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RESEARCH PAPER

Legal aspects of multilevel marketing in India: negotiating through murky waters

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Abstract The direct selling industry is one of the fastest growing industries in India. Despite the prevalence of this business model since 1990s, India has neither provided for an exclusive regulatory framework nor attempted to define and differentiate the multilevel marketing schemes from comparable but illegal pyramid/Ponzi schemes. The ambiguity in the Indian regulatory environment has been a subject of intense discussion in the recent times specifically in relation to the operation of Amway India Enterprises. The incident with Amway exposed simultaneously, the vulnerability of doing business in an uncertain legal environment that lacks regulatory clarity and the potential for misuse by enforcement authorities and also the vulnerability of consumers who are party to such business transactions, with the law not providing definite recourse. In the backdrop of this incident, this paper attempts to understand the facets of multilevel marketing, a concept recognized and accepted, but regulated worldwide. The paper shall examine the legality of multilevel marketing in the context of the Indian PCMCS Act 1978 with a view to understand and differentiate genuine multilevel marketing companies from pyramid schemes run by fly-by-night operators, an activity considered illegal universally. The paper shall also examine the legality of the multilevel marketing schemes in India in the backdrop of the *Amway* fiasco, the judicial interpretations and the existing legal framework from a comparative perspective.

Keywords Direct selling · Multilevel marketing · Pyramid schemes · Legality · Amway India

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Introduction

Direct selling is a century-old business model well recognized and accepted in more than 170 countries. The industry has evolved as one of the biggest revenue and employment generators and has attained the status of a global industry (Micklitz et al. 1999; Albaum and Peterson 2011). In 2013, the global direct sales industry was estimated at US $178,521 million employing more than 96 million personnel, predominantly women.[1] The direct selling industry is one of the fastest growing industries in India especially in the non-store retail format. The Indian industry is estimated at US $1175 million with about 5,775,345 personnel employed by it.[2] The industry has recorded a double-digit growth of more than 20 % during the period 2008–2013 and has the potential to reach a size

[1] WfDSA Sales Report 2013 <http://www.wfdsa.org/files/pdf/global-stats/Sales_Report_2013.pdf> (accessed 23 Mar 2015).

[2] *Ibid*.

of INR 645 billion by 2025 (KPMG 2014: 6). Despite the prevalence of this business model since 1990s, India has neither provided for an exclusive regulatory framework nor attempted to define and differentiate the direct selling and multilevel marketing schemes from comparable but illegal pyramid/Ponzi schemes. The ambiguity in the Indian regulatory environment has been a subject of intense discussion in the recent times specifically in relation to the operation of Amway India Enterprises a wholly owned subsidiary of Amway Inc., United States (US), in India.

The trouble for Amway India Enterprises, one of the premier multilevel marketing companies in India started in 2006 when the company and the management thereof was accused of indulging in promoting an illegal money circulation scheme and cheating the public with the promise of getting-rich-quick scheme in the guise of sale of health and dietary supplement products. Charges were filed under various sections of the Indian Penal Code (IPC) and under the provisions of the Prize Chits and Money Circulation (Banning) Act 1978 (PCMCS). Thereon, complaints were initiated in several states of India.[3] The arrest of Amway India CEO, William Pinckney, in 2014 escalated the issue, drawing sharp reactions from industry associations such as the American Chamber of Commerce (AMCHAM), Federation of Indian Chambers of Commerce and Industry (FICCI), Indian Direct Selling Association (IDSA), etc. More importantly, they sought operational and definitional clarity in the Indian law and emphasized on the urgent need to amend the PCMCS Act 1978.

The incident exposed simultaneously, the vulnerability of doing business in an uncertain legal environment that lacks regulatory clarity and the potential for misuse by enforcement authorities and also the vulnerability of consumers who are party to such business transactions, with the law not providing definite recourse. It is the ambiguity in the Indian law that led to equation of multilevel marketing with fraudulent pyramid/Ponzi schemes, thereby casting a shadow over a business model legitimately practiced around the world. In the backdrop of this incident, this paper attempts to understand the facets of multilevel marketing, a concept recognized and accepted, but regulated worldwide. The paper shall examine the legality of multilevel marketing in the context of the Indian PCMCS Act 1978 with a view to understand and differentiate genuine multilevel marketing companies from pyramid schemes run by fly-by-night operators, an activity considered illegal universally. The paper shall also examine the legality of the multilevel marketing schemes in India in the backdrop of the *Amway* fiasco, the judicial interpretations and the existing legal framework from a comparative perspective.

The concept

Direct selling is one of the oldest methods of commercial distribution known to mankind (Petersona and Wotrubab 1996). According to the IDSA direct selling is defined as "marketing of consumer products/services directly to the consumers generally in their homes or homes of others, at their workplace and other places away from permanent retail locations, usually through explanation or demonstration of the products by a direct seller."[4] Most direct selling associations have adopted a more or less consistent and similar definition. For example, the Direct Selling Association of the US defines direct selling as "the sale of a consumer product or service, person-to-person, away from a fixed retail location, marketed through independent sales representatives who are sometimes also referred to as consultants, distributors or other titles."[5] Direct selling offers a specialized channel of distribution that is neither wholesale nor retail, and covers both business-to-business and business-to-consumers

[3] The first case was initiated in Andhra Pradesh in 2006. Cases where registered against Amway in the Indian States of Kerala, Andhra Pradesh, Delhi in 2012 by the Crime Branch (Economic Offences Wing) of Kerala Police for money-chain activities. In 2013, the Delhi Police arrested the Managing Director of Amway for an alleged violation of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 and charged with Section 420 of Indian Penal Code (IPC), 1860. Crime Branch, Delhi Police Report, <http://delhipolice.nic.in/home/backup/26-11-2013.doc> (accessed 23 Mar 2015).

[4] What Is Direct Selling <http://www.idsa.co.in/WhatIsDirectSelling.html>, (accessed 23 Mar 2015). The Direct Selling Association of the United States provides *direct selling is the sale of a consumer product or service, person-to-person, away from a fixed retail location, marketed through independent sales representatives who are sometimes also referred to as consultants, distributors or other titles.* <http://www.directselling411.com/> (accessed 23 Mar 2013).

[5] What is Direct Selling? <http://www.directselling411.com/> (accessed 23 Mar 2015).

aspects.[6] The advantage associated with direct selling is the fact that it makes selling in new markets and selling of new products easier compared to conventional marketing.

One variant of direct selling is 'multilevel marketing' also known as network marketing. A multilevel marketing company is like any other company (or partnership) except that it adopts a distinctive marketing model for selling their products. Rather than adopting advertising and other traditional marketing methods, they approach the consumers directly. For this purpose, they sign up distributors who get commissions not only from the sales of the product, but also from the sales of the 'downline' distributors whom they recruit.[7] Unfortunately, the multilevel marketing model has been used by some companies which run illegal pyramid schemes that exploit 'downline' members of the organization. This has brought multilevel marketing infamy, thereby running the risk of legitimacy. Thus, understanding the difference between a legitimate and an illegal multilevel marketing is critical for the company operating in any legal system.

Multilevel marketing

The multilevel marketing model is a type of direct sales wherein the participants engage as independent agents, without being technically part of the organization. According to Keep et al. (Keep et al. 2014), multilevel marketing is a way of distributing products or services by which the distributors earn income from their own retail sales and from the sales/purchases by those whom they directly or indirectly enroll (Babener 2015). As each independent agent makes sales, they receive a commission. After recruiting other independent agents, the recruited agents become a part of the participant's downline. The agents who recruit the downline are referred to as upline and receive a combined commission from their sales and the downline's sales (Muncy 2015). In other words, in the multilevel marketing model 'products are distributed from one level of distributor to another and compensation is based not only on one's own product sales, but on the product sales of one's downline.'[8]

Multilevel marketing is thus basically a distribution and compensation plan as it not only involves the distribution of products and services but also involves compensation for the sale of the products and services by a person himself and also by the person who has been brought into the business by the former. In this form of business, the direct sellers are independent (buy/sell) dealers who may:

(a) purchase the company's products at a rebated price for resale or own and the family's use or consumption;
(b) resell them to consumers and/or independent dealers; and
(c) recruit (sponsor) other independent dealers who in turn may recruit additional independent dealers (Pareja 2008).

They receive overrides based upon their own sales (or purchases) of such products as well as upon the sales (or purchases) of independent dealers in their direct recruiting line to the extent defined by the company marketing plan.[9] For example, the multilevel marketing model would pay a direct commission of 25 % on retail sales, with overrides as follows: 15 % of volume generated by independent dealer's direct enrollees (level 1); then 10 % of volume generated by level 2; and 5 % of volume generated by level 3 and so on (Babener 2015).

