

NOTE

Multilevel Madness: Regulating Unfair Business Practices in Multilevel Marketing

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ABSTRACT

Multilevel marketing businesses (“MLMs”) sell everything from makeup to protein shakes, from dietary supplements to legal services. During the COVID-19 pandemic, people facing income insecurity who wished to work from home turned to the social-media driven MLM business model in droves. Most MLM participants, however, make little, if any, money from their participation in the multibillion-dollar industry.

Recently, there has been a push to remove the exemption that excludes most MLMs from disclosure obligations under the Federal Trade Commission’s Business Opportunity Rule. Although this is a step in the right direction, disclosure itself is not a complete answer to the harm MLMs can inflict upon participants. This Note recommends that the Federal Trade Commission promulgate a rule identifying certain business practices used by MLMs as per se unfair using its rulemaking authority under Section 57a of the Federal Trade Commission Act. Doing so would allow the Commission to seek consumer redress from companies that violate the rule and exploit participants for economic gain.

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INTRODUCTION

When Courtney Harwood gave up her full-time corporate career and took out a loan to pay LuLaRoe’s \$5,000 startup fee, she thought joining the multilevel marketing (“MLM”) company would allow her to make money while spending more time with her children.¹ Instead, she lost over \$100,000.² Ms. Harwood’s story is just one of many similar stories featured in the 2021 docuseries *LuLaRich*. Most of the women interviewed paid exorbitant fees to join LuLaRoe’s “business opportunity” and ended up losing thousands of dollars.³

While the docuseries undoubtedly focuses on the salacious aspects of LuLaRoe’s operations—including religious manipulation, excessive corporate spending, and unusual family dynamics⁴—the basic economic story reflects reality: most multilevel marketing participants do not make money.⁵

1 *LuLaRich: Start Up* (Amazon Studios television stream 2021).

2 *LuLaRich: Toe Up* (Amazon Studios television stream 2021).

3 *See LuLaRich* (Amazon Studios 2021).

4 *Id.*

5 *See Multi-Level Marketing Businesses and Pyramid Schemes*, FTC (May 2021), <https://www.consumer.ftc.gov/articles/multi-level-marketing-businesses-and-pyramid-schemes#MLM> [<https://perma.cc/8RSG-HNCK>] (instructing potential MLM participants of the risks of joining an MLM and providing criteria to determine whether an MLM is worthwhile).

MLM businesses, or businesses that recruit independent-contractor “distributors” to sell products and recruit other distributors,⁶ rose to prominence in the 1950s with “Tupperware parties,” and became emblematic of the idealized suburban lifestyle.⁷ Since then, the MLM model has been used to sell a wide variety of products and services, including clothing,⁸ supplements,⁹ beauty products,¹⁰ and even legal services.¹¹ During the COVID-19 pandemic, MLMs grew, benefiting from social media, economic insecurity, and the desire to work from home.¹²

Many who joined MLMs in a bid to regain financial stability amid the pandemic, however, would end up disappointed. According to the Federal Trade Commission, “[m]ost people who join . . . MLMs make little or no money. Some of them lose money.”¹³ Though often presented as a money-making opportunity, distributors have a very low chance of seeing significant—or any—profits from the endeavor.¹⁴ One recent survey of U.S. MLM participants found they had average earnings of approximately 70 cents per hour from their MLM work.¹⁵

⁶ See *id.*

⁷ See Erin Blakemore, *Tupperware Parties: Suburban Women’s Plastic Path to Empowerment*, HIST. (Mar. 1, 2019), <https://www.history.com/news/tupperware-parties-brownie-wise> [<https://perma.cc/E2LQ-3SQC>].

⁸ See, e.g., LULAROE, <https://www.lularoe.com> [<https://perma.cc/W2H6-C6D7>].

⁹ See, e.g., HERBALIFE NUTRITION, <https://www.herbalife.com> [<https://perma.cc/3SWY-SEHJ>].

¹⁰ See, e.g., ARBONNE, <https://www.arbonne.com/us/en>.

¹¹ See, e.g., LEGALSHIELD, <https://www.legalshield.com> [<https://perma.cc/BAQ8-SDZV>].

¹² See *Direct Selling in the United States: 2020 Industry Overview*, DIRECT SELLING ASS’N, https://www.dsa.org/docs/default-source/research/dsa-industry-overview-fact-sheet.pdf?sfvrsn=69c1daa5_6#:~:text=10%25%200%25%20Direct%20selling%20in,in%20retail%20sales%20in%202020. [<https://perma.cc/L7F3-XJMQ>] (stating that direct retail sales, which includes MLMs, grew 13.9% in 2020, with the top performing product category (wellness) growing 37.4%). For anecdotal evidence of MLMs’ growth during the COVID-19 pandemic, see generally Abby Vesoulis & Eliana Dockterman, *Pandemic Schemes: How Multilevel Marketing Distributors Are Using the Internet—and Coronavirus—To Grow their Businesses*, TIME (July 9, 2020, 6:29 AM), <https://time.com/5864712/multilevel-marketing-schemes-coronavirus/> [<https://perma.cc/7TJY-EAJW>]; Katie Bishop, *‘It’s Desperation’—The Multi-Level Marketing Scheme Using COVID to Attract Recruits*, VICE (June 3, 2021, 4:15 AM), <https://www.vice.com/en/article/m7eb34/mlm-arbonne-coronavirus-recruitment> [<https://perma.cc/WAU3-YAAV>]; Michael Waters, *‘They Saw an Opportunity with the Pandemic’: How Social Media Platforms Gave Multi-Level Marketing a Coronavirus Surge*, MODERNRETAIL (Nov. 10, 2020), <https://www.modernretail.co/retailers/they-saw-an-opportunity-with-the-pandemic-how-social-media-platforms-gave-multi-level-marketing-a-coronavirus-surge/> [<https://perma.cc/7PCC-D84Q>].

¹³ FTC, *supra* note 5.

¹⁴ See *id.*

¹⁵ Brittney Laryea, *Survey: Vast Majority of Multilevel Marketing Participants Earn Less than 70 Cents an Hour*, MAGNIFYMONEY (Sept. 17, 2018), <https://www.magnifymoney.com/blog/>

Although the Federal Trade Commission can seek enforcement action against MLMs that use unfair business practices pursuant to its general authority under Section 5 of the Federal Trade Commission Act,¹⁶ the Commission does not have any rules specifying what those practices are.¹⁷ Additionally, MLMs are generally exempt from the rule requiring disclosures from enterprises that purport to sell business opportunities.¹⁸ Specifying certain practices as per se unfair would implement a clearer path for the Commission to act against MLMs that harm consumers via certain unfair business practices and broaden the remedies the agency can seek in such cases.¹⁹

Part I of this Note examines the MLM business model, the rationale for regulating MLMs, and current regulatory and enforcement efforts. Part II addresses why disclosure alone is insufficient to address participant harms and proposes a regulatory solution for mitigating such harms.

I. BACKGROUND

An MLM is a direct sales organization that recruits independent distributors and compensates them for (1) selling products or services, (2) recruiting new distributors—together with the new distributors' subsequent recruits and so on, the original distributor's "downline"²⁰—or (3) sales made by those in their downline.²¹ MLM distributors often refer to themselves as "entrepreneurs"²² and handle their own recruitment, sales, and advertising with little operational support

news/survey-vast-majority-multilevel-marketing-participants-earn-less-70-cents-hour/ [https://perma.cc/T57G-QXX6].

¹⁶ Federal Trade Commission Act of 1914, 15 U.S.C. §§ 41–58.

¹⁷ See generally, *Legal Library: Rules*, FTC, <https://www.ftc.gov/enforcement/rules/rules-and-guides> [https://perma.cc/SH9A-99DG].

¹⁸ See Business Opportunity Rule, 16 C.F.R. § 437.1.

¹⁹ Compare 15 U.S.C. § 45(b), with 15 U.S.C. § 45(n).

