

**NEW YORK STATE SENATE
INTRODUCER'S MEMORANDUM IN SUPPORT
submitted in accordance with Senate Rule VI. Sec 1**

BILL NUMBER: S.
A.

SPONSOR: SENATOR KLEIN
MEMBER OF ASSEMBLY

TITLE OF BILL: An act to amend general business law, in relation to regulating multilevel distribution companies

PURPOSE: The purpose of this legislation is to create a new article 32-A in general business law to ensure transparency in multilevel distribution companies to allow investors and recruits to better distinguish between legitimate companies and unlawful pyramid schemes.

SUMMARY OF PROVISIONS:

Section 676: Adds section 676 to provide a definition for "multilevel distribution companies". The companies are defined as business entities that sell or distribute goods or services through independent agents, contractors or distributors who: (1) have the right to recruit prospective independent agents, contractors, or distributor and (2) earn compensation based on the sales they generate in addition to the sales generated by their recruits.

Section 677: Adds section 677 to enumerate multilevel distribution company disclosure requirements. By March first of each year, each multilevel distribution company must file a disclosure statement containing information on any open investigations against the company or its principals, officers, partners, or directors and six major data points in plain language to the department of law. Participating and prospective agents, contractors, or distributors can only receive a copy of the statement after it is filed with the department of law

The six data points include, information for the previous year on:

- (1) the total number of agents, contractors, or distributors said company had in the state;
- (2) the number of new of agents, contractors, or distributors added by said company in the state;
- (3) the total sales generated by agents, contractors, or distributors of said company in the state;
- (4) the number and percent of sales generated by purchases made by agents, contractors, or distributors of said company in the state;
- (5) the number and percent of sales generated by purchases made by persons who are not agents, contractors, or distributors of said company in the state;
- (6) the average and median amount of income earned by agents, contractors, or distributors of said company in the state;

Section 677-a: Adds section 677-a to establish contract requirements. Multilevel distribution companies must provide all prospective participants a statement with the benefits, risks, and actual effects of each product, service, and business opportunity in addition to the financial disclosure statement from section 2 at least 5 days before entering into a business contract or agreement with a prospective participant. The statement must be in the prospective participant's primary language, and in clear and easily understandable language.

Section 677-b: Adds section 677-b to regulate the use of recruitment and sales materials. Pamphlets, circular, form letter, advertisement, presentation, or other recruitment or sales literature or communication intended for prospective participants cannot be distributed until the disclosure statement is filed with the department of law.

Section 677-c: Adds section 677-c to regulate supervision. Multilevel distribution companies must provide and engage in the direct supervision of its participants to ensure compliance with the provisions of the article, and to prevent fraudulent, deceptive, and unlawful acts by such participants.

Section 677-d: Adds section 677-d to impose penalties on violators. Multilevel distribution companies or participants who knowingly violate any provision of this article or any associated rules or regulations created by the Department of Law are subject to a fine ranging from \$500 to \$1000 for a first offense, \$1000 to \$5000 for a second offense, and \$5000 to \$10000 for a third offense.

Section 677-e: Adds section 677-e to provide the attorney general the authorization to impose any rules and regulations necessary to implement the provisions of this article.

JUSTIFICATION:

This past Spring a Bronx resident of Hispanic descent filed a complaint asking for an investigation into the multilevel distribution company Herbalife International due to its deceitful and fraudulent business practices. The Bronxite was invited by an Herbalife distributor to attend a meeting where she would be taught how to lose weight while operating a business that could generate \$14,000 per month in income. The Herbalife recruiters promised to assist her in identifying clients and with time, they promised, she would be able to earn financial rewards on sales generated by her recruits and continue to move up the Herbalife distributor hierarchy. To accelerate her path to success, the Bronx resident was coerced into making an initial \$4,000 investment in product purchases, and subsequently open a "nutrition club" costing her close to \$10,000. After struggling to make her business thrive with no support from Herbalife, the Bronx resident had no other option but to give up. In the end, the resident suffered close to \$100,000 in financial losses.

Upon investigation into the issue, the Office of Senator Klein discovered that there are hundreds like this Bronxite all across the state. Herbalife distributors convince prospective participants to make large initial investments of close to \$4,000 because the Herbalife compensation scheme compensates distributors only after their new recruits reach a particular level of monthly sales close to \$4,000. Herbalife does not track whether a new recruit's initial purchase order is immediately intended to be for end

users or if it becomes inventory. According to the investigative findings, the vast majority of new recruits at first do not have the clientele to sell \$4,000 worth of products; instead the products become inventory. In seeking assistance to sell the products, their recruiters encourage them to lie about the medical benefits of the products to promote sales and to recruit new individuals to continue the cycle.

According to a press release sent out by Make the Road New York in 2013, "the multilevel distribution company has been accused of operating an illegal pyramid scheme that uses deceptive practices that target minority groups, particularly Latino immigrants who are lured into investing hundreds, and often thousands of dollars, with promises of easy money and jobs that don't require English or work authorization in the U.S. Herbalife advertises itself as a business opportunity and promises wealth and success, however, our research shows that the vast majority of its members generate virtually no income and lose money after dedicating massive amounts of time and energy."

The purpose of this legislation is to mitigate the potential harm suffered by participants in multilevel distribution companies such as Herbalife, and to curb some of the worst abuses that are prevalent in the industry.

LEGISLATIVE HISTORY: New Bill.

FISCAL IMPLICATION: To be determined.

EFFECTIVE DATE: On January first, next succeeding the date upon which it shall have become a law.

Pyramid.
3/10/2016