



# **Side-by-Side: A Comparison of Vemma and Herbalife**

**September 15, 2015**



**Pershing Square Capital Management, L.P.**

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**The FTC recently took legal action against alleged pyramid scheme Vemma Nutrition Company; we believe this is a win for the FTC and American consumers**

**The facts establish that Herbalife and Vemma are overwhelmingly similar – claims to the contrary are misleading**

# Introduction

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- ▶ On August 17<sup>th</sup>, 2015 the FTC filed a Complaint against Vemma Nutrition Company (“Vemma”) in Federal District Court in Arizona. Specifically, the FTC alleges violations of Section 5(a) of the FTC Act, including:
  - Operating an illegal pyramid scheme
  - Engaging in deceptive acts and practices including making false income claims
  - Failing to disclose that the structure of the business ensures that most participants will not earn substantial income
- ▶ The FTC is targeting Vemma, its holding company, its CEO and a top participant in the scheme
- ▶ On August 21, 2015, the FTC filed an *ex parte* motion for a temporary restraining order halting the operation of Vemma, freezing its assets, and appointing a receiver. The Court granted the motion the same day
- ▶ **Pershing Square believes there are substantial similarities between Vemma and Herbalife Ltd. (“Herbalife” or “HLF”)**
  - Although there are differences in the compensation systems, both systems incentivize distributors to focus their efforts on recruiting rather than making *bona fide* retail sales to customers outside the distributor network

# Introduction

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- ▶ The following comparison of Vemma and Herbalife is based upon our review of the following source documents from the FTC's recent legal action against Vemma:
  - The FTC press release announcing the legal action<sup>(1)</sup>
  - The FTC Complaint, filed August 17<sup>th</sup>, 2015, and unsealed August 26<sup>th</sup>, 2015
  - The FTC Memorandum of Law in support of the *ex parte* application for temporary restraining order and permanent injunction and the resulting court order
  - The expert declaration of Stacie A. Bosley, Ph.D.
  - The Vemma compensation plan, available on its public website<sup>(2)</sup>
  - The Vemma Affiliate Agreement Terms and Conditions<sup>(3)</sup>
  - Vemma's public website<sup>(4)</sup>
  - The Temporary Receiver's report, filed on September 4<sup>th</sup>, 2015
- ▶ All quotations regarding Vemma in the following pages come from one of the source documents listed above

(1) <https://www.ftc.gov/news-events/press-releases/2015/08/ftc-acts-halt-vemmas-alleged-pyramid-scheme>

(2) <https://www.vemma.com/Backoffice/pdf/compensationPlan.pdf>

(3) <https://www.truthinadvertising.org/wp-content/uploads/2015/08/Vemma-Affiliate-Agreement-Effective-June-2015.pdf>

(4) <https://www.vemma.com/>

## **Side-by-Side Comparison**

# Mission Statements

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*“At the company's core is our mission to help others by enhancing their well-being, and offering an income stream to people who introduce others to a product line they believe in” (1)*

*“Herbalife’s mission is to change people’s lives by providing the best business opportunity in direct selling and the best nutrition and weight-management products in the world” (2)*

(1) Vemma public company website. <https://www.vemma.com/our-story/>

(2) Herbalife public company website (circa 2012).

# Overview



*“[Vemma] claim[s] affiliates can earn substantial income by enrolling others either as affiliates or as customers, but Vemma focuses on recruitment rather than retail sales of its products to generate this income. The vast majority of participants make no money, and most of them lose money.” (1)*

*“[Vemma has] generated hundreds of millions of dollars in income from their deceptive activities at the expense of consumers...” (2)*

*Herbalife bills itself as “the best business opportunity on the face of the earth” and promises its recruits vast sums of money, but in reality 89% of distributors receive \$0 in “gross compensation” (3)*

*Herbalife has caused millions of failed distributors to lose billions of dollars (4)*

(1) FTC Acts to Halt Vemma as Alleged Pyramid Scheme, August 26, 2015. [Emphasis added]  
(2) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.9. Memorandum of Law, at 54. [Emphasis added]  
(3) Herbalife U.S. Statement of Average Gross Compensation (2014).  
(4) <http://factsaboutherbalife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf>

# Operation of a Pyramid Scheme



## Emphasis on Recruiting

“All forms of compensation are driven by recruitment or purchase volume and there is no direct connection between this compensation and retail sales or market demand.” (1)

## Recruitment Rewards

“This structure incentivizes participants to purchase product for the purposes of maintaining eligibility for recruitment rewards (inventory loading) and to encourage their ‘downlines’ to do the same.” (1)

## High Failure Rate

“Company statements provide data that indicate Vemma is experiencing a high drop-out rate.” (1)

## Lack of Safeguards

“I see no evidence of any safeguards in place that would be effective to deter inventory loading and encourage retail sales to ultimate users.” (1)

Herbalife distributors earn more than 10 times as much from Recruiting Rewards as they do by selling the company’s overpriced products to *bona fide* retail customers (2)

“Herbalife’s entire business model appears to incentivize primarily the payment of compensation that is ‘facially unrelated to the sale of the product to the ultimate users because it is paid based on the suggested retail price of the amount ordered from [Herbalife], rather than based on actual sales to consumers.’” (3)

“For the latest twelve month re-qualification period ending January 2005, approximately 60% of our supervisors did not re-qualify and more than 90% of our distributors turned over” (4)

58.8% of first time Sales Leaders as of February 1, 2014 failed to requalify by January 31, 2015 (5)

Herbalife does “not rely on the ‘70% rule’ in any meaningful way” and believes it is “not material” to their business (6)

Between 2006 and 2009, Herbalife disciplined fewer than 25 distributors for violating the 70 percent rule (fewer than 1 out of every 100,000 distributors) (7)

(1) Expert declaration of Stacie A. Bosley.

