ESTABLISHMENT OF AN APPROPRIATE REGULATORY FRAMEWORK FOR DIRECT SELLING IN INDIA

PREFACE

1. Direct selling has no universally accepted definition. However, for the sake of convenience, it can be stated that, direct selling refers to selling of goods and services to the consumers away from a fixed retail outlet, generally in their homes, workplace etc., through explanation and demonstration of the product by direct sellers. Unlike in the case of formal (i.e., selling through defined channels) selling, seller would take the buyer into confidence to sell the products. Direct selling adopts mouth-to-mouth dissemination of information, than advertisement. Therefore, there are several advantages.
2. Although direct selling has taken a refined shape in the contemporary era, was known to Indians for more than 100 years. The old experience of our villagers procuring goods & services at their doorsteps is testimony to this fact. One of the business families, which are known to me closely, started their business of selling oil, which they took to the doorsteps of the consumers, without having any fixed shop.
3. In such instances, the seller use to have; not only direct sales, but also establishes a personal relationship with his/her buyers. Inevitably and incidentally, due to this personal rapport, some other services, like investment advise, other useful market/product information etc., are given to the buyers.
4. As known by us, this 'direct selling' today has taken gigantic proportions with formal outlook. Wherein not

only Indian but foreign partners have invested in to this sector.[1] **As a natural consequence of this huge investment and turnover; people are talking about establishment of an overarching regulatory environment for the direct selling industry.**

5. This sector is one of the fastest growing non-store retail formats, recording double digit growth in the post-reform period.[2] Obviously the growing Indian market has attracted a large number of Indian and foreign direct selling companies. As per the IDSA estimate by 2019-20 the net-worth of direct selling industry would be INR 34,000 crore. It has consistently demonstrated double-digit growth since last decade; and is more than some of the sectors like, steel, textile, IT & BPM services.
6. Higher employment, women employment and skill development are among the best of the benefits of encouraging a direct selling industry. 40.6 million men and 59.4 million women are employed in the direct selling industry today. [3] Financial independence, development of personal and business skills, flexible timings and an improved ability to take care of their respective families are among the other critical benefits.
7. Without going further into the benefits of direct selling industry; nor its contribution to the economy (as there are number of studies done in this regard) – it is worth

[1] The total fiscal contribution of direct selling industry is INR 9,869 million during 2012-13.
[2] As per IDSA the growth of Direct Selling in India is 12.2% during the financial year 2012-13.
[3] Annual Survey Report 2012-13 of IDSA.

taking recourse to some of the causes of concern expressed in the recent past. In other words, the exact point of reference to undertake this study by FICCI.

8. There are few unfortunate incidents reported from several states across India where enforcers have confused with genuine direct selling personnel with those who are running *ponzi* schemes; and are booked under **The Prize Chits & Money Circulation Schemes (Banning) Act, 1978** (hereinafter referred to as PCMC Act).
9. Undoubtedly there are considerable numbers of fraud companies, who in the name of direct selling dupe the innocent customers. In fact either without a product or with a token/sham product they run money circulation schemes. Justifiably PCMC Act is to be applied to them, so that innocent investors/customers are protected. However, as indicated above genuine direct sellers are booked under PCMC and victimized. There are number of reported instances of police harassing genuine distributors as well.
10. If this trend, of use of PCMC for genuine direct selling agencies, were not arrested, would finally lead to demolishing the direct selling industry itself.
11. Undoubtedly, such a development would also deprive the society of the 'value' and benefit created by the direct selling industry so far. **Moreover the need of hour is to have a balanced strategy developed whereby fraud companies are eliminated – so that**

consumer interest is better protected and genuine player's interest is safeguarded.

INTRODUCTION

12. The PCMC Act is the direct out come of the report of James S. Raj Committee constituted by RBI in June 1974.[4] *Inter alia*, this Study Group advocated for banning of prize chits / benefits / savings schemes; and also suggested to have a law to ban these activities.

