Federal Trade Commission
Protecting America's Consumers

PREPARED STATEMENT OF

DEBRA A. VALENTINE, GENERAL COUNSEL FOR

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on

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I would like to thank you for the opportunity to speak about the growing international problem of pyramid schemes. What is striking about these schemes is that while they are very old forms of fraud, modern technology has vastly multiplied their potential for harming our citizens. The Internet in particular offers pyramid builders a multi-lane highway to world-wide recruits in virtually no time.

Introduction

First, let me tell you about the Federal Trade Commission.(1) The Commission is an independent government agency that Congress established in 1914. We perform a core function of government -- ensuring that free markets work. This requires competition among producers and accurate information in the hands of consumers in order to generate the best products at the lowest prices, spur efficiency and innovation, and strengthen the economy. For competition to thrive, consumers must be knowledgeable about available products and services. Our Consumer Protection Bureau ensures that consumer information in the marketplace is not deceptive or misleading. A free market also means that consumers have a choice among products and services at competitive prices. Our Competition Bureau ensures that the marketplace is free from anti-competitive mergers and other unfair business practices such as price-fixing or placing floors on retail prices.

With the exception of a few areas like air travel and insurance, the Commission has broad law enforcement authority over virtually every sector in our economy. Unfortunately, we now see pyramid schemes invading many of the sectors that we oversee.

What is a Pyramid Scheme and What is Legitimate Marketing?

Pyramid schemes now come in so many forms that they may be difficult to recognize immediately. However, they all share one overriding characteristic. They promise consumers or investors large profits based primarily on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public. Some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure. There are two tell-tale signs that a product is simply being used to disguise a pyramid scheme: inventory loading and a lack of retail sales. Inventory loading occurs when a company's incentive program forces recruits to buy more products than they could ever sell, often at inflated prices. If this occurs throughout the company's distribution system, the people at the top of the pyramid reap substantial profits, even though little or no product moves to market. The people at the bottom make excessive payments for inventory that simply accumulates in their basements. A lack of retail sales is also a red flag that a pyramid exists. Many pyramid schemes will claim that their product is selling like hot cakes. However, on closer examination, the sales occur only between people inside the pyramid structure or to new recruits joining the structure, not to consumers out in the general public.

A Ponzi scheme is closely related to a pyramid because it revolves around continuous recruiting, but in a Ponzi scheme the promoter generally has no product to sell and pays no commission to investors who recruit new "members." Instead, the promoter collects payments from a stream of people, promising them all the same high rate of return on a short-term investment. In the typical Ponzi scheme, there is no real investment opportunity, and the promoter just uses the money from new recruits to pay obligations owed to longer-standing members of the program. In English, there is an expression that nicely summarizes this scheme: It's called "stealing from Peter to pay Paul." In fact some law enforcement officers call Ponzi schemes "Peter-Paul" scams. Many of you may be familiar with Ponzi schemes reported in the international financial news. For example, the MMM fund in Russia, which issued investors shares of stock and suddenly collapsed in 1994, was characterized as a Ponzi scheme.(2)

Both Ponzi schemes and pyramids are quite seductive because they may be able to deliver a high rate of return to a few early investors for a short period of time. Yet, both pyramid and Ponzi schemes are illegal because they inevitably must fall apart. No program can recruit new members forever. Every pyramid or Ponzi scheme collapses because it cannot expand beyond the size of the earth's population.(3) When the scheme collapses, most investors find themselves at the bottom, unable to recoup their losses.

Some people confuse pyramid and Ponzi schemes with legitimate multilevel marketing. Multilevel marketing programs are known as MLM's,(4) and unlike pyramid or Ponzi schemes, MLM's have a real product to sell. More importantly, MLM's actually sell their product to members of the general public, without requiring these consumers to pay anything extra or to join the MLM system. MLM's may pay commissions to a long string of distributors, but these commission are paid for real retail sales, not for new recruits.

How Pyramid Schemes Operate

Let's look at how a pyramid scheme operates from three points of view: the potential investor, the promoter or con artist, and the victim. Many pyramid schemes will present a payout formula or matrix much like this one:

Payment of $500

Level 1 $150 x 3 = $450	#	#	#
Level 2 $30 x 9 = $270	# # #	# # #	# # #
Level 3 $30 x 27 = $810	# # # # # # # # #	# # # # # # # # #	# # # # # # # # #
Level 4 $30 x 81 = $2430	etc. # # # # # # # # #	# # # # # # # # #	# # # # # # # # #etc.