(2) “Who wants to be a Millionaire?” (pg. 148).

(3) Herbalife v. Ford, No. 07-2529 (C.D. Cal.) Dkt. # 374 at 16 (quoting Omnitrition, 79 F.3d at 782).

(4) HLF 2005 Annual Report. The company has stopped providing this disclosure.

(5) Herbalife U.S. Statement of Average Gross Compensation (2014).

(6) Letter from Herbalife to SEC (July 5, 2012).

(7) Deposition of Jacqueline Miller in Herbalife v. Ford, No. CV 07-2529 (C.D. Cal. 2009).

# Compensation Plan

## Vemma

## Herbalife

### Complexity

“Vemma's compensation plan includes many confusing and convoluted rules and requirements, and some bonuses or rewards impose additional restrictions or limitations.” (1)

Herbalife's Distributor Agreement is extremely difficult to comprehend. It has 124 pages, 48,000 words and 215 rules. Herbalife has made dozens of updates and revisions, all at the company's discretion

### Multiple Levels

Vemma “Brand Partners” comprise 15 primary levels from “Member” through “Star Royal Ambassador”

The Herbalife Sales and Marketing plan creates 11 levels of distributors, with certain levels having multiple sub-levels, including Sales Leader, Millionaire Team, President's Team, Chairman's Club

### Commissions Based on Recruitment, Not Retail Sales

“Affiliates do not primarily earn bonuses for actual sales of Vemma Products. Instead, Vemma rewards Affiliates for personally purchasing Vemma Products to maintain bonus eligibility, and for recruiting others who likewise purchase Vemma Products to maintain bonus eligibility. Overall, the key determinate of an Affiliate's income, and thus the activity incentivized by the compensation plan, is the recruitment of Affiliates into the Affiliate's downline teams, who then recruit other Affiliates, and so on.” (2)

“Herbalife's entire business model appears to incentivize primarily the payment of compensation that is ‘facially unrelated to the sale of the product to the ultimate users because it is paid based on the suggested retail price of the amount ordered from [Herbalife], rather than based on actual sales to consumers.’” (4)

Royalty Overrides and Production Bonus rewards are presented as an array of percentage commissions and overrides on the purchase of products (based on SRP) by distributors and purchases by members in the distributors downline. Production Bonus percentages increase as distributors recruit more participants into their downline organizations (5)

### Special Bonuses

“[D]uring company events and conventions, Vemma presents the select few top earners with large checks representing their yearly or lifetime earnings.” (3)

Upon attaining the rank of President's Team there are special bonuses such as the Mark Hughes Bonus (1% of company “Retail Sales”) that are presented as awards or large checks at Herbalife's sponsored “Extravaganzas”

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.3. Complaint for Permanent Injunction, at 19.

(2) Id., at 21.

(3) Id., at 16.

(4) Herbalife v. Ford, No. 07-2529 (C.D. Cal.) Dkt. # 374 at 16 (quoting Omnitrition, 79 F.3d at 782).

(5) “Who wants to be a Millionaire?” (pgs. 81-82).

# Compensation Plan (cont'd)

## Vemma

### Lack of “Retail Profit”

“The likelihood of Affiliates earning profits on retail sales is minimal. While Vemma states that Affiliates may keep profits they earn by selling Vemma Products, Vemma offers no meaningful discounts or incentives to encourage such behavior.” (1)

### Restrictions Placed on Retail Activity

“[Vemma] also severely restricts Affiliates from selling Vemma Products, expressly prohibiting sales at business or retail outlets or offices, flea markets, swap meets, garage sales, home shopping networks, and online stores or auction sites, including eBay and Craigslist.” (2)

### Lack of Genuine Retail Customers

“I consider it unlikely that many Affiliates would qualify as ‘ultimate users’ under Burn Lounge given the criteria.” (3)

## Herbalife

Herbalife artificially inflates the Suggested Retail Price (“SRP”) of its products and overstates “Retail Sales” in its public filings to conceal the fact that its commissions are overwhelmingly Recruiting Rewards. There is no proof of any retail profits (4)

The likelihood of Herbalife distributors earning profits on retail sales is minimal given (i) Herbalife encourages distributors to recruit their “customers” who would then automatically qualify for a 25% discount and, (ii) Herbalife products are widely available on online auction sites at prices ~40% below Herbalife’s inflated SRP

