

An Open Rebuttal to the Fraud Discovery Institute Report on Usana Health Sciences

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Assertions:

On March 15th the Wall Street Journal published a summary of an 86 page report by the Fraud Discovery Institute (FDI) which alleges that the public company Usana Health Sciences (USNA) is guilty of "multiple alleged misrepresentations, material non-disclosure and an untenable business model." The FDI is directed by Barry Minkow, who did employ the assistance of others in gathering his information, but who appears to be solely responsible for the report's contents.

According to Minkow, Usana is in violation of federal law because:

1. Usana's products are "hopelessly overpriced" and their claim that they can save consumers "75%" off retail prices due to the elimination of "middlemen" in the distribution chain is a lie;
2. Only 14% of sales comes from customers (thus Usana is a de facto pyramid scheme);
3. Usana is an unregistered security;
4. Usana leadership is deceptive and dishonest;
5. No less than 85% of current distributors are losing money, and at least 74% will fail within their first year of business;
6. Only 3% of Usana distributors receive 70% of all commissions and bonuses;
7. Usana has an "untenable"¹ business model which is based on the perpetual turnover of failed distributors, thus is destined to collapse due to market saturation.

Although Minkow makes other lesser, peripheral assertions, these seven points make up the bulk of his 86 page report and will therefore be the basis for this rebuttal.

Disclosure:

I am not now, nor have I ever been, a Usana distributor or employee. I have never owned Usana stock nor have I had any financial interest in Usana of any kind. I have never been hired by Usana as a speaker, consultant, expert witness, or any other type of position, nor have I been asked by *anyone* to produce this rebuttal. In fact, I currently hold a corporate position with a competing U.S. based health & nutrition network marketing company.

I am the founder and CEO of MarketWave, Inc.², a research, education and consulting firm exclusively serving the network marketing industry, and the author of the book "Inside Network Marketing". I have worked full time over the past 17 years studying and analyzing the MLM industry and have worked to expose the frauds and pyramid schemes that often try to *disguise* themselves as legitimate MLM operations. As one of only five court-certified experts in multilevel marketing in the United States, I am acutely aware of the difference.

¹ So poorly designed as to be indefensible.

² <http://www.marketwaveinc.com>

Rebuttal:

Before I respond to each of the seven points above, let's do a little house cleaning.

First, Barry, the company you claim to have so thoroughly investigated and gained such insight and expertise into is *not* called *oo-sana*, it's pronounced *you-sana*.

I have read Minkow's 86 page report, which is not "500 pages", although I agree it does create a greater illusion of substance when the larger number is used. I suppose he can rationalize this claim by including all the addendums, much of which has little or nothing to do with Usana. In fact, a good portion is nothing more than the tired, discredited regurgitations of his anti-MLM zealot cohorts Robert FitzPatrick³ and Dr. Jon Taylor⁴ (click on the links below for rebuttals to their biased, anti-MLM propaganda). I have also read Minkow's response to Usana's defamation law suit⁵, his follow up reports, and viewed his three (so far) video responses on YouTube.

Mr. Minkow claims he began his investigation into MLM in early 2004 when he was contacted by an ex-distributor for an unnamed MLM company who had been refused a \$500 refund. After an "eight week investigation" the FDI (which appears to be Minkow and one other partner, a private investigator) issued a report to "various law enforcement agencies" including the FTC which included opinions of the company from "experts in the multilevel marketing industry." Surely this was again Fitzpatrick and/or Taylor, but Minkow does not name them. The complainer eventually received a full refund of his \$500. Minkow includes this anecdote in the opening paragraphs of his Usana report "to confirm our methodology and approach..." in his Usana investigation. What Minkow described appears to me to be what's called a "shakedown". But then, there's no way of knowing for sure what the circumstances were surrounding Mr. Minkow's introduction to network marketing since no details are provided. The addendum that includes the complaining distributor's thank you letter to the FDI does cryptically mention getting a refund from "the FCC", but surely the Federal Communication Commission doesn't have an MLM division, and no such named MLM company has ever existed (nor could it, for obvious reasons). Since MLM companies are well respected for their generous refund policies (name any other type of business where you can get a 90%-100% refund on all unsold inventory and marketing materials if you decide to give up), it's very likely that this distributor was refused a refund because he either didn't qualify for one, or the company wasn't a legitimate MLM venture.

Since Minkow seems so well acquainted with the afore-mentioned anti-MLM zealots FitzPatrick and Taylor it appears likely that they played a significant role in his three year education into the MLM industry. He now appears to have been indoctrinated into their anti-MLM clique and brainwashed into believing certain aspects of MLM that are obviously, logically, and legally untrue. Which is unfortunate, on multiple levels (pun intended). To his credit, before this egregious misstep Minkow and his FDI have exposed (or assisted in exposing) a number of bona fide fraudulent operations. Seventeen of them by his count. Of course, there's no mention of how many companies he has investigated, or issued reports on, that turned out to be innocent. You'll appreciate the irony of this missing "beneath the iceberg" information in a moment.

Mr. Minkow appears to have taken the same debate classes I took in college, or at least learned the same techniques. One of the most effective, which he accuses guys like me of (MLM "apologists") is called the "diversion" technique. In other words, if you can't diminish the credibility of your opposition's point, try to diminish the credibility of your opposition. While somewhat hypocritical, since Minkow often employs the same *ad hominem* attack strategy, his most masterful move involves what's called the "preemptive" technique. That's where he tells you in advance what his opposition is going to say in their rebuttal, so when you hear it you will

³ <http://www.marketwaveinc.com/articles/Zealots02.asp>

⁴ <http://www.marketwaveinc.com/articles/Zealots08.asp>

⁵ http://sec.gov/Archives/edgar/data/896264/000110465907020646/a07-8527_1ex99.htm

think, "Ah ha! They're saying just what he said they would say." This is designed to get you to give less consideration to the actual rebuttal points, regardless of their legitimacy. For example, Minkow warns the reader of his report to expect us to claim that he is just "rehashing the same old arguments." So if you had already read his report before you read the third paragraph of this Rebuttal section you would be keen to believe I have just tried to distract or mislead you in *exactly* the way he had predicted. Let's forget the fact that many of his primary arguments *are* just a rehashing of the same old arguments! Another example is his prediction that we will label failed distributors who now criticize the industry as nothing more than "disgruntled" who have an ax to grind. But many, if not *most*, of those ex-distributors who now make a point of publicly bashing everything MLM (not just the single program they were involved in) *are* disgruntled, and *do* have an ax to grind. Minkow even videotaped one for your viewing pleasure on YouTube! You see, MLM is virtually the only form of business where you can blame someone or something else for your failure and receive almost 100% acceptance of your excuse. I had a bad sponsor, bad product, bad pay plan, bad company leadership, or the MLM model was just bad... well, of course it was. Case closed. No one ever seems to fail at MLM because they just weren't good at it. But if you fail at selling cars, or real estate investing, or your Taco Bell franchise closes, then it was because you weren't very good at selling cars, investing in real estate, or running a Taco Bell franchise. Only MLM seems to offer a roasted scapegoat on a silver platter.

Now here's where Minkow warned you I would try to "demonize" the critic. Barry Minkow is an ex-con. He spent about 7.5 years (of a 25 year sentence) in prison and was ordered to pay \$26,000,000 in restitution to his victims⁶ after being convicted on 57 counts of fraud. It's odd that he repeatedly mentions this in his reports to, I can only assume, paradoxically enhance his credibility today as a fraud investigator (it takes one to know one). Yet, when Usana points out his felony conviction for stock fraud (the legal term for *lying* to investors to manipulate the stock price of his company), he then asks that you disregard this fact. It means nothing. Ignore the fact that he took money from the Mob⁷ and white supremacists to fund his scam, or that he doctored more than 20,000 documents using Wite-Out correction fluid.⁸ Let's forget the fact that Minkow bought "put" options on Usana stock before he published his report and thus stands to gain thousands of dollars if Usana's stock price were to drop – which it did, by 15%, the day his report was published.⁹ He continues to warn us that those who attack MLMs may also be labeled by us as "short sellers" with a "profit motive". But, Minkow *is* a short seller with a profit motive!¹⁰ We are also asked to ignore the fact that an anonymous "paying client" commissioned the Usana report. Considering Usana's growth over recent years, and the fact its stock has risen over 1,600% since early 2002 while also being one of the most "shorted" stocks¹¹ on the market (1.75 million shares, or 18.5% of the float, as of 4/9/07) there's certainly plenty of potential "clients" out there who would be willing to pay for a negative report on them.

Minkow now asks us to dismiss all this, and to forget his past history of fraudulent stock manipulation, lying, and deception, and now implores us to just focus on the facts.

Okay, let's do that.

⁶ This restitution order to repay all victims was dismissed in 2002 (at the judge's discretion, not because it was repaid). Minkow is currently paying restitution of about \$19 million to only Union Bank.

⁷ Minkow reveals "I was involved in organized crime" during a TheStreet.com interview @ <http://tinyurl.com/36zn3n>.

⁸ http://www.signonsandiego.com/news/business/20020526-9999_1n26minkow.html

⁹ Minkow claims his profits from this investment will barely cover his investigative expenses. We are asked to take his word for this as no accounting of his investigative expenses are disclosed. This also offers no valid response to whether or not Minkow intended to manipulate the Usana stock price. Regardless of his expenses, either he gained substantial income by their stock price drop, or he didn't.

¹⁰ Minkow also points out that those who make such an assertion are ironically those with the "greatest profit motive for MLMs to succeed...". So, when you look at my credentials for example, you're suppose to think, "Look at that. He's right on again!" Considered logically this is perhaps the most obvious "duh" statement in his entire report. *Of course* those who are the most successful, who have the greatest to lose, will fight the hardest to defend their livelihood.

¹¹ An investing technique where one profits from a stock price going down rather than increasing.

Point 1 – “Overpriced” Products.

I own a belt. It’s a basic, flat, dark brown strip of leather with a plain rectangular brass buckle that doesn’t always function properly. I paid over \$100.00 for it. Or more specifically, for the word “Gucci” etched into the buckle. Gucci did over three billion in sales last year.

On a recent trip to the supermarket I noticed the price of a bottle of Perrier was about double that of Canada Dry’s brand. For fizzy water. Does Perrier have a higher quality water, or higher quality fizz, I wonder? Perrier did over one billion dollars in sales last year.

I recently purchased a box of peanut butter Girl Scout cookies for \$3.00. They’re almost identical to a shelf brand that sells for \$1.29. Yet every year I load up on Girl Scout cookies, and apparently I’m not alone. Those little girls sold over 174 million boxes last year.

The point being, there are things that can cause a product’s intrinsic value to increase that go beyond the sum of its component parts. For example, you might pay a premium for a nutritional or beauty care product if you also got the individual attention of your own personal salesperson, or the availability of a corporate support line. Or, as anyone with even a modicum of knowledge in supplement formulation would know, there’s much more to designing a nutritional product than simply dumping in a variety of nutrients to create big percentages in the RDA¹² column. There’s also things like ratios and balance to consider (i.e. many vitamins cannot be properly absorbed without certain trace minerals, too much copper and iron can cause a vitamin C deficiency, etc.). There’s the standardization process to make sure herbal products have a consistent amount of the active substance (some brands are standardized, some are not). There’s the *form* of the ingredient to consider (i.e. are the trace minerals colloidal, chelated or ionic?). There’s the form of the product to consider (i.e. is it a tablet, a powder, a capsule, a gel cap, etc.). We must also consider the *quality* of the nutrient (i.e. when researching Ganoderma suppliers for my own company I found one grade that sold for about 40% of the price of the premium grade, but both would appear as simply “Ganoderma” on the label). *Amounts* of each ingredient matter, but not for the most obvious reasons. Most vitamins and minerals can be *unhealthy* if taken in large enough doses, so the bigger the percentage in the RDA column isn’t necessarily the better.

Which of these multivitamin products¹³ do you think would be the higher priced one?

Nutrient	Product A RDA	Product B RDA
Vitamin A	100%	100%
Vitamin B1	133%	100%
Vitamin C	400%	100%
Vitamin D	125%	100%
Vitamin E	100%	90%
Calcium	500%	250%
Iron	300%	150%
Biotin	10%	100%
Magnesium	75%	70%
Potassium	100%	100%
Folic Acid	90%	85%

In fact, nothing more than the difference in Biotin, a relatively expensive and vital nutrient, could cause Product B to be sold at a higher price than Product A.¹⁴

¹² Recommended Daily Allowance.

