

Guidance on multi-level marketing/pyramid schemes

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The Danish Consumer Ombudsman

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Background

The Danish Consumer Ombudsman has revised and updated his guidance on multi-level marketing/pyramid schemes. The guidance may help assess the lawfulness of the many multi-level marketing schemes offered to ordinary consumers. [It should be noted that the second paragraph of item 3.2.3 has been deleted on account of Act no. 595 of 14 June 2011 on trade].

The guidance was last updated in November 2013 as a result of amendments to the underlying legislation.

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Section 1

Introduction

1.1 Background and objective of this guidance

In recent years, the Consumer Ombudsman has channelled considerable resources into investigation of various marketing concepts known as pyramid schemes, multi-level marketing and network marketing, among other things.

This guidance is a result of requests from journalists, public authorities and advisers in general who call for a clear position on schemes that they have encountered in different contexts. Promoters of various schemes have likewise expressed a wish for advice as to the legality of their schemes, as have consumers contemplating participation in these schemes. The Consumer Ombudsman has also conducted investigation into matters on his own initiative.

The aim of this guidance is to establish a Consumer Ombudsman standard procedure for conduct and practices. It is the result of the experience gathered by the Consumer Ombudsman in this area and is available on paper as well as on the Consumer Ombudsman's website.

In what follows, a number of general issues relating to the legality of the different schemes are explained.

Further, some special legislation provisions pertaining to this area have been included.

This guidance is not exhaustive. Schemes existing in the market are often greatly diversified and frequently change. Hence, circumstances surrounding the individual scheme, even if not explicitly touched upon here, may nevertheless give rise to concern. It follows, then, that this guidance is not an approval of some schemes as opposed to others.

Special legislation may also be relevant; although not included here, it may have to be observed in order to ensure a scheme's compliance with the law.

1.2 The schemes and their features

Schemes that have come to the Consumer Ombudsman's attention can be categorised in three groups: A common feature of the schemes is that they have a pyramid form.

Schemes that involve trade of products of real value. Revenue is actually created on the basis of a turnover. The distributor network is often built up to generate profit for participants who, apart from collecting revenue from their own sales, also benefit from sales made by 'downline' participants. These schemes are called multi-level marketing or network marketing.

Schemes that involve trade of products of insignificant or no value. Turnover is based on payments made by participants while revenue generated by actual sales of products is illusory or very slim. These schemes are sometimes – erroneously – called multi-level marketing or network marketing. If no products of real value are traded, it could be an illegal pyramid scheme. However, an individual assessment must always be made.

The last group of schemes is traditionally known as pyramid schemes/chain letters, schemes that operate exclusively with money transactions. The purpose of these schemes is to recruit new participants. Having paid a considerable amount of money, one has in effect 'bought' the right to recruit new members – and the pyramid scheme takes form. Money gradually moves up the scheme as more participants join in.

In the following, the guidance only distinguishes between illegal pyramid schemes and multi-level marketing and network marketing concepts that are generally legal.



Section 2

Illegal pyramid schemes/chain letters

The 1990s saw a number of pyramid schemes in operation in which many people lost large sums of money. The schemes proved difficult to clamp down, however, as they were not dealt with in the legislation in force at the time. This induced the Danish parliament to introduce a ban on pyramid schemes in 2000. See the Danish Public Collections and Pyramid Schemes Act. Pyramid schemes are now regulated by section 24 of the Danish Act on Regulation of Gambling (Act no. 848 of 1 July 2010, as amended).

The Danish Gambling Authority supervises the Act on Regulation of Gambling.

2.1 How to recognize a pyramid scheme

A pyramid scheme is not a lottery in the usual sense of the word, as chances of benefiting from the scheme do not depend on either coincidence or skill; rather, the number of incoming participants determines one's success in the scheme.

Pursuant to section 24 of the Act on Regulation of Gambling, a pyramid scheme is construed as a scheme with a pyramid form where:

- participation requires money or other kind of financial investment;
- participants are promised financial rewards; and
- the reward *primarily* stems from investments made by incoming participants below.

A pyramid scheme involves payment of money or other kind of financial investment that flows from the bottom to the top of the scheme; the turnover may have only little or nothing to do with sales of actual goods and services.

In practice, the supply of potential investors eventually dry up, leaving participants on the last level with considerable losses.

