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ALGEMENE KENNISGEWINGS

NOTICE 1134 OF 1999

DEPARTMENT OF TRADE AND INDUSTRY

CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988

I, Alexander Erwin, Minister of Trade and Industry, do hereby, in terms of section 10(3) of the Consumer Affairs (Unfair Business Practices) Act, 1988 (Act No. 71 of 1988), publish the report of the Business Practices Committee on the result of an investigation made by the Committee pursuant to General Notice 1545 of 1997 published in Government Gazette No. 18390 dated 31 October 1997 and General Notice 2723 of 1998 published in Government Gazette No. 19455 dated 13 November 1998, as set out in the Schedule.

ALEXANDER ERWIN
MINISTER OF TRADE AND INDUSTRY

KENNISGEWING 1134 VAN 1999**DEPARTEMENT VAN HANDEL EN NYWERHEID****WET OP VERBRUIKERSAKE (ONBILLIKE SAKEPRAKTYKE), 1988**

Ek, Alexander Erwin, Minister van Handel en Nywerheid, publiseer hiermee, kragtens artikel 10(3) van die Wet op Verbruikersake (Onbillike Sakepraktyke), 1988 (Wet No. 71 van 1988), die verslag van die Sakepraktykekomitee oor die uitslag van die ondersoek deur die Komitee gedoen kragtens Algemene Kennisgewing 1545 van 1997 soos gepubliseer in Staatskoerant No. 18390, gedateer 31 Oktober 1997, en Algemene Kennisgewing 2723 van 1998 soos gepubliseer in Staatskoerant No 19455, gedateer 13 November 1998, soos in die Bylae uiteengesit.

**ALEXANDER ERWIN
MINISTER VAN HANDEL EN NYWERHEID**

SCHEDULE . BYLAE

BUSINESS PRACTICES COMMITTEE

REPORT
IN TERMS OF SECTION 10(1) OF THE
HARMFUL BUSINESS PRACTICES ACT, 1988
(ACT No. 71 OF 1988)

REPORT 76

***Investigation in terms of section 8(1)(6) of the
Harmful Business Practices Act, 71 of 1988,
info money revolving or pyramid schemes***

1. Introduction

People **all** over the world, and South **Africans** are no exception, are **bewitched** and fascinated by any idea or scheme promising, **In** most cases, instant wealth, new homes, new cars, holidays abroad and **all material** possessions that can be acquired **with** an abundance of money. A further **attraction** of these schemes is the perception that the money will keep rolling in with **little** or no effort by the **participants**, the hardest part being to count one's money.

A consumer who **participates** in these "easy money making" schemes apparently believes that money, and lots of **it**, is there for the taking, without considering where this money comes from. Many consumers are handsomely rewarded by participating in these schemes. Unfortunately there are many more consumers who lose their money. The total amount gained by the promoters and other participants of these "easy moneymaking" schemes is usually equal to the amount lost by the other participants. Participants come from all walks of life.

Many of these schemes, commonly called "pyramids", have mushroomed in South Africa during the last two years. Pyramids create a dilemma for authorities. While a scheme is operating there are people, who are making money out of **it**. This apparent success is always visible to new entrants. Should the authorities step in and stop the scheme to prevent still more people from losing money, the authorities are accused of being paternalistic, unconstitutional, interfering with the consumers' freedom of choice, ignorance, bias and many more, When the authorities do not intervene and the scheme grinds to a stop, as all these schemes inevitably do, the outcry is "... why did the authorities not intervene?" The Business Practices Committee (the Committee) investigated a number of these schemes on a preliminary and a formal basis.

2. The Business Practices Committee

The Committee, a statutory committee within the Department of Trade and Industry, administers the Harmful Business Practices Act, 71 of 1988 (the Act). This is an enabling act. The Act makes provision for the prohibition or control of harmful business practices, and for connected matters, A "harmful business practice" means any business practice which, directly or indirectly, has or is likely to have the effect of harming the relations between businesses and consumers, unreasonably prejudicing any consumer, or deceiving any consumer. The Chairman of the Committee reports to the Minister of Trade and Industry (the Minister).

In terms of the Act the Committee may conduct two types of formal investigations. **First**, in terms of section 8 of the **Act**, the Committee may on its own initiative, and shall on the directions of the Minister, undertake such investigation as it may consider necessary into any harmful business practice of particular individuals or persons that the Committee believes exists or may come into existence. Secondly, the Committee may investigate any business practice being applied by persons in general for the purposes of creating or maintaining a harmful business practice. The first type of investigation is a **section 8(1)(a)** investigation in terms of the Act and the second a section 8(1)(b) investigation. These types of investigations are known as formal investigations.

