

THE FAIR TRADING ACT

PYRAMID SELLING AND MULTI-LEVEL MARKETING SCHEMES

Pyramid selling schemes are illegal in New Zealand. They are specifically prohibited by the Fair Trading Act because they are unfair and it is also common that many recruits are misled about the likely financial returns. Because the potential reward offered depends mainly on the recruitment of new people to pay into the scheme, many participants will always be at or near the base of the pyramid and will not achieve the promised return on their 'investment'. Only the few initial participants at the top of the pyramid are likely to make money, since the number of possible new recruits in any community is limited.

WHAT IS A PYRAMID SCHEME?

A pyramid scheme can take many forms, but has the following essential elements:

- it offers a financial return based on the payments made by new recruits;
- the return is dependent primarily on the continued recruitment of new members, not sales of a product or service.

Pyramid selling schemes may involve 'gimmick' products (for example certificates) or grossly overpriced products or services that have little or no resale value and are not likely to be purchased again (for example personal development programmes or general financial information).

EXAMPLE

A scheme offered membership costing \$3,500 plus GST to an alleged 'concierge' service and access to a closed buyer group that claimed to receive discounts at various rates from a number of businesses. Members were also given the opportunity to earn significant remuneration by the recruitment of new members.

The Commerce Commission obtained an injunction against the scheme, which prevented further operation or promotion of the scheme and effectively froze any money in its bank account.

The company and individuals involved were convicted and fined. In addition, the Court ordered repayment of membership fees to two witnesses from the frozen company bank account.

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ARE MULTI-LEVEL MARKETING SCHEMES THE SAME AS PYRAMID SELLING?

There are a number of multi-level marketing schemes operating in New Zealand which are not pyramid schemes. Multi-level marketing schemes involve the sale of rights to sell a product or products in different market levels. In multi-level marketing, participants earn commission from selling real products, whereas pyramid selling is earning money solely or primarily by introducing other people into the scheme.

Income expectation is limited by the number of sales, not by the number of new sales representatives. Customers of multi-level marketing companies can buy the goods or services they offer without joining the scheme.

Multi-level marketing usually involves commercially viable products (for example clothing, jewellery, cosmetics, health products or cookware) which present genuine business and income-earning opportunities through repeat sales to clients. Customers can repeatedly buy goods or services because they have a genuine use.

Such multi-level marketing schemes are not prohibited by the Act.

WARNING

The Commission has identified a number of pyramid selling schemes which have been described as multi-level marketing schemes. Some promoters do this to try and make the scheme sound legitimate. Therefore you should always check a scheme very carefully to ensure that it is genuinely a multi-level marketing scheme.

MISLEADING CLAIMS ABOUT POTENTIAL EARNINGS

The Act also prohibits any representations that exaggerate the earnings that participants are likely to obtain from their involvement with a business activity. The Commission has investigated claims of unrealistic earnings relating to both pyramid schemes and legitimate business activities.

Members of the public need to be wary of joining schemes where the promotional literature contains testimonials of high earnings from people who are not easily available for possible checking (for example, "Since I joined this scheme I have made \$100,000 without really trying", RS of Auckland).

Similarly, where schemes make claims such as "this is not a get rich quick scheme" or "this scheme is legal", the question needs to be asked – why is such a statement necessary? They may disguise the fact that the scheme is illegal or that the promotional material is misleading.

ARE CHAIN LETTERS PYRAMID SCHEMES?

Chain letters which request the sending of money are covered by the definition of pyramid schemes and are illegal.

REFERRAL SELLING

Referral selling is the practice whereby a business induces potential customers to purchase by promising some form of reward if they provide the names of other people who then buy goods or services from that business.

Referral selling is prohibited by the Fair Trading Act because the customer will receive the reward only if sales are made to the people whose names were supplied. If no sale is made, then the original customer receives no benefit.

Referral selling differs from the legitimate practice of offering a rebate or other benefit following the sale. It is not illegal for businesses to offer rewards for names of other potential customers if the offer is made after the first customer has paid for their goods or services.

CHECKING OUT A SCHEME

The following guide may help in checking the nature and legitimacy of a marketing scheme.

1	Is there a joining fee?	Pyramid selling schemes often have start-up fees which are not for purchasing commercially viable goods or services since most earnings come from introducing others to the scheme.
2	Does the promotional literature indicate unrealistic earnings (for example "make \$100,000 a month legally")?	Promoters who make unrealistic claims risk breaking the law.
If you answer yes to (1) and (2) then, regardless of whether the scheme is pyramid selling or not, you should seek financial advice before entering.		
3	Do participants earn commissions primarily from selling products or services, or are financial rewards largely dependant on recruiting others into the scheme?	Pyramid selling schemes are based on recruiting others into the scheme.
4	Is the marketing or purchasing of the scheme's products the real reason why most people would join or is the scheme really about creating an opportunity for members to recruit others?	Pyramid schemes are primarily focused on creating rewards for those members who recruit others.
5	Are the products commercially viable?	A legitimate scheme has, as its main feature, products which consumers want to buy.
6	Are the products sold to genuine customers?	Legitimate multi-level marketing depends on selling to customers and establishing an ongoing market.
7	Is the number of products required to be purchased or ordered by the participants reasonable?	Legitimate businesses require participants to buy or order only as much stock as they can realistically expect to sell.
8	Does the promotional literature offer benefits such as "a life of happiness and prosperity", or "it's easy to sign up new distributors"?	Such statements need to be read carefully as they may make unrealistic promises which conceal the amount of hard work necessary to actually achieve such goals.
9	Does the promotional literature contain testimonials from people who are not easily available for checking (for example "RS of Auckland writes ...")?	People giving testimonials may not want to be identified for reasons of privacy. This may raise suspicions about whether the testimonials are genuine. Even if they are, there is generally no way for consumers to check. References to testimonials should be read with this caution in mind.
10	Does the promotional literature contain claims such as "this is not a get rich scheme" or "this scheme is legal"?	Again, statements like this need to be read with care. You need to ask yourself why such a statement is necessary. They may disguise the fact that the scheme may be illegal, or contain illegal components.
11	Does the literature suggest the Commerce Commission or another government department of agency has endorsed the scheme?	The Commerce Commission does not endorse or approve any scheme. If this statement is made, it is untrue.
12	Does the promotional literature fail to provide a street address, so that you cannot contact a person for further details?	Legitimate schemes are unlikely to do this.
13	Does the scheme provide ongoing training and sales support?	Legitimate multi-level marketing businesses have a vested interest in ensuring that participants are well trained and supported.

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This fact sheet is part of a series looking at the Fair Trading Act. Other fact sheets can be downloaded from
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CONTACT

Contact the Commerce Commission with information about false or misleading trading practices.

TELEPHONE

Our Contact Centre during office hours on 0800 943 600

WRITE

To us at Contact Centre,
 PO Box 2351, Wellington 6140

EMAIL

Us at contact@comcom.govt.nz

This fact sheet is a guideline only, and reflects the Commission's view. The publication is not intended to be definitive, and should not be used instead of legal advice. It is traders' responsibility to remain up to date with legislation.

The Commerce Commission enforces legislation that promotes competition in New Zealand markets and prohibits misleading and deceptive conduct by traders.

Only the courts can make an authoritative ruling on breaches of the Fair Trading Act. Courts may fine companies found guilty of breaching provisions of the Fair Trading Act up to \$200,000 and individuals up to \$60,000.