ADDENDUM TWO

COMPILATION OF INDUSTRY EXPERTS REPORTS:

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An
Evaluation
of the Campaign of the Direct Selling Association to Protect Multi-Level Marketing from Prosecution as an Illegal Pyramid Scheme

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Background:

The Direct Selling Association (DSA) is currently engaged in a worldwide public relations and political lobbying campaign arguing that the business model and practices of most DSA members are legal and ethical. Specifically, DSA seeks to reverse federal court ruling and decades of public policy of the United States Federal Trade Commission that treat business practices common among DSA members as "unfair and deceptive," labeling them *illegal pyramid schemes*.

The DSA campaign on behalf of pyramid marketing schemes is unparalleled in America. Business lobbying may seek tax advantages, government contracts or relaxation of regulations, but no other lobbying effort seeks to legalize business practices that have been defined by federal and state regulators and federal courts as *fraudulent*.

DSA is chiefly doing this by claiming that MLMs can legally gain revenue primarily from the salespeople they recruit with their "opportunity" solicitation and reward each new recruit with commissions based on the opportunity-related purchases of other salespeople they in turn recruit in an endless chain.

The "business opportunity," in this model, is primarily a right to recruit others into the same business opportunity and to gain rewards based on their associated purchases and fees. A pre-determined level of purchases and fees are required of all recruits in order to participate in the scheme. The rewards extend to multiple levels of recruits that are structured in levels of a genealogical chain. Each new salesperson gains the same right to recruit others in an unbroken and ever-expanding chain. The money for this enterprise comes primarily from those within the chain.

Most MLM companies also offer each new participant the right to retail the products but few of these independent salespeople are able to earn a profit from retail selling. Consequently, they pursue the other part of the MLM business opportunity that is based on recruiting other salespeople and receiving payments from the MLM company based on the volume of the purchases by those they recruit in the multi-level pyramid. To remain qualified to receive these commissions, each MLM participant is typically required to maintain a quota of personal purchases each month or to have volume of purchases from other recruits.

One ambiguous legal decision coupled with lax law enforcement in the USA have resulted in the spread of "non-retailing" DSA members aggressively soliciting consumers with a "business opportunity" plan based upon endless chain recruiting.[1]

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[1] In a controversial and ambiguous ruling, an Administrative Law Judge ruled in 1979 that the Amway Corporation, the oldest and largest of all MLMs, could use an endless chain model. However, the business must be funded and driven primarily by the retail sales by the sales force, not from the investments of the distributors themselves. Various rules and safeguards were expected to be employed to insure that the business, despite the endless chain structure, did not operate as pyramid scheme in which investors gained profit from new investors rather than from their own retail sales or the retail sales of those they enrolled. Subsequent federal court rulings clarified this point that the MLM must be retail based and FTC prosecutions of more than a dozen MLMs have been based on a retail criteria.

Therefore the legitimacy of the entire MLM industry, including most DSA members, hinges on this question of whether a MLM can derive most of its revenue for commissions from the payments, purchases and investments of the salespeople, not end-user consumers.

DSA's campaign is based on the claim that retail sales from consumers outside the chain are unnecessary because the salespeople are actually making personal purchases for their own use, not business investments related to earning a profit. They have also claimed that the enormous loss rates among recruits are because few recruits seek a profit. They only wish to "buy at wholesale price." Paradoxically, many MLMs also claim that their extraordinary "turnover" rates among MLM recruits, as high a 50-70% typically, are normal among "direct selling" companies due to the difficulties of person to person retail selling.

DSA's own existence as a trade association depends on governments allowing the DSA members to continue operating in this manner.[2] Through political lobbying, MLM companies have even influenced US Trade Representatives to pressure foreign governments to allow such business practices in their respective countries. They have argued that World Trade Organization (WTO) rules require companies to allow MLMs to operate, inferring that non-retailing MLMs qualify as legitimate "direct selling."

Some countries have refused. The most significant opposition to this effort came in 2005 when the China, the largest new market in the world for MLM, banned the MLM "non-retailing" recruitment model.

Additionally, the question of MLM legality is still very much open in the USA. Besides prosecuting numerous MLMs for operating as "non-retailing" pyramid schemes, the FTC has recently proposed new rules that would require MLM to disclose to consumers such data as average incomes, business costs, loss rates and dropout rates among participants in their recruitment schemes. DSA is actively opposing these requirements.

In 2007, a significant class action lawsuit was filed against the largest MLM operating in the USA, Quixtar, Inc. (formerly Amway). The suit was filed by one of the most prominent and respected law firms in the country. The suit charges that Quixtar participants must recruit others in an endless chain in order to recoup their own investments, rather than retail Quixtar products. It charges that such a model must, by design, cause enormous consumer losses and that it must engage in deception in order to lure consumers into the fraudulent model.[3] Similar class action lawsuits have been filed against other prominent DSA members such as Nuskin and Herbalife.

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[2] The devious measures which DSA is willing to take to preserve its position are seen in what we could be characterized as a form of identity theft and a blatant effort to direct consumers away from independent consumer awareness and educational materials. In April 2003, approximately two and a half years after the non-profit organization, Pyramid Scheme Alert, had launched its independent website, http://www.pyramidschemealert.org/ and gained worldwide recognition for its name – receiving tens of thousands of visitors monthly – DSA purchased the exact name of the Pyramid Scheme Alert site but with .com and .net endings. These bogus names were then advertised on the web by DSA. Consumers who mistakenly went to these addresses were linked back to the DSA's own site. In October, 2006, DSA repeated this trickery by purchasing the namesakes of another widely read consumer education site, http://www.mlm-thetruth.com/, which is published by a Pyramid Scheme Alert Advisor, Dr. Jon Taylor. Both ruses were carried out by DSA Communications Director, Amy Robinson.

[3] http://www.pyramidschemealert.org/PSAMain/news/AmwaySuedasPyramidScheme.html

The question about retail sales is not just a legal technicality. Retailing in MLM is a defining characteristic used by regulators to identify predatory and destructive pyramid schemes, or what CBS correspondent Mike Wallace termed "devastating con games" in a *60 Minutes* exposé in 1999 of the MLM, International Heritage, Inc.

A fraudulent business opportunity solicitation, such as the non-retailing MLM, is far more damaging than a fraudulent product sale. Bogus business opportunity solicitations can result in consumers spending their entire life savings, ruining their credit, quitting their jobs and losing their homes. MLM solicitations involve the consumers in soliciting friends, relatives and colleagues into the scheme. If the plan is fraudulent, a person's entire social network can be alienated or lost entirely.

The DSA effort to legalize and legitimize – effectively, to *disguise* – an endless chain scam as a legitimate direct selling business that offers a viable income opportunity to most people has enormous consequences.

To clarify the position of the DSA on this matter, I wrote Mr. Joseph Mariano, the Exec. VP of DSA in December, 2006. Some of this evaluation references the general position that he offered in a follow-up telephone conversation on Dec. 27, 2006, all of which aligned with DSA assertions on its website or which DSA has written to federal regulators.

Pyramid Scheme Alert receives daily inquiries from consumers worldwide about how to make a valid distinction between a real business opportunity in direct selling and a pyramid recruitment fraud. Many consumers specifically ask how to determine if various members of DSA are direct selling companies or pyramid marketing scams.

Reasons for Applying the Retail Standard

In response to these inquiries Pyramid Scheme Alert recommend to consumers that they closely examine one key characteristic, among others. *This is the overall level of retail selling by all the distributors of the particular MLM company*. We explain that if there is little retailing occurring, just *purchasing* and *recruiting* by the distributors, then the income opportunity is, by definition, based on endless chain recruiting. Since little or no revenue comes from outside the chain of participants, only those few at the top could gain a profit. A large "downline" of unprofitable participants is required for a few to gain a profit. Such a closed structure is a money transfer system, not a market-driven sales business.

In support of our recommendation to apply a retail standard for evaluation we reference:

- The FTC on its website (http://www.ftc.gov/bcp/conline/pubs/alerts/pyrdalrt.htm) that states, "*Some multilevel marketing plans are legitimate. However, others are illegal pyramid schemes. In pyramids, commissions are based on the number of distributors recruited. Most of the product sales are made to these distributors - not to consumers in general. The underlying goods and services, which vary from vitamins to car leases, serve only to make the schemes look legitimate.*"
- The academic article[4] of the FTC's expert on pyramid sales schemes, Peter Vandernat, which details the crucial role of retailing in identifying MLM companies

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

that are actually recruitment frauds. This article was also footnoted in the FTC Notice of Proposed Business Opportunity Rule (April 12, 2006).

- Three federal court rulings (Omnitrition, Koscot and Gold Unlimited), that the FTC has also cited in recent prosecutions and which establish a lack of retailing to ultimate end-users as the basis for defining a pyramid marketing scam.
- The long term precedent of FTC actions against MLM companies, some of which were DSA members, in which the FTC used retail selling levels as the key determining factor.
- The "retail test" used by the FTC in its prosecution of Equinox International. This test determined what minimal level of retail revenue would be required to cover 51% (a majority) of the commissions paid by the MLM to the upline recruiters. 51% was used as the absolute minimal level of rewards that must be funded from outside the pyramid chain, i.e., from retail revenue paid in by consumers who are not also distributors.
  In the case of Equinox, the test revealed that at least 70% of Equinox distributor purchases would have to be resold at full retail price to generate this required outside revenue. The FTC estimated that less than 20% of Equinox goods were ever retailed, causing the FTC to determine that Equinox International, a DSA member, was a pyramid recruiting scam. The FTC successfully closed down Equinox and recovered millions of dollars in restitution for victims.
- Application of this test to other MLMs, including various DSA members, which reveals the same 70% benchmark. This 70% retail level has also been used by the state of North Carolina Attorney General in settlements with various MLMs that it prosecuted.
- A straightforward business model analysis that reveals the inherent flaw in an endless chain. Endless chain recruiting is not sustainable over time. In the pyramid design, with each level larger than the one above, the majority of all recruits are always in the lower levels where no profit can be earned, due to lack of new recruits below them. Therefore all promises or claims about an MLM recruitment model being a viable income opportunity are *false and misleading.*

DSA's Lobbying and Promotions

DSA's website appears to support a retail criteria[5], however, its code of ethics specifically references a few state statutes in which retail sales are not required. In the ethics code, DSA appears to claim that as long as rewards to recruiters are sourced from

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[5] At the page http://www.dsa.org/aboutselling/consumer/index.cfm?fuseaction=pyramid, DSA advises consumers: "Avoid dealing with companies that sell few or no products to consumers." At http://www.dsa.org/aboutselling/consumer/index.cfm?fuseaction=pyramid#multilevel DSA describes MLM as "like other methods of retailing" and recommends the consumer to ask, "Are the company's products sold to consumers? IF THE ANSWER IS NO (OR NOT MANY), STAY AWAY! This is a key element. Multilevel marketing (like other methods of retailing) depends on selling to consumers and establishing a market. This requires quality products, competitively priced. Pyramid schemes, on the other hand, are not concerned with sales to end users of the product. Profits are made on volume sales to new recruits, who buy the products, not because they are useful or attractively priced, but because they must buy them to participate. Inventory purchases should never be more than you can realistically expect to sell or use yourself."

wholesales purchases of other salespeople (investments) inside the MLM, the model is legitimate and meets the DSA's ethical test.

DSA's position is also questionable because the largest multi-level marketing company ever prosecuted by the FTC, Equinox International, was a dues-paying member of DSA; and one of the experts who testified on behalf of Equinox, defending the company against the FTC charges that it was a pyramid scheme, had been a member of the Direct Selling Association Education Foundation. The FTC applied a retail sales standard for determining that Equinox was a pyramid scheme.

Further, DSA has lobbied for a bill, referred to as HR 1220[6], in Congress and at the state level that pointedly omits retail selling as a criteria. The bill seeks to exempt from the definition of a pyramid scheme any multi-level marketing scheme that derives its revenue from product purchases. According to the wording of the DSA-lobbied bill, schemes that gain all their revenue from distributors, without any retailing, would be *exempt* from the definition of a pyramid scheme.

The DSA Position

In a 12/27/06 telephone conversation, Mr. Mariano offered nothing, only repeating DSA's seemingly contradictory position that is presented on the DSA website. He stated that the DSA does, in fact, hold that retail selling is an essential element of a legitimate direct selling business.

However, he also confirmed DSA lobbying efforts that oppose any method, as the FTC has used in prosecutions, of determining when a company is primarily based on wholesale purchases and endless chain recruiting rather than retail selling,.

Mr. Mariano emphasized the economic role of consumers who join MLM businesses but *deliberately* never make any retail sales. These persons, he claimed, invest in the business only to buy the MLM products at a wholesale price or perhaps just to socialize with other MLM participants, *but specifically not to earn any income at all*.[7]

He said DSA considers the people who don't want to make any money to be a fundamental constituency of MLM. He said their lack of income was *voluntary* and, therefore, should not be counted as consumer losses caused by the MLM model. Since they did not intend to make money, their lack of income should not be considered a *harm*. And, since they voluntarily entered the MLM with no intention to earn an income from retailing, their lack of retail income should not be used in any statistical standard established for required levels of retail selling.

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[6] For the full text and analysis of this proposed law see http://www.pyramidschemealert.org/PSAMain/news/DSABill/DSAbill.html

[7] In its letter to the FTC opposing the FTC proposed rules to regulate schemes that promote "business opportunities", (http://www.ftc.gov/os/comments/businessopprule/522418-12055.pdf) DSA segments MLM participants according to various motivations such as "social contacts, recognition and product advocate." Some of these "motives" are presented as alternatives and exclusive of the goal of earning a profit. Though DSA states that it cannot assign a percentage of the total to each group, it infers that the proportion of those who are not trying to earn any money is so large that DSA argues that MLM should, therefore, be exempt from any regulations that target companies that promote "business opportunities." The very first group identified by DSA among the seven subgroups is "Wholesale or Discount Buyers: These individuals technically are salespeople in that they sign up as salespeople but do so primarily to buy the company's products at the wholesale or discount price accorded members of the salesforce. Generally, they do not sell or recruit."