The Committee can also undertake preliminary investigations in terms of section 4(l)(c) of the Act into the business practice of an **entity**. A **salon 4(1)(c) investigation** enables the **Committee** to undertake such **preliminary** investigation as **it** may consider necessary into, or confer **with** any

Interested party in connection with, any harmful business practice which allegedly exists or may come into existence. Notice of section 4(1)(c) investigations are not published in the Government Gazette as opposed to section 8(1)(a) investigations. The purpose of section 4(1)(c) investigations is to enable the Committee to make a more informed decision as to whether a section 8(1)(a) investigation should be undertaken. The Minister is not empowered to make any decisions on the strength of a section 4(1)(c) investigation, but he may do so in terms of a section 8 Investigation.

The Committee reports to the Minister on the result of any investigation undertaken by it in terms of section 8. If the Committee, after an investigation, believes a harmful business practice exists, or may come into existence and is not satisfied that the harmful business practice is justified in the public interest, the Committee in its report recommends to the Minister the action that should be taken to ensure the discontinuance of the harmful business practice. The powers of the Minister are set out in section 12 of the Act. The orders of the Minister are published in the Government Gazette and a contravention of the Minister's order constitutes a serious criminal offence.

3. The decision to undertake this investigation

During August 1996 officials of the Committee met with representatives of the South African Reserve Bank, the Office for Serious Economic Offences, the Financial Services Board and the Commercial Branch of the SA Police Services. (SAPS). At the meeting it was resolved that the Committee, with its enabling legislation, was in the short term the only statutory body that could stop money revolving schemes if such schemes were found, after an investigation in terms of the Act, to constitute harmful business practices.

On 3 September 1996 the Committee resolved to request the Minister to obtain the approval of Cabinet to conduct a section 8(1)(b) investigation into money revolving schemes. Cabinet gave approval for a 8(1)(b) on 19 February 1997 and on 6 March 1997 the Committee resolved to undertake a section 8(1)(b) investigation into these schemes.

4. Investigations into specific schemes

Early in 1997 the Committee commenced with an investigation in terms of section 8(1)(a) of the Act into the business practices of the Newport Business Club (Newport). The investigation was protracted because of numerous court cases instituted by Newport against the Committee. These are set out in detail in the Committee's Report No 56: *Newport Business Club (Pty) Ltd and Others*. The Committee eventually was able to present its report to the Minister, The Committee was of the opinion that Newport was involved in harmful business practices that were not justified in the public interest and that the Minister should take steps in terms of section 12(b) and(c) of the Act to prevent Newport and the parties involved from continuing the harmful business practice. On 13 September the Minister declared the business practices of Newport Business Club (Pty) Ltd illegal. Newport lodged an appeal to the Special Court constituted in terms of the Act.

The investigation into Newport was preceded by an investigation into the business practices of

the **Rainbow** Business Club. These investigations obviously took considerable **time** and eventually led to the **general** or **section 8(l)(b) investigation into "money making schemes", "money revolting schemes" or "pyramid" schemes** being postponed.

5. Notice of the **section 8(l)(b)** investigation

The following appeared as **Notice 1545** in Government **Gazette** No 18390 of 31 October 1997.

"In terms of the provisions of section 8(4) of the Harmful Business Practices Act, 1988 (Act No 71 of 1988), notice is hereby given that the Business Practices Committee intends undertaking an investigation in terms of section 8(l)(b) of the said Act into money revolving schemes as defined in the schedule. Any person may within a period of 30 days from the date of this notice make written representations regarding the above-mentioned investigation to: The Secretary, Business Practices Committee, Private Bag X84, PRETORIA, 0001.

Schedule

In this notice, unless the context indicates otherwise, a 'money revolving scheme' means a scheme-

(a) whereby participants are required to contribute valuable consideration towards the scheme, part of which contribution is used to reward both the promoters of the scheme and/or **participants** who preceded new participants and whereby promoters and/or **participants** are entitled to receive rewards out of contributions made by successive participants; **and/or**

(b) whereby the rewards of promoters and/or participants are directly correlated to the numbers of new participants canvassed directly or indirectly by the existing promoters and/or participants; **and /or**

(c) in which a majority of participants will not recoup their contributions, irrespective of:

- (i) the stage on the life cycle of the scheme; **and/or**
- (ii) at what stage the scheme comes to an end; **and/or**
- (iii) at what stage the participants joined the scheme".

Notice of the proposed investigation was also brought to the attention of the Office for Serious Economic **Offences**, the **SABC**, the South African Reserve Bank, the South African Police **Services**, the Direct Selling Association and the **Financial** Services Board.

