



DIRECT SELLING ASSOCIATION

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LAWS MUST CLEARLY DIFFERENTIATE BETWEEN PYRAMID SCHEMES AND LEGITIMATE DIRECT SELLING COMPANIES

Background

Bills proposing to regulate direct selling companies often confuse legitimate businesses with pyramid schemes. Direct selling is a legitimate type of business recognized by the Federal Trade Commission (FTC) and used by hundreds of companies, including some of the world's best-known consumer brands. On the other hand, pyramid schemes are illegal business operations that defraud customers. Pyramid schemes compensate members of the salesforce primarily for recruiting new participants-as opposed to focusing on the sale of products to customers who in turn either sell them to others, or use them.

Position

State statutes, FTC published decisions and judicial rulings have laid out ways to distinguish between legitimate direct selling companies and pyramid schemes. These statutes provide clarity to consumers to distinguish between pyramid schemes and legitimate companies and clarity for direct selling companies on what constitutes ethical business practices.

DSA and its member companies believe that pyramid schemes should be prosecuted to the fullest extent of the law. A prohibition on illegal or fraudulent business activity is a central provision of the DSA Code of Ethics, to which every member company must abide.

Additionally, laws should protect the direct seller's purchase of reasonable amounts of products for their own use, consistent with a 2004 FTC staff advisory memo and the salient points of a 9th Circuit Court of Appeals Decision in *FTC v. BurnLounge*.

Policy Alternatives

- DSA supports enactment of the current industry model adopted by the Council of State Governments in 2004 as Suggested State Legislation. The model, or similar legislation, has been adopted in 18 states. Similar legislation, H.R. 5230, the Anti-Pyramid Promotional Act of 2016, has been introduced in the U.S. House of Representatives.
- DSA's model legislation clarifies that a pyramid scheme exists when direct selling sales representatives are compensated primarily for recruitment as opposed to sales, and that direct sellers purchasing reasonable amounts of products for their own use is a legitimate business practice.



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2004 CSG SUGGESTED MODEL ANTI-PYRAMID LEGISLATION

Section 1. [Short Title.] This Act may be cited as “An Act to Prohibit Pyramid Promotional Schemes.”

Section 2. [*Definitions.*] For the purposes of this Act:

“Promote” means contrive, prepare, establish, plan, operate, advertise, or otherwise induce or attempt to induce another person to participate in a pyramid promotional scheme.

“Appropriate Inventory Repurchase Program” means a program by which a plan or operation repurchases, upon request and upon commercially reasonable terms, when the salesperson’s business relationship with the company ends, current and marketable inventory in possession of the salesperson that was purchased by the salesperson for resale. Any such plan or operation shall clearly describe the program in its recruiting literature, sales manual, or contract with independent salespeople, including the disclosure of any inventory which is not eligible for repurchase under the program.

“Inventory” includes both goods and services, including company-produced promotional materials, sales aids, and sales kits that the plan or operation requires independent salespeople to purchase.

“Commercially Reasonable Terms” means the repurchase of current and marketable inventory within [twelve months] from the date of purchase at not less than [ninety percent] of the original net cost, less appropriate set-offs and legal claims, if any.

“Current and Marketable” excludes inventory that is no longer within its commercially reasonable use or shelf-period, that was clearly described to salespeople prior to purchase as seasonal, discontinued, or special promotion products not subject to the plan or operation’s inventory repurchase program, or that has been used or opened.

“Pyramid Promotional Scheme” means any plan or operation by which a person gives consideration for the opportunity to receive compensation that is derived primarily from the introduction of other people into the plan or operation rather than from the sale and consumption of goods, services, or intangible property by a participant or other people introduced into the plan or operation. The term includes any plan or operation under which the number of people who may participate is limited either expressly or by the application of conditions affecting the eligibility of a person to receive compensation under the plan or operation, or any plan, or operation under which a person, on giving any consideration, obtains any goods, services or intangible property in addition to the right to receive compensation.



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“Compensation” means a payment of any money, thing of value, or financial benefit conferred in return for inducing another person to participate in a pyramid promotional scheme.

“Consideration” means the payment of cash or the purchase of goods, services, or intangible property. The term does not include the purchase of goods or services furnished at cost to be used in making sales and not for resale, or time and effort spent in pursuit of sales or recruiting activity.

“Inventory Loading” means that the plan or operation requires or encourages its independent salespeople to purchase inventory in an amount, which exceeds that which salesperson can expect to resell for ultimate consumption or to consume in a reasonable period, or both.

Section 3. [*Participation in Any Pyramid Promotional Scheme: Penalties.*]

- (A) No person may establish, promote, operate, or participate in any pyramid promotional scheme. A limitation as to the number of people who may participate or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under the plan does not change the identity of the plan as a pyramid promotional scheme. It is not a defense under this section that a person, or giving consideration, obtains goods, services, or intangible property in addition to the right to receive compensation.
- (B) Any person who establishes or operates a pyramid promotional scheme is guilty of a [Class 5 felony]. Any person who knowingly participates in a pyramid promotional scheme is guilty of a [Class 1 misdemeanor].

Section 4. [*Participation in Any Pyramid Promotional Scheme: Exceptions.*]

- (A) Nothing in this Act may be construed to prohibit a plan or operation, or to define a plan or operation as a pyramid promotional scheme, based on the fact that participants in the plan or operation give consideration in return for the right to receive compensation based on purchases of goods, services, or intangible property by participants for personal use, consumption, or resale so long as the plan or operation does not promote or induce inventory loading and the plan or operation implements an appropriate inventory repurchase program.
- (B) The provisions of this Act do not preclude, preempt, or prohibit the [attorney general] from proceeding against any plan or scheme or any person involved with such a plan or scheme under any other provision of law.



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Section 5. *[Violations.]*

- (A) If it appears to the [attorney general] that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this Act, or any order under this Act, the [attorney general] may do one or more of the following:
- (1) Issues a cease and desist order, with or without prior hearing, against any person engaged in the prohibited activities, directing such person to cease and desist from further illegal activities;
 - (2) Bring an action in the [circuit court] to enjoin the acts or practices to enforce compliance with this Act, or any order under this Act; or
 - (3) Impose by order and collect a civil penalty against any person found in an administrative action to have violated any provision of this Act, or any order issued under this Act, in an amount not to exceed [ten thousand dollars] per violation per person.
- (B) The [attorney general] may bring actions to recover penalties pursuant to this subdivision in [circuit court.] All civil penalties received shall be deposited in the [state general fund].
- (C) Any person named in a cease and desist order issued pursuant to this Act shall be notified of his or her right to file, within [fifteen days] after the receipt of the order, a written notice for a hearing with the [attorney general]. If the [attorney general] does not receive a written request for a hearing within the time specified, the cease and desist order shall be permanent and the person named in the order deemed to have waived all rights to a hearing. Every such order shall state its effective date and shall concisely state its intent or purpose and the grounds on which it is based. Any person aggrieved by a final order issued pursuant to this Act may obtain review of the order in a [circuit court] pursuant to the provisions of [insert citation].
- (D) Upon a proper showing a permanent or temporary injunction, restraining order, or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or defendant's assets. In addition, upon a proper showing by the [attorney general], the [court] may enter an order of rescission, restitution, or disgorgement directed to any person who has engaged in any act constituting a violation of any provision of this Act, or any order under this Act. The court may not require the [attorney general] to post a bond. In addition to the fines or penalties, the [attorney general] shall collect costs and attorney fees.



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Section 6. [*Burden of Showing Compliance.*] The burden of showing compliance with the provisions of this Act lies with the plan, scheme, or person involved with such plan or scheme.