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# If it Sounds too Good to be True it Probably Is: Pyramid Schemes and other related Frauds

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## Introduction

South Africa is fast becoming a haven for unscrupulous entrepreneurs and get-rich-quick investment schemes. Reports abound in newspapers of investors who have lost fortunes and in some cases, their life savings, in schemes that suggest that they will be able to build immense wealth for a very small investment. To cite just one example, the *Sunday Times* (4 March 2001) carried a report of a scheme conducted in the Eastern Cape. Allegedly, some R500 million was invested and lost by about 900 people. The largest single investment in the scheme appeared to have been one of R40 million.

These schemes come in many different forms. Some are highly sophisticated operations with skilled and articulate promoters whilst others are quite crude. But they all have the same basic theme. Investors are promised that they will make a lot of money or receive a very high return on their investment — the kind of return that could not be achieved by more conventional investment avenues. Such schemes are promoted through newspaper and magazine advertisements, on traffic light poles, in fliers delivered by hand, outside supermarkets, on the Internet, and by word of mouth. A typical advertisement reads: 'Make R2 000–R10 000 per sale, without ever leaving home — you can make more money then ever thought possible'. Or,

'[a]re you serious about earning R700 plus in four weeks for only R35?'

The vast majority of those who invest in these schemes will lose their money and sometimes even commit a criminal offence by participating. These investment opportunities are commonly referred to as pyramid schemes. Unfortunately, this label is used very loosely and without a real understanding of what really constitutes a pyramid scheme. A well-publicized scheme was Miracle 2000, where promoters promised investors a 200 per cent return over 42 days. Investors were required to pay a R50 registration fee and make a minimum investment of R300. When the offices were raided, police allegedly confiscated R10 million in cash. Although this was referred to as a pyramid scheme it was, in terms of the South African definition, a money multiplication scheme (also known in America as a 'Ponzi' scheme).

It is not always easy for unsuspecting investors to judge the validity of

business transactions. In South Africa, with its social problems, poverty, and unemployment, there is fertile breeding ground for opportunists. Investors are sometimes led to believe that they are participating in a Black empowerment scheme, or a stockvel. (A stockvel is a 'type of informal credit-rotating association in which a group of people enter into an agreement to contribute a fixed amount of money to a common pool on a weekly or monthly basis or as frequently as the members may agree upon' (see, generally, WG Schulze 'The Origin and Legal Nature of a Stockvel' (1997) 9 *SA Merc LJ* 18 and 153; see also GN 2173 *GG* 16167 of 14 December 1994).) Some will even borrow money to participate. When the scheme collapses or the promoters disappear, they may leave behind a totally impoverished community. If the community consists of the elderly or the unemployed, they have no means of recouping their losses. In many instances they may even be indebted. This is not only a South African problem. Robert L FitzPatrick, the co-author (with Joyce K Reynolds) of *False Profits: Seeking Financial and Spiritual Deliverance in Multi-Level Marketing and Pyramid Schemes* (1997) and president of Pyramid Scheme Alert (an international consumer organization dedicated to preventing the spread of pyramid schemes and other types of investment fraud), states that '[these] schemes have become an insidious, pervasive and corrupting influence in the marketplace and community, causing financial and social harm on a global scale' (Robert L Fitzpatrick 'Is MLM Legal?', available at <<http://www.falseprofits.com/FSLegalityPg.html>>).

The government first tried to regulate pyramid schemes in 1980 when conditions were imposed on the operation of such schemes (Reg 469 *GG* 6880 of 14 March 1980). There are no reported decisions involving these regulations and they were generally regarded as being too cumbersome to be of any practical use. The Business Practices Committee ('BPC') was established in 1988 in terms of the Harmful Business Practices Act 79 of 1988. The Minister of Trade and Industry was given the power to declare a business practice 'harmful' after considering a report from the BPC. This committee received numerous complaints regarding investment opportunities that promised phenomenal returns but that often led to substantial losses for investors (for example, Report 55 *Rainbow Business Club*, *GG* 18531 of 12 December 1997; Report 56 *Newport Business Club (Pty) Ltd*, *GG* 18292 of 17 September 201997; Report 60 *Dunamus Marketing CC*, *GG* 18972 of 12 June 1998; Report 62 *AJ van Rensburg & Associates CC*, also known as *JVR & Associates CC*, Trading as *Itereleng*, *GG* 19477 of 20 November 201998; and Report 66 *Omega Trust*, *Omega Power Marketing*, *Gerhardus Francois Janse van Rensburg and Jan Frederick Olivier van Zyl*, *GG* 20199 of 14 June 99. Report 66 was the subject of the decision of the Constitutional Court in *Janse Van Rensburg NO v Minister of Trade and Industry* 2001 (1) SA 29 (CC)).

