

# *Analysis of USANA's Five Customer Rule*

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USANA has written in their policies and procedures<sup>1</sup> a list of requirements an associate must satisfy before being eligible to receive commission. For the purpose of this analysis, the focus will be the five customer rule. This rule requires associates to sell product to at least five customers during a 4-week period. These customers are defined as being either a **retail customer** or a **preferred customer**. Please review the following section from the policies and procedures section 5.1 Product Sales.

## 5.1 Product Sales

The USANA Binary Compensation Plan is based upon the sale of USANA products and services to end consumers. Associates must fulfill specified personal and Downline Organization sales requirements (as well as meet other responsibilities set forth in these Policies and Procedures) in order to be eligible for bonuses, commissions, and advancement to higher levels of achievement. **The following sales requirements must be satisfied in order for Associates to be eligible for commissions:**

- A minimum of seventy percent (70%) of an Associate's orders must be for Customers or end users. The sales volume of an Associate's personally enrolled Preferred Customers shall be included for the purposes of determining compliance with the 70% requirement. For those Associates who elect to be Distributors the sales volume of the Distributor's retail sales will be included as well. Associates may not purchase additional product until at least seventy percent (70%) of the previous order has been sold to end consumers.
- **Associates must develop or service at least five customers every four-week rolling period. For Associates who elect to be Distributors, these customers can be either Retail Customers, Preferred Customers, or any combination of the two. For all other Associates, these customers must be Preferred Customers.**
- Associates who choose to be Distributors are required to furnish their Retail Customers with a receipt which specifies the date of sale, the amount of sale, the items purchased, and the USANA satisfaction guarantee. **Associates must retain all retail sales receipts for a period of two years and furnish them to USANA at the Company's request. Records documenting the purchases of Associates' Preferred Customers will be maintained by USANA.**

*(My Emphasis in bold and red)*

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<sup>1</sup> <https://www.usana.com/media/File/Training%20page/BDS%20files/policies%20and%20pro/US-CEN-Policies%20Procedures.pdf>

How does USANA define what a retail customer is? Using USANA's online tool called Ask Andy<sup>2</sup>, associates are able to find help on various questions. The following statement shows how USANA describes what a retail customer is.

[http://obs.usana.com/UPLOADS/usana/2005/241/241-1\\_AFA.html](http://obs.usana.com/UPLOADS/usana/2005/241/241-1_AFA.html)

#### **Preferred Customer vs Retail Customer**

A Preferred Customer is someone who purchases USANA products for their personal use only, directly from USANA. A Retail Customer is someone who purchases USANA products directly from a USANA Distributor or directly from an Independent Distributor's web page. **Neither customer type is allowed to participate in the compensation plan.**

*(My Emphasis in bold and red)*

It is clear and without a doubt that an associate cannot be counted as a retail customer. USANA states that only retail customers and preferred customers count toward the five customer rule. This rule stems from the 1979 Amway safeguard which is a guideline Multi-Level Marketing companies follow. The five customer rule was put in place to ensure a pyramid scheme was not taking place. However, in USANA's case, it appears to provide nothing more than lip service to federal regulators. In fact, It appears that USANA is not enforcing their five customer rule and the retail customers simply do not exist. Keep this in mind as I discuss the following situation.

According to the 2006 10-K<sup>3</sup>, USANA paid out \$146.3 million in distributor incentives during the 2006 year. Due to USANA's sloppy bookkeeping, they may have overpaid approximately 90% of their active associates by not enforcing the five customer rule.

We know that in North America according to the 2006 Distributor Earnings Statement<sup>4</sup>, there were 59,600 commission qualified associates but only 48,240 received any commission, or 80.9% of them. We know world wide there are 178,000 "active" distributors which means they are commission qualified<sup>5</sup>. If we assume the 80.9% is constant throughout the world, then approximately 144,000 is the number of world wide associates who receive a commission.

From USANA's policies and procedures, one of the requirements to receive a commission is that each associate must have at least five customers they sold products to for a 4-week period. So for 144,000 associates to receive any commission, they must sell USANA products to approximately 720,000 customers. USANA states they have 79,000 active preferred customers, which is only 10.9% of what they actually need. So where are the remaining 641,000 customers?

