



THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

**Draft Information Bulletin on
Multi-Level Marketing and
Scheme of Pyramid Selling**
Sections 55 and 55.1 of the Competition Act

**NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION**

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PREFACE

The Canadian Bar Association is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Competition Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Competition Law Section of the Canadian Bar Association.

Draft Information Bulletin on Multi-Level Marketing and Scheme of Pyramid Selling

Sections 55 and 55.1 of the *Competition Act*

I. INTRODUCTION

The National Competition Law Section of the Canadian Bar Association (the CBA Section) is pleased to have the opportunity to comment on the draft information bulletin on *Multi-level Marketing and Scheme of Pyramid Selling Sections 55 and 55.1 of the Competition Act* (the draft MLM Bulletin) released for public comment by the Competition Bureau on April 1, 2008. This submission reflects our review only of the English language version of the draft MLM Bulletin. The CBA Section continues to strongly support the Bureau's public education program, including guidelines, bulletins and other interpretive aids made widely available to the business community in Canada.

Part II of this submission provides our summary comments and recommendations on the draft MLM Bulletin. Part III provides more detailed comments and recommendations.

II. SUMMARY COMMENTS AND RECOMMENDATIONS

The draft MLM Bulletin is more comprehensive than the existing Bureau enforcement guideline, *Multi-level Marketing and Pyramid Selling Provisions of the Competition Act* (current MLM Guideline), and in this regard improves on the current MLM Guideline. In particular, the draft MLM Bulletin builds on the current MLM Guideline by providing:

- a fuller description of a scheme of pyramid selling;
- new definitions and descriptions for certain terms (operator, prospective participant, and operator's cost/seller's cost);
- new illustrative examples (examples 7, 8, 11, 12, 15 and 16);

- new information about the factors the Bureau considers to determine whether a product purchase is required as a condition for participation;
- a more detailed treatment of the requirements for written opinion applications and the circumstances under which an opinion may not be issued; and
- other additions and changes to content from the current MLM Guideline.

While we view the draft MLM Bulletin as a positive step toward more comprehensive guidance on the Bureau's approach to sections 55 and 55.1 of the *Competition Act*, we believe some important improvements can be made to this document. In this regard, our summary comments and recommendations are as follows:

At an organizational level, the draft MLM Bulletin is difficult to understand. We make a number of recommendations (mostly concerning the nesting of headings) to make the document easier to understand and use.

We believe that the descriptions of an MLM plan, especially of a scheme of pyramid sales, can be improved. We suggest redrafts that we believe preserve the intended substance.

We believe that the Bureau's definitions and descriptions of certain key terms, namely Operator, Prospective Participant, Typical Participant, Non-Typical Participant, Representations Relating to Compensation and Operator's Cost/Seller's Cost, can be improved. Our redrafts simplify the definitions while preserving the essential substantive content. We also recommend stating that these are not statutory definitions.

We recommend a number of changes to correct errors and improve the reading of the Disclosure and the Due Diligence parts. We note that the stated disclosure and due diligence standards go beyond the requirements under the Act. We recommend clarifying the differences between the statutory standards and those the Bureau view to be best practices.

We recommend a number of changes to the “Purchase Requirements as a Condition of Participation” and the “Buy-back Guarantee/Right to Return” portions of the “Features of a Scheme of Pyramid Selling” part, with a view to improving their accuracy and clarity.

We question and recommend changes to the Bureau’s position on some conditions that must be met for the Bureau to provide a written opinion on an MLM plan: (1) the MLM plan operator must be incorporated in Canada or the Bureau must be satisfied that someone in Canada can be held liable for the actions of the operator; (2) the MLM plan cannot be presently operating in Canada (subject to limited exceptions); (3) the Bureau must be satisfied that all performance representations for all products that may be promoted by the MLM plan are based on adequate and proper tests; and (4) the MLM plan must not appear to the Bureau to raise an issue under any other Canadian legislation.

III. DETAILED COMMENTS AND RECOMMENDATIONS

A. Organization/Table of Contents (Pages 2-4)

The organization of the draft MLM Bulletin is difficult to understand, even by referring to its table of contents. We recommend a number of organizational changes, the rationale for which, where not self-evident, is addressed further below.

- Make the current second-level heading “Definition of a Multi-level Marketing Plan under the Act” a third-level heading beneath a new second-level heading “A Multi-level Marketing Plan”. Similarly, make the current second-level heading “Definition of a Scheme of Pyramid Selling under the Act” a third-level heading under the current second-level heading “A Scheme of Pyramid Selling”.
- Make the definitions for “Operator”, “Prospective Participant”, “Participant”, “Typical Participants”, “Non-Typical Participants”, “Representations Relating to Compensation” and “Operator’s Cost/Seller’s Cost” third-level headings under the current first-level heading “Multi-level Marketing Plans” and a new second-level heading “Working Definitions of Key Terms”.

