

# Stock Plunge on Internal Consumption: Whose Fault?

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*The fault, dear Brutus, is not in the stars...but in ourselves....*Shakespeare, Julius Caesar

It is shame that, in one day, in May 2012, leading direct selling companies would see their stock and capitalization value shrink by billions of dollars. And, all over a rather simple and reasonable investor question like, “what percentage of product is consumed personally by MLM distributors as opposed to resold to non-participants?”

Unfortunately, with some sound groundwork over the last 15 years, it is a question that need not have been asked...or at least, one that would not have provoked a tsunami of financial world discussion and billion dollar downturns in the stock market.

Although speculative “short sellers” played an undeniable role, this situation is radically different than the challenge posed by criminally convicted Barry Minkow, who negatively impacted stocks by attacking companies with false and misleading information.

In fact, the question about the destination of MLM products is a perfectly legitimate question in the absence of an uneducated marketplace; the stock market’s reaction to such a question is perhaps more reflective of the vacuum of leadership on the personal use/internal consumption issue that should have been undertaken by the industry 15 years ago, when the issue surfaced with an errant comment, criticizing personal use, by the U.S. Court of Appeals for the Ninth Circuit in the 1996 Omnitrition case.

At that time, it was suggested that a timid industry response would see escalation of the personal use issue to federal and state court decisions, class actions, adverse U.S. and foreign press, adoption of adverse rules by foreign regulators, etc. In a series of articles over the next 15 years, the direct selling industry was urged to “get bold” and seek remedial federal legislation or administrative rule making to legitimize personal use/internal consumption.

See 15 years (1996-2012) of advocacy on this precise topic in the law library of [www.mlmlegal.com](http://www.mlmlegal.com)

The Personal Use/ internal Consumption Issue

<http://www.mlmlegal.com/powerindex.html>

· Proposed New Federal MLM Statute: Personal Use OK  
<http://www.mlmlegal.com/proposed1220.html>

- Industry Applauds New Montana Legislation <http://www.mlmllegal.com/montana.html>
- FTC v. Direct Sellers – The Snail That Got Mugged <http://www.mlmllegal.com/snail.html>
- FTC v. Equinox <http://www.mlmllegal.com/equinox.html>
- FTC v. Futurenet <http://www.mlmllegal.com/futurenet.html>
- FTC v. JewelWay – New Concerns for the Industry <http://www.mlmllegal.com/jewelway.html>
- The AuQuest Case – A Wake-Up Call to the Industry <http://www.mlmllegal.com/auquest.html>
- The Omnitrition Appeal – An Industry Issue <http://www.mlmllegal.com/omni.html>
- Personal Use – A Call to Action <http://www.mlmllegal.com/personal.html>
- FTC vs. BurnLounge: Lessons Learned for MLM/Direct Selling [www.mlmllegal.com/burnlounge.html](http://www.mlmllegal.com/burnlounge.html)

And over the 15 years, the industry missed multiple opportunities to seize the opportunity to address the issue by promoting federal legislation or federal administrative rulemaking that might avert a repeating saga. Rather it “kicked the can down the road.” In so doing, it may have missed the window of opportunity of a favorable political climate to achieve this result.

Instead, the issue was addressed “at the edges,” albeit, with some very helpful changes to several state pyramid and multilevel statutes. But, the big picture and “game changer” at the federal level was missed completely.

1. The industry started and then abandoned proposed remedial federal legislation in 2003.

<http://www.mlmllegal.com/HR1220.html>

2. A favorable FTC Staff advisory opinion on “personal use” was received in 2004, but, inexplicably not publicized nor utilized for the public discourse. See the actual document produced pursuant to FOIA (Freedom of Information Act) request at:

<http://www.mlmllegal.com/ftcstaffadvisory.html>

3. Notwithstanding the absence of “personal use” criticism by the FTC vs. BurnLounge trial court, the industry missed its timely opportunity to object to inconsistent and errant language in the 2012 Final Order, which actually provided that “*sale of products or services to ultimate users*” *does not include sales to other participants or recruits or to the participants’ own accounts.*” As with the fallout of Omnitrition, these few “errant” words could be devastating to the industry in the future, even if the industry’s position is that the language should be limited to BurnLounge.

See: · FTC vs. BurnLounge: Lessons Learned for MLM/Direct Selling [www.mlmllegal.com/burnlounge.html](http://www.mlmllegal.com/burnlounge.html)

In all these situations, the industry missed a big opportunity to retake ownership of the conversation on personal use and internal consumption.

