



Senate Fiscal Agency
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BILL



ANALYSIS

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House Bill 5726 (Substitute H-1 as passed by the House)
House Bill 5727 (Substitute H-1 as passed by the House)
House Bill 5728 (Substitute H-1 as passed by the House)
House Bill 5729 (Substitute H-1 as passed by the House)
Sponsor: Representative Eric Leutheuser (H.B. 5726)
Representative Pamela Hornberger (H.B. 5727)
Representative Jeffrey R. Noble (H.B. 5728)
Representative Brandt Iden (H.B. 5729)

House Committee: Commerce and Trade
Senate Committee: Commerce

Date Completed: 5-8-18

CONTENT

House Bill 5726 (H-1) would enact the "Pyramid Promotional Scheme Act" to do the following:

- Prohibit a person from promoting or participating in a pyramid promotional scheme, and prescribe penalties for violations of the proposed Act.
- Allow the Attorney General to issue a cease and desist order if he or she had reasonable cause to believe that a person violated, or was about to violate, the Act.
- Allow the Attorney General to bring an action in circuit court to enjoin acts that violated the proposed Act, enforce compliance with the Act, or recover a maximum civil fine of \$10,000 per violation.
- Allow the Attorney General or a prosecuting attorney to issue a written demand for a person to appear and be examined and to produce documents or objects for inspection, before bringing an action in court.
- Establish a rebuttable presumption that a plan or operation was not a pyramid promotional scheme if certain conditions were met.
- Require the Attorney General or prosecuting attorney to keep testimony taken or material produced confidential before bringing an action, unless the person under investigation waived confidentiality or the court authorized disclosure.

House Bill 5727 (H-1) would amend the Franchise Investment Law to eliminate provisions prohibiting a person from offering or selling any form of participation in a pyramid or chain promotion; and prohibit the Department of the Attorney General from accepting for filing a franchise that involved a pyramid promotional scheme that violated the Pyramid Promotional Scheme Act.

House Bill 5728 (H-1) would amend the sentencing guidelines within the Code of Criminal Procedure to include the felony proposed by House Bill 5726 (H-1) as a Class F offense against the public trust with a statutory maximum of seven years' imprisonment, and remove the felony that House Bill 5727 (H-1) would eliminate.

House Bill 5729 (H-1) would amend the Michigan Consumer Protection Act to specify that "trade or commerce" would include a pyramid promotional scheme that violated the proposed Act, instead of pyramid and chain promotions.

House Bills 5727 (H-1), 5728 (H-1), and 5729 (H-1) are tie-barred to House Bill 5726. House Bill 5726 (H-1) is tie-barred to House Bills 5727 and 5729. Each bill would take effect 90 days after its enactment.

All of the bills, except House Bill 5728 (H-1), are described in more detail below.

House Bill 5726 (H-1)

Definitions

"Pyramid promotional scheme" would mean any plan or operation in which an individual gives consideration for the opportunity to receive compensation that is derived primarily from recruiting other individuals into the plan or operation rather than from the sale of products or services to ultimate users or from the consumption or use of product or services by ultimate users.

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

"Compensation" would mean the payment of cash or anything of value or the purchase of goods, services, or intangible property. The term 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.

"Ultimate user" would mean an individual who consumes or uses a product or service, whether or not the individual is a participant in the plan or operation.

"Promote" would mean to contrive, prepare, establish, plan, operate, advertise, or otherwise induce or attempt to induce an individual to participate in a pyramid promotional scheme.

Prohibition

The proposed Act would prohibit a person from promoting or participating in a pyramid promotional scheme. A limitation as to the number of individuals who could participate or the presence of additional conditions affecting eligibility for the opportunity to receive compensation under a plan or operation would not change the identity of the plan or operation as a pyramid promotional scheme.

A person who promoted a pyramid promotional scheme would be guilty of a felony punishable by a maximum fine of \$10,000 per violation or up to seven years' imprisonment. A person who knowingly participated in a scheme would be guilty of a misdemeanor punishable by up to 90 days' imprisonment or a maximum fine of \$1,000, or both.

Powers of the Attorney General

Cease & Desist Order; Civil Action. If the Attorney General had reasonable cause to believe that a person had engaged or was about to engage in any act or practice that violated the Act, or an order issued under it, the Attorney General could issue a cease and desist order against any person who was engaged in the prohibited activities. A cease and desist order

would have to state all of the following: a) the effective date of the order, b) the intent or purpose of the order, and c) the grounds on which the order was based.