- Rename the first-level heading “Disclosure Requirements” as “Multi-level Marketing Plan Disclosure Requirements”, and rename the first-level heading “Due Diligence” as “Multi-level Marketing Plan Due Diligence Requirements”.
- Change the first-level headings “Requirements for a MLM Written Opinion Application” and “Refusal to Provide a Written Opinion” to second-level headings (with consequent changes of current second-level headings to third-level headings). In addition, change the first-level headings “Refusal – Other Conduct Contrary to the Act” and “Refusal – Other Canadian Regulatory Agencies” to third-level headings under the “Refusal to Provide a Written Opinion”.
- Providing alpha-numeric reference numbers to the various parts (while keeping the current numbering and layout for examples).

B. Introduction (Page 5)

In the first sentence, we recommend adding the text “the nature of and” immediately after “This bulletin describes”.

C. Multi-Level Marketing Plans (Page 6)

We recommend adding a second-level heading “A Multi-level Marketing Plan” immediately below the first-level heading “Multi-Level Marketing Plans”. This provides a logical parallel structure of MLM description/MLM statutory definition and Pyramid Scheme description/Pyramid Scheme statutory definition to begin this part.

D. Multi-Level Marketing Plans (Page 7)

The first full paragraph on page 7 makes two separate points. We recommend separating those points into separate paragraphs and some rewording and rearranging to make the points clearer:

To prevent the deception of prospective participants, if the operator or participant makes any representation about the compensation that is or may be earned in the plan, the operator or participant making the representation must disclose the compensation earned by typical participants in the plan.

Often a product purchase, such as a distributor kit, is required to participate in an MLM plan. If the operator of an MLM plan requires a person to purchase a

product to participate in the plan then the product must be sold at the seller's cost and only for the purpose of facilitating sales.

We recommend that "Definition of a Multi-Level Marketing Scheme" be a third level-heading, that the relevant excerpt from subsection 55(1) of the Act be inserted and that reference be made to the full text of subsection 55(1) and other relevant provisions in Appendix A.

E. A Scheme of Pyramid Selling (Pages 7-8)

To assist in the flow of the description of illegal pyramid schemes, we recommend reorganizing the material in this part as set out below. In addition, we recommend adding at least a paraphrase of *Criminal Code* 206(1)(e) at the end of the part or in a footnote, and that the heading "Definition of a Scheme of Pyramid Selling" become a third-level heading.

A scheme of pyramid selling is a form of a MLM plan focussed primarily on generating earnings through recruitment. Such schemes typically offer products, however these products may have very little value or the plan may offer minimal incentives for their sale. Income in the scheme of pyramid selling is derived primarily from the money prospective participants pay to join the scheme and not from the sale of product.

Often schemes of pyramid selling promise huge wealth and financial security to their participants. They always require the participant to pay to join. This payment may be described as an enrollment fee, a membership fee or as an investment into a money-making enterprise. In addition to payment, participants are typically told that they must recruit others into the plan, who in turn must recruit others into the plan before they are able to earn any money. Given the finite pool of potential recruits, pyramid selling schemes are inherently unsustainable and eventually collapse. Although a small number of participants in a pyramid selling scheme make money, the overwhelming majority of participants lose their money.

Schemes of pyramid selling are illegal under both the Act and the *Criminal Code*.

F. Definitions (Pages 8-9 and 14-15)

We recommend a new second-level heading "Working Definitions of Key Terms" and a clear statement that the definitions are not statutory definitions but those used by the Bureau. In aid of this, we recommend beginning each definition with "The Bureau defines ...".

Under the heading “Working Definitions of Key Terms”, we recommend that the following definitions be provided under third-level headings for Operator, Prospective Participant, Participant, Typical Participants, Non-Typical Participants, Representations Relating to Compensation, and Operator’s Selling Cost/Seller’s Cost. Given that some of these terms are used earlier in this part of the draft MLM Bulletin, it also may be useful to note at that earlier point that the Bureau has developed working definitions for these terms.

Operator

Given that the word “operator” does not appear in the Act, we recommend stating “An operator is a person who operates an MLM plan.” If the current definition is maintained, we recommend that in the first sentence the word “manages” be changed to “operates”, because nothing in the Act indicates that the provisions targeting those who operate a plan extend to those who merely manage a plan. We also recommend that in the second sentence the word “usually” be inserted immediately before “legally”.

Prospective Participant

We recommend a revised definition that, in our view, more closely accords with the language of the Act.

A prospective participant is an individual who has expressed interest in joining an MLM plan or has been approached by a current participant or operator to supply the product to others, with the prospect of earning compensation through the MLM plan.

