

Note

American Dream: Social Pressures and Lackluster Regulation Allow Multi-Level Marketing Companies to Function as De Facto Pyramid Schemes

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The entrepreneurial spirit goes to the heart of the American Dream. Pull yourself up by the bootstraps. Put your nose to the grindstone. If you could just be given the tools to get started, you, too, can make something of yourself with hard work and perseverance. This mindset drives millions of people each year to participate in Multi-Level Marketing companies (MLMs), which are advertised as an opportunity to start your own business, sell products, and work on your own schedule. MLMs are also designed to reward sellers each time they successfully encourage another person to join, so much so that the reward for recruitment nearly always becomes more lucrative than selling the product. This business structure not only leads many participants to turn little, if any, profit, but also encourages manipulative and

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aggressive recruitment tactics to be used in order to bring in new recruits and earn a bonus.

If it was enough to point out that the statistical probability of financial success in an MLM was small, or that many of its defining characteristics reflect those of illegal pyramid schemes, participation in these companies may not be so high. However, MLMs simultaneously provide and rely on participants' personal communities in order to maintain the number of people involved. This reliance on community weaves the personal and professional together in such a way that makes it even more difficult to leave the company. These behavioral considerations—combined with case law that has produced broad standards and enforcement mechanisms that are difficult to successfully utilize—have created a predatory industry that is rarely held accountable.

This Note argues that the distinction between legal MLMs and illegal pyramid schemes is so ill-defined that illegal and deceptive practices dominate the MLM industry. The use of traditional consumer protection laws and private litigation requires intensive fact discovery and litigation costs that are often prohibitive to pursuit of a claim. This Note concludes that, in order to successfully protect participants and consumers, two solutions should be pursued. The first is a federal statute providing a nuanced definition of an illegal pyramid scheme that can be utilized by public and private legal entities. The second is a change to the Business Opportunity Rule—enforced by the Federal Trade Commission—that would include MLMs and require them to disclose potential earnings to new participants before they join.

INTRODUCTION

A charismatic entrepreneur steps onto the scene: they promise that what they are selling will be game-changing. It is more than just a product or investment—it is a vehicle to greater things and a community that shares your values. Behind the scenes, it turns out that the promises of the entrepreneur were false—but it’s complicated. That entrepreneur only wanted desperately to succeed, and it turns out they have redeeming qualities that are hard to ignore. This is the plot of *The Music Man*,¹ a classic 1957 musical whose main character is, at his core, a con man. But this plot also maps well to the stories of Elizabeth Holmes² and Billy McFarland,³ two entrepreneurs whose “fake

1. See, e.g., Gillian Russo, *Everything You Need to Know About ‘The Music Man’ Starring Hugh Jackman on Broadway*, N.Y. THEATRE GUIDE (Jan. 10, 2023), <https://www.newyorktheatreguide.com/theatre-news/news/everything-you-need-to-know-about-the-music-man-starring-hugh-jackman-on-broadway> [<https://perma.cc/ZQ2B-L5PN>]. Professor Harold Hill, the show’s main character, sells band uniforms and equipment to small midwestern towns and claims to be able to train the students in music. *Id.* This is his big scam. Once the uniforms and equipment are purchased, he moves on to the next town and starts the scam from the beginning. *Id.*

2. See Erin Griffith, *Elizabeth Holmes Is Sentenced to More Than 11 Years for Fraud*, N.Y. TIMES (Nov. 18, 2022), <https://www.nytimes.com/2022/11/18/technology/elizabeth-holmes-sentence-theranos.html> [<https://perma.cc/V4WB-6KDH>] (detailing the sentence given to the founder of Theranos, a “failed blood-testing start-up” for which Holmes was able to raise \$945 million in funding). Holmes is not unique in her tactics of using “exaggeration and hype” to foster funding, but is one of few to be charged with fraud. *Id.*; see also Tim Draper, Opinion, *Why Venture Capitalist Believes Elizabeth Holmes Should Be Freed*, MERCURY NEWS (Mar. 10, 2023), <https://www.mercurynews.com/2023/03/10/opinion-why-holmes-should-be-released-on-bond-pending-her-appeal> [<https://perma.cc/6SJY-CP7Y>] (“Entrepreneurs, by their nature, are projecting a future that they want to accomplish . . . The best entrepreneurs have a reality distortion field because they often believe that they have accomplished what they have set out to accomplish because they have done so in their minds.”).

3. McFarland planned a large music festival (“Fyre Festival”) in 2017, which was portrayed to be a large scale, luxury event. See Delia Cai, *Billy McFarland Is Sorry—Really. He’s Also Got a New Pitch for You*, VANITY FAIR (Dec. 21, 2022), <https://www.vanityfair.com/style/2022/12/billy-mcfarland-is-sorry-really> [<https://perma.cc/8TYZ-RY3Q>]. In reality, the event was a complete flop, and many of the promised luxuries were never brought to life. *Id.* (“[A]ttendees [] flew to the Bahamian island of Great Exuma in April 2017 only to find a pile of FEMA tents and wet mattresses in place of the luxe, Coachella-y getaway that had been promised.”).

it till you make it”⁴ tactics led to their fall from grace. This plot also applies to many participants in the direct selling industry,⁵ which has a long history in the United States. Avon Cosmetics, for example, was founded in 1886.⁶ The company sells makeup, skin care, perfume, and other beauty products,⁷ and is one of the oldest direct selling companies in the United States.⁸ Avon offers its representatives not just the opportunity to sell their products, but has built out digital tools to help their representatives successfully sell online,⁹ and offers benefits to representatives like access to health insurance and professional development courses.¹⁰ New representatives can sign up under a team member who has invited them, but they can also sign up on their

4. See Helaine Olen, Opinion, *This All-but-Forgotten Con Man Sold America on ‘Fake It Till You Make It,’* WASH. POST (Feb. 27, 2023), <https://www.washingtonpost.com/opinions/2023/02/27/fake-it-phrase-american-con-man> [<https://perma.cc/P2RS-SWHM>] (exploring the “dark side” of the phrase and the role it plays in multi-level marketing companies).

5. The “direct selling industry” refers to the collection of companies that facilitate the sale of products directly to a consumer through a salesperson rather than in a retail environment. See, e.g., *What Is Direct Selling?*, AMWAY, <https://www.amwayglobal.com/answers/what-is-direct-selling> [<https://perma.cc/MC3J-G38J>] (“Direct selling, also known as person-to-person retail, is a business model where people sell products directly to other people.”); see also Robert A. Peterson & Thomas R. Wotruba, *What Is Direct Selling? — Definition, Perspectives, and Research Agenda*, 16 J. PERS. SELLING & SALES MGMT. 1, 2 (1996) (defining direct sales as “face-to-face selling away from a fixed retail location”).

6. *Our Story*, AVON, <https://www.avonworldwide.com/about-us/our-story> [<https://perma.cc/G3JG-MAY8>].

7. See *id.*

8. See Kevin Kruse, *Avon Leader Shares 3 Things You Need For Success In Direct Sales*, FORBES, <https://www.forbes.com/sites/kevinkruse/2017/12/05/avon-leader-shares-3-things-you-need-for-success-in-direct-sales> [<https://perma.cc/5T3U-75CN>] (identifying Avon as one of the “oldest and largest [direct selling] companies”); *Direct Selling Timeline*, DIRECT SELLING J., <https://www.dsa.org/direct-selling-journal/direct-selling-timeline> [<https://perma.cc/748U-XA8D>] (displaying the founding of the California Perfume Company—Avon’s original business name—as one of the first events on the “direct selling timeline”).

9. See *Frequently Asked Questions*, AVON, <https://www.avon.com/becomearep#faqs> [<https://perma.cc/6EJC-XAA9>] (“All representatives receive FREE online support, training, social media tips . . . [and a] personalized online store [their] customers can shop from 24/7.”).

10. See *generally Experience*, AVON, <https://www.avon.com/becomearep#experience> [<https://perma.cc/ZE8F-K4T3>] (detailing the “benefits and extras” available to Avon representatives).

own.¹¹ Avon representatives are independent contractors and are responsible for conducting their business accordingly,¹² but they are also limited in how much profit they can make from the recruitment of others.¹³

Herbalife, another direct selling company, was founded in 1980 by Mark Hughes.¹⁴ The company sells health products, including “meal replacements” and “nutrition supplements,” and currently reports having more than 10,000 employees worldwide.¹⁵ They offer new distributors a “business builder pack,” which includes a product catalog, “nutrition buttons,”¹⁶ and several booklets explaining different opportunities and tools the distributor may use.¹⁷ Distributors are given access to an online

11. *Compare Frequently Asked Questions*, *supra* note 9 (“If you don’t want to sign up under someone, no worries — it’s not required. Just leave the field blank and the company may assign you to a mentor later.”), *with Start Your Business*, HERBALIFE NUTRITION, <https://www.herbalife.com/start-your-business> [<https://perma.cc/F8NY-YHKF>] (listing the only way to start as a “Herbalife Nutrition Independent Distributor” is to be connected with another distributor who will help you to set up your business).

12. *See Business Policies and Procedures for Avon Independent Sales Representatives*, AVON 3 (Mar. 15, 2022), <https://www.avon.com/magnoliaPublic/dam/jcr:62414096-42e5-48f7-9842-00d04e48824a/business-policies-and-procedures-for-avon-isr-en-v3.pdf> [<https://perma.cc/42KY-R9AY>] (defining “Avon Independent Sales Representative” as independent contractors in the first item of the policy overview).

13. *See, e.g.*, Jonathan Berr, *Why Avon Quit Direct-Sales Group*, CBS NEWS (Oct. 2, 2014), <https://www.cbsnews.com/news/whats-behind-avons-surprising-decision-to-quit-trade-group> [<https://perma.cc/5KPK-58GF>] (“Avon only allows representatives to profit from the sales of ‘three generations’ of their organization, meaning people who are recruited by the independent businessperson.”).

14. *Frequently Asked Questions: Company Facts*, HERBALIFE NUTRITION, <https://iamherbalifenutrition.com/company-facts> [<https://perma.cc/H6ND-A7FC>].

15. *See About Us*, HERBALIFE NUTRITION, <https://www.herbalife.com/about-us> [<https://perma.cc/WMG4-XT5Q>] (showing where distributors operate globally).

16. “Nutrition buttons” are wearable buttons featuring slogans such as: “Be healthier and happier, ask me how” or “Lose weight now, ask me how.” Chris Morris, *The Power of a Button: A Simple Tool to Starting a Conversation*, HERBALIFE NUTRITION, <https://iamherbalifenutrition.com/quality/button-conversation-starter> [<https://perma.cc/KM7G-X3P6>]. Herbalife promotes these as a tool for distributors to break the ice with potential customers, and likely new distributors. *Id.*

17. *See Start Your Business*, *supra* note 11 (appearing in “Your Business Builder Pack” section).

community that contains education and training tools,¹⁸ and have the option to have their own website to sell products online.¹⁹ In order to sign up, a new distributor must connect with a current distributor.²⁰

Both Avon and Herbalife offer products that a representative, or distributor, buys at a discount for the “opportunity” to resell it to consumers at full retail price.²¹ Both companies offer tools meant to bolster their representatives’ businesses, and both establish clearly within their websites that they have low start-up costs and easy refund policies.²² But only one of these companies—Herbalife—has been prosecuted by the Federal Trade Commission (FTC) for misleading distributors with deceptive claims about their business opportunity.²³ A court never found Herbalife to be an outright pyramid scheme, because Herbalife agreed to settle the case for \$200 million.²⁴

Approximately 6.8 million people participated in the direct sales industry in 2019.²⁵ Of them, fewer than one percent made

18. *Id.* (showing access to business tools under FAQ number four, “support”).

19. *Id.* (“With GoHerbalife, you can have your own website without the hassle and cost of creating your own.”).

20. *See id.* (detailing the only path to becoming a distributor for Herbalife).

21. *Compare Key Information About Being an Herbalife Nutrition Independent Distributor*, HERBALIFE NUTRITION (Sept. 8, 2023), https://assets.herbalifenutrition.com/content/dam/regional/nam/en_us/consumable_content/marketing_materials/guides/2020/10-Oct/Statement_of_Average_Gross_Compensation_USEN.pdf/_jcr_content/renditions/original [<https://perma.cc/L2WD-WLWY>] (showing the difference between distributor price and suggested retail price of Herbalife products to be \$12.52), *with Frequently Asked Questions*, *supra* note 9 (showing the initial discount for Avon distributors on products is twenty-five percent, and their commissions are based on the difference between the discounted amount they pay and the full price the customer pays).

22. *See Get Paid to Shop and Share Beauty!*, AVON, <https://www.avon.com/becomearep#earning> [<https://perma.cc/DBA9-KDG7>] (“Join for \$0 (free!) or with one of our other sign-up options.”); *Start Your Business*, *supra* note 11 (“There are no minimum purchases required or requirements to purchase any sales or business tools to start up . . .”).

23. *See Jen Wiczner, Herbalife Paid a \$200 Million Fine. Then the FTC Screwed It Up*, FORTUNE (Feb. 2, 2017), <https://fortune.com/2017/02/02/herbalife-lawsuit-ftc-settlement-payout> [<https://perma.cc/RB6Q-Q9Q6>].

24. *Id.*

25. *Direct Selling in the United States: 2019 Industry Overview*, DIRECT SELLING ASS’N (2020), https://www.dsa.org/docs/default-source/research/growth-outlook/2019-research-overview-fact-sheet-final.pdf?sfvrsn=3bfedda5_2%27 [<https://perma.cc/HEW3-XGM4>].

a profit.²⁶ Multi-level marketing (MLM) dominates the industry and has remained popular in United States for decades despite the consistent evidence that few participants will find financial success.²⁷ It is difficult to contemplate how an industry with these kinds of statistics remains popular, unless you consider what exactly it is the companies are selling. Not only do these companies offer a marketable product, but they also peddle something that goes to the core of the capitalistic spirit: the ability to run your own business, earn an independent income, and do it all while joining an empowered community of like-minded people.²⁸ At the same time, the MLM industry has not been seriously regulated by the government, voluntary measures, or even private legal action since the 1970s, leaving the industry free to develop within the wide gray area²⁹ between legitimate companies and illegal pyramid schemes.³⁰

This Note argues that the law allows the MLM industry to flourish as de facto pyramid schemes that financially injure participants. MLMs take little—if any—responsibility for the actions of distributors who may end up using deceitful tactics in order to meet the perceived expectations of their colleagues, the company, and ultimately themselves. Part I explores the origins of the MLM industry and what legal decisions have impacted its trajectory. Part II focuses on the mechanisms currently in place to combat potentially deceitful behavior from participants in the direct sales industry in both the sales tactics and the recruitment methods. Part III takes a deeper look at the behaviors of MLM participants and considers how that may factor into the

26. Mary V. Wrenn & William Waller, *Boss Babes and Predatory Optimism: Neoliberalism, Multi-Level Marketing Schemes, and Gender*, 55 J. ECON. ISSUES 423, 425–26 (2021).

27. *See id.*

28. *Id.* at 423 (discussing the opportunity offered by multi-level marketing schemes that emphasizes “optimism, meritocracy, and work ethic”).

29. Business Opportunity Rule, 73 Fed. Reg. 16110 (Mar. 26, 2008) (to be codified at 16 C.F.R. pt. 437) (requiring business opportunity sellers to provide prospective purchasers with specific information that is material to the consumer’s decision as to whether to purchase a business opportunity to help them identify fraudulent offerings). During the note and comment process for the FTC Business Opportunity Rule, the MLM and direct selling industry exerted influence over the shape of the rule, and ultimately were successful in keeping MLMs from falling within the regulation. *Id.* at 16119. This has kept MLMs within the legal gray area that suits them best.

30. *Id.*

continued success of the industry despite numerous examples of fraud. Finally, Part IV explores new paths forward for regulation and legal action that focus on defining a clearer line between legal and illegal business practices, and curbing the deceit at a business level in an effort to more effectively protect those at the bottom of the pyramid.

I. THE DIRECT SALES INDUSTRY: FROM DOOR-TO-DOOR TO DIRECT MESSAGES

In the United States, there is a retail industry known broadly as direct sales.³¹ Direct sales companies have existed in the United States since the early twentieth century,³² and were traditionally a face-to-face or “door-to-door” retail experience.³³ Direct sales prior to World War II were largely male-dominated and involved traveling door-to-door with products to sell.³⁴ Although MLM companies (sometimes called network sales companies) now make up a majority of the direct sales industry,³⁵ they did not always play such a prevalent role. Multi-level marketing companies became popular in the 1960s,³⁶ coinciding with the increase of women entering the workforce and new sales approaches being introduced that invited others to the seller’s home, rather than the seller traveling to the customer.³⁷

An MLM company is a company that offers two “business opportunities”: one is to make direct sales to consumers as a

31. *Direct Selling Business Model*, DIRECT SELLING ASS’N, <https://www.dsa.org/about/direct-selling> [<https://perma.cc/Z6NK-PE3L>].

