



Public Consultation Paper

**Proposed Legislative Amendments
to Eradicate Pyramid Schemes**

Commerce, Industry and Tourism Branch
Commerce and Economic Development Bureau

December 2010

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<http://www.cedb.gov.hk/citb>

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CHAPTER ONE

INTRODUCTION

1.1 The Pyramid Selling Prohibition Ordinance (Cap. 355) (“the Ordinance”) currently prohibits pyramid selling. However, its effectiveness has been eroded by new tactics that have emerged amidst changing socio-economic conditions. The Government has recently completed a review of the Ordinance, targeting at the operation of pyramid schemes and the promotional tactics deployed by participants. We now propose a package of legislative amendments to combat pyramid schemes for public consultation.

Background

1.2 The defining characteristic of pyramid schemes is that participants are required to pay a participation fee¹ to join such schemes in return for the right to receive benefits on the introduction of further new participants. The primary incentive for joining such schemes is to make money by recruiting new participants.

1.3 Pyramid schemes serve no economic purpose. By encouraging the ongoing introduction of members from which recruitment fees are extracted, these schemes would eventually become unsustainable when recruitment runs out, resulting in loss down the line. Since new participants may be recruited from amongst participants’ family members and friends, participants have to come under social or family pressure when the schemes fall through. Furthermore, promoters of some schemes adopt high

¹ The participation fee may take various forms. It may be disguised as a fee for receiving training in marketing (or any other) skills, the completion of which then qualifies the participants to introduce new members.

pressure tactics or make misrepresentation about earning opportunities when recruiting members. There were some cases where participants were tempted to borrow substantive sums (with the help of forged documents in certain cases) to join the schemes, only to find out later that they were unable to recruit enough new participants to gain sufficient recruitment payments to repay their debts.

1.4 Pyramid selling schemes are currently prohibited under the Ordinance. Section 2 of the Ordinance provides that:

“pyramid selling scheme” means a scheme whereby -

- (a) a participant in the scheme is granted a licence or right to introduce another participant into the scheme who is also granted such licence or right and who may further extend the chain of persons who are granted such licence or right, notwithstanding that there may be a limitation to the number of participants or that there may be any further conditions affecting eligibility for such licence or right; and
- (b) a participant receives a reward on, or at any time after, the introduction into the scheme by him of another participant which reward is based, whether wholly or in part, otherwise than on **the fair market value of goods or services actually sold** by him or by or through that other participant (emphasis added).

1.5 Section 3 of the Ordinance provides that any person who knowingly promotes a pyramid selling scheme commits an offence and is liable on conviction upon indictment to a fine of \$100,000 and to imprisonment for 3 years. Section 2 defines “promote” to mean “establish, advertise, manage or assist in the management of a pyramid selling scheme”.

1.6 Under section 4 of the Ordinance, where an offence has been committed by a body corporate, a director, secretary, principal

officer or manager of that body corporate commits a like offence.

1.7 In recent years, there have been a number of complaints concerning pyramid schemes and related promotional tactics. During the period from 2007 to September 2010, the Police received 10 complaint cases related to suspected pyramid selling schemes and subsequently arrested 27 persons in connection with five of the cases. After investigation, no prosecution was made due to insufficient evidence. During the same period, the Police received 148 complaint cases related to objectionable marketing tactics adopted by marketing companies or their agents. After investigation, 8 cases were found to be related to offending acts of a criminal nature (including withholding other people's goods, supplying other persons with or abetting others to use false documents to secure loans). The Police arrested 11 persons, and one of them was convicted by the Court of "using a false instrument" and was sentenced to imprisonment.

CHAPTER TWO

REVIEW AND OUTCOME

2.1 We have reviewed the effectiveness and operation of the Ordinance, having regard to regulatory regimes in other jurisdictions and the views of Members of the Legislative Council. This Chapter sets out the outcome of the review.

Regulatory Approach

2.2 Under the existing regulatory regime implemented through the Ordinance, express provisions are in place to prohibit undesirable pyramid selling schemes. The great majority of countries and economies, including the United Kingdom, Ireland and Australia², adopt a similar approach. In the Mainland of China and Singapore, a total ban on marketing schemes adopting a multi-level structure is imposed. Only schemes meeting specified requirements and registered with competent authorities are allowed³. The regulatory regime in Taiwan amalgamates the above two approaches: on the one hand, “distorted multi-level selling activities” (meaning arrangements where participants receive economic benefits mainly from introducing others to participate, rather than from the marketing or sale of goods or

² United Kingdom: paragraph 14 of Schedule 1 to the Consumer Protection from Unfair Trading Regulations 2008; Ireland: sections 64 to 66 of the Consumer Protection Act 2007; Australia: sections 65AAA to 65AAE of the Trade Practices Act 1974 and sections 44 to 46 of the Australian Consumer Law (contained in Schedule 1 to the Trade Practices Amendment (Australian Consumer Law) Act (No. 2) 2010).