Typical Participants

The Act does not make reference to a “typical participant”, but to “typical participants” and, more specifically, to representations relating to compensation actually or likely to be received by typical participants. Thus, we recommend defining “typical participants” rather than “typical participant”. As well as closer accord with the wording of the Act, this avoids the question that arises from the current definition of just how a “typical participant is representative of the smallest range ...”.

In addition, the second paragraph addresses disclosure, which is out of place in a definition of “typical participant” (and is addressed later). We recommend a sentence that more directly

addresses typical participants be inserted before the last sentence of the current first paragraph. We also recommend that Bureau permit some flexibility in what typical participants are in a given case by qualifying the definition with the word “normally”.

This redraft of the first paragraph incorporates the recommended changes:

The Bureau normally defines typical participants as the participants corresponding to the smallest range of compensation earned by a majority of participants in the plan. Where no single level of compensation accounts for a majority of participants (greater than 50%), reference must be made to the *fewest compensation levels* that together include a majority of the participants. Thus, the average compensation of participants in a plan alone is not normally considered to represent the compensation that typical participants in a plan actually or are likely to receive. For the purposes of this calculation the Bureau excludes individuals who have been participants for less than one year.

Non-typical Participants

Again, we recommend the plural “non-typical participants” rather than the singular “non-typical participant”. We also recommend defining non-typical participants primarily (and simply) by reference to typical participants. The second sentence does not provide an example of how to determine non-typical participants. We therefore recommend that it be removed. Finally, the last sentence addresses disclosure, which is out of place in a definition of non-typical participants (disclosure is addressed later), and it should also be removed.

This redraft of the definition incorporates the recommended changes:

The Bureau defines non-typical participants as any subset of participants that do not together correspond to the smallest range of compensation earned by a majority of participants in the plan.

Representations Relating to Compensation

We recommend minor changes to this definition:

A representation about compensation is any statement, declaration or image that conveys a message about the compensation a person could expect to earn as a participant of an MLM plan. A representation relating to compensation is not necessarily limited to a dollar figure or monetary range, but may also include:

- representations about obtaining, as a result of compensation from the MLM plan, luxury goods such as vehicles, jewellery, watches, homes, vacation destinations;
- promises of opportunities to earn bonuses, commissions and other financial rewards;
- profiles of non-typical participants who have been unusually successful in earning money in the MLM plan;
- similar representations as those above that are made in testimonials; and
- testimonials from people who claim that, as a result of compensation from the MLM plan, they were able to improve their quality of life, quit their jobs or pay down all their debts.

Operator's Cost / Seller's Cost

We recommend that this definition reflect that the Act speaks of seller's cost (not operator's cost) and of cost (not amounts paid), and that it also reflect that the seller of products to plan participants may not be the operator. This redraft incorporates these recommendations:

Operator's or seller's cost is the cost the operator of the MLM plan or another seller incurs to acquire a product. Thus, where a participant in the MLM plan gives consideration for a certain amount of product as a condition for participating in the plan, the Act requires that the operator or other seller supply the product to plan participants at a price no greater than the cost incurred by the operator or other seller to produce or acquire the product.

G. Disclosure Requirements (Pages 10-12)

The first paragraph of this part mentions subsections 55(2) and 55(2.1) of the Act, but does not make clear what each subsection requires and that the former applies to operators and participants, while the latter applies to operators only. We recommend clarifying this, preferably with excerpts from the Act (similar to references under the heading "New Multi-level Marketing Plans").

For the reasons above, we recommend that the text in this part incorporate the plural forms "typical participants" and "non-typical participants", rather than the singular of these terms.

We recommend that Example 1 note that if a different set of compensation levels are used for the same MLM plan, different compensation ranges for typical participants may emerge.

Under the heading “Fair, Reasonable and Timely Disclosure”, we note that in subsections 55(2) and (2.1) of the Act, the requirement for disclosure to prospective participants and participants, relates only to information concerning “typical participants”. We recommend making this clear by referring to typical participants in the first sentence, prior to the list of requirements. In addition, item (f) in the list of requirements goes beyond the requirements of subsections 55(2) and (2.1). If this is kept on the list, it should be noted.

H. Due Diligence (Pages 13-14)

Instead of all policies and procedures of an operator, the first paragraph of this part should more specifically reference only the making of representations related to compensation, given that the reference to due diligence pertains only to the defence under subsection 55(2.2) of the Act in respect of compensation representations under subsection 55(2.1).

In our view, the second paragraph indicates that the Bureau will seek to apply only a narrower due diligence defence than provided under subsection 55(3) of the Act. We recommend that this paragraph be removed, the preferred choice in our view (the examples in the draft MLM Bulletin are sufficient to give the necessary guidance). Alternatively, it should be made clear that although the standard of “clear, concise and continuous communication” is a best practice the Bureau would like operators to strive for, it is not a standard required under the Act.

