

Pyramid schemes

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Any 'business opportunity', 'gambling game' or chain letter that promises money through recruiting others may be a pyramid scheme.

It is illegal to promote or to participate in a pyramid scheme.

Western Australian laws protect the community from the financial and social costs of schemes where a few can profit from the deception of many others. Pyramid-type frauds turn over cash when money from new victims is used to pay those who set up the scheme, or who got in early.

"Profits" are earned only while the scheme grows at an increasing rate. Because the necessity to grow to infinity at an increasing rate is mathematically impossible, pyramid schemes collapse when recruiting slows down or runs out. Most of those involved lose out. This is why pyramid schemes are outlawed virtually all over the world.

A pyramid scheme is often an "affinity fraud" because participants sign up friends, family, social and business contacts, either one-on-one or by taking them to high-pressure sales seminars where questions are discouraged. Hope, greed and abuse of personal trust drive most schemes.

Types of Pyramid Schemes

Pyramid schemes fall into two groups: those without products (such as gambling games and chain letters) and "business opportunities" with goods and services for sale.

1. "Gambling game" and chain letter pyramid schemes

This type of pyramid scheme is not attached to any product or service. A "gambling game", with nothing to sell, might look like this ... *"At a secret location, give a gift of \$1,000, in an envelope marked "1,000 marbles" to a stranger whose false name is at the top of a game sheet."*

The organisers will assert it is not illegal because you can give a gift to anyone you like.



Examples of “gambling games” include The Cash Club, Concorde, the Plane Game, Abundance Gifting Program, and Amazing Grace Benefactor Project.

They are all based on the same principle. A four-tier chart would have one person at the top and eight recruits at the bottom. For each of these eight recruits to receive a payout, 64 others must join. They need to find 4,096 others, and so on.

In August 2003 a Perth couple who promoted the Abundance pyramid scheme were convicted and fined \$6,000 after holding promotional meetings in lounge rooms.

As soon as recruitment in an area becomes saturated, the “game” collapses. Everyone except the organisers and those who got in early lose their money (and their friends). For every person who collects \$8,000 at the top of a four-tier “game” there **must** be between six and fourteen people who **will** lose \$1,000. For every dollar that someone collects, someone else must lose a dollar.

Chain letters for money work the same way.

2. The “business opportunity” pyramid investment scheme

The second type of pyramid scheme has goods or services for sale. Investors in a pyramid trading scheme buy the right to receive payment for finding new members who then do the same. The business is based on **recruiting**, not the sale of useful products to uninvolved customers.

Warning signs for a product-based pyramid trading scheme include:

- *The “business opportunity” is the key reason you were approached, not the product.* The goods or services for sale

are not important; it is the **business** that is being promoted.

- *You have to pay to play.* It costs a significant amount to join the scheme, and the payment benefits the recruiter. There may be minimum monthly sales quotas (or volume discounts) that require a distributor to buy levels of stock that may be difficult to sell (especially as others join and the market shrinks). Unsold stock cannot be returned on normal commercial terms.
- *Training costs can disguise income from recruiting.* Distributors may be expected to buy costly sales aids or attend expensive training seminars. There might be a commission for selling training down the line to others.
- *“Get in on the ground floor!”* Listen for the pyramid scheme trigger word “pre-launch”. Promoters and the early participants in a pyramid scheme have a financial advantage over those who come later, as the market of likely victims becomes saturated. Sadly, those promoting schemes that rely on a multiplying rate of growth don’t tell their victims when the “ground floor” is full.
- *Documents leave out or gloss over legal issues.* Sales material, capable of being checked for advice, leaves out how promoters in the real world sell the scheme. The documents often assert (wrongly) that the scheme is legal or has been approved by the authorities.
- *Products are over-priced.* High prices may support a top-heavy network of distributors. If the price does not attract repeat purchases by uninvolved customers, then selling distributorships is probably the chief objective.
- *Presentations are high on energy but low on substance.* Questions are discouraged. Thoughtful consideration of the issues is impossible.

Giraffe World Australia Pty Ltd

promoted its “negative ion mat” as both a health product and a business venture at its Happiness Circle meetings. The mat’s negative ions cured anything from arthritis to asthma, insomnia to stress. For \$3,250, purchasers of the mat also became eligible to join the “Grow Rich System” and earn commissions by introducing other purchasers. The Federal Court of Australia declared it to be an illegal pyramid and referral selling scheme. Investors were also unable to recover commissions – the contracts were for an unlawful purpose.

