

Legislative Analysis



PROHIBIT PYRAMID PROMOTIONAL SCHEMES

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<http://www.house.mi.gov/hfa>

House Bill 5726 as introduced
Sponsor: Rep. Eric Leutheuser

Analysis available at
<http://www.legislature.mi.gov>

House Bill 5727 as introduced
Sponsor: Rep. Pamela Hornberger

House Bill 5728 as introduced
Sponsor: Rep. Jeffrey R. Noble

House Bill 5729 as introduced
Sponsor: Brandt Iden

Committee: Commerce and Trade
Complete to 3-19-18

BRIEF SUMMARY:

House Bill 5726 would create a new act to prohibit a person from establishing, promoting, operating, or participating in a pyramid promotional scheme. The bill would create penalties for noncompliance, allow the attorney general to bring legal actions and impose fines, and allow for plans or operations that meet certain requirements.

Generally speaking, a pyramid promotional scheme is one in which an individual pays to join a program and receives compensation from enrolling more individuals into the program, rather than from selling goods or services.

House Bills 5727, 5728, and 5729 would make complementary amendments to the Franchise Investment Law, Code of Criminal Procedure, and Michigan Consumer Protection Act, respectively.

HB 5726 is tie-barred to both HB 5727 and HB 5729, and HBs 5727, 5728 and 5729 are each tie-barred to HB 5726. A bill that is tie-barred to another bill cannot take effect unless that other bill is also enacted.

Each bill would take effect 90 days after being enacted into law.

DETAILED SUMMARY:

House Bill 5726

HB 5726 proposes a new act, the Pyramid Promotional Scheme Act, described below.

Prohibit Pyramid Promotion Schemes and Provide for Penalties

Under the Act, a person could not establish, promote, operate, or participate in a ***pyramid promotional scheme***.

Pyramid promotional scheme would mean any plan or operation by which an individual gives ***consideration*** for the opportunity to receive ***compensation*** that is derived primarily from the introduction of other individuals into the plan or operation rather than from the sale and consumption of goods, services, or intangible property by a participant or other individual introduced. It would include any plan or operation under which the number of individuals who may participate is limited, either expressly or by the application of conditions affecting the eligibility of an individual to receive compensation under the plan or operation. It would also include any plan or operation under which an individual, on giving any ***consideration***, obtains any goods, services, or intangible property in addition to the right to receive ***compensation***.

Consideration would mean the payment of cash or purchase of goods, services, or intangible property. Consideration would not include the purchase of goods or services furnished at cost to be used in making sales and not for resale, or time and effort spent in pursuit of sales or recruiting activities.

Compensation would mean a payment of any money, thing of value, or financial benefit conferred in return for inducing an individual to participate in a pyramid promotional scheme.

Any person that established, promoted, or operated a pyramid promotional scheme would be guilty of a felony punishable by imprisonment for not more than 4 years or a fine of not more than \$5,000, or both.

A person that knowingly participated in a pyramid promotional scheme would be guilty of a misdemeanor punishable by imprisonment for not more than 90 days or a fine of not more than \$1,000, or both.

Allow Attorney General to Issue Cease and Desist Orders, Fines, and Bring Certain Actions

If the attorney general (AG) had reasonable cause to believe that a person had engaged in or was about to engage in an act or practice that violated the Act, or any order issued under the Act, the AG could do any of the following:

- Issue a cease and desist order, with or without a prior hearing, against any person engaged in the prohibited activities, directing the person to cease and desist from further illegal activities.
- Bring an action in the circuit court of the county in which the violation is believed to have occurred to do any of the following:
 - Enjoin the acts or practices that violate the act.
 - Enforce compliance with the act or any order issued under it.
- Order payment of an administrative fine by any person found in an administrative proceeding to have violated the act or any order issued under it. The amount of the fine could not exceed \$10,000 for each violation. The AG could bring an action in

the appropriate circuit court to recover an administrative fine imposed. The proceeds of any fine would be paid to the state treasurer for credit to the general fund.

The AG would have to notify a person named in a cease and desist order of the person's right to file, within 15 days after receiving the order, a written notice for a hearing. If the AG did not receive a written request for a hearing within the 15 days, the cease and desist order would be permanent and the person named would be considered to have waived all rights to a hearing.

The cease and desist order would have to include all of the following:

- The effective date of the order.
- The intent or purpose of the order.
- The grounds on which the order is based.

A person aggrieved by a final order could obtain a review of the order in the appropriate circuit court.

Upon a proper showing to the appropriate circuit court, a permanent injunction, temporary injunction, restraining order, or writ of mandamus could be granted and a receiver or conservator could be appointed for the person alleged to have violated the act. Additionally, upon proper showing by the AG, the circuit court could enter an order of rescission, restitution, or disgorgement directed to any person that had engaged in any act violating the act or an order issued under it.

