



# Government Gazette Staatskoerant

REPUBLIC OF SOUTH AFRICA  
REPUBLIEK VAN SUID-AFRIKA

Vol. 474

Pretoria, 2 December 2004

No. 27052



**AIDS HELPLINE: 0800-0123-22 Prevention is the cure**

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## GENERAL NOTICES

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### NOTICE 2759 OF 2004

#### DEPARTMENT OF TRADE AND INDUSTRY

#### CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988

I, Mandisi Mpahlwa, 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 Consumer Affairs Committee on the result of an investigation made by the Committee pursuant to General Notice 3281 of 2000 as published in Government Gazette No.21585 dated 22 September 2000, as set out in the Schedule.

**M MPAHLWA**

**MINISTER OF TRADE AND INDUSTRY**

#### SCHEDULE

**CONSUMER AFFAIRS COMMITTEE**

**REPORT  
IN TERMS OF SECTION 10(1) OF THE  
CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988  
(ACT 71 OF 1988)**

**REPORT 96**

**A FURTHER INVESTIGATION IN TERMS OF SECTION 8(1)(b)  
OF THE ACT INTO MONEY MAKING SCHEMES**



## 1. Introduction

The former Business Practices Committee (BPC) administered the Harmful Business Practices Act, 71 of 1988. Several amendments were made to the Harmful Business Practices Act during the first half of 1999. The amended act, called the Consumer Affairs (Unfair Business Practices) Act, 71 of 1988 (the Act), came into operation on 14 May 1999. The Act is administered by the Consumer Affairs Committee (the Committee), a statutory body in the Department of Trade and Industry.

The purpose of the Act is to provide for the prohibition or control of unfair business practices and for matters connected therewith. An "unfair business practice", in terms of the Act, is 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, deceiving any consumer or unfairly affecting any consumer or natural person. The *raison d'être* of the Committee and the Act is therefore the interests of consumers and specifically consumers who are or who are likely to be unfairly affected by any business practice.

In the pursuance of its objective, the Act confers wide investigative powers on the Committee. The Committee could undertake two broad types of investigations, namely particular and general investigations. The focal point of an investigation in terms of section 8(1)(a) of the Act is any unfair business practice that exists or may come into existence and which involves a particular individual(s) or business entity(ies). The subsequent order of the Minister will be applicable to the particular individual(s) or business entity(ies). The focus of a section 8(1)(b) investigation is any business practice in general which is commonly applied for the purposes of or in connection with the creation or maintenance of unfair business practices. The subsequent order of the Minister will be applicable to all individuals and entities involved with those particular business practices.

In 1999 the BPC undertook a general investigation into money revolving schemes<sup>(1)</sup>. As a result of its findings, the BPC recommended to the Minister that he declare unlawful three types of money revolving schemes, namely, multiplication schemes, chain letters and pyramid schemes. The Minister accepted the recommendation of the Committee and he declared these schemes unlawful on 10 June 1999<sup>(2)</sup>.

The Committee is of the opinion that the Minister's order is being circumvented and it consequently resolved to revisit these schemes. The following was published under Notice 3281 in Government Gazette 21585 dated 22 September 2000:

"In terms of the provisions of section 8(4) of the Consumer Affairs (Unfair Business Practices) Act, 1988 (Act No 71 of 1988), notice is herewith given that the Consumer Affairs Committee intends undertaking an investigation in terms

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(1) See Report 76: "Investigation in terms of section 8(1)(b) of the Harmful Business Practices Act, 71 of 1988, into money revolving or pyramid schemes" published under Notice 1034 in Government Gazette 20169 dated 10 June 1999.

(2) See Notice 1035 in Government Gazette 20169 dated 10 June 1999.

of section 8(1)(b) of the said Act with a view to strengthening Government Gazette Notice 1135 of 1999, published In Government Gazette No 20169 of 9 June 1999. In Notice 1135 multiplication schemes, chain letters and pyramid schemes were declared unlawful by the Minister of Trade and Industry. The investigation will include the extending of certain clauses of the abovementioned Notice No 1135 of 1999 with a view to preventing the attempted circumvention of the mentioned notice. Any person may within a period of 30 days from the date of this notice make written representations regarding the abovementioned investigation to: The Secretary, Consumer Affairs Committee, Private Bag X84, Pretoria, 0001".

## **2. The money making schemes**

Although all legitimate business operates schemes to make money, the word scheme has a negative connotation. Synonyms for a scheme are, for example, collude, manipulate, plot and conspire. The BPC identified three types of money making or money revolving schemes which are prejudicial to consumers, namely: multiplication schemes, chain letters and pyramid schemes. The Consumer Affairs Committee identified a special type of pyramid, namely a binary scheme.

### **2.1 Multiplication schemes**

#### **2.1.1 The mechanics of these schemes**

These schemes appear to be widespread in South Africa and they usually flourish among the less sophisticated and poorest sectors of the community. They are characterized by the fact that would be participants are offered huge returns<sup>(3)</sup> for relatively small "investments" after a relatively short period. The amounts paid by participants can not be regarded as investments in the usual sense of the word, but they will be referred to as such.

These schemes were called multiplication schemes by the BPC because the word "multiply" is usually, but not always, used in the brochures issued by the promoters, such as "Multiply your money by 5 in 14 days" and "Multiply your money by 2 in 6 weeks".

The mechanics of a multiplication scheme is illustrated in table 1. To facilitate an understanding of such a scheme the following assumptions apply:

- (a) A participant is required to invest R450.
- (b) The participants are promised that they would receive R900 on their investments after six weeks.

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(3) Return as a percentage of the amount "invested". The Committee has not as yet come across a multiplication scheme where the promoters specify the return as a percentage of the amount invested.

- (c) The promoters do not take any money for themselves.
- (d) The promoters do not deposit the money received in a bank account and hence no interest is received.

