

Interview with MLM Attorney On The Difference Between a Pyramid Scheme and Legitimate MLM

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Interviewer: Jeff, let me ask you this question, what's the difference between a legitimate direct sales opportunity and a pyramid scheme?

Jeff Babener: If you're selling a product or service and it stands on its own in the marketplace and people would buy it because they want it, then you have a real, legitimate direct selling company. If on the other hand, the quality of the product is low, the price is high, then it merely becomes an excuse for people to buy the product because they want to qualify for the program in order to recruit others, make money, and earn commissions.

If you indulge me for a second, I'll give you a metaphor that I think will help you, and the viewers, to think about the essential difference between a legitimate MLM and a pyramid scheme:

The story is about a gentlemen, will call him Party #1, and he sells a case of canned tuna fish to Party #2 for \$10. And, Party #2 sells it to Party #3 for \$20, and Party #3 sells the case of canned tuna fish until it gets to Party #10, who buys the case of canned tuna for \$500. And, Party #10 opens up the case of tuna fish and it's rancid. It's inedible.

He goes back to Party #9 and complains, "I bought this case of tuna for \$500 and it's rancid." Party #9 tells him to take it to Party #8, and Party #8 tells him to take it to Party #7, and so on until Party #10 goes all the way back to Party #1 and says, "You're the one who started all of this! I have a problem!"

And, Party #1 asks, "What's your problem?"

Party #10 says, "Well, I bought this tuna fish, I opened it up, it's rancid. It's no good!"

Party #1 asks, "Well, what's your problem?"

Party #10 says, "Don't you understand? It's rancid. How am I going to sell this?"

And, Party #1 says, "Well, you don't have a problem."

Party #10 answers, "What do you mean I don't have a problem?"

And, Party #1 says, "You don't understand, this tuna is for selling, not for eating."

If you think about that metaphor, it may help explain the difference between a legitimate company and a pyramid scheme.

Interviewer: It was never meant to be consumed?

Jeff Babener: That's right.

Interviewer: It was always meant to be merely a product that got sold, and resold, and resold?

Jeff Babener: And, sometimes in the original cases, the original pyramid scheme cases, it was just about money. The original pyramid scheme case started before we had pyramid laws. There was a gentleman who was very charismatic, named Glenn Turner, who had a program called Dare-To-Be-Great. It was a motivational seminar. People would basically be invited to come to the seminar, pay \$5,000 where they would be taught how to go out and get someone else to come to the seminar, where they would pay \$5,000, and so on. We didn't used to have pyramid laws. This was in the late 1960s. He was prosecuted under securities laws and was put out of business as an illegal pyramid scheme because a pyramid is also a security. It's a passive investment that will not stand up on its own. As a result, almost all states adopted pyramid laws that basically say it's illegal to make people have to pay money for the right to go recruit others, effectively who will go out and do the same, and so on.

Interviewer: They call that a Pay to Play, right?

Jeff Babener: It's a Pay to Play. And, that's why every pyramid statute has what is referenced to as a "prohibited investment." Meaning, other than the exemption for purchasing an at-cost sales kit (typically \$49-\$100, which is sold not-for-profit, no commission paid, very well accepted, every leading company has one) all other purchases from the company are optional. The key issue is whether or not people buy the product because they want to use it for their own purpose or they want to sell it.

There was a recent situation that is perhaps the most recent situation in which our Federal Trade Commission accused a company of being a pyramid scheme, not a legit direct selling company. It had the legitimate elements, it looked on its face legitimate, but the FTC accused it of being a pyramid and a federal court agreed. The company was called Burnlounge. The company basically intended to make a mark in selling music online, probably not unlike what we get from iTunes or anywhere else. It tended to offer that through independent distributors, consultants, and marketers. It offered consultants the opportunity to buy various packages, website hosting packages, where they could drive customers to their website, where people could then download music, and make money. That's how it looked on its face. The packages went up to several hundred dollars. The problem is that the packages were really regarded by the court and by the FTC as tools not as products. But, in fact, Burnlounge paid commissions on all those purchases of website packages. In fact, what the court found was that there were approximately \$29 million in sales done by Burnlounge of which only one million was downloaded music. So, one million out of 29 million, the rest was basically from the sale of packages to distributors. And the court concluded: We think we know what is happening. We think distributors are encouraged to buy these packages, find other distributors to buy the packages, and make a lot of money. And that's

where the commissions were coming from. In the end, the FTC and the court said: You know what? The sale of music was really incidental, an excuse. Really what was happening was that Burnlounge was a movement of money.

We've seen this happen many times in the industry. And, it's only a matter of common sense. Again, what is it that people are paying and why are they paying for it? It's one of those situations where the court, in the Burnlounge case, indicated that if they were buying music and other things for their own use, not tools, then the court would recognize the concept that we've often seen in the industry called "Personal Use," which has been a bit controversial from time-to-time. We've even seen it recently in some questions posed in our stock market.

However, the court seemed to think that personal use would be fine if people were using the music or the product. Unfortunately, the FTC as it wanted to do in its final order, got an order that basically indicated that even purchases for personal use should not be considered in terms of illegitimate MLM. Its final order was inconsistent with its own previous position and inconsistent with some of the court's own statements. It will pose some problems in the future.

Getting back to the issue of what's real and what's not, it really is common sense. Common sense. That is, does something stand on its own? I often like to tell people, here's how you know if you're involved in something real: If you can go to your next door neighbor and you can look him in the eye and say I have a great product for you, I have a great opportunity for you, and feel like you're doing him a favor, then you're doing great. On the other hand, if go next door to your neighbor and you're looking down at your shoes the entire time you're telling him about this great product and opportunity, then maybe you're in the wrong opportunity. You've got to be proud of what you are marketing. You have to be bonded with the product and the company. It really is common sense.

Interviewer: Awesome. I appreciate that. Thank you.

For more information on pyramid schemes vs. legitimate MLM companies, read the following articles:

["Network Marketing Legal Issues"](#)

["Is This a Pyramid or a Legitimate MLM?"](#)

["Identifying Illegal Pyramid Schemes"](#)

Watch one of many of Attorney Jeff Babener's videos on MLM pyramid schemes:

[What Makes a Pyramid Scheme?](#)

[From a Legal Perspective: The Difference Between a Pyramid Scheme and Legitimate MLM](#) – Companion Video to this Blog Post

[Not all Direct Selling Companies are Pyramid Schemes](#)

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[The Hallmarks of Legitimate Direct Selling/Network Marketing Companies](#)

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