

FTC v. AdvoCare: Enforcement Action Demonstrates Importance of Compliance Programs

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On October 2, 2019, the FTC announced a settlement with AdvoCare International, L.P., in which AdvoCare, without admitting or denying the allegations in the order, agreed to abandon its multi-level compensation plan.^[1] Under the order, AdvoCare must pay the FTC \$150,000,000, which will be deposited into a fund for equitable relief.^[2] The question now is: what does this enforcement action and the resulting settlement mean, if anything, for the direct selling industry as a whole? Here, we answer that question and discuss lessons that can and should be learned from the AdvoCare enforcement action.

From the outset, it should be noted that we've fielded plenty of calls from our direct selling clients who are concerned about the AdvoCare situation and wonder whether their organizations will be targeted by the FTC and, if so, what can be done to prevent that. Our answer: contrary to the flurry of fear currently striking the direct sales channel, the AdvoCare enforcement action does not ring the death knell for multi-level marketing companies. It is true that the FTC is using this enforcement action to create a media blitz to put multi-level marketing companies in the hot seat. But in so doing, the FTC went too far and was called out by AdvoCare for falsely stating at the press conference that AdvoCare had admitted it was a pyramid scheme. Whatever AdvoCare's reasons for settling, and there are too many possibilities on which to even speculate here, AdvoCare simply did not admit that it was a pyramid scheme.

Looking past the FTC's hyperbole, the FTC reconfirmed two things: (1) that multi-level marketing is not inherently illegal and (2) that it is focused on the very same key compliance principles that it has been focused on for years.

Well, what are those principles? First, companies must strictly police misrepresentations and misleading income and lifestyle claims concerning the business opportunity presented to potential recruits. Second, companies must avoid having a culture that focuses on recruitment over a focus on real sales to consumers who use and consume the products. The focus should always be, first and foremost, on the product and selling that product to consumers. And third, companies with policies that require distributors to personally buy a specific amount of product to be eligible for compensation are suspect and will raise a red flag. The FTC has been repeating these same warnings for a very long time. Thus, although the AdvoCare settlement might embolden the FTC in future enforcement actions, the simple truth remains that the *Koscot* test and the FTC's previous guidance on the bounds of legitimate multi-level marketing still stand.

That said, there remain key lessons that can be learned from the AdvoCare enforcement action. One of those is that it is critical to have robust policies and procedures with a compliance team that has proven power to enforce those policies and procedures. And companies must have a means of monitoring and documenting compliance measures so that they can demonstrate that the policies are actually enforced. Also, there cannot be evidence of distributors or employees instructing others to focus on recruitment at the expense of real sales. Finally, a monthly PV requirement that can only be met by personal distributor purchases should be avoided.

Winston & Strawn has assisted many direct sellers in auditing their current business practices and policy and procedure enforcement procedures for compliance with FTC guidance. Winston routinely provides advice on improvements to those practices and procedures in an effort to help direct sellers avoid FTC scrutiny and withstand such scrutiny if the FTC comes knocking. Please contact us if we can be of any assistance to your team.

The Enforcement Action In More Detail

Viewing the FTC's statements, the complaint, and the AdvoCare stipulated order in conjunction, it's plain that the FTC continues to focus on what it believes to be misleading representations regarding the business opportunity (*i.e.*, misleading income and lifestyle claims) and preventing promotion of recruitment over real sales to real customers outside the organization. In the complaint, the FTC referenced a large number of what they considered to be income and lifestyle misrepresentations, as well as numerous statements and tutorials/lessons that they believed elevated recruitment over product sales. [3] Further, during the FTC's press conference, the FTC explained that any company that requires distributors to buy a specific amount of product to be eligible for compensation should be avoided.[4]

More specifically, the complaint detailed over two dozen statements allegedly made by AdvoCare or certain high-level distributors that the FTC argued were clear misrepresentations of the business opportunity, including:

- Claims by high-level distributors regarding their monthly income, including one unnamed distributor's claim that "the sky's the limit. There is no ceiling on our income" and another who stated at a 2018 AdvoCare Corporate event, "where in Corporate America can you give yourself a \$100,000 raise by working side-by-side with your best friend." [5]
- One named defendant and high-level distributor, Lisa Hardman also allegedly stated that AdvoCare "has the potential, with very little overhead, to pay you millions and millions of dollars" and "nowhere else in America can you go and earn the kind of income that's possible here." [6]
- Other distributors made claims on various social media platforms, including named defendant Diane McDaniel, who in posting about the AdvoCare opportunity used hashtags like #beachhouse, #financialfreedom, and #dreamcar, while another distributor used social media to post "\$2,833,355.94 What if this figure was possible for you to earn with a part-time income opportunity?" [7]
- The FTC also focused on AdvoCare distributors repeated messages that they are "ordinary people who chose to pursue the AdvoCare business opportunity," identifying training materials in which one distributor, after noting he made \$229,000 in the previous month, stated "We're just regular folks, guys. There is nothing special about us." [8]
- The complaint also alleges that "central to Defendants pitch is the prospect of earning substantial income through AdvoCare," citing to statements by Diane McDaniel who told her fellow distributors "to convince consumers they would make more money. Because that's the lingo they are looking for – more money...more money. More money." [9]
- Finally, the FTC also focused a substantial portion of the complaint on AdvoCare and its distributors' "purported income disclosures." [10] The complaint alleges that "income ranges on AdvoCare's disclosure statement were reported as "annual average income" but were actually annualized earnings-based only on pay periods where Distributors earned checks." [11] As an example, the FTC stated that "one year of income consisting of one \$100 check would thereby count as \$2,400 in average annual income." [12] These income disclosures were printed on posters and provided to distributors to use in marketing. [13]

While the FTC's focus on business opportunity misrepresentations is nothing new, [14] in the AdvoCare enforcement action the FTC provided specific examples of the kind of statements that they are scrutinizing. Further, the FTC's October 2019 consumer-facing guidance notes promoters of a pyramid scheme "may try to recruit you with pitches about what you'll earn. They may say you can change your life—quit your job and even get rich—by selling the company's products. That's a lie." [15] The 2019 consumer-facing guidance also warns potential participants to be wary of "extravagant promises about earning potential," emphasis on recruitment as the "real way to make money," and the use of "emotions or high-pressure sales tactics" like emphasis on losing out on an opportunity to make money. [16] Many of these "warning signs" track the FTC's complaint against AdvoCare. [17] For instance, the complaint highlighted that AdvoCare and its high-level distributors allegedly taught other distributors "to create a "fear of loss" in recruits," by using such messaging like "You can lose \$50,000 by not going." [18] As the complaint makes clear, the FTC will closely scrutinize direct-selling companies' marketing materials to ensure compliance with its guidance.

Furthermore, the complaint contends that AdvoCare's business plan is based on a structure that encourages people to reach a certain status and to recruit other consumers to reach the same status, through recruitment alone, rather than the sale of products to people who consume and use them. [19] First, the FTC asserts that AdvoCare, along with certain high-level distributors, "encourages consumers to personally purchase products to satisfy compensation plan requirements," suggesting that distributors were not purchasing products for consumer demand. [20] In its guidance, the FTC has expressed concern that certain compensation structures could incentivize participants to buy product and recruit or pressure other participants to buy product "for reasons other than their own or other consumers' actual demand," and rather, to advance in the marketing program. [21] The complaint cites to statements by AdvoCare and individual distributors encouraging other AdvoCare distributors to "personally purchase products to qualify for Advisor," with some high-level distributors like the McDaniel defendants "pressuring recruits to take financial risks to reach Advisor" status. [22] The complaint also notes that some distributors would "purchase products on other distributors' accounts. . . . These purchases are untethered to retail sales activity or demand and are instead made only to qualify for increased compensation." [23]

The FTC's complaint also details a number of tactics allegedly used by AdvoCare and certain distributors to encourage recruitment over product sales. [24] The complaint identifies statements by high-level distributors, such as "I'm not selling Spark [an AdvoCare product] I am selling stay at home mommies . . . We sell freedom," which the FTC contends is intended to dissuade consumers from focusing on retail sales and focus instead on recruitment. [25] In its guidance, the FTC has routinely stated that "at the heart of a legitimate MLM are real product sales to real customers" and has further expounded on that statement, explaining that such sales should be to "people unaffiliated with the company" and "profitable and verifiable." [26] In its October 2019 guidance to consumers, the FTC states "[i]f the MLM is not a pyramid scheme, it will pay you based on your sales to retail customers, without having to recruit new distributors." [27]

At base, the FTC's 2018 Business Guidance explains that in evaluating the lawfulness of a multi-level marketer, the FTC scrutinizes an organization's compensation structure, the organization's treatment of internal consumption, sales to customers, and the marketing and advertising of the organization's multi-level marketing program. This scrutiny is reflected in the AdvoCare complaint and stipulated order. Thus, there is no need to feed the frenzy of fear the FTC is attempting to create. Rather, companies must double down on their compliance efforts using the AdvoCare complaint as a guide to identify the practices and activities that MLMs must police, prevent, and avoid.