A person aggrieved by a cease and desist order could obtain a review of the order in the Ingham County Circuit Court.

The Attorney General also could bring an action in the circuit court for the county in which the violation was believed to have occurred, or in the Ingham County Circuit Court, to do any of the following:

- Enjoin the acts or practices that violated the Act.
- Enforce compliance with the Act or an order issued under it.
- Recover a civil fine of up to \$10,000 for each violation.

A civil fine would have to be paid to the State Treasurer and credited to the General Fund.

Upon a proper showing to the circuit court, a permanent injunction, temporary injunction, or restraining order could be granted and a receiver or conservator could be appointed for a person alleged to have violated the Act or the assets of such a person. In addition, the court could enter an order of rescission, restitution, or disgorgement directed to any person who violated the Act or an order issued under it. The circuit court could award to the Attorney General costs and attorney fees.

The Act would not bar the Attorney General or a prosecuting attorney from proceeding under any other provision of law against a pyramid promotional scheme or a person involved with a scheme.

Written Demand. If the Attorney General had reasonable cause to believe that a person had information or was in possession, custody, or control of a document or other tangible object that was relevant to an investigation or a violation of the proposed Act, the Attorney General, or a prosecuting attorney with the permission of or at the request of the Attorney General, before bringing an action in the circuit court, could serve on the person a written demand to appear and be examined under oath, and to produce the document or object for inspection and copying. The demand would have to be served on the person in the manner required for service of process in Michigan, and do all of the following:

- Describe the nature of the conduct constituting the alleged violation.
- Describe the document or object with sufficient definiteness to permit it to be fairly identified.
- If demanded, contain a copy of any written interrogatories.
- Prescribe a reasonable time at which the person would have to appear to testify, within which to answer any written interrogatories, or within which to produce the document or object.
- Advise the person that objections to or reasons for not complying with the demand would have to be filed with the Attorney General, or the prosecuting attorney, on or before the prescribed time.
- Specify a place for the taking of testimony or for production, and designate the person who would be the custodian of the document or object.

The demand also would have to include a copy of the following information: If a person objected to or otherwise failed to comply with a written demand, the Attorney General or prosecuting attorney could file an action to enforce the demand in the circuit court of the county in which the person resided or maintained a principal place of business in the State. Notice of hearing the action and a copy of all pleadings would have to be served on the person,

who could appear in opposition. If the court found that the demand was proper, that there was reasonable cause to believe that there was a violation of the proposed Act, and that the information sought or document or object demanded was relevant to the investigation, the court would have to order the person to comply with the demand, subject to any modification it prescribed. On motion by the person and for good cause shown, the court could make any further order in the proceedings that justice required to protect the person from unreasonable annoyance, embarrassment, oppression, burden, or expense.

Confidentiality

The Attorney General or prosecuting attorney would have to keep any procedure, testimony taken, or material produced confidential before bringing an investigation against a person, unless that person waived confidentiality and testified, answered interrogatories, or produced material, or unless disclosure was authorized by the court.

Rebuttable Presumption

The Act would establish a rebuttable presumption that a plan or operation was not a pyramid promotional scheme if both of the following conditions were satisfied: a) the plan or operation did not cause inventory loading, and b) the plan or operation implemented an inventory repurchase program.

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

"Inventory repurchase program" would mean a program that does all of the following: a) upon request, repurchases all current and marketable inventory in the possession of a participant within 12 months after the date of purchase, at not less than 90% of the original net cost, less appropriate setoffs, if any, when the participant's business relation is terminated; b) clearly and prominently communicates the terms of the inventory repurchase program in its recruiting literature, sales manual, or contracts with participants, including the manner in which the repurchase is to be exercised and how any setoffs are calculated; and c) clearly and prominently communicates to a participant, before the purchase, in its recruiting literature, sales manual, or contracts with participants, what inventory is excluded from the inventory repurchase program, including inventory that is classified as seasonal, discontinued, special promotion, is no longer within the inventory's commercially reasonable use or shelf life period, or is otherwise not eligible for repurchase under the inventory repurchase program.

