

*Memorandum to President Barack Obama and Members
of Congress Overseeing the Federal Trade Commission:*

The
Main Street

Bubble

A Whistle Blower's Guide to

Business Opportunity Fraud

How the FTC Ignored and Now Protects It



by Robert L. FitzPatrick, Pres.

Pyramid Scheme Alert

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Study and Prevent Pyramid Schemes*

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Date: June 15, 2009
To: President Barack Obama and Appropriate Members of Congress
From: Robert L. FitzPatrick
Re: Main Street Bubble

We recently witnessed shocking revelations that our Securities & Exchange Commission (SEC) failed America in the regulation of financial Ponzi schemes.

I urgently bring to your attention a parallel pattern occurring at the Federal Trade Commission (FTC). Just as Congress has begun to correct the corruption of our SEC, similar oversight is immediately needed at the FTC. In the last eight years, the FTC virtually stopped investigating and prosecuting – and effectively *legalized* – the most common form of fraud that citizens encounter. These are “business opportunities,” disguised as “direct selling” and commonly called “multi-level marketing” (MLM) or pyramid selling schemes. They are egregious violations of Section 5 of the FTC Act as “unfair and deceptive trade practices.” For purposes of this report, they will also be referenced by the name commonly used by regulators – Biz Op frauds. Collectively, they represent an enormous and highly manipulated financial bubble – billions of dollars invested in worthless or grossly overvalued assets – the Main Street Bubble.

The Main Street Bubble is inflated by hundreds of pyramid selling schemes and a related network of “cash gifting schemes.” Each year it expands with billions in investment dollars and the futile hopes and manipulated dreams of millions of Americans who are lured into them. Like all bubbles, the hoped-for returns are based on the deceptive and deluded projection of endless expansion. As in all bubbles, the losers are left with largely worthless assets, lost funds, squandered time and, frequently, more debt. Many are financially ruined. The overpriced purchases and payments made by participants are revealed, in retrospect, to have been motivated by their *perceived* future value, which had been falsely advertised as “unlimited.”

Wall Street bubbles inflate rapidly and then collapse suddenly and totally. They may later re-emerge over a number of years in a new form, shifting in appearance but not substance, from stocks to real estate.

The Main Street Bubble, in contrast, inflates, collapses and re-inflates *continuously*, year after year. The majority of the “losers” are cycled out annually and the bubble is sustained with the recruitment of new investors and those reinvesting. The bubble is maintained and allowed to grow each year under the current protective policies of the Federal Trade Commission. With political protection allowing it to continuously reconstitute, the Main Street Bubble enjoys a *permanent* bailout. It functions as a constant drain of funds and energy at the Main Street level. Money from 99% of consumer investors (the proverbial *last ones in*) is systematically transferred to 1%, the promoters

After years of no regulation, ubiquitous solicitations, publicized “success stories,” and orchestrated lobbying in which pyramid selling schemes are falsely depicted as viable income opportunities for millions of consumers or a unique business sector that produces a

disproportionate percentage of millionaires, some consumers *and legislators* dismiss news of a 99% loss rate among all consumers who join the schemes. Reality clashes jarringly with myth. The scale of government neglect, the scope of the deception and consequent public harm are too much for many people to accept. It is indeed an “uncomfortable truth.” Yet, the truth of these loss rates has been known and statistically verified for many years.

- In the early 1980s former Wisconsin Assistant Attorney General, Bruce Craig, brought fraud charges against Amway, the largest MLM operating in that state. During the case, he obtained and reviewed tax returns of *all of Amway’s active distributors in Wisconsin*. The losses revealed by the tax returns were shocking even to the prosecutors. The “active” direct distributors constituted the company’s top representatives in income. Yet this group’s tax returns showed an average net income of *minus \$900*. Those earning a net profit were *far less than 1%* of the total consumer participants. Asst. Attorney General Craig was later interviewed on the 1982 *CBS 60 Minutes* exposé of Amway entitled “Soap and Hope” where the findings were reported.¹
- In England in 2007, the Department for Business Enterprise and Regulatory Reform charged that Amway is “inherently objectionable” and must be “wound down” (closed down in USA-English). The government claimed that Amway violated England’s Fair Trading Act 1973 among other laws. The Fair Trading Act 1973 addresses “Get rich quick schemes [operating] on the same basis as chain letters...” The government based its action largely on its documented findings that more than 99% of all UK Amway distributors had lost money. This 99% loss rate held true from more than three decades of Amway UK operations and had inflicted financial harm on tens of thousands of UK consumer/investors.
- A huge data base of consumers who have lost money as Amway distributors has been compiled by whistle-blower, Eric Scheibeler, author of *Merchants of Deception*, a book about deception in Amway’s recruitment campaigns. Scheibeler was involved in Amway for nearly a decade and reached the upper level of Amway’s pyramid hierarchy. When he presented direct evidence of deception and massive consumers losses to Amway officials he

¹ From the transcript of the *60 Minutes* show:

CRAIG: We’re charging them with deceptive business practices because of the use of those hypotheticals because they so vary from what we feel is REALITY.

WALLACE: [voice over] Bruce Craig investigated some examples used in Amway literature. Examples that said that Amway distributors could make in excess of \$1200 a month. Money that some Amway distributors could be earned with just a few hours a week. But after looking at the average income of the 20,000 Amway distributors in Wisconsin, Craig came to the conclusion that such a claim was outlandish.

[to Craig] Surely, SOMEbody’s making that kind of money.

BRUCE CRAIG: Yes. That’s correct.

WALLACE: How many? Percentage wise.

BRUCE CRAIG: About one percent.

WALLACE: [voice over] Amway DID make the disclaimer that \$1200 a month was ONLY hypothetical but that still doesn’t convince Bruce Craig.

BRUCE CRAIG: If the figure of successful distributors was 1 out of 5 as opposed to 1 out of 100 we wouldn’t be in court right now.

WALLACE: [voice over] And, Craig says that even the distributors who, on paper, earn an average of \$14,000 dollars a year in Wisconsin actually earn a lot LESS. How much do they actually make?

BRUCE CRAIG: After business expenses, a net income of minus \$918.

WALLACE: WAAAAIT a MINute! The direct distributors who make a gross income on average of over \$14,000 wind up losing almost \$1000 after business expenses?

BRUCE CRAIG: On average. Yes.

was driven from the company, vilified and sued. His data base now has thousands of verified and documented reports of losses from consumers all over the world, including more than 200 from Australia and, increasingly, many coming in from China.²

- The 99% rate is by no means limited to Amway, but rather occurs among *all* MLM companies that employ Amway's "endless chain" pay plan and in which few distributors earn profits from retail selling. The pyramid structure, lack of retail sales and "top loaded" pay plans *guarantee* these loss rates. Most MLM companies employ the Amway-type pay plan and fit this description. *Pyramid Scheme Alert* compiled statistical data on commission payouts disclosed by 11 of the largest and better known multi-level marketing companies, including Amway. The data revealed that the 99% loss rate held true for *all of them*.³

Collectively and over time the Main Street Bubble far exceeds Bernard Madoff's Wall Street fraud in scale of financial harm. An estimated \$10 billion *per year* is lost by US consumers. Worldwide, the figure is far higher, with most losses inflicted by US-based companies.

As in Bernard Madoff's "hedge fund," the value of the consumer investments in the "direct selling" schemes depends on the continuous enlargement of an investor base. When Madoff's bubble suddenly burst most investors realized their losses immediately. But, as prosecutors and whistle blowers revealed, the investments were actually lost the day they were placed with Madoff. This is because his investment fund operated as a Ponzi scheme. It was only *disguised* as a hedge fund. Returns were not generated from profitable trades but from a money transfer of later to earlier investors. Such a money transfer plan dooms most investors *by design*.

Similarly, the Main Street Bubble is composed of investments ranging from hundreds to tens of thousands of dollars from millions of consumers seeking the "income opportunity" that the schemes dramatically portray and aggressively solicit investors to join. These "business opportunities" are actually pyramid schemes, only *disguised* as "direct selling" companies. The investors are told they are investing in "distributorships." In fact, returns are not generated from profitable retail selling, which real distributors do, but from each distributor recruiting many new distributors.⁴ The money transfer is laundered through "marketing fees" and mandatory purchases of absurdly inflated products. *This system, advertised as a "business opportunity," inflicts documented financial losses on 99% of all consumer/investors each year.*

Individual investments in these pyramid recruitment schemes are usually lost within a year. Each consumer/investor experiences the financial loss individually, not as part of a group of victims, and they seldom learn the nature of the fraud. Some may continue to pursue the "dream" for years and suffer far larger losses in the end. Yet, as in the Madoff scheme, their investments are actually doomed the day the consumers join the schemes because of the pyramid structure, impossible recruitment requirements and the unsustainable money transfer system which siphons funds to a handful of promoters at the top.

