

Vemma vs. FTC
Guidance for the Direct Selling Industry
Welcome to the Future
By Jeffrey A. Babener
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Facts are Stubborn Things - John Adams

Sir, you are entitled to your own opinion, but you are not entitled to your own facts. - Senator Daniel Moynihan

Q: In FTC vs. Vemma pyramid allegation, who will prevail?

A. With the BurnLounge court having set the legal standard (what is the primary motivation of distributor purchases: product sales to ultimate users or rewards for recruitment?), the result will be fact-driven. ***The party who "owns the facts" will prevail.***

Direct selling companies and their distributors should tune in! There are two magic words in your future:

1. Facts: Do the facts support a program driven by product sales to ultimate users or a program driven by rewards for recruiting?
2. Tracking: If a direct selling company is looking for a safe harbor, it must start tracking the ultimate destination of product sales... preferably to the "ultimate user" as opposed to a "dead end" (in a garage, basement, or "give away").

On August 17, 2015, the Federal Trade Commission (FTC) filed a complaint in the U.S. District Court in Arizona, seeking a permanent injunction against Tempe-based Vemma International Holdings, Inc., a long-time direct selling marketer of health-related products. The FTC was successful in obtaining a temporary restraining order, which shut the company and froze its assets. Further proceedings for a hearing on a preliminary and permanent injunction and other relief were set to the future. Download a copy of [FTC Complaint](#) and [FTC Restraining Order](#).

Such a scenario has been a common approach for the FTC. The most recent actions resulted in permanent injunctions against BurnLounge and Fortune Hi-Tech Marketing. For a summary of the most significant federal actions during the past few decades, please see:

[Herbalife: What Short Sellers Missed on the Way to the Press Conference... Jeffrey Babener \(2013\)](#)

The primary accusation against Vemma is that its program focused on recruitment rather than sale of product to the ultimate user, thus rendering the program a pyramid scheme and a deceptive practice under FTC legislation. In addition, the FTC has charged that Vemma is deceptive in its earnings representations.

FTC vs. Vemma Litigation Bullet Points:

1. (a) This case affirms the BurnLounge standard requiring emphasis on sales to ultimate users, which includes nonparticipant retail customers and personal use in reasonable amounts. Primary motivation for distributor purchases should be destination to ultimate users and not to qualify in the plan for compensation.

See: [BurnLounge Appeal Decision: Guidance on Pyramid v Legitimate MLM and the Role of Personal Use in Pyramid Analysis](#)

Jeffrey Babener (2014)

(b) Contrary to some industry comments, *autoship is not under attack*, but rather the method of its promotion and implementation and amount, which suggests the primary motivation for purchasing is not for sales to retail customers/ultimate users or reasonable amounts for personal use, but rather to induce purchasing to qualify for commissions in the plan.

(c) A similar analysis is applicable to up-front, fast-start packages.

2. The FTC alleges several accusations that Vemma is not complying with the BurnLounge standard, and thus, is a pyramid.

(a) The emphasis not on use or retail, but purchasing to qualify.

(b) Distributors are told to give away product.

(c) Little evidence of retailing, or emphasis on retailing, or teaching, or training to retail.

(d) Up-front emphasis on buying fast-start packs of \$500-\$600, plus sign up for \$150 per month autoship to qualify for commissions, rather than servicing an actual need.

(e) The FTC asserts that the Vemma program emphasis was about distributor purchasing and getting recruits to do the same, rather than sale of product in reasonable amounts for the needs of retail sales and personal use by distributors.

(f) And the FTC no doubt had complaints from parents of college students, and parent lawyers, for targeting vulnerable college age students with promises of fast wealth from working "the system" of buying and recruiting. The FTC complaint focused heavily on accusing Vemma of abuse by targeting young individuals. Clearly, this is a sore point for the FTC, and it has been a concern of some industry observers even prior to the FTC case. The last time this criticism was

made was when Equinox and Trek Alliance were shut by the FTC for the same reasons. In a way, this action is Equinox redux.

3. The FTC does not condemn, nor attack the MLM model (nor personal use), but rather goes out of its way to call out Vemma practices, which it contends makes Vemma an illegitimate pyramid. (See the FTC press release and complaint for FTC's highly pejorative characterization of the facts.)

"...an alleged pyramid scheme, Vemma Nutrition Company, that lures college students and other young adults with the prospect of getting rich without having a traditional 9-to-5 job."

'Rather than focusing on selling products, Vemma uses false promises of high income potential to convince consumers to pay money to join their organization,' said Jessica Rich, Director of the FTC's Bureau of Consumer Protection."

