

# Income and Earnings Representations

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## Scope

Let's face it – distributors are out there waiving checks and 1099s, telling prospects what they and others have made, and presenting hypothetical (*i.e., astronomical*) examples of the phenomenal incomes that can be earned with your company. Is this potentially problematic for the company? Absolutely. As discussed below, a few states have statutes that expressly limit or even prohibit income claims. Moreover, the consumer protection acts of all states prohibit any type of promotional activity that is misleading, unfair, or unsubstantiated. Finally, notwithstanding a company's substantial good faith compliance, the Federal Trade Commission ("FTC") is gleefully snuffing direct sellers out of existence if it finds only a handful of distributors making improper income claims.

This article will examine the legal issues surrounding earnings claims and income representations made by direct selling, multilevel marketing, or network marketing companies (collectively referred to as "direct selling companies") and their distributors. In addition, this article will analyze federal and state law relative to such representations.

## The Bottom Line

Let's cut to the chase and address exactly what companies *may* legally do. The bottom line is that direct selling companies may publish flyers, articles, and other printed media, and produce audio and video presentations containing income claims, provided that they include the elements set forth below relative to the type of claim that is made. Further, distributors may make income testimonials, so long as the company provides the income disclosure chart set forth at the end of this article and distributors properly use it.<sup>1</sup>

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<sup>1</sup>That said, earnings representations and income testimonials of any type nevertheless remain impermissible in Massachusetts and Wyoming.

**A. Statements of Average or Median Earnings**

- (1) a true statement;
- (2) of the average or median earnings;
- (3) actually achieved;
- (4) by **ALL** distributors; and
- (5) during any stated recent time period.

*(See the examples on page 15.)*

**B. Statements of Non-Average, Non-median Earnings Achieved by a Substantial<sup>2</sup> Number of Distributors**

- (1) a true statement;
- (2) of any particular amount of earnings;
- (3) actually achieved or exceeded;
- (4) by a substantial number of distributors;
- (5) during any stated time period; and
- (6) provided that it is accompanied by:
  - (a) a clear and conspicuous disclosure of the percentage of the total number of distributors who have achieved or exceeded such results; and
  - (b) is printed in a type size at least equal to that of the statement of sales, profits, or earnings of the percentage of the total number of distributors who have achieved such results.

*(See the examples on page 15.)*

**C. Statements of Earnings Ranges**

- (1) an accurate representation;
- (2) of a particular range or ranges of earnings;
- (3) actually achieved;
- (4) during any stated time period;
- (5) provided that it is accompanied by:
  - (a) a clear and conspicuous disclosure of *the percentage that such distributors achieving results within the range constitute of the entire number ALL distributors*; or

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<sup>2</sup>The FTC has not attempted to define the term “substantial” for the purpose of income claims within the context of direct selling.

(b) in the event that the company employs ranges beginning with \$0 and proceeding continuously upward, it need only indicate either the number or the percentage of distributors within each range; and

(6) the disclosure [5(a) or 5(b) above] is printed in type size at least equal to that of the statement of ranges of the distributors who have achieved such results.

*(See the examples on page 17.)*

#### **D. Income Testimonials**

To make income testimonials, the company must ensure that any such testimonial includes or is accompanied by the following clear and conspicuous disclosures (if printed, in boldface type at least equal in size to that of any sales, profits, or earnings figure stated in the testimonial):

(1) an accurate statement of the average amount of time per day, week, or month required by the distributor to achieve the stated results;

(2) an accurate statement of the year or years during which, and the geographical area(s) in which, the stated results were achieved;

(3) if the results achieved by the distributor providing the testimonial have not been achieved by at least 10 percent of ALL distributors during the time period covered by the testimonial:

(i) a statement of the average or median sales (or profits or earnings, whichever is included in the testimonial) of ALL distributors during the time period covered by the testimonial; *or*

(ii) the following statement: IMPORTANT NOTICE: THE RESULTS DESCRIBED ABOVE ARE SUBSTANTIALLY IN EXCESS OF THE AVERAGE RESULTS ACHIEVED BY ALL OUR DISTRIBUTORS. OUR RECORDS SHOW THAT ONLY \_\_\_% OF OUR DISTRIBUTORS HAVE EQUALED OR EXCEEDED THE PERFORMANCE DESCRIBED ABOVE DURING THE INDICATED TIME PERIOD; and

(4) if the results achieved by the distributor providing the testimonial have been achieved by 10 percent or more of all distributors during the time period covered by the testimonial, but are in excess of the average or median results achieved by all distributors:

- (i) a statement of the percentage of all the company's distributors who, according to its records, have achieved equal or better results during the same time period; or
- (ii) a statement of the average or median results achieved by all distributors during the same time period.

*(See the examples on page 18.)*

Because direct selling distributors usually have no access to the numbers and averages required to make permissible income claims, they should be strongly discouraged or prohibited from doing so . . . unless the company provides the proper information and training to them, and the distributors provide that information to their prospects. In light of the overwhelming likelihood that your distributors are making income claims, I emphatically encourage you to prepare an income disclosure statement that contains the information discussed in this article.

#### ***E. Lifestyle and Hypothetical Claims***

In addition to express income claims, two popular marketing techniques for promoting a compensation plan are "lifestyle" and hypothetical income representations.

A lifestyle claim typically includes pictures or statements involving large homes, luxury cars, exotic vacations, or other items suggesting or implying wealth. Claims such as "My XXXX income exceed my salary after six months in the business," or "Our XXXX business has allowed my wife to come home and be a full-time mom" also fall with the purview of "lifestyle" claims. "Lifestyle" claims were addressed in the Amway case, and defined as "claims . . . which generally consist of vague references to the achievement of one's dreams, having everything one always wanted, etc. — are phrased in terms of 'opportunity' or 'possibility' or 'chance.'" (See page 19 for a discussion of the *Amway* case.)