13. In the opinion of the Study Group – these activities (viz. prize chit / benefit / savings scheme etc.,) benefit primarily promoters and do not serve any social purpose. On the contrary, they are prejudicial to the public interest and also adversely affect the efficacy of fiscal and monetary policy. Such schemes, the Group felt, by whatever name called, should be totally banned in the larger interest of pubic policy.

14. While recommending for the ban of such activities through law; the Study Group made the following important recommendations –

    a. That the law should be a Central Act, which would ensure uniformity in the provisions applicable to

[4] In June 1974 the RBI had constituted a Study Group under the Chairmanship of Shri. James S. Raj, the then Chairman of Unit Trust of India, for examining in depth the provisions of Chapter III-B of the Reserve Bank of India Act, 1934, and the directions issued thereunder to non-banking companies in order to assess their adequacy in the context of ensuring the efficacy of the monetary and credit policies of the country and affording a degree of protection to the interests of the depositors who place their savings with such companies. In its report submitted to the RBI in July 1975 – the group observed that the prize chit/benefit/savings schemes benefit primarily the promoters and do not serve any social purpose. On the contrary the Group has stated that they are prejudicial to the public interest and affect eh efficacy of the fiscal and monetary policies of the country.

chit fund institutions throughout the country, would also prevent such institutions from taking undue advantage either of the absence of any law governing chit funds in any State or exploit the benefit of any lacuna or relaxation in any State Law by extending their activities to such States;

b. The administration of the proposed legislation should be left to the State Government concerned which, in turn, may seek the advice of Reserve Bank on policy matters;

c. Private limited companies as also unincorporated bodies on a restricted scale may continue to be allowed to run chits; and

d. Chit fund institutions may be prohibited from accepting deposits except as advance payments of subscriptions or deposits from the prized subscribers by way of security towards payments of their future installments.

15. For the benefit of our current context it may be repeated that, the PCMC Act banns the promotion of any prize chit or money circulation scheme by whatever name called, and participation of any person in such chit or scheme. Sub-section (c) of Section 2 of the PCMC Act defines **'money circulation scheme'** as follows:

> *"Money Circulation Scheme means any scheme, by Whatever name called, for the making of quick or Easy money, or for the receipt of any money or valuable thing as the consideration for a promise to*

pay money, on the event or contingency relative or applicable to the enrollment of members into scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions".

16. Section 3 of the Act banns these activities by stating that

"No person shall promote or conduct any prize chit or money circulation scheme or enroll as a member to any such chit or scheme, or participate in it otherwise, or receive or remit any money in pursuance of such chit or scheme".

17. Section 4 of the Act imposes a penalty for contravening the provisions of section 3 stated above. It contemplates – imprisonment for a term of 3 years or with fine up to five thousand rupees, or with both. It also states that, unless there is a special reason the minimum imprisonment shall necessarily be for a period one year as penalty.

18. Any one related to such banned activities under the act; and attempting to promote such activities are also liable to be imprisoned for a term up to two years or with fine up to three thousand rupees; or with both.[5] Again

[5] Like one who (i) prints or publishes any ticket, coupon or other document for use in the prize chit or money circulation scheme; (ii) sells or distributes or offers or advertises for sale or distribution, or has in his possession ofr the purpose of sale or distribution any ticket, coupon or other document for use in prize chits or money circulation scheme; or (iii) prints, publishes or distributes or has in his possession for the purpose of publication or distribution; (iv) brings, or invites any person to send, for the purpose of sale or distribution any ticket, coupon or other document for use in the prize chit or money circulation

there is a stipulation that, unless there is a very special reason the minimum imprisonment shall be at least for one year.

19. Shri. James S. Raj Committee intends to ensure the efficacy of monetary and credit policies of the country and affording a degree of protection to the interests of the depositors who place their saving with such companies, as its central theme. **To achieve such a broader objective, the Committee suggested to ban prize chit / benefit / savings schemes, who only benefit primarily the prompters and do not serve any social purpose.**

20. This is the underlying policy objective which the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 attempts to achieve. It must be *prima facie* observed that application of PCMC Act to the direct selling industry is rather accidental by enforcers and unintended by the legislators, provided the direct selling model is genuine.

