

BESTLINE PRODUCTS CORPORATION, ET AL.

CONSENT ORDER, ETC., IN REGARD TO THE ALLEGED VIOLATION OF THE FEDERAL TRADE COMMISSION ACT

Docket C-1986. Complaint, July 22, 1971—Decision, July 22, 1971

Consent order requiring a San Jose, Calif., seller and distributor of household, commercial and industrial cleaners and waxes, and also distributorships for the sale of respondents' products, to cease operating a multi-level program in which profits are dependent upon successive recruitment of others, paying any amount to any person unless in connection with the actual sale of products to the ultimate consumer, requiring prospective participants to make any other payment than that of the actual cost of materials, misusing in any manner the multi-level marketing program, misrepresenting the past earnings of participants, and making other misrepresentations as to the earnings of participants in the multi-level marketing programs.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Bestline Products Corporation and Bestline Products, Inc., corporations, and William E. Bailey and Robert W. DePew, individually and as officers of said

corporations, hereinafter referred to as respondents, have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Bestline Products Corporation, is a corporation organized, existing and doing business under and by virtue of the laws of the State of California, with its principal office and place of business located at 2350 Trimble Road, San Jose, California.

Respondent Bestline Products, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of California, with its principal office and place of business located at 2350 Trimble Road, San Jose, California. It is a wholly-owned subsidiary of Bestline Products Corporation.

Respondents William E. Bailey and Robert W. DePew are officers and stockholders of the corporate respondents. They formulate, direct and control the acts and practices of the corporate respondents, including the acts and practices hereinafter set forth. Their address is the same as that of the corporate respondents.

The aforementioned respondents cooperate and act together in carrying out the acts and practices hereinafter set forth.

PAR. 2. Respondents are now, and for some time last past have been, engaged in the advertising, offering for sale, sale and distribution of household, commercial and industrial cleaners and waxes and distributorships and franchises to the public, and are inducing, and have induced, persons to invest substantial sums of money in respondents' multi-level marketing program as hereinafter more fully described.

PAR. 3. In the course and conduct of their business, respondents now cause, and for some time last past have caused, their products, when sold, to be shipped from their places of business in the States of Illinois and California to purchasers thereof located in various States of the United States other than the state of origination, and in the course of establishing and maintaining their multi-level marketing program have transmitted and received contracts, promotional material and various business papers among and between the several states, and maintain, and at all times mentioned herein have maintained, a substantial course of trade in said products in commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. In the course and conduct of their business as aforesaid,

respondents have used and are now using a multi-level marketing program having four levels of participants. A description of these levels, in order of ascendancy, follows:

1. Retail distributor—The retail distributor purchases products from a subwholesaler or direct distributor at a 30-40 percent discount, for sale to the consuming public.

2. Subwholesaler—The subwholesaler purchases products from a direct-distributor at a 30-51 percent discount for distribution to retail distributors and direct sales to the consuming public. The subwholesaler is entitled to overrides on purchases by retail distributors below him in the chain. He is also entitled to a bonus for recruiting a direct distributor and a commission for recruiting another subwholesaler. An entrant qualifies as a subwholesaler upon purchasing products with a \$400 "refund volume" value.

3. Direct distributor—The direct distributor purchases products directly from the respondents at a 52 percent discount for distribution to subwholesalers and retailers below him in the chain. He is entitled to 22 percent of the "refund volume" value of purchases, made by subwholesalers and retail distributors below him in the chain, less refund bonuses paid according to the sales volume generated by these subdistributors. The direct distributor also receives a commission and continuing override on purchases by a direct distributor or subwholesaler who he has recruited into the marketing program. A participant qualifies as a direct distributor upon purchasing \$6,000 "refund volume" value of products at a cost of \$3,500.

4. General distributor—The general distributor does not normally purchase products for distribution in the chain but he may purchase products at a 60 percent discount. The general distributor is entitled to a commission and continuing override on all purchases by a direct distributor recruited by him, a release fee paid by a direct distributor recruited by him at such time as the direct distributor ascends to the position of general distributor, and a commission and continuing override on all purchases by a general distributor originally recruited by him.

To qualify as a general distributor, a participant must first be a direct distributor, and is required to pay \$2,750 to the respondents and recruit a direct distributor to replace him.

Participants at each level of distribution may sell products on a retail basis to the consuming public.