$3960

This example illustrates what is known as a three by four matrix. Each investor pays $500 to the promoter and is told to build a "downline" by recruiting three new members, who then each should recruit three more members. The investor is told that he will be paid $150 for each of the three members whom he enlists at the first level. The investor is also promised a $30 commission for each recruit at the next three levels. Thus, the investor should receive commissions for four levels of recruits below him, each of whom must recruit three more members, hence the name -- a three by four matrix.

To the potential investor/recruit this may look like a very appealing opportunity. The pyramid promoter is likely to persuade the investor that he is "getting in early" and that he should consider himself at the top of the matrix. From this perspective, it appears that he can earn $3,960 on an investment of $500, a whopping 792 percent return. You can do the math easily: $150 from the first level of 3 recruits is $450; $30 from the next 3 levels of recruits is $270 ($30 x 9), plus $810 ($30 x 27), plus $2,430 ($30 x 81). Not a bad deal.

Yet, consider the matrix from the promoter/con artist's point of view. He is the person at the top of the pyramid but in fact looks at the scheme from the bottom. He views each new investor as a predicable set of revenues and expenses, with the revenues flowing down to him. The con artist receives $500 for each new member, and at most he will have to pay $240 in commissions to earlier investors in the new recruit's "upline," i.e. those people responsible for bringing him into the system. So when an investor joins the system in the last level, the promoter will receive $500, but he will pay only $150 to the person who recruited the new investor, and $30 each to three longer-standing members in the new investor's "upline," for a total of $240. Thus, the con artist will keep over half of every $500 membership fee paid.

Let's assume that this scheme collapses after the fourth level of recruits is filled. The con artist will have made $500 from the first investor in the pyramid ($500 with no commissions paid out), $350 from the 3 at the next level ($500 minus commission of $150), $320 from the 9 at the next level ($500 minus commissions of $150 + $30), $290 from the 27 at the next level ($500 minus $150 + $30 + $30), and $260 from the 81 newest investors ($500 minus commissions of $150 + $30 + $30 + $30). The simple math -- $33,320 flowed down to the con artist -- and all he did was attract one investor!

Now consider the pyramid from the investor/victim's perspective -- after the entire scheme has collapsed around him. The victim, like the first investor, thought of himself at the top of the pyramid but suddenly realizes that he is actually at the bottom, unable to find people interested in the program to build out his downline. He is not alone because mathematics shows that MOST investors will find themselves at the bottom of the pyramid when it collapses. The very structure of this matrix dictates that whenever the collapse occurs, at least 70 percent will be in the bottom level with no means to make a profit. They all will be out $500. In our example, even those people one level above the bottom will not have recouped their investment. They each will have paid a membership fee of $500 and collected commissions of $150 for each of three recruits, leaving each investor in the second-from-the-bottom tier at least $50 shy of his break-even point. In short, when the pyramid collapses all the investors in the bottom two levels will be losers. Adding together the number of victims from these bottom two levels shows that 89 percent of all the pyramid's participants (108 of 121 investors) are doomed to lose money.

A Ponzi scheme could yield even worse results for investors, because it does not pay out any commissions at all. This can have disastrous consequences, as exemplified by Charles Ponzi's infamous fraud in the 1920's. Charles Ponzi, an engaging ex-convict, promised the Italian-American community of South Boston that he would give them a 50 percent return on their money in just 45 to 90 days.(5) Mr. Ponzi claimed that he could pay such a high rate of return because he could earn 400 percent by trading and redeeming postal reply coupons. These coupons had been established under the Universal Postal Convention to enable a person in one country to pre-pay the return postage on a package or letter sent back from another country. For a short time after World War I, fluctuations in currency exchange rates did create a disparity between the cost and redemption value of postal reply coupons among various countries. However, Mr. Ponzi discovered that he could only make a few cents per coupon and that handling large volumes of coupons cost more than they were worth. He stopped redeeming any coupons but continued to collect investors' money. When he actually paid a 50 percent return to some early investors, his reputation soared and more money flowed in from around the country. Mr. Ponzi bought a stylish house in the best part of town and purchased a large minority interest in his local bank, the Hanover Trust Company.