Further, since the purchases were not intended as investments or "consideration" for the right to recruit and resell in the business opportunity, then payments derived from these purchases are not rewards for having recruited these non-retailing participants. They are "commissions" from "sales" to them.

The proposed law that the DSA lobbies for continues this rationale by seeking to eliminate any reference to retail sales in defining a pyramid scheme. If rewards are tied to product sales "to anyone", as the DSA sponsored bill states, the scheme cannot be defined as a pyramid scheme. Thus a scheme that only sells to its own salespeople – who pursue the business opportunity of seeking rewards based on fees and purchases of new recruits – would now be legal. The need for retail selling would be legally *erased* and the massive loss rates that such as recruitment program necessarily would inflict would no longer be an "unfair" business practice. Recruiting people into this type of program that will inflict these losses and promoting it as "the opportunity of a lifetime" would no longer be "deceptive."

This political campaign is matched with a DSA publicity campaign that continuously states that MLMs are not pyramid schemes if "they sell a product."

Mr. Mariano said the exact percentage of MLM participants who deliberately choose not to seek a profit is unknown, but he indicated it is substantial, perhaps the majority. He and others characterize this group as a fundamental constituency of MLM. He compared them to conventional retail customers or to members of a buying club and rejected any evaluation that would include them as people who lost money in pursuit of the MLM "business opportunity."

Feasibility of MLM Retailing

Before evaluating DSA's claim that lack of retailing in MLM is "voluntary" and that millions of people become MLM resellers only to avoid retail pricing and explicitly not to earn any income, it is important to consider the feasibility for successful MLM retailing, if a reseller did want to pursue it.

That there is little or no evidence that MLM resellers actually resell any significant amount of products at retail prices is also borne out by nearly universal consumer experience of seldom encountering a door to door *product sales* solicitation by an MLM reseller. However, virtually everyone in America has been solicited or pressured by an MLM participant to invest in an MLM *business opportunity*.

The MLM industry and individual MLMs offer no data about retail sales other than the counts of "Preferred Customers" who are buying at *wholesale prices* and many of which may be former distributors or the immediate family members of distributors. Some may be accounted as phantom purchases needed by the distributor to meet purchase quotas for receiving commissions related to recruiting.

However some data is available and a market analysis can be made to shed light on the feasibility of successful MLM retailing.

1. Per capita purchases by MLM resellers are typically about $1,000 - $2,000 per year or even less. This small annual inventory investment generates very little potential retail profit. And this retail profit potential would be even smaller if actual personal purchases, product giveaways and discounting were considered.
2. Door to door selling has nearly vanished from the marketplace due to the availability of products through other more convenient and economical channels such as big box

stores and direct internet purchasing. Only a few market sectors remain where person-to-person selling outside a retail store prevails such as real estate, home improvement, some forms for insurance, funeral plans and personal financial planning. Some "party planning" products also generate retail sales in the home, aimed chiefly at women.

3. Door to door selling has dissipated also because few consumers have time for product demonstrations and sales presentations in their homes or on a one-to-one basis.
4. While most consumers *refer* products or services to friends and relatives, actually buying from or seeking to profit from close friends in commercial transactions is uncomfortable or inappropriate to many people who recognize that it can result in lost or alienated relationships.
5. The retail profit margin offer in most MLMs is less than what is traditionally offered in direct selling.
6. Personal advertising using the company logo is prohibited in most MLMs.
7. MLMs do not offer national brand advertising to support retail sales.
8. MLMs do not conduct marketing programs to generate sales leads for MLM resellers.
9. Most MLM products are unknown or are undifferentiated.
10. Most MLM products are higher priced than similar products.
11. Some MLMs interfere with retail sales by their own selling program to "Preferred Customers" who can purchase products at the same price distributors pay.
12. All MLMs authorize *every* reseller to recruit other resellers thereby thwarting those would seek to sell the products at retail prices to the public. The unlimited authorization exponentially increases competitors to a would-be retailer and offers all retail customers the opportunity to buy at wholesale pricing, The MLM compensation program rewards *recruiting* activity which generates commissions from the company more so than one-to-one retailing. 40% - 50% of net value of all *purchases* made by the Associates is transferred by MLMs to the recruiters in the form of commissions. The lure of recruiting is further compounded by MLM's granting greater percentages of reward to those at the highest level of the recruitment chain. 50% of all commissions from most MLMs are transferred to the top 1% of recruiters.
13. An MLM reseller gains potentially more reward from recruiting another reseller who purchases at wholesale than a retail customer. The newly recruited reseller likely generates more purchase volumes over time along with the additional potential reward from their own respective recruitment activity that accrues benefits to the earlier recruiter.

Evaluation of DSA Position

In my view, no legitimate business analysis could treat such non-retailing resellers as "ultimate end-users" or in any way equate them to retail consumers or as members of a discount buying club, as DSA attempts to characterize them. Nor could participation of such people be treated as central or fundamental to the MLM business model to justify opposing a proper assessment of retail sales levels for regulatory purposes, as DSA is doing.

The lack of retailing success or effort by some MLM participants is no basis for claiming they are not also participants in the "business opportunity." This is all the more true given that feasibility of MLM retailing is severely limited and DSA and all MLMs have no data on actual retail levels

Perhaps most important, previous FTC prosecutions and evaluations of MLM companies fully allowed for the existence of many participants who, *for whatever reason*, did not retail the products. The existence of these people in MLM, therefore, cannot be said to preclude a formal method of evaluating MLMs or be a basis to change laws to explicitly allow pyramid recruitment schemes.

The DSA lobbying effort and this line of rationalization for opposing a method of evaluating MLMs with a retail criteria appear to be a thinly disguised effort to defend and protect recruitment scams within the membership of the DSA.

Gifting Club Revisited

The DSA claim – that the people who purchase MLM products "for personal use" are effectively the same as retail customers and that their purchases should not be viewed in any way as "business investments" necessary for gaining rewards from recruits who make similar investments – has a familiar ring.

It is reminiscent of the women who were arrested in several states during the national epidemic of "gifting club" pyramid schemes in 2002-2004.[8] The schemes operated under various names but were essentially identical. They spread to more than 30 states as well as to Europe, Australia and Africa.

In those scams, the perpetrators insisted that no one was investing or paying money to join the scheme. No, they were only making "gifts" and in fact had no thought of reaping rewards from recruiting. They acknowledged that the "gifting" plan was organized in a pyramid structure, with four levels, each one twice the size of the one above. And each person did recruit others to advance to higher positions in the plan. And, when a person got to the top of a four-level structure they did receive money paid in by the last eight people to join the bottom level. But that was not a reward based on recruiting, they claimed. That money was a *gift* from those eight! All that the gifting club did, they said, was transfer money that was given and received as "gifts." This, they claimed was *voluntary* and *legal* and *no one was harmed* from the process of "giving and receiving." In fact, they said, government action to restrict this voluntary activity was oppressive and intrusive. In Texas, one group hired a lobbying firm to draft a bill that would legalize such clubs.

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[8] See *Ladies Home Journal*, April 2004, "More Money Than You Ever Dreamed Of", by Michael J. Weiss, an exposé of "gifting" pyramid schemes recruiting women throughout the United States.

MLMs, correspondingly, require the recruits to pay fees in order to join and sign a formal contract for participating. They require each recruit to maintain a monthly purchase levels, usually achieved through a pre-paid monthly order of products, in order to receive rewards based on the purchases of those they recruit. Some also require purchases of training programs or on-line tracking programs. Though not required, some exert extreme pressure on recruits to invest in seminars, books and tapes that they say are essential for success.

The MLM plan operates with a multi-level structure with each level larger than those above. And a formula is applied in which the *majority of all the money* paid in by the latest participants to join – who are also the *majority of all participants* – is transferred directly to those at the top levels.

But, when the rewards are paid, the DSA, like the women in the gifting schemes, claims that the payments did not come from anyone "paying consideration" to join the scheme with the intention of earning rewards. No, these people just purchased products for their “personal use” just as the women were making “gifts.” Similarly, the rewards paid to the MLM “upline” were not for *recruiting* anyone. It's just that new recruits purchased products for their personal use and the plan transferred some of that money as commissions on *sales* to them.

The gifting clubs claimed that the payments were *gifts given* and the rewards gained were *gifts received*. MLMs claim payment made by recruits are *purchases for personal use* and rewards gained are *commissions on sales*. Both claim that the losses of nearly all who participate – since in a closed pyramid system only a few at the top can be profitable – are harmless since the people are not trying to make money!

The MLM industry’s claim that many, perhaps most, recruits are not seeking rewards and the payments to recruiters are not connected to recruiting is as legally fictional as the claims of the perpetrators of the gifting scheme frauds. The payments made by MLM recruits are no more *purely* "purchases for personal use" (totally unconnected to a business opportunity) than the gifting club participants were earnestly giving and receiving "gifts."

Dropouts, Failure and Collapse Clarified

The DSA reclassification of lack of retailing as “purchasing for personal use” and consequent massive loss rates as “voluntary” follows previous DSA manipulations of realities concerning the nature of endless chain sales schemes. Earlier manipulations of reality include the reclassification of victims of pyramid expansion as “failures, quitters and dropouts.” The massive loss rates suffered by the churning of these consumers were redefined as normal “high turnover” and “low retention.”

MLMs are *designed* (structure and compensation plan) as endless chain recruitment programs. Unless the revenue to the recruiters would come from real customers who are not part of the chain, (retail selling) the only way for all new MLM salespersons to recoup their investments and gain a profit would be to recruit a multiple of new salespeople *in a never-ending expansion*.

Of course, this is not possible, any more than a chain letter could continue indefinitely. *It must collapse*. And collapse must cause losses to the great majority at the end of the chain. An endless chain cannot fulfill its promise of profit to any but a few; and to operate, it must deceive. This is why they are treated as "inherent" frauds.

However, when chartered as a "business" an MLM can continue for many years. When loss rates are covered up, it can even give the illusion of sustainability and stability. Its continuation and growth over time have been cited by Amway, the oldest and largest of MLMs, as an argument that it could not be a pyramid scheme, since, its promoters say, pyramid schemes are destined to collapse quickly by "running out of participants."

In reality, pyramid schemes do not "run out of participants." Rather, the latest participants perceive that they cannot recruit *enough people to move up the chain*. Many more people could still join the scheme, but not in the numbers to allow the large group at the bottom to be successful. When large numbers of people in the bottom levels "quit" the scheme, the plan will stop functioning – *unless the hapless "quitters" can be replaced*.

With little or no law enforcement[9] and with most "losers" silenced by ignorance or shame[10] and through expansion to more and more territories an MLM pyramid scheme can delay total collapse for many years. It can replace the doomed bottom levels of "losers and quitters" year after year.

For as long as it operates, the MLM scheme is collapsing *every year*. But due to the ability of the corporate entity to continue recruiting, the scheme can go on, while the collapse is borne by the latest recruits. This takes the form of 50-70% rates of "failures" or "dropouts" among those in the bottom levels – the last to join. These consumers who inevitably must lose in the pyramid model are falsely reclassified as "failures," meaning *personal* failures, or as dropouts, meaning consumers who make a *private decision* to leave the program, much like a student that "drops out" of college.

It must be remembered that the burden of collapse in *all* pyramid schemes is *always* borne by the latest recruits, since the latest recruits will always represent 70%-90% or

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[9] In 2001 George W. Bush appointed Timothy Muris to head the FTC. From that point, the FTC effectively stopped investigating and prosecuting MLM pyramid schemes. In the four previous years, the FTC had prosecuted more MLMs that it had in the previous 17 years. Muris' last job before chairman of the federal agency that regulates multi-level marketing was as an attorney with the antitrust division of the firm Howrey, Simon, Arnold and White, LLP. The antitrust division of Howrey counted among its largest clients the Amway Corporation. While Muris was with Howrey and while he was in charge of the FTC, his former partners in the antitrust division at Howrey represented Amway Corporation in a class action lawsuit initiated by a former Emerald-level distributor in the US District Court for the Southern District of Texas. The suit charged that the recruitment program of Amway is an illegal pyramid scheme.

[10] Seven key factors are manipulated by MLM schemes to assure silence of victims: 1. ***Gullibility*** – MLMs convince the new recruit that the scheme is entirely workable, legal and viable. The only reasons a person might fail, they are told emphatically and repeatedly, include laziness, lack of ambition, fear of success, poor character, lack of adequate effort, fear, or refusal to follow the prescribed marketing plan. In short, the people are told that those who fail are just "losers" or "quitters." Therefore anyone who loses money will have no one to blame but themselves. Thus, when they do quit, most do so silently, shamefully and with great personal disappointment in themselves. 2. ***Personal Shame*** – few people are willing to admit to their own folly in losing money in the MLM scheme, 3. ***Social Embarrassment*** – Most people enrolled friends, family and neighbors while they were in the scheme. They harmed people who trusted them. 4. ***Self-incrimination*** – by getting each recruit to recruit others pyramid schemes make each victim, to some extent, also a perpetrator. 5. ***Intimidation*** – MLMs have been known to vilify, bully intimidate or to sue those who challenge them. 6. ***Loyalty*** – Most people who join the schemes were recruited by friends or relatives, some of whom may still be in the scheme. 7. ***Cutting Losses*** – The victims of MLM schemes (99% of all participants each year) have already lost significant time and money. Some may have quit their jobs or taken on debt. Their immediate and urgent need is to cut their losses and rebuild their personal and financial conditions.

more of the total. Often, those who got in early enough will have gotten their money before the scam collapses. The same scenario occurs with MLMs except that the scheme is allowed to resurrect each year and repeat the recruitment activity. Those who “got in early” in their respective territories or recruitment networks, the top 3-4%, receive the great majority of all rewards gained from the purchases of the newest recruits *each year*.

