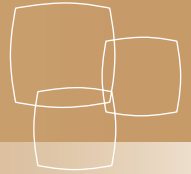




Enforcement Guidelines



Multi-level Marketing Plans and Schemes of Pyramid Selling

Sections 55 and 55.1 of the
Competition Act

This publication is not a legal document. It contains general information and is provided for convenience and guidance in applying the *Competition Act*.

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For information on the Competition Bureau's activities, please contact:

Information Centre
Competition Bureau
50 Victoria Street
Gatineau QC K1A 0C9

Tel.: 819-997-4282

Toll free: 1-800-348-5358

TTY (for hearing impaired): 1-800-642-3844

Fax: 819-997-0324

Web site: www.competitionbureau.gc.ca

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PREFACE

The purpose of this bulletin is to provide guidance on the Competition Bureau's policies and procedures relating to the administration of the multi-level marketing and scheme of pyramid selling provisions of the *Competition Act*. This bulletin is a guide only, any examples contained herein are for purposes of illustration and are not intended to provide an exhaustive list of permitted or prohibited practices. Further, the views expressed do not bind the Commissioner of Competition. The Commissioner has no authority to decide the law, and readers are advised to consult the *Competition Act* in circumstances requiring precise statements of the law.

Melanie L. Aitken
Interim Commissioner of Competition

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1. INTRODUCTION

This bulletin describes the nature of, and the differences between, a multi-level marketing plan (“MLM plan”) and a scheme of pyramid selling as outlined in sections 55 and 55.1 of the *Competition Act*. It also describes the general principles and policies applied by the Bureau with respect to these provisions.



2. THE *COMPETITION ACT*

The *Competition Act*¹ (the “Act”) is a law of general application that establishes basic principles for the conduct of business in Canada. The purpose of the Act is to maintain and encourage competition, thereby:

- promoting the efficiency and adaptability of the Canadian economy;
- expanding opportunities for Canadian participation in world markets while recognizing the role of foreign competition in Canada;
- ensuring small and medium-sized enterprises have equal opportunity to participate in the Canadian economy; and
- providing consumers with competitive prices and product choices.



3. ROLE OF THE COMPETITION BUREAU

The Competition Bureau is an independent agency that contributes to the prosperity of Canadians by protecting and promoting competitive markets and enabling informed consumer choice.

Headed by the Commissioner of Competition, the Bureau is responsible for the administration and enforcement of the *Competition Act*, the *Consumer Packaging and Labelling Act*, the *Textile Labelling Act* and the *Precious Metals Marking Act*.

When there has been a contravention or violation of the law, the Bureau’s objective is to correct anti-competitive activities and deter responsible firms and individuals from future anti-competitive conduct. The Bureau also encourages firms to set up corporate compliance programs² to ensure they adopt policies and practices that conform with the law.

¹ R.S.C. 1985, c. C-34, available on-line at: www.laws.justice.gc.ca.

² Refer to the Bureau’s website for its *Information Bulletin on Corporate Compliance Programs*.

The Bureau emphasizes education and voluntary compliance to limit the need for contested legal proceedings, and consequently, works to inform businesses and other stakeholders about the laws. Through its advocacy program, the Bureau actively promotes a competitive marketplace and contributes to the development of competition policy legislation.

The Bureau's commitment to educating the marketplace is complemented by several forms of voluntary compliance. These range from written opinions, which assist businesses that want to avoid breaking the law, to alternative case resolutions, which correct anti-competitive behaviour in a timely and cost-effective fashion.

Businesses and individuals who disregard the law or fail to take advantage of opportunities for voluntary compliance may be prosecuted by the Public Prosecution Service of Canada in criminal court or be subject to civil litigation by the Bureau before the Competition Tribunal or in a civil court.



4. MULTI-LEVEL MARKETING PLANS AND SCHEMES OF PYRAMID SELLING OVERVIEW

4.1 Multi-level Marketing Plans

An MLM plan is a plan with three or more levels (the operator and at least two levels of participants) that promotes the supply³ of a product⁴ to participants of the plan. Compensation is earned by participants in the MLM plan based on the supply of the product to participants and/or non-participants of the MLM plan. A legitimate MLM plan focusses on the supply of products rather than the recruitment of prospective participants into the MLM plan and offers products that consumers value and are willing to purchase (certain terms used in this section are defined below).

To prevent the deception of prospective participants, if an operator or a participant makes any representation about the compensation that is or may be earned under the MLM plan, the operator or participant making the representation must disclose the compensation received by typical participants in the MLM 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 MLM plan then the product must be sold at the seller's cost and only for the purpose of facilitating sales.

³ Refer to section 2 of the Act for the definition of "supply".

⁴ A product may be an article or a service.