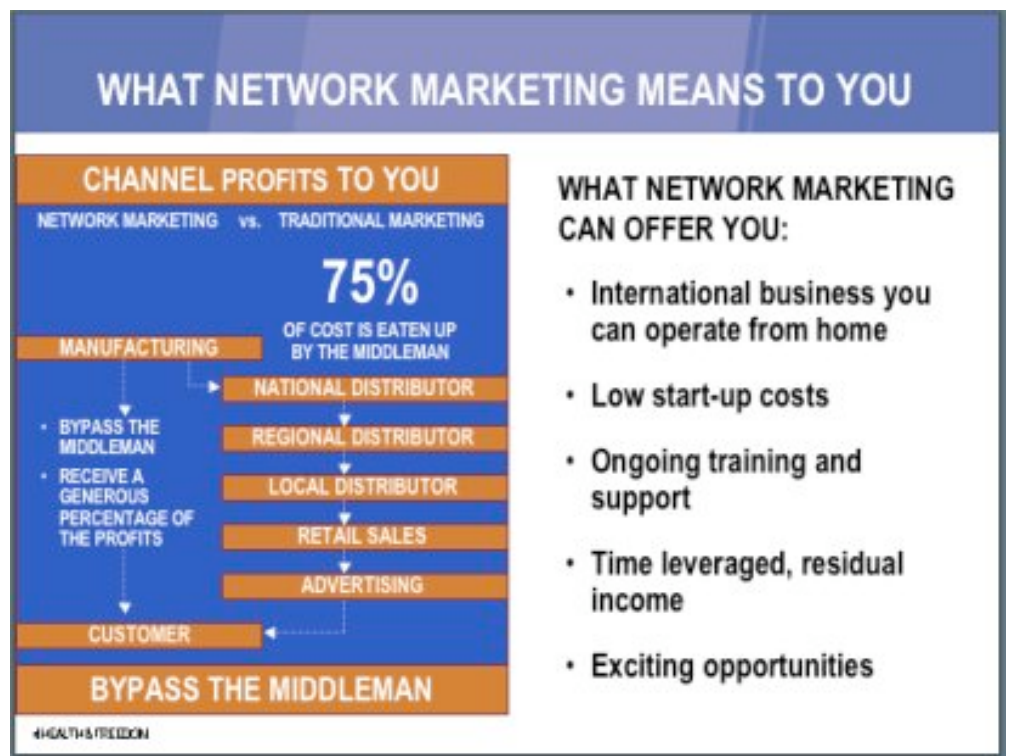
¹³ These are made up products for the sake of example.

When Minkow manically visited different supplement retailers (in an anti-Usana YouTube video) to compare the price of Usana's HealthPak 100 product with other "comparable" products, there is no mention as to whether *any* of these factors were considered, and from what was shown it's clear that none of it was.¹⁵ Minkow simply asked the clerk to find brands with a similar ingredient list and amounts. That's it.

I'm not attempting here to defend the value proposition of specifically Usana's products (I'm sure they are much more capable of that than I am). What I've just described applies to *every* nutritional product! To ignore these fundamental aspects of product comparison, as Minkow has done, is reckless and irresponsible.

Minkow's product pricing peeve isn't just about their premium prices, but appears more to do with their alleged claim that by going direct from manufacturer to customer, thus eliminating all the middlemen, a "75% savings" can be afforded the buyer. Minkow repeatedly mocks this claim and employs it often when criticizing Usana's product pricing.¹⁶ There's just one problem. Usana doesn't make such a claim. In both the transcript of the Usana meeting Minkow attended¹⁷ and in the PowerPoint slide Usana presents online (below) it is clearly stated that *Usana* saves 75%, not the end-user!

Most network marketing companies extol the benefits of this bypassing of the middleman as a means to afford greater commissions to their sales reps. This, and the dramatically reduced advertising costs, allow for a much larger chunk of the margin to go towards distributor rewards and compensation than those that are sold via conventional channels (since the distributors themselves are essentially the "middlemen" and their advertising mechanism).¹⁸ And that's exactly what



Usana is doing here. Note the slide above exclaims "Receive a generous percentage of the profits", not "Receive a generous discount on products", let alone receive a 75% discount. In fact, there is *nothing* in this Usana presentation (the only one I could find on the Usana web site related to this point) that claims a 75% lower product price. *Nothing!*

¹⁴ Next time you go to the store, check the various multivitamin brands and notice how many supply "megadoses" of each nutrient – except for Biotin.

¹⁵ At one stop the clerk brought a product to the counter which had a retail price of \$11.00 and change. Since all other retail brands chosen were as much as two to three times the price, it is extremely unlikely this was a "comparable" product to even the other brands, let alone to Usana's HealthPak 100. But the clerk said it was, so naturally Minkow ran with it.

¹⁶ He sites this alleged claim no less than 10 times in his report, and devotes an entire video to it.

¹⁷ At the Usana headquarters, where he posed as a prospect and secretly recorded a meeting (legal in Utah).

¹⁸ Minkow claims in one of his YouTube videos that Usana "can not pay all these levels and be competitively priced." If the expense associated with those levels replaces a multi-million dollar advertising expense, then yes, they can.

On a side note, back when I was a Longevity Network distributor we had a product called Nature's Vitality, a full spectrum supplement product similar to Usana's Essential Nutritionals, which they sold at the time for \$50.00 wholesale, \$65.00 suggested retail.¹⁹ Our Nature's Vitality sold for \$85.00 wholesale, \$106.00 retail. And we sold *a lot of it!* To *a lot* of people who *were not* distributors! In fact, I still get calls to this day from past customers asking how they can find this product – *four years* after the company discontinued it!²⁰

Minkow's intentions, or perhaps his investigative skills, are most suspect where he attempts to discredit specific Usana products claims with the use of lab reports. For example, he asserts that Usana's claim that their TenX bar has "10 times the antioxidant power of any juice product currently on the market" is false. To prove this he includes a lab report that shows the TenX™ bar contained only "just over 2" times²¹ the antioxidant units that were found in Langers Grape Juice Plus. However, he compared a 40 gram bar to 8 ounces of juice! Compared apples to apples (or in this case grapes to grapes) the TenX bar contained 384 antioxidant units per gram where the grape juice contained 23.2 units per gram. So, technically Minkow was right. Usana's bar does not contain "ten times" the antioxidants as this grape juice product – it contains *16.5 times* as much!

He also submits a lab report²² that allegedly validates his claim that Usana's Health Pak 100™ contained no N-Acetylcysteine at all, contrary to the 50 mg listed on the label. In reality the report clearly states that this nutrient was "Not Detected". That does not mean there was none. In response to this Usana did something that Minkow and his investigators apparently hadn't thought to do – they picked up a telephone and called the lab. What they discovered was that the lab, also questioning the non-detection of this ingredient, intentionally spiked a sample with N-Acetylcysteine and tested it again. Low and behold, it was still "Not Detected".

In yet another example of Minkow's clumsy (or perhaps deliberate) misrepresentation of facts, he claims the lab report shows the Health Pak 100 contained only 13.3 mg of grape seed extract rather than the 45 mg on the label. However, the lab report clearly specified that they only analyzed the amount of "proanthocyanidins", a *component* of grape seed extract. In other words, it was kind of like an orange juice product supplier claiming their bottle contained 32 oz. of pure orange juice, then someone calling them a liar because it didn't contain 32 oz. of vitamin C.

Okay, one more, then we're move on.

Minkow cites in his report that Usana tried to lower their prices in early 2000²³ but then "reverted back to the higher prices" which "sealed Usana's fate forever" since they now had no hope of providing a competitively priced retail product. This price reversion never happened. For example, Usana's lead product, Essentials™, cost \$52.50 before the price dropped to \$34.95. Today it's \$39.95, which doesn't even keep up with inflation!²⁴

Minkow so vigorously dwells on this pricing issue because it is the backbone to his pyramid scheme claim. He has been misled to believe that the FTC requires *all* MLM companies to sell at least 70% of their products to non-distributor at full retail²⁵ (so not even discount receiving

¹⁹ Circa early 1995.

²⁰ Actually they discontinued the company in the U.S., although it never completely ceased operations.

²¹ His findings produced a result of 2.6 times more, which seems a lot more than "just over" 2.

²² As Addendum 5.

²³ Which they did, by an average of 24%.

²⁴ If this product increased in price commensurate with inflation, it would now cost about \$42.00.

²⁵ This long debunked claim is a favorite of Robert FitzPatrick's, who Minkow acknowledges as his source.

Preferred Customers would count).²⁶ The pyramid scheme issue, and the proof of this claims illegitimacy, will be discussed in the next section. But let's be clear on this point before we continue: A *lot* of people buy products that are much higher priced than another with comparable components – *just for the product*. It probably happens a million times a day in this country. And we know for sure that there were at least 76,000 people who bought Usana products *just for the product* because Minkow tells us (albeit in a footnote) in his report!²⁷

Minkow claims that Usana is a pyramid because only distributors who have a quota to meet would buy their products at their prices, yet admits he is fully aware there were *seventy-six thousand people* last year who bought the products as Preferred Customers!²⁸

Usana surveyed over 48,000 of their own Associates a couple years ago and asked them why they joined the business. Over 75% said it was *primarily* to improve their health. Only 24.3% said it was *primarily* to improve their financial future, and 24% of that group said they only wanted to replace their current income or make a small supplementary income. Minkow mocks this claim as preposterous, and twists it into the make-believe claim that 75% are in Usana *only* for the products. Since I'm sure any intelligent reader will understand the difference between "primarily" and "only", I won't bore you with the Webster's definition of either.

Point 2 – Usana is a Pyramid Scheme.

Although Minkow prefers to state that only "14%" of Usana sales were to Preferred Customers, as opposed to "76,000" Preferred Customers, or the equivalent statement "Preferred Customers accounted for \$13.33 million dollars in sales"²⁹, there were surely even more who were just purchasing the products because they actually *wanted* them, and would have purchased them even if there were no financial incentive. As is true with all legitimate MLM companies, many distributors start out as customers and then enroll either to get the product at wholesale prices³⁰, to take advantage of discounts, specials or rewards exclusive to distributors (as would be the case in Usana), or to get a small commission from friends and family members who they were recommending the product to anyway (but not to build an MLM business). It is also typical for MLM companies to have a significant number of people who started out as business building distributors and then, for what ever reason, discontinued their efforts but continued to purchase products (but who would still show as a "distributor" in the company's computer). In Usana, there is no incentive for a distributor who no longer is an active business builder, but who still wished to purchase products, to revert to a Preferred Customer (perhaps there should be, so they can be counted as such). But surely they're there. If even 2% of what Usana now calls "active distributors" were among this group, that's another 3,000 *customers*. Or, what Minkow appears to believe are supplement shoppers who are too gullible and/or ignorant to understand the value of what they are purchasing. Sometimes there's a fine line between being courageous and being foolish, but to so blatantly insult almost 80,000 people this way surely makes Mr. Minkow one or the other.

Here's another fact that Minkow failed to include in his report: Usana offers a 100% refund to all customers and distributors (which Usana calls "Associates") within the first 30 days, and a 90% refund for up to *one year* (which it typical for many MLM companies). Surely with so many

²⁶ Minkow does acknowledge that preferred customer purchases would count on page 34 of his report, but then contradicts this on pages 54 and 55.

²⁷ Usana claims there are now over 80,000 Preferred Customers as of 3/30/07.

²⁸ Preferred Customers are not allowed to resell Usana products nor can they enroll distributors.

²⁹ All data based on Usana's 3rd quarter, 2006 10-Q, which is the same statement Minkow based his number on. Preferred Customer sales were reported to be \$52,386,600 for the entire year of 2006.

³⁰ In the case of Usana it costs nothing to enroll as a Preferred Customer and receive the same wholesale cost as a distributor.

people only making token purchases to meet their quotas each month, and then dropping out (over 113,000 per year, according to Minkow)³¹ one would think that Usana would be deluged with a tsunami of product returns. Yet, over the past three years Usana's product returns have been 2.1% in '04, 1.5% in '05, and 1.6% last year.³² This would be only slightly below the MLM industry average, by the way, so I'll ask Taylor and Fitzpatrick the same question I'll now ask Minkow: If the vast majority of Usana's \$374 million in product sales last year were to people who neither wanted nor resold any of it, and they could all easily return it for a 90-100% refund after they "failed" – why didn't they?

Minkow's basis for declaring Usana an illegal pyramid is gleaned from his "experts" Robert Fitzpatrick and Jon Taylor, who choose to believe that the FTC requires 70% of all sales by MLM companies to be to (non-distributor) retail customers. This is easily proved wrong, and while it's hard to believe they have not discovered this yet, I'll give them the benefit of the doubt and assume they are just confused. Admittedly, it's easy to see why. Back in 1975 the FTC sued Amway for being an illegal pyramid. Amway won, of course, but from that case came a set of "Amway Safeguards", one of which is now called the "70% Rule". This was not a law at all, but simply a requirement that Amway adopted to prevent the front loading or stock piling of unwanted product, usually purchased to achieve higher paying ranks in the pay plan.³³ In fact, the judge in the Amway case specifically identified this "70% Rule", including the part about "wholesale" sales to downline distributors, as one of the reasons why Amway was *not* an illegal pyramid!³⁴ Most MLM companies today use this as a guideline and have adopted a similar rule that requires all reps to "sell or consume" at least 70% of their previous orders before they can place another order (again to prevent front-loading and stockpiling of products)³⁵.

