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Get your hands off my downline!!!

When a raiding situation arises, the parties should look to the legal framework to ascertain their respective rights and obligations. By working within this framework, fair competition will be preserved and distributors and companies alike will have their legitimate interests protected.

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8122 words | 28 pages

If God had been running an MLM rather than delivering the Jews from Egypt, the first of the Ten Commandments given to Moses would have been "thou shalt not steal thy neighbors downline." Following closely on the heels of this commandment would be "thou shalt not covet thy neighbor's downline," and "thou shalt not commingle downlines."

> ***If there is one problem that every MLM faces at one time or another, it is the raiding of the company's distributor force for another MLM by one of its own current or recently departed distributors.***

In fact, a company should consider itself lucky if it only faces the issue once a year. In my practice I have found that improper distributor solicitation is the number one conflict between distributors and the company. And talk about an emotionally charged issue —if you want a sure-fire way to turn your best lifelong friends into mortal enemies, try raiding their downline just once. Your ex-friends will be sure to spit every time they mention your name, assuming of course that they continue to utter your name. It is far more likely that your last name will forever be preceded by "that dirty son of a $%@*," or some other equally endearing four-letter first name.

The Competing Interests

Yes, emotions run high, and everyone involved has a reason for taking their respective positions. The distributor who is recruiting for another company believes that free competition entitles him or her to recruit whomever he wants, whenever he wants, and for whatever company he wants. He is going to exercise that right since the company is keeping too much of the pie and putting unreasonable limitations on him. On the other hand, the upline of the distributors who are being solicited have labored long and hard to develop their downline, and will not let go without a fierce battle. They scream for company action to protect the fruits of their labor. Yet a third perspective is displayed by the company that is having its distributor force recruited away. The company finds it hard to believe that a distributor whom it has paid so well and given so much would have the audacity to turn on them.

> ***Throw into this mix several slanderous and ill-tempered remarks by all parties, a healthy dose of hearsay, an occasional threat of physical violence, and you have a recipe for a frothy lawsuit.***

As between MLM companies and their distributor forces, raiding problems have been addressed through provisions in distributor agreements and policies and procedures that place restrictions on their distributors' ability to solicit or recruit for other MLMs. The restrictions vary in degree from a prohibition against using distributor lists as recruiting aides to absolute prohibitions against participation in any other MLM. In addition, common law causes of action exist which offer companies means of protecting their sales force from unfair competition.

Distributors who have had enforcement action taken against them have responded with lawsuits claiming the policies are unenforceable based on restraint of trade theories. They further argue that they are independent contractors, and that the company does not have the right to burden them with non-competition agreements.

Raiding, however, is not always driven by distributors. Occasionally, the industry sees management from one company encouraging its distributors to target the distributors of another company. MLM companies that are members of the Direct Selling Association (DSA) have attempted to address this issue through the DSA's proselytizing guideline.[1]

So who is right?

> ***May a company lawfully restrict its distributors from recruiting fellow distributors for other companies?***
>
> ***Can a company completely restrict its distributors from participating in another MLM?***
>
> ***Are distributors free to participate in other programs and recruit whomever they wish, whenever they wish?***

There are certainly legal actions that can be taken by all parties involved to protect their rights. However, having handled many raiding claims, I have found several approaches that do not involve the legal process can adequately resolve many of the cases with the least amount of disturbance and expense. These approaches should first be considered before engaging in a legal battle.

Non-Adversarial Approaches to Address Raiding Problems

1. Clean House

No matter how hard a company strives for perfection, it is simply unrealistic to believe one MLM will please everyone all the time. An occasional disgruntled distributor will always be a fact of MLM life, and a raiding situation will undoubtedly arise. These situations can be dealt with through the approaches discussed below. However, if a company suffers from a chronic raiding problem, it must reflect inwardly to determine if the problem is of its own making. The company must honestly answer some basic, soul-searching questions:

1. Are my products or services of inferior quality?
2. Are my prices too high?
3. Is order entry and shipping prompt?
4. Is the customer service department courteous and helpful?
5. Is the compensation plan competitive with others in the industry?
6. Are my qualifiers too burdensome?
7. Have legal problems caused the company's reputation to deteriorate?

There are many questions of this nature that management must address. The fundamental issue, however, boils down to whether the company is keeping its distributors and customers happy. MLM is a fiercely competitive industry, and there is no shortage of good companies selling high quality products and offering generous compensation plans. If a company is not competitive in these areas, its distributors and customers will go elsewhere.

Thus, if a company has a high attrition rate and faces more than its fair share of raiding problems, the first step it should take is to identify and correct its own

shortcomings rather than try to pin the problem on rogue distributors.

