or inactive, already sold at the end of the last calendar year, and (b) the number of franchises or distributorships, whether active or inactive, already present in the market area in which the prospective franchisee or distributor plans to operate.

IV

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers,

agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly through any corporate or other device, in connection with the offering for sale, or distribution of goods or commodities in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, shall forthwith cease and desist from:

1. Entering into, maintaining, promoting, or enforcing any contract, agreement, understanding, marketing system, or course of conduct with any dealer or distributor of such goods or commodities to do or perform or attempt to do or perform any of the following acts, practices, or things:

(a) Fix, establish, or maintain the prices, discounts, rebates, overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be resold; *Provided*, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

(b) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct which fixes, establishes, or maintains the prices, discounts, rebates, overrides, commissions, fees, or other terms or conditions of sale relating to pricing upon which goods or commodities may be marketed pursuant to the provisions of such laws.

(c) Require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct requiring, inducing, or coercing any distributor to refrain from selling any merchandise in any quantity to or through any specified person, class of persons, business, or class of businesses.

2. Preventing distributors from entering into consignment agreements or selling their business to another individual.

3. Engaging, either as part of any contract, agreement, understanding, or course of conduct with any distributor or dealer of any goods or commodities, or individually and unilaterally, in the practice of:

(a) Publishing or distributing, directly or indirectly, any resale price, product pricelist, order form, report form, or promotional material which employs resale prices for goods or commodities without stating clearly and visibly in conjunction therewith the following statement:

> The prices quoted herein are suggested prices only. Distributors are free to determine for themselves their own resale prices.

(b) Publishing or distributing, directly or indirectly, any schedule of discounts, rebates, commissions, overrides, or other bonuses to be paid by one distributor or class of distributors to any other distributors or

class of distributors, without stating clearly and visibly in conjunction therewith the following:

The discounts [rebates, commissions, etc.] quoted herein are suggested only. Distributors are free to determine for themselves any amounts to be paid.

Provided, That in those States having Fair Trade laws, products may be marketed pursuant to the provisions of such laws.

4. Requiring any distributor or dealer or other participant in any merchandising program to obtain the prior approval of respondents for any product advertising or promotion, unless any selling prices and names of any selling outlets are required to be deleted from such proposed advertising or promotion prior to submission for prior approval.

V

It is further ordered, That respondents Koscot Interplanetary, Inc., and Glenn W. Turner Enterprises, Inc., corporations, their officers, agents, representatives, employees, successors, and assigns, and Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, individually, their agents, representatives, and employees, directly or indirectly through any corporate or other device, in connection with the offering for sale, or distribution of goods or commodities in commerce, as "commerce" is defined in the Federal Trade Commission Act and in the Clayton Act, shall forthwith cease and desist from:

1. Entering into, maintaining, promoting, or enforcing any contract, agreement, understanding, marketing system, or course of conduct with any dealer or distributor of such goods or commodities to require or coerce any person to enter into a contract, agreement, understanding, marketing system, or course of conduct which discriminates, directly, or indirectly, in the net price of any merchandise of like grade and quality by selling to any purchaser at net prices higher than the net prices charged to any other purchaser who in fact competes in the resale or distribution of such merchandise with the purchaser paying the higher price.

2. Discriminating, directly or indirectly, in the net price, or terms or conditions of sale of any merchandise of like grade and quality by selling to any purchaser at net prices, or upon terms or conditions of sale, less favorable than the net prices or terms or conditions of sale upon which such products are sold to any other purchaser to the extent such other purchaser competes in the resale of any such products with the purchaser who is afforded less favorable net price or terms or

conditions of sale, or with a customer of the purchaser afforded the less favorable net price or terms or conditions of sale.

VI

It is further ordered, That respondents Koscot Interplanetary, Inc., Glenn W. Turner Enterprises, Inc., Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann, their successors and assigns shall forthwith deliver a copy of Section II of this order to cease and desist to all present and future salespeople, franchisees, distributors, participants, or other persons engaged in the sale of franchises, distributorships, products, or services on behalf of respondents, and secure from each such person a signed statement acknowledging receipt thereof.

VII

It is further ordered, That the corporate respondents and their successors and assigns shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondents, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries, or any other change in the corporations which may affect compliance obligations arising out of this order.

VIII

It is further ordered, That each individual respondent (Glenn W. Turner, Ben Bunting, Hobart Wilder, Malcolm Julian, and Raleigh P. Mann) shall promptly notify the Commission of each change in his business or employment status, including discontinuance of his present business or employment, and each affiliation with a new business or employment following the effective date of this order. Such notice shall include the address of the business or employment with which respondent is newly affiliated and a description of the business or employment as well as a description of the respondent's duties and responsibilities in that business or employment.

IX

It is further ordered, That each of the respondents herein and their successors and assigns shall, within sixty (60) days after the effective date of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which they have complied with the provisions of this order.

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X

It is further ordered, That the complaint herein be, and it hereby is, dismissed as to Michael Delaney and Terrell Jones; *Provided, however*, That the dismissal as to Terrell Jones is without prejudice to the right of the Commission to institute further proceedings against him if the public interest so warrants.

IN THE MATTER OF

CAVANAGH COMMUNITIES CORPORATION, ET AL.

Docket 9055. Order, Nov. 18, 1975

Denial of petition for extraordinary review and application for stay of time to answer.

Appearances

For the Commission: *Jeffrey Tureck, David Keehn* and *Pamela B. Stuart.*

For the respondents: *Philip F. Zeidman, Brownstein, Zeidman, Schomer & Chase*, Wash., D.C.

ORDER DENYING PETITION FOR EXTRAORDINARY REVIEW AND APPLICATION FOR STAY OF TIME TO ANSWER

Respondents have petitioned for "extraordinary review" of the administrative law judge's Oct. 24, 1975, order denying respondents' motion for a more definite statement of those allegations in the complaint with respect to which the Commission may subsequently bring an action for consumer redress pursuant to Section 19 of the Federal Trade Commission Act. Following denial of the motion for a more definite statement, respondents filed an application for a determination by the administrative law judge allowing an interlocutory appeal, which the law judge denied on Nov. 3, 1975.

We have considered respondents' petition and have found nothing therein which would warrant departing from the procedural requirements of Section 3.23 of the Commission's Rules of Practice or directing a certification of the matter pursuant to Section 3.22(a). Accordingly,

It is ordered, That the aforesaid petition for extraordinary review be, and it hereby is, denied.

It is further ordered, That respondents' application for a stay of the time to answer the complaint be, and it hereby is, denied.

IN THE MATTER OF

HARBOR BANANA DISTRIBUTORS, INC.

Docket 8795. Order, Nov. 24, 1975

Time for complying with divestiture order extended until Jan. 28, 1976.

Appearances

For the Commission: *Owen N. Johnson, Jr.*

For the respondents: *Bernard Marcus, Deutsch, Kerrigan & Stiles*, New Orleans, La.

ORDER EXTENDING TIME FOR COMPLIANCE WITH COMMISSION ORDER

On Oct. 6, 1975, respondent Harbor Banana Distributors, Inc., (hereinafter "Harbor") filed with the Secretary of the Commission a document entitled: "Harbor's Petition To Reopen the Order of the Federal Trade Commission Served on January 28, 1975." This petition sought a six-month extension of time from July 28, 1975, to Jan. 28, 1976, within which to comply with the order of the Commission that Harbor divest the acquired assets of Charles C. McCann Co. and Tradewinds Produce, Inc. Harbor was required to divest the subject assets by July 28, 1975, pursuant to Paragraph II of the Commission's modified order, which issued on Jan. 3, 1975 [85 F.T.C. 7].

A petition for reopening and modification pursuant to Section 3.72(b)(2) of the Commission's rules is not an appropriate procedure to apply to the Commission for an extension of time within which to comply with a Commission order. Rather, respondent should have sought an extension of time pursuant to Section 4.3(b), and should have made application prior to June 28, 1975, when the time previously granted expired. The Commission notes, however, that respondent's application for an extension of time is supported by a substantial showing of good faith efforts to comply with the Commission's order and is endorsed by the Bureau of Competition. In these circumstances, the Commission has determined to grant the requested extension. Therefore,

It is ordered, That respondent, Harbor Banana Distributors, Inc., may have until Jan. 28, 1976, to comply with the order of the Commission entered on Jan. 3, 1975, requiring that said respondent divest the acquired assets of Charles C. McCann Co. and Tradewinds Produce, Inc., and other relief.

IN THE MATTER OF

ILLINOIS CENTRAL INDUSTRIES, INC., ET AL.

MODIFYING ORDER IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT AND SEC. 7 OF THE CLAYTON ACT

Docket C-2370. Decision, Mar. 26, 1973–Modifying Order, Nov. 24, 1975

Order modifying an earlier order dated Mar. 26, 1973, 82 F.T.C. 1097, 38 F. R. 10707, by changing the compliance reporting requirements for Paragraphs IIE and IIF from 30-day intervals to semi-annual reports on Dec. 15, 1975, and on June 15, 1976, after which only annual reports will be required in lieu of monthly reports with respect to the divestiture order.

Appearances

For the Commission: *K. Keith Thurman, James C. Egan, Jr.* and *James C. Hamill, Jr.*

For the respondents: *Robert Mitten*, Chicago, Ill., *Lloyd N. Cutler, Wilmer, Cutler & Pickering*, Wash., D.C. and *Bertrom M. Kantor, Wachtell, Lipton, Rosen & Katz*, New York City.

ORDER REOPENING AND MODIFYING ORDER TO CEASE AND DESIST

Respondent, by letter dated Sept. 12, 1975, which will be treated as a petition to reopen this proceeding, has requested that the requirement that it file compliance reports at 30-day intervals for Paragraphs II E and II F, contained in the order to cease and desist issued Mar. 26, 1973 [82 F.T.C. 1097], be modified so as to require semiannual reports on Dec. 15, 1975, and on June 15, 1976, and each calendar year thereafter.

The Commission has duly considered respondent's request and has determined that it should be granted.