A hypothetical claim exists when a company or distributor attempts to explain the operation of the compensation plan through the use of a hypothetical example. Certain assumptions are made regarding the: (1) number of distributors sponsored; (2) number of downline distributors; (3) average product volume per distributor; and (4) total organizational volume. Cranking these assumptions through the compensation plan yields an income figure.

Regulators have made abundantly clear that they take the position that lifestyle and hypothetical income statements are, at a minimum, implied claims. Thus, they constitute income claims. Accordingly, they trigger the same disclosure requirements as do express earnings representations.

To use a hypothetical income example in which the amount of *stated* profits, earnings, or sales in excess of the *average* profits, earnings, or sales of *all* distributors the company must clearly and conspicuously disclose (if printed, in boldface type at least equal in size to that of any sales, profits, or earnings figure stated in the example): (1) the average profits, earnings, or sales for *all* distributors; or (b) the percent of *all* distributors who actually achieved such stated profits, earnings, or sales.

***F. Definition of "Average"***

The computation of "average" earnings must not be based on less than all distributors as a whole, or all distributors in the stated category (i. e., a certain rank of distributor), unless the fact that some distributors are excluded *and* the basis for any such exclusion are clearly and prominently disclosed in close proximity to such representation. In light of the FTC's recent enforcement activities, however, I strongly recommend that companies indicate the percentage that the "reported" distributors constitute relative to *all* distributors.

***G. Record Keeping Requirements***

Direct sellers must maintain records that substantiate that any representation made regarding past or present earnings are accurate. Such records must be sufficient to:

- (1) substantiate the accuracy of any representations made regarding amounts earned;
- (2) the number or percentage of distributors achieving such results;
- (3) the time period during which such results were achieved; and
- (4) the amount of time per day, week, or month required to achieve such results.

## Discussion

### A. *Status of the Law*

Six jurisdictions, Georgia, Maryland, Massachusetts, Louisiana, Puerto Rico, and Wyoming have statutes that expressly limit or proscribe earnings claims or representations made by direct selling companies.<sup>3</sup> Georgia and Louisiana allow earnings representations provided that a direct seller has “documented data to substantiate the claims of income or earning potential.”<sup>4</sup> Maryland allows income claims so long as “the past earnings . . . are those of a substantial number of participants.”<sup>5</sup> Similarly, Puerto Rico allows earnings representations so long as such

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<sup>3</sup>Several other states condition, limit, or prohibit income claims relating to the sale of a “business opportunity.” See, e.g., Indiana Code §§ 24-5-8-2 and 24-5-8-5; General Statutes of North Carolina § 66-98; South Carolina Code § 39-57-60; Texas Civil Statutes § 5069-16.15; and Code of Virginia § 59.1-266. As long as a direct selling company is not a “business opportunity,” the foregoing statutes should not be problematic.

<sup>4</sup>Section 10-1-414 of the Georgia Code provides that a multilevel marketing company:

shall not represent that a business opportunity or multilevel program provides income or earning potential of any kind unless the seller [direct selling company] has documented data to substantiate the claims of income or earning potential, which data shall be furnished to the administrator or his representative upon request.

Louisiana Statutes Annotated, Title 51, Chapter 23, Section 1823 provides:

No business opportunity seller or agent shall:

- (1) Represent that a business opportunity provides income or earning potential of any kind unless the seller has documented data to substantiate the claims of income or earning potential and discloses this data to the prospective purchaser at the time such representations are made.
- (2) Advertise or make any written reference to a specific range or level of income or earning potential without setting forth the following disclosure, with blanks completed in print as large or larger than that referring to income or earning potential: “No assurance of earnings or ranges of earnings can be made. The number of purchasers who have earned more through this business than they invested is at least \_\_\_\_\_. This is \_\_\_\_\_ percent of the total number of purchasers. This information is current as of \_\_(date)\_\_.”

<sup>5</sup>Section 14-303 of the Maryland Code provides,

A multilevel distribution company may not represent directly or indirectly that participants in its marketing program may or will earn a stated gross or net amount or represent in any way the past earnings of participants unless the stated gross amount, net amount, or past

statements are “obtained by a reasonable number of participants.”<sup>6</sup> Two states,

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earnings:

(1) are those of a substantial number of participants in the community or geographic area where the representation is made; and

(2) accurately reflect the average earnings of participants under circumstances similar to those of the participant or prospective participant to whom the representation is made.

The Maryland statute goes farther than those of Georgia and Louisiana in that it also imposes a second requirement that the claims reflect the average earnings of those participants “under circumstances similar to those of the participant or prospective participant to whom the representation is made.” As discussed below, this language was taken from the Federal Trade Commission’s decision in *In re National Dynamics Corporation*, et al., 85 F.T.C. 1052 (June 17, 1975). On remand from the United States Court of Appeals for the Second Circuit, the FTC subsequently deleted this requirement from its order. Thus, in all likelihood, this criterion would not be enforced by Maryland.

<sup>6</sup>Section 997d of the Laws of Puerto Rico provides,

No multi-level distribution company may, directly or indirectly through its dealers, agents or participants, use as propaganda in the enlistment of new participants information on the profits or benefits obtained in the past by its dealers, agents or participants, or assure to prospective participants in this type of business a given amount of profits or benefits, unless the profits or benefits mentioned are those obtained at present by a reasonable number of participants in the Commonwealth or a similar geographical area and reflect the average profits and benefits obtained by them through the distribution and/or sale of properties or services. Likewise it is prohibited to make use of propaganda aimed at showing the facility of enlisting and retaining new participants and their operational or economic success.