According to the World Federation of Direct Selling Association (WfDSA) 'multilevel marketing' is not truly marketing at all. It is simply one of a variety of methods of organizing and compensating salespeople in a direct selling business for management, training, motivating and recruiting persons who will sell their companies' products.[10] Thus, at best, the concept may be described as a direct selling

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[6] PHD and IDSA, *The Indian Direct Selling Industry- Annual Survey* 2011–12, at 11 <http://phdcci.in/file/thematic_pdf/Indian%20Direct%20Selling%20Industry-2011–12.pdf> (accessed 7 June 2015)

[7] FTC, The Bottom Line About Multilevel Marketing Plans and Pyramid Schemes, *Federal Trade Commission Bureau of Consumer Protection* October 2009.

[8] DSA Frequently Asked Questions <http://www.dsa.org/about-direct-selling/faqs> (accessed 23 April 2015).

[9] Glossary of Terms, *Door to Door Selling—Pyramid Selling—Multilevel Marketing,* A Study Commissioned by the European Commission, Final Report, vol. 2: Analysis, November 1990, <http://ec.europa.eu/consumers/cons_int/safe_shop/door_sell/sur10_02.pdf> (accessed 23 Mar 2015).

[10] WfDSA, Multi-Level Marketing <http://www.wfdsa.org/legal_reg/index.cfm?fa=multimarketing>.

compensation plan in which salespeople may receive compensation in two fundamental ways—either from their personal sales of goods and services to consumers or from the sales of those persons they have personally recruited or sponsored into the plan. Additionally, they may also earn compensation from the sales of the group or the network recruited or sponsored into the plan by those they have personally recruited.[11] Thus, multilevel marketing offers a direct seller the opportunity to build one's own independent business selling goods and services to consumers and developing and training an organization or network of direct sellers to do the same.[12]

Understanding and differentiating multilevel marketing from pyramid and Ponzi schemes

Understanding the business model is of prime significance in order to distinguish legitimate multilevel marketing from illegal pyramid scheme, including Ponzi schemes, to suggest legal and policy interventions. Indeed, both multilevel marketing and illegal pyramid schemes share a similar pyramid structure. Pyramid schemes also claim themselves to be in the business of selling products to consumers in order to present themselves as a legitimate multilevel marketing company. However, illegal pyramid schemes are business structures in which only the people who are at the top of the pyramid structure get money and everyone else below them is duped.[13] Little or no effort is made to actually market the product and money is made in a typical pyramid fashion i.e. by recruiting other people to market the program.[14] The promoters of so-called pyramid 'investment' or 'trading' schemes enrich themselves in a geometric progression through the payments made by the recruits to such schemes (Beasley 2012).

According to, Koehn (2001) in a pyramid scheme, the investor pays for the opportunity to receive compensation when his or her recruit brings others into the scheme. The 'opportunity to recruit', according to Koehn is 'the product' in an illegal pyramid scheme (Bhushan 2014). For, Hyman (2007) the illegality of a pyramid scheme lies in, *first*, the derivation of profits out of the *recruitment of other people* rather than *actual sale* of goods and services; *second, payment of a large amount of fees* for enrolment and sales kit at the time of joining and *third,* pressurizing into *stockpiling large quantities of non-returnable inventory* (Grayson 2015).

The newly introduced are generally persuaded to buy overpriced products/services at time of signing up. All the profits made by the pyramid companies virtually come from the introduction of the new recruits into the scheme. In this process attempts are often made to project entry fees as the price charged for mandatory purchases of training, computer services, or product inventory.[15] Such schemes are bound to fail as the primary source of earning in a pyramid scheme is the recruitment of new recruits which is very likely to dwindle over a period of time.

Multilevel marketing companies, in contrast, use independent representatives to sell products or services to their family, friends, and acquaintances. Such a representative earns commissions from her retail sales and also from retail sales made by her recruits.[16] WfDSA clarifies that the compensation in a legitimate direct selling company which utilizes multilevel marketing plan, is derived primarily from 'sales of goods' and 'services to ultimate consumers and users' and not from the mere act of recruiting new members.[17] This makes the business model sustainable.

Whereas, illegal pyramid schemes take advantage of and defraud people as they promise large earnings with little effort; promise that one can earn a substantial income merely by recruiting people into the scheme or arrangement; may or may not have a product to sell, but if at all there is, it generally has little or no actual value; convince people to buy large amounts of products which they cannot easily sell to

[11] *Ibid.*

[12] *Ibid.*

[13] *Ibid.*

[14] Direct Selling Education Foundation, Consumer Protection Toolkit <http://www.dsef.org/wp-content/uploads/2015/03/DSEF-Consumer-Protection-Toolkit.pdf> (accessed 6 May 2015).

[15] State of Michigan Attorney General Bill Schuette, Multi-Level Marketing or Illegal Pyramid Scheme? <https://www.michigan.gov/ag/0,4534,7-164-17337_20942-208400–,00.html> (accessed 6 April 2015).

[16] *Ibid.*

[17] Multi-Level Marketing <http://www.wfdsa.org/legal_reg/index.cfm?fa=multimarketing> (accessed 6 April 2015).

others and is not returnable (inventory loading); charge large amount of fees to get involved, either as a direct payment or in the form of an obligatory payment for products; try to pressurize people to sign up immediately by suggesting that the same opportunity will not be available later; and base compensation primarily on recruitment of other members into the scheme (headhunting fees).[18]

For the US Federal Trade Commission (FTC), the legitimacy of the multilevel marketing model boils down to the 'products.' If the company and its independent distributors make money *primarily* from the sale of products to end-users (and not boxes of product accumulating in a distributor's garage), it's the model may be considered legitimate.[19] By contrast, if the scheme compensates only those at the top of the pyramid with participation fees paid by those recruited at the bottom, the model will be classified as an illegal pyramid scheme.

To differentiate legitimate multilevel marketing schemes from illegal pyramid schemes, the US DSA has laid down number of criteria for the companies.[20] Legitimate multilevel companies must:

(a) provide accurate information about the company, its products and what one can expect as a seller of the company's products and services;
(b) charge only a nominal fee for a starter kit usually including items such as samples, catalogs, order forms and other tools that help the seller begin selling;
(c) have a product or service that is competitive in the marketplace and is purchased by the ultimate user;
(d) require sellers to hold little or no inventory and have a buyback policy to protect against inventory loading;
(e) base compensation *primarily* on the sale of products and services to the ultimate user.[21]

It is worth noting here that although the terms 'pyramid schemes' and 'Ponzi schemes' are often interchangeably used, there are certain differences between the two. As encapsulated by the US Securities and Exchange Commission (SEC), the primary difference lies in the way the profit is generated in the two schemes. A pyramid scheme involves making a one-time payment and recruiting others to become the members of the scheme and distributors of the product which may be purported to be sold by the scheme. On the other hand, a Ponzi scheme does not involve any sale of a product. Instead all it requires is a simple handing over of the money of which investment is promised to be made. However, in reality either no investment is made at all or a very small percentage of the funds received are invested.[22] In the words of Adam Epstein, a Ponzi scheme does not provide any upline–downline commission incentive arrangement in which participants share a vested interest and it does not reward for selling products or recruiting new members (Micklitz et al. 1999). Further, as regards the demise of a pyramid scheme and a Ponzi scheme, the reasons are different. A Ponzi scheme has to ultimately fail because the investment upon which it was dependant either never existed or was grossly overvalued, whereas, a pyramid scheme is bound to fail for the reason that it requires an exponential increase in the downline recruits which is over a period of time impossible to attain (Hyman 2007).

The strongest critics of the multilevel marketing, however, argue that essentially there is no difference between multilevel marketing and pyramid schemes, and the industry's secret stay safe because of cult like mentality and a blind eye of regulators (Hyman 2007). They argue that most multilevel marketing schemes are by nature deceptive because the promotional materials used to recruit sales associates reflect impossible outcomes for almost all targets (Grayson 2015). Further, all multilevel marketing schemes suffer from the same fundamental flaw—their dependence on endless chains of newly recruited members. It has also been said that multilevel marketing are pyramid schemes that the government allows only because they have a 'tangible product' to sell that is used to make the structure appear legitimate (Karp 2013). There also exists skepticism as to the ethical

[18] *Ibid.*

[19] Multilevel Marketing <https://www.ftc.gov/tips-advice/business-center/guidance/multilevel-marketing> (accessed 6 May 2015).

[20] DSA, 'The Difference Between Legitimate Direct Selling Companies and Illegal Pyramid Schemes' <https://www.dsa.org/ethics/legitimatecompanies.pdf>.

