# Business Guidance Concerning Multi-Level Marketing

**TAGS:** Advertising and Marketing | Advertising and Marketing Basics | Franchises, Business Opportunities, and Investments

Do you have questions about multi-level marketing? The FTC staff has guidance to help members of the MLM industry apply core consumer protection principles to their business practices.

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Multi-level marketing is a diverse and varied industry, employing many different structures and methods of selling. Although there may be significant differences in how multi-level marketers sell their products or services, core consumer protection principles are applicable to every member of the industry. The Commission staff offers this non-binding guidance to assist multi-level marketers in applying those core principles to their business practices.

### 1. What is direct selling? What is multi-level marketing?

Direct selling is a blanket term that encompasses a variety of business forms premised on person-to-person selling in locations other than a retail establishment, such as social media platforms or the home of the salesperson or prospective customer.

Multi-level marketing is one form of direct selling. Generally, a multi-level marketer (MLM) distributes products or services through a network of salespeople who are not employees of the company and do not receive a salary or wage. Instead, members of the company's salesforce usually are treated as independent contractors, who may earn income depending on their own revenues and expenses. Typically, the company does not directly recruit its salesforce, but relies upon its existing salespeople to recruit additional salespeople, which creates multiple levels of “distributors” or “participants” organized in “downlines.” A participant’s “downline” is the network of his or her recruits, and recruits of those recruits, and so on.

### 2. Under Section 5 of the FTC Act, what is an MLM with an unlawful compensation structure, which is sometimes called a pyramid scheme?

The most widely-cited description of an unlawful MLM structure appears in the FTC’s *Koscot* decision, which observed that such enterprises are “characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to the sale of the product to ultimate users.” *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975).[1]

[1] This document is focused specifically on MLM practices that may violate the FTC Act. It does not address other types of unlawful structures that do not involve the right to sell a product or service, such as chain referral schemes (sometimes called “chain letters”) and Ponzi schemes.

### 3. How do MLMs with unfair or deceptive compensation structures harm consumers?

An MLM compensation structure that incentivizes participants to buy product, and to recruit additional participants to buy product, to advance in the marketing program rather than in response to consumer demand in the marketplace, poses particular risks of injury. Where such an unlawful compensation structure exists, a participant is unlikely to be able to earn money or recover his or her costs through selling product to the public. In such circumstances, participants will often attempt to recruit new participants who will buy product, and pressure existing recruits to buy product, with little concern for consumer demand. Where an MLM has a compensation structure in which participants’ purchases are driven by the aspiration to earn compensation based on other participants’ purchases rather than demand by ultimate users, a substantial percentage of participants will lose money.

### 4. How does the FTC distinguish between MLMs with lawful and unlawful compensation structures?

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. In evaluating MLM practices, the FTC, in accord with established case law, focuses on how the structure as a whole operates in practice, and considers factors including marketing representations, participant experiences, the compensation plan, and the incentives that the compensation structure creates. The assessment of an MLM’s compensation structure is a fact-specific determination that the FTC makes after careful investigation.

## 5. How does the FTC treat personal (or internal) consumption by participants in determining if an MLM's compensation structure is unfair or deceptive?

Product that is purchased and consumed by participants to satisfy their own genuine product demand – as distinct from all product purchased by participants that is not resold – is not in itself indicative of a problematic MLM compensation structure. For example, the final order entered in *FTC v. Herbalife* permits the payment of compensation based on personal consumption, subject to specific limitations and verification requirements. However, the FTC's law enforcement experience has shown that MLM participants may buy product – and recruit or pressure other participants to buy product – for reasons other than their own or other consumers' actual demand, such as to advance in the marketing program.

This issue, like all issues concerning the evaluation of an MLM's compensation structure, is fact-specific and usually involves a comprehensive analysis of a variety of factors. It is worthwhile, however, to highlight two topics that the FTC is likely to consider when evaluating an MLM's payment of compensation that is premised, in part, on participants buying product that is not resold. First, the FTC staff is likely to consider whether features of the MLM's compensation structure incentivize or encourage participants to purchase product for reasons other than satisfying their own personal demand or actual consumer demand in the marketplace. Second, the FTC staff is likely to consider information bearing on whether particular wholesale purchases by business opportunity participants were made to satisfy personal demand. The persuasiveness of this information in any particular case will depend on its reliability.

The FTC's case against BurnLounge provides an example. BurnLounge argued that its participants bought product packages consisting of sales websites and music-related merchandise because they wanted to use the merchandise. When BurnLounge's product packages were untied from the business opportunity, however, monthly sales of these packages plummeted by almost 98 percent. At most, actual demand was responsible for only a small minority of package sales, and BurnLounge was found to have an unfair or deceptive compensation structure.

## 6. Is it still correct, as stated in the 2004 "FTC Staff Advisory Opinion – Pyramid Scheme Analysis," that "the amount of internal consumption in any multi-level compensation business does not determine" whether the FTC will consider the MLM's compensation structure unlawful?

