What is The Competition Act?

The *Competition Act*, also known as C-34, is a Canadian federal law governing most business conduct. Its purpose is to maintain and encourage competition in Canada. The Act contains both criminal and civil provisions aimed at preventing anti-competitive practices in the marketplace.

The act was introduced by the conservative government of Brian Mulroney and came into effect in 1986. The administration and enforcement of the Competition Act is done by the Competition Bureau,which is also responsible for the administration and enforcement of the Consumer Packaging and Labelling Act, the Textile Labelling Act and the Precious Metals Marking Act.

Sections 55 and 55.1 of The Competition Act

1. **Introduction**

This bulletin describes the nature of, and the differences between, a multi-level marketing plan ("MLM plan") and a scheme of pyramid selling as outlined in sections 55 and 55.1 of the *Competition Act*. It also describes the general principles and policies applied by the Bureau with respect to these provisions.

1. **The *Competition Act***

The *Competition Act* (the "Act") is a law of general application that establishes basic principles for the conduct of business in Canada. The purpose of the Act is to maintain and encourage competition, thereby:

* Promoting the efficiency and adaptability of the Canadian economy;
* Expanding opportunities for Canadian participation in world markets while recognizing the role of foreign competition in Canada;
* Ensuring small and medium-sized enterprises have equal opportunity to participate in the Canadian economy; and providing consumers with competitive prices and product choices.

1. **Role of the Competition Bureau**

The Competition Bureau is an independent agency that contributes to the prosperity of Canadians by protecting and promoting competitive markets and enabling informed consumer choice.

Headed by the Commissioner of Competition, the Bureau is responsible for the administration and enforcement of the *Competition Act*, the *Consumer Packaging and Labelling Act*, the *Textile Labelling Act* and the *Precious Metals Marking Act*.

When there has been a contravention or violation of the law, the Bureau's objective is to correct anti-competitive activities and deter responsible firms and individuals from future anti-competitive conduct. The Bureau also encourages firms to set up corporate compliance programs to ensure they adopt policies and practices that conform with the law.

The Bureau emphasizes education and voluntary compliance to limit the need for contested legal proceedings, and consequently, works to inform businesses and other stakeholders about the laws. through its advocacy program, the Bureau actively promotes a competitive marketplace and contributes to the development of competition policy legislation.

The Bureau's commitment to educating the marketplace is complemented by several forms of voluntary compliance. These range from written opinions, which assist businesses that want to avoid breaking the law, to alternative case resolutions, which correct anti-competitive behaviour in a timely and cost-effective fashion.

Businesses and individuals who disregard the law or fail to take advantage of opportunities for voluntary compliance may be prosecuted by the Public Prosecution Service of Canada in criminal court or be subject to civil litigation by the Bureau before the Competition Tribunal or in a civil court.

1. **Multi-Level Marketing Plans and Schemes of Pyramid Selling Overview**

**4.1 Multi-level Marketing Plans**

An MLM plan is a plan with three or more levels (the operator and at least two levels of participants) that promotes the supply of a product to participants of the plan.

Compensation is earned by participants in the MLM plan based on the supply of the product to participants and/or non-participants of the MLM plan. A legitimate MLM plan focusses on the supply of products rather than the recruitment of prospective participants into the MLM plan and offers products that consumers value and are willing to purchase (certain terms used in this section are defined below).

To prevent the deception of prospective participants, if an operator or a participant makes any representation about the compensation that is or may be earned under the MLM plan, the operator or participant making the representation must disclose the compensation received by typical participants in the MLM plan.

Often a product purchase, such as a distributor kit, is required to participate in an MLM plan. If the operator of an MLM plan requires a person to purchase a product to participate in the MLM plan then the product must be sold at the seller's cost and only for the purpose of facilitating sales.

**Definition of a Multi-level Marketing Plan**

Subsection 55(1) of the Act defines an MLM plan as a plan in which a participant receives compensation for the supply of a product to another participant, who in turn receives compensation for the supply of the same or another product to yet another participant in the MLM plan. Subsections 55(2) and 55(2.1) set out certain obligations relating to compensation disclosure by operators of and participants in MLM plans. Failure to comply with these obligations is subject to criminal penalties as set out in subsection 55(3). The full text of these provisions is set out in Appendix A to this bulletin.