6. Types of schemes

Most people call any "easy money making scheme" or "money revolving scheme" a "pyramid scheme". In many cases the structure of the schemes does not resemble a pure pyramid and the

Committee, for various reasons, preferred to call these schemes "money revolving schemes". A "pyramid" implies that there is a broad base of consumers or participants at the base or lowest level of the scheme. Some schemes are structured in such a way that this is not the case. Another reason for the **Committee's reluctance to call these schemes "pyramids" is** that most organizational structures of companies, government departments, the police and the armed forces resemble a pyramid structure. One will, however, not be able to stop the popular parlance of the word "Pyramid" and the **Committee will also** henceforth use the word pyramid. Should the Minister accept the recommendations of the **Committee, it** is suggested that these schemes be referred to as illegal pyramids.

The following are a few examples of "pyramid" schemes. The examples are in no way exhaustive. There are numerous variations on each scheme and the number of different schemes is limited only by the extent of human Ingenuity. In this report reference is made to "investments" by consumers or the amounts paid to participate in a particular scheme. These "investments" are at times called "contributions", "donations" and sometimes other similar words are used. The Committee does not regard these "investments" as investments in the narrow sense of the word, but for ease of reading these "investments" will not be in inverted commas.

6.1 "Multiplication" schemes

A brochure of a money revolving scheme stated: "Multiply your money by 5 in 24 hours". In this scheme a registration fee of **R200** was payable by new members and existing members were required to pay only **R100**. Participants could invest as many times as they wished. In other pamphlets advertising the same scheme it was stated: "Multiply your money by 3 in 14 days".

"**ABC**" (Pty) Ltd was another multiplication scheme. The "pay out date" of this scheme was 10 weeks after the investment was made. The amount invested could vary between **R110** and **R5 500**. The return was 2.7272 times the amount invested, for example "... invest **R110** and get **R300**". The return on a **R990** investment was **R2 700**.

The "XYZ Assistance Society" operated four schemes, namely the Super Save Policy, Suppose-U-Die, Get-U-Go policy and the **Easy-Go-Policy**. The investments in the "Suppose-U-Die" scheme "matured" after three months. The brochure of "XYZ Assistance Society" stated *inter alia*: "All principles on the policy are compulsory to be observed. Then confirm with the office for your payment details and day". The following sets out the "benefits" participants could allegedly enjoy:

Investment (R)	Maturity (R)	Death Cover (R)	Defendants (R)
340	800	one 600	1000
680	2000	4000	2000
1300	4000	8000	4000
2500	8000	16000	8000

Sun **Multiserve** (Sun) was a well-known multiplication scheme. During **October 1995** the **Committee** received a complaint from the **South African Police Services** about Sun. Participants paid an **R50** membership fee and could then invest various amounts. The following are examples

of the returns promised **in 11 to 12 weeks: R1 200 would grow to R4 000, R5 000 to R20 000 and R58 000 to R200 000. A member had to introduce four new members to Sun before enjoying the promised returns. This condition was waived by the time the scheme was flourishing. Sun paid returns in excess of 1000 percent but invested at less than 10 percent in an ordinary savings account at a financial institution. The South African Reserve Bank (SARB) stepped in and froze the assets of Sun in terms of the Banks Act.**

Hundreds of disgruntled Sun investors protested in front of the **SARB** building in Pretoria against the closure of Sun. The demonstration enjoyed national television coverage, The **action** of the **SARB** ensured that the scheme was stopped and that not more consumers lost their money. The consumers who lost their investments were unreasonably prejudiced. This came **about**, not by the **actions** of the **SARB**, but by the self destructive characteristics of the scheme. Only those people who are total financial illiterates can believe that a scheme such as Sun could carry on **indefinitely** paying returns in excess of 1000 percent while the funds were invested by them at less than 10 percent.

The brochure of the "**MCIC**" was written in one of South Africa's official languages. The following is a direct translation into English of some phrases used:

"We pay out, twice a week, i.e. Monday and Wednesday. Come our people, money earns more interest, if you come to us all your dreams will come true with **MASAKHANE**, you can also be assisted". The following sets out the "returns" participants could enjoy:

Joining fee (R)	Investment (R)	Return (R)
100	100	350
150	200	600
200	300	1000
300	400	1500
350	500	2000

Even over a relatively short term these schemes are bound to collapse. The amounts promised are grandiose and utterly unattainable. The impossible dreams of the majority of participants could never be realised. The promoters used these schemes for obtaining money from desperate consumers. All that happens in these schemes, is that Paul is robbed to pay Peter. Multiplication schemes usually flourish among the less sophisticated and poorest sectors of the **community**. People participating in these schemes would be familiar with **stokfels**, which are run on a basis of trust and able to deliver according to the rules. This would give them a false sense of security.