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Massachusetts and Wyoming, flatly prohibit income representations.<sup>7</sup> Despite their apparent “total” prohibition, there is, nevertheless, a legitimate legal argument that income representations are permissible in Massachusetts and Wyoming under the auspices of certain Federal Trade Commission (“FTC”) decisions. (See *Discussion Sections B and C below.*) It is significant to note, however, that the Office of the Attorney General in Wyoming adamantly maintains that any and all types of income claims are strictly prohibited. Some companies specifically proscribe their distributors from disseminating any information that contains any type of income claim or earnings representation in both Wyoming and Massachusetts.

**B. “Plan B”**

As have most states, both the Massachusetts and Wyoming legislatures have directed that their respective state courts and attorneys general interpret their consumer protection laws in light of regulations promulgated and decisions rendered by the FTC.<sup>8</sup> *As discussed below in Discussion Section C, the FTC does allow certain*

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<sup>7</sup>Section 93-69 of the Massachusetts General Laws provides in pertinent part,

(e) Multi-level distribution companies shall not represent, directly or indirectly, that participants in a multi-level marketing program will earn or receive any stated gross or net amount, or represent in any manner, the past earnings of participants; provided, however, that a written or verbal description of the manner in which the marketing plan operates shall not, standing alone, constitute a representation of earnings, past or future. Multi-level distribution companies shall not represent, directly or indirectly, that additional distributors or sales personnel are easy to secure or retain, or that all or substantially all participants will succeed.

Section 40-3-107 of the Wyoming Statutes provides,

Multilevel distribution companies shall not represent directly or by implication that participants in a multilevel marketing program will earn or receive any stated gross or net amount, or represent in any manner the past earnings of participants. A written or verbal description of the manner in which the marketing plan operates shall not, standing alone, constitute a representation of earnings, past or future. Multilevel distribution companies shall not represent directly or by implication, that it is relatively easy to secure or retain additional distributors or sales personnel or that all or substantially all participants will succeed.

<sup>8</sup>Section 93A-2 of the Massachusetts General Laws Annotated provides in pertinent part:

(b) It is the intent of the legislature that in construing paragraph (a) of this section in actions brought under sections four, nine and eleven, the courts will be guided by the interpretations given by the Federal Trade Commission and the Federal Courts to section 5(a)(1) of the

*type of income and earnings representations, provided that certain criteria are met.* Thus, under the Massachusetts and Wyoming consumer protection acts, income representations are arguably permissible so long as they comport with the FTC's requirements. *It is important to note that while the decisions of the FTC are persuasive, they are not conclusive or dispositive of any issue at the state level.*

### **C. Federal Trade Commission Decisions**

Fortunately (or unfortunately, depending upon your perspective) for direct selling companies, the FTC has provided clear guidelines regarding income claims.

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Federal Trade Commission Act (15 U.S.C. 45(a)(1)), as from time to time amended.

©) The attorney general may make rules and regulations interpreting the provisions of subsection 2(a) of this chapter. Such rules and regulations shall not be inconsistent with the rules, regulations and decisions of the Federal Trade Commission and the Federal Courts interpreting the provisions of 15 U.S.C. 45(a)(1) (The Federal Trade Commission Act), as from time to time amended.

The Massachusetts Supreme Judicial Court has held that the Attorney General's interpretative powers are limited in that his definitions under the Consumer Protection Act not be inconsistent with Federal Trade Commission and federal court decisions, and the usual limitation that his regulations be neither arbitrary nor capricious. *Purity Supreme, Inc. v. Attorney General*, 380 Mass. 762, 407 N.E.2d 297 (1980).

Additionally, Section 93A-3 of the Massachusetts General Laws Annotated provides:

Nothing in this chapter shall apply to transactions or actions otherwise permitted under laws as administered by any regulatory board or officer acting under statutory authority of the commonwealth or of the United States. For the purpose of this section, the burden of proving exemptions from the provisions of this chapter shall be upon the person claiming the exemptions.

Thus, if certain income representations have been and are allowed by the FTC, they are allowable under Massachusetts law.

Wyoming Statutes, Section 40-12-110 provides:

- (a) Nothing in this act [the Consumer Protection Act] shall apply to:
  - (l) Acts or practices required or permitted by state or federal law, rule or regulation or judicial or administrative decision;

Again, if certain income representations are permissible by the FTC, they should be allowable under Wyoming law.

This guidance is derived primarily from *National Dynamics Corporation*<sup>9</sup> and its progeny.

### **1. The Initial Decision**

In *National Dynamics*, the defendant company was charged with violating the Federal Trade Commission Act by making certain statements regarding the earnings of its distributors. Typical and illustrative of these representations are the following:

- x I talk big figures, \$10,000, \$15,000, \$25,000 a year . . . VX-6 is the Aladdin's Lamp of specialty selling.
- x Pictures of individuals with captions
  - "\$1,554.00 one week"
  - "\$148 one day"
  - "\$2316.96 one week"
  - "\$1028 one month"
  - "\$500 one week"
  - "\$350 one week."
- x Our men made MORE THAN \$4,000,000 PROFITS and haven't even scratched the surface yet!
- x I'm going to show you how to enjoy an income of \$1,000 or more a month . . . without ever risking a penny of your own money.
- x One Quick Phone Call--At My Expense--And You Can Choose How Much You Want to Earn This Year--( ) \$2,000.00 ( ) \$5,000.00 ( ) \$10,000.00 ( ) \$15,000.00 ( ) \$25,000.00.
- x You too can make \$1,000.00 a month with VX-6 . . .
- x HERE'S HOW TO MAKE \$46.00 A DAY--EASY! HERE'S HOW TO MAKE \$95.00 A DAY--EASY!