[21] *Ibid.*

[22] Ponzi scheme <http://www.sec.gov/answers/ponzi.htm#PonziVsPyramid> (accessed 20 May 2015).

dimension of multilevel marketing schemes. According to Hyman, multilevel marketing schemes are unethical as they try to abuse and capitalize on familial relationships as well as on professional-client relationships. Besides, the methods used to recruit new members, such as propagation of myths that anyone can be a salesman and that multilevel marketing is road to the riches, are socially and psychologically unacceptable (Grayson 2015). Lastly, the identification of a pyramid scheme can be difficult as multilevel marketing schemes typically have product sales, along with recruitment fees and recruitment incentives and thus it gets cloudy when there is a situation involving incentives for both sales and recruitment (Karp 2013).

Regulatory framework for multilevel marketing

Since there is an absence of any specific legislation in India aimed at regulating direct selling and multilevel marketing, it may be helpful to understand as to how the business practice is treated in other major national legal regimes. In this part we shall consider the legal framework and judicial views of jurisdictions such as the US, the European Union (EU) and Singapore.

US Legal framework for multilevel marketing

The FTC is one of the key agencies that regulate direct selling and multilevel marketing in the US. The FTC is mandated to protect consumers from unfair, deceptive and fraudulent practices in the marketplace and ensuring competition by challenging anti-competitive practices that would have adverse effect on consumers.[23] Despite the fact that most famous multilevel marketing companies are US based, multilevel marketing schemes have been quite controversial and accordingly have been on the FTC watch-list. However, in the US there exists no Federal statute dealing with direct selling and particularly, multilevel marketing and illegal pyramid selling schemes. The FTC Business Opportunity Rules of 2011[24] were adopted to prevent unfair and deceptive practices in the sale of business opportunities through pre-sales disclosure of specific material information. The FTC while acknowledging the problems associated with the multilevel marketing industry, is of the opinion that Business Opportunity Rules are not the appropriate vehicle to address this problem. Accordingly, the definition of a "Business Opportunity" was considerably watered down to avoid the unnecessary inclusion of legitimate multilevel marketing schemes.[25] The FTC has also taken the view that deceptive practices by multilevel marketing industry could be challenged under section 5 of the FTC Act.[26]

So far as the states are concerned, almost all of them have enacted laws to regulate multilevel marketing schemes. (Keep et al. 2014) For example, the Section 327 of the California Penal Code penalizes contrivance, preparation, setting up, proposition and operation of an 'endless chain' by an imprisonment. The terms 'endless chain' has been defined to mean

> 'any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the *chance to receive compensation for introducing one or more additional persons into participation in the scheme* or for the chance to receive compensation when a person introduced by the participant introduces a new participant…'

Similarly, Oregon defines 'pyramid club' as a 'sales device whereby a person, upon condition that the person make an investment, is granted a license or right *to solicit or recruit for economic gain one or more additional persons* who are also granted such license or right upon condition of making an investment and who may further perpetuate the chain of persons who are granted such license or right upon such condition.'[27] It may be noted that although different in wordings, the underlying essence of both these provisions is same. They both are aimed at

[23] FTC, What we do, <https://www.ftc.gov/about-ftc/what-we-do> (accessed 20 May 2015).

[24] FTC, Disclosure Requirements and Prohibitions Concerning Business Opportunities (Business Opportunity Rule), 16 CFR Part 437 Federal Register, Vol. 76, No. 236, December 8, 2011 p. 1.

[25] See, Discussion related to the formulation of Section 437.1(c) defining "Business Opportunity" in Federal Register, *ibid.*

[26] Section 5 of the FTC Act 'prohibits any 'unfair methods of competition…and unfair or deceptive acts or practices in or affecting commerce.'<http://www.directselling411.com/about-direct-selling/industry-self-regulation/federal-legal-framework/>.

[27] Section 646.609, Oregon Revised Statutes 2013.

regulating schemes sole basis whereof is payment of compensation and introduction of new members into the scheme. However, the different States have different laws and the jurisdictional issues may make enforcement problematic. Thus, at the federal level the FTC is left with section 5 of the FTC Act to initiate action against illegal pyramid schemes.

One of the most important decisions of the FTC in the context of multilevel marketing was the *Koscot Interplanetary Inc* case.[28] In this case, the FTC has evolved a two pronged test to recognize illegal pyramid schemes:

> Such schemes are characterized by the payment by participants of money to the company in return for which they receive (1) *the right to sell a product* and (2) *the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users.* In general such recruitment is facilitated by promising all participants the same '*lucrative*' rights to recruit.[29]

Violations of the *Koscot* standard must be determined using an analysis of whether or not sales of product to ultimate users are taking place and driving the compensation mechanism, and in light of what features exist in the plan to prevent the evils of a pyramid scheme.[30]

Another major decision of the FTC was the *In re Amway* case[31] which established the distinction between an illegitimate pyramid scheme and legitimate multilevel marketing. Since the distributors of Amway were compensated both for selling products to consumers which included retail sale to the consumers and also to the sponsored and newly-recruited distributors, an issue arose as to whether Amway was a legitimate multilevel marketing program or was in fact a pyramid scheme. The FTC held that:

> Pyramid sales plans involve compensation for recruiting regardless of consumer sales. In such schemes, participants receive rewards for recruiting in the form of headhunting fees or commissions on mandatory inventory purchases by the recruits known as 'inventory loading.
>
> Pyramid sales plans based on inventory loading or head-hunting fees create an incentive for recruiting rather than selling products to consumers. This potentially results in the number of recruits outgrowing the market for products being sold to consumers. The Amway sales and Marketing Plan provides incentives for sponsoring which are based on the sales of products to consumers. It is not a pyramid sales plan.

Thus, the FTC upheld the legitimacy of the business plan of Amway because of the following reasons (a) it provided for buy-back of the goods of terminating distributors (b) it required the customers to have sales to at least ten persons per month, and (c) it required distributors to sell 70 % of the products they purchased each month to non-distributors.[32] However, the Commission found that Amway 'have agreed, combined and conspired with each other and Amway distributors to fix resale prices for Amway products, on sales between Amway distributors and to consumers, in violation of section 5 of the FTC Act.[33]

The US Court of Appeals reaffirmed the decision of the *Amway* in *US vs. Gold Unlimited Inc.*[34] and *Webster vs. Omnitrition.*[35] Sergio Pareja ,Pareja 2008 however, is skeptical that the three steps or safeguards, also known as Amway safeguards, established in *Amway* have rendered it difficult for the FTC to

[28] *Koscot Interplanetary Inc.* 86 F.T.C. 11106 (1975), recruitment with rewards unrelated to product sales, is nothing more than an elaborate chain letter device in which individuals who pay a valuable consideration with the expectation of recouping it to some degree via recruitment are bound to be disappointed. Cf. *Twentieth Century Co. Quilling*, 130 Wis. 318, 110 N.W. 173, 176.

[29] *Ibid.* at 1180.

[30] Legitimate Direct Selling v Illegal Pyramid Schemes, *A White Paper*, Direct Selling Association, <https://www.dsa.org/ethics/internalconsumptionwhitepaper.pdf> (accessed 30 May 2015).

[31] *In the Matter of Amway Corporation, Inc., et al.,* 93 FTC 618 (1979).

[32] *Ibid.* at 716. The'70 percent rule' provides that '[every] distributor must sell at wholesale and/or retail at least 70 % of the total amount of products he bought during a given month in order to receive the Performance Bonus due on all products bought….' This rule prevents the accumulation of inventory at any level …[T]he buy-back rule, the 70 percent rule, and the ten customer rule are enforced, and … they serve to prevent inventory loading and encourage retailing.

[33] *Ibid.* at 706.

[34] 177 F.3d 472, 475 (6th Cir. 1999).

[35] 79 F.3d 776 (9th Cir. 1996).

prosecute the multilevel marketing companies under the FTC Act. He considers that these safeguards mere 'mechanical steps' which are now routinely implemented by other multilevel marketing companies to avoid prosecution (Debroy 2013). Since *Amway* decision in 1979, other factors have been added by the self regulating DSA *Code of Ethics* to determine whether a particular business is a legitimate multilevel marketing or a pyramid scheme.[36] As per Rule 6 of the Code, the Code Administrator shall determine whether such pyramid or endless chain schemes constitute a violation of this Code.[37] In accordance with these laws, member companies shall remunerate direct sellers primarily on the basis of sales of products, including services, purchased by any person for actual use or consumption.[38]

Regulatory framework in European Union

Several EU member States have developed national framework to regulate direct selling so as to protect the interests of the consumers.[39] The EU, in their effort to progressively harmonize national measures and guarantee high level of protection throughout the region enacted the Council Directive 85/577/EEC in 1985 to protect the consumers in respect of the contracts negotiated away from business premises.[40] However, this did not directly deal with the issue of pyramid schemes and applied only to the contracts for supply of goods and services by the trader at a place away from his business premises or during a visit by a trader to the consumers' home or at their place of work which could be considered as referring to direct selling.[41] The Directive provided the right of cancellation (Article 4) requiring the traders to give a written notice of the consumers' right of cancellation of the contract within a period of not less than 7 days from receipt by the consumer of such notice.[42] This Directive was replaced by the Directive 2011/83/EU on consumer rights (Consumer Rights Directive)[43] whereby the time period for exercise of the 'right of withdrawal' (Article 9) was increased to 14 days.[44,45] Thus primary aim of this Directive was to secure the right of the consumer to withdraw from the contract where

[36] The factors include: absence of a 'real world marketplace' for the products; marketing program is just a cover for a scam; there is a substantial "buy in" qualification or in other worlds "inventory loading"; there is an initial cash investment over 500$; members must purchase to ancillary products or services just to remain in scheme; emphasis on recruitment of new members rather than sale of products; non-existence of a buy-back policy or in other words inventory re-purchase policy in event of member leaving the scheme; and Misrepresentations related to earnings claims or outright misrepresentation related to potential income by the member. US Direct Selling Association *Code of Ethics*.

