

## Legal Pitfalls Of Multilevel Marketing In Illinois

Multi-level marketing may offer many benefits to business owners and their distributors. However, in structuring your multi-level distribution network in Illinois, you will need to avoid three traps: an Illinois statute governing pyramid and chain referral sales, Illinois and federal statutes governing franchises, and Illinois and federal statutes governing certain types of business opportunities.

### Pyramid and Chain Referral Sales

The Illinois Consumer Fraud and Deceptive Business Practices Act (we'll call it the Business Fraud Act) makes pyramid sales schemes and chain referral sales unlawful. A pyramid sales scheme is basically a sales scheme in which the "distributors" earn their fee by inducing others to participate in the plan rather than by selling goods or services.

The best example of a pyramid sales scheme comes from a real case. Mr. A (I've changed the name) started a so-called buyers' club, which charged a fifty-dollar membership fee. Supposedly, members could receive discounts on consumer goods. However, the real inducement to joining was the opportunity to sell memberships. After becoming members themselves, the "distributors" could earn commissions by selling memberships to others. These new members would in turn sell memberships, and so on. The venture involved multiple "distribution" levels, and the bonuses increased at each higher level. No one was required to sell merchandise. In fact, very little merchandise was actually available. The few items that were sold were shoddy and overpriced.

In chain referral sales, a seller induces a buyer to purchase merchandise by promising to give the buyer a discount or a rebate if the buyer furnishes the seller with the names of other prospective buyers. However, the rebate is paid only if the seller actually makes a sale to those other buyers. Like the pyramid sales scheme, chain referral sales often involve multiple levels of referrals supposedly entitling buyers to ever-increasing rebates.

In Illinois and in most other states, pyramid sales schemes and chain referral sales are unlawful because they are deceptive. Eventually, the market becomes saturated and the "endless" chain ends. Those at the end of the chain may lose their investment. The sanctions for violating these laws may include monetary damages to the victims, fines, and incarceration.

The lesson for business owners who want to establish a multi-level marketing program is quite straightforward: (1) Your distributors must be

compensated based on actual sales, and (2) their primary inducement must not be based on recruiting other distributors.

### Franchises

Under the Illinois Franchise Act and the Federal Trade Commission Act, a multi-level distribution system may be a franchise if three elements are present. (To keep the players straight, remember that the franchisee is the person who sells the goods or services to the end user. The franchiser is the person who owns the brand name or the trade name under which the franchisee sells the goods or services.) These three elements are as follows: (1) The franchisee sells goods or services under a marketing plan that the franchisor developed. (A marketing plan is any plan or system by which the franchisee will conduct business. For example, a business plan or system can include pricing, sales or merchandising techniques, or advertising or promotional materials.) (2) The franchisee sells the goods or services with a trademark, service mark, trade name, logotype, advertising, or other commercial symbol owned by the franchiser. (3) For the privilege of using the franchiser's brand name or trade name and receiving a marketing plan, the franchisee has paid the franchiser a fee in the amount of at least five hundred dollars. The franchise fee can take many forms. Examples include payments for mandatory training or markups on the cost of goods or services sold by the franchiser to the franchisee for resale by the franchisees.

### Business Opportunity Ventures

For some time, the Federal Act has made unlawful a type of marketing arrangement known as a business opportunity venture. Under the Federal Act, a business opportunity venture exists when the following three factors are present: (1) A person (the Seller) sells goods or services to another (the Buyer). (2) The Seller (or the Seller's agent) secures or helps the Buyer secure retail outlets, accounts, or locations at which the Seller sells or displays products. (3) The Seller pays the Buyer a fee at least in the amount of \$500.

Since January 1, 1996, business opportunity ventures are now also illegal under an Illinois statute known as the Business Opportunity Sales Law. The Illinois statute is broader than the Federal Act in some respects. In addition to the factors provided by the Federal Act, the Illinois statute also covers a Seller's agreement to repurchase the Buyer's goods or services or to give the Buyer a marketing plan. However, the Illinois statute exempts transactions in the following cases: the fee paid to the Seller exceeds \$25,000 (so long as the Buyer's net worth exceeds \$125,000); the Buyer's

net worth exceeds \$250,000 (regardless of the fee paid to the Seller); or when the Seller's net worth exceeds one million dollars.

The Illinois Franchise Act, the Illinois Business Opportunity Sales Law and the Federal Trade Commission Act require franchisers and sellers to make numerous disclosures to prospective franchisees and buyers before they make any formal agreement with or receive any money from a franchisee or buyer. If franchisers or sellers fail to make the required disclosures, they can be liable to franchisees, buyers and to the state and federal governments for fines and attorneys fees. Criminal sanctions may also be imposed. In other words, if by using a multi-level marketing plan, you have unknowingly and unintentionally created a franchise or an illegal business opportunity venture you could be liable to pay these fines if you have not made the requisite disclosures.

### Conclusion

Multi-level marketing plans can offer wonderful business opportunities. They can also cause unintended, severe adverse legal problems. To avoid these difficulties, you should have an attorney review your marketing plan before you implement it.