Definition of a Multi-level Marketing Plan

Subsection 55(1) of the Act defines an MLM plan as a plan in which a participant receives compensation for the supply of a product to another participant, who in turn receives compensation for the supply of the same or another product to yet another participant in the MLM plan. Subsections 55(2) and 55(2.1) set out certain obligations relating to compensation disclosure by operators of and participants in MLM plans. Failure to comply with these obligations is subject to criminal penalties as set out in subsection 55(3). The full text of these provisions is set out in Appendix A to this bulletin.

4.2 Schemes of Pyramid Selling

A scheme of pyramid selling is a form of an MLM plan focussed primarily on generating earnings through recruitment. These schemes may offer products, however the products may have very little value or the plan may offer limited incentives for their sale. Income in the scheme 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 usually require the participant to pay to join. This payment may be described as an enrollment fee, a membership fee or an investment into a money-making enterprise. In addition to payment, participants are typically told that they must recruit others into the MLM plan, who in turn must recruit others before they are able to earn any money. Given the finite pool of potential recruits, pyramid schemes are inherently unsustainable and eventually collapse. Although a small number of participants at the top of the pyramid may make money, the overwhelming majority of participants lose their money.

Schemes of pyramid selling are illegal under both the Act and the *Criminal Code*⁵.



⁵ Paragraph 206(1)(e) of the *Criminal Code* is set out in Appendix B.

Definition of a Scheme of Pyramid Selling

Section 55.1 of the Act defines a “scheme of pyramid selling” as an MLM plan with one or more of the following features:

- requires a payment for the right to receive compensation for recruiting others into the MLM plan (compensation for recruitment);
- requires purchases as a condition of participation (purchase requirement), other than a specified amount of product at the seller’s cost for the purpose of facilitating sales;
- includes inventory loading; or
- lacks a buy-back guarantee on reasonable commercial terms or participants are not informed about the guarantee.

It is a criminal offense to establish, operate, advertise or promote a scheme of pyramid selling.



5. WORKING DEFINITIONS OF KEY TERMS

This section sets out the Bureau’s working definitions of certain key terms used in this bulletin and/or the MLM provisions of the Act. These terms are not defined in the Act

5.1 Operator

An operator is a person or entity who is responsible for an MLM plan. An MLM plan may have more than one operator. For example, if an MLM plan is operated by a corporation, any individual who is the directing mind of the corporation, or who directs the making of a representation relating to compensation on the corporation’s behalf, is also responsible for ensuring compliance with the MLM provisions of the Act.

5.2 Prospective Participant

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

5.3 Participant

A participant in an MLM plan is an individual who actively engages in the activities necessary to realize the benefits of the MLM plan. A participant in an MLM plan has joined the MLM plan, has the right to sponsor others in the MLM plan and has the right to sell products to others.

5.4 Typical Participants

Typical participants are representative of the smallest range of compensation earned by over 50% of the participants in the MLM plan. Where an MLM plan sets out defined levels of compensation and no single level accounts for the majority of participants (greater than 50%), reference must be made to the *fewest levels* that together, include a majority of the participants. Thus, the average compensation of participants in an MLM plan is not normally considered to reflect the compensation that typical participants receive or are likely to receive, because the average can be skewed upward by a few high income earners. For the purposes of this calculation the Bureau excludes individuals who have been participants for less than one year.

5.5 Representations Relating to Compensation

A representation relating to 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 limited to a dollar figure or monetary range, but may also include:

- representations about obtaining, as a result of compensation under the MLM plan, luxury goods such as vehicles, jewellery, watches, homes and vacation destinations (this could include images of such luxury items, where the general impression created by the context in which the images appear is that the items can be obtained as a result of compensation under the MLM plan);
- promises of opportunities to earn bonuses, commissions and other financial rewards;
- profiles of individuals 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 under the MLM plan, they were able to improve their quality of life, quit their jobs or eliminate all their debts.

5.6 Operator's Cost or Seller's Cost

Operator's or seller's cost is the cost that the operator of an MLM plan or another seller incurs to acquire a product. This includes their direct costs of labour, materials, handling and shipping, but does not include any mark-up by the seller or allocation of indirect (overhead) costs. Thus, where a participant in an MLM plan gives consideration for a certain amount of product as a condition of participating in the plan, the Act requires that the operator or other seller supply the product to the participant at a price no greater than the cost incurred by the operator or other seller to produce or acquire the product.



6. DISCLOSURE REQUIREMENTS

Subsection 55(2) prohibits an operator or a participant of an MLM plan from making representations relating to compensation to a prospective participant without fair, reasonable and timely disclosure of the information within the knowledge of the operator or the participant relating to: (a) compensation actually received by typical participants in the MLM plan; or (b) compensation likely to be received by typical participants in the MLM plan, having regard to any relevant considerations including the factors listed in paragraph 55(2)(b) (these factors are discussed in the section about new MLM plans).

