

**立法會**  
**Legislative Council**

LC Paper No. LS70/10-11

**Paper for the House Committee Meeting  
on 3 June 2011**

**Legal Service Division Report on  
Pyramid Schemes Prohibition Bill**

**I. SUMMARY**

- 1. Objects of the Bill** To prohibit certain acts in relation to pyramid schemes and to provide for related matters.
- 2. Comments**
  - (a) The Bill seeks to introduce a new regime for the prohibition of pyramid schemes to replace the Pyramid Selling Prohibition Ordinance (Cap. 355)
  - (b) The Bill is broader in scope than Cap. 355 in that it seeks to regulate all pyramid schemes whether they involve the sale of goods or services or not.
  - (c) It would be an offence to knowingly promote a pyramid scheme, or to induce or attempt to induce others to participate in such scheme.
  - (d) The maximum penalty for the proposed offences is a fine of \$1,000,000 and imprisonment for 7 years.
- 3. Public Consultation** The public was consulted in December 2010 and January 2011. According to the LegCo Brief, the great majority of respondents supported the legislative proposals.
- 4. Consultation with LegCo Panel** The Panel on Economic Development was briefed on the outcome of the public consultation at its meeting held on 28 March 2011. Members generally supported the proposals.
- 5. Conclusion** In view of the possible implications of the Bill on business practices and consumer protection, Members may wish to study the policy aspects of the Bill in detail.

## **II. REPORT**

### **Objects of the Bill**

The Bill seeks to:

- (a) repeal the Pyramid Selling Prohibition Ordinance (Cap. 355) and introduce a new regulatory regime to prohibit pyramid schemes whether they involve the marketing of goods or services or not; and
- (b) make it an offence (punishable by a fine of \$1,000,000 and imprisonment for 7 years) for a person to knowingly promote a pyramid scheme, or to participate in such scheme and induce or attempt to induce another person to participate in the scheme.

### **LegCo Brief Reference**

2. File Ref.: CITB CR 05/18/13 Pt. VI. issued by the Commerce and Economic Development Bureau (CEDB) on 20 May 2011.

### **Date of First Reading**

3. 1 June 2011.

### **Background**

4. At present, pyramid selling is regulated by the Pyramid Selling Prohibition Ordinance (Cap. 355) (the Ordinance) which was enacted in 1980. Section 2 of the Ordinance defines a "pyramid selling scheme" as one whereby:

- (a) a participant in the scheme is granted a licence or right to introduce another participant into the scheme who is also granted such licence or right and who may further extend the chain of persons who are granted such licence or right; and
- (b) a participant receives a reward on, or at any time after, the introduction into the scheme by him of another participant which reward is based, whether wholly or in part, otherwise than on the fair market value of goods or services actually sold by him or by or through that other participant.

5. Under section 3 of the Ordinance, any person who knowingly promotes (i.e. establishes, advertises, manages or assists in the management of) a pyramid selling scheme commits an offence and is liable on conviction upon indictment to a fine of \$100,000 and to imprisonment for 3 years.

6. According to paragraph 6 of the LegCo Brief, the Administration considers that the current provisions of the Ordinance are no longer effective in combating objectionable pyramid schemes in the light of the judgments in *HKSAR v Yau Mee Kwan and others* (CACC 96/2003) and *HKSAR v Li Chi Yung and others* (CACC 55/2004) where the Court of Appeal, in construing the definition of "pyramid selling scheme" under section 2 of the Ordinance, held that the definition must involve the selling of goods or services by a participant and a reward for the selling of goods or services. Consequently, pyramid schemes not involving the sale of goods or services, or pyramid schemes involving the supply of goods or services by the promoters (but not by the participants), would fall outside the scope of the Ordinance.

7. The Administration has since conducted a review of the current regulatory approach and the effectiveness of the Ordinance, having regard to the above Court of Appeal judgments and regulatory regimes in other jurisdictions. According to paragraph 9 of the LegCo Brief, the Administration considers that the current regulatory approach of enacting provisions to prohibit undesirable pyramid schemes is in line with international practices, is appropriate to Hong Kong's legal and economic environment, and would avoid over-regulation of legitimate multi-level marketing schemes. To address the issues referred to in paragraph 6 above, the Administration proposes replacing the Ordinance with a new regime for the prohibition of pyramid schemes.

## **Comments**

8. This Bill seeks to repeal the Ordinance and introduce a new regime for the prohibition of all pyramid schemes whether they involve the sale of goods or services or not. To reflect this policy intent, clause 1 of the Bill provides that the new legislation, if enacted, would be called the "Pyramid Schemes Prohibition Ordinance" so as to remove the reference to "selling". The main provisions of the Bill are set out in the paragraphs below.

### *Definition of "pyramid scheme"*

9. Clause 3(1) defines a "pyramid scheme" as a scheme where:
- (a) a new participant in the scheme must provide a financial or non-financial benefit ("participation payment") to, or for the benefit of, any participant or promoter of the scheme and/or another person;

- (b) the making of the participation payment is entirely or substantially induced by the prospect held out to the new participant that he or she (either alone or together with another person) will be entitled to a financial or non-financial benefit ("recruitment payment"); and
- (c) the recruitment payment is entirely or substantially derived from the introduction to the scheme of a further new participant.

10. Under clause 3(3)(a) of the Bill, a scheme may be a pyramid scheme whether or not it involves the marketing of goods and/or services. Clause 4 sets out the matters to which the court must have regard in determining whether a scheme that involves the marketing of goods and/or services is a pyramid scheme. It is noted that clauses 3 and 4 of the Bill are similar to the corresponding provisions in the Australian legislation on pyramid schemes (i.e. sections 45 and 46 of the *Australian Consumer Law* (ACL)).

