

FAQ

Frequently Asked Questions – About MLM and Network Marketing

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Thought You'd Never Ask

Here are answers to some of the most frequently asked questions about the network marketing industry.

Q: Can I belong to more than one company?

A: Most network marketing companies will allow you to belong to more than one company. However, most companies do restrict their distributors' activities in promoting other companies' opportunities and products. The most common policy allows distributors to introduce other opportunities only to individuals that they have already personally sponsored. In addition, most companies won't let their distributors promote other opportunities or products at any company-sponsored events or activities.

Q: Can my husband and I have two distributorships?

A: Actually this is not a legal issue. This is a policy adopted by companies who are concerned that distributors will "stack" and manipulate to achieve better payout in the compensation plan. Although many companies permit more than one distributorship in a household, the majority do not.

Q: Can I sponsor in foreign countries?

A: Some companies permit this; some don't. Be sure to talk to your company about this before you devote any time or money to overseas recruitment. The pace of sponsoring in foreign countries is often faster than a company's ability to lay the proper ground work for such expansion. Each country has its own rules regarding network marketing, door-to-door sales, products of claims, etc. Chances are, your company will ask you not to sponsor distributors in a foreign country until it has laid the proper legal groundwork in that country.

Q: Do attorneys general approve marketing programs?

A: Although government agencies in some foreign countries may issue advisory opinions, no attorney general office in the United States gives its stamp of approval to an MLM program. Inquirers are always told to review the appropriate laws. In fact, nothing will bring the wrath of an attorney general's office more than a claim by a distributor or a company that the program has been approved by the attorney general.

Q: Can I sign up by fax?

A: Some companies do allow distributors to sign up by fax. In an electronic age, more and more courts are recognizing that we must honor the way the commercial world actually works. Facsimile signatures are legal. However, the best approach is to have an original, signed distributor agreement on file at the home office.

Q: Who is the true sponsor the first contact, or the name on the distributor application?

A: Some distributors think that the first contact who introduced them to the company should be the true sponsor. However, this creates problems for a company, because it is often difficult, if not impossible, to determine who the first contact really was. Therefore, most companies tell distributors that the sponsor listed on the distributor application will be deemed the true sponsor.

Q: Why do I have to pay sales tax?

A: This is a long complicated story and not without ongoing legal dispute. Unlike mail order firms which are immune from sales and use tax, direct selling companies are viewed by state officials as having "nexus" (sufficient contacts in a state for sales tax purposes). Their reasoning is based on the fact that distributors of direct selling companies actually promote the product and opportunity, and conduct opportunity meetings and training meetings in the states in which they live. Consequently, their sales are not considered to be in the same category as mail order sales. Distributors must either obtain resale tax licenses and take care of the taxes themselves, or the company will collect and remit sales and use tax.

Q: If I'm an independent contractor, why are there rules regarding my conduct?

A: From a legal standpoint, you are an independent contractor because the company does not tell you when, where, and how to perform your tasks. If it did, you would be an employee. Adopting guidelines on ethical issues, consumer legal safeguards, and general rules for fair competition

among distributors does not negate independent contractor status. Independent contractor status generally means that individuals are liable for their own income taxes, unemployment insurance, worker's compensation, etc. In 1982, the federal government specially recognized independent contractor status of direct sellers, and many states have followed suit with specific legislation.

Q: What can I do on the Internet with my network marketing business?

A: Here again, you will have to talk to the company. Keep in mind that companies closely guard their trademark names and have a right to regulate their usage in all media, whether it is print or on the Internet. The Internet offers tremendous possibilities for both companies and distributors, and this opportunity is one with which many companies are wrestling. Some companies will provide space at their home page for distributors. Some companies will provide a linking mechanism from distributors' home pages to the company's home page. Many companies will not allow a distributor to promote the company's product or opportunity on the Internet. The main reason for this restriction is two fold. First, if the company's name appears on distributor home pages, individuals who use search engines would likely be unable to find the company's home page because a search would produce thousands of "hits" on the company name. The company's home page would be lost amid the huge number of hits. The other reason for restrictions by the company is the concern about earnings claims and unauthorized product claims that have been made by distributors in the past and have threatened the business opportunities of both the company and its distributors. Many government agencies hold the company responsible for the statements of its distributors, and at the very least expect the company to regulate such advertising.