³ Mainland China: Regulations on Prohibition of Multi-level Marketing Activities and Regulations on Administration of Direct Selling Activities; Singapore: Multi-level Marketing and Pyramid Selling (Prohibition) Act and Multi-Level Marketing and Pyramid Selling (Excluded Schemes and Arrangements) Order 2000.

services or from work rendered at reasonable market prices) are prohibited. At the same time, a series of record-filing requirements concerning the operations of multi-level marketing schemes are laid down⁴.

2.3 We consider that the regulatory approach currently adopted in Hong Kong, i.e. enacting express provisions prohibiting pyramid selling schemes, is in line with international practices and appropriate to our legal and economic environment. Such an approach will avoid over-regulation on legitimate multi-level marketing schemes⁵. We therefore propose to maintain our current approach and consider appropriate legislative amendments on the basis of the Ordinance.

Legal Definitions

2.4 We consider that the current provisions of the Ordinance, particularly the definition of “pyramid selling scheme”, are no longer effective in combating objectionable schemes which adopt a pyramid structure in various guises. In 2003 and 2004, when ruling on two cases involving alleged pyramid selling schemes (CACC 96/2003 and CACC 55/2004), the Court of Appeal acquitted the defendants in both cases of charges of breaches of the Ordinance. In the judgments, the Court of Appeal raised the following problems in relation to the definition of “pyramid selling scheme” in the Ordinance:

- (a) section 2(b) of the Ordinance implies that the operation of a pyramid selling scheme **must** involve the selling of

⁴ Article 23 of the Fair Trade Act and the Supervisory Regulations Governing Multi-Level Marketing Activities.

⁵ Legitimate multi-level marketing schemes involve genuine selling activities. The income or benefits that members in such schemes can receive come mainly from the selling activities of their own and/or from the selling activities of any further new members that they may have introduced. On the contrary, participants are incentivized to join pyramid schemes by the benefits derived primarily from the recruitment of further new participants. Multi-level marketing schemes can provide earning opportunities for those who prefer to work outside conventional office hours or settings. They may also help meet the shopping needs of consumers who prefer more personalized services.

goods or services, which means that schemes not involving the sale of goods or services would fall outside the scope of the Ordinance; and

- (b) section 2(b) is also taken to imply that that a pyramid selling scheme must involve the sale of goods and services **by participants**. This means that schemes under which goods or services are not sold by participants (for example, sold by the company directly to new participants) would fall outside the scope of the Ordinance.

2.5 As indicated in the judgments, there are loopholes in the provisions of the Ordinance that have to be plugged. As mentioned in paragraph 1.7 above, of the complaint cases reported, only a few led to successful prosecutions, and conviction was based on criminal offences other than those prescribed under the Ordinance. Pending the completion of the amendment exercise, the Police will continue to tackle schemes adopting a pyramid structure on the basis of existing criminal offences, such as “fraud” contrary to section 16A of the Theft Ordinance (Cap. 210) and the common law offence of “conspiracy to defraud”. Besides, the charge of “using a false instrument” may be pursued if participants abet or induce new participants to borrow money with false instruments.

CHAPTER THREE

PROPOSED AMENDMENTS

3.1 On the basis of the outcome of the review, we propose to amend the Ordinance with the objective of defining more clearly what constitutes a “pyramid scheme”. We consider that the new definition should be based on its fundamental characteristic and stipulate clearly that the incentives for participants to join such a scheme come from benefits which are primarily derived from the recruitment of new members. Besides, to plug the loopholes mentioned in paragraph 2.4 above, we should also make it clear in the law that a scheme can be deemed to be a pyramid scheme even if no sale of goods or services is involved. Furthermore, the level of penalty prescribed under the Ordinance should carry a sufficient deterrent, having regard to the harm done to society and individuals and the level of penalties for offences of a similar nature.

Proposals

3.2 We propose that the Ordinance be amended in the following manner⁶:

- (a) to revise the definition of “pyramid scheme” along the following lines:
 - (i) to define “pyramid scheme” as a scheme in which new participants must make a payment (or other consideration) and such a payment or consideration is entirely or substantially induced by the prospect held out to the new participants that they will be entitled to receive a benefit

⁶ Subject to the outcome of public consultation, the proposed formulations would be subject to further refinement at the legal drafting stage.