Respondents represent through oral and written statements to prospective investors that it is not difficult to sell their household cleaning products and to recruit additional participants in their market-

ing plan and thereby achieve high levels of income. Typical and illustrative of said statements and representations, but not all inclusive thereof, are the following:

1. If a subwholesaler recruits six (6) retailers and each of those six buy from the subwholesaler \$200 in products in one month, and in addition the subwholesaler sells \$200 in products at the retail level, the subwholesaler will earn in profit \$210 that month.

2. In the following month, if each of the six (6) retailers initially recruited by the subwholesaler in the example above recruits six (6) retailers below them in the chain, the subwholesaler may become a direct distributor and the initial six (6) retailers may become subwholesalers. If each of the thirty-six (36) new retailers buys \$200 in products from their respective subwholesalers, and the six (6) subwholesalers buy \$1,400 in products from the direct distributor, and the direct distributor sells \$200 in products at retail, the direct distributor will earn in profit \$1,046 that month.

PAR. 5. Respondents' multi-level marketing program contemplates a virtually endless recruiting of participants in the sales program. Further, additional participants must increase progressively to insure the participants the represented financial gains while the overall number of potential investors remains relatively constant. Thus, the participant may be, and in a substantial number of instances will be, unable to find additional investors in a given community or geographical area by the time he enters respondents' merchandising program. This comes about because the recruiting of participants who come into the program at an earlier stage has already exhausted the number of prospective participants. As to the individual participant, therefore, respondents' program must of necessity ultimately collapse when the market for distributors becomes saturated.

Although some participants in respondents' multi-level merchandising program may realize a profit, all participants do not have the potentiality of receiving sums of money equal to or greater than those described in Paragraph Four through recruiting other participants and through finder's fees, commissions, overrides, and other compensation arising out of the sale of respondents' products or the recruitment of other distributors by other participants in the program. As a matter of fact, some participants in the program will receive little or no return on their investment.

For the foregoing reasons, respondents' multi-level merchandising program is organized and operated in such a manner that the realization of profit by any participant contemplates, and is necessarily predicated upon, the exploitation of others who have virtually no

chance of receiving a return on their investment and who have been induced to participate by misrepresentations as to potential earnings. Therefore, the use by respondents of the aforesaid program in connection with the sale of their merchandise was and is an unfair act and practice, and was and is false, misleading and deceptive.

PAR. 6. In the course and conduct of their business as aforesaid, and for the purpose of inducing the purchase of their products, and the purchase of distributorships and participation in their multi-level marketing program, the respondents have made, and are now making numerous statements and representations in certain promotional materials, including, but not limited to, film strips, long play records, recorded tapes, news letters, information manuals, marketing plan booklets, meeting scripts and other materials.

Typical and illustrative of said statements and representations, but not all inclusive thereof, are the following:

1. By the time you get the job done, you may have fifty retailers and twenty-five sub-wholesalers * * * [sic].

2. With a little work it is obvious that you could become a direct distributor your second month with the company.

3. We'll show you how you can earn * * * \$100—\$300—\$500 a month and for those a little more serious, \$1000 and \$2,000 per month and more.

100 for working approximately two hours a day.

This is the position that is designed to earn \$2,000, \$3,000 a month and up, and we've got lots of folks, some of them right here in this room, today, who are doing that.

4. It has worked time and time again for hundreds of people in Bestline.

There is no limit to the number of direct distributors that you are allowed to recruit nor to the new areas you can open up with your business.

PAR. 7. By and through the use of the above-quoted statements and representations, and others of similar import and meaning, but not expressly set out herein, and for the purpose of inducing participation by others in their said marketing program and the purchase of their said merchandise, respondents and their agents and representatives, represent, and have represented, directly or by implication, to prospective participants, that:

1. It is not difficult for investors to recruit and retain persons who will invest in said program as distributors and as sales personnel to work home routes and sell respondents' products door-to-door so as to enable said investors to recoup their investment and to earn the represented profits set forth herein.

2. It is not difficult for participants to ascend to a higher level of distribution within the marketing chain so as to increase the chances of said participants to recoup their investment and to earn the represented profits set forth herein.

3. Participants in their said marketing program have the potentiality and reasonable expectancy of receiving large profits or earnings.

