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From,

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To

The Prime Minister of India,

South Block,

New Delhi-110001

Sub: **REGULATION OF MULTI-LEVEL MARKETING SCHEMES**

Dear Mr. Prime Minister,

I am addressing this letter to you on behalf of Common Cause, a civil society organization dedicated to articulating the common problems of the people and securing redress for them. In its espousal of public causes over three decades, Common Cause has used the instruments of policy advocacy and public interest litigation to good effect.

At the outset, we welcome the move of the Government to form a central agency to regulate multi-level marketing (MLM) schemes, as reported in “The Mint” of April 12, 2012 ( **Annexure 1**). These schemes have indeed become the preferred mode of fraud by unscrupulous companies. They resort to disingenuous marketing techniques to loot the gullible public, which is lured into join them by promises of extraordinary profits. Projected as great business opportunities for enterprising people, these schemes, which go under a variety of names, such as chain business, network marketing, sponsoring business, introduction business, and referral marketing, are designed to benefit the promoters, and a handful of people close to them, at the expense of millions of common people, who end up being defrauded of their lives’ savings.

The MLM companies camouflage their real motive of making easy and quick money as a legitimate business activity of sale of goods at the front end. They may pretend to market various high-priced goods, like health-care products, fancy household items, gold coins, cosmetics and medicines, only to confuse the law enforcing agencies and throw them off their trail. Experience has shown that many such companies do the vanishing trick after having enrolled and entrapped a large number of unwary members and making a killing from the hefty enrolment fees extracted from them.

The report in The Mint seeks to make a specious distinction between basically fraudulent fly-by-night operators and companies running legitimate direct-selling businesses, which are supposed to have welcomed the government move. It proceeds to quote extensively from the self-righteous statements made by the Secretary General of the Indian Direct Selling Association and the spokesperson of Amway.

In this context, we consider it our duty to sound a note of caution and underline the danger inherent in giving credence to labels such as multi-level marketing company and network marketing company and assuming that all so-called direct-selling companies, or companies dealing with the distribution of goods, are exempt from the penal provisions of the law against money circulation schemes.

If one were to scratch a little under the surface, one would discover that the real interest of most MLM companies lies not in direct sale of products, but in the enrollment of a hierarchy of members.  They eventually create more distributors than customers, empowering every distributor to enroll an infinite number of distributors without any restrictions. A person can become a “distributor” only if he is sponsored by another distributor/independent business associate.  The incentives to which a newly enrolled distributor is entitled to are a function of the number of distributors/independent business associates he sponsors. The chain can go on endlessly so long as fresh distributors can be entrapped by the mirage of fantastic commissions projected with the help of motivational tools and mind control techniques. Eventually, the bubble bursts; the multi-level pyramidal structure put in place cannot expand any further resulting in the ruin of millions of distributors.

CNN-IBN, a well regarded TV News channel, had conducted an investigation into the working of MLM companies and brought to light the stories of exploitation of innocent people. A report in this regard is enclosed for your perusal. **(Annexure 2)**

Many countries across the world, such as China, Sri Lanka, Singapore, Canada and Albania, have banned the activities of pyramid schemes on charges of resorting to unfair trade practices, siphoning of money and endangering the health of their economies. In India as well, the Prize Chits and Money Circulation Schemes (Banning) Act, 1978, has been enacted to deal with this menace. Section 2(c) of the said Act defines a Money Circulation Scheme to mean any scheme, by whatever name called, for making of quick or easy money; or for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme; whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions. A plain reading of this provision makes it clear that the supposedly legitimate direct-selling businesses also fall within the mischief of this provision as the incentives payable to the members are linked to the enrolment of new members in their schemes.

The Constitutional validity of this provision was examined by the Apex Court in **Srinivasa Enterprises Vs Union of India AIR 1981 504 SC.** The Supreme Court held that money circulation schemes are prejudicial to the public interest and adversely affect the efficacy of fiscal and monetary policy. In the words of the Hon’ble Court, the conduct of prize chits or benefit schemes by whatever name called should be totally banned in the larger interest of the public.

In order to grasp the significance of the definition of Money Circulation Scheme in the said Act, one has to look at the mischief which the legislation has sought to remedy. The legislation was proposed by a study group constituted by the Reserve Bank of India under the leadership of Dr. J.S. Raj, Deputy Governor, Reserve Bank, in the year 1974. After extensive research and analysis of various schemes which were operating in the country at that time and taking into consideration their impact on the economy, the study group suggested a ban on prize chit and money circulation schemes, which were causing a great loss to the economy by siphoning off funds that could have been used for industrial and social development. The study group observed that such schemes primarily benefited the promoters and did not serve any social purpose. On the contrary, they were prejudicial to the public interest and adversely affected the efficacy of the fiscal and monetary policy. At that time, there was a public clamour for banning such schemes in the context of rampant malpractices by the promoters and the unbridled exploitation of a gullible public.