Subsection 55(2.1) requires an operator of an MLM plan to ensure that any representations relating to compensation under the MLM plan that are made to a prospective participant by a participant of the MLM plan or a representative of the operator, constitute or include fair, reasonable and timely disclosure of the information within the knowledge of the operator relating to: (a) compensation actually received by typical participants in the MLM plan; or (b) compensation, likely to be received by typical participants in the MLM plan, having regard to any relevant considerations including the factors listed in paragraph 55(2)(b). Subsection 55(2.2) provides that an operator shall not be convicted of an offence under subsection 55(2.1) if the operator establishes that he or she took reasonable precautions and exercised due diligence (see section 6.4 - *Due Diligence*) to ensure that no representations relating to compensation under the plan were made by participants or representatives of the operator, or that any representations made by participants or representatives of the operator constituted or included fair, reasonable and timely disclosure.



6.1 Compensation Actually Received

Example #1

Circumstance:

The operator of an MLM plan states that the following amounts of compensation were received by the given percentages of participants in the MLM plan during the last year:

Participants (%)	Compensation received (\$)
5	0-\$1,000
5	\$1,001-\$2,000
25	\$2,001-\$3,000
35	\$3,001-\$4,000
3	\$4,001-\$5,000
5	\$5,001-\$6,000
3	\$6,001-\$7,000
4	\$7,001-\$8,000
10	\$8,001-\$9,000
5	\$9,001-\$10,000

Comment:

A typical participant in the above situation would be someone who earned between \$2,001-\$4,000/year because this range represents the fewest levels that include more than 50% (in this case 60%) of the participants in the MLM plan.

If the operator were to make representations such as “60% of participants made between \$2,001-\$4,000”, or “typical participants made between \$2,001-\$4,000” or the operator set out the above table in connection with any other compensation representation, no issues would likely be raised under the Act.

If the operator were to make a representation relating to compensation such as “earn more than \$7,000 per year”, or “many participants earned more than \$7,000 last year” without disclosing the compensation actually received by typical participants in the plan, an issue would likely be raised under the Act.

Operators and participants may make representations about compensation received by non-typical participants as long as the required information about compensation of typical participants is also disclosed at the same time. However, reference to non-typical participants should not be made in a way that detracts from the representations regarding typical participants. With reference to Example #1, an operator could represent that 15% of participants earned between \$8,001-\$10,000 as long as the earnings for typical participants (i.e. 60% made between \$2,001-\$4,000) were also disclosed.

6.2 Compensation Likely to be Received (New Multi-level Marketing Plans)

An operator or participant making a representation about compensation in a new MLM plan must disclose the information within his or her knowledge relating to compensation likely to be received by typical participants having regard to any relevant considerations, including the factors listed in paragraph 55(2)(b) of the Act:

- the nature of the product, including its price and availability;
- the nature of the relevant market for the product;
- the nature of the plan and similar plans; and
- whether the operator of the plan is a corporation, partnership, proprietorship or other form of business organization.

An operator or participant making a representation about likely compensation should consider any assumptions made, and the resulting compensation estimates, to ensure that they are realistic and reliable.

Compensation levels in new MLM plans should be reviewed after six months from commencement to ensure that there is no major discrepancy between the disclosure of the stated levels of compensation likely to be received and the levels of compensation actually being received by typical participants in the plan. After one year, the operator of an MLM plan should disclose compensation actually received by typical participants instead of any projected compensation forecasts.

Foreign MLM plan operators wishing to expand operations into Canada may make representations relating to compensation based on that plan's foreign compensation history. Basing information on a foreign history is conditional on the operator establishing that there are sufficient similarities between the foreign MLM plan and the proposed Canadian MLM plan, such as:

- type of product;
- market conditions; and
- demographic similarities.

Compensation actually received by typical Canadian participants should be used after one year and reviewed and updated annually.

6.3 Fair, Reasonable and Timely Disclosure

The Act requires that representations relating to compensation constitute or include fair, reasonable and timely disclosure of information within the knowledge of the person making the representations relating to compensation actually received or likely to be received by typical participants. The Bureau considers that in order for disclosure to be fair, reasonable and timely it must:

- be accurate;
- be clear (e.g.: of an appropriate size and in legible font, if written; at an appropriate speed, if oral; and presented in a comprehensible manner);
- be presented in close proximity to any other representation relating to compensation (e.g.: on the same page of a written document; or immediately before or after the representation in an oral or audio/video presentation);
- have similar prominence to other representations (e.g.: not buried in a footnote);
- relate to compensation of typical participants (defined above);
- include a description of the amount of time and effort that would be necessary to earn a particular level of compensation under the MLM plan;
- ensure that prospective participants learn what a typical participant would earn in a year;
- be available to participants (and prospective participants) looking for information about compensation levels; and
- be updated after six months of operation (in the case of a new MLM plan) and annually thereafter, using the most recent findings and data regarding what its participants earn.