In MLM, as in all pyramids, the last ones in are the source of all the money that is fed to the small group at the top. As data shows on Amway, the largest and best established of all MLMs, within five years, 96% of all who ever join have quit. 72% quit within the first year.[11]

This is not normal "dropout" or "failure." This is *collapse*. MLMs collapse every year with 50-70% of all participants “quitting”, after suffering financial losses. *But, they are replaced.*

This annual collapse must happen because if it did not, the entire scheme would *totally* collapse as the market would be saturated quickly with MLM recruits. Consider a hypothetical "successful" scenario of an MLM with 150,000 distributors and in which no one quit over a period of just two years and each person *recruited only two other people*

If each of the 150,000 recruited just two other salespeople as required in the "binary" plan used by many MLMs, there would already be at 450,000 (150,000 + 300,000). If the newly recruited 300,000 during this same year did the same thing – which *seems* likely given that the entire pay plan offers the incentives based on this kind of modest recruitment rate – then they would add another 600,000 in the same year. (300,000 x 2 = 600,000) That would mean a total 1.05 million (450,000 + 600,000) sales reps if just everybody stayed in for *one year* and recruited two and their recruits did the same.

If this was repeated the next year, the latest 600,000 recruited last year then recruited their two enrollments, that would add about another 1.2 million, (600,000 x 2) resulting in a total of about 2.25 million MLM reps *for this one company*. And if the newly recruited 1.2 million recruited their "binary" requirement of two people each, we would have another 2.4 million new MLM reps for a grand total of 4.65 million sales reps in just two years. This would be achieved if each person only recruited two other people!

This “successful” scenario or anything near it is obviously impossible. The market could not sustain nearly 4.65 million sales reps for this one company in this time frame. The scheme would collapse *totally*. If it did not collapse at that point, then the “sales force” would increase by 15 million more in the next year, etc.

Instead of this explosive collapse scenario in which eventually all of us would become MLM salespeople, the "dropout rates" of 50-70% slow the advance, thereby *enabling* the MLM company to operate for a longer period. In this way the scheme can go on for longer – but not forever. New territories are continuously needed. Exponential expansion does not occur, but extraordinary numbers of new people are needed every year to replenish the bottom ranks that fund the entire scam, triggering the need for geographic expansion.

When these terms, "dropout,” "turnover" and “retention” carry or infer *personal* failure, this is deceptive and misleading. When MLMs use these terms to imply normal business

[11] “Company data from 2005 obtained by the Free Press show that about 72% of distributors drop out during their first year, and 96% are gone within five years.” (*Soap and Hope Model Criticized, Only Those at Top Get Rich, Some Say* by John Gallagher, Sept. 24, 2006)

failure among resellers or the rate of dropout as a result of "choice" or lack of talent or ambition among the resellers, they obscure and cover-up the reality of inevitable pyramid collapse. *When these terms are used in this way in SEC filings and other public documents, they are inaccurate and misleading descriptions of what is occurring each year and they disguise the true nature of the business that depends totally of a new base of "losers" each year.*

MLM "dropouts" are *pre-determined and unchangeable*. They are the result of unbending market limitations about which the MLMs have misled the resellers and the investors. 50-70% annual "failure' rates in MLMs and 99% financial loss rates each year among the resellers[12] are not by choice. Consumers "fail" at these staggering rates in MLM in the same way that nearly all lose in a lottery. The losses at these huge rates are *required* since they are the source of the "winnings." (The great majority of the MLM commissions are transferred from the "losers" to the top 3% as "earnings"). Such a failure is not by choice and it is not for lack of effort or ability. It is mathematically planned and determined. And those organizing and managing the MLM know this will and must occur even as they recruit consumers with promotions about "unlimited" income and the "opportunity of a lifetime."

FTC Prosecutions and Retail Benchmarking

Without assigning any motive or reasons, the Federal Trade Commission prosecutions of MLMs in which a retail standard was applied took into consideration that many MLM participants do not retail the products. The FTC retail test used in the Equinox case, for example, allowed 49% of all commissions to be sourced from wholesale purchases of the distributors. It only required that the commissions be *primarily* based on retail revenue, that is, revenue from outside the chain.

The FTC considered this to be the minimal level of outside funding of an MLM business, which allows and rewards endless chain recruiting, without *being* an endless chain. Effectively, it allowed that the MLM scheme could operate legally, even though it is structured as a pyramid and in fact pays participants to recruit, so long as the majority (51%) of the payments (commissions) came from sources outside the chain, that is, from retail customers.[13]

Less than that, and the FTC prosecution treated the scheme as *primarily based on rewarding recruiting with payments derived from the later recruits in a classic endless chain fashion.* In that scenario the money for the pyramid transactions was simply laundered through product purchases. 40-50% of the price paid by the new recruit was transferred to the recruiters through these purchase transactions, and in most MLMs one-half of all the commission money on each purchase by a new recruit is transferred directly to the promoters in the top 1% of the chain. As the FTC website states, "The

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[12] Pyramid Scheme Alert has statistically documented 99% loss rates among all "active" participants in major MLMs, even before product purchases and other business costs are factored. See http://www.pyramidschemealert.org/PSAMain/news/MythofIncomeReport.html

[13] In the Equinox case, the FTC determined that at least 70% of all Equinox products sold to the distributors would have to be retailed at full retail price, without discounting, in order to pass the test. Pyramid Scheme Alert has applied the same test to other MLMs, some that are members of DSA, and produced the same mathematical result – 70% of all goods would need to be retailed at full price to be legal operations.

underlying goods and services, which vary from vitamins to car leases, serve only to make the schemes look legitimate."[14]

Evaluating the Identity and Role of MLM Distributors

The existence of the non-retailing MLM participants cannot justify a redefinition of their role in the system from reseller, as they are legally defined by the contract they sign, to "ultimate end-user," as the DSA appears to be claiming. It is possible for an MLM to establish a category of end-users who buy at the wholesale price and is not authorized to resell the products or to recruit resellers for the MLM. But even where that status exists, it does change the basic model. The "preferred customers" are just retail customers who buy at distributor cost. Their payments are counted as retail sales.

It should be noted, however, that establishing a category of end-users who can buy at distributor cost serves to undercut the MLM as a "direct selling" business. The practice of selling to one group of "end users" at wholesale prices harms all the distributors who seek to earn profits from retail sales.

The legitimacy of all MLMs, even those with "preferred customers," rests on a retail foundation. If a retail foundation does not exist, the MLMs operate as endless chain recruiting schemes that are only *disguised* as retail operations.

- MLM distributors sign a legally binding business contract that defines them as authorized independent *resellers*.
- The contract is an agreement to participate in a "business opportunity."
- The contract authorizes the signer to function as an independent representative of the company empowered to recruit other resellers and to resell the product. It also establishes a formal system of rewards for doing so. Whether certain people purposefully choose not to retail the product or to seek rewards from recruiting other resellers, they are empowered to do so and could exercise that right at any time while the contract is in force.
- The signers are required to purchase a "sales" starter kit.
- Many of those who never retail any product purchase the MLM goods on an auto-ship monthly minimal order level, the level that the company establishes and requires for participants to maintain their qualification for commissions if they recruit others. *Purchasing at these specified amounts is tied to seeking profits and constitutes participation in the business opportunity.*
- The signers purchase the product at a fixed, non-negotiable price. No distributor can offer another distributor a discount within the MLM sales channel. If the MLM considered these people its prime market, not the retail end-users, this pricing practice would be illegal price fixing.
- Upon signing the agreement, the signers are henceforth restricted to purchasing goods only through the channel members in their direct upline. They are prohibited by the company from purchasing products through distributors of their choice. Likewise, the upliners cannot distribute goods to people in other lines, also an illegal practice if non-retailing people were actual "consumers" and the upline distributors are truly "independent resellers."

[14] http://www.ftc.gov/bcp/conline/pubs/alerts/pyrdalrt.htm

- Upon purchasing goods, the resellers are restricted from reselling in any manner other than the company allows. They cannot publicly advertise to sell them or even to sell them on eBay, for example. Few "consumers" would buy any goods under what are clearly *commercial* restrictions that are intended to regulate the MLM sales channel, not the end-users.
- If they meet minimal monthly purchasing requirements, the signers are contractually entitled to receive rewards from purchases of a long line of other members. The rewards to this long line of upliners are built into the price paid by the new recruits (40-50% of the "wholesale price" is transferred to the recruiters). Many are told that they can recoup their entire costs of products if they should recruit even one other person who then recruits others in an eventual chain. So, whether they choose to seek a reward, an incentive is always presented to them and built into the price they pay.
- The signers contractually surrender rights that a consumer would normally have as a purchaser, e.g., agreeing never to disparage the company privately or publicly and to settle disputes only by binding arbitration, not in court.
- As a reseller, the signers could be implicated in any illegal or fraudulent activity of the company or upliners.[15]
- Upon signing the reseller agreement, they contractually surrender the right to promote other similar product lines or, in many cases, they must agree not to participate any other MLM companies at all, thereby limiting other income opportunities.
- The historical behavior of most MLM participants does not match those of consumers who would be so committed to a product that they would contractually obligate themselves as legal resellers. Most MLMs experience a 50-70% annual dropout rate among recruits. Based on sales data disclosed by the MLMs, these dropouts also stop buying the MLM products upon resigning from the contract. It would be extraordinary that so many would take on the costs and responsibilities of contracting as resellers only to stop buying the goods even as consumers in just several months. This pattern is, rather, the classic behavior of entrepreneurs who were not profitable and soon determined the cost of the "business opportunity" to be not worth further financial investment, time or effort. The dropout levels indicate failure among seekers of the business opportunity, not disgruntled consumers, who somehow abruptly and totally changed their mind about a product they had earlier sought so avidly.

These conditions clearly separate these MLM participants from consumers or even from a category of a member of a buying club. They are obviously what the contract defines them as, *authorized resellers*. That some might choose or by circumstance be unable to resell the products and earn a retail profit does not change their status.

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[15] The (January 2007) FTC website advisory entitled *The Bottom Line on Multilevel Marketing Plans*, advises consumers, "If you decide to become a distributor, you are legally responsible for the claims you make about the company, its product and the business opportunities it offers. That applies even if you're repeating claims you read in a company brochure or advertising flyer. The Federal Trade Commission advises you to verify the research behind any claims about a product's performance before repeating those claims to a potential customer.
In addition, if you solicit new distributors, you are responsible for the claims you make about a distributor's earnings potential. Be sure to represent the opportunity honestly and avoid making unrealistic promises. If those promises fall through, remember that you could be held liable."
(http://www.ftc.gov/bcp/conline/pubs/alerts/pyrdalrt.htm)

It is not reasonable that large numbers of people would take on all of these legally binding restrictions and obligations only to purchase goods at a discount *without any interest whatsoever in the attached "income opportunity."*

The question also arises as to why these consumers would not just seek a discount from any of thousands of existing MLM resellers that are available. Any of these resellers can sell the MLM goods at any price they choose, *including at cost.*

Evaluating the MLM Business Model

It is not reasonable that any group that purposefully chooses not to retail the MLM products would be central or fundamental to the MLM company's marketing or business model and the "income opportunity" that it offers. In any event, such a group of "non-performing" resellers, does not change the business model. The MLM income opportunity is still based on each reseller recruiting others in an endless chain.

- If selling directly to consumers at the wholesale price is the core mission of an MLM company, that company could not claim also to support "authorized resellers." All those who do try to resell the goods at a retail price would be competing with the company that is offering to sell the goods to consumers at wholesale price.
- Despite the damage such activity does to retail efforts of other resellers, several MLMs have, in fact, established a "preferred customer" category of consumers that can buy at wholesale but cannot resell or recruit. These are ultimate end users, however, the resellers earn no retail profit from soliciting them. They can, however, earn commissions on the purchases under the MLM pay plan. Often the pay plans require the recruitment of other resellers before income can be earned from the "preferred customer" purchases.

  In no case do these people constitute more than 20% of the company's revenue. Many are ex-resellers and remain "preferred customers" only a short period before quitting the scheme completely. In all cases, the MLM company promotes efforts to upgrade or reinstate their status from Preferred Customer to authorized reseller.
- Where income is based primarily on resellers recruiting other resellers, the existence of a large group of non-performing resellers, whether they are purposefully unprofitable or not, does not change the pyramid recruitment model. Rather, the large group at the bottom who, according to DSA rationalization, voluntarily chooses not to even try to make a profit, serves to restrict the incomes of the lower ranks of recruiters. The non-performers "break the chain."

Evaluating the Financial Results

Whatever the number of "consuming-only" MLM distributors, it would not appreciably affect the devastating financial realities inherent to a multi-level pyramid structure and recruitment-based pay plan *affecting those who do pursue the business opportunity*. If the income of those who seek a profit depends primarily on commissions derived from the purchases of a downline, the ratio of the downline to the upline is fixed. A large number of downline participants will be required for a small upline to be profitable. The percentage of commissions paid to those at each level of the hierarchy is also established in the pay plan formula. *The loss rates among those pursuing the recruitment-based business opportunity, based on these pre-determined ratios and pay plan formulas that send most of the money to the top ranks, will be extreme.*

In such a plan, regardless of "consuming-only" MLM distributors, the largest number of those seeking an income must, by the design of the pyramid structure, be at the bottom levels. If the majority of the rest of the participants are just interested in buying the goods from time to time, and not in reselling them or in recruiting other participants, then those at the lower levels cannot earn a profit.

In a recruitment-based program, the existence a large number of non-performing distributors at the base is the same as the end of the "endless chain." They could not provide nearly enough revenue from their own "personal" purchases or be in large enough number to be profitable to the entire upline, only to the few at the top. Moreover, this group quits the scheme at rates of 50-70% each year, adding to the costly recruitment work of those in the lower ranks.

Without a large base of retail customers for *all* resellers, profitability in a recruitment-based pay plan requires *multiple and ever-expanding* levels of a downline, which is impossible.

Illustration

To illustrate how reclassifying the no-profit participants does not appreciably change the harm caused by a recruitment-based MLM scheme, consider the actual data from one representative DSA member, Usana Health Sciences, a publicly traded company that has disclosed some payout data.

On its website[16] Usana reports that 60% of its entire sales force earns no commissions at all. Additionally, Usana also offers a "preferred customer" status to consumers who can buy Usana products at wholesale price. These consumers represent only 14% of Usana annual revenue. Resellers earn no retail profit from preferred customers but, under certain conditions, can receive company commissions based on their purchases.