4. The said marketing program is commercially feasible for all participants and the supply of available entrants and investors is virtually inexhaustible.

PAR. 8. In truth and in fact:

1. It is difficult for investors to recruit and retain persons who will invest in said program as distributors and as sales personnel to work home routes and sell respondents' products door-to-door so as to enable said investors to recoup their investment and to earn the represented profits set forth herein.

2. It is difficult for participants to ascend to a higher level of distribution within the marketing chain so as to increase the chances of said participants to recoup their investment and to earn the represented profits set forth herein.

3. For the reasons hereinabove set forth, participants in respondents' marketing program do not have the potentiality and reasonable expectancy of receiving large profits or earnings.

4. The said marketing program is not commercially feasible for all participants and by the nature of the said marketing plan as herein described the supply of available entrants and investors must ultimately be exhausted.

Therefore, the statements and representatives as set forth in Paragraphs Six and Seven have been and are false, misleading and deceptive.

PAR. 9. Respondents' merchandising program is in the nature of a lottery in that participants are induced to invest substantial sums of money on the possibility that by the activities and efforts of others, over whom they exercise no control or direction, they will receive the profits described in Paragraphs Four and Six herein. The realization of such financial gain is not dependent on the skill and effort of the individual participant, but is the result of elements of chance including the number of prior participants and the degree of saturation of the market which exists when the participant is induced to make his investment.

The use by respondents of a multi-level marketing program, which is in the nature of a lottery, is contrary to the established public policy of the United States and is an unfair act and practice.

PAR. 10. In the conduct of their business, at all times mentioned herein, respondents have been in substantial competition in com-

merce with corporations, firms and individuals in the sale of home care products of the same general kind and nature as those sold by respondents.

Par. 11. The use by the respondents of the aforesaid false, misleading and deceptive, statements, representations, and practices has had, and now has, the capacity and tendency to mislead members of the public into the erroneous and mistaken belief that said statements and representations were and are true and into the investment of substantial sums of money to participate in the respondents' multi-level marketing program and the purchase of substantial quantities of respondents' products by reason of said erroneous and mistaken belief.

PAR. 12. The aforesaid acts and practices of the respondents, as herein alleged, were and are all to the prejudice and injury of the public and of respondents' competitors and constituted and now constitute, unfair methods of competition in commerce and unfair methods and deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act.

DECISION AND ORDER

The Commission having heretofore determined to issue its complaint charging the respondents named in the caption hereof with violation of the Federal Trade Commission Act, and the respondents having been served with notice of said determination and with a copy of the complaint the Commission intended to issue, together with a proposed form of order; and

The respondents and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondents of all the jurisdictional facts set forth in the complaint to issue herein, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondents that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having considered the agreement and having accepted same, and the agreement containing consent order having thereupon been placed on the public record for a period of thirty (30) days, and having duly considered the comments filed thereafter pursuant to § 2.34(b) of its Rules, now in further conformity with the procedure prescribed in § 2.34(b) of its Rules, the Commission

hereby issues its complaint in the form contemplated by said agreement, makes the following jurisdictional findings, and enters the following order:

1. Respondent Bestline Products Corporation, is a corporation organized, existing and doing business under and by virtue of the laws of the State of California, with its principal office and place of business located at 2350 Trimble Road, San Jose, California.

Respondent Bestline Products, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of California, with its principal office and place of business located at 2350 Trimble Road, San Jose, California. It is a wholly-owned subsidiary of Bestline Products Corporation.

Respondents William E. Bailey and Robert W. DePew are officers and stockholders of the corporate respondents. Their address is the same as that of the corporate respondents.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondents, and the proceeding is in the public interest.

ORDER

It is ordered, That respondents Bestline Products, Inc., Bestline Products Corporation, corporations, and their officers and William E. Bailey and Robert W. DePew, individually and as officers of said corporation and respondents' agents, representatives and employees, directly or through any corporate or other device in connection with the advertising, offering for sale, sale or distribution of household, industrial or commercial cleaners or waxes or other products or of distributorships or franchises in a multi-level or other marketing program or with the seeking to induce or inducing the participation of persons, firms, or corporations in a multi-level or other marketing program in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

1. Operating or, directly or indirectly, participating in the operation of any multi-level marketing program wherein the financial gains to the participants are dependent upon the continued, successive recruitment of other participants.

