



UNITED STATES OF AMERICA
Federal Trade Commission
Washington, D.C. 20580

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March 15, 2024

Mr. Joseph N. Mariano, President
Direct Selling Association
1667 K Street, N.W., Suite 1100
Washington, D.C. 20006

Re: Staff Advisory Opinion – Pyramid Scheme Analysis

Dear Mr. Mariano:

When I spoke at the Direct Selling Association’s (“DSA”) Legal & Regulatory Seminar on September 22, 2023, among the many topics covered was the January 14, 2004 advisory opinion letter (“2004 letter”) that staff of the Federal Trade Commission (“Staff”) sent to the DSA in response to questions posed by the DSA. I expressed my concern that Staff’s position in the 2004 letter has been repeatedly misinterpreted to assert a “primary source” test for determining whether a company operates an illegal pyramid scheme. Some in the room took issue with my comments in this regard. Because of that exchange and previous similar discussions, I write to restate Staff’s position on this discrete issue. This letter should dispel any confusion or misinterpretation regarding this issue.

The 2004 letter addressed the following issues posed by DSA: 1) “the Commission’s analysis of compensation based on personal consumption by members of a multi-level company’s sales force”; and 2) “the legal significance of consent orders that the Commission has entered into with several pyramid scheme operators.” The 2004 letter responded only to those questions. Like this letter, the 2004 letter did not comprehensively set forth Staff’s position on all aspects of pyramid law.

Some appear to have misinterpreted the discussion in the 2004 letter about personal consumption to claim that so long as 50% or more of a company’s revenue is generated by sales of its products or services to end users, the company is not a pyramid scheme. As I said at the September 22 DSA Seminar, this is neither Staff’s position nor the law regarding whether a multi-level marketing company’s (“MLM”) operation constitutes an illegal pyramid scheme. The MLM industry has evolved significantly over the years, but this has been consistent; Staff has stated as much on countless occasions, to you and others.

In a pyramid scheme, participants pay “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 product to ultimate users.” *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1182, 1975 WL 173318 at *59 (1975). This is not a percentage-based test. Under the operative legal standard, whether an MLM is a pyramid scheme depends on how the MLM’s compensation plan incentivizes participants, including the *rights* the compensation plan offers to participants. Reviewing the MLM’s compensation plan to determine which activities it incentivizes is

an important step in this analysis. An MLM operates as a pyramid where the “focus [is] in promoting the program rather than selling the products.” *FTC v. BurnLounge*, 753 F.3d 878, 884 (9th Cir. 2014) (internal emphasis removed); *see also* *FTC v. Noland*, No. CV-20-47-PHX-DWL, 2023 WL 3372517, at *42 (D. Ariz. May 11, 2023) (“Put another way, the second prong of *Koscot* is satisfied when “participants purchase the right to earn profits by recruiting other participants, who themselves are interested in recruitment fees rather than the sale of products.”).

In this inquiry, “courts look beyond a company’s policies and procedures and examine how the company operates in practice.” *FTC v. Vemma Nutrition Co.*, No. 15-cv-01578, 2015 WL 11118111, at *10 (D. Ariz. Sept. 18, 2015), *citing* *BurnLounge*, 753 F.3d at 883. For example, a court has found that an MLM was a pyramid when its “focus was recruitment. . . . Recruiting was built into the compensation structure in that recruiting led to eligibility for cash rewards and more recruiting led to higher rewards.” *BurnLounge*, 753 F.3d at 884. Similarly, another court recently held that an MLM is a pyramid scheme because, among other things, it “drove []sales by pushing recruitment, taking advantage of the momentum from recruitment to sell large up-front product packs, urging large monthly purchases to stay on the path to financial freedom, and encouraging one’s recruits to do the same (*i.e.*, to ‘duplicate’).” *Noland*, 2023 WL 3372517, at *43.

Courts will look at the structure of the organization, both on paper and in practice, to see whether recruitment, rather than selling products, is the focus of the business opportunity. *See BurnLounge*, 753 F.3d at 884-7. Under *Koscot*, rewards need not be completely unrelated to retail sales. *Id.* at 886; *see also Koscot*, 86 F.T.C. 1106, 1182, 1975 WL 173318 at *59 (“Indeed, even where rewards are based upon sales to consumers, a scheme which represents to all comers that they can recoup their investments by virtue of the product sales of their *recruits* must end up disappointing those at the bottom who can find no recruits capable of making retail sales.”) (emphasis in original). Also, while purchases by participants do not per se result in a pyramid, “evidence that distributors purchase and consume product for the purpose of qualifying for recruitment incentives is evidence of a pyramid scheme.” *Vemma*, 2015 WL 11118111, at *3. Where recruiting is necessary to earn significant rewards and the system is set up to motivate participants to earn rewards, it is clear that rewards are for recruiting. *BurnLounge*, 753 F.3d at 887 (collecting cases).

In some earlier cases, the FTC has included counts that allege pyramid violations where the compensation program was “based *primarily* on providing payments to participants for the recruitment of new participants, not on the retail sale of products or services.” *See, e.g.*, Complaint, ¶ 66, *FTC v. Vemma Nutrition Co.*, Case No. CV-15-578 (D. Ariz. filed 2015) (emphasis added). The use of counts in this style was a litigation decision in cases where the Commission considered the pyramid structure to be particularly blatant, and court decisions in those cases sometimes echoed the framing of the count. Thus, we recognize that some courts have referred in their decisions to the “primary source” of revenues or of participant rewards, but those statements were not the key holdings in the decisions. Courts have evaluated the structure of the MLM as a whole, including what rights are given to participants, how they are compensated, and what activities are incentivized by the program.

I hope this letter corrects the misinterpretation of the 2004 letter by some. Because of the extensive misuse of the letter, I no longer consider it to be a valid and useful statement of Staff’s views and therefore rescind it.

This letter sets out the views of the Staff of the Bureau of Consumer Protection. The Commission is not bound by this Staff opinion and reserves the right to rescind it at a later time. In addition, Staff retain the right to reconsider the questions involved and to rescind the opinion if it would be in the public interest to do so. Also, advice rendered by Staff is without prejudice to the right of the Commission later to rescind the advice and, where appropriate, to commence an enforcement proceeding. In the interests of transparency, this letter is being posted on the FTC's website.

Respectfully,

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GREISMAN

A digital signature consisting of a red scribble and a text box containing the following information: Digitally signed by LOIS GREISMAN, Date: 2024.03.15 10:14:13 -04'00'

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