

## Vemma: Preparing for the FTC Ambush

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*Oh sinnerman, where you gonna run to?  
Well I run to the rock, please hide me  
But the rock cried out, I can't hide you*

-Nina Simone

### **Times Have Changed... We Live in a Fish Bowl...**

On August 17, 2015, the life of Vemma (and its owners) was completely upended by an FTC lawsuit which challenged the company's practices as a pyramid scheme. A Temporary Restraining Order resulted in the close of the business, an asset freeze and a receiver in charge. Everything came to a screeching halt. As it turns out, in the court filings, ***the FTC sought to "hang" Vemma with its own words...*** a product of a world of instant communications in which everything, we do or say, is on public display.

### **Was this action avoidable? Probably.**

By the tenor of the FTC filings and press release, the ***FTC seems to have felt provoked***, trumpeting to the public and the court that this program was promoted less as a ***direct sales program*** and more as a ***recruiting system*** program:

1. Where recruits were instructed to buy and recruit...running afoul of ***Koscot/BurnLounge***;
2. Where recruits were promised wealth when few, in fact, would make any money;
3. In which a vulnerable class, with precious little money to spend, college students, were targeted.

In the end, the actual facts will determine the winner. **However, no matter the outcome of the Vemma litigation, the Vemma filing has changed everything for direct sellers.** Direct selling companies should consider it their wake up call to prepare for their turn.

For this discussion, two suggestions for direct sellers: **What You Say... What You Do (or Don't Do)...**

**That May Haunt You...** are two key factors to protect against the *Vemma* scenario and the FTC ambush (ambush is used here, not in its "this is a hold up" context, but rather that such litigation comes as a complete "surprise," and in a time sequence where the FTC has had a long time to prepare declarations, affidavits and briefs, but the direct selling company, on almost no notice, is caught unprepared to adequately respond. To a certain extent, it is not a fair fight... the direct selling company was not informed nor prepared that its opponent would bring a gun to a fist fight... maybe, it is time to even the odds...).

*First the legal standard and then two important tasks to consider...*

### **The Legal Standard... Legitimate MLM vs. Pyramid**

The current legal standard for legitimate MLM vs. pyramid was set forth in the *BurnLounge* appeal case, requiring a fact "driven" analysis of whether a program is **product/sales driven or recruitment/purchase driven**.

The *BurnLounge* standard requires emphasis on sales to ultimate users, which includes nonparticipant retail customers and distributor personal use in reasonable amounts. Primary motivation for distributor purchases should be its destination to ultimate users and not to qualify in the plan for compensation.

For an in-depth analysis of the legal environment on the issue of pyramid vs. legitimate direct selling, please read these other articles by this author:

***BurnLounge Appeal Decision: Guidance on Pyramid vs. Legitimate MLM and the Role of Personal Use in Pyramid Analysis***

<http://www.mlmlegal.com/Burnlounge%20Appeal.html>

Jeffrey Babener (2014)

***Vemma vs. FTC: Guidance for the Direct Selling Industry***

<http://www.mlmlegal.com/vemma%20v%20ftc.html>

Jeffrey Babener (2015)

## **Your Fate: Two Critical Factors: What You Say and What You Do (or Don't Do)**

### **Factor One: What You Say Will Come Back to Haunt You**

Times have changed. We live in a transparent and instant world of Twitter, YouTube, Facebook, Google, Instagram, Snapchat. What is said in company webinars, conference calls, back office messages, tweets, Facebook, conferences and conventions, is recorded on smart phones, captured on computers and uploaded immediately... i.e., it's all public and the world is invited to listen.

To paraphrase the *Field of Dreams*, if you say it, they will come... and that includes distributors, recruits, customers... **and yes, the FTC.**

And the FTC is looking for "**low lying fruit**" to submit in its lawsuit and application for an injunction. If you give it to them, they will use it... and it may be too late to play "catch up" and "explain" to the court.

In the *Vemma* case, the FTC quoted from the company's own communication to argue that the program was "recruitment/purchase driven" as opposed to "product/sales driven." It is not possible, without extensive discovery, to know if the FTC was "cherry picking" the evidence, but, it must be remembered that the FTC filing/documentation creates a first and lasting impression for the court.