The FTC found that of the 12,000 distributors who purchased VX-6 from National Dynamics during the calendar year 1969, not more than 60 distributors, or one-half of one percent of the total number of distributors, "made profits in excess of \$10,000 through the resale of VX-6; that of those 60, not more than 20 made profits in excess of \$15,000; that not more than 5 made profits in excess of \$25,000; and that no distributor made profits in excess of \$75,000." Not surprisingly, the FTC held that "distributors do not realize such earnings . . . on the

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<sup>9</sup>*In re National Dynamics Corporation, et al.*, 82 F.T.C. 488 (Feb. 16, 1973).

contrary, few, if any, attain such earnings.” The FTC further opined that “while it may be possible for a distributor to realize earnings of the magnitude stated in respondents' advertising, the representation that a substantial number of distributors have made and can make the high profits indicated is false, misleading, and deceptive” and violative of the Federal Trade Commission Act.

The FTC ordered National Dynamics to cease and desist from:

representing, directly or by implication, that persons purchasing respondents' products for resale will derive any stated amount of gross or net profits or other earnings through representations as to the past earnings of purchasers of respondents' product *unless, in fact, the past earnings represented are those of a substantial number of purchasers* and accurately reflect the average earnings of such purchasers under circumstances similar to those of the purchaser to whom the representation is made; or misrepresenting in any manner the past, present, or future profits or earnings derived, or to be derived, from the resale of respondents' products.

(Emphasis added.) In light of the subsequent modifications made to the Commission's order as the result of National Dynamics' subsequent appeal and the Commission's modified orders, the value of the above-cited language is primarily historical.

## **2. National Dynamics<sup>10</sup> – The First Modification**

National Dynamics appealed the decision of the FTC to the United States Court of Appeals for the Second Circuit, which reversed the Commission's decision and remanded the case back to the FTC. The FTC modified its earlier order to permit statements regarding sales, earnings, and profits in a format utilizing ranges instead of averages.<sup>11</sup>

Recognizing the Court's direction regarding earnings statements, the FTC concluded that:

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<sup>10</sup>*In re National Dynamics, et al.*, 85 F.T.C. 391 (Mar 4, 1975).

<sup>11</sup>The FTC also addressed “income testimonials” in its opinion. Since this topic is beyond the scope of this article, it will not be discussed herein. However, in light of income testimonials invariably contained in direct selling companies' videos, it is unquestionably a timely topic.

the use of earnings ranges may be made provided that for any stated range (i.e., \$5-10,000), respondents also provide an equally clear and conspicuous statement of the number of distributors who achieved earnings within that range, and a statement of the period of time over which the figures were compiled. In addition, the top figure for the highest earnings range may not exceed the highest earnings figure actually achieved by a distributor, to prevent, for example, use of a \$20-40,000 category when the highest achieved figure might be only \$30,000. We believe that these requirements are necessary to prevent the deceptive use of earnings ranges, without being unduly burdensome.

The FTC again ordered National Dynamics to cease and desist from:

representing, directly or by implication, that persons purchasing respondents' products can or will derive any stated amount of sales, profits, or earnings; or misrepresenting in any manner, the past, present, or future sales, profits, or earnings from the resale of respondents' products; *Provided, that the foregoing paragraph shall not be construed to prohibit:*

*(a) an accurate representation of any range or ranges of sales, profits, or earnings achieved by purchasers of respondents' products which includes a clear and conspicuous disclosure (in bold-face type at least equal in size to that of the representation of the range or ranges where such appear in print) of the following information:*

*(i) an accurate statement of the number of participants achieving sales, profits, or earnings within the stated range; and*

*(ii) an accurate statement of the time period in which the reported figures were achieved.*

The figure purporting to be the end figure of the highest range in an advertisement may not exceed the highest amount of sales, profits, or earnings actually achieved by a purchaser.

(Emphasis added.)<sup>12</sup>

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<sup>12</sup>The FTC also held that National Dynamics must

maintain records which substantiate that any past or present sales, profits, or earnings represented are accurate. Where ranges of sales, profits, or earnings are represented, such records shall be sufficient to substantiate the number of purchasers achieving results within

### **3. National Dynamics -- The Second Modification**

The FTC revisited its modified March 4, 1975 order only three months after its creation.<sup>13</sup> This last order “eliminated certain ‘loopholes’ in the March 4, 1975 order and set forth with greater clarity a wide variety of options . . . available for making truthful claims concerning the earnings of their distributors.”

The “adjusted” attitude of the Commission, thanks to the Second Circuit, is readily apparent from the following language:

*In fashioning our modified order, we have proceeded on the theory that respondents should be allowed to make a wide variety of simple, truthful, nondeceptive statements concerning the earnings of their distributors. At the same time, they must be prevented from bandying about high earnings achieved by a minority of purchasers with no indication of the unrepresentativeness of such earnings. If respondents lack evidence that the high reported earnings of a few distributors are in fact representative of the earnings of large numbers of other distributors, then it is clearly deceptive for them to portray the minority results reported to them without a clear indication of their unrepresentativeness.*

(Emphasis added.)

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any stated range and the time period during which such results were achieved. Where average or median figures are represented, such records shall be sufficient to substantiate that such median or average figures are accurate.

<sup>13</sup>*In re National Dynamics Corporation, et al.*, 85 F.T.C. 1052 (June 17, 1975).

Again, the FTC ordered National Dynamics to cease and desist from:<sup>14</sup>

(a) Representing, directly or by implication, that persons purchasing respondents' products can or will derive any stated amount of sales, profits, or earnings therefrom;

(b) Misrepresenting in any manner the past, present, or future sales, profits or earnings from the resale of respondents' products, or representing, directly or by implication, the past or present sales, profits or earnings of purchasers of respondents' products except that any or all of the following representations shall not be prohibited:

(1) A true statement of the *average or median sales, profits, or earnings actually achieved* by all purchasers [distributors] of respondents' products *during any stated time period*.

(2) A true statement of *any particular amount of sales, profits, or earnings actually achieved or exceeded* by a *substantial number* of purchasers of respondents' products *during any stated time period*, provided that it is accompanied by a clear and conspicuous disclosure (if printed, in type size at least equal to that of the statement of sales, profits, or earnings) of the percentage of the total number of purchasers who have achieved such results.

