

Beware of Pyramid Schemes



Recently my office has received numerous inquiries regarding “get rich quick” offers. In particular, consumers have asked about the legality of

multilevel marketing plans (MLMs) and gifting clubs. While these solicitations may be tempting, you should use extreme caution before investing in offers that sound too good to be true--they usually are. In addition to possibly losing money, you could be participating in an illegal pyramid scheme.

Multilevel marketing plans entail selling goods or services through distributors. These plans typically promise that if you sign up as a distributor, you'll receive commissions for your sales and those of the people you recruit to become distributors.

Some multilevel marketing plans are legitimate. However, others are illegal pyramid schemes. In pyramids, commissions are based on the number of distributors recruited, not on the items you sell. Most of the product sales are made to these distributors, not to consumers in general. The underlying goods and services serve only to make the schemes look legitimate.

Joining a pyramid is risky because the vast majority of participants lose money to pay for the rewards of a lucky few. Most people end up with nothing to show for their money except the expensive products or marketing materials they were pressured to buy.

The Texas Deceptive Trade Practices Act (DTPA) prohibits pyramid promotional schemes. The DTPA defines a pyramid as a plan or operation by which a person gives consideration for the opportunity to receive compensation that is derived primarily from a person's introduction of other persons to participate in the plan or operation, rather than from the sale of a product.

This means that, for an MLM plan to be legal, commissions must come from the retail sale of a product and not from the recruitment of people to the sales team.

Besides being a violation of civil law, pyramid promotion is also a state jail felony punishable by imprisonment in a state jail for up to two years and by a fine of up to \$10,000.

You should be skeptical of programs that can only be successful if new recruits continually join the sales organization. Are you required to recruit new people as a condition of joining the organization or can

you earn money simply by selling the product?

Before you join, be sure the product offered is something for which there is a market. Ask what the average monthly retail sales are per salesperson. Be wary of anyone who tells you that you do not have to sell anything to make money. For it to be legitimate, commissions must come from the retail sales of goods, so at some point someone will have to sell something.

If the program you are considering does not provide distributors with a contractually enforceable right to a 90% refund of commercially resalable product within one year of the purchase of the product by the distributor, the program may be an illegal pyramid, not a multi-level distributorship.

Be extremely careful and wary of buying business opportunities out of weekend seminars given in local hotels or advertised on late night television infomercials. If you buy from a hotel seminar, you must be given notice of a three-day right to cancel.

Be wary of a sales pitch that includes promises of high rewards with little effort. Investments of these types are risky and can lead to significant financial loss.

POINTS TO REMEMBER

Pyramids and Gift Clubs

- Beware of offers that sound too good to be true
- Don't invest in offers where commission is contingent upon bringing in new recruits
- Pyramid schemes are illegal

For more information on pyramid schemes:

Federal Trade Commission
600 Pennsylvania Ave. NW
Washington, DC 20580
877-FTC-HELP (382-4357)
www.ftc.gov

To access a copy of the Texas Deceptive Trade Act:

Texas State Law Library
Post Office Box 12367
Austin, TX 78711
(512) 463-1722
www.sll.state.tx.us
www.capitol.state.tx.us



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