6.4 Due Diligence

Pursuant to section 55(2.1), an operator may be prosecuted if improper representations relating to compensation are made by participants or by representatives of the operator. To avoid liability under this section the operator must establish that he or she took reasonable precautions and exercised due diligence to ensure either that: (a) participants or representatives of the operator do not make representations relating to compensation; or (b) any such representations constitute or include fair, reasonable and timely disclosure.

In order to establish due diligence, operators must make sufficient efforts to communicate their policies and procedures regarding compensation representations to all participants of the plan. As well, operators must demonstrate that sufficient efforts to prevent wrongdoing are in place and any wrongdoing is corrected.

Operators are encouraged to clearly and frequently communicate their policies and procedures about compensation representations to participants and prospective participants. In addition, operators should implement effective sanctions against those participants who do not comply with those policies and procedures. In short, the greater the effort by operators to ensure that participants are aware of, and follow their policies, the more likely that due diligence will be established.

As indicated in the Bureau's *Information Bulletin on Corporate Compliance Programs*, a credible and effective corporate compliance program, and documented evidence of compliance measures, may support a claim of due diligence by enabling a business to demonstrate that it took reasonable steps to avoid contravening the law. The five essential elements that should be incorporated in any corporate compliance program are:

- senior management involvement and support;
- corporate compliance policies and procedures;
- training and education;
- monitoring, auditing and reporting mechanisms; and
- consistent disciplinary procedures and incentives.

Obtaining a written opinion from the Bureau (see section 8 - *Written Opinions*) about a proposed MLM plan, and ensuring that the plan is operated in the manner described in the opinion request, may also assist in establishing due diligence.

Example #2

Circumstance:

A participant eager to recruit other participants into an MLM plan tells a prospective participant that he can earn \$1,000 a week under the MLM plan.

Comment:

If this representation does not constitute, or is not accompanied by fair, reasonable and timely disclosure of the compensation received by, or likely to be received by typical participants, the participant has likely contravened subsection 55(2). In addition, the MLM plan operator has likely contravened subsection 55(2.1), unless the operator establishes that he or she took reasonable precautions and exercised due diligence to ensure that participants comply with subsection 55(2.2).

Note: What constitutes “fair, reasonable and timely disclosure” is discussed in section 6.3.

Example #3(a) and #3(b)

Circumstance:

The operator of an MLM plan prohibits participants from making representations relating to compensation earned by participants in the MLM plan. The operator has clearly communicated this policy to participants in the promotional material it has supplied, including the distributor agreement signed by each participant. The operator reiterates this policy at company functions, such as its annual meeting. Consider the following two different scenarios:

(a) References to the policy at annual meetings are generally met with derisive laughter because the operator does not enforce it and most participants consider it, “not worth the paper it’s written on.” There are frequent incidents in which participants make representations about inflated compensation.

- or -

(b) The operator also monitors seminars promoting the MLM plan. Incidents in which participants make representations related to compensation are rare and the operator takes effective corrective measures against those participants who do not follow its policy.

Comment:

Example #3(a) outlines a situation where a due diligence defence could not be established by the operator, while in example #3(b), a due diligence defence could be established.

Example #4

Circumstance:

A company operates an MLM plan in which participants make representations relating to compensation. The operator gives participants and prospective participants information relating to compensation received by typical participants in the MLM plan. The information is dated, and the operator has not reviewed the information to ensure that it remains accurate.

Comment:

This example outlines a situation where a due diligence defence could not be established by the operator if participants make representations related to compensation that are inaccurate because the information was not updated by the operator.



7. FEATURES OF A SCHEME OF PYRAMID SELLING

7.1 Compensation for the Recruitment of Others

Paragraph 55.1(1)(a) of the Act defines a scheme of pyramid selling as those situations in which participants give consideration, including cash or any other benefit, to join an MLM plan, and in turn have the right to receive consideration when others are recruited into the MLM plan. The terms “recruitment bonuses” and “head-hunting fees” are often used to refer to such situations.

Example #5

Circumstance:

An operator initiates an MLM plan in which a prospective participant pays \$150 to be eligible to receive \$50 for each person they recruit into the MLM plan, who would also be required to pay \$150.

Comment:

This MLM plan falls within the definition of a scheme of pyramid selling [paragraph 55.1(1)(a) of the Act] because the participant receives \$50 as compensation for each prospective participant they recruit. This will likely raise an issue under subsection 55.1(2) of the Act.

Example #6

Circumstance:

An operator initiates an MLM plan in which prospective participants who have paid to join the MLM plan are required to recruit a certain number of other prospective participants into the MLM plan before they are eligible to receive compensation, or attain a higher level of compensation.

Comment:

This MLM plan falls within the definition of a scheme of pyramid selling [paragraph 55.1(1)(a) of the Act] as the MLM plan requires participants to pay to join the MLM plan and only provides the right to receive compensation when they recruit other prospective participants into the MLM plan. This will likely raise an issue under subsection 55.1(2) of the Act.