Q: What can I say about a company's nutritional and dietary supplements?

A: Generally, companies will be very clear about what can be said and what cannot be said, as demonstrated in their official literature. Unauthorized claims can lead to problems not only with state officials, but with the FDA and FTC as well. The Dietary Supplement Act of 1994 dramatically increased the ability of companies and distributors to comment on the benefits of dietary supplements. Under the Act, third-party literature or scientific studies which are generic in nature may be passed out to the public. In addition, companies that have specific backup data may make claims about ingredients in their products when the claims relate specifically to their impact on the structure and function

of the human body, as opposed to medical therapeutic claims. For example, under the Act, a company may comment that vitamin C is beneficial to connective tissue. Keep in mind, this is not the same thing as saying that a particular nutrient will treat or cure a connective tissue disease.

Q: Is it appropriate to pay commissions on sales aids?

A: No. Commissions should only be paid on products or services that are available to be sold or used by consumers. Sales aids do not fall in that category because they are merely tools for distributors. Payment of commissions on sales aids would be criticized as a payment of "head hunting fees" for the mere act of finding other distributors, as opposed to sales to users of the company's products or services.

Q: Are there any trade organizations for the industry?

A: There are two major trade organizations in this industry. *The Direct Selling Association* in Washington, D.C. represents a broad spectrum of direct selling companies. Some are strictly direct sale, some are party plan, but almost all the growth in membership in recent years comes from multilevel companies. *The Multi-Level Marketing International Association (MLMIA)*, in Newport Beach, California opens its membership to multilevel companies, multilevel distributors, and professionals and suppliers involved in the multilevel marketing industry. Both associations have the same goal, which is to promote the industry, and to assure consumer safeguards for network marketing distributors and consumers.

Q: Is the type of compensation plan the key to a company's success?

A: Historically this has not been proven to be true. "Sexy" compensation plans have come and gone, but long-term success has always been a function of product, management, company vision or mission, a quality training program, and the bonding of distributors and consumers with the goals and products of the company.

Q: Which is more important: sponsoring or selling?

A: They are both important. An army of distributors that sells nothing will produce no commissions. On the other hand, recruitment is very important in a business where 90 percent of the distributors are part-time and productivity per distributor is relatively low. A balance is the key.

Q: Must companies be registered in every state?

A: Actually, a number of states have multilevel distribution statutes that require registration. In addition, most companies will be registered to pay

sales taxes throughout the country. However, most network marketing companies will only register to do business as a foreign corporation doing business in those states in which they have a physical presence such as manufacturing facilities, warehouses, offices, or employees. The corporate laws of most states provide that a company is not "doing business in the state" merely because it sells through independent distributors in that state.

Q: Who is Glenn Turner?

A: In the 1970s, Glenn Turner was the man behind a company called *Dare to Be Great* and *Koscot International*. *Dare to Be Great* sold motivational programs and *Koscot* sold cosmetics. Many people in the industry who knew Turner have remarked that he was one of the most charismatic individuals and motivating leaders ever to come along in the industry. Many company executives of subsequent network marketing companies came from the Turner programs. Regulatory agencies and courts held that *Dare to Be Great* and the *Koscot* programs promoted the opportunity rather than the product. As a result of extensive litigation, those companies were forced out of business in many jurisdictions. In the aftermath of those cases, almost every state adopted pyramid statutes. Later in the 1980s, Turner resurfaced again in association with *Challenge to America*, another motivational type program. That program also faced difficulties and even a criminal conviction in Arizona.

Q: What is the Amway FTC decision?

A: This is the landmark decision for the network marketing industry. In 1975 the Federal Trade Commission charged Amway with violating FTC rules. After four years of litigation, Amway prevailed when an FTC administrative law judge ruled that Amway was a legitimate direct selling company and not an illegal pyramid scheme. The basis of the decision is recognition of Amway's (1) ten retail customer rule, (2) 70 percent rule, and (3) buy-back policy. The industry owes Amway a debt of gratitude. The industry would not likely exist if Amway had not prevailed.

Q: Who owns the downline?