Corporate management must also analyze their attitude toward distributors. I have seen companies develop the cavalier attitude of "We are the company, so we can do as we damn well please—and anyone who doesn't like it is welcome to leave!" Any company that has this attitude is simply leaving the barn door wide open for a stampede of exiting distributors. Corporate management must remember that with all of the new MLMs that have arisen in the last 10 years, distributors have many options. The successful companies understand that they need the distributors more than the distributors need them. Accordingly, they make customer and distributor satisfaction their foremost priority.

Distributors must perform a similar self-evaluation. The key inquiry each distributor must ask is "why do I want to change companies?" If a distributor is jumping between companies with the intent of making a quick buck and moving on (the "MLM Junkie" approach), he should consider the consequences of treating his downline as personal property.

Remember that a downline is made up of real people, all of whom have individual emotions, goals, aspirations and dreams. It is not a piece of industrial machinery that can be used, moved around, and replaced when worn out.

Playing manipulative games with a downline will eviscerate the dreams of many people and cause emotional reactions ranging from exasperation to raw hostility. In addition, those who trust a distributor enough to follow him or her to a new program with a new promise may find themselves bewildered and betrayed when the distributor abandons that new promise

and moves on to the next program. Ultimately, if a distributor is driven by self-interest and acts without regard to the carnage that will follow in his wake, he must recognize that he is wearing a sign that says "I'm self-centered and arrogant - please sue me."

2. Identify the True Scope of the Problem and Act Accordingly
A common raiding scenario involves a distributor (John Doe) who has recently resigned or been terminated from Company A, and then joins company B. Mr. Doe will attempt to solicit his former downline to company B as quickly as possible. This results in a flurry of telephone calls by Mr. Doe to select members of his previous downline. The distributors who have been solicited by Mr. Doe will then tell their upline what is going on and the upline will complain to company A.

The upline will also tell others in the organization, and they too will complain to the company. Mr. Doe may have actually solicited only a handful of company A distributors, but the home office will receive numerous hearsay complaints from many more distributors than were actually solicited. Moreover, the complaints are often emotional and exaggerate the extent of the situation. Thus, from the reports coming in to company A, it will appear as if its entire distributor force is jumping ship.

Reality, however, is often quite different. Despite distributors' exasperated complaints that their organization is being devastated by Mr. Doe's raiding activity, upon further investigation it becomes apparent that Mr. Doe has not contacted the complaining distributor, and he is hard pressed to come up with the names of any downline members that have jumped ship due to Mr. Doe's solicitation. Rather, the dust usually settles within two weeks, and once a body count is taken, the actual number of deserters is minimal. The problem will usually pass and soon be forgotten with no quantifiable negative impact.

If the company shoots first and asks questions later, it may find that it has made a mountain out of a molehill and created a

greater problem than existed in the first place.

Thus, a company should always thoroughly investigate the accuracy of the information it receives, and *never* rely on hearsay. The only information it should act on are the reports that come from the people who have personally been solicited by the distributor who is under investigation. If the investigation reveals a significant problem exists, formal legal action should then be considered.

Determining the point at which legal action is appropriate depends on the company's philosophy and a risk-benefit analysis. Corporate management must balance the expense of legal action and the extent to which the company's sales and distributor force will be negatively affected against the loss of trust and faith which may develop among its loyal distributors if the company does not move quickly and the perception that the company is an easy target for raiding. Once a company identifies its priorities within this equation, it will be in a position to determine if legal action is appropriate or if the situation is better handled with a less formal response.

Other Approaches to Handling Distributor Raiding

1. Inter-Company Proselytizing and the Direct Selling Association's Proselytizing Guideline

The Direct Selling Association (DSA) has adopted a Code of Ethics to which all DSA member companies are required to comply. The Code serves as a self-regulating set of rules that protect the industry from unethical conduct and practices that would otherwise tarnish the industry's image and lead to greater scrutiny by law enforcement agencies.

The DSA has received pressure from industry to enforce an ethical rule that places limits on one company's ability to raid another company's distributor force. In response, the DSA has developed a proselytizing *guideline* in an effort to define what constitutes fair competition between members of a highly competitive industry. The proselytizing guideline provides:

> It is considered to be an improper business practice when Company A, or its representatives, specifically and consciously target the sales force of Company B with the intent of persuading Company B's salespersons or employees not only to sell or work for Company A, but also to cease selling or working for Company B, thereby interfering with Company B's business or contractual relations. This is not intended to encompass the occasional incident or two, but it does apply to situations involving more than several persons, where the pattern, approach and timing of Company A would clearly indicate an intention to adversely impact on Company B.

Whenever company A's distributors raid from company B, rest assured that if both companies are DSA members, the DSA proselytizing guideline will be the first paragraph of the letter sent by company B's lawyer to Company A. However, the significance of the proselytizing guideline is often overstated. It is frequently confused as a part of the DSA Code of Ethics. **Actually, the guideline *is not* an official rule of the Code of Ethics, much less a rule of law.** It is simply a "guideline" because the DSA recognizes it would violate antitrust laws if it establishes rules limiting its member companies' ability to compete for customers and distributors.