If every single person among the no-commission resellers is excluded from average income evaluations and is treated as *purposefully unprofitable* and only those who pursued the income opportunity are counted, the following data are revealed:

- The bottom two levels of the multi-level structure – counting only those who pursued the income opportunity -- constitutes 69% of the entire sales force. The mean average income of this group is $3.87 per week, before product purchases costs, business expenses and taxes, *meaning a substantial financial loss.*
- The mean average income of the bottom 99% of all resellers who pursued the business opportunity was $21.73 per week, before product purchases costs, business expenses and taxes – *indicating an average loss.*
- Less than 1% (0.86%) of the sales force who constitute the top ranks of the sales chain received 44% of the entire company commission payout.
- The bottom two levels, who constitute 69% of the entire sales force received just 8% of the entire company commission payout

Even when the losses suffered by 60% of the other members of the chain are reclassified as "voluntary," dismissed as "no harm" and are excluded from the calculation, the devastating pyramid pattern remains – a concentration of profit at the very top of the chain and the vast majority of others positioned at the bottom where they are doomed to

[16] http://www.usana.com/media/File/Policies and Procedures page/US/US AveIncome.pdf

financial loss (being at the bottom of the "endless" chain.) *Any characterization of this system as a viable business opportunity for consumers would be deceptive.*

Finally, whether a significant number of recruits purposefully choose never to seek a profit, it would not change the fact that the commissions that are paid to the upline are based primarily on recruitment efforts. It would still be a closed system with fixed prices and based on endless chain recruiting.

Evaluating the Offer of Refunds

The associated DSA claim – that MLMs' offer of limited refunds to recruits serve to protect consumers from harm – deserves only brief disproof and repudiation.

- Either the non-retailing, recruitment MLM model is unfair and deceptive and constitutes a pyramid scheme or not. If it is, a refund would hardly serve as restitution and would not change the fact that a systematic fraud was perpetrated.
- Said another way, the DSA claim is that if a consumer is quick witted enough to discover the fraud, the perpetrators will allow the victim to recoup some, but not all, losses, while the promoters retain the right to continue perpetrating the scam on others.
- The victims that discover the odds of success in the recruitment model are insurmountable may have a limited opportunity to recoup some losses from product purchases, but not from fees, the costs of bogus "motivation" programs and the possibly large amounts of time and effort invested in the scheme, all of which accrued to the benefit of the perpetrators.

Other more mundane realities about nature of MLM operations also negate the value of a limited refund offer.

- MLM participants are told emphatically that the *cause* of failure is *quitting*. Quitting is vilified as the hallmark of "pathetic losers" and lazy people. The thrust of the solicitation is to induce people to remain in the scheme as long as possible, thereby inflicting larger losses and also *forfeiting some of the refund opportunity*.
- The MLM recruits are told to use, consume or give away the goods, also forfeiting the opportunity to limited refunds.
- The refund offers are fraught with limitations, including conditions of goods, continued offer of the exact product by the company (often packaging is changed, negating the refund offer), time restrictions, methods of application for a refund, and packaging and shipping the returned goods for refund.
- Consumers enter MLM as a *business venture*. They sign legally binding reseller agreements. Seeking a refund requires a recognition that entry into the program was a an error in judgment or that lack of success was caused by the program itself, not the recruit's lack of ability. These are insights and realizations few recruits have at the time of quitting. The MLM companies emphatically claim and repeatedly tell the recruits that if they fail, *it will be only their own fault*. To seek a refund, a participant must overcome and reject this powerful message of condemnation and self-blame.
- Consumers who quit the MLMs are coping with disappointment, shame, pressure from colleagues, concern for others that they many have implicated, worry about legalities, etc. Typically, consumers leaving MLM schemes want to distance themselves from the bad experience, move quickly to some other enterprise,

> rationalize their losses or try to forget about their "failure." All such emotions and concerns weigh against a rational and calculated decision to go through the procedures for a limited refund.

The refund offer is of little actual value to victims. It is a ruse to divert proper regulation and evaluation.

DSA's Disinformation Campaign

DSA's claim that the existence of non-retailing MLM participants should preclude a retail level criteria for evaluating an MLM's legitimacy is without merit. An effort to redefine as "ultimate end users" tens of thousands of consumers who suffer financial losses in MLMs or to ascribe a no-income *intention* to them – and therefore no harm – is unsubstantiated, unreasonable, and absurd. Considering the extraordinary marketing campaigns of MLM companies based on the lure of a "unique income opportunity" and MLM's self-definition as "direct selling" and "home based business" the claim is disturbingly disingenuous.

Not only is the claim unfounded and unreasonable but it does not appreciably change the devastating financial outcome of a pyramid recruiting scheme, masquerading as a direct selling business.

The claim turns out to be the cornerstone of a political campaign by DSA to change state and federal laws in order to legalize behavior that currently is treated as fraudulent. This campaign chiefly would protect DSA members from future prosecution. The effort to reclassify those who suffer losses in the MLM business opportunity as ultimate end-users who never sought to earn a profit in the MLM program is a dis-information campaign to obscure reality. It is also an egregious insult to the millions of consumers who responded to MLM business opportunity solicitations and suffered financial and personal harm due to an inherently fraudulent model and deceptive business practices.

USANA Health Sciences

Report by Jon M. Taylor, Ph.D. to Barry Minkow of Fraud Discover Institute, dated January 29, 2007

Objectives of report

- Analyze network or multi-level marketing (hereinafter MLM) practices of USANA Health Sciences as compared with the general MLM industry.
- Identify vulnerabilities in such practices as it could dramatically affect the price of the stock.
- Determine size of downline of "kingpin" distributors (referred to as "Associates" at USANA) at the top of pyramids of pyramids of participants.
- Determine extent to which departure of a kingpin distributor could result in mass transfer of his/her downline to another MLM.
- Identify provisions in Associate agreements that could affect the ability of those terminated to recruit existing downline to another MLM, such as a non-compete agreement and independent contractor status of Associates.
- Determine extent of legitimate direct sales to non-participants in the USANA program.
- Determine reasonably provable loss rates and attrition rates of Associates.
- Assess USANA as both a "business opportunity" for Associates and how that assessment might affect the performance of USANA's stock.
- Identify material information crucial to investment decisions that is not disclosed to stockholders.

Management

Several years ago, Dr. Myron Wentz's son, David Wentz, took over as president. The company is managed by capable professionals, some with PhD or advanced college training. This is not unusual for a well-financed MLM company. In fact, it is customary for them to recruit management officers whose names will add credibility to their company, which may be under attack from regulators and from consumer advocates.

The core of any MLM business is the distributor network. Distributors rise in the hierarchy of distributors on the basis of their recruitment success and by their timing of entrance into the program. The first ones in have the obvious advantage in any "recruiting MLM," or "product-based pyramid scheme." (See my report: *"5 Red Flags: Five Causal and Defining Characteristics of Recruiting MLM's, or Product-based Pyramid Schemes")*

Company recognition

Partly because of extraordinary growth in its stock price (6,370% in five years!), resulting at least in part by healthy growth in sales revenues (almost triple in five years) and net earnings (over 15 times in five years), USANA has received much attention in the financial press. The company was recently ranked #3 Hot Growth Company by *Business Week* and #5 Best Small Company by *Forbes* magazine.

Such recognition should not be taken as proof that a company is legitimate, especially in the case of MLM. Several companies adjudged in at least one court to be illegal pyramid schemes were once touted as up-and-coming entrepreneurial ventures by mainstream press, including Equinox and PrePaid Legal.

Products and product research

USANA takes great pride in its line of health and wellness products, consisting of nutritional "essentials," "optimizers," powdered drinks, "Nutrabars," and hair, dental, and body care items. Many of these were developed under the supervision of its original president, Dr. Myron Wentz. In 2003, USANA acquired the manufacturer of skin and personal care products – which may have been to take advantage of foreign markets, some of which have tighter controls on sales of nutritional supplements than is the case in the U.S.

The touting of USANA's "great product line developed by an outstanding team of researchers" is not well supported by the fact that for the past several years less than 1% of revenues is spent on research and development, performed by over a dozen PhD-level researchers on staff. Also, USANA's claim to have had some of its products listed in the Physician's Desk Reference PDR) has been challenged by Dr. Wendy Stock, a specialist in clinical psychopharmacology. On investigating, she found that the PDR does not include any independent research or evaluation, but merely information furnished by drug manufacturers.

Although it is not the purpose of this report to investigate product claims, it is not unusual for MLM companies promoting wellness products to make exaggerated claims of product effectiveness in promoting wellness and longevity, even claims of prevention and potential cures for cancer and other life threatening diseases. An excellent source of information on the validity of health and wellness claims for products sold by MLM companies can be found on the web site – www.quackwatch.com. Dr. Stephen Barrett, who sponsors the site, also warns against MLM companies that promote questionable products on another site – www.mlmwatch.org.

Pricing problems with USANA products

MLM critics refer to the types of products produced and sold by USANA as "pills, potions, and lotions," that can be made to appear unique enough that it is difficult to make price comparisons with competitive products. Most MLM's products, including USANA's, must be priced very high to support their extensive network of downline distributors.

However, it should be noted that in the year 2000, USANA officials introduced a broad re-pricing initiative, reducing the average price of its products by 24%. The intent was to make the products more affordable and competitive, but because it decreased incentive payouts to Associates, at least 15 "kingpin" Associates left, many moving on to other MLM companies.

The MLM Industry

USANA works hard to be classed as a direct sales company. For investors to make industry comparisons, USANA has managed to get its stock classed with the industry group "Retail/cosmetics – drugs – cosmetics." Since most companies in this group are stable companies, USANA – with its recent explosive growth – looks sensational against them.

Based on my "5 Red Flags" analysis (See Appendix A for a summary "5 Red Flags" report and B for my evaluation of USANA based on this proven model), I would classify USANA as a product-based pyramid scheme, or "recruiting MLM" (requiring extensive recruitment to be successful). Sales for such programs will often spike upwards when the economy is in the doldrums. This is not surprising to anyone who attends their opportunity meetings. Prospects are told that *this* MLM will be the answer to their yearning for an opportunity that will outdo the rest of the economy and that it will be providing them with residual income while their friends are laid off and scrambling for work.

USANA's business model

USANA claims to market its health and wellness products through a "direct sales" model, which is no different than the multi-level marketing described above. Distributors are called "Associates," apparently to further distance USANA from the typical MLM model. Of course, this would be disputed by critics of such "recruiting MLM's" as USANA, Nu Skin, Melaleuca, etc.

Following extensive analysis comparing the structure and effects of compensation plans of recruiting MLM's, such as USANA, with legitimate direct selling outlets, such as Avon (which has recently evolved to less retail focused), Pampered Chef, Fuller Brush Company, etc., five distinguishing characteristics became evident.

Contrary to what the MLM spokesmen would like the public to perceive, the differences between legitimate direct selling and recruiting MLM's are striking. The aforementioned report on the "5 Red Flags" makes these distinctions very clear. Where data has been available, when these five red flags appear in an MLM, the loss rate is approximately 99.9%. USANA displays all 5 Red Flags in its compensation system. (See Appendix B)

Briefly, in legitimate direct sales programs, as opposed to recruiting MLM's, the following are evident:

- Some balance is maintained between recruitment of distributors and the market potential for any given area. Market (*not* total) saturation from over-recruitment leads to discouragement of the current sales force. Endless chain recruitment, which is at the core of all MLM's, is mathematically uneconomic, dooming the vast majority of participants to financial loss.
- Branch and district sales managers are appointed, not self-appointed by recruitment.
- New sales persons need not purchase an expensive supply of products and sales materials to get started. Usually the cost is minimal or nil.
- There are no more levels of sales managers than can be functionally justified - certainly no more than five.
- Sales persons who do the actual selling get the lion's share of the commissions. Managers above them may get small overrides, that could be substantial with a number of sales persons beneath them – but not a huge downline.

The Vice President of the Family Division for World Book, Inc., with whom I spoke, made this shrewd observation: "In a [product-based] pyramid scheme, the emphasis is on recruiting people to BUY products, whereas in a direct sales company (like World Book or Avon), people are recruited to SELL products."

Robert Fitzpatrick of Pyramid Scheme Alert has suggested that both MLM's and no-product pyramid schemes operate in a state of "continuous collapse." They survive by continual recruitment of a revolving door of new recruits as primary customers.

USANA assigns the designation of "preferred customers" to anyone (not a distributor) who buys products and has made a purchase in the past three months (changed from purchases in past year in 2002). The fact that the total number of preferred customers is less than the number of Associates (distributors) belies the myth that USANA is a direct seller.

USANA's compensation plan

USANA uses what their leaders call a "cellular binary" compensation plan. No doubt the word "cellular" is used to reinforce the idea that its nutritionals address nutritional needs "at the cellular level."

In its binary plan, an "associate" has a business center when he/she has recruited two distributors under him/her. The three of them make up a "business center," or cellular unit in one's downline. The associate can then have any number of business centers ("layers upon layers," as one disgruntled associate put it) in his/her downline, but in each case the sales volume used for calculating commissions is the lesser of the two "legs" in the business center beneath the one on top.

With USANA, an associate could have a major producer in one leg whose volume would be totally cancelled out by lack of production by the other leg. So there is tremendous pressure built into the system to get the volume of the lesser leg to equal the volume of the higher-producing leg.

As in other MLM compensation plans, the pressures built into the plan to get people signed up and products purchased is so great that it is not uncommon for participants to set up what I call "dummy distributors" and "counterfeit customers," in order to qualify for greater rewards – or to prevent getting no commissions at all in the case of one leg being non-productive.

Since it is so difficult to meet volume requirements in the USANA program, and doing so may mean hyper-consumption of products from the company, the percentage of Associates who actually realize a profit could be infinitesimally small. (See Appendix C.) But Associates are on a perpetual treadmill trying.

Also, it should be noted that it has been rare for MLM companies using binary compensation plans to grow to great size or to last for very long. USANA has been unusual in this regard. In *Multi-level Marketing – the Definitive Guide to America's Top MLM Companies*, compiled in 1998 by Will

Marks, none of the top 39 MLM companies (which did not include USANA) featured in the book used a binary system. Over 80% used the stairstep/breakaway systems, including companies such as Amway, Nu Skin, and Nikken – all of them with extremely high-leveraged (the degree to which top distributors income is leveraged by the efforts and purchases of those in their downline) compensation plans. So it seems that non-binary compensation plans tend to survive longer – at least until 1998, when Marks' book was published.

