

State Senator Jeff Klein & Public Advocate Letitia James



HERBALIFE®

Independent Distributor



The American Scheme:

Herbalife's Pyramid 'Shake'down

October 2015

Introduction

On May 5, 2015 a Bronx resident of Hispanic descent from the 34th Senate District filed a complaint with the Office of the Attorney General calling on the office to investigate health product distributor Herbalife International due to its deceitful and fraudulent business practices. Working as a real estate agent in 2007, the Bronxite was invited by a client 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 recruiter promised to assist her in converting her real estate clients into Herbalife members; with time, the recruiter promised, she would be able to earn financial rewards on sales generated by her recruits and continue to move up the Herbalife distribution hierarchy. She would effectively create her own pyramid sales business by encouraging her recruits to bring in new members, which would provide her with profits based on their sales.

Ultimately, she was convinced to sign up as an Herbalife Independent Member. To accelerate her path to the supervisory level with extra privileges, the resident made an initial \$4,000 investment in product purchases, and after just one month, opened up a nutrition club costing her close to \$10,000. After five years of struggling to make her business thrive, the Bronxite had no other option but to give up. In the end, the resident had suffered close to \$100,000 in financial losses and tarnished her reputation as a real estate agent in New York City due to the lies she often shared with her clients for Herbalife recruitment purposes.

Like this Bronxite, there are thousands of New York State residents who have endured a similar tale; however, even more worrisome is that there are thousands of New Yorkers who are expected to live the same nightmare. Herbalife International is an American multi-level marketing corporation that develops, markets, and sells nutritional products for weight loss and health enhancement. Consumers who are convinced and pursue the business opportunity designed by the company are promised a low start up cost in exchange for inflated future income if they are able to recruit as many new members as possible. Most vulnerable to this deceptive business opportunity are recent immigrants who came to the United States in pursuit of the American Dream. New York State has one of the largest Latin American immigrant populations in the country that has been, and will continue to be, disproportionately victimized by Herbalife's fraudulent practices.

In partnership with the New York City Office of the Public Advocate Letitia James and the Make The Road New York, a New York based advocacy organization, the Office of State Senator Jeff Klein compiled data on 56 victims affected by the Herbalife pyramid scheme and conducted an investigation of 60 nutrition clubs in The Bronx, Queens, and Brooklyn to capture evidence of deceptive business practices. Our investigation and research determined New York State must act now against Herbalife. We have drafted legislation that would amend New York State General Business Law to better protect New York State residents. The bill imposes stricter regulations on health product franchisors that will require Herbalife to provide a meaningful financial disclosure to its prospective distributors, require its marketing materials to be approved by the state Attorney General, and calls for Herbalife to increase supervision of its distributors to prevent unlawful and deceptive practices.

Key Findings

- Since 2004, only 56 Herbalife victims in New York have been brave enough to file complaints against the company. Most victims are afraid of betraying family, friends, and neighbors.
- The 56 victims that have filed complaints reported nearly \$1 million in financial losses ranging from \$90 to \$100,000. The average amount loss was approximately \$20,000.
- Over 60 percent of new members make initial investments larger than the required \$60 to \$100 for the new member kit. The average initial investment is \$1,800, but some are as high as \$10,000.
- Herbalife distributors purport that supervisors can make as much as \$20,000 in monthly income.
- Of 56 complaints analyzed, only eight victims received a check directly from Herbalife for their royalty claims. The average amount was \$100.

Part I: Understanding the Herbalife Pyramid Scheme

Multi-Level Marketing at Herbalife International

Herbalife International is an American multinational multi-level marketing corporation that develops, markets, and sells nutritional products for weight loss and health enhancement. The company has 7,800 employees, operates in over 95 countries, and is publicly traded on the New York Stock Exchange with net sales of \$5 billion in 2014.¹ The corporation is listed as a direct selling business; meaning distributors, who are not company employees, sell and market the products person-to-person away from a fixed retail location such as a pharmacy or health and nutrition store. There are approximately 3.2 million product distributors worldwide of which 554,353 reside in the United States.² Since its inception in 1980, Herbalife International has confronted several lawsuits, both domestically and abroad, alleging that the corporation uses its nutritional products to mask an illegal pyramid scheme.

