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19 Federal Trade Commission

20 UNITED STATES DISTRICT COURT
21 CENTRAL DISTRICT OF CALIFORNIA

22 FEDERAL TRADE COMMISSION,

23 Plaintiff,

24 v.

25 HERBALIFE INTERNATIONAL OF
26 AMERICA, INC., a corporation,
27
28

Case No. 2:16-cv-05217

**COMPLAINT FOR
PERMANENT INJUNCTION
AND OTHER EQUITABLE
RELIEF**

1 HERBALIFE INTERNATIONAL,
2 INC., a corporation, and
3 HERBALIFE LTD., a corporation,
4
5 Defendants.

6
7 Plaintiff, the Federal Trade Commission (“FTC” or “the Commission”), for
8 its Complaint alleges:

9 1. The FTC brings this action under Section 13(b) of the Federal Trade
10 Commission Act (“FTC Act”), 15 U.S.C. § 53(b), to obtain permanent injunctive
11 relief, rescission or reformation of contracts, restitution, the refund of monies paid,
12 disgorgement of ill-gotten monies, and other equitable relief for Defendants’ acts
13 or practices in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), in
14 connection with the advertising, marketing, promotion, and sale of a multi-level
15 marketing business opportunity.

16 **JURISDICTION AND VENUE**

17 2. This Court has subject matter jurisdiction pursuant to 28 U.S.C.
18 §§ 1331, 1337(a), and 1345, and 15 U.S.C. §§ 45(a) and 53(b).

19 3. Venue is proper in this district under 28 U.S.C. §§ 1391(b)(2) and
20 (c)(2) and 15 U.S.C. § 53(b).

21 **PLAINTIFF**

22 4. The FTC is an independent agency of the United States Government
23 created by statute. 15 U.S.C. §§ 41–58.

24 5. The FTC enforces Section 5(a) of the FTC Act, 15 U.S.C. § 45(a),
25 which prohibits unfair or deceptive acts or practices in or affecting commerce.

26 6. The FTC is authorized to initiate federal district court proceedings, by
27 its own designated attorneys, to enjoin violations of the FTC Act and to secure
28 such equitable relief as may be appropriate in each case, including rescission or

1 reformation of contracts, restitution, the refund of monies paid, and the
2 disgorgement of ill-gotten monies. 15 U.S.C. § 53(b).

3 **DEFENDANTS**

4 7. Defendant Herbalife International of America, Inc. is a Nevada
5 corporation with its principal place of business at 800 W. Olympic Boulevard, Los
6 Angeles, California. Defendant Herbalife International of America, Inc. is a
7 wholly-owned subsidiary of Herbalife International, Inc. and an indirectly wholly-
8 owned subsidiary of Herbalife Ltd., and is employed by those entities to conduct
9 their U.S. operations. Herbalife International of America, Inc. transacts or has
10 transacted business in this district and throughout the United States.

11 8. Defendant Herbalife International, Inc. is a Nevada corporation with
12 its principal place of business at 800 W. Olympic Boulevard, Los Angeles,
13 California. Herbalife International, Inc. is an indirect wholly-owned subsidiary of
14 Herbalife Ltd. Herbalife Ltd. employs Herbalife International, Inc. to manage its
15 global marketing company. Herbalife International, Inc. transacts or has transacted
16 business in this district and throughout the United States.

17 9. Defendant Herbalife Ltd. is a corporation organized under the laws of
18 the Cayman Islands with its principal place of business at P.O. Box 309GT,
19 Ugland House, South Church Street, Grand Cayman, Cayman Islands. Herbalife
20 Ltd. transacts or has transacted business in this district and throughout the United
21 States.

22 10. This Complaint refers to Herbalife International of America, Inc.,
23 Herbalife International, Inc., and Herbalife Ltd. collectively as “Herbalife” or
24 “Defendants.”

25 11. At all times material to this Complaint, acting alone or in concert with
26 others, Defendants have advertised, marketed, distributed, or sold the business
27 opportunity at issue in this Complaint to consumers throughout the United States.
28

1 **COMMON ENTERPRISE**

2 12. Defendants have operated as a common enterprise while engaging in
3 the deceptive and unlawful acts and practices alleged herein. Defendants have
4 conducted the business practices described below through interrelated companies
5 that have common ownership, officers, directors, and office locations. Because
6 Defendants have operated as a common enterprise, each entity is jointly and
7 severally liable for the acts and practices alleged below.

8 **COMMERCE**

9 13. At all times material to this Complaint, Defendants have maintained a
10 substantial course of trade in or affecting commerce, as “commerce” is defined in
11 Section 4 of the FTC Act, 15 U.S.C. § 44.

12 **DEFENDANTS’ BUSINESS PRACTICES**

13 14. Defendants promote Herbalife as a multi-level marketing business
14 opportunity through which participants may earn compensation by selling weight
15 management, nutritional supplement, and personal care products and by recruiting
16 new participants into the organization.

17 15. Individuals who participate in Defendants’ business opportunity are
18 called “Distributors” (also referred to herein as “participants”). In 2013,
19 Defendants began calling participants “Members” rather than “Distributors.” The
20 change in terminology, however, was not accompanied by any substantive change
21 to the nature of the business opportunity available to Herbalife participants.

22 16. Defendants represent, expressly or by implication, that Herbalife
23 Distributors are likely to earn substantial income, including significant full-time or
24 part-time income, from pursuing a retail-based business opportunity.

25 17. In reality, however, Defendants’ program does not offer participants a
26 viable retail-based business opportunity. Defendants’ compensation program
27 incentivizes not retail sales, but the recruiting of additional participants who will
28 fuel the enterprise by making wholesale purchases of product.

1 18. The retail sale of Herbalife product is not profitable or is so
2 insufficiently profitable that any retail sales tend only to mitigate the costs to
3 participate in the Herbalife business opportunity.

4 19. As a consequence, the small minority of Distributors who receive
5 substantial income through Herbalife are primarily compensated for successfully
6 recruiting large numbers of business opportunity participants who purchase
7 Herbalife product.

8 20. The overwhelming majority of Herbalife Distributors who pursue the
9 business opportunity make little or no money, and a substantial percentage lose
10 money.

11 **Defendants' Promotional and Marketing Activities Are Misleading**

12 21. Defendants promote their business opportunity in both English and
13 Spanish through a variety of channels, including videos, live presentations, and
14 print materials. Through each of these channels, Defendants represent, expressly
15 or by implication, that consumers who become Herbalife Distributors are likely to
16 earn substantial income, including significant full-time or part-time income by
17 purchasing and re-selling Herbalife products.

18 22. In some but not all instances, Defendants accompany their misleading
19 income representations with purported "disclaimers." These purported
20 disclaimers, which often appear in small print, do not alter the net impression
21 created by Defendants' misleading representations, namely, that Distributors are
22 likely to earn substantial income. (See, for example, the graphic illustration at
23 Paragraph 37, which contains the following disclaimer: "Incomes applicable to the
24 individuals (or examples) depicted and not average. For average financial
25 performance data, see the Statement of Average Gross Compensation of U.S.
26 Supervisors at Herbalife.com and MyHerbalife.com.")

27 23. As in the example at Paragraph 37, Defendants' purported disclaimers
28 typically reference a separate document, the "Statement of Average Gross

1 Compensation,” that supposedly presents “realistic expectations of the possible
2 income you can earn.” The Statement of Average Gross Compensation does not
3 provide clarity or realistic expectations, but instead obfuscates through a dense
4 maze of verbiage and numbers. Neither the reference to nor the Statement of
5 Average Gross Compensation itself alters the net impression created by
6 Defendants’ misleading representations.

7 *Misleading Income Representations*

8 24. Defendants use videos to promote their business, making them
9 available to Distributors through Herbalife’s websites, including myherbalife.com
10 and video.herbalife.com. Defendants have at times also included videos in the
11 starter packs that all new Distributors must purchase. Many of the videos are
12 disseminated in both English and Spanish.

13 25. Defendants’ videos include representations that Distributors are likely
14 to earn substantial income through Defendants’ business opportunity; images of
15 expensive houses, luxury automobiles, and exotic vacations; and income
16 testimonials.

17 26. For example, a promotional video available through February 2016 on
18 myherbalife.com portrays a “Mini-HOM (Herbalife Opportunity Meeting)” at
19 which various Herbalife Distributors take turns giving income testimonials. The
20 video includes the following income representations:

- 21 a. I made \$4,100 my second month. . . . And I retired from
22 corporate America. . . . Last month it was \$7,300.
- 23 b. I average an extra \$1,500 a month part-time, around a 60-hour
24 workweek [working in corporate finance], so you can really
25 build this around whatever you’re doing.
- 26 c. I’ve been a coach on the team for a year and a half. . . . Fast
27 forward maybe a year and five months later, that’s when I hit
28 six figures in the company. . . . Couple of months later, I make

1 over \$13,000 a month now.