It is ordered, That the proceeding be, and it hereby is, reopened.

It is further ordered, That the order to cease and desist be, and it hereby is, modified by requiring that the compliance reporting for Paragraphs II E and II F of the order be changed to a semiannual basis by submitting such reports on Dec. 15, 1975, and on June 15, 1976, and thereafter for each calendar year in lieu of the monthly reports heretofore required with respect to the divestiture provisions of the order.

IN THE MATTER OF

KELLOGG COMPANY, ET AL.

Docket 8883. Order, Nov. 25, 1975

Denial of (1) complaint counsel's application for review of administrative law judge's order setting a schedule for pretrial briefing and trial in this matter, and (2) administrative law judge's order denying motion for reconsideration.

Dismissing as moot complaint counsel's petition for stay of action by Commission on administrative law judge's report and orders of Oct. 14, 1975.

*Appearances**

For the Commission: *Robert B. Greenbaum* and *Steven A. Newborn.*

ORDER DENYING APPLICATION BY COMPLAINT COUNSEL FOR REVIEW OF THE SUBSTITUTE ADMINISTRATIVE LAW JUDGE'S ORDERS AND DISMISSING PETITION FOR STAY

This matter is before the Commission upon an uncertified application for review.

On Oct. 22, 1975, Administrative Law Judge Joseph P. Dufresne[1] denied complaint counsel's motion that he reconsider and amend his order of Oct. 14, 1975, setting a schedule for pretrial briefing and trial in this matter. The law judge's order, setting Jan. 26, 1976 as the date for the commencement of hearings on complaint counsel's case, was issued pursuant to the Commission's orders of Sept. 16, 1975, and Sept. 23, 1975, requiring that the law judge, after consultation with the parties, promptly establish a schedule for trial and certify to the Commission a status report on this matter.

The law judge has also declined to make a determination that his rulings are appropriate for interlocutory review under Section 3.23(b) of the rules of practice.

Complaint counsel have now applied for review of the law judge's orders of Oct. 14, 1975, and Oct. 22, 1975. They contend that the judge's failure to determine that this matter is appropriate for review under Section 3.23(b) was a clear abuse of discretion and that the rulings setting a briefing and trial schedule were likewise abuses of discretion.

Complaint counsel ask that the scheduling of this matter be "returned to the discretion of Judge Hinkes to set a schedule consistent with the record, the needs of the parties, and the interests of the public in a proper resolution of this important matter. If the Commission

* For additional appearances see p. 650, herein.

[1] Judge Dufresne was designated to substitute for Harry R. Hinkes, the law judge to whom this matter was assigned, who was required to be absent from the Commission for personal reasons.

decides that it will itself set the schedule, complaint counsel recommend a trial date of Apr. 5, 1976, as originally proposed by the substitute judge and accepted by all parties."

We cannot conclude, from the record before us, that Judge Dufresne abused his discretion in making any of the determinations challenged by complaint counsel. However, the law judge retains discretion to modify the trial schedule for good cause. Accordingly,

It is ordered, That the aforesaid application for review be, and it hereby is, denied;

It is further ordered, That the petition by complaint counsel for stay of any action by the Commission on Judge Dufresne's report and orders of Oct. 14, 1975, be, and it hereby is, dismissed as moot.

IN THE MATTER OF

LUSTINE CHEVROLET, INC., ET AL.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT

Docket 8974. Complaint, July 1, 1974-Decision, Nov. 25, 1975

Consent order requiring a Hyattsville, Md. new and used car dealer, among other things to cease misrepresenting that any vehicle is new when it has been used in any manner other than the limited use necessary in moving or road testing prior to delivery; and to disclose, orally and in writing, specific information with respect to used motor vehicles.

Appearances

For the Commission: *Jerry W. Boykin, Michael E.K. Mpras, Michael Dershowitz, Frank H. Addonizio* and *Robert G. Day.*

For the respondents: *Jacob Stein, Stein, Mitchell* [*Mezines*, Wash., D.C.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Lustine Chevrolet, Inc., a corporation, and Phillip Lustine and Burton Lustine, individually and as officers of said corporation, hereinafter referred to as respondents, have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be

in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Lustine Chevrolet, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Maryland, with its principal office and place of business located at 5710 Baltimore Ave., in Hyattsville, Md.

Respondents Phillip Lustine and Burton Lustine are individuals and officers of the corporate respondent. They formulate, direct and control the acts and practices of the corporate respondent, including those hereinafter set forth. Their business address is the same as that of the corporate respondent.

The respondents cooperate and act together in carrying out the acts and practices hereinafter set forth.

PAR. 2. Respondents are now, and for some time last past have been, engaged in the advertising, offering for sale, and sale to the public of new and used motor vehicles and in the servicing and repair thereof.

PAR. 3. In the course and conduct of their aforesaid business, respondents now cause, and for some time last past have caused, their said motor vehicles to be sold to purchasers thereof located in various States of the United States and the District of Columbia, including the State of Maryland, and maintain, and at all times mentioned herein have maintained, a substantial course of trade in said motor vehicles in commerce, as "commerce" is defined in the Federal Trade Commission Act. Also in the course and conduct of their business, respondents have caused, and now cause, customers' notes, contracts, payments, checks, credit reports, title registrations, correspondence and other documents relating to payment of the purchase price for respondents' motor vehicles to be transmitted by various means, including but not limited to, the United States mails, in commerce, as "commerce" is defined in the Federal Trade Commission Act.

In the course and conduct of their business, as aforesaid, and for the purpose of inducing the purchase of their motor vehicles, the respondents have made, and are now making, numerous statements and representations in advertisements inserted in newspapers of general interstate circulation, and by other means in commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. Typical and illustrative of the statements and representations in said advertisements, published in November of 1970, disseminated as aforesaid, but not all inclusive thereof, are the following:

SAVE $400 to $1200 ON EVERY CAR IN OUR INVENTORY OF UNSOLD '70 MODELS!

SPECIAL PURCHASE LAST OF THE 5-YEAR WARRANTY CARS AT 400 BELOW ORIGINAL COST

1970 MALIBU 2-DOOR HARDTOP AIR COND. AUTO. PWR. ST. & DISC. BR.,

RADIO, WWT, WHEEL COVERS, TINTED GLASS, VINYL TOP, GREEN AMERICA'S LARGEST SPECIAL PURCHASE DEALER * * *.

PAR. 5. By and through the use of the above-quoted statements and others of similar import and meaning but not expressly set out herein, the respondents have represented, and are now representing, directly or by implication:

1. That the motor vehicles described or referred to in said advertisements are new;

2. That Lustine Chevrolet, Inc. is America's largest special purchase dealer.

PAR. 6. In truth and in fact:

1. The motor vehicles described or referred to in said advertisements, in many instances, are not new. To the contrary, they have been driven substantially in excess of the limited use necessary in moving or road testing a new vehicle prior to its delivery to the ultimate purchaser.

2. Lustine Chevrolet, Inc. is not America's largest special purchase dealer.

Therefore, the statements and representations as set forth in Paragraphs Four and Five, hereof, were, and are, unfair, false, misleading and deceptive.

PAR. 7. In the further course and conduct of their business as aforesaid, and for the purpose of inducing the purchase of their said motor vehicles, respondents, directly or through their representatives and employees, have engaged in the deceptive act and practice of representing to customers that lease buy-back motor vehicles purchased from various metropolitan Washington, D.C. area motor vehicle leasing operations were demonstrator motor vehicles; by such representations, respondents misled and deceived purchasers as to the actual prior use of said lease buy-back motor vehicles.

Therefore, respondents' statements and representations, and their failure to reveal in their advertisements and during their sales representations, the material facts as to the nature and extent of such previous use of said motor vehicles, are unfair, false, misleading and deceptive.

PAR. 8. In the further course and conduct of their aforesaid business, respondents have engaged in the following acts and practices in connection with the sale of their said motor vehicles:

1. A $35 dealer handling and service charge is added to the price of respondents' used motor vehicles, the first indication that such a charge is being made, in many instances, occurs at the time the buyer receives a copy of the sales invoice and the conditional sales contract. The purchaser, in many said instances, believes that the motor vehicle will

be delivered in satisfactory condition and appearance without the imposition of additional charges. The dealer handling and service charge becomes an undisclosed cost that should have been made known prior to the consummation of the sale.

2. Respondents have repaired or repainted, or have caused to be repaired or repainted, damaged cars, said repairs or repainting hide damage that may adversely affect a vehicle's performance and life expectancy. Respondents have failed to disclose to prospective purchasers and purchasers of respondents' motor vehicles that said damage has been hidden by repairs or repainting.

Therefore, respondents' failure to disclose such material facts, prior to the time of sale was, and is, unfair, false, misleading and deceptive.

PAR. 9. In the course and conduct of their aforesaid business and at all times mentioned herein, respondents have been, and are now, in substantial competition, in commerce, with corporations, firms and individuals in the sale, service and repair of new and used motor vehicles of the same general kind and nature as that sold, serviced and repaired by respondents.

PAR. 10. The use by the respondents of the aforesaid unfair, false, misleading and deceptive statements, representations, acts and practices and the failure to disclose material facts, as aforesaid, has had, and now has, the capacity and tendency to mislead members of the purchasing public into the erroneous and mistaken belief that said statements and representations were, and are, true and complete and into the purchase of substantial quantities of respondents' motor vehicles and services by reason of said erroneous and mistaken belief. Respondents' aforesaid acts and practices unfairly cause the purchasing public to assume debts and obligations and to make payments of money which they might otherwise not have incurred.

PAR. 11. The acts and practices of the respondents, as herein alleged, were, and are, all to the prejudice and injury of the public and of respondents' competitors and constituted, and now constitute, unfair methods of competition in commerce and unfair or deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act.