The only way to purchase Herbalife products is to directly contact an Herbalife distributor who sells the products at a suggested retail price. Prices on the merchandise vary by distributor because the Herbalife product catalogue does not include fixed prices. Consumers who do not wish to face high retail prices can become an Herbalife member and purchase the products at a discounted price directly from Herbalife or from the distributor that recruited, or “introduced”, them to the company. Those desiring to become a member must submit an application and purchase an Herbalife Member Pack ranging from \$60 to \$100.³ Upon becoming a member, the individual can choose to purchase the product at a 25 percent discount for personal consumption, and/or start an independent business selling the products at a higher retail price than the discounted wholesale price.

According to the Herbalife Sales & Marketing Plan and Business Rules, Independent Herbalife Members earn volume points for each purchase they make.⁴ In the United States, every dollar spent on Herbalife products is equivalent to one volume point. At a certain level of volume points or by making a single order valued at 1,000 volume points, meaning a \$1,000 purchase order, the distributor is granted a 42 percent discount on future purchases and becomes a senior consultant.⁵ By acquiring 4,000 volume points in one month, meaning \$4,000 worth of product purchases in one month, or 2,500 volume points in two consecutive months, meaning \$2,500 per month worth of product purchases for two consecutive months, the distributor is granted a 50 percent discount on all future purchases and becomes a supervisor.⁶

Once an independent Herbalife member is a supervisor, he is entitled to open a nutrition club and can begin to profit through other schemes. At this stage, supervisors profit in several ways: (1) selling products directly to customers at a retail price higher than the wholesale price, (2) selling products to customers who are converted into distributors, and (3) collecting monthly checks from Herbalife in “Royalty Overrides” equal to five percent of the entire purchase volume of the network of distributors the supervisor recruited.⁷

As a supervisor continues to collect volume points through the sales generated in his network, he stands to gain special status in the following order: “World Team”, “TAB Team”, “Global Expansion Team”, “Millionaire Team”, and “Presidents Team”. With each move up the ladder, distributors continue to collect the five percent “Royalty Overrides”, become eligible for production bonuses ranging from two to seven percent, can earn yearly bonuses if recognized as a “top achiever”, and are promised other advantages including luxury items and travel opportunities.⁸

¹ Herbalife Nutrition. (2015). About Herbalife. Retrieved from <http://company.herbalife.com>

² Herbalife International. (2015). “Statement of Average Gross Compensation Paid by Herbalife to U.S. Members in 2014”. Retrieved from <http://www.herbalife.com/Content/en-US/pdf/business-opportunity/statement-of-average-gross-compensation-usen.pdf>

³ Herbalife Opportunity. (2015). Retrieved from <http://opportunity.herbalife.com/>

⁴ Herbalife. (2012). *Sales & Marketing Plan and Business Rules*. Retrieved from <http://factsabouth Herbalife.com/media/2012/12/Marketing-Plan-and-Business-Rules-2012.pdf>

⁵ Ibid.

⁶ Ibid.

⁷ See supra note 4.

⁸ Ibid.

Direct Sales Strategy Becomes Fraudulent Business Practice

A simple explanation of the aforementioned plan would not alarm many. With a small \$60 to \$100 investment, any person can open up a distribution business and use their family, friends, and neighbors as their primary market. For many, this can be a side business if they start off as small and choose to nurture a few hours per day or on weekends. No one is required to become a nutritionist and the product catalogue tells you the purpose of each product. So then how does this ostensibly simple business model spiral into a whopping \$100,000 financial loss and reputational disaster for a working class Hispanic woman in The Bronx?

