Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Commerce & Labor Committee

HB 1142

Brief Description: Prohibiting pyramid promotional schemes.

Sponsors: Representatives Chase, Conway, Pettigrew, Skinner, Ormsby, Condotta, Kessler, Armstrong, Linville, Eickmeyer, Morrell, Kenney and Santos.

Brief Summary of Bill

- Prohibits establishment, promotion, operation or knowing participation in pyramid promotional schemes.
- Makes a violation of the prohibition a violation of the Consumer Protection Act.

Hearing Date: 1/27/05

Staff: Rebekah Ward (786-7106).

Background:

Pyramid sales involve schemes in which the right to sell new memberships in the pyramid are sold under the guise of selling a product. Investors make their return not through the sale of the product, but through encouraging others to invest. Under these schemes, large numbers of people at the bottom of the pyramid pay money to a few people at the top. Each new participant pays for a chance to advance to the top and profit from the payments of others who might join later. Pyramid schemes are illegal in every state and may be prosecuted either under the Consumer Protection Act or specific laws prohibiting pyramid schemes.

In 2004 the Council of State Governments, in conjunction with the Federal Trade Commission, developed and adopted a model bill that has been adopted in a number of states. The last states to adopt this model bill were Idaho in 2004 and South Dakota in 2003. Utah, Florida, and New Jersey are considering similar measures.

In Washington, chain distribution schemes are prohibited. However, while state law prohibits such schemes, the statute does not explicitly prohibit "gifting schemes." Under Washington law, there is an illegal scheme if a person makes an investment to obtain the right to recruit others into a program. Limits, such as the number of participants or the right to receive profits, do not change the identity of the scheme.

A violation of the chain distribution scheme statute is a violation of the Consumer Protection Act (CPA). Under the CPA, a court may impose civil penalties on a perpetrator in the amount of

$2,000 per violation, or order restitution to injured parties, or court costs and attorney fees, or an injunction.

Summary of Bill:

Establishing, promoting, operating, or knowingly participating in a pyramid promotional scheme is prohibited. A violation of this prohibition is a violation of the Consumer Protection Act.

A pyramid promotional scheme is defined as any plan or operation in which the participant gives consideration for the right to receive compensation that is derived primarily from the recruitment of other persons as participants in the plan or operation, rather than from the sales of goods, services, or intangible property to participants or by the participants to others. This definition does not include a plan or operation in which participants give consideration in return for compensation based on purchases of goods, services, or intangible property for personal use or resale, as long as the plan or operation does not promote inventory loading and has an appropriate inventory repurchase program.

Inventory loading occurs when a plan or operation requires or encourages its independent sales people to purchase inventory in an amount that unreasonably exceeds that which the sales people can expect to resell for ultimate consumption, or to use or consume in a reasonable period of time.

An appropriate inventory repurchase program is one in which the plan or operation repurchases, upon request at the termination of the business relationship, the current and marketable unused inventory at a commercially reasonable rate.

The law regarding chain distributor schemes is repealed.

Rules Authority: The bill does not address the rule-making power of an agency.

Appropriation: Requested on January 27, 2005.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.