² See <http://www.merchantsofdeception.com/>

³ The data supporting the 99% loss rate and the concentration of commission rewards to the top 1% is available in the report "The Myth of MLM Income Opportunity" which examined payout data on eleven MLMs. See <http://www.pyramidschemealert.org/PSAMain/news/MythofIncomeReport.html>

⁴ It is important to grasp that the absence of retail sales in a "direct selling" business opportunity scheme is not an infraction or an excess or an abuse. Rather, it fundamentally alters the business from legitimate direct selling to a "closed market" in which the vast majority of participants *cannot succeed*, since endless expansion of "distributors" is *impossible*. It is this type of "non-retailing" multi-level marketing scheme, that prevails among the members of the Direct Selling Association (DSA).

The Main Street Bubble is not hidden. Indeed, the schemes operate in plain sight. As many as 10 million Americans are lured to invest in them annually. Solicitations to join them are everywhere now – in churches, at the office, in the neighborhood. They inundate the internet. *USA Today* recently reported that *YouTube* now features nearly 23,000 “cash gifting” videos. The *London Times* has referred to America’s Biz Op Pyramid schemes as the “poor man’s Ponzi scheme.”⁵ Others compare them to a form of economic cancer. The schemes multiply in number each year, financially devouring savings and investments of millions of consumers.

The multi-level marketing (MLM) Biz Op schemes gain little media attention because they have enjoyed *de facto* government endorsement over the last eight years. The news media is faced with a dilemma of *accusing*, not exposing, them. Journalists routinely raise the *question* of fraudulence and economic harm when reporting the schemes, but they have few authoritative sources to reference. Many investigative writers fall back on anecdotes of consumer losses but also inevitably include, for “balance,” the rare instance of one who made a great deal of money in the scheme.⁶

Consequently, the American public is left largely in the dark and sadly misled. The prevailing media and government message is the myth that MLM is a viable, legal and perhaps, as the promoters claim, the consumer’s *best* chance for income in troubled economic times. Those who do confront reality after being harmed are mostly silenced by shame or fear into accepting losses. If they overcome these obstacles they still have limited recourse for restitution. Private lawsuits are beyond the means of most. Regulators routinely ignore complaints. Independent whistle blowers, at great cost to themselves, have provided facts and analysis to the media and, in vain, to the FTC. Other consumers have sought justice in class action lawsuits.⁷ Some fraud investigators and financial analysts have also warned investors, the FTC and the SEC about the pyramid selling schemes, such as Herbalife, Usana, Your Travel Biz.com, Pre-Legal, Nuskin and Mannatech that sell securities on major stock exchanges.

The FTC has direct federal regulatory oversight over multi-level marketing. This oversight was effectively abandoned in 2000 following President George W. Bush’s appointment of Timothy Muris to chair the FTC. At that time, Muris was an anti-trust lawyer whose largest client was the

⁵ See full *London Times* article, “Pyramid Swindlers Unmasked,” February 1, 2009, in the Appendix.

⁶ The rare “winners” in MLM are not the result of their special talent, ambition or persistence as MLM schemes routinely claim. Nor are they the outcome of mathematical odds in open market competition. Rather, they are intrinsic to the *design*. 99% of consumer/investors *must* lose for a tiny group at the pyramid’s peak to gain as “commissions and profits.” Their “success” is not evidence of the scheme’s potential opportunity for the others but the impossibility of that opportunity. The system is closed. Value is not exchanged. Money is merely transferred.

⁷ In the past, the FTC utilized class action lawsuits to support prosecutions and as reasonable cause to open investigations. Today, though numerous class action suits have been filed against major MLMs such as Amway, Herbalife, Usana, Pre-Paid Legal, and others – all making the same charges of pyramid fraud – the FTC has not even opened investigations. In one previously settled class action lawsuit brought by consumers against Herbalife, 2,700 former distributors filed claims with aggregate losses totaling approximately \$19 million. The suit charged Herbalife with operating a pyramid scheme and using false and misleading claims about income to lure investors. (Nancy Jacobs, Individually on behalf of herself and all others similarly situated, and on behalf of the General Public, Plaintiff, vs. Herbalife International, Inc., et. al., Class Action Complaint, Feb.15, 2002 filed before the US District Court for the Central District of California, Los Angeles Division).

Even state prosecutions do not prompt FTC action against MLMs. The Attorney General of California brought suit against a large MLM, Your Travel Biz.com (YTB), which is a member of the Direct Selling Association. The Attorney General called YTB “a gigantic pyramid scheme.” The FTC has not responded. See <http://pyramidschemealert.org/PSAMain/news/YTBProsecuted.html>

multi-level marketing company, the Amway Corporation. In addition to being the icon and business prototype of nearly all other multi-level marketing companies, Amway is one of the most politically influential corporations in America with powerful ties to the previous George W. Bush administration and to the National Republican Party. Amway's paramount lobbying goal is to shield itself and other schemes of its type from FTC fraud investigation. To prevent prosecution it has engaged in influence-buying on an extraordinary (details of Amway's and the "pyramid lobby's" influence-buying are included later in this memorandum).

Under Timothy Muris, the FTC went beyond what the SEC did in terms of lax law enforcement and regulatory negligence of Wall Street. It effectively *legalized* this form of Main Street business fraud. This was achieved, not by vote of FTC Commissioners, some of whom may have been unaware of the policy change, but primarily by staff actions under the chairmanship of Muris and continues to date. These have included:

- Effectively halting investigations and prosecutions of pyramid selling schemes.
- Consistently failing to monitor companies that had been issued enforcement orders by earlier FTC Commissions and are blatantly violating these orders.
- Issuing a widely circulated letter that obscured and appeared to permit practices – paying rewards for “endless chain” recruiting without retail sales as a revenue source – that the courts, and 30 years of earlier FTC policy have declared are illegal.⁸ The letter was used by MLM companies to persuade millions of consumers that previous FTC policies and court actions that defined pyramid selling fraud were no longer valid.
- Consistently ignoring consumer requests, complaints, class action lawsuits, international regulatory actions and media exposures concerning fraudulent business practices of US-based multi-level marketing companies.
- After taking public comment on a proposed FTC rule, which had been years in the making, to protect consumers from fraudulent “business opportunity” schemes, the staff rejected further comments from whistleblowers but at the same time held an *ex-parte* meeting with the MLM lobbying organization, the Direct Selling Association, which was seeking to exempt all MLM companies from the rule.

⁸ The judicial foundation for the FTC to prosecute MLM endless chain schemes is clear and well established. It was cited in one of the last significant prosecutions that the FTC undertook, before the Bush administration placed a protective canopy over them with the appointment of former Amway attorney, Timothy Muris, as FTC Chair.

Count 5 of FTC Complaint against the large MLM, Equinox International, filed in the United States District Court, District Of Nevada, August, 1999, stated, “the Equinox program is an inherently unlawful scheme whose essential element is 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 the ultimate users.... The result of the structure and operation of the program is that financial gains to Equinox participants are primarily dependent upon the continued, successive recruitment of other participants... This type of scheme is often referred to as a pyramid.”

In his formal declaration that concluded Equinox was a pyramid scheme, FTC pyramid expert, Dr. Peter Vandernat wrote at that time, “In distinguishing between a pyramid scheme and a legitimate business, the critical issue is whether rewards paid in connection with recruitment are tied to, or are derived from, the sales of goods and services to the general public (i.e. retail sales)...The Koscot case affirmed the stated issue to be the critical factor. Later, cases such as Webster v Omnitrition and Gold Unlimited affirmed Koscot. In Webster the court also found that for pyramid analysis the sales that are made to a distributor's downline do not count as retail sales. A “retail sale” refers to a sales of product to general consumer, i.e., someone who is not a member of the organization.”

- Following the meeting, the FTC staff recommended that MLM companies would be *exempted* from any new rule to regulate business opportunity frauds. This ruling was made even though multi-level marketing schemes overwhelmingly constitute the most common form of “business opportunity” frauds that consumers encounter and MLM schemes have been the source of numerous FTC prosecutions.
- In recent years, a new pattern of revolving door work has developed between the FTC staff and MLM lobbyists. Key FTC staff have taken jobs with law firms that represent the multi-level marketing schemes. The former chairman of the FTC, Timothy Muris and the former head of Consumer Protection, J. Howard Beales (appointed by Timothy Muris while he was FTC Chairman) worked as MLM lobbyists to influence the FTC against regulation of multi-level marketing. Another Director of Consumer Protection, Jodie Bernstein, subsequently became a lobbyist for the Amway Corporation, and has urged the FTC to exempt Amway and similar schemes from any new rules over business opportunity frauds.