A: Actually no one owns the downline. Distributors enter into an individual contract with the company. Inherent in the contract is the company's agreement to pay overrides on the downline sales organization of the distributor. However, downlines are people and no one owns people. On the other hand, companies provide distributors with computer printouts and genealogical reports, which the companies view as proprietary and confidential. Companies do expect that distributors will not use printouts

to solicit for other opportunities, or to conduct mass mailings or in any other way utilize computer printouts to compete.

Q: Is multilevel marketing taught in leading business schools?

A: This is one of the popular myths in the marketing industry. Though case studies have been done on some leading direct selling companies such as Mary Kay, multilevel marketing itself has not historically been a course topic in business schools. This may be changing, however. In the mid-1990s, the University of Illinois in Chicago first offered studies on network marketing, and other universities have followed.

Q: How many people are engaged in network marketing in the United States?

A: Over 10 million people are working either part-time or full-time in network marketing in the United States, and upwards of 20 million worldwide.

Q: Are noncompete agreements enforceable?

A: This is a tricky area of law. For example, the State of California specifically holds noncompete agreements to be unenforceable. Other states uphold noncompete agreements if their terms are reasonable. Most courts frown on noncompete agreements, and look for ways to not uphold them on the basis that they interfere with an individual's ability to earn a livelihood. Network marketing companies do have the right if they so choose (although few do) to ask their distributors to have an exclusive relationship with them when they are under contract with the company. However, after termination, the power of companies to is very limited unless distributors are using confidential or proprietary information. On the other hand, courts have upheld clauses which prohibit distributors from returning to their old companies to interfere with contractual relationships, or solicit or raid distributors from those companies.

Q: What about companies with offshore banking?

A: From a regulatory standpoint, companies that transfer funds to offshore banks or tax haven countries immediately go on the radar scope. The suspicion is that money is being hidden for tax purposes or to avoid potential creditors. Networkers should take a clue from this and avoid such regulatory suspicion.

Q: What is an umbrella organization?

A: Through the years, a number of organizations have invited distributors to join multiple network marketing companies under the auspices of one organized effort. For whatever reason, these types of organizations

generally do not last very long because peoples' interests and efforts are pulled in different directions. Most industry experts agree that a distributor's best return on his or her efforts is to work hard at one company at a time.

Q: Are there conferences on multilevel marketing?

A: Quality conferences are being held on the subject of network marketing with increasing frequency. The DSA and MLMIA sponsor conferences. For more than a decade, Legaline Publications and the law firm of Babener & Associates (Portland, Oregon) have sponsored the MLM Entrepreneur Series twice a year. This conference, which addresses trends in the industry, is co-hosted by the publication, Money Maker's Monthly. In addition, Legaline Publications and Babener & Associates are also the hosts of an annual national symposium on network marketing, a serious look at the network marketing industry for company management. For information on upcoming conferences, call Legaline Publications at 1-800-231-2162.

Q: Will MLM account for 90 percent of the sales of products in the 1990s?

A: This is another one those myths about multilevel marketing. While it may help recruiting, its not true. The types of products sold by network marketing companies cut across the entire spectrum of consumer goods and services. Although it is a significant industry, it should be kept in mind that is a \$20 billion industry in a \$5 trillion economy.

Q: Did most of America's millionaires make their money in MLM?

A: Again, this is a myth. There is good money to be made in multilevel marketing, and quite a few people have become millionaires in this industry. Though you will find Rich DeVos and Jay VanAndel of Amway among the Forbes 400 America's richest individuals, the vast majority of others do not come from the network marketing industry.

Q: What is an "at cost" sales kit?

A: Almost all states' pyramid statutes prohibit the payment of an investment for the right to be involved in a multilevel type business. Many of the states specifically hold that the purchase of an "at cost" sales kit from a company is not considered to be an investment. Sales kits typically cost between \$15 and \$75. The term "at cost" means that the sale of the mandatory sales kit does not generate profit for the company. Profits for the company and its distributors should come from the sale of the company's products and services.

Q: What geographical areas dominate network marketing?