Another place where anti-MLM zealots go to get their "proof" is to federal cases involving companies like Equinox and Five Star Auto Club. Minkow states "...the FTC required that at least 51% of commissions paid to recruiting distributors... must be sourced from retail revenue (sales to consumers who are not part of the chain)" (emphasis original).³⁶ In the Equinox and FSAC cases the FTC did indeed require 70% of these company's sales to be to non-distributors. However, since this seemed to contradict the ruling in the earlier FTC vs. Amway case, the DSA contacted the FTC and asked them for clarification. In the FTC's response letter³⁷ they clearly stated that "In fact, the amount of internal consumption in any multi-level compensation business does not determine whether or not the FTC will consider the plan a pyramid scheme" (emphasis mine). There it is, in black and white, straight from the horse's mouth. Case closed. They're wrong. FitzPatrick, Taylor, Minkow – wrong. But we're not done.

In regards to cases such as Equinox and Five Star Auto Club, the FTC goes on to say that "these orders often contain provisions that place extra constraints upon a wrongdoer that do not apply to the general public... These 'fencing-in' provisions only apply to the defendant signing the order... They do not represent the general state of the law." (emphasis mine). The FTC goes on to confirm that they evaluate the *motive* for buying the products, not how the purchaser is classified.

³¹ Based on Usana's reported 153,000 distributors and Minkow's assertion that 74% of them fail within their first year.

³² Based on Usana's 2006 10-K, stated as a percentage of net sales.

³³ Amway's original "70% Rule" provides that every distributor "must sell at wholesale and/or retail at least 70% of the total amount of products he/she bought during a given month in order to receive the Performance Bonus...".

³⁴ Initial Decision, p. 26, Findings 72-75, and p. 58, Findings 145-47.

³⁵ No provision for products wholesaled to one's downline is included today because no company distributes their products this way any more. All distributors and most customers now buy directly from the company.

³⁶ Page 55 of his Usana report.

³⁷ See http://www.marketwaveinc.com/FTC_Letter.pdf.

Even FTC economist and anti-MLM ally Peter Vander Nat is quoted in the Wall Street Journal as saying distributor purchases can be a bona fide end-user sale depending on intent. "If people are buying because they want to use a company's products, those sales can count as retail" he says.

By the way, there are now eight states³⁸ that have specifically designated personally consumed products purchased by distributors to be a bona fide sale to and end user.³⁹

Minkow tries to make a connection between Usana and previously prosecuted pyramid schemes, such as International Heritage Inc., which was closed down by the SEC in 1998. Minkow states that the SEC's reasoning for declaring IHI an illegal pyramid "clearly applies to Usana...". But if you read the entire complaint,⁴⁰ rather than the cherry picked sections he asks you to focus on, you'll discover two things: First; the primary reasons for the SEC action was that IHI was selling shares in the company (in violation of securities law), and secondly; not only was IHI essentially selling *positions* in their binary plan (up to 7), the company was openly *discouraging* retail sales! Why International Heritage was deemed illegal has nothing what-so-ever to do with Usana!

The lengths that Minkow goes to in an attempt to conjure up negativity towards Usana almost makes it seem as if someone *paid* him to make this company look bad. Oh, wait...

Side note: I believe I have sufficiently established at this point that the basis for much, if not most, of Minkow's case, as far as Usana (and MLM in general) being an illegal and "untenable" business model, is parroted from the claims made by Robert Fitzpatrick and Jon Taylor. Rather than continuing to address them as a trio, or referring to them by a more efficient moniker, such as FitzMinklor, I will refer only to Mr. Minkow as the source of these accusations from this point forward unless addressing a claim specific to one or the other.

Since there is absolutely and verifiably no case precedent or law that omits the products willingly and legitimately purchased by Usana distributors from the equation when applying any state of federal anti-pyramid test (no matter how much FitzMinklor makes believe there is – sorry, I had to use it just once), no further rebuttal within the legal arena is necessary.

So how about a *common sense* one?

Minkow sanctions the claim⁴¹ that Usana violated securities law by not revealing to investors that they are an illegal pyramid. Seriously. Presumably we must infer from this that Minkow believes Usana was *knowingly* operating as an illegal pyramid scheme. Yet, they chose to be a publicly traded company thus allowing access by anyone and everyone to every page of their books. They *decided* to take all the necessary steps to allow the *most* possible scrutiny of their operation. And they've not only deceived thousands of investors, they've managed to pull one over on the regulators at every level of government not only in the United States (for 15 years), but all the regulators within *thirteen foreign governments* as well! Minkow even includes a set of Investment Research Reports on Usana⁴² by eight different Wall Street analysts, who's expertise is in evaluating the growth potential of public companies – *all* of which found no fault in Usana's business model, nor any concern as to their legality. Minkow included these reports as examples of how Usana so masterfully fools even seasoned stock analysts – by not fully disclosing all of the data that Minkow easily acquired from Usana's public disclosures.

I'm sure Usana's attorneys appreciate the irony of this as well. Hopefully, so will the SEC.

³⁸ Louisiana, Montana, Texas, Oklahoma, Kentucky, Utah, Idaho and Washington.

³⁹ All other states are mute on this issue. All have anti-pyramiding laws, but none specifically discount personally consumed products by distributors as a bona fide sale (although, based on case precedent, North Dakota seems to lean heavily in this direction).

⁴⁰ Included with the Usana report as Addendum 7.

⁴¹ Via a report submitted by Doug Brooks, Esq. and included as Addendum 11.

⁴² Addendum 8.

Minkow asserts that Usana, in spite of all its “evil”⁴³, has managed to exist for so long by staying “under the regulatory radar.” A public company. With an army of over 100,000 distributors. Forbes “5th Best Small Company”. Who’s home state’s Attorney General spoke at their national convention. *That Usana?*

Finally, Minkow chastises Usana’s auditor, Grant Thornton LLP (who has an expertise in auditing retail sales)⁴⁴, for not noticing that their client’s data was “fictional”. He sites there are standards Grant Thornton should follow that require them to “have a thorough knowledge of the business of multi-level marketing and, specifically, Usana’s business.”

Shouldn’t Mr. Minkow be held to this same standard?

Point 3 – Usana is an Unregistered Security.

The laymen’s definition of a security is something that someone invests in expecting the value of it to go up so they can sell it at a profit, without doing anything else. A share of stock is the most common example. The legal definition⁴⁵ is: 1) The investment of consideration (anything of value, even effort or a promise, but usually money); 2) into a common enterprise (where others are investing into as well); 3) with “profits to come solely from the efforts of others.” If you offer such a security to someone that is not registered as such with the Securities & Exchange Commission, and/or you are not licensed to offer such securities, you would be breaking the law.

Although appearing to be a “common enterprise”, a distributorship and an MLM company are actually two distinct entities. The source and distribution of profits between the two are different. The distributor can succeed when the company operates at a loss and vice-versa. Although it is debatable as to whether the non-required inventory purchased by distributors or the at-cost distributor kit is an “investment of consideration”, and this clearly doesn’t apply to the spirit and intent of the law, let’s concede this point for now. Of the three parts of the “Howey Test”, it only takes one failure to make the subject *not* a security. Although a strong case can be made that MLM ventures do not meet *any* of the SEC’s standards for a security, MLM distributorships *absolutely do not create profits solely from the efforts of others!*

Of all the anti-MLM mantras I’ve heard over the years, none offend me more than this one. To suggest that I did not apply *any* effort into building my businesses, and my success was achieved solely by the efforts of others, is ignorant and insulting. To put it not nearly as bluntly as I’d like, I worked my tail off to make money in this business. I *earned* it! And I am not unusual. In fact, in my 17 years of full time participation, I have never seen even one person succeed in this business who did not also provide a great deal of their *own* efforts in, yes, enrolling others, but also in selling products, educating themselves, and in supporting and training their organization.

Minkow desperately tries to make a case to the contrary by first rewriting securities law. Actually, he quotes from a report supplied by attorney Doug Brooks where Mr. Brooks now defines the Howey Test as requiring “profits to be derived primarily, but not exclusively, from the entrepreneurial or managerial efforts of others.” Note the addition of “but not exclusively”,

⁴³ This is the word he actually used during a TheStreet.com interview. Although I might forgive his hyperbole, he seemed to be speaking literally. I’d have thought such a term would be reserved for the likes of Charles Manson and the Nazi Party, not an MLM company who doesn’t have enough retail customers.

⁴⁴ <http://www.grantthornton.com>.

⁴⁵ SEC vs. J. W. Howey Co., 1945.

which seems to be a deliberate attempt to *make* the Howey test fit the MLM model.⁴⁶ Curiously, in Book's actual report⁴⁷ he does state this revised requirement just one paragraph after quoting the real Howey decision verbatim.

Brooks claims, and Minkow reiterates, that the profits from the activity of enrolling distributors "is primarily dependent on the activities of the Company and the upline." This is one of the most glaring examples of where practical experience in MLM would have served Minkow and his "MLM experts" well. Instead they must resort to pure speculation and theory. And in this case they misfire so badly it would be humorous if not for its seriousness. Those readers who do possess even a modicum of MLM experience will likely assume here that Minkow et al are referring to "spill over"⁴⁸. If only they were. Hyping of spill over is a practice that was, for the most part, abolished in the early 90s after a wave of regulatory attacks involving gold coin, jewelry and phone card schemes. Today is it considered taboo among responsible companies and distributors. But now, Minkow somehow believes that our success is based primarily on our upline and company because they "organize and orchestrate the recruitment program and rigidly control the tools and methods." Even if that were true, which is isn't, logic still fails to repair the disconnect between this claim and my downline being built without my effort. Doesn't someone have to *follow* that recruitment program and *use* those tools and methods? Brooks and Minkow create an oddly irrational dichotomy between the "distributor" and "upline", as if they are two distinct and specific entities. But if you were, say, 100 levels deep from the apex of the Usana (or any company's) national organization, wouldn't the person one level up from you be your "upline"? And wouldn't they have an upline of 98 others? In fact, shouldn't the person 90 levels up from you also be your upline, who also has an upline? The moment you enroll your first person, don't you become their upline? So at what level down from the apex, I wonder rhetorically, does one stop becoming the upline doing the work and start becoming the non-working downline who is benefiting from it?

But the Brooks/Minkow case gets even weirder.

In the Brooks report he goes on to suggest that the new distributor's "profit potential is further dependent on the collective entrepreneurial activities and fates of those he/she enrolls." In other words, every distributor's income is primarily dependent on the efforts of *every other* distributor above and below them, but not on their own efforts (thus, all distributors are applying the effort that provides income to all of the same distributors who are applying no effort).

One way out of this conundrum is to somehow make the process of enrolling new distributors not count towards the "effort" requirement (which only works if we also assume there's no retail profits to be had, but we won't retread old territory). And sure enough, Brooks does just that. And naturally, Minkow is quick to endorse the concept. Brooks claims that by listing a series of cases involving actual pyramid schemes, where the "efforts of a distributor to invite new distributors into the scheme" did not satisfy the Howey Test, this is prima-facie evidence that a Usana distributor's enrollment efforts would not be applicable as well. However, earlier in Brook's report he claims he has prosecuted cases against Nu Skin, Herbalife and was co-counsel

⁴⁶ There may be other more recent case precedent where the phrase "but not exclusively" was incorporated, but you can't use the Howey decision as the basis for your argument and then append to it more convenient language to prevent it from essentially disproving your argument.

⁴⁷ Which Minkow includes as Addendum 11, yet also reproduces almost verbatim and in it's entirety in the body of his report as well.

⁴⁸ Where the downline structure has a limited width thus, once a level is filled, forcing new enrollees to be positioned below previously enrolled distributors.

in the Webster vs. Omnitrition⁴⁹ class action case. But, if the laborious task of “recruiting” new reps doesn’t count as “effort”, then wouldn’t Nu Skin, Herbalife and Omnitrition all be unregistered securities as well? So, why are they all still in business – for a combined 55 years – using the same basic MLM business model as they used when Brooks prosecuted them?