Business opportunity frauds, structured as multi-level marketing schemes, are insidious as well as financially destructive because they lure consumers to spread financial harm among close friends and relatives, the “warm list” of recruits, as they are termed. The schemes operate by exciting misguided dreams and false hopes of a secure financial future through financial investments in the schemes. These deceptive promises lead many consumers to forego jobs and education, to incur additional debt, and to commit months or even years of time in what are carefully crafted financial traps.

Most, but not all, members of the Washington, DC-based lobbying group, the Direct Selling Association, now operate under the Amway “business model.” The Amway model, under FTC protection, has come to dominate and corrupt the direct selling industry.

In this model, the consumers pay money in fees and required inventory purchases as they are sold “distributorships.” They are then directed to recruit other “distributors” and are offered a percentage from multiple levels of future investors’ payments. The model promises “unlimited income potential” based on the “endless” levels of distributorships. However, the pyramid structure dooms the vast majority of all investors to be in loss positions at the bottom. It is both deceptive and harmful.

Endless chain frauds are illegal under many state statutes and in some countries. Lacking FTC support, few states can prosecute the large schemes, due to limited resources. The schemes now operate with relative immunity from prosecution.

The true effect of these Main Street frauds is even more destructive since \$10 billion is filched from the middle class, least able to afford losses. The schemes claim perfect legality and, just as Bernard Madoff did, they cite the lack of federal prosecutions as proof of their legitimacy.

While our government seeks to repair America’s tarnished reputation abroad, the FTC’s policy has resulted in US-based pyramid schemes damaging US credibility internationally. Most MLM companies operating worldwide are US-based.

- In 2005, China, America’s largest economic competitor, banned this US-sanctioned MLM business model entirely.⁹
- In 2006, England sought to close down the Amway Corporation, the largest US MLM operating in that country, on the grounds that it harmed the public.¹⁰

⁹ <http://pyramidschemealert.org/PSAMain/news/ChinaoutlawsMLM.html>

- Sri Lanka recently passed new anti-pyramid scheme laws aimed at curbing the exploitation of its poor citizens by MLM schemes, most of which are from the USA.
- Government officials in India have raided Amway offices and now brought criminal charges against Amway for operating a pyramid scheme.¹¹
- Other MLMs that operate under the model that the FTC now allows, have been prosecuted in others countries for fraud.¹²

While this memo may be read as alarmist, I ask you to consider that SEC whistle-blower, Harry Markopolis, was viewed similarly. And, just as a charge of fraud against prominent, politically-connected figures may seem far fetched to some, I ask you to remember that Bernard Madoff was viewed as above reproach by many in the government, media and investor community. I also ask you to recall that, using fraudulent accounting, Enron grew to become our 7th largest company and its CEO, Kenneth Lay, held celebrated business credentials and political connections at the very highest level.

Ferretting out and confronting fraud that is imbedded within the fabric of the legitimate marketplace and affiliated with elected leadership requires courage and will. Revealing fraud inevitably triggers collapse, loss and outrage. However, as the Madoff debacle has shown, lack of action leads to even greater harm.

While the government works to rescue our economy from Recession and financial chaos, the spread of false “income opportunity” schemes subverts the economy, misleads and confuses the public, obstructs the goal of renewed productivity and entrepreneurship and impoverishes millions of people.

I ask you to please review this outline of facts and events that reveals the tragedy of the Main Street Bubble, in which millions of Americans are taken advantage of by business opportunity frauds that the FTC has effectively legalized by its inaction and political protection.

Sincerely,

Robert L. FitzPatrick, Pres.
PYRAMID SCHEME ALERT

¹⁰ <http://pyramidschemealert.org/PSAMain/news/AmwayOnTrialinEngland.html>

¹¹ <http://pyramidschemealert.org/PSAMain/news/AmwayinIndia.html>

¹² <http://pyramidschemealert.org/PSAMain/news/GoldQuest-QuestNetinIndia.html>

I. The FTC's Role in Promoting and Protecting Biz Op Pyramids

1. Background and Overview

It is a sad but true fact that there is nothing new about a regulatory agency cooperating or colluding with an industry it regulates. Regulators have bent laws, loosened rules or granted favors. Experience has repeatedly revealed this kind of corruption and the consequences have also been repeatedly demonstrated. When the corrupting behavior passes certain thresholds of abuse, enormous harm follows. The SEC's lax oversight of Wall Street is the clearest example.

The FTC's collusion with business opportunity schemes, however, is in another category. The FTC has engaged not just in lax oversight but active facilitation of illegal activity under Section 5 of the FTC Act. The FTC's actions since 2000 have been to *legalize* activities and business practices that the courts, the states and previous FTC policy have consistently understood to be illegal. A pyramid scheme is not "abuse" by a legitimate business, or an "excess" of a basically legal business practice, or just a violation of rules. It is a *per se* fraud, defined as an "unfair and deceptive trade practice" in the FTC Act. It is a device *constructed* to deceive and to harm. This is what the FTC's policies and action in recent years have protected.

Prior to 1980, pyramid schemes, as a major force in the market, were not widespread. When they began to appear in the mid 1960s, pyramid selling schemes were widely understood to be classic frauds and were prosecuted. In 1968, California passed its famous "endless chain" statute, which has been a model for other states.¹³ The endless chain was understood to be not only a fraud for inducing "business opportunity" investment but also for illicitly driving purchases. Some states bolster anti-pyramid selling scheme laws with anti-referral discounts statutes. These laws prevent discount plans that require the customers to recruit new customers in order to gain the advertised price. In both scenarios the endless chain places the vast majority of all participants at the end of the chain where profit or discounts cannot be gained. In short, the endless chain was understood to be a menace to an open and fair marketplace, a corruption of business and a new form of swindle in the annals of capitalism.

Multi-level marketing schemes combine an endless chain pay plan with a referral-based discount. Recognizing the impossibility of its income plan, in 1975, the FTC sued to close down Amway, the first pyramid selling scheme that showed significant growth nationally. FTC attorneys saw that Amway's endless chain pay plan, by design, doomed most consumers to losses and it therefore would cause widespread harm. It followed that the promotion of the plan was inherently deceptive.

¹³ § 327. "Endless chain" schemes

Every person who contrives, prepares, sets up, proposes, or operates any endless chain is guilty of a public offense, and is punishable by imprisonment in the county jail not exceeding one year or in state prison for 16 months, two, or three years.

As used in this section, an "endless chain" means any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant. Compensation, as used in this section, does not mean or include payment based upon sales made to persons who are not participants in the scheme and who are not purchasing in order to participate in the scheme.

In 1980, an fundamental shift occurred in America that enabled pyramid selling frauds to proliferate and begin to spread worldwide. It occurred with the coincidence of two events:

- 1) The FTC lost its court effort to close down Amway as an *inherent* fraud. While winning on its charges that Amway fixed prices and engaged in false income claims, the FTC was unsuccessful in its effort to prove its case of a *per se* pyramid scheme. After a four-year legal battle, an FTC Administrative Law Judge's ruled in 1979 that Amway, under certain conditions (commissions are to be paid primarily from retail sales revenue, not from investments of new salespeople), could continue to operate.
- 2) Then, Ronald Reagan's administration took office whose official policy was "de-regulation." The oversight of MLM that was required in the Amway court outcome *was not carried out*. New staffers with a de-regulation ideology came to the agency. In the new climate of de-regulation, the MLM business quickly devolved from the retail selling of products to the calculated selling of *distributorships*. The distributorships' value depended upon an endless chain reward system. Little or no profits were gained from retail selling but from the investments of future distributorship.¹⁴

An MLM "industry" developed that operated exactly as the FTC case against Amway had tried to prevent. Under FTC de-regulation, the requirement of the 1979 decision of the Administrative Law Judge linking commissions to retail sales was ignored. Retail sales virtually disappeared. "Direct selling" became the official disguise of a newly invented and distinctly *American* business scam. Its chief protagonist was even called "American Way." Product purchases with inflated prices became the standard M.O. for laundering pyramid money transfers. Each new distributor was induced to purchase goods each month as part of the "investment." Then, 40-50% of the price was transferred to as many as 12 levels of recruiters above, with nearly all of it concentrating in the top tier. Each newly recruited "distributor" was told that he/she too could recruit an "endless chain" of levels of distributors below them. The opportunity was said to be "unlimited" and the market potential to be "infinite."