“No Distributor shall (directly or indirectly, through any person, means or device) display or sell Herbalife products, product-related literature, or promotional items in any retail establishments, including but not limited to stores, open or enclosed markets, pharmacies, grocery, health food or military stores, temporary kiosks, booths in malls, outlets, or any other location which Herbalife determines, in its sole and absolute discretion, is inconsistent with direct selling.” (5) Herbalife also prohibits the sale of product on online auction marketplaces (i.e. eBay) even when proposed sales are at a fixed price (6)

“We don’t track this number and do not believe it is relevant to the business or investors.” (7)

Despite having the contractual ability to do so – Herbalife retains the right to collect retail order forms – and Pershing Square’s offer to pay the full cost at the Robin Hood conference on November 22, 2013, Herbalife refuses to track or disclose retail sales

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.3. Complaint for Permanent Injunction, at 21.

(2) *Id.*, at 21.

(3) Declaration of Stacie A. Bosley, PH.D., at 23.

(4) “Who wants to be a Millionaire?” (pgs. 95-110).

(5) Herbalife Sales & Marketing Plan and Business Rules, at 73. <http://factsaboutheralife.com/media/2012/12/Marketing-Plan-and-Business-Rules-2012.pdf>

(6) *Id.*, at 82.

(7) Referencing final sales outside the distributor network. Herbalife 8K. May 2, 2012.

# Focus on Recruitment

## Vemma

### Focus on Recruiting Rather than Selling Product to Ultimate-User Consumers

“As evidenced by their sales and marketing activities and compensation plan, Defendants’ business model depends upon recruiting individuals to participate in Vemma as Affiliates and encouraging them to purchase Vemma Products in connection with such participation, rather than selling products to ultimate-user consumers. Defendants’ sales and marketing activities and their compensation plan place little emphasis on sales to consumers outside of the Vemma organization.” (1)

“Defendants emphasize recruitment over product sales and stress the importance of recruiting new participants into the Vemma program.” (2)

### “Duplication”

“If new entrants follow the aforementioned system of duplication, suggested by the company’s founder and consistently echoed by top Vemma distributors, firm growth will rest entirely on ongoing recruitment and bonus-qualifying purchases. Moneys paid, derived from behavior that follows this suggested pattern of growth, are not significantly connected to sales to ultimate users and are, instead, effectively rewards for recruitment.” (3)

## Herbalife

Herbalife’s compensation plan fundamentally incentivizes distributors to recruit aggressively as opposed to retailing product (4)

Rich Goudis: “Whereas someone up in the very top, they’re \$2+ million, they’re probably working on very little retail margin, because they’re not really retailers.” Michael Johnson: “They’re recruiters.” (5)

Chairman’s Club member Stephan Gratziani: “[S]uccessful people in retailing in our business, it’s a very small percentage. . . . The majority of our people have a difficulty in selling products, in general.” (6)

Herbalife CEO Michael Johnson (circa 2005) acknowledged distributors engage in “false promises, claims, in hopes for product, for money, for recruiting, for customers, for pyramiding.” (7)

Herbalife’s business model and marketing materials, including Herbalife’s Nutrition Clubs and deceptive training programs (i.e. Club 100) constantly stress the importance of “duplication” for achieving success as an Herbalife distributor (8)

Herbalife board member and senior distributor John Tartol stresses to recruits that “the name of the game is duplication... duplication, like I said, is so important here.” (9)

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.3. Complaint for Permanent Injunction, at 5.

(2) *Id.*, at 7.

(3) Declaration of Stacie A. Bosley, PH.D., at 16.

(4) “Who wants to be a Millionaire?”

(5) Herbalife at the Goldman Sachs 15<sup>th</sup> Annual Global Retailing Conference. September 5<sup>th</sup>, 2007.

(6) <http://www.factsaboutherbalife.com/media/2014/12/Herbalife-Anaheim-2005-White-Paper-12.17.14.pdf>

(7) New York Post. <http://nypost.com/2015/06/25/video-reveals-herbalife-boss-saw-pyramiding-signs-early-on/>

(8) “The Big Lie” (pgs. 67-73 and 148-155).

(9) Profile of John Tartol, available at <https://www.herbalifepyramidscheme.com/perpetrators/john-tartol/>

# Deceptive Income Claims

## Vemma

### Exaggerated Earnings Claims

"Defendants assert that consumers can earn significant income and rewards through Vemma, and that Affiliates' income potential is limited only by their own efforts." (1)

### Anybody Can Do It

"Defendants consistently lead consumers to believe that if they simply work hard, they can and will earn substantial sums." (2)

### The Solution for These Economic Times

"Vemma documents and videos suggest that the opportunity remains the same for any new member, regardless of economic conditions." (3)

### Misrepresenting the Probability of Success

"[Vemma] repeatedly claim[s], both explicitly and implicitly, that Affiliates have made and can make substantial earnings. These claims are clearly made for the purpose of convincing consumers to participate in Vemma. The claims are misleading, however, as the vast majority of consumers will be unable to achieve these earnings and will never even recoup their initial investment." (4)