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<sup>2</sup> <http://obs.usana.com/Main/supportCenterIndex?groupId=0&locale=en&nolog=1>

<sup>3</sup> USANA 2006 10-K filing:  
<http://yahoo.brand.edgar-online.com/fetchFilingFrameset.aspx?dcn=0001104659-07-017321&Type=HTML>

<sup>4</sup> <http://www.usana.com/media/File/Policies%20and%20Procedures%20page/US/US%20AveIncome.pdf>

<sup>5</sup> "To receive commissions in the USANA Cellular Compensation Plan, you must keep your Business Center(s) active by achieving a minimum PSV requirement." - [http://obs.usana.com/UPLOADS/usana/2005/238/238-1\\_NCA.html](http://obs.usana.com/UPLOADS/usana/2005/238/238-1_NCA.html)

This means that the 144,000 commission earning associates have to be selling USANA products to an additional 641,000 customers defined as “retail customers”. If they do not, then they are not supposed to be receiving a commission check. If these retail customers do not exist, then commission should not be paid. It would appear that USANA is grossly overpaying their associates because they are not actively requiring proof that their retail customers exist.

Based on the 79,000 active preferred customers, only 15,800 associates at most could receive a commission check based on the preferred customer count. The rest of the 128,000 associates would have to show proof to USANA that they each actually sold to five customers. However, USANA does not actively verify this because as we saw in the policies and procedures earlier, the following statement is given:

“Associates must retain all retail sales receipts for a **period of two years** and furnish them to USANA **at the Company’s request**. Records documenting the purchases of Associates’ Preferred Customers will be maintained by USANA.”

USANA could not possibly be enforcing the five customer rule because they do not even know how many retail customers the associates have. USANA does not even know the retail customer’s names. USANA has no record of associate’s retail sales because they don’t keep record of it in their database. I believe it is because the retail customers do not even exist. The following is from USANA’s 2007 first quarter preliminary conference call on April 4, 2007<sup>6</sup>:

### USANA Q1 Preliminary Earnings Call

Time into conference call - 1:10:47 to 11:11:38

Dave Wentz: “...To say that 14% of our sales is to customers is completely ridiculous and misconstruing the facts and it doesn’t also include all of the retail sales that our distributors make on after we get the products to them that **we don’t have the names**. **They keep their retail customer lists to themselves** and they own those retail customers so to speak, and service them by providing the products directly to them and **the company does not know who they are, does not have contact with them**. So completely misconstrued allegations”

Doug Lane with Avondale Partners: “**There’s a component of users of USANA products that you don’t even have in your database**. **Those are the retail customers of your distributors, correct?**”

Gil Fuller & Dave Wentz: “**Absolutely correct**”

A short sound clip from the conference call which corresponds with the transcript above is located at: [http://www.geocities.com/terminatedramp/USANA\\_RetailSales.mp3](http://www.geocities.com/terminatedramp/USANA_RetailSales.mp3)

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<sup>6</sup> <http://phx.corporate-ir.net/phoenix.zhtml?c=95179&p=irol-EventDetails&EventId=1522660>

I believe the majority of commission receiving associates do not have five customers, and USANA breaks this policy because they can't risk destroying the illusion that so many distributors are collecting a commission. The company's auditors need to check USANA's records to find out if they are paying commission checks to associates who are not meeting the five customer rule. If the five customer rule is not being met, then they could be in violation of the Amway Safeguards for the ratio of associates to customers. Have them find out how many associates have at least five active preferred customers within a 4-week period. The remaining associates would have to show USANA proof that they have five active retail customers within the 4-week period.

This type of audit would give enough evidence to show that USANA does not have the required retail customers to meet the five customer rule. USANA has the mechanics for obtaining this information each week. However, they are not. If they did, there would be evidence that they do not meet the five customer rule for each associate. USANA may not be requesting the five retail customer information and in addition may be paying commission to associates who do not have five customers.

The stockholders would be interested to find out how many associates receive a commission while in violation of the five customer rule. How much of the commission is paid to associates who are in violation of the five customer rule and are also relatives of insiders. This would be a clear conflict of interest.

The FTC should require USANA to hand over the information regarding the number of retail customers. If USANA cannot furnish the required number of retail customers for the number of commission paid associates, then the FTC should consider formal action against USANA. It would appear that USANA wrote this rule only to comply with the Amway Safeguard. However, in actual operation, I believe the rule is being ignored. It would appear the sole purpose of this rule is to give the illusion they are complying with regulations when in fact they are not. To mask this, they are overpaying the commission.