The new pyramid "business model" spread to all 50 states and expanded to 60 other countries. This was an American scam on a scale far larger than Nigeria's famous export.¹⁵

Some negative media coverage about consumer losses, false income promises and the operation of obvious pyramid recruiting led the larger MLMs such as Herbalife and Amway to focus their businesses outside the USA where there were even fewer restrictions. Without the spread to new territories, the schemes would have collapsed even without regulation. The schemes have no repeat "customers". They churn through 50-80% of victims annually, replacing them with new

¹⁴ In the prepared statement on "pyramid schemes" presented at the International Monetary Fund's Seminar on Current Legal Issues Affecting Central Banks, Washington, D.C., May 13, 1998, Debra A. Valentine, General Counsel for the U.S. Federal Trade Commission stated, "Pyramid schemes now come in so many forms that they may be difficult to recognize immediately. However, they all share one overriding characteristic. They promise consumers or investors large profits based primarily on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public. Some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure... A lack of retail sales is also a red flag that a pyramid exists. Many pyramid schemes will claim that their product is selling like hot cakes. However, on closer examination, the sales occur only between people inside the pyramid structure or to new recruits joining the structure, not to consumers out in the general public." (<http://www.ftc.gov/speeches/other/dvimf16.htm>)

¹⁵ For a comparison of the Nigerian scam with America's version of MLM (now banned in China) see <http://www.falseprofits.com/Americanscam.html>

ones. The influx of new cash from abroad continued the illusion of sustainability, thus enabling them to continue recruiting new USA residents, long after markets were saturated.

Today, more than 80% of Amway's and Herbalife's revenue comes from consumers outside the USA. The global expansion came to a halt in 2005, when China banned the MLM recruitment model. Effectively, China achieved in 2005 within its borders what the FTC had sought to do for US consumers 30 years earlier – to protect its citizens from the orchestrated, well funded, and disguised “direct selling” frauds.

In the mid-1990s through 2000, the FTC began to reassert law enforcement over pyramid selling schemes. It relied on common sense tests for recognizing endless chain schemes, federal court rulings and it cooperated with states in identifying and prosecuting them. Nearly 20 cases were prosecuted.

In these prosecutions, one fundamental factor was reconfirmed repeatedly as a criterion for identifying and defining the pyramid selling scams that masquerade as “multi-level marketing.” This was the same factor identified in the Amway case: *retail sales*.

Despite the impossible proposition of income based on endless chain recruiting, the Amway decision of 1979 had allowed the pyramid *structure* to stand. Regulation and prosecution, therefore, had to go below the structure and examine *how the MLMs operate*. The fundamental role of retail selling became a key qualifier. This approach goes to the heart of the question addressed in all pyramid and Ponzi investigations: *Where does the money come from?*

Without sustainable and profitable retail sales, the reward money can only come from one place: *the investments of later recruits*. Without significant numbers of distributors earning profits from retail sales, the only way to be profitable in such a scheme is to engage in hopeless (for nearly all) recruiting. Only by examining this key factor, can the perverse workings of a pyramid scheme be revealed behind the façade of “direct selling.”

During the 1990's resumption of FTC oversight and prosecutions, FTC Senior Economist, Dr. Peter Vandernat, became an internationally recognized expert in explaining and analyzing pyramid frauds disguised as multi-level marketing. He provided declarations and expert witness testimony on most FTC cases to show how a classic pyramid fraud can be dressed up as “direct selling.” He assisted state Attorneys General cases, explained the analysis to the news media and assisted consumer watchdog groups that had begun to spring up in support of FTC enforcement. His declarations and depositions have been widely quoted.

Of special importance, Dr. Vandernat developed a simple “test” for determining the legitimacy of a MLM. It measured how much retail sales (outside revenue) would have to occur for an MLM to pay legitimate commissions rather than rewards for illegal pyramid recruiting. The test enabled the FTC to enforce Section 5 of the FTC Act on multi-level marketing with minimal research and discovery. Only a few key financial data points were needed to perform the test. In general, in a typical MLM pay plan, the test usually revealed that at least 70% of all purchases by MLM “distributors” would have to be resold to retail customers at full retail price in order to generate legitimate commissions.¹⁶

¹⁶ The state of North Carolina imposed a 70% standard in four pyramid scheme cases that it prosecuted in 1999. Indicating the vast reach of MLM pyramid frauds, the four relatively small MLM companies, Club Atlanta Travel, Destiny Telecomm International, Inc., Tele-Card International, and International Heritage, Inc., had enrolled 40,000 distributors in that one state alone. The settlement agreement with Destiny Telcomm International stated: "...at least 70% of all North Carolina sales shall be retail sales to persons who are not connected in any way to the Destiny sales

Dr. Vandernat also co-authored the only academic paper that explains how to distinguish a legitimate MLM from a disguised pyramid scheme. In this paper, he fully presented the legal and mathematical basis for applying the “retail test” to multi-level marketing.¹⁷

force." The ruling also excluded from the 70% portion, sales to individuals who subsequently became Destiny representatives."

A more recent application of the retail sales standard was applied by the California Attorney General. In a May, 2009 settlement with the MLM scheme, Your Travel Biz.com (YTB), the ruling requires that at least 60% of sales by YTB representatives must come from non-representatives (retail customers). The ruling also stripped YTB of much of its “pay to play” revenue in which participants paid monthly fees for “websites.” See <http://www.pyramidschemealert.org/PSAMain/news/CA.AG.YTB.Judgment.pdf>

¹⁷ Peter J. Vandernat and William W. Keep, *Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes*, 21 *Journal of Public Policy & Marketing* (Spring 2002), at 139– 151.

2. FTC Protection of Pyramid Selling Schemes

When Timothy Muris, a former attorney for Amway, was named by President George W. Bush as head of the FTC, a series of actions unfolded to roll back FTC oversight of Amway and other pyramid selling schemes and to halt prosecutions and enforcement. The shift in policy was critical for Amway, which Muris's law firm previously represented. Amway's own "SA4400" document, which it provided to new recruits, stated that less than 20% of all sales to distributors led to retail sales. Later class action lawsuits by top Amway insiders asserted that less than 4% of all Amway "sales" were ever made on a retail basis. Virtually all Amway revenue was sourced ultimately and only from the investments of the "salespeople."

Retail sales were unprofitable and unfeasible due to high prices, no consumer demand, and low retail profit margin available to the distributors. If FTC policies were maintained and Dr. Vandernat's test and analysis were applied to Amway, it would fail and would become a target of prosecution and with it many others would follow. The Main Street Bubble would burst in which hundreds of MLMs leveraged the investments of millions of consumers, who could never gain returns. The MLM house of cards was in jeopardy of imminent collapse.

1) Reassignment of FTC's Internal Expert on Pyramid Schemes

One of the first actions taken that resulted in protection of Biz Op Pyramids from future prosecutions was to move Dr. Vandernat out of the area of MLM fraud investigation and analysis. He was reassigned to an unrelated area of examining the accuracy of credit ratings. Dr. Vandernat's extensive expertise and enormously valuable experience and international reputation in pyramid scheme analysis were largely furloughed and no longer put to use on behalf of US consumers.

2) Official Policy of No More Pyramid Scheme Prosecutions

Sources inside the FTC, who must remain anonymous, have verified that Dr. Vandernat's reassignment was an early signal of an unstated but nonetheless official FTC policy in which pyramid selling schemes would no longer be prosecuted to any significant degree. In fact, this occurred. Over the next eight years, FTC prosecutions virtually stopped. One prosecution of the MLM scheme, Burnlounge, was conducted but was initiated by the state of South Carolina and arose from many complaints within the music industry (Burnlounge used an endless chain income promise to sell downloaded music and entice musicians to place their music in its library.)

The FTC imposed this virtual moratorium on MLM investigations despite increased consumer activism against multi-level marketing schemes in the United States and dramatic international prosecutions against them.

- √ Class action cases were brought against large MLMs, Amway, Herbalife, Usana, and Pre-Paid Legal, among others. All the cases made the same claim – that the MLMs are pyramid schemes in violation of Section 5 of the FTC Act and other state statutes against endless chain frauds.
- √ Another new and fast growing MLM and members of the DSA, Your Travel Biz.com, was sued by the Attorney General of California as a "gigantic pyramid scheme."
- √ The state of Texas prosecuted the MLM company, Mannatech. The Attorney General of Texas, where the scheme is based, charged that Mannatech falsely claimed that its food supplements cured Down syndrome, cystic fibrosis, cancer and other serious diseases.

The company was subsequently fined \$6 million and its founder required to pay \$1 million to settle. Mannatech is a member of the Direct Selling Association and is publicly traded on the Nasdaq stock exchange.

- √ The nation of China banned the MLM payment model in 2005 as an inherent pyramid fraud.
- √ The government of England sought to close down the largest MLM, Amway, after discovering that less than 1% of all English consumers who had invested in Amway's "business opportunity" had ever earned a profit.

The FTC protection of MLMs had a wider effect also on *states*. Without FTC resources and support, state prosecutions, which had limited prosecution and investigation budgets, were cut back. Large MLMs, with significant legal defense funds, were effectively granted immunity from the FTC Act Section 5.