The Independent status of Associates is inconsistent with USANA's management practices.

USANA exerts seeks to control Associates to a greater degree than is justified by their "independent distributor" status, forcing out Associates who don't comply with what some "kingpin" recruiters have seen as unreasonable and unfair contract (written or unwritten) provisions. Whether due to the demands of USANA's management or to frustration at the lack of control over product pricing and incentives for Associates, some disgruntled key Associates with thousands of downline distributors have been reported to have left the company in the past five years, including Ron Glover, Jimmy Smith, Randall Burt, Mark Ewell, Rob and Nikki Horkings, Ken Seto, Rick Connolly, George Reise, Lorin Miller, Bud Corkin, and George Ruiz (spelling uncertain for some). Ron Glover claimed that 15-20 top recruiters were "forced out" of the company by enforcing "rules" that management found in the Association agreement could be used against them.

Ron said that USANA has a one-year non-compete agreement in their contract, but that it does not apply if the Associates are terminated involuntarily ("forced out"). When Jimmy Smith began his involvement with Isagenix, another MLM, USANA officials tried to get him to quit the other company and stick with USANA. He refused, so they terminated him. He then brought some of his immediate family with him to Isagenix.

Ron Glover said that the notion that anyone could or would attempt to bring his or her entire downline with him or her is "pure baloney" and that less than 10% would follow the upline that made the change. But Jimmy claims "the word gets around" and that others came "streaming in" when they found out how well he was doing with Isagenix – becoming their top producer, with over $1 million a week in volume.

For MLM's like USANA, changes in distributor compensation can have a dramatic effect on "the bottom line," unless drastic measures are taken to offset distributor dissatisfaction.

Some of the 14-fold rise in earnings from 2001 to 2004 may be explained by changes in incentives for the distributor network, the core of the business. USANA officials seem to have backed off some on paring down these costs, however, when Associates who were their top recruiters perceived less incentive to promote the business and began leaving.

As explained earlier, the 24% price reductions had a significant impact on commissions of top recruiters. Jimmy Smith claimed his income dropped 25-30% as a result of the price reductions. He left for another MLM, where he became their top recruiter. He brought with him his two daughters and some close friends and relatives, and he claims that without recruiting them, many of his former downline Associates in USANA came "streaming over" to his downline in his new company when they learned of his success. But at least one other former Associate claims he aggressively recruited Associates from USANA.

Ron Glover, who was USANA's #1 recruiter, claimed his income dropped 50% as a result of changes in prices and "enhancements" in the compensation plan. With a downline of as many as 275,00 Associates (he wasn't sure of the number, as "inactives" are not counted), and downline sales volume of approximately $4 million, one would expect his departure to have had a dramatic effect on sales volume.

USANA reaps the commissions that would have been paid to these "kingpins" when they leave, which can substantially reduce expenses and thus have a major effect on profits. But one would also expect that when top recruiters leave, sales to new recruits would drop off proportionately. However, that does not seem to have been the case with USANA during the 2003 improvements in performance fundamentals and subsequent run-up in stock prices. As explained below, the continuing rise in sales volume can be explained at least in part, by an aggressive campaign by company officials to beef up their recruitment efforts to replace terminated Associates.

When a person with a large downline terminates with the company, not only are payments to him/her terminated (reducing expenses), but commissions from his/her downline do not automatically "roll-up" to the next upline Associate, as with some MLM's, but go directly to the company – thereby increasing USANA"s bottom line in both respects. However, because of the loss of revenue from the recruiting efforts of these "kingpins," other means of recruitment must be employed to compensate. USANA has done this.

As stated in the 2004 1-K (p. 6), the number of "Health and Freedom" Thursday meetings increased to *over 500 each week* in 2004, resulting in an increase in the number of active Associates during 2004 and (per the 10-K) "producing significant positive momentum with our Associate field." For these (opportunity) meetings to be conducted in 500 separate locations, one has to conclude this is an astonishing level of recruitment activity – another evidence of a pyramid scheme.

A suspicious alteration in 10-K reports and in definition of "active Associates" resulted in an apparent (and probably misleading) steady growth in sales, profits, and number of Associates

On comparing the data from 10-K financial reports required by the FTC, I found a very curious modification of statistics between 2001 and 2002. According to the 2002 10-K, the number of Associates dropped 23% from 86,000 to 66,000. But in 2003, the number of Associates in 2001 was dropped to 56,000 – a restatement with no explanation! This meant that Associates instead increased 17.9% and that all relevant parameters followed a pattern of steady and even remarkable increase. This is when the earnings and revenue increases resulted in dramatic increases in stock prices.

The effect of such alteration on the overall picture that might be of interest to a financial analyst looking at a stock are shown in Appendixes E and F, with the former showing the chart patterns based on the original reports and the latter showing the "improved" picture with the alterations.

Another interesting adjustment that was not noted on the 10-K report was that until 2001, Associates and Preferred Customers counted as "active" were those who had made at least one purchase in the past year. Beginning in 2002, the definition was changed to those who had made a purchase in the past three months. One high level distributor told me that this had the effect of making it appear that twice as many Associates were "active." This may not have raised any red flags with the SEC or with investors, but to those of us who are intimately familiar with the reporting practices of MLM companies, this is very significant. Had investors understood the significance of these changes, the stock price surely would not have climbed as rapidly as it did.

Emphasis on income from recruitment makes USANA technically a pyramid scheme, based on my "5 Red Flags" analysis.

This high number of "opportunity meetings" illustrates an extraordinary commitment to recruitment of new Associates, which are the primary source of income for USANA, since bone fide customers (labeled "preferred customers") are only slightly more than half the number of "active Associates." (Both active customers and active Associates are participants who have purchased products in the past three months.)

An important lesson can be learned from the departure of these "kingpins" and the subsequent Herculean campaign to recruit Associates to replace them. MLM's such as USANA are almost totally dependant on a revolving door of new recruits to maintain their sales volume. With the FTC and in most states in the U.S., such emphasis on income from recruitment (though "laundered" through product sales), rather than on sales to customers outside the network of distributors, makes it an illegal pyramid scheme. Numerous court cases have confirmed this interpretation.

For eight years I consulted with top experts and performed extensive comparative analyses of factors that could clearly separate pyramid schemes from legitimate direct selling businesses. I was finally able to identify five "red flags" in a program's compensation plan that distinguished between the two. These factors are those that cause the harm (losses) to the vast majority of participants and (for those who understand the pay incentives), satisfy the definition of what is an illegal pyramid scheme in most jurisdictions.

As seen in Appendix B, USANA clearly satisfies all “5 Red Flags” of what I call a product-based pyramid scheme, or recruiting MLM (i.e., a program that emphasizes income from recruitment, rather than sales to non-participating customers).

Actual selling to customers who are not participants in MLM’s like USANA is not significant enough to justify a distributor network.

Rick Young, a 3-star Diamond for USANA, confessed to me that he finds himself too busy to sell products to non-participating customers. In fact, all of the financially successful distributors I have spoken with in MLM programs such as USANA spend the bulk of their time recruiting new distributors and servicing and training their downline. They do almost no selling that is not related to recruitment.

Ron Glover said that he gave away as samples most of the products he purchased from the company. I found myself doing the same thing when I was with Nu Skin, becoming a “health food Santa Claus” at Christmas time.

In a randomized household survey in Utah County, near where USANA is located, it was found that there were four MLM distributors for every one purchaser of MLM products who was not a part of the network.

Rod Cook, who sponsors the web site MLM Watchdog, also claims that almost all of the top MLM distributors he has spoken have no real customers.

This lack of solid sales to end use customers is another evidence of pyramid scheme abuse. Sales are primarily to an endless chain of participants who buy products to “play the game” in a phony “business opportunity.”

USANA, like similar large MLM’s, have of necessity evolved into worldwide Ponzi schemes.

Beginning in 2004, over 50% of USANA revenues were generated in markets outside the USA, with US volume totaling 52.4% of revenues in 2003 and 41.6% in 2004. This sharp 20.6% drop in domestic volume reflects the desperate overseas recruitment efforts to offset market saturation in the US and the vulnerability of unsophisticated markets to MLM recruitment.

In their desperation to find new recruits, USANA and other MLM’s have begun recruitment campaigns on university campuses in this country and abroad “to provide part-time income opportunities” for students. Unfortunately, it is predictable, as with other MLM recruits, that almost all students who participate will lose money, some a significant amount. This could mean the loss of essential student funds and some even dropping out of school for this reason.

Loss rates for MLM’s like USANA are too extreme for them to be promoted as a legitimate business opportunity.

In every case in which the “5 Red Flags” become apparent in an MLM compensation plan, and where data on average income of distributors is available, the percentage of participants who lose money is approximately 99.9%. This assumes an estimate of at least 90% attrition rate over five years and the subtraction of all “pay to play” expenses, as well as minimal operating expenses. (See Appendix C for calculations of loss and attrition rates for USANA.)

In MLM's like USANA, necessary expenses include minimum product purchases required to qualify for commissions or to advance in the scheme. These may be termed “incentivized” or “play the game” purchases. They also include payments for training and sales materials or “sales tools” needed to obtain the crucial help of upline sponsors.

In a one-year test of the Nu Skin program, another MLM located in Utah, I found that in order to be successful in MLM recruiting (which is essential to earn enough in commissions to exceed incentivized purchases), I also had significant operating expenses – as in any business. There were phone calls, travel, sales materials, meeting room rentals, advertising, etc. Total minimum expenses necessary for me to climb the pyramidal hierarchy of distributors was $18,000 for that year, including “pay to play” purchases from the company.

As an example of a “business builder” in the USANA organization, Ron Glover said his operating expenses were easily $30,000 a month, including advertising and traveling to the Orient to build a downline there where the market was more fertile (less like the USA which is saturated with people who had been exposed to MLM and were not interested). The $40,000 per month that he was bringing in does not look so profitable when he was spending $30,000 per month and working around the clock to produce it!

After subtracting both minimum "pay to play" and operating expenses from average incomes of Associates in the USANA program, less than 1% of Associates realize a profit from the USANA program (see Appendix C). This would help to explain why the attrition rate for MLM's like USANA is so high.

If IRS officials were to look closely at the percentage of MLM participants who are attempting to write off expenses for promoting an MLM, they might conclude that they are abusing the "hobby rule," requiring a profit in at least one in five years for a home business not to be considered a hobby. The IRS could also be justified in ruling that MLM expenses could be written off only against actual revenues (winnings), as is the case with gambling or Para mutual betting on horse races.

In fact, after a survey of tax preparers in four Utah counties, it was found that a much higher percentage of gamblers report a profit from gambling than MLM participants report from MLM involvement. For details, see the Statistics page on the author's web page at – http://www.mlm-thetruth.com/STATISTICS.htm

At the USANA opportunity meeting I attended in 2003, Jeff Jensen related the 100-10-1 rule he uses. He claimed that out of 100 who hear the presentation, ten will sign up. Then one in 10 of those will do the business. Then one in ten of those will be "business builders" – or 1% of the total. Based on my exposure to other MLM's, not more than one in 10 "business builders" (which would be a small percentage of ALL recruits) will actually realize a profit, and far less will see a *significant* profit. Using this analysis, we're down to 1/10 of 1% who would profit – leaving approximately 99.9% in a loss position, which is what other analyses have shown.

Even if the loss rate at USANA were not quite 99.9%, as it is with other MLM's that were found with the "5 Red Flags" of a product-based pyramid scheme, it would not be far off – perhaps as low as 99.6% (See Appendix C). But even a 99.0% loss rate should be considered unacceptable. Classic, no-product pyramid schemes have a guaranteed failure rate of only about 90%, and they are illegal in almost all jurisdictions.

Attrition rates for MLM's like USANA are also too extreme for them to be promoted as a legitimate business opportunity.

While the departure of top recruiters could affect USANA's sales, perhaps even more significant is the dropout rate of the enormous pool of new recruits brought into the system each year. While USANA, like other MLM's, treats such information as highly confidential, I have been able to estimate attrition rates based on reports of key personnel and distributors for certain MLM's – which are far worse than MLM apologists and MLM company officials will acknowledge. For example, Ron Glover estimated that he had personally recruited as many as 2,300 Associates over a period of five years with USANA. When he left, he said that only 20-30 remained or were considered "active." This would mean a retention rate of only approximately 1% over 5 years!

At the very least, at estimate of a 10% loss rate over ten years is reasonable, based on the fact that 99% lose money and can therefore be expected to eventually drop off the vine of purchasers who are the life blood of USANA's revenue stream.

As a "point of similarity," in 2001 I met with Corey Lindley, who at that time was Chief Financial Officer for Nu Skin. With considerable prodding, confessed that Nu Skin recruited between 200,000 and 300,000 people a year. Based on the current number of "active distributors" at the time, this meant just over 2% remained active after five years, and 1% after ten years. And in a case involving Melaleuca, which claimed to have "the best retention rate in the industry," the attrition rate was 5% per month – which translates to about 49% (compounding monthly) after a year, less than 3% after 5 years, and less than 1% after ten years.

To estimate attrition, it is helpful to estimate the number of Associates that have been in the program since it's founding, or at least for the past ten years or so. This is because (as in other MLM's) many if not most of those in the program who are touted as making substantial profits have been with the company from the beginning, or would have joined soon thereafter. So a comparison of success rates must use long-range data on numbers of Associates at the various levels, including dropouts and those who have become inactive.

Unfortunately, the information that USANA publishes about its Associate base is misleading in that only "active Associates" are counted. Active Associates are persons who have made a purchase in the past three months. The DSA and officials from prominent MLM's have made the case that this is the relevant statistic, since many customers sign up "just so that they can buy the products." The assumption is that if a participant were not successful in selling products or in building a downline, they did not make a serious effort. This assumption is misleading in that it does not correctly convey to potential recruits true statistics regarding all who attempted the program.

On checking with a person (in September of 2003) at the cash register in the USANA headquarters building that assigns customer numbers to Associates and "preferred customers" (which are consistently *less* than the number of Associates), I learned that approximately 10,000 customer numbers had been assigned in the previous 19 working days. At the time, about 55% of customer numbers were assigned to Associates.