Skybiz.com sold websites and places in the Skybiz 2000 Home Based Business Scheme for US\$100. Members were promised bonuses for signing up others. The Federal Court again declared: “illegal pyramid and referral selling scheme.”

Greenstar Co-op Ltd, through meetings, the Internet and email, promoted investing in its worm farm scheme and in a related worldwide internet transaction card system to generate “multiple sources of lifelong income” – with bonuses for expanding the business. This pyramid scheme collapsed owing members more than \$10 million.

In product-based pyramid schemes, running costs are shifted from the promoter to the members. Low-level distributors may carry the cost of storing goods in stock – then get stuck with them as more and more distributors compete for fewer customers.

Investors will lose any unpaid or disputed earnings from a pyramid scheme. An unlawful contract cannot be enforced through legal action in Australian courts.

Printed material may be supported by legal advice saying that a scheme appears legitimate – but it is not. Documents may have simply left out that no one can make money without concentrating on recruiting. New members may have to make a stark choice after they have paid; break the law or walk away from their losses.

Promoters may claim that because the authorities have registered the business name, this proves the business is legitimate or has been approved. Wrong! Just because the business name is registered, it does not mean that a business is legitimate.

Any “business opportunity” where the inducement to pay to join the scheme is that benefits can be obtained by recruiting others, who can then do the same, is likely to be a pyramid-type fraud. The payment may be a joining fee or disguised as the purchase of a training kit or the initial purchase of stock.

Legal multilevel marketing or illegal pyramid selling scheme?

A legitimate multilevel marketing scheme will have distributors sharing sales commissions with those who sponsored them into the business. In a pyramid selling scheme, selling products is secondary to recruiting.

A legal multilevel marketing program will have the following features:

- customers who want to buy the product and not the scheme;
- repeat sales of competitively priced products to customers who are not necessarily members; and
- commissions are only for sales of products, with no link to finding new distributors.

If you are unsure whether a scheme is legal, contact the Consumer Protection Call Centre for advice on 1300 30 40 54.

Consequences

Anyone involved in a pyramid scheme risks being sued by others, as well as prosecuted by the authorities.

Western Australia's *Fair Trading Act 1987* makes it an offence to be the promoter of, or a participant in, a pyramid scheme. The maximum fine is \$20,000 for an individual or \$100,000 for a corporation (and its directors). If an action is brought under the Commonwealth *Trade Practices Act 1974*, an individual can be fined up to \$220,000 and a company up to \$1.1million. Although law enforcement agencies usually concentrate on a scheme's promoters, victims who have participated are just as responsible under the law.

If a pyramid scheme involves financial products such as shares, managed funds, superannuation, insurance or credit then the Australian Securities and Investments Commission can also prosecute.

The Fair Trading Act and the Trade Practices Act specifically provide that anyone who loses money when someone else contravenes these Acts is entitled to recover the amount from **any person** involved in the offence. So any or all of the victims could choose any person above them in the structure, or anyone who was involved in promoting or presenting the scheme (including other victims) to sue for all their losses. This right to compensation exists independently of any action that law enforcement authorities may or may not take.

Misrepresentations by presenters and promoters about likely earnings can also create a right to compensation and be the subject of criminal charges. It can be pointless trying to take civil action against a "fly-by-night" major scam operator who, like the money, is long gone.

Distributors risk being stuck with supplies they cannot sell or return when recruiting slows. Remember, pyramid schemes only run while they grow at an increasing rate.

The Fair Trading Act does not deal with the social cost of losing friends, or creating family conflict, when a business deal from someone you trusted turns into a financial mess or a criminal investigation.

What should you do now?

The best defence against the cost of pyramid schemes is not to participate!

If you become aware of a scheme that does not look quite right, or if you need more information, contact the Consumer Protection Call Centre on 1300 30 40 54 or Consumer Protection online at www.docep.wa.gov.au.

Visit WA ScamNet at www.docep.wa.gov.au/wascamnet for updates on the latest scams affecting Western Australian consumers.

The Australian Competition and Consumer Commission on 1300 302 502 can also provide advice. The ACCC web site is www.accc.gov.au.

If a suspect scheme involves financial products such as shares, superannuation or credit, it should be reported to the Australian Securities and Investments Commission on 1300 300 630 or through its web site www.asic.gov.au.

The "Fido" website operated by ASIC provides advice on investment scams including pyramid schemes involving financial products, www.asic.gov.au/fido.