3) No Enforcement of Past FTC Orders against MLMs

Not only were virtually no prosecutions initiated over the last eight years, but orders from past prosecutions were not enforced. Representatives of *Pyramid Scheme Alert* met with and repeatedly notified FTC officials concerning the violations of past enforcement orders against the MLM, Nuskin.¹⁸ This company had been fined two times for more than \$1 million each for making false claims about its products and about its claims of "income potential."

Similar consumer requests were made to reopen the Amway case in which the FTC was to enforce court rulings regarding retail sales. In 2004, *NBC Dateline* aired a documentary showing Amway distributors misleading consumers about income and the sources of the money of Amway promoters. Consumer requests to the FTC, based on the airing of that national news show, to reopen an investigation of Amway and enforce past orders were ignored.¹⁹

4) Obscuring the Longstanding Interpretation of Section 5 of the FTC Act that a Multi-Level Marketing Scheme without Significant Retail Sales Is a *Per Se* Fraud

On January 14, 2004, James A. Kohm, Acting Director of Marketing Practices, Federal Trade Commission, wrote a highly publicized letter to Neil H. Offen, President, Direct Selling Association, that, according to many in the MLM industry and the DSA, repudiated all past FTC interpretations of Section 5 of the FTC Act and federal court rulings regarding the fundamental requirement of retail sales (external revenue source). The letter is entitled: "Staff Advisory Opinion - Pyramid Scheme Analysis."²⁰

This letter was cited twice by the former FTC Chairman, Timothy Muris, after he left the FTC and served as a lobbyist for an MLM company. Mr. Muris referenced the letter to

¹⁸ *Pyramid Scheme Alert* sent consumer petitions to the FTC asking for enforcement of its orders against Nuskin and cited many instances of violation. The petitions were ignored. See <http://www.pyramidschemealert.org/psamain/action/nuskinpet.html>

¹⁹ The *NBC Dateline* show can be seen in full on YouTube at <http://video.google.com/videoplay?docid=-215989802739458876&>. The formal letter from *Pyramid Scheme Alert* to the FTC asking for an investigation can be read at <http://www.pyramidschemealert.org/psamain/action/FTCCommissLtr.html>

²⁰ The full text of the letter can be read at <http://www.pyramidschemealert.org/PSAMain/resources/FTC.Kohm.Letter.pdf>

support his arguments that the FTC should not impose disclosure regulations on MLM companies.²¹

Kohm's letter has been widely circulated by MLM recruiters to persuade consumers that product purchases made by MLM distributors can count as retail sales, i.e., no external revenue is required for legitimacy. Kohm's letter refers to "fees" as the primary payment made by pyramid participants and obscures the far larger role of the product purchases. In those purchases, which are effectively required by the pay plans prices are inflated 50-250% and then 40-50% of the exorbitant price is transferred directly to the top of multiple levels of recruiters through "top-loaded" pay formulas.

5) Colluding with Pyramid Lobbyists

While still in deliberations over rules to regulate the MLM industry, FTC officials, arguably, held at last one *ex parte* meeting with lobbyists of the MLM industry in possible violation of the Administrative Procedure Act ("APA"), 5 U.S.C.²²

Complying with the requests of the Pyramid Lobby, the FTC staff has recommended that all multi-level marketing companies be exempted from its proposed new rule that was to require more income disclosure on "business opportunity" schemes. This extraordinary recommendation reversed the earlier FTC statements about the proposed rule in which "pyramid selling schemes" were featured as a major source of "business opportunity" fraud. The Direct Selling Association (DSA) lobbied to exempt its member companies.

In the case of one DSA member, Pre-Paid Legal, an MLM that has been the target of more class action and private lawsuits for fraud than any others, the company argued that nearly 500,000 North American consumers "depended" on it for "income." In fact, 80% of Pre-Paid Legal's "salespeople" never make even one sale and only 2% make 10 sales. The mean average "income" of the salespeople is about \$5 a week. In short, the DSA presented a false claim that disclosure rules would harm rather than protect the public. The FTC staff accepted the arguments and recommended that MLMs be exempted.

6) Influence Peddling

In recent years, the FTC has experienced a pattern in which staff and even Commissioners have been able to market their roles within the FTC to multi-level marketing companies, which lobby against regulation and law enforcement, and MLM lobbyists have been brought in as FTC staff to oversee MLM.

- √ George W. Bush appointed Timothy Muris to head the FTC. Muris' last job before chairing the federal agency that regulates multi-level marketing was as an attorney with the antitrust

²¹ Timothy Muris' July 17, 2006 letter to the FTC as a MLM lobbyist can be seen at

<http://www.ftc.gov/os/comments/businessopp/522418-11929.pdf>

²² In the fall of 2008, the DSA issued a press release announcing the attendance of Lois Greisman, Associate Director of the Division of Marketing Practices at the FTC, and Lem Dowdy, FTC Attorney, to a closed DSA seminar October 23-24 in Alexandria, Va with DSA members. This was during the period of deliberations on a new rule to regulate income disclosures of MLMs. The release stated that "attendees will have the opportunity to ask questions and engage in an open dialogue with these (FTC) representatives, The general public had no opportunity for rebuttal and at the same time was not even allowed the chance to offer further comment as the comment period had ended. See http://www.dsa.org/press/press_releases/index.cfm?fuseaction=show_release&Document_id=1928

division of the firm Howrey, Simon, Arnold and White, LLP. The antitrust division of Howrey counted among its largest clients the Amway Corporation.

- √ As the new chairman of the FTC, Timothy Muris appointed David Scheffman as the FTC's new Chief Economist. Only a year earlier, Scheffman worked as an expert for the multi-level marketing company, Equinox International, a member of the Direct Selling Association that was prosecuted by the FTC for violating Section 5 of the FTC Act. David Scheffman testified against the FTC and on behalf of the scheme. Scheffman argued that the Equinox business model was legitimate, not a pyramid scheme. His claim was largely based on the assertion that Equinox operated just like Amway. The FTC ultimately succeeded in shutting down Equinox and recovering about \$50 million for consumers. However, the FTC estimated that consumer losses at the hands of Equinox exceeded \$330 million.
- √ After leaving the FTC in 2004, Timothy Muris joined the Washington DC law firm, O'Melveny & Myers. The website of O'Melveny & Myers lists Mr. Muris as "representing Primerica Financial Services... in the Federal Trade Commission's Business Opportunity Rulemaking proceeding." Primerica is a member of the Direct Selling Association and a multi-level marketing company that, like all MLMs, could be negatively affected by a new rule proposed by the FTC to regulate any business that sell a "business opportunity." A 2006 letter sent to the FTC on behalf of Primerica argued against the proposed FTC rule. The letter was signed by Timothy Muris.
- √ While head of the FTC, Timothy Muris appointed J. Howard Beales III, as Director of the Bureau of Consumer Protection. He had previously served at the Commission in the 1980s during the "de-regulation" era. After leaving the FTC, Beales co-signed the letter to the FTC with Timothy Muris on behalf of the MLM, Primerica, that argued against regulation of multi-level marketing. Howard Beales was also known for his consulting work for Reynolds Tobacco and his public defense of the Joe Camel advertising campaign.
- √ Jodie Bernstein after serving as Director of Consumer Protection at the FTC from 1997 to 2002 joined the law firm, Bryan Cave. In that capacity she lobbied the FTC on behalf of the MLM, the Amway Corporation, arguing against regulation.

The law firm, Bryan Cave, has considerable experience in representing companies accused of operating as pyramid schemes. It defended the notorious Ponzi operator Reed Slatkin and previously represented Michael C. Cooper, president and chief executive officer of the MLM company, Renaissance the Tax People, which was shut down by the state of Kansas as a pyramid scheme.²³

²³ The firm of Bryan Cave, which lobbies for and represents Amway, also counts among its newer attorneys:

- Frank Gorman, formerly legal advisor to the director of the Federal Trade Commission's Bureau of Consumer Protection. Gorman left the FTC and joined the firm in 2003 when Ms. Bernstein also came over from the FTC and began lobbying for Amway.
- Dana Rosenfeld, who served as the assistant director of the Federal Trade Commission's Bureau of Consumer Protection and was senior legal advisor to Jodie Bernstein.

II. The Political Influence of the Pyramid Lobby

This memorandum cannot conclude without addressing the question of *why* the FTC reversed policy and protected companies that violate Section 5 of the FTC Act. The answer is plainly *political*. Influence was purchased.

While many people are somewhat aware of large lobbying forces in Washington such as Tobacco, Guns and Pharmaceuticals, few are aware of the powerful political influence of the MLM industry which constitutes a Pyramid Lobby. Like the stealth marketing of MLM companies which is mostly carried out without national media, the Pyramid Lobby's work is similarly low profile. This is partly due to its extraordinary purpose. MLM's top priority is not just to curry favoritism or receive income at the public trough, but to *prevent its extinction*. This requires *thwarting law enforcement and foiling consumer protection*. Only the tobacco industry has as much at stake in its political lobbying and its public marketing campaign.