32. William W. Keep & Peter J. Vander Nat, *Multilevel Marketing and Pyramid Schemes in the United States: An Historical Analysis*, 6 J. HIST. RSCH. MKTG. 189, 189 (2014).

33. *Id.*

34. *Id.* Salesmen carried products ranging from Bibles to household cleaning supplies. *The Business of Direct Selling*, PBS, <https://www.pbs.org/wgbh/americanexperience/features/tupperware-direct> [<https://perma.cc/R6LY-VLVM>]. The latter turned out to be particularly appealing to the target customer: stay-at-home mothers. *Id.*

35. Keep & Vander Nat, *supra* note 32, at 194 (pointing out that, by 1997, MLMs accounted for over 72% of direct selling sales in the United States).

36. Vincent G. Ella, Comment, *Multi-Level or Pyramid Sales Systems: Fraud or Free Enterprise*, 18 S.D. L. REV. 358, 358 (1973).

37. Keep & Vander Nat, *supra* note 32, at 192.

distributor³⁸ for the MLM; the other is to build a “downline” of other distributors.³⁹ A distributor’s downline consists of each person they recruit directly, as well as anyone recruited by those direct recruits, and so on down the line.⁴⁰ As the “upline” to a recruit, participants often receive commission on the downline’s purchase and sales of product.⁴¹ This type of recruitment structure naturally leads to a pyramid shape,⁴² with exponentially more people joining as new recruits attempt to build their downline.⁴³ Letting this structure grow unchecked leads to an inevitable shortage of recruits to build on, and “[a]s recruitment begins to falter and many at the bottom drop out, the scheme engages in more recruitment in an effort to replace the

38. For the sake of clarity, this Note uses the term “distributor” in reference to anyone who signs up to sell products for a multi-level marketing company. Different companies will use different terms—representative, independent seller, etc.—to describe this position, but they are all similar in what the job entails. Distributors at most MLMs are considered independent contractors, meaning that there is no employer-employee relationship between distributors and the parent company. *See e.g., Policies and Procedures*, RODAN + FIELDS 3 (July 1, 2023), <https://www.rodanandfields.com/en-us/assets/us/policies-procedures.pdf> [<https://perma.cc/B23S-E739>] (“Consultants are self-employed, non-exclusive independent contractors who are authorized by Rodan + Fields to market and sell the R+F Products and sponsor Consultants . . .”).

39. Keep & Vander Nat, *supra* note 32, at 192–93 (“The MLM ‘business opportunity’ ties together different themes of entrepreneurship: 1) selling products to non-distributors, 2) selling products to other distributors, and 3) earning company compensation based on personal purchases and the purchases of a distributor’s downline.”).

40. *See, e.g.,* Rachelle L. Pavelko & Cory Barker, *It Really Works! Qualitative Content Analysis of Multilevel Marketing Organizations’ Online Promotional Messaging and Recruitment Strategies*, 45 WOMEN’S STUD. COMM’N 399, 400 (2022) (describing the encouragement of “original recruiter[s]” or “uplines” to develop a downline in order to benefit from the sales performance of new members).

41. *See id.* at 401 (noting that the “aggressive” recruiting and “hazily defined” compensation of MLMs make it difficult to distinguish them from pyramid schemes).

42. *See Multi-Level Marketing or Illegal Pyramid Scheme?*, MICH. DEPT OF ATT’Y GEN., <https://www.michigan.gov/ag/consumer-protection/consumer-alerts/consumer-alerts/invest/mlm-illegal-pyramid-scheme> [<https://perma.cc/5KWJ-UB56>] (displaying a table that visually maps the exponential growth of pyramid sales recruitment).

43. *See* Donald Daniels, *Toward a Uniform Approach to Multilevel Distributorships*, 8 U. MICH. J.L. REFORM 546, 549 n.16 (1975) (explaining that because of natural market saturation, “by the time the thirteenth level of the pyramid has been reached, the number of distributors will exceed the population of the United States”).

dropouts—a churning of the base.”⁴⁴ In addition to the untenable nature of the business structure, studies have consistently shown that at least ninety percent of participants in an MLM either make no profits or take a loss.⁴⁵ Many MLM participants are enticed by the opportunity to generate a livable income, but most often only those who join early are able to recover their initial financial investment.⁴⁶

In order to understand the legal framework for MLMs and the direct selling industry, it is necessary to look back at critical stages of industry development. Section A of this Part first explores the standards created in two major cases regarding the direct sales industry. Then, it looks at how those standards have been nuanced in subsequent years. Finally, Section B demonstrates the ways broad legal standards impact outcomes for parties who suffer financial injury after participating in a legally formed MLM.

A. BUDDING SKEPTICISM OF MLM LEGITIMACY LED TO INDUSTRY-DEFINING CASES

The growing prevalence of MLMs in the 1970s led the FTC to begin heavily investigating their legitimacy.⁴⁷ There was concern that many MLMs, which were legal forms of direct selling businesses, were actually illegal pyramid schemes: businesses whose compensation structure is based predominantly on the commission a participant receives for recruiting new participants, not the sale of a product.⁴⁸ A pyramid scheme is an illegal

44. Keep & Vander Nat, *supra* note 32, at 199.

45. See Heidi Liu, *The Behavioral Economics of Multilevel Marketing*, 14 HASTINGS BUS. L.J. 109, 112 (2018) (finding participation led to a net loss for 94% of consultants in one company); Wrenn & Waller, *supra* note 26 (noting that 99.6% of MLM participants lose money).

46. NAT'L CONSUMER L. CTR., UNFAIR AND DECEPTIVE ACTS AND PRACTICES, ch. 9.6.4 (10th ed. 2021) [hereinafter NCLC TREATISE UDAP].

47. See Theresa Josephine Kelley, Note, *Girl-Bossing Too Close to the FTC Regulations: How MLMs Avoid FTC Enforcement Actions and the Need for More Stringent Regulation*, 51 HOFSTRA L. REV. 311, 324 (2022) (observing that the growth in MLM popularity coincided with the launch of FTC investigations and enforcement actions).

48. See Annie Blackman, Comment, *Regulating the Reluctant: Policies That Benefit Vulnerable Participants in Multi-Level Marketing*, 25 U. PA. J.L. & SOC. CHANGE 83, 90 (2021) (explaining the distinction between an MLM and an illegal pyramid scheme); Keep & Vander Nat, *supra* note 32, at 193 (exploring how an MLM's business and recruitment structure can become a pyramid scheme).

business model under federal regulations⁴⁹ and most state laws.⁵⁰ The outcomes of two cases from the 1970s have defined the trajectory of the MLM industry over the last forty years.⁵¹

The first case still relied on today is *Koscot Interplanetary, Inc.*,⁵² an administrative proceeding in which the FTC alleged that the cosmetics company violated Section 5 of the Federal Trade Commission Act (FTC Act).⁵³ The company required distributors to continually recruit new distributors in order to earn income.⁵⁴ The court found that Koscot's program constituted an unfair and deceptive business model,⁵⁵ and in doing so defined two key characteristics of unlawful pyramid schemes that are still used today.⁵⁶ The first characteristic is "the right to sell a

49. The FTC is authorized to pursue cases against MLMs through its authority to prevent unfair or deceptive business practices. *See* 15 U.S.C. § 45(a)(2) ("[The FTC] is hereby empowered and directed to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce."); *see also* Press Release, Fed. Trade Comm'n, FTC Acts to Shut Down 'Success by Health' Instant Coffee Pyramid Scheme (Jan. 16, 2020), <https://www.ftc.gov/news-events/news/press-releases/2020/01/ftc-acts-shut-down-success-health-instant-coffee-pyramid-scheme> [<https://perma.cc/B3PS-7KNA>] (filing against Success by Health under Section 5(a) of the FTC Act for operating as a pyramid scheme).

50. *See, e.g.*, IDAHO ADMIN. CODE r. 04.02.01.190 (2023) ("It is an unfair and deceptive act or practice for a seller to promote, offer, advertise, or grant participation in a pyramid or chain distribution scheme."); WASH. REV. CODE § 19.275.030(1) (2023) ("No person may establish, promote, operate, or participate in any pyramid scheme.").

51. *See, e.g.*, Peter Vander Nat, *The Enduring Primacy of Retail Sales in an MLM Context*, TRUTH ADVERT. (Oct. 23, 2015), <https://truthinadvertising.org/blog/the-enduring-primacy-of-retail-sales-in-an-mlm-context> [<https://perma.cc/HF5Y-MFPA>] (arguing that the current legal issues within the MLM industry can be traced back to seminal decisions made by the FTC in the 1970s).

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

53. Section 5 of the FTC Act authorizes the FTC to prevent "persons, partnerships, or corporations" from using unfair or deceptive acts or practices "in or affecting commerce." 15 U.S.C. § 45(a)(2). It also directs the FTC to prevent the use of unfair methods of competition, *id.*, but this is not necessarily at issue with unlawful pyramid schemes.

54. *Koscot*, 86 F.T.C. at 1112 (discussing that Koscot's program "contemplates an endless recruiting of participants . . . to achieve the represented earnings").

55. *Id.* at 1157.

56. Corey Matthews, Note, *Using a Hybrid Securities Test to Tackle the Problem of Pyramid Fraud*, 88 FORDHAM L. REV. 2045, 2061–62.

product”⁵⁷ in exchange for payment to the company, and the second is “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.”⁵⁸ In other words, a pyramid scheme is defined in *Koscot* as a business opportunity that a participant pays to gain access to, and through which the salesperson may receive rewards for recruiting other new sales participants but not necessarily for the sale of products.⁵⁹

The judge in *Koscot* called these types of companies “entrepreneurial chains” rather than pyramid schemes but discussed that the right to sell a product in this type of scheme is “likely to prove worthless for many participants.”⁶⁰ It is the presence of the second defining characteristic *in combination* with the first that is important in application, because if substantial rewards are offered for recruitment of new distributors, retail sales will be overshadowed by recruitment bonuses and eventually will result in an “insupportably large” number of distributors brought in who cannot make sufficient retail sales.⁶¹ The characteristics of a pyramid scheme laid out in *Koscot* remain critical to the legal analysis of a company’s business practices, but the opportunity to receive rewards for the recruitment of new participants is not the only consideration.⁶²

Amway Corp., which was decided four years after *Koscot* in 1979,⁶³ is the second case, and remains one of the most important cases regarding the legitimacy of MLMs today.⁶⁴ It was the first

57. *Koscot*, 86 F.T.C. at 1180.

58. *Id.*

59. *Id.*

60. *Id.* at 1180–81.

61. *Id.* at 1181.

62. See Matthews, *supra* note 56, at 2061–62 (summarizing the importance of the *Koscot* decision, as well as subsequent FTC actions).

63. *Amway Corp., Inc.*, 93 F.T.C. 618 (1979).

64. See Matthews, *supra* note 56, at 2062 (summarizing the legal precedent established by *Amway* and used by MLMs to limit FTC liability); *Is Amway a Pyramid Scheme?*, AMWAY, <https://www.amwayglobal.com/answers/is-amway-a-pyramid-scheme> [<https://perma.cc/XW54-FLWS>] (recognizing a case Amway was party to in 1979 as a worldwide influence on how regulation of the direct selling industry has developed); see also Jeff Babener, *The Landmark Amway Case*, MLM LEGAL (2017), <https://www.mlmllegal.com/landmark.html> [<https://perma.cc/Q6L5-AU2K>] (discussing the influence that Amway’s legal victory in 1979 had on the development of other multilevel marketing companies); Jessica

time a court distinguished an illegal pyramid scheme from a legal MLM.⁶⁵ The case brought against Amway—a direct sales company founded in 1959 that offers a huge variety of products⁶⁶—claimed that the business was a pyramid scheme, and the FTC presented extensive evidence to show the allegedly deceptive business practices.⁶⁷ The court in *Amway* found the company to be a legitimate business based on three main criteria:

First, Amway had a policy of buying back goods of distributors leaving the program. Second, Amway required that distributors make sales to at least ten unique customers each month. And third, distributors were required to sell 70 percent of the product they purchased each month to customers outside the Amway program.⁶⁸

These three criteria have become known as the “*Amway Safeguards*”⁶⁹ and have become a legal defense for MLMs to show their sufficiency in protecting consumers.⁷⁰ Most MLMs structure their businesses in such a way that they fall within these guidelines to avoid potential liability for operating under a deceptive business model or as a pyramid scheme.⁷¹ Both *Koscot* and *Amway* were critical in creating an initial delineation

Kay Burch, “Soap and Hope”: Direct Sales and the Culture of Work and Capitalism in Postwar America 16 (Aug. 2015) (Ph.D. dissertation, Vanderbilt University) (identifying Amway as one of the earliest and most successful multilevel organizations and noting that they had “powerful influence on the rest of the direct sales industry”).

65. Leonie Schiffauer, *Let’s Get Rich: Multilevel Marketing and the Moral Economy in Siberia*, 38 CRITIQUE ANTHROPOLOGY 285, 288 (2018) (“This court case was of particular importance because for the first time a court distinguished an illegal pyramid scheme from a legal MLM scheme. Not only did the judge’s decision allow Amway to continue its business, but it also helped to legitimize the MLM model.”).

66. See *Our History*, AMWAY, https://www.amway.com/en_US/about-amway/history [<https://perma.cc/8C4G-VP5D>] (summarizing Amway’s origins and subsequent business developments). The products currently offered by Amway range from water filter systems, to energy drinks, to CBD-infused facial oils. *Shop*, AMWAY, https://www.amway.com/en_US/Shop/c/1?q=&text=&pageType=CATEGORY&clearAll=true# [<https://perma.cc/QY39-3A7R>].

67. *Amway*, 93 F.T.C. at 630–31 (describing the thoroughness of both the FTC’s complaint and discovery).

68. Matthews, *supra* note 56, at 2062 (footnotes omitted).

69. Blackman, *supra* note 48, at 91 n.44.

70. See Matthews, *supra* note 56, at 2062 (“Legitimate MLM companies have generally been able to limit much of their potential FTC liability by incorporating Amway’s policies into their business models.”).

71. *Id.*

between illegal pyramid schemes and legal MLMs.⁷² *Koscot* is relied on for the definition of what constitutes an illegal pyramid scheme,⁷³ while *Amway* created the criteria needed to prove a company is a legal MLM.⁷⁴

B. GIVING NUANCE TO WHAT CONSTITUTES AN ILLEGAL SCHEME: WHO IS A “CONSUMER” AND WHAT IS A “PRODUCT”

Nearly twenty years after the *Amway* and *Koscot* decisions, *Webster v. Omnitrition International* added more specificity to the two-pronged *Koscot* standard, further clarifying what constitutes an illegal pyramid scheme.⁷⁵ Omnitrition was a seller of health supplements, vitamins, and skin care products.⁷⁶ The court found that “[o]n its face” the Omnitrition program appeared to be a pyramid scheme.⁷⁷ The company defended its legitimacy by showing the *Amway* safeguards it had in place to avoid a pyramid scheme label.⁷⁸ The company established policies similar to those upheld as legitimate in *Amway*,⁷⁹ but the court did not find that to be enough to disprove the company of being a pyramid scheme in practice.⁸⁰ There must be evidence that not only are there policies in place similar to the *Amway* safeguards, but also that those policies are actually enforced.⁸¹ The key—if a company incentivizes recruitment over retail sales—is “to tie recruitment bonuses to actual retail sales in some way.”⁸² *Omnitrition* is an example of the court upholding

72. *Id.* at 2061.

73. *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180 (1975).

74. *Amway Corp., Inc.*, 93 F.T.C. 618, 700 (1979).

75. *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 782 (9th Cir. 1996) (finding that despite validity at the distributor level, Omnitrition’s overall business structure had the “recruitment focus” characteristic of an illegal pyramid scheme).

76. *Id.* at 780.

77. *Id.* at 782.

78. *Id.* at 782–83.

79. *Id.* at 783.

80. *Id.* (“Where . . . a distribution program appears to meet the *Koscot* definition of a pyramid scheme, there must be evidence that the program’s safeguards are enforced . . .”).