## Herbalife

We analyzed 393 testimonials and earnings claims from Herbalife Today magazines from 1997-2004. Annual earnings claims average \$178,000/yr, which only roughly 1 in 5,000 new distributors achieves (5)

Herbalife promotional materials and distributor testimonials routinely mislead new recruits into believing that anyone can become successful (6)

"I'm the Chairman and CEO of Herbalife, and we have a solution for you, a solution for these tough economic times..." (7)

Herbalife management have publicly stated they do not see a "direct correlation," positive or negative, between economic activity within individual markets and their business performance (8)

Former Herbalife board member and current senior distributor Leslie Stanford tells recruits that "we have a plan here that shows you how you can make \$120,000 in a year or \$240,000 a year," and that "we have it up to \$3.6 million for those of us who really like to dream big." (9)

Privately, amongst senior distributors, Herbalife's CEO has admitted that success in Herbalife is akin to a "lottery ticket" (10)

In the United States: 89% of Herbalife Members earn \$0 in gross commissions; 47% of Sales Leaders earn \$0 in gross commissions; the median gross compensation of an Herbalife distributor is \$0 (11)

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.3. Complaint for Permanent Injunction, at 12.

(2) *Id.*, at 16.

(3) Declaration of Stacie A. Bosley, PH.D., at 4.

(4) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.9. Memorandum of Law, at 44.

(5) "Who wants to be a Millionaire?" (slide 187).

(6) Various distributors engaged in such deceptive and misleading claims have been profiled at <https://www.herbalifepyramidscheme.com/perpetrators/>. For instance, Herbalife Chairman's Club member Dan Waldron's promotional materials claim "You can do this business, as long as you are teachable and have the desire to succeed."

(7) Michael Johnson. Herbalife Investor Day. (December 16<sup>th</sup>, 2008)

(8) Des Walsh. Q2'2015 Earnings call. (August 5<sup>th</sup>, 2015)

(9) Profile of Leslie Stanford available at <https://www.herbalifepyramidscheme.com/perpetrators/leslie-stanford/>

(10) New York Post. <http://nypost.com/2015/06/25/video-reveals-herbalife-boss-saw-pyramiding-signs-early-on/>

(11) Herbalife U.S. Statement of Average Gross Compensation (2014).

# Insufficient and/or Misleading Disclaimers

## Vemma

## Herbalife

### Misleading Compensation Disclaimers

“While the figures contained in the company's disclosure statements are somewhat revealing, they nonetheless do not show the whole picture and are misleading.” (1)

“[Vemma’s income statement disclosures] inflate the earnings averages by reflecting only the income of Affiliates who meet certain minimum purchase thresholds, do not factor in any costs of participation or other expenses, and likely misidentify unsuccessful Affiliates as Customers.” (2)

“[D]isclosure statements only take into account ‘active’ Affiliates who have met certain minimum purchase thresholds and omit participants who fared worse.” (3)

### Ineffective Disclaimers

“While Defendants sometimes attempt to provide disclaimers when making these and other income claims, their attempts are inadequate. Vemma typically dilutes purported disclaimers, such as ‘results may vary,’ with statements implying that negative results are due to the inadequate efforts of the Affiliate.” (4)

### Ability of the Company to Police Distributors’ False and/or Misleading Claims

“Affiliates have also created training and promotional materials related to Vemma... Vemma requires company approval prior to the distribution of materials by Affiliates.” (5)

Herbalife’s key income disclosure is misleading, insofar as it: (i) presupposes retail profits, (ii) excludes any expenses incurred attempting the business opportunity, (iii) improperly assumes that all members who did not receive commissions must be “discount purchasers,” (iv) selectively focuses the statistical analysis on the most successful subset of the total member base, and (v) is based on a single point of time, without consideration for intra-year or multi-year turnover (6)

Herbalife disclosure statement selectively focuses earnings statistics on “Sales Leaders with a Downline,” thereby excluding 87% of all members (6)

Although Herbalife provides marketing materials to distributors of the relevant rules for making claims, in practice these are largely ineffective and rarely enforced. Herbalife distributors routinely make exaggerated income and health claims in marketing materials and at Extravaganzas (7)

Herbalife purportedly imposes rules upon distributors regulating their ability to make income and product claims and reserves the “sole and absolute discretion to determine the appropriate penalty,” which may include monetary fines or the termination of the distributorship. (8) We know of no examples of such discipline, and misleading claims persist

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.3. Complaint for Permanent Injunction, at 17.

(2) *Id.*, at 46.

(3) *Id.*, at 17.

(4) *Id.*, at 16.

(5) *Id.*, at 11-12.

(6) Herbalife Statement of Average Gross Compensation Paid by Herbalife to U.S. Members in 2014.

(7) See example profiles available at <https://www.herbalifepyramidscheme.com/perpetrators/>

(8) Herbalife Sales & Marketing Plan (2014).