[37] The Code's definition of an "illegal pyramid" is based upon existing standards of law as reflected in the matter of *Amway* and the anti-pyramid laws of Kentucky, Louisiana, Montana, Oklahoma, and Texas.

[38] Other significant rules regulating the aspects direct selling are related to the 'Deceptive or Unlawful Consumer or Recruiting Process, 'Products, Services and Promotional Materials, 'Terms of Sale, 'Warranties and Guarantees, 'Identification and Privacy, 'Inventory Purchases, 'Earnings Representation, 'Inventory Loading, 'Payment of Fees' and 'Training and Materials. See Rule A, DSA's Code of Ethics (US).

[39] For instance, in Netherlands, a pyramid scheme is considered to be a game of chance according to Article 1a par. 1 of the *Act on Games of Chance* 1964 for which license cannot be issued; in Belgium, Article 91(14), the *Market Practices and Consumer Protection Act* of 6 April 2010 provides that establishing, operating or promoting a pyramid promotional scheme shall be considered as unfair and misleading commercial practice. Article 99 categorically prohibits establishment, operation or promotion of a pyramid promotion scheme where a business gives consideration for the opportunity to receive compensation that is derived more from the introduction of other businesses into the scheme than from the sale or consumption of products.

[40] *Council of European Communities Directive* 85/577/EEC of 20 December 1985.

[41] *Ibid*. Article 1.1.

[42] *Ibid*. Article 5.1.

[43] The Consumer Rights Directive defines 'off-premises contracts' as the contracts between a trader and a consumer that is made in their simultaneous physical presence in a place which is not the business premise of the trader or which is concluded during an excursion organized by the trader for promoting and selling goods and services to the consumers. Article 2.8, Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011.

[44] Art. 9.1, Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011.

[45] *Ibid.* Art. 10.1.

such contract with no specific reference to pyramid schemes.

A direct mention of the pyramid scheme is found in the Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005. This Directive concerns unfair business-to-consumer commercial practices in the internal market, and provides the list of commercial practices which in all circumstances are considered to be misleading.[46] According to this Directive, any scheme wherein a consumer is required to furnish a consideration in lieu of the opportunity to receive the compensation and such compensation is primarily derived from the introduction of new members into the scheme rather than from the sale or consumption of products, amounts to a pyramid promotional scheme.[47] Such pyramid promotional schemes are commercial practices that are considered to be unfair and are prohibited.[48] The 2005 Directive thus categorically prohibits any kind of pyramid promotional schemes penalizes the same in accordance with the national laws of the member States.

In 2011, the Belgian subsidiary of a US direct selling company Herbalife ran into a legal trouble with its multilevel marketing scheme being alleged as a pyramid scheme and was accordingly challenged in the Brussels Commercial Court (Koehn 2001; Mclain 2014). The Brussels Commercial Court in *Test-Aankoop vs. Herbalife International Belgium* held that the marketing scheme of Herbalife was indeed a pyramid scheme.[49] However, on appeal by Herbalife, the Court of Appeal reversed the lower court's finding and held that it did not violate Articles 91, 14 and 99 of the Belgian Commercial Practices Act (WMPC) [50] and therefore, is a legitimate multilevel marketing business and not a pyramid.[51] Articles 91, 14 is basically the conversion into Belgian law of Annex I, point 14 of 2005 EU Directive. The Court of Appeal considered the following factors significant to determine the legitimacy of the Herbalife multilevel marketing scheme:

- The price of the International Business Pack (IBP) was not unreasonable and disproportionate to the value of the products contained in the IBP.[52]
- The provision related to the repayment of the price of the IBP within 90 days irrespective of whether it is in sellable state, in case any distributor decides to cancel his distributorship.[53]
- The provision relating to the deduction or reversal of all sums concerning royalty overrides, commissions, production bonuses and other earnings or benefits that have been paid in respect of the products returned by an outgoing distributor.[54] The primary purpose of such a provision which has also been referred to as the 'claw-back clause' is to ensure that commissions were not paid on product that was not sold to customers or used by distributors (Koehn 2001).
- The products could be purchased by a distributor only from Herbalife and not any other distributor. In addition, the products which are purchased from the company should only be sold to the consumers or be retained for own personal use.[55]
- The purchase of large quantities of products exclusively and solely to rise to a higher position in the hierarchical ladder was not permitted.[56]

Considering all these factors along with the overall sales and compensation system, the Court held:

Consequently, it cannot therefore be claimed that it is a question of the forbidden pyramid sale for the reason that the distributor could obtain additional profit from the indirect distribution of profit, 'royalty overrides' and production bonuses, calculated on the sale of products by the distributors ranked below him/

[46] *Ibid*. Annex 1.

[47] Annex 1, point 14, Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005.

[48] Art. 5, Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005.

[49] *VZW Test-Aankoop v. Herbalife International Belgium NV*, A.R. 2004/7787. The Court held that because it has established, managed and promoted a pyramid scheme in which a consumer or a company, after payment, is likely to receive compensation that is derived primarily from the introduction of other consumers or businesses in the scheme, rather than from the sale or consumption of products. <http://www.mlmlegal.com/Herbalife%20Belgian%20Appeal%20Decision_Certified_Translation.pdf>.

[50] Law of April 6, 2010, on market practices and consumer protection.

[51] *N.V Herbalife International Belgium vs. VZW Test—Aankoop*, A.R. No. 2012/AR/736, December 2, 2013, para 9.

[52] *Ibid*, para 11.

[53] *Ibid*, para 12.

[54] *Ibid*, para 14.

[55] *N.V Herbalife International Belgium vs. VZW Test—Aankoop*, A.R. No. 2012/AR/736, para 15.

[56] *Ibid* para 16.

her in the network, rather than from the direct sales to consumers. As such, it is not forbidden for a distributor to aim for a network that is as broad as possible of 'downliners' in order to make as much profit as possible, as long as he/she is compensated on the basis of the purchase of products for selling on or for own use and not merely on the basis of the recruitment of new distributors.[57]

An important aspect of this case is the *recognition of personal use* by the Belgian Court of Appeals, wherein the Court observed that the 'personal use' of the products by the distributors is a legitimate destination of the products and for the payment of commission (Koehn 2001).

Singapore

Multilevel marketing and pyramid schemes are governed under the Multi-Level Marketing and Pyramid Selling (Prohibition) Act of 2000 (Singapore Act), which replaced the 1973 Act[58] and expanded the scope of the definition of 'pyramid schemes'. The Act in its preamble recognizes the aim of the legislation as 'to prohibit the registration of businesses that are designed to promote multilevel marketing schemes or arrangements or pyramid selling schemes or arrangements in relation to the distribution and sale of commodities.' Neither the old nor the new Act distinguish between a multilevel marketing and pyramid selling scheme.[59] The Act however, defines a 'pyramid selling scheme or arrangement' as 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 direct or indirect benefit as a result of the recruitment, acquisition, action or performance of one or more additional participants in the scheme or arrangement, or 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 the person referred to in (a) and (b)].[60]

The Act makes the 'promotion or participation' in multilevel marketing scheme or pyramid selling scheme, including holding out by a person that he is promoting or participating in any such scheme, unlawful. Further, the Act also prohibits the registration of any business designed to or a company that proposes to promote a multilevel marketing scheme or a pyramid selling scheme. The penalty may vary from Singapore $ 200,000 million or imprisonment for a term not exceeding 5 years or both.[61]

However, not all multilevel marketing activities are considered as illegal. To exclude legitimate multilevel marketing activities which employ innovating sales techniques, Singapore has enacted the Multi-Level Marketing and Pyramid Selling (Excluded Schemes and Arrangements) Order 2000. The Exclusion Order provides a list of activities that shall not be considered as pyramid selling scheme or arrangement under section 2 of the Singapore Act, which include activities of insurance companies, master franchises, and direct selling companies which fulfill certain criteria.[62] The Exclusion Order 2000 allows the operation of multilevel marketing scheme or arrangement or any class thereof which satisfy the following conditions[63]:

1. A person shall *not be required to provide any benefit or acquire any commodity for the participation* in the scheme other than the purchase of the materials and equipments for sales demonstration as a price not exceeding the cost of such materials.
2. *Any benefit* received by any promoter or participant in the scheme *should accrue as a result of the sale, lease, licence or other distribution of*

[57] *Ibid*, para 15.