- 2 d. My income ended up getting to \$4,000 a month, part time, at
3 Herbalife. . . . It's been five years, my income got up to
4 \$10,000 a month a couple years ago. It's more than double that
5 now.

6 27. Another video, "Design Your Life," was included in every new
7 Distributor's starter pack until January 2013 and was available on
8 video.herbalife.com until October 2014. Because Defendants intended the "Design
9 Your Life" video to be given to potential recruits, ten copies of the DVD were
10 included in the starter pack. In addition to images of expensive cars and opulent
11 mansions the video includes the following testimonials:

- 12 a. About a year and a half into the business, still part-time, I was
13 making \$2,500 a month.
- 14 b. First month in the business, without having a clue . . . first
15 month it was unbelievable, actually, our income was \$1,500.
- 16 c. A year exactly after I started the business, my checks that
17 month were \$5,468.28. Two months later my check went up to
18 \$7,080—and that was the month I went on vacation, and came
19 back, and got that \$7,000 check! So, it's been amazing.
- 20 d. You know, the royalties grew five times in five months, and last
21 month, we hit about \$16,000.
- 22 e. When I got to ten thousand, I thought, well that wasn't so hard
23 after all, maybe I can get to fifteen, and I went from fifteen, to
24 twenty, and then to thirty, and then even up to forty thousand
25 dollars a month.
- 26 f. The first nine months of really getting going, I had made a
27 quarter of a million dollars.

28 28. The "Design Your Life" video also includes the following:

1 There are basically three types of people Herbalife is looking for.
2 What you need to do next is get back to the person who gave you this
3 video and let them know what you are. Just tell them A, B, or C . . .

4 Category A is someone who might be saying . . . I don't need any
5 extra income but the products sound great . . . I want to get started on
6 the products right away.

7 Category B is someone who might be saying, you know, the products
8 sound great, and I'd like to start a small business to earn an extra \$500
9 to \$1,500 a month part-time

10 Category C, you might be saying, wow, everything sounds great. I
11 like the products and would like to start a big business that could
12 generate a career level income or more. \$2,500 to \$10,000 a
13 month. . . .

14 You make the choice. Are you A, B or C?

15 29. In addition, from at least January 2009 through August 2013, a DVD
16 called "Getting Started" was included in the starter packs that all Distributors must
17 purchase. The most recent version of "Getting Started" included the testimonials
18 of Distributors "Glenn" and "Jennifer":

19 a. Glenn explains that he was a bartender, "broke" and "struggling
20 to pay [his] bills," before becoming an Herbalife Distributor.

21 Although he "didn't have any formal education" or "any
22 business background," he quickly succeeded with Herbalife and
23 was able to make enough money to quit his job and work full-
24 time as an Herbalife Distributor. Now "I'm able to live in a
25 beautiful home, drive whatever I want, and there's nothing else
26 I'd rather do than work from home, be able to set my own
27 schedule, and be my own boss."

28 b. Before Herbalife, Jennifer wanted to be a stay-at-home mom for

1 her son. However, she had to put her son in daycare and work
2 long hours while her husband worked eighty-hour weeks. After
3 just four months as an Herbalife Distributor, she “went full-
4 time, took [her] son out of daycare, and [] became that stay-at-
5 home mom.” Today, she and her husband are both stay-at-
6 home parents, “we travel the world, we have a six-figure
7 income, and this company and the products have totally
8 changed my life.”

9 30. Defendants also sponsor numerous events for Distributors in both
10 English and Spanish. Many of these events include live presentations at which
11 speakers boast about the high incomes they earn as Herbalife Distributors. These
12 events have names such as “Extravaganzas,” “Leadership Development
13 Weekends,” and “Success Training Seminars.”

14 31. Defendants strongly encourage Distributors to attend these events,
15 which often require Distributors to pay an attendance fee and/or purchase a
16 minimum amount of product from Herbalife. Defendants craft the agendas and
17 select the speakers who present at these events. Speakers are usually chosen from
18 among the very small percentage of Herbalife participants who have reached the
19 highest status levels of the Herbalife organization. The presentations made by the
20 selected top Distributors repeatedly emphasize that Distributors are likely to earn
21 substantial income through Herbalife, and that Distributors’ income potential is
22 limited only by their own efforts.

23 32. For example, speakers giving live presentations at Defendants’ events
24 have made the following statements:

- 25 a. [H]ow many of you would like to make at least a million
26 dollars a year in income? I gotta tell ya, every extra million
27 dollars, I find, comes in handy. OK? You know? Then you
28 get 2 million, 5 million, you know, and with the increases of

1 20%, 25%—

2 Even now, you can put into your mind—like, if you made a
3 hundred thousand dollars last year, and your income went up
4 proportionately, an extra twenty thousand dollars? That’s
5 pretty cool, huh? Couple thousand a month? You make five
6 hundred thousand dollars, would an extra hundred thousand
7 dollars come in handy? And we’re gonna go through how to
8 make it happen.

9 [Herbalife Chairman’s Club member John Tartol, 2012
10 President’s Summit, Los Angeles]

11 b. . . . I can remember when I was new, and I didn’t know
12 anything, I didn’t know anybody, didn’t have any sales or
13 marketing experience, I didn’t know, how was I ever gonna get
14 successful? . . .

15 And make no mistake about it, ’cause it happened for me, I’m
16 living proof that it can happen, and all the people down here in
17 this floor here, and the people behind you, all of us are, you
18 know—I’m a multi-millionaire, but, you know, all of us are
19 getting groomed to become multi-millionaires. That is an
20 awesome opportunity.

21 Now, you can take advantage of it, or you may only want to
22 make sixty thousand, a hundred thousand, a couple hundred
23 thousand.

24 [Herbalife Founder’s Circle member Geri Cvitanovich, 2010
25 Herbalife Extravaganza, Los Angeles]

26 c. [translated from Spanish] It has been 15 years since we arrived
27 here in the United States searching for the American
28 Dream In ’95, we came from Mexico to the United

1 States I lasted 7 years in a cleaning company, 7 years
2 earning \$2,000 a month. We started the business doing it part
3 time, the income started coming, it was something incredible,
4 our lifestyle started to change spectacularly. . . . In the last
5 three months the company has paid us more than \$45,000.

6 Welcome to Herbalife!

7 [Raul Sánchez, Herbalife President's Team member, 2009
8 Herbalife Extravaganza Latina, Atlanta]

9 33. In addition to the spoken content, the live presentations at Defendants'
10 events often involve images of expensive houses, luxury automobiles, and exotic
11 vacations.

12 34. Defendants have recorded many of the live presentations given at
13 Defendants' sponsored events and have formally integrated the presentations into
14 their own resources, making the recordings available to Distributors through
15 Herbalife's websites, including myherbalife.com and video.herbalife.com.

16 35. Like Defendants' videos and sponsored-events, Defendants' print
17 publications include representations that Distributors are likely to earn substantial
18 income through Defendants' business opportunity.

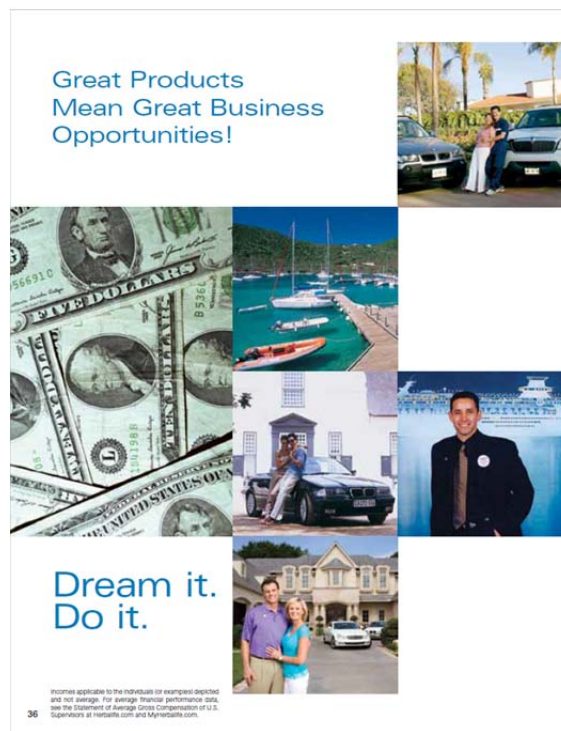
19 36. Defendants' print publications include, for example, "Your Business
20 Basics," which is available in both English and Spanish and is provided to all new
21 Distributors. From 2014 through at least December 2015, "Your Business Basics"
22 included the following representations:

- 23 a. Earn extra money each month. \ Be your own boss. \ Have the
24 time and money to enjoy the finer things in life.
- 25 b. Regardless of your background and job experience, you can
26 succeed because we have people just like you who started
27 where you are and are now earning substantial incomes.
- 28 c. Your income and lifestyle potential with Herbalife are yours to

determine. Thousands of others like you have achieved success with Herbalife. You can do it!

d. From nutrition to the business opportunity, you'll see there's no limit to your personal or financial potential, and others just like you have tapped into this incredible opportunity.