Table 1 - The mechanics of a multiplication scheme - 12 weeks

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	
Week	Members			C	A	S	H	C O M M I T M E N T			Required
1	2		2	900		0	900	1800		1800	4
2	3		5	1350		0	2250	2700		4500	10
3	5		10	2250		0	4500	4500		9000	20
4	8		18	3600		0	8100	7200		16200	36
5	9		27	4050		0	12150	8100		24300	54
6	10		37	4500		0	16650	9000		33300	74
7	10	2	45	4500	1800		19350	9000	1800	40500	90
8	15	3	57	6750	2700		23400	13500	2700	51300	114
9	20	5	72	9000	4500		27900	18000	4500	64800	144
10	30	8	94	13500	7200		34200	27000	7200	84600	188
11	40	9	125	18000	8100		44100	36000	8100	112500	250
12	50	10	165	22500	9000		57600	45000	9000	148500	330

Column 1 shows the number of weeks that the scheme has been in operation. In the first week two consumers (column 2) join the scheme and the total number of members at the end of week one is two (column 4). These two consumers or investors each pay R450 or a total of R900 (column 5) and the total amount available at the end of week 1 is R900 (column 7). The enrolment of the two members during the first week means that the promoters committed themselves to pay these two members R900 each after six weeks. Their commitment is therefore R1 800 (column 8). The total commitment at the end of week 1 is R1 800 (column 10). To fulfil this commitment the promoters must find four (R1 800 divided by R450) consumers to each invest R450.

During week 2 another three consumers (column 2) join the scheme and at the end of week 2 the scheme has five members (column 4). These three consumers or investors each pay R450 or a total of R1 350 (column 5) and the total amount available at the end of week 2 is R2 250 (column 7). The enrolment of the three members during the second week means that the promoters commit themselves to pay these three members R900 each after six weeks. They now have a commitment of R2 700 (column 8). The total commitment at the end of week 1 is R4 500 (column 10). To fulfil this commitment of R4 500, the promoters must find 10 (R4 500 divided by R450) consumers to each invest R450.

The first returns are paid during week 7. Ten more consumers (column 2) join the scheme during week 7. These 10 members, in addition to the 37 members at the end of week 6, brings the total number of members to 47. The two consumers who were canvassed during week 1 are paid (column 3) their returns<sup>(4)</sup> so the total number of

(4) Participants are usually not allowed to make multiple investments of the required amount, but once they have received the amounts due to them they may again join the scheme.

members at the end of week 7 is 45 (column 4). The ten new members invest R4 500 (column 5) and two members receive their R1 800 (column 6). Therefore the total amount available at the end of week 7 is R16 650 (end of week 6) plus R4 500 less R1 800, or R19 350 (column 7). The addition of ten new members means that the promoters have a further commitment of R9 000 (column 8). The total commitment of the scheme at the end of week 7 is R40 500 (column 10), that being: R33 300 at the end of week 6 plus the additional commitment of R9 000 in week 10 less the reduced commitment of R1 800 (column 9) - this is the amount paid to the two consumers whose claims have "matured". To fulfil this commitment of R40 500, the promoters must find 90 (R40 500 divided by R450) consumers to each invest R450.

The columns in table 2 are the same as those which applied to table 1. Table 1 demonstrates the mechanics of a multiplication scheme for 12 weeks and table 2 demonstrates how the scheme works over 48 weeks. Given the assumptions about the number of consumers who join the scheme weekly, it is clear from table 2 that the cash available reaches its highest levels, namely R1 191 600 in weeks 30 and 31 and that the scheme will experience a shortage of cash in week 48. The scheme will collapse in week 48. Tables 1 and 2 show that the number of new members required to sustain the scheme increases continuously. In order to satisfy the claim of an existing member, two new members are required to join the scheme. Two assumptions underlying tables 1 and 2 are that the promoters do not take any money for themselves and that no interest is received earned.

It is difficult to assume what amounts the promoters of these schemes appropriate for themselves. Judging from schemes reported in newspapers, televised on television and investigated by the Committee, it is usually substantial. Depending on the amount (mis)appropriated, the life cycle of a scheme will be curtailed.

The scheme discussed above is based on an actual multiplication scheme. Participants each received R900 after six weeks on an initial investment of R450. This is an effective annual return is 800 per cent<sup>(5)</sup>. Unless the promoters of the scheme, set out in tables 1 and 2, are able to earn more than 800<sup>(6)</sup> per cent per annum on the money accepted by them from investors, the continued existence of the scheme depends on ever increasing numbers of people joining the scheme.

## 2.1.2 Comments about multiplication schemes

### (a) Multiplication schemes are known as Ponzi schemes in the USA

During the 1920's Charles Ponzi, based in Boston, USA, collected millions of dollars

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(5) Applying the formula  $r = \frac{R \times 5200}{C \times T}$ , where:  $r$  = the effective interest rate,  $R$  = the interest in Rand, or the difference between the amount paid out to the investor and the amount invested,  $C$  = the amount invested by the investor and  $T$  = the period of the investment in weeks.

(6) In the example, an unrealistic assumption is that the promoters do not appropriate any money for themselves. Should the promoters take 50 per cent of the money invested, the required annual interest earned on the investments would have to be 1 600 per cent.