# Insufficient Safeguards

## Vemma

## Herbalife

### Inadequate 70% Rule

“Vemma’s 70% rule is insufficient to deter inventory loading or to encourage retail sales. Buried in its lengthy Affiliate Agreement, Vemma simply states that the placement of a new order is the Affiliate’s ‘certification that 70% of the products previously purchased have been sold to or consumed by end consumers.’ Thus, it is subject to self-certification, and there is no evidence that it is monitored or enforced. This self certification is particularly problematic...” (1)

“[T]he requirement can seemingly be met by the Affiliate’s personal use of the products, regardless of whether they purchased the products for participation in the business opportunity.” (1)

### 10 Retail Customers Rule

“Vemma does not have a 10 customer rule, and there is no minimum retail sales requirement for Vemma Affiliates, whether by re-sale from inventory or development of Customers. Vemma Affiliates can obtain rewards purely from recruitment without selling a single product.” (2)

### Insufficient Return Policy

“Vemma’s buy-back rule is likewise insufficient. The high cost of shipping in receiving and returning Vemma Products makes returns difficult, even assuming the products are still marketable” (3)

The 70% Rule is based on self-certification and includes stipulations to allow for downline sales / internal consumption to count as retail sales. Moreover, not all distributors have to comply with the rule (as the rule is only required for Sales Leaders to qualify for commission payments) (4)

Between 2006 and 2009, Herbalife disciplined fewer than 25 distributors for violating the 70 percent rule (fewer than 1 out of every 100,000 distributors) (5)

Herbalife does “not rely on the ‘70% rule’ in any meaningful way” and believes it is “not material” to their business (6)

While Herbalife does have a 10 customer rule, it is based on self-certification and includes stipulations to allow for downline sales / internal consumption to count as retail sales. Moreover, not all distributors have to comply with the rule (the rule is required for Sales Leaders to qualify for commission payments) (4)

Herbalife’s repurchase policy creates a cumbersome process and acts to limit distributors from returning product and thus fails to adequately protect distributors from losses (see page 21)

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.9. Memorandum of Law, at 40-41.

(2) *Id.*, at 42.

(3) *Id.*, at 41.

(4) “Who wants to be a Millionaire?” (pgs. 123-129).

(5) Deposition of Jacqueline Miller in Herbalife v. Ford, No. CV 07-2529 (C.D. Cal. 2009).

(6) Letter from Herbalife to SEC (July 5, 2012).

# Miscellaneous

## Vemma

### Unsuccessful Distributors Purposely Classified as Customers

“It seems far more likely, given Vemma’s marketing and the above discussion of the incentive structure, that many, if not most, of these individuals were interested in the business opportunity but chose not to purchase an Affiliate Pack and were unable to recruit. In other words, they are best viewed as distributors who were unsuccessful in the business opportunity, but have been redefined by Vemma as Customers.” (1)

### Targeting Affinity Groups

Vemma specifically targets college-aged recruits through their Young People Revolution (“YPR”) slogan and marketing materials (2)

### Role of Senior Distributors

Vemma frequently points to top Affiliate (and defendant) Tom Alkazin as a model for success, and has adopted some of his training materials as their own. Alkazin is also “intimately involved in the creation” of certain Vemma training programs (3)

## Herbalife

Contrary to Herbalife’s belief that a large part of its “customer” base is comprised of distributors who sign up to receive a discount on product purchases, we believe the vast majority of “discount buyers” are nothing more than failed distributors (4)

“Our customers are sometimes called distributors. That’s the only confusion we have.” – CEO Michael Johnson (5)

Herbalife overwhelmingly targets Latino’s in the United States. When last reported, more than two-thirds of Herbalife’s U.S. distributors were Latino. (6) Herbalife has also been known to target other affinity groups including young adults (Generation H) through their “Wellness Coach” program

Herbalife repeatedly highlights the purported success of senior distributors, like Chairman’s Club members Doran Andry, John Tartol, and Leslie Stanford (amongst others) at company-sponsored “Extravanzas,” and invited them to serve on both its Board of Directors and its “Strategy and Planning Committee.” Moreover, Herbalife adopts and proliferates recruitment methods developed by senior distributors (7)

Over time, various senior distributors have been members of Herbalife’s public company board (8)

(1) Declaration of Stacie A. Bosley, PH.D., at 24.

(2) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.9. Memorandum of Law, at 9.

(3) *Id.*, at 5.

(4) “Who wants to be a Millionaire?” (pgs. 111-129).

(5) CEO Michael Johnson, CNBC interview. December 19, 2012.

(6) “Stealing the American Dream: *How Herbalife Targets the Latino Community in the U.S. and Around the Globe*” (January 2015)

(7) Profile of Doran Andry and other senior distributors available at <https://www.herbalifepyramidscheme.com/perpetrators/doran-andry/>; “The Big Lie,” available at [https://www.herbalifepyramidscheme.com/media/2014/07/Nutrition\\_Club\\_Presentation\\_The\\_Big\\_Lie\\_7.22.14.pdf](https://www.herbalifepyramidscheme.com/media/2014/07/Nutrition_Club_Presentation_The_Big_Lie_7.22.14.pdf)

(8) Presently this includes Pedro Cardoso and John Tartol (<http://ir.herbalife.com/directors.cfm>), both of whom are profiled on <https://www.herbalifepyramidscheme.com/perpetrators/>.