Each scheme was investigated on an ad hoc basis until the BPC was approached by members of the South African Reserve Bank, the Office for Serious Economic Offences, the Financial Services Board, and the Commercial Branch of the South African Police Services and requested to do a general investigation into get-rich-quick schemes. It was felt that the committee and the Act were the most practical means of dealing with what had become a substantial problem. Although thorough investigations would have revealed fraud and contravention of existing legislation such as the Companies Act 61 of 1973, the Stock Exchanges Control Act 1 of 1985, the Financial Markets Control Act 55 of 1988, and the Banks Act 94 of 1990, and should have resulted in criminal prosecution, the schemes were disguised as legitimate investment opportunities. The police are not trained to deal with problems of this nature and so disgruntled investors, who approached them with complaints, were advised to see their attorneys. When the schemes collapsed, promoters either disappeared or simply alleged that with every investment there was risk and so they could not be held responsible. A lack of prosecutorial will on the part of enforcement agencies coupled with insufficient resources often meant that poor and elderly investors were left destitute and without any recourse or remedy.

The Act was amended in 1999 and renamed the Consumer Affairs (Unfair Business Practices) Act. The committee also underwent a name change and is now known as the Consumer Affairs Committee (CAFCOM). The definition of a 'harmful business practice' was replaced by a definition of an 'unfair business practice'. Despite these changes, the role of the committee and the powers of the Minister remained substantially the same.

The Act authorizes the committee to investigate any business practice. If it is considered to be unfair, the committee makes recommendations to the Minister. An unfair business practice is defined as 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 (s 1). If the Minister accepts the recommendations of the committee, he or she publishes a notice in the *Government Gazette*, declaring the business practice to be unfair and hence unlawful. It is a criminal offence to ignore the Minister's order. An offender may be liable to a fine of up to R200 000, or to imprisonment not exceeding five years, or to both (s 2(7)).

The Act provides for two types of formal investigation (s 8). An investigation into a specific person or business is conducted in terms of section 8(1)(a). Any order made by the Minister following such an investigation is relevant only to those who were investigated. So it is not a criminal offence for others to become involved in similar business practices. When it is discovered that a particular unfair business practice

is widespread, the Committee may resolve to embark on a general investigation in terms of section 8(1)(b). The Minister's order then applies generally. Any person (or business) that operates in a similar manner commits a criminal offence.

Initially, the Committee undertook specific investigations into individual schemes in terms of section 8(1)(a). So the Minister's regulations applied only to the promoters of these particular schemes. Investors who had lost money in one particular scheme sometimes use a similar concept to set up a scheme of their own. As they had not been prohibited from doing so by the Minister, they were not committing an offence in terms of the Act. So the Committee, with other concerned bodies, decided to conduct a general investigation into money making schemes.

Although there are countless variations, they are all based on the same fraudulent concepts. So the compilers of the final report were able to identify three basic schemes — pyramid promotional schemes, money revolving schemes, and chain letters (Report No 76 *Investigation in Terms of Section 8(1)(b) of the Harmful Business Practices Act, 71 of 1988 into Money Revolving or Pyramid Schemes*, GG 20169 of 9 June 1999). The Minister declared these schemes to be harmful business practices and hence unlawful (GN 1135 GG 20169 of 9 June 1999).

### Pyramid Promotional Schemes

These schemes begin with a promoter who invites potential investors to join his or her organization, which may be referred to as a club, business club, or investment scheme. These potential investors are invited to meetings or seminars that usually involve high pressure sales. They have been described as being like old-time revival meetings 'directed towards the joy of making money' (JM Taylor 'Product Based Pyramid Schemes: When should a Multilevel Marketing or Network Marketing Program Be Considered an Illegal Pyramid Scheme', Report prepared for the Consumer Awareness Institute of America, p 6). The purpose of these meetings is to convince investors that this is the route to great wealth. Each person who joins is required to make a payment to the promoter. He or she is then entitled to canvass other people to join. As each new person joins the scheme, they are required to make a payment to those who are above them in the hierarchy. To recover their investment they are required to recruit new members.