With an average of 21 working days a month, this would suggest a total of 11,053 customer numbers assigned per month, including 6,079 Associates. She said this volume was fairly constant for the past year, so approximately 72,947 signed up per year. Over a ten-year period, that would be 729,470 Associates. At that time, USANA's 10-K showed 88,000 Associates, for a 12.1% retention over ten years. Based on the personal experience of Ron Glover, that would definitely be on the high side.

Of course, another way to estimate attrition is to study the loss rates of participants, since one can assume a built-in limit on the length of time participants will continue with a program while losing money. Eventually they run out of money and "drop off the vine." There are however, programs like Amway/QuIxtar that employ cultish behavior patterns that keep people in a state of denial for many years. They are led to believe that if they keep working at it, some day they will "make Diamond" and the flow of profits will begin. But I have not found evidence of this extreme cultish behavior in USANA.

The USANA "pitch" to prospective Associates

At the aforementioned USANA opportunity meeting, I witnessed the USANA "opportunity" presented by Jeff Jensen, a Silver Diamond Director, at the USANA headquarters in West Valley City, Utah. The pitch was eerily similar in almost all respects to other MLM presentations I have witnessed. For example, at Nu Skin presentations I attended about twelve years ago, the same sales points were used as at USANA's meeting.

Jensen opened the meeting by explaining the desirability of time and financial freedom. He spoke of many years of working long hours for someone else, while others were being fired all around him. Employees wondered who would be next. The inefficiency of traditional marketing models was explained, with all the middlemen taking 75% of the sales dollar. Word of mouth advertising is less costly and more effective, etc.

Nutritional products were presented as the trillion-dollar industry of the future, with the baby-boomers coming of age. Then the unique credentials of the company's founder, Dr. Myron Wentz, were touted as holding the secret to wellness products that work miracles at the "cellular level."

Jensen spoke of the growth of the company, its great product line, and its many awards. He spoke of the vision of Dr. Wentz to spread health and wellness and to curb disease. If you were buying this, you felt tears coming to your eyes as he explained that Dr. Wentz takes no salary from the business (without mentioning that Dr. Wentz is the principal stockholder who profited hugely from the recent run-up in price of his stock, over $10 million of which he sold in that year!).

The he touted the "opportunity" to own your own business, one that is "willable to your children, and even sellable." He spoke of getting rich "by building equity in yourself." He suggested that one's involvement could be "only 15 minutes here and a half-hour there," as though the money would flow in effortlessly.

Then Jensen spoke of "the power of two" to introduce the binary compensation plan used by USANA. He referred to it as a "true retirement income." He gave the steps to get started, including a starter pack for $49.95. Then, very deftly, he suggested we consider more expensive starter kits with sample products and sales aids. A "Three-business kit" sold for $776.50, and a "Pro-pack" sold for $1388 wholesale.

He closed by encouraging everyone there to get together with his or her sponsor and to take action *now*. It was all very smooth and very convincing.

In over 250 MLM programs I have studied, a pattern is seen of a complex web of deceptions, which seem essential for successful recruitment campaigns. See Appendix D for a list of “30 Typical Misrepresentations Engaged in by Recruiting MLM’s.” USANA is no exception in using these deceptions to further its programs.

Of course, in MLM much of the deception is self-deception on which the MLM industry depends. While it is true that a few succeed, it is not just about working hard as in any business. My twelve years’ research has led me to conclude that to succeed in a product-based pyramid scheme like USANA, one must go through three stages to climb the pyramid of “success”:

1. Be deceived.
2. Maintain a high level of self-deception
3. Aggressively deceive large numbers of new recruits into joining and purchasing products.

USANA stock fundamentals and price patterns during the sharp run-up in stock price after 2001

> The stock price shot up from below $6 a share in early 1996 to about $18 a share in 1998 and again in 1999, then dropped to under $2 by the end of 2000. It floundered until April of 2002, when it doubled in less than a week. It gradually continued its climb until by mid-June of 2003 it had reached $50 a share. It slowly dropped to $35 by the first of August, when it began a slow ascent back up to as high as $66.77 before a 2:1 stock split on October 31, 2003. Since then it has ranged from $28 to $55. Its closing price on January 25, 2007, was $52.39 a share.

Fundamentals looked very promising during the 2002-2003 period when the stock price rose so sharply. Revenues declined 7.2% from 2000 to 2001, but then increased 17.1% from 2001 to 2002. For the first 6 months of 2003, revenues rose about 33%. Earnings showed the most remarkable improvement, having increased 257% between 2001 and 2002. Total sales volume grew from $3 million during 1992, the year of it’s founding to about $200 million by the end of 2003 – still modest volume in comparison to many of its MLM competitors. But the rapid growth curve caught the attention of investors. While not as ascendant, sales volume grew from 200 million at the end of 2003 to $327 million at the end of 2006, a 63% increase.

Distributors and company officials I spoke with pointed to a change in management, improved operations, and the opening of foreign markets for the run-up in price. But an increase in short interest in the summer of 2003 seems to have dampened the price rise. Also, since the company is technically a product-based pyramid scheme (see Appendixes A and B) that is dependent on new recruits for the bulk of its business, the leveling off of continued growth was inevitable.

Insider and distributor activity with USANA stock during its acceleration in price

Company officers were engaged in heavy selling of USANA stock all during the time of the sharp run-up in stock price. This included USANA’s founder, Dr. Myron Wentz, and his virus detection firm, Gull Holdings, LTD. Together, they sold almost 468,000 shares of stock, for over $14 million, in the past year. Dr. Wentz and Gull Holdings each owned 4.6 million shares, for a total of 9.2 million shares. Outstanding shares as of Sept. 19, 2003 totaled 9.6 million shares.

As far as I could determine, the buying and selling of stock by distributors varied widely, with no clear pattern. I spoke with one of the top USANA distributors (a 3-star Diamond Director), who had owned 6,000 shares of USANA stock and sold it in the spring of 2002 when the price doubled. He boasted of this to people he knew and then felt sick when it went up another 10 times.

The daughter of another Diamond Director said he kept the stock he had until it had gone up several times. Other relatives who were distributors sold before making anything. Another very active distributor, a doctor, never did buy stock. I could find little evidence of collusion by top distributors or of their having manipulated stock prices by their trading of the stock.

Evasiveness of USANA officials to requests for information

Most of my requests for information from company officials were met with evasiveness or formal denials. When I asked for the number of Associates who were recruited last year or for anything that might reveal attrition rates or loss rates, I was met with comments such as "The Company does not release that information." Therefore, much of my information had to be obtained from ex-Associates or management that had departed the company. It is also interesting to note that Greg Swartz, the producer of the documentary movie about MLM entitled "The Downline," commented that USANA was one of the MLM companies whose officials refused to be interviewed.

My assessment of USANA's future

Though the founders may have had good intentions in the products they have developed, USANA as a business opportunity is fundamentally a scam – one of many MLM's that I classify as "product-based pyramid schemes." Some tweaks have been made to improve USANA's binary compensation system, but these do not correct the inherent flaws in the system, which doom the vast majority of participants to financial loss.

This is important to investors because the core of USANA as a business is its base of "Associates." In its own 10K report, company officials state, "We rely on non-employee, independent Associates to purchase, market and sell our products." It is admitted that the company cannot completely control the actions of Associates, in spite of a written agreement signed by Associates agreeing to abide by company policies and procedures.

As discussed above, prior to the sharp rise in stock prices, management had been undertaking cost-cutting measures for some time. While profits and revenues climbed dramatically from 2001 to 2005, there is a limit on how much costs can be cut without cutting distributor incentives – which would adversely impact sales.

USANA has been touting its entry into more and more foreign markets. However, as can be seen from patterns followed by other MLM's, this could lead to a somewhat predictable pattern – less than optimistic in the long run. For example, when Nu Skin moved into Asian markets, each market experienced a brief surge in sales (actually purchases from new recruits), followed in short order by what I call de facto or market saturation (total saturation of a population is unrealistic) and a frantic search for new markets to satisfy commission-hungry top distributors. Nu Skin became, in effect, a Ponzi scheme, with promoters telling prospects in each country that when the opportunity for growth in their country dried up, they could go to the next country. They went from Japan to Korea to the Philippines to Singapore to Malaysia, etc.

As USANA continues to follow Nu Skin's pattern, the excitement over foreign markets will be short-lived, as the company scrambles to open new markets to prop up sales and to keep up appearances of continued growth. And with the burden of prior experience in these countries, USANA is not likely to do as well as did Nu Skin and other MLM's who preceded it, as many prospects will have been burned by other MLM campaigns.

Much of USANA's future depends on minimal consumer awareness and the ineffectiveness of law enforcement in dealing with recruiting MLM's. Good information in the media could pop the bubble of USANA's growth in stock prices, which is not matched by company fundamentals or legitimacy of its MLM program. With cooperation from the press and/or revelations from ex-insiders, etc., the price of USANA's stock could drop sharply. As it is, it is riding on a cloud.

Conclusion – the disturbing truth about USANA that consumers, investors, and law enforcement need to know

USANA is a product-based pyramid scheme, in a state of continuous collapse, with rapidly departing Associates replaced by continual and aggressive recruitment of new Associates, who are deceived into becoming the primary buyers of the products in order to "do the business." 99.9% of Associates who remain do so in the face of increasing losses, so their stay is dependent on a complex web of deceptions and unrealistic promises. USANA has evolved into a worldwide de facto Ponzi scheme, with recruitment in new markets, including vulnerable developing countries, vital to continued growth due to significant market saturation of MLM in the USA.

Management found ways to offset the high attrition by aggressive and resourceful recruitment and by altering price structures and compensation incentives. However, USANA is extremely vulnerable to market saturation, government restrictions in developing markets, law enforcement actions in the USA, private class actions, public perceptions, and numerous intangible factors – far more so than the disclaimers in its financial reports would suggest.

In short, USANA is a pseudo business with no significant or stable customer base and is dependent on a revolving door of new recruits, 99% of whom lose money and eventually terminate or become inactive, only to be replaced by still more opportunity seekers. Investors, law enforcement, potential recruits, and the general public (through the media) deserve to know this.

Appendix A: The 5 RED FLAGS for Identifying Exploitive Product-based Pyramid Schemes, or Recruiting MLM's*

(*MLM is short for "multi-level marketing," a.k.a. "network marketing," "consumer direct marketing," etc.)

By Dr. Jon M. Taylor, President, Consumer Awareness Institute and Director, Pyramid Scheme Alert

NOTE: This is a brief summary of the full 40-page report titled "The 5 Red Flags: Five Causal and Defining Characteristics of Product-based Pyramid Schemes, or Recruiting MLM's"

*Recruiting MLM's require extensive recruiting before realizing actual profits. Retailing is not significant, as the compensation plan does not provide sufficient rewards to make actual sales to legitimate customers worthwhile. Also, prices are not competitive, since they must support payments to a huge downline of "middlemen distributors" – who are the primary customers. So the sellers are the buyers, and the buyers are the sellers – to themselves and their families. Recruiting MLM's typically display five features:

1. *Recruiting of participants is unlimited in an endless chain of empowered and motivated recruiters recruiting recruiters.*

Ask: *"Is unlimited recruiting allowed, and are those who are recruited empowered and spurred on by incentives (such as overrides from downline purchases, advancement, etc.) to recruit additional recruiters, who are likewise empowered and motivated to recruit still more recruiters, etc. – so that the effect is an endless chain of recruiters recruiting recruiters?"* This leads to a perception that a given market is saturated ("de facto saturation"), and the program must move on to another location or introduce new products or divisions to continue. The opportunity for each new person to make money becomes less and less as this endless chain or pyramid of participants continues to expand.

2. *Advancement in a hierarchy of multiple levels of "distributors" is achieved by recruitment, rather than by appointment.*

Ask: *"Does a participating "distributor" advance his/her position (and potential income) in a hierarchy of multiple levels of 'distributors' by recruiting other 'distributors' under him/her, who in turn advance by recruiting 'distributors' under them, etc.?"* If so, the result is self-appointment through recruitment to ascending payout levels in the distributor hierarchy. If the only way a person can profit significantly in the scheme is through recruiting to advance to higher payout levels (or to buy another's downline), this strongly suggests a pyramid scheme.

3.*"Pay to play" requirements are satisfied by ongoing "incentivized purchases*."*

Ask: *"Are 'distributors' encouraged to make significant purchases when recruited? That is, are they encouraged to make sizable investments in 'incentivized purchases'** in order to take advantage of the 'business opportunity,' and later to continue qualifying for advancement in – or overrides from – the MLM company?"* Watch out for minimum quantity purchases of products or services over time – where you must "pay to play" the game – to qualify for commissions or advancement. **Be wary when you are asked to sign up for continuing product purchases on auto-ship through an automatic bank draft**, rather than making occasional purchases as needed. Such "pay to play" or "incentivized" purchase requirements may be disguised investments in a product-based pyramid scheme, or a clever system of laundering pyramid investments in the form of product purchases. Few make sufficient commissions to cover the cost of these expenses.

4. *The company pays commissions and/or bonuses to more than five levels of "distributors."*

Ask: *"Does the company pay overrides (commissions and bonuses) to distributors in a hierarchy of more levels than are functionally justified; i.e., more than five levels?"* Even in major corporations, the entire world marketplace can be covered in five levels of sales management – branch, district, regional, national, and international sales managers. Paying commissions and bonuses on more than five levels in an MLM program primarily enriches those at the top at the expense of those at the bottom. You would be wise to avoid any program that pays overrides on more than five levels. Breakaway compensation systems are particularly exploitive, as payments are on a hierarchy of "breakaway" organizations of whole groups of participants, not just individuals – creating an extraordinarily high loss rate, except for those at the top of a "mega-pyramid of pyramids."

5. Company payout per sale for the person actually selling the product is less than the total of all upline participants , creating inadequate incentive to retail and excessive incentive to recruit – and an extreme concentration of income at the top.