In the case of contributions other than money, an individual assessment must be made as to whether the contribution has any economic value. Contributions consisting of items of insignificant value are not covered by the prohibition.

It will be considered a pyramid scheme only when financial rewards are *primarily* based on payments made by new participants. Payment of money to obtain a "traders right" does not necessarily mean that it is a pyramid scheme. The decisive factor is whether the value of the product being traded is commensurate with the investment made and may be deemed to be part of a usual business relationship. If, on the other hand, the revenue associated with the negotiation of the products is less important than the revenue derived from the recruitment of new participants, this could indicate that it is an illegal pyramid scheme.

Other trading schemes such as multi-level marketing concepts may take a pyramid form, but should not be regarded as pyramid schemes, see below.

Distinguishing between multi-level marketing and a pyramid scheme is often difficult and must be subject to individual assessment; however, where exchange of goods or services is not involved, this will usually turn out to be an illegal pyramid scheme.

An overall assessment of each scheme will be made, including an individual assessment as to where the revenue actually comes from, regardless of what the investment is formally called. One of the objectives of this approach is to prevent any attempts to circumvent the rules.

2.2 Offenders will be prosecuted

Offering pyramid schemes is a criminal offence in Denmark.

One of the implications of this is that the scope of offence has been extended to also include individuals offering pyramid schemes with a view to recruiting new members. This applies whether or not the potential member, in fact, later becomes part of the scheme. Moreover, actions aiming to organise and prepare pyramid schemes may be punishable as attempts or complicity to offer pyramid schemes subject to individual assessment. However, the mere participation in a pyramid scheme in the form of an investment is not a criminal offence under the Act on Regulation of Gambling.

The punishment for offering pyramid schemes is a fine or imprisonment for a period of up to four months and in aggravating circumstances imprisonment for a period of up to two years. See section 59(4) of the Act on Regulation of Gambling.

People who live in Denmark, but promote pyramid schemes abroad to people living in Denmark are also liable to punishment.

2.3 Where to direct enquiries

Citizens holding information about a possible pyramid scheme can contact the Danish Gambling Authority supervising the Act on Regulation of Gambling. The Danish Gambling Authority will investigate whether it is a pyramid scheme and, if relevant, report it to the police.

Have you received an invitation to join a pyramid scheme, or has the existence of one such scheme come to your knowledge in any other way, you should inform the Danish Gambling Authority. For more information, go to www.spillemyndigheden.dk.

However, you can also still contact the police about such matters.

2.4 The legislation on lotteries etc.

Multi-level marketing, network marketing or other similar trading schemes with a pyramid form are generally legal as opposed to pyramid schemes.

If "schemes" in a pyramid form are offered, it is important to note, however, whether such offer requires authorisation from the Danish Gambling Authority and whether it is covered by



Danish gambling legislation. Violation of gambling legislation could be associated with criminal liability.

To read more about the rules in the gambling area, go to the website of the Danish Gambling Authority: www.spillemyndigheden.dk.

Section 3

Multi-level marketing, network marketing or other trading schemes with a pyramid form

As mentioned above, multi-level marketing, network marketing or other similar trading schemes with a pyramid form are generally legal as opposed to pyramid schemes.

However, the Consumer Ombudsman holds the opinion that some aspects surrounding these trading schemes may cause concern. Likewise, a number of rules applying to Danish businesses make it difficult for the schemes to flourish in the Danish market.

The most important provisions in this connection is the ban on "recruiting friends" and the ban on doorstep selling/telephone selling (unsolicited communication).

One should also know the relevant legislation before joining a multi-level marketing scheme. The most important of these rules are reviewed below, but it is not an exhaustive review. It is thus recommended to seek necessary advice beforehand – for example with a lawyer.

3.1 Recruitment of new traders

3.1.1 Recruiting friends

Many multi-level marketing promoters encourage participants to recruit new members through their personal network, e.g. family, friends, colleagues, parents of their children's playmates etc. This is popularly known as recruitment of friends.

The Consumer Ombudsman holds the view that recruitment of friends may violate the principles of good marketing practice - especially if recruitment primarily serves one's own financial interests.

A consumer who is contacted by a friend or family member with a view to persuading him or her to join a scheme will often take a more favourable attitude than if the same enquiry had been made by a business or trader unknown to this person. However, an enquiry, irrespective of personal relations, will always have the same objective: to meet financial obligations as well as get a reward.

