



The Consumer Protection Act, 1986 and Regulation of Multi-Level Marketing Schemes

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ABSTRACT

The process of globalization along with the expanding liberalization process has increased the number of consumer related issues. Consumer protection has earned an important place in the political, economic and social agendas of many nations. In India, the Government has taken many steps including legislative, to protect consumers. The enactment of The Consumer Protection Act, 1986 can be seen one of such step. The Consumer Protection Act, 1986 completed more than 25 years of its enactment. This law was largely based on United Nation's Guidelines for protection of rights of consumers worldwide. In last 25 years many developments have taken places and sophisticated methods of the sales and marketing of goods and services came in practice. These marketing practices more or less affect the interest of the consumers. Since at the time of enactment of the Consumer Protection Act, 1986 the lawmakers did not imagine these practices and their effect on interest of consumers. One of such practice is multilevel marketing, which was widely used in recent past by the manufacturers and service providers. Though all multilevel marketing practices are not adversely affecting the interests of the consumers but most of them are impacting the consumers. At present in India there is a vacuum in law for regulating multilevel marketing or pyramid schemes. Hence it is an urgent need to have structure for regulating multilevel marketing or pyramid schemes in India. By having the proper regulatory mechanism for regulating multilevel marketing and pyramid schemes, serious and non-serious players can be differentiated and interest of the consumers can be protected from the fly by night players in this field.

KEYWORDS

Introduction

The process of globalization along with the expanding liberalization process has increased the number of consumer related issues. Consumer protection has earned an important place in the political, economic and social agendas of many nations. The state plays a number of roles, including administrative, legislative and many others. One of the functioning aspects of legislative role of state is to frame various laws, rules and regulations for the purpose of not only maintaining law and order in the society but also for providing a practical framework for the justice to the common man. In India, the Government has taken many steps including legislative, to protect consumers. The enactment of The Consumer Protection Act, 1986 can be seen one of such step.

The Consumer Protection Act, 1986 completed more than 25 years of its enactment. This law was largely based on United Nation's Guidelines for protection of rights of consumers worldwide. In last 25 years many developments have taken places and sophisticated methods of the sales and marketing of goods and services came in practice. These marketing practices more or less affect the interest of the consumers. Since at the time of enactment of the Consumer Protection Act, 1986 the lawmakers did not imagine these practices and their effect on interest of consumers. One of such practice is multilevel marketing, which was widely used in recent past by the manufacturers and service providers. Though all multilevel marketing practices are not adversely affecting the interests of the consumers but most of them are impacting the consumers.

Multilevel marketing or Network marketing are ways to sell the products directly to the consumers in which the salesmen are compensated not only for the work done by them but also for the sales of people who have joined the company through them. These people are usually referred to as the down line and various levels of down line are created. The commission which is distributed among the salesmen depends upon the scheme used for division of the commission. These salesmen are known by various names like distributors, affiliates, dealers, sales consultant, etc.

A Pyramid Scheme is a non-sustainable business which involves payments to participants primarily to recruit other people into the scheme and there is no real investment or sale of products.

Review of related Literature

Bardhan Anshuman (2011) observed that the legality of these schemes he says MLM business operates in over 100 countries including countries like United States of America. Multilevel Marketing or Network Marketing has been going on India for many years and Amway, Oriflame, RCM are some of the companies, which have been frontrunners in this field. The Federal Trade Commission of USA which deals with issues of consumer protection and competition jurisdiction clearly states: "Not all multi-level marketing plans are legitimate. Some are pyramid schemes. It's best not to get involved in plans where the money you make is based primarily on the number of distributors you recruit and your sales to them, rather than on your sales to people outside the plan who intend to use the products."

Dhar Preeta (2011) analysed that while the jurisprudence on the matter is yet to be developed, it can be broadly observed that the Indian Courts have opted a more cautionary approach than that of the USA. However, the cautionary approach of the judiciary is inadequate, given the large economic stakes held by such business operations, and the span of the population affected by them. Adequate regulatory framework on the issue of direct selling and multi-level marketing is urgently needed.