(Emphasis added.)

As regards the issue of timeliness, the Commission explained that the company must:

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<sup>14</sup>The Commission reiterated the requirements to:

maintain records which substantiate that any representation made regarding past or present sales, profits, or earnings are accurate. Such records shall be sufficient to substantiate the accuracy of any representations made regarding amounts earned or sold, the number or percentage of purchasers achieving such results, the time period during which such results are achieved, and the amount of time per day, week, or month required to achieve such results.

provide some indication of the time period upon which a statement of earnings is based . . . Failure to disclose that represented achievements are in fact several year old is clearly misleading, since the assumption of readers is likely to be that they are based on recent information.

Thus, the Commission's order embodies a general prohibition on representations of past earnings, followed by a detailed enumeration of various broad sorts of earnings claims, in addition to allowable average earnings claims. The order makes clear that any true statement of average or median earnings achieved by distributors during any particular stated past time period is permissible. In fact, the FTC cited the following examples as permissible:

1. Last year our distributors earned an average of \$\_\_\_\_\_.
2. In 2002 our distributors earned an average of \$\_\_\_\_\_.
3. For all of 2002 our distributors earned an average of \$\_\_\_\_\_ per month.
4. In May, 2002, our distributors earned an average of \$\_\_\_\_\_.

As regards statements of non-average, non-median earnings achieved by a substantial number of distributors, the Commission provided the following:

1. Last year at least 585 of our distributors (\_\_\_\_% of all our distributors) earned \$\_\_\_\_\_ or more.
2. In 2002, \_\_\_\_% of our distributors earned \$\_\_\_\_\_ or more.
3. In all of 2002, hundred of our distributors (\_\_\_\_% of all distributors) earned an average of \$\_\_\_\_\_ or more per month.
4. In May, 2002, at least 600 of our distributors (\_\_\_\_% of the total) earned \$\_\_\_\_\_ or more.

With respect to income ranges, the Commission wrote:

. . . statements of ranges may be deceptive if the earnings ranges are too large. A consumer presented with a statement that thousands of distributors have earned from "\$\_\_\_\_\_ to \$\_\_\_\_\_" is likely to assume that the average lies somewhere near the middle of the range, and that substantial numbers of people have achieved results in the top of the range . . . Common sense would suggest that in most business opportunity situations one would find a few exceptional individuals

performing well above average, rather than an even distribution of earnings results from bottom to top. Thus, the use of an unduly large range which encompasses the exceptional earnings of a few will result in deception, with the extent of the deception increasing as the range does.

In *National Dynamics*, the data showed that 99% of the company's distributors earned less than \$10,000 per year, while a few earned in excess of \$25,000. The Commission noted that in earlier cases that dealt with income ranges, it mandated particular ranges within which disclosures were required to be made. In *National Dynamics*, however, it elected to set an outer limit on the size of permissible ranges, which given the company's data, was \$4,000.

Thus, if respondents wish to use earnings ranges to give consumers an accurate picture of the earnings achieved by their distributors, it appears they will be able to cover the earnings of over 99 percent of their distributors by the use of at most three ranges. Even allowing for some measure of inflation and improvement in the performance of respondents' distributors, it would appear that at most four or five \$4,000 ranges will, for the foreseeable future, be adequate to permit a description of the earnings of all but a tiny, unrepresentative handful of purchasers [distributors]. Larger ranges, in light of these considerations, could too easily be used to deceive.

The Commission allowed the use of income ranges as long as they meet the following criteria:

- (1) an accurate representation;
- (2) of a particular range or ranges of earnings;
- (3) actually achieved;
- (4) during any stated time period;
- (5) provided that it is accompanied by:
  - (a) a clear and conspicuous disclosure of the percentage that such distributors achieving results within the range constitute of the entire number ALL distributors; or
  - (b) in the event that the company employs ranges beginning with \$0 and proceeding continuously upward, it need only indicate

either the number or the percentage of distributors within each range; and

(6) the disclosure [5(a) or 5(b) above] is printed in type size at least equal to that of the statement of ranges of the distributors who have achieved such results.

As regards range for the highest earnings distributor, the Commission stated that a company can use a representation in the form "\$\_\_\_ or more." It provided the following examples for income ranges:

1. In 2002, (number) of our distributors ((\_\_\_%) of all our distributors) earned from \$5,000 to %10,000.
2. In April, 2002, \_\_\_% of our distributors earned from \$250 to \$500.
3. In the first 9 months of 2002, (number) of our distributors (\_\_\_% of the total) earned from \$500 to \$1,000 each month.

Finally, the Commission listed four criteria that apply to income testimonials. They include:

- (1) an accurate statement of the average amount of time per day, week, or month required by the distributor to achieve the stated results;
- (2) an accurate statement of the year or years during which, and the geographical area(s) in which, the stated results were achieved;
- (3) if the results achieved by the distributor providing the testimonial have not been achieved by at least 10 percent of ALL distributors during the time period covered by the testimonial:
  - (i) a statement of the average or median sales (or profits or earnings, whichever is included in the testimonial) of ALL distributors during the time period covered by the testimonial; *or*
  - (ii) the following statement: IMPORTANT NOTICE: THE RESULTS DESCRIBED ABOVE ARE SUBSTANTIALLY IN EXCESS OF THE AVERAGE RESULTS ACHIEVED BY ALL OUR DISTRIBUTORS. OUR RECORDS SHOW THAT ONLY \_\_\_% OF OUR DISTRIBUTORS HAVE EQUALED OR EXCEEDED THE PERFORMANCE DESCRIBED ABOVE DURING THE INDICATED TIME PERIOD; and
- (4) if the results achieved by the distributor providing the testimonial have been achieved by 10 percent or more of all distributors during the

time period covered by the testimonial, but are in excess of the average or median results achieved by all distributors:

- (i) a statement of the percentage of all the company's distributors who, according to its records, have achieved equal or better results during the same time period; or
- (ii) a statement of the average or median results achieved by all distributors during the same time period.