Report 76 defines a pyramid promotional scheme as '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'. This definition is very similar to that found in anti-pyramid statutes in the United States of America.

The problem with pyramid schemes is that there is a need for a constant supply of new investors to satisfy the needs of existing investors and basic mathematical calculations demonstrate that within a relatively short time there are not enough people available for such schemes to sustain themselves.

A typical pyramid scheme was conducted by Newport Business Club (Pty) Ltd (see Report 56). This club was a subsidiary of Newport LLC, which was a company incorporated according to the laws of Nevis in the West Indies. The administrative offices of Newport LLC were located in Amsterdam. Neither the director nor those who initially promoted the scheme in South Africa were South African citizens. Newport LLC commenced business in South Africa during October 1996 and recruited members to join its business club. Newport Business Club (Pty) Ltd was formed in January 1997. Prospective members had to be invited by existing members and were required to attend meetings that were held twice weekly on Saturdays and Sundays at venues throughout the country. New members had to pay R14 000, most of which was used to pay commission to those who had recruited them. Once members had paid this non-refundable payment, they were regarded as junior partners. Each member was required to canvass two new members. They did not receive any compensation for the recruitment of their first two members but they became senior partners and were entitled to recruit any number of new partners who became their junior partners. For each junior partner recruited they were paid R5 200. They also received a lesser payment for every partner their juniors recruited. From the initial R14 000, R3 960 was paid to Newport for administrative, operating, and legal costs. Any outstanding balance was allegedly for investment purposes. (This scheme operated on the same basis as the 'Aeroplane Game' that was popular throughout the world, including South Africa, in the 1980s.)

Although evidence of a proposed investment scheme was presented to the Committee, it was clear that investors did not join the scheme to earn income from an investment, and this was clearly not the focus of Newport's recruitment drive. In a video presentation that was used to entice new members the presenter stated: 'We have a product which everybody wants, that everybody needs and a product that I know is positively addictive.' This product was later identified as money. So the Committee concluded that the only real product was money. For the scheme to continue operating there had to be an ever-increasing supply of new members. As the scheme progressed, it would have become more and more difficult to canvass new members. In the end the scheme would have collapsed. For example, 40 new members would have to canvass 160 people, who would have to canvass 2 560 people, who would have to canvass 10 240 new recruits. This is just so that they could recoup their initial R14 000 investment. Using these same numbers, by the time the

tenth level was reached, 10 485 760 participants would have been required. Mathematical calculations demonstrated that at whatever stage the scheme collapsed, at least 75 per cent of investors would lose their money.

During its investigation the Committee conducted two studies of Newport's financial statements, one in March 1997, and one in July 1997. The March study revealed that there were 1671 members. 61 per cent of them had not recouped any money at all, and 30 per cent had received less than their initial payment of R14 000. In July there were 6 54 members. Again 61 per cent of the members had not recouped any of their money, and another 30 per cent had earned less than their investment. So the Committee concluded that the longer the scheme was allowed to continue the greater the number of people there would be who would suffer loss. By contrast, the three promoters of the scheme earned over R16 million.

### Product-Based Pyramid Schemes

The definition of a pyramid promotional scheme states that the compensation must derive *primarily* from introducing another person, because in some instances the promoter may introduce a product such as a gold coin, computer program, or self-help book. If the word 'primarily' did not appear one could argue that the income was derived from selling the product and not from the commission earned for introducing new participants. Here the promoter tries to disguise the scheme as a legitimate multi-level marketing programme. Multi-level marketing, also known as 'network marketing', is a form of direct selling in which independent distributors sell products on a 'party plan' basis, or over the telephone. Distributors usually generate an income from their own sales as well as from the sales of those whom they recruit. This is a legitimate way of selling products and there are a number of successful businesses that operate in this way. Unfortunately, this business model is being exploited and today many multilevel marketing programmes are simply disguised pyramid schemes (see, generally, Ruth Carter (pseudonym) 'Behind the Smoke and Mirrors', available at <[www.mlmsurvivor.com](http://www.mlmsurvivor.com)>; Fitzpatrick op cit (*Is MLM Legal?*); Dean VanDruff 'What's Wrong with Multilevel Marketing', available at <[www.vandruff.com/mlm.html](http://www.vandruff.com/mlm.html)>).