The Brooks report includes a series of 24 bullet points that attempt to bolster his case that Usana reps are tightly controlled by the company which creates a “syndrome of anti-retail factors” that “negate personal ability to gain a return on investment.”⁵⁰ This list is either redundant (i.e. “Severe restriction on advertising”, and “No television or radio advertising is allowed”), completely irrelevant to the issue (i.e. “Distributorships cannot be merged”), reveal a lack of understanding of the Usana program (i.e. “The option to offer Usana products at wholesale prices to so called Preferred Customers”, which would eliminate retail profits, that’s true, but would still result in a sales override) or of the MLM concept in general (i.e. “No marketing investment by the company to attract retail customers, such as national advertising, corporate sponsorship, lead generation programs, etc.”, which is not only untrue⁵¹ in the case of Usana, but is the primary reason the MLM model provides such high commission structures – the distributors *are* their advertising!). The rest of the list is mostly policies employed by most MLM companies that are designed to discourage the very types of things anti-MLM zealots criticize MLM programs for! For example, a prohibition against: spouses activating more than one distributorship (to prevent “buying centers”); creating their own advertising until they reach a high level of experience (to prevent inexperienced reps from making misleading or illegal claims); using the company logo (to prevent misleading the public into believing they are a part of corporate); approaching a prospect for at least two weeks after they have been invited to an event by another distributor (to prevent prospect poaching); pitching existing reps on a competing MLM opportunity, changing uplines, or accessing contact information for downline members they did not personally sponsor (to prevent cross-sponsoring and downline raiding)⁵²; and disparaging other distributors or the company (do I even need to explain this one?). Brooks concludes his report by reminding us of the Civil Code that requires distributors and companies to refrain from making unsubstantiated earnings claims. I’m sure he would also agree that making medical claims about our products is prohibited as well. Yet when Usana, like virtually all legitimate MLM companies, employs policies & procedures to discourage and control such activity he exploits it as indirect evidence of Usana’s illegality! Brooks, like any skilled attorney, has masterfully set up the board to make sure Usana is checkmated no matter where they move.

Once Minkow is finished quoting Brooks he offers some of his own observations, such as:

A Usana distributorship “requires an initial investment”, which can be easily verified as untrue. Like any sales position in any industry, greater income can be earned by achieving higher quotas. However, no product purchase of any kind (other than an at-cost distributor kit for as

⁴⁹ In 1994 the 9th Circuit Court (the most overturned Appellate court in the U.S., which has ruled the Pledge of Allegiance unconstitutional) simply overturned a summary judgment in favor of Omnitrition and remanded the case back to the lower court. After refusing to hear an amicus brief offered by the DSA the 9th Circuit issued their ruling which included *dicta* (non-binding opinion) suggesting that personally purchased product by distributors should not be counted as a sale to an end user. The “class” in this case involved a total of two ex-Omnitrition distributors, and was eventually settled out of court with no action taken against Omnitrition. In spite of all of this, the “Omnitrition Case” has become infamous as the anti-MLMer’s Rosetta Stone of “evidence” supporting their legal claims against MLM.

⁵⁰ Minkow refers to Usana reps as “distributors” throughout his report, but once a discussion of securities law comes into play they suddenly revert to “investors”. Once this section is concluded they return to their previous “distributor” status.

⁵¹ Minkow begins one of his anti-Usana YouTube videos by holding up a copy of a recent issue of “Success at Home” magazine (which he incorrectly refers to as the unrelated “Success Magazine”) which is a high-cost corporate advertising piece.

⁵² Based on cases where I have served as an expert witness, the company has a “fiduciary responsibility” to protect the interests of distributors in this manner.

low as \$20) is required to acquire a distributorship and the right to enroll Associates, purchase at wholesale, and resell to others.

Usana reps are "required" to order products themselves every four weeks to remain qualified for commissions. This is also untrue. Retail customer orders count towards a distributor's "Personal Sales Volume" qualifier. This quota (200 BV, or about \$260) can be met entirely by orders placed by others with no personal expenditure by the rep (thus creating a very strong incentive to *retail* and gain *customers*, which applies to virtually all product based MLM programs).

Distributor "fees" are commissionable. They are not. Ever. By any MLM company.

Although not directly related to being an "unregistered security", there are a couple other security violation allegations that should be addressed before moving on.

Minkow claims that Usana's "President and CEO", Dave Wentz, authored a letter to the FTC in response to the FTC's proposed new business opportunity rule⁵³ where he cited strong concerns about Usana's ability to grow if the new rule was implemented as written. But then, according to Minkow, Dave Wentz signed, under oath, the company's subsequent quarterly disclosures (10-Q) filed with the SEC where the "Risk Factors" section downplayed the impact of the new rule. Minkow then asserts that Dave Wentz must be lying to one federal agency or the other.

First, if read closely the statements are not even contradictory. The 10-Qs suggest that the new rule will likely be revised from its original form to have a much less negative impact on MLM companies, if the new rule will even apply to MLM at all (it may not, and it *will* very likely be revised significantly). If it is not revised and applied as is, then it may cause severe hardship on MLM companies (although, in my personal opinion, it still wouldn't). This would be analogous to my saying that if a meteor were to strike the Earth it could cause devastation, but it would probably burn up in the atmosphere, or break up into smaller, less destructive chunks, so don't worry about it. Are either of those statements a lie?

But this is all academic. Because Dave Wentz, who is *not* the CEO of Usana as Minkow asserts (he is the President), didn't sign the 10-Q. Usana's CFO Gil Fuller and their *actual* CEO Dr. Myron Wentz did. The two documents in question were signed by different people! An easy blunder for you and I, maybe. But Minkow is suppose to be a pro at this!⁵⁴

Minkow can be excused for believing a "re-entry" position in the Usana pay plan "has no functional justification" (without re-entries a distributor's income would be capped, or "max out"). Most distributors aren't even 100% clear on every aspect of their program's pay plan. But for him to ethically question why several Usana "insiders" have been selling stock (by exercising their stock options) while at the same time the company is repurchasing a large number of shares seems to be a deliberate attempt to create suspicious by design. I've only been investing in the stock market for three years, and have read just one book on the subject, but have learned enough to know you "buy low and sell high". So maybe – I'm just posing another possible theory here – these "insiders" sold their stock because the value of it had increased 1,600% over the past five years! Although the most innocent, and much more likely explanation for the repurchasing of shares by the company requires a primer in the subject (which I have neither the expertise nor space to include), suffice it to say it's not an uncommon practice for

⁵³ Rule R511993; see <http://www.ftc.gov/os/comments/businessopprule>.

⁵⁴ After Usana exposed these errors in their libel suit, Minkow managed to get himself off the hook by locating a later 10-K document with the same reference to the proposed FTC rule which was signed by nine members of Usana corporate, including Dave Wentz. However, Minkow never even attempts to explain how he got so much wrong the first time.

publicly traded MLM companies⁵⁵ who want to assert greater control of their company (especially those who may be laying the groundwork to take the company private – I’m not implying anything as far as Usana, I’m just saying...).

Minkow ostensibly makes his case against Usana to save their distributors and investors from financial harm. Yet, his report was directly responsible for huge financial losses by Usana investors when it caused their stock value to drop 15% in one day (now down 29.1% as of this writing). In his report he exclaims that Usana “is obsessed with keeping the stock price escalating and the company appears to be willing to do anything to accomplish this goal.” Well, if I were an investor in Usana stock I’m not sure I’d have a problem with that. Now, if I had shorted the stock, and was *losing* money as the stock price increased...

It looks like somebody had a problem with that.

Point 4 – Usana leadership is deceptive and dishonest.

According to Minkow, Usana Founder and Chairman Dr. Myron Wentz, the majority stock holder, renounced his United States citizenship and “misrepresents the location of the entity that owns 46% of Usana stock” – which, allegedly, is the tax-haven country of Liechtenstein.

I am a court certified expert in multilevel marketing, not tax law. My admittedly naive but reasoned response to Dr. Wentz’s citizenship, and where and how he invests his personal funds, is “so what?” None of this has anything to do with the legitimacy of Usana’s MLM business model. But then, it’s doubtful that this exposé of Dr. Wentz’s personal finances was included in Minkow’s report because it has any bearing on the value of Usana, either as an investment or an business opportunity. This appears to have been added for the sole purpose of manufacturing an atmosphere of fraud and distrust where none otherwise existed.

Minkow includes as two of his addendums a letter from a Sara Jones⁵⁶, who claims to have never been a Usana employee nor the employee of any bank or government agency. Yet, she somehow knows that Usana is “hiding 2 million in debt”. Apparently Minkow’s investigation into this allegation could not turn up any evidence of wrong-doing, otherwise he surely would have included this in his report. But, of course, this didn’t stop him from including the letter anyway.

This letter, sent to Minkow on 2/17/07, also alludes to an IRS “criminal” investigation of Dr. Wentz back in 2004-05. There was no criminal investigation of Dr. Wentz by the IRS during or around those years.⁵⁷ But, of course, this didn’t cause Minkow to write-out this section of the letter (a task he is keenly familiar with, as noted previously), nor did it prevent him from declaring it in his report.

The insidiousness of this letter goes much deeper than just a trust-bruising throw in. About two months ago Usana got a call from their bank informing them that someone claiming to be CFO Gil Fuller had called and spoken with a lower level bank employee. This caller had Usana’s valid account numbers. The male caller asked for an accounting of any debt or lines of credit held by Usana and the employee mistakenly identified a 2 million dollar line of credit that does not actually exist.⁵⁸ However, because the employee mistakenly identified it as a line of credit when

⁵⁵ Herbalife, Nu Skin, Market America, PrePaid Legal, Reliv and Mannatech have all repurchased large blocks of shares in recent years.

⁵⁶ This letter is listed as Addendum 17 on the FDI web site, but is also included as Addendum 20 which is suppose to be a list of “Insider Transactions”.

⁵⁷ Dr. Wentz did have his returns from two years in the mid-90s investigated by the IRS in the late 90s, but he was cleared and the investigation was dismissed without any finding of wrong doing.

⁵⁸ It was an internal line of credit that banks set aside for customers with good credit that they are authorized to

it was not, the bank informed Usana of the incident. At that point Usana first became aware that their CFO had been impersonated and that Usana and the bank had been the victim of a scam.

Within days of this incident Usana received a list of questions from Tracey Coenen, a minor-league anti-MLM zealot,⁵⁹ fraud investigator, and forensic CPA. Ms. Coenen claimed to have been retained by a client to examine Usana's financial statements and wanted to know why they had a previously undisclosed line of credit for \$2 million dollars. Usana responded truthfully (that there was no such line of credit) but, not knowing who her client was or anything about Minkow at that point, did nothing further. Ms. Coenen's "client" was the FDI. She assisted in the production and editing of Minkow's Usana report.⁶⁰

The letter, with a "sent" date of January 8th, includes an email header with a sent date of February 17th. This suggests Minkow is still in contact with "Sara Jones" and may have asked her to resend the letter.⁶¹

It is my suspicion that Minkow had to introduce these accusations and rumors using an anonymous email because he knew he could not use this illegally retrieved (thus inadmissible) information otherwise. Since Usana has no knowledge of a Sara Jones (which is likely a pseudonym), Usana can't question him/her. Admittedly, this is only a theory based on circumstantial, but compelling, evidence.

Minkow must have danced with joy when he discovered that Usana board member Dr. Denis Waitley (who's name he misspells) didn't really have a Masters Degree (although he does have a Ph.D.), as was stated in Usana's Proxy Statement to the SEC. Minkow has exploited this to the hilt. Surely not a single investor ever relied upon the fact one board member had a Masters Degree in their decision to buy shares of Usana stock, but no matter. "This proves a pattern of behavior by (Waitley), but more importantly, a public cover-up and distortion of the facts by Usana Health Sciences...", says Minkow.⁶² He further asserts that, when Dr. Waitley was busted, Usana took the fall. "He lied, they covered", by claiming it was an editing error on Usana's part.

Here's Usana's press release on the matter. You be the judge.

"Dr. Waitley recently informed Usana that an error appeared in his biography listed in the Company's proxy statement and that he did not in fact earn a masters degree in Organizational Development..."

Here's a comment from the investigative service Minkow hired to look into Dr. Waitley:

"Curiously, (Waitley's) Masters degree does not appear in the biography on either of two web sites maintained by the subject, namely <http://www.waitley.com> and <http://www.deniswaitley.com>."

That is curious, isn't it Barry?

Minkow also exploits the fact that La Jolla University, where Dr. Waitley earned his Doctorate (Ph.D.) degree, is no longer in existence and, it appears, neither are their records from the time Dr. Waitley was a student. Since the Private Eye Minkow hired to snoop into Waitley's past was unable to verify his Ph.D., this means, according to Minkow, that it must be suspect as well.

extend should the customer ask. Usana did not ask for the line nor did they sign for it.

⁵⁹ She is the founder of PinkTruth.com which is dedicated to destroying Mary Kay Cosmetics.