An analysis of 44 complaints filed by New Yorkers with Office of the Attorney General and 12 with the United States Federal Trade Commission (FTC) in conjunction with undercover work performed in The Bronx, Queens, and Brooklyn revealed that the story of the Bronxite from the 34th Senate District is not unusual. The story typically begins with an Herbalife distributor who invites a friend, family member, or neighbors to try out a health supplement product that can help with weight loss, weight gain, stress management, or any health issues the individual regularly confronts.

Once lured into a nutrition club or the distributor's home, the customer is offered a tasting of three Herbalife products for approximately \$6. First, the customer drinks an aloe-based drink to "clean out the digestive system," then a tea to "help cut fat," and lastly a shake that "contains a person's daily need of nutrients."⁹ While consuming the products, the distributor shares testimonials describing ways in which Herbalife products have changed her life. Often, distributors mention ways in which Herbalife products have helped them alleviate the effects of diseases and illnesses including chronic asthma, diabetes, and "rare ailments from Asia."¹⁰



After sharing superficial information about the products, Herbalife distributors transition into a discussion about the company's business opportunity. At this time, the distributor describes the two primary forms of earning income as an independent member and eventually a supervisor: (1) purchase the product at a discount and sell at a higher retail price to family, friends, and neighbors, and (2) recruit new members into the business and earn royalties paid by Herbalife International based on their recruits' sales. The distributors then finalizes the conversation by showcasing the luxurious trips they have enjoyed during their tenure as an Herbalife distributor and go on to share monthly income information that can be as high as \$20,000 per month to entice the customer to attend an information session usually hosted during the weekend or a weeknight.¹¹

During the information session, current Herbalife members as well as new recruits sit through two to three hours of various presentations. Each presentation is conducted by an Herbalife member that claims to have experienced enormous success. The speakers share their testimonials, which often start with an immigrant story. They share their experiences as immigrants to the United States from poor rural towns in pursuit of the American dream. They share the hardships they have faced in the United States since their arrival, and then transition into the opportunity Herbalife has provided them.¹² They inform recruits that after five years of hard work as an Herbalife distributor, they can earn up to \$20,000 in monthly income if they can commit to start a membership and recruit new members.¹³

⁹ Luna, M. & Vasquez, A. (Oct. 20, 2015). Video of 481 49th Street.

¹⁰ Ibid.

¹¹ Luna, M. & Vasquez, A. (Oct. 13, 2015). Video of University of Success Course.

¹² Luna, M. & Vasquez, A. (Sept. 26, 2015) Video of Information Session.

¹³ See supra note 11.

When describing the recruitment plan, labeled the “90 Day Plan,” the presenters scan over ways in which new members can accelerate to supervisory status. Becoming a supervisor is heavily emphasized because as a supervisor, members can claim royalty fees on their recruits’ sales.¹⁴ The speaker educates the audience on the definition of a royalty fee—comparing it to profit schemes used by actors and artists—and shares vague details of the “90 Day Plan.” While in theory a 90 day plan would only require a new member to purchase the \$60 to \$100 new member kit, and then provides them with three months to recruit and sell \$2,500 worth of products during two consecutive months or \$4,000 worth of products in one month to obtain supervisory status, meaning they can claim royalty fees, this is not the case.

In fact, recruiters and presenters use the privilege of earning royalty fees as the sales pitch to encourage new members to become supervisors as quickly as possible. A combination of overemphasizing royalty fees and sharing exorbitant monthly incomes urges new members to make an initial investment greater than the simple \$60 to \$100 for a member kit. While some cannot make the full \$4,000 investment that is required to automatically become a supervisor, others take the less financially burdensome route and make an initial \$2,500 investment. With \$2,500 to \$4,000 worth of products, new members must act fast to sell the products to receive a return on their investment. Once many find themselves without a large enough client base to sell the overstocked products, they turn to their recruiters who pressure them to lie about the products’ health benefits to increase sales and encourage them to shift focus and work on their recruitment efforts to increase the network size.