Table 2 - The mechanics of a multiplication scheme - 48 weeks

Week	M e m b e r s			C A S H			C O M M I T M E N T			Required
	New	Paid	Total	In	Out	Available	This week	Paid	Total	
1	2		2	900	0	900	1800		1800	4
2	3		5	1350	0	2250	2700		4500	10
3	5		10	2250	0	4500	4500		9000	20
4	8		18	3600	0	8100	7200		16200	36
5	9		27	4050	0	12150	8100		24300	54
6	10		37	4500	0	16650	9000		33300	74
7	10	2	45	4500	1800	19350	9000	1800	40500	90
8	15	3	57	6750	2700	23400	13500	2700	51300	114
9	20	5	72	9000	4500	27900	18000	4500	64800	144
10	30	8	94	13500	7200	34200	27000	7200	84600	188
11	40	9	125	18000	8100	44100	36000	8100	112500	250
12	50	10	165	22500	9000	57600	45000	9000	148500	330
13	60	10	215	27000	9000	75600	54000	9000	193500	430
14	70	15	270	31500	13500	93600	63000	13500	243000	540
15	80	20	330	36000	18000	111600	72000	18000	297000	660
16	90	30	390	40500	27000	125100	81000	27000	351000	780
17	100	40	450	45000	36000	134100	90000	36000	405000	900
18	125	50	525	56250	45000	145350	112500	45000	472500	1050
19	150	60	615	67500	54000	158850	135000	54000	553500	1230
20	175	70	720	78750	63000	174600	157500	63000	648000	1440
21	200	80	840	90000	72000	192600	180000	72000	756000	1680
22	300	90	1050	135000	81000	246600	270000	81000	945000	2100
23	400	100	1350	180000	90000	336600	360000	90000	1215000	2700
24	500	125	1725	225000	112500	449100	450000	112500	1552500	3450
25	600	150	2175	270000	135000	584100	540000	135000	1957500	4350
26	700	175	2700	315000	157500	741600	630000	157500	2430000	5400
27	800	200	3300	360000	180000	921600	720000	180000	2970000	6600
28	900	300	3900	405000	270000	1056600	810000	270000	3510000	7800
29	1000	400	4500	450000	360000	1146600	900000	360000	4050000	9000
30	1100	500	5100	495000	450000	1191600	990000	450000	4590000	10200
31	1200	600	5700	540000	540000	1191600	1080000	540000	5130000	11400
32	1300	700	6300	585000	630000	1146600	1170000	630000	5670000	12600
33	1400	800	6900	630000	720000	1056600	1260000	720000	6210000	13800
34	1500	900	7500	675000	810000	921600	1350000	810000	6750000	15000
35	1750	1000	8250	787500	900000	809100	1575000	900000	7425000	16500
36	2000	1100	9150	900000	990000	719100	1800000	990000	8235000	18300
37	2250	1200	10200	1012500	1080000	651600	2025000	1080000	9180000	20400
38	2500	1300	11400	1125000	1170000	606600	2250000	1170000	10260000	22800
39	2750	1400	12750	1237500	1260000	584100	2475000	1260000	11475000	25500
40	3000	1500	14250	1350000	1350000	584100	2700000	1350000	12825000	28500
41	3500	1750	16000	1575000	1575000	584100	3150000	1575000	14400000	32000
42	4000	2000	18000	1800000	1800000	584100	3600000	1800000	16200000	36000
43	4500	2250	20250	2025000	2025000	584100	4050000	2025000	18225000	40500
44	5000	2500	22750	2250000	2250000	584100	4500000	2250000	20475000	45500
45	5500	2750	25500	2475000	2475000	584100	4950000	2475000	22950000	51000
46	6000	3000	28500	2700000	2700000	584100	5400000	2700000	25650000	57000
47	6500	3500	31500	2925000	3150000	359100	5850000	3150000	28350000	63000
48	7201	4000	34701	3240450	3600000	-450	6480900	3600000	31230900	69402

from thousands of investors by selling "promissory notes" paying "fifty per cent profit in forty-five days". Ponzi claimed he was giving investors a portion of the 400 per cent profit he was earning through "... trade in postal reply coupons". As Ponzi paid the matured notes held by early investors, word of enormous profits spread through the community, whipping investors into a frenzy. By July 1920 he was taking in about \$1 million a week. Investigations later revealed that there were no coupons or profits - earlier notes (Peter) were paid at maturity from the proceeds of later ones (Paul). The simplicity of his scheme linked Ponzi's name with this type of scheme, once called a "bubble," but referred to as a "Ponzi scheme".

**(b) Duration of a multiplication scheme's life cycle**

The life cycle of a multiplication scheme can be extended by *inter alia*

- (i) Offering lower returns.
- (ii) Extending the period between the date of the investment and the pay-out date.
- (iii) Controlling the number of new entrants per cycle, whether the cycle is days, weeks, months or years.
- (iv) Reducing the amount appropriated by the promoters.

The life cycle of a multiplication scheme can be significantly reduced by doing the opposite of (i) to (iv) above.

**(c) How are the returns generated?**

The promoters of multiplication schemes always guarantee that they can achieve the necessary returns to fulfil their commitments. They are, however, reluctant to divulge to others how this is achieved. The truth of the matter is that the Peters are robbed to pay the Pauls. In other words, those that enter the schemes first are paid from the income derived from those who enter the scheme at a later date. The promoters do not even attempt to earn income from other sources. Three recent investigations conducted by the Committee confirmed that this was how the income was generated<sup>(7)</sup>.

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(7) The most recent multiplication schemes investigated by the Committee were (a) Metro Financial Services Ltd, C Holsthauzen and Z Beswick; (b) Propalux 46 Ltd, Lucky Motialepula Mthombeni and Others; and (c) Messenger of Hope Marketing CC, Anthony Suze and Layten Franks. These schemes are documented in Reports 79, 80 and 84 respectively.

### (c) What is a reasonable return?

The return one can reasonably expect from an investment depends on the risks involved. A return which is substantially higher than the average must inevitably be associated with substantially higher risk. The assessment of this risk in quantitative terms is a technical task, in which *inter alia* statistical correlations are used. This is beyond the skills of the average professional investor and certainly beyond the general knowledge of the average consumer.

It is misleading therefore for any scheme to purport to "promise" such returns. It is doubly misleading to promise inordinately high returns on any investment without reference to the inevitable risk that will accompany such an investment.

It should be noted that this "limit" of 20 per cent above the REPO rate does not preclude a particularly successful scheme from paying more than 20 per cent above the REPO rate, should it be able to do so. The limit applies to the offer, which is made before the fact, and represents the promoter's opinion. The limit is not a ceiling, but an indication to consumers that such unsubstantiated estimates of excessive future returns are probably unfair misrepresentations.

### (d) A multiplication scheme defined

A multiplication scheme exists when a natural or a juristic person ***offers or promises or guarantees*** 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 consumer, investor or participant, whether or not the consumer, 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.

## 2.2 Chain letter type schemes

The heading of this section is chain letter type schemes. These schemes include chain letters, but it also includes schemes which have the characteristics of chain letters. The most important characteristic of a chain letter type scheme is that the name of a new participant appears at the end of some type of list and as the scheme progresses, the participant's name moves to the top of the list.