⁶⁰ <http://www.sequence-inc.com/fraudfiles/>

⁶¹ There has been no reply to two email requests for a response to sajones09@excite.com.

⁶² Newly Acquired Information (posted at FDI on 4/12/07).

Since the dead can no longer defend themselves, Minkow was surely comfortable in referring to "Mr." Waitley's degree as coming from a "now defunct and never-accredited diploma mill."

Ah, but the dead can sometimes defend themselves. Well, at least a dead University's past president can. In a notarized affidavit⁶³ supplied by Dr. Denis Muhilly, the president of La Jolla University from 1985 to 1991, the California State Department of Education issued La Jolla U. "Full Institutional Approval". Dr. Muhilly alleges that the California SDE issued a statement asserting that such approval was comparable to "full accreditation".⁶⁴ He further verified that Dr. Waitley did indeed attend classes, produce a dissertation, and many people attended his graduation ceremony.

Although it's hard to imagine attacking Denis Waitley, one of the most beloved and respected educators, motivators and mentors in America, on moral grounds as it would seem his lifetime of service speaks for itself. However, Brett Blake, a past Vice President of Marketing for Usana and now a consultant to the industry, knows Dr. Waitley and both David and Myron Wentz on a personal level. Brett maintains a blog⁶⁵ pertaining to the Minkow attack on Usana, within which he states, "I have found each to be honorable, honest and respectful individuals... Minkow has smeared all three of these men to the point that the uninformed would believe that they are evil and conniving men just out to make a buck. A careful examination of their personal lives and their business careers would reveal that these three individuals are good men."

Minkow continues to build his house-of-cards on quicksand by attacking the Usana Medical Advisory Board for having positions in the distributor hierarchy. "The company presents their advisory board as an independent medical body...", he claims. "What is never disclosed is that each and every one of these advisory board members have a financial stake and vested interest in peddling Usana products, as they are part of the total compensation paid to distributors... They tout Usana products with an undisclosed and undeniable financial motive."

Obviously unbeknownst to Minkow is that many MLM companies compensate consultants, programmers, board members, etc. by providing them upline positions in the compensation plan. This provides a substantial financial advantage to the company that few other types of businesses can access. Rather than paying the board member *and* the distributorship position (which they'd have to pay to somebody), they only pay the distributorship. What's more, the performance of the individual who is compensated this way is based more on merit than for just showing up. There is no law, or legal precedent, to suggest this method of compensation is improper, nor do securities issues come into play since they are proving *effort* for their income.

However, in the case of Usana, this isn't even the case! I only explained the above to show that even if Minkow were correct in his accusation it would be meaningless. But he isn't. The members of all of Usana's boards (they also have a sports advisory board and market specific distributor boards) are all made up of people who were *already* successful distributors first, and *then* were asked to be part of the advisory board. Usana not only doesn't try to hide this fact, as Minkow claims, they trumpet their successes as distributors on their web site, in newsletters, on conference calls and from the stage. Usana has never held out the members of the medical advisory board to be independent, nor were they rewarded or paid with a distributorship.

In one case a medical advisory board member was married to a successful Usana distributor. That was the case with Dr. Ladd McNamara, which Minkow beats up on by flicking his ear with his finger and calling them pile-drivers. Dr. McNamara "voluntary" surrendered his medical

⁶³ <http://www.marketwaveinc.com/articles/WaitleyAffidavit.pdf>

⁶⁴ Freelif International has recently made the same assertion when Dr. Earl Mindell's Ph.D. from a California university was challenged.

⁶⁵ <http://directsellingtrends.blogspot.com>

license in Georgia three years ago. Knowing that the reader's imagination will fill in the blanks, Minkow presents nothing to provide an explanation, nor any evidence of specific disciplinary action against the doctor. The fact that the good doctor moved to California not long after this apparently made no impression on Minkow. Instead, he exploits the innocent, arguable mistake of McNamara setting up his corporation under the name Ladd McNamara, M.D., Inc. in California before actually having a medical license in that state. Obviously just creating a legal corporation doesn't mean you are in business yet, or actually practicing medicine yet, in this case. The fact this corporation was legally established just two months ago, and that there is no reference to a practicing physician of that name in or around his new residence, either online or in the phone book – well, of course this had to be ignored by Minkow and his hired gun because it would offer a reasonable and rational explanation. What's more, had these professional investigators bothered to use the "email them and ask" technique they would have discovered that Dr. McNamara doesn't even intend to practice medicine in California! According to McNamara his corporation is for "marketing" related to his Usana business.

Minkow isn't done with poor Dr. McNamara. In an effort to dig up even the smallest pebble to sling at Usana (glass house be damned) Minkow claims he is also affiliated with a non-profit foundation run by Dave and Myron Wentz, which is still not registered with the IRS. Surely knowing that the average reader will be unaware that such registration is not legally required, this does create the illusion of evasion. First of all, there's no evidence this foundation is even functional yet. Secondly, even if it is, not having IRS registration⁶⁶ does not necessarily mean you are not a legitimate non-profit organization. It just means the IRS hasn't certified you as such *yet*, and those who donate to your organization may not be able to write off the donation.

I mentioned earlier that Utah State Attorney General Mark Shurtleff spoke at a recent Usana convention (2004). Minkow claims that a Usana distributor, speaking at a meeting Minkow attended and secretly recorded, claimed that Mr. Shurtleff told the convention audience that Usana was "doing it right". That's about all the distributor said in the way of claiming Mr. Shurtleff endorsed Usana, and yes, even this was in violation of the Usana policy against claiming any AG has approved the company. But he can't leave it as simply an overenthusiastic, but truthful slip. Minkow, clearly believing he's struck gold amongst the dirt he's digging for, then claims the following (excerpted verbatim from his Usana Report – I have added the underlines for emphasis):

Fact: On February 16, 2007, our associate called Paul Murphy, the Press Secretary for Attorney General Mark Shurtleff. Mr. Murphy spoke to Helen (Shurtleff's personal assistant) and she does not retain his schedule that far back (the Usana 2004 Annual Convention). Paul did confirm that Mr. Shurtleff has never and will never endorse any company or product. He will, however, show up to conventions or groups that have donated money to good causes and give thank you speeches.

In this particular case with Usana, Paul believes Mr. Shurtleff would have gone and delivered a speech on the founding fathers or a point of law this is his standard speech he delivers at every convention. He most likely would have ended with thanking the company for inviting him and telling them to keep up the good work. But he would have not endorsed them in any way.

Also, Mark would be extremely interested to see any promotional material Usana is using which states that Mr. Shurtleff does indeed endorse them. He would put out a cease and desist immediately.

⁶⁶ Per Publication 78.

Moreover, on February 16, 2007, Paul Murphy called our associate back and confirmed that Mr. Shurtleff was indeed present at the Usana convention in September 2004. Paul spoke with Mr. Shurtleff personally on this. Mr. Shurtleff only gave a quick 5 to 10 minute opening remarks speech, and he did not endorse Usana in any way. His speech included welcoming people to the convention and a shortened version of his standard speech, which had nothing to do with Usana.

Who does a distributor confront about this material misrepresentation that took place on the very premises of Usana's headquarters? This kind of lie and distortion is an example of just how far the Usana organization and its distributors are willing to go in order to feed the recruiting beast that devours unknowing distributors.

Unlike Barry Minkow, apparently, I think a video or audio recording of what someone said is a better source of confirmation that a second hand verbal description from someone who wasn't even present. So I contacted Usana and asked them if they had any recordings of the AG's presentation – and guess what!

Yes, it was that simple. And after watching a video of Mr. Shurtleff's 6.5 minute speech there wasn't much doubt about whether he said Usana was "doing it right". Oh, he did. In fact, he said, "Usana has the reputation around this country for being the ones who do it right." He started his speech by saying that he and Utah's governor had decided to change the name of the state to "Utana". I'm sure he was joking. But then he also said, "If you do it right, and you do it legal, (MLM) is one of the greatest ways to help people realize the dreams and benefits and advantages of the free market system in the world today. And it's legal, and AGs know this." The emphasis is mine – and he wasn't joking. And he said, "With Usana, as it stands today, when we get an email from somebody questioning it, all we have to do is write back and say they've been looked at and they are a great company, and they are doing it right and they are doing it legal." Yes, he said it *twice!* We're not done. He also said, "What you folks are offering, in every sense of the word, is that pursuit of happiness to everybody. Not only are you providing quality of life to people but you are also providing a system where it doesn't matter who you are... if you work hard you can realize the dream of financial wealth and success. There is no greater way to do that than through direct sales and multilevel marketing programs" (all emphasis is mine). He ended his speech with this closing remark: "After watching this (Usana) video this morning, maybe when I'm done being AG I'll go out and really do something that will benefit people's lives and become a Usana distributor." We'll have to wait and see if he was joking about that.

So what do you think? I kind of think he did say nice things about Usana.⁶⁷ In fact, I don't think any of those "facts" Minkow just related about Mr. Shurtleff's speech were facts at all. In fact, I think Minkow's depiction of it was a gross material misrepresentation!

By the way, I had a link to the video of Mr. Shurtleff's presentation here⁶⁸, but Barry Minkow called the AG's office under the pretext that Usana reps were using it for promotional purposes⁶⁹ (but strangely provided no, what should have been easily obtainable, evidence of this – no web site URL, no link to a message board, nothing). Being a student and staunch defender of the constitution and the first amendment, not to mention *the truth*, Mr. Shurtleff did not demand that the link be removed. However, at the risk that it could be used for promotional purposes, his office did politely request that it be removed. Since my intent was not to promote Usana, but only to disprove Minkow's claim, and I believe I have effectively accomplished this, I certainly obliged their request.

⁶⁷ I even skipped the part where Mr. Shurtleff endorses, and consumes from the stage, one of Usana's products.

⁶⁸ Usana provided the video only in response to my fact checking efforts. The decision to post the video within this document was entirely mine. In fact, Usana had also requested that it be removed.

⁶⁹ As is the policy in all MLM programs, Usana reps are strictly forbidden to even suggest that any state or federal regulator has in any way endorsed or approved their company.

While trying to dig up even more dirt on Usana Minkow buries himself even deeper with his latest YouTube video where he interviews a disgruntled ex-Usana distributor (the first in what he's threatened to be a weekly series). His premier edition features Jane and JC Bishop, from the Kansas City area. In the heavily edited interview (I'd love to see what hit the cutting room floor) Mrs. Bishop tries to tell Minkow she joined because she was interested in nutrition but, of course, Minkow can have none of that. So he asks leading questions to steer her to say she actually joined because she was looking for an income opportunity. She claims "I gave this all I had" but only managed to enroll her neighbor and her daughter (who enrolled one person) and lost about \$5,000. According to Usana Mrs. Bishop was promoted twice to the rank of "Builder"⁷⁰ which would appear inconsistent with a three-person downline. Minkow asks her more leading questions, such as "Why did you purchase three business centers?" Mrs. Bishop's answers to the effect of "To make more money", rather than explaining to Minkow that Usana distributors don't purchase business centers.⁷¹ Naturally, Minkow never asks her pertinent questions like; How many months did she give it all she had; how many people did she talk to about the products or business, or; how much of her \$5,000 in products and sales aids did she return for a refund? Who knows, maybe he did and just didn't like her answers. Which is very possible considering Mrs. Bishop *never even attempted to return a single product!* Since she joined in May of 2006, she's still eligible for a 90% refund on all of it. If she consumed or sold the product already she cannot claim that as a loss as she received the value. If she still has it, she can give it back. Perhaps she's keeping it because, God forbid, she actually *likes* the products and *wants* them. Which is also very possible considering she originally joined Usana as a *Preferred Customer!* Then upgraded her status to Associate later.

Here's a question I'd love for Mr. Minkow to answer on YouTube: If this particular ex-distributor is a "victim" who was "doomed to fail" before she even joined Usana, then why are there several other profitable distributors within the same geographic area – including one of Usana's most successful Gold Directors?

Point 5 – Eighty-five percent of distributors are losing money, 74% will fail within their first year.

The hub of FitzMinklor's Wheel of Misfortune when it comes to virtually all MLMs is this claim of great failure rates among distributors. Almost every spoke of their anti-MLM argument leads here. And in this case, they're right.

The large majority of MLM distributors *don't* succeed in even making a profit.

But to use a couple of phrases that Minkow seems to be in love with (which, I admit, I also like), this is the "skin of the truth, stuffed with a lie". Let's look "below the iceberg".⁷²

First, I had no choice but to invoke the name FitzMinklor again because Minkow's data specific to Usana comes directly and entirely from the "expert" reports by Robert FitzPatrick and Jon Taylor, the latter of which appears to have done the most data torturing. I mean, number crunching.