Mukherjee Arpita et.al (2011) reported that in spite of the large number of regulations, the direct selling sector in India does not have a comprehensive Act as in the case of countries like Malaysia. This study found that the Prize Chits and Money Circulation Scheme (Banning) Act, 1978, which is sometimes cited for regulating this sector, is not applicable to direct selling and is outdated. India should have a comprehensive Act focusing on banning fraudulent practices such as pyramid schemes. The Act should have a clear definition of pyramid and other money circulation schemes and draw a distinction between fraudulent schemes and legitimate multi-level mar-

keting (including direct selling). Since, the number of pyramid schemes and the modes of operation of fraudulent players change frequently, it may be easier to lay down the procedures for identification of legitimate direct selling companies. Such procedures can be drawn up by carefully studying the code of conduct for direct selling companies across the world. The India Direct Selling Association (IDSA) has laid down a code of conduct but this is voluntary and is only applicable to IDSA members. There is need to have a proper regulation in place that lays down conditions for identification of a legitimate direct selling company. A majority of survey participants felt that registration of direct selling companies with a central authority, based on a clearly specified procedure and nominal registration fees, would help identify legitimate operators in the sector. The Consumer Protection Act, 1986, and the Consumer Protection (Amendment) Act 2002, which came into effect in March 2003, need some modifications in order to protect consumers of products sold through direct selling.

Ananth S. (2007) finds that the past two decades in the domain of investment in India have seen the proliferation of pyramid schemes, variously referred to as direct marketing, network marketing or multi-level marketing, among others. At the popular level, they are simply referred to as chain marketing schemes or money circulation schemes. The organisers convince investors about an excellent business opportunity to get rich quickly and enjoy the benefits of financial freedom for the rest of their lives and even for posterity. This essay examines pyramid schemes as they have evolved in contemporary Andhra Pradesh (AP), and asks some questions that are of interest from the perspective of social science. It is essential to look beyond the binaries of ethical/unethical in order to understand the culture and economy of a large section of people who often chase extra income in order to move up the social ladder or to avoid slipping a few rungs. Pyramid schemes function in a more complex manner than is probably understood. While they may not be a part of the mainstream finance capital (like the stock market), they form a fast-growing fringe of finance capital. Their illegality is discernible only on close scrutiny, and when identified, they often seem to be located on the boundaries and margins of the acceptable and the legal. Their emphasis is on business opportunity, entrepreneurship, quick money; the chimera of unimaginable riches only masks their continuous attempts to probe and, where possible, extend the frontiers of the legally acceptable. They are equivocally positioned outside the spirit of the law and simultaneously within the letter of the law. A sophisticated façade of business opportunity, savings, extra income, with the right dose of systematic motivation, enables them to proliferate and prosper. Perhaps the lure of a new and better life is too seductive to resist, especially when it only involves persuading two curious and willing recruits during ones free time.

Debra A. Valentine (1998) concluded that as we continue to pursue pyramid schemes, we would be delighted to coordinate our efforts with law enforcement in your countries. It is only too evident that the expansion of fraud across borders and on the World Wide Web means that no one agency or country can work effectively on its own. We must be collectively vigilant in order to protect the integrity of our marketplaces and the pocketbooks of our consumers.

Above review of literature clearly indicates that there is a loophole in the laws in India for regulating the multilevel marketing and pyramid schemes. This study tries to find out the legal position of other countries in this respect and to suggest the measures for India.

Objectives of Study

1. To study the concept of multilevel marketing and jurisdiction of the present consumer law on it.
2. To study the provisions related to regulation of multilevel marketing and pyramid schemes of other countries.
3. To explore the avenues for inclusion of some relevant provisions on the issue in present consumer law.

Methodology

This study is conceptual, qualitative and exploratory in nature. For this, available relevant literature on the subject is surveyed. In the study relevant provisions of laws of other countries also studied. To arrive on conclusion inputs from legal expert also taken.