²⁰ Letter from James Kohan, Acting Dir. of Mktg. Prac., FTC, to Neil H. Offen, President, Direct Selling Ass'n (Jan. 14, 2004) https://www.ftc.gov/system/files/documents/advisory_opinions/staff-advisory-opinion-pyramid-scheme-analysis/040114bizopp-pyramid.pdf [https://perma.cc/SBU3-LF47] (advisory opinion regarding the FTC's Pyramid Scheme Analysis) [hereinafter FTC Advisory Opinion].

²¹ See FTC, *supra* note 5; Vincent G. Ella, *Multi-Level or Pyramid Sales Systems: Fraud or Free Enterprise*, 18 S.D. L. REV. 358, 360 (1973) (offering an early overview of MLMs and discussing the possibility that consumers might be misled by the nature of the business).

²² See, e.g., Casey Bond, *Joining an MLM Does Not Make You a 'Small Business Owner,'* HUFFPOST (Jan. 8, 2021), https://www.huffpost.com/entry/mlm-consultant-not-small-business-owner_1_5ff749c2c5b6fc79f46382d8 [https://perma.cc/U7KM-6MPY].

from the main enterprise.²³ MLM distributors are likely to be women.²⁴

Though often presented as an income-generating opportunity, according to the Federal Trade Commission, “[m]ost people who join legitimate MLMs make little or no money.”²⁵ Successful participants are most often those who can recruit a large downline.²⁶ Even when they are not technically illegal pyramid schemes—a type of fraudulent enterprise where participants’ earnings are heavily or entirely dependent on the money generated from recruiting new participants²⁷—MLMs present many of the same fundamental problems as pyramid schemes. They are designed so that distributors are incentivized to recruit new distributors to be part of their downline, even though most of the low-level participants will not profit and may lose money.²⁸

Some MLMs, in disclosing that the average distributors make little to no income, tacitly place the blame for this on the distributors themselves and their lack of hard work or commitment.²⁹ Viewing their failure to earn substantial income through this lens, distributors may see their lack of financial success in an MLM as a failing of their personal work ethic, rather than an organizational inevitability.³⁰ In fact, most MLMs are structured such that very few people, even with

²³ See Peter J. Vander Nat & William W. Keep, *Marketing Fraud: An Approach for Differentiating Multilevel Marketing from Pyramid Schemes*, 21 J. PUB. POL’Y & MKTG. 139, 140 (2002).

²⁴ See DIRECT SELLING ASS’N, *supra* note 12.

²⁵ FTC, *supra* note 5; see also Vander Nat & Keep, *supra* note 23, at 149 (“[O]ngoing recruitment creates a situation in which the vast majority of distributors . . . typically fail to recoup their investments. When new participation inevitably stops because of the limitation on potential recruits, the same vast majority loses money.”).

²⁶ See E. Napoletano & Benjamin Curry, *Understanding Multi-Level Marketing*, FORBES ADVISOR (May 10, 2022, 12:18 PM), <https://www.forbes.com/advisor/investing/multi-level-marketing-mlm/> [<https://perma.cc/7EL9-9VS7>].

²⁷ See *In re Amway Corp., Inc.*, 93 F.T.C. 618, 715 (1979). For further discussion on the difference between pyramid schemes, Ponzi schemes, and MLMs, see *infra* Section I.A.1.

²⁸ See Daryl Koehn, *Ethical Issues Connected with Multi-Level Marketing Schemes*, 29 J. BUS. ETHICS 153, 153, 157 (2001) (discussing why MLMs, even when they are not technically pyramid schemes, have many of the same ethical problems as businesses that are technically pyramid schemes); Anne T. Coughlan, *Multi-Level Marketing Business Opportunities: Analyzing Net Economic Return and Avoidable Economic Loss to Distributors 1–3* (July 2016) (unpublished manuscript).

²⁹ See, e.g., 2021 U.S. Income Disclosure, AMWAY, https://www.amway.com/en_US/income-disclosure [<https://perma.cc/6SUT-4PJ3>] (“As with any other sales opportunity, the compensation earned by IBOs varies significantly. . . . Earnings depend on many factors, including: customer base, business experience, *skills, effort, dedication*, and quality and depth of your sales team.”) (emphasis added); see also Laryea, *supra* note 15 (discussing a survey of 1,049 Americans who had participated in multi-level marketing).

³⁰ See sources cited *supra* note 29.

hard work, make substantial amounts of money.³¹ One recent survey found that the majority of surveyed MLM participants make less than seventy cents per hour of time spent on their MLM participation and sixty percent of those surveyed earned less than \$500 in the last five years.³²

At the same time, MLM owners, stockholders, and a handful of distributors at the top can make huge returns.³³ Due to this imbalance, this structure has a high potential to become exploitative. The direct retail sales industry—of which MLMs are a part—made over \$40.1 billion in 2020.³⁴ Amway, one of the nation’s most well-known MLMs that sells a variety of “wellness” products, made \$8.5 billion in sales in 2020 (a two percent increase over its 2019 sales).³⁵ Meanwhile, the average income for Amway participants in the United States in 2021 was \$766 *before* expenses, which—according to Amway—“can include: registration/renewal fees, shipping charges, taxes and expenses you incur from samples, travel, any optional training and support you purchase from Approved Providers, or otherwise.”³⁶ Amway members are charged \$76 annually to maintain their registration.³⁷ This fee alone is approximately ten percent of the average annual earnings.

Agencies with the power to regulate unfair business practices have regulated similar industries in the past, such as the payday lending industry.³⁸ MLMs appeal to and target those suffering financial challenges, preying on their desperation, financial hardship, and economic uncertainty.³⁹ This is similar to the payday lending industry, in which creditors target those who are not in a strong enough financial position to access credit via traditional means.⁴⁰ While payday lending is not outlawed, it is subject to additional requirements by regulators

³¹ FTC, *supra* note 5; *see also* Vander Nat & Keep, *supra* note 23, at 140.

³² Laryea, *supra* note 15.

³³ *See* DIRECT SELLING ASS’N, *supra* note 12; *Amway Sales Reach \$8.5 Billion in 2020*, AMWAY (Feb. 25, 2021), <https://www.amwayglobal.com/newsroom/amway-sales-reach-8-5%E2%80%AFbillion-in-2020%E2%80%AF/#:~:text=THrough%20it%20all%2C%20and%20due,States%20growing%20an%20impressive%2010%25> [<https://perma.cc/3WCQ-F6VM>].

³⁴ DIRECT SELLING ASS’N, *supra* note 12.

³⁵ AMWAY, *supra* note 33.

³⁶ AMWAY, *supra* note 29 (“[A]verage income for all U.S. registered IBOs . . . was \$766 before expenses.”).

³⁷ *Id.*

³⁸ The Consumer Financial Protection Bureau passed the Payday Lending Rule, 12 C.F.R. pt. 1041, in 2018 and further amended the rule in 2019 and 2020. *See All Versions of 12 CFR Part 1041 (Payday Lending Rule)*, CONSUMER FIN. PROT. BUREAU, <https://www.consumerfinance.gov/rules-policy/regulations/1041/versions/1/> [<https://perma.cc/3GRE-9P8D>].

³⁹ *See* sources cited *supra* note 12.

⁴⁰ *See What is a Payday Loan?*, CONSUMER FIN. PROT. BUREAU, (Jan. 17, 2022), <https://>

because of the vulnerable demographic it targets.⁴¹ In reviewing the practice, the Consumer Financial Protection Bureau concluded that consumer harm exists and should be mitigated by regulatory intervention because payday loans target “consumers who are living paycheck to paycheck” and those who “struggle to repay unaffordable loans and in doing so suffer a variety of adverse consequences.”⁴²

The same logic should apply to MLMs. Although the business model is not illegal so long as it is not a pyramid scheme, the high potential for abuse even in a legitimate MLM⁴³ is reason enough for the Federal Trade Commission to take action to address specific, high-risk business practices in the industry.

A. *Regulatory Enforcement: The Federal Trade Commission*

The Federal Trade Commission can regulate MLMs and other businesses pursuant to Section 5 of the Federal Trade Commission Act, which prohibits “unfair or deceptive acts or practices.”⁴⁴ The cur-

www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567/ [<https://perma.cc/P9PT-DADQ>].

