

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Promote personal responsibility -- This bill creates criminal offenses for wrongful conduct.

B. EFFECT OF PROPOSED CHANGES:

Section 849.091, F.S., provides in part that a pyramid sales scheme is declared to be a lottery. It is a first degree misdemeanor for any person to participate in any such lottery by becoming a member of or affiliating with, any such group or organization, or to solicit any person for membership or affiliation in any such group or organization. A first degree misdemeanor is punishable by up to one year in county jail and a fine of up to \$1,000.

That section defines a "pyramid sales scheme" as 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. The term "consideration" and the term "investment" do not include the purchase of goods or services furnished at cost for use in making sales, but not for resale, or time and effort spent in the pursuit of sales or recruiting activities

In a similar vein, s. 849.0915, F.S., prohibits referral selling schemes. It is a first degree misdemeanor for any person to conduct a lottery by referral selling. Referral selling is defined as a scheme whereby the seller gives or offers a rebate or discount to the buyer as an inducement for a sale in consideration of the buyer's providing the seller with the names of prospective purchasers, if earning the rebate or discount is contingent upon the occurrence of an event subsequent to the time the buyer agrees to buy.

The Attorney General, a state attorney, and the Division of Consumer Services of the Department of Agriculture and Consumer Services are each authorized seek an injunction against a person operating a referral selling scheme.

Pyramid sales schemes are also prohibited by federal law. The Federal Trade Commission has taken the lead, prosecuting such schemes as a deceptive and unfair trade practice. The Securities and Exchange Commission has prosecuted pyramid schemes under securities laws (fraudulent representation of expected return on investment).¹ The Postal Service prosecuted pyramid schemes that use the mail as mail fraud.

In practice, distinguishing an illegal pyramid sales scheme from a legal multi-level marketing program is sometimes difficult. The hallmark of an illegal pyramid is that its continued existence depends primarily upon recruitment of new members, and the new member fees that are distributed up the pyramid. The problem with any pyramid scheme is that it eventually collapses as it runs out of new recruits. By contrast, a legitimate multi-level marketing plan, while having the same organizational structure in the form of a pyramid, and while rewarding recruitment of new members by making progressive payments up the pyramid, continues its existence because it relies on the continued sale of goods and services to ultimate consumers.

Florida law looks solely to the test of whether the marketing plan is "primarily contingent" on the recruitment of new members to maintain its existence. The federal law has developed a more

¹ The most notorious of the SEC cases was the prosecution of Orlando, Florida resident Glen W. Turner, who created the "Dare To Be Great" motivational program that was, in effect, a pyramid scheme.

sophisticated model. The two leading cases in the area, both in mid-1970's, were *FTC v. Koscot Interplanetary, Inc.*, and *FTC v. Amway*. *Koscot* listed several factors that the FTC said are indicative of an illegal pyramid disguised as a multi-level marketing plan, where the *Amway* case created a "safe harbor" for multi-level marketing plans by listing factors that tended to show legitimacy. Since the ruling, multi-level marketing plans that have followed the *Amway* model have been considered legitimate multi-level marketing plans, and not illegal pyramid schemes. The *Koscot* list of bad factors include:

- Large membership fees
- Front-end loading, or inventory loading
- Misrepresentation of the reasonable commissions that members could expect
- Commissions not based on the sale of products to ultimate consumers

By contract, the elements of the *Amway* model that the FTC felt showed legitimacy are:

- A representative must make at least 10 sales calls a month in order to be eligible for commissions
- A representative must sell 70% of previously ordered inventory before placing a new order
- The company would buy back unsold inventory at 90% of cost

In examining whether a plan is illegal, one issue that frequently arises is whether sales to members for the member's own use constitute sales to the general public. It is not uncommon for members to purchase the goods for their own use. Indeed, these companies are intended to sell consumer goods, it is logical to think that the best salesperson for a good is someone who is using the good. On the other hand, if the only people buying goods from the company is its own salespeople, then it is little different from the classic pyramid scheme that relies on membership or initiation fees.