> ***The DSA has therefore wisely taken the position that if one company believes another is unfairly soliciting its distributors, the matter should be resolved between the companies informally or through the courts.***

As a trade association, it is not the function of the DSA to try to regulate competition among industry members. Thus, the DSA's position on proselytizing is simply a guideline; it should not be considered a rule which companies or distributors should look to as protection from raiding.

2. Contractual Restrictions

One would be hard pressed to find an MLM that lacks any form of contractual provision restricting its distributors' ability to recruit other distributors for another MLM program. There are two principal types of policies:

1. prohibitions against using downline lists or genealogy reports to aid in recruiting for another company; and

2. prohibitions against recruiting distributors for another MLM.

There are several approaches to this second type of policy. Some policies allow distributors to recruit their personally sponsored distributors for another program, whereas other companies restrict distributors from soliciting any distributors for another program.

Some companies have taken an even more restrictive position and prohibit distributors who have achieved a specific rank from participating in another MLM. The point to recognize is that while some approaches are more common than others, companies have crafted policies to fit their specific programs and corporate philosophies, and that there is no single industry standard in this area.

Regardless of the format of the contractual limitation adopted by a company, the legal issues and analysis regarding the enforceability of the provision are similar. These issues are:

1. Can the company protect its downline lists as trade secrets?

2. Does the contractual provision violate anti-trust laws? and

3. Is the restriction overly broad?

a. Is a Downline List a Trade Secret?
It is common for an MLM to claim its downline lists are trade secret information, and therefore prohibit their use for any purpose other than to further the company's business. If information is truly a trade secret a court will enjoin a third party from using it. However, simply claiming information constitutes a trade secret is not enough to ensure a downline list is afforded trade secret protection. Rather, the list must satisfy specific criteria before acquiring such protection.

Although there is variability among state law as to what is required to secure trade secret status, a majority of the states closely follow the Uniform Trade Secrets Act. Pursuant to this Act, a "trade secret" is defined as:

> Information, ... that (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.
> Uniform Trade Secrets Act, 1.

A downline list clearly has economic value to an MLM company's competitors because it can be used as a prospecting list for customers and experienced sales people. But that fact alone is insufficient to render the information on the list trade secret information. Two other key issues arise: 1) Can the information be readily discovered through alternate proper means; and 2) What steps has the company taken to ensure the information remains secret?

i. Proper Means of Discovery

The United States Supreme Court has proclaimed one of the policies supporting trade secret law as "the maintenance of standards of commercial ethics."[(2)]

Even with this guidance, the scope of what constitutes "proper means" is so broad that the Uniform Trade Secrets Act has not defined the term. Rather, the Act sets parameters on what is *not* permissible by defining "improper means":

> 'Improper means' includes theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means.
> Uniform Trade Secrets Act, 1(1).

Thus, if the information on a distributor's downline list can be ascertained independently of the list and without the use of improper means, the list itself will not constitute a trade secret. In this regard, distributors with modest downlines may find it a simple task to reproduce their downline lists from memory. However, it is unlikely that distributors with extensive

downlines will be able to independently reproduce a majority of their downline information.

> ***Thus, when a large downline is involved in a raiding case, a company will view a representation that the information was obtained properly with extreme skepticism.***

The result will be a fact-intensive inquiry into exactly how the distributor obtained the information.

ii. Protecting Trade Secret Information

The second key inquiry necessary to determine if a downline list is a trade secret is: "What did the company do to protect the information?" Classifying a downline list as a trade secret is simply a first step. To protect the information, the company must take affirmative steps that are reasonable under the circumstances to prevent its dissemination to third parties. This will again necessitate a fact-intensive inquiry.

However, at a minimum, companies should investigate any suspected misuse of downline lists, and aggressively pursue any party that it confirms is misusing the list. If a company enforces a trade secret policy on a selective or sporadic basis, the information will lose any trade secret status it has acquired. Similarly, companies should print on each downline list a notice that it constitutes trade secret information and should be used solely for promoting the company's business.

b. Does the Restriction Violate Antitrust Statutes?

i. The Clayton Act

One type of restrictive policy prohibits distributors from selling competing goods for another company. For example, company X sells dietary supplements and prohibits its distributors from selling any competing brands of dietary supplement. Such contractual restrictions are called

"exclusive dealing contracts." That is, the distributor is bound to deal exclusively in company X's brand of dietary supplements.