⁴¹ See Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017) (codified at 12 C.F.R. pt. 1041) (the Consumer Financial Protection Bureau promulgates and explains rules for payday and other high-cost loans, including requirements that the lender assess the borrower’s ability to repay, registration with the Bureau, and limiting the ways in which borrowers can seek direct repayment by taking funds directly out of the borrower’s account).

⁴² *Id.* at 54,472.

⁴³ See sources cited *supra* note 29.

⁴⁴ See 15 U.S.C. § 45(a). Other regulatory entities can also pursue action against MLMs. The Securities and Exchange Commission can regulate MLMs to the extent that their activities constitute the sale of securities. See *Securities Law and MLM—What’s the Deal*, REESE RICHARDS PLLC (Sept. 24, 2019), <https://www.mlmlaw.com/law-library/securities-law-and-mlm-whats-the-deal> [<https://perma.cc/RDD4-MKC6>]; *Beware of Pyramid Schemes Posing as Multi-Level Marketing Programs*, SEC (Oct. 1, 2013), https://www.sec.gov/oiea/investor-alerts-bulletins/investor-alerts-ia_pyramidhtm.html [<https://perma.cc/FH92-FU5U>]. Likewise, the United States Postal Inspection Service has the authority to investigate crimes that involve fraudulent or other illegal uses of the U.S. Postal Service; they have previously investigated businesses that constitute pyramid schemes. See *What We Do*, U.S. POSTAL SERV., <https://www.uspis.gov/about/what-we-do> [<https://perma.cc/7539-58NH>]; *Pyramid Schemes*, U.S. POSTAL SERV. (May 1, 2019), <https://www.uspis.gov/news/scam-article/pyramid-schemes> [<https://perma.cc/2H4U-7TGJ>]. This Note focuses on the enforcement by the Federal Trade Commission because the Commission has broad regulatory authority with respect to any business practice deemed “unfair or deceptive.” 15 U.S.C. § 45(a), (n).

Although there is no specific federal statute that criminalizes pyramid schemes, MLMs (and other enterprises) that operate as pyramid schemes are vulnerable to criminal charges such as mail fraud, wire fraud, and securities fraud. See *What is a Pyramid Scheme, and Is it a Chargeable Offense?*, THE WISEMAN L. FIRM (July 22, 2019), <https://www.wisemantriallaw.com/blog/2019/july/what-is-a-pyramid-scheme-and-is-it-a-chargeable-/> [<https://perma.cc/YKZ3-WGUU>]. Recently, civil litigants have alleged that certain MLMs violate the Racketeer Influenced Corrupt

rent standard for what is “unfair” was articulated by the Federal Trade Commission in a policy statement and later codified as law in Congress’s 1994 amendment to Section 5 of the Federal Trade Commission Act.⁴⁵ A business practice is unfair if it (1) causes “substantial injury to consumers,” (2) is not “reasonably avoidable” by the consumer given the information publicly available, and (3) is not justified by enabling some significant benefit to consumers or competition.⁴⁶ The Federal Trade Commission can also promulgate and enforce more specific rules,⁴⁷ such as the Business Opportunity Rule.⁴⁸

One of the ways in which the Federal Trade Commission exercises its general enforcement authority is by bringing action against a specific type of deceptive or unfair business practice: the pyramid scheme.

1. *Pyramid Schemes*

A pyramid scheme is a type of fraud where companies sell a business opportunity in which a participant’s earnings are entirely or heavily dependent upon recruiting new members to the scheme, rather than the sale of goods or services or a legitimate investment.⁴⁹ Selling a product does not disqualify a venture from being a pyramid scheme if the product offering is merely pretextual and the bulk of the income

Organizations Act (“RICO”), although such cases have not yet ended in successful criminal charges. *See RICO Charges are Proving the Weapon of Choice in the Growing Fight Against Multi-Level Marketing Schemes*, THE FASHION L. (Feb. 25, 2020), <https://www.thefashionlaw.com/rico-charges-are-proving-the-weapon-of-choice-in-the-growing-fight-against-multi-level-marketing-schemes/> [https://perma.cc/S9VK-NDGC]; *see also, e.g.*, Class Action Complaint at 16, *O’Shaughnessy v. Young Living Essential Oils, LC*, No. 1:19-CV-412 (W.D. Tex. Apr. 12, 2019); Class Action Complaint at 19–22, *Berry v. LulaRoe, LLC*, No. 5:17-cv-02176-SVW-SP (C.D. Cal. Oct. 23, 2017).

⁴⁵ *FTC Policy Statement on Unfairness*, FTC (Dec. 17, 1980), <https://www.ftc.gov/public-statements/1980/12/ftc-policy-statement-unfairness> [https://perma.cc/UJV6-M2CM]; *see* 15 U.S.C. § 45(n) (“The Commission shall have no authority . . . to declare . . . an act or practice . . . unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.”).

⁴⁶ Sources cited *supra* note 45.

⁴⁷ 15 U.S.C. § 57(a).

⁴⁸ Business Opportunity Rule, 16 C.F.R. § 437.1.

⁴⁹ *See* FTC, *supra* note 5; *Pyramid Schemes*, SEC, <https://www.investor.gov/introduction-investing/investing-basics/glossary/pyramid-schemes> [https://perma.cc/K7LN-79X9]. Note that a pyramid scheme is different from (but similar to) a Ponzi Scheme, in which participants are promised high returns and then paid with investments of new participants (but where participants are not necessarily required to recruit new participants). *See Ponzi Scheme*, SEC, <https://www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme> [https://perma.cc/TC7Y-AT62].

generated from the venture is due to recruiting new participants.⁵⁰ Pyramid schemes are considered deceptive, unfair, or even fraudulent because their structure is unsustainable; once the scheme inevitably collapses, those at the bottom are unable to recover their investment.⁵¹

The Federal Trade Commission opened the door to the possibility that MLMs could be considered pyramid schemes within the reach of its enforcement authority under Section 5 of the Federal Trade Commission Act in 1976 through *In re Koscot Interplanetary*.⁵² The Commission held that a cosmetics MLM was a pyramid scheme because it was nearly impossible for consumers who joined to recoup their (substantial) initial investment, in part because the company employed price discrimination between various distributors, and commissions were paid only for recruitment and not for actual product sales.⁵³

In *In re Amway Corp.*, the Federal Trade Commission held that Amway was not technically a pyramid scheme and explicitly articulated some business practices that separate a legitimate MLM from a pyramid scheme.⁵⁴ Specifically, Amway was required to buy back unsold inventory from distributors who left the company, distributors were required to sell at least seventy percent of the products bought in a given month to receive a bonus that month (rather than being allowed to receive a bonus based on recruitment of downline distributors alone), and distributors were required to submit proof of sales to at least ten different people per month to receive a monthly bonus.⁵⁵

The courts and the Federal Trade Commission have since clarified, in case law and advisory opinions respectively, that implementing policies modeled after those enacted by *In re Amway Corp* is not suf-

⁵⁰ See *Pyramid Schemes*, *supra* note 49; see also *In re Amway Corp.*, Inc., 93 F.T.C. 618, 672–73 (1979).

⁵¹ See *Pyramid Schemes*, *supra* note 49. Assuming that one party originates the scheme and each participant recruits ten new participants, it would take only thirteen “levels” of recruitment for the number of participants required to sustain the scheme to surpass the population of the Earth. *Why Are Pyramid Schemes a Scam?*, RELATIVELY INTERESTING, <https://www.relativelyinteresting.com/pyramid-schemes-explained-and-why-they-are-a-scam/> [<https://perma.cc/Y26F-BJK2>].

⁵² See *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1116 (1975) (“[R]espondents’ multilevel merchandising program is organized and operated in a manner that results in the recruitment of many participants who have virtually no chance to recover their investments of substantial sums of money in respondents’ program.”).

⁵³ See *id.* at 1115, 1180–81.