Said the FTC in its press release:

"...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,"

From the FTC perspective, Vemma invited regulatory action. It drew on Vemma public presentations to say that the emphasis was not on use or retail, but on purchasing to qualify:

- (1) Distributors were told to give away product.
- (2) There was little evidence of retailing or emphasis on retailing or teaching or training to retail.
- (3) There was 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 service an actual need.
- (4) The FTC asserted the evidence showed that Vemma targeted vulnerable college age students with promises of fast wealth from working "the system" of buying and recruiting.
- (5) The FTC cited to Vemma's earnings disclosure, claiming 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.

Lesson Learned in anticipation of the FTC encounter:

***Every breath you take, every move you make... I'll be watching you...***

***-Sting***

Every direct selling company should take this opportunity to **carefully vet company and distributor public discussions and presentations** to assure that the focus and emphasis is on teaching a program whose purpose is to create a customer base and not a "system" of finding recruits who purchase, who find other recruits who purchase... i.e., rewards for sales to ultimate users rather than recruitment of distributors to buy and recruit.

**Factor Two: What You Do (or Don't Do) will Come Back to Haunt You**

Of course, nothing is new about all the long known practices that should be followed:

1. Avoidance of earnings representations without an adequate earnings disclosure that does not play fast and loose with statistics... particularly, showing percentages of all signups who make or don't make money in the program.
2. Policies that adopt Amway standards, including stated and enforced retail customer mandates, enforced 70% anti-inventory loading rule, reasonable buy back for terminating distributors

But, post-*Vemma*, a new imperative task is mandated for direct selling companies to avoid and be prepared to avoid the *Vemma* scenario. For the most part, few, if any, direct selling companies have committed their resources to ***tracking the destination of product and to objectively assuring that product is bought in amounts that are reasonably needed*** rather than amounts to qualify in the plan for commissions. In an FTC ambush, they are caught completely "off guard."

**1. Tracking Product Movement.**

Track product to its final destination. The bottom line is that companies should be able to document that product makes its way on to "ultimate users" and is used. Although this task is a "no brainer" for party plan companies, consumables MLMs have resisted development of systems to track product to assure that it is either purchased in reasonable amounts and consumed for personal use by distributors, or that it is purchased in reasonable amounts and is sold and used by nonparticipant retail customers. **The time for "resistance" has passed.** If Fed Ex, Amazon, UPS and every major online retailer can develop tracking systems, then direct sellers can invest in tracking software and systems to assure that product has met its correct

destination and not been "dead-ended" in a closet, basement or merely "given away" as part of a plan to meet volume requirements.

The tracking initiative may be expensive and challenging, but, had Vemma undertaken such an initiative, it would be in a position to immediately rebut the FTC that fast-start packages and autoship subscriptions merely exist to inventory load to qualify for commissions.

***When must the tracking initiative be done?... Yesterday is not too soon.***

## **2. Create Surveys and Systems to Determine Reasonable Ordering Needs.**

Companies that are ambushed by FTC injunction actions have not only missed out on their ability to rebut the accusation that product is not making its way to the ultimate user, but that fast-start kits and autoship orders are merely inventory loading tactics... and that such purchase options are about qualification for commissions rather than servicing the honest needs of distributors. Companies need to take a close look at the needs of novice and experienced distributors to determine what are reasonable needs requirements. This task may entail extensive user studies, focus groups and the creation of objective criteria to determine that the ordering patterns of distributors, new or experienced, is matching to "reasonable needs" and not merely to qualifying in the plan.

Again, few, if any companies, may have undertaken this task. However, when the FTC files and challenges whether or not the pattern of "ordering" represents a "needs based" system or a "qualification driven based" system, a company should be in a position to rebut the inventory loading accusation.

Starter packs and autoship are merely options for ordering. If a company has data to support "reasonable needs," the accusation that purchasing is made merely to qualify in the program becomes far weaker. And this is the test under *BurnLounge*, i.e., the primary motivation for ordering.

The time for taking on this task is "yesterday."

### **Your Character is Your Fate...**

#### **- Heraclitus**

In a world with instantaneous communication and where you operate in a glass bubble, what you say and what you do may be pivotal to your survival. In the post-*Vemma* era, direct selling companies are now apprised of new tasks, heretofore unmet, that may be essential to their future.

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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](http://www.mlmlegal.com).

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