Example 3 incorrectly states that a participant may be liable under subsection 55(3) of the Act for a breach of subsection 55(2.1). This should be corrected either by making reference to subsection 55(2) or removing reference to the possible contravention of subsection 55(2.1) by a (non-operator) participant.

I. Features of a Scheme of Pyramid Selling (Pages 15-22)

Purchase Requirements as a Condition of Participation (pages 16-17)

The last sentence of the first paragraph is confusing as regards restrictions on purchase requirements as a condition of the plan. We recommend that it be removed. The preceding

sentence is sufficient to raise awareness that a lack of retail sales may indicate that an issue on this basis may be identified.

To clarify the first sentence of the second paragraph, we recommend inserting “, as a condition of participation in the plan,” immediately after “have”, and removing “which is”.

In footnote 3, we recommend substituting “means” for “is defined as”.

Buy-back Guarantee/Right to Return (pages 20-21)

In the first sentence of the second paragraph, we recommend substituting “Some factors the Bureau will consider” for “Factors to be considered”, since the list should presumably not be treated as exhaustive.

To better match the wording of the Act, in bullet (d) in the second paragraph we recommend substituting “commercially unreasonable limits on the ability of a participant to” for “the number of times a participant may”.

To indicate that the Bureau understands the business realities faced by operators, we recommend adding to bullet (g) “, excluding required product purchases that otherwise satisfy section 55.1 of the Act” immediately after “product”.

J. Written Opinions (Pages 23-26)

Requirements for an MLM Written Opinion (pages 23-24) and Refusal to Provide a Written Opinion (pages 24-25)

We understand including in the last paragraph on page 23 “the methodology used for determining the compensation of a ‘typical participant’” in the information required for an application for a written opinion indicates that the definition of typical participant may not be appropriate in all cases. We agree with this view. However, prior to an MLM plan being launched, it is difficult (often very difficult) for the MLM plan operator to project accurately the level and distribution of compensation across participants in the plan. For this reason, we recommend that “the methodology used for determining the compensation of a ‘typical

participant” be excluded from the list of required information, or, at a minimum, that the following text be included in at least a footnote:

The Bureau understands that, prior to an MLM plan being launched, it is generally difficult for an MLM plan operator to project accurately the level and distribution of compensation across participants in the plan. The Bureau does not propose to refuse to issue a written opinion on the basis of the proposed methodology for determining the compensation of typical participants.

We recommend that the “Canadian Legal Identity” part and the bullet point “the MLM plan has no legal Canadian identity” be deleted. In our view, the written opinion process authorized under section 124.1 of the Act should not be used to create obstacles for non-Canadians seeking to do business in Canada. The Act does not indicate that the Commissioner should withhold a written opinion on the applicability of the Act or regulations to MLM plans on the basis that the MLM operator is not a Canadian corporation or that, in the view of the Commissioner, no one else in Canada may be held liable for the actions of the operator. Ownership and investment in Canada by non-Canadians is addressed through other federal legislation.

In addition, we question what purpose is served by generally denying a written opinion on an MLM plan only on the basis that the MLM plan is already operating in Canada. We recommend, therefore, that the page 25 bullet point “the MLM plan is already operating in Canada (refer to Proposed conduct on page 21 [sic])” be deleted, and that a written opinion be available only in respect of proposed conduct, not past conduct, in connection with an MLM plan (with the page 24 “Proposed Conduct” part amended accordingly).

Furthermore, in respect of Performance Claims, we recommend that the Bureau qualify its written opinion on the MLM plan to specifically exclude any opinion on product performance claims, rather than refuse to provide the written opinion until it is satisfied as to all product performance claims. Indeed, the draft MLM Bulletin explicitly acknowledges at page 23 that, depending on the facts available to it, the Bureau may need to (and therefore must be willing to) qualify its written opinion on an MLM plan. A written opinion on an MLM plan could simply state that the opinion does not speak to the performance of the products. We recommend, therefore, that the page 25 bullet point “the MLM plan contains

performance representations that are not based on an adequate and proper test” and the section “Performance Claims [paragraph 74.01(1)(b)]” be deleted.

Finally, in our view, prior to refusing to issue an advisory opinion on the basis that a proposed MLM plan appears to raise an issue under other Canadian legislation, the Bureau should provide the applicant with information about the issue in question and the reasons why the Bureau believes the issue arises (including any views obtained from any “Other Canadian Regulatory Agency”), and the applicant should have the opportunity to make submissions to the Bureau on the issue in question. We recommend that this part be amended to reflect these views. We also recommend that the Bureau clarify whether reference in this part to “an issue under other Canadian legislation” includes legislation of Canadian provinces and territories.

K. Appendix A (Pages 27-28)

We recommend including the text of section 206 of the *Criminal Code* in Appendix A.