⁵⁴ *In re Amway Corp.*, Inc., 93 F.T.C. 618, 716.

⁵⁵ *Id.*

ficient on its face to prevent an MLM from being a pyramid scheme.⁵⁶ A company must also demonstrate that the rules are actually enforced and “deter inventory loading and encourage retail sales,” and that, in practice, the rules serve to tie bonuses to retail sales more strongly than to recruitment.⁵⁷

“Inventory loading,” also known as “internal consumption,” is a warning sign that an MLM that has crossed the line into a pyramid scheme.⁵⁸ This refers to the practice of requiring participants to purchase a certain amount of the company’s products (ostensibly for resale) on a recurring basis whether or not they have sold the products currently in their possession.⁵⁹ Rather than buying product for legitimate resale purposes, internal consumption policies can be pretext for a payment the participant makes for “the right to participate in the venture.”⁶⁰ The Federal Trade Commission has also noted that internal consumption itself is not dispositive of an MLM being a pyramid scheme—profits the company garners from internal consumption fees must *also* be the primary mechanism by which payouts to other participants are funded.⁶¹ In other words, the business must have significant sources of revenue beyond internal consumption such that it does not depend on the constant recruitment of new participants to avoid being a pyramid scheme.⁶²

2. *The Business Opportunity Rule*

The Federal Trade Commission can also take regulatory action under rules they establish through the agency’s rulemaking process. The Commission’s congressionally mandated rulemaking procedures, known as the “Magnuson-Moss rulemaking procedures,”⁶³ require the agency to go through an extensive process that includes multiple periods of public notice and comment, mandatory hearings, and establish-

⁵⁶ See *Webster v. Omnitrition Int’l, Inc.*, 79 F.3d 776, 783 (9th Cir. 1996); FTC Advisory Opinion, *supra* note 20.

⁵⁷ See *Webster*, 79 F.3d at 783.

⁵⁸ See *id.*; FTC Advisory Opinion, *supra* note 20.

⁵⁹ See FTC Advisory Opinion, *supra* note 20, at 1.

⁶⁰ *Id.*

⁶¹ *Id.* (“The critical question for the FTC is whether the revenues that primarily support the commissions paid to all participants are generated from purchases of goods and services that are not simply incidental to the purchase of the right to participate in a money-making venture.”).

⁶² See *id.*

⁶³ The Magnuson-Moss rule making procedures are named after their implementing legislation, 15 U.S.C. §§ 2301–12.

ing an exhaustive record of communications pursuant to the rule.⁶⁴ Once established, however, the Commission can seek broader penalties, including civil damages and consumer redress, in actions enforcing a rule.⁶⁵ The Business Opportunity Rule is one such rule that applies to companies selling business opportunities, which theoretically could apply to MLMs.⁶⁶

The Business Opportunity Rule applies to businesses that sell proposed business opportunities, support, or products in exchange for some payment by the consumer.⁶⁷ The rule was originally established to enact distinct regulatory requirements for business opportunities that were not franchises.⁶⁸ Franchises are typically costly, legally complex relationships that the Commission determined could comply with extensive disclosure rules, whereas nonfranchise business opportunities feature comparatively simpler relationships wherein the parties are less able to understand and comply with complex disclosure requirements.⁶⁹ The rule requires covered businesses to disclose certain information to those considering accepting the opportunity offered before their ultimate acceptance, including identifying information, pending legal actions, cancellation or refund policies, and references.⁷⁰ There are additional required disclosures if the business is making any earnings claims in its advertising.⁷¹ The Business Opportunity Rule allows the Federal Trade Commission to seek civil penalties and monetary damages against violators.⁷²

⁶⁴ See 15 U.S.C. § 57a; see also Jeffrey S. Lubbers, *It's Time to Remove the "Mossified" Procedures for FTC Rulemaking*, 83 GEO. WASH. L. REV. 1979, 1982–85 (2015) (listing in summary all the steps required in the FTC rulemaking process).

⁶⁵ 15 U.S.C. §§ 45(m), 57(b).

⁶⁶ See Business Opportunity Rule, 16 C.F.R. pt. 437.

⁶⁷ *Id.* § 437.1(c) (defining "Business opportunity" as "a commercial arrangement in which: (1) A seller solicits a prospective purchaser to enter into a new business; and (2) The prospective purchaser makes a required payment; and (3) The seller, expressly or by implication, orally or in writing, represents that the seller or one or more designated persons will: (i) Provide locations for the use or operation of equipment, displays, vending machines, or similar devices, owned, leased, controlled, or paid for by the purchaser; or (ii) Provide outlets, accounts, or customers, including, but not limited to, Internet outlets, accounts, or customers, for the purchaser's goods or services; or (iii) Buy back any or all of the goods or services that the purchaser makes, produces, fabricates, grows, breeds, modifies, or provides, including but not limited to providing payment for such services as, for example, stuffing envelopes from the purchaser's home.").

⁶⁸ See Business Opportunity Rule, 76 Fed. Reg. 76,816, 76,817 (Dec. 8, 2011) (codified at 16 C.F.R. pt. 437).

⁶⁹ See *id.*

⁷⁰ See 16 C.F.R. § 437.3(a)(1), (3)–(5).

⁷¹ See *id.* § 437.3(a)(2).

⁷² See 15 U.S.C. § 45(m) (stating that violations of specific Commission rules issued pursu-

Due to an explicit 2011 exemption, the Business Opportunity Rule does not apply to MLMs.⁷³ Upon its proposal, the rule did not contain an exemption for—and likely would have applied to most—MLMs.⁷⁴ During the required notice and comment period, however, the agency was flooded with thousands of comments from MLM participants, mostly using the same template language, urging the agency to carve out an exemption for MLMs.⁷⁵ In addition to providing their own comments, large MLMs and the Direct Selling Association (“DSA”)—the industry’s powerful trade association and lobbying arm, discussed in Section I.B—spent thousands of dollars in and around this time to protest the rule.⁷⁶ Eventually, the agency crafted an exemption that carved out nearly all MLMs from compliance obligation under the rule.⁷⁷

Some MLMs still issue their own (sometimes misleading) disclosure reports.⁷⁸ However, because there is no standard for the metrics and reporting that they use, companies can leave out crucial data points⁷⁹ or provide calculations with no explanation or transparency.⁸⁰

3. *Other Federal Trade Commission Enforcement*

The Federal Trade Commission also acts against deceptive or unfair business practices where the enterprise is not a pyramid scheme. For example, the agency announced in December 2020 that it would spearhead a crackdown—called Operation Income Illusion—on companies making deceptive “illusory income claims” to attract those disadvantaged by the COVID-19 pandemic.⁸¹ Claims have been

ant to 15 U.S.C. § 45(a) are subject to civil penalties of up to \$10,000, adjusted for inflation, per violation).

⁷³ See Business Opportunity Rule, 76 Fed. Reg. 76,816, 76,820–24.

⁷⁴ See *id.* at 76,818; Matt Stroud, *How Lobbying Dollars Prop Up Pyramid Schemes*, THE VERGE (Apr. 8, 2014, 10:30 AM), <https://www.theverge.com/2014/4/8/5590550/alleged-pyramid-schemes-lobbying-ftc> [<https://perma.cc/E2W3-H8BZ>].

⁷⁵ See Business Opportunity Rule, 76 Fed. Reg. at 76,816 n.20; Stroud, *supra* note 74.

⁷⁶ See Stroud, *supra* note 74.

⁷⁷ See Business Opportunity Rule, 76 Fed. Reg. 76,816, 76,820–24.

⁷⁸ See Robert FitzPatrick, *Deceptive Income Disclosures Power MLM Recruiting and Expansion*, NASDAQ (Mar. 30, 2016), <https://www.nasdaq.com/articles/deceptive-income-disclosures-power-mlm-recruiting-and-expansion-2016-03-30>.

⁷⁹ See *id.*

⁸⁰ See *id.*; see also Mina Kimes, *Drew Brees Has a Dream He'd Like to Sell You*, ESPN (Mar. 15, 2016), https://www.espn.com/espn/feature/story/_/id/14972197/questions-surround-advocate-nutrition-empire-endorsed-saints-qb-drew-brees [<https://perma.cc/F933-CH8G>].