### 2.2.1 Ordinary chain letters

Most consumers have at some stage received ordinary chain letters in their post boxes or tucked under the windscreen wipers of their motorcars. The instructions contained in these "run of the mill" chain letters are uncomplicated. The following is quoted from a chain letter on the Committee's files.

"I became a millionaire within 5 months and 3 days!



I have a new home in Clifton, two brand new BMW's, a new printing and clothing business, a happy family, no debt, excellent health and R100 000 per month to spend on investments, luxuries and holidays or all over the world. The 'Make a Million' is a legitimate business opportunity that cannot fail to earn you a lot of money. For this unique opportunity, you are required to make an investment of only R30!

Dear **millionaire to be**, follow these instructions and within 90 days you will receive R270 000 in cash!

#### Step 1

- Write
  1. Your name and address on 3 pieces of paper (A4 size).
  2. Add 'Please add my name to your mailing list' on each piece of paper.
- Place a R10 note in the middle of each piece of paper.
- Mail them to the 3 addresses below;
  1. The Director, address 1.
  2. The Secretary, address 2.
  3. The Holder, address 3.

Remember, this is a legitimate service for which you are paying and the listed people above brought you this opportunity just as you will bring it to others. So please don't skip their payments. We all depend on each other. There is a saying in the business world: "You have to spend money to make money". In this case it is only R30 to make you a millionaire and there is no easier way to make money than this!

#### Step 2

- After you have sent R10 to each of the three people listed above, remove number 3 on the list.
- Put your name and address at number 1.
- This can be done by typing a new list on a piece of paper and inserting it to fit the existing list and space. Paste it over the existing list.

**DO NOT CHEAT BY PLACING YOUR NAME NUMBER 2 OR 3 - THIS WILL BE TO YOUR DISADVANTAGE. YOU WILL LOOSE A LOT OF MONEY!<sup>(8)</sup>**

- Photocopy the letter 200 or 10 000 times, depending on how much money you want to make. Keep the quality of the letter good for others to copy. Keep the master copy you are reading and use it again whenever you want to make more money.

As soon as you have sent 200 or more copies, you are automatically in the mail order business and people are sending you money to be placed on your mailing list. This is

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(8) At times the recipients of the chain letters are warned that all types of misfortunes could befall them should they do not strictly adhere to the prescribed steps.

a service that is perfectly legal".

The Committee made serious efforts to investigate a number of these ordinary chain letters on an informal basis. The problems encountered during these investigations were:

- (a) The names, initials or surnames of the participants were seldom mentioned and they used titles such as the secretary, the director and the holder.
- (b) The addresses of the participants on the lists were invariably post box numbers.
- (c) Enquiries often revealed that the particular post box is no longer in operation. It appears that the participants or promoters of these schemes rent various post boxes at more than one post office.
- (d) It is extremely difficult to establish the real names and physical addresses of the participants. It is impossible to investigate the business practices of persons if their names and physical addresses are unknown.

Because of the practical problems encountered in locating the promoters and participants of ordinary chain letters, the Committee does not intend to make a recommendation to the Minister in this regard.

## **2.2.2 Controlled chain letters**

There is no control over ordinary chain letters in the sense that the scheme is organized or controlled by an unidentifiable person(s) or entity. This is in contrast to controlled chain letter schemes. Two of these types of schemes are discussed to illustrate the mechanics thereof.

### **2.2.2.1 Dunamus**

#### **(a) The mechanics of the scheme**

In order to become a participant to the Dunamus<sup>(9)</sup> scheme, a participant referred to as "E" starts with five "Commission Structure Certificates". E's name appears as number five on each of the certificates. The certificates have the following appearance:

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(9) See Report No. 60: Dunamus Marketing CC and Others. The report and consequent order of the Minister were published under Notices 963 and 964 in Government Gazette 18972 dated 12 June 98 respectively.

**Commission Structure Certificate**

	Name	Bank	Account type	Account no
1	A	Standard	Savings	555555555
2	B	United	Credit card	222222222
3	C	Volkas	Cheque	333333333
4	D	Nedbank	Savings	111111111
5	E	Trust	Credit card	444444444
6	Dunamus	FNB	Cheque	5001123181

An application form for membership of the scheme appears underneath the "Commission Structure Certificate". The name of Dunamus always appears as number 6 on all certificates issued to participants. The names A, B, C and D are the names of people who are already participants in the scheme. Next to each name are details such as "bank", "account type" and "account number". E must now canvass five more people to participate in the scheme. Each new participant will receive a certificate from E with E's name at number 5 and Dunamus at number 6. In order to simplify this explanation, only the procedure following the canvassing of one person referred to as V will be discussed.

V must deposit R50 into the bank accounts of each of the six names on the list. The total outlay by V is thus R300, R50 being earmarked for Dunamus and R50 each for the accounts of A, B, C, D and E. V sends the original deposits slips together with his/her application form to Dunamus. On the application form V fills in his/her name, address, telephone number, bank, branch, type of account and account number. Upon receipt of the application form and the six deposit slips, Dunamus issues 5 certificates to V. His/her name now appears at number 5 on each of these certificates. E moves to the number 4 spot, D to number 3, C to number 2 and B to number 1. A drops off the list. V must find other potential participants and the cycle repeats itself. V eventually appears as number 1 on all the lists of his/her own "pyramid".

The total potential amount V could receive was  $R50 \times 5^5$ , or R156 250, provided that the participants canvassed by V each also canvass five others and the chain is not broken. V could receive more than R156 250 should he/she participated more than once. Each new participant deposits R50 into the account of Dunamus.

**(b) The Dunamus brochure**

A brochure of Dunamus explained the scheme as follows:

**"Eight easy steps to participate:**

- 1) Subject to stipulations: characteristics; commission agency.
- 2) Acquire a certificate from the person who introduced you to Dunamus.