Eventually his scheme began to unravel, bringing ruin to the bank and thousands of investors. When Mr. Ponzi began to overdraw his accounts at Hanover Trust, the Massachusetts Banking Commissioner ordered Hanover Trust to stop honoring Ponzi's checks. The bank refused and even issued back-dated certificates of deposit to cover Mr. Ponzi's overdrafts. A few days later, the Banking Commission took over Hanover Trust, and Mr. Ponzi was arrested for mail fraud. In the end, Charles Ponzi owed investors over $6 million, an enormous sum of money for that time. He was convicted of fraud in both state and federal court and served ten years in prison.(6)

Law Enforcement Partners

The legacy of Mr. Ponzi lives on as pyramid and Ponzi schemes continue to plague us and challenge the law enforcement community. Fortunately, in the U.S., the Federal Trade Commission is just one among many agencies that have the authority to file suit to stop this type of fraud. The Securities and Exchange Commission also pursues these schemes, obtaining injunctions against so-called "financial distribution networks" which in fact sell unregistered "securities."(7) The U.S. Department of Justice, in collaboration with investigative agencies like the FBI and the U.S. Postal Inspection Service, prosecutes pyramid schemes criminally for mail fraud, securities fraud, tax fraud, and money laundering.(8)

State officials independently file cases in state court, often under specific state laws that prohibit pyramids. California defines pyramids as "endless chains" and prohibits them under its laws against illegal lotteries.(9) In a slightly different vein, Illinois classifies pyramid schemes as criminal acts of deception directed against property.(10) Some states like Georgia prohibit pyramid schemes under a statutory framework that regulates business opportunities and multilevel marketing.(11)

At the Commission, we bring cases against pyramid schemes under the FTC Act, which broadly prohibits "unfair or deceptive acts or practices in or affecting commerce."(12) That Act allows the Commission to file suit in federal court and seek a variety of equitable remedies, including injunctive relief, a freeze over the defendants' assets, a receivership over the defendants' business, and redress or restitution for consumers.

FTC Precedent from the 1970's

The Commission took its first concerted action against pyramid schemes in the 1970's during a boom in home-based business and MLM or direct selling. One-on-one marketing became common for many consumer items -- from cosmetics to kitchenware, and Tupperware™ parties became an icon of the era. Unfortunately, the rise in legitimate multilevel marketing was accompanied by a surge in pyramid schemes. Those schemes played off the popularity of MLM or network sales but paid more attention to networking than to selling actual goods. Pyramid schemes became so notorious that then-Senator Walter Mondale sponsored a federal anti-pyramiding bill. It passed the United States Senate twice in the 1970's, but never became law.(13)

One of the Commission's first cases was In re Koscot Interplanetary, Inc.,(14) which involved a company that offered the opportunity to become a "Beauty Advisor" and sell cosmetics. The company's incentive structure really did not encourage retail sales. Instead, it encouraged people to pay $2000 for the title of "Supervisor" and purchase $5400 in Koscot cosmetics, and then to earn bonuses by recruiting others to make the same investments.(15) The Commission found that Koscot operated an illegal "entrepreneurial chain" and articulated a definition of illegal pyramiding that our agency and the federal courts continue to rely on.(16) The Commission found that pyramid schemes force participants to pay money in return for two things. First is "the right to sell a product", second is "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)"(17) The Commission explained that paying bonuses for recruiting:

> . . . will encourage both a company and its distributors to pursue that side of the business, to the neglect or exclusion of retail selling. The short-term result may be high recruiting profits for the company and select distributors, but the ultimate outcome will be neglect of market development, earnings misrepresentations, and insufficient sales for the insupportably large number of distributors whose recruitment the system encourages."(18)

In In re Amway Corp.,(19) another landmark decision from the 1970's, the FTC distinguished an illegal pyramid from a legitimate multilevel marketing program. At the time, Amway manufactured and sold cleaning supplies and other household products. Under the Amway Plan, each distributor purchased household products at wholesale from the person who recruited or "sponsored" her. The top distributors purchased from Amway itself. A distributor earned money from retail sales by pocketing the difference between the wholesale price at which she purchased the product, and the retail price at which she sold it. She also received a monthly bonus based on the total amount of Amway products that she purchased for resale to both consumers and to her sponsored distributors.(20)