2. Offering to pay, paying or authorizing the payment of any finder's fee, bonus, override, commission, cross-commission, discount, rebate, dividend or other consideration to any participants in respondent's multi-level marketing program for the solicitation or recruitment of other participants therein.

3. Offering to pay, paying or authorizing payment of any

bonus, override, commission, cross-commission, discount, rebate, dividend or other consideration to any person, firm or corporation in connection with the sale of any product or service under respondent's multi-level marketing program unless such person, firm or corporation performs a bona fide and essential supervisory, distributive, selling or soliciting function in the sale and delivery of such products to the ultimate consumer.

4. Requiring prospective participants or participants in respondents' said program to purchase the product or pay any other consideration, other than payment for the actual cost of necessary sales materials, in order to participate in any manner therein: *Provided, however*, That respondents may require or may suggest the purchase of specific and reasonable inventories only, by any distributor, on the express condition that respondents at the same time agree to repurchase any unused and undamaged portion of an initial inventory from any purchaser thereof at full cost less reasonable shipping costs, if any, within 90 days from the delivery of the product at the option of the purchaser; *Provided further*, however, that if inventory costs reach \$500 or more, within said 90 day period, then said obligation to repurchase shall cease immediately upon participant's tendering a subsequent order to purchase the product.

5. Using any multi-level marketing program, either directly or indirectly:

(a) Wherein any finder's fee, bonus, override, commission, cross-commission, discount, rebate, dividend or other compensation or profit inuring to participants therein is dependent on the element of chance dominating over the skill or judgment of the participants; or

(b) Wherein no amount of judgment or skill exercised by the participant has any appreciable effect upon any finder's fee, bonus, override, commission, cross-commission, discount, rebate, dividend or other compensation or profits which the participant may receive; or

(c) Wherein the participant is without that degree of control over the operation of such plan as to enable him substantially to affect the amount of any finder's fee, bonus, override, commission, cross-commission, discount, rebate, dividend or other compensation or profit which he may receive or be entitled to receive.

6. Using any multi-level marketing program which fails to:

(a) Inform orally all participants in respondents' multi-

level marketing programs and to provide in writing in all contracts of participation that the contract may be cancelled for any reason by notification to respondents in writing within three working days from the date of execution of such contract.

(b) Refund immediately all monies to (1) participants who have requested contract cancellation in writing within three working days from the execution thereof, and (2) participants showing that respondents' contract solicitations or performance were attended by or involved violation of any of the provisions of this order.

7. Representing, directly or by implication, that participants in respondents' multi-level marketing programs will earn or receive any stated or gross or net amount; or representing, in any manner, the past earnings of participants unless in fact the past earnings represented are those of a substantial number of participants in the community or geographical area in which such representations are made and accurately reflect the average earnings of these participants under circumstances similar to those of the participant or prospective participant to whom the representation is made.

8. Representing, directly or by implication, that it is not difficult for participants to recruit or retain persons to invest in respondents' multi-level marketing programs as distributors or as sales personnel to work home routes or sell respondents' products door-to-door or any other manner.

9. Representing, directly or by implication, that it is not difficult for participants to ascend to a higher level of distribution within the marketing chain.

10. Representing, directly or by implication, that all participants in the respondents' multi-level marketing program or any other sales program will succeed.

11. Representing, directly or by implication, that the supply of available entrants or investors in the respondents' marketing program is inexhaustible; or misrepresenting, in any manner, the availability of such entrants or investors.

12. (a) Failing to disclose, orally and in writing, the terms of this order to cease and desist to all present and future distributors, salesmen or other persons engaged in the sale of respondents' products, services, or merchandising programs, and securing from each such distributor, salesmen or other person a signed statement evidencing receipt of said disclosure.

(b) Failing to make available on request a copy of this cease and desist order to any participant or prospective participant.

It is further ordered, That respondents notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent, such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change in the corporation which may affect compliance obligations arising out of this order.

It is further ordered, That the respondent corporations shall forthwith, distribute a copy of this order to each of their operating divisions.

It is further ordered, That the respondents herein shall within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this order.

IN THE MATTER OF

DRUG FAIR, INC., TRADING AS DRUG FAIR

CONSENT ORDER, ETC., IN REGARD TO THE ALLEGED VIOLATION OF

THE FEDERAL TRADE COMMISSION ACT