⁸¹ Lesley Fair, *Operation Income Illusion Cracks Down on Illusory Income Claims*, FTC (Dec. 14, 2020, 11:05 AM), <https://www.ftc.gov/news-events/blogs/business-blog/2020/12/operation-income-illusion-cracks-down-illusory-income-claims> [<https://perma.cc/NA2U-9R8Y>]; see,

brought—and in most cases, settled—under Section 5 of the Federal Trade Commission Act, which bans “unfair or deceptive acts or practices in or affecting commerce.”⁸²

Another recent example of enforcement in the absence of a pyramid scheme allegation is the Commission’s 2016 action against Herbalife International of America, LLC (“Herbalife”),⁸³ an MLM that sells wellness products such as supplements and skin care products.⁸⁴ Although the Commission did not allege that Herbalife was a pyramid scheme,⁸⁵ it took action based on the company’s unfair business practices that emphasized recruitment over retail sales and encouraged distributors to “purchase products in order to advance in the marketing program, rather than in response to actual retail demand for the product.”⁸⁶ Ultimately, Herbalife agreed to a settlement that significantly restructured its compensation and operational model.⁸⁷ The company also agreed to pay \$200 million in consumer redress.⁸⁸

B. Industry Enforcement

Industry groups and trade associations can self-regulate in the absence of, or in addition to, government enforcement. The DSA, a national trade association representing direct selling companies including MLMs,⁸⁹ self-regulates via their Direct Selling Self-Regula-

e.g., Order on Stipulation, *FTC v. Moda Latina BZ Inc.*, No. 20-cv-10832, 2021 U.S. Dist. LEXIS 37758 (C.D. Cal. 2021).

⁸² 15 U.S.C. § 45(a); *see* Lesley Fair, *supra* note 81.

⁸³ Complaint for Permanent Injunction and Other Equitable Relief, *FTC v. Herbalife Int’l of Am., Inc.*, 2:16-cv—05217 (C.D. Cal. July 15, 2016).

⁸⁴ *See generally* HERBALIFE NUTRITION, <https://www.herbalife.com/> [<https://perma.cc/9GB6-FG8Y>].

⁸⁵ *See* Complaint for Permanent Injunction and Other Equitable Relief, *supra* note 83.

⁸⁶ *Herbalife Will Restructure Its Multi-Level Marketing Operations and Pay \$200 Million For Consumer Redress to Settle FTC Charges*, FTC (July 15, 2016), <https://www.ftc.gov/news-events/press-releases/2016/07/herbalife-will-restructure-its-multi-level-marketing-operations> [<https://perma.cc/W7KS-ZBWG>].

⁸⁷ *See* Stipulated Order for Permanent Injunction and Monetary Judgment at 5–14, *FTC v. Herbalife Int’l of Am., Inc.*, 2:16-cv-05217 (C.D. Cal. July 25, 2016); *see also* FTC *supra* note 86; Press Release, FTC, 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/971213/160715herbalifestatement.pdf [<https://perma.cc/GS2L-RFJC>].

⁸⁸ Stipulated Order for Permanent Injunction and Monetary Judgment, *supra* note 87, at 23. Note that this case was settled prior to a 2021 Supreme Court decision that significantly limits the Commission’s ability to seek consumer redress. *See* *AMG Capital Management, LLC v. FTC.*, 141 S. Ct. 1341, 1344 (2021) (holding that Federal Trade Commission Act, 15 U.S.C. § 45(b), does not empower the Federal Trade Commission to seek consumer redress).

⁸⁹ *Who We Are*, DIRECT SELLING ASS’N, <https://www.dsa.org/about> [<https://perma.cc/FV3K-NDZN>]. Direct selling companies are not necessarily MLMs—direct sales companies rely on a business model where independent sellers are responsible for distributing the company’s

tory Council, a program administered by the Better Business Bureau National Programs.⁹⁰ The Council identifies standards through its Code of Ethics and enforces these standards within its membership, including those related to earnings claims, terms of sale, warranties, and inventory purchases.⁹¹ The Council refers cases to the Federal Trade Commission when a member either does not respond to a complaint or does not comply with the Council's recommendations.⁹² However, the Council's Code of Ethics is not industry wide; it is only enforceable against those companies that decide to become member organizations.⁹³ As such, it is an incomplete solution.

C. *Proposed Changes to the Business Opportunity Rule*

As the Federal Trade Commission's 2011 Business Opportunity Rule approached its ten-year review, many, including former Commissioner Rohit Chopra, called for the revocation of MLMs' exemption from the rule.⁹⁴ In June 2021, then-Commissioner Rohit Chopra released a statement saying that the Federal Trade Commission had "failed to take even the most basic steps" to protect consumers from

products directly to consumers, usually with minimal operational support from the company. MLMs also incentivize these contractors to recruit others and build their "downline." See Lainie Petersen, *What Is the Difference Between Direct Sales & Multilevel Marketing?*, CHRON (Nov. 27, 2018), <https://smallbusiness.chron.com/difference-between-direct-sales-multilevel-marketing-20952.html> [<https://perma.cc/MW95-QWYE>]. The DSA also has a significant lobbying arm, which includes the Direct Selling Advocacy Center and the Congressional Direct Selling Caucus. See *Direct Selling Day on Capitol Hill*, DIRECT SELLING ASS'N, <https://www.dsa.org/advocacy> [<https://perma.cc/PBG3-YYRD>]. The caucus has thirty-eight members from the House of Representatives as of January 4, 2023. See *Direct Selling Caucus*, DIRECT SELLING ASS'N, <https://www.dsa.org/advocacy/caucus> [<https://perma.cc/ZSB5-ZH4D>].

⁹⁰ *DSA/BBB National Programs, Inc. Direct Selling Self-Regulatory Council*, DIRECT SELLING ASS'N, <https://www.dsa.org/consumerprotection/dssrc/direct-selling-self-regulatory-council> [<https://perma.cc/M4KD-7FVD>].

⁹¹ See DIRECT SELLING ASS'N, *CODE OF ETHICS* (2018), https://www.dsa.org/docs/default-source/code-of-ethics/dsa-code-of-ethics-december-2018.pdf?sfvrsn=5598cda5_10 [<https://perma.cc/ED6R-LF6U>] (prohibiting practices such as unreasonably high fees, distributors failing to identify themselves and the nature of their business at the beginning of a sales presentation, and failing to implement an inventory buyback policy).

⁹² See DIRECT SELLING ASS'N, *supra* note 90. Between 2019—when the Council was founded—and 2022, the Council referred fifteen cases to the FTC. *Id.* It closed 227 cases pursuant to its own internal administrative processes. *Id.*

⁹³ *Id.* The DSA currently has 101 members, including some large MLMs such as Amway, CUTCO, and Avon. *Member Directory Results*, DIRECT SELLING ASS'N, <https://www.dsa.org/forms/CompanyFormPublicMembers/search?action=find> [<https://perma.cc/7WX4-TGYP>].

⁹⁴ See Press release, FTC, Statement of Commissioner Rohit Chopra (June 14, 2021), https://www.ftc.gov/system/files/documents/public_statements/1591046/statement_of_commissioner_rohit_chopra_regarding_the_business_opportunity_rule.pdf [<https://perma.cc/V38K-DNX4>].

MLMs and should reconsider exempting MLMs from the Business Opportunity Rule “to protect consumers, workers, and honest businesses.”⁹⁵

In 2011, when the Federal Trade Commission explicitly declined to extend the Business Opportunity Rule to MLMs, it reasoned that (1) the complexities of the MLM business model make it difficult to craft appropriate disclosures and (2) references would be of little use to those thinking about joining an MLM because those who are already a part of the organization have an incentive to misrepresent their experience in a positive light to convince new distributors to join as part of their downline.⁹⁶

Even if these specific disclosure requirements are unworkable with respect to MLMs, alternative disclosure requirements could be proposed and implemented.⁹⁷ Assuming, as the Federal Trade Commission asserts in its reasoning for the exemption, that MLMs are not in the position to report on these metrics now,⁹⁸ the Federal Trade Commission could implement a reporting structure to satisfy the requirements. It is illogical to allow a company to advertise and sell a business opportunity to consumers while accepting that the same company is incapable of collecting basic information on the outcomes of that opportunity once a consumer has joined as a distributor. Former Commissioner Chopra urged the Federal Trade Commission to implement “this sensible safeguard” so that the Commission has more authority to seek a broader range of penalties from MLMs that

⁹⁵ See *id.* at 1.