At the same time, reference may be made to the judgment delivered by the Maritime and Commercial High Court printed as U.2002.277/2S. The case concerned a telecommunications provider marketing the sale of telephone subscriptions by promising sports clubs certain sums for each subscription taken out through the club. The clubs were to work actively to take out subscriptions among members, etc. The Maritime and Commercial High Court found that the marketing concept was not contrary to section 1 of the Marketing Practices Act although the marketing was also directed at children and young people as they could not take out a telephone subscription on their own.

In cases where a scheme with a pyramid form is based on participants' recruitment of friends, the whole scheme could be violating the principles of good marketing practice.



3.1.2 Potential new traders and marketing

Independent traders involved in multi-level marketing schemes are themselves responsible for acting according to law and with it, the Marketing Practices Act.

Traders must act according to the principles of good marketing practice, see section 1 of the Marketing Practices Act. The law also makes it an offence to use misleading, incomplete or incorrect statements, see section 3 of the Marketing Practices Act. Infraction of the latter provision is punishable by fine.

Needless to say, the other provisions of the Act must likewise be complied with.

Recruitment should be organised in a way as to do away with later doubt as to whether recruitment has actually taken place. A personal signature may be required.

3.1.2.1 Good marketing practice

The principles of good marketing practice should at all times be observed regardless of the marketing method used – this also applies to Internet-related marketing activities.

A multi-level marketing company may not always appear as such at first sight when marketed through preliminary enquiries, advertisements or on the Internet. Often people are not meant to realise it until well into the process. Examples of trader contracts in which it was stated that disclosure as to the true nature of the scheme should be avoided in the marketing have also come to the Consumer Ombudsman's attention. However, the Consumer Ombudsman holds the view that withholding this kind of information, even in the initial stages, is a violation of the principles of good marketing practice.

It is also an instance of violation of the principles of good marketing practice when marketing material is deemed to be of a nature that is likely to violate the ban included in the Danish Consumer Contracts Act on unsolicited enquiries via telephone or unsolicited personal enquiries.

Nor should promoters use intrusive/aggressive marketing methods or use surprise manoeuvres.

When a promoter encourages the use of after-sales marketing in order to follow up on buyers and their purchases, this activity may be in conflict with the principles of good marketing practice. Also, it violates the ban on intrusive/aggressive conduct of business, see section 3(2) of the Marketing Practices Act.

It is also considered improper to encourage participants to borrow money or open an overdraft account where the overdraft is gradually reduced in step with the introduction of new participants to the scheme.

3.1.2.2 Misleading marketing

As mentioned above, marketing should not make use of incorrect, misleading or unreasonably incomplete statements, including unrealistic statements about possibilities of making a profit. See section 3(1) of the Marketing Practices Act.

Statements about possibilities of making profit should be regarded as real facts subject to substantiation under section 3(3) of the Marketing Practices Act. If it is not possible to sub-

stantiate the statements, they will, under the circumstances, be regarded as misleading and hence in conflict with section 3(1) of the Marketing Practices Act.

Further, if a scheme with a pyramid form appears to be non-transparent to the participant, and if the lack of transparency is aggravated by misleading marketing material, then it may conflict with section 3(1) and (2) of the Marketing Practices Act.

In general, it may be in conflict with the ban on misleading statements included in section 3(1) and (2) of the Marketing Practices Act to organise a trader network in a way which is likely to mislead as to the actual possibilities of making a profit.

3.1.3 Recruitment of vulnerable groups or children etc.

Promoters who only look for new participants among children, young people, students or impressionable people may be acting socially irresponsible, and this conflicts with section 1 and possibly section 8 of the Marketing Practices Act.

3.1.4 Recruitment meetings

During recruitment meetings and information meetings, promoters must not use psychological triggers extensively to fuel the impression that joining the scheme can make you rich quick. Psychological triggers of this kind may conflict with the principles of good marketing practice. See section 1 of the Marketing Practices Act.

If promoters organise meetings primarily for people below the age of 18, this may also be deemed socially irresponsible and in conflict with section 1 and section 8 of the Marketing Practices Act.

Invitations for such meetings should clearly state the objective of the meeting.

3.2 How products are sold

Retail points of sale such as business premises are usually not that common in multi-level marketing schemes.

The actual sale or contracts/agreements are therefore primarily regulated under the Consumer Contracts Act.