The hallmark of a pyramid scheme is the fact that its primary focus is on the amount of money that can be made rather than on the merits of the product that is being sold. Those who participate do not become involved because of the product, but because they have been assured that they will make their fortune. Legitimate multi-level marketing involves real products that are of significant value. And, most importantly, the profits for the participants come from the sale of the products to people to whom the product also has value. With a pyramid scheme, the profits come from commission earned through recruiting distributors and not

from selling products. But legitimate multi-level marketers sometimes earn commission for introducing new recruits (this is permissible in terms of the Direct Marketing Code of Conduct), and so there may be a blurring of the distinction between illegal pyramid schemes and legitimate multi-level marketing programmes. The distinction between the two is controversial. There are some who are of the view that, with very few exceptions, the multilevel marketing industry is composed of pyramid operations (Fitzpatrick op cit (*Is MLM Legal?*); Taylor op cit; see also Bob Blaylock *Pyramid Schemes, Ponzi Schemes and Related Frauds*, available at <[members.impulse.net/7Ethebob/Pyramid.html](http://members.impulse.net/7Ethebob/Pyramid.html)>).

There are strong pyramidal elements in most multi-level marketing programmes. Evidence suggests that the majority of participants have little chance of financial success. They certainly will not achieve the outstanding results that are often advertised. Most of them will barely cover their costs. Real profits are reserved for a small minority at the top of the hierarchy. These multi-level marketing plans cause great harm, as they require high levels of recruiting and participants are often enticed to give up their existing employment, and to neglect or defraud their families and other relationships. Schools and churches are particularly vulnerable, as schemes are promoted as a means of raising much-needed funds. Those who commit themselves, sometimes by purchasing expensive start-up kits, often discover that the market is already saturated and that there are not enough people who want to buy the usually overpriced product, whether it be washing powder, health products, or a website. Participants then resort to purchasing unneeded products themselves, or coercing their friends and families in purchasing their products.

### Money Multiplication Schemes

The history of money multiplication schemes (sometimes called 'pyramid schemes') can be traced as far back as 1719 when John Law developed his 'Mississippi Bubble' in France. In America, they are called Ponzi schemes, after Charles Ponzi who ran such a scheme from 1919 to 1920. (For a full discussion of Charles Ponzi and his postal coupon business, see Mark C Knutson *Charles K Ponzi Website*, available at <[www.mark-knutson.com](http://www.mark-knutson.com)>). With his promises to double money within 90 days Ponzi collected over \$15 million before his scheme collapsed.

In South Africa, these schemes are referred to as money multiplication schemes, because investors are promised that if they invest a small amount of money today they will at some later stage (usually within a fairly short period of time) receive a large payment. In other words, their initial investment will simply be multiplied. These schemes can be distinguished from pyramid schemes in that they do not involve the hierarchal structure found in a pyramid. There is usually just one central person or company who collects the money and who promises to make a large payout after some time. The problem with these schemes is that



early investors receive their returns from those who invest later. The promoter does not attempt to create any new wealth, for example, by manufacturing products that can be sold, or by investing the money. In many instances the money is not even deposited into a bank account. These schemes are doomed to fail, because again there is the problem of numbers. The earnings of each participant depend on more and more investors joining the scheme. As more join, even more are required to ensure that their investment targets are met. The promoter of the scheme usually takes a percentage of the profits for him- or herself; there is rent and there are employees to pay, and many other expenses. In one case investigated by the Committee, the promoter was found to have purchased many vehicles and properties that were registered in his own name with money that could only have come from the investors. There seemed to have been no separation between his personal finances and those of the investment company. The company 'books' consisted of two school exercise books (see Report 80 *Propolux 46 Ltd, Lucky Mthombeni and Others*, GG 21611 of 29 September 2000). It appears that Jurgen Harksen operated such a scheme in Germany from 1990 until 1992. He promised investors a return of 1 300 per cent on their money, and managed to persuade many wealthy and influential Germans to invest R446 million in his non-existent scheme. He has admitted that he spent a substantial portion of investors' money on his luxurious lifestyle. He is presently on trial for fraud in Germany (*Daily News*, 12 March 2003)

Although the Committee did not provide a comprehensive definition of a money multiplication scheme, the Minister has declared unlawful any multiplication scheme that offers, promises, or guarantees an effective annual interest rate of 20 per cent or more above the REPO rate (the rate at which the Reserve Bank lends money to commercial banks) (GN 1135 GG 20169 of 9 June 1999). There is no magic in the figure of 20 per cent. But it is not the intention of the Committee to interfere with legitimate investment, and it was felt, after careful consideration, that such a figure was sufficiently high to ensure that legitimate business practices would not be affected. In practice, the interest rates of these questionable schemes are usually much higher, sometimes in the region of 1 000 per cent. For example, Sun Multiserve offered a return of 1 000 per cent, and Miracle 2000 a return of 1 733,33 per cent.