11. The definitions of "goods" and "promote" proposed in the Bill are the same as those in the Ordinance. The term "new participant" is defined to include a person who has applied, or been invited, to participate in a pyramid scheme. This definition is similar to that of the same term in section 45 of ACL.

### *Offences*

12. Clause 5(1) preserves the existing offence of knowingly promoting a pyramid scheme. Clause 5(2) creates a new offence of participating in and inducing others to join a pyramid scheme<sup>1</sup> with the knowledge (actual or deemed) that any benefit receivable would be entirely or substantially derived from the introduction of new participants to the scheme. The maximum penalty for the proposed offences upon conviction on indictment is a fine of \$1,000,000 and imprisonment for 7 years<sup>2</sup>.

13. While clause 5(2)(b) sets out the specific knowledge required for the offence of participating in and inducing others to join a pyramid scheme, clause 5(1) refers generally to the offence of knowingly<sup>3</sup> promoting a pyramid scheme. It is further noted that paragraph 3.2(c) of the "Public Consultation

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<sup>1</sup> It is also an offence to induce or attempt to induce another person to participate in a pyramid scheme under section 44(2) of ACL and section 65(1)(c) of the *Consumer Protection Act 2007* of Ireland (CPA). A pecuniary penalty (AUS\$1,100,000 for a body corporate and AUS\$220,000 for other persons) may be imposed for the offence under ACL, whereas the maximum penalty for the offence under CPA is €150,000 and imprisonment for 5 years.

<sup>2</sup> It is noted that the offence of fraudulently or recklessly inducing others to invest money under section 107 of the Securities and Futures Ordinance (Cap. 571) attracts the same maximum penalty.

<sup>3</sup> The word "knowingly" is not used in the offence of establishing, operating or promoting a pyramid scheme under section 65(1)(a) of CPA, nor does it appear in section 44(1) of ACL which provides that a person must not participate in (which includes establish or promote) a pyramid scheme. Section 164(3) of ACL provides that the offences of participating in, and inducing another person to participate in, a pyramid scheme are strict liability offences.

Paper on Proposed Legislative Amendments to Eradicate Pyramid Schemes" published by the Administration in December 2010 proposed providing appropriate defences for publishers who innocently published advertisements promoting pyramid schemes. No such defences are, however, provided in the Bill. The Legal Service Division will ask the Administration the reason for not providing for such defences in the Bill.

14. Under clause 6, if an offence under the Bill is committed by a body corporate or by a person as a member of an unincorporated body, and if it is proved that the offence has been committed with the consent or connivance or is attributable to the neglect of a director, secretary, principal officer, manager, partner, office holder or member (the relevant person) of the body corporate or the unincorporated body, that person also commits the offence. The effect of this provision, if enacted, is to make the relevant person's consent, connivance or neglect an element of the offence whereas under the corresponding provision (i.e. section 4(2)) of the Ordinance, it is for the relevant person to prove by way of defence that the offence was committed without his consent or connivance, and that he exercised diligence to prevent the commission of the offence.

#### *Award of compensation*

15. Clause 7 retains the court's power under section 5 of the Ordinance to order a person convicted of an offence under the Bill to pay compensation of a reasonable amount to another person who has suffered financial loss as a result of the offence.

#### *Commencement*

16. The Bill will come into operation on a day to be appointed by the Secretary for Commerce and Economic Development, when it is enacted as an Ordinance.

#### **Public Consultation**

17. According to paragraph 18 of the LegCo Brief, the public was consulted from December 2010 to January 2011 on the legislative proposals. According to the Administration, the great majority of respondents (including the Direct Selling Association of Hong Kong) supported the proposals.

#### **Consultation with LegCo Panel**

18. At the meeting of the Panel on Economic Development held on 28 March 2011, the Administration briefed members on the outcome of the public consultation on the key elements of the Bill. Panel members were generally in support of the legislative proposals. Some members urged the

Administration to step up publicity and public education to help the public to differentiate legitimate marketing schemes from illicit pyramid schemes and unfair trade practices. The Administration advised that it would include in the legislation factors to be considered by the courts in ascertaining the nature of schemes involving the marketing of goods and/or services (see clause 4 of the Bill). Other members enquired whether the Administration would consider adding a provision in the Bill stipulating disgorgement of improperly gained money as part of the penalties, and whether existing legislation was insufficient to deal with deception cases. In its written reply dated 23 May 2011 (which was circulated to Panel members for information on 24 May 2011), the Administration advised as follows:

- (a) as far as the interests of victims of pyramid schemes were concerned, the proposed offences (clause 5) and the courts' power to make compensation orders (clause 7) in the Bill would address their concerns more directly than the civil sanction of disgorgement orders; and
- (b) while certain deception cases could be dealt with by the existing general criminal offences such as fraud and conspiracy to defraud, the most effective and targeted approach was to tighten the definition of "pyramid scheme" as proposed in the Bill.

Members may refer to the minutes of the meeting held on 28 March 2011 (LC Paper No. CB(1)2198/10-11) and the Administration's reply dated 23 May 2011 (LC Paper CB(1)2267/10-11(01)) for further details.

## **Conclusion**

19. Apart from the issues mentioned in paragraph 13 above, the Legal Service Division will seek clarification from the Administration on certain technical issues. In view of the possible implications of the Bill on business practices and consumer protection, Members may wish to study the policy aspects of the Bill in detail.

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1 June 2011