81. *Id.*

82. *Id.*

and applying the standards of *Koscot* and *Amway*, as courts continue to do today.⁸³

An even more recent example of a court upholding the *Amway* and *Koscot* standards is *FTC v. BurnLounge, Inc.*⁸⁴ The MLM business in this case revolved around selling music, merchandise, and other packages in return for “BurnRewards.”⁸⁵ The company also offered “Concentric Retail Bonuses” to their distributors for the sales made by their “downline recruits.”⁸⁶ When assessing BurnLounge, the court yet again applied the two-prong approach established in *Koscot* and nuanced in *Omnitrition*.⁸⁷ Within the second prong—which looks at whether participants paid money in return for the right to receive rewards for recruitment—the court added two additional nuances.⁸⁸ The first nuance is that the rewards do not have to be entirely unrelated to the sale of products.⁸⁹ If a *majority* of the rewards come from recruitment rather than sales, that is enough.⁹⁰ The second nuance addresses the question of who is the “ultimate user” of BurnLounge products.⁹¹ In the *BurnLounge* case, many of the purchasers were also distributors,⁹² and the company argued that these individuals should be considered legitimate end consumers of the product rather than co-distributors.⁹³ The court decided that a distributor’s status as an “ultimate user” depends on whether another distributor is buying the products primarily for personal use or for sales.⁹⁴ It is not clear from *BurnLounge* how future courts should make this distinction. Both *BurnLounge* and *Omnitrition* demonstrate that, overall, courts have consistently relied upon *Amway* and *Koscot* in recent

83. See generally Vander Nat, *supra* note 51 (summarizing recent instances where courts have interpreted and expounded upon the frameworks of *Koscot* and *Amway*).

84. *FTC v. BurnLounge, Inc.*, 753 F.3d 878 (9th Cir. 2014).

85. *Id.* at 881–82. BurnRewards were redeemable for music or merchandise, and if distributors paid an additional monthly fee, they could potentially redeem BurnRewards for cash. *Id.* at 881.

86. *Id.* at 882.

87. *Id.* at 883–85.

88. *Id.* at 885–88.

89. *Id.* at 885–86.

90. *Id.* at 886.

91. *Id.* at 886–88.

92. *Id.* at 886–87 (discussing the issue of “internal consumption”).

93. *Id.* at 887.

94. *Id.*

litigation. This alignment likely will continue given how infrequently the FTC brings cases against MLMs.⁹⁵

C. MODERN PYRAMID SCHEMES BENEFIT FROM VAGUE LEGAL STANDARDS

As it stands today, the FTC defines an MLM as a form of direct selling.⁹⁶ An MLM must compensate its distributors based on actual sales to non-distributors, rather than either wholesale purchases or payments by distributors.⁹⁷ What is key to distinguish between an MLM and a pyramid scheme is the existence of a product for sale to non-distributors, because outside a viable product the two business structures are essentially identical.⁹⁸ At the time the MLM business model gained traction, the phrases “multi-level” and “pyramid” were used interchangeably to describe the same type of business.⁹⁹ Although the structure of an MLM is still ultimately a literal pyramid, these phrases have come to mean different things both legally¹⁰⁰ and colloquially.¹⁰¹

A pyramid scheme is an illegal business model.¹⁰² Being described as a pyramid scheme can negatively impact a business’s

95. Blackman, *supra* note 48, at 103 (explaining that the FTC has only brought twenty-nine cases against potentially illegal pyramid schemes acting as MLMs since 1997).

96. *Business Guidance Concerning Multi-Level Marketing*, FED. TRADE COMM’N (Jan. 2018), <https://www.ftc.gov/business-guidance/resources/business-guidance-concerning-multi-level-marketing> [<https://perma.cc/N4MT-7DM6>].

97. *Id.* (explaining how the FTC distinguishes between lawful and unlawful compensation structures).

98. *See id.* (“At the most basic level, the law requires that an MLM pay compensation that is based on actual sales to real customers, rather than based on mere wholesale purchases or other payments by its participants.”).

99. *See, e.g.,* Ella, *supra* note 36, *passim* (using both phrases interchangeably to describe the same types of businesses).

100. *See supra* Part I.A (summarizing how case law has developed a distinction between legal MLMs and illegal pyramid schemes).

101. *See, e.g.,* AMWAY, *supra* note 8 (alluding to public misconceptions on what constitutes a pyramid scheme and defending the legitimacy of Amway’s direct selling model).

102. *See, e.g.,* E. Napoletano & Benjamin Curry, *Understanding Pyramid Schemes*, FORBES: ADVISOR (May 10, 2023), <https://www.forbes.com/advisor/investing/pyramid-scheme> [<https://perma.cc/NA6A-QQHJ>] (describing pyramid schemes as “always illegal”).

reputation.¹⁰³ An MLM is considered a legal business model.¹⁰⁴ In fact, a majority of members of the Direct Selling Association (DSA)—a national trade association that lists “helping direct selling companies and their independent salesforce become more successful” as one of its roles¹⁰⁵—are structured as MLMs.¹⁰⁶ A legal MLM has a product or line of products that distributors are contracted to sell. An illegal pyramid scheme may (or may not) also have a product, but what often is key in distinguishing between the legal and the illegal is the percentage of profit for a distributor that comes from retail sales as opposed to discounted sale to other distributors or a bonus received for recruiting a new distributor.¹⁰⁷

The MLM industry is still incredibly strong, with approximately 6.8 million participants in 2019,¹⁰⁸ despite consistent anecdotal evidence that many distributors are unable to sell the product *or* recruit new distributors and end up losing money.¹⁰⁹ Of those 6.8 million, participants in MLM sales are overwhelmingly white women, with about twenty percent of total

103. See, e.g., Abby Vesoulis & Eliana Dockterman, *Pandemic Schemes: How Multilevel Marketing Distributors Are Using the Internet—and the Coronavirus—to Grow Their Businesses*, TIME (July 9, 2020), <https://time.com/5864712/multilevel-marketing-schemes-coronavirus> [<https://perma.cc/3WFF9-HY96>] (acknowledging that MLM companies would like to evade an official classification as pyramid schemes).

104. See Napoletano & Curry, *supra* note 102 (explaining that MLMs can function as “legitimate businesses”).

105. *Who We Are*, DIRECT SELLING ASS’N, <https://www.dsa.org/about/association> [<https://perma.cc/54AW-67XJ>].

106. *Frequently Asked Questions*, DIRECT SELLING ASS’N, <https://www.dsa.org/about/faq> [<https://perma.cc/6GYJ-7CGJ>] (“DSA estimates that the sales made by its members account for more than 80 percent of all direct sales in the United States . . .”).

107. See Matthews, *supra* note 56, at 2052–54 (summarizing how pyramid schemes often function by selling to distributors at discounted retail prices, thereby allowing those at the top of the pyramid to profit despite minimal sales to consumers).

108. Williams, *supra* note 25.

109. See, e.g., Brynne Conroy, *I Failed at Multi-Level Marketing. It Taught Me a Lot About My Priorities — and Myself*, BUS. INSIDER (Feb. 2, 2022), <https://www.businessinsider.com/i-failed-at-multi-level-marketing-arbonne-cosmetics-2022-1> [<https://perma.cc/C2DT-8GCF>] (detailing one woman’s failed attempt to improve her economic situation by joining an MLM).

participants identifying as Hispanic.¹¹⁰ Nearly half of all participants fall within the age range of thirty-five to forty-four years old.¹¹¹ MLMs have also expanded to an international market, including many European countries.¹¹² Amway, for example, has distributors internationally, including in Siberia.¹¹³ Although most participants will never see significant income from their time with an MLM,¹¹⁴ and many may actually experience financial losses,¹¹⁵ FTC regulations give legitimacy to the business opportunity an MLM creates.

Settlement is often the outcome of cases brought against MLMs, whether it is a case brought by the FTC, a state attorney general's office, or a private class action.¹¹⁶ The FTC case against Herbalife serves as an excellent case study. The FTC brought several claims against Herbalife in 2016 alleging violations of Section 5 of the FTC Act.¹¹⁷ These allegations included having "misleading income representations" and a business model that relied on recruitment rather than sales.¹¹⁸ The complaint detailed, for example, promotional videos distributed on Herbalife's websites that included "images of expensive homes, luxury

110. Ilana Greenberg, Note, *Why the Law Protects Multi-Level Marketing Companies Despite the Negative Impact on Women: Feminism, Female Disempowerment, and the FTC*, 14 WASH. U. JURIS. REV. 401, 404 (2021) (detailing the results of data collection by the Direct Selling association).

111. Williams, *supra* note 25.

112. See generally *Europe*, WORLD FED'N OF DIRECT SELLING ASS'NS, <https://wfdsa.org/europe> [<https://perma.cc/YZ7W-CF46>] (listing direct selling associations in countries throughout Europe, including Croatia, France, and Ukraine).

113. Schiffauer, *supra* note 65, at 285.

114. Camille H. Mangiaratti, Note, *Big Dreams and Pyramid Schemes: The FTC's Path to Improving Multi-Level Marketing Consumer Protection in Light of AMG Capital Management and the 2016 Herbalife Settlement*, 30 J.L. & POL'Y 228, 242 (2021) (noting that MLMs have a 99% loss rate).

115. *Id.* ("For example, the top 200 Amway distributors across Wisconsin netted on average an annual income of *negative* \$900.").

116. See Lisette Voytko, *Herbalife, Younique, LuLaRoe and Other MLMs Suddenly Under Fire*, FORBES (Nov. 7, 2019), <https://www.forbes.com/sites/lisettevoytko/2019/11/07/herbalife-younique-lularoe-and-other-mlms-suddenly-under-fire> [<https://perma.cc/VV5N-HENP>] (detailing several actions brought against MLMs that have ended in settlement).

117. Complaint para. 1, at 2, *FTC v. Herbalife Int'l of Am. Inc.*, No. 2:16-cv-05217-BRO-GJS (C.D. Cal. July 15, 2016).

118. *Id.* paras. 24–51, 81–87, at 6–17, 23–26.

automobiles, and exotic vacations”¹¹⁹ even though the overwhelming majority of distributors barely break even after purchasing products at wholesale prices.¹²⁰ A settlement agreement was filed simultaneously with the complaint in which Herbalife agreed to restructure its business and pay \$200 million in restitution to distributors.¹²¹ The settlement did not, however, find Herbalife to be a “pyramid scheme,”¹²² nor did it stop the company from continuing operations.¹²³

The settlement with Herbalife garnered media attention and plenty of speculation,¹²⁴ but in a legal sense it did very little to change the framework used to define illegal pyramid schemes and what kinds of businesses qualify as one. Not only that, but

119. *Id.* para. 25, at 6.

120. *See id.* para. 94 (alleging that the small percentage of distributors that make a living from Herbalife do so through recruitment rather than retail sales).

121. FED. TRADE COMM’N, STATEMENT OF THE FEDERAL TRADE COMMISSION: FTC V. HERBALIFE INTERNATIONAL OF AMERICA, INC. (July 15, 2016), https://www.ftc.gov/system/files/documents/public_statements/971213/160715_herbalifestatement.pdf [<https://perma.cc/5TWN-P49F>]. Although this was one of the largest settlement distributions that the FTC has ever made, in the year prior to the settlement Herbalife Nutrition reported \$4.47 billion in revenue. *See* Press Release, Fed. Trade Comm’n, FTC Sends Checks to Nearly 350,000 Victims of Herbalife’s Multi-Level Marketing Scheme (Jan. 10, 2017), <https://www.ftc.gov/news-events/news/press-releases/2017/01/ftc-sends-checks-nearly-350000-victims-herbalifes-multi-level-marketing-scheme> [<https://perma.cc/59YL-J2MX>]; *see also* Jim Puzanghera & Melody Petersen, *Herbalife Agrees to Pay \$200-Million Settlement and Change Its Business Practices*, L.A. TIMES (July 15, 2016), <https://www.latimes.com/business/la-fi-herbalife-settlement-20160715-snap-story.html> [<https://perma.cc/FXM7-FFAQ>] (reporting that the Herbalife CEO viewed the settlement as “an acknowledgement that [the] business model is sound” and expressed confidence in continuing to operate successfully).

122. Sam Thielman, *Herbalife Dodges ‘Pyramid Scheme’ Label and Agrees to Pay \$200m Fine*, GUARDIAN (July 15, 2016), <https://www.theguardian.com/business/2016/jul/15/herbalife-ftc-fine-200-million-pyramid-scheme-label> [<https://perma.cc/28RA-XPQ6>] (quoting FTC Chairwoman Edith Ramirez explaining that the FTC “focused less on the label”).

123. Herbalife maintains an active website where new visitors can sign up. HERBALIFE, <https://www.herbalife.com> [<https://perma.cc/UA28-4Y5X>].

124. *See, e.g.*, Michael Hiltzik, *FTC Moves Against Herbalife, but Leaves a Question: Why Is This Company Still Allowed in Business?*, L.A. TIMES (July 18, 2016), <https://www.latimes.com/business/hiltzik/la-fi-hiltzik-herbalife-20160718-snap-story.html> [<https://perma.cc/N6ZW-6S9Y>] (questioning why the FTC did not act more aggressively to close the metaphorical doors of Herbalife and instead allowed the company to continue operating).

the payments meant to bring some relief to injured distributors sometimes ended up in the pockets of people who essentially handed it right back to the company.¹²⁵ The settlement between Herbalife and the FTC had a significant price tag attached but did little to help provide clarity to future distributors about whether the company they are about to sign up for is fraudulent.

State attorneys general can also bring cases against companies operating in their state that violate state laws. These could potentially be a part of the state's unfair and deceptive practices laws¹²⁶ or a law aimed more specifically at pyramid schemes.¹²⁷ The state of Washington filed a case against LuLaRoe in 2019,¹²⁸ alleging violation of the state's Antipyramid Promotional Scheme Act¹²⁹ and Consumer Protection Act.¹³⁰ LuLaRoe made women's apparel and encouraged distributors to purchase large amounts of product.¹³¹ Washington alleged that the company's compensation plan—which gave bonuses to distributors for recruiting new distributors and bonuses for product purchased by those new recruits—was misleading, and ultimately was a pyramid scheme.¹³² The case was eventually settled in 2021, with LuLaRoe agreeing to pay \$4.75 million.¹³³ The company also agreed to several other measures that stipulated changes to their business operations.¹³⁴ LuLaRoe did not, however, have to admit to any of the allegations made against them,¹³⁵ nor did the court

125. *Wieczner*, *supra* note 23 (noting that some Herbalife distributors planned to use their payout to buy more Herbalife products).

126. *See, e.g.*, LA. ADMIN. CODE tit. 16, § 503(B)(1) (2023) (classifying a “chain distributor scheme” as “per se an unfair and deceptive trade practice”).

127. *See, e.g.*, VA. CODE ANN. § 18.2-239 (2023) (defining “pyramid promotional scheme” and stating that operating one is a misdemeanor).

128. Complaint, *State v. LLR, Inc.*, No. 19-2-02325-2 SEA (Wash. Super. Ct. Jan. 23, 2019), 2019 WL 325225.

129. WASH. REV. CODE § 19.275 (2023).

130. WASH. REV. CODE § 19.86 (2023).

131. Complaint, *supra* note 128, paras. 4.1, 4.3, at *3.

132. *Id.* paras. 4.2–11, 5.1–3, at *3–5, *9–10.

133. Consent Decree para. 1.3, *State v. LLR, Inc.*, No. 19-2-02325-2 SEA (Wash. Super. Ct. Feb. 1, 2021).

134. *Id.* § V.B (defining several banned business practices).

135. *Id.* para. 3.2 (“The settlement, this Consent Decree, or the fact of its entry does not constitute evidence or an admission by any party regarding the existence or non-existence of any issue, fact, or violation of any law alleged by Washington. To the contrary, [LuLaRoe has denied] and continue[s] to deny any and all wrongdoing of any kind whatsoever . . .”).

make any findings that LuLaRoe was in fact operating as a pyramid scheme.¹³⁶ Similar to the Herbalife settlement with the FTC, LuLaRoe agreed to compensate injured distributors and make changes to its business practices, but the settlement did little to help define the legal differences between a pyramid scheme operating under deceptive business practices and a legitimate MLM. A closer look at the mechanisms currently available to investigate and prosecute companies operating as illegal pyramid schemes gives a bit more clarity into why cases like *FTC v. Herbalife* and *Washington v. LuLuRoe* had the outcomes they did.

II. CURRENT ENFORCEMENT: LINEAR RULES IN AN EXPONENTIAL MARKET

Enforcement mechanisms against illegal pyramid schemes masquerading as legal MLMs exist at both the state and federal level. The FTC has the authority to regulate deceptive business practices, like illegal pyramid schemes, and handles many of the investigations of MLMs on the federal level.¹³⁷ The Securities and Exchange Commission (SEC) can also pursue cases involving MLMs if the activity in question is related to securities regulation,¹³⁸ and the Department of Justice (DOJ) has tried to prosecute illegally operating MLMs under both the federal statute that prohibits lottery schemes¹³⁹ and the statute prohibiting

136. *But see id.* para. 5.2 (establishing that the company is permanently restrained from promoting or offering a pyramid scheme in Washington).