[58] The Multi-Level Marketing and Pyramid Selling (Prohibition) Act of 1973.

[59] Section 2, The Multi-Level Marketing and Pyramid Selling (Prohibition) Act, 2000.

[60] *Ibid*.

[61] *Ibid*. Section 3.

[62] Ministry of Trade and Industry, Singapore, Multi-Level Marketing and Pyramid Selling <http://www.mti.gov.sg/legislation/Pages/Multi-level%20Marketing%20and%20Pyramid%20Selling.aspx#10>.

[63] Section 2(1)(c), The Multilevel Marketing and Pyramid Act (Excluded Schemes and Arrangements) Order 2000.

commodity to other person and *not from introduction of other members* into the scheme.

3. The promoter should not *misrepresent* about the *benefit* that may be accrued under the scheme.
4. The promoter or participants shall not make any *false or misleading representation* or conduct *regarding the scheme or arrangement or the commodity* involved therein.
5. There should not be any resort to any fraud, coercion, harassment, unconscionable or *unlawful means for the promotion* of a scheme or arrangement.
6. Clearly stated policy on *full refund or buy-back guarantee*, exercisable by every participant in the scheme on reasonable commercial terms.

It is important to note that the Exclusion Order 2000 gives sufficient leeway to the direct selling companies, primarily multilevel marketing schemes to operate so long as they conform to the conditions mentioned in the Order. This is evidenced by the presence of a large number of direct selling companies following a multilevel marketing structure in Singapore which includes Amway.

Regulation of direct selling and multilevel marketing in India

In India there is an absence of a specific legislation that defines or regulates direct selling, multilevel marketing or the pyramid scheme. As in the case of Amway India, the PCMCS Act and the general criminal law, the IPC is often used to frame charges against perceived case of multilevel marketing and the pyramid scheme. The prime purpose of the PCMCS Act declares that it has been enacted "to ban the promotion or conduct of prize chits and money circulation schemes and for matters connected therewith and incidental thereto".[64] However, the Act does not define or distinguish between a legitimate multilevel marketing activity and an illegal pyramid structure. Therefore, the applicability of the Act in these activities is open for debate. The Act criminalizes 'money circulation scheme' which is at the center of this whole controversy. Section 2(c) of the PCMCS Act defines the Money Circulation Scheme as:

> Any scheme, *by whatever the name called*, *for making of quick or easy money*, or for the receipt of any money, or valuable thing as the consideration for a promise to pay money, *on any event or contingency relative or applicable to the enrollment of members into the scheme*, whether or not such money or thing is derived from the entrance money of the members of such scheme for periodical subscriptions.[65]

Section 3 of the Act bans money circulation schemes or enrolment as member to any such scheme or participation in such scheme. Section 4 provides or penalty with an imprisonment till 3 years, or with fine, or with both. Except for special and adequate reasons to be mentioned in the judgment of the court, the imprisonment shall not be less than 1 year and the fine shall not be less than one thousand rupees.

While, the Act does not provide any further clarification on its applicability to multilevel marketing scheme or pyramid schemes, there have been a few cases where the Supreme Court of India has had the opportunity to interpret and clarify the provisions and its coverage. The leading decision on this subject is *State of West Bengal vs. Swapan Kumar Guha*.[66] In this case, Chief Justice YV Chandrachud, speaking for the Court noted that two preconditions for attracting the provisions of this Act: (1) it must be proved that he is promoting or conducting a scheme for the making of quick or easy money, and (2) the chance or opportunity of making quick or easy money must be shown to depend upon an event or contingency relative or applicable to the enrollment of members into that scheme.[67] The Court clarified that simply because

[64] Preamble, PCMCS Act 1978.

[65] Section 2(c), PCMCS Act 1978.

[66] *State of West Bengal v. Swapan Kumar Guha*, (1982) 1 SCC 561, 1982 AIR 949, 1982 SCR (3) 121. The issue in this case was the firm 'Sanchaita Investments' had been offering fabulous interest at 48 per annum to its members, later reduced to 36 % though the loan certificate receipts showed the rate of interest to be 11 % only. The amount in excess of 12 % clearly indicated that the 'Money Circulation Scheme' was being promoted and conducted for the making of quick and/or easy money and that prizes and for gifts in cash were also awarded to agents, promoters and members, and that the firm and its three partners in conducting such money circulation schemes had violated Section 3 of the Act and were therefor punishable under Section 4 of the Act.

[67] *Ibid.*

someone is making quick money (in this case offering fabulous interest at 48 % pa) does not mean that they are into 'money circulation schemes' and therefore, attract the provisions of the Act. The Supreme Court noted that:

> It is far too vague and arbitrary to prescribe that whosoever makes quick or easy money shall be liable to be punished with fine or imprisonment. *For then, in the absence of any demarcation of legitimate money making activities from those which fall within the ban, the question whether the penal provision is attracted in a given case will depend upon the will and temper, sweet or sour, of the magistracy*.[68]

The Court went on to note that a person may make quick money 'legitimately by the use of his wits and wisdom and no moral turpitude may attach to it.' For instance, a lawyer, a doctor, an engineer, an architect, a chartered accountant and other professionals who make quite quick money by the use of their talents, acumen and experience acquired over the years by dint of hard work and industry, 'cannot by any stretch of imagination be brought into the dragnet of Clause (c). 'But the point of the matter is that it will verge upon the ludicrous to say that the weapon devised by law to ban the making of quick or easy money is the provision contained in Section 2 (c) of the Prize Chits and Money Circulation Schemes (Banning) Act'.[69]

According to the Court, what is within the mischief of the Act is not any scheme, by whatever name called, for the 'making of quick or easy money' *simpliciter*,

> but a scheme for the making of quick or easy money, "*on any event or contingency relative or applicable to the enrolment of members into the scheme*", (whether or not such money or thing is derived from the entrance money of the members of such scheme or their periodical subscriptions).[70]

The Court, in order to bring out its meaning clearly, reshaped the definition to be read as follows; 'money circulation scheme' means any scheme, by whatever name called,

1. for the making of quick or easy money, or
2. for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrollment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscription;

The Court, therefore, in the current case concluded that the deposit of a sum of money on promise of being paid interest at a rate higher than the agreed rate of interest 'cannot, *without more*, be a 'money circulation scheme' within the meaning of Section 2(c) of the Act, howsoever high the promised rate of interest may be in comparison with the agreed rate.'

The precedent set in *Swapan Kumar Guha* case, was reiterated by the Supreme Court of India in *Kuriachan Chacko* case wherein the Court held that for the activity charged to fall within the mischief of the Act, it 'must be shown to be a part of the scheme for making quick or easy money depending upon the happening or non-happening of an event or contingency relative or applicable to the enrolment of members into the scheme.'[71] Commenting on the scheme at issue in that case, the Court noted that '[i]t must be evident for any discerning mind that this scheme cannot work unless more and more subscribers join and the amount paid by them as unit price is made use of to pay the previous subscribers. The system is an inherently fragile system which is unworkable.'[72] The Supreme Court agreed with the observation of the Kerala High Court terming the scheme as a 'mathematical impossibility':

> Scheme is so grossly unworkable that the persons who made representations to that effect and induced persons to part with money did entertain the contumacious intention. They knew fully well that unworkable false representations were being made. The obvious attempt, it can be presumed at this stage, was to induce persons by such false unworkable representations to part with money. Initially some subscribers can be kept satisfied to induce them and others similarly

[68] *Ibid*, *Emphasis added*.

[69] *State of West Bengal vs. Swapan Kumar Guha* (1982) 1 SCC 561.

[70] *Ibid*.

[71] *Kuriachan Chacko & Ors vs State Of Kerala* (2008) INSC 1082 Criminal Appeal No. 1044 OF 2008 arising out of Special Leave Petition (CRL.) No. 4977 of 2007, para 25.