Since distributors were compensated both for selling products to consumers and to newly-recruited distributors, there was some question as to whether this was a legitimate multilevel marketing program or an illegal pyramid scheme. The Commission held that, although Amway had made false and misleading earnings claims when recruiting new distributors,(21) the company's sales plan was not an illegal pyramid scheme. Amway differed in several ways from pyramid schemes that the Commission had challenged. It did not charge an up-front "head hunting" or large investment fee from new recruits, nor did it promote "inventory loading" by requiring distributors to buy large volumes of nonreturnable inventory. Instead, Amway only required distributors to buy a relatively inexpensive sales kit. Moreover, Amway had three different policies to encourage distributors to actually sell the company's soaps, cleaners, and household products to real end users. First, Amway required distributors to buy back any unused and marketable products from their recruits upon request. Second, Amway required each distributor to sell at wholesale or retail at least 70 percent of its purchased inventory each month -- a policy known as the 70% rule. Finally, Amway required each sponsoring distributor to make at least one retail sale to each of 10 different customers each month, known as the 10 customer rule.(22)

The Commission found that these three policies prevented distributors from buying or forcing others to buy unneeded inventory just to earn bonuses. Thus, Amway did not fit the Koscot definition: Amway participants were not purchasing the right to earn profits unrelated to the sale of products to consumers "by recruiting other participants, who themselves are interested in recruitment fees rather than the sale of products."(23)

Pyramid Schemes in the 1990's

The 1990's first brought an important refinement in the law. As the Commission pursued new pyramid cases, many defendants proclaimed their innocence, stating that they had adopted the same safeguards -- the inventory buy-back policy, the 70% rule, and the 10 customer rule -- that were found acceptable in Amway. However, an appellate court decision called Webster v. Omnitrition Int'l, Inc.,(24) pointed out that the Amway safeguards do not immunize every marketing program. The court noted that the "70% rule" and "10 customer rule" are meaningless if commissions are paid based on a distributor's wholesale sales (which are only sales to new recruits), and not based on actual retail sales.(25) The court also noted that an inventory buy-back policy is an effective safeguard only if it is actually enforced.(26)

While new cases were refining the law in the 1990's, radical changes were underway in the marketplace. Pyramid schemes came back with a vengeance. Like most economic activity, fraud occurs in cycles, and new pyramid schemes exploited a new generation of consumers and entrepreneurs that had not witnessed the pyramid problems of the 1970's. Also, the globalization of the economy provided a new outlet for pyramiding. Pyramids schemes found fertile ground in newly emerging market economies where this type of fraud had previously been scarce or unknown.(27) In Albania, for example, investors poured an estimated $1 billion into various pyramid schemes -- a staggering 43% of the country's GDP.(28)

In the U.S., probably nothing has contributed to the growth of pyramid schemes as much as Internet marketing. The introduction of electronic commerce has allowed con artists to quickly and cost-effectively target victims around the globe. After buying a computer and a modem, scam artists can establish and maintain a site on the World Wide Web for $30 a month or less, and solicit anyone in the world with Internet access. Pyramid operators can target specific audiences by posting messages in specialized news groups (e.g., "alt.business.home" or "alt.make.money.fast"). In addition, through unsolicited e-mail messages -- known on the Internet as "spam" -- pyramid operators can engage in cheap one-on-one marketing. Whereas it might cost hundreds or thousands of dollars to rent a mailing list and send 10-cent post cards to potential recruits, it costs only a fraction of that to send out similar e-mail solicitations. On the Internet, you can acquire one million e-mail addresses for as little as $11 and spend nothing on postage.(29)

The Federal Trade Commission's current law enforcement efforts reflect this new wave in pyramiding. The Commission has brought eight cases against pyramid schemes in the last two years,(30) and six of those have involved Internet marketing.(31) One recent case, FTC v. FutureNet, Inc., is particularly instructive because it starkly reflects the potential for abuse in hi-tech and newly deregulated industries. FutureNet allegedly claimed that, for payment of $195 to $794, investors could earn between $5000 and $125,000 per month as distributors of Internet access devices like WebTV. The FTC filed suit, charging that FutureNet's earnings claims were false because the company really operated an illegal pyramid scheme. Near the time of filing, FTC investigators discovered that FutureNet had begun to sell electricity investments as well, riding a wave of speculation in advance of the deregulation of California's electricity market. The Commission obtained a TRO and an asset freeze over the defendants' assets and eventually reached a $1 million settlement with the corporate defendants and two individual officers. The settlement requires the defendants to pay $1 million in consumer redress, bars them from further pyramiding activity of any kind, requires them to post a bond before engaging in any network marketing, and requires them to register with state utility officials before engaging in the sale of electricity. The Commission continues to litigate its case against three non-settling individual defendants.(32)