This definition also affects those investment opportunities where investors are promised a very high monthly return on a lump sum investment. Investors may, for example, be guaranteed a monthly return of 10 per cent. This translates into an annual return of 120 per cent, and so contravenes the Minister's notice. It is the Committee's experience that it is not possible to guarantee such returns. In all cases investigated by the Committee, promoters were meeting their monthly commitments to their investors by using money invested by others. Put differently, they were simply robbing Peter to pay Paul. Depending on the returns offered and

how much the promoters were taking for themselves the point would eventually be reached where it would no longer be possible to meet the monthly commitments and the scheme would collapse. At such time, the promoters would disappear or face liquidation, and it would be very difficult, if not impossible, for participants to recoup their initial lump sum investment. It is alleged that Krion Financial Services (KFS), presently under liquidation and with its directors facing criminal charges, operated such a scheme.

### Chain Letters

This is a letter that starts with a list of names. Participants are asked to send money to the person at the top of the list. They are then entitled to add their name to the list, cross off the name at the top of the list (to make sure that in the end they reach the top), and send the letter to a number of people who are asked to repeat the exercise. These are uncontrolled chain letters, as the name at the top of the list is always removed. So it is difficult to monitor the scheme's progress. But there are also controlled chain letters where the name of the promoter remains on the list. Money must always be sent to the promoter and to at least one other person. This is usually the person whose name appears directly below the promoter's. As with the schemes discussed above, to reach the earning levels that are promised by the promoter improbable numbers must become involved in the scheme. A simple example: X starts a chain letter with five names on the list. He sends the letter to five people, who must send it to five people, who must send it to five people, and so on. By the time this process has repeated itself five times, 3 125 people must be involved. If Y becomes involved on the sixth level, 9 765 625 people must participate before Y will receive any money at all. In many circumstances these schemes are rigged even further. The promoters will not only make sure that their names remain on the list, but they will re-enter their names at various stages, or will have a number of different aliases with addresses as post office boxes registered to their names.

A typical chain letter was that promoted by Dunamus (Report 60). Dunamus was described by its promoters as 'a multi-level debt repayment and capital empowerment corporation.' When an investor joined Dunamus, he or she was supplied with five certificates, called 'Commission Structure Certificates'. On these certificates were the banking details of Dunamus, as well as the names and banking details of five other people. The new member's name appeared in the fifth place. At the bottom of each certificate was an application form for membership of Dunamus. The member was required to distribute these certificates to five new investors. These investors would complete the application form and deposit R50 into the bank account of each person, including Dunamus, that appeared on the certificate. They would send the deposit slips to Dunamus with their application form for membership. Dunamus

would issue them with five certificates on which their name would appear in the fifth spot. The name at spot number one would have been removed. The cycle would then repeat itself.

When the Committee became aware of Dunamus there were about 40 000 certificates in circulation, and the business had made about R1 million. (An interesting aside is that the father of the person who started the scheme had been involved in Newport Business Club and had lost money there.) An examination of the business practice revealed that the only product that Dunamus dealt in was money, and that its continued existence relied totally on an ever-increasing supply of new participants. Mathematical calculations demonstrated that 80 per cent of those involved would never recover their initial payment of R300. So the Committee concluded that the business practices of Dunamus were harmful and recommended to the Minister that they be declared unlawful. The Minister accepted the Committee's recommendation (GN 964 GG 18972 of 12 June 1998). This investigation formed the basis on which the definition relating to chain letters in Report 76 was developed. A chain letter is defined as

[a scheme] where any person (hereinafter referred to as the "promoter(s)" or "supplier(s)" of the scheme)