Under certain facts an exclusive dealing contract constitutes an illegal restraint of trade under Section 3 of the Clayton Act.[3]

The pertinent provisions of the Clayton Act provide:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to ... make a sale or contract for sale of goods, wares, merchandise, ... or other commodities, for use, consumption or resale within the United States, or fix a price charged therefore, ... on the condition, agreement or understanding that the ... purchaser thereof shall not use or deal in the goods, wares, merchandise, ... or other commodities of a competitor or competitors of the ... seller, where the effect of such lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.
> 15 U.S.C. 14.

After boiling the fat away, the statute provides that it is illegal to prohibit a distributor from selling a competitor's goods if the restriction would substantially reduce competition or tend to create a monopoly. To determine if these anti-competitive forces exist, the law requires that a plaintiff: 1) identify the relevant market which is affected by the contract, and 2) prove that the contract creates a substantial —not remote— lessening of competition in the relevant market.[4]

Thus, the critical first step is defining the "relevant market."

> ***The courts have defined "the relevant market" as a function of the products sold by the parties and the geographic area in which the parties to the action operate.[5]***

Thus, if there are few competitors selling any given product in a specific geographic area, it is possible for a company to establish a dominant position within that locale such that its actions have a substantial impact on competition.

In the context of the multilevel marketing industry, proving that an exclusive dealing contract substantially decreases competition or tends to create a monopoly is very difficult. Speaking generically, the product lines that most MLMs market are not unique. While any given company's products may have distinctive features, these attributes are usually insufficient to distinguish the products for purposes of creating a separate relevant market for a Clayton Act analysis. A court will determine if, despite the unique features of a product, consumers will be able to acquire substitute products. An exclusive dealing contract will not have the requisite substantial negative impact on competition if buyers can freely substitute products for another brand.

For example, many MLMs sell cosmetics. Despite the unique attributes of each brand, most cosmetics are still in the same generic category. Since this category includes numerous competitors, and is dispersed so broadly across the United States, it would be extremely difficult for a single MLM to establish a dominant position in any locality such that its conduct would have a measurable impact the local cosmetics market. There are simply too many cosmetics merchants for one company to establish such a dominant market position in any geographic region.

The same analysis is applicable to other products and services that are often marketed through MLM - dietary supplements, cleaning supplies, and long distance telephone services for example. Because it is unlikely any MLM will have a dominant position within a geographic region for these products and services, an exclusive dealing contract will not violate Section 3 of the Clayton Act.

ii. The Sherman Act

Sections 1 and 2 of the Sherman Act provide in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, ...is hereby declared to be illegal. ...
> 15 U.S.C. 1.

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, ... shall be deemed guilty of a felony, ...
> 15 U.S.C. 2.

The United States Supreme Court has identified two types of Sherman Act violations. A *per se* violation is one which, because of its "pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm which they have caused or the business excuse for their use."[6]

Price fixing is an example of a well-understood *per se* anti-trust violation. The second type of violation is established from a *rule of reason* analysis. This is a fact intensive inquiry pursuant to which a court or jury "weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition."[7]

Distributor termination cases arising from a distributor's violation of a restrictive covenant will be analyzed under the rule of reason test so long as the restrictive covenant is not a concerted action to set prices.[8]

Princess House v. Lindsey[9] illustrates how the rule of reason test is applied in an MLM distributor termination case.

In *Princess House*, the distributors (the Lindseys) were terminated as Princess House distributors because they were soliciting and enrolling other Princess House distributors for another MLM (Park Lane). The distributors claimed that Princess House had violated Sections One and Two of the Sherman Act by: 1) terminating distributor contracts and refusing to pay override commissions; and 2) by entering into a consent decree with Park Lane in another lawsuit wherein Park Lane agreed to refrain from recruiting Princess House distributors.

The court held that the Princess House's termination of the distributor contracts and refusal to pay override commissions was not a cognizable cause of action under the Sherman Act, because these actions were "unilateral." That is, Princess House took these steps on its own accord—

there was no third party with which Princess House contracted, combined, or conspired. Since a contract, combination or conspiracy to restrain competition is necessary to establish a violation of the Sherman Act, the distributors' allegations did not constitute a proper Sherman Act claim.

However, the court found that Princess House's agreement with Park Lane pursuant to which Park Lane agreed not recruit Princess House distributors was sufficient to establish the requisite contract between separate entities. Once the requisite contract between separate entities was establish, the court analyzed the restriction under the *per se* rule. It found that the restriction was not the type that the courts have deemed to be per se violations.[10]

The court then conducted a rule of reason analysis utilizing the following test:

> Under the rule of reason analysis, a claim for unreasonable restraint on competition must provide evidence of either market power on the part of the defendant or actual detrimental effects of the alleged restraint on competition.
> 918 F.Supp. at 1369.