DECISION AND ORDER

The Federal Trade Commission having issued a complaint charging the respondents named in the caption hereof with violation of the Federal Trade Commission Act; and

The Commission having duly determined upon motion submitted by complaint counsel and respondents that, in the circumstances presented, the public interest would be served by a withdrawal of the matter

from adjudication for the purpose of negotiating a settlement by the entry of a consent order; and

The respondents and counsel for the Commission having executed an agreement containing a consent order, an admission by the respondents of all the jurisdictional facts set forth in the complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondents that the law has been violated as alleged in the complaint, and waivers and other provisions as required by the Commission's rules; and

The Commission having considered the agreement and having provisionally accepted same, and the agreement containing consent order having thereupon been placed on the public record for a period of sixty (60) days, now in further conformity with the procedures described in Section 2.34 of its rules, the Commission hereby makes the following jurisdictional findings, and enters the following order:

1. Respondent Lustine Chevrolet, Inc. is a corporation organized, existing and doing business under and by virtue of the laws of the State of Maryland, with its principal office and place of business located at 5710 Baltimore Ave., Hyattsville, Md.

Respondents Phillip Lustine and Burton Lustine are officers of said corporation. They formulate, direct and control the policies, acts and practices of said corporation, and their principal office and place of business is located at the above-stated address.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondents, and the proceeding is in the public interest.

ORDER

It is ordered, That respondents Lustine Chevrolet, Inc., a corporation, its successors and assigns and its officers, and Phillip Lustine and Burton Lustine, individually and as officers of said corporation, and respondents' agents, representatives and employees directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale or distribution, service and repair of new and used motor vehicles, or any other products or services, in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, as amended, do forthwith cease and desist from:

1. Representing, orally or in writing, directly or by implication, that any vehicle is new when it has been used in any manner other than the limited use necessary in moving or road testing a new vehicle prior to delivery of such vehicle to the customer.

2. Offering for sale or selling any vehicles of the current or

previous model year, which has been used in any manner, other than the limited use referred to in Paragraph 1., above, without orally disclosing, prior to any sales presentation, the nature and extent of such previous use of said vehicle.

3. Advertising any vehicle of the current or the previous model year which has been used in any manner, other than the limited use referred to in Paragraph 1., above, without clearly and conspicuously disclosing in any and all advertising thereof the nature of such previous use of said vehicle.

4. Displaying, offering for sale or selling any vehicle of the current or the previous model year which has been used in any manner, other than the limited use referred to in Paragraph 1., above, without clearly and conspicuously disclosing by decal or sticker affixed to the inside of the side window containing the manufacturer's suggested retail price or "Monroney sticker," or if space is not available thereon, in close proximity thereto, so as to be clearly visible, the nature of such previous use of said vehicle. Said decal or sticker shall also contain the following statement: "FOR EXACT MILEAGE, SEE ODOMETER."

5. Offering for sale or selling any motor vehicle of the current or the previous model year which has been used and which respondents have reason to believe has been damaged to the extent that it may adversely affect said motor vehicle's performance and life expectancy and the repair and repainting of said motor vehicle may hide said damage, without:

(a) Disclosing, both orally and in writing, the manner in which the motor vehicle has been damaged and the nature of the damage sustained by the vehicle; and

(b) clearly and conspicuously disclosing by decal or sticker attached thereto, as required by Paragraph 4., above, that the motor vehicle has been damaged.

6. Misrepresenting, orally or in writing, directly or by implication, the nature or extent of previous use or condition of any vehicle displayed, offered for sale or sold.

7. Failing to disclose, both orally and in writing, prior to the signing of the completed retail order for a used motor vehicle, and in any and all advertising of such vehicles, the precise amount of handling and service charges which will be added to the cost of respondents' used motor vehicles.

8. Representing, orally or in writing, directly or by implication, that respondent Lustine Chevrolet, Inc. is America's largest special purchase dealer, or using words of similar import, unless it does occupy such purchasing position, at the time aforesaid representation is made;

misrepresenting, in any manner, the size, status, sales or purchasing position of respondents' dealership.

It is further ordered:

(a) That respondents shall forthwith distribute a copy of this order to each of their operating divisions;

(b) That respondents deliver a copy of this order to cease and desist to all present and future personnel engaged in the offering for sale, or sale, of any motor vehicle, and in the consummation of any extension of consumer credit or in any aspect of preparation, creation, or placing of advertising, and that respondents secure a signed statement acknowledging receipt of said order from each such person;

(c) That respondents notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of the order;

(d) That respondents post in a prominent place in each salesroom or other area wherein respondents sell motor vehicles or other products or services, a copy of this cease and desist order, with the notice that any customer or prospective customer may receive a copy on demand;

(e) That the individual respondents named herein promptly notify the Commission of the discontinuance of their present business or employment and of their affiliation with a new business or employment. Such notice shall include respondents' current business address and a statement as to the nature of the business or employment in which they are engaged as well as a description of their duties and responsibilities; and

(f) That the respondents herein shall, within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this order.

IN THE MATTER OF

NATIONAL TALENT ASSOCIATES, INC., ET AL.

Docket 8960. Complaint, Apr. 3, 1974-Decision, Nov. 26, 1975

Consent order requiring a New York City talent and modeling agency and three closely held corporations in New Jersey, Illinois and California, among other things to cease misrepresenting their ability to place customers into modeling and entertainment positions; using unethical and exploitative high pressure sales tactics and failing to disclose relevant facts. Further, respondents are

STATE OF WASHINGTON
KING COUNTY SUPERIOR COURT

STATE OF WASHINGTON, Plaintiff, v. LLR, Inc.; LLR LULAROE, Inc.; LENNON LEASING, LLC; MARK A. STIDHAM; DEANNE S. BRADY a/k/a DEANNE STIDHAM; and JORDAN K. BRADY. Defendants.	NO. COMPLAINT FOR INJUNCTIVE AND OTHER RELIEF UNDER THE CONSUMER PROTECTION ACT, RCW 19.86, AND THE ANTIPYRAMID PROMOTIONAL SCHEME ACT, RCW 19.275

Plaintiff, the State of Washington, appearing through its attorneys, Robert W. Ferguson, Attorney General, and Tiffany L. Lee, Assistant Attorney General, brings this Action against corporate defendants, LLR, Inc; LLR LuLaRoe, Inc.; and Lennon Leasing, LLC (collectively "Corporate Defendants" or "LuLaRoe"); and individual defendants Mark A. Stidham; DeAnne S. Brady (a/k/a DeAnne Stidham); and Jordan K. Brady (collectively, "Individual Defendants"). Plaintiff, on information and belief, alleges as follows:

I. INTRODUCTION

1.1 Corporate Defendants LLR, Inc.; LLR LuLaRoe, Inc.; Lennon Leasing, LLC, and Individual Defendants Mark. A Stidham; DeAnne S. Brady; and Jordan K. Brady through the establishment, promotion, operation, and participation in the LuLaRoe multi-level marketing business have established, promoted, operated, and participated in an unlawful pyramid scheme

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in violation of the Washington Antipyramid Promotional Scheme Act, RCW 19.275 a *per se* violation of the Washington Consumer Protection Act (CPA), and further committed other unfair and deceptive acts or practices in trade or commerce also in violation of the CPA.

II. JURISDICTION AND VENUE

2.1 This Complaint is filed and these proceedings are instituted under the provisions of the Unfair Business Practices – Consumer Protection Act, RCW 19.86, and the Antipyramid Promotional Scheme Act, RCW 19.275.

2.2 The violations alleged in this Complaint were and are committed in whole or in part in the State of Washington, including in King County, Washington, by Defendants named herein.

2.3 The violations alleged in this Complaint are injurious to the public interest.

2.4 The Attorney General has authority to commence this action as conferred by RCW 19.86.080; RCW 19.86.140; and RCW 19.275.040.

III. THE PARTIES

3.1 Plaintiff is the State of Washington.

Corporate Defendants

3.2 Corporate Defendant LLR, Inc. is a Wyoming Corporation with its principal place of business at 1375 Sampson Avenue, Corona, CA 92879.

3.3 Corporate Defendant LLR, Inc. d/b/a LLR LuLaRoe, Inc. is a California Corporation with its principal place of business at 1375 Sampson Avenue, Corona, CA 92879.

3.4 Corporate Defendant Lennon Leasing, LLC, is a Wyoming Corporation with its principal place of business at 1375 Sampson Avenue, Corona, CA 92879.

3.5 Together, Corporate Defendants LLR, Inc., LLR, Inc. d/b/a LLR LuLaRoe, Inc. and Lennon Leasing, LLC, comprise the LuLaRoe multi-level marketing (MLM) apparel business (collectively "LuLaRoe"). Corporate Defendants LLR, Inc., LLR LuLaRoe, LLC, and Lennon Leasing, Inc. operated as a common enterprise while engaging in the deceptive and

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unlawful practices alleged herein. At all times material to this Complaint, acting alone or in concert with others, LuLaRoe advertised, marketed, distributed, or sold business opportunities to consumers throughout the State of Washington. Defendants have conducted the business practices described below through interrelated companies that commingle funds and have common ownership, officers, directors, and office locations. Because LuLaRoe operated as a common enterprise, each entity is jointly and severally liable for the acts and practices alleged.

Individual Defendants

3.6 Individual Defendant Mark A. Stidham ("Stidham") is a California resident and co-founder of LuLaRoe. He serves as President and CEO of LLR, Inc., President of LLR LuLaRoe, LLC, and President and Chief Executive Officer of Lennon Leasing, LLC. At all times material to this Complaint, acting alone or in concert with others, Defendant Stidham formulated, directed, controlled, had the authority to control, or participated in the acts and practices set forth in this Complaint. Defendant Stidham transacts or has transacted business in this county, and throughout the State of Washington.

3.7 Individual Defendant DeAnne Brady ("Brady") is a California resident and co-founder of LuLaRoe. She serves as Secretary of LLR, Inc.; Chief Executive Officer and Secretary of LLR LuLaRoe, LLC, and Secretary of Lennon Leasing, LLC. At all times material to this Complaint, acting alone or in concert with others, Brady formulated, directed, controlled, had the authority to control, or participated in the acts and practices set forth in this Complaint. Defendant Brady transacts or has transacted business in this county, and throughout the State of Washington.