The \$2,500 to \$4,000 initial investment coupled with the immigrant drive to succeed and attain the American dream makes it almost impossible for any individual who becomes involved with Herbalife to give up quickly. Many are persistent, and like the resident from The Bronx invest over five years of their lives and close to \$100,000 in trying to make their business flourish. Unfortunately, after just one year, close to 90 percent of new Herbalife distributors leave the business having suffered financial losses equal to their entire life savings and credit, public embarrassment, and personal discouragement from becoming reputable entrepreneurs.¹⁵

Part II: Research and Investigation

Methodology

To better understand the full extent of the problem in New York, the Office of Senator Klein in partnership with the New York City Office of the Public Advocate Letitia James and Make The Road New York conducted a data analysis of complaints filed by New Yorkers against Herbalife International and performed an undercover investigation of nutrition clubs in The Bronx, Queens, and Brooklyn. With this data, we were able to uncover the extent of the damage that New Yorkers have incurred thus far as well as document the devious business practices used by unsupervised Herbalife distributors.

We collected 44 complaints filed with the Office of the Attorney General in 2015 and 12 complaints filed with the FTC from 2004 through 2014 using a FOIL request to create a database that would identify systemic patterns. The database highlighted patterns in claimant zip code and neighborhood, primary language spoken, type of recruiter, years involved with Herbalife as a distributor, size of initial investment, amount of total financial loss claimed, quantity of total monthly income promised at time of recruitment, total income received in checks directly from Herbalife International, whether urged to sell products or recruit new members, whether sold on disease curing capabilities, a brief summary of experience with Herbalife as a distributor, and comfort with sharing the experience with regulators and the public.

¹⁴ See supra note 11.

¹⁵ Wilkes, B. (2013). “Herbalife: A Pyramid Scheme Disguised as a Business Opportunity”. The Huffington Post. Retrieved from http://www.huffingtonpost.com/brent-a-wilkes/herbalife-a-pyramid-scheme_b_4220426.html

After having a fair understanding the systemic patterns, an investigative undercover project was put together to pull real evidence of fraudulent business practices used at nutrition clubs by Herbalife distributors. At first, a list of nutrition clubs in The Bronx, Queens, and Brooklyn was compiled. There were 36 listed in The Bronx, 25 listed in Queens, and 18 listed in Brooklyn. Using these lists, undercover investigators were sent out to visit three to four nutrition clubs in each borough to film their experience at the clubs as well as provide written testimonials using a survey created for the investigation. The survey was designed to capture tactics used by distributors for recruitment purposes. The remainder of the clubs were only visited to confirm their status as operational or defunct. In all, 16 clubs in The Bronx, 26 clubs in Queens, and 18 clubs in Brooklyn were found to be operating.

During the undercover project, two investigators were asked to attend a weekend “information session” and a weeknight “class” at a local Herbalife “Universidad del Éxito”—meaning University of Success. The investigators attended both the information session and class, filmed their experiences during both events, and documented the experiences as a written testimonial. Attending the session and class was the culmination of the investigative work as the offices felt enough information was gathered to support the claims made in the original 56 complaints analyzed.

Patterns Identified by Research and Complaint Analysis

In 2013, Brent A. Wilkes, the National Executive Direct of United Latin American Citizens, explained in an op-ed piece published in The Huffington Post that somewhere between 60 and 83 percent of all 550,000 distributors in the United States are Latino.¹⁶ Furthermore, he explained that on average 90 percent of new distributors will quit within a year. Between 300,000 to 400,000 Latinos will quit just within one year and another 300,000 to 4000,000 Latinos will be recruited to replace them.¹⁷ In 2013, it was predicted that if Herbalife were left unchecked, close to 4 million Latinos could be affected by the scheme within ten years.¹⁸

Of all individuals who filed a complaint with the New York State Office of the Attorney General, 93 percent indicated Spanish as their primary language. According to survey data collected by Pew Research Center, there are 3.5 million Hispanics living in New York State—the fourth largest Hispanic population in the nation.¹⁹ Of the 3.5 million, approximately 805,000 are classified as low income, which leaves New York State with a significant number of residents that are most susceptible to Herbalife’s predatory practices. And with the company’s 90 percent turnover rate among distributors, this only encourages Herbalife to target states like New York with large Hispanic populations.