The Direct Selling Association estimates that, in 2003, direct sales of consumer goods and services through multi-level marketing plans accounted for gross sales of \$22.4 billion, through nearly 11 million salespeople.

Effect of Bill

This bill repeals the prohibition on pyramid sales schemes in s. 849.091(2), F.S., moving regulation of pyramid schemes to a new section.

This bill creates s. 849.09105, F.S., regarding pyramid promotional schemes. This bill provides that no person may establish, promote, operate, or participate in any pyramid promotional scheme. A limitation as to the number of persons who may participate in or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under a plan does not change the identity of the plan as a pyramid promotional scheme. It is not a defense under this section that a person, on giving consideration, obtains goods, services, or intangible property in addition to the right to receive compensation.

This bill provides that it is a third degree felony to establish, promote, or operate a pyramid promotional scheme. A third degree felony is punishable by up to 5 years imprisonment and a fine of up to \$5,000. The offense is not specifically ranked in the Offense Severity Ranking Chart of the Criminal Punishment Code, and is therefore a Level 1 offense. This bill further provides that it is a first degree misdemeanor to participate in a pyramid promotional scheme. A first degree misdemeanor is punishable by up to 1 year in county jail and a fine of up to \$1,000. Neither offense requires that the offender knowingly be involved with a pyramid promotional scheme.

This bill defines "pyramid promotional scheme" as any plan or operation by which a person gives consideration for the opportunity to receive compensation that is derived primarily from the introduction of other persons into the plan or operation rather than from the sale and consumption of goods,

services, or intangible property by a participant or other persons introduced into the plan or operation. The term includes any plan or operation under which the number of persons who may participate is limited either expressly or by the application of conditions affecting the eligibility of a person to receive compensation under the plan or operation, or any plan or operation under which a person, on giving consideration, obtains any goods, services, or intangible property in addition to the right to receive compensation. The bill defines the following terms:

- "Compensation" means a payment of any money, thing of value, or financial benefit conferred in return for inducing another person to participate in a pyramid promotional scheme.
- "Consideration" means the payment of cash or the purchase of goods, services, or intangible property. The term does not include the purchase of goods or services furnished at cost to be used in making sales and not for resale or time and effort spent in pursuit of sales or recruiting activities.

By this definition, Florida continues using the classic definition of a pyramid scheme, that is, a pyramid scheme is a plan whose primary means of paying commissions to existing members is by recruitment of new members.

The bill also contains a safe harbor provision relating to personal use by members of the marketing plan. This bill provides that a plan or operation is not an illegal pyramid promotional scheme simply because participants purchase goods, services, or intangible property for personal use, consumption, or resale, provided that the plan or operation does not promote or induce inventory loading and the plan or operation implements an appropriate inventory repurchase program.

For purpose of this safe harbor, this bill defines the following terms:

- "Promote" means contrive, prepare, establish, plan, operate, advertise, or otherwise induce or attempt to induce another person to participate in a pyramid promotional scheme, including a pyramid promotional scheme run through the Internet, e-mail, or other electronic communications.
- "Appropriate inventory repurchase program" means a program by which a plan or operation repurchases, upon request and upon commercially reasonable terms, when the salesperson's business relationship with the company ends, current and marketable inventory in the possession of the salesperson that was purchased by the salesperson for resale. Any such plan or operation shall clearly describe the program in its recruiting literature, sales manual, or contract with independent salespersons, including the disclosure of any inventory that is not eligible for repurchase under the program. "Inventory" includes both goods and services, including company-produced promotional materials, sales aids, and sales kits that the plan or operation requires independent salespersons to purchase. "Commercially reasonable terms" means the repurchase of current and marketable inventory within 12 months from the date of purchase at not less than 90 percent of the original net cost, less appropriate set-offs and legal claims, if any. "Current and marketable" excludes inventory that is no longer within its commercially reasonable use or shelf-life period; was clearly described to salespersons prior to purchase as seasonal, discontinued, or special promotion products not subject to the plan or operation's inventory repurchase program; or has been used or opened.