3.8 Individual Defendant Jordan K. Brady ("Jordan Brady") is a promotor of the business opportunities offered by LuLaRoe. Since November 2014, Jordan Brady has served in a Leadership and Culture Development role at LuLaRoe. At all times material to this Complaint, acting alone or in concert with others, Jordan Brady participated in the acts and practices set forth in this Complaint. Defendant Jordan Brady is a California resident, and in connection with

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the matters alleged herein, transacts or has transacted business in this county, and throughout the State of Washington.

IV. THE FACTS

4.1 LuLaRoe is MLM company founded by husband and wife couple, Individual Defendants Mark Stidham and DeAnne Brady in 2013, that promotes and sells colorfully patterned leggings, shirts, skirts, and dresses through a network of independent distributors called "Independent Fashion Consultants" (hereinafter "Consultants"). LuLaRoe operated an unlawful pyramid scheme in the State of Washington through the Leadership Bonus Plan of its Independent Fashion Consultant Program ("LuLaRoe MLM").

Unlawful Compensation Structure

4.2 Any Consultant who signs up for the LuLaRoe MLM and pays the initial "onboarding" fee, which ranges from $2,000 to $9,000 depending on the package, is eligible to participate in LuLaRoe's Leadership Bonus Plan. Until July 1, 2017, LuLaRoe's Leadership Bonus Plan gave Consultants a right to receive compensation entirely based on the recruitment of other persons as participants in the LuLaRoe MLM.

4.3 LuLaRoe incentivized existing Consultants to recruit and sponsor new Consultants, and to encourage them and their recruits to purchase large amounts of inventory, by basing its bonus structure on the dollar amount of wholesale orders paid for, instead of on bona-fide retail sales to end-consumers. Historically, the Leadership Bonus Plan rewarded Consultants based on a percentage of the "Personal Volume" or "total of pieces ordered for which payments are received in a calendar month" of their teams (or "T.E.A.M.s", LuLaRoe's acronym for "Together, Everyone, Achieves, More").

4.4 LuLaRoe's Leadership Bonus Plan generally had four tiers of status, which Consultants qualified for based upon the number of inventory pieces purchased by a Consultant and her or his team (referred to as "Group Volume"), and the number and status of recruits in a Consultant's team.

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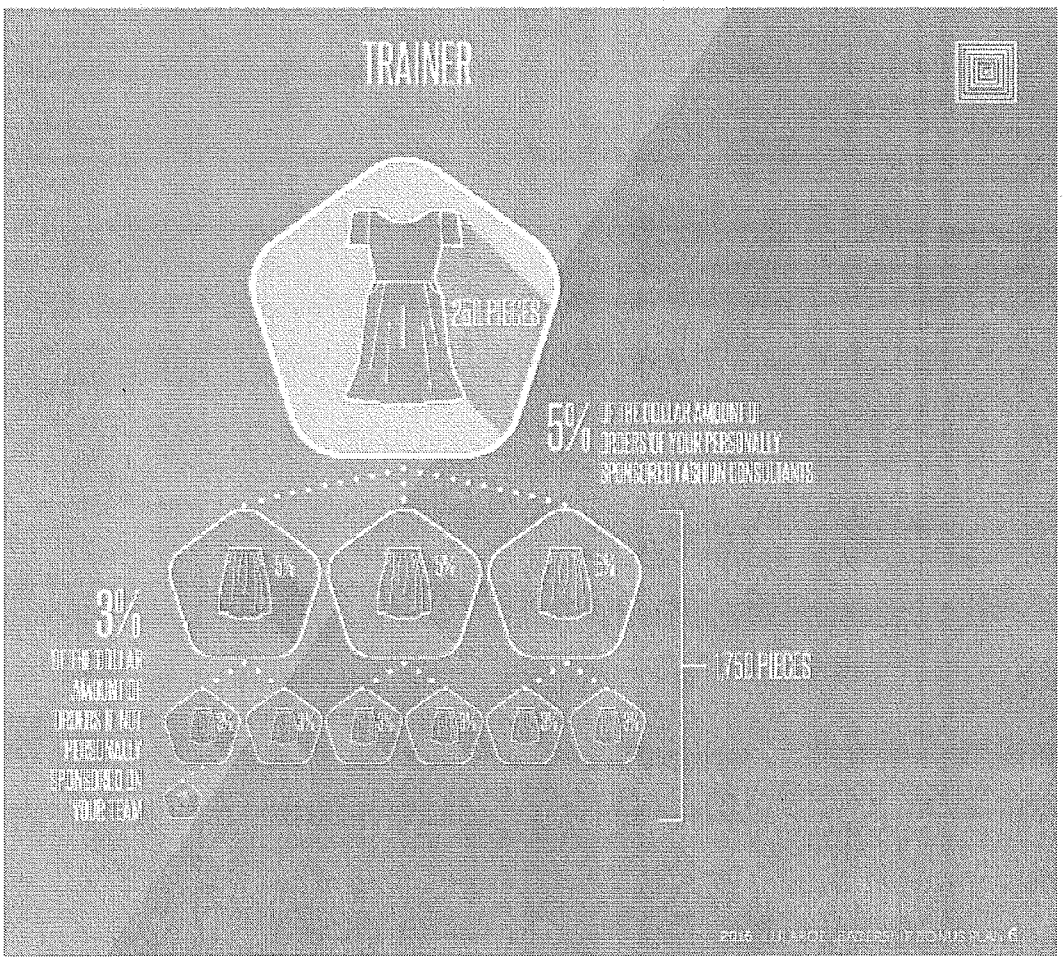
4.5 Any Consultant could participate in the Leadership Bonus plan by recruiting Consultants to be part of their teams. Prior to July 2017, the Leadership Bonus Plan was generally structured as follows:

a. "Sponsors" were the lowest tier. Any Consultant could become a "Sponsor" by recruiting Consultants. Sponsors who met a minimum purchase requirement of 175 pieces per month were eligible for a 5% "override bonus on the Personal Volume (Payments Received)" of their sponsored Consultants.

b. "Trainers" were the second tier. A "Trainer" had to qualify with "250 pieces (100 of which must be generated by their personal orders), at least three Personally Sponsored Fashion Consultants, with a total of ten Fashion Consultants in their team and 1,750 Total Group pieces ordered and paid for." Trainers were eligible to earn "qualification points" to reduce their own personal purchase requirement. Trainers earned a 5% bonus on personally sponsored Consultants and a 3% bonus on the rest of the team's inventory purchases.



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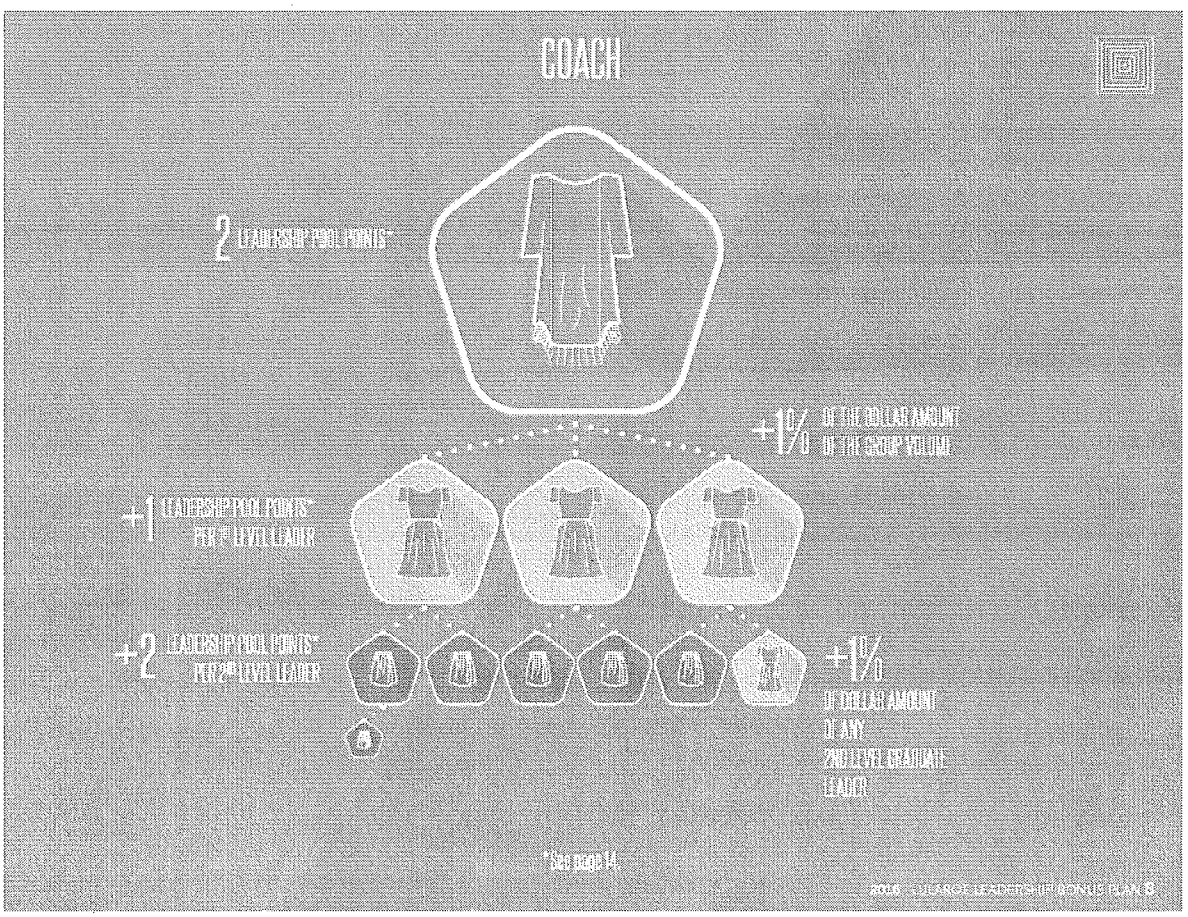
c. "Coaches" were the third tier. Coaches had to meet the requirements of a Trainer and have at least three First Level Trainers. Coaches had a minimum group volume of 1,750 pieces, and were eligible for Trainer Leadership Bonuses in addition to 1% of the Dollar Amount of any Second Level Leader's Group Volume. Coaches were also eligible to receive leadership "points," which could be cashed out or be used for other rewards such as the LuLaRoe Cruise.