Note, however, that this does not apply to sales of goods and services intended for resale. A new trader's purchase of goods and services for resale is therefore not considered a consumer purchase, sale or agreement.

3.2.1 Bans on doorsteps selling and telephone sales

A multi-level marketing trader must not direct enquiries to a consumer in his working place or at his address unless on request from the consumer himself.



It follows then, that unsolicited calls or visits to a consumer at his home, at his workplace or in any other places outside public space conflict with the law. See section 6 of the Consumer Contracts Act.

Some exceptions apply. Traders/sellers are allowed to phone without prior request in cases where the following goods and/or services are offered for sale:

- insurance policies
- books
- periodical and newspaper subscriptions
- rescue and ambulance services

Non-compliance with the ban on doorstep selling will be fined, and agreements entered into in connection to this activity will not be binding on the consumer.

Consumers are also, in most cases, owners' associations, non-commercial sports clubs and other non-professional clubs or societies etc. See the Consumer Contracts Act.

A trader is not allowed to direct enquiries to members of his own family or friends with a view to selling his services and goods *without prior request*. A trader is only allowed to call or visit for purposes of demonstrating and selling his products when specifically requested to do so.

3.2.2 Marketing of products and services

As mentioned above, no incorrect, misleading or incomplete statements about the products may be made. See section 3 of the Marketing Practices Act.

3.2.3 Home shopping parties – products demonstrations in private homes

An invitation for a home party should clearly state the objective of the session: to demonstrate products.

[Paragraph deleted on account of Act no. 595 of 14 June 2011 on trade].

Home shopping parties must not be intrusive or aggressive. See sections 1 and 3 of the Marketing Practices Act.

3.2.4 Sales at trade fairs and exhibitions

Permission to sell products at trade fairs and exhibitions is subject to registration with the Danish Business Authority. See section 5 of the Danish Trade License Act.

3.2.5 The right to cancel a purchase

Consumers have the right to cancel a purchase or contract within the first 14 days of any event hosted or arranged by the trader in which an agreement was entered into or a purchase was made. See section 2(2)(ii), paragraph b, of the Consumer Contracts Act.

This also applies to purchases or contracts made in public places, at exhibitions and fairs unless payment take place at the exhibition or fair. See section 2(2)(ii), paragraph c, of the Consumer Contracts Act.

If the purchase or contract was made by the trader visiting the consumer at his home, workplace or elsewhere to which there is generally no access, there is no right of withdrawal if the consumer has expressly requested a visit from the trader with a view to making a contract or a purchase. See section 2(2)(ii), paragraph a, of the Consumer Contracts Act.

In cases where a visit from a trader has not been requested, sale and conclusion of agreements in connection with this will be considered a violation of the law. In the event that sale and conclusion of agreements nevertheless take place, these actions are considered non-binding on the consumer. For both, see sections 6 and 7 of the Consumer Contracts Act and 3.2.1. above.

In the case of distance selling, consumers also have a right of withdrawal within the first 14 days. See section 17 of the Consumer Contracts Act.

Distance selling includes online purchases and mail order sales. See section 4 of the Consumer Contracts Act.

The consumer must be informed of his right to cancel the agreement, see section 9 of the Consumer Contracts Act.

If the agreement is not concluded at the trader's permanent place of business, the consumer must be given his rights in writing.

See section 10 of the Consumer Contracts Act.

Information about rights must also be available on paper or in another durable medium to which the consumer has access if the agreement is concluded via distance selling. See sections 11 and 12 of the Consumer Contracts Act.

The period of cancellation begins when the consumer has been informed of his rights.

Even if the trader does not observe the information duty, the agreement will nonetheless be valid. However, this means that the period in which goods may be returned is extended so that it begins from the time on which information about the right to return goods becomes available in writing to the consumer

As for distance selling, the period of cancellation may be extended no more than 3 months, beginning on the day on which the consumer receives the goods or, in the case of a service, from the day on which the consumer is notified that the agreement has been made. See section 18(3) of the Consumer Contracts Act.

3.2.6 Further obligations to be observed by the trader

When joining a multi-level marketing scheme, you are no longer a consumer; instead, you assume the legal status of trader, and provisions and rules included in the Consumer Contracts Act, the Danish Contracts Act and the Danish Sale of Goods Act on consumer protection must be complied with.