- 3) Deposit a non-refundable amount of R50 (VAT included) into our account (initial cash payment)
- 4) Deposits the amounts reflected in the certificate into the other accounts mentioned therein.
- 5) Complete the application form and hand same in together with the deposit slips at the point of collection - only deposits for cash will be acceptable.
- 6) We will give you 5 commission structure certificates (with your name appearing in position 5) as well as your product and our brochure.
- 7) Your name will progressively advance from no 5 to no 1 depending upon introduction by you of new participants.
- 8) Watch your benefits increase and reap the benefits afforded to participants".

**(c) An analysis of the scheme**

Dunamus' only product was money and the scheme's continued existence relied totally on the ever increasing number of new participants.

A new participant needs to recruit a number of other participants in order to recoup his/her payment of R300. The R300 was appropriated as follows: R50 was paid into the account of Dunamus and R250 was paid to the five other participants. Five new participants need to recruit at least 25 other participants to recoup their payments. These 25 participants need to recruit at least 125 new participants to recoup their payments. The scheme now has 150 participants of whom only 25 have recouped their payments. The 125 "out-of-pocket" participants need to recruit at least 625 new participants. The scheme now has 775 participants of whom only 150 have recouped their payments while the remaining 625 participants need to recruit at least 3 125 new participants to recoup their payments. The cumulative figures are set out in table 3.

Table 3 - The percentage of participants that will not recoup their money

New participants (A)	Total participants (B)	A as a % of B
	25	
100	150	83.3333
500	775	80.6451
2 500	3 900	80.1282
12 500	19 525	80.0256
62 500	97 650	80.0051
312 500	488 275	80.0010
1 562 500	2 441 400	80.0002
7 812 500	12 207 025	80.0000

The figures in column A reflect the number of new participants required to enable previous participants to recoup their payments. For example, the 100 new participants would need to canvass 500 new participants to recoup their payments, and the 12 500 participants need to recruit 62 500 new participants to recover their payments.

The figures in column B show the numbers of participants necessary to enable the previous participants to break even. For example, 150 people must participate to enable the previous 25 participants to recoup their payments.

The last column in table 3 shows the percentage of participants that have not yet recouped their payments. Given the assumptions underlying the figures in the table, it is clear that the percentage of participants that would not recover their payments would never be smaller than 80 per cent. This would apply to the total number of participants, irrespective of at what stage they joined the scheme.

Proponents of schemes such as Dunamus argue there is no saturation point. Theoretically and mathematically this might be the case, depending on the underlying assumptions. The extent of a new participant's possible earnings is clearly limited by the extent of the market. And the market is limited. 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 schemes such as Dunamus join with the expectation of making a handsome profit quickly - that is the money will materialise in weeks, not months and certainly not years.

The scheme can never reach a stage where everybody has recovered their payments. Those that have not canvassed any new participants will lose their R300. It will become increasingly difficult for participants to find further potential participants the longer the scheme operates. Only a growth in the target market would provide potential participants. 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.

#### **(d) The conclusion of the BPC**

The BPC was of the opinion that Dunamus participants would be unreasonably prejudiced for the following reasons:

At any time at least 80 per cent and possibly more of the participants were at risk.

The argument that saturation will never be reached relied on the proposition that growth in the target market will exceed the growth in the scheme. The promoters did not provide any evidence to substantiate this.

The principles of a free market economy are not absolute but relative. For example, the right of an individual to free market activity is counterbalanced by the right of an equally free society to curb its excesses. It is contended by some people that, where informed individuals engage in a business entity in which a substantial number of such individuals will lose their money, such loss is not



unreasonably prejudicial because it was a free and informed decision. The essential flaw in this contention is that the reasonableness or unreasonableness of the prejudice inherent in the practice of a business entity likely to be suffered by a substantial number is not the purview of the free individual but of the free society. What is reasonable in the perspective of the free individual is likely to be unreasonable in the perspective of free society when substantial numbers are involved. The standards of reasonableness will also depend upon the facts of each particular case, regard being had to the operational methods and controls of the business practice, the extent of disclosures in the absence of regulatory mechanisms and the accountability of its office bearers.

The BPC was of the opinion that the activities of Dunamus constituted harmful business practices which were not justified in the public interest. The Committee recommended that the Minister take steps in terms of section 12(b) and (c) of the Act to prevent the parties involved continuing with such practices. The Minister accepted the recommendation of the Committee.

#### 2.2.2.2 The "ABC" scheme

The Consumer Affairs Committee undertook an informal investigation in terms of section 4(1)(c) of the Act into this scheme operated by a close corporation. This is a preliminary investigation, notice of the investigation is not published in the Government Gazette and the Committee does not reveal the names of the persons or juristic persons who are subject to a section 4(1)(c) investigation<sup>(10)</sup>. The scheme will thus be referred to as the "ABC" scheme.

Ms RS Zabana receives a recipe book or a CD Rom with recipes from ABC when she becomes a member of the ABC scheme. She also receives three each of the following documents: An ABC brochure, a "Proof of sale form" and a document entitled "You have Bought Recipe Booklet No 123456". The ABC brochure claims that this is the "... only way to make R196 830 in commission". This figure is also repeated on pages 2 and 3 of the brochure. On the Recipe Booklet document the name of Ms Zabana appears last on a list that contains eight names. The name of Elsa Barnyard appears at the top of the list.

ABC Marketing Logo  
You have Bought Recipe Booklet No.: 123456  
**Elsa Barnyard**  
Account#: 1234576789

Zane Barnyard  
Melody False  
Hercule Poirot  
Velapi Mugabe  
Vakele Mumsa  
Eve Mthembu  
Rebecca S Zabana

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(10) Public knowledge of an investigation may do serious damage to a legitimate business. Therefore, until the Committee has made a decision to embark on a formal investigation in terms of section 8 no information regarding a complaint or preliminary investigation is publicised. The Act also contains a secrecy clause (section 14).

Ms Zabana then approaches B, B2 and B3 to become participants in the scheme. For the sake of simplicity, the new participants B2 and B3 will be ignored. What applies to B though, will also apply to B2 and B3. Likewise, what applies to C will also apply to C2 and C3 and any further participants.