### **Who will frame the conversation....**

In the end, as a result, it was not the industry that framed the discussion on personal use and internal consumption, but rather external events. The industry was “reactive” rather than “pro-active” time after time. And when the “crisis of the day” abated, it became complacent...and seemingly unaware of the ticking time bombs that would surely come its way. The most recent collapse in the markets, occasioned by a simple question on personal use, predictably resulted in hyper reaction including new website defenses on personal use and internal consumption. Again, the industry was not in control of the conversation, but rather reacting to “events.”

And blaming the stock market for “picking” on the direct selling industry is not necessarily a fair criticism in light of the fact that the industry has abdicated its opportunities to educate the public, the markets, legislative and administrative organizations on the direct selling model and that, as recognized by the FTC’s own Staff Advisory Letter, personal use and internal consumption is quite legitimate if product purchases are purchased in reasonable amounts for actual use rather than for the mere purpose of qualifying in a business opportunity, ie. as the BurnLounge court noted the “evil” as “products purchased merely as incidental to the business opportunity.” In fact, legitimate purchases for personal use are the hallmark of many of the world’s largest direct selling companies. The problem is that the industry has not done a good job over the last 15 years of explaining to the world that personal use/internal consumption, if done right, is quite legitimate. And thus the recent stock plummet scenario in response to a simple question on personal use.

And this cycle will continue until the industry helps frame the issue to defend “personal use and internal consumption” in federal legislation and federal administrative rule making. Has the window of opportunity passed for reclaiming the conversation. It is hard to say. However, it is clear, and has been, that since the 1996 Omnitrition case, if there was a number one priority for companies and distributors to urge upon their “trade association,” the issue of personal use and internal consumption legitimacy was “the one.”

### **Nature abhors a vacuum....**

And unfortunately, as they say “nature abhors a vacuum”. Someone is going to “fill it”....the question is “who?”

It is respectfully suggested that the industry fill the vacuum and reclaim the conversation.

Ironically, the industry actually had a running head start, on capturing the dialogue on personal use and internal consumption, from one of the companies heavily affected in the May, 2012 downturn. In fact, it was a head start a full 10 years before Omnitrition even hit the courts. The issue of recognizing personal use is not new. As far back as 1986, the State of California entered into a Stipulated Order with Herbalife that provides good direction on this subject. The Stipulated Order provided:

*5(c). The term “retail sale” as used in this Section 5 means a sale at defendants’ product(s) in*

any of the following situations: (1) to persons who are not part of defendant's marketing program or distribution system; or, (2) to persons who are not buying to become part of defendant's marketing program or distribution system; or, (3) to persons who, although desirous of becoming or who are a part of defendant's marketing plan or distribution system are buying for their own personal or family use.

Contents of the Order: <http://www.mlmllegal.com/herbalifejudgment.html>

It is submitted that the following model pyramid language, relating to personal use, might serve as a synthesis of trending state legislation, FTC staff advisory and reasoning set forth in various federal and state court opinions:

***Prohibited Marketing Scheme means an illegal pyramid sales scheme, ... Ponzi scheme, chain marketing scheme, or other marketing plan or program in which participants pay money or valuable consideration in return for which they obtain the right to receive rewards for recruiting other participants into the program, and those rewards are unrelated to the sale of products or services to ultimate users. Prohibited payment or consideration does not include payment for non-commissionable "not for profit" or "at cost" sales and marketing materials support. For purposes of this definition, "sale of products or services to ultimate users" include sales to participants, in reasonable amounts, for actual personal or family use.***

**The DSA weighs in.....**

To its credit, the DSA (Direct Selling Association) immediately responded to the stock downturn with the following press release on internal consumption. And, for the first time, the organization set up a complete section dedicated to "internal consumption" at its web site at [www.dsa.org](http://www.dsa.org)

Was this reactive as opposed to proactive? Absolutely. Was this a good start at regaining the conversation? Absolutely. Has the political opportunity passed for meaningfully addressing this long term issue? Only time will tell.

**Press Release: May 9, 2012**

The Direct Selling Association Responds to Questions about the Purchase of Products by Direct Salespeople

As the association representing more than 200 leading firms that manufacture and distribute goods and services sold directly to consumers, the Direct Selling Association (DSA) would like to set the record straight in response to questions raised about the direct selling business.