House Bill 5727 (H-1)

The Franchise Investment Law prohibits a person from offering or selling any form of participation in a pyramid or chain promotion. The Law defines a pyramid or chain promotion, specifies that a pyramid or chain promotion is illegal and against the public policy of the State, and specifies that any contract made in violation of the prohibition is voidable at the sole option of the purchaser. The bill would eliminate these provisions.

(A person who violates the Law must be fined up to \$10,000 or imprisoned for up to seven years, or both.)

The Law also prohibits the Department of Attorney General from accepting for filing a franchise that involves a pyramid or chain distribution contrary to State law. Under the bill,

the Department would be prohibited from accepting for filing a franchise that involved a pyramid promotion scheme that violated the proposed Pyramid Promotional Scheme Act.

House Bill 5729 (H-1)

The Michigan Consumer Protection Act states that unfair, unconscionable, or deceptive methods, acts, or practices in the conduct of trade or commerce are unlawful. "Trade or commerce" means the conduct of a business providing goods, property, or service primarily for personal, family, or household purposes and includes the advertising, solicitation, offering for sale or rent, sale, lease, or distribution of a service or property, tangible or intangible, real, personal, or mixed, or any other article, or a business opportunity. The term does not include the purchase or sale of a franchise, but does include pyramid and chain promotions, as "franchise", "pyramid", and "chain promotions" are defined in the Franchise Investment Law. Under the bill, instead, the term would not include the sale of a franchise, as defined in Section 2 of the Law, but would include a pyramid promotional scheme that violated the proposed Pyramid Promotional Scheme Act.

MCL 445.1528 (H.B. 5727)
777.14h (H.B. 5728)
445.902 (H.B. 5729)

Legislative Analyst: Jeff Mann

FISCAL IMPACT

House Bill 5726 (H-1)

The bill would require the Department of Attorney General to pursue legal action and enforce the regulation of pyramid promotional schemes. The amount of litigation and services is indeterminate and would depend on the number of legal actions brought pursuant to the bill. The Department has indicated that it could need additional resources, including one additional FTE equivalent that would be split 50% for an attorney and 50% for a support staff person at an estimated annual cost of \$125,000. The Department could receive payment for its costs and attorney fees, if ordered by the court.

The proposed civil fine could increase revenue to the General Fund.

The bill's criminal penalties would have an indeterminate fiscal impact on the State and local government. Along with House Bill 5727 (H-1), the bill would repeal a prohibition against offering or selling participation in a pyramid or chain promotion and replace it with a new prohibition against promoting or participating in a pyramid promotional scheme. The existing prohibition in the Franchise Investment Law is a Class D felony with a maximum penalty of imprisonment for up to seven years, a fine of up to \$10,000, or both. House Bill 5726 (H-1) would make promoting a pyramid promotional scheme a Class F felony with a maximum penalty of imprisonment for up to seven years, a fine of up to \$10,000 per violation, or both. Knowingly participating in a pyramid promotional scheme would be a misdemeanor with a maximum penalty of imprisonment for up to 90 days, a fine of up to \$1,000, or both. It is unknown whether the changes would lead to more or fewer felony arrests and convictions. It also is unknown whether new misdemeanor arrests and convictions would be for violations that would not be charged or would be charged as felonies under the current statute.

More misdemeanor and felony arrests and convictions could increase resource demands on law enforcement, court systems, community supervision, jails, and correctional facilities. The average cost to State government for felony probation supervision is approximately \$3,024 per probationer per year. For any increase in prison intakes, in the short term, the marginal

cost to State government is approximately \$3,764 per prisoner per year. Any associated increase in fine revenue would increase funding to public libraries.

Conversely, fewer misdemeanor and felony arrests and convictions could reduce resource demands on law enforcement, court systems, community supervision, jails, and correctional facilities. Any associated decrease in fine revenue would reduce funding to public libraries.

House Bill 5727 (H-1)

The bill would have no fiscal impact on State or local government.

House Bill 5728 (H-1)

The bill would have no fiscal impact on local government and an indeterminate fiscal impact on the State, in light of the Michigan Supreme Court's July 2015 opinion in *People v. Lockridge*, in which the Court ruled that the sentencing guidelines are advisory for all cases. This means that the addition to the guidelines under the bill would not be compulsory for the sentencing judge. The bill also would remove a guideline for a substantially similar crime. As penalties for felony convictions vary, the fiscal impact of any given felony conviction depends on judicial decisions.

House Bill 5729 (H-1)

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Ryan Bergan
Joe Carrasco

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.