

Complaint

IN THE MATTER OF

DEVOUR CHEMICAL COMPANY, INC., ET AL.

CONSENT ORDER, ETC., IN REGARD TO THE ALLEGED VIOLATION OF THE
FEDERAL TRADE COMMISSION ACT*Docket C-2294. Complaint, Oct. 2, 1972—Decision, Oct. 2, 1972.*

Consent order requiring an Alma, Arkansas, manufacturer, seller, and distributor of household cleaners, among other things to cease its operation of a marketing program where financial gains to participants are dependent upon not only the sale of the promoter's goods, but upon the sale of redistributorships necessarily predicated upon the exploitation of others as well; misrepresenting past earnings of participants; running a program in the nature of a lottery; failing to inform participants of their right to cancel their contract within three business days; and furnishing means and instrumentalities of deception.

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 Devour Chemical Company, Inc., a corporation, and Otis D. Powell, Jr., individually and as an officer of said corporation, 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 Devour Chemical Company, Inc., is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Arkansas with its principal office and place of business located at Highways 64 and 71, in the city of Alma, State of Arkansas.

Respondent Otis D. Powell, Jr., is an individual and is an officer of the corporate respondent. He formulates, directs, and controls the acts and practices of the corporate respondent, including the acts and practices hereinafter set forth. His address is the same as that of the corporate respondent.

PAR. 2. Respondents are now, and for some time last past have been, engaged in the business of manufacturing, advertising, offering for sale, selling, and distributing household cleaners under the brand names "Glasshine," "All Purpose Cleaner," "Ruff & Tuff," "Carpet Shampoo" and "Poodle Kleaner," to distributors and to the public.

PAR. 3. In the course and conduct of their business as aforesaid, respondents now cause, and for some time last past have caused, their

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set products, when sold, to be shipped from their place of business in the State of Arkansas to purchasers thereof located in various other States of the United States other than the state of origination, 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 the respondents' aforesaid business, and for the purpose of inducing the purchase of their said products, the respondents have employed and are now employing a marketing program which operates as follows:

In order to become a participant (or "customer," as respondent designates them) in the program, an individual must first purchase a minimum of \$75 of respondents' products. He is then required to recruit two additional customers within a 45-day period to begin his particular group, over which he is considered the head. All subsequent customers are also required to recruit two new customers within a 45-day period. Each new customer in turn becomes the head of his particular group and, thus, the system works in a pyramiding down manner with each new group beginning with each new customer. With respect to the group he heads, the customer receives 17 percent commission on the purchases of the first two customers, 4 percent on the purchases of the third through the 2,046th customer and 7 percent through the next 2,048 customers.

Respondents' program also has a category referred to as a "Director." This individual conducts sales meetings, which are the sole method of selling in the program. The Director receives a commission of \$16 for each new customer that is recruited as a result of his meeting. In addition, he recruits and trains other directors and receives an overriding commission of \$4 for each sale made by the directors he recruits.

Respondents represent through oral and written statements to prospective purchasers and/or participants in their program, that it is not difficult to sell their said products and/or recruit additional participants and thereby achieve high levels of income. Typical and illustrative of said statements and representations, but not all inclusive thereof, are the following:

If a participant recruits two participants who in turn recruit two additional participants and this process is repeated ad infinitum, a participant can earn profits by commissions and overrides to the extent indicated by the following chart:

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People	Product	Percent	Paycheck
2	\$150	17	\$25.50
4	300	4	12.00
8	600	4	24.00
16	1,200	4	48.00
32	2,400	4	96.00
64	4,800	4	192.00
128	9,600	4	384.00
256	19,200	4	768.00
512	38,400	4	1,536.00
1,024	76,800	4	3,072.00
4,048	153,600	7	10,752.00
4,094	\$307,050	60	\$16,909.50

PAR. 5. Respondents' marketing program contemplates a virtually endless recruiting of participants in the sales program. The program as represented by respondents contemplates the participation of numerous recruits operating under each customer. Further, additional participants must increase progressively to insure the participants the represented financial gains while the overall number of potential investors remain 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' 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' 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, and for the purpose of inducing participation by others in their marketing program and in selling their merchandise, by and through statements and oral representations, and by means of brochures and other written material respondents represent, and have represented, directly or by implication that:

1. Participants in their merchandising program have a reasonable expectancy of receiving profits or earnings fully equal to or greater than those described in Paragraph Four herein by recruiting other participants into their program and receiving commissions on their own sales or the sales or recruiting of others.

2. It is not difficult for investors to recruit and retain persons who will invest in the program, to sell respondents' products and recruit others to invest therein.

PAR. 7. In truth and in fact:

1. Most participants in respondents' program do not have a reasonable expectancy of receiving profits or earnings in the form of finder's fees, commissions, overrides or other compensation fully equal to or greater than those described in Paragraph Four herein. In fact, most participants will receive little or no return on their investment.

2. It is difficult, and becomes increasingly difficult under respondents' continually expanding marketing system, to recruit and retain persons who will invest in respondents' products, and/or to sell respondents' products, and/or to recruit others to invest therein.