Unfortunately, even though these questions have been asked and answered many times by the direct selling industry over the years, stock prices of Herbalife and other publicly traded direct selling companies fell as a result of inquiries by hedge fund manager David Einhorn.

First and foremost, the direct selling business model is solid and strong. After falling slightly in the wake of the Great Recession, total industry sales grew nearly one percent in 2010 and are expected to show even stronger gains when 2011 numbers are announced in early June. Most publicly traded companies reported strong earnings and income in 2011.

Nearly 16 million Americans engaged in direct selling in 2011, some as full-time entrepreneurs

seeking to build a business and some as part-time representatives hoping to earn a little extra money. Others sign up as representatives simply to purchase products or services for their own use at a discount and never sell to anyone else. Regardless of their income expectations, almost all direct sellers use the products themselves. This is what is known as “internal consumption.”

As the Federal Trade Commission (FTC) stated in a January 2004 Staff Advisory Opinion, internal consumption is not considered to indicate impropriety. Instead, “the critical question for the FTC is whether the revenues that primarily support the commissions paid to all participants are generated from purchases of goods and services that are not simply incidental to the purchase of the right to participate in a money-making venture.”

In short, what the FTC watches for — and what the DSA Code of Ethics is designed to protect against — are compensation systems that are funded primarily or exclusively by payments made for the right to recruit other participants. Compensation must primarily be based on the sale of products and services to the ultimate consumer — whether or not that consumer is also a seller of the products.

Unfortunately, direct sellers have been targeted in the past by short sellers who have deliberately injected inaccurate information or rumors into the marketplace with the goal of driving down stock prices for financial gain. In the end, it is the millions of hardworking American direct sellers who suffer the results of these attacks while the perpetrators walk away with millions in profit.

DSA exists to protect and promote the direct selling industry by educating policymakers, the business community and the general public about the nature of the industry and how it works; and ensuring DSA member companies behave ethically in all aspects of their businesses through enforcement of the DSA Code of Ethics.

The direct selling business model has been thriving for more than 100 years. We encourage anyone who wants to learn more about this quintessential American industry to visit our websites at [www.dsa.org](http://www.dsa.org) or [www.directselling411.com](http://www.directselling411.com), or contact us by phone at (202) 452-8866.

SOURCE: Direct Selling Association

### **Back to the Future....**

As the famed economist Milton Friedman noted, “the future is longer than the present.” And as less distinguished, but no less prescient, Marty McFly noted, it is time to get “back to the future.” Proactive rather than reactive is a good strategy. “Kicking the can down the road” is a strategy, but not a winning solution.

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And, visit [www.mlmlegal.com](http://www.mlmlegal.com) for a plethora of information on the MLM, network marketing, direct selling industry.

The next *Starting and Running the Successful MLM Company Conference* is quickly approaching! On February 21<sup>st</sup> and 22<sup>nd</sup>, 2013 we are hosting the [MLM Conference](#) for the 25<sup>th</sup> year! This is now our 63rd annual conference (held almost consistently three times per year over the last 24 years). All executives/owners of MLM, direct selling, network marketing, and party plan companies are welcome to attend. This is the [original MLM Startup Conference](#), hosted and perfected by direct selling industry expert, [MLM Attorney Jeff Babener](#). Call 503-226-6600 or 800-231-2162 to register. **(Can't make this event? Keep an eye out for our May and October conferences as well. We hold the conference every year.)**

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**Jeffrey Babener**  
On Assignment

On any given day you can catch [Jeffrey Babener](#) lecturing on Network Marketing at the University of Texas or the University of Illinois, addressing thousands of distributors in Los Angeles, Bangkok, Tokyo and Russia, or writing a new book on Network Marketing, an article for Entrepreneur Magazine or a chapter for a University textbook. Over two decades he has served as marketing and legal advisor to some of the world's largest direct selling companies, the likes of Avon, Nikken, Melaleuca, Discovery Toys, NuSkin, and he has provided counsel to the most successful telecom network marketing companies...Excel, ACN, World Connect, ITI, AOL Select and Network 2000. An active spokesperson for the industry, he has assisted in new legislation and served on the Lawyer's Council, Government Relations Committee and Internet Task Force of the Direct Selling Association (DSA) as well as serving as General Counsel for the Multilevel Marketing International Association. He is an MLM attorney supplier member of the DSA and has served as legal counsel and MLM consultant on MLM law issues for many DSA companies.

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