

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. DOES THE BILL:

- | | | | |
|--------------------------------------|------------------------------|-----------------------------|---|
| 1. Reduce government? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. Lower taxes? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. Expand individual freedom? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. Increase personal responsibility? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. Empower families? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a “no” above, please explain:

B. EFFECT OF PROPOSED CHANGES:

Section 849.091(2), F.S., provides a definition for a pyramid sales scheme¹ and declares the scheme to be a lottery and further provides that anyone who participates, solicits, or is in affiliation with such a group organized to participate in such a lottery is guilty of a first degree misdemeanor as provided in s. 775.082, F.S. This bill repeals s. 849.091(2), F.S., and creates a new section of law providing definitions and declaring that it is unlawful for a person to establish, promote, operate, or participate in any pyramid promotional scheme.

Background

According to the Federal Trade Commission, pyramid sales schemes promise consumers or investors large profits based primarily on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public. Some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure. Two signs that a product is simply being used to disguise a pyramid scheme are inventory loading and a lack of retail sales.

Inventory loading occurs when a company's incentive program forces recruits to buy more products than they could ever sell, often at inflated prices. If this occurs throughout the company's distribution system, the people at the top of the pyramid reap substantial profits, even though little or no product moves to market. The people at the bottom make excessive payments for inventory that simply accumulates.

A lack of retail sales may also be a sign that a pyramid exists. Many pyramid schemes will claim that their product is selling at a very successful rate. However, on closer examination, the sales occur only between people inside the pyramid structure or to new recruits joining the structure, not to consumers out in the general public.

Pyramid sales schemes are seductive because they may be able to deliver a high rate of return to a few early investors for a short period of time. Yet, pyramid schemes are illegal because they inevitably must fall apart. No program can recruit new members forever. When the scheme collapses, most investors find they are unable to recoup their losses.

¹ “ Any sales or marketing plan or operation whereby a person pays a consideration of any kind, or makes an investment of any kind, in excess of \$100 and acquires the opportunity to receive a benefit or thing of value which is not primarily contingent on the volume or quantity of goods, services, or other property sold in bona fide sales to consumers, and which is related to the inducement of additional persons, by himself or herself or others, regardless of number, to participate in the same sales or marketing plan or operation, is hereby declared to be a lottery, and whoever shall participate in any such lottery by becoming a member of or affiliating with, any such group or organization who shall solicit any person for membership or affiliation in any such group or organization commits a misdemeanor of the first degree.”

How Pyramid Schemes Operate

A pyramid scheme operates from three points of view: the potential investor, the promoter, and the victim. Many pyramid schemes will present a payout formula or matrix much like this one:

	#	#	#
Level 1 \$150 x 3 = \$450	#	#	#
Level 2 \$30 x 9 = \$270	###	###	###
Level 3 \$30 x 27 = \$810	#####	#####	#####
Level 4 \$30 x 81 = <u>\$2430</u>	#####	#####	#####etc.
\$3960			

This example illustrates what is known as a three by four matrix. Each investor pays \$500 to the promoter and is told to build a "downline" by recruiting three new members, who then each should recruit three more members. The investor is told that he will be paid \$150 for each of the three members whom he enlists at the first level. The investor is also promised a \$30 commission for each recruit at the next three levels. Thus, the investor should receive commissions for four levels of recruits below him, each of whom must recruit three more members, hence the name -- a three by four matrix.

To the potential investor or recruit this may look like a very appealing opportunity. The pyramid promoter may persuade the investor that he is "getting in early" and that he should consider himself at the top of the matrix. From this perspective, it appears that he can earn \$3,960 on an investment of \$500, a 792 percent return: \$150 from the first level of 3 recruits is \$450; \$30 from the next 3 levels of recruits is \$270 (\$30 x 9), plus \$810 (\$30 x 27), plus \$2,430 (\$30 x 81).

Promoter's Point of View

The promoter is the person at the top of the pyramid but looks at the scheme from the bottom. The promoter views each new investor as a predicable set of revenues and expenses, with the revenues flowing down to the promoter. The promoter receives \$500 for each new member, and at most will have to pay \$240 in commissions to earlier investors in the new recruit's "upline," or those people responsible for bringing the investor into the system. So when an investor joins the system in the last level, the promoter will receive \$500, but the promoter will pay only \$150 to the person who recruited the new investor, and \$30 each to three longer-standing members in the new investor's "upline," for a total of \$240. Thus, the promoter will keep over half of every \$500 membership fee paid.