⁹⁶ Business Opportunity Rule, 76 Fed. Reg. 76,816, 76,823 (Dec. 8, 2011) (stating that “the MLM [may] not [be] in a position to verify the extent to which a distributor has resold the product at retail, is warehousing the product, or bought the product for his or her own personal consumption. Even where the MLM has policies in place purportedly to ensure that a portion of its distributors’ income is derived from retail sales, these policies could go unenforced, or even where ostensibly enforced, could be circumvented by distributors who may have an incentive to ‘inflate’ their retail sales by ‘certifying’ that such sales occurred in order to qualify for higher levels of commissions,” and “[t]he MLM model is inherently structured to create financial incentives for distributors to recruit prospects into their downlines.”). Although the organization may be held liable for material misrepresentations by participants, this may be difficult to enforce with respect to individuals having private, one-on-one recruitment conversations. See Guides Concerning the Use of Endorsement and Testimonials in Advertising, 16 C.F.R. pt. 255 (2009).

⁹⁷ See Business Opportunity Rule, 76 Fed. Reg. 76,816 n.83 (stating that one commentator had recommended an entirely different set of disclosure rules for MLMs based upon an already existent Federal Trade Commission consumer education program about MLMs); see also Johnson, Public Comment #00003 on Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Business Opportunities, FED TRADE COMM’N File No. R511993 (Nov. 11, 2010), <https://www.ftc.gov/policy/public-comments/comment-00003-56> [<https://perma.cc/7XTN-J4GP>].

⁹⁸ See Business Opportunity Rule, 76 Fed. Reg. 76,816 at n 83.

misrepresent the earning potential of the opportunities they peddle, including monetary penalties.⁹⁹

In an article on its website, the Federal Trade Commission advocates an individual approach to due diligence, suggesting that consumers who are considering joining an MLM ask specific financial and operational questions of current and past distributors.¹⁰⁰ It stresses that gathering this information upfront can help consumers decide if the opportunity is “really a deal, a dud, or straight up illegal.”¹⁰¹ However, as a result of a business model that rewards distributors for recruiting new participants, current distributors are highly incentivized not to disclose negative consequences of joining the organization and to misrepresent the financial benefits.¹⁰² In a recent survey, over twenty-two percent of MLM distributors admit to lying to friends and family about their earning or total investment.¹⁰³

This data is not easily accessible in other places. Although the DSA provides high-level infographics highlighting certain data points from their broader Salesforce survey,¹⁰⁴ the full report is only accessible for purchase at a price of \$1,500 for nonmembers.¹⁰⁵ Some MLMs issue voluntary income disclosure statements, but there is no requirement that they do so, and the disclosure statements often lack information crucial to understanding the numbers they do provide.¹⁰⁶ As such, it can be difficult for those considering joining an MLM to do

⁹⁹ Statement of Commissioner Rohit Chopra, *supra* note 94, at 2.

¹⁰⁰ See FTC, *supra* note 5.

¹⁰¹ *Id.* The suggested questions are: “How long have you been in the MLM?” “How much money did you make last year, after expenses?” “What were your expenses last year?” “Have you borrowed money or used your credit card to fund your business?” “How much did you borrow?” “How much do you owe?” “Do you need to have recruits to make money?” “How many people have you recruited?” “How many did you recruit last year?” “How many of your recruits have left the business?” “What percentage of the money you made came from selling the product to customers outside the MLM?” “What percentage of the money you made — income and bonuses less your expenses — came from recruiting other distributors and selling them inventory or other items to get started?” “How much time do you spend on the business?” “How much inventory did you buy from the MLM last year?” “Did you sell all of your inventory?” *Id.*

¹⁰² Laryea, *supra* note 15.

¹⁰³ *Id.*

¹⁰⁴ See, e.g., DIRECT SELLING ASS’N, IN DIRECT SELLING, SUCCESS IS DIFFERENT FOR DIFFERENT PEOPLE (2019), <https://www.dsa.org/docs/default-source/advocacy/dsa-successisdifferentfactsheetv4.pdf?sfvrsn=2> [<https://perma.cc/PQY8-2RAM>] (summarizing data from the DSA 2019 National Salesforce Study using infographics).

¹⁰⁵ See *Purchase Page for 2019 Salesforce Survey*, DIRECT SELLING ASS’N, <https://www.dsa.org/forms/store/ProductFormPublic/2019-salesforce-survey> [<https://perma.cc/HKP5-TZKN>].

¹⁰⁶ See FitzPatrick, *supra* note 78.

their due diligence if they cannot come by accurate, unbiased information about earning potential, risks, and potential consequences.

II. ANALYSIS

A. *Disclosure Alone Is an Insufficient Solution*

Though subjecting MLMs to the same disclosure requirements as other companies selling business opportunities is a start, disclosure alone cannot adequately address the consumer harms inflicted by MLMs. The lack of information about MLMs available to potential distributors prior to joining is an issue; however, research on disclosure-based regulations in other areas casts doubt on the effectiveness of disclosures for consumer protection.¹⁰⁷ A potential solution must go farther than simple disclosure requirements.

The consumer credit industry is one example. There is some empirical evidence that disclosures required for credit cards by the Truth in Lending Act have at most a modest positive effect on consumer behavior, and sometimes no measurable or even a negative effect.¹⁰⁸

Another area where research has cast doubt on the effectiveness of disclosure is privacy. The current notice and choice framework used in many United States and European Union privacy regulations is controversial, with many researchers and policymakers saying it is ineffective and does not communicate the uses of personal data and associated risks effectively enough for a consumer to give informed consent.¹⁰⁹

¹⁰⁷ See Arthur G. Fraas & Randall Lutter, *How Effective Are Federally Mandated Information Disclosures?*, 7 J. BENEFIT-COST ANALYSIS 326, 328–48 (2016) (concluding that federal agencies often do not issue effective disclosure requirements based on scientific understanding of consumer comprehension of the information contained in disclosures).

¹⁰⁸ See Enrique Seira, Alan Elizondo & Eduardo Laguna-Müggenburg, *Are Information Disclosures Effective? Evidence from the Credit Card Market*, 9 AM. ECON. J.: ECON. POL'Y 277, 279 (2017) (finding that interest rate disclosures had no effect on related negative consumer economic behaviors, such as indebtedness and default, and that many disclosures required by the Truth in Lending Act actually *increased* the instance of negative economic consumer behaviors).

¹⁰⁹ See Richard Warner, *Notice and Choice Must Go: The Collective Control Alternative*, 23 SMU SCI. & TECH. L. REV. 173, 174 (2020) (finding that notice and choice does not enhance consumer privacy protections); Joel R. Reidenberg, N. Cameron Russell, Alexander J. Callen, Sophia Qasir & Thomas B. Norton, *Privacy Harms and the Effectiveness of the Notice and Choice Framework*, 11 I/S: J.L. & POL'Y FOR INFO. SOC'Y 485, 490–96 (2015) (discussing how inadequate requirements, cognitive hurdles, and negative externalities—such as consumers' overlapping information that can lead to one person's consent disclosing another person's private information—hamper the effectiveness of disclosures as a mechanism for privacy protection); Robert H. Sloan & Richard Warner, *Beyond Notice and Choice: Privacy, Norms, and Consent*, 14 J. HIGH TECH. L. 370, 390–98 (2014) (explaining the difficulty of including information in a disclosure that is sufficiently inclusive and nuanced to fully explain the risk of the choice

There are also features specific to MLMs that would make effective disclosure challenging. Most MLM advertising and recruitment is done individually by distributors in their role as both salesperson and recruiter,¹¹⁰ often on social media.¹¹¹ Diffuse social media advertising across many personal accounts and one-on-one conversations could make it difficult to identify violations and enforce such requirements. Requiring disclosures would not address the root problem of the high potential for exploitation.