6.2 "Chain letter" schemes

There are many variations of **chain** letters. Ordinary chain letters invariably operate as follows: A person receives a **letter** by post and is asked not to break the **chain** and to send a sum of money to the names on the **list**. The participant then sends off the money, adds his name to the bottom of the **list**, deletes the name at the top and makes a number of copies, depending on the number of names on the **list**. These copies are then sent to other persons, and if they participate, the cycle repeats itself. These **chain** letters are usually not very **profitable** for the promoters,

because there is no way to monitor whether a new participant has forwarded monies to the names on the list.

In a variation of the ordinary chain letter the promoter ensures that his/her name stays on the list and payments by new participants to preceding participants are controlled. An example of such a chain letter was operated by an entity called Dunamus CC. This entity was investigated by the Committee in terms of section 8(1)(a) of the Act. The detail of this scheme is set out in the Committee's Report No 60: *Dunamus Marketing CC and Others*.

The explanation of the scheme showed that a new participant needed to recruit a number of other participants in order to recoup his or her payment and make a profit. The amount paid by a new participant went into the pockets of the members of Dunamus CC and the other participants. New participants had to recruit at least five other participants to recoup their payments. These five new participants needed to recruit at least 25 new participants to recoup their payments and these 25 participants had to recruit another 125 participants. The scheme thus required exponential growth in the number of participants to enable the previous participants to recoup their investments. Any chain letter scheme is subject to an exogenous "switch off" of the scheme (see section 6.3).

It is difficult to identify a particular section of the community that participates in these schemes. The attitude of most participants is to "... get in quickly and get out quickly" to make a "profit" while the scheme lasts. The cost of participating in chain letter schemes is usually lower than the other types of schemes.

6.3 Pyramids in the guise of multi-level marketing schemes

Two examples of these schemes which were investigated by the Committee on a formal basis were Newport Business Club and Rainbow Business Club. The Newport scheme was set out on pages 12 and 13 of Government Gazette No 18292 dated 17 September 1997 and that of Rainbow on pages 34 and 35 of Government Gazette No 18531 dated 12 December 1997.

Both schemes allowed each member, provided the member advanced to the status of a "senior partner", to start his own small "pyramid". The Newport Business Club consisted of a great number of *en commandite* partnerships and each partnership was characterised by a separate "pyramid structure". These structures were not the same. For example, member A could canvass ten new members and member B three new members. Each new member thus canvassed by A and B would probably enrol various numbers of other new members. The number of people in each structure differed amongst each partnership. In general, however, the business club was also characterised by a pyramid structure in the sense that the promoters found themselves at the top, netting a considerable amount of the money paid by new members.

In the case of Rainbow new members had to pay R10 000. Of this amount R4 800 was paid to the person or persons who canvassed the new member and the remaining R5 200 went to Rainbow. The entrance fee in the Newport case was R14 000. Of this amount R5 300 was paid as commissions to exiting partners who canvassed the new members, R4 740 was paid to the "executive partners, assistant marketing directors, marketing directors and the regional directors".

The **remaining R3 960** was for the account of the Newport Business Club. Part of this was expended on administrative and other costs of the partnership business. The **remainder** was then **allegedly** invested.

Theoretical models of schemes such as Newport and **Rainbow** seem to indicate that a stable growth rate in the number of members could eventually **result. But**, and this is **important**, a stable growth rate does not attract members to such schemes. The only factor that **really** attracts members is the phase of rapid growth where fortunes could, and have been made, **within** months, if not weeks. Prospective members were told at the meetings held by Newport that an individual could earn up to **R153 900** after nine periods, whether these periods were weeks or months. A deceleration of the growth rate **inevitably** leads to a compliant decrease of interest in the scheme. **It** would seem that this decline in interest is an exogenous "switch off" of the scheme. A "switch off" of the scheme would lead to its collapse.

The potential "advantage" to a consumer who became a **partner** or member was the right to recruit and introduce new members. A considerable part (R5 300 plus **R4 740** or 71.71 per cent of **R14 000**) of the new members' payment served to fund the recruitment costs, that is, the commissions paid to existing members who had recruited the new members and also the management of the scheme. The incentive to new members to recoup their initial cash payment lay in **the introduction of further new members on which this scheme was dependent**. The greater the number of new members introduced, the sooner the recoupment of the original cash **payment**.

In the Newport case the **Committee** calculated that at any time at least 75 per cent and possibly more of the members would have been at risk of not recouping their investments. This applied to the **total** number of members, irrespective of at what stage they joined the scheme. An analysis of the commissions earned by **Newport** members showed that 61 per cent of the members had not recouped any of their monies and another 30 per cent recouped some monies, but less than **R14 000**. Only 9 per cent earned more than **R14 000**. These Percentages were identical at the stage where Newport had 1671 members and again at a later stage when the scheme had 6354 participants. The **overwhelming** majority of consumers who **participated** in the Newport and Rainbow schemes were unreasonably prejudiced. Whether the schemes would have come to an end during whichever period, an overwhelming majority of participants would have lost their investments.