137. Christopher Bradley & Hannah E. Oates, *The Multi-Level Marketing Pandemic*, 89 TENN. L. REV. 321, 340 (2022) (referring to the FTC as the “primary watchdog” in the regulation of MLMs).

138. See SEC Off. of Inv. Educ. & Advoc., *Beware of Pyramid Schemes Posing as Multi-Level Marketing Programs*, SEC. EXCH. COMM’N (Oct. 1, 2013), <https://www.sec.gov/oiea/investor-alerts-bulletins/investor-alerts-ia-pyramid> [<https://perma.cc/5YAY-YWX7>] (“[T]he SEC has sued the alleged operators of large-scale pyramid schemes for violating the federal securities laws through the guise of MLM programs.”).

139. See 18 U.S.C. § 1301 (laying out the federal criminal statute prohibiting the importation or transportation of lottery tickets); *see also* Mangiaratti, *supra* note 114, at 250 (“The DOJ] focuses on . . . ‘whether the victim has given funds to the company, how much the company benefits, and how much the victim may benefit from his or her consideration.’” (quoting Liu, *supra* note 45, at 115)). This approach doesn’t seem to be a reliable enforcement tactic given its “intricate proof requirements.” *See* Daniels, *supra* note 43, at 553 (discussing the idea that the lottery approach will not be an efficient deterrent for “so mutable an abuse”).

mail fraud.¹⁴⁰ Legislatures in all fifty states have enacted laws to protect against unfair and deceptive business practices,¹⁴¹ but these statutes vary in who they give prosecutorial authority to and whether it is possible to bring a class action lawsuit,¹⁴² as well as their definitions of pyramid schemes.¹⁴³

In this Part, the different enforcement mechanisms available to stop illegal pyramid schemes from operating are explored in more detail. Federal enforcement is considered first, focusing on three federal agencies: the FTC, the SEC, and the DOJ. This Part then considers how well federal statutes and regulations apply to stopping the operation of pyramid schemes. Finally, this Part takes a look at enforcement at the state level, recognizing that there is significant variation in approaches across state lines.

140. See 18 U.S.C. § 1341 (criminalizing “[f]rauds and swindles” involving public or private mail carriers).

141. See generally Carolyn Carter, *Consumer Protection in the States: A 50-State Evaluation of Unfair and Deceptive Practices Laws*, NAT’L CONSUMER L. CTR. (Mar. 2018), https://www.nclc.org/wp-content/uploads/2022/09/UDAP_rpt.pdf [<https://perma.cc/K2MS-KA4D>] (detailing similarities and differences between consumer protection laws in all 50 states).

142. See *id.* at 5–8 (illustrating variation among state statutes, including variation with respect to enforcement and class action availability).

143. Compare ARK. CODE ANN. § 4-88-109(b)(9)(A) (2023) (“‘Pyramid promotional scheme’ means any plan or operation through which a person gives consideration for the opportunity to receive compensation primarily from the introduction of other persons into the plan or operation rather than from the sale and consumption of goods, services, or intangible property by a participant or other persons introduced into the plan or operation.”), with MASS. GEN. LAWS ANN. ch. 93, § 69(a) (2023) (“[T]he term ‘multi-level distribution company’ shall mean any person, firm, corporation or other business entity which distributes for a valuable consideration, goods or services through independent agents, contractors or distributors, at different levels, wherein participants in the marketing program may recruit other participants, and wherein commissions, cross-commissions, bonuses, refunds, discounts, dividends or other considerations in the marketing program are or may be paid as a result of the sale of such goods and services or the recruitment, actions or performances of additional participants.”).

A. FEDERAL GOVERNMENT ENFORCEMENT: TOO LITTLE TOO LATE

There are several potential avenues for enforcement by federal regulatory agencies, but the main agency to pursue investigations and cases is the FTC.¹⁴⁴

1. FTC Enforcement: Thorough Investigatory Procedures Leave Much to Be Desired

Enforcement against illegal pyramid schemes can be brought through three different provisions of the FTC Act: Section 5, Section 13(b), and Section 19.¹⁴⁵ Section 5 gives the FTC the authority to prevent persons from using “unfair or deceptive acts or practices in or affecting commerce.”¹⁴⁶ If the FTC finds an MLM to be in violation of Section 5, the pathway to adjudication is through administrative proceedings within the Commission.¹⁴⁷ In order to declare an action unlawful, the Commission must show that the act “causes or is likely to cause” substantial injury to customers.¹⁴⁸ In addition, the action cannot be one that a consumer could “reasonably avoid[]” on their own and the injury caused must outweigh the benefits “to consumers or to competition.”¹⁴⁹

After the process within the Commission completes, the party required by the FTC to cease and desist may appeal to a U.S. Court of Appeals that has jurisdiction.¹⁵⁰ Section 19 gives the FTC the ability to enforce the potential administrative judgment found under Section 5 in federal court and get monetary

144. Bradley & Oates, *supra* note 137, at 340 (“The FTC has been the primary watchdog regulating MLMs and protecting victims from pyramid schemes.”).

145. Mangiaratti, *supra* note 114, at 250–52 (specifying that “[t]he FTC also has the power to enforce consumer protection and competition laws, including against MLMs” under Sections 5, 13(b), and 19 of the FTC Act).

146. Bradley & Oates, *supra* note 137, at 340 (quoting Federal Trade Commission Act § 5, 15 U.S.C. § 45(a)(2)).

147. Mangiaratti, *supra* note 114, at 251 (“Section 5 allows the FTC to file an administrative complaint against a deceptive or anticompetitive MLM.”).

148. 15 U.S.C. § 45(n).

149. *Id.*

150. 15 U.S.C. § 45(c) (“[A party subject to a cease-and-desist order] may obtain a review of such order in the court of appeals of the United States, within any circuit where the . . . practice in question was used or where [the party] resides or carries on business.”).

relief for injured customers.¹⁵¹ Although the definition under Section 5 is broad, there has not been consistent interpretation by administrative judges, which makes a potentially successful outcome for injured distributors more difficult.¹⁵² In many cases, a more consistent path for the FTC was under Section 13(b), which allowed them to bring cases directly in federal court and seek restitution and disgorgement damages on behalf of participants in an MLM who had lost money.¹⁵³ Bringing cases under this section allowed for the FTC to get relief to participants faster than a case adjudicated through administrative proceedings.¹⁵⁴

The avenues for reimbursing injured parties with monetary damages through federal enforcement have narrowed significantly in recent years. In *AMG Capital Management v. Federal Trade Commission*, a case decided in 2021, the Supreme Court unanimously ruled that Section 13(b) of the FTC Act did not give the FTC authority to seek equitable monetary relief such as restitution or disgorgement.¹⁵⁵ This ruling eliminated the FTC's ability to bring claims in an Article III court as their primary course of action.¹⁵⁶ They now have to use their administrative avenues against potentially illegal schemes first.¹⁵⁷ This elimination leaves potential victims of an illegal scheme waiting through an intensive investigation period by the FTC,¹⁵⁸ and

151. Mangiaratti, *supra* note 114, at 251.

152. *Id.* at 260 n.212 (explaining the difficulties of achieving successful outcomes through the administrative pathway).

153. *Id.* at 234 n.34.

154. *Cf. id.* at 259 (“For decades, these [Section 13(b)] actions were the Commission’s most direct and consistent mode of obtaining payment for financially harmed consumers.”).

155. *See* *AMG Cap. Mgmt., LLC v. FTC*, 141 S. Ct. 1341, 1347 (2021) (“Several considerations, taken together, convince us that § 13(b)’s ‘permanent injunction’ language does not authorize the Commission directly to obtain court-ordered monetary relief.”); Mangiaratti, *supra* note 114, at 252 (summarizing the *AMG* decision).

156. *See* Mangiaratti, *supra* note 114, at 252 (“[T]he FTC may no longer take deceptive or anti-competitive MLMs directly to federal court to reimburse injured consumers.”).

157. *Id.* (“[T]he FTC must first seek administrative relief before taking the judgment to the federal district court for monetary redress.”).

158. *Keep & Vander Nat*, *supra* note 32, at 203 (noting that such investigations require extensive factual inquiries).

with a much stronger possibility that they will never see monetary relief for the losses they experienced.¹⁵⁹

There are several downsides for consumers (but upsides for MLM companies) to forcing administrative adjudication.¹⁶⁰ The FTC has neither the staff nor the resources to investigate claims, and when they do, it can take years to resolve.¹⁶¹ Administrative enforcement actions are also non-binding, meaning any MLM that is not a party to the action is not bound by the outcome or guidelines given by an administrative law judge.¹⁶²

2. SEC Enforcement: Difficult to Secure

The SEC has its own mechanisms for pursuing action against an illegal pyramid scheme.¹⁶³ The SEC has the authority to pursue claims under the anti-fraud provisions of the Securities Act¹⁶⁴ and the manipulative and deceptive devices provision

159. See Mangiaratti, *supra* note 114, at 258–59 (“In *AMG Capital Management*, the United States Supreme Court . . . effectively hollow[ed] out the FTC’s consumer protection enforcement authority.”).

160. *Id.* at 260 (“[T]he FTC is relatively less likely to prevail on Section 5 claims . . .”).

161. See *id.* at 260 (noting the slow and uncertain relief under Section 19).

162. An Administrative Law Judge (ALJ) for the FTC “performs the initial adjudicative fact-finding” in administrative complaint proceedings and will, “where appropriate, issue[] an order on remedy.” D. Michael Chappell, *Office of Administrative Law Judges*, FED. TRADE COMM’N, <https://www.ftc.gov/about-ftc/bureaus-offices/office-administrative-law-judges> [<https://perma.cc/JK6D-UTMA>]. The findings made by an ALJ can be appealed, however, and if an appeal is filed with the FTC, all the legal and factual issues are reviewed de novo. *The Standard of Review by Courts in Competition Cases – Note by the United States*, ORG. FOR ECON. COOP. & DEV. 5 (June 4, 2019), https://www.ftc.gov/system/files/attachments/us-submissions-oecd-2010-present-other-international-competition-fora/standard_of_review_us-oecd.pdf [<https://perma.cc/T762-TAX8>] (“The Commission is not required to give deference to the ALJ’s factual determinations; it reviews both the legal and factual issues de novo.”); see also *Administrative Law Judge Decisions*, NAT’L LAB. RELS. BD., <https://www.nlr.gov/cases-decisions/decisions/administrative-law-judge-decisions> [<https://perma.cc/4FCJ-C54R>] (“An administrative law judge’s decision is not binding legal precedent in other cases unless it has been adopted by the [National Labor Relations Board] on review . . .”).

163. See Mangiaratti, *supra* note 114, at 250 (“The SEC may bring actions against MLMs using securities law . . .”).

164. 15 U.S.C. § 77q(a) (“It shall be unlawful for any person in the offer or sale of any securities . . . to employ any device, scheme, or artifice to defraud, or . . . to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.”).

of the Securities Exchange Act.¹⁶⁵ If an MLM is construed as a security,¹⁶⁶ the SEC can investigate whether the MLM has made materially false or misleading statements when bringing new participants into the scheme.¹⁶⁷ This boils down to whether “a participant invests money into the company expecting for profit to derive solely from the effects of a third party (their down-line).”¹⁶⁸ In *Securities and Exchange Commission v. TelexFree, Inc.*, for example, the SEC found that TelexFree was paying old investors with money from new investors rather than the revenue generated from “product” sales.¹⁶⁹ Although the SEC is

165. 15 U.S.C. § 78j (“It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.” (footnote omitted)).

166. The definition of a “security” is understood broadly to be “an investment in a business.” *Securities Law*, GEO. L., <https://www.law.georgetown.edu/your-life-career/career-exploration-professional-development/for-jd-students/explore-legal-careers/practice-areas/securities-law> [<https://perma.cc/X5JA-MKSA>]; *What Constitutes a Security and Requirements Relating to the Offer and Sales of Securities and Exemptions from Registration Associated Therewith*, AM. BAR ASS’N (Apr. 27, 2017), https://www.americanbar.org/groups/business_law/publications/blt/2017/04/06_loev [<https://perma.cc/J8LN-DS8W>] (defining securities and registration process under the Securities Act). Nonetheless, an “investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others” potentially does encompass at least some MLMs. Matt Levine, *The SEC Cracks Down on Crypto*, BLOOMBERG: MONEY STUFF (Feb. 13, 2023), <https://www.bloomberg.com/opinion/articles/2023-02-13/the-sec-cracks-down-on-crypto#xj4y7vzkg> [<https://perma.cc/8Q2N-T582>] (quoting *Framework for “Investment Contract” Analysis of Digital Assets*, SEC. EXCH. COMM’N, <https://www.sec.gov/files/dlt-framework.pdf> [<https://perma.cc/4URN-PCC7>]).

167. Liu, *supra* note 45, at 116 (“[T]he securities approach utilizes federal and state securities laws that are violated when an MLM makes materially false or misleading statements in connection with a security . . .”).

168. Blackman, *supra* note 48, at 101.

169. See Massachusetts-Based TelexFree President Sentenced to 6 Years Imprisonment for Operating Pyramid Scheme, S.E.C. Release No. 23788 (Mar. 24, 2017), 2017 WL 2402695 (“The SEC’s complaint alleged that TelexFree, Merrill, Wanzeler, and other defendants claimed to run a multilevel marketing company . . . but actually were operating an elaborate pyramid scheme.”); see also Rory Zamansky, *Multi-Level Marketing Companies Can Be Pyramid*

capable of taking action against potential pyramid schemes, the business opportunity offered by most MLMs does not meet the definition of a security,¹⁷⁰ which severely limits their involvement in enforcement efforts.¹⁷¹ In addition, the SEC must first process and investigate claims made against a company (as would the FTC under their current regulatory scheme), which extends the time frame for harm to be done to consumers.¹⁷²

3. Department of Justice Enforcement: Not the Best Bet

There is also potential for the DOJ to bring an enforcement action against a potentially illegal pyramid scheme.¹⁷³ These cases generally fall under one of two approaches: the lottery approach¹⁷⁴ or mail fraud.¹⁷⁵ The lottery approach considers “whether the victim has given funds to the company, how much the company benefits, and how much the victim may benefit from his or her consideration.”¹⁷⁶ In the case of a fraudulent MLM structured to run mainly via materials distributed through the mail,¹⁷⁷ the DOJ could potentially bring charges under the federal mail fraud statute.¹⁷⁸ Similar to the lottery

Schemes, AM. BAR ASS’N (Nov. 14, 2016), <https://www.americanbar.org/groups/litigation/committees/securities/practice/2016/multilevel-marketing-companies-can-be-pyramid-schemes> [https://perma.cc/E96H-T2TT] (“TelexFree was paying its older investors, not with revenue raised from the sale of its VoiP product but with money received from its newer investors.”).

170. Liu, *supra* note 45, at 116 (describing Supreme Court’s four-prong test to identify securities).

171. See Bradley & Oates, *supra* note 137, at 349–50 (“[M]ost MLMs do not fall within the SEC’s ambit because they do not offer ‘securities’ as defined by federal law.”).

172. See Daniels, *supra* note 43, at 556 (“[C]omplaints alleging that pyramid sales schemes are technically securities are incapable of being processed with the celerity needed to protect potential investors.”).

173. Liu, *supra* note 45, at 115–16 (describing in broad terms what approaches the DOJ has to prosecute illegal schemes).

174. See 18 U.S.C. §§ 1301–1308 (criminalizing various activities related to lotteries). The “lottery approach” refers to bringing a claim against a fraudulent MLM or pyramid scheme under the federal criminal statutes against operating a lottery scheme.

175. See Liu, *supra* note 45, at 116 (“Another DOJ-driven approach includes prosecution under mail order fraud . . .”).

176. *Id.* at 115.

177. The “mail” in this case includes items sent or delivered by the United States Postal Service or by a “private or commercial interstate carrier.” See 18 U.S.C. § 1341.

178. *Id.* (criminalizing mail fraud).

approach, there are three elements that need to be proven in a mail fraud case. These are “(1) that the defendant knowingly devised a scheme to defraud; (2) that the defendant did so with the intent to defraud; and (3) that the defendant mailed something or caused another to mail something to implement the scheme.”¹⁷⁹

The more difficult element to prove in mail fraud cases is whether the company was operating with intent to defraud.¹⁸⁰ In the case of *United States v. Gold Unlimited, Inc.*, the court dealt with the question of whether operating an illegal pyramid scheme should be considered a scheme to defraud.¹⁸¹ The company in *Gold Unlimited* ran a “gold matching program,” which involved placing a down payment on gold and then recruiting more participants to make their own down payments, and so on.¹⁸² The court found that equating a pyramid scheme with a scheme to defraud was reasonable, and because the company in question was operating via mail, the federal mail fraud statute applied.¹⁸³ Although these federal criminal statutes *could* apply to fraudulent MLMs, direct sales have always relied much more on in-person sales tactics,¹⁸⁴ making mail fraud a difficult and unlikely charge. This avenue is even more unlikely now that

179. *United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 478 (6th Cir. 1999); see also *United States v. William Savran & Assocs., Inc.*, 755 F. Supp. 1165, 1180–81 (E.D.N.Y. 1991) (explaining that the government must show there was participation in a scheme to defraud, intent to defraud, and use of mail to further the scheme).