If the results achieved by the purchaser [distributor] are in fact those of only an unrepresentative fraction of total purchasers [distributors], then we believe it is imperative that consumers be placed on notice in the strongest terms of the unrepresentativeness of the stated performance. A disclosure of average earnings should be sufficient to notify viewers of the full extent of the disparity. If [a company] does not wish to compile average figures, then it must make a disclosure which warns in the strongest possible terms of the unrepresentativeness of the [distributor]. The alternative disclosure provided would not require any additional record keeping on [the company's] part, since it requires only a disclosure of the fraction of purchasers who, according to whatever records [the company] has chosen to keep, have equaled or exceeded testimonial performance.

Examples of proper testimonials provided by the Commission include:

1. In 2002, Jane Doe earned \$\_\_\_ in the New York metropolitan area, spending an average of \_\_\_ hours per week on the job. The average earnings for all our distributors during the same period were \$\_\_\_.
2. In 2002, John Doe earned \$\_\_\_ in the Chicago metropolitan area, spending an average of \_\_\_ hours per week on the job. Fifteen percent of all our distributors did as well as or better than John that year.

#### **4. *In re Larry Brog*<sup>15</sup> and the Computation of "Average"**

*In re Larry Brog* dealt with representations regarding distributor income and the computation of "average" distributor earnings. The Commission found that Brog's promotional literature "represented, directly or by implication, that the income figures

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<sup>15</sup>*In re Larry Brog*, 106 F.T.C. 576 (Dec. 3, 1985).

shown thereon reflect an average which is computed by taking into account the *total number of distributors* who have advanced to the specified bonus level and the amount of money earned by each of them during the month in question.” The FTC concluded, however, that:

In truth and in fact, the income figures shown on the flipcharts do not reflect an average which is computed by taking into account *the total number of distributors who have advanced to the specified bonus level and the amount of money earned by each of them during the month in question*. Respondent provides distributors with monthly income figures for use on the flipchart which are computed by taking into account only those distributors *who earn some income during the month in question*, and the total amount of money earned by them. *Because the large majority of distributors earn no income during a given month, this manner of computation results in average income figures which are substantially larger than would be the case if the figures were computed by the method set forth in Paragraph Ten*. Therefore, respondent's representation as set forth in Paragraph Ten is false and misleading.

(Emphasis added.)

The Commission ordered Brog to cease and desist from representing as an “average,” directly or by implication, any computation of income levels, earnings, sales or other payments received by distributors as a whole or by a specified distributor category which was based on less than all distributors in the stated category, unless the fact that some distributors are excluded and the basis for any such exclusion are clearly and prominently disclosed in close proximity to such representation. The Commission defined a “distributor” as

any person, partnership or corporation which is granted the right to offer, sell or distribute goods or services manufactured, processed, distributed, offered or sold by [the company] or to recruit other persons, partnerships or corporations to be distributors of [the company's] goods or services.

It has been my experience that in an attempt to increase the marketability of their respective opportunities, the companies that provide disclosures regarding “average” distributor compensation invariably exclude certain distributors, namely

“inactive” distributors. The Commission’s definition of “average” appears to allow such an exclusion, so long as it clearly and conspicuously discloses: (1) the fact of exclusion; and (2) the basis for the exclusion.

Notwithstanding the Commission’s definition of “average,” however, recent FTC enforcement action strongly suggests that if a company excludes certain distributors from its computation of “average,” the two disclosures are not sufficient. In addition to the two disclosures, I strongly recommend that the company indicate the percentage that the “reported” distributors constitute relative to *all* distributors of any stripe.

### **5. In the Matter of Amway Corporation**

Twenty-one days after the Commission handed down its last order in *National Dynamics*, the FTC filed suit against the Amway Corporation.<sup>16</sup> Among other things, the FTC alleged that Amway falsely represented that it was “easy to recruit distributors” and that “distributors will receive substantial earnings.”<sup>17</sup> The complaint also alleged that Amway misrepresented the profitability of a distributorship by failing to disclose that there was substantial turnover among its distributors, and that substantial expenses are incurred in the business of being an Amway distributor.<sup>18</sup>

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<sup>16</sup>*In the Matter of Amway Corporation, Inc. et al.*, 93 F.T.C. 618 (1979).

<sup>17</sup>In its complaint, the FTC contended:

PAR. 22. . . . respondents and their representatives or agents represent, and have represented, directly or by implication, to distributors, dealers and prospective participants, that:

1. It is easy for distributors or dealers to recruit and/or retain persons to participate in the program as distributors, dealers or sales personnel.
2. Distributors or dealers in the program can anticipate receiving or will receive substantial profits or earnings.

PAR. 23. In truth and in fact:

1. It is not as easy as respondents represent for distributors or dealers to recruit and/or retain as distributors, dealers or sales personnel persons who will participate in the sales program.
2. Distributors or dealers in the sales program do not receive nor are likely to receive the substantial profits or earnings that respondents represent that they will receive or are likely to receive.

(Complaint, pp. 13-14)

<sup>18</sup>The FTC specifically alleged:

Some of the representations involved in the Amway case included:

- ✗ To build a big business you, plus your 10 distributors-each sponsoring 4 people (total 51 distributors) with everyone selling one hour per day you will earn . . . your total monthly profit \$1,368.00. Excellent income for one hour per day.
- ✗ To build a larger business . . . you simply sponsor 10 distributors who work . . . one hour per day . . . You will earn . . . Your total monthly profit . . . \$264.00. Great income for one hour per day.
- ✗ Amway six year plan for financial independence. Step 1--become a direct distributor . . . Step 2--develop one direct distributor per year . . . Annual income after 6 years \$24,300.00.
- ✗ Assuming that you become a Direct Distributor within a year's time and that you develop a Direct Distributor each year for the next five years, at the end of six years you can be earning in Direct Distributor bonuses \$225 x 5, or a total of \$1,125 a month. . . . The \$1,069 a month which you receive on your personal group and the 3% refund bonuses of \$1,125 on the 5 Direct Distributors whom you personally sponsor will amount to \$2,194 a month or a total of \$26,328 a year. This is gross income for managing a business of your own. This can be your six-year plan for financial independence.