- (a) invites any other person (hereinafter referred to as the "participating person") to enter into any arrangement with any of the promoter(s) or supplier(s) of the scheme the terms which include any provision which have the effect that the participating person is obliged to make a payment of a financial consideration with prospect of such participating person receiving payment or other money-related benefits, directly or indirectly, in respect of the participation in the recruitment or introduction (whether by himself or another person) of other persons to enter into similar arrangements with any of the persons or promoter(s) or supplier(s) of the scheme;
- (b) enters into any arrangement with the promoter(s) or supplier(s) or any person of the scheme 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 (whether by himself or another person) to enter into similar arrangements with any of the persons or promoter(s) or supplier(s) of the scheme.
- (c) accepts any financial consideration from the promoter(s) or supplier(s) or any person of the scheme in terms of any arrangement which financial consideration is used in part or in full to fulfil the obligations of either party to a third party who has entered into a similar arrangement with any of the persons or promoter(s) or supplier(s) of the scheme; and
- (d) makes any payment of any financial consideration or gives any money-related benefit, directly or indirectly, to the promoter(s) or supplier(s) or person of the scheme in terms of any arrangement as prohibited in terms of paragraph (b) or (c) above.'

This very cumbersome definition is difficult to understand. It has also proved inadequate to deal with some of the new permutations of chain letters that have emerged. Fortunately, most of these new schemes have folded as soon as the promoters have become aware of the Committee's interest. But this has not stopped investors from losing their investments. The Committee is in the process of reviewing this definition, and I hope that in the near future it will publish a more streamlined version.

## The Problem Persists

Despite the Minister having outlawed money revolving schemes the problems persists. The Committee continues to receive complaints from disappointed investors. Since Report 76, the Committee has investigated many schemes informally, and a substantial number have necessitated the Committee conducting a formal investigation (see, for example, Report 79 *Metro Financial Services Ltd, C Holstanzen and Z Beswick*, GG 21546 of 15 September 2000; Report 80; Report 84 *Messenger of Hope Marketing CC, Anthony Suze and Layten Franks*, GG 22709 of 28 September 2001; Report 87 *Acinad Productions Ltd, Trading as Business Development International*, GG 23261 of 22 March 2002; Report 90 *SkyBiz — an Internet Scheme*, GG 24053 of 8 November 2002; Report 92 *Core Club*, GG 24052 of 8 November 2002; Report 93 *Zibycom — A Binary Scheme* GG 24054 of 8 November 2002; Report 95 *Gold Charity Fund Investments Ltd*, GG 24055 of 8 November 2002; Report 98 *Prosper International League Ltd (PILL)*, GG 24051 of 8 November 2002).

The Committee has had to resort to formal investigations, despite the Minister's prohibition, because of the subtle variations that are adopted by ingenious entrepreneurs. In particular, a variety of products are used to disguise the schemes. In a number of instances promoters attempted to avoid the saturation problem by using the argument that they would be introducing new products in future. This would mean that existing participants would have more products to sell. But these products are just a smokescreen. Even where it is assumed that the product does have a legitimate value it cannot disguise the true nature of the scheme. Dr Peter Van der Nat, a Federal Trade Commission (FTC) economist who investigated Skybiz, an Internet investment scheme, believes that the value of the product and its technical characteristics are not important. In his words (Federal Trade Commission Report, quoted in Report 90 at 12):

'If a [money revolving scheme] uses a product that is generally worth what the company claims, it may seem all the more plausible to general participants that the operation is a legitimate business and that, ostensibly, the rewards are being funded from the sale of the product. But such a view misunderstands the funding mechanism that a pyramid uses. Unbeknown to general participants — and whatever the product may or may not be worth — the terms of the . . . compensation plan secure the result that the vast majority will fail to obtain monetary rewards. . . . If, in addition, the . . . promoters also misrepresent the value of the product and can thereby extract additional funds from the participants, the net transfer becomes all the greater for the "winners", while the losses for others increase correspondingly. In my opinion, the value of the product addresses the extent of the harm, not whether a pyramid exists.'

The use of the Internet is a recent development (see, for example, Reports 90, 92, 93, 95 and 98). It makes the schemes far more difficult to regulate and gives the promoters access to world-wide markets. The Committee was, for example, aware that Skybiz was operating in many countries such as America, Canada, New Zealand, Australia, and Qatar. On 6 June 2001, the Federal Trade Commission requested the United

States District Court of the Northern District of Oklahoma to freeze the assets of Skybiz and to appoint a Temporary Receiver. The Committee received the receiver's report on 4 July 2001. It stated that there were 1 946 630 participants in Skybiz, and that 92,65 per cent of them had received no compensation at all, whilst 228 individuals had received 23 per cent of all commission paid.