37. The "Presentation Book" is another of Defendants' publications that is available in both English and Spanish and that is provided to all new Distributors. It is designed to be shown to potential recruits. The English-language version of the Presentation Book that was included in the starter pack from 2012 through 2014 stated that Herbalife offers "[t]he opportunity to earn more than you ever thought possible and make your dreams come true!" That publication, a page of which is shown below, included pictures of big houses, fancy cars, cash, and boats alongside the text "Great Products Mean Great Business Opportunities! Dream it. Do it."



38. Other versions of the Presentation Book have also included Distributor income testimonials:

1 a. . . . I started my Herbalife business with the goal of quitting my
2 job as a collection specialist within a year. Just 13 months
3 later, I realized that dream! . . . And with my \$6,500-a-month
4 income, we've been able to move into a new house and
5 renovate.

6 b. Now, while earning \$25,000 a month with Herbalife, I get to do
7 all the things I love: play music and ride my motorcycle!

8 c. We went from bankruptcy to being set for life!

9 39. From 2012 through 2013, the Spanish-language version of
10 Presentation Book offered similar income testimonials (translated here into
11 English):

12 a. The days when I would earn a living cleaning houses are behind
13 me because now we are fully dedicated to our prosperous
14 Herbalife business.

15 b. When we worked in factories our earnings could only pay for
16 basic needs, but now we can take our 12 grandkids on
17 vacations. These are the best years of our lives.

18 c. Before Herbalife I worked on a ranch tending cattle, but when
19 my sister showed me her royalty check she convinced me then
20 and there. Today, at 22 years old, I'm economically
21 independent.

22 d. We figured out that if we worked hard with our independent
23 Herbalife business, we could achieve anything: health, wealth,
24 and financial liberty. And that's exactly what we've done!

25 40. Similar representations regularly appear in the Defendants' magazine,
26 "Herbalife Today," which is available in both English and Spanish and is provided
27 online to Distributors through myherbalife.com. The March 2013 issue of
28 "Herbalife Today," for example, includes the following testimonials:

- 1 a. Now I have the freedom to do what I like. I can travel the
- 2 world and help others change their lives wherever I go.
- 3 b. Today, as Independent Distributors, they're able to work from
- 4 home, take vacations and have a flexible schedule.
- 5 c. Now, Dan and Orlyn feel they have found financial stability
- 6 and take pride in helping others find better nutrition and
- 7 financial success.

8 41. To help Distributors recruit new participants, Defendants have
9 provided Distributors with several tools and training materials, including the
10 videos and print materials discussed above. Defendants encourage Distributors to
11 use these materials in attempting to recruit new participants.

12 ***Misleading Representations Regarding Income from Retail Sales***

13 42. Many of Defendants' representations that Herbalife participants are
14 likely to earn substantial income expressly or impliedly represent that Herbalife
15 participants earn significant full-time or part-time income from selling Herbalife
16 products at retail.

17 43. Defendants' promotional materials often focus on the growth of the
18 weight-loss industry as a result of the worldwide "obesity epidemic," and claim or
19 imply that this industry growth translates into the potential for making large
20 amounts of money from the retail sale of Herbalife weight management products.
21 For example, the "Ready To Go" video, available through February 2016 on
22 video.herbalife.com, begins by portraying a bleak picture of the current state of the
23 economy ("rising unemployment," "layoffs," "salary reductions," "reduced
24 benefits") and urges the viewer to "take control of your . . . situation / financial
25 future / life" and "join the emerging megatrend of wellness." The video cites
26 estimates that the global weight loss market will reach \$672 billion by 2015 and
27 explains, "[t]hat spells growth / opportunity / the answer you've been looking for."
28 The video makes the following invitation: "Get in on the opportunity / the health

1 and wellness megatrend / the premier nutrition and wellness company in the world.
2 Get in on Herbalife.”

3 44. In 2013, Defendants created and made available to Distributors a
4 PowerPoint presentation to show prospective and newly-recruited Distributors.
5 The presentation, which was still in use in 2015, claims that “total revenue in the
6 fitness industry reached \$21.8 billion in 2012,” and that “statistics show a rise in
7 consumer spending for body image concerns.” The presentation goes on to portray
8 Herbalife as “the brand leader” in the meal replacement category, noting that in
9 2012 the company had “over \$6.4 billion [in] suggested retail sales.” The
10 presentation claims that through offering “great products” and a “great business,”
11 Herbalife “allows you to earn Member discounts and profits instantly by retailing
12 products.”

13 45. Similarly, the “Getting Started” video mentioned above at Paragraph
14 29, which was included in the starter pack for new Distributors from at least
15 January 2009 through August 2013, claims that the 3 trillion dollar weight-loss
16 industry “has surpassed the GNP of all major European countries.” The video goes
17 on to claim that Herbalife, “with more than 2.5 billion dollars in sales generated by
18 a team of over one million distributors throughout the world,” is a leader in this
19 industry, which “has become the newest financial powerhouse in the world.”
20 Herbalife is described as a “great business opportunity”: “You have the
21 opportunity for financial independence and freedom; you can do it with helping
22 people change their lives, by getting them in a better nutritional mode, by getting
23 them healthier.”

24 46. The “Mini-HOM (Herbalife Opportunity Meeting)” promotional
25 video available through February 2016 on myherbalife.com presents testimonials
26 that expressly or impliedly represent the full-time or part-time income that
27 participants earn from selling Herbalife products at retail, by emphasizing how
28 much money participants can make immediately (presumably before they have

1 had a chance to build an organization that would generate recruiting-reward
2 payments):

- 3 a. In my first three weeks, I made an extra \$1,200 around my full-
4 time nursing schedule. So this is really part-time, doing this
5 super part-time, and I just saw the potential with this
- 6 b. I started as a client, I was actually the CFO of an entertainment
7 finance company So, you know, had the career down
8 Went to a volleyball tournament that I was already gonna play
9 in. Everyone on the beach, you guys, was like, what are you
10 doing, you look better than you did when you were at UCLA,
11 like, hook me up, like, help me, basically!
12 . . . You know, my three days on the beach at a beach
13 volleyball tournament, I made \$2,100. And I wasn't actively
14 looking for extra money, but I wasn't gonna give it back.
- 15 c. [I]n my first month, I made an extra 500 bucks around . . . a
16 crazy corporate job.

17 47. In the "Design Your Life" video, available on video.herbalife.com
18 until October 2014, one of the speakers states that Herbalife's "great consumable
19 products that people want and need [are] why we have an incredible financial
20 opportunity." A speaker later states that as an "Herbalife Distributor you can
21 develop a successful retail base to help put money in your pocket every day and
22 every month." A voiceover additionally states that "[w]ith just ten customers, each
23 spending a hundred dollars a month, you can take in a thousand dollars in retail
24 sales, and make up to \$420 in profit."

25 48. The "Design Your Life" video also presents numerous testimonials
26 that expressly or impliedly represent the full-time or part-time income that
27 participants earn from selling Herbalife products at retail:

- 28 a. My first week in the business, part-time, just learning what to

1 do, I earned \$1,000! . . . [M]y first month, part-time, I earned
2 over \$5,000!

3 b. I earned \$420 in my first ten days. . . . working this business
4 part-time. I was able to fire my boss, and I've never had a real
5 boss since.

6 c. When I got started on these products, I got such great results
7 that I made a thousand extra dollars my first month. . . . And so
8 I kept working my business part-time . . . while I was still
9 [working as a nurse] full-time . . .

10 d. When I got started, my first day I actually earned \$420

11 e. [I]n the month of August I had retail sales of \$3,700.