7.2 Purchase Requirements as a Condition of Participation

Pursuant to paragraph 55.1(1)(b) of the Act, an MLM plan may not have as a condition of participating in the MLM plan, a requirement to purchase a product at a price above the seller's cost. In addition, an MLM plan may not require existing participants to purchase products above cost in order to attain a higher commission/benefit level.

Paragraph 55.1(1)(b) allows a requirement to purchase products at the seller's cost for the purpose of facilitating sales. Accordingly, a plan is not likely to raise an issue under this paragraph if a participant is required to purchase a "starter kit" (manual, directives, product samples, promotional material) at the seller's cost (see the definition of *Operator's Cost or Seller's Cost* under section 5.6).

An MLM plan may not have a requirement to purchase a product which is at a price above the seller's cost. This applies whether the purchase requirement is an explicit condition or an implicit "de facto" condition. In determining whether an MLM plan includes a requirement to purchase product the Bureau considers factors including the following:

- whether sales are made to participants at a price that exceeds the seller's cost and are not accompanied by a commercially reasonable buy-back guarantee;
- whether the plan directly or indirectly promotes purchases of product by participants solely to achieve sales requirements or maintain compensation levels;
- whether the plan requires the sale of product to receive compensation, reach a level of compensation or maintain a level of compensation in the marketing plan, and if so, whether:
 - the purchases made by a participant are in commercially reasonable quantities given the nature of the product,
 - the purchases made by a participant reflect sales that can be expected to be achieved over a reasonable period of time given the nature and price of the product; and
 - the terms offered by the seller for the return of the product are commercially reasonable;

- whether the product is meant for sale to non-participants of the plan; and
- the nature of the product involved in the plan (e.g. tangible good, membership, etc.)

The Bureau will consider each MLM plan on a case by case basis in determining whether participants are required to purchase product to participate in the plan.

While purchase requirements are likely to contravene this section, sales requirements involving the sale of a product or products to non-participants of the plan are not likely to contravene this section.

Example #7

Circumstance:

An operator establishes an MLM plan in which a participant, as a condition of entry, must purchase \$75 of product samples at the seller's cost to allow the participant to demonstrate the operator's various products.

Comment:

This MLM plan is not likely to fall within the definition of a scheme of pyramid selling [paragraph 55.1(1)(b) of the Act] as the product is purchased at the seller's cost to facilitate sales. If this is the case, there is not likely an issue under the Act.

Example #8

Circumstance:

An operator establishes an MLM plan promoting widgets. Participants have the option to purchase a training package at a price higher than the seller's cost. After purchasing a training package, a new participant gains the right to sell training packages to new participants. Participants receive a monetary bonus each time they sell a training package to another participant.

Comment:

This MLM plan appears to promote two products, widgets and training. Participants who choose to sell training are required to purchase training themselves, as a condition of participating in the training aspect of the plan and at a price higher than the seller's cost. The requirement to purchase an above-cost training package before a participant can sell training packages is likely to raise an issue under paragraph 55.1(1)(b). In addition, the compensation paid for the training package and the associated right to receive compensation for recruiting and training new participants, who may in turn pay for the same right, is likely to raise an issue as a recruitment bonus under paragraph 55.1(1)(a). If the training package were sold at the seller's cost, or participants were not required to purchase a training package in order to provide training, there would likely not be an issue under the Act.

Example #9

Circumstance:

An operator establishes an MLM plan that requires participants to sign-up for a program in which a specified amount of the product, which is priced higher than the operator's cost, is automatically shipped and billed to participants on a monthly basis through an "Autoship Program".

Comment:

This MLM plan is likely to fall within the definition of a scheme of pyramid selling [paragraph 55.1(1)(b) of the Act] as participants are required to purchase a specified quantity of the product on a monthly basis in order to participate in the MLM plan. If this is the case, there is likely an issue under the Act.

An optional Autoship Program would generally not raise an issue under the Act.

7.3 Inventory Loading

Paragraph 55.1(1)(c) of the Act defines a scheme of pyramid selling as those situations in which an operator or a participant in an MLM plan supplies products to participants in amounts that he or she knows are commercially unreasonable. In other words, there can be no inventory loading. The amount considered "commercially unreasonable" is based on considerations such as:

- the type of product;
- the selling price of the product;
- the size of the market;
- the number of participants;
- the number of competitors; and
- the sales history of the products.

Example #10

Circumstance:

An operator establishes an MLM plan in which participants are supplied with large quantities of product following entry into the MLM plan. The market for the product is depressed due to the substantial number of competing companies. Numerous participants in the same geographic market have recently joined the MLM plan and have also purchased large quantities of products.

Comment:

This situation may fall within the definition of a scheme of pyramid selling [paragraph 55.1(1)(c) of the Act] as the facts suggest that the operator knows or ought to know that participants are unlikely to be able to sell the large quantity of products supplied. If this is the case, there is likely an issue under the Act.

