Medical Xpress

Herbalife dodges most serious charges from US

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In this May 6, 2016 file photo, the Herbalife logo appears above the post where it trades on the floor of the New York Stock Exchange. The Federal Trade Commission is closing an investigation of Herbalife and the multinational, nutritional supplements company will to pay $200 million to settlement allegations that it deceived consumers. The company said in a written statement on Friday, July 15, that the FTC settlement doesn't change its business model as a direct selling company. (AP Photo/Richard Drew)

Federal regulators closed an investigation of the multinational, nutritional supplements company Herbalife, which has for years been dogged by accusations that it was run as an elaborate pyramid scheme.

Though Herbalife was ordered to restructure its U.S. operations and pay a $200 million settlement Friday, it avoided being classified by the U.S. as a pyramid scheme.

Under the settlement announced Friday, Herbalife must rework the way in which it pays its salespeople. They must be compensated for selling Herbalife products, and the company must scrap incentives that reward them for recruiting other salespeople.

A business model that rewards participants for bringing in others to take part in an enterprise is essentially the base model of a pyramid scheme.

"The settlements are an acknowledgment that our business model is sound and underscore our confidence in our ability to move forward successfully, otherwise we would not have agreed to the terms," said Herbalife Chairman and CEO Michael Johnson.

News that the U.S. Federal Trade Commission was closing its two-year investigation without labeling Herbalife as a pyramid scheme sent shares soaring by 16 percent at the open of trade Friday, shares that were hammered when a prominent hedge fund manager unleased a blistering attack on the company almost four years ago.

Since that time, Herbalife has become a proxy battlefield for major Wall Street players who took opposing sides, some shorting the company's stock believing it would collapse, while others bought huge caches of Herbalife shares.

One of the most vocal supporters has been activist investor and billionaire Carl Icahn, who built up an 18 percent stake in the company after it came under assault from hedge fund manager Bill Ackman in 2012.

On Friday, Herbalife announced that it's boosting Icahn's stock ownership limit to 34.99 percent, from 25 percent.

"The FTC settlement announced today, coming after a two-year investigation also concluded that Herbalife is not a pyramid scheme - a conclusion that obviously vindicates our research and conviction," Icahn said in a printed release. "While Bill Ackman and I are on friendly terms, we have agreed to disagree (vehemently) on this subject."

Yet the two had once sparred viciously when they both called into the business channel CNBC, with Ackman calling Icahn a bully, and Icahn saying that Ackman reminded him of a little boy crying on a playground.

On Friday Ackman's Pershing Square Capital Management LP issued a statement standing behind its characterization of Herbalife.

"While it appears that Herbalife negotiated away the words "pyramid scheme" from the settlement agreement, the FTC's findings are clear," it said. Pershing Square said that it foresees Herbalife's top distributors and others leaving the company once its restructuring is fully implemented.

A number of Wall Street heavyweights, from George Soros to Michael L Gordon, at some point took sizeable positions in Herbalife against Ackman.

In late 2012, Ackman excoriated Herbalife with a 342-slide, three-hour PowerPoint presentation, saying the company was a scam and a pyramid scheme.

Herbalife shares tumbled 12 percent before the presentation when word leaked that he was shorting the shares, which would lead to huge profits if they fell. After the presentation, shares plunged another 10 percent.

For quite some time, however, that day in late 2012 has appeared to have been something of an apex for Ackman and his bet against the Herbalife.

As other major investors took opposing positions, Herbalife not only recovered, but its shares by last year were reaching all-time highs, a catastrophe for Ackman who, even this week, was publicly forecasting the company's complete collapse.

However, under requirements of the deal it struck with the FTC, Herbalife is facing some significant hurdles going forward.

At least 80 percent of Herbalife's product sales must come from "legitimate end-users," the FTC said Friday.

That is exactly the contention that Ackerman first made four years ago, that Herbalife was able to generate huge sales because so much of its products were sold to its own salespeople, who in turn would have to sell the products to turn a profit themselves.

Shares of Herbalife gained more than 9 percent in Friday afternoon trading.