**4.2 Schemes of Pyramid Selling**

A scheme of pyramid selling is a form of an MLM plan focussed primarily on generating earnings through recruitment. These schemes may offer products, however the products may have very little value or the plan may offer limited incentives for their sale. Income in the scheme is derived primarily from the money prospective participants pay to join the scheme and not from the sale of product.

Often schemes of pyramid selling promise huge wealth and financial security to their participants. They usually require the participant to pay to join. This payment may be described as an enrollment fee, a membership fee or an investment into a money-making enterprise. In addition to payment, participants are typically told that they must recruit others into the MLM plan, who in turn must recruit others before they are able to earn any money. Given the finite pool of potential recruits, pyramid schemes are inherently unsustainable and eventually collapse. Although a small number of participants at the top of the pyramid may make money, the overwhelming majority of participants lose their money.

Schemes of pyramid selling are illegal under both the Act and the *Criminal Code*5.

**Definition of a Scheme of Pyramid Selling**

Section 55.1 of the Act defines a "scheme of pyramid selling" as an MLM plan with one or more of the following features:

* Requires a payment for the right to receive compensation for recruiting others into the MLM plan (compensation for recruitment);
* requires purchases as a condition of participation (purchase requirement), other than a specified amount of product at the seller's cost for the purpose of facilitating sales;
* includes inventory loading; or
* lacks a buy-back guarantee on reasonable commercial terms or participants are not informed about the guarantee.
* It is a criminal offense to establish, operate, advertise or promote a scheme of pyramid selling.

1. **Working Definitions of Key Terms**

This section sets out the Bureau's working definitions of certain key terms used in this bulletin and/or the MLM provisions of the Act. These terms are not defined in the Act

**5.1 Operator**

An operator is a person or entity who is responsible for an MLM plan. An MLM plan may have more than one operator. For example, if an MLM plan is operated by a corporation, any individual who is the directing mind of the corporation, or who directs the making of a representation relating to compensation on the corporation's behalf, is also responsible for ensuring compliance with the MLM provisions of the Act.

**5.2 Prospective Participant**

A prospective participant is an individual who has expressed interest in joining an MLM plan or who has been approached by a current participant or the operator of the MLM plan to supply the product to others with the prospect of earning compensation under the MLM plan.

**5.3 Participant**

A participant in an MLM plan is an individual who actively engages in the activities necessary to realize the benefits of the MLM plan. A participant in an MLM plan has joined the MLM plan, has the right to sponsor others in the MLM plan and has the right to sell products to others.

**5.4 Typical Participants**

Typical participants are representative of the smallest range of compensation earned by over 50% of the participants in the MLM plan. Where an MLM plan sets out defined levels of compensation and no single level accounts for the majority of participants (greater than 50%), reference must be made to the *fewest* levels that together, include a majority of the participants. Thus, the average compensation of participants in an MLM plan is not normally considered to reflect the compensation that typical participants receive or are likely to receive, because the average can be skewed upward by a few high income earners. For the purposes of this calculation the Bureau excludes individuals who have been participants for less than one year.

**5.5 Representations Relating to Compensation**

A representation relating to compensation is any statement, declaration or image that conveys a message about the compensation a person could expect to earn as a participant of an MLM plan. A representation relating to compensation is not limited to a dollar figure or monetary range, but may also include:

* Representations about obtaining, as a result of compensation under the MLM plan, luxury goods such as vehicles, jewellery, watches, homes and vacation destinations (this could include images of such luxury items, where the general impression created by the context in which the images appear is that the items can be obtained as a result of compensation under the MLM plan);
* Promises of opportunities to earn bonuses, commissions and other financial rewards;
* Profiles of individuals who have been unusually successful in earning money in the MLM plan;
* Similar representations as those above that are made in testimonials; and
* Testimonials from people who claim that, as a result of compensation under the MLM plan, they were able to improve their quality of life, quit their jobs or eliminate all their debts.

**5.6 Operator's Cost or Seller's Cost**

Operator's or seller's cost is the cost that the operator of an MLM plan or another seller incurs to acquire a product. This includes their direct costs of labour, materials, handling and shipping, but does not include any mark-up by the seller or allocation of indirect (overhead) costs. Thus, where a participant in an MLM plan gives consideration for a certain amount of product as a condition of participating in the plan, the Act requires that the operator or other seller supply the product to the participant at a price no greater than the cost incurred by the operator or other seller to produce or acquire the product.