Three persons received R10.9 million, **R2.1** million and **R4** million respectively in the Newport scheme. These amounts included "management commissions". The top 30 earners each received more than **R226 000**. These rewards were financed by those 91 per cent who had not recouped their payments of **R14 000**. These percentages were almost identical to those calculated during the **investigation** into the **Rainbow** Business Club and maybe indicative of the trend in these types of schemes.

Pyramid schemes can be regarded as "up-market" schemes, **although it** has come to the **attention** of the **Committee** that people of the lower income groups and poorer communities do at **times** get involved in these schemes. When they do so they usually borrow funds from friends or relatives or take out **additional** mortgages on their homes. These **participants** were even more severely **prejudiced** than the more **affluent participants**. They dreamt of escaping from their debt ridden struggles for **existence**. Instead they were plunged deeper into **debt**.

7. Summary of the **schemes**

Although a smokescreen of other advantages is often used, the only genuine product & schemes is money and the scheme's continued existence relies totally on the ever increasing numbers of new participants. The success of the promoters and its participants is dependent on the money received from its participants and new participants on a continuous basis. The potential advantage to consumers who become participants lies in the right to recruit new participants. The incentive to new participants to recoup their initial cash payment lies in the canvassing of further new participants on which a scheme is dependent

The proponents of schemes, such as **Newport**, argue vehemently that no saturation point could be reached. Theoretically and **mathematically this** might be the case, depending on the underlying assumptions. The extent of a new member's possible earnings is clearly limited by the extent of the market. **And the market is limited.** There is, at any time, a finite number of people with the buying power to become members of a scheme. The population growth rate does not match the exponential rate required to make the scheme viable for all participants over a relatively short period. Most of the people that join these schemes do so with the expedition of making a handsome profit in a few months and not over a period of years.

The Committee was presented with mathematical models which seemed to indicate that a scheme such as **Newport** could experience a stable growth rate. But this stable growth rate does not attract members to the scheme. When a stable growth rate is achieved, it could take many years before the number of **participants** doubles itself. The only factor that really attracts members is the phase of rapid growth where fortunes could, and have been made, in months. During the slower **growth** phase interest in the scheme declines. It would seem that this decline in interest is an exogenous "switch off" of the scheme. A "switch off" of the scheme would lead to the **collapse** thereof.

The **Committee** took note of a number of theoretical models but these models are oversimplifications of reality. They do not reflect the real world, and for this very reason they are called models. There could probably be just as many theoretical models on the saturation issue as the number of **econometricians**. The outcome of each model will depend on the underlying assumptions.

In these schemes, at any one point in time, present or future, the majority of the participants will never recoup any monies at all, irrespective of the length of existence of the scheme.

The longer the scheme operates, the more **difficult** it would become for a member to **find** further potential members. Only a growth in the target market would provide potential members. The growth in the target market would **also** have to **be equal** or higher than **the exponential** rate required for everyone to **recoup** their payments **within** a reasonable **period of time**.

8. **Multilevel** marketing and pyramids

The **section is based** on a brochure of the Direct **Selling Education Foundation** (the **Foundation**), a Washington **DC not-for-profit** public **educational organization**. In a brochure of the Foundation pyramid **schemes** are **described** as **illegal scams** in which a large number of people at the bottom pay money to a few people at the top.

The Foundation states *inter alia*:

“That thousands of Americans have lost millions of dollars participating in pyramid schemes. Many of those that lost money, the **victims**, knew they were gambling, **although** they did not know that the odds were rigged **against** them. In order for everyone in a pyramid scheme to profit, there would have to be a **never-ending** supply of new **participants**. In reality, however, the supply of participants is limited.

Pyramiding is based on simple mathematics: many losers pay a few winners.

Participants in a pyramid scheme are, conscious or unconsciously, deceiving those they recruit. Few would pay to join if the diminishing odds were explained to them,

Pyramid promoters are masters of group psychology. At recruiting meetings they create a frenzied, enthusiastic atmosphere where group pressure and promises of easy money play upon people's greed and fear of missing a good deal. Thoughtful consideration and questioning are discouraged. **It** is difficult to resist this kind of appeal unless one recognises that the scheme is rigged against you.

Some pyramid promoters try to make their schemes look like multilevel marketing methods. **Multilevel** marketing is a lawful and legitimate business method (in the United States of America) which uses a network of independent distributors to sell consumer products.

To look like a multilevel marketing company, a pyramid scheme takes on a line of products and claim to be in the business of selling to consumers. However, **little** or no effort is made to actually marketing the products. Instead money is made in typically pyramid fashion, namely, from recruiting. Often products which have no established market value, such as new miracle products and exotic cures are “sold”,

How to tell the difference between a pyramid and a legitimate multilevel marketing company:

Pyramids seek to make money from you (and quickly). **Multilevel marketing** companies seek to make money with their clients as the clients build their businesses as well as the multilevel company with consumer products, **Consumption** of these products ensures that repeat sales are possible.