Ask: *"Would a 'distributor' purchasing products 'for resale' receive less in total payout (in commissions, bonuses, etc.) from the MLM company as the total of all upline participants who had little or nothing to do with the sale?"* If so, the company's payments to the person retailing the product would be pitifully small, while those at the top in his upline can compound the small commission per sale by the sales of hundreds or even thousands of downline distributors. This is great for that upline person, but lousy for those attempting retail sales. *Avoid any MLM company that pays less than half of all distributor payout to the person actually selling products to customers outside the network of distributors.*

You should not accept income projections of retail sales at full retail prices, especially for products that are overpriced and not competitive in the marketplace. Also be wary when an MLM promoter asks you to choose between two options or "tracks" – one for those who want to "retail" the products and another track for those who are serious about "building the business." If the incentives are heavily weighted towards recruiting, this is a moot question.

While no one of these red flags by itself constitutes an exploitive pyramid scheme, taken together they create enormous leverage, enriching those at the top of the pyramid at the expense of a huge downline of unwitting victims of the scheme. Where valid data has become available, recent research has led to the remarkable finding that— *When all five of these red flags are found in an MLM, the percentage of participants who lose money is approximately 99.9% – far worse than the 87.5–93.3% loss rate for classic, no-product pyramid schemes and for many games of chance in Las Vegas. You will likely do better selling pencils on a street corner.*

Summary: A "recruiting MLM" is a multi-level (or network) marketing system that depends upon recruitment of new distributors to replace a continuously collapsing base of new participants in a pyramid of recruits. As such, it constitutes an endless chain scheme of marketing by recruitment of distributors as primary customers. It is a pseudo-business with no significant customer base and is dependent on a large network of distributors, approximately 99% of whom lose money from investing in products and services (including "success tools") offered by the sponsoring MLM company. The extremely high loss rate and aggregate losses make recruiting MLM's, or product-based pyramid schemes, the worst of all types of pyramid schemes.

Thus, recruiting MLM's are inherently flawed systems that promise ongoing residual income, but deliver very little except financial loss at the least, and loss of treasured relationships and values of honesty and integrity at the worst. They maintain themselves by continuous recruitment of new recruits, as investing participants give up or run out of funds and leave the system. Victims almost never file complaints with law enforcement because (1) they have been conditioned to blame themselves for their "failure," (2) they fear consequences from or to friends of family they have recruited – or who recruited them, (3) they fear self-incrimination for have (unwillingly) victimized others, and (4) simply not understanding what happened to them. And since the squeaky wheel gets the grease in law enforcement, officials rarely take action.

So – to be successful in a recruiting MLM, one must first be deceived, then maintain a high level of self-deception, and finally go about deceiving others. Some would label this " theft by deception," except that few of those doing the deceiving are aware that they are deceiving and defrauding those they are recruiting. They may even put on a display of being "successful," by buying expensive cars and homes and inviting others to be like them.

* "Incentivized purchases" are purchases of goods and services from the MLM company that are tied to qualification to participate in commissions or to advance through ascending levels in the distributor hierarchy. If they constitute a required cost of participating in the "business opportunity," then whether they are used, sold, given away, or stored is irrelevant – they should be considered a cost of doing business.

For a more complete report or for more research information, read other reports on the web site: www.MLM-thetruth.com

Law enforcement agencies and consumer awareness organizations can e-mail to: jonmtaylor@juno.com. For related reports, go to the web site: http://www.pyramidschemealert.org/. By doing a Google search, you can find numerous other sites to counteract the hype of MLM promoters, and I have provided a limited annotated list of some of the better ones.

APPENDIX B: **Is USANA a "Recruiting MLM*," or Product-based Pyramid Scheme?**

By Jon M. Taylor, Ph.D., Consumer Awareness Institute

When one examines the compensation plan of USANA, one finds all five red flags of a "recruiting MLM*," or product-based pyramid scheme. When these 5 red flags are all present, available data lead to the conclusion that the loss rate approximates 99.9% - far worse than the average 90% loss rate of clearly illegal 1-2-4-8 no-product pyramid schemes.

In other words, of all participants who sign up for such recruiting MLM programs, approximately 99.9% lose money – especially if purchases from the company to qualify for commissions and advancement in the scheme are subtracted as a business expense! See the statistics in the chart "Which Does the Greater Harm?" (available on the web site – www.mlm-thetruth.com) Though USANA is not on the chart, we nonetheless find the "5 Red Flags" in its compensation plan which, taken together, has been found to result in such abysmal loss rates.

Here is how USANA stacks up against the "5 Red Flags" of a recruiting MLM, or product-based pyramid scheme	**YES**	**NO**
1.Recruitment of participants is unlimited in an endless chain of empowered and motivated recruiters recruiting recruiters.	✓	
2. Advancement in a hierarchy of multiple levels of participants is achieved by recruitment, rather than by appointment.	✓	
3. Significant requirements that participants "pay to play" the game via product purchases. Thus, new recruits are the primary customers.	✓	
4. MLM company pays commissions and/or bonuses to at least 5 levels of participants, creating great "leverage" at the top.	✓	
5. Most of the payout goes to the upline, rather than to the person selling products, creating excessive incentive to recruit and inadequate incentive to sell products (except to new recruits) – and an extreme concentration of income at the top of a hierarchy (pyramid) of participants.	✓	

Again, it is important to note that where the "5 Red Flags" are found in an MLM compensation plan, the participant loss rate is approximately 99.9%. You may do better in Vegas! For more information, see MLM Numbers page on www.mlm-thetruth.com.

For the full report on the five red flags of a recruiting MLM, or product-based pyramid scheme, and related reports, read the reports listed on our page of consumer guides – and/or read other reports on research related to MLM or network marketing. You may also find information on legal and regulatory issues related to MLM or network marketing on our page on law enforcement and MLM or network marketing. For a more complete listing of pages on our web site go to the home page of our site – www.mlm-thetruth.com.

** A recruiting MLM is an MLM with a compensation system that rewards recruitment more than actual sales of products to persons outside the network of participants. So significant income is unlikely without recruitment of a large downline.*

APPENDIX C: ***Calculations of Loss Rates and Attrition Rates for Usana***

	No. of Associates at each level	**Per cent of total Active Associates**	**Average payments in commissions & bonuses for 2005**	**Total incentives paid by USANA in 2005**
"Full Time"				
DDIR+	34	0.30%	$319,740	$10,871,170
EDIR	36	0.03%	187,715	6,757,725
RDIR	65	0.06%	103,638	6,736,494
GDIR	218	0.20%	50,817	11,078,093
Total "full time"	353	0.32%		$35,443,482
"Part Time"				
SDIR	1,136	1.10%	$11,980	$13,609,379
BDIR	397	0.36%	7,756	3,078,978
DIR	1,208	1.09%	5,230	6,318,170
ACHVR	2,428	2.18%	2,901	7,044,223
BLDR	7,220	6.49%	1,272	9,182,962
BLVR	16,943	15.22%	328	5,557,593
SHR	11,301	10.15%	99	1,119,335
Total "part time"	40,633	36.51%		$45,910,640
	40,986	36.83%		$81,354,121
Associates who earned no commissions	70,310	63.17%	$0	$0
U.S. total	111,296	100.00%		$81,354,121
	"Total U.S. Associates as of 12/31/05 is 111,296" Total worldwide Associates (per 10-K) -133,000			Total worldwide payout to Associates (per 10-K) $128,698,000

Estimated percentage of Associates who profit:

Assuming half of active Associates purchase the 1-business center plan and half buy the 3-business center plan, the average monthly sales points are about 150, costing an average of about $180 a month, or $2160/year. This is the minimum "pay to play" requirement to be "active." Then assume other payments to USANA for additional products, training, sales materials, etc., total a minimum of $150 a month, or $1,800 a year, the total to USANA would be $3,960 per year.

Minimum operating expenses, with very little travel, are very conservatively estimated at $750 per month, or $9,000 per year. This is only half of what I found to be the minimum necessary expenses for recruitment efforts to advance up the hierarchical levels in my one-year test of another major MLM program.

Based on these very realistic assumptions, the minimum expenses to advance in the USANA compensation plan would be **$12,960 per year.** This is for fairly aggressive and ambitious recruiters who recruit primarily in the area in which they reside. Higher level Associates who travel extensively on recruitment campaigns, are likely spending several times that amount.

Assume that one in ten Associates remains with the company for ten years, a period less than many of the top Associates who are counted in the statistics as "Full-time Associates."

Using these conservative estimates of expenses, only those with commissions and bonuses paid to GDIR and above would be profiting. So (estimating) –

0.32%, or 0.0032 x 10% = .00032, or 0.032% profit (about 1/30 of a percent)

Conversely about **99.95% lose money – and are likely to eventually leave the program or become inactive.**

Percentage of Associates who profit - estimating on the high side:

Assuming half of the above expenses, and twice of the retention (20%), the expenses would be $6,480 per year, those at levels "BDIR" and above would profit. The calculations would then be as follows:

So (estimating) – 1.78%, or 0.0178 x 20% = 0.00356, or 0.36% (about 1/3 of a percent) realize a profit.

Conversely, about **99.64% lose money – and are likely to eventually leave the program or become inactive.**

CONCLUSION: Even the most conservative estimates, based on USANA's own reports, suggest an extraordinarily high 99+% loss rate and (ultimately) resultant high attrition rate.

APPENDIX D: **30 Typical Misrepresentations Engaged in by Recruiting MLM's***

By Jon M. Taylor, Ph.D., Consumer Awareness Institute

Typical MLM enticements, all of which are misrepresentations	**The truth or actual realities about "recruiting MLM's,"* or product-based pyramid schemes**
Presented as a great "income opportunity," with huge incomes reported for many.	Recruiting MLM's nearly always lead to certain loss for new recruits. A few are at the top of a pyramid of participants are enriched at the expense of a multitude of downline participants, at least 99% of whom lose money.
"Everyone can do this" – and earn a good income.	Holding up top earners as examples of what others can do is deceptive. It is unfair to sell tickets when – for nearly everyone – the ship has left the port.
Average earnings statements on official reports make MLM's appear highly profitable.	Reports of average incomes are full of deceptions – (Example - 20 on one page for Nu Skin's report of "Actual Average Incomes." See "Report of Violations" of the FTC Order for Nu Skin to cease misrepresenting earnings of distributors.)
Products can be resold at retail prices for a handsome profit	Products are high priced and sold primarily to recruits to "do the business," rather than to persons outside the network of participants.
Presented as a legitimate business – "not a pyramid scheme"	Product-based pyramid schemes have been found to be the most extreme of all the types of pyramid schemes, with the highest loss rates (approximately 99.9%) – far worse than for no-product schemes, or even than most games of chance in casinos.
Work for only an hour or two a day, and build up a "residual income" that will allow you the "time freedom" to quit your job and spend more time with your family or do whatever you want.	To profit at a recruiting MLM, one must work long hours and be willing to continue to recruit to replace dropouts. One must also be willing to deceive large numbers of recruits into believing it is a legitimate income opportunity. Recruits are only fattening their upline's commissions. And is there anything immoral about hard work for honest rewards?
"The job market is not secure." The stock market is even shakier. MLM offers a much more secure and permanent (residual) income."	MLM is far more risky than either the stock market or the job market. It even makes gambling look like a safe investment by comparison. Residual income for almost all MLM recruits is a myth.
Standard jobs are not rewarded fairly. In MLM, you can set your own standard for earnings.	Fair? Most MLM compensation plans are weighted heavily towards those who got in early or scrambled to get to the top of a pyramid of participants.
"If not legal, the program would have been shut down long ago." MLM's have survived legal challenges. The fact that they are still around tells you they are legitimate.	Consumer protection officials are reactive, not proactive. Since victims rarely file complaints, law enforcement seldom acts against even the worst schemes. Victims don't complain because they blame themselves, and they fear self-incrimination or consequences from or to their upline or downline.
If you fail at this program, it is because you failed to properly "work the system."	The system itself is inherently flawed – an endless chain recruitment of participants as primary customers. The vast majority will always lose money.
"In any business, one must invest time and money to be successful." (Committed MLM participants may continue investing thousands, and even tens of thousands of dollars, over many years before running out of money or giving up.)	The more one invests in time, money and effort, the more he/she loses – unless willing to deceive enough people to rise to the top of a pyramid of victims. In legitimate companies, sales persons are not expected to stock up on inventory or subscribe to monthly purchases. But in recruiting MLM's, incentivized purchases (required to participate in commissions and/or advancement) are often merely disguised or laundered investments in a pyramid scheme.
The report of "Actual Income" of distributors states " .16% of active distributors have achieved the level of Blue Diamond," etc. This appears to be respectable odds of success. (See the book *"How to Lie with Statistics"*)	When statistics are presented without deception, the "opportunity" is not so attractive. The ".16" should be preceded by a "0" (0.16% – or odds of 0.0016), and ALL who signed up should be factored in. But MLM's eliminate dropouts in their statistics – a huge deception. With 5% remaining (usually less) after 5 or 10 years, the number should be reduced by 95%. This leaves odds of **0.00008** of becoming a "Blue Diamond." This looks far worse that **".16%"**
MLM is the "wave of the future." In fact, "Our MLM is experiencing phenomenal world-wide growth," etc. "So get in on the ground floor of this great growth opportunity."	MLM'rs have been saying this for twenty years, but MLM still accounts for less than ½ of 1% of consumer purchases – in spite of the fact that the number of MLM companies has numbered in the thousands. MLM's come and go, as do new recruits, 99.9% of whom drop out. Long-term MLM growth is a myth.
Saturation never happens. Turnover, as in any business, is a reality that assures an ample supply of available prospects. (NOTE: The issue is not TOTAL saturation as MLM apologists suggest, but MARKET saturation. In a town of 10,000 people, the notion of 10,000 distributors to serve them is absurd.)	With few real customers, MLM products are sold by recruiting a revolving door of new "distributors" who buy products to "do the business." And since people perceive the opportunity as dwindling with each new "distributor," market saturation requires promoters to recruit elsewhere. So MLM's quickly evolve into Ponzi schemes, requiring the opening of new markets and/or new product divisions to repay earlier investors, as has happened with Amway (now Quixtar) and Nu Skin (which became IDN, then Big Planet and Pharmanex). It's not turnover, but continuous churning of new recruits to replace dropouts.
The demand for these MLM products is growing at a rapid rate. "They literally sell themselves."	The sale of products is distributor-driven, not market driven. Most products are sold to new participants to get in on this "ground floor opportunity."