180. *William Savran*, 755 F. Supp. at 1181 (finding that the scheme in this case was “intentionally vague, ambiguous and calculated to create confusion among unwary consumers”).

181. *Gold Unlimited*, 177 F.3d at 479 (“We believe that this instruction raises two questions: whether Gold engaged in a pyramid scheme or in a legitimate activity, and whether a pyramid scheme constitutes a scheme to defraud.”). The defendant in *Gold Unlimited* was contesting a jury instruction that equated a pyramid scheme with a scheme or artifice to defraud. *Id.* (“Gold alleges that the final sentence of the challenged instruction, equating a pyramid scheme with a scheme or artifice to defraud, violates the Constitution.”).

182. *Id.* at 475–76 (describing the gold matching program).

183. *Id.* at 484 (“[W]e turn to the second question implicitly raised by Gold—namely, whether a pyramid scheme without adequate anti-saturation policies constitutes a ‘scheme to defraud’ prohibited by the mail fraud statute. Unquestionably, an illegal pyramid scheme constitutes a scheme to defraud.”).

184. See *Keep & Vander Nat*, *supra* note 32, at 189–90 (describing early methods and growth of direct selling model).

much MLM activity has moved online.¹⁸⁵ Proving the elements of either the lottery approach or mail fraud tends to be difficult, which makes enforcement via the DOJ an unlikely avenue.

B. STATE GOVERNMENT ENFORCEMENT

All states have some form of an Unfair or Deceptive Acts or Practices Act (UDAP), sometimes called “Little FTC Acts.”¹⁸⁶ Many states have a specific provision or regulation within their UDAP scheme that prohibits pyramid sales outright, while many others are silent on the status of MLMs.¹⁸⁷ A violation of these state pyramid sale provisions is considered to be a per se UDAP violation.¹⁸⁸ Courts generally find UDAP laws to apply in cases of pyramid schemes, even without a particular provision pertaining to them, because they are deceptive in their structure.¹⁸⁹

In the 1970s—around the same time that the FTC was pursuing its *Koscot* and *Amway* cases—many states began implementing statutes making pyramid schemes illegal.¹⁹⁰ Minnesota, for example, has a statute defining “chain referrals,

185. See Kat Albrecht & Kaitlyn Filip, *Weaponizing Rhetoric to Legitimate Regulatory Failures* 4 (CrimRxiv Working Paper, 2021) (available at CrimRxiv), <https://www.crimrxiv.com/pub/s8erpr3p/release/1> [<https://perma.cc/9E7T-EA48>] (“The terrain of MLMs has continued to change with the advent of the internet . . . [N]ow, most buying, selling, and recruiting takes place online.”).

186. Bob Cohen, Annotation, *Right to Private Action Under State Consumer Protection Act—Preconditions to Action*, 117 A.L.R.5th 155 (2004) (“Virtually every state in the nation permits one or more nongovernmental parties to enforce state ‘Little FTC Acts,’ laws of general applicability prohibiting deceptive or unfair acts and practices in the marketplace.”).

187. See NCLC TREATISE UDAP, *supra* note 46, § 9.6.4 n.686 (listing several states with provisions prohibiting pyramid or chain distribution schemes); see e.g., IDAHO ADMIN. CODE r. 04.02.01.190 (“It is an unfair and deceptive act or practice for a seller to promote, offer, advertise, or grant participation in a pyramid or chain distribution scheme.”).

188. NCLC TREATISE UDAP, *supra* note 46, § 9.6.4 (“Violations of these state statutes and regulations are generally found to be per se UDAP violations.”).

189. *Id.* (“Pyramid sellers’ most common defense is that their particular sales arrangement does not fall within the scope of the state statute or UDAP regulation’s definition of an illegal pyramid scheme. Nevertheless, courts generally find the statutory definition to apply.”).

190. Ella, *supra* note 36, at 380 (“At least seventeen states have identified multi-level or pyramid sales systems by name and enacted legislation regarding them. The majority of these statutes were enacted in 1971.” (footnote omitted)).

pyramid or multi-level sales distributorships”¹⁹¹ as a business opportunity that has a new participant “give[] or agree to give” something of value (usually money) for a chance to receive something of value if they can recruit additional participants who in turn will give something of value.¹⁹² This type of operation is illegal under the statute, and anyone found to violate the statute is guilty of a misdemeanor.¹⁹³

This statute was enacted in 1971, several years before one of the only major cases directly dealing with a multi-level sales distributorship.¹⁹⁴ In this case, the State had claimed that Holiday Magic and its distributors were operating a scheme that violated Minnesota’s UDAP statute.¹⁹⁵ Holiday Magic’s business scheme consisted of four different distributor levels, all of which required an entry payment and gave bonuses for recruitment.¹⁹⁶ The court found that the Minnesota statute was “prohibiting, as evil in themselves, only those distribution schemes which place their primary emphasis on profits made by recruiting other participants, thereby producing a pyramiding result,” and therefore sales in the state from distributors of the company Holiday Magic were unlawful.¹⁹⁷ The statutory language relied upon by the State in this case is the same today as it was when enacted in 1971.¹⁹⁸ Other states have similar statutes, although some do not include any mention of “multilevel” distributorships and

191. *Id.*; MINN. STAT. § 325F.69, subdiv. 2(2)(a) (2023) (detailing what is covered by prohibition of referrals and chain referrals).

192. MINN. STAT. § 325F.69, subdiv. 2(2)(a) (2023).

193. *Id.* subdivs. 2(2)(a), (6).

194. *See State v. Solem*, 222 N.W.2d 98, 98 (Minn. 1974) (“This is an appeal by defendant . . . from a judgment of conviction of operating a multi-level distributorship . . .”).

195. *Id.* (explaining the scheme violated MINN. STAT. § 325.79, subdiv. 2(2)(a), where Minnesota formerly codified its anti-pyramid provision). At the time of this case, there was also a case brought against Holiday Magic in which the cosmetics distributor similarly was found in violation of Section 5 of the FTC Act. *See Holiday Magic, Inc.*, 84 F.T.C. 748 (1974).

196. *See Solem*, 222 N.W.2d at 99 (detailing all four distributorships and what was required at each level).

197. *Id.* at 100.

198. *Compare Solem*, 222 N.W.2d at 99 (quoting statute operative in 1974), with MINN. STAT. § 325F.69, subdiv. 2(2)(a) (2023) (containing exact same description of prohibited schemes).

focus specifically on either “endless chains” or pyramid schemes.¹⁹⁹ Statutes enacted or amended more recently make no mention of multilevel distributorships.²⁰⁰

A majority of states prosecute illegal schemes indirectly through “endless chain statutes.”²⁰¹ This type of statute evaluates compensation awarded based on recruitment with more scrutiny than whether recruitment is the primary source of compensation.²⁰² “[E]ndless chain statutes . . . allow regulators to take action when it is clear that MLM participants are buying products themselves or earning commissions based on sales to their own downline, both of which create problems with participants’ personal debt and excessive stockpiling of inventory.”²⁰³ Although these statutes seem to offer a clear pathway to prosecute illegal pyramid schemes, they are not often utilized by states.²⁰⁴

Many of the enforcement mechanisms that currently exist on both the federal and state level were implemented in the 1970s.²⁰⁵ Since they were created, a number of contributing forces have weakened their impact: these include intensive

199. See, e.g., CAL. PENAL CODE § 327 (West 2022) (“Every person who contrives, prepares, sets up, proposes, or operates any endless chain is guilty of a public offense . . .”); WASH. REV. CODE ANN. § 19.275.030(1) (2023) (“No person may establish, promote, operate, or participate in any pyramid scheme.”).

200. See e.g., WASH. REV. CODE ANN. § 19.275.030 (2023) (effective June 7, 2006) (prohibiting pyramid schemes); ARK. CODE ANN. § 4-88-109 (2023) (amended 2019) (defining a pyramid promotional scheme using similar language to the Minnesota statute but not using the term “multilevel” within the statute).

201. See, e.g., 16 LA. ADMIN. CODE tit. 16, § 503(B)(1) (2023) (defining “chain distributor schemes” as a per se unfair and deceptive trade practice); 06-002 VT. CODE R. § 101.01 (2023) (“[P]romotion or offer of, or the grant in participation in a chain distributor scheme in connection with the solicitation of investments from members of the public constitutes an unfair and deceptive trade act and practice . . .”); WIS. ADMIN. CODE ATCP § 122.01 (2023) (“[U]se of a chain distributor scheme . . . serves as a lure to improvident and uneconomical investment.”).

202. Mangiaratti, *supra* note 114, at 249.

203. *Id.*

204. Similar to claims brought under federal statutes like Section 5 of the FTC Act, cases under state law require immense evidentiary findings to meet the burden of proving fraudulent intent by an MLM company. See *id.* at 259.

205. Compare Daniels, *supra* note 43, at 552–57 (describing the enforcement mechanisms available via federal agencies), with Liu, *supra* note 45, 115–18 (describing those same mechanisms based on Daniels’ law review article from 1975).

lobbying by the MLM industry,²⁰⁶ removal of authority from agencies like the FTC,²⁰⁷ and broad regulations giving many MLMs the ability to avoid culpability.²⁰⁸ There are a number of promising avenues of enforcement that could be pursued or created that would better represent the interests of participants and allow for the direct sales industry to continue on a legitimate path, but those avenues must consider the human factor of what drives distributors in MLMs to deceive others. Part III explores these motivations in more depth.

III. BEHAVIORAL MOTIVATIONS BEHIND JOINING AN MLM

Legal regulation of the direct sales industry only tells part of the story. The legal structures in place to distinguish between an illegal pyramid scheme and a legal MLM give the impression it should be easy for consumers and potential distributors to steer clear of companies that aim to exploit them. The reality is much more complicated and requires a deeper look into why people join MLMs. Research indicates that there is a pattern to the ways in which MLMs recruit (or train their distributors to recruit).²⁰⁹ This pattern involves a promise of community and a

206. The direct selling industry has strong ties to Washington, D.C. In 2015, for example, two members of Congress created the Congressional Direct Selling Caucus. *Direct Selling Caucus*, DIRECT SELLING ASS'N, <https://www.dsa.org/advocacy/caucus> [<https://perma.cc/TZ32-FPJG>] (last updated July 19, 2023). The caucus is “a bipartisan forum to build greater awareness about direct selling and policy issues.” *Id.* It is unclear whether the Caucus has held hearings since the beginning of the COVID-19 pandemic, but their website points to a goal of showing the direct selling industry’s commitment “to the highest ethical and consumer protection standards.” *Id.* The caucus is made up of roughly forty members of Congress. *Id.*

207. See *AMG Cap. Mgmt., LLC v. FTC*, 141 S. Ct. 1341, 1344 (2021) (removing authority from the FTC under Section 13 of the FTC Act to “seek . . . equitable monetary relief such as restitution or disgorgement”).

208. See, e.g., Mangiaratti, *supra* note 114, at 232 (“Thanks to pressure from the MLM lobby on lawmakers, the statutes defining MLMs in minority jurisdictions simply describe their business operations and say nothing about how they *should* operate, nor do they provide any guidelines for consumer protection.”).

209. Anecdotally, many distributors have shared their experience with the training on recruitment. See, e.g., Sarah Silverstein et al., *People Who Sell for Multilevel Marketing Companies Look Wildly Successful on Facebook, but the Reality Is Much More Complicated*, BUS. INSIDER (Aug. 6, 2019), <https://www.businessinsider.com/mlms-use-social-media-facebook-portray-financial>

network of like-minded people who will support a new distributor as they build their own network.²¹⁰ Tied with that community is the possibility of entrepreneurship and financial success,²¹¹ which often leads participants to exploit the community they already had in order to drive their financial goals.

This Part considers the practical impact of MLM recruitment tactics and what motivates many distributors to join a potentially illegal pyramid scheme. This Part first discusses the way that community is used in the direct selling space both as an incentive and as a tool for recruitment. This Part next explains how the move of legitimate MLMs, and illegal pyramid schemes, online incentivizes distributors to utilize more aggressive recruitment tactics and accelerates the pace of market saturation. Finally, this Part shows why these behavioral incentives for distributors are important to consider in drafting new policies to stem the financial injury experienced by so many in the direct selling industry.

A. THE BEHAVIORAL DESIGN OF RECRUITMENT

When a new distributor is asked to join an MLM, an extremely prevalent recruitment tactic is to emphasize the community that distributors will have access to once they commit to selling a particular product, in addition to creating income.²¹² MLMs often underscore this in training materials given to new distributors who have committed to taking on the “business opportunity.”²¹³ From the outside looking in, MLMs can appear to provide “sisterhood, community, and entrepreneurship,”²¹⁴ all of

-success-2019-7 [https://perma.cc/9J38-7ZPP] (discussing the pressure put on distributors to post on their Facebook pages about their success, no matter if it was true or not).

210. Frankie Mastrangelo, *Theorizing #Girlboss Culture: Mediated Neoliberal Feminisms from Influencers to Multi-Level Marketing Schemes* 106 (2021) (Ph.D. dissertation, Virginia Commonwealth University) (explaining how MLM participants aim to recruit members by offering the promise of community as well as financial prosperity).

211. *Id.*

212. See Branislav Hock & Mark Button, *Why Do People Join Pyramid Schemes?*, J. FIN. CRIME (forthcoming) (manuscript at 7), <https://doi.org/10.1108/JFC-09-2022-0225> (“[T]here is a particular lifestyle dimension to involvement where joining opens up social opportunities to join with like-minded people . . .”).

213. *Id.* at 8.

214. Mastrangelo, *supra* note 210, at 104.

which appeal in particular to women²¹⁵ trying to create income without entering into a typical nine-to-five work environment.²¹⁶ For example, several former participants in LuLaRoe expressed that, as stay-at-home moms, working for an MLM was appealing because of the opportunity to contribute financially to their family with a flexible schedule.²¹⁷ While a job on its own creates financial stability, a job with the addition of community appeals to a more vulnerable, emotional need.²¹⁸ Finding community while building a business and gaining financial autonomy is an enticing offer, but even if there is genuine intent by the uplines of a new distributor to help them achieve this, the structure of an MLM—a pyramid—requires that the later you join the community, the more likely you are to fail.²¹⁹

Reliance on the promise of community in addition to financial success in the recruitment process creates two distinct effects. The first effect is how success can be seen as a result of the collective, but failure is on the part of the individual.²²⁰ The community that a new distributor joins is packaged as one full of success stories.²²¹ New distributors are added to the MLM network by someone that they trust; even if something about the opportunity feels off, there is an incentive to believe they will be able to find success the same as the distributors they see in the

215. See *supra* Part I (pointing out that as of 2021, three quarters of participants in MLMs are women).

216. LULARICH (Amazon Studios 2021) (interviewing several participants on why they wanted to join LuLaRoe, many of whom mention that it seemed like a flexible work option for them as a mom).

217. See *id.*

218. See Mastrangelo, *supra* note 210, at 103 (noting the “allure” of community, economic stability, and independence).

219. See, e.g., *Multi-Level Marketing or Illegal Pyramid Scheme?*, *supra* note 42 (“Because pyramid schemes rely on recruitment of new members to bring in money, the schemes often collapse when the pool of potential recruits dries up (market saturation). When the plan collapses, most people, except the few at the top of the pyramid, lose their money.”).

220. See Pavelko & Barker, *supra* note 40, at 413 (“The predatory optimism, or ‘toxic positivity,’ of MLMs discourages all ‘negative’ thinking and therefore silences and shuns those distributors who have not succeeded.” (citation omitted)).

221. See Liu, *supra* note 45, at 122 (explaining that recruitment strategies may involve “base-rate neglect,” which is an over-reliance on “successful but unlikely” examples of distributors in the MLM).

recruitment process.²²² If a distributor is unable to find success within an MLM, even a fraudulent one that is operating as a pyramid scheme, they may see this as their own personal failing and be less likely to complain.²²³

The second effect is the way that community begins to function not only as benefit to gain from joining an MLM, but also as a tool for increasing a participant's "downline" and ultimately their income. MLMs have used community as a tool since they began encouraging sales parties with friends in the living rooms of their distributors.²²⁴ A distributor's "personal sphere" is relied on heavily to make sales and enlist new recruits,²²⁵ entangling the community they build with the success of their business. This can create difficult social dynamics as recruitment reaches outer circles of acquaintances.²²⁶ That difficulty is exacerbated by the move of MLM sales and recruitment to the online space.