The court first found that the distributors had not offered any evidence of an actual detrimental effect on competition. Since there was no actual detrimental effect proven, the court held that the distributors must prove that "Princess House possessed market power by identifying the relevant market for Princess House and Park Lane products and the effect of the consent decree on that market."[11]

The court then found that the distributors failed to adequately define the relevant market, and therefore ruled that the agreement between Princess House and Park Lane was not a violation of Section 1 or 2 of the Sherman Act.

If it seems that we have come full circle, you are correct. While the Sherman Act analysis applied by the court took its own initial approach, it ended with the same analysis as under the Clayton Act. That is, the *Princess House* court required the distributors to define the relevant market in terms of its geographic area and the product that is involved, and show that Princess House held a dominant position within the

relevant market. As was shown in the Clayton Act analysis, this is a difficult proposition due to the nature of the goods sold through MLM. Therefore, unless a defendant's restrictive conduct amounts to a *per se* violation, a Sherman Act analysis will usually have the same result as a Clayton Act analysis. That is, no single MLM will sufficiently dominate the relevant market to the extent that its restrictive covenant will violate the Sherman Act.

c. Is the Restriction Unduly Broad?
It is undeniable that a non-solicitation provision constitutes a partial restraint of trade. Nevertheless, a partial restraint will be upheld if:

1. it is founded on valuable consideration;

2. it is reasonably necessary to protect the interest of the company; and

3. does not unduly prejudice the interests of the public.[12]

Courts recognize that there are competing interests involved, so they will balance the interests of the parties to determine if the restrictions are reasonable. Broadly stated, courts will weigh the individual's right to work and earn a living against the company's interest in protecting its goodwill and investment in developing distributors and customers. Determining whether a restriction is reasonable under the circumstances depends on the type of provision involved. Non-solicitation provisions fall under two categories: 1) in-term prohibitions; and 2) post-term prohibitions.

i. In-Term Prohibitions Against Solicitation
Courts generally uphold prohibitions against employees and agents acting on behalf of a third party during the term of their employment or agency. On this point, the Restatement, Second, of Agency[13]
, provides the general duty of loyalty owed by an agent to a principal:

> Unless otherwise agreed, an agent is subject to a duty not to compete with the principal concerning the subject matter of his agency.
> Restatement of Agency, Second, 393.
>
> Unless otherwise agreed, an agent is subject to a duty not to act or to agree to act during the period of his agency for persons

> whose interests conflict with those of the principal in matters in which the agent is employed.
> Restatement of Agency, Second, 394.

The law recognizes that no public policy supports an agent's right to compete with his principal unless the parties specifically agree to it. Therefore, from a legal-risk standpoint it is a fairly easy decision for a company to terminate a distributor if he or she violates a non-solicitation provision. Since the risk that the company's policy will be held unenforceable is slight, the plaintiff-distributor will be required to prove his or her case on the facts—that is, the distributor must convince a jury that he or she did not recruit fellow distributors for another MLM. If, however, the company presents credible rebuttal evidence that the policy was violated, the company will win on a breach of contract claim.
A case that illustrates a court's straightforward approach to enforcing in-term restrictions is S*haklee U.S., Inc. v. Giddens*.[14]

Shaklee had a policy which provided:
[a] Shaklee Family Member may not promote ... another direct selling company ... while remaining a Shaklee Family Member.

Upon reviewing the evidence presented to the trial court, the Ninth Circuit Court of Appeals stated:

> There was no genuine issue of material fact as to whether the rule was a binding contractual term, nor was there any dispute that the rule prohibits recruiting other Shaklee distributors for other direct selling companies, and that Giddens knowingly violated the rule. Giddens has offered no evidence sufficient to raise factual questions on these points. Thus, Shaklee was within its contractual rights in terminating Giddens' distributorship for breach of contract.

The Ninth Circuit's analysis in *Shaklee* provides a clear illustration of the straightforward approach to analyzing an in-term termination provision. Nevertheless, a word of caution is in order.

Before moving forward with litigation, all parties involved

must understand that although the legal principals are not particularly complicated, gathering the requisite evidence is easier said than done.

Since most distributor termination cases are rife with hearsay and overblown reactionary emotion by all parties, separating fact from fiction is often a very laborious and *extremely* expensive proposition.

ii. Post Termination Non-solicitation Provisions

While in-term non-solicitation provisions are generally upheld, they do not offer the comprehensive protection that most companies desire. After all, once a distributor is terminated, he feels free to solicit every other distributor in his prior downline. What does he have to lose—is the company going to terminate him again? Companies therefore utilize post-termination non-solicitation provisions in their policies.

A post termination non-solicitation provision typically provides that an ex-distributor may not recruit remaining distributors for a given period of time following the termination of a distributor agreement. Unlike the general acceptance of in-term non-solicitation provisions, the enforceability of post-term non-solicitation provisions are subject to greater judicial scrutiny because there is a greater impact on the distributor's ability to earn a living.