As is Taylor's style (whose PhD is in Psychology), his arguments make sense on the surface, but when exfoliated one thin layer deep his logic completely falls apart. For example, in determining his "failure rate" he must, of course, make up numbers. I'd call them "educated guesses" except that Taylor's only practical experience in MLM is one year in an old-school break-away program 16 years ago (which had a completely different pay plan and qualification system than Usana).

⁷⁰ The Builder rank had an average annual income of \$1,194 in 2005.

⁷¹ A new distributor gets a position in the hierarchy at no charge, but then must achieve higher monthly product volume quotas to be paid higher commissions – much like every commissioned sales position in history!

⁷² Ironically, the image of an iceberg Minkow references in his first footnote is fraudulent. See: <http://www.snopes.com/photos/natural/iceberg.asp>.

Taylor assumes that the average Usana rep buys \$180 per month in product to remain qualified for income.⁷³ For an “active” distributor, that’s probably not far off.⁷⁴ But then he takes a wild guess that every rep also spends \$150 per month for additional products (which would only be purchased for *retailing* at this point since the rep has already met their quota), training (which most MLM companies offer for free, as does Usana), and sales materials (which Usana has *lost* money on in two of the last three years)⁷⁵. If we can’t count extra products purchased for retail, since they supposedly don’t exist (and actually provide a *profit* to the rep, so it makes no sense to factor it in when you’re trying so hard to show losses), and training is actually free, then do Usana reps really spend \$150 per month on sales aids? No. They spend an average of \$53 *per year*. How do I know this when Usana only reports *net* “Other Income” (I’d need the *gross* amount to determine this average expense)? Well, I dug down deep and did some really sophisticated investigating. I emailed Usana and asked them. But no sense confusing the issue with things like *facts*! Let’s continue with Taylor’s guesses.

Next he pulls a figure of \$750 per month out of his... thin air, and calls this a “very conservative” estimate of “operating expenses”, with “very little travel”. Taylor makes no attempt to justify this figure, other than to say it was about half of what he spent monthly during his “one year test” of MLM years earlier. Which probably explains why Taylor failed in that venture⁷⁶. I can’t even begin to rationalize this number as an ongoing monthly expense (gas, phone bill, what else?). There is simply no rational justification for anyone but the most active, successful, full time distributor spending this much on their business. But let’s drudge on.

So Taylor assumes Usana reps spend a total of \$12,960 per year on their business. Based on Usana’s publicly disclosed commission-by-rank breakdown, he says, only those at the “Gold Director” rank and above would earn a profit (see chart below). That would be .32% (one-third of a percent) of all distributors. He then tortures this data a little more by assuming that only one in ten of these people will stay active in Usana for ten years, so he takes that figure further down to .032% (1/30th of a percent).

First, let’s completely forget that last line because it’s completely arbitrary and makes absolutely no sense (if someone was earning \$50,000 to \$300,000 per year in *residual* income, I’m guessing more than 10% will keep doing that for ten years). Also, as the chart below⁷⁷ shows there are many people within the four ranks under Gold Director who are also making a profit (check the Max column). He’s also taking a percentage of *all* distributors, not just those who are active (more on that in a minute). There’s also no mention anywhere of the tax savings an MLM rep can achieve by starting a legitimate home business.

He also surmises that, conversely, “99.95% lose money and are likely to leave the program.” But this assumes all those at each rank are fixed and constant. This is not the case! This chart would be in a constant state of flux, with yes, people dropping out, but also with those at the bottom moving up the ranks. In fact, every single one of those top earning “Diamond Directors” were once down there among the bottom rung of this ladder.

⁷³ Half activate one business center, half activate three business centers.

⁷⁴ Taylor also states that this \$180 is the minimum to be “active”. It is not. Active status is maintained by achieving 100 CV, or Commissionable Volume (about \$115) monthly.

⁷⁵ Chart F-3 in their 2006 10-K.

⁷⁶ In Taylor’s previous works he claims he was one of the most “successful” distributors in that company, thus cannot be accused of holding a grudge against MLM for that reason, yet paradoxically also claims he lost money. No attempt is ever made to reconcile these diametrically opposing claims.

⁷⁷ At the time of this writing Usana had just published their 2006 commission data chart, but all references in the Minkow report and Taylor addendum are to the 2005 chart. There is no material difference between the two charts.

		EARNINGS				MONTHS TO REACH TITLE			
FULL TIME	Count	PCT	Max	Min	Average	Total	Max	Min	Average
	DDIR+	34	9.6%	772,432.90	131,254.41	319,740.28	10,871,169.51	143	7
EDIR	36	10.2%	264,068.82	64,661.41	187,714.59	6,757,725.31	124	15	76
FDIR	65	18.4%	183,911.08	8,275.00	103,638.37	6,736,494.03	136	3	65
GDIR	218	61.8%	111,625.47	3,000.00	50,816.94	11,078,092.58	154	1	50
	353								
PART TIME	Count	PCT	Max	Min	Average	Total	Max	Min	Average
	SDIR	1,136	2.8%	66,700.00	94.95	11,980.09	13,609,379.41	169	1
BDIR	397	1.0%	46,452.64	40.00	7,755.61	3,078,977.88	153	1	33
DIR	1,208	3.0%	34,700.00	100.00	5,230.27	6,318,169.52	169	1	27
AGHVR	2,428	6.0%	24,050.00	40.00	2,901.24	7,044,222.80	128	1	22
BLDR	7,220	17.8%	11,431.73	40.00	1,271.88	9,182,961.93	147	1	18
BLVR	16,943	41.7%	4,700.00	20.35	326.02	5,557,592.79	139	1	6
SHR	11,301	27.8%	1,680.00	20.94	99.05	1,119,335.39	132	1	6
	40,633					81,354,121.15			

Total Associates as of 12/31/05 is 111,296

Percent Participating is 37%

Total	Total Avg Dist	Avg Earnings
\$81,354,121.15	101,361	\$802.62

BREAKDOWN OF CANADIAN DISTRIBUTORS		
Earnings (CAN\$)	Count	Percent
0-100	1,516	14%
101-500	4,815	43%
501-1,000	1,711	15%
1,001-2,000	1,181	11%
2,001-5,000	1,006	9%
5,001-50,000	851	8%
50,000+	95	1%
	11,175	100%



AVERAGE INCOME CHART

Arguably the most egregious misrepresentation by Taylor is to assume *all* active distributors are spending almost 13 grand a year on their business. Taylor does eventually acknowledge that this expense "is for fairly aggressive and ambitious recruiters who recruit primarily in the area in which they reside", and "higher level Associates who travel extensively on recruitment campaigns are likely spending several times that amount." Granted Taylor gave MLM a try back in 1991, but that's no excuse to not know about things like the internet, or email. Or for that matter, fax machines, regular mail, and telephones! These are now almost exclusively how organizations are built and supported in the 21st century. High level distributors who travel extensively typically do so to *train and support* their *existing* organization, not to personally recruit in new areas. Jon Taylor's depiction of how multilevel marketing works today is severely outdated. His comparing the operating budgets of more successful distributors with those who are extending essentially no effort at all appears disingenuous and desperate. Taylor is correct in that aggressive and ambitious distributors may spend this much on their business, but they tend not to be the one's on the lower "part time" half of the chart! At least, not for long. This point will be covered extensively in the next section.

This whole argument also assumes these highly pessimistic expense estimates are ongoing. Not only are they not, this is perhaps the greatest, most highly touted, benefit of building a network marketing business! Once the income is developed, and you have a layer of leadership under you that will maintain it, it becomes completely *residual!* Even those 7,220 "Builders" (BLDR) don't need to expend a penny more than what ever it takes to maintain their 200 CV monthly

quota to earn that average \$1,271.88. In fact, the *majority* of those “Part Time” participants could easily be making a profit!

To demonstrate: I served as an expert witness in a wrongful termination case⁷⁸ a few years ago where I testified as to damages. The distributor was earning about \$4,000 a month in gross commissions (and another \$400 in retail, but I keep forgetting – that doesn’t exist), and *zero* net profits. I explained to the jury that, other than a \$100 monthly sales quota (which those non-existent retail customers could have easily covered) they need not spend another dime to continue to earn that \$4,000 every month – for the life of the distributorship. Since the company naturally promoted the “residual income potential” of the opportunity this was easy to justify. The defendant’s expert, a CPA with 30 years experience and 150 business appraisal cases under his belt, tried to make pretty much the same case Taylor is making. The jury got it. The plaintiff was awarded \$650,000.

Although many more people are making a profit in Usana than Taylor and Minkow would like you to believe, there are certainly many who are not. Most, actually. Maybe even 85%. No one knows because no one truly knows what each person’s expenses are. Even those who are not earning enough to cover their monthly 100 or 200 CV commission qualification may still be earning a profit depending on how much of it they retail and their tax savings. Technically, even the inventory they don’t resell, or use as samples, are still an asset on the books. And if this product is personally consumed then yes, technically it’s an expense. But an expense the same way your cost for a carton of milk is an expense. You have “lost money” on the transaction, but you gained an asset in return. If Usana reps were spending about \$230 (200 CV) every month on *nothing* (just to “pay to play” as Taylor calls it), then this would truly be a net loss, and Usana would indeed be an illegal pyramid. But, of course, this is clearly not the case.

It’s surely a lesser number, but let’s go with 85% are losing money just so we have a number to play with. Eighty-five percent *do not* lose money because the market is saturated. Eighty-five percent *do not* lose money because Usana (or MLM) products can not be retailed. Eighty-five percent *do not* lose money because of a flaw in Usana’s (or MLM’s) business model.

Eighty-five percent of distributors lose money because 85% of distributors don’t do what they’re suppose to do to *make money!*

People who spent \$1,000,000 for a Taco Bell franchise typically take their business pretty seriously. People who spend \$20 for a distributor kit do not. People usually spend 4-8 years and tens-of-thousands of dollars preparing for their career. For those who join a network marketing venture to eventually earn a living income (92%)⁷⁹ this would essentially be a career choice. Yet, most will make this decision based on nothing more than a compelling “opportunity call” or a jazzy online flash presentation. Sure, a few really do their due-diligence, work hard and give it their best shot and still fail, as is true in any business. But the vast majority of those who enroll as an MLM distributor do little more than tell a couple friends about it, who decline, and they’re done. Many don’t even do that much. Some may even give it a good effort for a month or two, then not understanding the commitment level necessary to succeed they either drop out, or more likely hop from one “better” MLM program to another. Over and over and over. Much like a marathon runner who repeatedly stops at the one mile marker and returns to the starting line, then stands their scratching her head wondering why she can’t “succeed”. Then finally, as most ex-MLMers do, they walk away disgusted, blaming their failure on their shoes, the course, the race officials, the weather – everything but themselves.⁸⁰

⁷⁸ Fugo vs. Starlight, 2002, Superior Court of California, County of Monterey. Case no. M51539.

⁷⁹ MarketWave survey, n=6,600, 1991-2000.

⁸⁰ I actually had an ex-distributor I sponsored tell me her failure was because, based on her astrological chart, her “moon was in the wrong house”.

This is not the place for a primer on MLM psychology, but suffice it to say, as mentioned earlier, MLM seems to be the only form of free enterprise where no one ever failed because they just weren't very good at, or didn't do anything. There are many ex-MLMers out there who worked the business wrong, and then claimed the business is wrong when it didn't work. And existing MLM distributors, in general, tend to be a very fickle, flighty bunch. The cash is always greener in some other MLM program (Of 422 recently surveyed active distributors representing many companies, the number of distributors who are trying to pursue more than one MLM program simultaneously is over 25%; the average number of years in MLM is 8.6; and the number of companies they've been involved in averages 4.7)⁸¹. There's always someone to tell them how their deal will make them richer, faster, easier (although a minority of MLM practitioners, there are still too many that play this game – which is a challenge with MLM's packaging, not its content). MLM-folk also tend to spook easily (as do, to a lesser extent, stock market investors). Every bump in the road is Mount Everest, every puff of smoke is a mushroom cloud. This is why credibility wrecking reports like Minkow's can be far more damaging to an MLM company than to a conventional one. If you wanted to make money by shorting a stock, destroying the confidence of reps for a publicly traded MLM company (and their customers, prospects and investors) is by far the most effective, fastest way to do it (although in Usana's case exactly the opposite appears to be happening – the second full week after Minkow's report was published they had their best sales week ever, which also ended another record quarter).

Minkow claims Usana is hiding their attrition and turn-over rates from investors, and overstating the success potential to new distributors (the "below the iceberg" numbers). You be the judge:

"The number of active Associates may not increase and could decline in the future. Associates may terminate their services at any time, and, like most direct selling companies, we experience a high turnover among Associates from year to year."

