

## City of London Law Society

### Response to the joint Consultation by the DTI (as was) and the OFT on the proposed Guidance Notes on the Consumer Protection from Unfair Trading Regulations 2007 Consultation

#### **Introduction**

This response has been prepared by the Commercial Law Committee of the City of London Law Society. The City of London Law Society (“CLLS”) represents approximately 12,000 City solicitors, through individual and corporate membership including the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. Through this practice in both the UK and abroad, City solicitors facilitate the working of the City and of national and international business and they contribute considerably to the UK economy.

The Commercial Law Committee comprises partners from law firms in the City of London. The members all specialise in commercial law, and represent suppliers and customers across all business sectors, including businesses who supply goods and services to consumers. The members of the Commercial Law Committee are set out in Section 2 to this response. The Committee is non political.

#### Section 1

*Q1 Is the draft Guidance sufficiently clear?*

Whilst the draft Guidance is relatively clear, given the important new changes regarding the concept of the typical consumer, we consider that this aspect should be further highlighted and not confined to the Glossary (pages 71-73).

We also consider that given the potential criminal consequences for breach of the regulations, these consequences are insufficiently highlighted in the early part of the Guidance.

We are concerned that the description of the Scope (page 17) does not refer to the separate Business Protection from Misleading Marketing Regulations 2007 being enacted at the same time. We consider that this omission may cause confusion in that this section does refer at the same time to business to business transactions.

*Q3 Does it provide a helpful summary of the possible enforcement options that may be used by enforcers to prevent unfair practices?*

As noted above, the apparent downplaying of potential criminal enforcement may give an incorrect impression.

*Q4 Do the examples helpfully illustrate the effect of the prohibitions in practical terms?*

We consider that these are helpful in general subject to specific concerns regarding Pyramid Promotion Schemes (see below).

We draw your attention to the example (13) (page 24). We note that the example given would also breach the Business Protection from Misleading Marketing regulations 2007, and suggest that this be mentioned.

### **Pyramid Promotional Schemes (example 14, page 25)**

The CLLS is concerned that businesses operated by Direct Selling Organisations may be inadvertently caught within the example of a pyramid promotional scheme under the proposed guidance. This is of particular significance given the way in which the Directive has been interpreted by Belgian regulators.

The CLLS believes there are some problems inherent in the text of the primary draft legislation. It hopes that the ambiguity can be lessened through the medium of the Guidance Notes and suggests that the example is clarified to identify the head hunting element of commission as indicating whether an operation falls within unfair practice.

Item 14 in both Annex I to the UCPD and Schedule 1 to the draft CPRs reads (in part):

“Pyramid promotional schemes where a consumer gives consideration for the opportunity to receive compensation that is derived primarily from the introduction of other consumers into the scheme rather than from the sale or consumption of products”

The meaning of the section quoted is not clear. This is not a case where one can sympathise with the legislators for introducing an element of ambiguity with the intention of bringing about the termination of a wide range of undesirable activities rather than merely a specific item. Correspondingly, the ambiguity makes it difficult to be absolutely confident that any one interpretation is correct.

The prohibition is of particular, perhaps unique, concern to those operating in the £2 billion industry variously known as direct selling, or network marketing, especially those businesses (representing, we understand, the majority by turnover) which adopt a multi-level marketing format. In such businesses, the new direct selling organisation (a “DSO”) sells products (and services, in many cases) to consumers, at discounted prices. Some of those (“first level”) consumers become business people in their own right to one degree or another (we shall call them “agents” for the sake of brevity in this submission), and arrange sales to other (“second level”) consumers and receive commission from the DSO on such sales. If one or more of the second and subsequent level consumers themselves become agents, and effect sales to consumers still more remote in the hierarchy from the DSO, some or all of the agents in the “genealogy” between the selling agent and the DSO may be entitled to a commission.