Pyramids often disguise entry fees as part of the price charged for the required “purchases” training, computer services and product **inventory**.

Multilevel marketers sell products to **final** consumers. **If there** are no sales **to final** consumers one **should suspect** that **one is dealing with a** pyramid scheme”.

9. Existing regulations on pyramid schemes

Regulation No **R.469** of 14 March 1980, published in Government **Gazette** No 8880, imposed **conditions** in respect of a “pyramid selling scheme” **as defined. These** regulations were promulgated more than 18 years ago, but the **Committee** is not aware of any court **actions** that were brought against any operator of a pyramid in terms of these regulations. The reason could be that the **existing** regulations are too cumbersome and in the spirit of deregulation it is recommended that these regulations should be repealed.

10. Conclusion

This **report** was first published under Notice 2723 in Government **Gazette** 19455 dated 13 November 1998. The **Minster** invited interested parties to make written representations regarding the report. All comments received were positive, with one exception. The only negative “**legal commentary**” received was to the effect **that:**

- (a) “It does not appear that enquiry was made of affected customers about whether they were harmed by the practices dealt with in the **report.**”
- (b) “**It is** not clear that the **definition** in the Act of a “commodity” includes money, a right to **claim** money, or the right to recruit new participants to the schemes”, and
- (c) “The report does not clearly find that the customers of these schemes were unreasonably prejudiced, or deceived”.

The Committee:

- (a) did receive comments from affected customers,
- (b) believes that the definition in the Act of a “**commodity**” includes money and that “... a right to claim money, or the right to recruit new participants to the schemes” are business practices as defined in the Act and
- (c) is of the opinion that the report clearly found that the **participants** of the schemes identified in the **report** were **unreasonably prejudiced, or deceived.**

On 8 March 1999 the **Committee** invited **representatives** of various bodies to attend a meeting to discuss the report that was published under **Notice** 2723 of 1998. The **meeting** was well attended by **representatives of inter alia leading auditing firms**, the State Attorney, the South African **Polices Services**, the **Investigation** Directorate for Serious Economic **Offences**, the Direct Selling Association and **non-governmental organisations**, such as the **Consumer Institute of South Africa**, the South African National **Consumer** Union and the National Consumer Forum. Those present **enthusiastically** supported the report and suggested minor amendments to the proposed

prohibitions by the **Minister**. There were two **dissenting** opinions. The report was vehemently **attacked** by the **representative** of a pyramid **promotional scheme** that was being **investigated** by the **Committee** in terms of **section 8(1)(a)** of the Act and **less so** by the **representative of the body** that **submitted** the **legal commentary** referred to above. This **representative also suggested positive** amendments to the then proposed **prohibition** by the **Minister**.

The Cabinet's approval to conduct this section 8(1)(b) investigation into money revolving **schemes** shows that the **Government considers these schemes in a serious light**. Thousands of South **African consumers** have lost large sums of money by **participating** in these **schemes**. The **Committee** is aware that many **participants** indebted themselves, many who are amongst the poor, have **incurred** debt in order to **become** members of these schemes. These schemes are clearly not in the public interest

11. Recommendation

Money revolving schemes, "**multiplication schemes**", "**chain letter schemes**" or "**pyramid schemes**" **constitute** harmful business practices. There are no grounds justifying these **practices** in the public interest **It is** accordingly **recommended** that the Minister declares these harmful business **practices** unlawful in terms of Section 12(l)(b) of the Act whereby, in the course of the business -

1. Any person who operates a **multiplication** scheme offering or promising or guaranteeing an **effective** annual interest rate of 20 per cent and more above the **REPO** rate, as determined by the South **African** Reserve Bank, to any investor, whether or not the investor **becomes** a member of the lending **entity**. The applicable **REPO** rate is that which applied at the date of the investment. The **effective** annual interest rate will be:

$$r = \frac{R \times 1200}{C \times T}$$

Where:

- r** = the **effective** interest rate,
- R** = the interest in **rand**, which is the difference between the amount paid out to the investor and the amount invested,
- C** = the amount invested by the investor or any amount paid by a person to **become** a member of a scheme, and
- T** = the **period** of the investment in months.