B completes the proof of sale form and indicates whether he would prefer to receive a recipe book or the CD Rom with the recipes. B then mails the completed form and R90 to ABC. ABC forwards the recipe book or the CD-Rom to B, together with three copies of each of the ABC brochure, the "Proof of sale form" and the Recipe Booklet document. On the Recipe Booklet document B's name will appear at the bottom of the list and Ms Zabana will appear in seventh spot. Zane Barnyard will move to the top of the list and Elsa Barnyard's name will be removed.

Upon receipt of the R90 from B, ABC will credit the accounts of the persons occupying the second to seventh places on the Ms Zabana's Recipe Booklet document. The account of Elsa Barnyard will be credited with R30.

B now canvasses C to become a member. C will receive a Recipe Booklet document with his name at the bottom of the list. B's name will appear just above C's and Ms Zabana will appear above B's. Theoretically Ms Zabana could receive as much as R206 667, as set out in table 4.

Table 4 - Potential commission that could be earned

Level	No of groups	Commission	Total
1	3	R3	R9
2	9	R3	R27
3	27	R3	R81
4	81	R3	R243
5	243	R3	R729
6	729	R3	R2 187
7	2 187	R3	R6 561
8	6 561	R30	R196 380
Total	9 840	R48	R206 667

Ms Zabana starts on level 1 and should B, B1 and B2 each forward R90 to ABC, she will receive R9. Should they each "sell" to three consumers, her name will appear second from the bottom on the lists of nine people. She would now be on level two and will receive R27. Assuming a completely symmetrical structure, that is, each person in her "pyramid", namely B, B1 and B2, "sells" to three consumers who in turn each again sells to three consumers up to level eight, she would receive R196 380 or 6 561 consumers times R30 plus the amounts that she would have received on the preceding levels, a total of R206 667.



The Committee found that the scheme was unfair because consumers were *mised* into believing that they could earn up to R196 830. Even if they have read the proviso that such earnings were only possible "...if all levels have been reached", they would still have been misled because these words do not illustrate the enormous numbers which would have to be involved for the participants to achieve these earnings. For example, 9 840 participants are required to produce R206 667 for the person on the eighth level. If only 500 participants were to receive R206 667, the participation of 4.92 million consumers would be required. The Committee was of the view that very few consumers would pay to receive the recipe book or CD Rom (the product) if the odds stacked against them were fully explained. It is just not possible to recruit the numbers of people required to support such a scheme.

The growth in the number of ABC members is given in table 5.

Table 5 - Growth in the number of ABC members.

Month	Enrolments	% of total	Accumulated total	% of total	% growth Previous month = 100
May 1999	2 313	0.82	2 313	0.82	-
June 1999	8 706	3.11	11 019	3.94	276
July 1999	31 952	11.43	42 971	15.37	267
Aug 1999	58 874	21.06	101 845	36.43	84
Sep 1999	72 740	26.03	174 585	62.45	24
Oct 1999	48 866	17.47	223 451	79.93	Minus 33
Nov 1999	29 496	10.56	252 947	90.48	Minus 40
Dec 1999	13 029	4.67	265 976	95.14	Minus 56
Jan 2000	7 680	2.74	273 656	97.88	Minus 41
Feb 2000	5 900	2.11	279 556	100	Minus 14
Total	279 556	100			

It is evident from table 5 that the growth in the number of enrolments showed a steady but certain decline. Nearly two-thirds of the total number of participants at 29 February 2000 joined ABC during the first five months of its operation. The other third joined the scheme during the last five months. The scheme showed a dramatic growth during the first months (this is often the case). Thereafter participants experienced more difficulty in recruiting new participants because of the market saturation. The declining increase in the number of members is a clear indication that the saturation point is being reached. The promoters attempted to sidestep the saturation argument by claiming that they would continually introduce new "products", such as language courses on CD-Rom and that people were participating in the scheme to buy the products and not to profit from the potential earnings.

The argument that consumers joined the scheme to acquire the product is contradicted by the facts. Five participants joined ABC on more than 50 occasions; another 150 participants joined five times and 144 joined four times. It is not known how many participants joined two or three times. This clearly suggests that consumers joined the scheme to earn commissions and not to improve their culinary skills.

It is stated in the brochure that the principal objective of ABC is the sale of products. One would then expect the brochure to extoll the virtues of the products. This is not so. The text in the brochure is predominantly devoted in answering questions such as "How does the system work? What commissions are paid? How much can I earn? Can you replace marketing group members? Is it really possible for anyone to receive R196 800? Where does the commission come from? How does it work? Can I help speed up the process?" The scheme is deceptive and the product is a smoke screen. ABC and its participants have only one objective - to recruit people.

The owner of ABC informed the Committee on 8 June 2000 that he had discontinued the scheme and that he did not intend to market any other products on a multilevel marketing basis. He admitted that the market for the recipe books was saturated.

The existing prohibition<sup>(11)</sup> on chain letter schemes reads as follows:

"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 aforesaid 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 aforesaid 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 aforesaid 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 aforesaid 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".

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(11) See footnote 2.

### 2.2.3 Difficulties with the existing prohibition

The existing prohibition is difficult to understand and to use as a guideline to analyse new chain letter type schemes. The prohibition was based on the wording of the Minister's prohibition of Dunamus, and the Committee is of the opinion that it would not apply to permutations of Dunamus, such as ABC and others. With this in mind, the Committee will recommend to the Minister that a revised definition be adopted.

### 2.2.4 The definition of a chain letter

A chain letter is defined as a scheme:

- (a) that has various levels
- (b) wherein new recruits are canvassed by existing participants
- (c) wherein the new recruits are expected to pay a certain amount(s) to one or some or all of the existing participants in their "uplines" as well as the promoter(s) of the scheme, whether or not the new recruits receive products or services.
- (d) wherein the new recruits would recover their monies by recruiting other recruits, each of whom are expected to pay one or some or all of the existing participants in their "uplines" as well as the promoter(s) of the scheme, whether or not the recruits receive products or services.
- (e) wherein the events in (a) to (d) above repeat themselves and an existing participant receives money from all the recruiting done by the new recruits and their recruits as well as those further down line.
- (f) whereby the new recruit or the new recruit's name, appears at the bottom of a list or at the bottom end of any number of levels, and should the new recruit canvass one or more new recruits, the new recruit will move one place up on the list or to the next higher level and the further new recruits or their names will then appear at the bottom of the list or at the bottom end of any number of levels.
- (g) whereby the new recruit or the recruit's name will eventually appear at the top of the list or at the top of any number of levels should the events in (a) to (f) above repeat themselves.
- (h) whereby the new recruit's name, once he/she has reached the top of the list or the levels, and should the events in (a) and (e) above repeat themselves, will no longer appear on top of the list or the levels.