Unfortunately, the approaches taken by the states to determine whether a post-term restriction is unreasonable are not uniform. Therefore, the following is a general discussion of the approaches taken by a majority of jurisdictions, but the law of the applicable state should always be reviewed.

1) Scope, Temporal, and Geographic Limitations

The most common approach to determine if a non-solicitation provision is unreasonable requires an analysis of the restrictions placed on the scope of the activity, the duration of the limitation, and the geographic area covered by the limitation.

The scope of a non-solicitation provision simply extends to preventing a former distributor from soliciting the company's remaining distributors. This should be distinguished from the scope of a non-competition provision, which restricts a distributor from participating in a competing MLM. Although the same legal analysis is often applied to non-solicitation and non-competition clauses,[15] the distinction is significant because a non-competition clause is more restrictive, and thus less likely to be upheld.[16]

A non-solicitation provision cannot last forever. Courts therefore seek to determine what is a reasonable time frame under the circumstances to protect the legitimate business interests of the company. Unfortunately, this is often a subjective analysis, and courts rely on inapplicable precedent because it is convenient and easy. Thus, a two-year limitation is often upheld since many cases have upheld restrictions of similar duration. However, such an approach does not address the central issue, which is what factors make the restriction reasonable under the circumstances of the specific case.

In the MLM field we can answer this question by analyzing the company's attrition rate. For example, if a company has an annual attrition rate near 100% per year, a one-year non-solicitation provision is reasonable because the company has a legitimate interest in protecting that class of distributors who were active at the time the raiding distributor left the company. Since the former distributor had no relationship with the new class of distributors who joined one year later, he should be free to recruit them for another venture. The duration of the limitation will therefore vary between companies since their respective attrition rates will differ.

Geographic limitations present difficult issues for MLMs. Historically, the geographic limitation was designed to prevent employees from going down the street to work for a competitor and taking advantage of business relationships that had been developed with the prior employer's customers. Thus, most non-compete and non-solicitation provisions restricted the former employee or agent from competing within a limited radius (25 miles for example) from their former place of employment.

A precise geographic limitation is useless in MLM because even a

moderately successful distributor will have downline members dispersed across the country.

It is a simple matter to telephone an out-of-town distributor to solicit him or her for another program. Because the law has recognized the reality of long-distance commercial transactions, there is a developing trend that moves away from stringent application of geographic limitations. This approach is well illustrated by *W.R. Grace & Co., v. Mouyal.* In place of a geographic limitation, the Georgia Supreme Court required that the scope of the limitation be defined narrowly so that a former employee or agent would understand the precise limitations that are applicable. This was achieved by defining the class of persons with whom a prior employee or agent had a relationship while working for his or her previous employer.

The Georgia Supreme Court held:

> Requiring an express geographic territorial description in all cases is not in keeping with the reality of the modern business world in which an employee's "territory" knows no geographic bounds, as the technology of today permits an employee to service clients located throughout the country and the world. Where the parameters of the restrictive covenant are as narrow as those set forth in the certified question, i.e., where the former employee is prohibited from post-employment solicitation of employer customers which the employee contacted during his tenure with the employer, there is no need for a territorial restriction expressed in geographic terms.
> *W.R. Grace & Co. v. Mouyal*, 422 S.E.2d 529, 533 (1992).

Applying these principals to MLM, it is clear that a non-solicitation provision may restrict a former distributor from soliciting other distributors with whom he had a business relationship. This group is sufficiently defined that the distributor can identify those persons that are temporarily off-limits. Similarly, this reasoning can be applied to situations where a former distributor knows another distributor by virtue of their mutual relationship to the company, but they have not had business dealings with one another.

For example, it is common for a company's higher-ranking distributors to know one another through company functions even though they are cross-line to one another. However, because the company created and nurtured this relationship, it is reasonable to extend a non-solicitation provision to this situation.

2) The Legitimate Business Interests Test

Another approach to evaluating a non-solicitation provision is known as the "legitimate business interests test." Under this approach, a non-solicitation agreement will be upheld if: 1) the employer has a "near-permanent" relationship with its customers and but for his employment, the defendant would not have had contact with those customers; or 2) the former employee learned trade secrets or acquired other confidential information through his prior employment and attempted to use it to his advantage.[17]

Determining whether a "near permanent" relationship exists requires consideration of the following factors:

1. the number of years the company required to develop the clientele;

2. the amount of money the company invested in developing the clientele;

3. the degree of difficulty in developing the clientele;

4. the amount of personal contact by the distributor;

5. the extent of the company's knowledge of its clientele;

6. the length of time the customers have been associated with the company; and

7. the continuity of the distributor-company relationship.[18]

Conducting a "near permanent" analysis in an MLM context leads to different results depending on the rank of the distributor involved. It would be difficult to classify a distributor who is new or who has a modest downline as "near permanent." Distributor attrition is a fact of life in MLM, and it is the lower ranking distributors that fall out most often.