12 49. Print materials included in the starter packs that all new Distributors
13 must purchase also portray an opportunity to earn significant income through retail
14 sales of Herbalife products. For example, from 2014 through at least December
15 2015, the "Sales & Marketing Plan and Business Rules" book, which is included in
16 the starter pack for new Distributors, discussed the opportunity for Distributors to
17 make "Immediate Retail Profit" from direct sales to customers and states that
18 retailing is an important "key to success" as an Herbalife Distributor.

19 50. From 2014 through at least December 2015, the book "Building Your
20 Business," which is also included in the starter pack for new Distributors,
21 represented that "a satisfied customer base can provide you with regular, long-term
22 income."

23 51. Similarly, through at least December 2015, a pamphlet that is also
24 included in the starter pack for new Distributors, "Your First 72 Hours: Making
25 Your First Sale," provides instruction on "making your first sale in 5 easy steps."

26 **Defendants Do Not Offer a Viable Retail-Based Business Opportunity**

27 52. Although Defendants represent, expressly or impliedly, that
28 Distributors will be able to sell Herbalife products at a profit, Defendants do not

1 track either the existence or profitability of Distributor attempts to retail Herbalife
2 products.

3 53. The overwhelming majority of Herbalife Distributors who pursue the
4 business opportunity do not make anything approaching full-time or even part-time
5 minimum wage because the promised retail sales to customers simply are not there.

6 54. Even according to Defendants' own survey, sales to customers outside
7 the Herbalife network account for only 39% of Herbalife's product sales each year;
8 the remaining approximately 60% is simply Herbalife selling to its own
9 Distributors. [Herbalife Press Release, July 22, 2014]

10 55. Analysis of Defendants' own Distributor purchase data shows that,
11 even under favorable assumptions about Distributors' market reach and sales price,
12 the overwhelming majority of Herbalife Distributors who pursue the business
13 opportunity make little or no money from retail sales. Under these assumptions,
14 and assuming no costs other than an individual's total payments to Herbalife, half
15 of Distributors whom the Defendants designate as "Sales Leaders"¹ average less
16 than \$5 per month in net profit from retail alone, and half of these Distributors lose
17 money.²

18 56. As a direct-selling company, Defendants encourage Distributors to
19 sell product face-to-face to family and friends, and to customers with whom they
20 are supposed to develop personal relationships. Distributors are taught to follow
21 three key steps in retailing the product: use the product themselves, wear a button

22
23 ¹ "Sales Leaders" are defined by Defendants as Distributors who have reached
24 status levels of "Supervisor" and above. Approximately \$3,000 in product
25 purchases are required to reach the lowest level of "Sales Leader." "Sales
26 Leaders" may purchase products from the Defendants at a 50% discount, which is
27 the largest discount available to Distributors. See ¶¶ 111–18.

28 ² This figure is based on analysis of Distributors who joined in 2009–11 and were
designated as "Sales Leaders." It assumes that they sold 75% of the product they
purchased, at the full suggested retail price, and incurred no expenses other than
the monies they paid to Herbalife.

1 advertising Herbalife, and talk to people (“use, wear, talk”).

2 57. In order to restrict sales to the direct-selling channel, Defendants have
3 adopted rules that effectively prevent Distributors from being able to sell to a
4 larger customer base. Defendants’ rules prohibit the sale of product in retail stores
5 and impose many restrictions on online selling. Nonetheless, Defendants foster an
6 illusion that Distributors can make significant full-time or part-time income from
7 retail sales. One way in which Defendants accomplish this is by promoting the
8 concept of the “Nutrition Club.” The Nutrition Club model was developed from an
9 idea that started in Mexico and, according to Defendants, has particular appeal for
10 members of the U.S. Latino community.

11 58. According to Defendants, the Nutrition Club is supposed to be a
12 neighborhood gathering place to promote health and wellness, and to provide
13 income for the Nutrition Club owner. In practice, Nutrition Clubs operate
14 primarily as a tool for recruiting new members rather than as a method for
15 profitably retailing Herbalife products.

16 59. Defendants encourage Distributors to lease a commercial space (or
17 use space in their homes) to operate a business similar to a juice bar, in which the
18 Distributor will work on a daily basis as the owner and sole employee. [Herbalife
19 Rule of Conduct 8.1.3]

20 60. Customers who come to the club pay a daily “membership fee” of a
21 few dollars that entitles them to consume certain Herbalife products that are
22 prepared on the premises. Visitors typically receive one serving of soy protein
23 powder mixed with water and ice (referred to as a “shake”), herbal tea, and aloe.
24 This method of operating an Herbalife business is often referred to as “daily
25 consumption.”

26 61. To find customers, Nutrition Club operators are encouraged to pass
27 out flyers to potential customers on the street, at their children’s school, or other
28 locations, inviting them to visit the “club.”

1 62. While only a small percentage of the roughly half-million U.S.
2 Herbalife Distributors report operating Nutrition Clubs, Defendants claim that club
3 owners purchase a disproportionate amount of volume of Herbalife product. In
4 2012, Defendants estimated that there were 3,700 commercial Nutrition Clubs in
5 the North America region (consisting primarily of the United States); Defendants
6 also claimed that Nutrition Clubs were driving 30–35% of the overall volume of
7 product purchased in the United States. [Herbalife Second Quarter 2012 Earnings
8 Conference Call]

9 63. Although Nutrition Clubs would appear to be retail establishments,
10 Defendants’ rules provide that Nutrition Clubs are not retail stores or outlets, nor
11 are they restaurants or carry-out establishments. Nutrition Clubs are not intended
12 to attract “walk-in” traffic; Defendants’ rules prohibit signs that state or suggest
13 that Herbalife products are available for retail purchase on the premises. Club
14 owners are not permitted to post signs indicating whether the club is open or
15 closed, and the interior of the club must not be visible to persons outside.
16 [Herbalife Rules of Conduct 8.3.3, 8.4.3, 8.4.4]

17 64. Club operators may not post, list, or charge prices for servings of
18 prepared products such as shakes, teas, or aloe. The only permissible charge in
19 connection with the provision of these products is the “membership fee.”
20 [Herbalife Rules of Conduct 8.2.1, 8.2.8] Provision of the shake, tea, and aloe
21 generally costs a Distributor a few dollars, leaving little of the “membership fee” to
22 cover the various operational expenses associated with the club.

23 65. Although Defendants create the impression that Nutrition Club
24 owners will make significant full-time or part-time income from retailing Herbalife
25 products to customers at their clubs, many Distributors find it all but impossible to
26 make enough money from retail sales of product to cover the overhead of the club
27 and also generate income for the owner.

28 66. Many club owners incur thousands of dollars in expenses—including

1 but not limited to product purchases, rent, utilities, supplies, and licensing fees—
2 that they are unable to recover through the operation of their clubs, and end up
3 losing money.

4 67. In fact, Defendants’ own telephone survey of 433 current and 69
5 former Nutrition Club owners in February 2013 paints a discouraging picture of
6 the experience of many Nutrition Club owners. Fifty-seven percent of Nutrition
7 Club owners reported that their clubs made no profit or lost money. Club owners
8 reported spending an average of about \$8,500 to open their club.

9 68. Some Nutrition Club owners continue to operate their clubs for little
10 or no profit—or at a loss—for years, in the hope that things will turn around and
11 their investment will eventually pay off. However, the promised retail-based
12 business opportunity is simply not there.

13 69. Because Nutrition Clubs are expressly not retail establishments and
14 are often unprofitable, they are principally of value to a small minority of
15 financially successful Herbalife Distributors as a location from which they can
16 recruit new participants.

17 70. As one top Distributor explained in a PowerPoint presentation:
18 [Nutrition Club] Operators need to realize that the end goal is not how
19 many \$4.00 services they sell each day as that is not the way for them
20 to achieve their financial goals. Rather, it’s upgrading a Consumer to
21 become a Customer and eventually a Distributor and ultimately
22 having Distributors become Operators who will duplicate the
23 Nutrition Club method.

24 [“Financial Success System” presentation dated March 24, 2010]

25 71. “Successful” Nutrition Club owners make money not from retailing
26 product, but from recruiting other participants who are encouraged to open their
27 own clubs, buy more product, and recruit more participants. When recruited
28 participants purchase product to sell at their clubs, these purchases generate

1 recruiting rewards for the sponsor, even if the clubs themselves lose money. These
2 recruiting rewards are the only pathway to achieve the high incomes touted in
3 Defendants' promotional materials.