After the enactment of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978, the practice of camouflaging money circulation schemes as direct-selling schemes for distribution of goods and services has become firmly established. The promoters of such schemes have also tried to distinguish themselves from pyramid-structure schemes and secure declarations from government authorities as well as the courts that the penal provisions of the said Act do not apply to them. The Ministry of Consumer Affairs, Food and Public Distribution, in fact, obliged by issuing a circular dated March 31, 2003 to the effect that activities of direct/network/multi-leve marketing did not fall within the provisions of the said Act. This view was reiterated by members of the government in Parliament.

The correct legal position in this regard has been clarified by the High Court of Madras in Apple FMCG Marketing (Pvt) Limited V. Union of India and others (W.P.No:22674 OF 2004). It deserves to be quoted *in extenso*.

“20. Section 2 of the Prize Chits and Money Circulation Schemes (Banning) Act, defines ‘Money Circulation Scheme’, as follows:

“Money circulation scheme” means any scheme, by whatever name called, for the making of quick or easy money, or for the receipt of any money or valuable thing as the consideration or a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical sub-scriptions.”

“The above definition makes it clear that any scheme by whatever name it is called whereby on a promise that one would receive or would make quick or easy money by enrolment as members into the scheme is ‘money circulation scheme’. In this case, there is enrolment of members into the scheme; there is also a promise made that on such enrolment of large number of persons into the scheme, one would make quick money or easy money. There cannot be any doubt that by enrolling new members and by the process of selling the goods to new distributors this chain progresses; the person who became such members earlier get commission without doing any work; getting such a commission is nothing but getting quick or easy money. Therefore, such schemes the so called ‘Multilevel Marketing’, definitely falls within the definition of ‘money circulation scheme’.

“21. The learned counsel for the petitioner submitted that Union of India has made a clarification in an answer to a question in Parliament that Multi-level Marketing does not violate or offend the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act. It is suffice to say (sic) that it is not for Union of India or any Member of Parliament to interpret the provisions of any Member of Parliament. The act has been passed by the Parliament, but the power to interpret the Act is only vested in judiciary and that power is not given to the Executive. The statement given by the Union of India or its Officers that Multi-level Marketing does not attract the provisions of the Act cannot legalise an illegal act.

“22. It is true that several companies including Multinational Companies carry on the business of the “Multilevel Marketing” and it is also true that the executive and the law enforcing authorities keep a blind eye on such activities. This also does not make an illegal act legal. It is always a fact that the law enforcing authority would try to close the stable only after the horse had escaped.” That is the law enforcing authority would realize that this scheme would ultimately leave a large number of persons cheated. Thereafter, after losing their money, they would approach the executive complaining that they were cheated. Till such time, the law enforcing authorities do not act. They do not take preventive action to enforce the provisions of the existing law.”

The test to be applied for identifying a money circulation scheme has been laid down by the Supreme Court in **State of West Bengal V. Swapan Kumar Guha, (1982) I SCC 561 (Cri) 283** and relied on in **Kuriachan Chacko & Others V. State of Kerala (2008) 8 SCC.** It follows that any business model of multi-level marketing, which is predicated on an open-ended enrolment of members, who are arranged in a hierarchy and derive benefits from the activity of enrolment of members in function of their proximity to the promoters forming the top of the hierarchy, is illegal per se, being in violation of the provisions of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. This is irrespective of whether the so-called MLM company actually engages in direct selling of goods. The model also bears the taint of fraud as unwary, innocent people are enticed into joining such schemes by holding out unrealizable prospects of quick enrichment. The distributors of the scheme are pressurized in various ways into abusing family loyalties and social relationships to entrap new members to enrich themselves. However, the lion’s share of the membership fees is siphoned off by the promoters.

It would be pertinent to refer here to the verdict in writ petition **Geminitech Marketing Private Ltd, Amway India Enterprises & Others Vs State of A.P. and Others** in the Andhra Pradesh High Court at Hyderabad, wherein the petitioners had sought a declaration that the provisions of the Prize Chits and Money Circulation Scheme (Banning) Act, 1978 had no application to the business carried on by the petitioners and their distributors. They sought a consequential direction to the respondents not to apply or enforce the provisions of the Act in relation to the petitioners’ businesses. The High Court comprehensively dismissed the writ petition vide its order dated 30.7.2010 (**Annexure 3**), holding that the schemes run by the petitioners squarely attracted the definition of “money circulation scheme.”

The verdict of the Andhra Pradesh High Court has brought out the inherent illegality of the operations of MLM companies. The mandate of the proposed central regulatory authority should be derived from this basic premise. It should be adequately empowered to be able to ensure that the law is implemented in its true spirit and that no MLM company, whose business model is dependent on enrollment of members into its scheme, is allowed to carry on its operations.

We would urge you to share the thinking of the government on the scope, structure and statutory backing of the proposed regulatory authority with us. We would also request you to ensure that, in keeping with the best traditions of participatory democracy and the spirit underlying Section 4 (1) (c) of the Right to Information Act, 2005, this information is placed in the public domain and that the views of civil society are taken into account while finalising the terms of reference and constitution of the said authority.

Yours faithfully,

(Kamal Kant Jaswal)

Director