Thus, a particular agent’s compensation may comprise:

- commission from the DSO on his own sales (or a distributor’s profit margin, if he buys and sells on his own account);

- (in some countries) compensation from the DSO for the act of recruiting other agents (this would not be lawful in the UK, by virtue of s:120, Fair Trading Act 1973); and
- commission from relevant sales made by those other second and subsequent level agents.

It is clear that, depending upon the relative commission rates, the volume of sales, and the success in sales of the particular agent as compared to the sales achieved by the potentially numerous agents in the second and subsequent levels, the extent to which the DSO pays commission on multiple “levels”, and other factors, the particular agent may receive more commission deriving from sales by the latter than by virtue of his own sales. We understand this is quite common.

There are two significant sources of ambiguity in the short paragraph 14. The first arises through the use of the word “where”; the second arises by virtue of the words “compensation that is derived primarily from the introduction of other consumers”.

Note that the preliminary wording of para 14 is “... pyramid promotional schemes where ...” after which appears the language with which the second part of this section is concerned.

The phrase “... pyramid promotional schemes where ...” is essentially ambiguous, as it is not clear whether it is **defining** “pyramid selling schemes” or limiting the illegality to certain types of (by implication, lawful) pyramid selling scheme.

If the first interpretation is intended, pyramid selling schemes, by definition, demonstrate the features appearing after the word “where”, thus making all “pyramid selling” schemes unlawful.

If the second, then para 14 is concerned to specify and render illegal only those particular pyramid schemes which do demonstrate the features appearing after the word “where”. Please note that in the direct selling industry, the expression “pyramid selling” has come to connote something intrinsically corrupt and generally unlawful.

Turning to the second ambiguity, we understand that the Belgian regulators, for example, take the view that this wording has the effect of including commission earned from the indirect sale and consumption of products in the “wrong” side of the comparison called for by the definition.

We believe that interpretation is wrong because it misconstrues the mischief against which pyramid selling law has, with a high degree of consistency, been targeted throughout the period of 70 years or more during which such schemes have been promulgated in various parts of the world.

We are concerned here with “compensation that is derived primarily from the introduction...” The first point we would note is the use of the concept of “introduction”. If the draftsman had intended an interpretation such as that adopted by the Belgian regulators, it would have been a simple matter to have covered the point by providing instead for “compensation that is derived primarily from the introduction of, and sale and consumption by, other consumers...”

We note that the paragraph ends with the words “the sale or consumption of products” without specifying by whom those products will have been sold. If the legislature had intended the interpretation taken in Belgium, then it would have been appropriate, consistent and, in our view, necessary, to define the relevant products as those being sold or consumed by the consumer himself. The definition does not say that. The definition refers to “sale or consumption of products”. Therefore, in our view, the calculation that is required includes, on the “good” side, all elements of income derived by the agent from the sale of products whether it is called commission, margin, discount or otherwise.

On the “wrong” side of the calculation is a recruitment, or “head-hunting” commission.

Many cases in which the promoters have been prosecuted for fraud and/or companies promoting such schemes have been wound up on the “just and equitable” ground represent more or less complex money circulation schemes where it is clear that the new recruit’s subscription has in reality done no more than pay the returns required by the promoter on the one hand and promised to earlier recruits on the other. As regards payment to earlier recruits, these are clearly head hunting fees. It seems to us that this is the mischief to which para 14 should be addressed.

*Q5 Are there sufficient cross-references to other material, for example other Guidance, legislation?*

As an exercise has been carried out in analysing the current legislation affected by the Unfair Trading Regulations, we consider that a section indicating the other legislation, regulation and guidance that it is relevant for a trader to consider would be helpful.

*Q11 Do you have any comments on the order of information presented in the Guidance?*

Please see our response to Question 1 above.

### ***Specific Questions***

*Q16 Is there sufficient information on the key concepts of ‘typical consumer’ and ‘transactional decision’?*

We consider that this aspect which is one of the difficult and novel areas of the legislation could be helpfully expanded and further illustrations given.

Section 2

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Commercial Law Committee  
(membership as at 9 August 2007)

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