# Distribution of Income

- ▶ In analyzing Vemma’s business model, the FTC reviewed Vemma’s annual disclosure statement of U.S. “active” Affiliates<sup>(1,2)</sup>. An analysis comparing Vemma’s “active” Affiliates’ commissions and commissions of Herbalife’s Sales Leaders<sup>(3,4)</sup> – distributors attempting to build a sales organization – reveal the following:
- ▶ The vast majority of participants earn little to no income:

**Vemma: The bottom 93 percent of Affiliates earned less than \$6,169**

**Herbalife: The bottom 94 percent of Sales Leaders earned less than \$2,245**

**Vemma: The bottom 87 percent of Affiliates earned less than \$3,674**

**Herbalife: The bottom 83 percent of Sales Leaders earned less than \$303**

**Vemma: The bottom 40 percent of Affiliates earned less than \$939**

**Herbalife: The bottom 49 percent of Sales Leaders earned less than \$1**

- ▶ Only a tiny fraction at the top earn substantial income:

**Vemma: The top 0.62 percent of Affiliates earned \$92,181 or more**

**Herbalife: The top 0.60 percent of Sales Leaders earned \$148,413 or more**

(1) A Vemma defined term which includes only such affiliates that have achieved sufficient purchases in the preceding month. Vemma 2013 U.S. Disclosure Statement.  
(2) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.3. Complaint for Permanent Injunction, at 17.  
(3) Herbalife 2014 Form 10-K, at 9. Herbalife U.S. Statement of Average Gross Compensation (2013).  
(4) Note that this excludes non-sales leaders. Including non-sales leaders would make Herbalife’s income statistics substantially worse.

## **Differences in Form**

# Affiliate Packs and Supervisor Qualification

**Both Vemma and Herbalife purport to offer recruits a “low cost” avenue to joining the business. For Vemma, that is the initial customer purchase, while Herbalife offers the IBP. In reality, both networks heavily push recruits to reach higher levels to ensure eligibility for recruiting rewards**

- ▶ Vemma’s Affiliate Packs are more comparable to HLF distributors’ inventory loading to achieve Supervisor status than to Herbalife’s International Business Pack (“IBP”) (see Appendix B)

## Vemma

### Eligibility Contingent Upon Substantial Purchase

The purchase of an Affiliate Pack is technically optional, but eligibility for most bonuses is contingent upon a recruit’s purchase of one (1)

### Pressure to Make Substantial Initial “Investment”

Vemma strongly suggests that the only way to become profitable in the business is to purchase the ~\$600 Affiliate Pack (2)

Vemma CEO: “You don’t have to buy an Affiliate Pack, but you *have* to buy an Affiliate Pack” (3)

## Herbalife

Purchasing the approximately \$3,000 of Herbalife products to qualify for Supervisor is technically not required, but Distributors are only eligible for the vast majority of recruiting rewards if they do so

Herbalife recruits are repeatedly told by senior distributors that the only way to earn money with Herbalife is by qualifying for Supervisor (4)

Senior Herbalife Distributor Shawn Dahl: “I want everyone to understand that the most important thing in this business is to get to Supervisor” (5)

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015), Case No. 15-cv-01578, Memorandum of Law, at 12.

(2) *Id.*

(3) *Id.*

(4) <https://www.herbalifepyramidscheme.com/perpetrators/>

(5) “Who Wants to Be a Millionaire” (p. 173)

# Discounting & Suggested Retail Price

***In practice – despite HLF’s tiered “wholesale discounts” – Herbalife distributors are unlikely to generate any meaningful retail profits***

- ▶ Vemma does not have a Suggested Retail Price (“SRP”) from which distributor discounts are calculated; distributors enrolled in the auto-ship program receive a 10% discount off Vemma’s price list
  - The lack of significant discounts helped support the FTC’s conclusion that the “Compensation Plan drives recruitment over retailing”<sup>(1)</sup>
- ▶ While Herbalife offers tiered discounts (25%-50%) on product purchases (i.e. “wholesale discounts”), discounts are calculated on a fictitious Suggested Retail Price, unrelated to market demand<sup>(2)</sup>
- ▶ In its filings, the FTC touts the expert analysis of Dr. Stacie Bosley, who conducted a review of eBay pricing data and concluded that the data demonstrated “the challenge in finding retail customers who will pay above the distributor’s cost.”<sup>(3)</sup> Using a similar methodology, Pershing Square showed that Herbalife distributors cannot make substantial retail profit because the products are available on eBay and other online marketplaces for prices lower than even the discounted wholesale prices that Herbalife distributors are paying for products
- ▶ By falsely misrepresenting the concept of SRP, Herbalife deceives distributors into believing they can generate retail profits. In fact, the vast majority of distributors cannot generate any retail profits<sup>(4)</sup>
  - ▶ Any efforts to generate such profits are further undermined by the fact that Herbalife places no limits on the number of distributorships granted, generally or geographically
- ▶ Absent retail profits, the only way to generate substantial income is from recruiting rewards

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.9. Memorandum of Law, at 30.