(financial or otherwise) substantially relating to the introduction of further new participants;

(ii) on the basis of (i), a scheme may be a “pyramid scheme” no matter whether it involves the marketing or supply of goods or services (or both) by participants or by other persons or entities;

(iii) if a scheme involves the marketing or supply of goods or services (or both), in determining if the scheme is a pyramid scheme, the court may have regard to the following factors and any other factors as it may consider appropriate:

- whether, in the promotion of the scheme, any emphasis has been given to the entitlement of participants to the benefit receivable for the introduction of new participants; and

- to what extent the payment made by new participants bears a reasonable relationship to the value of the goods or services. The court may if appropriate, draw reference from the price of the same or comparable products available elsewhere.

(b) to provide that any person who knowingly establishes, manages or promotes a pyramid scheme commits an offence under the Ordinance;

(c) to provide appropriate defences for publishers who innocently published advertisements promoting pyramid schemes; and

(d) to increase the **maximum** penalty to imprisonment for 7 years and a fine of \$1 million on conviction upon

indictment⁷.

Other Relevant Issues

(a) Criminal Liability for Participation in Pyramid Schemes

3.3 We would also like to invite public views on the question of whether persons who participate in pyramid schemes should shoulder criminal liability. While there is consensus in the community that persons establishing, promoting or managing a pyramid scheme should be sanctioned, views are varied as to whether persons who participate in a pyramid scheme in order to obtain benefits from recruitment fees should also be held responsible.

3.4 Since a pyramid scheme cannot be sustained if not for the introduction of new participants by existing participants, there are views suggesting that participants should be treated on par with persons establishing, promoting or managing a pyramid scheme and be subject to sanctions. We consider that there are valid grounds for such views. In Australia and Ireland for example, participants are held liable for criminal offences. To combat and curb the expansion of pyramid schemes, we propose that additional provisions be added in the Ordinance with a view to deterring people from participating in and inducing others to join pyramid schemes through the introduction of criminal sanctions. In order not to cast the net so wide as to catch innocent participants who may be lured into joining the scheme, we propose that the legislative amendments should be targeted at those **who induce or attempt to induce other persons to participate in the scheme, with the knowledge that the benefits they may get from joining**

⁷ In making this proposal, we have paid regard to the penalties for existing offences of a like nature. The offence of fraud under section 16A of the Theft Ordinance (Cap. 210) and the common law offence of conspiracy to defraud both carry a maximum penalty of 14 years' imprisonment without a fine. The offence of "fraudulently inducing persons to invest money", contrary to section 107 of the Securities and Futures Ordinance (Cap. 571), carries a maximum sentence of 7 years in prison and a fine of \$1 million.

the scheme are entirely or substantially derived from the introduction of further new participants.

(b) Penalty Level

3.5. Apart from proposing to impose criminal liability on participants, we need to consider how to set the level of penalty. In both Australia and Ireland, a single maximum penalty level is set for promoters, establishers and participants of pyramid schemes. The court will have regard to all relevant factors (such as the extent of involvement and the role of the convicted in the offending conduct) when handing down sentences. It is for consideration whether the maximum level of penalty should be set at the same level for participants as that proposed for the offence of establishing or promoting a pyramid scheme (i.e. imprisonment for 7 years and a fine of \$1 million, see paragraph 3.2(d) above). In view of the fact that pyramid schemes live on participation, the effectiveness of the Ordinance in combating pyramid schemes would be compromised if participants were exempt from criminal liability. We are prepared to consider any different views that the public may have.

CHAPTER FOUR

COMMENTS SOUGHT

4.1 We welcome views from the public on the proposals set out in Chapter three. Comments can be submitted by mail, facsimile or email on or before 31 January 2011:

Address : Special Duties Division
Commerce, Industry and Tourism Branch
Commerce and Economic Development Bureau
Level 29, One Pacific Place
88 Queensway
Admiralty
Hong Kong
Fax number : 2869 4420
E-mail address : pyramid@cedb.gov.hk

4.2 It is voluntary for any member of the public to supply his/her personal data when providing views on this consultation document. Any personal data provided with a submission will only be used for the purpose of this public consultation exercise. The submissions and personal data collected may be passed to relevant Government bureaux and departments for purposes directly related to this consultation exercise.

4.3 This Bureau may publish the submissions made in response to this consultation document for public viewing after the conclusion of the public consultation exercise. If you do not wish your name or your affiliation (or both) to be disclosed, please state so when making your submission.

4.4 Any sender providing personal data to this Bureau in the submission will have the rights of access and correction with respect to such personal data. Any requests for data access or

correction of personal data should be made in writing to:

Address: Special Duties Division
Commerce, Industry and Tourism Branch
Commerce and Economic Development Bureau
Level 29, One Pacific Place
88 Queensway
Admiralty
Hong Kong
Fax number: 2869 4420
E-mail address: pyramid@cedb.gov.hk