Moreover, our analysis of complaints retrieved revealed that new members do not only purchase a new member kit upon signing up, but tend to overstock in inventory to be able to sign up as supervisors and claim royalty fees. In fact, close to 60 percent of new members made an initial investment that was larger than just the \$60 to \$100 required for the new member kit; and of the 60 percent, half of the initial investments were above \$2,500. On average, individuals made an approximate \$1,800 initial investment upon signing up, with some as high as \$10,000. Ultimately, recruiters convince new members to make such large investment by promising future monthly income that can range from \$2,000 to \$20,000 according to our complaint analysis. To support our analysis, a 2013 report of 500 surveys conducted by Make The Road indicated that of those who join Herbalife as an independent member, 35 percent did so as supervisors.²⁰

¹⁶ See supra note 15.

¹⁷ See supra note 15.

¹⁸ See supra note 15.

¹⁹ Pew Research Center. (2011). “Demographic Profile of Hispanics in New York, 2011”. Retrieved from <http://www.pewhispanic.org/states/state/ny/>

²⁰ Make The Road. (2013). Survey Results Report.

Online research done on Ebay.com suggests that Herbalife's renowned aloe concentrate, tea mix, and Formula 1 weight loss shake sell for an approximate \$30, \$20, and \$30 retail price respectively. Given that all three are needed to replace a meal, and the 50 percent supervisor discount applies, this suggests that a \$4,000 initial investment would supply each new member with a minimum 100 sets of Herbalife products. In other words, a new member who solely diverts her efforts to selling products is expected to sell 100 sets at an average price of \$80 to claim \$4,000 in income.



However, as the complaints indicate, selling this many products becomes a challenge for new members. As a result, they reach out to their recruiters for help who in exchange pressure them to use lies about the health product's benefits to increase sales. Over 30 percent of complaints filed with the Office of the Attorney General indicated that an existing Herbalife member informed them of the products' disease curing capabilities including cancer and diabetes. In addition to pressuring new members to use lies to increase sales, the complaint analysis shows that of all 56 complaints analyzed, 66 percent claim that as new members they were urged to focus their efforts on recruitment.

New members are determined to sell and recruit to be able to claim the promised royalty fees paid directly by Herbalife, but according to our analysis so few ever receive a monthly check from the company. Of the complaints filed with the Attorney General, only eight indicated having received a check from Herbalife International, with the largest monthly checks ranging from \$92 to \$700. Notwithstanding the relatively large financial burden incurred by new members in exchange for a relatively low return, their tenacity prevails. On average, claimants in our analysis assert to having devoted approximately two years to this business endeavor before feeling defeated and waving the white flag. In the end, after removing four major outliers from our analysis of 56 complaints, the average revenue loss per claim was about \$20,000; and in total, these state residents have suffered financial losses equal to approximately \$950,000. If Herbalife continues to run rampant, financial losses in the future can total up to \$2 billion in the future.²¹

Undercover Investigation Results

The undercover investigation began with a total of 79 nutrition clubs located in The Bronx, Queens, and Brooklyn. Of all the nutrition clubs, three in each borough were selected at random to be visited by undercover investigators. The investigators documented their experience with undercover cameras and/or in the form of written testimonial using a survey created for the investigation. The remainder the nutrition clubs were only visited to confirm as operational or defunct. A total of 60 nutrition clubs were found operational. Additionally, the investigators visited an information session and University of Success course.