4 72. Regardless of whether Distributors operate a Nutrition Club,
5 Distributors experience difficulty in selling product to customers outside the
6 network. Nevertheless, Defendants' compensation structure puts pressure on
7 Distributors to purchase large quantities of product in order to qualify for greater
8 wholesale discounts and recruiting-based rewards (*see* discussion below at ¶¶ 135–
9 44).

10 73. As a result, many Distributors buy product that they find difficult to
11 sell. Although Defendants have a buy-back policy, in order to take advantage of
12 the policy, a Distributor must resign his distributorship. Many Distributors have
13 been unaware of the policy or, for various reasons, have been reluctant to attempt
14 to use it.

15 74. Distributors dispose of excess product purchases in numerous ways.
16 At the simplest level, when Distributors are left with product they are unable to sell
17 they may give it to friends, throw it away, or gradually consume it themselves.
18 Such self-consumption is not driven by genuine demand for the product, but is the
19 easiest and most convenient way for a Distributor to get some benefit from product
20 that the Distributor would not have bought absent his or her participation in the
21 business opportunity. In other instances Distributors attempt to sell their excess
22 inventory at a discount on auction websites or at flea markets, although such
23 efforts to mitigate their losses are prohibited by Defendants' rules. [Herbalife
24 Rules of Conduct 4.1.1, 7.3]

25 75. The overwhelming majority of Distributors who attempt to retail the
26 product make little or no net income, or even lose money, from retailing the
27 product.
28

1 ***Distributors Abandon the Business Opportunity in Large Numbers***

2 76. In light of their poor financial results, many Distributors either stop
3 buying product or leave the organization altogether, resulting in a high turnover
4 rate.

5 77. Despite Defendants' efforts to promote retention of Distributors
6 whom it characterizes as "Sales Leaders," in 2014 nearly 60% of first-time Sales
7 Leaders did not purchase sufficient product to requalify as Sales Leaders.
8 [Statement of Average Gross Compensation Paid by Herbalife to U.S. Members in
9 2014]

10 78. Retention for non-Sales Leaders, many of whom are pursuing the
11 business opportunity, is even worse. An analysis of Defendants' data shows that
12 the majority of Distributors stop ordering Herbalife products within their first year,
13 and nearly 50% of the entire Herbalife U.S. Distributor base quits in any given
14 year. Roughly half of all Herbalife Distributors at any given time are in their first
15 12 months of membership, and roughly 40% of the volume of Herbalife products
16 sold by Defendants each year is sold to participants in their first year.

17 79. During 2009–13, an annual average of approximately 242,000 new
18 Distributors signed up in the United States. On average, 89% of those newly-
19 recruited Distributors, however, simply replaced U.S. Distributors who left that
20 same year, with an annual average of approximately 216,000 Distributors leaving
21 during this time period.

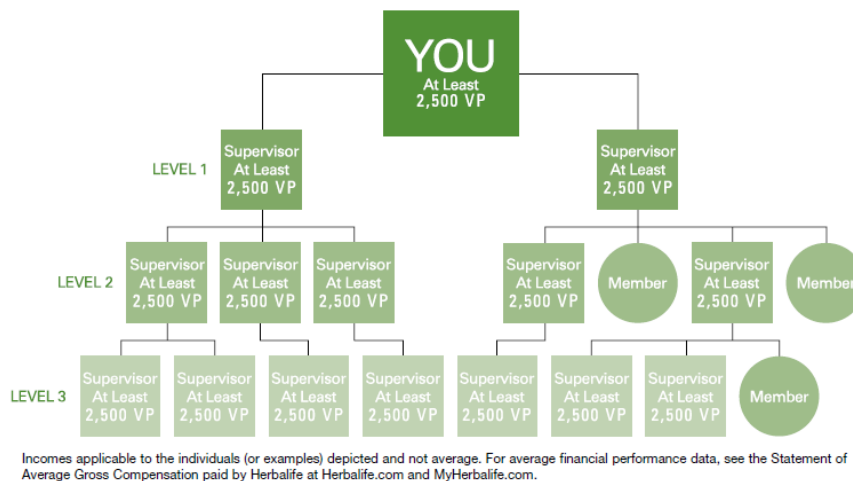
22 80. For example, while approximately 277,000 new Distributors joined
23 Herbalife in the U.S. in 2013 (from a base of approximately 520,000 Distributors
24 at the end of 2012), approximately 256,000 existing Distributors left that year.

25 ***Defendants' Business Opportunity is Based on Recruitment***

26 81. Notwithstanding Defendants' express and implied representations that
27 Herbalife offers a retail-based business opportunity, in truth the only way to
28 achieve wealth from the Herbalife business opportunity is to recruit other

1 Distributors. Purchases by these recruited Distributors, referred to as a
 2 “downline,” generate rewards for the sponsoring Distributor. (See ¶ 119.)
 3 Through a variety of channels, Defendants admit, expressly or by implication, that
 4 recruiting is the key to financial success.

5 82. Defendants’ print materials emphasize the importance of recruiting
 6 new Herbalife participants. For example, through at least December 2015 the book
 7 “Building Your Business,” which is included in the starter kit that every
 8 Distributor must purchase, discussed “the power of duplication” and illustrated
 9 “what you can achieve” if “you recruit and retain two active Supervisors.” In the
 10 illustration, the Distributor purchases a certain quantity of product (costing over
 11 \$1,000) each month and recruits two new participants who also purchase that
 12 quantity each month. Those two participants then recruit a total of twelve
 13 additional participants in two additional levels below them. For each month that
 14 the Distributor and the fourteen recruits purchase the specified quantity of product,
 15 the Distributor will earn \$1,750.



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 25 83. The English-language version of the 2012-2014 Presentation Book
 26 also includes examples of how recruiting two or three new participants can
 27 translate into \$2,450 to \$8,775 per month for the recruiter, assuming that the new
 28 participants make substantial wholesale product purchases and themselves recruit

1 new participants who also make substantial wholesale product purchases.

2 84. The Spanish-language version of the 2012-2013 Presentation Book
3 similarly discusses “the power of duplication” that can result when “you bring in 3
4 people to the business, who each bring 3 people, who in turn bring 3 people”
5 (translated from Spanish).

6 85. Speakers giving live presentations at Defendants’ events also make
7 representations concerning the importance of recruiting in Herbalife’s
8 compensation program:

- 9 a. It’s wonderful that we have everybody consuming and we have
10 everybody doing the different methods of retail . . . but you got
11 to think about it, guys, the name of the game here is royalty . . .
12 and you don’t get paid royalty off of customers. You get paid
13 royalties off of distributors that you help to become successful
14 to become supervisors. [Herbalife Founder’s Circle member
15 Susan Peterson, 2009 Herbalife Extravaganza, Atlanta]
- 16 b. [translated from Spanish] The only way to scale the ladder of
17 success is through sponsorship. [Herbalife President’s Team
18 member Dalia González, 2009 Herbalife Extravaganza Latina,
19 Atlanta]
- 20 c. The key to royalty growth[:] New distributors qualifying as
21 Supervisor every month. [Herbalife Chairman’s Club member
22 Kurt O’Connell, “Building Your Royalties” Presentation, 2011
23 Herbalife Extravaganza, Las Vegas]

24 86. Savvy Distributors have figured out ways to use the recruiting reward
25 structure to reap rewards, even without profitable retail sales. For example, during
26 the years 2009–14, one top Distributor paid over \$8 million for product (with a
27 total Suggested Retail Price of over \$16 million) which the Distributor purchased
28 in the names of various downline members, thereby generating additional rewards

1 and qualifying for higher payments from Defendants. This Distributor then
2 donated all of this product to charity, rather than attempting to sell it. The
3 Distributor generated enough rewards through these purchases to make a net profit,
4 without even selling the products.

5 87. Similarly, other Distributors have used unprofitable retail sales of
6 product to generate large reward payments. These Distributors have created
7 specialized websites offering products at discounts of up to 50% with no tax and
8 free shipping. Although the net profit earned from these online retail sales has
9 been *de minimis*, by manipulating Herbalife's compensation system, these
10 Distributors have generated significant "recruiting" reward payments from the
11 large volume of product purchases made by their purported downlines.

12 **Few Business Opportunity Participants Earn Recruiting Rewards**

13 88. Although recruiting is the only path to a high income, very few
14 Herbalife participants earn income from recruiting.

15 89. Most Distributors (80%) do not successfully recruit any new
16 participants, and therefore receive no recruiting rewards.

17 90. Even among those who do recruit, a substantial percentage
18 receive no reward payments. For example, as of December 31, 2014, more
19 than 111,000 U.S. Distributors had recruited a downline, but approximately
20 43% of them (47,714) received no reward payments from Defendants.