[72] *Ibid*, para 38.

placed to join the long queue. But inevitably and inescapably later subscribers are bound to suffer unjust loss when they swallow the false promises and make payments.[73]

It is interesting to note the conclusion of the Madras High Court decision in *Apple FMCG Marketing* (*Pvt.*) *Ltd. vs. The Union of India*[74] on the validity of the 'network marketing scheme' of the petitioner company in the context of the PCMCS Act:

> The above definition makes it clear that *any scheme by whatever name it is called whereby on a promise that one would receive or would make quick or easy money by enrolment as members into the scheme is 'money circulation scheme'*. In this case, there is enrolment of members into the scheme; there is also a promise made that on such enrolment of large number of persons into the scheme, one would make quick money or easy money. *There cannot be any doubt that by enrolling new members and by the process of selling the goods to new distributors this chain progresses; the person who became such members earlier get commission without doing any work; getting such a commission is nothing but getting quick or easy money. Therefore, such schemes/the so called 'Multilevel Marketing', definitely falls within the definition of 'money circulation scheme'*.[75]

Accordingly, the High Court held that multilevel marketing violates the PCMCS Act. The court based its conclusion on the following reasoning:

> As stated above, this scheme called Multilevel Marketing creates a chain of customers and the long and unbroken chain would ensure larger amount of quick or easy money. The shorter and missed links in the chain would result in earning lesser commission. Therefore, there should be unbroken chain or customers. Second, the person does not get the value of the money he pays; third, the companies are collecting service charges as stated above in a sale of goods. No service charges can be collected while the goods are sold.[76]

The reasoning adopted by the Madras High Court in *Apple FMCG* case, seems to have ignored the Supreme Court reasoning in *Swapan Kumar Guha case* and *Kuriachan Chacko* case as to the conditions precedent for attracting the provisions of the PCMCS Act. The High Court seems to have adopted too simplistic a reasoning to address the issue related to the legality of multilevel marketing schemes.

The case of *Amway* (*India*)

The main question, therefore, is whether the Amway business model which also has a pyramid structure is a 'money circulation scheme' criminalized under the PCMCS Act?

Amway India started its operation in India in 1995 which was followed by other multilevel marketing companies like Avon, Oriflame and Tupperware in 1996 (KPMG 2014).[77] Amway commenced its commercial operation in India in 1998 and has emerged as the largest direct selling fast moving consumer goods (FMCG) company with a turnover of Rs. 2046 crores for the financial year 2013–2014.[78] The biggest challenge for Amway business model came in 2012–2014 when they were accused of operating an illegal pyramid scheme, leading to the arrest of their top managerial personnel on the charges of unethical circulation of money (Petersona and Wotrubab 1996). At the heart of the contestation is the PCMCS Act of 1978 which has been interpreted to criminalize the multilevel marking scheme of Amway India.

[73] *Ibid*, para 39.

[74] WP No. 22674 and W.P.M.P. No. 27411 of 2004, Decided on 07.01.2005.

[75] *Ibid*, para 20. *Emphasis added*. Elaborating on the unethical dimension of multilevel marketing, the Court observed that: Multilevel marketing results in exploitation of the personal influence of each and every distributor or his close relative. As stated already, a superior Officer or his ward when he involves in this Multi-level Marketing, the subordinates are forced to become members in the chain. Though it may not amount to violation of this (PCMCS) Act, it would attract some other laws; it may result in undue influence, extraction, coercion, etc. *Ibid*. para 28.

[76] *Ibid*, para 26.

[77] Amway India has been registered as a private company with unlimited liability under the Companies Act 1956 having its registered office at C-3, Quatab Institutional Area, New Delhi.

[78] Amway India Factsheet <http://www.amway.in/about-amway/our-company/amway-india-factsheet> (accessed 12 June 2015).

To adjudge the legality of the Amway India's multilevel marking scheme, it is imperative to have first an understanding of Amway's business and marketing model. The core aspect of business model, as is represented by Amway in their propaganda documents, is the sale of 'products' to the retail customers and does not merely depend on the recruitment of new members into the scheme (pyramid).[79] There is no entry fee for becoming a member of the business scheme.[80] Once a person becomes the distributor of Amway India, her membership continues for a period of 12 months, and the membership automatically expires unless renewed.[81] Importantly, with regard to sponsoring of new members, Amway India prohibits any kind of payment of any joining fee, purchase of any specified amount of product or maintenance of minimum inventory, as a precondition to becoming a new member.[82] This indicates towards the fact that mere headhunting or recruitment/sponsorship of new members in the plan is not the prime thrust of Amway India's business strategy.

The ways in which money can be earned in the business model of Amway is threefold—first, through the retail profit margin, which is basically the difference between the price at which a distributor acquires products and the price at which the product is sold by her to the consumers; second, through the commission that a distributor can earn on the volume of her individual purchase of the Amway products during a month; and third through the commission that may be earned by her based on the success and productivity (measured in terms of actual sales of the Amway products by the downline members) of the sales group recruited by her.[83] It is important to note that the commission which is to be paid to the distributors in the third method is primarily dependent not on the induction of more recruits but on the performance of the members of the group indicated through the actual sales. Amway also provides for a 30 days 'product return policy' both for the consumers and as well as for the distributors.[84]

Let us now consider the allegations that have been leveled against Amway.

Allegations against Amway

Amway's legal trouble in India is just one of the various allegations that they have faced globally. For instance, in 2010, in the US case of *Pokorny vs. Quixtar*[85] it was alleged that Quixtar (the former name of Amway) and its senior officials fraudulently induced individuals to join the business by promising them that they will be able to resell the Quixtar products at profit, while in reality the products were too high priced to generate any profit through resale. Further it was alleged that when a new recruit joins the scheme, she was asked to purchase products not only for her personal use but also to focus on the recruiting new members. Additionally, the alternative dispute resolution mechanism of Quixtar was also challenged to be unconscionable and unenforceable. In this case, the US Court of Appeal (Ninth Circuit) held the ADR mechanism to be unconscionable and accordingly denied the motion of Quixtar to compel arbitration according to their ADR mechanism.[86] Eventually, this decision was followed by a class action settlement where Quixtar agreed to pay US$ 56 million without

[79] See, Sales and Marketing Plan <www.amway.in>.

[80] Amway's Business Starter Guide <http://www.amway.in/lcl/en/ResourceCenterDocuments/visitor/Business_Starter_Guide.pdf>. All that is required is a sponsorship by an existing distributor or Amway Business Owner (ABO). If there is no sponsorship from an existing ABO, a person can very well become the member of business and marketing plan of Amway India provided she—is minimum 18 years of age; is not unable to manage his business because of mental or legal reasons; has not been suspended from his current profession or business; and must not be in jail or confined to any correctional institution and has filled up, signed and filed an application for authorization to become a distributor. Rule 3.3, Code of Ethics for Amway Distributors (India).

[81] Rule 3.7–3.10, Code of Ethics for Amway Distributors (India).

[82] Rule 3.6, Code of Ethics for Amway Distributors (India).

[83] Amway Business Starter Guide, supra note 112, p 6.

[84] Product Return Policy, Amway India: Any distributor can return the product within 30 days of the purchase and the amount of refund shall be based on—first the condition of the products i.e. whether they are marketable (unopened and sealed) or unmarketable (products which have been partially used up to 30 percent) and second—the proof of purchase.

[85] *Jeff Pokorny, Larry Blenn, And Kenneth Busiere, Plaintiffs, vs. Quixtar, Inc., et al., Defendants*, 601 F.3d 987 (9th Cir. 2010) <http://cdn.ca9.uscourts.gov/datastore/opinions/2010/04/20/08-15880.pdf>.

[86] *Ibid*, at 5989.

acknowledging any sort of illegality in the scheme operated by it.[87]

In India, complaints were filed in several states such as Andhra Pradesh, Delhi, and Kerala where it was alleged that Amway is running money circulation scheme and brainwashing the public to join the scheme.[88] The primary allegation against Amway India was that of cheating, looting by extorting the hard earned money of gullible public by making false promises of getting quick rich and promoting illegal money circulation scheme in the guise of sale of products by enrollment of members into the scheme. Accordingly, the company was charged with Sections 420, 385 read with 120(B) of IPC and also Sections 3, 4, 5 and 6 read with 2(c) of PCMCS Act 1978 (Sadiraj and Shcram 1998). The Andhra Pradesh CID's press release states that Amway India schemes are covered under money circulation scheme and are in clear violation of the PCMCS Act, 1978. The Govt. of AP has issued notice restraining publishing of any material/advertisements of the Amway India,[89] which has been upheld by the High Court of Andhra Pradesh and the Supreme Court of India.[90] Industry organizations such as the American Chamber of Commerce (AMCHAM), Indian Direct Selling Association (IDSA), FICCI have come out in defense of Amway stating that the PCMCS Act was enacted more than 20 years before direct selling companies entered India and accordingly the PCMCS Act in its present form is unable to distinguish genuine direct selling companies which a relatively a new Industry in India, from illegal pyramid schemes.