2168 Ellis Ave. Bronx, NY 10462—The investigators entered the nutrition club on Wednesday, September 23 at around 10 a.m. to find a seasoned female Herbalife distributor who offered the investigators a \$6 tasting of the aloe, tea, and shake products while sharing testimonials of her weight loss experience supported by pictures. After about five minutes, her husband entered the nutrition club with a female recruit he picked up on the streets. The recruit was sat at the table with the investigators and began her tasting. About three minutes later, an unknown man entered the nutrition club and presented himself as an Herbalife user. He shared his 12 year weight loss experience using the products and their health benefits. As the recruit and the investigators participated in the tastings, the two gentlemen discussed their plan for an afternoon fishing trip on the Long Island Sound. Meanwhile, the recruit was drawn to pictures taped on the wall showcasing the distributor and her husband on extravagant trips across the United States. The distributor shared information about the grand business opportunity Herbalife has afforded her family, which has led to those trips. After

²¹ The average loss according to President of LULAC is \$3,000 per distributor. If every low income Hispanic in New York is recruited to participate, that is all 805,000 low income Hispanics, then the total financial loss can add up to \$2 billion.

the two gentlemen left for their fishing trip, the female distributor shared with the recruit and investigators that the second gentleman to enter the nutrition club has a mansion in Westchester County, and has done well for himself in the Herbalife business. She finally invited the recruit and investigators to a Saturday information session to learn more about the business opportunity and products to be held at an undisclosed location. The investigators shared their contact information and exited the nutrition club.

Jackson Heights, Queens—Investigators visited four different nutrition clubs on Friday, October 23 from 10 to 12 p.m. As undercover mother and son, the son explained to distributors that his mother suffers from severe migraines, his younger brother has a rash, and he was interested in a business opportunity because he is unemployed. A distributor explained that Herbalife products can alleviate migraines because they remove fat in the body and “clean your intestines that get dirty and clogged,” which are the causes of the headache. The mother informed the distributor that she is allergic to herbal remedies, to which the distributor promised that Herbalife products do no harm as they are recommended by scientists and doctors. The mother was also encouraged to join a “weight loss competition” to lose weight. She would have to pay \$35 to register and monitor her weight every other day. As for the younger brother’s rash, a distributor informed the undercover mother and son that the cream products were an excellent solution. At their fourth visit, a distributor informed the investigators that her son used to have diabetes, which has been cured thanks to the products. After complaining that the products are too expensive, the Herbalife distributor explained that by becoming an Herbalife member, they would receive the products at a 25 percent discount. The undercover mother and son were invited to an upcoming information session during the weekend before concluding their investigation.

218 *Stockholm St., Brooklyn, NY 11237* - Team of investigators entered Carita Feliz Herbalife nutrition club on October 23, 2015 at approximately 2 p.m. The store windows were completely covered with garbage bags and curtains. The door was locked. A woman opened the door, whereupon the team noticed two additional women and two infants. Team member sought assistance with a cleanse and weight loss. The woman, Ms. Ramirez provided Herbalife Aloe Water and stated that it would “clean your inside” in the same manner that a “shower cleans your outsides.” She then gave the team Herbalife Tea that would “melt away fat” and provide “energy.” Ms. Ramirez also informed members of classes required to become a member. Membership costs \$110 per month. She also showed several small certificates of people who successfully passed Herbalife courses. Ms. Ramirez featured a large poster of a man who she claimed is her husband holding a New York City Department of Health letter grade “A.” She represented that the money they made from Herbalife afforded her husband’s success as a chef. She also kept a letter “A” grade rating in a binder that she showed to recruits. She solicited the team to come back to the location the next day to discuss possibilities of opening their own Herbalife business, instructed them on how to take appropriate classes, and took contact information for follow-up.