### 2.3 Pyramid schemes

Newport Business Club and Rainbow Business Club<sup>(12)</sup> were both pyramid schemes which were investigated by the Committee on a formal basis. 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 and the numbers enrolled by existing members differed amongst the various partnerships. In general, however, the business club was 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 existing 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, what is important from a consumer protection stance, a stable growth rate does not attract members. 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 decrease of interest in the scheme, and its ultimate 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. In order to recoup their initial cash payment, members had to introduce 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 the stage at

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(12) 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.



which 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 money and another 30 per cent recouped some money, but less than R14 000. Only 9 per cent earned more than R14 000. These percentages were identical at the stage where Newport had 1 671 members and again at a later stage when the scheme had 6 354 participants. The overwhelming majority of consumers who participated in these schemes were prejudiced because they 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 the 91 per cent who did not recoup their payments of R14 000. These percentages were almost identical to those calculated during the investigation into the Rainbow Business Club and may be indicative of the trend in these types of schemes.

Pyramid schemes have in the past been regarded as "up-market" schemes, although it has come to the attention of the Committee that people from lower income groups and poorer communities have been participating in such schemes. When they do they often borrow funds from friends and relatives or take out additional mortgages on their homes. These participants were even more severely prejudiced than the more affluent participants. These schemes are sometimes promoted as form as "black empowerment" and these participants are often severely prejudiced as they invest their life savings.

A **"pyramid 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 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.

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 which leads to its collapse.

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 are probably just as many theoretical models on the saturation issue as there are 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 money at all, irrespective of the length of existence of the scheme. The longer the scheme operates, the more difficult it becomes for members to find new 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.

#### 4. Recommendation

"Multiplication schemes", "chain letters", "pyramid schemes" and "binary schemes" constitute unfair business practices. There are no grounds justifying these practices in the public interest. It is accordingly recommended that the Minister declares these unfair business practices unlawful in terms of section 12(1)(b) of the Act whereby, in the course of the business -

1. Any person, directly or indirectly, operates, conducts, promotes or causes to operate a multiplication scheme.

A multiplication scheme exists when a natural or a juristic person **offers, promises or guarantees** 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 consumer, investor or participant, whether or not the consumer, 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:

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

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 days, weeks or months. If  $T$  is in days, weeks and months respectively,  $f = 36\ 500, 5\ 200$  and  $1\ 200$  respectively.

2. Any person, directly or indirectly, operates, conducts, promotes or causes to operate a chain letter.

A chain letter is a scheme:

- (a) that has various levels
- (b) wherein new recruits are canvassed by existing participants
- (c) wherein the new recruits are expected to pay a certain amount(s) to one or some or all of the existing participants in their "uplines" as well as the promoter(s) of the scheme, whether or not the new recruits receive products or services.
- (d) wherein the new recruits would recover their monies by recruiting other recruits, each of whom are expected to pay one or some or all of the existing participants in their "uplines" as well as the promoter(s) of the scheme, whether or not the recruits receive products or services.
- (e) wherein the events in (a) to (d) above repeat themselves and an existing participant would then receive money from all the recruiting done by the new recruits and their recruits as well as those further downline.
- (f) whereby the new recruit or the new recruit's name, appears at the bottom of a list or at the bottom end of any number of levels, and should the new recruit canvass one or more new recruits, the new recruit would move one place up on the list or to the next higher level and the further new recruits or their names will then appear at the bottom of the list or at the bottom end of any number of levels.
- (g) whereby the new recruit or the recruit's name will eventually appear at the top of the list or at the top of any number of levels should the events in (a) to (f) above repeat themselves.
- (i) whereby the new recruit's name, once he/she has reached the top of the list or the levels, and should the events in (a) and (e) above repeat themselves, will no longer appear on top of the list or the levels.



3. Any person, directly or indirectly, operates, conducts, promotes or causes to operate a pyramid scheme.

A **"pyramid 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 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 90 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-resalable 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.

4. Any person, directly or indirectly, operates, conducts, promotes or causes to operate a binary scheme.

A binary scheme in which:

- (a) a participant is required to sell at least two of an entity's products or packages (hereafter called products) to two different persons who are in turn each required to sell to two further participants who are in turn required to sell to two further participants and the process is repeated,
- (b) each participant are assigned to two downlines or legs, which could be labelled *left* and *right*, or A and B, whatever the case may be,
- (c) any further buyers who buy products from a participant are assigned below these left and right legs in the first available node, from top to bottom and left to right in the matrix,
- (d) participants receive commission for all sales, or batches of sales, no matter how many levels there are in their downlines,
- (e) the commissions paid are dependant on a particular ratio that must be maintained between the sales on the left and right legs, such as a " $\frac{1}{3}$ -rule". The " $\frac{1}{3}$ -rule" would require that, in order to receive commissions, at least  $\frac{1}{3}$  of the sales credited to a participant's downline must come from one of the two legs,
- (f) the maximum earnings per week or month per participant are limited to a certain amount but this need not be the case,

**"Unfair business practice"** means operating, conducting, promoting or cause to operate a multiplication scheme and/or a chain letter and/or a pyramid scheme and/or a binary scheme.

It is recommended that the Minister:

- 1. declare unlawful the unfair business practices and
- 2. direct persons to refrain from applying the unfair business practices;

The Committee will also recommend to the Minister that Notice 1135 of 1999, published in Government Gazette No 20169 dated 10 June 1999, be repealed.

