



The State of South Carolina  
**OFFICE OF THE ATTORNEY GENERAL**

CHARLES MOLONY CONDON  
 ATTORNEY GENERAL

November 15, 1995

The Honorable Herbert Kirsh  
 Member, House of Representatives  
 Post Office Box 31  
 Clover, South Carolina 29710

RE: Informal Opinion

Dear Representative Kirsh:

By your recent letter to Attorney General Condon, you had sought an opinion as to whether the marketing techniques employed by Excel Telecommunications, a long-distance telephone company, may be violative of the South Carolina Unfair Trade Practices Act as that act relates to pyramid clubs. You had enclosed with your letter a copy of an article appearing in the August 6, 1995, edition of The State, page B-1, entitled "Politician Recruiting Others into Sales Plan."

In your letter you summarized the article by observing that Excel sales agents recruit persons by offering discount telephone rates. Each person must pay \$195.00 to join the service, and all persons are encouraged to recruit others. Original recruiters receive a percentage of the discounts of all recruits in the chain.<sup>1</sup> Excel's organization is referred to in the article as "multilevel marketing." Because an opinion of this Office is inadequate to resolve factual issues and further because this Office has no authority to

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<sup>1</sup>One individual was quoted in the newspaper article as estimating that there are several thousand Excel sales agents in this state. She stated that she collected two percent of the long-distance costs rung up by her recruits, plus 0.25 percent of the bills of customers recruited by the sales agents she recruited, plus "leadership bonuses" for building up the business.

undertake an investigation of facts for purposes of issuing an opinion, we assume as true the facts as given for purposes of this informal opinion.

Unfair Trade Practice statutes

Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are declared unlawful by S.C. Code Ann. §39-5-20, which provides as follows:

(a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.

(b) It is the intent of the legislature that in construing paragraph (a) of this section the courts will be guided by the interpretations given by the Federal Trade Commission and the Federal Courts to §5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1)), as from time to time amended.<sup>2</sup>

A pyramid scheme has been described by the Federal Trade Commission as follows:

Such schemes are characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users. [Emphasis added.]

State ex rel. McLeod v. VIP Enterprises, Inc., 286 S.C. 501, 504, 335 S.E.2d 243 (1985), quoting from In re Koskot Interplanetary, Inc., 86 F.T.C. 1106, 1180 (1975). Stated another way, a pyramid scheme is

any plan in which (1) in exchange for "money or other thing of value" (2) a person acquires the opportunity to receive a benefit or thing of value where this benefit received is primarily based upon the inducement of others

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<sup>2</sup>Communication with the Regional Office of the Federal Trade Commission in Atlanta, Georgia, revealed that that agency has not investigated Excel and apparently is not presently looking at complaints against that agency.

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to participate in the same plan rather than upon the volume of goods to be sold or distributed. [Emphasis in original.]

People v. Knop, 249 Ill.App.3d 605, 188 Ill.Dec. 839, 619 N.E.2d 203, 211 (1993). The evil sought to be remedied by laws against such pyramid schemes has been described as:

Pyramid programs \*\*\* which induce a person to participate on the representation that he or she cannot only regain the purchase price, but also reap profits by selling the plan to others, are inherently deceptive and contrary to public policy. [Citations.] The deception arises because the market eventually becomes saturated and the seemingly endless chain must end; consequently, many participants cannot even recoup their investments, let alone make a profit. People ex rel. Fahner v. Walsh (1984), 122 Ill.App.3d 481, 486-87, 77 Ill.Dec. 691, 461 N.E.2d 78.

People v. Knop, 619 N.E.2d at 211.

A pyramid scheme is specifically declared to be an unfair trade practice. Section 39-5-30, S.C. Code Ann., provides:

Any contract or agreement between an individual and any pyramid club, or other group organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members, is hereby declared to be an unfair trade practice pursuant to §39-5-20(a) of the South Carolina Unfair Trade Practices Act of 1971.

Thus, the issue becomes whether the Excel Telecommunications multilevel marketing plan is in fact a pyramid scheme as that concept was explained in the above-cited decisions.