On the other hand, successful distributors who have advanced through the ranks of a company's compensation system and developed profitable sales organizations would satisfy the "near permanent" criteria. Such distributors have generally been with the company long enough to satisfy the temporal requirements of the test and have earned substantial commissions for generating business. They have worked hard to become successful and have a strong financial incentive to remain with the company.

The interesting aspect of the legitimate business interest approach is that while lower ranking distributors may be "more legally available" for solicitation, it is the "less legally available" high-ranking distributors who are the most attractive targets for solicitation. It is uncommon to see a distributor jump to another company and then solicit unsuccessful distributors from his former company.

Clearly the incentive is to recruit the successful distributors from the previous company, but these are the individuals with whom the company has a strong claim to a "near permanent" relationship.

3. Common Law Causes of Action

In addition to causes of action based on contract, legal theories based in tort are commonly raised in distributor raiding cases. Principal among these causes of action are tortious interference with contract and interference with a prospective economic advantage. These causes of action are intended to allow rivals to compete for customers in the marketplace, but restrict them from using wrongful methods in their pursuit of satisfying otherwise legitimate business interests. Therefore, the law places limits to what a company may do attract customers away from its competitors.

If a company has a contract with a customer or distributor, or reasonable expectation of an advantageous commercial relationship, a competitor cannot unjustifiably interfere with that contract or relationship. To prevail

on an interference claim, the plaintiff must prove: 1) the existence of a valid contract or advantageous business relationship; 2) that a third party had knowledge of the contract; 3) that the third party intentionally and improperly caused that contract to be breached; and 4) the breach caused the plaintiff's damage.[19]

Simply inducing someone to discontinue a business relationship that is terminable at will is not sufficient grounds to support a tortious interference claim. The act of inducing the breach must be coupled with some form of wrongful conduct. The law recognizes two broad categories of wrongful activity in tortious interference claims: *wrongful means* and *wrongful motive*.

Wrongful means of causing another to breach a contract include conduct such as fraud, misrepresentation, threats or coercion, or violation of a duty owed to the plaintiff.

Wrongful motive requires that the defendant act with malice.

One of the standard methods distributors use to raid another company's distributor force involves ripping the other company apart through a seemingly endless menu of defamatory statements. Misrepresentations about the other company's management, its compensation plan, its financial condition, and its products or services are thrown about in fast and loose fashion.

Claims range from personal attacks on the morality of members of a company's management to allegations that a company's products contain rat droppings. Such defamatory remarks, if untrue, supply ample basis for a claim that a defendant is using improper means to induce a breach of his recruit's contract.

Improper motive requires that the defendant act with malice. The common understanding of the word "malice" infers a degree of contempt or ill will toward another. However, in the legal profession the word "malice" is a term of art which differs from the common understanding of the word. Proving malice requires that the plaintiff establish that the defendant acted with the purpose of injuring the plaintiff, or benefiting himself at the expense of the plaintiff.[20]

Illustrative of a tortious interference case in the direct selling industry is *Wear-Ever Aluminum, Inc. v. Towncraft Industries, Inc.* The case is particularly noteworthy because the defendant's conduct in raiding the plaintiff's distributor force involved both improper means and improper motive. In *Wear-Ever*, the defendant Towncraft recruited an employee from Wear-Ever. The court noted that this particular employee, who was one of Wear-Ever's sales managers, "had the trust and confidence of his sales force and was able to lead and mold them in the direction contemplated by the defendant's president...."

Utilizing the influence of the sales manager, Towncraft set out on a campaign to recruit Wear-Ever's distributor force. The sales manager called a meeting of Wear-Ever's key distributors, and without telling them he was employed by Towncraft, convinced them to leave Wear-Ever and join Towncraft. The court also noted that the "predictable group reaction" of other distributors would be to follow those key distributors who had moved to Towncraft. In reaching its decision that Towncraft tortiously interfered with Wear-Ever's contracts with its distributors, the court held:

> The conduct of the defendant.... was designed and intended to promote the interests of the defendant at the expense of the plaintiff. The injury suffered by the plaintiff, i.e., loss of man power and loss of revenue, was not an incidental consequence of the defendant's wrongful act; it was the ultimate consequence envisioned and planned for by the defendant. The defendant's desire was to build up its sales force, and Wear-Ever was as good a source as any to pick from.
> *Id.* at 393.

The facts of this case and the court's holding reveal three significant points. First, it highlights that a court will recognize that if key leaders in an MLM organization are recruited to another company, the "predictable

group reaction" of other distributors will be to follow those leaders. It is important for a court to understand this because the "group reaction" is commonly the desired result of those who recruit leaders from another company. Their ultimate goal is that the key distributors will be able to persuade their downlines to come over to the new company, and they too will convince their downlines to do the same. Consequently, there is a pattern of inducements by distributors to influence their downlines to breach their distributor agreements.