– 2006 10-K (for investors)

"The earnings portrayed in this literature are not necessarily representative of the income, if any, that a USANA Associate can or will earn through his or her participation in the USANA Compensation Plan. These figures should not be considered as guarantees or projections of your actual earnings or profits. Any representation or guarantee of earnings would be misleading. Success with USANA results only from successful sales efforts, which require hard work, diligence, and leadership. Your success will depend on how effectively you exercise these qualities."

– Online Presentation (for distributors)⁸²

"MLM 'dropouts' are consistently abysmal, based on their own reports."

Oh wait. That last one was from Minkow's report. I was confused because he kind of made it sound like MLMers *did* disclose our high drop out rates. Actually, I just read it again and I'm still confused.

While clearly grasping for every last proverbial straw he can find, Minkow further claims Usana is "misleading" distributors (not investors) by referring to their total income as "earnings". As Minkow points out, in the "investing world" earnings usually refers to profits. He's right. Except, *this isn't the investing world*. It's the network marketing world, where "earnings" is routinely synonymous with "total commissions and bonuses". Another example of Minkow's ignorance of the form of business he is attacking.

⁸¹ MarketWave survey, 2001 to present. <http://www.marketwaveinc.com/mlmdata>. An earlier survey of over 6,600 respondents (1991 to 2000) had almost 50% trying to build a sales organization in more than one MLM program.

⁸² Presented in the same size font as the rest of the compensation related information.

Minkow claims newly enrolled MLM distributors are “doomed to fail” but don’t know it. I didn’t know that either when, in 1995, I joined an MLM company – which earned me a 5-digit monthly income by the end of 1997. I’m glad I was ignorant of my imminent failure. Clearly MLM does work for those who take their business seriously. Those who applied a laser beam focus on one good network marketing opportunity and committed to it long term are among those *thousands* of successful distributors who absolutely did, in fact, achieve “financial freedom”.⁸³ Those within the “Director” ranks in the above Usana commission chart surely fit this description of success. Although Taylor and Minkow pretend to not see it, the right most column of Usana’s chart clearly shows the time commitment one should expect to make to reach each level of income – with the mid-range Director rank averaging over *two years*! Usana openly tells us that the top paying rank (where the income could be defined as “wealth”) takes an average of 5.6 years, and took some as long as almost 12 years!

Of course 74% fail in the first year and quit – because 74% quit in their first year!

Point 6 – Only 3% of Usana distributors receive 70% of all commissions and bonuses.

Let’s say you were in charge of conducting a clinical trial on a new arthritis medication. You gave the pain reliever tablet to 100 subjects with the strict instructions to take it one hour before dinner (to avoid dilution) with an 8 ounce glass of water (a required activator). The next day you surveyed the pool of participants and found 10 of them took the tablet right *after* dinner. Another 5 forgot to drink a glass of water. Fifty, for what ever reason, decided not to take the tablet and discarded it. A total of 30 people received great relief from the medication.

While analogous to new MLM distributors to an extent, one might argue that those who didn’t follow the instructions but at least tried the product should still be counted. Maybe. But if not counted the medication had an 86% success rate (30/35). If counted at full weight, at worse there was a 60% success rate (30/50). But surely no one would argue that the 50 who took the medication home but didn’t consume it should be counted, right?

Wrong. FitzMinklor thinks we should.

Much like doing a study on the effectiveness of gym memberships, Minkow et al believe we should factor into our “success” rate all those who paid their dues but never stepped foot into a gym (or did, but lifted a ten pound weight for two reps, walked on the Stairmaster for 30 seconds, then walked out). Americans spend billions a year on gym memberships, the vast majority of which never succeed in getting in shape, but for some reason this gym membership scam gets a pass from Minkow and his experts.

Based on the above chart there were 111,296 “total” Usana distributors in North America⁸⁴ at the end of 2005, and an average for the year of 101,361 (which is the figure Taylor and FitzPatrick use in their calculations)⁸⁵ although only 40,986 of them (37%) were “participating” in the compensation plan. Rather than actually check, the author simply assumes this 40,986 figure represents the number of “active” distributors. Usana, like many MLM companies, defines “active” as having ordered or sold even a single product within the last three months. So Usana voluntarily counts all those who have not ordered or sold anything for over two months as “active”. And just placing an order sure doesn’t mean a distributor is seriously, *actively* pursuing their business. Usana used to count anyone who had ordered within the past year as active, but

⁸³ Anti-MLM zealots do occasionally acknowledge these successes, but those who do succeed are the “perpetrators” and those who fail are their “victims”.

⁸⁴ Both Taylor and Fitzpatrick repeatedly and erroneously refer to this chart as U.S. data only, when in fact it represent North America (U.S., Mexico, and Canada, which by Canadian law must be displayed separately).

⁸⁵ Although this Addendum is authored by Jon Taylor and Robert FitzPatrick, and this particular section title shows FitzPatrick as the author, the section oddly ends with a signature of “Steven R.” So it is unclear who is actually responsible for this data.

changed this in 2002. Taylor insinuates this was done to prop up activity rates to impress investors. I'm thinking it was done to provide investors with *more accurate information!* Clearly it would be inaccurate to count someone who has not ordered or sold a single product in *eleven months* as "active". But the point is irrelevant since Usana *did* use the average for *all* distributors signed up in Usana for the year in their average income calculation. Had they used only their "active" number, that would have been the easily obtainable number of 82,000⁸⁶, not the lazily assumed 40,986 figure. If only those who had placed even one order in the last three months were counted, the average annual income would be \$1,090.24, not \$802.62.⁸⁷ Usana was actually being conservative.

In Jon Taylor's previously published anti-MLM manifesto he claims the percent who lose money in a classic pyramid scheme is 90.4% (9.6% make a profit), but 99.95% lose money in MLM. If we follow the asterisks to the fine print, we discover that his 9.6% figure came from a news report of a scheme called "The Original Dinner Party" and Robert FitzPatrick's personal participation in the "Airplane Game"⁸⁸ over 20 years ago. That's it. Another asterisk leads us to where Taylor arrived at his so often cited "99.9% fail" figure. He picked six MLM companies (out of thousands) and analyzed "internal reports" along with SEC and FTC filings, even though only one is a public company in the United States. He also factored in (insert sarcastic tone here) the extremely reliable "reports from ex-distributors." But apparently his findings were still not to his liking, so he had to "correct" what he refers to as "deceptive data." First, he didn't care for the way MLM companies only report the earnings of those who are "active." Adding back in all those who made no money because they *didn't do anything to earn it* (signed up, bought a kit, and quit) sufficiently increased his "failure" percentage.

One of my favorite Robert FitzPatrick leaps-of-logic is his statement that an MLM company he was denouncing "only counted the 'active' group when reporting average incomes... leaving out the larger group who never earns anything."

Perhaps they never earned anything because they were... inactive?

Point 7 – Usana has an "untenable" business model destined to collapse due to saturation.

In Jon Taylor's report he recites the "100-10-1 rule" as told to him by a Usana rep, where out of 100 people who hear a presentation, ten will sign up. Of those ten only one will do the business. Then just one in ten of those will be real "business builders". So we're down to 1% of all who sign up being "business builders", which is already one-third of the number who achieve the highest incomes in Usana. But as is his usual modus operandi, Taylor must arbitrarily go one step further and declare that only one in ten "business builders" will even realize a profit. This, of course, completely contradicts his findings relevant to the above Usana chart, but let's move on. Taylor accepts this 100-10-1-(1) rule as evidence of his 99.9% failure rate claim, rather than as a valid explanation for it. Taylor, who is the Master of the Misquote⁸⁹, takes the Usana reps statement that, of the ten who *sign up*, only one will "do the business" and changes the meaning completely to ten *doing* the business and only one succeeded to *build* a business.

The reason I am still belaboring this point is this: because so few MLMers even attempt to build their business, or apply so little effort towards it, is exactly why no MLM company ever reaches

⁸⁶ 2005 10-K.

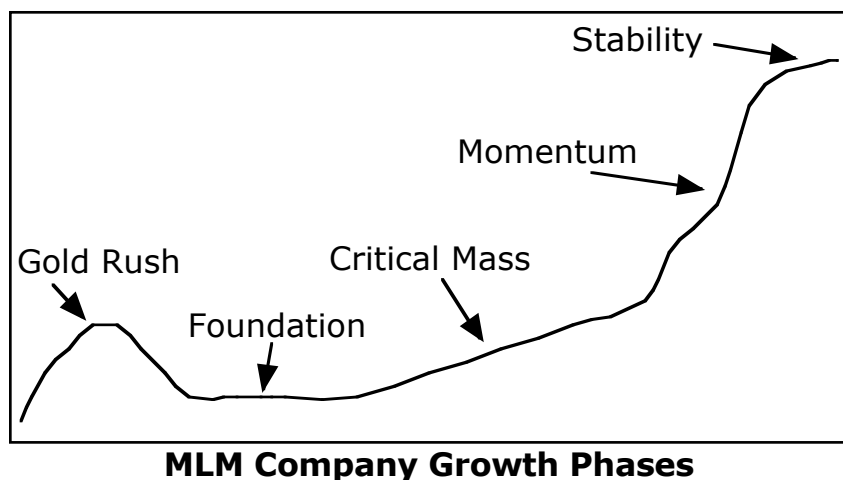
⁸⁷ Assuming the ratio of total distributors at year's end to average distributors during the year (91%) is commensurate with active distributor totals (which it very likely would be), there would have been an average of 74,620 active distributors during 2005 (91% of 82,000).

⁸⁸ A classic illegal pyramid scheme, and one of the most prominent in U.S. history.

⁸⁹ Jon Taylor personally interviewed me in the mid-90s, then proceeded to cherry pick, completely out of context, only those statements that could be folded, spindled and mutilated to support his point, and then completely misquoted me in his writings such that it dramatically changed the meaning of my comments.

saturation! Anti-MLM zealots never even attempt to reconcile these diametrically opposing claims (99.9 fail to build a downline, but MLM companies are destined to die of saturation).

It's funny, sort of, how when a less experienced (or ethical) networker describes a geometric progression down a set number of levels, a la 5-25-125-625-3,125-etc., anti-MLMers are quick to jump all over us for the absurdity of it. "It will never actually happen!" they howl. Oh, but when they need to demonstrate how MLM *must* inevitably reach saturation, what do they turn to? A geometric progression down a set number of levels – usually whatever number of levels are necessary to exceed the population of the Earth, which is exactly what Minkow does. This is one of the rare issues on which I and the anti-MLM zealots totally agree. *It will never actually happen!* So why use it to show what absolutely *will* happen?



Taylor claims Usana is opening foreign markets only to delay the inevitably point of market saturation. Rather than point to examples of what *Usana* has done in foreign markets, Taylor instead points to Nu Skin, and how when they "moved into Asian markets, each market experienced a brief surge in sales... followed in short order by what I call de facto or market saturation." This first begs the question, So why hasn't this happened to Usana in the United

States – after 15 years? What Taylor describes is actually accurate, but for completely different reasons. In *any* new market where an MLM venture opens there is *always* a gold rush mentality among the less serious, lazier participants. They flock to the "ground floor" or "prelaunch" opportunity looking to "get in early". However, *unlike a pyramid scheme*, there is no inherent advantage to getting in first in a legitimate, product based MLM venture. So all those who came in only for this opportunistic reason either discover there is no free lunch, or most likely they blame their lack of success on "missing the wave" or getting in too late. They then scurry out as fast as they came in (in search for the next hot, start-up deal) leaving the opportunity to those that are taking the business more seriously, who got in due to a sincere affinity for the products and long term opportunity. Taylor doesn't know all this because he never spent enough time actually *in* the business to see how it really works.

It's fascinating that there are still people in this country that believe the Earth is flat, the Moon landing was faked, and that MLM companies are doomed to market saturation. This argument is as silly as debating whether or not we should stop selling solar powered generators because the sun might go nova someday. It may, but it's a pretty good bet it won't happen in our lifetime. Besides being a 71 year old industry⁹⁰ which was popularized half a century ago⁹¹, there are currently nine companies who have operated with a multilevel compensation structure for over 40 years.⁹² There are dozens over ten years old and many are still growing. Usana has had 16 consecutive quarters with a net increase in distributors *after* they were ten years old! Nu Skin has gained distributors three years in a row and they launched almost 23 years ago. Reliv has grown five years in a row in the U.S. and is 15 years old⁹³. Mannatech has grown six straight

⁹⁰ The first legally recognized multilevel commission structure was introduced by Nutralite Corporate in 1936.