2. Any person, **directly** or **indirectly**, operates, **conducts**, promotes or **causes** to operate a **chain letter scheme**. A chain letter scheme is operated, **conducted**, promoted or **caused** to operate where any person (hereinafter referred to as the aforesaid persons)

(a) **invites** any other person (hereinafter referred to as the "**participating** person") to enter into any arrangement **with** any of the **aforsaid persons** the terms which **include** any **provisions which** have the effect that the **participating** person is **obliged** to make a payment of a **financial consideration with** the prospect of such **participating person receiving** payment or other **money-related benefits, directly** or **indirectly**, from **his/her participation** in the **recruitment** of other persons to enter into similar **arrangements** with any of the **aforsaid** persons;

(b) enters into any arrangement with any person the terms of which include any **provision** which has the effect that the **participating** person is obliged to make a payment of a financial consideration with the prospect of such participating person receiving payment or other **money-related** benefits, **directly** or **indirectly**, from **his/her** participation in the recruitment of other persons to enter into similar arrangements with any of the **aforsaid** persons.

(c) accepts any financial consideration from any person in terms of any arrangement which financial consideration is used in **part** or in full to **fulfil** the obligations of either party to make payment to a third party who has entered into a similar arrangement with any of the aforsaid persons; and

(d) makes any payment of any financial consideration or give any **money-related** benefit, **directly** or **indirectly**, to any person in terms of any arrangement as prohibited in terms of paragraph (b) or (c) above.

3. Any person, **directly** or **indirectly**, **participates** in a pyramid promotional scheme.

"**Pyramid promotional scheme**" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from the person's introduction of other persons into a plan or operation rather than from the sale of products by the participant or other persons introduced into the plan or operation.

"**Participant**" means a person who contributes money or any other form of consideration into a pyramid promotional scheme.

"**Consideration**" means the payment of cash or purchase of goods, services, or intangible property. Consideration does not include: purchase of products furnished at cost to be used in making sales and not for **resale**, purchase of products where the seller offers to repurchase the **participant's** products under reasonable **commercial** terms and the **participant's** time and effort in pursuit of **sales** or **recruiting activities**.

"**Compensation**" means the payment of money, a thing of value, or any financial **benefit** or any discounts which may accrue to the **participant**. **Compensation** does not include: Payments to **participants** based upon **sales** of products purchased for **actual** use or consumption, including products used or consumed by **participants** in the plan and payment to participants under reasonable commercial terms.

"Person" means an individual, a company, a partnership, a **close** corporation or **any association, or unincorporated organization.**

"Product" means a good, a service, or intangible property of any kind.

"Promote" means **any** of the following: To operate, or **advertise** or to induce or attempt to induce another person or persons to be participants.

"Reasonable commercial terms" includes repurchases by the seller, at the participant's **request**, and upon termination of the business relationship or contract **with** the seller, of all unencumbered products purchased by the participant from the seller within the previous 80 days which are unused and in commercially resalable condition, provided that repurchase by the seller shall be for not less than ninety percent of the actual amount paid by the participant to the seller of the products, less any consideration received by the **participant** for purchase of the products which are being returned and less a reasonable handling charge of not more than 25 per cent of the products' original purchase price, A product shall not be deemed **non-resaleable** solely because the product is no longer marketed by the seller, unless it is clearly disclosed to the participant at the time of the sale that the product is a seasonal, discontinued, or special promotional product, and not subject to the repurchase obligation

"Harmful business practice" means:

- (a) offering or promising or guaranteeing to pay an annual effective interest rate exceeding the **REPO** rate by more than 20 per cent **and/or**
- (b) operating, conducting, promoting or cause to operate a chain letter scheme **and/or**
- (c) operating, conducting, promoting or cause to operate a pyramid promotional scheme.

It is recommended that the **Minister:**

1. declare unlawful the harmful business practices and
2. direct persons to -

- (a) **refrain from applying the** harmful business practices;
- (b) **refrain at any time from** applying the harmful business **practices.**

The **Committee** will **also** recommend to the Minister that Regulation No **R.469** of 14 March **1980**, published in **Government Gazette** No 6880, be repealed.

LOUISE A TAGER
CHAIRMAN: BUSINESS PRACTICES COMMITTEE
22 April 1999

NOTICE 1135 OF 1999**DEPARTMENT OF TRADE AND INDUSTRY****CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988**

I, Alexander Erwin, Minister of Trade and Industry, by virtue of the powers vested in me by section 12(6) of the Consumer Affairs (Unfair Business Practices) Act, 1988 (Act No 71 of 1988), and after having considered a report by the Business Practices Committee in relation to an investigation of which notice was given by General Notice 1545 of 1997 in Government Gazette No. 18390 dated 31 October 1997 and General Notice 2723 of 1998 published in Government Gazette No. 19455 dated 13 November 1998, which report was published by Notice 1134 of 9 June 1999 in Government Gazette No. 20169 of 1999, promulgate in the public interest the notice in the Schedule.