(2) “Who wants to be a Millionaire?” (pgs. 105-110).

(3) Declaration of Stacie A. Bosley, PH.D., at 17.

(4) “Who wants to be a Millionaire?” (pgs. 131-154).

# Auto-Delivery

***Despite not having a substantial auto-delivery system,<sup>(1)</sup> Herbalife's compensation plan encourages the same underlying behavior - uneconomic purchases of product for the purpose of maintaining qualification and bonus eligibility***

- ▶ Vemma encouraged distributors to enroll in an “auto-delivery” feature whereby Affiliates set a standing product purchase-order (typically ~\$150); the auto-delivery feature was promoted as an expense to participate in the business and a means by which to maintain qualification and ensure uninterrupted qualification for bonuses<sup>(2)</sup>
- ▶ The auto-delivery feature promotes the uneconomic purchases of Vemma product for the purpose of maintaining qualification and bonus eligibility
- ▶ Herbalife is no different. Herbalife's compensation plan incentivizes orders without regard for retail demand,<sup>(3)</sup> specifically:
  - Junior distributors purchase product to participate and advance in the business opportunity
  - Mid-level distributors purchase product to re-qualify and maintain their downline “lineage”
  - Senior distributors purchase product to maintain bonus eligibility (“pay-for-their-paycheck”)

(1) Herbalife has a small auto-ship program called the Herbalife Advantage Program. We do not believe this is a material percentage of Herbalife's revenue composition.  
(2) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.3. Complaint for Permanent Injunction, at 8 and 19.  
(3) “Who wants to be a Millionaire?” (pgs. 158-174).

# Return Policy

**Similar to Vemma, Herbalife's repurchase policy acts to limit distributors from returning product and thus fails to adequately protect distributors from losses**

- ▶ The only differences are Vemma's pragmatic application of the 70% rule used to disqualify Vemma product as "marketable" and Herbalife's (recently revised) policy to cover the cost of return shipping

Criteria	Vemma (1,2,3)	Herbalife (4)
<b>Term / Duration</b>	Affiliates may return marketable product within one year of purchase	Product purchased within the last 12 months
<b>Product Scope</b>	Product must be marketable: they must be usable (unexpired and undamaged) and not seasonal, discontinued, special promotion items, or certified as consumed by end consumers	"A Member leaving the business may return unused products or sales materials which are unopened and in resalable condition..."
<b>Original S&amp;H Reimbursement</b>	No	No
<b>Return S&amp;H Reimbursement</b>	No	Yes (revised in 2013)
<b>Required Supporting Documentation</b>	Vemma "will not issue a refund for products certified as consumed by end consumers."	To return product, distributors are required to produce lengthy sales documentation ("proof of purchase"), in part to verify the 70% Rule and Ten Customer Rule certifications
<b>Bonus / Commission Clawback Feature</b>	Yes ("All commissions, bonuses, advancements or awards earned upon the sale of the returned products will be reversed.")	Yes ("Herbalife will deduct the amount of Royalty Overrides, Commissions, Production Bonuses and any other earnings or benefits paid on the returned product from the appropriate Members, and adjust qualifications as necessary.")
<b>Adverse Psychological Pressures</b>	"Returns also reverse any bonus payments based on the returned purchase and there may be upline pressure to limit returns."	Yes Distributors are encouraged to sell to friends and family who may be reluctant to return product (as this causes a claw-backs in upline commissions); product returns require resignation from Herbalife, an admission of failure
<b>Resignation Requirement</b>	Yes	Yes

(1) FTC v. Vemma Nutrition Company, et al. Memorandum of Law, Complaint for Permanent Injunction and Other Equitable Relief.  
 (2) Declaration of Stacie A. Bosley, PH.D.  
 (3) Vemma Affiliate Agreement Terms and Conditions. (June 12, 2015)  
 (4) Herbalife Sales & Marketing Plan and Business Rules. (circa 2013). Rule 10-D.

# Bonus Structure

***Both Vemma and Herbalife pay commissions to distributors based on the quantity of individual purchases (not retail sales) and purchases by downline recruits***

- ▶ Vemma’s primary bonus – described as the “most powerful” and as a pathway to residual income – is the “Cycle Commission,” an unlimited downline bonus based on cumulative organizational volume,<sup>(2)</sup> similar to Herbalife’s “Production Bonus”
  - Vemma’s up-front bonus payments are based on *purchases* of recruited Affiliates, not the act of recruitment itself<sup>(1)</sup>
- ▶ While Vemma provides both up-front and long-term bonuses, the FTC notes:

*“Affiliates do not primarily earn bonuses for actual sales of Vemma Products. Instead, Vemma rewards Affiliates for personally purchasing Vemma Products to maintain bonus eligibility, and for recruiting others who likewise purchase Vemma Products to maintain bonus eligibility. Overall, the key determinate [sic] of an Affiliate's income, and thus the activity incentivized by the compensation plan, is the recruitment of Affiliates into the Affiliate's downline teams, who then recruit other Affiliates, and so on.” (3)*
- ▶ This is no different with Herbalife – the key determinant of a distributor’s income is the accumulation of volume points by ordering product from Herbalife (without regard to retail demand) and recruiting others to do the same

(1) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.9. Memorandum of Law, at 26.