Laws in other Countries for Regulation of Multi-Level Marketing and Pyramid Schemes

Law of Singapore

Singapore is the country where a separate law is enacted to prohibit the multi-level marketing and pyramid schemes. Multi-Level Marketing and Pyramid Selling (Prohibition) Act of Singapore prohibits these practices in Singapore. Preamble of the Act read as follows:

An Act to prohibit the registration of businesses that are designed to promote multi-level marketing schemes or arrangements or pyramid selling schemes or arrangements in relation to the distribution and sale of commodities; to prohibit the incorporation or registration of companies which propose to promote multi-level marketing schemes or arrangements or pyramid selling schemes or arrangements in relation to the distribution and sale of commodities and to make it unlawful for any person to promote such schemes or arrangements and to provide for matters connected therewith.

Relevant Provisions

"Pyramid selling scheme or arrangement" means any scheme or arrangement for the distribution or the purported distribution of a commodity whereby —

(a)

a person may in any manner acquire a commodity or a right or a licence to acquire the commodity for sale, lease, licence or other distribution;

(b)

that person receives any benefit, directly or indirectly, as a result of —

(i)

the recruitment, acquisition, action or performance of one or more additional participants in the scheme or arrangement; or

(ii)

the sale, lease, licence or other distribution of the commodity by one or more additional participants in the scheme or arrangement; and

(c)

any benefit is or may be received by any other person who promotes, or participates in, the scheme or arrangement (other than a person referred to in paragraph (a) or an additional participant referred to in paragraph (b)).

[19/2000]

"Multi-level marketing scheme or arrangement" has the same meaning as "pyramid selling scheme or arrangement" in this Act;

Section 3.

—(1) It shall be unlawful for any person to promote or participate in a multi-level marketing scheme or arrangement or a pyramid selling scheme or arrangement or to hold out that he is promoting or participating in such a scheme or arrangement.

(2) Any person who contravenes subsection (1) shall be guilty of an offence and shall be liable on conviction to a fine not

exceeding \$200,000 or to imprisonment for a term not exceeding 5 years or to both.

[19/2000]

Registration of business which is designed to promote pyramid selling scheme or arrangement prohibited

Section 4.

—(1) No business which is designed to promote a multi-level marketing scheme or arrangement or a pyramid selling scheme or arrangement shall be registered under any written law relating to the registration of businesses.

(2) A person who in contravention of subsection (1) obtains registration of a business which is designed to promote a multi-level marketing scheme or arrangement or a pyramid selling scheme or arrangement shall be guilty of an offence and shall be liable on conviction to a fine not exceeding \$200,000 or to imprisonment for a term not exceeding 5 years or to both.

[19/2000]

Registration of company which proposes to promote pyramid selling scheme or arrangement prohibited

Section 5.

—(1) No company which proposes to promote a multi-level marketing scheme or arrangement or a pyramid selling scheme or arrangement shall be incorporated or registered under the Companies Act (Cap. 50).

(2) Where a company which is designed to promote a multi-level marketing scheme or arrangement or a pyramid selling scheme or arrangement contravenes subsection (1) by obtaining incorporation or registration under the Companies Act, that company and every officer thereof shall be guilty of an offence and shall be liable on conviction to a fine not exceeding \$200,000 or to imprisonment for a term not exceeding 5 years or to both. [6/19/2000]

Law of Canada

Competition Act of Canada prohibits the multilevel marketing and pyramid schemes.