A circuit court could award the AG court costs and attorney fees. Finally, none of the above provisions would bar the AG or a prosecuting attorney from proceeding under any other provision of law against pyramid promotional schemes or any person involved with a scheme.

Allow Certain Plans or Operations

The Act would not be construed to prohibit a plan or operation, or to define a plan or operation as a pyramid promotional scheme, based on the fact that participants in the plan give *consideration* in return for the right to receive *compensation* based on purchases of goods, services, or intangible property by participants for personal use, consumption, or resale **if** both of the following were met:

- The plan or operation did not cause *inventory loading*.
- The plan or operation implemented a bona fide *inventory repurchase program* that meets the Act's requirements.

Inventory would mean both goods and services, including company-produced promotional materials, sales aids, and sales kits that a plan or operation requires participants to purchase.

Inventory loading would mean the requirement or encouragement by a plan or operation that its participants purchase inventory in an amount that exceeds the amount

the participant could expect to resell for ultimate consumption or to consume in a reasonable time period, or both.

Inventory repurchase program would mean a program by which a plan or operation does all of the following:

- Promises to repurchase all current and marketable inventory in the possession of a participant, upon request and upon *commercially reasonable terms*, when the participant's business relation is terminated.
- Clearly communicates the terms of the potential repurchase in its recruiting literatures, sales manual, or contracts with participants, including the manner in which the repurchase is to be exercised and disclosure of any inventory that is not eligible for repurchase.

Commercially reasonable terms would mean repurchase of marketable inventory within 12 months after the date of purchase at not less than 90% of the original net cost, less any appropriate setoffs and legal claims.

A person would be required to clearly describe an inventory repurchase program in its recruiting literature, sales manual, or contracts. The inventory repurchase program would **not** be required to apply to inventory that meets any of the following:

- It is no longer within the inventory's commercially reasonable use or shelf life.
- It has been used or opened.

Finally, a person would have to clearly describe to the participant, before the purchase, any inventory that is excluded from the person's inventory repurchase program as seasonal, discontinued, or special promotion products that are not subject to the repurchase program.

Proposed MCL 455.2581 et seq.

House Bill 5727

HB 5727 would amend the Franchise Investment Law to delete existing language regarding the prohibition on offering or selling participation in a pyramid or chain promotion, the illegality of such a pyramid or chain promotion, and the Department of Attorney General's prohibition on accepting a filing for a franchise that involves such a pyramid or chain distribution.

Instead, the bill would prohibit the Department of Attorney General from accepting for filing a franchise that involves a pyramid scheme that violates the Pyramid Promotional Scheme Act.

MCL 445.1528

House Bill 5728

HB 5728 would amend the sentencing guidelines in the Code of Criminal Procedure to add the crime of establishing, promoting, or operating a pyramid promotional scheme as a class F felony against the public trust with a maximum term of imprisonment of 4 years.

The bill would also remove the existing guidelines for the crime of offering or selling a franchise through a pyramid or chain promotion under the Franchise Investment Law, which currently is a class D felony against the public trust that carries a maximum term of imprisonment of 7 years.

MCL 777.14h

House Bill 5729

HB 5729 would amend the Michigan Consumer Protection Act to update a reference within the Act's definition of "trade or commerce." Currently under the Act, trade or commerce does not include the purchase or sale of a franchise, but does include pyramid and chain promotions, as defined in the Franchise Investment Law.

The bill would instead state that trade or commerce does not include the purchase or sale of a franchise, but does include a pyramid promotional scheme that violates the Pyramid Promotional Scheme Act.

MCL 445.902

FISCAL IMPACT:

House Bill 5726 would have an indeterminate fiscal impact on the state and on local units of government. Information is not available on the number of persons that might be convicted under provisions of the bill. New felony convictions would result in increased costs related to state prisons and state probation/parole supervision. In fiscal year 2017, the average cost of prison incarceration in a state facility was roughly \$37,000 per prisoner per year, a figure that includes various fixed administrative and operational costs. State costs for parole and felony probation supervision averaged about \$3,600 per supervised offender in the same year. New misdemeanor convictions would increase costs related to county jails and/or local misdemeanor probation supervision. The costs of local incarceration in a county jail and local misdemeanor probation supervision vary by jurisdiction. The fiscal impact on local court systems would depend on how provisions of the bill affected caseloads and related administrative costs. Any increase in penal fine revenues would increase funding for local libraries, which are the constitutionally designated recipients of those revenues.

HB 5726 would both permit and require the Department of Attorney General to undertake additional legal services associated with enforcing the regulation of "pyramid promotional schemes." The department reports that it has not yet estimated what additional resources

would be required to satisfy the requirements put forth in the bill. Should the department require additional personnel, the cost of an additional attorney FTE is approximately \$180,000.

House Bills 5727 and 5729 would have no fiscal impact on state or local governments.

House Bill 5728 amends sentencing guidelines and would not have a direct fiscal impact on the state or on local units of government.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.