The Impact of Pyramids on Banking

Pyramid schemes not only injure consumers. In many cases, they affect the daily operations of banks and taint the banking industry's overall reputation for safety and soundness. Many pyramid promoters disparage the bank industry and promote their own program as a superior alternative to traditional banking and investment. Melvin Ford, a defendant in the SEC's recent case against International Loan Network, stated that his company's bonus program was "the most powerful financial system since banking."(33) At the height of his popularity, Charles Ponzi actually proclaimed that he would form a new banking system and divide profits equally between depositors and shareholders.(34)

In FTC v. Cano,(35) the Commission observed first-hand the impact of pyramid schemes on the banking system and individual banks. In that case, the Commission targeted an alleged Internet pyramid scheme that operated under the name Credit Development International ("CDI"). For an initial payment of $130 and subsequent monthly payments of $30, consumers could join CDI's "Platinum Infinity Reward Program" and become a participant in its "3x7 Forced Matrix" -- a structure that promised commissions going seven layers deep and that required each participant to recruit just three new members. CDI represented that participants could earn more than $18,000 per month in this program.

Besides the promise of high profits, the real attraction of CDI was its offer of an unsecured Visa or MasterCard, with a $5000 credit limit and a low 6.9% annual financing rate. This offer was especially attractive to consumers with poor credit histories, to whom CDI advertised saying "Guaranteed Approval, No Security Deposit! No Credit Check, No Income Verification and Bankruptcies No Problem!"(36)

CDI representatives claimed that they could offer such attractive terms because they had a special marketing relationship with a large overseas bank, the Banque Nationale de Paris (BNP). According to the transcript of a taped sales meeting, CDI hinted that a broad conspiracy prevented U.S. banks from offering such favorable terms. A CDI representative claimed, "normal banks do not want people to know that they could have a 6.9 [percent] credit card."(37) In the same meeting, CDI painted itself an alternative to a regular bank and said "our whole concept is to have the largest membership credit union in the world."(38) "We're the bank."(39)

In fact, according to the Commission's evidence, CDI had no business relationship with Visa, MasterCard, or BNP, and no relationship with any bank willing to issue credit cards to CDI members. Our evidence also showed that the defendants likely misled the one bank with which they did have a relationship. When investors paid by credit card to join CDI, the defendants apparently processed these payments, not through CDI but through a different "front" company with a VISA merchant account. Consequently, the defendants put their own merchant bank at risk for any charge backs that VISA might credit to angry investors.

In the end, CDI members never received their credit cards, and according to a Commission economist, at least 89 percent of them would never have made enough money to recoup their initial investment. Last autumn, the Commission obtained a temporary restraining order and a preliminary injunction against the CDI defendants, as well as a freeze over their assets. The Commission estimates that over the five-month life of CDI, more than 30,000 consumers from the U.S., Europe, Australia, and Southeast Asia lost $3 to $4 million dollars in this alleged scam. The matter is still in litigation; the Commission is now seeking to amend its complaint and name additional defendants.

In the largest pyramid case brought by the Commission in the 1990's, we witnessed how pyramid operators often try to use the international banking system to hide their assets. In FTC v. Fortuna Alliance,(40) the defendants allegedly promised consumers that, for a payment of $250, they would receive profits of over $5,000 per month. The program spawned numerous web sites on the Internet and victimized thousands of investors across 60 different countries. Although the defendants initially operated out of the United States, the Commission discovered they had secreted millions of dollars to offshore bank accounts in Antigua. But international cooperation saved the day. With the aid of the courts and banks in Antigua, the Commission obtained an order against the defendants, requiring them to repatriate over $2 million in offshore assets and pay approximately $7 million in redress to consumers from 60 countries.

Consumer Education

Law enforcement is the cornerstone of the Commission's fight against pyramid schemes; however, we also try to educate the public so that they can protect themselves. In our educational efforts, we have tried to take a page from the con artists' book and use new online technology to reach consumers and new entrepreneurs. For example, on the agency's web site at "www.ftc.gov", the Commission has posted several alerts regarding pyramid schemes and multilevel marketing problems. The Commission records over 2 million "hits" on its home page every month and receives several thousand visitors on its pyramid and multilevel marketing pages.