[1] See Press Release, Federal Trade Commission, Multi-Level Marketer AdvoCare Will Pay \$150 Million To Settle FTC Charges it Operated an Illegal Pyramid Scheme, *available at* <https://www.ftc.gov/news-events/press-releases/2019/10/multi-level-marketer-advocare-will-pay-150-million-settle-ftc>; see also *FTC v. AdvoCare International, L.P.*, Case No. 4:19-cv-00715 (E.D. Tex. Oct. 2, 2019).

[2] See Stipulated Order for Permanent Injunction and Monetary Judgment Against Defendants AdvoCare International, L.P. and Brian Connolly at Part VI. ¶ G, *FTC v. AdvoCare International, L.P.*, Case No. 4:19-cv-00715 (E.D. Tex. Oct. 2, 2019).

[3] Below, we detail the alleged misrepresentations as identified by the FTC in its complaint. Note that we list these not because they have been verified or to imply that they violate the law. But they are important to catalogue as the

FTC found them important in pursuing an enforcement action against AdvoCare.

[4] See Press Conference, Federal Trade Commission, Oct. 2, 2019 *available at*: <https://www.facebook.com/federaltradecommission/videos/vb.137136626303203/508585946387892/?type=2&theater>; see also Seena Gressin, *FTC: AdvoCare business model was pyramid scheme*, FTC Blog, (Oct. 2, 2019), <https://www.consumer.ftc.gov/blog/2019/10/ftc-advocare-business-model-was-pyramid-scheme>.

[5] See Plaintiff's Complaint for Permanent Injunction and Other Equitable Relief at 7-8, *FTC v. AdvoCare International, L.P.*, Case No. 4:19-cv-00715 (E.D. Tex. Oct. 2, 2019).

[6] *Id.* at 8.

[7] *Id.* at 8-9.

[8] *Id.* at 11.

[9] *Id.*

[10] *Id.* at 12-14.

[11] *Id.* at 13.

[12] *Id.*

[13] *Id.*

[14] In early 2018, the Federal Trade Commission released business guidance for direct sellers and multi-level marketers describing the principles it will apply when evaluating companies' practices under the FTC Act. See Federal Trade Commission, Business Guidance Concerning Multi-Level Marketing ("2018 Business Guidance"), *available at* <https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing>. The 2018 Business Guidance reiterates that the *Koscot* test is key to the FTC's analysis, and also echoes much of its earlier guidance regarding MLMs; see also Lesley Fair, *Redress checks and compliance checks: Lessons from the FTC's Herbalife and Vemma cases*, <https://www.ftc.gov/news-events/blogs/business-blog/2017/01/redress-checks-compliance-checks-lessons-ftcsheralife> (FTC Guidance Jan. 10, 2017); Edith Ramirez, *Keynote Remarks of FTC Chairwoman Ramirez, DSA Business & Policy Conference*, https://www.ftc.gov/system/files/documents/public_statements/993473/ramirez_-_dsa_speech_10-25-16.pdf.

[15] See Federal Trade Commission, Multi-Level Marketing Businesses and Pyramid Schemes, *available at* <https://www.consumer.ftc.gov/articles/0065-multi-level-marketing-businesses-and-pyramid-schemes>. Along with the release of the AdvoCare complaint, the FTC also updated additional consumer-facing guidance that reiterates much of what was contained in earlier guidance.

[16] *Id.*

[17] See Plaintiff's Complaint for Permanent Injunction and Other Equitable Relief at 6-16, *FTC v. AdvoCare International, L.P.*, Case No. 4:19-cv-00715 (E.D. Tex. Oct. 2, 2019).

[18] *Id.* at 12.

[19] *Id.* at 16-26.

[20] *Id.* at 17-18.

[21] See 2018 Business Guidance, Q&A 5.

[22] See Plaintiff's Complaint for Permanent Injunction and Other Equitable Relief at 17-18, *FTC v. AdvoCare International, L.P.*, Case No. 4:19-cv-00715 (E.D. Tex. Oct. 2, 2019).

[23] *Id.* at 19.

[24] *Id.* at 20-21 (alleging growth happens not from retail purchases, but through recruitment of more advisors).

[25] *Id.* at 21.

[26] Lesley Fair, *Redress checks and compliance checks: Lessons from the FTC's Herbalife and Vemma cases*, <https://www.ftc.gov/news-events/blogs/business-blog/2017/01/redress-checks-compliance-checks-lessons-ftcsherbalife>.

[27] See Federal Trade Commission, *Multi-Level Marketing Businesses and Pyramid Schemes*, available at <https://www.consumer.ftc.gov/articles/0065-multi-level-marketing-businesses-and-pyramid-schemes>

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