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## Illinois Appellate Court Holds that a Marketing Plan Need Not Meet Federal Trade Commission Criteria to Qualify as a Pyramid Sales Scheme

M. E. Welsh

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that if an offset is allowed only when consumers opt for a refund, then consumers will never choose the refund option. A consumer might wish a refund if the defect is immediately apparent or if the consumer is sufficiently dissatisfied to want to purchase a different type of vehicle.

Regarding the defendants' argument that the Chmills would receive a windfall if they were given a new car without an offset for their use of the old car, the court held that it was not unreasonable to allow the Chmills to receive a new car without an offset for use. The Chmills used the vehicle they purchased from Friendly because

Friendly had been unable to repair the defect. Moreover, the Chmills had been required to litigate their claim for over a year and had necessarily used the car during this period.

Finally, the court noted that the Lemon Law provides that the court may award costs, disbursements, and reasonable attorneys' fees, including attorneys' fees for essential appellate work. The court concluded that on remand the trial court should determine reasonable attorneys' fees to award to the Chmills for their appeal. Such an award was necessary to fully enforce the Chmills' rights under the Lemon Law.

**Elbert D. Reniva**

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## **ILLINOIS APPELLATE COURT HOLDS THAT A MARKETING PLAN NEED NOT MEET FEDERAL TRADE COMMISSION CRITERIA TO QUALIFY AS A PYRAMID SALES SCHEME**

In *People ex rel. Hartigan v. Unimax Inc.*, 168 Ill. App. 3d 718, 523 N.E.2d 26 (1st Dist. 1988), the Illinois Appellate Court for the First District concluded that headhunting fees, inventory loading, and endless chains are not required to prove the existence of an illegal pyramid sales scheme.

### **Background**

Unimax, Inc. ("Unimax"), an Illinois corporation, engaged in two separate activities: Unimax Buyers' Service and Unimax Matrix. Unimax Buyers' Service members, or "subscribers," completed an application and paid initial, monthly, and annual fees for the opportunity to purchase products and services at a discount. Subscribers were not obligated to make any purchases and could withdraw from the service at any time and obtain a refund of their unused fees.

Members of Unimax Matrix, or "marketers," signed an "Independent Marketer's Agreement" and were given training in selling memberships in the Unimax Buyers' Service. Unimax required marketers to recruit at least three new subscribers, and to keep themselves and their subscribers up to date on fee payments. Marketers earned monthly commissions on the fees paid by the subscribers they sponsored. They also received commissions on subscription fees from subscribers in their "down-line" organization. Commission rates increased according to

the number of "down-line" subscribers, ranging from 1%, or \$1.08/month, for the first down-line level (three subscribers), to 6% plus a 5% bonus, or \$77,944.68/month, for the ninth level (19,683 subscribers).

Subscribers could become marketers merely by signing the marketer's agreement, but individuals who wished to become marketers without being subscribers were required to pay a "set-up" charge of \$52. Although not required to do so, all 10,874 subscribers had signed marketers' agreements. Approximately 1000 of these signatories were active marketers.

### **Procedural History**

The State of Illinois ("State") brought suit against Unimax and its president, Tim Dern, under the Illinois Consumer Fraud and Deceptive Business Practices Act, ("the Act"). Ill. Rev. Stat. ch. 121 1/2, §§ 261-272 (1987). The State alleged that Unimax's marketing plan was a "pyramid sales scheme" and a "chain referral sales technique" in violation of the Act. The State sought appointment of a receiver and asked the court to enjoin the defendants from selling memberships. Further, the State asked that Unimax provide an accounting, that it be forced to disgorge all profits, and that it be assessed \$50,000.

Unimax argued that its operations were neither a pyramid sales scheme nor a chain referral sales technique as prohibited by the Act. Section 1(g) of the Act defines a "pyramid sales scheme" as one in which a person pays money in exchange for the opportunity to receive a benefit primarily "based upon the inducement of additional persons" to participate in the same plan or operation. Unimax claimed that the tra-

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## **PYRAMID SALES SCHEME** (from page 55)

ditional pyramid scheme offers buyers the right to sell new memberships, thereby moving others to become buyers. Unimax argued that its marketing plan was unlike a typical pyramid scheme because marketers' commissions were determined by the sale of subscriptions and were a percentage of the subscribers' fees. Unimax further distinguished its plan from the traditional pyramid scheme by noting that it did not require its marketers to purchase and retain non-refundable merchandise.

The trial court found that membership in the Unimax Buyers' Service, rather than commissions from sales of memberships, was the benefit received by Unimax marketers. According to the court, this benefit was not primarily based on the inducement of additional subscribers. Therefore, the trial court granted Unimax's motion for summary judgment and the State appealed.

### **Illinois Appellate Court**

On appeal, the State argued that it was possible to infer from the undisputed facts that Unimax's marketing plan was a pyramid scheme. First, the State alleged that Unimax marketers exchanged something of value when they signed the marketer's agreement in that the agreement itself was a form of consideration. Second, the State claimed that the opportunity to receive a benefit—commissions—was unrelated to the sale of goods or services through the Unimax Buyers' Service because commissions could be gained only by inducing others to become members.

Unimax maintained that its practices did not meet the criteria for a pyramid scheme established by the Federal Trade Commission ("FTC"): payment of money by participants in return for the right to sell a product, and for the right to receive, in return for recruiting other participants into the program, benefits unrelated to the sale of the product. Unimax further maintained that its methods were atypical of classic pyramid schemes. Unimax did not require the payment of a large sum of money as an entry fee ("headhunting") nor did it require the purchase

of non-refundable inventory ("inventory loading"). It did not pressure subscribers to recruit new participants, nor did it create endless chains of members. With regard to the allegation that the opportunity to receive commissions was unrelated to the sale of goods or services, Unimax argued that commissions were earned for selling the Unimax system, and not for recruiting others to recruit.

The appellate court held that the trial court erred in granting Unimax's motion for summary judgment. The appellate court stated that the Act, not FTC decisions, sets the proper standard for determining the illegality of a multi-level marketing scheme. Under the Act, unlawful conduct is not limited to headhunting fees, inventory loading and other practices identified by the FTC as part of pyramid schemes. Unimax marketers' commissions were contingent upon the recruitment of new members and the payment of subscription fees by the marketers and their down-line subscribers. Accordingly, there was as much opportunity to earn commissions by inducing additional persons to participate in the plan as there was by selling the Unimax service. It was significant to the court that Unimax levied an extra start-up fee against those who wanted to sell subscriptions without becoming subscribers themselves, and that no individuals had chosen this alternative. All subscribers had signed marketing agreements. The court held that Unimax's emphasis upon recruiting new members rather than on selling the product was evidence of a pyramid scheme.

Based upon these undisputed facts, the appellate court held that the trial court erred in concluding that the benefit received in the multi-level marketing plan was membership in the Buyers' Service. The only apparent way to have obtained a benefit through Unimax's marketing plan was to sponsor new subscribers and to earn commissions on new subscribers' membership fees. Accordingly, the appellate court reversed the order of summary judgment in favor of Unimax and remanded the case to the lower court for further proceedings.

**M. E. Welsh**