21 [Statement of Average Gross Compensation Paid by Herbalife to U.S.
22 Members in 2014]

23 91. Income from recruiting is low even for many in the top 13% of all
24 Distributors—those who reached the status of "Sales Leaders with a downline." In
25 2014, more than half (57.6%) of the Distributors in this elite group received
26 average gross reward payments from Defendants of under \$300 *for the year*. [*Id.*]

27 92. Rewards are highly concentrated among a small number of
28 Distributors. In contrast to the experience of the vast majority of Distributors who

1 make little or no money from recruitment-based rewards, the top 0.03% of U.S.
2 Distributors (205 individuals) received average gross reward payments of over
3 \$600,000 per year. [Statement of Average Gross Compensation Paid by Herbalife
4 to U.S. Members in 2014]

5 93. For the fewer than 1% of Distributors who receive substantial income
6 through Defendants' business opportunity, their compensation for recruiting large
7 numbers of new business opportunity participants dwarfs whatever they might
8 make from retail sales of the product.

9 94. The overwhelming majority of Herbalife Distributors who pursue the
10 business opportunity earn little or lose money, while those few Distributors who do
11 make a living from their Herbalife business do so by recruiting other business
12 opportunity participants who purchase product, not by retailing the product.

13 **To Confuse Participants and the Public About Distributors' Poor Financial**
14 **Outcomes, Defendants Understate the Percentage of**
15 **Distributors Who Are Pursuing the Business Opportunity**

16 95. Although Defendants heavily promote their business opportunity, in
17 recent years Defendants have begun to claim that most consumers who sign up to
18 be Distributors are merely customers who purchase the product only for their own
19 consumption and are not interested in pursuing the Herbalife business opportunity.

20 96. Defendants do not offer a separate "customer" or "discount buyer"
21 status for consumers who are uninterested in pursuing a business opportunity and
22 thus do not systematically track or distinguish Distributors who might be "discount
23 buyers" from Distributors who are pursuing a business opportunity.

24 97. Defendants' rules provide that all consumers who sign up with
25 Herbalife must enter into an agreement that includes the business opportunity. The
26 2015 version of that agreement consists of seven pages of small print and includes
27 a number of provisions that would be inapplicable to a "discount buyer," such as a
28 requirement that the participant indemnify, defend, and hold harmless Herbalife

1 from any cost or liability arising from the participant's breach of the agreement or
2 the conduct of his or her Herbalife business.

3 98. Since 2013 Defendants have publicly claimed or implied that a mere
4 27% of their Distributors are pursuing the business opportunity either full-time or
5 part-time, and that a "substantial majority" (73%) are simply interested in buying
6 Herbalife products for their own personal consumption.

7 99. Defendants' express or implied claim that a "substantial majority" of
8 their Distributors are not pursuing the business opportunity is based not on
9 Distributor behavior, but on surveys commissioned by Defendants beginning in
10 July 2012 that are flawed and unreliable. For example, many survey participants
11 who were included in the category of Distributors who purportedly "joined
12 Herbalife primarily as discount customers" themselves reported that they quit
13 Herbalife because "finding new customers was too difficult and/or time
14 consuming," or the "business was harder than [they] originally believed."

15 100. Based on such survey results, even some Distributors who reach
16 "President's Team" (the highest status level in Herbalife) and earn over \$100,000
17 in recruiting rewards annually from the business opportunity have been categorized
18 in Defendants' representations as merely "discount buyers."

19 101. When observable Distributor behavior from Defendants' data is
20 analyzed, the percentage of Distributors who are attempting to earn income from
21 the Herbalife business opportunity readily exceeds the 27% in Defendants' claims.
22 Such behaviors include, for example, purchasing promotional literature and sales
23 and recruiting aids from Defendants.

24 102. Furthermore, many Distributors interested in the business opportunity
25 may make some effort to earn income and fail, without engaging in the type of
26 measureable and overt behaviors that would make their pursuit of the business
27 opportunity readily apparent.

28 103. In short, many of the Distributors whom Defendants would expressly

1 or impliedly characterize as solely “discount buyers” are, in fact, pursuing the
2 business opportunity.

3 104. Regardless of the number of so-called “discount buyers,” it is clear
4 that collectively they could account for only a small percentage of the volume of
5 Defendants’ products sold in the United States. Even using a grossly overstated
6 measure of “discount buyers”—that is, counting as “discount buyers” the roughly
7 80% of participants who are not “Sales Leaders”—such Distributors collectively
8 account for less than 25% of the volume of Defendants’ products sold in the
9 United States. The remainder, over 75%, is purchased by Distributors at the “Sales
10 Leader” level, who are clearly pursuing a business opportunity.

11 **Overview of Defendants’ Compensation Plan**

12 105. The amount of compensation a Distributor receives from Defendants
13 is not based on retail sales of Herbalife products, but rather is based on the volume
14 of product purchased by the Distributor’s recruits, and by their recruits, and so on.

15 106. Thus, the compensation plan contains incentives for Distributors to
16 recruit participants and to persuade them to buy as much product as they can.

17 107. To become a Distributor, an individual must pay either \$59.50 or
18 \$92.25, plus tax and shipping, to purchase a starter pack called an “International
19 Business Pack,”³ the contents of which have varied over time but which have
20 included an Herbalife tote bag; samples of various Herbalife products; literature
21 about Herbalife’s products; sales aids (such as a “Presentation Book” and buttons
22 the distributor is supposed to wear to advertise Herbalife); DVDs about the
23 business opportunity such as “Design Your Life”; multiple publications concerning
24 the Herbalife business opportunity, including the pamphlet “Your First 72 Hours:
25 Making Your First Sale” and the books “Your Business Basics,” “Using &

26
27 ³ In 2013, Defendants began calling the pack required for all new participants the
28 “Herbalife Member Pack” rather than the “International Business Pack.”

1 Retailing Your Products,” “Building Your Business,” and “Sales & Marketing Plan
2 and Business Rules”; and a single receipt form that can be given to a customer in
3 the event of a single sale of product.

4 108. Defendants’ rules provide that participants must enter into an
5 “Agreement of Distributorship” either online or, if the pack is not purchased
6 online, in hardcopy form. (In 2013, Defendants began calling the agreement an
7 “Herbalife Membership Application and Agreement” rather than an “Agreement of
8 Distributorship.” The change in terminology, however, was not accompanied by
9 any substantive change to the nature of the business opportunity available to
10 Herbalife participants.) Upon purchasing the International Business Pack and
11 submitting the Agreement to Defendants, a participant is assigned an Herbalife ID
12 number and becomes an official Distributor.

13 109. The details of Defendants’ compensation program are complex and
14 convoluted, and involve specialized terminology and concepts. These details,
15 terminology, and concepts are laid out in a book included in the International
16 Business Pack entitled “Sales & Marketing Plan and Business Rules.” The 2014
17 version of the “Sales & Marketing Plan and Business Rules” has 114 pages and
18 consists of more than 58,000 words. The book is difficult to read and understand
19 and many participants rely upon their sponsors to explain the program.

20 110. The core concepts of Defendants’ compensation program are as
21 follows:

- 22 a. Participants advance to higher status levels in the organization
23 and qualify for reward payments based on product purchases
24 (not product sales); and
- 25 b. The only way to reach the highest levels of compensation is to
26 recruit more participants.

27 A simplified version of the compensation plan is set forth below.

28 111. New recruits start at the lowest level, called “Distributor” (or, since

1 2013, “Member”). A Distributor can purchase product from Defendants at a
2 discount of 25% off the “earn base” (a dollar value that Defendants assign to each
3 product that is generally slightly less than the value that Defendants assign as the
4 Suggested Retail Price for that product). The only way a participant at this level
5 can make money is to buy product from Herbalife and sell it to a customer for
6 more than his total cost, with the difference representing the participant’s “Retail
7 Profit.” “Retail Profit” is also the only form of compensation available to those
8 Distributors who have not recruited other Distributors.

9 112. The vast majority of Herbalife participants never progress higher than
10 the Distributor level, and most stop purchasing product within a year and do not
11 renew their memberships.

12 113. Higher status levels are obtained by meeting threshold requirements
13 of “Volume Points,” which are accumulated by purchasing greater quantities of
14 products. (The “Volume Point” is a unit created by Defendants to measure the
15 value of product purchases across currencies. A product with a Suggested Retail
16 Price of \$100 generates roughly 100 Volume Points.) The Sales and Marketing
17 Plan contains complicated rules regarding how much of the threshold Volume
18 Point requirement must be volume that is personally purchased by the Distributor,
19 and how much may be volume purchased by other Distributors whom he recruits.

