FTC Staff's Revised MLM Guidance—More Content, Less Clarity

Donnelly L. McDowell, John E. Villafranco, Robert N. Ward

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Yesterday FTC Staff released updated Business Guidance Concerning Multi-Level Marketing that provides a detailed account of their current perspective on applicable standards governing the direct selling and multi-level marketing (MLM) industry. The new Guidance updates guidance from January 2018 (that we covered here) and lays out several principles and issues that Staff intend to consider in evaluating whether MLMs constitute illegal pyramid schemes and/or are otherwise engaged in unfair or deceptive acts or practices, including through misleading earnings and lifestyle claims and potential agency liability.

For followers of this blog and the FTC, the Guidance will ring familiar as another recent attempt by the FTC to declare law through guidance, analogous to the FTC's revised Health Products Compliance Guidance in December 2022. Despite its length, the Guidance conspicuously omits any reference to last fall's landmark decision in *FTC v. Neora* where the district court rejected many of the same theories that Staff now recasts as guidance, such as an amorphous prohibition against a "focus" on recruitment. As noted in our earlier coverage of the *Neora* decision (here), we expected the Commission to remain undeterred and regroup to lay the groundwork for future litigation—which the Guidance certainly appears to be issued with an eye toward.

Some of these principles were previewed in last month's letters to the Direct Selling Association and the Direct Selling Self-Regulatory Council, which we discussed here. Others are more detailed and provocative pronouncements on longstanding issues; others appear at least somewhat new. We address a few highlights below but note that there is a lot to unpack here. While the legal standard for pyramiding has never been black and white and has always been fact-specific, the Guidance muddies the water further – at least as to the FTC's perspective of the law – by appearing to diminish the importance of retail sales validation and differentiation between distributors and customers, both practices that the FTC has long encouraged and required as injunctive relief in the Herbalife settlement.

Injecting Further Uncertainty Into Pyramiding

- **No safe harbors for retail sales; repudiating the "primarily" test.** Echoing comments made in last month's letter to DSA, the Guidance repeatedly states Staff's view that there are no safe harbors to avoid classification as a pyramid scheme, including where even the vast majority of an MLM's revenue comes from retail customer sales or where rewards paid to participants are contingent upon sales. Staff adds a wholly new section to the Guidance seeking to repudiate the standard of whether a pyramid scheme is inherently based on rewards "*primarily*" unrelated to retail sales – a standard set forth both in longstanding case law and the

FTC's since renounced 2004 advisory opinion letter. Instead, Staff explains its current view that, where a compensation plan requires a certain level of downline participants for eligibility for rewards, even where a sale is required to trigger compensation, "[p]articipants will be incentivized to focus on recruitment to build a large downline, with the hope that someone in their downline will sell or buy products."

- **Prohibiting compensation plans "focused" on recruitment.** Instead of evaluating whether a plan is primarily based on retail sales or rewards unrelated to retail sales, the Guidance suggests that FTC Staff will consider whether "the structure as a whole operates in practice" to "focus on recruiting rather than product sales to real customers who don't also participate in the MLM network," including based on "marketing representations," "participant experiences," "the compensation plan," and the "incentives that the compensation structure creates for participants." The Guidance does not dispute that legitimate direct selling companies can and must recruit participants to sell products, but suggests that any structure that *over-emphasizes* recruitment – either facially or in practice – may constitute a pyramid scheme. Similar arguments were advanced and rejected by the court in *Neora*.

- **Personal consumption questioned.** Courts have long accepted that MLM participants may purchase products to meet genuine demand for personal consumption and that such purchases within reasonable limits must be considered legitimate retail sales. The Guidance again casts doubt on the willingness of Staff to credit this consumption and demand, by listing potential scenarios that the FTC considers problematic, such as purchases used to meet thresholds to earn or maintain a level of compensation or rank, or purchases encouraged by a participant's upline.

- **Preferred customer purchases.** The Guidance newly questions the validity of purchases by "preferred customers"—customers who have not registered as participants in the MLM opportunity—as potentially problematic if purchases "may be incentivized by the compensation plan." The Guidance does not elaborate on what incentives would be permissible or prohibited for preferred customers.

Restricting Earnings Claims

- **Atypical earnings claims.** The Guidance strongly discourages claims of atypical earnings, stating that a "claim should reflect what the typical person to whom the representation is directed is likely to achieve" and emphasizing that even truthful testimonials from participants earning atypical amounts of money will likely generate a deceptive impression and must "at a minimum" be accompanied by "a clear, prominent, and unavoidable presentation of the typical participant's revenue and expenses—all of which must be substantiated." What's more, Staff sets a remarkably low threshold for the types of claims that are likely to be considered deceptive. Whereas the 2018 Guidance discussed "expensive" houses and "luxury" automobiles, the updated Guidance now calls out claims about "modest or supplemental income" or that income from an MLM compensation funded gas or grocery purchases as potentially deceptive where the typical participant may not obtain that level of net income or without consumer perception evidence regarding how consumers interpret "modest or supplemental income."

- **Factoring in expenses.** Without citing authority, Staff repeatedly assert that, to make any earnings claim, an MLM must first know the typical expenses of participants—not just to the company, but all expenses associated with pursuing the opportunity (travel, training, etc.)—and

that any earnings claim must be based on these expenses being deducted from income. According to the Guidance, if a company "does not have access to data showing what participants typically spend pursuing the business opportunity (e.g., product or service purchases, website fees, party costs, and training or conference expenses), they should refrain from making any earnings claims." In this regard, the Guidance seems to assume that reasonable consumers would assume that earnings claims would always be net of expenses, even though most earnings figures for occupations are not and even though many direct selling companies expressly disclose this fact.

- **Income disclosure statements.** The Guidance memorializes views expressed in Staff's letter to the DSSRC in March which takes issue with the independent body's issued guidance on income disclosure statements (covered here). Notably, the revised Guidance not only details Staff's views on *how* income levels are determined such that expenses must be included, it also addresses *who* ought to be included in that calculation. Staff takes issue with disclosure statements excluding participants deemed "inactive" or who did not earn compensation, reasoning that such participants may have unsuccessfully tried to pursue the opportunity and that participants should not be omitted from earning statistics without evidence that they "affirmatively opted out of the income-earning opportunity, not merely failed to qualify for it or not merely exercised any inventory buy-back program."

Agency Liability for Third-Party Claims

Despite the Commission's Endorsement Guide acknowledging that it is "unrealistic" to expect a company to be aware of every statement made by a member of its network, Staff throughout the Guidance repeatedly notes that an MLM may be liable for the claims made by its participants and includes an entire section on this agency theory of liability and states there is "no safe harbor" for agency liability under existing law. Staff does, however, provide examples of potential actions to improve the effectiveness of compliance measures, including training, obtaining access to platforms used by participants (such as social media), and meaningful discipline for violations.

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As we have discussed, Commission guidance does not have the force of law, although it does offer important insight into how current Staff intends to apply the law. To its credit, FTC Staff characterize the document as "non-binding guidance to assist multi-level marketers in applying those core principles to their business practices." Elsewhere on the FTC's website, Staff explains that guidance documents are "intended only to provide clarity to the public regarding existing legal requirements or agency policies."

While this acknowledgment may offer some respite, the Guidance itself seems unlikely to advance its objective to "provide clarity," except perhaps to emphasize that Staff is willing to selectively interpret precedent in a way that supports its long-held skepticism of the industry.