During the Skybiz investigation, the Committee became aware of another Internet scheme that was operating along the same lines — ZibyCom. ZibyCom is for all intents and purposes Skybiz spelt backwards. The same family that was involved in promoting Skybiz promoted Zibycom. After a short investigation the Committee had no difficulty in concluding that Zibycom was a pyramid scheme.

When the Committee began an investigation into Gold Charity Investment Fund (Pty) Ltd, which purported to sell a 1/10 ounce gold coin endorsed by ex-President Nelson Mandela (a complete untruth), and to raise money for charity (another untruth), the promoters moved their business to the Internet and appeared to be operating from the Caribbean, although this was never established as a fact. The business plan was identical to that of Skybiz, although in the case of Skybiz the product was a website and with Gold Charity it was a gold coin. One of the promoters admitted that he was a Skybiz associate (see Report 95).

The Committee has again launched an 8(1)(b) investigation to re-evaluate the definitions and deal with the new scheme that has emerged, a binary pyramid scheme such as that operated by Skybiz, Zibycom, and Gold Charity. But as long as investors can be convinced that it is easy to make money and they do not question how that money is being made, it is highly unlikely that further regulation will solve the problem. It is also impossible to legislate against greed. In some instances the investors themselves are aware that they participate in an illegal scheme but feel that as long as they can get in early enough they will be able to make their money and get out before the scheme collapses. Perhaps they do not appreciate that the only reason why they are making money is that someone else is losing theirs, and it is for this reason that the actual fact of participating in such a scheme is also a criminal offence. It is not just the promoters of the scheme who are at fault. In some instances where large sums have been invested and lost, curators are trying to trace those who have received payouts and recover these in an attempt to obtain a more fair distribution of loss. This development is welcome, as it is through these high profile cases that the public is warned against participating in such schemes.

Consumer organizations, legislators, and the courts need to work together to make sure that the regulations are effectively enforced. There is also a need for them to improve their understanding of these highly prejudicial schemes. In one instance, during a television programme where a promoter was justifying his scheme, a member of Parliament and

leader of a political party defended the scheme and argued that as Kentucky Fried Chicken is not obliged to reveal its recipe, so this promoter should not be obliged to reveal how he intended to make the 200 per cent return that he was offering. When Skybiz commenced operating in South Africa it was lauded by attorneys, accountants, and members of the Association of Marketers as a 'brilliant idea' and 'a means of bringing the information superhighway to everyone'. This kind of ignorance allows these schemes to flourish.

A further problem is that if investments are to be 'saved' and consumer loss limited, the authorities need to act quickly, often whilst the scheme is still flourishing. This causes a great deal of resentment amongst investors, as they believe that the government is interfering with their constitutional rights. Promoters argue that South Africa has a free-market economy and that the government should not interfere with market forces. But 'it is a laudable aim of government to protect consumers from exploitation even if that exploitation takes place with their enthusiastic co-operation' (Van Dijkhorst J in *Van Rensburg NO v Die Minister van Handel and Nywerheid NO* (TPD 22 October 1998 (case no 22658/98) unreported), a judgment that deals with the Omega Trust pyramid scheme (Report 66)). Further, this argument ignores the ethical and moral issue that such schemes can continue only if gullible and uninformed people are persuaded to participate. Some will make money, but the pool that will eventually lose will just get bigger. As Fitzpatrick (op cit (*Is MLM Legal?*)) notes,

'the free market of sales is converted into a confidence scheme. The only way to win ... is to enter early or to become a master manipulator and deceiver of those you enroll. There's a loser in this game. The trick is to not let it be you.'

These get-rich-quick schemes are inherently fraudulent and it is impossible for promoters to realize the promises that they make to investors. The old adage has never been more accurate than that, in these circumstances, if it sounds too good to be true it probably is (see, generally, the Federal Trade Commission Alert *Profits in Pyramid Schemes? Don't Bank on It*, available at <[www.ftc.gov](http://www.ftc.gov)>).

## Postscript

I hope that the promulgation of the Financial Advisory and Intermediary Services Act 37 of 2002 will assist in radically curtailing the activities of unscrupulous investment advisors. It is expected that this Act will be fully implemented by the end of March 2003 and that the registration and licensing of financial intermediaries and advisors will follow immediately. The Financial Services Board also intends to embark on a high profile consumer education campaign.