Though disclosure is an important step, it is an incomplete solution. As the Federal Trade Commission reconsiders whether to revoke MLMs' exemption to the Business Opportunity Rule,¹¹² this Note's proposed solution could be implemented in tandem to bolster consumer protection from MLMs' bad practices.

B. Proposed Solution

The Federal Trade Commission should undertake a rulemaking, pursuant to its power to regulate "unfair" business practices,¹¹³ to identify certain MLM business practices as per se unfair. The current standard for what is generally "unfair" was articulated by the Federal Trade Commission in a policy statement¹¹⁴ and later codified as law in Congress's 1994 amendment to Section 5 of the Federal Trade Commission Act.¹¹⁵ A business practice is unfair if it (1) causes "substantial injury to consumers," (2) is not "reasonably avoidable" by the consumer given the information publicly available, and (3) is not justified by enabling some significant benefit to consumers or competition.¹¹⁶

Though many agencies have potential regulatory authority over some MLMs, depending on what they sell, how they are structured, etc., the Federal Trade Commission has broad authority to bring suit

presented while also keeping the disclosure simple enough that a consumer can comprehend it enough to give informed consent).

¹¹⁰ See Vander Nat & Keep, *supra* note 23, at 140.

¹¹¹ See Sara Silverstein, Jennifer Lee & Amelia Kosciulek, *People Who Sell for Multilevel Marketing Companies Look Wildly Successful on Facebook, but the Reality Is Much More Complicated*, BUS. INSIDER (Aug. 6, 2019, 12:11 PM), <https://www.businessinsider.com/mlms-use-social-media-facebook-portray-financial-success-2019-7> [<https://perma.cc/7JYX-3SF5>].

¹¹² *FTC Schedules Review of Business Opportunity Rule*, FTC (June 14, 2021), <https://www.ftc.gov/news-events/press-releases/2021/06/ftc-schedules-review-business-opportunity-rule> [<https://perma.cc/469X-K8TD>]. The Federal Trade Commission initiated a ten-year review of the rule in 2021. *Id.*

¹¹³ 15 U.S.C. § 45(a).

¹¹⁴ *FTC Policy Statement on Unfairness*, FTC (Dec. 17, 1980), <https://www.ftc.gov/legal-library/browse/ftc-policy-statement-unfairness> [<https://perma.cc/K5ST-TTFP>].

¹¹⁵ 15 U.S.C. § 45(n).

¹¹⁶ *Id.*

against any business practice that is unfair or deceptive.¹¹⁷ The Commission also has the specific authority to make rules that identify specific practices as per se unfair, thus negating the need to prove each element of unfairness every time it brings an enforcement action with respect to a certain practice.¹¹⁸ This is the same authority the Commission relied upon when promulgating the Business Opportunity Rule.¹¹⁹

Although the Federal Trade Commission can pursue actions against MLMs for unfair business practices today, promulgating a new rule expands the remedies that the Commission is able to seek in such actions. ¹²⁰ If the Commission brings action under its general authority to challenge unfair business practices, consumer redress and civil penalties are unavailable.¹²¹ If the Commission brings action for a violation of a specific Commission rule, however, then it can seek other remedies, including civil penalties of up to \$46,517 per violation and consumer redress.¹²²

Additionally, MLMs recruit heavily online, particularly on social media.¹²³ Because of this, downline recruitment, advertising, and sales are all likely to cross state borders. Therefore, a federal solution ad-

¹¹⁷ See 15 U.S.C. § 45(n).

¹¹⁸ See *id.* § 57(a).

¹¹⁹ See 16 C.F.R. § 437.

¹²⁰ See 15 U.S.C. § 57(a).

¹²¹ *Id.* § 45(b); see *AMG Cap. Mgmt., LLC v. FTC*, 141 S. Ct. 1341, 1346, 1352 (2021) (holding that the Federal Trade Commission Act, 15 U.S.C. § 45(b), does not empower the Federal Trade Commission to seek consumer redress). The Commission has acknowledged the benefits of rulemaking in the context of enforcement now that consumer redress is unavailable as a remedy when the Commission acts in absence of a specific agency rule. See *FTC Votes to Update Rulemaking Procedures, Sets Stage for Stronger Deterrence of Corporate Misconduct*, FTC (July 1, 2021), <https://www.ftc.gov/news-events/press-releases/2021/07/ftc-votes-update-rulemaking-procedures-sets-stage-stronger> [<https://perma.cc/E2XC-25JB>]; see also *Duane Pozza Discusses FTC's Focus on Rulemaking After Supreme Court's AMG Decision*, WILEY (June 2, 2021), <https://www.wiley.law/news-Duane-Pozza-Discusses-FTCs-Focus-on-Rulemaking-After-Supreme-Courts-AMG-Decision> [<https://perma.cc/JJC3-LHCZ>]; William E. Kovacic, *AMG Aftershocks*, REGUL. REV. (July 26, 2021), <https://www.theregreview.org/2021/07/26/kovacic-amg-aftershocks/> [<https://perma.cc/HN6S-TWAX>].

¹²² 15 U.S.C. § 45(m); *FTC Publishes Inflation-Adjusted Civil Penalty Amounts for 2022*, FTC (Jan. 6, 2022), <https://www.ftc.gov/news-events/news/press-releases/2022/01/ftc-publishes-inflation-adjusted-civil-penalty-amounts-2022> [<https://perma.cc/YG8P-XDGY>] (adjusting the original statutory cap on civil damages for inflation).

¹²³ See Silverstein et al., *supra* note 111 (characterizing MLMs as “turbocharged by social media”); Pavanan Ghosh, *Leveraging the Power of Social Media in Network Marketing*, INFINITE MLM SOFTWARE (Nov. 22, 2022), <https://infinite MLMsoftware.com/blog/power-of-social-media-in-network-marketing/> [<https://perma.cc/JFH5-DFVE>] (article targeted toward MLM distributors advising them to “make sure that you really extract and use the real potential of social media tools in your MLM or network marketing business to the maximum” and stating that

addressing specific unfair business practices, instead of a state-by-state approach, is appropriate to capture conduct that may not necessarily fall within state-specific statutes.

1. *Unfair Practices*

There are several sources that provide examples of unfair business practices employed by MLMs. The DSA's own Code of Ethics¹²⁴ is a valuable resource in identifying potentially harmful business practices used by MLMs. The Code of Ethics identifies unethical practices that it prohibits within its own cohort.¹²⁵

One practice the DSA prohibits is charging "unreasonably high" fees unrelated to the purchase of inventory, including "entrance fees, training fees, franchise fees, fees for promotional materials or other fees related solely to the right to participate in the member company's business."¹²⁶ Though the Code of Ethics specifies that the Association's own administrator has discretion to determine whether a fee is "unreasonably high," the Commission could implement a mathematical standard for ease of enforcement.¹²⁷ For example, fees that exceed a certain percentage of the average annual income generated by participants could be identified as unfair.¹²⁸

The Federal Trade Commission's own past enforcement actions against MLMs suggest other practices that could be considered per se unfair. For example, the Commission's settlement with Herbalife identifies various organizational and recruitment practices that the agency alleged were unfair, including a compensation plan that heavily incentivized recruitment over sales and required distributors to purchase products to qualify for certain financial rewards.¹²⁹

While the Herbalife settlement identifies many practices that, in this specific case, the Commission alleged were unfair, the settlement

social media "[e]xpands [y]our [r]each," "[s]trengthen[s] [r]elationships," and "[b]uilds [y]our [b]rand").

¹²⁴ DIRECT SELLING ASS'N, *supra* note 91.

¹²⁵ *Id.*

¹²⁶ *Id.* at 10–11.