**ALEXANDER ERWIN
MINISTER OF TRADE AND INDUSTRY**

SCHEDULE

1. In this notice, unless the context indicates otherwise -

“harmful business practice” means:

- 1. The operation of or participation in a multiplication scheme offering an effective annual interest rate of 20 (twenty) per cent and more above the REPO rate determined by the South African Reserve Bank, to any investor or participant, whether or not the investor or participant becomes a member of the lending party. The applicable REPO rate is the rate which applied at the date of the investment or commencement of participation. The effective annual interest rate will be:**

$$r = \frac{\bar{R} \times 1200}{C \times T}$$

Where:

- r** = the effective interest rate,
R = the interest in Rand, which is the difference between the amount paid out to the investor or participant and the amount invested,
C = the amount invested by the investor or any amount paid by a person to become a member of a scheme, and
T = the period of the investment in months.

2. **Directly or indirectly, operating, conducting, promoting or causing the operation of a chain letter scheme. A chain letter scheme is operated, conducted, promoted or caused to operate where any person (hereinafter referred to as the promoter or supplier of the scheme)**

(a) **invites any other person (hereinafter referred to as the "participating person") to enter into any arrangement with any of the promoter or supplier of the scheme the terms which include any provision which has the effect that the participating person is obliged to make a payment of a financial consideration with the prospect of such participating person receiving payment or other money-related benefits, directly or indirectly, in respect of the participation in the recruitment or introduction (whether by himself or another person) of other persons to enter into similar arrangements with any of the persons or promoter or supplier of the scheme;**

(b) **enters into any arrangement with the promoter or supplier(s) or any person of the scheme the terms of which include any provision which has the effect that the participating person is obliged to make a payment of a financial consideration with the prospect of such participating person receiving payment or other money-related benefits, directly or indirectly, from his/her participation in the recruitment of**

other persons (whether by himself or another person) to enter into similar arrangements with any of the persons or promoter or supplier of the scheme;

(c) accepts any financial consideration from the promoter or supplier(s) or any person of the scheme in terms of any arrangement which financial consideration is used in part or in full to fulfil the obligations of either party to make payment to a third party who has entered into a similar arrangement with any of the persons or promoter or supplier(s) of the scheme; and

(d) makes any payment of any financial consideration or gives any money-related benefit, directly or indirectly, to the promoter or supplier(s) or person of the scheme in terms of any arrangement as prohibited in terms of paragraph (b) or (c) above.

3. Directly or indirectly, participating in a pyramid promotional scheme where:

(a) "pyramid promotional scheme" means any plan or operation by which a participant gives consideration for the opportunity to receive compensation which is derived primarily from the person's introduction of other persons into a plan or operation rather than from the sale of products by the participant or other persons introduced into the plan or operation,

(b) "participant" means a person who contributes money or any other form of consideration into a pyramid promotional scheme,

(c) "consideration" means the payment of cash or purchase of goods, services, or intangible property. Consideration does not include: purchase of products furnished at cost to be used in

making sales and not for resale; purchase of products where the seller offers to repurchase the participant's products under reasonable commercial terms and the participant's time and effort in pursuit of sales or recruiting activities,

- (d) **“compensation” means the payment of money, a thing of value, or any financial benefit or any discounts which may accrue to the participant Compensation does not include: Payments to participants based upon sales of products purchased for actual use or consumption, including products used or consumed by participants in the plan and payment to participant under reasonable commercial terms,**
- (e) **“person” means an individual, a company, a partnership, a close corporation or any association, or unincorporated organization,**
- (f) **“product” means a good, a service, or intangible property of any kind,**
- (g) **“promote” means any of the following: To contrive or advertise or to induce or attempt to induce another person or persons to be participants,**
- (h) **“reasonable commercial terms” includes repurchase by the seller, at the participant's request, and upon termination of the business relationship or contract with the seller, of all unencumbered products purchased by the participant from the seller within the previous 90 (ninety) days which are unused and in commercially resalable condition, provided that repurchase by the seller shall be for not less than 90 (ninety) percent of the actual amount paid**

by the participant to the seller of the products, less any consideration received by the participant for purchase of the products which are being returned and less a reasonable handling charge of not more than 25 (twenty five) per cent of the products' original purchase price. A product shall not be deemed non-resaleable solely because the product is no longer marketed by the seller, unless it is clearly disclosed to the participant at the time of the sale that the product is a seasonal, discontinued, or special promotional product, and not subject to the repurchase obligation.

2. **The harmful business practice is hereby declared unlawful and no person shall operate, conduct, promote or cause to operate the harmful business practice and are directed to -**
 - (a) **refrain from applying, operating, conducting, promoting or causing to operate the harmful business practices;**
 - (b) **refrain at any time from applying, operating, conducting, promoting or causing to operate the harmful business practices.**
3. **Regulation No R.469 of 14 March 1980, published in Government Gazette No 6880 is hereby repealed.**
4. **This notice shall come into operation on date of publication.**

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