It is however pertinent here to note the reasoning of the Division Bench of Andhra Pradesh High Court in the *Amway India Enterprises vs. UoI*, on a writ petitions filed by Amway India.[91] Amway admitted that its marketing pyramid has the 1-6-4-3 pattern and to the following fact:

> The first member sponsors six members. Each of the six members in turn sponsors four members and each of the twenty four members sponsors three members. Thus the strength of the total group becomes 103. At the minimum level of PV and BV, the profit margin and the commission the person heading the group, by taking his personal PV and BV gets is Rs. 12,420/-, from the point value (PV) and business volume (BV) of the six persons he sponsored he gets Rs. 23,760/-, from the PV and BV of the 24 distributors who were sponsored by six distributors he gets Rs. 1,14,480/- and from the PV and BV of 72 distributors whom the 24 distributors sponsored he will get Rs. 6,83,300/.[92]

Analyzing in the context of the Supreme Court decision in *Swapan Kumar Guha*, the court noted that current scheme satisfies all the ingredients necessary for attracting the provision of the Act i.e., (a) making of quick or easy money, and (b) the chance or opportunity of making quick or easy money depending on an event or contingency relative or applicable to the enrollment of members into the scheme are satisfied. The Courts reasoned that:

- First, the whole scheme ingeniously designed to induce aggressive chase for new members to earn more and more commission to make quick/easy money. Thus, the scheme satisfies the first ingredient.[93]

[87] *Jeff Pokorny, Larry Blenn, And Kenneth Busiere, Plaintiffs, vs. Quixtar, Inc., et al., Defendants*, US District Court, N.D. California, April 17, 2013. Inc., No. C 07-00201 SC. See, Chris Knape, Amway Agrees to Pay $56 million, Settle Case Alleging it Operates a 'Pyramid Scheme' <http://www.mlive.com/business/west-michigan/index.ssf/2010/11/amway_agrees_to_pay_56_million.html>. see also, The Pyramid Scheme Industry: Examining Some Legal And Economic Aspects Of Multi-Level Marketing, NASDAQ, March 17, 2014 <http://www.nasdaq.com/article/the-pyramid-scheme-industry-examining-some-legal-and-economic-aspects-of-multi-level-marketing-cm340786#ixzz3dZlpCL7G>.

[88] The first complaint against Amway was filed in the CID Police Station, Hyderabad which was registered as FIR No. 10 of 2006 dated 24-9-1996.

[89] Government Order (G.O.) Ms. No. 178 of Home (General-B) Department, Government of A.P., dt. 5-9-2008.

[90] The Supreme Court upheld t the AP High Court judgment and instructed the Andhra Pradesh CID to complete the investigation and file the charge-sheet in 6 months. Press Release, Crime Investigation Department (CID), Andhra Pradesh, <http://www.cidap.gov.in/Videos/PressReleases.aspx>.

[91] *Amway India Enterprises vs Union Of India (UoI)*, 19 July, 2007; 2007 (4) ALT 808, W.P.Nos.20470 and 20471 of 2006 <http://indiankanoon.org/doc/1369717/>.

[92] *Ibid*, para 27.

[93] *Ibid*, para 30.

- Second, a substantial part of the income which the first sponsor member gets depends on the "event or contingency relative or applicable to the enrollment of members into the scheme." Money that the member at the top of the line gets depends upon the members whom she enrolls or the members enrolled by him enroll.[94] The second ingredient is also satisfied.

On the question of where these two ingredients are satisfied qua the promoter (Amway), the court noted the following:

- An enrolment fee of Rs. 4400 (126 USD in 1996–7 rate) is collected from each of the 4, 45,000 subscribers all over India. Rs. 1800 of Rs. 4400 is collected as subscription fee, license fee, business kit, etc., thus, with an enrolment of 4,50,000 distributors a sum of Rs. 81 Crore is credited direct to the account of the company at the time of enrollment of the members itself.
- To qualify for earning commission a member has to distribute/purchase/sell products worth Rs. 2000/- (to earn the minimum monthly PV of 50) every month to enable an ABO to get commission @ 3 % every month. Else she will not be eligible to get any commission or continue as member in the scheme. Thus, Amway would automatically get a business of Rs. 1080 crores [4,50,000 × 2000 × 12 (months)] per annum without any service to the distributors/members irrespective of whether they sell the products or not.
- In addition, each person in order to continue to be the distributor, shall pay renewal subscription fee of Rs. 995/- per annum.

In short, a substantive portion of the money received by Amway is not from the sale of their 'product', but from the enrolment fee ('headhunting fee') of new members and the recurring subscription fee.

Thus, the Court concluded that (1) Amway is earning quick/easy money from its distributors by promising payment of commission on the business turned out by the downline members,[95] and (2) the chance to make quick or easy money is directly dependent on to the enrolment of new members into the scheme. The two ingredients are therefore satisfied and the Court concluded that the scheme is nothing but a 'money circulation scheme' as provided in Section 2(c) of the Act. In other words, Amway by pushing each member to achieve the minimum sales worth Rs. 2000/- per month assures itself about Rs. 1000 crores per annum. Further, the court also noted that the scheme is structured in such a way that once a person gets into this scheme he will find it difficult to come out of the web and it becomes a vicious circle for him.

Legality of Amway scheme in the light of Indian jurisprudence and practice abroad

From the discussions above, it can be deduced that the legal system globally has attempted to criminalize a practice whereby the promoter (the company) entices or allures a person to join a scheme by paying valuable consideration (entry or subscription or 'headhunting' fee) with a promise to make quick/easy money by introducing additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant. Such a scheme would satisfy the requirement of an illegal pyramid scheme and therefore, attracting penal sanction. Indeed, the Indian Supreme Court has held that the possibility of making easy or quick money alone should not attract penal sanction. 'For then, in the absence of any demarcation of legitimate money making activities from those which fall within the ban, the question whether the penal provision is attracted in a given case will depend upon the will and temper, sweet or sour, of the magistracy.'[96] Further, the existence of the pyramid marketing structure alone must not make a scheme illegal. Rather, it is the combination of the two key factors, that is, a business opportunity to make 'easy/quick money' which is largely depended on the 'recruitment of new members' rather than the wholesale and retail sale of a legitimate product that would attract illegality. The pyramid by itself is an impracticable and unworkable business model and in the long run, the person at the downline is bound to lose. As the Court in its preliminary finding noted:

94 *Ibid*, para 28.

95 *Ibid*, para 35.

96 *Ibid*, *Emphasis added*.

It could work for some time in that 'Paul can be robbed to pay Peter' but ultimately when there is *a large mass of Peters they will be left in the lurch* without any remedy as they would by then have been deceived and deprived of their money. If it is so, it could be said to be a case for application of Section 420 (Cheating) with Section 34 (Joint Liability) of the Indian Penal Code,….[97]

In addition there are several other factors that must be considered for arriving at a conclusive determination. Thus, the following attributes could be critical for the test to determine the legitimacy of the business model:

1. *Entry or subscription fee*: If the promoter is charging a substantial entry fee for becoming a member of the distribution network which is unconnected to the product cost, this could be treated as easy money for the promotor without any service rendered to the distributors or consumers. The entry fee may take many names such as license fee, 'startup kit', promotional materials, training fee, etc. In some jurisdictions, entry fees are permitted as long as it is *reasonable and refundable*.
2. *Share of revenue from recruiting new members*: If the substantial portion of revenue/commission/compensation is derived primarily from the recruitment of new members for both the promoter and the distributor, this would be a key indication of the existence of the illegal pyramid scheme, a 'mathematical impossibility' as mentioned above.

   The 70 % rule established by the US FTC provides guidance on this matter whereby the percentage of wholesale and retail sale of the product must be at least 70 % of the total product sale. The rule apart from indicating the self-sustenance of the business model prevents the accumulation of inventory at any level.

3. *Product and their quality*: Is the product sale merely incidental to the recruitment of new members and are the products being sold real and of good quality? Product quality is central for the legal differentiation of the scheme as it lends credibility to the business and commercial viability. Often pyramid schemes thrust on the distributer's sub-standard products to legitimize the recruitment, and the primary sources of revenue/commission are the new recruits, not the products. Generally the product to be sold in a pyramid scheme is sold at a price that one would not otherwise pay in the market.[98] However, determination of quality and competitiveness of the product would be difficult to establish because of the exclusive and 'captive' nature of marketing and sales. Bottom line is that multilevel marketing is a marketing tool to sell a 'product' not visa-versa.
4. *Product pricing and price fixing*: Is the product overpriced? In other words, is the retail price for the product in question substantially higher than the similar competitive products available in the market? Can the product survive in open competition with similar products? Indeed, a company is free to price its product; however, its survival in the marketplace could give an indication that 'downline' (distributers and consumers) is using the product because of its quality/usefulness and not merely to stay part of the distribution chain.