Much of the influence is carried out at the state level where legislatures and state Attorneys General are lobbied to change or not enforce clearly worded statutes that ban business opportunity frauds and endless chain schemes. One notable example is the state of Utah, which has more MLM headquarters per capita than any other state. MLM brings more money into that state than its famed skiing industry. While Utah has no lottery, it is the beneficiary of an industry based on endless chain speculating. *The actual odds of winning are significantly better at a Las Vegas craps table than joining at the end of an MLM recruitment chain.*²⁴ The Attorney General of Utah, Mark Shurtleff, recently supported a "safe haven" amendment (SB 182) to Utah's anti-fraud law that exempts multi-level marketing schemes. Shurtleff's largest political contributors are MLM companies. He has been a featured speaker at MLM meetings, giving every appearance of commercial endorsement.

But it is on the *national* level where the FTC is directly influenced. Here, the Pyramid Lobby has focused virtually all its resources on the National Republican Party. Democrats are conspicuously absent from any list of recipients of MLM money.

In 2003, the Pyramid Lobby made its boldest and most overt move. It sought a national law that would protect the industry, once and for all, from FTC and state law enforcement. A bill was written by the Direct Selling Association and introduced in the House by Texas Republican, Joe Barton. The bill, HR1220,²⁵ would have exempted endless chain schemes in which the money transfer was laundered with product purchases. HR1220 was essentially a replica of the bill that Utah adopted with Attorney General Shurtleff's endorsement, as have several other states, such as Texas, where the DSA has held sway.

Co-sponsors of HR1220 were all Republicans, including Congresswoman Sue Myrick of Charlotte, NC, whose main campaign funds were raised by Amway's largest distributor, Dexter Yager who is based in the Charlotte area. Myrick was herself an Amway distributor. Other co-sponsors included Vernon J. Ehlers of Michigan (from Amway's home district with Amway as 2nd largest campaign contributor in 2006) and three Republican Congressional representatives from Texas, among others.

²⁴ <http://www.mlm-thetruth.com/ShockingMLMstats.htm>

²⁵ Full details about HR1220 can be found at http://pyramidschemealert.org/PSAMain/news/DSABill/DSAbill_analysis.html - Behind DSA

A brief overview of the political activities, influence-buying and financial contributions of the MLM industry, led by its largest member, the Amway Corporation, readily answers the question of why the FTC, under President Bush's appointee, Timothy Muris, undertook a policy of protecting illegal business practices. The answer is plain and simple. Protection of business opportunity frauds was *purchased*.

- According to the consumer watchdog group Common Cause, Amway and affiliated donors made soft money contributions to the Republican National Committee totaling \$4,147,000 between January 1, 1991 and June 30, 1997. In April 1997, the co-founder of Amway Corp. gave \$1 million to the Republican Party, one of the largest single donations on record from an individual. Federal Election Commission records show that Richard DeVos, said to be worth \$3.2 billion, and his wife, Helen, wrote two \$500,000 checks on April 2, 1997 from their personal accounts. DeVos is the former finance chairman of the Republican National Committee.
- In 2000, Amway "soft money" contributions to the Republican National Party totaled \$1,138,500. A publication of the Brookings Institute lists Amway among the top ten "soft money" contributors to the Republican Party in 2000, just below and – only \$500 less than – Enron.²⁶
- In 2004, the 527 "Progress for America" received major contributions from Amway. "The latest crop of donors includes Amway founders Richard DeVos and Jay Van Andel, who each chipped in \$2 million." (*Newsweek*, "The Secret Money War," September 20, 2004.) This 527 subsequently poured \$28.8 million into supporting George W. Bush in 2004.²⁷
- Dick DeVos, the son of the founder of Amway is married to Betsy Prince, sister of Erik Prince, the founder of the politically powerful military contracting firm of Blackwater (recently renamed Xe). The Prince/DeVos marriage, which links Blackwater and Amway, both based in Michigan, created what has been called the most politically influential family in the Republican Party. Erik Prince has been a steady contributor to the Republican National Committee.
- In 2006, Dick DeVos ran unsuccessfully for the governorship of Michigan. Had he won, some analysts speculated he would have been a viable candidate for President.
- The above referenced wife of Dick Devos (sister of Erik Prince), Betsy DeVos, served as chair of the Michigan Republican Party. In 2000 she won special status as a so-called "Pioneer" after raising \$100,000 for the Bush/Cheney campaign.
- In 1999, the inaugural fundraising event for the Republican Majority Issues Committee (RMIC) was held aboard the DeVos family yacht. The RMIC, a "527" organization, was founded by Rep. Tom DeLay (R-Texas). The committee declared its intention to "identify, educate, and mobilize conservative voters in key House races."
(http://www.motherjones.com/news/special_reports/mojo_400/12_devos.html)
- Describing the events at the 2000 Republican Convention in Philadelphia, the *New York Times* wrote, "For the party's top underwriters, there will be an array of gold-plated events in Philadelphia, including cocktails with Gen. Colin L. Powell and an evening cruise on the

²⁶ <http://www.brookings.edu/gs/cf/Financing2000/ch06.pdf>

²⁷ http://www.sourcewatch.org/index.php?title=Progress_for_America_Voter_Fund

Delaware River aboard the 'Enterprise,' the yacht owned by Richard M. DeVos, the Amway founder.

- In the 2000 national election, the George W. Bush campaign used Amway's voicemail network to broadcast its message to tens of thousands of Amway/Quixtar distributors with a "personal voicemail message" from Mr. Bush.
- For large speaking fees, former Presidents George Bush, Ronald Reagan, Gerald Ford and former Vice Presidents Bob Dole and Dan Quayle have spoken at Amway-related functions, as have former Republican heavyweights Newt Gingrich, Oliver North, and the SE Regional Chairman for Bush-Cheney '04, Ralph Reed, among others.
- Regarding Amway's formidable political lobbying power in Congress, syndicated columnist Molly Ivins wrote in 1997, "Amway has its own caucus in Congress. Yes, the Amway caucus. Five Republican House members are also Amway distributors: Reps. Sue Myrick of North Carolina, Jon Christensen of Nebraska, Dick Chrysler of Michigan, Richard Rombo of California and John Ensign of Nevada. Their informal caucus meets several times a year with Amway bigwigs to discuss policy matters affecting the company, including China's trade status." (Amway lobbied to get the US Dept. of Commerce to back its efforts to get China to legalize the Amway pyramid pay plan. In 2005, this effort failed as China banned MLMs.) Ivins also noted, "House Majority Whip Tom DeLay, a onetime Amway salesman, also remains close to the company."
- Sen. Rick Santorum of Pennsylvania was a favored speaker at large meetings held by Amway "kingpin" Fred Harteis, and received financial support from the Harteis family, their recruits, and other Amway kingpins.
- A close personal friend and "spiritual advisor" to George W. Bush is a former high ranking (Diamond) distributor with Amway and regular Amway convention speaker, evangelist Doug Wead. Wead was President George H.W. Bush's liaison to the Christian Right. During the early 1988 George Bush presidential campaign, Wead reported to son, George W. Bush. He later served as Special Assistant to the President in the Bush Senior, White House. *Time* magazine referred to him as "the man who coined the phrase the compassionate conservative." The phrase, "compassionate conservative" is closely related to a Rich DeVos book title, "Compassionate Capitalism." Wead also researched and wrote about the children of presidents, at the request of George W. Bush.
- At the 2004 Republican National Convention in New York insiders were feted aboard Dick and Betsy DeVos' yacht, as well as Jay Van Andel's lavish 169-footer." (Kathleen Gray, *Detroit Free Press*, 9/2/04)
- In a 1997 article, nationally syndicated columnist, Molly Ivins, reported that the budget package passed by Congress that year provided a tax break "worth \$283 million to one corporation: Amway."

Ivins noted, "The company and its top leaders have contributed at least \$4 million to the Republican Party during the past four years, so that's a \$4 million investment in campaign contributions with a \$283 million payoff for Amway."

"The payoff for Amway was not in the original House or the Senate version of the tax bill," she wrote. "House Speaker Newt Gingrich intervened at the last minute to help get the special tax break inserted in the bill."

- Describing this special tax break, Common Cause reported: “Buried in the 1997 budget and tax deal is Provision C, Section XI. The provision... reads: ‘Modification of passive foreign investment company provisions to eliminate overlap with subpart F and to allow market-to-market election, and to modify asset measurement rule.’ In other words... the provision primarily benefits Amway Corp. and could be worth millions of dollars to (Amway).”

III. Conclusion: Business Opportunity Scams, the Cruellest of Frauds

Today, millions lose their jobs; life savings are wiped out in the 401K meltdown; and many suffer the disaster of home foreclosure. The government pours in money for “stimulus” and “rescue.” Legitimate businesses reorganize; citizens struggle to survive.