**VICE-CHAIRPERSON  
CONSUMER AFFAIRS COMMITTEE**

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## NOTICE 2761 OF 2004

## DEPARTMENT OF TRADE AND INDUSTRY

## CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988

I, Mandisi Mpahlwa, Minister of Trade and Industry, in terms of section 12 (6) (a) (iii) of the Consumer Affairs (Unfair Business Practices) Act, 1988 (Act No. 71 of 1988), hereby give notice that I intend publishing the following notice in the *Government Gazette*. Interested parties are hereby invited to comment on the proposed notice. These comments must be directed to the address which appears at the end of the proposed notice.

NOTICE IN TERMS OF SECTION 12 (6) (a) (iii) OF THE  
CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988

"I, Mandisi Mpahlwa, Minister of Trade and Industry, after having considered a report by the Consumer affairs Committee in relation to an investigation of which notice was given in Notice 3281 of 2000 published in Government Gazette No. 21585 of 22 September 2000, which report was published in Notice 2759 in Government Gazette No. 27052 of 2 December 2004, and being of the opinion that an unfair business practice exists which is not justified in the public interest, do hereby exercise my powers in terms of section 12(i)(b) of the Consumer Affairs (Unfair Business Practices) Act, 1988 (Act No. 71 of 1988), as set out in the Schedule.

## SCHEDULE

1. In this notice, unless the context indicates otherwise -  
    **"unfair business practice"** means to, directly or indirectly, in the course of business, operate, conduct, promote or cause to operate, conduct or promote a multiplication scheme, a chain letter scheme, a pyramid scheme or a binary scheme.  
  
    1(a) A **multiplication scheme** exists when a person offers, promises or guarantees an effective annual interest rate of 20% and more above the REPO rate as determined by the South African Reserve Bank, to any

consumer, investor or participant, whether or not the consumer, 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:

$$r = \frac{R \times f}{C \times T}, \text{ where: } r = \text{the effective interest rate, } R = \text{the interest in Rand,}$$

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 days, weeks or months. If T is in days, weeks and months respectively, f = 36 500, 5 200 and 1 200 respectively.

2(a) A **chain letter** is a scheme:-

- (i) that has various levels;
- (ii) wherein a new recruit is canvassed by an existing participant;
- (iii) wherein the new recruit is expected to pay a certain amount to one or some or all of the existing participants in his or her "upline" as well as the promoter of the scheme, whether or not the new recruit receives a product or service;
- (iv) wherein the new recruit would recover his or her monies by recruiting another recruit, who is expected to pay one or some or all of the existing participants in his or her "upline" as well as the promoter of the scheme, whether or not the recruit receives a product or service;
- (v) wherein the events in (i) to (iv) above repeat themselves and an existing participant would then receive money from all the recruiting done by the new recruit and his or her recruit as well as

those further downline;

- (vi) whereby the new recruit's name appears at the bottom of a list or at the bottom end of any number of levels, and should the new recruit canvass one or more new recruit, the new recruit will move one place up on the list or to the next higher level and the further new recruit will then appear at the bottom of the list or at the bottom end of any number of levels;
  - (vii) whereby the new recruit's name will eventually appear at the top of the list or at the top of any number of levels should the events in (i) to (vi) above repeat themselves;
  - (viii) whereby the new recruit's name, once he or she has reached the top of the list or the levels, and should the events in (i) and (v) above repeat themselves, will no longer appear on top of the list or the levels.
- (b) For the purpose of a chain letter scheme -
- (i) "**upline**" means the name of a participant on a list above the name of a new recruit or new participant and
  - (ii) "**downline**" means the name of a participant on a list underneath the name of a new recruit or new participant.
- (3)(a) A **pyramid 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) For the purpose of a pyramid scheme: -

- (i) **“participant”** means a person who contributes money or any other form of consideration into a pyramid scheme;
- (ii) **“consideration”** means the payment of cash or purchase of goods, services, or intangible property but 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;
- (iii) **“compensation”** means the payment of money, a thing of value, or any financial benefit or any discounts which may accrue to the participant but 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;
- (iv) **“product”** means a good, a service, or intangible property of any kind;
- (v) **“promote”** means to operate, or advertise or to induce or attempt to induce another person or persons to be participants;
- (vi) **“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 90 days which are unused and in commercially resaleable 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

(4)(a) A **binary scheme** is a scheme in which:

- (i) a participant is required to sell at least two of an entity's products or packages (hereafter called products) to two different persons who are in turn each required to sell to two further participants who are in turn required to sell to two further participants and the process is repeated;
- (ii) each participant is assigned to two downlines or legs, which could be labelled *left* and *right*, or A and B, whatever the case may be;
- (iii) any additional products sold by a participant are assigned below these *left* and *right* legs in the first available node, from top to bottom and left to right in the matrix;
- (iv) participants receive commission for all sales, or batches of sales, no matter how many levels there are in their downlines;
- (v) the commissions paid are dependant on a particular ratio that must be maintained between the sales on the left and right legs, such as a " $\frac{1}{3}$ -rule". The " $\frac{1}{3}$ -rule" would require that, in order to receive commissions, at least  $\frac{1}{3}$  of the sales credited to a participant's downline must come from one of the two legs;
- (vi) the maximum earnings per week or month per participant are

limited to a certain amount but this need not be the case.

(b) For the purpose of a binary scheme: -

(i) **“downline”** means the two lines or legs assigned to a participant to which sales are credited based on a certain rule and in terms of which the commission payable is determined.

2. Any person who operates, conducts, promotes or causes to operate, conduct or promote an ‘unfair business practice’ commits an offence.
3. Notice 1135 of 1999, published in Government Gazette No 20169 dated 9 June 1999 is hereby repealed.
4. This notice shall come into operation upon the date of publication hereof.”

On the recommendation of the Consumer Affairs Committee I may, in a particular case, in terms of section 12 (6) (c) of the Act in writing, grant exemption from a prohibition contemplated in this notice to such extent and for such period and subject to such conditions as may be specified in the exemption. Such applications for exemption must be directed to:

The Secretary, Consumer Affairs Committee, Private Bag X84, Pretoria, 0001  
(For attention: Mr Ebrahim Mohamed, Fax: (012) 394 1542)

**M MPAHLWA**

**MINISTER OF TRADE AND INDUSTRY**

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