(2) *Id.*, at 27.

(3) Federal Trade Commission v. Vemma Nutrition Company, et al. (August 17, 2015). Case No.15-cv-01578, Dkt. No.3. Complaint for Permanent Injunction, at 21.

**Differences between Vemma and Herbalife do not alter the fundamental reality that both systems incentivize distributors to focus their efforts on recruiting rather than making bona fide retail sales to customers outside the distributor network**

## **Appendix A: The FTC's Application of the Law**

# FTC Reaffirms Core Principles Relating to Pyramid Schemes

In its court filings, the FTC demonstrated a continued commitment to identifying and prosecuting companies that favor recruitment over retail sales

- ▶ **Investment Need Not Be Technically Mandatory to Satisfy First Element of *Koscot***
  - ▶ Requirement to pay money element of *Koscot* test is satisfied where participants are required to purchase inventory in order to receive full benefits of the program<sup>(1)</sup>
- ▶ **Focus Remains on Balance Between Recruitment and Retail Sales**
  - ▶ “The determination of whether an enterprise is a pyramid scheme focuses on whether the *primary purpose* of the enterprise is to reward recruitment over sales”<sup>(2)</sup>
- ▶ ***Amway* Safeguards Must Actually Be Enforced**
  - ▶ FTC reiterated that “these *Amway* safeguards are not one size fits all . . . To rebut pyramid allegations, ‘there must be evidence that the program’s safeguard are *enforced* and *actually serve to deter inventory loading and encourage retail sales.*”<sup>(3)</sup>
- ▶ **Economic Analysis of Compensation System Considers Incentives and Resultant Behaviors**
  - ▶ FTC expert Dr. Stacie Bosley modeled the Vemma compensation plan based on the “promoted system for success” and concluded that its compensation system favored recruiting over retail sales. Were this approach applied to Herbalife, its promoted system for success—qualifying for Supervisor and engaging in immediate duplication—would lead to a similar result

(1) Memorandum of Law, 35 (citing *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 781 (9th Cir. 1996)).

(2) *Id.* at 36 (emphasis added).

(3) *Id.* at 36-37 (emphasis added by FTC).

# FTC Reaffirms Core Principles Relating to Pyramid Schemes

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In its court filings, the FTC demonstrated a continued commitment to identifying and prosecuting companies that favor recruitment over retail sales

- ▶ **FTC Continuing to Focus on Income Misrepresentations by Distributors**
  - ▶ Misrepresentations about profitability violate the FTC Act, and “results may vary” type disclaimers are ineffective because consumers believe that statements of earning *potential* represent what they may reasonably expect to earn. Consumers’ “common sense net impression” determines whether misleading income representations paired with disclaimers violate the FTC Act<sup>(1)</sup>

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(1) Memorandum of Law, 43-44.

## **Appendix B: Supplementary Analysis**

## Appendix B – Vemma Affiliate Packs

**Vemma's Affiliate Packs are more comparable to HLF distributors inventory loading to achieve Supervisor status than to Herbalife's International Business Pack ("IBP")**

- ▶ The following analysis is based on Vemma's revised \$599.95 Affiliate Pack announced in June 2015; Vemma specifically markets the starter pack as being "[w]orth over \$757 USD"<sup>(1)</sup>
- ▶ Vemma's Affiliate Packs, if resold at Vemma's listed prices, would retail for \$620<sup>(2)</sup>

	<u>Suggested Retail Price</u>		
	<u>Auto-Ship</u>	<u>Regular</u>	<u>QV</u>
<u>Affiliate Starter Pack Contents</u>			
1-pack Vemma (2 - 32 oz bottles)	\$67.50	\$74.00	60
V2 Fridge Brick (30 - 2 oz bottles)	78.00	86.00	60
4 cans of Vemma Renew	13.67	15.00	10
Vemma Co Q10	44.95	49.50	40
Vemma EPA 1000 Omega-3	34.95	38.50	30
Vemma Coral Calcium	19.95	21.95	20
48 cans of Bod•e Pro™ Build	159.90	175.90	120
24 cans of Bod•e Pro Burn	79.95	87.95	60
4 cans of Verve®	13.67	15.00	10
4 cans of Verve Zero Sugar	13.67	15.00	10
4 cans of Verve Bold®	14.33	15.83	10
4 cans of Verve ParTea™	13.67	15.00	10
4 cans of Verve Remix™	9.50	10.50	7
Vemma Success Kit	NA	NA	NA
90-day free trial of Back Office Pro	NA	NA	NA
<b>Assessed Value at Vemma's List Price</b>	<b>\$563.70</b>	<b>\$620.13</b>	<b>447</b>
<b>Vemma Assessed "Retail Value"</b>		<b>\$757.00</b>	<b>500</b>

(1) <http://vemmanews.com/2015/06/12/new-affiliate-starter-pack-vevma-nutri-pack-available/>

(2) Assessed value based on Vemma's public product lists; non-standard size formats have been ratably adjusted from the standard size format