B. THE INDUSTRY GOES "ONLINE": SOCIAL MEDIA'S ROLE IN GROWING DISTRIBUTOR "DOWNLINES"

The Internet, and social media in particular, has grown to play a critical role in the way many people connect with friends and family. MLMs have transitioned to digital platforms along with the population at large.²²⁷ MLMs moved from creating

222. Liu explores the idea of "imperfect disclosure" throughout the recruitment process in an MLM. *Id.* She defines this as a combination of "(1) design choices by a MLM to influence prospective consultants into joining and (2) the cognitive biases that consumers might demonstrate in the process." *Id.*

223. See Pavelko, *supra* note 40, at 411 (explaining that MLMs emphasize that success or failure is due to an individual's personal ambition or character, ignoring the fact that failure can be due to systemic issues with MLMs).

224. See Albrecht & Filip, *supra* note 185, at 4 (explaining that, although MLMs now largely exist through social media, they began as sales parties in distributors' living rooms).

225. Mastrangelo, *supra* note 210, at 118.

226. Many of these social interactions are documented on a subreddit page titled "[/r/antimlm](https://www.reddit.com/r/antimlm)." *Stop MLM Schemes from Draining Your Friends Dry*, REDDIT, <https://www.reddit.com/r/antiMLM> (last visited Oct. 25, 2023). Posts detail messages received from high school acquaintances, and even the ways that some distributors will use tactics that exploit the health of potential new recruits.

227. See Silverstein et al., *supra* note 209 and accompanying text. *But see* Allana Akhtar, *TikTok Is Banning Content That Promotes Pyramid Schemes and Multi-Level Marketing Companies*, BUS. INSIDER (Dec. 16, 2020), <https://www.businessinsider.com/tiktok-bans-mlm-pyramid-ponzi-scheme-content-promotions-2020-12> [<https://perma.cc/CHN7-A8EL>] (laying out TikTok's

community in the living room of friends to a private Facebook group with daily live videos showcasing new products.²²⁸ Social media platforms like Facebook and Instagram are now the predominant way distributors connect with their customers and fellow distributors,²²⁹ and the COVID-19 pandemic has only increased the online nature of MLMs.²³⁰ Operating online gives distributors access to a larger pool of potential customers and downlines more quickly than relying on in-person interactions. This means the MLM itself will grow at an exponential rate and reach market saturation more quickly.²³¹ In order to tap into that market (and receive a bonus for new recruits²³²), distributors are pushed by their uplines to reach out to as many people in their network as possible.²³³

updated community guidelines, which prohibited promotion of MLM content); Kaitlyn Tiffany, *How the Pandemic Stoked a Backlash to Multilevel Marketing*, ATLANTIC (Jan. 27, 2021), <https://www.theatlantic.com/technology/archive/2021/01/anti-mlm-reddit-youtube/617816> [<https://perma.cc/3F8X-DAMZ>] (“The same social networks that multilevel-marketing distributors are called upon to exploit—their friends, their family, their followers, their ‘mutuals’—are now the social networks through which women are pushing out a completely different message.”).

228. See Olivia Little, *A Predatory MLM Scheme Is Thriving on TikTok*, MEDIA MATTERS FOR AM. (Mar. 30, 2022), <https://www.mediamatters.org/tiktok/predatory-mlm-scheme-thriving-tiktok> [<https://perma.cc/SF56-H89U>] (showing examples of the kinds of posts distributors on TikTok have made of their success using products from the company “It Works!” and recruiting other distributors, all against the TikTok community guidelines).

229. Albrecht & Filip, *supra* note 185, at 4 (“MLM distributors utilize all forms of social media — including Facebook groups and Instagram stories in particular — in order to buy, sell, and recruit additional participants.”).

230. Sabrina Fluegel & Kendall King, *#workfromhome: How Multi-Level Marketers Enact and Subvert Federal Language Policy for Profit*, 21 LANGUAGE POLY 121, 123 (2021) (noting that the COVID-19 pandemic has accelerated the already-occurring shift toward e-commerce and online marketing).

231. Hock & Button, *supra* note 212, at 7 (“Pyramid schemes are increasingly enabled by social media. A scheme has the potential to grow exponentially when large groups of like-minded people are encouraged to promote the scheme with other like-minded people.”).

232. See, e.g., *Leadership Compensation Plan*, LULAROE 9, https://s3-us-west-2.amazonaws.com/llrprod/exigo/llrAdmin/documents/LLR_Ldr_Bonus_Plan.pdf [<https://perma.cc/3GG9-NSXW>] (offering bonuses to [uplines] when the [downlines] they recruit hit certain sales benchmarks).

233. See Lina Enblad & Evelina Öhlander, *Deception and Self Deception: An Investigation of Multi-Level Marketing Distributors and Their Deceptive Practices on Social Media* 58 (2019) (Master’s thesis, Linköping University) (“[U]plines have an obsessive interest in their downline’s success.”).

As uplines push for more recruits to be found, distributors aiming to please their newfound community may be pushed to engage in more aggressive and potentially deceitful tactics. Online interactions, rather than face-to-face, utilize different social cues,²³⁴ relying on a more detached style of communication.²³⁵ Although many online connections are acquaintances, friends, or even family, the digital barrier between a distributor and their customers (more likely new recruits) creates a space in which committing “digital deception”²³⁶ feels anonymous and therefore easier to perpetrate.²³⁷ These lowered social consequences can lead distributors to spam every connection they have on a given social media platform,²³⁸ craft carefully worded posts that stretch the reality of a product’s ability to produce medical healing,²³⁹ or even join private conversations that facilitate a network of distributors posing as satisfied customers to boost each other’s sales.²⁴⁰ These practices in isolation do not have a significant impact on an MLM network, but if new

234. See Naomi L. Yanike, *Hunzoning: A Qualitative Study of Women’s Expectancy Violations Surrounding Multi-Level Marketing Message Strategies on Facebook 2–3* (May 2020) (B.A. thesis, University of Nebraska at Omaha) (ProQuest) (explaining that interactions on online social networking sites involve specific online social norms); see also Enblad & Öhlander, *supra* note 233, at 29 (“The characteristics of the online world trigger a wide assortment of role plays, deceptions, half-truths, and exaggerations, partly because anonymity and the absence of visual and auditory cues allow them, and at the same time insulate us from the consequences.” (quoting Jeanne M. Logsdon & Karen D.W. Patterson, *Deception in Business Networks: Is It Easier to Lie Online?*, 90 *J. BUS. ETHICS* 537, 540 (2009))).

235. See Enblad & Öhlander, *supra* note 233, at 30 (“[T]he probability of unethical behaviour/deception is higher if the actor does not feel proximity to the person, which is more likely online.”).

236. *Id.* at 61 (“Digital deception is to intentionally produce false messages in order to give false beliefs to the receiver of the messages.”).

237. *Id.* at 62 (“The online world triggers exaggerations and deceptions because of e.g. the anonymity it provides.”).

238. Yanike, *supra* note 234, at 18 (explaining that some MLM members message their social media connections and gain “social reputations of aggressive sellers lacking self-awareness”).

239. Fluegel & King, *supra* note 230, at 130 (exploring how distributors for Rodan + Fields (R+F), a cosmetics MLM, worded posts online during the COVID-19 pandemic to insinuate R+F products could protect or help with the virus).

240. Enblad & Öhlander, *supra* note 233, at 61–62 (explaining that “boost groups” exist for distributors to ask for engagement on their posts from other distributors, sometimes even posing falsely as consumers).

distributors are consistently utilizing deceptive tactics to sell products and recruit new distributors below them, it can catch the eye of regulators seeking to curb consumer fraud.

A closer look at what drives distributor behavior throughout the recruitment process and more broadly reveals a set of incentives beyond financial gain.²⁴¹ This likely contributes to why current legal frameworks and statutory schemes fall short of protecting distributors from financial injury, given that existing solutions do not account for what role access to community plays in the decision to join an MLM. Some policy makers would perhaps consider the choice to join an MLM to be a “mistake”²⁴² when financial gain is clearly small, or even non-existent, for a majority of distributors. This makes two related assumptions: one, that people make decisions primarily based on economic advantage,²⁴³ and two, that a choice based on finances is more rational than one based on social gains.²⁴⁴ A more holistic understanding of distributor behavior reveals that in order to make meaningful changes to the legal structures that differentiate illegal pyramid schemes from legitimate MLMs, lawmakers and regulators must pay more attention to the influence of distributors on newcomers and the non-financial incentives that motivate distributors to sign up. Part IV suggests two solutions that

241. See, e.g., *The Dream: Women's Work*, PUSHKIN INDUS. & LITTLE EVERYWHERE (Sept. 24, 2018) (accessed via Spotify) (“[W]e miss the significance of what these organizations are doing if we only look at them in financial terms.”). This podcast discusses the history of the direct sales industry and follows the experience of a new distributor in an MLM. The second episode features an interview with Tracey Deutsch, a historian and professor at the University of Minnesota, who emphasizes the impact MLMs have had in communities that goes well beyond finances. *Id.*

242. See, e.g., Claire A. Hill, *Beyond Mistakes: The Next Wave of Behavioural Law and Economics*, 29 QUEEN'S L.J. 563, 566 (2004) (“The ready and uncontroversial characterization of something as a ‘mistake’ [in the first wave of behavioural law and economics] is assumed: people either make mistakes or they don’t, and we know which they are doing.”).

243. See Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1476 (explaining the foundational task of law and economics to determine what types of behaviors maximize performance in economic markets).

244. See Hill, *supra* note 242, at 593–94 (explaining the author’s alternative premise of bounded rationality, which is an understanding of decision-making that acknowledges decisions can be “reasonable” or “rational” within the context of a person’s lived experience rather than as compared to a standard “rational” choice).

focus less on economic “mistake” and more on building structures that support distributors making informed choices.

IV. FORGING A NEW PATH: TRANSPARENCY AND ACCOUNTABILITY

Current regulatory mechanisms and legal precedent have created a distinction between an illegal pyramid scheme and a legal MLM that is “so narrow as to be functionally meaningless.”²⁴⁵ In order to better serve the distributors who suffer losses at the bottom of the pyramid, the legal mechanisms used to combat predatory MLM companies need to hold MLMs more accountable for their distributors’ behavior. This is particularly important if the industry continues to operate with self-regulating codes of ethics. The problematic nature of many MLMs arises when the company can propose ethical practices on paper that are not implemented in the day-to-day business.²⁴⁶

A. DEFINING PYRAMID SCHEMES ON A NATIONAL SCALE

Although many states have laws defining illegal pyramid schemes, a national statute has never been passed by Congress,²⁴⁷ nor has a rule ever been promulgated by a federal agency, to define what constitutes an illegal pyramid scheme. Instead, federal agencies rely on statutes or rules that address fraudulent or deceptive business practices, and the fuzzy factors courts have developed regarding what to look for when considering whether a business is a legal MLM or an illegal pyramid scheme. A rule to establish what it means to be an illegal pyramid scheme would stand to benefit companies looking to comply with regulations, as well as the customers and distributors of a particular company.

As the judge in *Koscot Interplanetary, Inc.* pointed out in 1975, the system to identify and pursue businesses engaged in illegal pyramid schemes requires so much complicated evidence

245. Albrecht & Filip, *supra* note 185, at 5.

246. *See id.* at 14 (discussing that companies will often have “buy-back” structures for distributors on paper in order to meet the test laid out in *Amway*, but in reality, it is rare or difficult to actually use them).

247. *See, e.g.,* Sean Reyes, *Learning from the States: Feds Should Adopt Anti-Pyramid Scheme Law*, HILL (Nov. 29, 2017), <https://thehill.com/blogs/congress-blog/judicial/362235-learning-from-the-states-feds-should-adopt-anti-pyramid-scheme> [<https://perma.cc/9PY9-9LUZ>] (discussing the need for a “federal counterpart” to many state laws prohibiting or defining pyramid schemes).

gathering that many distributors lose money by the time a case can be brought.²⁴⁸ This continues to be the case for actions brought in private class actions or by a government entity. Even if a settlement is reached,²⁴⁹ or in the rare case, a judge finds a company to be operating as an illegal pyramid scheme,²⁵⁰ distributors who experienced financial losses may never be able to fully recover that cost.²⁵¹ The current legal structure for addressing deceptive business practices within a company claiming to be a legal MLM has two problems. The first is an assumption regarding what the incentives are for distributors to join. The second is reliance on standards that no longer serve the purpose of curbing fraudulent business practices in the direct selling industry.

When contemplating how to structure new regulations, statutes, or policies, there is often consideration of the incentives and

248. See *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181–82 (1975) (“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, and no more than a fraction of that is presently accounted for. Whether more than a small fraction of the consumer loss will ever be recovered is open to serious doubt.” (citation omitted)).

249. See, e.g., Press Release, Fed. Trade Comm’n, *Herbalife Will Restructure Its Multi-Level Marketing Operations and Pay \$200 Million for Consumer Redress to Settle FTC Charges* (July 15, 2016) [hereinafter *FTC, Herbalife Will Restructure*], <https://www.ftc.gov/news-events/news/press-releases/2016/07/herbalife-will-restructure-its-multi-level-marketing-operations-pay-200-million-consumer-redress> [<https://perma.cc/E5F7-SVNR>] (explaining the terms of the settlement reached between Herbalife and the FTC after charges were filed alleging unfair business practices).

250. Some orders for injunctive relief more directly address the question of whether a company was operating as an illegal pyramid scheme. Cf. *Stipulated Order for Permanent Injunction and Monetary Judgment Against Vemma Nutrition Co., Vemma Int’l Holdings, Inc., & Benson K. Boreyko* at 6, *FTC v. Vemma Nutrition Co.*, No. CV-15-01578-PHX-JJT (D. Ariz. 2016), https://www.ftc.gov/system/files/documents/cases/161215_proposed_vemma_bk_stipulated_final.pdf [<https://perma.cc/7Z8H-W2AH>] (“Defendants are permanently restrained and enjoined from advertising, marketing, promoting, or offering a pyramid scheme, Ponzi scheme, or chain marketing scheme, whether directly or through an intermediary.”).

251. Cf. *Wieczner*, *supra* note 23 (covering the variation in amounts that different distributors receive in a settlement, which may or may not match the amount lost).

disincentives that will extend from the policy being created.²⁵² The form that a new legal command takes is often classified as a “rule” or a “standard.”²⁵³ Rules are viewed as the more structured approach, while standards are fuzzier.²⁵⁴ Rules provide more clarity *ex ante*;²⁵⁵ standards allow for a fact-finder to evaluate on a case-by-case basis. On the spectrum between “rule” versus “standard,”²⁵⁶ laws regarding illegal business schemes in the direct selling industry lie much further towards the “standard” end. These standards²⁵⁷ and tests²⁵⁸ operate under the assumption that distributors within any particular MLM are driven by the same incentives, or at the very least normatively rational incentives.²⁵⁹ The current standards assume certain

252. See, e.g., Russell B. Korobkin, *Behavioral Analysis and Legal Form: Rules vs. Standards Revisited*, 79 OR. L. REV. 23, 31 (2000) (“[L]egal economists take seriously that the law will encourage or discourage citizens from taking various possible actions and, consequently, the law can cause good and bad social consequences.”).

253. See, e.g., Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559 (1992); Eric A. Posner, *Standards, Rules, and Social Norms*, 21 HARV. J.L. & PUB. POL’Y 101, 101 (1997); Pierre J. Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 379 (1985).

254. The classic example given by scholars on the topic is a speed limit rule as compared to a “reasonable driving speed” standard. A statute that provides a concrete number over which drivers should not speed tells all drivers the expectations before they ever put a car in drive. A reasonable driving speed test on the other hand requires a judge or other factfinder to determine whether the speed of a particular driver was “reasonable” given the circumstances.

255. Defined as, “[b]ased on assumption and prediction, on how things appeared beforehand, rather than in hindsight; subjective; prospective.” *Ex ante*, BLACK’S LAW DICTIONARY (11th ed. 2019).

256. See Korobkin, *supra* note 252, at 26 (explaining that considering “rules” and “standards” as “endpoints of a spectrum” is more accurate than two distinct categories given how the legal form of a pronouncement can alter over time).

257. See *Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1180 (1975) (laying out a two-pronged standard for what constitutes an illegal pyramid scheme); *Amway Corp., Inc.*, 93 F.T.C. 618 (1979); *FTC v. BurnLounge, Inc.*, 753 F.3d 878, 883 (9th Cir. 2014) (“To determine whether a MLM business is a pyramid, a court must look at how the MLM business operates in practice.”); *Webster v. Omnitrition Int’l*, 79 F.3d 776, 782 (9th Cir. 1996) (“We adopt the *Koscot* standard here and hold that the operation of a pyramid scheme constitutes fraud for purpose of several federal antifraud statutes.”).