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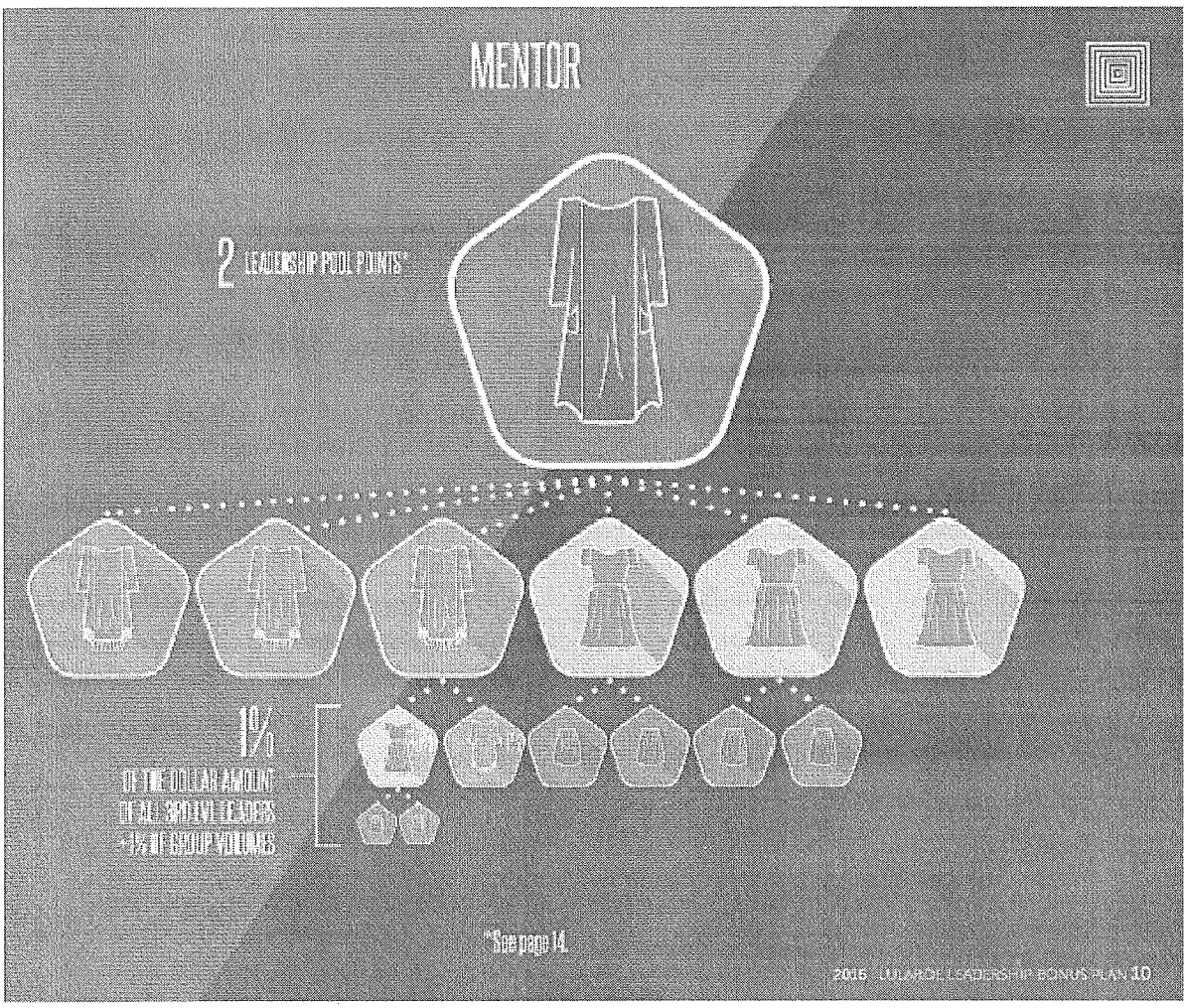
d. Mentors were the top tier. To qualify as a Mentor, a Consultant had to meet the requirements of a Trainer and have at least three leadership lines with coaches or above and three additional leadership lines. In addition to the Coach Bonuses, Mentors were eligible to earn 1% of the Dollar Amount of the total inventory purchases of all Third Level Leaders teams.



4.6 Income earned through the Leadership Bonus Plan significantly dwarfed retail profits for top consultants. At a Leadership Conference themed, "Be the Light" hosted at the Riverside Convention Center in California in January 2017, Defendant Brady asked Consultants to publicly state their last month's total retail sales and bonus checks. Consultants, at Defendant Brady's direction, announced the amounts of their monthly bonus checks, which ranged from $85,000 to $307,000. Compared to their monthly retail sales, which ranged from $12,000 to

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$25,000, it was clear that the primary opportunity for compensation was not through sale of LuLaRoe apparel, but bonuses earned through recruiting.

4.7 On July 1, 2017, LuLaRoe revised their Leadership Bonus Plan to compensate Consultants based on actual retail sales rather than inventory purchases. As explained by Defendant Jordan Brady in a "Train the trainers" webinar on October 27, 2016:

> What it is, is we've always been planning this, talked about for the last year. *We need to get away from being a pyramid scheme.* Ok! What it is, is if you sign up Sally, you have, you have no reason to help Sally, sell the product in her room. Right? You can just keep promoting her to buy, to buy, to buy, to buy. You can even be paying for her inventory to make your bonus check, there are some dishonest consultants that do that. Ok! *So, the way we get away from a pyramid scheme and incentivize you as leaders, is we change it.* Sally needs to sell, in order for you to get a bonus check that means you have to have a personal connection with Sally in order to get a bonus check.
>
> *(emphasis added)*

4.8 Following the change in bonus structure on July 1, 2017, Consultants participating in the Leadership Bonus Plan were no longer financially rewarded primarily based on recruiting. Rather, Consultants would not earn money from the LuLaRoe MLM until they or their recruits actually sold merchandise to consumers. In other words, LuLaRoe moved away from having a compensation structure that primarily rewarded Consultants based on recruiting towards a compensation structure based on bona fide retail sales to consumers.

Sales and Marketing Activities

4.9 Defendants' sales and marketing activities similarly emphasize recruiting individuals into the LuLaRoe MLM and encouraging inventory purchases in connection with their participation, rather bona fide retail sales. As stated in their marketing materials, "One of the greatest financial awards LuLaRoe has to offer Consultants is its proven Leadership Bonus Plan" where "you can earn significant income when you sponsor and build a strong T.E.A.M. that has consistently grown sales."

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4.10 Defendants promote the LuLaRoe program through a variety of channels, including websites, social media, videos, testimonials, weekly webinars, conference calls, training calls, and live presentations and meetings at conferences. Defendants used a number of channels to promote the LuLaRoe Program, such as "opportunity calls," "opportunity events," "trainer calls," and "pop-ups." LuLaRoe's core management team, including Defendants Stidham, Brady, and Jordan Brady, plan, host, and execute "opportunity calls," "opportunity events," and "trainer calls."

4.10.1 "Opportunity events" are events designed to recruit new Consultants and motivate existing Consultants to do the same, typically hosted in hotel ballrooms, conference rooms, or convention centers around the country. LuLaRoe annually hosted a conference called VISION for active Consultants. Individual Defendants often spoke at "opportunity events."

4.10.2 "Opportunity calls," often hosted by Defendant Brady, are weekly conference calls to promote and market the LuLaRoe MLM to potential recruits.

4.10.3 "Trainer calls," often hosted by Defendant Jordan Brady, are calls designed to entice and train consultants to grow their teams through the Leadership Bonus Program.

4.10.4 "Pop-ups" are events hosted by Consultants, where Consultants are encouraged to recruit "Hostesses" in order to help them sell LuLaRoe merchandise. LuLaRoe encourages Consultants to reward "Hostesses" with free LuLaRoe merchandise, and at each "pop-up," recruit additional "Hostesses" for additional "pop-ups."

4.11 Through each of these channels, Defendants encouraged consumers to become LuLaRoe Consultants and to recruit others, including friends and family members, to do the same. For example, in trainings, Defendants represent that a key to success is "Buy more, sell more", further emphasizing the key to success is growing "Group Volume" to receive large rewards through the Leadership Bonus Plan.

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Defendants' Business Opportunity and Income Claims

4.12 In order to recruit Consultants to the LuLaRoe MLM, Defendants assert throughout their sales and marketing activities that consumers can earn significant rewards through the LuLaRoe MLM, and that Consultants' income potential is significant.

4.13 Defendants repeatedly tout that the LuLaRoe MLM offers anyone an easy path to financial freedom and independence with part-time work. Print materials for recruiting distributed by LuLaRoe state: "MAKE A FULL-TIME INCOME DOING PART TIME WORK. BECOME A LULAROE INDEPENDENT BUSINESS OWNER" and "WANT TO EARN FULL-TIME INCOME FOR PART-TIME WORK? ASK ME HOW?" LuLaRoe encouraged consultants to frame and hang these print materials at "pop-up parties" and distribute these materials to potential recruits. At an opportunity event in 2015, Defendant Stidham also made similar lifestyle claims of "full-time income on part-time work":

a. "We started this business on the premise that you could make a full-time income on part-time, part-time work, alright? I always boiled that down to this, a party takes about 5 hours. Uh, we say it takes 5 hours because the party itself takes about an hour and half because you got to set it up. You take it down. You gotta call and prep the hostess. You have to organize your inventory. So, you have lots of ancillary . . . activities that goes with the party. So . . . , I think it's very generous to say you have 5 hours for a party. Now, can you do 4 parties in a week? 4 parties times 5 hours is 20 hours; 20 hours in the week is definitely part time work. Now what do you make if you do 4 parties in a week? Average party sales are about 25 pieces. Okay, so 4 parties in a week equals 100 pieces sold in a week. There's are 52 weeks in a year, but we're gonna give you two weeks off. So 50 weeks take 100 pieces, that's 5000 pieces sold in a year. Average profit is 12 to 15 dollars per item, that's 60 to 75 thousand dollars a year working 20 hours a week."