Yes. Personal or internal consumption – meaning product participants purchase and consume to satisfy their own genuine product demand – does not determine whether the FTC will consider an MLM's compensation structure unlawful. As noted in the answer to question 5, when evaluating the issue of participants' internal consumption, the FTC staff is likely to consider, among other factors, both (i) whether features of the MLM's compensation structure incentivize or encourage participants to purchase product for reasons other than satisfying genuine demand; and (ii) information bearing on whether purchases were in fact made to satisfy personal demand to consume the product. When evaluating MLMs, the FTC focuses on how the structure as a whole operates in practice and considers factors including marketing representations, participant experiences, the compensation plan, and the incentives that the compensation structure creates.

The 2004 letter should not be misconstrued as suggesting that an MLM can lawfully pay compensation on wholesale purchases that are not based on actual consumer demand by characterizing such purchases as "internal consumption." The 2004 letter itself does not support such a construction, nor do subsequent judicial decisions. For example, the court in *BurnLounge* held that, notwithstanding the defendants' characterization that participants bought packages for "internal consumption," the compensation paid on such purchases was not tied to consumer demand for the merchandise in the packages; instead, the opportunity to advance in the marketing program was the major driver of package purchases. Similarly, in granting a preliminary injunction against Vemma Nutrition Company, the court rejected the argument that individuals who had joined as business opportunity "Affiliates" only wished to purchase product for their own consumption, finding that this claim was "not based in fact."

### 7. What is "inventory loading"? Do buyback provisions cure inventory loading?

"Inventory loading" is a term that may be used to describe a participant's wholesale product purchases that are made in an attempt to advance in the marketing program, rather than made to satisfy actual consumer demand in the marketplace for those products. Just as MLMs involve a variety of structures and products, payments that participants make to advance in the marketing program rather than to purchase product to satisfy actual consumer demand can take many forms, such as expenditures to purchase inventory.

As in any business opportunity, it can be a beneficial practice if an MLM allows participants to return unsold product to the MLM because the ability to return product can decrease the risk of losing money for participants who take advantage of that policy. Allowing participants to return product, however, does not in and of itself shield an unfair or deceptive compensation structure from law enforcement. As a general matter, money-back guarantees and refunds are not defenses for violations of the FTC Act. Even where such policies are offered, dissatisfied participants may not seek a refund for a number of reasons, including because they are unaware of their right to a refund, the refund process is too complicated or obscure, or they blame themselves for not being able to sell the product.

### 8. Does the FTC Act require MLMs to retain sales receipts?

No, there is no such requirement. However, as discussed above, to comply with the FTC Act, the compensation structure of an MLM must be based on actual sales to real customers. Thus, documentation of actual sales to real customers provides relevant information concerning an MLM's compensation structure.

There is no single method for creating and retaining such documentation. Different MLMs employ a variety of approaches to demonstrate that their product is sold to retail customers, including collecting retail sales receipts created by participants; having retail customers buy product directly from the company, rather than from a participant's inventory; and having product users sign up with the company as customers who are not participating in a business opportunity. Other MLMs use other approaches or a combination of approaches.

The most persuasive documentation is obtained through direct methods and used to verify that retail sales are made to real customers. Documentation obtained through indirect methods – such as policies requiring participants to attest they have sold a certain amount of product to qualify to receive reward payments – are less likely to be persuasive, with unsupported assertions being even less persuasive.

### 9. Are there specific federal statutes or regulations enforced by the FTC that relate to multi-level marketing?

The FTC enforces a variety of laws and regulations relating to advertising, marketing, sales, billing, privacy, data security, franchises, and business opportunities, among other topics, that apply or may apply to MLMs. Helpful information for businesses interested in these topics is available at the FTC's Business Center.

### 10. Are MLMs subject to the FTC's Business Opportunity Rule?

As stated in the Business Opportunity Rule's Statement of Basis and Purpose, the Commission crafted the Rule to avoid broadly sweeping in MLMs. It did so by tailoring the definition of business opportunity to exclude certain types of business assistance common to MLMs. 76 Fed. Reg. 76816, 76824 (Dec. 8, 2011). It is important to note, however, that the Rule does not explicitly exempt MLMs from coverage. As with any other business entity, the determination whether an MLM would be a business opportunity to which the Rule applies would have to be made on a case-by-case basis.

### 11. The FTC has proceeded case-by-case in evaluating whether the claims or conduct of multi-level marketers violated Section 5 of the FTC Act. Why?

In many areas, the Commission undertakes case-by-case law enforcement, which can offer significant benefits when compared with prescriptive rulemaking or legislative action. For example, a case-by-case approach allows the FTC to address bad actors engaged in a specific harm, without directly affecting an entire industry. This approach also limits the potential unintended consequences that can result from one-size-fits-all industry standards in statutes or regulations.

