

立法會

Legislative Council

LC Paper No. CB(1)95/10-11(04)

Ref: CB1/PL/EDEV

Panel on Economic Development Meeting on 25 October 2010

Background brief on review of Pyramid Selling Prohibition Ordinance

Purpose

This paper provides background information on the legislative provisions prohibiting pyramid selling activities in Hong Kong and summarizes concerns raised by Members on related matters.

Background

Pyramid selling schemes

2. Pyramid selling schemes are different from ordinary business model in that profits under the former are mainly derived from recruiting participants who pay to join the schemes. Economic benefits that could be generated from such sale of goods or services are limited. Pyramid schemes are unsustainable as they rely solely on the recruitment of new members, and participants may suffer from financial loss when such recruitment cannot be sustained. The Pyramid Selling Prohibition Ordinance (Cap. 355) (PSPO) is therefore put in place to regulate such schemes.

3. According to the definition in section 2 of PSPO, one of the defining characteristics of pyramid selling schemes is that the reward a participant may receive through the introduction of another participant to join the scheme is not based on the fair market value of goods or services that are actually sold. During the period from 2007 to November 2009, the Police received seven complaint cases relating to suspected pyramid selling schemes. After investigation, the Police has arrested 21 persons in respect of four cases (involving 157 affected persons and \$8.78 million). Investigation for the remaining three cases has been suspended as there is no evidence of contravention of any legislation. Under PSPO, any person who knowingly promotes a pyramid selling scheme commits an offence and is liable to a fine of \$100,000 and to imprisonment for three years upon conviction.

It is also a criminal offence to conspire to defraud others to join pyramid schemes.

Court cases

4. In two court cases (CACC 96 of 2003 and CACC 55 of 2004), the Court of Appeal quashed the conviction of the offence of conspiracy to promote a pyramid selling scheme in the District Court of all applicants, and set aside the sentences imposed by the lower Court. According to the judgment of the Court of Appeal in CACC 96 of 2003, the definition of "pyramid selling scheme" in section 2 of PSPO, viz

"pyramid selling scheme means a scheme whereby –

(a) [...]

(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."

was hardly drawn with clarity, and perniciousness could be seen in the schemes in question the sole purpose of which was to make money from the recruitment of other participants with no element of trading in goods at all, for such schemes which involve no more than the ongoing introduction members. According to the Court, the present drafting of the section assumes a scheme which envisages the selling of goods by a participant and a reward for the selling of goods. In CACC 96 of 2003, members of the scheme did not sell nor were they expected to sell any goods, despite members might themselves acquire goods. For CACC 55 of 2004, the commission paid was not based on the value of the goods or services sold by the members, but was instead paid for by the introduction of new members, and solely according to the number of members thus introduced. The judges in that case also observed that there was no requirement in the dictionary meaning of "pyramid scheme" for the selling of goods or services or that the reward had to be based on the value of such goods or services. They also noted that the Financial Secretary, in moving the legislation at the Council on 11 June 1980, provided the following concluding remarks:

"But it is a tricky area in which to introduce legislation, and if in practice we find we have not got it quite right, we may have to come back to this Council to amend the definition."

Legislation on pyramid selling in other jurisdictions

5. In the European Union (EU), the practice of pyramid schemes are on the

blacklist of practices banned EU-wide under the Unfair Commercial Practices Directive (Directive)¹. Ireland, in particular, has enacted the Consumer Protection Act in 2007 to formally establish the National Consumer Agency as a statutory agency to defend consumer interests in Ireland. The Act transposes into Irish law the provisions of the Directive and introduces new provisions in relation to pyramid schemes, making it an offence to establish, operate, promote or participate in a pyramid promotional scheme.

6. In Australia, the government has recently revamped its consumer protection legislation and the Australian Consumer Law (ACL) was enacted in 2010 as a result.² ACL is a single, national law concerning consumer protection and fair trading administered by the Australian Competition and Consumer Commission and each State and Territory's consumer law agency. The new law re-enacts, with improvements, the then existing legislative provisions against pyramid schemes and provides that participation in such schemes is a criminal offence under ACL.

7. In Macao, the government amended the Proibição da venda «em pirâmide» (《禁止層壓式傳銷》法例) in 2008 to eliminate fraudulent pyramid selling activities. Under the new Ordinance, pyramid selling refers to activities of sale of goods or services organized in the form of chains or similar forms, and participants of such schemes receive rewards which depend mainly on the recruitment of new participants. The Ordinance also prohibits anyone initiates, organizes or solicits others to join pyramid selling scheme.

Previous discussions by the Legislative Council

Council meeting

8. An oral question on pyramid selling activities was raised at the Council meeting on 18 November 2009. A Member opined that the Macao government adopted a tougher stance than Hong Kong in curbing fraudulent cases related to pyramid selling activities. Some Members also enquired about the timetable for amending PSPO. The Administration noted that the mode of operation of undesirable pyramid selling schemes in the market kept changing and the Government would need to draw reference from the legislative models in other places to devise proposals which suit the circumstances and needs of Hong Kong. The Administration undertook to examine if there were inadequacies in the existing Ordinance.