4.14 Defendant Brady made lifestyle and income claims during "opportunity calls" designed to recruit new Consultants, "opportunity events" designed to motivate Consultants to recruit others, and in webinars put on by existing Consultants:

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a. "You are going to make about three to five-thousand on average, I'm saying on average, you know, you gonna, you're going to have to get yourself going. . . . Your business will start to grow and it will grow and grow and grow. . . On average our consultants are paying their debt back . . . anywhere from 2 weeks to 2 months, depending on how much you want to commit to. . . ."

b. "In fact, today, I was making calls. I reached out to 25 retailers that are selling an average of 12 to 15, [correct self] 10 to 15 thousand a month, I mean is that, is that comprehensible or what, it's amazing, to make that kind of money, doing it part-time, being a stay at home mom. . . ."

c. "I mean I could blow your, your mind away by telling you that we have over 100 people that make a lot of money, like between 50 thousand to 500 thousand dollars a month, and I'm not lying."

d. "What really affects me is when women call me and say, 'my husband just lost his job, so I guess I'm it.' And they say, 'do you think I can do it DeAnne?' And I get to get my pom-poms out, and I say, 'But don't you see this is an answer! This is easy! This is fun! This is something you guys can do together and he can watch the kids while you go and do parties.'"

e. "This is a business that is going to bring in a lot of money for you, a lot of money, I mean a lot. I'm going to say that over."

Defendants' Training Materials Emphasized Recruiting Over Bona Fide Retail Sales

4.15 Defendants claimed that anyone who followed LuLaRoe's "process" could succeed through the LuLaRoe MLM. But even LuLaRoe's "process" to sell merchandise emphasized recruiting "Hostesses" to help sell LuLaRoe apparel and using "pop-up" parties as Consultant-recruiting opportunities. LuLaRoe's onboarding print materials advise Consultants to recruit "Hostesses" to host "pop-up boutiques" to help sell LuLaRoe merchandise. LuLaRoe encourages Consultants to reward Hostesses for their efforts with free merchandise, and to share their excitement, including by rewarding them with additional free merchandise, with Hostesses when any piece sells. Further, a Consultant should promote pop-up boutiques through "personal phone calls, text messages, conversations, emails Facebook, Instagram, Events, and flyers . . . ."

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LuLaRoe recommended that at each pop-up boutique, a Consultant recruit three additional "Hostesses" to host more pop-up boutiques.

4.16 LuLaRoe encouraged Consultants to flaunt their success in order to recruit others. Training materials state:

a. "By sharing your success stories with others around you, you allow that success to grow."

b. "SHARE THE OPPORTUNITY. LuLaRoe believes that anyone, anywhere has the ability to share the amazing opportunity LuLaRoe has to offer! . . . One direct way to ensure that your LuLaRoe business will succeed is by growing your clientele and your potential T.E.A.M. People are intrigued and excited by another's personal triumphs! Share with those interested about your success and how they too can have a business of their own and the freedom that comes with it."

4.17 Although it is against LuLaRoe's written Policies and Procedures for Consultants to make income claims, Defendants encourage Consultants to make income and lifestyle claims and flaunt their success in order to recruit additional Consultants. At several Opportunity Events, Defendant Brady led panels and asked top Consultants present their Leadership bonus checks publicly, which were much larger than the amount of profits earned from retail sales. On July 13, 2015, Defendants Stidham and Brady publicly presented a Consultant and her husband an oversized bonus check at VISION Leadership Conference in the amount of $1,425,701.18, creating the impression that other Consultants could also achieve such income through the LuLaRoe Program. Defendants Stidham and Brady posed with the Consultants for a photo with the check, which was then posted on a Consultant's blog site designed to recruit additional Consultants.

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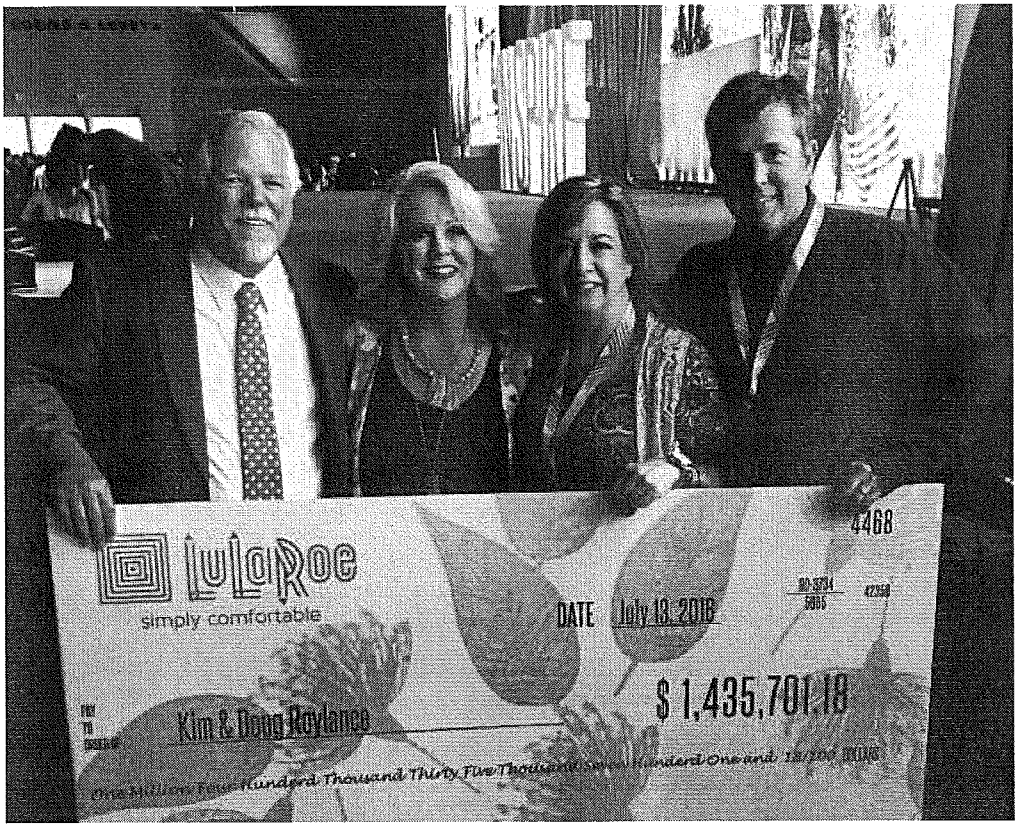

Failure to Disclose Material Terms

4.18 While Defendants sometimes provide disclaimers when making these and other income or lifestyle claims, their attempts are inadequate. LuLaRoe typically dilutes purported disclaimers, with statements such as "results will vary" and other statements implying that negative results are due to the inadequate efforts of the Consultant. For example, many prospective Consultants rely on information publicly available on LuLaRoe's website in evaluating whether the LuLaRoe MLM will be a worthwhile business opportunity. However, LuLaRoe fails to disclose accurate information material to their decision.

4.19 For example, LuLaRoe has published annual disclosure statements on its website since 2014. The figures contained in the company's disclosure statements do not show the whole picture and are misleading. Among other things, the disclosure statements only take into account "active" Consultants who have met minimum purchase thresholds and omit participants who

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fared worse. Additionally, LuLaRoe never published a 2017 Income Statement, leaving a 2016 Income Statement on its website, which was not reflective of 2017 when business declined. As such, LuLaRoe misled prospective Consultants who evaluated whether to join the LuLaRoe MLM in 2017, by omitting material information from its disclosures.

4.20 LuLaRoe's "Retailer Map" which is published on its website, misrepresents the number of active Consultants in a particular geographic location. While LuLaRoe maintains exact data and statistics on the location and number of active and inactive retailers, the map understates the number of Consultants, misleading potential Consultants about the level of saturation of active Consultants in a location. The map informs prospective Consultants about market saturation, which is material information about the potential business opportunity. Instead of updating the map with accurate information, LuLaRoe added a disclaimer to the map in 2018, the efficacy of which was diluted by stating that it "cannot and does not guarantee the accuracy of the Retailer Map" in non-conspicuous fine grey print.

Unfair and Deceptive Practices Encouraging Inventory Loading

4.21 LuLaRoe also engages in a number of practices that encourage Consultants to purchase significant wholesale inventory, further reinforcing the pyramid scheme. In addition to the unlawful Leadership Bonus Plan, LuLaRoe engaged in unfair and deceptive business practices that encourage inventory loading. Such practices include educating Consultants that a key to success is maintaining significant inventory; not permitting Consultants to pick the pattern or size of apparel included in inventory purchases; minimum monthly inventory purchase requirements to stay "active" or qualify for the Leadership Bonus Plan; and marketing limited edition "unicorn" pieces to create a "frenzy" of inventory ordering.

4.22 Defendants deceptively trained Consultants that the key to success is "Buy more, sell more". In training materials, LuLaRoe encourages Consultants to invest all profits from retail sales back into inventory purchases:

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> "Having a wide selection will lead to more customer engagement and bigger sales. It is crucial that you carry a significant number of pieces in every size before moving onto other styles. We have found that our Consultants who carry several hundred items in their inventory have the highest rate of success. Of course there are no set-in-stone rules, and you may proceed at your own pace, but we have learned that abundant inventory often creates abundant sales!"

4.23 Defendant Brady stated in a November 14, 2016 mentor call:

> "The way this business was created, was you have the merchandise, you put it before people and you sell it and you have money in your bank account. That is how this business goes and the more investment that you put into your business, you treating it like a business, the first 90 days to 120 days, YOU DO NOT SPEND YOUR MONEY. Sorry, you can buy an ice cream cone, or a diet coke or cup of coffee and gas, you pour everything back in your business . . . . well this kind of business is driven by the more you invest in your business, the more you have, the more you are going to sell it. So I want to reach out to you and let you know and give you permission that this is a business that is going to bring in a lot of money for you, A LOT, I mean A LOT, I'm going to say that over."

