Herbalife Agrees to Settle “Pyramid Scheme” Class-Action Lawsuit for $15 Million

By Ben Mathis-Lilley

The "multi-level marketing" company Herbalife, which recruits individuals as distributors who sell its products to friends, family, and other consumers, has agreed to pay $15 million to settle a class-action lawsuit that alleges its business model is a pyramid scheme. The suit was initiated by a Herbalife distributor in California who says the company violates that state's colorfully named Endless Chain Scheme Law. From Bloomberg:

“We are fully confident that we would have prevailed,” Herbalife General Counsel Mark Friedman said in an e-mailed statement. “Settling this matter, however, is in the company’s best interest as it allows us to put it behind us and focus on the future growth of the company.”
Former distributor Dana Bostick sued in April 2013, claiming he couldn’t sell his products because distributors who are higher up the chain receive a bigger discount than he did on the products they purchased from Herbalife. Bostick also claimed Herbalife’s structure systematically rewards recruiting other distributors over retail sales.

The allegation that Herbalife (founded in 1980) is a pyramid scheme is not limited to this case. An Federal Trade Commission investigation of the company is ongoing (Herbalife just hired a former FTC official to run its legal compliance operations), as is a public relations campaign by hedge funder Bill Ackman, who has said he's shorted the company’s stock because he believes its sales system involves several scams. When a new Herbalife distributor is recruited, he purchases a chunk of Herbalife products, which it’s then up to him to sell. One big question at issue is whether the company ultimately makes its money because there are "end users" out there consuming those products—or if what's actually happening is that new distributors are getting lured into buying big batches of stuff they'll never be able to get rid of. (The company does allow distributors to return unsold products—but does so only under conditions, this Wonkblog article says, that discourage many returns.)

One irony in all of this, of course, is that even if there are millions of Herbalife fans paying for and using the company’s “Cell Activators” and “Male Factor 1000” pills, those people might just be paying for the placebo effect. As a manufacturer of supplements, Herbalife’s products are not required to undergo Food and Drug Administration-regulated clinical trials, and are sold with the warning that they are not intended to “treat, prevent, or cure disease.”