Secondly, the court's holding illustrates that the defendant's conduct of specifically targeting another company's distributor force can result in a finding that the goal of the defendant is to harm the business of the plaintiff. This finding is sufficient to establish that the defendant acted with malice.

Finally, the case presents a classic scenario of improper means used to induce one to breach a contract. Since Wear-Ever's former sales manager did not advise the Wear-Ever distributors that he was employed by Towncraft, he engaged in deceptive and misleading conduct.

What Does All of This Mean?

When one reads a heading entitled *What Does All of This Mean?*, you get the impression that what follows will be a synopsis that summarizes the entire preceding analysis into a nice, tidy package that contains all of the information you need to proceed with your business. I'm sorry to let you down, but that is not the case here.

There is no magic legal dust that we can sprinkle over distributors and companies which will avoid distributor-raiding confrontations.

In the pursuit of distributors and customers, the MLM industry is as competitive as a kick-boxing match in the 15th round, and it is only getting tougher with the influx of new entrants.

The best we can hope for is that companies and distributors act professionally and treat one another with respect. This will avoid most raiding problems (as well as most other conflict situations). However, when a raiding situation arises, the parties should look to the above legal framework to ascertain their respective rights and obligations. By working within this framework, fair competition will be preserved and distributors and companies alike will have their legitimate interests protected.
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1. The Direct Selling Association is the premier industry trade group for the direct sales and multilevel marketing industries.
2. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974).
3. States have enacted restraint of trade legislation which often follows federal law. Despite their common focus, state law should always be considered because it will have unique nuances.
4. *See Tampa Electric Co. v. Nashville Coal Co*., 365 U.S. 320, 327 (1961).
5. *See Image Technical Services, Inc. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997).
6. *Continental T.V. Inc., v. GTE Sylvania Inc.*, 433 U.S. 36, 50 (1977).
7. *Id.* At 49.
8. *Monsanto Co. v. Spray-Rite Service Corp*, 465 U.S. 752, 761 (1984).
9. 918 F.Supp. 1356 (W.D. MO 1994).
10. The court noted that *per se* violations of Section One of the Sherman Act are "price fixing, tying arrangements, group boycotts, horizontal market divisions, and vertical market divisions." 918 F.Supp. at 1369.
11. 918 F.Supp. at 1370.
12. *W.R. Grace & Co. v. Mouyal*, 422 S.E.2d 529, 531 (GA 1992).
13. A "Restatement" of the law is a set of model rules written the American Law Institute. Although the model rules do not constitute law, they are frequently cited by courts as guiding principles when analyzing legal issues.
14. 1991 U.S. App. Lexis 11617, *affirmed* 934 F.2d 324 (1991)*, cert. denied* 502 U.S. 1033 (1992). The *Shaklee* case is an unreported decision, which means that it may not be cited as controlling precedent to other courts. Nevertheless, it is illustrative of how a court will analyze an in-term restriction.
15. *See Kovarik v. American Family Insurance* Group, 108 F.3d 962, 964, note 5 (8th Cir. 1996); *Commonwealth Life Insurance Co. v. Neal*, 521 F.Supp. 812, 816 (LA 1981).

16. *Kovarik v. American Family Insurance* Group, 108 F.3d 962, 967 (8th Cir. 1996).
17. *Trailer Leasing Co., v. Associates Commercial Corp.,* 1996 U.S. Dist Lexis 9654 (Illinois 1996). Consideration of whether a distributor had sufficient contact with the employer's customers to establish a business relationship is discussed in connection with geographic limitations and will not be repeated in this analysis. Likewise, whether a former distributor acquired and misused trade secrets or confidential information is discussed in relation to the trade secret analysis and will also not be repeated.
18. *Id.*
19. *See e.g., Cohen v. Davis*, 926 F.Supp. 399, 402 (NY 1996).
20. *Wear-Ever Aluminum, Inc. v. Towncraft Industries, Inc.*, 182 A.2d 387 (N.J. 1962).

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Mr. Reese is a member of the Utah, Idaho, Colorado and Missouri bars, and is an active member of the Direct Selling Association's Lawyer's Council and the Government Relations Committee. He regularly contributes articles to a variety of industry publications, and is a contributing author to Angela Moore's industry acclaimed book *Building a Successful Network Marketing Business*. He is also a regular speaker at network marketing and dietary supplement conferences and events across the country, and is a board member of The Symposium Group, which is an educational organization focused on teaching and training best practices within the network marketing industry. Many of Mr. Reese's articles are available on Grimes & Reese's website at: MLMLaw.com.