A: Network marketing is a people business. Friendly climates make for great network marketing. Although all companies have their own specific hot spots, many network marketing companies count on initial success on the West Coast of the United States, the Sunbelt (California, Arizona, Texas, Florida, and East Coast areas from Florida up through Georgia and the Carolinas), and the Bible Belt of the Midwest. Network marketing typically does not do well in major, high-density urban areas. Rather, it does well in suburban communities and rural and smaller towns. This is not surprising, because more socializing is likely to occur in these areas.

Q: What is a trademark?

A: Historically, in England, craftsmen put their marks on their products to denote their source or origin. This was the beginning of what today is referred to as common law trademark rights. A company or individual that is the first to use a name or logo associated with a product or service in commerce has common law trademark rights. Additional rights come to trademark owners who register their trademarks in the U.S. Patent and Trademark Office.

Q: Can a company restrict my advertising?

A: The rights of the distributor and the network marketing company are determined by their contract, and specific restrictions on advertising are contained in the distributor agreement and the company's policies and procedures. The rules regarding advertising are usually very detailed. Companies are zealous about protecting their trademarks. In addition, they want to avoid inappropriate claims about earnings opportunities or product properties, such as medical claims.

Q: Is it okay to pay commissions for recruiting new distributors?

A: Absolutely not! This is what is referred to as "head hunting" fees and is commonly referenced as an element of pyramid schemes in court cases. Commissions should be paid only on the sale of company product or services.

Q: What is a "heavy hitter"?

A: The term "heavy hitter" is used in the industry to denote individuals who have had major success building sales organizations and selling products. Heavy hitters who have the ability to build quality long-term sales organizations are very much in demand. On the other hand, heavy hitters who merely recruit "multilevel junkies" (those who frequently move from one company to another) are of little use to companies or to their distributors.

Q: Who owns the distributorship in a divorce?

A: There are no special network marketing laws for divorces. The same laws that regulate dissolutions of marriage in each state regulate the fate of a distributorship in a divorce situation. In court proceedings, valuations are placed on the distributorship just as other assets are valued. Network marketing companies, however, commonly ask distributors to inform the company who will be the successor distributor after a divorce.

Q: Why do network marketing companies prohibit sales in retail stores?

A: If consumers could buy Avon, Tupperware, and Shaklee products in retail stores, why would they bother purchasing them from distributors? Network marketing distributors have made the market for these products. Sales in retail stores would be viewed by companies as undermining the very foundation of the growth of these companies. Providing distributors with a proprietary product to bring to the marketplace, with the assurance that the product will not be sold through retail channels, is a key ingredient in the success of network marketing companies.

Q: Are network marketing companies active in Japan?

A: You bet. Not only are they active in Japan, they are active all over the world. Japan-based direct selling companies such as Nikken, Noevir, and Pola are among the world's largest, with billions of dollars in sales. Companies like Amway, Shaklee, and NuSkin have had singular success in Japan and in the Asian markets. In fact, the majority of the sales of leading network marketing companies such as Amway or Herbalife are in their foreign markets. This doesn't mean that there are not still tremendous opportunities in the United States. It merely means that they are also great overseas opportunities.

Q: What is stacking?

A: Stacking is a term used by network marketing companies to describe a distributor's attempt to manipulate compensation in the marketing plan by placing members of his or her household or family in the downline sales structure. It is frowned upon, and most companies have rules that are intended to discourage the practice of stacking.

Q: If it sounds too good to be true, is it?

A: Yes!



Jeffery Babener

On any given day you can catch Jeffrey Babener, Babener & Associates, lecturing on Network Marketing at the University of Texas or the University of Illinois, addressing thousands of distributors in Los Angeles, Bangkok, Tokyo and Russia, or writing a new book on Network Marketing, an article for *Entrepreneur Magazine* or a chapter for a University textbook.

Over two decades he has served as marketing and legal advisor to some of the world's largest direct selling companies. An active spokesperson for the industry, he has assisted in new legislation and served on the Lawyer's Council and Government Relations Committee of the Direct Selling Association (DSA) as well as serving as General Counsel for the Multilevel Marketing International Association.

He is an MLM attorney supplier member of the DSA and has served as legal counsel and MLM consultant on MLM law issues for many DSA companies. He has chaired more than 50 national conferences on the subject of "Starting and Running the Successful MLM Company". He is editor of one of the most informative and popular websites on Network Marketing, Direct Selling and MLM, www.mlmllegal.com.