4.24 Despite encouraging Consultants to maintain a large variety of inventory, LuLaRoe does not permit Consultants to select the pattern or size of the merchandise ordered. Inventory is sold in 33-piece sets called "pods," pre-selected by LuLaRoe. Consultants may not specify the size or print of an inventory order. Thus, in order to obtain merchandise of a particular size or print, such as a particularly desirable "unicorn" piece, Consultants were required to "to buy, to buy, to buy", but could only hope to receive specific desirable sizes or prints.

Exiting Consultant Refund Policy

4.25 As part of its "Policies and Procedures," LuLaRoe has an official inventory buy back policy for exiting consultants. Section 3.16.3 permits retailers to receive "90% of the net cost of the original purchase price(s)" upon "cancellation of an Independent Fashion Consultant's Agreements." LuLaRoe's "Returns on Cancellation of the Agreement" repurchase policy assured prospective Consultants that they could recoup most of their investment in the LuLaRoe Program if the opportunity did not work out for them.

4.26 However, LuLaRoe implemented a very complex process for initiating a refund, which it did not clearly disclose to Consultants. While the process has varied over time,

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currently, the process is as follows: In order to obtain a refund, a Consultant must log into "Build", LuLaRoe's online portal, and click the "cancel my business" button. Then, LuLaRoe sends "formstacks" for Consultants to list inventory they plan to return for a refund. After a Consultant submits her or his formstacks, LuLaRoe sends Consultants a confirmation of the refund amount they are eligible for, which according to their policies and procedures should be 90% of the wholesale price of inventory purchased within the last year, less any bonus earned through the Leadership Bonus Plan. If the refund offered is satisfactory to the Consultant, the Consultant must pay for shipping, and return her or his merchandise to LuLaRoe. After LuLaRoe inventories the merchandise and deems it resalable, LuLaRoe issues a refund check.

4.27 On April 25, 2017, in response to market saturation and a growing number of "G.O.O.B" or "Going Out of Business" sales, LuLaRoe announced it would be changing its 90% policy to 100%, and committed to paying for return shipping. LuLaRoe made representations that the revised 100% policy would not go away. On June 30, 2017, LuLaRoe deceptively posted a "Home Office Update" on LuLaRoe's online portal "Build," "This policy does not have an expiration date, nor does it have a required timeframe in which the product should have been purchased in . . . ." However, without any advance notice to Consultants, LuLaRoe announced on September 13, 2017, that it would no longer honor its 100% refund policy.

4.28 Following the announcement, many retailers who had started the exit process experienced issues with their refunds, including a lack of response to initiating refunds, delays in sending formstacks, miscalculations in the amount of refunds owed (which became known among Consultants as "LuLaMath"), and significantly delayed or non-payment of refunds. Word spread quickly amongst LuLaRoe Consultants about LuLaRoe's failure to honor the repurchase policy. As a result of LuLaRoe's failure to honor its written repurchase policy, many Consultants who initiated a cancellation did not send in their merchandise because they believed LuLaRoe would not refund them the appropriate amount, if at all. Others were forced to attempt to mitigate their losses through other means, such as G.O.O.B. sales, consignment thrift shops,

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or donating merchandise at a loss. Many others are still holding onto boxes of unsaleable inventory.

Harm to Washingtonians and the Public Interest

4.29 In sum, LuLaRoe's business model was a pyramid scheme. The primary business opportunity in the LuLaRoe MLM was its Leadership Bonus Plan, which until July 2017, rewarded compensation solely based on recruiting and inventory purchases. Further, LuLaRoe's marketing and sales activities, misleading income and lifestyle claims, emphasis on recruiting and inventory purchases over emphasis on sales to consumers outside the LuLaRoe organization, and inventory loading practices ensured that the primary business opportunity with LuLaRoe was through recruitment.

4.30 Using this business model, LuLaRoe experienced exponential growth. In Washington, the LuLaRoe MLM grew from 19 Consultants in 2014, to 180 in 2015, to 2,343 in 2016, to over 3,500 Consultants in 2017. Defendant Stidham announced in February 2017, that LuLaRoe had over 70,000 Consultants nationwide and that by August 10, 2017, LuLaRoe had achieved "over $1.5 Billion in retail sales for 2017 so far this year."

4.31 As a result of LuLaRoe's business and marketing practices that encouraged inventory loading, LuLaRoe faced so much demand for inventory that it could not keep up with orders. In early 2017, the quality of LuLaRoe's merchandise declined, with Consultants receiving mis-sized merchandise or low quality merchandise, such as leggings with mismatched pant leg lengths or merchandise that quickly developed holes. Even with these production and quality problems, LuLaRoe continued to keep its minimum purchase requirements in place, and instead routinely shipped backorder slips in lieu of merchandise.

4.32 Defendants market the LuLaRoe MLM as a transformational, empowering opportunity to achieve dreams and achieve financial freedom while providing a flexible and part time alternative to traditional employment. LuLaRoe's marketing prominently features testimonials of independent, stylish, affluent women who have it all: a successful career,

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flexibility and time to spend with their children, and a harmonious marriage. LuLaRoe marketing materials claim that joining the LuLaRoe Program can "change lives", "build confidence", and offer Consultants the opportunity to "create freedom, serve others and strengthen families." In reality, LuLaRoe's pyramid scheme business model and compensation plan, and its corresponding marketing activities dictated that during any particular time, a majority of Washington Consultants lost money.

V. COUNT I: ILLEGAL PYRAMID

(ANTI-PYRAMID PROMOTIONAL SCHEME ACT, RCW 19.275)

5.1 Plaintiff re-alleges paragraphs 1.1 through 4.32, and fully incorporates them herein.

5.2 As alleged above, Defendants have established, operated, promoted, and participated in the LuLaRoe MLM, which primarily rewards participants on recruitment of new participants rather than on bona fide retail sales, thereby resulting in a substantial percentage of participants losing money. Through the establishment, promotion, operation, and participation of LuLaRoe in the State of Washington, Defendants have committed acts in furtherance of a pyramid scheme. These acts include, but are not limited to the following:

5.2.1 Establishing, promoting, and operating a plan where the opportunity to receive compensation is derived primarily from the recruitment of other Consultants;

5.2.2 Establishing and engaging in unfair business practices and deceptive marketing practices which encourage inventory loading; and

5.2.3 Failing to honor LuLaRoe's Returns on Cancellation of the Agreement for exiting consultants by miscalculating, delaying, or failing to issue refunds according to LuLaRoe's written repurchase policy.

5.3 The conduct described in paragraphs 1.1 through 4.32 constitutes unreasonable business practices in violation of RCW 19.275, and *per se* unfair and deceptive acts and practices

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in trade or commerce and unfair methods of competition in violation of RCW 19.86.020 and pursuant to RCW 19.275.040 is contrary to the public interest.

VI. COUNT II: MISLEADING INCOME CLAIMS (CONSUMER PROTECTION ACT, RCW 19.86.020)

6.1 Plaintiff re-alleges paragraphs 1.1 through 4.32, and fully incorporates them herein.

6.2 In numerous instances in connection with the advertising, marketing, promotion, offering for sale, or sale of right to participate in the LuLaRoe program, Defendants have represented, directly or indirectly, expressly or by implication, that consumers who become LuLaRoe Consultants are likely to earn substantial income.

6.3 In truth, in numerous instances in which Defendants have made representations set forth in Paragraph 6.1 of this complaint, consumers who become LuLaRoe Consultants are not likely to earn substantial income.

6.4 Therefore, Defendants' representations are false or misleading, and constitute unfair or deceptive acts or practices in trade or commerce and unfair methods of competition in violation of RCW 19.86.020, and are contrary to the public interest.

VII. COUNT III: FAILURE TO DISCLOSE MATERIAL TERMS IN VIOLATION (CONSUMER PROTECTION ACT, RCW 19.86.020)

7.1 Plaintiff re-alleges paragraphs 1.1 through 4.32, and fully incorporates them herein.

7.2 In numerous instances in connection with the advertising, marketing, promotion, offering for sale, or sale of the right to participate in the LuLaRoe program, Defendants have represented, directly or indirectly, expressly or by implication, that individuals have earned substantial income from participation in the LuLaRoe program, and that any consumer who becomes a LuLaRoe Consultant has the ability to earn substantial income.

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7.3 In numerous instances in which Defendants have made the representations set forth in Paragraph 7.1 of this Complaint, Defendants have failed to disclose, or disclose adequately, that LuLaRoe's structure ensures that most consumers who become LuLaRoe Affiliates will not earn substantial income.

7.4 This additional information is material to consumers in considering whether to participate in the LuLaRoe program.

7.5 Therefore, Defendants' practices, as described in Paragraph 7.1 of this Complaint constitute unfair or deceptive acts or practices in trade or commerce and unfair methods of competition in violation of RCW 19.86.020, and are contrary to the public interest.

VIII. COUNT IV: MEANS AND INSTRUMENTALITIES (CONSUMER PROTECTION ACT, RCW 19.86.020)

8.1 Plaintiff re-alleges paragraphs 1.1 through 4.32, and fully incorporates them herein.

8.2 By furnishing LuLaRoe Consultants with promotional materials to be used in recruiting new participants that contain false or misleading representations, Defendants have provided the means and instrumentalities for the commission of deceptive acts and practices.

8.3 Therefore, Defendants' practices as described in Paragraph 8.1 of the Complaint constitute unfair or deceptive acts or practices in trade or commerce and unfair methods of competition in violation of RCW 19.86.020, and are contrary to the public interest.

IX. PRAYER FOR RELIEF

WHEREFORE, Plaintiff, STATE OF WASHINGTON, prays that this Court grant the following relief:

9.1 That the Court adjudge and decree that Defendants have engaged in the conduct complained of herein.

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9.2 That the Court adjudge and decree that the conduct complained of in the Complaint constitutes unfair or deceptive acts or practices and unfair methods of competition in violation of the Consumer Protection Act, Chapter 19.86 RCW.