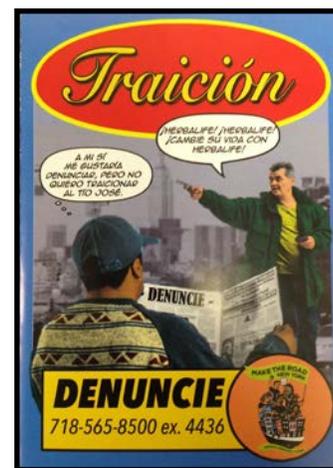
Information Session—The investigators enter an information session at a nutrition club on Saturday, September 26 at approximately 12:30 p.m. Upon entering, music is blaring to announce the investigators’ arrival. About 25 people are sitting in seats and an Herbalife distributor is using a Power Point that projects income information while he shares information about the four forms of generating income including royalties, like actors and artists, as an Herbalife supervisor. The speaker shares with the audience that he joined as a supervisor, and after just one month was able to generate \$1,800. He then shares with the audience that after 12 to 24 months supervisors generate \$3,000 to \$8,000 in income per month. Following his presentation, approximately ten audience members, who have already signed up as Herbalife distributors, are asked to come to the front of the room to share their testimonials. Some share their immigrant experience turned success thanks to Herbalife’s business opportunity, and others share their weight loss success using the products. Toward the end of the investigation, an Herbalife distributor with Presidential status is introduced and greeted with a standing ovation as audience members request her autograph. The distributor shares her testimonial as a woman from a poor rural town in Ecuador who has not seen her children in 14 years, but Herbalife has made it possible for her to maintain her family abroad while living lavishly here in the United States. After her testimonial, the investigators exit the information session at around 2:15pm and

are chased by a recruiter. The recruiter informs them that she is willing to pay for their new member kit if they can each bring in four to five new members to her nutrition club.

University of Success Course—The investigators enter a University of Success course at a rental hall on Tuesday, October 13 at 7:00 p.m. Upon entering, the investigators sign in and are asked for a \$10 fee. As attendees they are seated, and an Herbalife distributor informs an audience of approximately 35 people that after 5 years, Herbalife supervisors can make up to \$20,000 per month. In addition to the audience members who all have notepads to take notes, there is a side panel of distributors who have earned Presidential status in the company. The presenter proceeds to superficially discuss the different approaches to create a downline that will generate the promised income. Following this presentation, the Herbalife distributor shares his personal testimonial as a construction worker turned successful entrepreneur. He claims that in 2014, he and his wife reported an income of \$1,138,000. The presenter shares more testimonials of successes of friends and family members. Meanwhile, the investigators pull aside a Presidential status distributor who shares with them the secret to generating high income. She informs them that they must first buy the products, come up with a testimonial to share with audience members, and then focus their efforts in recruiting new members. She compliments the investigators as young and attractive, which would serve as a perfect pull for new customers and members.

Limitations

The complaint analysis conducted incorporated 44 complaints filed with the New York State Attorney General and 12 complaints filed with the FTC. While some researchers would claim that a total of 56 complaints is not a representative sample of the true population, these numbers reveal a more alarming problem. Herbalife distributors use their family, friends, and neighbors as their primary market for sales and recruitment. New members who are recruited and do not succeed are often faced with committing the worst form of betrayal against a close relative or companion if they speak out against Herbalife. The confrontation is exacerbated when that family member or acquaintance assisted the new member in any way upon their arrival to the United States as an immigrant. As a result, new members feel the pressure to maintain their loyalty to their family members, friends, and neighbors and remain silent. However, by placing Herbalife in the limelight, more victims will feel comfortable with stepping out of the dark and sharing their stories with the public.



Part III: Regulation and Legislation

Regulation by FTC Not Enough

Multi-level marketing corporations in the United States are monitored by the FTC to ensure their direct selling strategies do not fall into the category of illegal pyramid schemes. In 2004, the FTC released a staff advisory opinion on the commission's pyramid scheme analysis directed to the President of the Direct Selling Association.²² The advisory opinion focused on the commission's analysis of the compensation that is distributed to members based on products purchased by individuals the members recruit into the organization ("internal consumption"). According to the FTC, the compensation paid to members generated by the products purchased and amassed by existing members of the organization for whatever reason the member may have does not necessarily consider the business plan an illegal pyramid scheme. For the FTC, illegal pyramid schemes are recognized in one of two ways: 1) If compensation distributed to its members is based on product purchases that are inextricably linked to a new membership fee; and 2) If the organization requires a certain level of monthly purchases to qualify for direct compensation. In this case, compensation