"It takes time to build any business." "This is not a get-rich-quick scheme, but a 'get-rich-slow' program." "Don't expect instant success," etc.	MLM promoters sell recruits on their programs as a business, but defend it to authorities as a "direct selling" opportunity. However, In legitimate direct sales programs, sales persons earn commissions right away and don't have to wait months or years for commissions to exceed expenses.
Take advantage of "momentum" and "windows of opportunity."	Again, this kind of appeal has been used for twenty years. In any endless chain scheme, the momentum cannot continue indefinitely, leaving those who come in later in a loss position, which is at least 99% of recruits.
In this new (MLM) program, you can be the master of your destiny.	You will be a slave to the phone, to meeting the qualifications for commissions and bonuses, and to continual pressure to recruit new participants to replace dropouts. You are also caught in a money trap of hyper-consumption.
Unlike franchises, business startups, or sales of existing businesses, you can start an MLM business with very little capital.	MLM's typically bleed new recruits of their funds by inducing them to buy products on a subscription basis, to pay for ongoing training, and otherwise draining them of their resources until they run out of money or give up.
Fear of loss (of potential income by not recruiting aggressively) is a great motivator.	If MLM participants understood what is happening to them, they would fear accumulating further losses by continuing to invest in the MLM.
You will belong to a great support team. In MLM, you have a whole network of people willing to help you succeed and be your friends.	Some MLM's operate like a cult with an "us vs. them" mentality. Watch how quickly the team ostracizes you when you quit or discover contrary information about the legitimacy of the program.
You will be offering people you care about the very best products available for promoting their health and well-being.	No matter how high the quality of the products, investment in products for which you do not have orders in hand becomes a cleverly disguised means of laundering investments in a product-based pyramid scheme.
Our products are unique and consumable – perfect for repeat business.	MLM products are typically "potions and lotions." The secret formulas are a cover for the fact that they are priced too high to compete in standard markets.
Products are less expensive through MLM because you cut out the middleman.	MLM creates thousands of middlemen, with few real customers outside a bloated network of "distributors" ("agents," "consultants," "demonstrators," etc.) And typically, they are very expensive; i.e., not competitively priced.
Build your business by duplication. Buy five of these "business in a box" packages now, sell them to five people, and ask each to do the same, etc. Be a "product of the products" by signing up for monthly shipment of these items. Soon you will be reaping huge commission checks.	This is how recruiting MLM's earn fortunes for their top recruiters. Commissions from initial and ongoing purchases by new "distributors" (in hopes of profiting) are the lifeblood of their business. The promised rewards never come, except to those who recruit their way to the top of a pyramid of participants. Take away inducements for participant purchases, and these companies would fall like a house of cards.
Our "tools for success" are unbeatable. Sign up for our seminars and conferences, and buy our books and tapes to assure your success in this business.	In at least one major MLM, the "tools business" is a pyramid within a pyramid. Hardly anyone makes money selling products, so a lucrative source of income for those at the top is the sale of "success tools" to supposedly assure the success of their downline – who are in fact only further victimized when they buy these motivational items.
MLM is like insurance, investing, inventing, acting, and writing in that hard work at the outset yields residual income for the rest of your life. This is done be "leveraging" the efforts of your downline. So you can retire early, travel, etc.	MLM is more like gambling than legitimate residual income. It appeals to the "something for nothing" mentality. MLM addiction has been observed in some "true believers." The large residual incomes reported are more the result of time of entry and willingness to deceive prospective recruits than of payoff for hard work. To succeed in MLM, one must leverage one's deceptive recruiting through others who can be persuaded to do the same..
Some very reputable people are involved in MLM.	This credibility argument is used with many scams. Notables can be bought.
Some MLM companies invest in very worthy (and visible) causes.	The mafia supported local charities. And because a bank robber donates some of his take to charity, does that excuse the robbery?
You will be helping your friends and family by recruiting them into your downline.	For potential personal gain, you are exploiting those you care about the most. In other words you are squandering your social capital.

* Recruiting MLM's are multi-level marketing programs that reward aggressive recruitment far more than direct sales of products to legitimate customers. This makes them pyramid schemes that are technically illegal in most jurisdictions.

IMPORTANT NOTE: After studying the compensation plans of over 250 leading MLM's, I have to conclude that virtually all MLM's are recruiting MLM's. When I find an exception, the company's compensation plan soon evolves into a more recruitment-driven plan. It seems that with the inherent flaws in MLM, it would be difficult for an honest retail-focused MLM to compete with blatantly deceptive recruiting MLM's – especially since law enforcement does not require honest disclosure of essential information to new prospects.
CONCLUSION: The appeal in MLM promotions and the typical MLM reports of earnings of participants are dependent on a host of misrepresentations and deceptive sales practices. The degree of deception (and even total amounts in aggregate damages), exceed the deceptions reported in the Enron stock scandal (with similar findings in the financial reports of WorldCom and Global Crossing). In short, the typical MLM is a lie and engages in massive theft by deception.

Pyramid Scheme Alert Data Analysis
Robert L. FitzPatrick, Pres. © 2006

MLM Company: Usana (Data for USA)

Data Source: Usana Webpage: "USAve Income" 2005 (Dec., 2006)
http://www.usana.com/media/File/Policies%20and%20Procedures%20page/US/US%20AveIncome.pdf

Levels	No. in each Level per 10,000 Distributors	% of all Distributors in each Level/ Group	Average Payment per Distributor in each Level	Total Payment per Level/Group per 10,000 Distributors.	% of Total Payments per Level/ Group
DDIR	3	.034%	$319,740.28	$959,220.84	12.02%
EDIR	4	.036%	$187,714.59	$750,858.36	9.41%
RDIR	6	.064%	$103.638.37	$621,830.22	7.80%
GDIR	22	.22%	$50,816.94	$1,117,972.68	14.01%
Total per Group	35	.35%		$3,449,882.10	43% (rounded)
SDIR	112	1.12%	$11,980.09	$1,341,770.08	16.82%
BDIR	39	.39%	$7,755.61	$302,468.79	3.79%
DIR	119	1.19%	$5,230.27	$622,402.13	7.80%
ACHVR	240	2.40%	$2,901.24	$696,297.60	8.73%
BLDR	712	7.12%	$1,271.88	$905,578.56	11.40%
BLVR	1,672	16.72%	$328.02	$548,449.44	6.88%
SHR	1,115	11.15%	$99.05	$110,440.75	1.38%
All Others	5,956	59.56%	0	0	0%
Total Per Group	9,965	99.65%		$4,527,407.35	57% (rounded)
Totals	10,000	100%	$797.73	$7,977,289.45	100%

For each 10,000 Usana distributors:

- ▲ 35 people out of 10,000 received over 40% of the total company payout.
- ▲ The top 1% of all distributors (1.47) received 60% of the entire payout.
- ▲ The top 3% of the total received over 70% of the total company payout.
- ▲ The mean average payment to the bottom 99% was $6.21 a week, *before product purchases, taxes and all other business expenses*
- ▲ At any point in time and at all times, 5,956 Usana recruits out of each 10,000, will not earn even one penny in commissions.

***Note**: Usana reports that the mean average annual earnings of its "full time" and "part time" Associates is $802.62. This figure is based on a total commission payout in 2005 of $81,354,121.15 to a reported 101,361 total Associates. The "per 10,000" Associates analysis shows a mean average $797.73. The slight difference is attributable to rounding of decimal points in the percentages in the sample.*

This is the way I understood the US Distributor Income Document:

While the document first states "Total Associates as of 12/3105 is 111,296" I do not believe this figure is relevant to their calculations.

Two lines below that statement, is gives the following

$81,354,121.15 Total | 101,361 Total Avg Dist | $802.62 Avg Earnings

Therefore, the total number of distributors/associates participating in the $81,354,121.15 total United States Distributor Incentives is 101,361. So the previous number they gave is not relevant to the calculation.

Since they used the 101,361 number of distributors to calculate the $802.62 average, I assumed that 40,986 associates in the table are the "active" associates. Therefore, 101,361 total distributors – 40,986 "active" associates = 60,375 Inactive associates.

The 37% participating and 111,296 figures don't seem to have any relevance.

Thus, I would end up with the following for the per 10,000 model:

Levels	No. in each Level per 10,000 Distributors	% of all Distributors in each Level/ Group	Average Payment per Distributor in each Level	Total Payment per Level/Group per 10,000 Distributors	% of Total Payments per Level/ Group
DDIR+	3	0.03%	$ 319,740.28	$1,072,519.95	13.4%
EDIR	4	0.04%	$ 187,714.59	$ 666,698.76	8.3%
RDIR	6	0.06%	$ 103,638.37	$ 664,604.14	8.3%
GDIR	22	0.22%	$ 50,816.94	$1,092,934.42	13.6%
Total per Group	35	0.35%		$3,496,757.28	43.6%
SDIR	112	1.12%	$ 11,980.09	$1,342,664.28	16.7%
BDIR	39	0.39%	$ 7,755.61	$ 303,763.57	3.8%
DIR	119	1.19%	$ 5,230.27	$ 623,333.38	7.8%
ACHVR	240	2.40%	$ 2,901.24	$ 694,963.82	8.7%
BLDR	712	7.12%	$ 1,271.88	$ 905,966.00	11.3%
BLVR	1672	16.72%	$ 328.02	$ 548,296.96	6.8%
SHR	1115	11.15%	$ 99.05	$ 110,430.58	1.4%
All others	5956	59.56%	0	0	0.0%
Total per Group	9965	99.65%		$4,529,418.59	56.4%
Total	10000	100.00%	$ 802.62	$8,026,175.86	100.0%

- For each 10,000 USANA Distributors:
- 35 people out of 10,000 received over 40% (43.6%) of the total company payout.
- The top 1% of all distributors received about 53% of the entire payout.
    - **the 53% figure is from adding the top 35 distributor's total of $3,496,757.28 to 65 distributors from SDIR average income (65 **

11,980.09 = $778,705.85), which comes to $4,275,463.13. Therefore $4,275,463.13 / $8,026,175.86 = 53.3%

- The top 3% of all distributors received over 70% (71.5%) of the total company payout.
- The mean average payments to the bottom 99% was $7.29 a week, *before product purchases, taxes and all other business expenses*.
    - **($8,026,175.86 - $4,275,463.13) / 9900 associates / 52 weeks = $7.29*
- Out of each 10,000 USANA associates, 5956 will not earn even one penny in commissions.

Notice the Average Associate Payment highlighted in light green. This number was simply the total payments of $8,026,175.86 divided by 10,000 to give me the $802.62. This figure is exactly what USANA's document claims is the average US associate income for 2005. This is why I chose to use 101,361 number for the total.

Also note the bottom of this link:
http://www.usana.com/dotCom/opportunity/payplan/index.jsp

*"***The average income for North American Associates in 2005 was $802.62.** The earnings portrayed in this literature are not necessarily representative of the income, if any, that a USANA Associate can or will earn through his or her participation in the USANA Compensation Plan. These figures should not be considered as guarantees or projections of your actual earnings or profits. Any representation or guarantee of earnings would be misleading. Success with USANA results only from successful sales efforts, which require hard work, diligence, and leadership. Your success will depend on how effectively you exercise these qualities."*

In your table, you gave $1075 for the average distributor payout, and I am not sure how you ended up with that figure. Dividing the total payouts by 10,000 would have given you $728.95.

I hope this clears some things up with the US Associates Income document
http://www.usana.com/media/File/Policies%20and%20Procedures%20page/US/US%20AveIncome.pdf

Next, I will show you a method I used to figure out how many distributors USANA has recruited within the past year. I have not verified this and not even sure if this figure is at all accurate. But I believe the links that I will provide in this example are a treasure chest full of valuable information.

If you attempt to purchase some products after visiting www.usana.com it will take you to the Checkout Form. This checkout form asks the following:

"From whom did you find out about this site?
USANA Associate – Please enter your sponsor's ID Below:
(text field for ID number)
[BUTTON] "I don't know my sponsor's ID"

If you click that button, it takes you to a page to look up a sponsor ID number. The direct link to this is https://shop.usana.com/shop/jsp/onlineServices/shop/SponsorLookup.jsp

(one thing to know about this. Once you click on this link and enter a first and last name, it comes up with an internal error on USANA's site. Simply hit the Back button so you go back to the SponsorLookUp screen, and hit CTRL-R to reload the page. Then click the button again to "LOOKUP". The search will work them.)

Once you put in a member's name it will give you their ID number. The ID numbers seem to go chronologically from the time they are enrolled into the program. This tactic to get the ID number is useful as well as finding out who is an associate of USANA.

The next step is to go to the website:
http://host.netatlantic.com/read/?forum=zdanisusanateam&max=3000
This site is a private forum used by many USANA associates. Well, it should be private☺. If you find the subject headings "USANA: New Team Members, Rank Advancements – Week Ending ##/##/##" You will be able to find out the names of new associates that have enrolled for that particular week. So take a few names of those new associates in USANA for a given week and put those names into the Sponsor Lookup Screen. You will get the ID numbers. You can do this to find out how much the ID number has risen for a given length of time by looking through the forum at the NEW TEAM MEMBER messages. Just make a table of those individuals with their corisponding dates of enrollment.

The only reason I have not yet been able to verify these numbers is that I have not been able to identify any significant gaps in the way the numbers are issued. The ID numbers may not increment 1 digit at a time. Much more research in this tactic is needed. I will let you know of my findings when I learn more about it.

See what you can find. I put in the last names of the management, and it appears the enroll their entire families into the pyramid scheme without having their name involved. This indicates to me that the names that come up are in fact associates because employees of USANA cannot join, but their family members can as long as they don't live in the same household. I would suggest putting the last name of "Hatch" or anyone else who may have a conflict of interest with USANA. I find it all very interesting.

If there is anything else I might be able to do for you or help with, let me know. I will stay on these USANA distributors on the YAHOO forum for Usana's stock. They keep opening their mouths revealing information they probably shouldn't be. That is how I was able to get you the US Distributor 2005 income document.

- Steven R