9.3 That the Court issue a permanent injunction enjoining and restraining Defendants and their representatives, successors, assigns, officers, agents, servants, employees, and all other persons acting or claiming to act for, on behalf of, or in active concert or participation with Defendants from continuing or engaging in the unlawful conduct complained of herein.

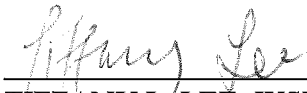
9.4 That the Court assess civil penalties, pursuant to RCW 19.86.140, of up to $2,000 per violation against Defendants for each and every violation of RCW 19.86.020 alleged herein.

9.5 That the Court make such orders pursuant to RCW 19.86.080 as it deems appropriate to provide for restitution to consumers of money or property acquired by Defendants as a result of the conduct complained of herein.

9.6 That the Court order such other relief as it may deem just and proper to fully and effectively dissipate the effects of the conduct complained of herein, or which may otherwise seem proper to the Court.

DATED this 23rd day of January, 2019.

ROBERT W. FERGUSON
Attorney General



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LuLaRoe to pay $4.75 million to resolve AG Ferguson's lawsuit over pyramid scheme

FOR IMMEDIATE RELEASE:
Feb 2 2021

$4 million going to help Washingtonians deceived by LuLaRoe

SEATTLE — Attorney General Bob Ferguson announced today that LuLaRoe will pay $4.75 million to resolve Ferguson's consumer protection lawsuit asserting that LuLaRoe, a California-based multi-level marketing business that sells leggings and other apparel to a network of independent retailers, was operating a pyramid scheme.

In January 2019, Ferguson filed a lawsuit against LuLaRoe and several of its executives, asserting that the defendants made unfair and deceptive misrepresentations regarding the profitability of being an independent retailer for LuLaRoe. For example, one LuLaRoe executive claimed that "so many of our retailers are making amazing money doing this part time" and "a huge number of people" sell $15,000 to $20,000 each month. Later in the same call, she claimed LuLaRoe has "a bunch of people" that can sell up to $150,000 per month. Instead of profiting, many of the company's independent retailers were left with debt and unsold

merchandise they could not return without taking a loss.

Are you a Washington retailer with questions about our case?
Contact LLRrestitution@atg.wa.gov.

Ferguson's lawsuit asserted that LuLaRoe violated the Washington Antipyramid Promotional Scheme Act and the Consumer Protection Act. In addition to LuLaRoe's deceptive misrepresentations regarding profitability, Ferguson's lawsuit challenged LuLaRoe's unlawful bonus structure and unfair refund policy.

The resolution, filed in King County Superior Court, prohibits LuLaRoe from operating a pyramid scheme. Additionally, LuLaRoe must be more transparent with retailers to avoid future deception. For example, LuLaRoe must publish an income disclosure statement that accurately details retailer income potential.

Ferguson will provide $4 million to Washingtonians who were deceived by LuLaRoe's business practices. The Attorney General's Office estimates that approximately 3,000 Washingtonians will receive checks. Every Washington retailer who lost money under LuLaRoe's pyramid structure will receive restitution. The remaining $750,000 will partially reimburse the Attorney General's Office for the cost of investigating the conduct and bringing the lawsuit.

"LuLaRoe tricked Washingtonians into buying into its pyramid scheme with deceptive claims and false promises," Ferguson said. "As a result, thousands lost money and two individuals made millions from their scheme. Washingtonians deserve fairness and honesty — and accountability for those who don't play by the rules."

Existing LuLaRoe retailers recruit and sponsor new independent retailers who join LuLaRoe's network to sell the company's clothing.

Since January 2014, more than 3,600 Washingtonians joined LuLaRoe's network as retailers.

LuLaRoe required new retailers to purchase an "onboarding" package costing between $500 to $5,000, depending on the amount and type of inventory included. Retailers could not choose specific sizes or prints of the inventory they bought, but rather were limited in selecting only the style of clothing to purchase, receiving a random assortment of sizes and prints.

LuLaRoe's misleading income claims

LuLaRoe made several misleading claims regarding the profitability of its business model to encourage more consumers to become retailers.

For example, LuLaRoe advertised that retailers could make "full-time income" for "part-time work." At recruitment events and calls, LuLaRoe executives made representations regarding the income or profits earned by their top retailers, implying that such income was representative. The LuLaRoe executive who claimed "a huge number of people" sell $15,000 to $20,000 each month stressed to prospective recruits that LuLaRoe "is a crazy and incredible opportunity for you."

LuLaRoe also posted annual income disclosure statements on its website that were incomplete, outdated or otherwise not representative of incomes earned by Washington retailers. These disclosure statements deceptively focused on bonus income derived from recruitment, and, consequently, they failed to disclose that many LuLaRoe retailers in fact lost money overall.

One former LuLaRoe retailer said she became a retailer after hearing founder DeAnne Brady describe how "women rescued their families during financial crisis by selling LuLaRoe." LuLaRoe, however, did not live up to those expectations, resulting in a "big loss" for her and her family. Ferguson asserted that LuLaRoe's profitability claims were unfair and deceptive, violating the Consumer Protection Act. Misleading claims about income potential is a hallmark of a pyramid scheme.

LuLaRoe's pyramid structure

LuLaRoe's structure ensured that the highest-ranking retailers would earn income by recruiting retailers in the lower categories. This allowed two LuLaRoe retailers — who each had hundreds of recruits in their "downlines" — to make more than $5 million in profit collectively between 2016 and 2019, while at the same time, more than a third of retailers reported losses. At a LuLaRoe event in late 2017, one of those top retailers acknowledged, "I got overpaid while people on my team were failing."

Direct-selling businesses sometimes provide incentives for existing retailers to recruit additional retailers. When the company offers retailers the right or opportunity to earn compensation primarily derived from recruitment, rather than retail sales to consumers, the company is a pyramid scheme under the Washington Antipyramid Promotional Scheme Act. In 2006, the Legislature enacted the anti-pyramid scheme law, which was sponsored by Sen. Karen Keiser, D-Des Moines.

Pyramid schemes often charge new participants steep startup costs. They also often require minimum purchases on a regular basis in order to earn rewards. LuLaRoe's bonus structure incentivized retailers to recruit more retailers and encouraged the new recruits to purchase inventory, rather than sell clothing to consumers for personal use. The company also pressured retailers to "buy more, sell more," convincing many retailers that the key to profitability was to put all of their revenue toward purchasing more inventory.

In a LuLaRoe webinar, a LuLaRoe executive explained that a 2017 change in policy came about because of LuLaRoe's "need to get away from being a pyramid scheme." Even after these changes, the lawsuit alleged LuLaRoe continued to offer the opportunity to earn rewards based primarily on recruitment and to encourage and incentivize recruitment over retail sales.

LuLaRoe's unfair refund policy

LuLaRoe's repurchase policy allowed retailers who wished to stop selling its merchandise to receive a 90 percent refund for certain unsold inventory purchased within the last year. Despite LuLaRoe's claims, many retailers did not receive the promised 90 percent, and some received no refund at all. The process was so complex, and the refund amounts were so arbitrary and unpredictable, that retailers began referring to refund calculations as "LuLaMath." Many retailers who returned items waited for months before receiving their refunds.

In a declaration supporting Ferguson's case, one former LuLaRoe independent retailer said, "LuLaRoe did not handle my cancellation of business in a reasonable time. They did not indicate that they would process a refund in five months. Nor did my sponsor advise me that LuLaRoe might short me a couple of hundred dollars and not explain why." Ultimately, she "had to take money out of savings accounts to pay off the credit card used for LuLaRoe purchases to avoid more interest."

Another consultant was told that thousands of dollars-worth of her inventory was ineligible for a refund because she had swapped her merchandise with another consultant through a feature LuLaRoe made available on its app.

Resolution details

Under the terms of the resolution, LuLaRoe must pay $4.75 million to the Attorney General's Office. Ferguson will use $4 million of this payment to provide restitution to LuLaRoe retailers from Washington.

Ferguson is providing financial payments to LuLaRoe retailers who lost money, or who may have quit their job or sacrificed opportunities as a result of LuLaRoe's deception, but who failed to make a "full-time" income as LuLaRoe promised. The Attorney General's Office estimates that approximately 3,000 Washingtonians will receive checks. Every Washington retailer who lost money under LuLaRoe's pyramid structure will receive restitution.

In addition to paying $4.75 million, LuLaRoe is required to:

- Publish an income disclosure statement that accurately details retailer income potential
- Calculate bonuses based on retail sales, not on the amount of merchandise purchased by independent retailers

- Conduct random and targeted audits to determine whether sales are to genuine consumers, rather than an effort to manipulate the compensation system
- Allow new retailers to return all inventory for a full refund, including shipping costs, within 45 days of becoming a new retailer
- Return inventory not eligible for a refund to the retailer
- Prohibit certain types of deductions from refund requests
- Warn retailers when the inventory they are purchasing is seasonal or otherwise does not qualify for return and refund

Assistant Attorneys General Joe Kanada, Breena Roos, Kate Barach and Ben Brysacz handled the case for Washington.

LuLaRoe retailers with questions about the restitution can contact the office at llrrestitution@atg.wa.gov.

The Attorney General's Office Consumer Protection Division enforces the Consumer Protection Act and other statutes to help keep the Washington marketplace free of unfair and deceptive practices. The division investigates and files legal actions to stop unfair and deceptive practices, recovers refunds for consumers, seeks penalties and recovers costs and fees to ensure that wrongdoers pay for their actions.

Consumers may report any unfair or deceptive business practices to the Consumer Protection Division by filing a complaint at https://www.atg.wa.gov/file-complaint.

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The Office of the Attorney General is the chief legal office for the state of Washington with attorneys and staff in 27 divisions across the state providing legal services to roughly 200 state agencies, boards and commissions. Visit www.atg.wa.gov to learn more.

Questions about restitution for retailers? Send an email to: llrrestitution@atg.wa.gov

Media Contact:

Brionna Aho, Communications Director, (360) 753-2727; Brionna.aho@atg.wa.gov

General contacts: Click here