258. See *generally supra* Part II (covering the tests used by different federal agencies and state laws that look for broad categories like “unfair or deceptive business practices” or violation of “securities interests”).

259. See, e.g., Korobkin, *supra* note 252, at 24 (overviewing a premise of law and economics which views the law as content that will cause a reaction from “citizens and system participants”).

behaviors and incentives for the companies as well. What is clear when looking at the actual behavior of distributors²⁶⁰ is that the current legal standards do not accurately incentivize non-fraudulent behavior (or disincentivize fraudulent behavior). Due to the nature of the structure of MLMs and illegal pyramid schemes,²⁶¹ legal standards that require intensive fact-finding in every case leave a majority of the distributors participating in the companies without clear guidance on what behaviors may be viewed as perpetuating an illegal scheme. Distributors must rely on the interpretation of legal standards made by company leadership and must trust that the distributor who recruited them is following guidelines set by company leadership (although there are few structures to hold distributors to any particular behavioral standards).²⁶² There are high costs to individual distributors if they want to conduct their own research regarding the legal standards used to determine the legality of a particular direct selling company. The further down a line of distributors an individual is, the higher the cost may be to understand the expectations and norms of the company they are contracted to work for.

In many of the MLM cases covered intensely by the media in recent years—LuLaRoe,²⁶³ Herbalife,²⁶⁴ and others covered by podcasts like *The Dream*,²⁶⁵ for example—the companies accused of illegal pyramid scheme activity often settle the case before a

260. See *supra* Part III (showing the actual behavior of distributors in MLMs).

261. As noted, these structures are both pyramids. See *Multi-Level Marketing or Illegal Pyramid Scheme?*, *supra* note 42 and accompanying parenthetical (explaining the pyramid shape formed by endless recruitment in an MLM company).

262. A distributor in almost all MLMs is considered an independent contractor. See *supra* note 38 and accompanying text. The company is liable for remarkably little because of that classification. See, e.g., ROBERT MICHAEL EY, 8 CAUSES OF ACTION SECOND SERIES § 1 (1995) (“As a general rule, an employer is not liable for the acts or omissions of an independent contractor.”).

263. See generally LULARICH, *supra* note 216. This documentary gives background on LuLaRoe as a company, including its rapid growth and the stories of several distributors who initially enjoyed being a part of LuLaRoe but ended up with inventory they could not sell and large financial losses.

264. The Herbalife settlement was one of the largest settlements the FTC had ever entered with an MLM. FTC, *Herbalife Will Restructure*, *supra* note 249.

265. See generally *The Dream*, *supra* note 241 (reporting in-depth the experience of MLM distributors and the industry’s history).

finding against them is entered. In some cases, this leads to recovery for late joining distributors who lost not-insignificant amounts of money,²⁶⁶ but does little to stop future MLMs from exploiting new recruits unfamiliar with the risks. While the companies themselves are responsible for the creation of potentially exploitative structures, distributors are put in charge of many of the responsibilities a company normally takes on.²⁶⁷ This includes recruitment, onboarding and training, and on-going management.²⁶⁸ Many MLM companies, and the Direct Selling Association itself, have created their own code of ethics for distributors within their network.²⁶⁹

MLM companies have indicated that they understand public concern surrounding potentially fraudulent practices.²⁷⁰ In many cases, this has led businesses to implement policies at the company level to encourage ethical and legal behavior from distributors.²⁷¹ This does not acknowledge, however, the power that

266. See FTC, *Herbalife Will Restructure*, *supra* note 249 (“[T]he order imposes a \$200 million judgment against Herbalife to provide consumer redress, including money for consumers who purchased large quantities of Herbalife products . . . and lost money.”).

267. See, e.g., Albrecht & Filip, *supra* note 185, at 3 (“[T]he MLM model also makes recruiting, training, and supervising recruits the job of sales consultants.”).

268. *Id.*

269. *Code of Ethics*, DIRECT SELLING ASS’N, <https://www.dsa.org/consumer-protection/code-of-ethics> [<https://perma.cc/L7NM-UWAF>]; Claudia Groß & Dirk Vriens, *The Role of the Distributor Network in the Persistence of Legal and Ethical Problems of Multi-Level Marketing Companies*, 156 J. BUS. ETHICS 333, 337 (2019) (referring to MLM companies’ codes of ethics).

270. This can be seen through Avon’s departure from the Direct Selling Association for lax ethical standards. Berr, *supra* note 13. The fundamental problem ethical standards encounter is eradicating pyramid schemes while preserving lawful businesses. See Bonnie Patten, *Not Your Grandma’s Tupperware: MLMs vs Pyramid Schemes*, TRUTH IN ADVERT. (Mar. 31, 2015), <https://truthinadvertising.org/blog/not-your-grandmas-tupperware-mlms-vs-pyramid-schemes> [<https://perma.cc/C53A-2L6X>] (“[T]he issue becomes how do we find the wolves among the sheep and how do we best eradicate these illegal predators without also killing all the sheep? Given the current state of the law, that’s actually a really tough legal question to answer.”). Regardless, it is clear that there is increasing public concern about these schemes. See, e.g., *Stop MLM Schemes from Draining Your Friends Dry*, *supra* note 226 (creating a gathering space for online users to publicize fraudulent behavior from MLM distributors).

271. See *Policies & Procedures: U.S.*, ARBONNE 2 (Apr. 1, 2023), <https://embed.widencdn.net/pdf/view/arbonne/ibdvgyiipn/Policies+%26+Procedures+>

uplines have over whether these company policies are implemented, encouraged, or talked about. As an MLM network grows, the “[n]orms of how selling or recruiting is handled by the MLM distributors are transferred through training and socializing new distributors.”²⁷² Those norms may not necessarily reflect the code of ethics the company has put together, the further down the line from the company a distributor is.²⁷³ It is all dependent on what the distributor above has taught.²⁷⁴ This can play in a fraudulent MLM’s favor and mislead potential new distributors in more than one way.

It is possible that potential new distributors may be aware of the public legal battles MLMs have faced, leading them to be wary of joining despite what sounds like a promising opportunity. Independent research could be done by potential distributors, but given that many MLM trainings encourage recruitment from within your existing social networks, a recruit may feel it is enough to ask their upline any questions regarding the legitimacy.²⁷⁵ A fraudulent MLM benefits from the fact that the FTC defines MLM’s as a legal business structure.²⁷⁶ Within a chain of distributors for LuLaRoe, for example, uplines could assure their new distributors that LuLaRoe “could not possibly be a pyramid scheme” because those are illegal, while MLMs are

Manual [<https://perma.cc/HWW4-A4DP>] (laying out Arbonne’s Code of Ethics and other official policies and procedures); *LuLaRoe Etiquette and Ethics*, LULAROE, <http://lovehustlestyle.com/wp-content/uploads/2016/04/LuLaRoe-Etiquette-and-Ethics.pdf> [<https://perma.cc/SBM3-3AGF>]; *Our Values*, AVON, <https://www.avonworldwide.com/about-us/our-values#codeofconduct> [<https://perma.cc/4JCA-FUKZ>].

272. Enblad & Öhlander, *supra* note 233, at 58.

273. *See id.* at 28 (“[S]ince the distributors have their ‘own business’ they are independent which leads to companies not having the power to influence the ethics of the sales force.”).

274. *See id.* (describing the effect distributors have on their downline distributors).

275. *Id.* at 2 (highlighting the importance of utilizing social networks for distributors). A distributor may ask their upline these questions because the upline functions as a liaison to the rest of the organization. *See id.* at 28.

276. *See* Business Opportunity Rule, 73 Fed. Reg. 16110, 16119 (Mar. 26, 2008) (to be codified at 16 C.F.R. pt. 437); *see also Multi-Level Marketing Businesses and Pyramid Schemes*, FED. TRADE COMM’N (July 2022), <https://consumer.ftc.gov/articles/multi-level-marketing-businesses-pyramid-schemes> [<https://perma.cc/UVB4-7R2S>] (describing MLMs as “[b]usinesses that involve selling products to family and friends and recruiting other people to do the same” and clarifying that “[s]ome MLMs are illegal pyramid schemes”).

not.²⁷⁷ For an MLM that has a code of ethics to display on their website, and that functions within the mostly gray area between pyramid scheme and entirely legitimate MLM, an upline distributor assuring their downline of the company's legitimacy spares the MLM from ensuring this to be true.²⁷⁸ An MLM places reliance on the distributor network to enforce things like an official code of ethics, but it is not clear that any real repercussions exist for a distributor if they do not.²⁷⁹ Increased liability for distributors, and MLMs as a whole, that fail to follow or enforce a code of ethics would likely lead to less fraudulent, misleading, and plainly unethical behavior.

Congress has made attempts to establish a statutory definition of a pyramid scheme as recently as 2017, but that law did not make it past initial readings on the floor.²⁸⁰ The Anti-Pyramid Promotional Scheme Act of 2017 (Anti-Pyramid Act or H.R. 3409) created language that was to be added to the FTC Act.²⁸¹ Under the new language, it would be illegal to “establish, operate, promote, or cause to be promoted a pyramid promotional scheme.”²⁸² The bill provided definitions of a “pyramid promotional scheme,” “participant,” and other key phrases often used in relation to the direct sales business and MLM businesses in

277. Albrecht & Filip, *supra* note 185, at 16.

278. This gray area has always been permitted. Peter Vander Nat, *FTC Chairwoman Creates Framework for MLM Regulatory Environment*, TRUTH IN ADVERT. (Oct. 31, 2016), <https://truthinadvertising.org/blog/ftc-chairwoman-creates-framework-mlm-regulatory-environment> [<https://perma.cc/H4SY-Q36W>] (“Whether one agrees or not, from the beginning the FTC permitted a legitimate form of multilevel marketing, i.e., upline rewards based on consummated retail sales.”).

279. Groß & Vriens, *supra* note 269, at 346–47 (explaining that a distributor network's “teaching and socialization techniques might reinforce unethical behavior” and that rules against that type of behavior are “allowed to be ignored” by distributors).

280. See *H.R. 3409: Anti-Pyramid Promotional Scheme Act of 2017*, PROPUBLICA [hereinafter PROPUBLICA, *Anti-Pyramid*], <https://projects.propublica.org/represent/bills/115/hr3409> [<https://perma.cc/9WV2-YVS5>] (last updated July 28, 2017) (showing the most recent action date as two days after the bill's initial introduction on July 26, 2017). Some said this law would have been the right “federal counterpart” to different state anti-pyramid laws. Groß & Vriens, *supra* note 269, at 346–47.

281. Anti-Pyramid Promotional Scheme Act of 2017, H.R. 3409, 115th Cong. (2017), <https://www.govinfo.gov/content/pkg/BILLS-115hr3409ih/pdf/BILLS-115hr3409ih.pdf> [<https://perma.cc/5G9Z-WMKR>].

282. *Id.* § 2.

particular.²⁸³ While most of the media coverage at the time agreed that a law like the Anti-Pyramid Act was needed in a space with limited clarity,²⁸⁴ opinions were mixed on whether the Anti-Pyramid Act was the right statute to protect participants and consumers while also creating clarity for businesses.²⁸⁵ The Anti-Pyramid Act was a bipartisan bill drafted by then House Representative Marsha Blackburn and sponsored by forty-nine others.²⁸⁶ The language of the bill was also influenced by the DSA, whose members are sometimes the very same businesses that are investigated for allegedly operating as illegal pyramid schemes.²⁸⁷ Representative Blackburn was also a member of the Direct Selling Caucus, which works closely with the

283. A “pyramid promotional scheme” is “any plan or operation in which individuals pay consideration for the right to receive compensation that is based upon recruiting other individuals into the plan or operation rather than primarily related to the sale of products or services to ultimate users.” *Id.* § 3. A “participant” is “a person who joins a plan or operation.” *Id.*

284. See Anne T. Coughlan, *Anti-Pyramid Scheme Bill Will Protect Consumers and Support Entrepreneurs*, FORBES (Oct. 12, 2017), <https://www.forbes.com/sites/realspin/2017/10/12/anti-pyramid-scheme-bill-will-protect-consumers-and-support-entrepreneurs/?sh=46f748bfd7a> [<https://perma.cc/MEX5-2THZ>] (noting the importance of this bipartisan congressional effort to address the growing issues surrounding illegal pyramid schemes); Reyes, *supra* note 247 (discussing the benefits of the Anti-Pyramid Promotional Scheme Act of 2017); Frank L. Vandersloot, *Anti-Pyramid Measure Is Really a Pro-Pyramid Bill*, HILL (Sept. 6, 2017), <https://thehill.com/blogs/congress-blog/politics/349537-anti-pyramid-measure-is-a-step-in-the-wrong-direction-for> [<https://perma.cc/Y449-6UEE>] (highlighting the need for legislation that would prevent the practice of inventory loading and illegal pyramid schemes).

285. Compare Coughlan, *supra* note 284 (describing the Anti-Pyramid Act as “an economically sensible and timely bill that finally lays out clear industry definitions and requirements across the United States which will protect consumers and support entrepreneurs”), and Reyes, *supra* note 247 (stating that the federal bill would “complement the work being done” in the states to “stamp out” illegal pyramid schemes), with Vandersloot, *supra* note 284 (“In reality, this bill is anything but anti-pyramid. To the contrary, among other problems, it gives protection to pyramid schemes by redefining the term ‘pyramid scheme’ in a way that allows almost any pyramid scheme to escape the definition.”).

286. See PROPUBLICA, *Anti-Pyramid*, *supra* note 280 (listing Marsha Blackburn as the bill sponsor with forty-nine bill cosponsors). Blackburn has since become a member of the United States Senate representing Tennessee. See *Biography*, MARSHA BLACKBURN: U.S. SEN. FOR TENN., <https://www.blackburn.senate.gov/biography> [<https://perma.cc/VV4W-SPPQ>].

287. Vandersloot, *supra* note 284 (arguing that Blackburn’s error in drafting the legislation was in accepting the “carefully crafted language authored by the DSA, which is currently dominated by companies who, themselves, practice inventory loading”).

DSA to promote participation in direct selling.²⁸⁸ Given the overlap between companies that are members of the DSA and companies that engage in deceptive behaviors that are arguably features of illegal pyramid schemes,²⁸⁹ the DSA should not be able to participate in defining the rules. One of the stated purposes of the Anti-Pyramid Act is to “ensure that compensation is not based upon recruitment of participants into a plan or operation, but on sales to individuals who use and consume the products or services sold.”²⁹⁰ Nowhere in the language, however, is there a provision that addresses the issue of measuring where compensation comes from for distributors.

While a national statute codifying a definition of illegal pyramid schemes and their key identifying features could be a helpful step forward for protecting distributors from entering into a business structure designed for them to fail, the Anti-Pyramid Act of 2017 is not that statute.²⁹¹ The language used in the Anti-Pyramid Act would codify the gaps created by court standards.²⁹² In the same way that the *Amway* safeguards did not prevent injury to distributors in the long run, the Anti-Pyramid Act would not prevent companies or other distributors from employing tactics that would cause financial injury.²⁹³ For example, the bill’s definition of a “pyramid promotional scheme” is “any plan or operation in which individuals pay consideration for the right to receive compensation that is based upon recruiting other individuals into the plan or operation rather than *primarily* related to the sale of products or services to ultimate users.”²⁹⁴ This

288. *Direct Selling Caucus*, *supra* note 206.

289. See *Member Directory Results*, DIRECT SELLING ASS’N, <https://www.dsa.org/forms/CompanyFormPublicMembers/search?action=find> [<https://perma.cc/KZ5H-ESUH>] (displaying companies like Herbalife and Amway that have been involved in previous actions with the FTC in which they were alleged to be acting in unfair or deceptive ways and/or operating as pyramid schemes).

290. Anti-Pyramid Promotional Scheme Act of 2017, H.R. 3409, 115th Cong. (2017), <https://www.govinfo.gov/content/pkg/BILLS-115hr3409ih/pdf/BILLS-115hr3409ih.pdf> [<https://perma.cc/5G9Z-WMKR>].

291. See Vandersloot, *supra* note 284 (“We would enthusiastically support legislation that would actually prevent the practice of inventory loading and illegal pyramid schemes. But in its current form, H.R. 3409 does the opposite.”).

292. *Id.* (arguing that the definitions proposed in the Anti-Pyramid Act would allow for “serious mischief”).