4. Vemma is accused by the FTC of deceptive earnings claims, potentials and hypotheticals as to how distributors could earn substantial income. Vemma published an earnings disclosure, but it was inadequate and deceptive to show the entire picture by limiting disclosure to earnings of active distributors rather than disclosing earnings of all individuals who signed up, of which the vast majority had no income.

5. Autoship: Rumors of its demise are exaggerated. In the future, autoship will continue as a form of orderly ordering... ***the legal key will be "tracking" how that product is consumed or sold to ultimate users. After the Vemma case, all other cases will demand "tracking" evidence to determine what will clearly become cases that are "fact driven."***

6. As the *FTC v. Vemma* action unfolds, the outcome will be "fact driven" on the issue of "primary motivation" for distributor purchasing. The FTC has made it clear that it believes that the facts show that Vemma operated a "recruitment" machine that targets college age students with promises of wealth for merely using the system to "buy and recruit" rather than "sell and use," i.e., per *BurnLounge*, the product was incidental to the opportunity. The FTC's complaint does its best to present a factual picture that the Vemma program implementation and distributor purchasing patterns are dominated by "recruitment and qualify" motivation rather than sales to be used by "ultimate users," whether they be outside retail customers or distributors for personal use.

7. Of course, Vemma will argue a completely different characterization of the facts. Vemma will be obliged to prove the opposite. The "facts" will determine the outcome.

If the FTC allegations on incomplete earnings disclosure are correct, the FTC has a point that merits correction... But certainly not a shut down.

If the FTC is factually supported that distributor purchases are "dead ended" to garages and basements or given away, then there is a real pyramid problem.

However, if Vemma can demonstrate that distributor purchases actually make their way to "ultimate users," whether retail customers or personal use in reasonable amounts, then the wholesale ordering mechanisms of fast start packages and autoship subscriptions are not really a challenge for pyramid analysis.

The entire direct selling industry has been offering fast start packages and autoship ordering for a half century. If product is making its way to a destination to be used by ultimate users, then a program is a legitimate direct selling/MLM program, and not a pyramid.

8. How will the facts play out? Without extensive discovery, it cannot be determined at this stage. (Presumably, in its sealed filing, the FTC provided significant fact scenarios to support its position). However, if extensive discovery is needed at this point, a temporary restraining order and preliminary injunction seem inappropriate on the pyramid issue, particularly for a company, Vemma, whose roots, including its predecessor company from which Vemma was "spun out," New Vision, go back almost 25 years. Nevertheless, this is a reality of this matter. Historically, the FTC has done a good job on the "fact gathering" even though it has been wrong on or misstated the state of pyramid law. (It was roundly rebuked by the U.S. Court of Appeals for the Ninth Circuit for its stated legal position that distributor "personal use" should not be considered in pyramid analysis.)

9. How long will this litigation process take? Had the FTC merely asked for injunctive relief and a preliminary injunction, Vemma would be in a stronger position to see through the litigation. However, the fact that the court ordered an asset freeze and appointed a receiver does not bode well for Vemma. And although a preliminary injunction hearing was set for a very short period of time after the temporary restraining order, case history suggests that most companies, including Vemma, are not prepared to present factual testimony at a preliminary injunction hearing on short notice. The net result is that companies often stipulate to continue the temporary restraining order for months while they gather evidence. And the remainder of the litigation may go on for months or years all the while that a company is shut down and not in control of its assets. Similar scheduling scenarios for companies such as BurnLounge, Fortune High Tech Marketing, Equinox, Trek Alliance, spelled a death knell to the future of those companies, all of whom became "dead man walking."

In the last two decades, MLM companies, which have been subject to a receiver and asset freeze at the commencement of FTC litigation, have not emerged "alive." If Vemma survives the process, it may be viewed by some as an outlier. Unless Vemma can immediately compile a mountain of evidence to refute the FTC fact allegations on "product movement," it is more than an uphill battle.

10. Lessons learned for the future for MLM companies... and for which they should start "yesterday:"

- (a) Track product to its final destination. Bottom line, is that companies should be able to document that product makes its way on to and is used by ultimate users.
- (b) Marketing emphasis should always be on product first, and opportunity second.
- (c) Employ procedures to avoid inventory loading.
- (d) Employ procedures to mandate and guarantee retailing.
- (e) Do not make claims of wealth, fast wealth, easy money, or sure fire systems, nor effectively invite the FTC to inquire into a program based on earnings hype and systems based on distributor "purchasing" rather than distributor "selling" and "using."
- (f) Do not boldly target demographic markets that the FTC might view as vulnerable to hype and abuse. Such groups may be young people or poor populations.
- (g) Do not play fast and loose with earnings disclosures. To be transparent, always indicate the percentage of new sign ups who have no earnings, i.e., what percentage of new distributors actually make money.