20 114. A Distributor can advance to the status level of “Senior Consultant,”
21 which allows him to purchase product at a 35% discount, by accumulating at least
22 500 Volume Points in one month.

23 115. A Distributor who purchases 1,000 Volume Points in a single order
24 obtains the status of “Success Builder” and is entitled to a 42% discount for that
25 month.

26 116. A Distributor who accumulates a total of 2,500 Volume Points over
27 one to three months obtains the status of “Qualified Producer” and is entitled to a
28 42% discount through the following year.

1 117. The maximum discount, for those at the “Supervisor” status level and
2 above, is 50% off the “earn base.” A Distributor who accumulates a total of 4,000
3 Volume Points obtains “Supervisor” status and is entitled to a 50% discount
4 through the following year.

5 118. If a Distributor makes it to the Supervisor level, there are numerous
6 higher levels that offer additional rewards that are based on recruiting. Herbalife
7 refers to Distributors who reach the Supervisor level or above as “Sales Leaders.”

8 119. The essential requirement for moving up to the highest status levels is
9 recruiting a large “downline.” A given participant’s “downline” is comprised of all
10 those whom the participant has personally recruited (Level One), all those
11 recruited by his Level One participants (Level Two), and so forth, down to as
12 many levels as have been created by recruitment.

13 ***Defendants’ Compensation Plan Incentivizes Recruiting***

14 120. Defendants’ compensation plan gives participants a powerful
15 incentive to recruit more participants, because recruiting a downline entitles a
16 participant to receive multiple different types of payments directly from
17 Defendants.

18 121. One such type of payment is called “Wholesale Profit” (or
19 “Commissions”). An Herbalife participant may receive “Wholesale Profit” based
20 on purchases made by participants he has recruited who are at a lower discount
21 rate. For example, if a participant at the “Supervisor” status level (50% discount
22 rate) recruited a participant at the “Senior Consultant” status level (35% discount
23 rate) who then ordered product with a Suggested Retail Price of \$100, the
24 participant at the “Supervisor” level would receive a commission check from
25 Defendants of approximately \$15, representing the 15 percentage point difference
26 between the two participants’ discount rates.

27 122. An additional type of payment based on downline purchases, available
28 to participants who are at or above the status level of “Supervisor” and who have

1 recruited a downline, is called “Royalty Overrides.” To understand how Royalty
2 Overrides work, it is necessary to understand two “volume” concepts in
3 Defendants’ Sales & Marketing Plan: “Total Volume” and “Organizational
4 Volume.”

5 123. “Total Volume” is a total of the Volume Points associated with a
6 participant’s own product purchases, plus the Volume Points associated with the
7 product purchases made by certain members of the participant’s downline.
8 Specifically, the “Total Volume” of Participant A would include the product
9 purchases of Participant A’s downline members who (i) have a status level lower
10 than “Supervisor,” and (ii) do not have any participants who have a status level of
11 “Supervisor” or higher in the chain of participants between them and Participant A.

12 124. In simplified form, “Organizational Volume” refers to the Total
13 Volume of a participant’s first three levels of “Supervisors” who are active in a
14 given month.

15 125. “Royalty Overrides” are payments ranging from 1% to 5% of a
16 participant’s “Organizational Volume.” The amount of the “Royalty Override”
17 percentage that a given participant earns each month depends on the participant’s
18 “Total Volume” for that month. Thus, 500 Total Volume points entitles the
19 participant to a 1% Royalty Override; 1,000 Total Volume points earns a 2%
20 Royalty Override; and so on, up to 2,500 Total Volume points which earns a
21 maximum 5% Royalty Override.

22 126. Participants are eligible to earn Royalty Overrides only if they have
23 (i) obtained a status level of “Supervisor” or above (*i.e.*, “Sales Leaders”) and
24 (ii) recruited a downline.

25 127. As of December 31, 2014, only about 13% of all U.S. Distributors fell
26 into the category of “Sales Leaders” who had recruited a downline. Even among
27 this group, most receive little or nothing in compensation from Defendants. In
28 2014, approximately 57.6% of this group received an average gross annual

1 payment from Herbalife of about \$299, and approximately 14.3% received
2 nothing. [Statement of Average Gross Compensation Paid by Herbalife to U.S.
3 Members in 2014]

4 128. The participants who receive the highest gross compensation from
5 Defendants are at the top three status levels of the compensation system: “Global
6 Expansion Team,” “Millionaire Team,” and “President’s Team,” called
7 collectively “TAB Team” (“Top Achievers Business Team”).

8 129. At the “TAB Team” status levels, participants may be eligible to
9 receive three different types of income based on their downlines’ purchases:
10 Wholesale Profits, Royalty Overrides, and a third category of income called
11 “Production Bonuses.” A Production Bonus is a monthly payment of 2% to 7% of
12 the product purchases of the participant’s entire downline, on all levels infinitely
13 deep.

14 130. Participants at the “TAB Team” status levels may also qualify to
15 receive the “Mark Hughes Bonus Award,” which is a payment based on a
16 percentage of Herbalife’s worldwide sales.

17 131. It is only at the “TAB Team” status levels that a small number of
18 participants begin to see the rewards promised by Defendants, although even at this
19 level, the majority of participants are hardly receiving lavish income from
20 Defendants. For example, in 2011—the last year in which Defendants publicly
21 released income data by participant level—the median annual compensation that
22 participants at the “Global Expansion Team” status level received from Defendants
23 was \$19,417. In comparison, the U.S. Census Bureau’s 2011 poverty threshold for
24 a family of two with no children was \$14,657.

25 132. Rewards are concentrated at the very highest levels. Participants at
26 the top level, “President’s Team,” accounted for only about 0.05% of all
27 Distributors in 2011 but their median annual gross income from Defendants was
28 \$336,901.

1 133. In 2011, the top U.S. Distributor received over \$7 million from
2 Defendants, broken down as follows:

3 Wholesale Profits	\$2,847
4 Royalty Overrides	\$944,058
5 Production Bonuses	\$4,256,817
6 Mark Hughes Bonus	\$2,000,000
7 Total	\$7,203,722

8
9 These reward payments were not based on retail sales to consumers, but on
10 wholesale purchases made by downline Distributors in his worldwide organization.

11 134. The only way to reach the “TAB Team” status levels is to recruit a
12 large organization of participants at the “Supervisor” status level who purchase
13 thousands of “Volume Points” worth of product. Thus, for example, to reach the
14 top level, “President’s Team,” a participant must recruit an organization of
15 Supervisors who generate at least 10,000 Royalty Override points each month for
16 three consecutive months. Because the maximum Royalty Override percentage is
17 5%, this means that the first three levels of Supervisors must collectively generate
18 a minimum total of 200,000 Volume Points of product purchases each month, for a
19 total of 600,000 Volume Points of product purchases over the three months.

20 ***Defendants’ Compensation Plan Incentivizes Wholesale Product Purchases***

21 135. Defendants’ compensation plan requires large wholesale purchases of
22 products in order for a participant to advance to a higher status level and to make
23 money from rewards. As explained below, participants must purchase product
24 from Defendants, or convince others to join and purchase product from
25 Defendants, in order to (i) qualify to move up to a higher status level; (ii) requalify
26 for those status levels and prevent being demoted; and (iii) qualify to receive
27 “Royalty Override” and “Production Bonus” payments from Defendants. These
28 product purchases are made as payments to participate in the Herbalife operation

1 rather than in response to actual retail demand for Herbalife products.

2 ***Product Purchases Are Required to Advance to Higher Levels***

3 136. To advance from the lowest status level, “Distributor,” to any of the
4 status levels providing a higher discount, an Herbalife participant must make
5 substantial wholesale product purchases from Defendants and/or recruit downline
6 participants who will make substantial wholesale product purchases from
7 Defendants.