Amway's "Career Manual" trained distributors to recruit prospects by appealing to their financial goals of prospects. The suggested presentation provided that the distributor should:

Announce to your guests that you would like to tell them about an exciting opportunity to be in business for themselves and to develop an income of as much as \$1,000 per month. Explain that it is an opportunity that grows as they share it with others.

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PAR. 24. The following statements constitute material facts with respect to the making of claims or representations regarding the potential for recruitment of prospective distributors or dealers and/or the profitability of a distributorship or dealership:

1. There is a substantial turnover or dropout rate of distributors, dealers, wholesale and retail sales personnel, and a constant recruitment effort must be made simply to maintain a constant number of sub-distributors, sub-dealers, or sales personnel.
2. There are substantial business expenses associated with an active Amway distributorship or dealership.

(Complaint, pp. 13-14)

Ask if they are as successful as they would like to be. If not, would they be interested in a chance to realize their dreams through a business of their own that they can build on a part time basis--and, with such a modest initial expenditure? An opportunity does exist that will give them such a chance.

What does all this mean to you? It means you can become a part of a dynamic growing organization. It means that this opportunity can mean the realization of your dreams.

What are some of your dreams?

Do you want a new car, a new house, college education for your children?

Do you want retirement income that will afford you a comfortable standard of living?

What income do you want six years from now?

Are you willing to work hard to get this?

How much extra money per month do you need for that new car? \$100 a month or more?

What kind would you like--a Chevrolet, Pontiac, Oldsmobile?

How much money per month do you need for that new house?

What kind of home do you want--a three-bedroom ranch--with a price tag of \$35,000-\$40,000?

How much will you need for monthly payments--\$250, \$300 a month?

How much will it take to send the youngsters through college--\$2,500 to \$3,000 a year for each youngster?

If you could earn an extra \$250 a month, you would have an additional \$3,000 a year. This might be sufficient to send one youngster through one year of college.

How much would you like as a continuing income--\$1,000 a month?

Would you work for your goal?

Would you be interested if I could show you a way you can make your dreams come true?

Would you be interested in a way to achieve this on a part-time basis?

What would you be willing to give up to get this?

You can realize the achievement of your dreams through the Amway Sales and Marketing Plan. It is broad enough for you to achieve

whatever your goal is. First of all, you start like everyone else--you are sponsored by another Amway distributor. You are in business for yourself, but not by yourself. You buy Amway products at wholesale from your sponsor, and you sell them at retail to your customers.

In his adjudication of the case, and specifically the issue of hypothetical examples, the Administrative Law Judge found:

The Amway literature stresses that retail selling is essential, and that sponsoring new distributors brings the responsibilities of training, motivating and supplying. The literature also warns the distributor never to give the impression that a business can be built only by sponsoring new distributors and not to quote dollar incomes by specific distributors or otherwise to imply that the plan is for anyone 'who is unwilling to work hard.' In this context, it is clear that drawing the circles to show the Amway plan is not an attempt to deceive prospects into believing that such earnings are 'typical' for Amway distributors, *Goodman v. FTC*, 244 F.2d 584, 595-96 (9th Cir. 1957), or that distributors 'will obtain' the amount specified. *Tractor Training Service v. FTC*, 227 F.2d 420, 425 (9th Cir. 1955), *affirming*, 50 F.T.C. 762, 769, 774.

For the same reason, there is no law violation in Amway's use of the \$1000 figure as the earnings of a business which a distributor 'may build.' There is no doubt that some Amway distributors earn that amount. It is used to entice prospects to an opportunity meeting where the details of the Amway Sales and Marketing Plan can be explained. In the context of the plan, it is clear that the amount is not meant to represent the average or typical earnings of an Amway distributor.

The Commission affirmed the findings and conclusions of the Administrative Law Judge, with the exception of Amway's "income questions" and hypothetical examples. The Commissions concluded:

The different kinds of alleged misrepresentations involved are discussed in detail in the Initial Decision at pages 17-23 and 48-57. Most come from the 1975 edition of the Amway Career Manual, from the section advising a would-be sponsor on how to go about recruiting a new distributor. The method employed consists of explaining the

Amway plan and appealing to the financial goals of the recruit. The ALJ found that, viewed in context, none of the statements challenged constitutes an illegal misrepresentation. Initial Decision, pp. 110-18. *With the exception of those statements which make unrealistic earnings or sales claims, we affirm this finding.*

The 'non-earnings' claims made by Amway — which generally consist of vague references to the achievement of one's dreams, having everything one always wanted, etc. — are phrased in terms of 'opportunity' or 'possibility' or 'chance'; and they are surrounded by warnings that hard work is required. *We believe that these claims are primarily inspirational and motivational; to the extent that they dangle the likelihood of financial security and material success before the potential distributor, they constitute vague 'puffs' which few people, if any, would take literally; and in any event, they are accompanied by appropriate qualifiers.*

The same cannot be said, though, for certain statements and claims which contain references to *specific dollar amounts* which distributors are likely to earn. For example, in the 1975 Career Manual, Amway advises recruiting distributors to announce to persons they are trying to recruit that Amway offers an opportunity to 'develop an income of as much as \$1,000 per month.' Amway also advises recruiting distributors to ask questions like the following:

How much money per month do you need for that new car?  
\$100 a month or more?