How Did We Get Here and Where are We Going?

Vemma is the first FTC case post the landmark decision by the U.S. Court of Appeals for the Ninth Circuit regarding *BurnLounge*. In the *Burnlounge* case, the court roundly rebuked the FTC's longstanding position on personal use, in favor of the industry, but it also sent a blunt message to the direct selling industry, as noted in this author's article on the *BurnLounge* Appeal Decision, effectively summarized as follows:

Accept your victory on recognition of personal use as a legitimate destination for product and representative of "sales to ultimate users." However, "get your act together," and adopt "best practices" methods and rules that promote product use over mere recruiting. The presence of personal use is not "a free ticket out of trouble." It will be viewed as part of a legitimate MLM, but it is only one factor for the case by case fact based analysis of the "economic reality" of an entire program in which the acid test will be that the predominant and primary motivation of distributor purchases is for personal use or resale and not merely to qualify for rewards in the program by personal purchases and recruitment of others to do the same.

In that same article, this author described how things would work in the future and this is how the industry can expect things to work in the Vemma litigation:

BurnLounge Establishes a "Fact Driven" Balancing Standard: Recruitment v. Sales.

The BurnLounge Ninth Circuit Appeals Court established a going forward pyramid test that is fact driven, and which balances whether distributor payments and commissions are driven by recruitment, on the one hand, or sales to ultimate users on the other hand, i.e.

Are distributor product/service purchases incidental to the business opportunity?

Or rephrased: Is the focus in promoting the program, rather than selling products to ultimate users?

If one reads the trial court decision, listens to the oral argument before the Ninth Circuit or reads the Ninth Circuit opinion, the words "primarily" or "predominant" are frequently used to discuss the motivation of distributor purchasing, in order to determine if they should be included in the category of ultimate users.

The central inquiry will always be:

What do they pay, and why do they pay it?

And the ultimate standard of inquiry going forward in pyramid cases will be:

What is the predominant or primary motive of distributors in making purchases?

Is the primary motivation:

(a) For purposes of resale or personal use?

(b) Or, as a gateway purchase to qualify for rewards in the MLM opportunity and compensation plan?

What is clear after the BurnLounge case is that "personal use" purchases become somewhat "neutral," i.e., such purchases, which are not incidental to the opportunity, are not to be excluded in the analysis of sales to ultimate users. And, on the other hand, the mere presence of some personal use purchases or even some sales to retail customers, will not, in itself, be determinative of legitimacy. With that in mind, many other factors will need examination.

How will this work in future cases? It is fairly simple. Get out a piece of paper and make two columns for the "good facts" and the "bad facts." In a simplistic sense, the winner of pyramid v. legitimate or recruitment v. sales, will be the dominant list. Well, actually, it is not all that simple, because a court will likely choose to ascribe more weight to designated items on each list.

Clearly, the "bad" list will include, but is not limited to, such factors as:

Front-end loading or inventory loading, Large upfront fees, Mandated purchases to qualify for commissions or rank advancement, Bogus product or service, Inflated prices, No buyback policy, No mandate for retail sales by distributors, No restrictions on "over" ordering, Unsubstantiated earnings representations, No evidence of product consumption by ultimate users, either by outside customers or distributors, Payment of commissions for training or sales tools as opposed to being based on product sales to ultimate users, Evidence of unsold product in the marketplace characterized by "garage loading," Actual headhunting or recruitment fees, Mandatory purchases of peripheral or accessory products or services, And the list will continue with any abusive practice that does not focus rewards primarily driven by sales to ultimate users,

And the "good list" ... again, some, but certainly not all the important factors:

*High quality goods and services,
Demonstration of a "real world" marketplace for the product or service,
Goods and services that are fairly priced,
No upfront mandated investment or payment other than a modestly priced sales kit,
No inventory requirements,
Demonstration that product/service is used by consumers, whether they be retail customers or distributors,
Sales commissions and rank advancement strictly based on sales of product or service to ultimate users,
Emphasis on sales and use to ultimate users, including retail customers and personal use by distributors,
Amway Safeguard: Buyback policy for terminating distributors,
Amway Safeguard: Anti-inventory loading rule, such as 70% rule, prohibiting purchases unless distributors have sold or used a specified amount of previously purchased product,
Amway Safeguard: Mandate of some specified level of retail sales to outside customers as a condition for qualifying for commissions and rank advancement,
Avoidance of Earnings Representations/Potentials/Hypotheticals/Testimonials unless a transparent average earnings disclosure is provided to potential distributors,
Above all, emphasis on rewards on sales of product/service to ultimate users (retail customers or distributor personal use in reasonable amounts) rather than rewards arising from recruitment of other distributors,
Requirement that any personal use purchases by distributors be in reasonable amounts,*

***Requirement that any product purchases for resale be in commercially reasonable amounts and subject to buy back policy for terminating distributors,
Quality training to distributors that emphasizes both product sales as well as recruit development.***

In the end, any court will be required to conduct this balancing test. And it will seek assistance not only from the parties and the evidence, but as noted, in the *BurnLounge* Ninth Circuit decision, from qualified direct selling experts. Those experts will assist in fact finding, but they not will be the fact finder nor the author of the legal standard... this role is for the trial court.