8 137. For example, reaching the status of “Supervisor” requires wholesale
9 product purchases totaling a minimum of 4,000 Volume Points. An order totaling
10 4,000 Volume Points costs roughly \$3,000 and would entail a large amount of
11 Herbalife product. As an example, the following would represent a 4,000 Volume
12 Point order sufficient to qualify a participant as a “Supervisor”:

13 SKU	Description	Qty	Volume Points Each	Volume Point Total
14 3106	Formula 1 shake mix canister (30 servings)	16	32.75	524.00
15 0365	Protein bar deluxe (14 bars)	32 boxes	13.22	423.04
16 1188	Herbal aloe concentrate (half gallon)	8	92.55	740.40
17 0106	Herbal tea concentrate (3.5 oz.)	16	34.95	559.20
18 3115	Formula 2 multivitamin (90 tablets)	16	19.95	319.20
19 3123	Formula 3 Cell Activator (60 tablets)	16	21.95	351.20
20 3277	Lift-Off (30 tablets)	16	47.70	763.20
21 1415	Herbalife 24 – Prolong canister (37 oz.)	8	41.60	332.80
22	TOTAL			4,013.04

1 138. It is impossible to reach the highest status levels of Defendants’
2 compensation program—“Global Expansion Team,” “Millionaire Team,” and
3 “President’s Team”—without recruiting new participants who collectively
4 purchase large quantities of product. Under Defendants’ compensation plan,
5 recruitment is required to reach these status levels.

6 ***Product Purchases Are Required to Requalify for Status Levels***

7 139. Participants who obtain a particular status level must annually
8 “requalify” to retain that level or be demoted. Requalification is based on the
9 volume of wholesale product purchases by the participant and/or his organization.
10 To requalify as a Supervisor and retain his or her downline, for example, a
11 participant must accumulate another 4,000 or 10,000 Volume Points, depending on
12 the method of requalification.

13 ***Monthly Product Purchases Are Required to Qualify for Reward Checks***

14 140. Participants who are eligible to receive “Royalty Overrides” or
15 “Production Bonuses” must also accumulate, on a monthly basis, specific volumes
16 of product purchases to “qualify” to receive those reward payments. An eligible
17 participant “qualifies” to receive “Royalty Override” and “Production Bonus”
18 reward payments for a given month by accumulating in that month a threshold
19 amount of “Total Volume” ranging from 2,500 Volume Points to 5,000 Volume
20 Points.

21 141. All of these volume requirements are based on wholesale *purchases* of
22 product from Defendants. Defendants do not track what happens to the product
23 after a participant purchases it.

24 142. Higher-level Distributors who are eligible to receive reward payments
25 frequently buy Herbalife products in order to meet the thresholds for obtaining
26 these rewards, rather than to satisfy consumer demand. For example, analysis of
27 Defendants’ purchasing data reflects that, in the months in which participants at the
28 “TAB Team” levels—the highest levels in the Herbalife marketing plan—received

1 “Royalty Override” payments, they frequently purchased almost precisely the
2 amount of product necessary to qualify for the payment.

3 143. These participants at the highest status levels who must make monthly
4 product purchases in order to earn recruiting rewards are the most robust wholesale
5 purchasers of Herbalife products. In the time period from January 2009 through
6 March 2014, such high-level participants purchased on average almost eight times
7 as much product per person as participants at the lowest level of “Sales Leaders”
8 (Supervisors), who by and large were ineligible for such recruiting rewards.

9 144. This purchasing behavior reflects an excessive emphasis on
10 purchasing product for the purpose of qualifying for recruitment rewards.

11 **CONCLUSION**

12 145. In sum, Defendants’ compensation structure incentivizes Distributors
13 to purchase thousands of dollars of product to receive recruiting-based rewards and
14 to recruit new participants who will do the same.

15 146. This results in the over-recruitment of participants and the over-
16 supply of Defendants’ products and exacerbates participants’ difficulty in selling
17 Herbalife products for a profit.

18 147. Participants in a business opportunity should have some reasonable
19 prospect of earning profits from reselling products to customers. However, most
20 Herbalife participants earn little or no profit, or even lose money, from retailing
21 Herbalife products.

22 148. In the absence of a viable retail-based business opportunity,
23 recruiting, rather than retail sales, is the natural focus of successful participants in
24 Defendants’ business opportunity.

25 149. Thus, participants’ wholesale purchases from Herbalife are primarily
26 a payment to participate in a business opportunity that rewards recruiting at the
27 expense of retail sales.

VIOLATIONS OF THE FTC ACT

150. Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), prohibits “unfair or deceptive acts or practices in or affecting commerce.”

151. Misrepresentations or deceptive omissions of material fact constitute deceptive acts or practices prohibited by Section 5(a) of the FTC Act.

152. Acts or practices are unfair under Section 5 of the FTC Act if they cause or are likely to cause substantial injury to consumers that consumers cannot reasonably avoid themselves and that is not outweighed by countervailing benefits to consumers or competition. 15 U.S.C. § 45(n).

COUNT I

Unfair Practices

153. As alleged above, Defendants promote participation in Herbalife, a multi-level marketing program, which has a compensation structure that incentivizes business opportunity participants to purchase product, and to recruit new business opportunity participants to purchase product, in order to advance in the marketing program rather than in response to actual retail demand.

154. Defendants’ actions cause or are likely to cause substantial injury to consumers that consumers cannot reasonably avoid themselves and that is not outweighed by countervailing benefits to consumers or competition.

155. Therefore, Defendants’ practices as described in Paragraph 153 above constitute unfair acts or practices in violation of Section 5 of the FTC Act, 15 U.S.C. §§ 45(a) and 45(n).

COUNT II

Income Misrepresentations

156. In numerous instances in connection with the advertising, marketing, promotion, offering for sale, or sale of the right to participate in the Herbalife program, Defendants have represented, directly or indirectly, expressly or by implication, that consumers who become Herbalife Distributors are likely to earn

1 substantial income.

2 157. In truth and in fact, in numerous instances in which Defendants have
3 made the representations set forth in Paragraph 156 of this Complaint, consumers
4 who become Herbalife Distributors are not likely to earn substantial income.

5 158. Therefore, Defendants' representations are false or misleading and
6 constitute deceptive acts or practices in violation of Section 5(a) of the FTC Act,
7 15 U.S.C. § 45(a).

8 **COUNT III**

9 **False or Unsubstantiated Claims of Income from Retail Sales**

10 159. In numerous instances, in connection with the advertising, marketing,
11 promotion, or offering for sale of the Herbalife business opportunity, Defendants
12 have represented, expressly or by implication, that consumers who become
13 Herbalife Distributors are likely to earn significant full-time or part-time income
14 from selling Herbalife products at retail.

15 160. In numerous of these instances, the representations set forth in
16 Paragraph 159 are false or were not substantiated at the time the representations
17 were made. Therefore, the making of the representations set forth in Paragraph
18 159, above, constitutes a deceptive act or practice, in or affecting commerce, in
19 violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a).

20 **COUNT IV**

21 **Means and Instrumentalities**

22 161. By furnishing Herbalife Distributors with promotional materials to be
23 used in recruiting new participants that contain false and misleading
24 representations, Defendants have provided the means and instrumentalities for the
25 commission of deceptive acts and practices.

26 162. Therefore, Defendants' practices, as described in Paragraph 161 of
27 this Complaint, constitute a deceptive act and practice in violation of Section 5(a)
28 of the FTC Act, 15 U.S.C. § 45(a).

1 **CONSUMER INJURY**

2 163. Consumers have suffered and will continue to suffer substantial
3 monetary loss as a result of Defendants' violations of Section 5(a) of the FTC Act.
4 In addition, Defendants have been unjustly enriched as a result of their unlawful
5 acts and practices. Absent injunctive relief by this Court, Defendants are likely to
6 continue to injure consumers, reap unjust enrichment, and harm the public interest.

7 **THIS COURT'S POWER TO GRANT RELIEF**

8 164. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), empowers this Court
9 to grant injunctive and such other relief as the Court may deem appropriate to halt
10 and redress violations of any provision of law enforced by the FTC. The Court, in
11 the exercise of its equitable jurisdiction, may award ancillary relief, including
12 rescission or reformation of contracts, restitution, the refund of monies paid, and
13 the disgorgement of ill-gotten monies, to prevent and remedy any violation of any
14 provision of law enforced by the FTC.

15 **PRAYER FOR RELIEF**

16 Wherefore, Plaintiff FTC, pursuant to Section 13(b) of the FTC Act,
17 15 U.S.C. § 53(b), and the Court's own equitable powers, requests that the Court:

- 18 A. Enter a permanent injunction to prevent future violations of the
19 FTC Act by Defendants;
- 20 B. Award such relief as the Court finds necessary to redress injury
21 to consumers resulting from Defendants' violations of the FTC
22 Act, including but not limited to, rescission or reformation of
23 contracts, restitution, the refund of monies paid, and the
24 disgorgement of ill-gotten monies; and
- 25 C. Award Plaintiff the costs of bringing this action, as well as such
26 other and additional relief as the Court may determine to be just
27 and proper.
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Respectfully submitted,

DAVID C. SHONKA
Acting General Counsel

Dated: July 15, 2016

_____/s/_____
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