The staff of the Commission also has posted several "teaser" web sites, effectively extending a hand to consumers at their most vulnerable point -- when they are surfing areas of the Internet likely to be rife with fraud and deception. The "Looking for Success" site is one example. It advertises a fake pyramid scheme. The home page of "Looking for Success" promises easy money and talks in glowing terms about achieving "financial freedom." On the second page, the consumer finds a payout plan common to pyramid schemes, as well as typical buzz words like "forced matrix," "get in early," and "downline." Clicking through to the third and final page in the series, however, brings the consumer to a sobering warning: "If you responded to an ad like this one, you could get scammed." The warning page provides a hyper-text link back to FTC.GOV, where consumers can learn more about how to avoid pyramid schemes.

Business Education

In an effort to provide information to new entrepreneurs, especially those who may unwittingly violate the law, the Commission has conducted a number of "Surf Days" on the Internet. The first Surf Day, conducted in December 1996, focused on pyramid schemes. Commission attorneys and investigators enlisted the assistance of the SEC, the U.S. Postal Inspection Service, the Federal Communications Commission, and 70 state and local law enforcement officials from 24 states. This nationwide ad hoc task force surfed the Internet one morning, and in three hours, found over 500 web sites or newsgroup messages promoting apparent pyramid schemes. The Commission's staff e-mailed a warning message to the individuals or companies that had posted these solicitations, explaining that pyramid schemes violate federal and state law and providing a link back to FTC.GOV for more information. In conjunction with the New York Attorney General's Office and the Interactive Service Association, the Commission announced the results of Internet Pyramid Surf Day at a televised press conference in New York City. A month later, the Commission's investigative staff revisited web sites or newsgroups identified as likely pyramids during Surf Day and found that a substantial number had disappeared or improved their representations and claims made to consumers.

More recently in October 1997, the Commission helped coordinate the first "International Internet Surf Day." Agencies from 24 countries joined this effort and targeted "get-rich-quick" schemes on the Internet, including pyramid schemes.(41) Australia's Competition and Consumer Commission oversaw the world-wide effort while the FTC led the U.S. team consisting of the SEC, the Commodities Futures Trading Commission ("CFTC") and 23 state agencies.

In February of this year, the Commission announced yet another innovative use of the Surf Day concept, this time targeting deceptive e-mail solicitations. The Commission collects unsolicited commercial e-mail from annoyed consumers and other sources. A large percentage of these e-mails contain apparent chain letters or pyramid schemes. The Commission searched its e-mail database, topic by topic, and along with the Postal Inspection Service sent a warning letter to over 1000 individuals or companies identified as potentially responsible for promoting pyramids or other get-rich-quick schemes.

Looking Ahead

Unfortunately, pyramid schemes are likely to continue to proliferate both here and abroad in the near future. However, we can all help stem the tide by working together. Members in the the banking or financial sector can help law enforcement agencies in several ways. First, if your country does not have a law that makes pyramid schemes illegal, you should encourage your government to enact the necessary legislation and provide sufficient resources for enforcers to pursue pyramid schemes. Associations of reputable bankers or insurers, whose businesses can be jeopardized by the illicit schemes of unlicensed insurers or securities dealers, can be effective allies. Recent history in Eastern Europe makes it only too clear that pyramid schemes exploit the absence of a fully-functioning market, adequate supervision, and/or an effective legal infrastructure. Second, you can report any suspect investment programs or potential pyramid schemes. Any information can help, and you may be able to provide valuable insight into who is operating a pyramid, how it works, and whom it victimizes. In the Cano case, it was the substantial assistance of financial fraud investigators at VISA that enabled the Commission to develop and bring its case. Third, help us and others foreign enforcers to identify and freeze defendants' assets located in your countries. Understandably, banks must observe their privacy laws, but to the extent it is legally possible for you to provide assistance in tracing and freezing the assets of pyramid operators, you will benefit all our citizens. This is often the only way to halt an illegal scheme and return money to victims. We hope that the Fortuna Alliance case signals the beginning of a trend in obtaining valuable help from foreign courts and banks.

Finally, you can encourage the relevant officials in your countries to combat pyramid schemes by educating consumers and businesses about how to recognize and avoid this type of fraud. This can be particularly important in emerging markets, where experience with investment opportunities may be scarce.