Therefore, the above-described representations are false, misleading and deceptive.

PAR. 8. 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 Paragraph Four 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 their 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. 9. In the course and conduct of their aforesaid business, and at all times mentioned herein, respondents have been, and now are, in substantial competition, in commerce, with corporations, firms, and individuals engaged in the business of selling products of the same general kind and nature as those sold by respondents.

PAR. 10. The use by 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 purchasing public into the erroneous and mistaken belief that said statements and representations were and are true and into the purchase of substantial quantities of respondents' products by reason of said erroneous and mistaken belief.

PAR. 11. The aforesaid acts and practices of respondents, as herein alleged, were and are all to the prejudice and injury of the public and of respondents' competitors, and constituted, and constitute, unfair methods of competition in commerce and unfair and deceptive acts and practices in commerce in violation of Section 5 of the Federal Trade Commission Act.

DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondents named in the caption hereof, and the respondents having been furnished thereafter with a copy of a draft of complaint which the New Orleans Regional Office proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondents with violation of the Federal Trade Commission Act; 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 aforesaid draft of complaint, 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 thereafter considered the matter and having determined that it had reason to believe that the respondents have violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of thirty (30) days, now in further conformity with the procedure prescribed in Section 2.34(b) of its rules, the Commission hereby issues its complaint, makes the following jurisdictional findings, and enters the following order:

1. Respondent Devour Chemical Company, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Arkansas, with its principal office and place of business located at Highway 64 and 71, Alma, Arkansas.

Respondent Otis D. Powell, Jr., is an individual and officer of said corporation. He formulates, directs and controls the policies, acts and practices of said corporation including the acts and practices herein-after set forth. His address is the same as that of said corporation.

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 Devour Chemical Company, Inc., a corporation, and Otis D. Powell, Jr., individually and as an officer of said corporation, its successors and assigns, and respondents' officers, agents, representatives, and employees, directly or through any corporation, subsidiary, division or other device, in connection with the advertising, offering for sale, sale, or distribution of any product or of distributorships, franchises, licenses or marketing agreements with respect thereto, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from directly or indirectly:

1. Operating or participating in the operation of any marketing program wherein the financial gains to the participants are dependent in any manner 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 participant in respondents' 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 said products, or distributorships under respondents' 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 said program to purchase said products or pay any consideration, other than payment for necessary sales materials, in order to participate in any manner therein.

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

- (a) Wherein any finder's fee, bonus, override, commission, cross-commission, discount, rebate, dividend or other compen-

sation 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 profits which he may receive or be entitled to receive.

6. Using any marketing program which fails to:

(a) Inform orally all participants in respondents' marketing program 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 (3) business days from the date of execution of such contract.

(b) Refund immediately all monies to (1) customers who have requested contract cancellation in writing within three (3) business days from the execution thereof, and (2) customers showing that respondents' contract solicitations or performance were attended by or involved violation of any of the provisions of this order: *provided, however*, That subpart (2) hereof shall not apply to such contracts entered into before the date of this order, nor shall the payments of refunds hereunder be construed as an admission that this order or any part thereof has been violated.

7. Representing directly or by implication, orally or in writing, that participants in any marketing program will earn or receive any stated or gross or net amount of earnings or profits; 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 to whom the representation is made.

8. Representing, directly or by implication, orally or in writing, that it is not difficult for participants to recruit or retain persons to invest in any marketing program as distributors or as sales personnel to sell said products.

9. Failing to deliver a copy of this order to cease and desist to all present and future distributors, salesmen or other persons engaged in the advertising, sale or distribution of any products through the use of a marketing program, and securing from each such distributor, salesman or other person similarly involved a signed statement acknowledging receipt of said order.

10. Furnishing others any means or instrumentalities, services and facilities, whereby they may mislead participants or prospective participants as to any of the matters or things prohibited by this order.

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

It is further ordered, That:

(A) Respondents immediately obtain from each person described in Paragraph 9 above a signed statement setting forth his intention to conform his business practices to the requirements of this order.

(B) Respondents advise each such present and future salesman, agent, solicitor, independent contractor, distributor or any person engaged in the promotion, sale or distribution of any of respondents' products and/or franchises that respondents will not engage or will terminate the engagement or services of any said person, unless such person agrees to and does file a notice with the respondents that he will be bound by the provisions contained in this order.

(C) If such party will not agree to so file notice with the respondents and be bound by the provisions of the order, the respondents shall not use such third party, or the services of such third party to promote, sell or distribute any of respondents' products and/or franchises or distributorships.

(D) Respondents so inform the persons so engaged that the respondents are obligated by this order to discontinue dealing with those persons who continue on their own the deceptive acts or practices prohibited by this order.

(E) Respondents institute a program of continuing surveillance adequate to reveal whether the business operations of each of said persons so engaged conform to the requirements of this order; and

(F) That respondents discontinue dealing with the persons so engaged, revealed by the aforesaid program of surveillance, who continue on their own, deceptive acts or practices prohibited by this order.

It is further ordered, That respondents herein shall notify the Commission at least thirty (30) days prior to any proposed change in any