9. A motion on "Establishing a comprehensive consumer protection regime" was carried at the Council meeting on 6 January 2010, urging the Government to, inter alia, expeditiously amend PSPO with a view to combating and eliminating all

¹ Directive No. 2005/29/EC of the European Parliament and of the Council of 11 May 2005.

² The Australian Consumer Law was introduced by two Acts, namely the *Trade Practices Amendment (Australian Consumer Law) Act (No.1) 2010* and the *Trade Practices Amendment (Australian Consumer Law) Act (No.2) 2010*.

types of fraudulent multi-level marketing practices. The Administration, in its response, agreed that PSPO, which was enacted some 20 years ago, could hardly cope with ever-changing pyramid selling practices in the local market. Hong Kong should also speed up the revision of the Ordinance to extend its scope, raise the penalties, and step up the curb on fraudulent multi-level marketing practices, so as to prevent people from being cheated and trapped.

Estimates of Expenditure 2010-2011

10. During the examination of Estimates of Expenditure 2010-2011, Members noted that in the light of changes in the modus operandi of pyramid selling schemes, the Administration was reviewing the existing PSPO and would draw reference from the approaches and legislative models adopted in other countries and places such as Australia, the United Kingdom and Ireland when conducting the review. It was hoped that the review would be completed within 2010.

Panel on Economic Development

11. When the Administration briefed the Panel on Economic Development on the policy directions to strengthen consumer protection legislation on 24 May 2010, Panel members expressed dissatisfaction about the prevalence of pyramid selling in Hong Kong. In particular, secondary school leavers were vulnerable to such malpractices that might cost them and their families indebted to huge amounts of loans. Members expressed concern that there was presently no effective mechanism to handle complaints or crack down the malpractices which had been rooted in Hong Kong for many years.

Latest development

12. At the policy briefing on relevant policy initiatives in the Chief Executive's 2010-2011 Policy Address on 15 October 2010, the Administration indicated that it had conducted a review of PSPO and come up with initial proposals how to amend the current definition of pyramid scheme, the regulatory reach and penalty level. It would consult members on the proposals at the Panel meeting on 25 October 2010 before conducting public consultation. The Administration plans to introduce legislative amendments into the Council within the current legislative session.

References

13. The relevant papers are available at the following links:-

Pyramid Selling Prohibition Ordinance (Cap. 355)

[http://www.legislation.gov.hk/blis_pdf.nsf/6799165D2FEE3FA94825755E0033E532/8270BFB366C60960482575EE006F74F4/\\$FILE/CAP_355_e_b5.pdf](http://www.legislation.gov.hk/blis_pdf.nsf/6799165D2FEE3FA94825755E0033E532/8270BFB366C60960482575EE006F74F4/$FILE/CAP_355_e_b5.pdf)

The High Court of the Hong Kong Special Administrative Region Court of Appeal
Criminal Appeal No. 96 of 2003 (On Appeal from DCCC No. 898 of 2001)
[http://legalref.judiciary.gov.hk/lrs/common/search/search_result_detail_frame.jsp?
DIS=7593&QS=%2B&TP=JU](http://legalref.judiciary.gov.hk/lrs/common/search/search_result_detail_frame.jsp?DIS=7593&QS=%2B&TP=JU)

The High Court of the Hong Kong Special Administrative Region Court of Appeal
Criminal Appeal No. 55 of 2004 (On Appeal from DCCC no. 757 of 2002)
[http://legalref.judiciary.gov.hk/lrs/common/search/search_result_detail_frame.jsp?
DIS=39018&QS=%2B&TP=JU](http://legalref.judiciary.gov.hk/lrs/common/search/search_result_detail_frame.jsp?DIS=39018&QS=%2B&TP=JU)

Press release on "LCQ1 – Pyramid selling activities" dated 18 November 2009
<http://www.info.gov.hk/gia/general/200911/18/P200911180130.htm>

Motion on "Establishing a comprehensive consumer protection regime" moved by
Hon Starry LEE at the LegCo meeting on 6 January 2010 and Progress Report
http://www.legco.gov.hk/yr09-10/english/legco_rpt/legco_motion01071-e.pdf
<http://www.legco.gov.hk/yr09-10/english/counmtg/motion/cm0106-m2-prpt-e.pdf>

Examination of Estimates of Expenditure 2010-2011 (CEDB(CIT)078)
http://www.legco.gov.hk/yr09-10/english/fc/fc/w_q/cedb-cit-e.pdf
Minutes of Panel on Economic Development dated 24 May 2010 (pages 16&17)
<http://www.legco.gov.hk/yr09-10/english/panels/edev/minutes/edev20100524.pdf>

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Legislative Council Secretariat
19 October 2010