Here are some tips that consumers and business might find helpful.

1. Beware of any plan that makes exaggerated earnings claims, especially when there seems to be no real underlying product sales or investment profits. The plan could be a Ponzi scheme where money from later recruits pays off earlier ones. Eventually this program will collapse, causing substantial injury to most participants.

2. Beware of any plan that offers commissions for recruiting new distributors, particularly when there is no product involved or when there is a separate, up-front membership fee. At the same time, do not assume that the presence of a purported product or service removes all danger. The Commission has seen pyramids operating behind the apparent offer of investment opportunities, charity benefits, off-shore credit cards, jewelry, women's underwear, cosmetics, cleaning supplies, and even electricity.

3. If a plan purports to sell a product or service, check to see whether its price is inflated, whether new members must buy costly inventory, or whether members make most "sales" to other members rather than the general public. If any of these conditions exist, the purported "sale" of the product or service may just mask a pyramid scheme that promotes an endless chain of recruiting and inventory loading.

4. Beware of any program that claims to have a secret plan, overseas connection or special relationship that is difficult to verify. Charles Ponzi claimed that he had a secret method of trading and redeeming millions of postal reply coupons. The real secret was that he stopped redeeming them. Likewise, CDI allegedly represented that it had the backing of a special overseas bank when no such relationship existed.

5. Beware of any plan that delays meeting its commitments while asking members to "keep the faith." Many pyramid schemes advertise that they are in the "pre-launch" stage, yet they never can and never do launch. By definition pyramid schemes can never fulfill their obligations to a majority of their participants. To survive, pyramids need to keep and attract as many members as possible. Thus, promoters try to appeal to a sense of community or solidarity, while chastising outsiders or skeptics. Often the government is the target of the pyramid's collective wrath, particularly when the scheme is about to be dismantled. Commission attorneys now know to expect picketers and a packed courtroom when they file suit to halt a pyramid scheme. Half of the pyramid's recruits may see themselves as victims of a scam that we took too long to stop; the other half may view themselves as victims of government meddling that ruined their chance to make millions. Government officials in Albania have also experienced this reaction in the recent past.

6. Finally, beware of programs that attempt to capitalize on the public's interest in hi-tech or newly deregulated markets. Every investor fantasizes about becoming wealthy overnight, but in fact, most hi-tech ventures are risky and yield substantial profits only after years of hard work. Similarly, deregulated markets can offer substantial benefits to investors and consumers, but deregulation seldom means that "everything goes," that no rules apply, and that pyramid or Ponzi schemes are suddenly legitimate.

Conclusion

As we continue to pursue pyramid schemes, we would be delighted to coordinate our efforts with law enforcement in your countries. It is only too evident that the expansion of fraud across borders and on the World Wide Web means that no one agency or country can work effectively on its own. We must be collectively vigilant in order to protect the integrity of our marketplaces and the pocketbooks of our consumers.

1. The views I give, of course, are my own and do not reflect the official views of the Commission or any particular Commissioner.

2. Barbara Rudolph, Poof Go the Profits . . ., Time, Aug. 8, 1994 at 44.

3. Assume a pyramid scheme in which each person recruits 10 new people. There would be one person at the top, 10 beneath her, 100 beneath them, 1,000 beneath them and so forth. The pyramid would involve everyone on earth in just 10 layers of people with one con artist on top. The bottom layer would have more than 4.5 billion people. The Skeptic's Dictionary at "http://wheel.vcdavis.edu/nbtcarrol/skeptic/pyramid.html"

4. Some people also refer to multilevel marketing as direct selling or network selling.

5. See Mark C. Knutson, "The Ponzi Scheme," published online at "http://www.usinternet.com/users/mcknutson/pscheme.htm".

6. Id.

7. See e.g., SEC v. Int'l Load Network, Inc., 770 F. Supp. 678 (D.D.C 1991), aff'd, 968 F.2d 1304 (D.C. Cir. 1992)..

8. See e.g. U.S. v. Crowe, 4:95CR-13-C (W.D. Ky. 1995) (charging an alleged pyramid promoters with mail fraud under 18 U.S.C. § 1341; securities fraud under 15 U.S.C. § § 78j(b), 78ff, 17 C.F.R. § 240.10b-5, and 18 U.S.C. § 2; and money laundering under 18 U.S.C. § § 2, 1957.)