As it relates to actions by the Attorney General, this safe harbor only applies to a determination as to whether a plan is an illegal pyramid scheme. The Attorney General may proceed against any plan, operation, or scheme, or any person involved with such plan, operation, or scheme under any other provision of law.

This bill give the Attorney General the power to do any of the following:

- Issue a cease and desist order, with or without prior hearing, against any person engaged in the prohibited activities, directing such person to cease and desist from further illegal activities;
- Bring an action in the circuit court to enjoin the acts or practices to enforce compliance with this section or any order under this section;
- Impose by order and collect a civil penalty against any person found in an administrative action to have violated any provision of this section, or any order issued under this section, in an amount not to exceed \$10,000 per violation per person. The Attorney General may bring actions to recover penalties pursuant to this paragraph in circuit court. Civil penalties received are deposited in the General Revenue Fund;
- Bring an action in the circuit court under the criminal laws of this state.

If the Attorney General issues a cease and desist order, the order must provide that the recipient has 15 days after the receipt of the order to request a hearing. If no hearing is requested, the order becomes final. A cease and desist order must state its effective date, the intent or purpose, and the grounds on which such order is based. The recipient of a cease and desist order may appeal to the circuit court.

As related to an illegal pyramid scheme, a court may enter a permanent or temporary injunction, restraining order, or writ of mandamus. A court may appoint a receiver or conservator.

The Attorney General may petition a court to enter an order of rescission, restitution, or disgorgement directed to any person who owns or participates in an illegal pyramid scheme. The court may not require the Attorney General to post a bond. The Attorney General is entitled to costs and attorney fees.

C. SECTION DIRECTORY:

Section 1 amends s. 849.091, F.S.

Section 2 creates s. 849.09105, F.S., which section prohibits illegal pyramid schemes and provides for administrative and civil causes of action.

Section 3 provides an effective date of upon becoming law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

The Criminal Justice Estimating Conference estimates that this bill will have an insignificant prison bed impact.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable.

2. Other:

Article I, s. 21, Fla.Const., guarantees access to courts. Article V, s. 1, Fla.Const., provides that the judicial power of the state must rest in the county, circuit, and appellate courts established pursuant to Article V. It is possible that a court might construe the portions of this bill referring matters to administrative tribunals to violate one or both of these provisions.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

There are two concerns with s. 849.09105(5), created by this bill, regarding actions by the Attorney General:

- Paragraph (5)(c) provides that the Attorney General may file an action seeking a civil penalty against a person operating or participating in an illegal pyramid scheme of up to \$10,000 in either an administrative action or in the circuit court. It is unknown whether the administrative hearing process has jurisdiction over this type of legal action. As to circuit court jurisdiction, the jurisdiction of the circuit courts is set by general law, and the legislature can place these cases within the circuit courts, but the current minimum dollar figure for general circuit court jurisdiction is \$15,000. Referring cases that cannot exceed \$10,000 in the circuit courts is inconsistent with current policy on the jurisdictional split between county court and circuit court.
- Paragraph (5)(d) purports to allow the Attorney General to file and prosecute a criminal court action. However, only locally elected state attorneys may prosecute actions in the circuit court²; unless the criminal activity occurs in two or more judicial circuits as part of a related transaction, in which case the statewide prosecutor may prosecute the offender.³ The state constitution does not allow or permit the Attorney General to bring or prosecute criminal charges.

This bill creates a strict liability offense for participating in a pyramid promotional scheme. It is possible that an unsophisticated person may not realize that he or she is buying into a pyramid promotional scheme. Indeed, it is the unsophisticated who are victimized by the scheme.

This bill provides an effective date of "upon becoming law." Bills creating a new criminal offense, like this bill, traditionally are given a specific effective date, usually October 1.

² Article V, s. 17, Fla.Const.

³ Article IV, s. 4(b), Fla.Const.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

n/a