"Sections 55 and 55.1 of the Competition Act are criminal provisions addressing multi-level marketing and pyramid selling. Section 55 prohibits operators or participants in a multi-level marketing plan from making representations relating to compensation without fair, reasonable and timely disclosure of the amount of compensation received or likely to be received by typical participants in the plan. Section 55.1 of the Act provides that a multi-level marketing plan that includes either compensation for recruitment, required purchases as a condition of participation, inventory loading, or the lack of a buy-back guarantee on reasonable commercial terms, constitutes a prohibited 'scheme of pyramid selling'. Any person who contravenes section 55 or 55.1 is guilty of an offence and liable to a fine of up to \$200,000 and/or imprisonment up to one year on summary conviction, or to fines in the discretion of the court and/or imprisonment up to five years upon indictment

Subsection 55(1) of the Competition Act (the "Act") defines "multi-level marketing plan" ("MLM" plans) as a "plan for the supply of a product whereby a participant in the plan receives compensation for the supply of the product to another participant in the plan who, in turn, receives compensation for the supply of the same or another product to yet other participants in the plan."

The Act sets out certain compensation disclosure requirements for operators and participants of MLM plans.

In particular, the Act makes it a criminal offence for operators and participants of MLM plans to make compensation claims to prospective participants unless fair, reasonable and time-

ly disclosure is made of the: (i) actual compensation received by typical participants in the plan or (ii) likely compensation to be received, based on a number of factors set out in the Act which include the nature of the product, nature of the relevant market and the type of operator.

MLM plans that constitute pyramid selling schemes under the Act are illegal. In other words, while MLM plans are legal provided certain prescribed disclosure requirements are met, pyramid selling schemes are illegal under the Act and the Criminal Code.

Section 55.1 of the Act defines a pyramid selling scheme as an MLM plan that has one or more of the following features: (i) requires a payment for the right to receive compensation for recruiting other participants into the MLM plan who pay for the same right (paying compensation for recruiting other participants), (ii) requiring purchases as a condition of participation, other than a specified amount of product at the seller's cost to facilitate sales, (iii) inventory loading (knowingly supplying product to participants in commercially unreasonable quantities), or (iv) a participant is supplied with product without a buy-back guarantee or right to return the product in saleable condition on reasonable commercial terms (or is not informed of the existence of the guarantee or right and how it may be exercised).

Law of Newzealand

Fair Trading Act, 1986 of Newzealand prohibits multilevel marketing and pyramid schemes. Relevant provisions of the same are as follows:

Pyramid selling schemes

- (1) No person shall promote or operate a pyramid selling scheme.

(2) For the purposes of this section, the term pyramid selling scheme means—

(a) a scheme—

(i) that provides for the supply of goods or services or both for reward; and

(ii) that, to many participants in the scheme, constitutes primarily an opportunity to buy or sell an investment opportunity, whether personally or through an agent, rather than an opportunity to buy or supply goods or services; and

(iii) that is or is likely to be unfair to many of the participants in the scheme in that—

(A) the financial rewards of many of those participants are dependent on the recruitment of additional participants (whether or not at successively lower levels); and

(B) the number of additional participants in the scheme that must be recruited to produce reasonable financial rewards to participants in the scheme is not attainable or is not likely to be attainable by many of the participants in the scheme:

(b) a scheme of the type commonly known as a chain letter scheme (whether or not it provides for the supply of goods or services or both) that is likely to be unfair to many of the participants in the scheme, in that—

(i) the financial rewards of many of those participants are dependent on the recruitment of additional participants; and

(ii) the number of additional participants in the scheme that must be recruited to produce reasonable financial rewards to participants in the scheme is not attainable or is not likely to be attainable by many of the participants in the scheme.

[Section 24(2)(a)(ii): substituted, on 8 July 2003, by section 5 of the Fair Trading Amendment Act 2003 (2003 No 31).]

Law of Republic of South Africa

Recently enacted Consumer Protection Act, 2008 of Republic of South Africa also contains the provisions related to pyramid schemes and multilevel marketing. Relevant provisions of the Act are as follows:

Pyramid and related schemes

Section 43. (1) In this section—

(a) **“consideration”** has the meaning set out in section 1, except that it does not include—

(i) the purchase of any goods at cost to be used in making sales, or not for resale;

(ii) the purchase of any goods in exchange for which the seller of those goods offers to repurchase the participant's products under reasonable commercial terms; or

(iii) the participant's time and effort in pursuit of sales or recruiting activities; and

(b) **“participant”** means a person who is admitted to a scheme for consideration.