In FTC vs. *Vemma*, who owns the facts?

BurnLounge set the standard for years to come. The decision in case after case, including *FTC vs. Vemma*, will be "fact driven"... ***is distributor behavior driven by product sales to the ultimate user or is it driven by recruitment?***

In the end, he, who owns the facts, will prevail.

Stay Tuned.

Vemma: FTC Press Release

<https://www.ftc.gov/news-events/press-releases/2015/08/ftc-acts-halt-vemmas-alleged-pyramid-scheme>

FTC Acts to Halt Vemma as Alleged Pyramid Scheme
Promised Unlimited Income Potential, But Most Participants Lose Money
FOR RELEASE August 26, 2015

At the Federal Trade Commission's request, a federal court has temporarily halted an alleged pyramid scheme, Vemma Nutrition Company, that lures college students and other young adults with the prospect of getting rich without having a traditional 9-to-5 job. The FTC seeks to stop the operation, which earned more than \$200 million annually in 2013 and 2014 and has affected consumers throughout the United States and in more than 50 other countries, from continuing as an unlawful pyramid.

"Rather than focusing on selling products, Vemma uses false promises of high income potential to convince consumers to pay money to join their organization," said Jessica Rich, Director of the FTC's Bureau of Consumer Protection. "We are also alleging that Vemma is an illegal pyramid scheme."

Vemma is a multilevel marketing company that claims to use its members, called “affiliates,” to promote its health and wellness drinks. According to the FTC’s complaint, the defendants claim affiliates can earn substantial income by enrolling others either as affiliates or as customers, but Vemma focuses on recruitment rather than retail sales of its products to generate this income. The vast majority of participants make no money, and most of them lose money.

According to the FTC’s complaint, the defendants’ websites, social media, and marketing materials show seemingly prosperous young people with luxury cars, jets, and yachts, and falsely claim that Vemma affiliates can earn substantial incomes – as much as \$50,000 per week. The defendants allegedly claim that affiliates’ earning potential is limited only by their own efforts and that Vemma provides young adults an opportunity to bypass college and student loan debt. Vemma urges consumers to make an initial investment of \$500-\$600 for an “Affiliate Pack” of products and business tools, buy \$150 in Vemma products each month to remain eligible for bonuses, and enroll others to do the same.

Consumer losses are inevitable because Vemma is an illegal pyramid scheme that rewards affiliates for recruiting participants rather than for selling products, the FTC alleges. The defendants provide affiliates little guidance for selling products, but instead teach them to give away products as samples when recruiting new participants. Vemma offers no meaningful discounts or incentives to encourage retail sales, according to the complaint.

In addition to allegedly running an illegal pyramid scheme, the defendants are charged with making false earnings claims, failing to disclose that Vemma’s structure ensures that most people who join will not earn substantial income, and furnishing affiliates with false and misleading materials to recruit others.

The defendants are Vemma Nutrition Company, Vemma International Holdings Inc., Tom Alkazin, and Benson K. Boreyko, who is under a 1999 court order after settling with the FTC for his involvement with New Vision International Inc., a multilevel marketing company that sold nutritional supplements. The complaint names Bethany Alkazin as a relief defendant who profited from the scheme. On August 21, 2015, the court halted the deceptive practices, froze the defendants’ assets, and appointed a temporary receiver over the business pending a trial.

The Commission vote authorizing the staff to file the complaint for permanent injunction was 5-0. The order was entered by the U.S. District Court for the District of Arizona on August 21, 2015.

The FTC appreciates the assistance of the Attorney General Offices of Arizona, South Carolina, and Michigan, the Tempe Police Department, and the nonprofit organization Truth in Advertising in bringing this case.

To learn more about multilevel marketing, read [Multilevel Marketing and Business Opportunity Scams](#).

NOTE: The Commission files a complaint when it has “reason to believe” that the law has been or is being violated and it appears to the Commission that a proceeding is in the public interest. The case will be decided by the court.

For more information on this subject and other important issues in the area of MLM, Direct Selling and Network Marketing, please visit www.mlmlegal.com.

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