7.4 Buy-back Guarantee or Right to Return

Under paragraph 55.1(1)(d) of the Act, MLM plans must have a buy-back guarantee, or a right to return the product in saleable condition on reasonable commercial terms. Participants must also be informed of the buy-back guarantee or right and how it can be exercised.

Factors to be considered in determining what constitutes “reasonable commercial terms” include, but are not limited to:

- the type of product;
- the cost of the product;
- the condition of the product (whether the product is damaged or otherwise unsaleable);
- the commercial reasonableness of any limits on the number of times, or the frequency with which a participant may return a product under the MLM plan;
- the number of days a participant has to return a product after purchasing it (a requirement to return product within 30 days or more will generally not be considered commercially unreasonable);
- the percentage of the participant’s cost refunded;
- any consequences, including termination, if a participant returns product; and
- the product return policies of other companies offering similar products.

The buy-back guarantees of some MLM plans provide for the termination of participants who exercise their right to return product. The Bureau may consider the terms of a buy-back guarantee commercially unreasonable if a return of product will result in termination. A return policy must not create an incentive for a participant to accumulate products rather than return them to the operator.

However, termination on buy-back will not be considered commercially unreasonable if: (a) the product return indicates the participant’s intention to not continue in the plan (e.g., if a participant returns a product that is required in order to participate in the plan and the required product purchase otherwise complies with section 55.1 of the Act); (b) the participant returns all product on hand; or (c) the product return constitutes an abuse of the return policy (e.g., if a participant returns product with excessive frequency, or if the circumstances of a return suggest that the product was purchased with an intention to return it after qualifying for bonus compensation).

Example #11

Circumstance:

An operator establishes an MLM plan featuring the sale of widgets. A participant who orders widgets is entitled to return any or all of the widgets in saleable condition at the participant's expense within 30 days and will be reimbursed 90% of the participant's cost. The operator has made the terms of the policy known in promotional material and in agreements signed by participants. The policy and related procedures are also discussed at seminars and participants are trained to inform prospective participants about them prior to recruitment. The 10% restocking fee defrays the operator's reasonable shipping and handling expenses and the operator does not earn a profit on product return.

Comment:

This return policy is not likely to fall within the definition of a scheme of pyramid selling [paragraph 55.1(1)(d) of the Act] as the operator's return policy appears to be on reasonable commercial terms. If this is the case, there is not likely an issue under the Act.

Example #12

Circumstance:

An operator establishes an MLM plan that promotes a full line of widgets. Participants have the right to return product in saleable condition for a full refund less 10% for the cost incurred by the operator, but the operator has the right to terminate a participant that returns product. A participant is successful in selling all of the product line of widgets, with the exception of one of the products.

Comment:

Whether or not the terms of a right of return are reasonable depends on various factors. Termination from the MLM plan as a consequence of returning one product in the circumstances of this example would likely be considered commercially unreasonable.

Example #13

Circumstance:

An operator establishes an MLM plan that provides participants of the MLM plan with the right to return product and to be reimbursed for that product. A participant of the MLM plan has purchased a certain quantity of products from the operator for the purpose of qualifying for sales bonuses. The participant has difficulty selling the product and returns the product. The operator requires all bonuses received on that product to be repaid.

Comment:

This MLM plan is not likely to fall within the definition of a scheme of pyramid selling [paragraph 55.1(1)(d) of the Act] as the bonus repayment clause is likely to be commercially reasonable. If this is the case, there is not likely an issue under the Act.



8. WRITTEN OPINIONS

The Bureau facilitates compliance with the law by providing written opinions pursuant to section 124.1 of the Act, subject to a fee. A written opinion provided under section 124.1 is binding on the Commissioner. It remains binding for as long as the material facts on which the written opinion was based remain substantially unchanged and the conduct or practice is carried out substantially as proposed.

Company officials, lawyers and others are encouraged to request a written opinion as to whether the implementation of a proposed business plan or practice would raise an issue under the Act. A specific written opinion will be based on information provided by the requester and will take into account previous case law, prior written opinions and the stated policies of the Bureau.

The requester should recognize that written opinions are only given in relation to the Act and not in relation to other statutes, such as the *Criminal Code*.

Those who seek a written opinion are not bound by it and should a negative written opinion be given on the MLM plan, operators remain free to adopt the MLM plan in question, recognizing that the matter may be prosecuted in the courts. Such written opinions are prepared in relation to a specific set of facts. Should an MLM plan that is implemented be different from the MLM plan presented to the Bureau, or should conditions change in a way that materially affects the MLM plan, the MLM plan could be subject to further examination.