What kind of home do you want--a three-bedroom ranch--with a price tag of \$35,000-\$40,000? [27]

How much will it take to send the youngsters through college--\$2,500 to \$3,000 a year for each youngster? If you could earn an extra \$250 a month, you would have an additional \$3,000 a year. This might be sufficient to send one youngster through one year of college.

How much would you like as a continuing income--\$100 a month?

(Emphasis added.)

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Part of Amway's recruiting strategy included the use of hypothetical examples. Unfortunately, Amway's used a number for average monthly distributor volume (\$200) that was many times higher than the actual number (\$33). The Commission wrote:

. . . At one point in the Career Manual it states: 'If you make 'two sales a day . . . the Amway way' on each of 20 days per month, your retail sales can easily amount to \$200.00 per month even though you work less than an hour per day.' The Manual uses this \$200 figure again when it instructs a recruiting distributor on how to 'draw the circles'--a device used to explain the way a distributor earns a Performance Bonus off the purchases made from him by the distributors he has sponsored. He is advised to state: 'Let's say, for example, that you sponsor six distributors and that each one of these distributors starts his own retail business selling \$200 a month.' He then draws a big circle, representing the sponsor, and six smaller circles, each of which represents a sponsored distributor. The figure \$200 is written into each of these six smaller circles to indicate that each sponsored distributor has a Business Volume of \$200 per month. The recruiting distributor then does a series of calculations showing the Performance Bonus the sponsor will earn as a result of having six sponsored distributors with individual monthly Business Volumes of \$200. In the example of this diagram included in the Career Manual, the following language is placed above the circles: 'For discussion purposes, let's round out the numbers to \$200.00. I'm sure you realize that some will do much less and some more. But, if they make two sales a day, they should sell at least \$200 (at BV) per month.' *But in spite of this prominent disclaimer, the impression is created that \$200 is a typical or average monthly Business Volume.*

In fact, the record shows that in 1969-70 the average monthly Business Volume of Amway distributors, was about \$20, and in 1973-74 it was about \$33. And while some Direct Distributors do have annual Business Volumes in the thousands of dollars, they are less than 1 percent of Amway's 360,000 distributors. *Thus the claims of incomes of \$100 to \$1,000 per month and the use of the \$200 figure in such a way as to imply that it is a typical monthly retail sales figure, constitute misstatements of the amount of money a distributor is likely to earn.*

*The \$200 Business Volume figure overstates the true average Business Volume by more than 500 percent. And the often unqualified claims regarding actual income are even more removed from reality, at least as reality exists for the vast majority of Amway distributors.*

The Commission ultimately concluded that:

Amway's specific earnings and sales claims are similar to the claims in *National Dynamics*: they far exceed the amounts normally received by distributors, and, in their cumulative impact, they have the capacity and tendency to lead potential distributors to believe that a substantial number of distributors really do receive such amounts. Therefore, they constitute illegal misrepresentations under Section 5.

Respondents have also made earnings and sales claims which have the capacity to deceive the potential distributors to whom they have been made; this too, is in violation of Section 5.

## **Conclusion**

The issue of income claims and earnings representations *is* a “bet the farm” proposition. The life of a company can be jeopardized by improper claims.

It is imperative that corporate executives and distributors realize that income claims are first and foremost, a legal exercise. They are only secondarily – and a very distant second at that – a sales and marketing exercise.

When it comes to income claims, ***more disclosure*** is infinitely better than less. Do not play games. Do not spin or position the numbers. Do not try to be cute. Just tell it like it is -- ***all of it!***

# Income Disclosure Statement for 2002

Active Distributor Rank	Average hours worked per week	Number of Distributors at this Rank	Percent of <b>active</b> distributors	Percent of <b>all</b> distributors	2002 Annual Income (U.S. Dollars)			Months Active in Company X		
					High	Low	Average	High	Low	Average
Supervisor	8	6092	58%	14.5%	\$600.00	\$10.00	\$50.00	70	12	24
Manager	14	3704	35%	9.75%	\$3,000.00	\$10.00	\$200.00	80	12	27
Executive	21	693	6.5%	1.625%	\$200,000.00	\$10.00	\$3,000.00	81	13	32
Gold Executive	32	44	0.004%	0.001%	\$240,000.00	\$8,000.00	\$75,000.00	82	14	41
Platinum Executive	35	8	0.00075%	0.00018%	\$650,000.00	\$110,000.00	\$300,000.00	97	24	48

The income statistics above are for all **active** U.S. \_\_\_\_\_ Distributors who were eligible to earn downline commissions in 2002. An "active distributor" is defined as \_\_\_\_\_. Those Distributors at the Consultant level are not included in the statistics above because Consultants are not eligible to earn downline commissions. The average annual income for **all** Distributors in 2002 was \$\_\_\_\_\_. **In 2002, \_\_\_% of all distributors received no income at all.** The chart below shows the percentage of distributors who received bonus and commission checks in one to twelve calendar months during 2002.

	1 Check	2 Checks	3 Checks	4 Checks	5 Checks	6 Checks	7 Checks	8 Checks	9 Checks	10 Checks	11 Checks	12 Checks
Percent of all distributors	6.25%	5.81%	4.04%	3.76%	3.52%	3.06%	3.29%	2.26%	3.08%	2.47%	2.89%	2.51%
Average earnings	\$1.41	\$1.93	\$6.70	\$9.34	\$25.92	\$37.52	\$45.54	\$52.18	\$59.55	\$68.22	\$91.32	\$143.22

The earnings of the Distributors in this chart are not necessarily representative of the income, if any, that a [Company] Distributor can or will earn through his or her participation in the [Company] Compensation Plan. These figures should not be considered as guarantees or projections of your actual earnings or profits. Any representation or guarantee of earnings would be misleading. Success with [Company] results only from successful sales efforts, which require hard work, diligence, leadership. Your success will depend upon how effectively you exercise these qualities.