²² Khom, J. (2004). "Staff Advisory Opinion-Pyramid Scheme Analysis". Federal Trade Commission. Retrieved from http://www.mlmmatchdog.com/files/FTC_Letter.pdf

for members is generated through monthly purchases; with enough recruits, those higher up in the distribution hierarchy will receive enough compensation from purchases made by their recruits to cover their own monthly purchase requirement.

As applicable to Herbalife International, the FTC does not classify the organization as an illegal pyramid scheme because the required \$60 to \$100 fee to receive a membership kit is not money used to compensate higher up distributors who recruit. Furthermore, once an Herbalife member becomes a supervisor, she is allowed to maintain the title and royalty collecting privilege for an entire year before having to re-qualify. However, our research and investigation reveal that Herbalife distributors do not follow the rules set by the FTC and are in fact running an illegal pyramid scheme. Our analysis demonstrates that higher up distributors encourage recruits to make large first-time product purchases, which the recruiters stand to gain on. And once the new members are unable to sell off their inventory, recruiters encourage them to recruit other members to increase their compensation claims and maintain operation. By contractually following FTC guidelines, Herbalife International has managed to skirt the law, but in reality their lack of proper financial disclosure and supervision over their members allows distributors on the ground to operate illegal pyramid schemes to the benefit of Herbalife International.

Proposed Legislation

Herbalife International needs to be held accountable. For too long the company has masked an illegal pyramid scheme by advertising rules the company does not enforce. That is why the Office of Senator Klein, supported by the New York City Office of the Public Advocate Letitia James and Make The Road New York, will introduce a Senate bill that will impose stricter regulations on multi-level marketing corporations that distribute health products using direct marketing strategies. The legislative proposal is a comprehensive bill that will amend New York State General Business Law in relation to health product franchises.

Key Senate Bill Provisions

- Defines “health product” in New York State as nutrition, weight management, energy and fitness, and health improvement products for human consumption.
- Requires that health product franchisors in the state file an annual financial disclosure statement written in plain and understandable English and Spanish for the Attorney General to review before submitting to prospective franchisees that includes the number of franchisees in the state, average income claimed by franchisees, percentage of franchisees that fall within various amount parameters as determined by the New York State Attorney General, and the reported turnover rate of franchisees.
- Requires that prospective franchisees receive their offering prospectus in the primary language of the prospective franchisees.
- Requires that any pamphlets, circular, form letter, advertisement or other sales literature of advertising communication intended for prospective health product franchises be approved by the New York State Attorney General.
- Calls for health product franchisor engage in supervision of its franchisees to ensure compliance with this bill to prevent fraudulent, deceptive and unlawful acts by the franchisees.

Conclusion

New York State must protect its working class Hispanic population who often come to the United States in pursuit of the American dream from predatory corporations like Herbalife International. Those who immigrate to the United States and make their residence in New York State should be offered legitimate business opportunities to become entrepreneurs, not ones that will demoralize them and scam them of their life savings. Companies like Herbalife International set up rules and regulations to avoid being categorized as running illegal pyramid schemes as defined by the Federal Trade Commission, but in reality the rules are not enforced and instead the company turns a blind eye to the illegal pyramid scheme it promotes. The Office of Senator Jeff Klein, the New York City Office of the Public Advocate Letitia James, and Make The Road New York have accumulated evidence to show that Herbalife International is in fact running an illegal pyramid scheme masked behind their product sales. In an effort to curtail Herbalife's fraudulent practices, a Senate bill will be introduced that will require Herbalife to provide a more meaningful financial disclosure to its prospective distributors, require its marketing materials to be approved by the state Attorney General, and calls for Herbalife to increase supervision of its distributors to prevent unlawful and deceptive practices.