**6. Disclosure Requirements**

Subsection 55(2) prohibits an operator or a participant of an MLM plan from making representations relating to compensation to a prospective participant without fair, reasonable and timely disclosure of the information within the knowledge of the operator or the participant relating to:

1. Compensation actually received by typical participants in the MLM plan; or (*b*) compensation likely to be received by typical participants in the MLM plan, having regard to any relevant considerations including the factors listed in paragraph 55(2)(*b*) (these factors are discussed in the section about new MLM plans).

Subsection 55(2.1) requires an operator of an MLM plan to ensure that any representations relating to compensation under the MLM plan that are made to a prospective participant by a participant of the MLM plan or a representative of the operator, constitute or include fair, reasonable and timely disclosure of the information within the knowledge of the operator relating to:

1. Compensation actually received by typical participants in the MLM plan; or
2. Compensation, likely to be received by typical participants in the MLM plan, having regard to any relevant considerations including the factors listed in paragraph 55(2)(*b*). Subsection 55(2.2) provides that an operator shall not be convicted of an offence under subsection 55(2.1) if the operator establishes that he or she took reasonable precautions and exercised due diligence (see section 6.4 — *Due Diligence*) to ensure that no representations relating to compensation under the plan were made by participants or representatives of the operator, or that any representations made by participants or representatives of the operator constituted or included fair, reasonable and timely disclosure.

**9. Penalties**

The penalties upon conviction for contravening the MLM plan provisions are set out in subsection 55(3) of the Act. The penalties upon conviction for contravening the scheme of pyramid selling provisions are set out in subsection 55.1(3) of the Act.

**Appendix A**

**Section 55 and 55.1 of the *Competition Act***

**Multi-level Marketing Plan**

55. (1) For the purposes of this section and section 55.1, "multi-level marketing plan" means a plan for the supply of a product whereby a participant in the plan receives compensation for the supply of the product to another participant in the plan who, in turn, receives compensation for the supply of the same or another product to other participants in the plan.

(2) No person who operates or participates in a multi-level marketing plan shall make any representations relating to compensation under the plan to a prospective participant in the plan unless the representations constitute or include fair, reasonable and timely disclosure of the information within the knowledge of the person making the representations relating to

* compensation actually received by typical participants in the plan; or
* compensation likely to be received by typical participants in the plan, having regard to any relevant considerations, including
  1. the nature of the product, including its price and availability,
  2. the nature of the relevant market for the product,
  3. the nature of the plan and similar plans, and
  4. whether the person who operates the plan is a corporation, partnership, sole proprietorship or other form of business organization.

(2.1) A person who operates a multi-level marketing plan shall ensure that any representations relating to compensation under the plan that are made to a prospective participant in the plan by a participant in the plan or by a representative of the person who operates the plan constitute or include fair, reasonable and timely disclosure of the information within the knowledge of the person who operates the plan relating to

* compensation actually received by typical participants in the plan; or
* compensation likely to be received by typical participants in the plan, having regard to any relevant considerations, including those specified in paragraph (2)(*b*).

(2.2) A person accused of an offence under subsection (2.1) shall not be convicted of the offence if the accused establishes that he or she took reasonable precautions and exercised due diligence to ensure

1. that no representations relating to compensation under the plan were made by participants in the plan or by representatives of the accused; or
2. that any representations relating to compensation under the plan that were made by participants in the plan or by representatives of the accused constituted or included fair, reasonable and timely disclosure of the information referred to in that subsection.

(3) Any person who contravenes subsection (2) or (2.1) is guilty of an offence and liable

1. on conviction on indictment, to a fine in the discretion of the court or to imprisonment for a term not exceeding five years or to both; or
2. On summary conviction, to a fine not exceeding $200,000 or to imprisonment for a term not exceeding one year, or to both.

The Competition Act: Comprehension and Analysis Questions:

1. In your opinion, how effective is *The Competition Act* in “ensuring small and medium-sized enterprises have equal opportunity to participate in the Canadian economy; and providing consumers with competitive prices and product choices”?
2. How is compensation earned in a typical MLM scheme?
3. What is required to participate in an MLM scheme?
4. In your opinion, what issues exist in regards to “representation relating to compensation”?
5. What penalties exist in regards to violations of *The Competition Act*?
6. In your small group, research a business with operations in Canada that meets the criteria of an MLM as defined by *The Competition Act*. Please note that this document contains an edited version of *The Act*. The full *Act* may be found on-line.