

USANA Watchdog

April 12, 2013

USANA May Be Operating an Illegal Pyramid Scheme By Primarily Paying Associates To Recruit Rather Than Selling Product To Customers.

Multi-Level Marketing company USANA Health Sciences, Inc. (NYSE: USNA) is required to pay commission to their associates based on the sale of product to customers outside the business plan and not based on the enrollment of new distributors. The Federal Trade Commission (FTC) recently shut down MLM company Fortune High Tech Marketing¹ for operating an illegal pyramid scheme and used the fact they paid commission for enrolling new associates as their main argument. There are established rules that are meant to prevent MLM associates from being duped into a pyramid scheme. One such preventative measure is a 5 customer rule, which is in place to prevent inventory loading and ensure the associate has sold product to 5 or more customers before they can be eligible to collect a commission check. I believe USANA grossly violates this rule and uses it simply to provide lip service to federal regulators.

USANA has stated in a customer relations training document² the following: (*my emphasis in bold underline*)

*“A pyramid scheme is defined as a plan where a person pays money for an opportunity to make money by enrolling other people into the plan. **In short, you get paid to recruit.** All governments have ruled this activity to be illegal, as they are fundamentally flawed.”*

Now surely USANA wouldn't openly pay their associates commission directly for recruiting. However, I believe USANA technically pays their associates to recruit and I will demonstrate how and why USANA

¹ Fortune High Tech Marketing shut down as a pyramid scheme: <http://www.robbevans.com/html/fortune.html>

² USANA Customer Relations Training – Compensation Review
http://obs.usana.com/Main/redirectArticles/UPLOADS/usana/2010/159/159-1_1AA.html

does everything in their power to keep a particularly important statistic a mystery. I will use USANA's latest 2012-10K SEC filing³ for purposes of this discussion.

USANA claims to have 247,000 active associates and 64,000 active preferred customers world wide during the last quarter of 2012. According to USANA's policies and procedures⁴, associates must have sold product to at least 5 customers during a 4 week period in order to receive a commission from USANA. It can be easily confirmed whether USANA pays out commission to associates who do not have enough customers (or any at all). USANA has two types of associates (*not mentioned in their SEC filings*): Distributing Associate and a Non-Distributing Associate⁵. USANA defines the two types of associates as follows:

Non-distributing Associates pay taxes on the wholesale/autoship price of USANA product. They are forbidden to retail product and must abide by USANA's 5 customer rule by sponsoring at least 5 preferred customers who have all made purchases during a 4 week period in order for the associate to receive a commission from USANA.

Distributing Associates pay taxes on the retail price of USANA product. They are allowed to retail USANA product and must abide by USANA's 5 customer rule by selling product to at least 5 customers, whether they are retail customers, preferred customers, or a combination of the two in order for the associate to receive a commission from USANA.

Top USANA associates who are star diamond directors and have tens of thousands of associates in their downline can confirm whether most associates in their downline are non-distributing associates. The very top associates even have almost the entire USANA associate organization in their downline. This small group of associates at the top are privy to insider information because they have access to undisclosed statistics about USANA's associate organization and know the actual ratio of non-distributing versus distributing associates. USANA does not want the public to know the ratio as I have asked them several times to disclose it.

3 USANA 10K-2012 <http://www.sec.gov/Archives/edgar/data/896264/000104746913002524/a2213469z10-k.htm>

4 USANA Policies and Procedures <http://whatsupusana.com/wp-content/uploads/2013/01/EN-PoliciesProcedures.pdf>

5 USANA's Ask Andy – Associate versus Distributor http://obs.usana.com/Main/redirectArticles/UPLOADS/usana/2007/171/171-1_KAA.html

USANA has stated for several years in their associate “North American Average Total Earnings” report⁶ that one third of USANA associates received a commission check. That is one third for the entire year, but USANA does not disclose yearly figures and leaves it up to investors to guess. For the sake of argument, I'll take one third of the 247,000 active associates, which is about 82,300 active associates that collected a commission from USANA during the fourth quarter of 2012. However, there were only 64,000 preferred customers, which can satisfy the 5 customer rule for a maximum of only 12,800 non-distributing associates who received a commission check.

What about the remaining 69,500 associates who received a commission check? Are they all distributing associates, or are the majority of them non-distributing associates as well? If they are non-distributing associates, then USANA is operating an illegal pyramid scheme and should be an easy case for the FTC to shut USANA down just as they recently had multilevel marketing company Fortune High Tech Marketing shut down.

Recap for fourth quarter 2012 figures:

247,000 active associates (according to SEC filing)

82,300 estimated associates received a commission check (one third of total active associates)

64,000 active preferred customers (according to SEC filing)

12,800 maximum allowed non-distributing associates who can receive a commission check

69,500 remaining commission received associates. USANA must disclose how many of these are distributing associates versus non-distributing associates

If the majority of USANA's active associates who collect a commission check are non-distributing associates, which I believe they are, then USANA has a catastrophic problem on their hands. It means USANA is paying commission to associates who do not have the required number of customers (or any whatsoever). In other words, USANA is paying associates to recruit and therefore USANA is operating an illegal product-based pyramid scheme. I'd like to use USANA's own incriminating words against them

⁶ USANA North American Average Total Earnings <http://www.usana.com/media/File/Prospecting%20page/Tools/US/USANABusiness/US-AveIncome.pdf>

where USANA admits that paying associates commission who don't meet the 5 customer rule is technically paying them to recruit! – USANA Compensation Review Document.⁷ (*my emphasis in bold underline*)

“A pyramid scheme is defined as a plan where a person pays money for an opportunity to make money by enrolling other people into the plan. In short, you get paid to recruit. USANA on the other hand pays Associates to sell product. Commissions are earned based on the sale of product, not enrolling.

...

If an Associate is earning a commission but not making sales, **USANA would technically be paying them to recruit.**”

Investors, auditors, and federal regulators should demand USANA disclose the following in their SEC financial filings - **How many active associates received a commission check and of those how many are non-distributing associates?** This would be USANA's hardest questions to ever answer because doing so could and should put them out of business. I look forward to USANA's response.

A little important side note:

USANA associates are required to personally purchase over \$100 worth of product every four weeks before USANA will pay that associate their commission check. USANA associates account for 90% of USANA's net sales. Most associates are non-distributing associates and are not permitted to retail product, yet they are required to purchase over \$1300 in inventory every year. This is forced inventory loading a subject for another article.

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⁷ *USANA Customer Relations Training – Compensation Review*
http://obs.usana.com/Main/redirectArticles/UPLOADS/usana/2010/159/159-1_1AA.html