In this climate, the “product” in most demand – and in least supply – is an *income opportunity*. This is what more than 10 million Americans and many more worldwide think they are buying *each year* when they invest in a multi-level marketing business opportunity scheme. The “opportunity” that is offered is, in fact, to sell the opportunity to someone else, a classic Ponzi. Unwittingly, the consumer investors have been lured into the Main Street Bubble. Their investments in fees and inventory were worthless or absurdly inflated in price. Collapse for the *new investors, one at a time*, is inevitable as they each “fail” to recruit enough new investors.

The cruelty of the fraud extends beyond causing a financial loss. The schemes induce the victims to spread the loss to their very own friends and relatives. Social and personal harm may exceed the financial losses.

In violation of Section 5 of the FTC Act, business opportunity frauds have an enormous corrupting influence on the marketplace. They promote a predatory and deceptive reward system in which one person’s gain is based on many others’ losses. They incorporate deception into the model to conceal the inevitable fate of those solicited to join.

The scale on which MLMs promote and teach these predatory practices cannot be understated. To take the example of only two of the hundreds of multi-level marketing schemes, over 10 million Americans have become Amway distributors over the last 20 years; 1.6 million Americans have signed up as sales representatives of the MLM, Pre-Paid Legal (NYSE:PPD). Virtually all of these investors quit these schemes after suffering losses. There are hundreds of smaller versions of these two.

Each recruit is subjected to a powerful “message machine” in which gainful employment, corporate America, and legitimate careers or businesses are derided, while the MLM pyramid plans are presented as a last refuge for the average person. The endless chain pay plan is taught as the wave of the future and the key to success. Covering up and diverting attention from the massive consumer loss rates, the schemes’ leaders indict the “failures” as quitters, “pathetic losers” or as consumers who (despite their quitting the scheme within a year and never buying the goods again) joined only out of love of the high priced products, not to earn an income.

Multi-level marketing is an Enron waiting to be exposed. Like Enron it claims to be the “business model of the future”, hides its actual operations from the public and regulators and globally generates funds illegitimately, using some of that money to buy protection from regulation or oversight.

Unless Congress intercedes and restores the FTC to its lawful duty of enforcing Section 5 of the FTC Act against frauds of this type, they will continue to multiply, harm millions more consumers each year and further strengthen their hold on the marketplace.

IV. Appendix

TIMES ONLINE

From *The Sunday Times of London*

February 1, 2009

Pyramid swindlers unmasked

Ponzi scams are being laid bare by the slump

Dominic Rushe in New York

On its website, Agape World claims: “We provide the bridge to your future.” The New York lender specialising in short-term loans also claims to have been in business since 1999. The date must be wrong. At the end of the millennium founder Nicholas Cosmo of Long Island, New York, was serving 21 months in jail for mis-appropriating funds. Sadly it wasn’t the only number Cosmo had wrong.

Last week the 37-year-old was arrested, accused of swindling investors out of \$370m (£254m). Among his alleged victims were a group of disabled policemen and firemen, all lured in by the promise of sky-high returns. Many lost their life savings as Cosmo blew their cash on limousines, a baseball league and paying off fines from his earlier fraud.

As Cosmo was led off to court last week he was dubbed “the mini-Madoff”. Like Bernie Madoff, the money manager accused of a \$50 billion scam, Cosmo ran a “Ponzi” scheme, paying investors with the money from new victims, the authorities allege. More than 1,500 individuals trusted their money to Agape World (agape means Christian love), and they are not alone. At least six suspected multi-million-dollar fraud cases are being probed.

The Securities and Exchange Commission, the US financial regulator, has launched four Ponzi investigations so far this year. It started 23 Ponzi cases last year, up from 15 in 2007, and experts believe there are many more to come. A decade of lax regulation, booming markets and changes in investment attitudes created the perfect environment for financial scams. “It’s like a petri dish for the bacteria of fraud,” said Robert FitzPatrick, president of consumer watchdog Pyramid Scheme Alert.

Collapsing markets have investors clamouring for their money across the US, and as they call in their accounts more Ponzi schemes are being exposed. Last Tuesday the authorities arrested Arthur Nadel, a Florida hedge-fund adviser who had gone missing amid accusations that he defrauded clients of millions of dollars. Earlier last month Marcus Schrenker, an Indiana financial adviser, was arrested in Florida after allegedly trying to fake his death in a plane crash to avoid an investigation of his businesses. Schrenker parachuted from his plane, which crashed just 200 yards from a residential neighbourhood.

When investigators found the wreckage they also found a national campground directory with the pages torn out. Schrenker was arrested three days later at a Florida camp-site where US marshals found him semiconscious inside a tent muttering the word “die” as he bled from a self-inflicted gash to his left wrist.

Schrenker was not the first financier to fake his death in the latest meltdown. Last year hedge-fund manager Samuel Israel III’s 4X4 was found abandoned on a bridge in New York. The words “Suicide is Painless” were scrawled on the bonnet. After the authorities launched

an international manhunt, Israel turned himself in. He was convicted for his involvement in a \$450m fraud and sentenced to 20 years.

It's not just the US where Ponzi schemes are proliferating. In Canada 1,000 farmers recently lost money in a bird-brained scheme that promised record returns for breeding racing pigeons. Arlan Galbraith, owner of Pigeon King International, sold racing pigeons to farmers for \$500 and promised to buy back offspring for \$50 each. Investors were told Galbraith would sell the pigeons to rich Arabs. When the baby-pigeon market failed to hatch, many farmers lost their life savings.

And there were riots across Colombia last year after the collapse of a series of firms that had conned people with promised returns of 150%. One firm alone managed to take in more than £110m in its last four months. Many investors had turned to the scam firms because they did not trust the established banks. The criminals left taunting notes. "Dear investors, thanks for trusting us and depositing your money," said one.

"Now, for being stupid and believing in financial witchcraft, you will have to work for your money."

The US, though, is the centre of the Ponzi renaissance. "These schemes by definition survive by bringing in new money. Now everybody is pulling money out while no new money is coming in they are all collapsing at once," said Robert Mintz, a former federal prosecutor and now a partner at McCarter & English in New York. Mintz said in the instance of Madoff there were signs that might have alerted the authorities, but most of these schemes were difficult to detect until they fall apart.

FitzPatrick said the schemes were hard to detect because they so closely resemble legitimate ventures. "The Ponzi scheme is like the evil twin of normal business. It can operate fluidly in a regular environment," he said. And in a market where big promises were being made for returns on investments, it offers the promise that those returns can continue, said FitzPatrick.

One factor behind the rise of the Ponzi has been the rise of hedge funds, said FitzPatrick. Lightly regulated, opaque and invested in complex derivatives few of their investors understand, hedge funds sound like scams themselves, he said. Investors who have heard of the success of hedge funds are more likely to feel comfortable with a scheme that once might have given them second thoughts. "The disguises have become better and better," said FitzPatrick.

He added that what was happening on Wall Street had been raging on Main Street for some time. He believes pyramid schemes (the poor man's Ponzi) have doubled over the past 10 years as people look for extra income to meet rising healthcare, education, food and housing costs. In the search for extra cash, practices that were once seen as illegal have been legitimised, he said.

The same trend had also been seen in the housing market where fraudulent appraisals were combined with fraudulent loans and sold en masse to Wall Street. "It goes all the way up the line," he said. Even with the crackdown, FitzPatrick believes scams will proliferate. "Unless there is very rigorous regulation, a lot of public education, people going to jail, I can't see it changing."

The Ponzi scheme is essentially a confidence trick, so what better victims could there be than investors who have lost their confidence in the established finance firms and are desperately in need of cash? When all else fails, fraud will be there to meet their demands.



FRAUD GONE WILD

Pyramid, Ponzi schemes disguised as valid investment opportunities

By Staff Report

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The people taken in by Bernie Madoff's alleged Ponzi scheme may be seen as greedy, but Robert FitzPatrick, a nationally recognized expert on pyramid and Ponzi schemes as well as other consumer frauds, says that isn't the case with most people taken in by such frauds.

"I've been to meetings where they promote these things, and I don't see a lot of greed in the room," he said. "I see desperation, need, hope.

"What's not easy is to understand why it doesn't work," he said. "Another problem is that they're everywhere. What causes people to 'not get it' is the sheer prevalence of them.

"This is fraud that has gone wild. It's no accident at all that Madoff took some of our smartest people for billions of dollars. There is no one dealing with these things."

He said the pyramid schemes are disguised as "matrix selling" and "cash gifting" opportunities that assert their legality and legitimacy by citing lack of government action.

Madoff's scheme began to unravel when investors wanted about \$7 billion back, and Madoff couldn't pay them.

Securities and Exchange Commission Chairman Christopher Cox blamed his staff for failing to catch the 70-year-old Madoff's scheme until now. He said the agency failed to act on "credible, specific" allegations about Madoff dating back to 1999.