9. Cal. Penal Code § 327 (Deering 1996)

10. 720 Ill. Compiled Stat. Ann. 5/17-7 (Michie 1997) (formerly Ill. Rev.

Stat., ch. 38, para. 17/7 (1993))

11. Ga. Code Ann. § 10-1-410 (1997)

12. 15 U.S.C. § 45 (1997)

13. See Thomas P. Rowan, Report, Confronting the Pyramid Hazard in the United States 15 (submitted to Prof. Robert Vaughn, Wash. College of Law, Am. U.) (1998) (citing Joseph N. Mariano & Mario Brossi, Multilevel Marketing: A Legal Primer 29 (2d ed. 1997)).

14. 86 F.T.C. 1106 (1975), aff'd sub. nom. Turner v. FTC, 580 F.2d 701 (D.C. Cir. 1978).

15. Id. at 1108-110 (complaint).

16. See e.g., Webster v. Omnitrition Int'l, Inc., 79 F.3d 776, 781-82 (9th Cir. 1996), cert. denied, 117 S. Ct. 174, __ U.S. __ (1996).

17. Koscot 86 F.T.C. at 1180.

18. Id. at 1181.

19. 93 F.T.C. 618 (1979)

20. Id. at 710-14.

21. Id. at 729-33.

22. Id. at 715-17

23. Id. See Rowan at 18-21 (analyzing the Amway decision).

24. 79 F.3d 776, 781-82 (9th Cir. 1996), cert. denied, 117 S. Ct. 174, __ U.S. __ (1996).

25. Id. at 783.

26. Id. at 783-84.

27. Tom Hundley, Always Poor, Albanians Go for Broke, Chicago Tribune, Feb. 11, 1997 at 18.

28. Id. For an analysis of the effect of pyramid and Ponzi schemes on Eastern Europe's insurance market, see Int'l Chamber of Commerce, Pyramid sales of insurance policies condemned, Business World, July 9, 1997 at "http://www.iccwbo.org/html/pyramid.htm".

29. Ram Avrahami, FTC Workshop on Consumer Information Privacy, Transcript of June 12, 1997 at 107.

30. See FTC v. Affordable Media, LLC, Civil Action No. CV-S-98-00669-LDG) (D. Nev. filed April 23, 1998); FTC v FutureNet, Inc., No. 98-1113 FHK (AIJx) (C.D. Cal. filed Feb. 17, 1998); FTC v. Cano, No. (C.D. Cal. filed Oct. 29, 1997); FTC v. Jewelway Int'l Inc., No. CV-97-383 TUC JMR (D. Ariz. filed June 24, 1997); FTC v. World Class Network, Inc., No. SAV-97-162 AHS (Ebx) (C.D. Cal. filed Feb. 28, 1997); FTC v. Mentor Network, Inc., No. SACV 96-1104 LHM (Eex), (C.D. Cal. filed Nov. 5, 1996); FTC v. Global Assistance Network for Charities, No. CIV 96-2494 PHX RCB (D. Ariz. filed Nov. 5, 1996); FTC v. Fortuna Alliance, L.L.C., No. C96-799M (W.D. Wash. filed May 23, 1996).

31. Based on complaints the FTC has filed, the Internet was a major recruiting tool used in FutureNet, Cano, World Class Network, Mentor Network, Global Assistance Network for Charities, and Fortuna Alliance.

32. See, FTC, FutureNet Defendants Settle FTC Charges: $ 1 Million in Consumer Redress for "Distributors", Apr. 8, 1998 at "/opa/9804/futurenet.htm" (press release).

33. Int'l Loan Network, 770 F. Supp. at 678.

34. Knutson, supra, note 5.

35. Cano, supra, note 30.

36. Exhibits in Support of Motion for TRO and Asset Freeze, Ex. 2, Attachments 2, 7, Cano, supra, note 30.

37. Exhibits in Support of Motion for TRO and Asset Freeze, Ex. 2, Attachment 5 at 141, Cano, supra, note 30 (transcript of sales presentation) [hereafter "Transcript"].

38. Id. at 86.

39. Id. at 110.

40. Fortuna Alliance, supra, note 30.

41. International participants included Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Hungary, Ireland, Jamaica, Japan, Korea, Mexico, New Zealand, Norway, the Philippines, Poland, Portugal, South Africa, Spain, Sweden, Switzerland, and the United Kingdom.

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