



School of Business
William W. Keep, Dean

Ms. Mary Jo White
Chair, U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

June 16, 2014

Dear Chair White:

I write to you as a concerned citizen, an educator, and a former expert witness for the Securities and Exchange Commission (SEC). On June 2, 2014 the United States Court of Appeals for the Ninth Circuit supported charges brought by the Federal Trade Commission (FTC) in finding BurnLounge to be a pyramid scheme. As with many past pyramid schemes, the company claimed to operate a legal multilevel marketing (MLM) business.

Since at least the early 1970s, when The New York Times reported them to be “the number one consumer fraud in the metropolitan area,” product-based pyramid schemes have duped unsuspecting consumers and investors. The FTC and SEC each have numerous experiences, with your agency bringing pyramid scheme action against *TelexFree, Inc.*, *WCM* and *WCM 777*, *Fleet Mutual Wealth* and *MWF Financial*, and *CKB* and *CKB 168*, in just the last twelve months.

In 1995-96, I served as an expert witness for the Department of Justice in *Gold Unlimited*, a pyramid scheme involving 96,000 investors and referenced in BurnLounge (2014). In 1998, I assisted the SEC in the International Heritage Inc. case with 155,000 investors, at the time the largest pyramid scheme ever prosecuted by the SEC. In 2002, I published with Dr. Peter Vander Nat, senior economist at the FTC and lead pyramid scheme analyst, the first academic article to present a model for differentiating a pyramid scheme from legal multilevel marketing.

Citing *Koscot*, *Omnitrition*, *Gold Unlimited* and other decisions, the BurnLounge decision reinforced the key issues of rewards primarily reliant on recruitment and the need for effective, enforced company policies. The importance of the decision comes not only from affirming case law and a proven analytical approach, but also in its timing. The direct selling industry in the United States, now comprised overwhelmingly of MLM companies (i.e., more than 90%), tripled the number of sales people involved—from 5.1M to 15.6M between 1991 and 2011. Despite now engaging approximately 8.5 percent of the U.S. adult population ages 20-64, the industry’s share of total U.S. Retail Sales remains at less than one percent, about the same as 1991.

Perhaps not coincidentally, serious questions were raised concerning Herbalife, a large public MLM company with a high rate of distributor turnover, documented deceptive marketing by some distributors, and a 10-K statement (every year since 2004) that attempts to distance the company from distributor behaviors by stating “As a result, there can be no assurance that our distributors will participate in our marketing strategies or plans...**or comply with our distributor policies and procedures**” (emphasis added).

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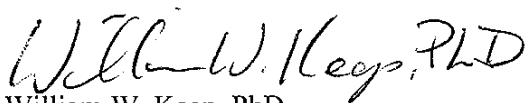
MLM companies that disavow responsibility for the implementation of effective anti-pyramid scheme policies would seem exactly what the BurnLounge decision warns against. Specifically, the court wrote: "In contrast [to *Kosco*], in Amway the FTC found that a MLM business was not an illegal pyramid scheme. Amway, 93 F.T.C. at 716–17. Though Amway created incentives for recruitment by requiring participants to purchase inventory from their recruiters, **it had rules it effectively enforced** that discouraged recruiters from "pushing unrealistically large amounts of inventory onto" recruits" (emphasis added). When a major MLM company disavows responsibility for distributor actions could we be looking at systemic, industry-wide failure? I believe the answer is "Yes." The BurnLounge decision specifically relates just such a failure to the possibility of an MLM operating a pyramid scheme.

MLM companies present policies (e.g., 10-customer rule, 70% rule, etc.) that mimic those of Amway in 1979 but without adopting the actual language. As a result, the policies can be ineffective, unenforced or unenforceable. Regulators know all too well the results (intended or otherwise) that can come from poorly chosen words in company and government policies. BurnLounge provides timely impetus for change. I urge you to take serious the ongoing threat of unregulated behaviors by hundreds of thousands of MLM distributors affecting the lives of millions of Americans annually. As a prophylactic measure, I specifically recommend that every five years all MLMs be required to submit for regulatory review their anti-pyramid scheme policies and enforcement strategies (changes made within the five year interval would be submitted for review prior to enactment).

Though the vast majority of MLM companies operating in the United States (estimated to be 1,000 or more) are private, some of the biggest are public (e.g., Herbalife, Nu Skin, and USANA). I realize the SEC and FTC have overlapping concerns. When it comes to pyramid schemes, both are concerned with deceptive marketing and fraud, while the SEC may also consider the issue of a "passive investment" (e.g., SEC v. Glenn W. Turner Enterprises) and even criminal behavior. Having interacted with staff at each agency, I know the hard work and commitment of these regulators. I also see long-term value in well written, regulator approved, and actively enforced anti-pyramid scheme policies – public policy goals certainly reinforced by the BurnLounge decision.

Please know that I have accepted no compensation related to these issues since well before December 2012. I have no affiliation with any hedge fund, investor group, or individual with a financial interest in these matters, and I do not knowingly hold a financial position in any MLM company. In the interest of the industry and investors, I believe the concerned public looks to the SEC, as well as to other government regulators, in taking a pro-active stance for achieving a well-regulated direct selling industry free of pyramid schemes.

With regard,



William W. Keep, PhD
Dean