

1 NOT FOR PUBLICATION
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6 **IN THE UNITED STATES DISTRICT COURT**
7 **FOR THE DISTRICT OF ARIZONA**

8
9 Federal Trade Commission,
10 Plaintiff,

No. CV-15-01578-PHX-JJT

ORDER

11 v.

12 Vemma Nutrition Company, *et al.*,
13 Defendants.

14 At issue is the Motion to Approve Revised Compensation Plan (Doc. 155, Mot.)
15 filed by Defendants Vemma Nutrition Company and Vemma International Holdings, Inc.
16 (collectively, “Vemma”), to which Plaintiff Federal Trade Commission (“FTC”) filed a
17 Response in opposition (Doc. 158, Resp.) supported by a Supplemental Declaration by
18 Dr. Stacie Bosley (Doc. 158-1. Bosley Supp. Decl.). The Court heard oral argument on
19 the Motion on October 21, 2015. (Doc. 159.) For the reasons that follow, the Court will
20 deny the Motion.

21 In an effort to comply with the Court’s September 18, 2015 Preliminary Injunction
22 Order (Doc. 118) and the FTC Act, Vemma has proposed a new plan for the
23 compensation of its Affiliates.¹ (Mot. at 2; Doc. 155-1 at 2-13, Proposed Compensation
24 Plan.) Under the plan, an Affiliate is defined as a participant who “intends to participate
25 and earn rewards under Vemma’s Marketing Plan,” and a Customer is a participant who
26 “is interested in purchasing and using” Vemma products. The plan makes some
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¹ The Court adopts its factual findings in the Preliminary Injunction Order (Doc. 118) to the extent they are applicable here.

1 adjustments to the number of Personal Volume (PV) points required for an Affiliate to
2 qualify for bonuses, and an Affiliate's own purchases of Vemma products do not earn the
3 Affiliate qualifying PV points. Under the "51% Rule," full bonuses are paid to an
4 Affiliate if 51% of the sales of the Affiliate's organization are to Customers. When less
5 than 51% of sales are to Customers, an Affiliate is still paid a bonus, but the portion of
6 the bonus resulting from sales to Affiliates may not exceed the bonus resulting from sales
7 to Customers.

8 The FTC objects to Vemma's proposed compensation plan on the grounds that it
9 still incentivizes recruitment of Affiliates over retail sales in violation of the Preliminary
10 Injunction and the FTC Act. (Resp. at 2-7.) Specifically, the FTC argues that the 51%
11 Rule is an insufficient anti-pyramiding safeguard because it provides an Affiliate
12 significant compensation even if most of the Affiliate's sales are to downstream
13 Affiliates, not Customers. (Resp. at 5-7.) This argument is premised on the presumption
14 that a downstream Affiliate's own purchases of Vemma products will be motivated by
15 income opportunities for upstream Affiliates and not personal consumption, leading to
16 inventory loading. (Resp. at 2-5.) For its part, Vemma contends that if the economic
17 behavior of Affiliates is rational, they will purchase products only because they want to
18 consume them, not because they want to allow upstream Affiliates to earn bonuses.
19 (Oct. 21, 2015 Hr'g Tr. at 35:16-24.) Vemma also states that it will not promote or
20 develop new sales and marketing materials that incentivize Affiliates to buy products for
21 income opportunities rather than for personal consumption. (Hr'g Tr. at 36:5-8.)

22 In assessing the foreseeability that Affiliates will continue to engage in inventory
23 loading under the proposed compensation plan, the Court must consider that Vemma is a
24 ten year-old company with an existing culture and history and that its thousands of
25 existing Affiliates developed their businesses in an environment in which they were
26 encouraged to purchase product not for personal consumption, but rather to give away as
27 samples to potential new Affiliates, among other things. (*See* Bosley Supp. Decl. at 3.) In
28 this context, it is foreseeable that Affiliates will perceive that the proposed compensation

1 structure continues to hinge bonuses on Affiliate consumption, not sales to Customers,
2 and they will behave accordingly. (*See* Bosley Decl. at 3.)

3 The principal defect with the proposed 51% Rule is that it does not provide any
4 real disincentive for the majority of an Affiliate's sales to be to downstream Affiliates.
5 Using the FTC's example, if 60% of the sales of an Affiliate's organization are to
6 downstream Affiliates and not Customers, the Affiliate is still fully compensated for the
7 40% of sales made to Customers—even though they did not constitute most of the
8 Affiliate's sales—and, more disconcertingly, the Affiliate is also compensated almost
9 40% more for the sales made to other Affiliates—even though those sales may in fact be
10 inventory loading. The Affiliate thus earns nearly 80% of the compensation available
11 even though most sales were made to Affiliates. (*See* Resp. at 6.)

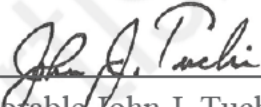
12 Aside from the 51% Rule, the proposed compensation plan contains neither
13 additional anti-inventory loading safeguards nor incentives to sell to Customers rather
14 than Affiliates. By way of comparison, the multilevel marketing company Amway was
15 not considered a pyramid scheme under the *Koscot* test in part because it enforced anti-
16 inventory-loading safeguards that included requirements that at least 70% of the products
17 bought by a distributor were sold to customers and that a distributor must sell products to
18 at least ten different retail customers per month in order to earn a bonus; no bonus was
19 paid if a distributor failed to meet these requirements. *In re Amway Corp.*, 93 F.T.C. 618,
20 716 (1979). As discussed above, Vemma's proposed compensation plan would give
21 Affiliates full bonuses for meeting a lower threshold of sales to customers—51% in the
22 Vemma plan versus 70% in the Amway plan—and Vemma Affiliates would still earn
23 potentially significant bonuses even when the 51% threshold is not met. Nothing like
24 Amway's ten customer rule is present in Vemma's proposed compensation plan, nor does
25 the plan include revised retail pricing or other incentives to encourage sales to Customers
26 rather than Affiliates.

27 Because the 51% Rule can provide significant compensation to an Affiliate whose
28 sales are principally to downstream Affiliates, who may well be inventory loading, and

1 because the proposed compensation plan does not include other anti-inventory loading
2 safeguards or otherwise incentivize sales to Customers rather than Affiliates, the
3 proposed compensation plan does not meet the provisions of the Preliminary Injunction
4 (Doc. 118) or go far enough to prevent pyramiding behavior that violates the FTC Act.
5 The FTC suggests that the Court require that any plan proposed by Vemma only provide
6 for the payment of a bonus to an Affiliate whose organization's sales to Customers are at
7 least 51% of the total sales for the organization. (Resp. at 6.) While Vemma requested
8 that the Court not dictate the terms of its compensation plan, the Court notes that the
9 FTC's suggestion would serve to remedy the issues incumbent in the present 51% Rule.

10 **IT IS THEREFORE ORDERED** denying Vemma's Motion to Approve Revised
11 Compensation Plan (Doc. 155).

12 Dated this 28th day of October, 2015.

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16 Honorable John J. Tuchi
17 United States District Judge
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