"Without regulation, it is not reasonable to expect the average person would be able to know enough to avoid such schemes," FitzPatrick said.

"We believe that the markets are legitimate and relatively free of utter fraud, that regulators are watching them, and that they have rules that are relatively transparent. But when you pull out the regulation, you still have a public trained to invest," said FitzPatrick, president of Pyramid Scheme Alert, an international organization formed to expose, study and prevent illegal pyramid schemes.

He said organizers of Ponzi and pyramid schemes will tell people who question their legitimacy that there is such strict regulation in this country, it's virtually impossible to run a scam.

"The exact opposite is the case, and of course they know that," FitzPatrick said.

He said pyramid and Ponzi schemes work for a while — a long while in Madoff's case.



Charles Ponzi is the namesake of the Ponzi Scheme

“He was paying consistent double-digit returns when no one else could for 10 years,” he said. “In that plan, nobody could get their money back because he was simply recycling the money. There was no money being made other than that introduced by new investors.”

Investors in Madoff’s hedge fund were largely wealthy individuals or entities who may have lost as much as \$50 billion.

But FitzPatrick said the average person is more likely to encounter a Ponzi or pyramid in a “business opportunity” scheme that requires an investment plus recruiting of new investors — who are rarely called “investors” by the organizer.

“You’ll go to a meeting that’s carefully orchestrated,” he said. “They’re held in nice hotels. The presenter is dressed nicely, and there will be people just like you and me giving testimonials.”

“The question will be asked, ‘If it doesn’t work, how does it keep working?’” FitzPatrick said.

The reason is that 60 percent to 70 percent of the people who are recruited quit every year, without making a dime, and are simply replaced,” he said. “The top people are making money by churning the people under them every year.”

To avoid such schemes, FitzPatrick said, you have to dig deeper and ask lots of questions.

“Do your due diligence like nobody used to have to do,” he said. “In a Ponzi scheme, look at how the organizer pays these extraordinary returns. Probe where the money comes from.”

FitzPatrick said another warning bell in the Madoff scheme was that the statements he sent to clients “basically were unintelligible.”

One investor asked how the fund could be so successful and was told it followed a “split strike conversion” strategy, which involved owning stock and buying and selling options at the same time, he said, an explanation that makes no sense, either.

“You also may get, ‘I can’t tell you in-depth because then I’d be giving away my secrets,’” he said.

FitzPatrick said Ponzi schemes, unlike pyramid schemes, don’t churn investors.

“They just have to keep growing,” he said. “He had to get new people in or get people who thought they were earning money to reinvest it. But it was all on paper. They weren’t earning anything.” FitzPatrick said there are other factors that slow detection of Ponzi schemes.

“The whole concept of investing is that you have to trust somebody,” he said. “And if you’re going to trust someone, why not the former chairman of the Nasdaq stock market (Madoff)?”

The difference between the two schemes

The term “Ponzi scheme” is used primarily in the United States. Other English-speaking countries do not distinguish between this and other forms of pyramid schemes.

In both pyramid and Ponzi schemes, early investors are paid by subsequent ones in an unsustainable model. In a pyramid scheme, the investors recruit new investors, while in a Ponzi scheme, the organizer does the recruiting.

Ponzi scheme origin

The Ponzi scheme is named after Charles Ponzi, an Italian immigrant who ran a scam in New England in the early 1900s that promised investors in postal reply coupons a 40 percent return on their money in just 90 days. He planned to use the difference in the exchange rate

between the dollar and foreign currencies to buy and sell the international mail coupons at a profit.

His company, Securities Exchange Co., and the scheme collapsed around 1920, however, when people started calling for their money amid a growing investigation.

Ponzi had been paying the high return to early investors (and himself) with money paid in by subsequent investors, rather than from the profit from any actual business. The system is doomed to collapse because there are little or no underlying earnings from the money the promoter gets.

Ponzi actually bought only about \$30 in mail coupons.

A couple schemes dissected

Canada has become a feasting ground for pyramid schemes, says Robert FitzPatrick, founder of Pyramid Scheme Alert and co-author of “False Profits: Seeking Financial and Spiritual Deliverance in Multi-Level Marketing and Pyramid Schemes.”

“The Canadian government is completely compliant of these things,” he said. “It becomes an endorser by means of doing nothing.”

Case in point is a Ponzi scheme disguised as a pigeon-breeding business called Pigeon King International. The organizer claimed he had a plan to save the family farmer, and lured more than 1,000 such farmers from the United States and Canada into the scheme.

Most lost all their investment.

The company is now bankrupt and closed. Returns were obtained from the investments of later investors. The operator had no external market for the pigeons. He sold breeding pigeons and then contracted to buy the offspring at agreed-upon prices. The selling prices of the breeding pairs and purchasing prices of the offspring were arbitrary but promised very high rates of return.

He lied to investors about markets and future sales of the pigeons and inflated their values.

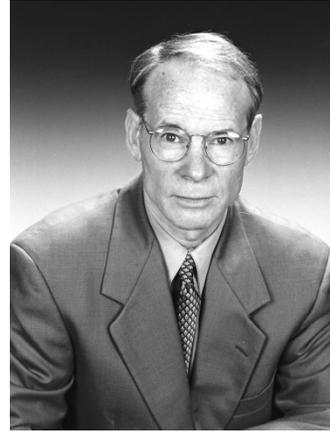
Federal prosecutors in St. Louis recently have alleged that a securities firm there defrauded customers of more than \$4.5 million in what they called a Ponzi scheme.

Rate Search Inc. claimed it was able to find the best return on certificates of deposit by searching nationwide, and made its money by taking a percentage of the interest.

But the company and its owner faked account statements to hide missing money and soothe investors, while in fact it never bought some of the CDs customers thought they owned, federal authorities said.

<http://www.sj-r.com/business/x1647203252/Pyramid-Ponzi-schemes-disguised-as-valid-investment-opportunities> Staff writer, [Chris Dettro](#) can be reached at 217-788-1510

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Robert L. FitzPatrick is an expert in examining and revealing deception and fraud in bogus home-based businesses. He is an author, teacher and internationally recognized authority in multi-level marketing schemes and pyramid sales fraud.

He is co-author of *False Profits*, the first book to critically examine the multilevel marketing industry. He was featured on *ABC World News*, and he was interviewed by correspondent Mike Wallace on *CBS 60 Minutes*. He has been interviewed live on *NBC Today* show. He was featured as an expert on Canada's CBC National News Program, *Marketplace*. Has been interviewed on BBC radio news aired in the UK and quoted in the *Wall Street Journal* and *New York Times*.

False Profits was a featured resource at the 2003 annual meeting of the Association for Professional and Practical Ethics. The related booklet, *Pyramid Nation* by Robert FitzPatrick, has been translated to Chinese and used by government regulators in writing China's first laws on pyramid schemes.

In June 2005, Robert FitzPatrick was asked by the Central Bank of Sri Lanka to address banking representatives from that country as well as India, Bangladesh, Bhutan, Maldives and Nepal in Sri Lanka's capital, Colombo. The presentation was later published as part of a national consumer education campaign against pyramid schemes.

Robert FitzPatrick has conducted seminars for staff of Federal Trade Commission, state Attorney General's offices, US Postal Inspector and members of the White Collar Crime Center in Richmond. He was a featured speaker at the 2006 annual meeting in San Francisco of the Association of Certified Fraud Specialists and the 2003 of the National Association of Consumer Protection Investigators. He has developed informational resources for consumers, journalists, academics and regulators including a multi-media PowerPoint presentation and a statistical analysis of the losses suffered by participants in multi-level marketing schemes. He also published a widely read booklet on the landmark federal case brought against the Amway Corporation.

Robert FitzPatrick founded and serves as president of Pyramid Scheme Alert, the first international organization to expose and prevent pyramid scheme fraud. PSA's website, <http://www.pyramidschemealert.org/>, is visited each month by thousands of consumers, regulators and journalists worldwide. He personally responds to hundreds of consumer and news media inquiries. He has served as consultant and expert witness for Attorney General or State Attorney offices in four states, the US Dept. of Justice, and in numerous cases involving distributor fraud and pyramid schemes.

Deeply held convictions and values of fairness, trust, equity, and integrity drive Robert FitzPatrick. His expertise is founded upon studies in a Catholic seminary leading to degree and graduate studies in Sociology. His advocacy work began as a community organizer in the neighborhoods of Charlotte North Carolina. He later organized and managed national trade associations that advocated the interests of independent distributors in three industries. For more than a decade, he provided strategic guidance and executive coaching in the field of manufacturer/distributor relationships where factors of trust, integrity and sensitive communications are critical to the business. His corporate clients included Fujifilm, DuPont, Epson, and many others.