Investor's Perspective

The victims find themselves at the bottom of the pyramid, unable to find people interested in the program to build out their downline. Many investors will find themselves at the bottom of the pyramid when it collapses. The structure of this matrix dictates that whenever the collapse occurs, at least 70 percent may be in the bottom level with no means to make a profit.

Direct Sales

Direct selling companies include commercial names such as Alticor, Avon Products, Inc., Mary Kay Inc., The Pampered Chef, Longaberger Baskets, and Tupperware. The individual direct sellers who sell for direct selling companies in the U.S. are independent contractors; they typically sell on a part-

time basis to their neighbors, relatives and friends to supplement their family income. The Direct Selling Association estimates that there are over 700,000 direct sellers in Florida. The products and services sold by legitimate multilevel marketing companies are used or consumed, and compensation is based upon those sales for consumption by the end-user. To the contrary, in a pyramid scheme, the product or service is not used or consumed by anyone, but money is made from the mere act of recruiting new participants into the scheme.

Proposed Changes

Section 1 Amends s. 849.091, F.S., to repeal language related to pyramid sales schemes.

Section 2 Creates s. 849.09105, F.S., to provide definitions and declare that it is unlawful for a person to establish, promote, operate, or participate in any pyramid promotional scheme. This section clarifies that law does not prohibit a person from participating in a promotional scheme as long as that scheme:

- Delivers compensation based on purchases of goods, services, or intangible property and does not promote the concept of a person purchasing more than the person can resell in a reasonable time period, and
- Provides a program designed to repurchase goods from the salespeople when the salesperson's term with the operation ends.

Section 2 declares that the provisions of the bill do not preclude the Attorney General from proceeding against any scheme under any other provision of law. The bill states that a violation of the bill constitutes an unfair or deceptive trade practice as pursuant to s. 501.204, F.S., and any violation may be the basis for civil action.

The bill provides that any person establishing, promoting, or operating a pyramid sales scheme is guilty of a felony of the third degree, punishable as provided in ss. 775.082 or 775.083, F.S., and any person participating in such a scheme is guilty of a misdemeanor of the first degree, punishable as provided in ss. 775.082 or 775.083, F.S.

Section 3 provides that the bill will take effect upon becoming a law.

C. SECTION DIRECTORY:

Section 1. Amends s. 849.091, F.S., to repeal language related to pyramid sales schemes.

Section 2. Creates s. 849.09105, F.S., to provide definitions and declare that it is unlawful for a person to establish, promote, operate, or participate in any pyramid promotional scheme. This section clarifies that law does not prohibit a person from participating in a promotional scheme that delivers compensation based on purchases of goods, services, or intangible property.

Section 3. This bill will take effect upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

Please see "Fiscal Comments."

2. Expenditures:

Please see "Fiscal Comments."

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

Please see "Fiscal Comments."

2. Expenditures:

Please see "Fiscal Comments."

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Please see "Fiscal Comments."

D. FISCAL COMMENTS:

The fiscal impact on state government is uncertain. According to information provided by the Office of the State Court Administrator, only 1 case was filed during FY 02-03 for violations of s. 849.091(2), F.S.²

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The bill does not require counties or municipalities to take an action requiring the expenditure of funds, does not reduce the authority that counties or municipalities have to raise revenues in the aggregate, and does not reduce the percentage of state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

In the meeting on April 13, 2004, the Commerce Committee adopted a strike all amendment to the bill and passed the bill favorably with a committee substitute. The amendment does the following:

- Creates s. 849.09105, F.S., to provide definitions and declare that it is unlawful for a person to establish, promote, operate, or participate in any pyramid promotional scheme. This section clarifies that law does not prohibit a person from participating in a promotional scheme as long as that scheme:

² The information on filings comes from the clerks of the courts in every county except for Brevard, Nassau, St. Lucie, and Seminole.

- Delivers compensation based on purchases of goods, services, or intangible property and does not promote the concept of a person purchasing more than the person can resell in a reasonable time period, and
- Provides a program designed to repurchase goods from the salespeople when the salesperson's term with the operation ends.
- Declares that the provisions of the bill do not preclude the Attorney General from proceeding against any scheme under any other provision of law.
- Provides that a violation of the bill constitutes an unfair or deceptive trade practice as pursuant to s. 501.204, F.S., and any violation may be the basis for civil action.
- Provides that any person establishing, promoting, or operating a pyramid sales scheme is guilty of a felony of the third degree as pursuant to ss. 775.082 or 775.083, F.S., and any person participating in such a scheme is guilty of a misdemeanor of the first degree pursuant to ss. 775.082 or 775.083, F.S.