### 12. Are orders obtained as a result of FTC enforcement actions, such as the ones entered in *FTC v. Herbalife* and *FTC v. Vemma Nutrition Co.*, binding on the industry?

Orders obtained through settlements of FTC law enforcement actions are not binding on the entire industry. Such orders, however, can be useful to MLMs that are not bound by them. Industry members may choose voluntarily to follow the provisions in these orders or to consider the provisions in developing their own practices and procedures. All industry members have an obligation to follow the law, and the provisions in FTC orders may provide guidance and insights to help them do so.

### 13. How should an MLM approach representations to current and prospective participants?

An MLM's representations and messaging concerning the business opportunity it offers must be truthful and non-misleading to avoid being deceptive under Section 5 of the FTC Act. An MLM's representations about its business opportunity, including earnings claims, violate Section 5 of the FTC Act if they are false, misleading, or unsubstantiated and material to consumers.

Although whether representations are deceptive is a fact-specific inquiry, below are some guiding principles.

- A company must have a reasonable basis for the claims it makes or disseminates to current or prospective participants about its business opportunity. A "reasonable basis" means objective evidence that supports the claim. If a company lacks such objective supporting evidence, the claims are likely deceptive.
- Some business opportunities may present themselves as a way for participants to get rich or lead a wealthy lifestyle. They may make such representations through words or through images such as expensive houses, luxury automobiles, and exotic vacations. If participants generally do not achieve such results, these representations likely would be false or misleading to current or prospective participants.
- Business opportunities may also claim that participants, while not necessarily becoming wealthy, can achieve career-level income. They may represent through words or images that participants can earn thousands of dollars a month, quit their jobs, "fire their bosses," or become stay-at-home parents. If participants generally do not achieve such results, these representations likely would be false or misleading to current or prospective participants.
- Even truthful testimonials from the very small minority of participants who do earn career-level income or more will likely be misleading unless the advertising or presentation also makes clear the amount earned or lost by most participants. (For more information on this topic, see the FTC's Guides Concerning the Use of Endorsements and Testimonials in Advertising.)

- In addition, a hypothetical earnings scenario – such as "if you recruit 30 people who each sell $1,000 of product each month, you will earn $1,500 a month" – may imply that the assumptions made (*e.g.*, the number of people recruited, the amount sold by each recruit) are consistent with the actual experiences of typical participants. If the assumptions are not, the earnings scenario likely would be false or misleading to consumers.
- An MLM's compensation structure may give its participants incentives to make representations about the business opportunity to current or prospective participants. As a consequence, an MLM should (i) direct its participants not to make false, misleading, or unsubstantiated representations and (ii) monitor its participants so they don't make false, misleading, or unsubstantiated representations.

### 14. What are some elements of a successful MLM compliance program?

An MLM's compliance program should ensure that the MLM accurately represents the business opportunity it offers, both through its own marketing materials and messaging and through the representations its participants make to current or prospective participants. In addition, an MLM's compliance program should ensure that compensation paid by the MLM is based on actual sales to real customers, rather than based on wholesale purchases or other payments by its participants.

### 15. How does the FTC consider compliance with industry self-regulatory standards in its assessments of MLMs?

The FTC has long supported industry self-regulation as an efficient way to secure consumer benefits and promote a robust and competitive marketplace. MLM self-regulation may create these same types of benefits.

Belonging to a self-regulatory organization, however, does not shield MLMs engaged in unfair and deceptive practices from FTC law enforcement action. Under appropriate circumstances, the FTC can and will bring law enforcement actions against companies that claim to follow self-regulatory guidelines but in practice do not. Similarly, the FTC can and will bring law enforcement actions against companies that, despite following such guidelines, nonetheless violate the FTC Act.

### 16. Beyond law enforcement, what activities does the FTC undertake with respect to multi-level marketing?

As in many other areas, the FTC periodically meets with consumer groups, industry representatives, and other stakeholders to learn more about evolving practices and concerns. Also, the FTC has issued and updates consumer and business educational materials. In addition, the FTC's Bureau of Economics has devoted and continues to devote its research expertise to issues relating to direct sales and multi-level marketing. These various efforts can provide valuable insight to inform the FTC's investigations of MLMs, which involve fact-specific and comprehensive analysis of multiple factors.

### 17. What should stakeholders do if they believe the claims or other conduct of multi-level marketers may be unlawful?

The FTC welcomes complaints from any individuals who have concerns about the conduct of a multi-level marketer. Concerned individuals can share their complaints with the Commission online through the FTC's Complaint Assistant.

### 18. Are the answers in this document legally binding?

No, this is an FTC staff business guidance document. It does not necessarily represent the views of the Commission or any Commissioner and is not intended to, and does not, create any rights or obligations with respect to the Commission, the FTC staff, or the public.

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