   Price fixing, a restraint on competition, is prohibited. Here a product is taken out of the competitive environment by channelizing it through a distribution network avoiding competitive forces at the determent of the end consumer. Most often, the multilevel marketing companies fix the wholesale and retail price of the product through a contract/understanding between the company and the distributers which restrains and eliminates competition in the offering for sale, distribution and sale of its various products. The practice which lessens price competition touches the core of the free enterprise system[99] and could be termed as a

[97] The Supreme Court of India quoting the High Court of Kerala in the case of *Kuriachan Chackko and others vs. State of Kerala* (2008) 8 SCC. *Emphasis added*.

[98] Unethical company might try to pass the *Koscot* test by this. People push for over-priced and unneeded products to friends and relatives with the logic that it will somehow help them make up for the money they have invested in buying the inventory and as others will also be forced to re sell it, they will eventually make money. See reference note (Vardi 2013).

[99] *The Coca-Cola Company, et al.* FTC Dkt. 8855 (Final Order dated April 7 1978), at p. 89, in FTC *Amway case*, supra note at p. 619. See also, Pricing is too critical, too sensitive a control to allow it to be used even in an informal manner to restrain competition. *US vs. Container Cor. of America* 393 U. 333 338 (1969).

restrictive trade practice under the competition and consumer laws.

5. Finally, whether the scheme causes inventory overloading or is there an appropriate product return policy put in place? Besides, misrepresenting the amount of profits, etc., would be an additional cause of action (Surendranath 2013).

In short, not all multilevel marketing plans are legitimate and many of them are pyramid schemes where most participants lose money. The Amway practices seem to fall in the borderlines with wavering legitimacy, with their legality more dependent on their global status as a legitimate enterprise rather than on the strength of practices. One cannot clearly identify as to which side of the legal line does the Amway India's scheme falls, precisely for the reason that the company generally adapt their practices to suit the legal environment of the country where they operate. If one applies the above test, several aspects of the Amway scheme and practice are unclear to reach a conclusive opinion. For instance, in the Andhra Pradesh High Court decision, Amway seems to have accepted that they charge an entry fee of Rs. 4400 per distributor. Whereas, in the current scheme, it has been represented that the entry is free without any requirement as to payment of money or buying of starter kits by the new members. This could only mean a change in the recent times, tweaking the business model according to circumstances.

Further, Amway India is charging prices 4 to 12 times the cost price [100] (Vander Nat and Keep 2002) and comparable price of similar products in the market. Moreover, it is very difficult to determine whether the consumers are satisfied by the Amway products. Whether or not Amway products are superior to similar products available in the markets is inconclusive. Whether most consumers are buying the products for their quality or to be a member of the chain and become a seller (i.e.: ground-floor/leadership position) is also something that needs to be determined. However, Amway has introduced a comprehensive refund policy along with the 'claw-back clause' which was appreciated by the Belgium Court of Appeals in the *Herbalife case*. At the same time, Amway scheme allows a person to form her distribution group through sponsoring new members and allows payment of commissions. Thus, with the current data, it is extremely difficult to determine on the illegality of the Amway multilevel marketing model. The Andhra Pradesh High Court at least seems to have taken a preliminary view that the scheme would attract the penal provisions of the PCMCS Act, which is not encouraging for the Amway India at least in the context of their past practice. The recent actions and orders by the state governments were found to be sustainable by the High Courts and the Supreme Court of India.

In the context of protecting and compensating the consumers (including distributors[101]) against unfair and restrictive trade practices, the Consumer Protection (CP) Act 1986 does provide an appropriate and expedite remedy, including the power to issue cease and desist order. Section 2(r) of the CP Act provides an inclusive definition of unfair trade practices (UTP) as 'a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice…'[102] The list of UTP is only indicative as observed by the Supreme Court in *Maruti Suzuki India* case. [103](Epstein 2010) Accordingly, if a complaint is brought before the consumer dispute redressal forum alleging that a particular scheme is a pyramid scheme, then the forum may ascertain whether the practice amounts to an UTP or not taking into account all the circumstances of the case. However, a more rational and objective way would be to amend the Section 2(r) of the CPA 1986 to

[100] A calcium-magnesium tablet, the production cost of which is Rs. 60.76, is sold by Amway for Rs. 639—at 10 times the cost price. Mascara costing Rs. 73.14, meanwhile, is sold at Rs. 445. See (Surendranath 2013).

[101] Section 2(1)(d) of CPA 1986 stipulates that a person shall not be treated as 'consumer' within the meaning of this Act if he buys any goods or avails any service at a price, not for his consumption but for reselling it or buying it for commercial ends. However, "commercial purpose" does not include use by a consumer of goods bought and used by him exclusively for the purpose of earning his 'livelihood', by means of self-employment. Amway Business Owners (ABO), upline members and downline members would come within the ambit of this exception and would be treated as a consumer for the purpose of initiating a remedy under the CP Act.

[102] Section 2(1)(r) provides a list of practices which are considered as unfair trade practice from s 2(1)(r)(1) to (6) Consumer Protection (CP) Act 1986.

[103] *Maruti Suzuki India Ltd vs. Rajiv Kumar Loomba and Anr*, AIR 2010 SC 3141.

specifically include pyramid schemes as an UTP. Besides, the Competition Commission of India is another venue for remedying price fixing and other restrictive practices.

The Inter-Ministerial Committee established by the Government of India in June 2014 has taken the view that the regulatory clarity can be addressed through incorporating 'pyramid marketing scheme' into the PCMCS Act rather than enacting a central legislation.[104] Under the PCMCS Act, the state governments are the authority competent to regulate multilevel marketing entities. However, the Committee felt that there is a need for proper operational and definitional guidelines for the multilevel marketing companies to avoid unnecessary police action.[105] The Government of Kerala has recently circulated a draft Kerala State Multi-level Marketing (Control and Regulation) Bill, 2013 which inter alia proposes the registration of multi-level marketing entity and distributors, establishment of a Multi-level Marketing Regulatory Authority, etc.[106] Section 15 of the draft Bill has identified some of the practices which are prohibited in the context of multilevel marketing. The IDSA has raised concerns about the presence of section 13(3) that has the potential of prohibiting the formation of pyramid structure even in legitimate multi-level marketing companies (Athul Lal 2014).

Concluding remarks

Ambiguity in the legal environment is a double edged weapon. Business enterprises could take advantage of an absence of specific laws as long as the legal system is passive. However, the same lacuna in the legal environment could emerge a major impediment for the business once a proactive stand is taken by the legal system, which usually happens when there is a public outcry. This is specifically true with business models such as the multilevel marketing schemes, which borderlines with illegal pyramid schemes and the legitimacy of which would essentially lay in the specificities of business practices. For companies like this, it becomes very problematic for authorities to define under which business structure they fall and thus it becomes the grey area. Thus, the legitimacy of a scheme, be it Amway or any other multilevel marketing company, lies in the detail.

As has been mentioned earlier, multilevel marketing as an industry is big money and its contribution cannot be negated. At the same time, the legitimacy gained globally and the potential employment opportunities does not necessarily guarantee ethical and legal practices without an appropriate regulatory mechanism in local contexts. Indeed, the IDSA is urging the Government to amend the PCMCS Act, which was never intended to regulate the direct selling market. Further attention has been drawn to the fact that it has become a common practice to describe any and every financial scam as a pyramid or Ponzi scheme without delving into the finer intricacies of the issue. Therefore, the best possible solution to tackle the problem is the enactment of a legislation specifically aimed at regulating multilevel marketing and pyramid schemes. A specific legislation as in the case of Singapore or Malaysia cannot be underscored. In the interim, it was also suggested that the PCMCS Act is amendment thereby defining direct selling including multilevel marketing and specifically explaining that direct selling does not amount to money circulation scheme unless there is pyramid structure involved (Debroy 2013). Such a blanket legitimization could be considered inappropriate in the current context. The attempt of such a law should be to identify and put a check on certain practices which are globally identified, rather than to define and distinguish multilevel marketing and pyramid schemes. The tests laid down above could be used to arrive at the legitimacy of the business opportunity offered by these schemes. Until then, Amway India and its counterparts shall continue to function in a legal vacuum at the mercy of a judicial interpretation which is long awaited.

[104] Report of the Inter-Ministerial Committee on Issues Relating to the Entities Engaged in Direct Selling/Network/Multilevel Marketing <http://fdsaindia.org/pdf/IMC-Report.pdf> (accessed 22 September 2015).

[105] *Ibid*.

[106] Report of the Committee for Preparation of draft bill to Control the Multi-level Marketing in the State, Constituted Under G.O.(MS) No.3/2013/id dated 10.01.2013 <http://www.kerala.gov.in/docs/bills/1160_14.pdf>.

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