A person seeking to apply for a written opinion under sections 55 and 55.1 of the Act can submit their request in writing to the Bureau's Information Centre. The application for the written opinion must include the relevant supporting information and the appropriate fee. For more information on the written opinion program or for contact information relating to a request under other provisions of the Act please refer to the *Fee and Service Standards Policy and Handbook* which can be found on the Bureau's web site at:

[www.competitionbureau.gc.ca
(under A-Z Index and under Fees and Service Standards)

8.1 Requirements for a Multi-level Marketing Written Opinion Application

The following are requirements when applying for a written opinion under section 124.1 of the Act:

8.1.1 Disclosure of all Relevant Information

In order for the Bureau to provide an informed written opinion, adequate disclosure of all material facts relating to the proposed MLM plan is required. The more complete and accurate the information provided, the less the Bureau will have to qualify its written opinion.

The information that is submitted should include the following: the name of the requester, the name of the proposed business, a description of the compensation plan, the methodology used for determining the compensation of a “typical participant”, all promotional brochures, training material, presentation scripts, pamphlets, videos, audiotapes, a copy of any web sites, contractual agreements, product information, product ordering forms and any other material which provides relevant information relating to the MLM plan.

8.1.2 Product

The Bureau requires that a product exist at the time of the MLM written opinion request. A detailed description of the product should be provided. If a proposed plan includes a representation about the product’s performance or efficacy, the Bureau may consider whether it is based on an adequate and proper test in support of the representation (see section 8.2 - *Refusal to Provide a Written Opinion*) .

8.1.3 Not Subject of Investigation

The operator must confirm that the proposed MLM plan is not the subject of an investigation by any other law enforcement agency in Canada or abroad.

8.1.4 Canadian Legal Entity

Documentation provided by the operator must also indicate that the operator of the MLM plan has been incorporated in Canada or, alternatively, that there is an individual located in Canada who can be held liable for the actions of the operator.

8.1.5 Proposed Conduct

The proposed MLM plan should not be presently operating in Canada, nor have active participants, even on a test marketing basis. Generally, the Bureau will deny an applicant’s written opinion request if the MLM plan is already operating in Canada. An exception exists in that certain Canadian provinces (such as Alberta, Saskatchewan, Manitoba and Nova Scotia) require operators of MLM plans to obtain a favourable written opinion from the Bureau prior to issuing a Direct Sellers License to operate in their respective provinces. The Bureau will consider issuing written opinions to MLM plan operators who are already engaged in business in one or more provinces, but require a written opinion from the Bureau in order to obtain the necessary provincial license to commence business in one of the provinces that impose such conditions.

8.2 Refusal to Provide a Written Opinion

It is the Commissioner’s practice not to issue written opinions under sections 55 and 55.1 of the Act in the following situations:

- insufficient information is provided for the Bureau to properly assess the proposed MLM plan;
- there is no legitimate product associated with the proposed MLM plan;
- the MLM plan is currently under investigation by the Bureau;
- the MLM plan is currently under investigation by another Canadian or foreign authority;
- the MLM plan has no legal Canadian identity;
- the MLM plan is already operating in Canada (refer to section 8.1.5 - *Proposed Conduct for exception*);
- the MLM plan involves gold or silver coins, the travel industry, discount cards, or where the product of the MLM plan is ‘training’ (a written opinion will not be provided in these situations because of the difficulty of establishing the value of these products);
- the MLM plan contains performance representations that are not based on an adequate and proper test;
- the MLM plan contains other conduct contrary to the Act; or
- the MLM plan contains conduct contrary to other Canadian legislation.

8.2.1 Other Conduct Contrary to the Act

If a proposed MLM plan raises an issue under any other section of the Act, the Bureau may decline to issue a written opinion for the MLM plan. It should be noted that only one fee (the highest) applies for a written opinion that might involve multiple sections of the Act. As outlined below, one relevant area of potential concern relates to performance claims.

Performance Claims [paragraph 74.01(1)(b)]

Many MLM plans promote the supply or use of their product(s) with representations about their performance or efficacy. Under paragraph 74.01(1)(b), the Act requires that any representation to the public in the form of a statement, warranty or guarantee about the performance, efficacy or length of life of a product be based on an adequate and proper test thereof.

It is the applicant’s responsibility to ensure that representations related to performance, efficacy or length of life of the product are based on an adequate and proper test. The Bureau may exercise its discretion to refuse to provide a written opinion if it has concerns that the representations are not based on an adequate and proper test.

8.2.2 Other Canadian Regulatory Agencies

If a proposed MLM plan appears to raise an issue under other Canadian legislation⁶, the Bureau may decline to issue a written opinion under the MLM plan provisions. In such circumstances, the Bureau may consult with the department or agency that administers the relevant legislation to determine whether it would be appropriate to issue an MLM written opinion. The Bureau may also notify the applicant of these concerns.

⁶ Canadian legislation includes legislation at the federal, provincial and municipal levels.



9. PENALTIES

The penalties upon conviction for contravening the MLM plan provisions are set out in subsection 55(3) of the Act. The penalties upon conviction for contravening the scheme of pyramid selling provisions are set out in subsection 55.1(3) of the Act.