293. For example, companies can easily load inventories while being in full compliance with the Anti-Pyramid Act. *Id.*

294. H.R. 3409 § 3 (emphasis added).

language mirrors the rule from *BurnLounge*, which established that participant compensation cannot come primarily from bonuses gained based on the referral of other participants.²⁹⁵ While this reads as a reasonable limitation on MLM sales structures, it is not clear what “primarily” actually means.²⁹⁶ Codifying the *BurnLounge* standard would allow bad actors to establish legitimacy with product sales even if participants gain a majority of their compensation via referral bonuses. A rule that clearly articulates what percentage of compensation must come from product sales versus referral bonuses would better serve MLM companies and participants.

The proposed Anti-Pyramid Act statute also includes language that clarifies that a company will not be considered a pyramid promotional scheme so long as they “[do] not require inventory loading” and implement a “bona fide inventory repurchasing agreement.”²⁹⁷ This proposed language mirrors some of the guidelines established in the *Amway* case, particularly having a buy-back program for participants looking to leave the program.²⁹⁸ The Anti-Pyramid Act’s repurchasing program definition articulates clear guidelines as to what companies must do in order for their repurchasing to be considered “bona fide,” but it contains several conditions on the inventory that undercut the possibility that a participant will be able to return their unused product.²⁹⁹ This includes a time limitation based on the date of

295. *FTC v. BurnLounge, Inc.*, 753 F.3d 878, 888 (9th Cir. 2014) (“[T]he rewards BurnLounge paid to Moguls were primarily in return for selling the right to participate in the money-making venture—the Mogul program. . . . The district court correctly applied the *Omnitrition* test and its conclusion that BurnLounge was an illegal pyramid scheme was amply supported by the evidence.”).

296. See generally Dan McCrum, *BurnLounge Is a Pyramid Scheme, While 9th Circuit Leaves Herbalife Debate Unresolved*, FIN. TIMES (June 3, 2014), <https://www.ft.com/content/f9e24c19-2270-3552-bc0e-f956b458a960> [<https://perma.cc/9NEH-EZQ7>] (highlighting that significant issues remain unsolved after the *BurnLounge* ruling).

297. H.R. 3409 § 2.

298. See *Amway Corp., Inc.*, 93 F.T.C. 618, 716 (1979) (discussing how the buyback rule can help prevent inventory loading).

299. See H.R. 3409 § 3 (“Bona fide inventory repurchase agreement’ means a program by which a plan or operation—(1) promises to repurchase, on commercially reasonable terms, current and marketable inventory purchased and maintained by a participant for use, consumption, or resale, upon request at the termination of the participant’s business relationship with the plan or

purchase by the participant rather than the time a termination request has been submitted.³⁰⁰ For things like repurchasing agreements to effectively support participants, there must be less qualification placed on the goods they are attempting to return, and a successful statutory scheme should reflect that.

In addition, clear rules regarding who can be considered an end “user” or customer and who is a “participant” should be set. The Anti-Pyramid Act defines the “ultimate user” as someone who uses the product or service, “whether or not the individual is a participant in the plan.”³⁰¹ This reflects a common occurrence in the MLM industry in which participants join as customers but end as a user and participant.³⁰² Although it is a common occurrence, allowing this definition to continue will not benefit participants in the long-term because it allows for a warping of other preventative measures. For example, the definition of “inventory loading” in the proposed Anti-Pyramid Act language bases the measure of excess inventory purchases on resale to ultimate users.³⁰³ This would include participants in their downline in addition to customers outside the organization, which skews what excess really means.

Repackaging the fuzzy standards regulating the MLM industry as a statutory scheme will not prevent de facto pyramid schemes from continuing to establish themselves.³⁰⁴ A much more nuanced rule should be written by Congress that considers

operation; and (2) clearly communicates such terms in its recruiting literature, sales manual, or contracts with participants, including the manner in which the repurchase is to be exercised and disclosure of any inventory not eligible for repurchase under the program.”). The exact conditions upon which inventory can be determined are spelled out in the following paragraphs of the bill. *Id.*

300. *See id.* (“‘Commercially reasonable’ means, with respect to the terms of repurchase by a plan or operation of current and marketable inventory from a participant, that the inventory is repurchased not later than 12 months after the date of purchase at not less than 90 percent of the original net cost to the participant, less appropriate set-offs and legal claims, if any.”).

301. *Id.*

302. *Cf. Wiczner, supra* note 23 (describing how participants who received a Herbalife settlement check used that payment to buy more products).

303. *See* H.R. 3409 § 3 (“‘Inventory loading’ means a practice in which a plan or operation requires or encourages its participants to purchase inventory in an amount exceeding that which the participant can reasonably expect to use, consume, or resell to ultimate users, and that is not subject to a bona fide repurchase agreement.”).

304. *See* Vandersloot, *supra* note 284 (noting that inadequacies in the Anti-Pyramid Act would cause bad operators to be “emboldened”).

the incentives that drive distributors to join MLMs and what incentives would help distributors as well as MLM leadership teams to avoid tactics that promote illegal business practices.

B. A “BUSINESS OPPORTUNITY” THE FTC CANNOT REFUSE

Another straightforward step that should be taken is to improve transparency of the actual business opportunity an MLM offers to potential distributors when they join. This can be accomplished by the FTC updating language in the Business Opportunity Rule to incorporate MLMs.³⁰⁵ The Business Opportunity Rule establishes that a disclosure document must be given to a prospective purchaser of a “business opportunity” at least seven days before that purchaser signs a contract or makes payment for the “business opportunity.”³⁰⁶ Failure to provide a disclosure document to the prospective purchaser is a violation of both the Business Opportunity Rule and Section 5 of the FTC Act.³⁰⁷ According to the rule, a business opportunity is an arrangement in which “[a] seller solicits a prospective purchaser to enter into a new business . . . [and] the prospective purchaser makes a required payment.”³⁰⁸ Before the purchase, the seller makes representations to the purchaser about what will be provided to them as a new seller.³⁰⁹ Currently, the rule does not encompass any businesses in the MLM industry.³¹⁰ However, the

305. Currently, the Business Opportunity Rule contains no mention of MLMs. *See* 16 C.F.R. § 437 (2023).

306. *See id.* § 437.2. The disclosure document requires six pieces of material information to be included: identifying information, earnings claims, legal actions, cancellation or refund policy, references, and a receipt to be signed by the prospective purchaser that they received the disclosure document. *Id.* § 437.3(a)(1)–(6).

307. *Id.*; *see* 15 U.S.C. § 45(a) (setting forth Section 5 of the FTC Act).

308. 16 C.F.R. § 437.1(c).

309. *Id.*

310. However, the Business Opportunity Rule does encompass other “work-at-home” arrangements like “envelope stuffing” or “craft assembly.” *See Selling a Work-At-Home or Other Business Opportunity? Revised Rule May Apply to You*, FED. TRADE COMM’N (Nov. 2011), <https://www.ftc.gov/business-guidance/resources/selling-work-home-or-other-business-opportunity-revised-rule-may-apply-you-1> [<https://perma.cc/38AE-KBZ5>].

industry already has a significant history with the rule through its drafting.³¹¹

When the rule was originally proposed in 2006, its language encompassed MLMs as one of the types of companies that would need to publicly disclose the actual potential earnings for those interested in the business opportunity they were offering.³¹² The DSA, of which many MLMs are a part, was consulted in the drafting of the FTC's first proposed rule.³¹³ Many of its concerns were addressed directly in the proposed rule, but ultimately MLMs still qualified under the rule as proposed in 2006.³¹⁴ When the proposed rule was *published* in the Federal Register, it received over 17,000 comments, the majority of which came from the DSA, member companies of the DSA, and individual

311. See Matt Stroud, *How Lobbying Dollars Prop Up Pyramid Schemes*, VERGE (Apr. 8, 2014), <https://www.theverge.com/2014/4/8/5590550/alleged-pyramid-schemes-lobbying-ftc> [<https://perma.cc/8E9J-QPFP>] (“After years of political maneuvering, the principal organization that represents MLMs—the Direct Selling Association (DSA)—succeeded in exempting most MLM distributors from this new law, which was designed with ‘work-from-home’ business-opportunity sellers in mind.”).

312. See Business Opportunity Rule, 73 Fed. Reg. 16110, 16110 (Mar. 26, 2008) (to be codified at 16 C.F.R. pt. 437) (noting that the comments led the Commission to narrow the scope of the proposed Rule to avoid broadly sweeping in sellers of multi-level marketing opportunities); see also Sergio Pareja, *Sales Gone Wild: Will the FTC’s Business Opportunity Rule Put an End to Pyramid Marketing Schemes?*, 39 MCGEORGE L. REV. 83, 108 (2008) (“The ‘business opportunity’ definition in the Proposed Rule ‘contemplates that business opportunity sellers will solicit prospective purchasers to enter into new businesses, as opposed to merely soliciting purchasers for goods or services.’” (quoting Business Opportunity Rule, 71 Fed. Reg. 19054, 19087 (proposed Apr. 12, 2006) (to be codified at 16 C.F.R. pt. 437.1(d))). However, the proposed rule would not have affected MLM distributors who seek out customers for the company’s products. *Id.* Rather, it would have affected only distributors who seek out new distributors. *Id.*

313. See Business Opportunity Rule, 71 Fed. Reg. at 19056 (listing the DSA as one of the groups the FTC consulted in their process to create the rule on publicly held workshops); Vandersloot, *supra* note 284 (noting that the DSA played a role in crafting the language of the bill).

314. See Business Opportunity Rule, 71 Fed. Reg. at 19080 (“The proposed Rule would cover those business opportunities currently covered by the Franchise Rule, as well as those not covered by the Franchise Rule, including work-at-home and multilevel marketing programs.”). In fact, the FTC devoted a lengthy section to discussing the harmful effects of pyramid schemes and the need for increased regulation in this area in the proposed regulation. See *id.* at 19060–61.

participants in MLMs.³¹⁵ The comments expressed serious concerns about including MLMs in the rule, ranging from how the proposed rule would burden different MLM companies to how the rule was detrimental to individual sellers participating in the market of direct selling.³¹⁶ The industry expressed concern about the high burden the rule imposed on companies with little benefit to consumers and the misrepresentation of certain behaviors of different direct selling companies to the public if they are not in compliance.³¹⁷ Individual sellers were concerned about how the rule would “hamper their ability to run their small businesses.”³¹⁸

These concerns were considered by the FTC, and ultimately MLMs were successful in having the language explicitly including them in the rule removed.³¹⁹ It was determined that Section 5 of the FTC Act would be a better avenue to address potentially fraudulent activity.³²⁰ Since the final rule’s adoption in 2011, MLMs have continued offering business opportunities to new distributors without being required to disclose what that opportunity really is.

In November 2022, the FTC opened comments for potential updates to the Business Opportunity Rule.³²¹ It called for

315. Business Opportunity Rule, 73 Fed. Reg. at 16113.

316. *See id.* (documenting that the comments urged the Commission to narrow the rule).

317. *Id.* at 16121 (highlighting industry concerns that the burdens imposed on MLMs are not justified because the proposed Rule does not help consumers identify fraudulent ventures). In addition, MLMs also expressed concern about the indirect cost of loss recruitment. *Id.*

318. *Id.* at 16118.

319. *Id.* at 16114 (“[T]he Commission has narrowed the proposed definition of the term ‘business opportunity,’ to exclude from coverage distribution arrangements in which the only required payment is for reasonable amounts of inventory at bona fide wholesale prices. In addition, the proposed definition of ‘business opportunity’ has been substantially narrowed as explained in Section D.”). To see how the language differed, compare Business Opportunity Rule, 71 Fed. Reg. 19054, with the final codified version at 16 C.F.R. 437.

320. *See id.* at 16113 (“The Commission, therefore, has determined that at this point, it will continue to use Section 5 to challenge unfair and deceptive acts or practices in the MLM industry.”).

321. Press Release, Fed. Trade Comm’n, FTC Explores Changes, Possible Expansion of Its Business Opportunity Rule (Nov. 17, 2022), <https://www.ftc.gov/news-events/news/press-releases/2022/11/ftc-explores-changes-possible-expansion-its-business-opportunity-rule> [<https://perma.cc/MMP2-HW5N>]. For

answers to questions such as whether there are businesses or “other money-making opportunities” that are not currently covered by the Business Opportunity Rule that should be added, which may implicate MLMs.³²²

MLMs should be covered by the Business Opportunity Rule, not only because it would encourage uniform transparency across the industry, but also because it may not actually decrease the number of participants in an MLM, despite the industry’s arguments otherwise.³²³ Inclusion of MLMs under the Business Opportunity Rule would instead allow potential distributors to enter this new endeavor with more realistic expectations about possible outcomes. One of many concerns raised by the MLM industry in the initial rule proposal process was a decrease in opportunities for small business owners.³²⁴ Read

a more detailed explanation of the exact comments requested, see *FTC Seeks Comment on Business Opportunity Rule ANPR, Project No. R511993*, REGULATIONS.GOV (Nov. 24, 2022) <https://www.regulations.gov/docket/FTC-2022-0072> [<https://perma.cc/H5DT-PQVJ>].

322. FTC Explores Changes, *supra* note 321 (“The Federal Trade Commission is exploring changes to the Business Opportunity Rule, seeking comment from the public on the rule’s effectiveness and a potential expansion to the rule to cover other types of money-making opportunities, such as coaching or mentoring programs, e-commerce opportunities, or investment opportunities.”). As of November 2023, a new proposed rule has not been issued, but several comments were submitted to directly address the application of the Business Opportunity Rule to MLMs. *See, e.g.*, Stacie Bosley, Comment Regarding the Federal Trade Commission’s Business Opportunity Rule ANPR, Project No. R511993 (Jan. 22, 2023) (submitting under ID number FTC-2022-0072-0015); Senators Michael Lee, Mitt Romney, and Marsha Blackburn, Comment Letter on Federal Trade Commission’s Business Opportunity Rule ANPR, Project No. R511993 (Jan. 30, 2023) (submitting under ID number FTC-2022-0072-0030); Direct Selling Ass’n, Comment Letter on Federal Trade Commission’s Business Opportunity Rule ANPR, Project No. R511993 (Jan. 31, 2023); William Keep, Comment Letter on Federal Trade Commission’s Business Opportunity Rule ANPR, Project No. R511993 (Jan. 31, 2023) (submitting under ID number FTC-2022-0072-0031).

323. *See generally* Austin M. Miller et al., *Income Disclosure and Consumer Judgment in a Multilevel Marketing Experiment*, 57 J. CONSUMER AFFS. 92 (2023). This study found that disclosure does not affect interest in MLM business opportunities. *Id.* at 114. Interestingly, it also found that disclosing potential income earnings did help lower the outcome expectations of some in the study. *Id.* at 92. However, the disclosures increased expectations in participants who believed their earning potential to be higher than average. *Id.*

324. Business Opportunity Rule, 73 Fed. Reg. at 16118 (“Many of these commenters extolled the benefits of the products they sell and overwhelmingly

another way, there was concern that required disclosure of the potential income from the business opportunity would decrease interest in joining an MLM. However, there is evidence that even when a participant is told it is likely they will not make any money, the chance that they join an MLM does not decrease.³²⁵ Disclosures made to participants of their potential earnings did not significantly affect subjects' interest in the MLM opportunity.³²⁶ Furthermore, these disclosures did decrease the participants' income expectations—sometimes even by half.³²⁷ Not only would this benefit participants as they determine whether they would like to become a distributor for an MLM, but it would also encourage more uniform disclosure of earning potential for the wider industry.³²⁸

The MLM industry has fought to be excluded from the Business Opportunity Rule on the basis that it is too onerous a burden financially compared to the benefit to consumers, but if distributors are asked to make a financial investment in becoming a distributor, it is reasonable for the company to invest in giving a clear picture of what is being offered. This empowers distributors to make informed choices based on real data, not word of mouth from a fellow distributor who may or may not know what kind of opportunity is really being offered.

CONCLUSION

It is not an objective question to determine how the law should influence behavior. No matter what stance one takes regarding the MLM industry, there is a way for the industry to operate without creating an environment where almost everyone loses. Two actions can be taken at the federal level to decrease deceptive behavior within the MLM industry and give potential participants the tools to make fully informed choices. The first is

urged the Commission not to impose a rule that would hamper their ability to run their small businesses.”).

325. See Miller et al., *supra* note 323, at 113–17.

326. *Id.* at 114.

327. *Id.* (“Across all subjects, estimated typical earnings are reduced by about half if subjects are shown the company-produced income disclosure and half again if they are shown the graphical disclosure that clearly accounts for the likelihood of earning zero revenue.”).

328. Historically, MLMs could voluntarily make disclosures of income, but many chose not to do so. However, some MLM firms are now making voluntary disclosures. *Id.* at 93.

to enact a law with enough structure that fraudulent behavior is easier to identify and prevent. The second is to update the FTC Business Opportunity Rule to encompass MLM businesses. Both of these solutions are necessary in order for future distributors to join communities understanding clearly the potential financial risks, and for fewer of them to experience substantial financial injury when they do.