

FTC Staff Doubles Down on Rejected Koscot Standard for Pyramiding Claims, Challenges DSSRC IDS Guidance

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Over the past two years, we have seen FTC staff express its opinions on the state of the law in multiple ways. In December 2022, for example, staff issued its Health Products Compliance Guidance, intended to supersede the FTC’s 1998 guidance, “Dietary Supplements: An Advertising Guide for Industry,” as we covered [here](#). We also have seen a slew of proposed guides and rules on endorsements and testimonials, junk fees, earnings claims, negative option and automatic renewal plans, and environmental marketing, among many others – all intended to explain FTC staff’s view of the law as it currently sees it.

On Friday, FTC staff put another stake in the ground when it sent a [letter](#) to the Direct Selling Association (“DSA”), doubling down on its reframing of the longstanding *Koscot* test for determining whether a business is an illegal pyramid scheme – a reframing that Judge Barbara Lynn soundly rejected in the *Neora* matter, as we previously discussed [here](#). Also on Friday, the FTC sent a [separate letter](#) to the Direct Selling Self-Regulatory Council (“DSSRC”), taking issue with the independent body’s issued guidance on income disclosure statements.

We discuss these two letters in more detail below, but note the following key takeaways:

- Advisory opinions and letters such as the ones discussed below reflect the views of the *current staff* and are not official Commission positions. The Commission is not bound by these opinions, and future staff may rescind or modify them at any time (as illustrated below by staff’s disavowal of its 2004 Advisory Opinion, upon which many in the direct selling industry have relied over the years).
- Regardless of Commission staff’s opinions, Section 5 and associated case law ultimately control. Commission staff undoubtedly intends to raise the bar for compliance while attempting to improve its litigation position in future matters (and possibly avoiding a repeat of the *Neora* loss), but courts must ultimately look to the law and relevant precedent in determining whether a practice is unfair or deceptive under the FTC Act.

Repudiation of “Primary Source” Test

In 2004, when DSA sought guidance regarding FTC staff’s analysis of a pyramid scheme, staff clarified in a [letter](#) that “[t]he 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.”

In other words, if compensation was “primarily” based on recruitment rather than product sales, the operation would be considered a pyramid scheme. This Advisory Opinion is well-known within the direct selling industry and has been cited in multiple complaints and decisions over the last 20 years, including in the recent *Neora* decision.

In last week’s letter to DSA, Division of Marketing Practices Associate Director Lois Greisman restated a position expressed during the *Neora* trial and at recent industry events that the “primary source” test for differentiating a legitimate business from an illegal pyramid scheme does not exist, and that industry has misinterpreted the 2004 Staff Advisory Opinion. The letter cites language in certain decisions such as *Koscot*, *Noland*, and *Vemma* to suggest that the dispositive inquiry for a pyramid analysis is *whether a compensation plan incentivizes recruiting and/or relies on recruiting to unlock significant rewards* – a position the agency advanced (and lost) in the *Neora* case.

While acknowledging that many FTC complaints and court decisions use the “primarily” or “primary source” language, the staff letter discounted that language as related to “litigation decisions” and/or “not key holdings in the decisions” and stated that the 2004 letter is no longer valid and therefore rescinded.

The disavowal of the 2004 Advisory Opinion demonstrates a shift in staff’s thinking on pyramid scheme standards, but – importantly – does not change applicable law. The FTC’s position did not hold in *Neora*, and future litigation will determine whether other courts accept the FTC’s reframing.

DSSRC IDS Guidance

The DSSRC, a national advertising self-regulatory program administered by BBB National Programs, is tasked with monitoring and addressing earnings and product claims made by the direct selling industry, and issuing guidance on lawful advertising and marketing practices. For example, DSSRC’s “Guidance on Earnings Claims for the Direct Selling Industry,” which was first issued in July 2020 and subsequently revised in 2022, lays out guiding principles for making truthful and non-misleading claims, including that companies refrain from making lavish lifestyle claims and focus on the overall “net impression” communicated by any product or earnings claims.

In fall 2023, DSSRC issued a new document, “[Guidance on Income Disclosure Statements for the Direct Selling Industry](#),” to provide guiding principles to help direct selling companies develop income disclosure statements, which are commonly used in the industry to provide prospective participants with earnings and other key information that consumers may wish to consider.

In last week’s letter to DSSRC, FTC staff raised several concerns with this new IDS Guidance. For example, Ms. Greisman took issue with the Guidance’s discussion of business costs, arguing that all costs – mandatory and optional – must be tracked and accounted for when determining whether earnings claims have a “reasonable basis.” But this position does not account for the manner in which direct selling companies allow sellers to determine how to build their businesses and which costs to incur. DSSRC’s Guidance takes the balanced approach that companies should disclose mandatory costs, but that non-incident expenses should be evaluated on a case-by-case basis, thus acknowledging that different sellers may engage in a variety of different marketing techniques.

FTC staff also argued that even supplemental income claims may be misleading if most people are not making any money net of expenses. But this position ignores the low entry costs associated with a direct sales opportunity, and does not acknowledge that industry calculations of expected earnings, whether measured as averages or medians, do not account for the significant variability in the amount of time and effort invested in building sales businesses.

The letter also takes the position that any representations regarding substantial earnings must be qualified “at a minimum [by] a clear, prominent, and unavoidable presentation of the typical participant’s revenue minus expenses—all of which must be substantiated.” But FTC staff provides no support or precedent for why an appropriately qualified earnings claims could not be made based on gross earnings where the claim makes that fact clear and reiterates that expenses vary by seller.

With these two letters, FTC staff has unmistakably turned up the heat on the direct selling industry and reiterated that it will not cede ground based on its loss in the *Neora* trial. Yet the agency can’t make law by proclamation – that will be for a judge or jury to decide.