It must first be acknowledged that not all multilevel marketing plans fall within the definition of a pyramid scheme so as to be unlawful. The insurance industry is unquestionably a multilevel marketing system. You may also be familiar with the Amway marketing system; the Federal Trade Commission has examined Amway and found it not to be a pyramid system. The court in State ex rel. Edmiston v. Challenge, Inc., 54 N.C. 513, 284 S.E.2d 333, 338 (1981), distinguished Amway from other multilevel marketing

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schemes which did amount to pyramid schemes; in making the distinction, the court observed that Amway did not contain the essential features of an illegal pyramid plan:

In Amway a sponsoring distributorship receives nothing from the mere act of sponsoring. It is only when the newly recruited distributor sells to consumers that the Sponsor begins to earn money from his recruit's efforts. Amway prevents inventory loading and encourages the sale of Amway products to consumers with two rules: the "70 percent rule" provides that a distributor must sell at least 70% of the products he bought during a given month and the "10 customer" rule provides that a distributor must make sales to ten different customers each month. Therefore, these safeguards and others not here discussed prevent the Amway plan from being an illegal pyramid scheme. In re Amway Corporation, supra.

The ruling of the Federal Trade Commission as to Amway's sales practices, 93 F.T.C. 618, also observed that

[t]he Amway system does not create the potential for massive deception present in a pyramid distribution scheme which relies primarily on the profits to be made from recruiting new distributors rather than from ultimate sales to consumers. ... Unlike the pyramid companies, Amway and its distributors do not make money unless products are sold to consumers. The inherent potential for deception is not present in the Amway plan. In the full context of the plan, it does not have an unlawful capacity to deceive.

The marketing plan at issue in State ex rel. McLeod v. VIP Enterprises, Inc., supra, was described thusly:

VIP sells the Clout card for \$25.00 and the right to sell Clout cards for an additional \$50.00. Before November 15, 1982, a person could not buy a card without also buying the right to sell cards. The trial court found this requirement is still in effect. Before November, 1982, when an agent made a sale he received \$10.00 from the sale of the card and another \$10.00 from the sale of the right to sell the card. Now when he makes a sale he receives \$10.00 from the sale of the card and advancement points from the sale of the right to sell. When the agent, his buyers, and their buyers, accumulate 300 advancement points, he receives other commissions based on his and their sales. All commissions are received directly from the corporation.

Id., 286 S.C. at 503. In light of the definition of pyramid schemes employed by the Federal Trade Commission, supra, the appellants argued unsuccessfully that their system was not a pyramid because their sales agents did not receive rewards, for their recruitment of new sales agents, which were "unrelated to sale of the" VIP card. The Court of Appeals responded:

The trial court found VIP's policy a prospective sales agent must buy a card before the right to sell cards, continued at the time of trial. We find sufficient evidence to support this finding. The evidence is clear while the corporation may have stopped paying the \$10.00 direct commissions to sales agents for recruiting new agents, the company has begun giving "advancement points" for each new sales agent recruited. Sales agent A thus receives "advancement points" not only for sales made by sales agent B, which he recruited, but also for sales made by sales agent C, recruited by sales agent B. Further, these advancement credits are "valuable" because they entitle sales agent A to other commissions. We hold this marketing scheme provides awards to agents not related to the sale of the Clout card. Cf. In Re Amway Corp., Inc., 93 F.T.C. 618, 715-717 (1979).

Id., 286 S.C. at 505.

From the newspaper article attached to your letter, it is not possible to determine the extent to which participants have the right to sell a product, one of the elements necessary to establish a pyramid scheme. Additional fact-finding would be necessary to determine whether all subscribers or participants in the Excel marketing plan are expected or permitted to sell the product. Are there subscribers of the long-distance telephone service who are not expected or allowed to recruit others to sell the product, for example? Further, do the participants have the right to receive, in return for recruiting other participants into the program, rewards which are unrelated to the sale of the product to ultimate users of the product? As observed in footnote 1, one participant described a bonus which she received for building up the business; assuming that information to be true for purposes of this informal opinion, the answer to this prong of the test may be affirmative. (Such would be a distinguishing factor from the Amway plan, as a sponsoring distributor receives nothing from the mere act of sponsoring; only when the newly recruited distributor sells to customers does the sponsor begin to earn money from his recruit's efforts.) Until the facts are conclusively determined by the appropriate fact-finding entity (perhaps a court, through a declaratory judgment action), it cannot be established with certainty that the marketing plan of Excel Telecommunications is an unlawful pyramid plan or scheme.

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This letter is an informal opinion only. It has been written by a designated Senior Assistant Attorney General and represents the position of the undersigned attorney as to the specific questions asked. It has not, however, been personally scrutinized by the Attorney General nor officially published in the manner of a formal opinion.

With kindest regards, I am

Sincerely,

*Patricia D. Petway*

Patricia D. Petway  
Senior Assistant Attorney General