The trader must provide the buyer with information about the product in good faith and may not withhold any important information about the product or its properties. In connection with negotiations about a product requiring guidance (user manual) due to the functional



properties, hazardous nature and maintainability of the product, the seller must provide adequate instructions about it under section 7 of the Marketing Practices Act. At least in the case of technical or hazardous products, it is a requirement that the user manual is in Danish.

Pursuant to section 83 of the Sale of Goods Act, it is possible to complain about defective goods for two years, i.e. the statutory guarantee period that comes with any purchase. The guarantee period cannot be shortened by additional agreements between the parties.

In case of defects found by the consumer, the consumer may contact the trader in order to have it repaired, replaced or to receive a full or partial refund. See section 78 of the Sale of Goods Act. If the seller offers remedial action or replacement delivery, the consumer cannot claim a refund in whole or in part.

Guarantees must always afford the consumer a considerably better legal position than otherwise provided by existing legislation, in this case the Sale of Goods Act. It is a good idea to have a copy of the guarantee in writing. Any written guarantee must be in Danish. See section section 12(2) of the Marketing Practices Act.

If it is a continuing contract for services, attention must be paid to whether unfair contract terms are included in the consumer contract that may be set aside under section 36 and section 38 c of the Contracts Act.

3.3 The trader contract

One of the special characteristics of multi-level marketing schemes that causes problems is that traders often are recruited among ordinary pay earners with little experience when it comes to running a business.

This is a problem for two reasons:

- First, such persons are usually not aware of the rules applicable to traders although they are independently responsible for compliance with the rules. They are consequently used to having the same legal position as consumers.
- Secondly, as traders they generally have the same legal position as the company, but they are, in fact, rather the "weak" party without the same resources to seek advice and assistance in the event of disputes with the company or third parties.

Even if the traders are deemed to be traders in terms of the law, it is the opinion of the Consumer Ombudsman that any assessment of the relationship between the traders and the company should also include consumer-like protective considerations because of the unequal relative strength.

However, this does not change the general rule that a person involved in multi-level marketing acquires legal status as a trader with the duties and obligations this entails.

3.3.1 The parties' duties and obligations in a trader contract

Unreasonable terms in a contract may be set aside under section 36 of the Contracts Act. Terms that are considered unreasonable are also generally in conflict with section 1 of the Marketing Practices Act.

The contract drawn up between the promoter and trader should be in writing, and the duties and obligations of the respective parties should be balanced.

The contract should not be difficult to understand or be written in a font which is too small. Onerous terms must be highlighted.

The trader is not bound by terms of which he has not been informed when signing the contract.

Contract terms not attached or immediately available are not binding.

Contract terms should be included in one single document. The Consumer Ombudsman has seen examples of trader contracts that merely make general references to other documents – for example business terms or marketing plans – which then contain a range of onerous terms. In this connection, the Consumer Ombudsman has stated that all terms should be included in one document which is easy to read and easily available to the trader.

The right to interpret the terms stated in the contract, i.e. to decide whether delivered goods meet the terms, should not be accorded unilaterally to one party.

The duty to fulfil contractual obligations can never be accorded unilaterally.

If one of the parties can unilaterally decide whether an event has occurred changing the relationship between the parties, such term may in any case be set aside under section 36 of the Contracts Act. The contract terms should not be amended unilaterally without reasonable grounds stated in the contract.

A trader who fails to fulfil his obligations should not be under the duty to pay a disproportionate remuneration to the other contracting party.

It must be possible for the trader to terminate the contract by giving a reasonable notice. On the trader's termination of the contract, the promoter should commit himself to take back goods bought by the trader.

The trader contract must not contain any unreasonable choice-of-law clauses or jurisdiction clauses, nor should it include far-reaching non-competition clauses, restrictive covenants or waivers of responsibility.

Unreasonable investment in equipment or goods must not be required. It is considered an unreasonable term of contract to require the trader to invest in equipment or goods before having been approved for the scheme by the promoter. Approval, on the other hand, may be subject to the trader's investment in equipment or goods provided that only a modest amount of money is needed to this end.

Whether collection of administrative fees, annual fees etc. is carried out must be clearly stated in the trader contract.

The promoter must not charge extra fees for assigning a better position to the trader in the scheme.

Information about product liability and defect liability should be included in the trader contract. See the Sale of Goods Act.

To prevent a trader under the contract from contacting public authorities is a violation of the principles of good marketing practice.