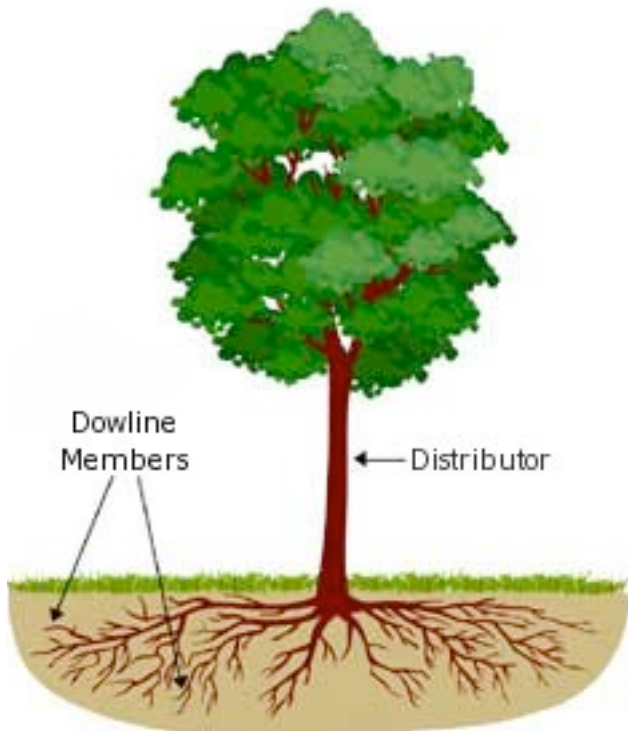
⁹¹ Shaklee Corporation, launched in 1956.

⁹² Shaklee, Amway (Quixtar), Avon, Mary Kay Cosmetics, Tupperware, Fuller Brush, Wachtors, and NeoLife (now part of Diamite Corp.).

⁹³ American Life Investors, Inc. was incorporated in 1985 and became Reliv International in 1992.

years and is 13 years old. After 27 years of business, and after already accumulating 468,365 distributors, Pre-Paid Legal still managed to add 173,000 *more* of them in 2006. And after all of these decades, and with millions of people already involved, and hundreds of MLM companies already in existence, companies like XanGo, Agel and Tahitian Noni, can still launch within the last few years and attract tens-of-thousands of new distributors.

If the MLM business model is as “untenable” as Minkow claims, because of inevitable market saturation, which both he and Jon Taylor claim has *already occurred*, then why hasn’t it caused the demise, or even disruption, of even a single MLM company? Ever?



Jon Taylor claimed he discontinued his “one year test” of MLM when he had an epiphany and realized, despite his own “success”, all those who he was trying to recruit would be “at the bottom” of the pyramid and, with MLM being a “zero sum game” and all, have no chance of achieving the same success. First of all, MLM organizations are not pyramid shaped. If you were to track the number of people on each level of a typical downline it would look more like a diamond, with the greatest number of participants falling within the middle levels. To assume that you have a pyramid shaped downline, with the widest point (most reps) at the base and not a single one of them have a downline themselves of even one person is, of course, ridiculous. To further assume that at some point these base level members all simultaneously build an even wider first level to themselves, thus a geometrically wider base to the pyramid, is now in the realm of absurdity. Yet, based on Minkow’s report,⁹⁴ he actually *does* believe this is what happens!

The greatest irony in the notion that MLMs are all pyramid schemes is that MLM is actually the only form of business whose structure does *not* form a pyramid!

In fact, when plotted out graphically, downlines tend to look much more like the roots of a tree. It *should* go without saying that Jon Taylor was himself “at the bottom” when he first joined an MLM program, yet still managed to find “success”. In fact, literally *every* successful distributor, whether that meant earning an extra couple hundred dollars per month to pay bills, or earning millions per year to buy their dream home, were all “at the bottom” when they first filled out their distributor application. Then, like a root that had already penetrated deep into the ground, the new distributor placed near the tip of it proceeded to form a new branch off of that root.

In 1995 I joined an MLM company that was already a year old and had about 4,000 members. My position was on the 112th level from the apex of the national organization. My partners and I proceeded to build a downline of over 10,000 people, and I always remained on the 112th level. However, I know for a fact there was someone who was three levels down from the company who had a very small downline.

Anyone, anywhere, at any time in the history of an MLM opportunity can be among the 3% who earn 70% of the commissions paid. And they will have *earned* it!

⁹⁴ See the last three paragraphs of Section 5 (Minkow’s Usana report does not include page numbers).

Epilogue.

Living 15 minutes from "The Strip", I am fortunately not a betting man. But if I were, I'd lay Vegas Odds on the identity of Minkow's "paying client" being:

A competing MLM distributor:	500 to 1
A competing MLM company:	50 to 1
Another short seller of Usana stock:	20 to 1
A disgruntled ex-Usana distributor:	15 to 1
Pyramid Scheme Alert (PSA):	Even

The PSA's president is Robert FitzPatrick. Jon Taylor is a board member. So is Doug Brooks and Tracy Coenen. The PSA, particularly Jon Taylor, has tried desperately to be taken seriously by federal regulators over the years and have so far failed. While Fitzpatrick seems content to just maintain his anti-MLM web site, write attack pieces against Amway, and assist in court cases against MLMs and pyramids (of which he makes no distinction), Taylor actively presents his anti-MLM manifestos to state and federal regulators, including the FTC. Then they ignore him.

To get a flavor of the PSA agenda, here are a few sound bites from their web site:

"No more denial, shame or embarrassment. No more confusion. No more blaming the victim. No more resignation. And absolutely no more fear."

"Pyramid Scheme Alert is the first consumer organization to confront the abuses and trickery of pyramid scheme perpetrators... Pyramid Scheme Alert is about ACTION -- coordinated, informed, professional, and effective citizen/consumer action."

"Millions of people have been harmed. Enough! Families and friends have been divided, communities disrupted. Enough! Billions of dollars in savings have been lost. Enough!"

"Misleading product claims, deceptive income promises, lawsuits, protest website -- we have seen enough, learned enough, and tried enough ourselves. It is time for people to come together to expose and prevent one of the most pervasive frauds and ethical abuses of our times."

Maybe someday they'll open up and tell us what they *really* think about MLM. Here's one more:

"*Pyramid* Scheme Alert offers information about the deception and harm of multi-level marketing (MLM) pyramid schemes... State and federal Govt (sic) officials receive millions in campaign contributions from product based pyramid scheme companies and lobby groups. PSA has been formed to counter this imbalance at the national and state level, and to educate consumers directly of the fraud and abuse of MLM."

I would be remiss to not point out that, after 71 years, thousands of MLM companies ("perpetrators"), and tens of millions of distributors ("victims"), isn't it odd that PSA is the very "first" consumer organization to confront this pandemic of fraud? Or that the number of anti-MLM zealots who make a point of "exposing" us to the true evil behind this insipid scheme can be counted on one hand and a toe, literally?

Although there are several others involved in the PSA, only FitzPatrick and Taylor seem desperate to get the attention of federal regulators. When the FTC requested public comment⁹⁵ on their proposed new business opportunity rule⁹⁶ last year over 18,000 people wrote in. Over

⁹⁵ <http://www.ftc.gov/os/comments/businessopprule/>

⁹⁶ #178 FTC Matter No.: R511993 16 CFR Part 437 Notice of Proposed Rulemaking: Business Opportunity Rule.

98% were heavily in support of MLM⁹⁷ and 99% submitted only one response, as I did⁹⁸. Robert FitzPatrick submitted two under his own name, and three more as "Pyramid Scheme Alert." Jon Taylor submitted *eight!* All under the name "Consumer Awareness Institute". When the public got their chance to send rebuttal comments to the FTC⁹⁹, I sent one¹⁰⁰ along with surprisingly only 23 other people. One was Jon Taylor – who submitted *twenty-eight!* Everyone else combined only submitted 25. Virtually none of Taylor's or FitzPatrick's submissions had anything to do with the proposed rule the FTC was requesting comment on (which was not exclusive to MLM at all). They simply had a chance to get their anti-MLM rants in front of an FTC staffer and they took full advantage of it. They utterly abused this public comment forum to forward their own personal agendas.

I've spent a disproportionate amount of time on FitzPatrick, Taylor, and to a lesser extent Brooks and Coenen, in this Rebuttal Report because I firmly believe I am, in fact, rebutting the beliefs of these four more than I am Barry Minkow. As Minkow states "In fact, the statements in our original report are drawn from expert analysis of the (Usana) business model... Without their input, our original report would simply be the opinion of one person. With them, we have the opinions of several experts who support our findings and make a cumulative, persuasive case."¹⁰¹

These anti-MLM zealots are at least smart enough to only attack "MLM" in general, or those who have already been attacked. If you were a medical doctor and someone called all physicians "quacks", you'd have a hard time making a case for slander. But if someone called *you* a quack, it's on! So it's safe to call MLM a scam, or even Equinox in particular, because they have been ruled as such.¹⁰² Otherwise, they'd be foolish to call a specific company, say, like Usana, fraudulent, or an illegal pyramid scheme. That would be slander, or libel if put in writing.

Ah, but if you can find someone *else* to do your dirty work, and take the fall for you, then you're free to assist by supplying requested "reports" and "analyses". And if your mark happens to have some credibility with the FTC, IRS and SEC, you've struck gold! You can then piggyback your anti-MLM propaganda on his shoulders right into the offices of these federal agencies.

Although it was certainly ill-advised to take a short position in a company whose stock you know you are about to trash, I'm not convinced that was Minkow's primary motive. He claims he only had 200 to 300 puts on Usana¹⁰³ (you'd think Minkow could estimate such a critical number with better than a 50% margin for error), which he allegedly purchased for about \$20,000. That means he's already made a substantial profit¹⁰⁴, and that number will continue to rise as Usana's stock drops. So sure, it certainly looks suspicious, as does Minkow's well funded publicity efforts which are certainly bringing a lot of business to his for-profit FDI.¹⁰⁵ But I'd be more interested in how much Minkow is being paid by his "paying client" and what *their* motive is.

⁹⁷ I randomly sampled 253 non-form letters, ten from each letter of the alphabet (incl. all 7 from the Z list), and actually found only two (1%) that were in favor of the new rule and made any negative comments towards MLM.

⁹⁸ <http://www.ftc.gov/os/comments/businessopprule/522418-12553.htm>

⁹⁹ <http://www.ftc.gov/os/comments/businessopprule/rebuttal/>

¹⁰⁰ <http://www.ftc.gov/os/comments/businessopprule/rebuttal/522418-13244.htm>

¹⁰¹ Minkow's response to the Usana libel suit.

¹⁰² Similar to us not being able to call O.J. Simpson a murderer until after the *second* trial, when he was found guilty.

¹⁰³ <http://video.google.com/videoplay?docid=-7853488649783085640&q=barry+minkow&hl=en>

¹⁰⁴ As of 4/13/07.

¹⁰⁵ On Minkow's FDI web site you can purchase his 3 "Frauds Gone Wild" DVDs for \$18 each, his two books, or his investigative services and seminars.

As a side note, Minkow says he'll give back his puts if Usana will give back the millions they received from their distributors. I wonder, if Usana is found innocent, will Minkow give back the millions his report has cost Usana investors?

There is now a conga-line of investor class action law suits filed by several law firms looking to exploit Minkow's report based on face value. Some don't even appear to have any class members yet. Law firms often times adopt the "If you build it they will come" tactic when filing class action suits. Now they will compete for class members. Eventually all the suits will be combined into one, then will likely be dropped or dismissed. Because there is no case.

Barry Minkow is obviously passionate about defending his case against Usana. Unfortunately, he's now dug himself into a position far too deep to ever emerge – the obviousness of his folly be damned. Ego is a powerful thing. If someone tries hard enough, long enough, to make a case that the sky is always red by focusing only on images of desert sunsets, they're stick to their case no matter how many times you force their heads upward in mid-afternoon.

Usana has never even approached market saturation in over 15 years, nor has *any* MLM company in over half a century. Thousands of distributors succeed in reaching their income goals (what ever that may be), many with mature companies that have been around for decades – and all started at the bottom. The vast majority didn't exploit friendships, or hype their products. Products which they genuinely love, some with a passion, perhaps even at times to a fault. Most that failed did so due to poor, but completely voluntary business decisions. The legality of network marketing is well defined and based on decades of precedent, the model is sound, and to those seeking a home based business, the benefits are substantial. Evidence of this is everywhere, and easily obtainable – assuming you *want* to find it.

Minkow describes learning from his own prosecution the importance of the words "relied upon". Investors relied upon Minkow's disclosures when investing in his fraudulent business. Minkow must now come to terms with what, and whom, he "relied upon" to form his Usana report.

And now, ironically, he's the victim of fraudulent information.

Leonard Clements has concentrated his full-time efforts over the last 17 years on researching and analyzing all aspects of MLM and is a court certified expert in the field of Network Marketing. He is the author of the controversial book "Inside Network Marketing" and the best selling cassette tapes "Case Closed! The Whole Truth About Network Marketing" and "The Coming Network Marketing Boom." Visit <http://www.MarketWaveInc.com> for more information.