¹²⁷ *Id.* at 11.

¹²⁸ The public notice and comment process could also help determine actual net income of MLM participants, including advertising and operational expenses not facilitated or tracked by the main organization.

¹²⁹ See Stipulated Order for Permanent Injunction and Monetary Judgment, *supra* note 88, at 5–14 (mandating practices such as limiting distributor compensation to that derived from a distributor's actual sales or their downline's actual sales and limiting the dollar amount of products that new distributors can purchase from the company).

is not binding on other organizations.¹³⁰ In order to extend the *Herbalife* standard to the greater MLM ecosystem, the Commission should identify these practices as unfair under this proposed rule.¹³¹

Furthermore, the Federal Trade Commission should specifically request examples of unfair business practices from the public during the requisite notice and comment period built into any Federal Trade Commission rulemaking procedure.¹³² Given that it is often difficult for those outside an MLM to determine how it operates,¹³³ public comments could provide valuable insight into harmful practices that may otherwise go unnoticed.

2. Counterarguments

Federal Trade Commission rules can be struck down by a court if the Commission fails to show that the rule addresses a current and prevalent unfair practice. In *Katharine Gibbs School (Inc.) v. FTC*,¹³⁴ the Second Circuit explained that, to have a valid basis on which to enact a rule designed to prevent unfair practices, the Federal Trade Commission must identify “prevalent” practices the rule is designed to prevent and make factual findings to explain why those practices are unfair.¹³⁵ Upon judicial challenge, an Federal Trade Commission rule may be set aside if not supported by “substantial evidence.”¹³⁶ The Commission’s conclusions must be based upon “such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.”¹³⁷

¹³⁰ See FTC Advisory Opinion, *supra* note 20, at 3.

¹³¹ See *id.*

¹³² See 15 U.S.C. § 57a.

¹³³ See Heidi Liu, *The Behavioral Economics of Multilevel Marketing*, HASTINGS BUS. L.J. 109, 110–11 (2018) (describing the difficulty in obtaining operational information from the website of American Communication Network, LLC, a large U.S. MLM).

¹³⁴ 612 F.2d 658, 662 (2d Cir. 1979).

¹³⁵ 15 U.S.C. § 57a(b)(3); see *Katharine Gibbs Sch.*, 612 F.2d at 662 (“Requirements designed to prevent unfair practices are predicated upon the existence of unfair practices.”).

¹³⁶ 15 U.S.C. § 57a(e)(3)(A).

¹³⁷ *Consol. Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938); see also *Ass’n of Nat’l Advertisers, Inc. v. FTC*, 627 F.2d 1151, 1160–61 (D.C. Cir. 1979) (equating the FTC’s “substantial evidence” standard in rulemaking to the “substantial evidence” standard to which FTC findings of fact are held during adjudication). Note that although FTC rules are also technically subject to the “arbitrary and capricious standard” prescribed by the Administrative Procedure Act (“APA”), the higher “substantial evidence” standard that the Magnuson-Moss Procedures imposes for all FTC rulemaking review would govern. Compare 15 U.S.C. § 57a(e)(3), with 5 U.S.C. § 706(2)(A); see also Jessica Rich, *The FTC’s Magnuson-Moss Rulemaking Process—Still an Uphill Climb*, JD SUPRA (Jan. 11, 2022), <https://www.jdsupra.com/legalnews/the-ftc-s-magnuson-moss-rulemaking-7757749/#:~:text=the%20Many%20Steps%20in%20the%20Mag%2DMoss%20Rulemaking%20Process&text=of%20significance%2C%20Mag>

To mitigate the potential for such a challenge to be successful, the Commission should rely on the aforementioned sources for identifying unfair business practices and those of a similar nature. The prohibition of a practice in DSA's Code of Ethics¹³⁸ suggests that they are widespread enough—or at risk of becoming widespread enough—to warrant inclusion. The Herbalife settlement is another strong piece of evidence that these business practices exist in the market—in 2015, the company had four million participants worldwide and did about twenty percent of its sales in North America.¹³⁹ Lastly, relying on public comments from those affected by MLMs could lend support to the existence and prevalence of certain damaging business practices.

Some proponents of MLMs claim that not every distributor joins an MLM expecting to make money—some join simply for the discounts on products.¹⁴⁰ The DSA emphasizes that many distributors join these companies for motivations other than financial gain, stating that sixty-four percent of people involved in direct selling stay involved because they want to take advantage of product discounts and sixty-one percent enjoy the flexibility that accompanies the MLM “lifestyle.”¹⁴¹ Under the proposed regulations, this will still be possible. Nothing in this proposed solution would prevent participants from joining an MLM to take advantage of perceived benefits; however, the solution would give the Federal Trade Commission more power to protect those that join expecting a greater income opportunity than is available and target practices identified as unfair.

Another potential weakness of this solution is the Federal Trade Commission's cumbersome rulemaking process. The Commission has seldom used this rulemaking authority since Congress enacted the Magnuson-Moss Procedures.¹⁴² These procedures—significantly more difficult than the Administrative Procedure Act rulemaking process by which most federal agencies abide—require a number of steps and rules that take an average of 5.57 years from proposal to finalization to complete.¹⁴³ However, there is cause for optimism: the Commission

%2DMoss%20requires,reach%20in%20its%20enforcement%20actions [https://perma.cc/TP3D-XHLP] (“In addition to normal grounds for review under the APA, the court may . . . set aside the rule if it's not supported by ‘substantial evidence’ (a markedly different standard than ‘arbitrary and capricious’).”).

138 See DIRECT SELLING ASS'N, *supra* note 91.

139 HERBALIFE NUTRITION, ANNUAL REPORT 2015 at 7, 9 (2015).

140 See DIRECT SELLING ASS'N, *supra* note 104.

141 *Id.* (infographic summary of data from the DSA 2019 National Salesforce Study).

142 See Lubbers, *supra* note 64, at 1989.

143 *Id.* at 1988–89.

recently streamlined its non-congressionally-mandated rulemaking procedures in a way that was meant to simplify and “reinvigorate” the agency’s rulemaking.¹⁴⁴ Legal commentators are optimistic that the changes are a sign that the agency will be more willing to engage in more and faster rulemaking.¹⁴⁵

CONCLUSION

While MLMs can be tempting for those looking to earn extra income, the business model is such that most participants ultimately lose money.¹⁴⁶ Hefty fees, obligations to buy inventory, and a heavy emphasis on recruitment are just some of the practices that can chip away at participants’ bottom line.¹⁴⁷

Though the Federal Trade Commission has pursued a variety of enforcement avenues to protect consumers against MLMs,¹⁴⁸ promulgating a rule designating certain MLM business practices as per se unfair would create a simpler path to enforcement and allow the Federal Trade Commission to seek monetary redress for consumers.¹⁴⁹ To target practices that are both harmful and prevalent, the Federal Trade Commission should look to existing sources such as past enforcement actions, industry regulations, and consumer comments. Doing so would allow the Commission to better protect consumers from the potential harms MLMs can inflict on participants.

¹⁴⁴ FTC, *supra* note 121.

¹⁴⁵ See, e.g., Alan Charles Raul, Colleen Theresa Brown, Ash Nagdev, Gabriel Schonfeld, Mark Prior & Sophia Aguilar, *Changes to FTC Rulemaking Procedures Herald More Aggressive Action on Consumer Privacy*, SIDLEY (Oct. 4, 2021), <https://datamatters.sidley.com/changes-to-ftc-rulemaking-procedures-herald-more-aggressive-action-on-consumer-privacy#:~:text=on%20July%202022%2C%202021%2C%20the,18%20of%20the%20FTC%20Act.&text=with%20a%20more%20streamlined%20Section,%2D%20and%20cybersecurity%2Drelated%20rulemaking> [https://perma.cc/XHM6-FUUM]; WILEY, *supra* note 121.

¹⁴⁶ See FTC, *supra* note 5.

¹⁴⁷ See *supra* Part I.

¹⁴⁸ See *supra* Section I.A.

¹⁴⁹ See sources cited *supra* note 121.