10. HOW TO CONTACT THE COMPETITION BUREAU

Anyone wishing to obtain additional information about the *Competition Act*, the *Consumer Packaging and Labelling Act*, the *Textile Labelling Act*, the *Precious Metals Marking Act*, or the program of written opinions, or to file a complaint under any of these acts should contact the Competition Bureau's Information Centre.

Web site

[www.competitionbureau.gc.ca]

Address

[Information Centre
Competition Bureau
50 Victoria Street
Gatineau, Quebec
K1A 0C9]

Telephone

[Toll-free: 1-800-348-5358
National Capital Region: 819-997-4282
TTY (for hearing impaired) 1-800-642-3844]

Facsimile

[819-997-0324]



APPENDIX A

Section 55 and 55.1 of the *Competition Act*

Multi-level Marketing Plan

55. (1) For the purposes of this section and section 55.1, “multi-level marketing plan” means a plan for the supply of a product whereby a participant in the plan receives compensation for the supply of the product to another participant in the plan who, in turn, receives compensation for the supply of the same or another product to other participants in the plan.

(2) No person who operates or participates in a multi-level marketing plan shall make any representations relating to compensation under the plan to a prospective participant in the plan unless the representations constitute or include fair, reasonable and timely disclosure of the information within the knowledge of the person making the representations relating to

(a) compensation actually received by typical participants in the plan; or

(b) compensation likely to be received by typical participants in the plan, having regard to any relevant considerations, including

(i) the nature of the product, including its price and availability,

(ii) the nature of the relevant market for the product,

(iii) the nature of the plan and similar plans, and

(iv) whether the person who operates the plan is a corporation, partnership, sole proprietorship or other form of business organization.

(2.1) A person who operates a multi-level marketing plan shall ensure that any representations relating to compensation under the plan that are made to a prospective participant in the plan by a participant in the plan or by a representative of the person who operates the plan constitute or include fair, reasonable and timely disclosure of the information within the knowledge of the person who operates the plan relating to

(a) compensation actually received by typical participants in the plan; or

(b) compensation likely to be received by typical participants in the plan, having regard to any relevant considerations, including those specified in paragraph (2)(b).

(2.2) A person accused of an offence under subsection (2.1) shall not be convicted of the offence if the accused establishes that he or she took reasonable precautions and exercised due diligence to ensure

(a) that no representations relating to compensation under the plan were made by participants in the plan or by representatives of the accused; or

(b) that any representations relating to compensation under the plan that were made by participants in the plan or by representatives of the accused constituted or included fair, reasonable and timely disclosure of the information referred to in that subsection.

- (3) Any person who contravenes subsection (2) or (2.1) is guilty of an offence and liable
- (a) on conviction on indictment, to a fine in the discretion of the court or to imprisonment for a term not exceeding five years or to both; or
 - (b) on summary conviction, to a fine not exceeding \$200,000 or to imprisonment for a term not exceeding one year, or to both.

Scheme of Pyramid Selling

55.1 (1) For the purposes of this section, “scheme of pyramid selling” means a multi-level marketing plan whereby

- (a) a participant in the plan gives consideration for the right to receive compensation by reason of the recruitment into the plan of another participant in the plan who gives consideration for the same right;
- (b) a participant in the plan gives consideration, as a condition of participating in the plan, for a specified amount of the product, other than a specified amount of the product that is bought at the seller’s cost price for the purpose only of facilitating sales;
- (c) a person knowingly supplies the product to a participant in the plan in an amount that is commercially unreasonable; or
- (d) a participant in the plan who is supplied with the product
 - (i) does not have a buy-back guarantee that is exercisable on reasonable commercial terms or a right to return the product in saleable condition on reasonable commercial terms, or
 - (ii) is not informed of the existence of the guarantee or right and the manner in which it can be exercised.

(2) No person shall establish, operate, advertise or promote a scheme of pyramid selling.

- (3) Any person who contravenes subsection (2) is guilty of an offence and liable
- (a) on conviction on indictment, to a fine in the discretion of the court or to imprisonment for a term not exceeding five years or to both; or
 - (b) on summary conviction, to a fine not exceeding \$200,000 or to imprisonment for a term not exceeding one year, or to both.



APPENDIX B

Paragraph 206(1)(e) of the *Criminal Code*

206(1) Everyone is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years who

(e) conducts, manages or is a party to any scheme, contrivance or operation of any kind by which any person, on payment of any sum of money, or the giving of any valuable security, or by obligating himself to pay any sum of money or give any valuable security, shall become entitled under the scheme, contrivance or operation to receive from the person conducting or managing the scheme, contrivance or operation, or any other person, a larger sum of money or amount of valuable security than the sum or amount paid or given, or to be paid or given, by reason of the fact that other persons have paid or given, or obligated themselves to pay or give any sum of money or valuable security under the scheme, contrivance or operation.