(2) A person must not directly or indirectly promote, or knowingly join, enter or participate in—

(a) a multiplication scheme, as described in subsection (3);

(b) a pyramid scheme, as described in subsection (4);

(c) a chain letter scheme, as described in subsection (5); or

(d) any other scheme declared by the Minister in terms of subsection (6), or cause any other person to do so.

(3) A multiplication scheme exists when a person offers, promises or guarantees to any consumer, investor or participant an effective annual interest rate, as calculated in the prescribed manner, that is at least 20 per cent above the REPO Rate determined by the South African Reserve Bank as at the date of investment or commencement of participation, irrespective of whether the consumer, investor or participant becomes a

member of the lending party.

(4) An arrangement, agreement, practice or scheme is a pyramid scheme if—

(a) participants in the scheme receive compensation derived primarily from their respective recruitment of other persons as participants, rather than from the sale of any goods or services; or

(b) the emphasis in the promotion of the scheme indicates an arrangement or practice contemplated in paragraph (a).

(5) An arrangement, agreement, practice or scheme is a chain letter scheme if—

(a) it has various levels of participation;

(b) existing participants canvass and recruit new participants; or

(c) each successive newly recruited participant—

(i) upon joining—

(aa) is required to pay certain consideration, which is distributed to one, some or all of the previously existing participants, irrespective of whether the new participant receives any goods or services in exchange for that consideration; and

(bb) is assigned to the lowest level of participation in the

scheme; and

(ii) upon recruiting further new participants, or upon those new participants recruiting further new participants, and so on in continual succession—

(aa) may participate in the distribution of the consideration paid by any such new recruit; and

(bb) moves to a higher level within the scheme, until being removed from the scheme after reaching the highest level.

(6) The Minister, by regulation made in accordance with section 120, may declare any arrangement, agreement, practice or scheme to be a scheme contemplated in subsection (2)(d), if it is similar in purpose or effect to a scheme contemplated in that subsection.

From the above it is clear that many countries having either separate law for regulating or prohibiting the multilevel marketing or pyramid schemes or containing the specific provisions in their consumer, competition law to regulate, prohibit the same.

Law in India

In India there are two specific laws for the protection of the interest of the consumers i.e. The Consumer Protection Act, 1986 and The Competition Act, 2002. But if we see provisions of these statutes nothing is mentioned about the regulation, prohibition of multilevel marketing or pyramid schemes. The Prize Chit and Money Circulation (Banning) Scheme Act, 1978 is enacted in India which bans promotion or conduct of any money circulation and/or prize chit scheme and provides for imprisonment and penalty in case of failure to comply with the provisions. But The Prize Chit and Money Circulation (Banning) Scheme Act, 1978 deals only with money circulation schemes and multilevel marketing or pyramid schemes are outside the purview of this Act.

Suggestions for Regulation of Multilevel Marketing and Pyramid Schemes in India

At present in India there is a vacuum in law for regulating multilevel marketing or pyramid schemes. Hence it is an urgent need to have structure for regulating multilevel marketing or pyramid schemes in India. This can be achieved in following ways:

- A specific law can be enacted to regulate multilevel marketing and pyramid schemes.
- Alternatively provisions can be inserted in present Consumer Protection Act, 1986 or in the Competition Act, 2002 by way of proposing amendment in these statutes.

Conclusion

By having the proper regulatory mechanism for regulating multilevel marketing and pyramid schemes, serious and non-serious players can be differentiated and interest of the consumers can be protected from the fly by night players in this field. Once the regulatory mechanism will be in place regulatory vacuum in this sector will be fulfilled and chances of unfair practices can be minimized. Regulations for multilevel marketing and pyramid schemes should have to be drafted with the consultation of all stakeholders, so that genuine players in this field should not suffer and those who are practicing fraudulent practices must be punished.

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