THE MIS-APPLICATION OF PCMC ACT TO GENUINE DSCs

21. There are few instances where enforcement agencies have invoked the PCMC Act to the genuine direct selling companies, which has created considerable worry among genuine players; and a felling that, unless

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scheme or any advertisement of such prize chit or money circulation schemes; or (v) uses any premises, or causes or knowingly permits any premises to be used, for purposes connected with the promotion or conduct of the prize chit or money circulation scheme; or (vi) causes or procures or attempts to procure any person to do any of the abovementioned acts.

such misapplication is remedied immediately – the entire industry may get hit.

22. Closer examination of these cases demonstrate that, the enforcement agencies have failed to distinguish between *'money circulation schemes',* which the PCMC Act bans and genuine *'multi-level marketing schemes'* organized for the legitimate purpose of selling quality products to customers. **In other words the State (enforcement) agencies have failed to understand the nuances of the direct selling business v/s pyramid schemes.**

23. This has led to formidable hardship for the genuine players – as the stipulations of PCMC law are pretty harsh. There was an instance of a top managerial personnel of a direct selling company remanded to the custody as well.

24. The issue of distributor reward is another critical issue needing attention. A distributor with no active selling or with nominal selling may earn enormous rewards (commission, reward, incentive etc.) – if his recruitments can perform well. Direct selling companies highlight such high incentivizing opportunities in IEC materials published. This creates an impression that, direct selling activity or multi-level marketing enables earning of 'easy money' among certain enforcers (especially police).

25. To remedy the situation created by misapplication of law there are many suggestions made. Amending of

the PCMC Act, passing of a dedicated law to govern direct selling industry are among the prime suggestions in this regard.

THE WAY OUT

26. The Direct Selling Industry in India contemplates the following possible solutions, to over come the haunting PCMC Act's misapplication:

a. Amending subsection (c) of Section 2 of the PCMC Act - to bring out clearly the distinction between *'pyramid scheme'* or *'money circulation scheme'* and *'multi-level marketing'* schemes run by the direct selling industry. It is also suggested to add an 'explanation' to amplify that direct selling is not to be interpreted as money circulation scheme, as long as there is no pyramid structure involved.

b. Have a dedicated Central legislation enabling the smoother operation of direct selling companies (of course the genuine ones). This suggestion is on the lines of few countries in the world where specific legislation are in vogue. Such legislation may also formalize the IDSA Code of Ethics.

c. The contemplated dedicated law may take into its ambit issues like – introduction of a licensing cum registration system for direct sellers, prohibitions on certain categories of products, restrictions on collecting money, cooling off period (the period during which the consumers may cancel the contract) etc.;

27. In addition there are interesting suggestions, brought to our notice collaterally, as follows:

a. Amending the Sale of Goods Act, 1930 (few provisions);

b. Amending or amplifying Section 2(r) of the Consumer Protection Act, 1986; and

c. Amending of the Constitution.

EVALUATION OF THE OPTIONS

28. Which of these above options, or permutations and combination of the options, is practical; or any other independent option suitable to help the cause? is the question to be answered.

29. Although having a dedicated law for Direct Selling Industry is making vigorous circles and been favored by many, appears to be hard to achieve target as of now. The past attempts made by the industry in this regard, have yielded no results.

30. The *Loksabha* debated the demand for a separate dedicated legislation in 2002, and the need for the same was examined in detail with all concerned ministries.[6] However, the need for a separate legislation was not felt in view of the fact that there were adequate provisions already existing in the Sale of Goods Act, 1930; the Indian Contract Act, 1872; and of course the Consumer Protect Act, 1986.

[6] This was in response to *Loksabha* unstarred question No. 4875 dated December 12, 2002.

31. Therefore, it is extremely difficult to overcome the exiting opinion of the above ministries and to convince the Government to bring a new law again.

32. The assessment of the inter-ministries is correct that, all the issues pertaining to direct selling industry are capable of addressing through the existing law. The only impeding element for the direct selling industry is the wrong application of PCMC Act. This impediment is curable without getting to the route of having a dedicated law. Therefore, for the sake of clarity, once again it may be stated that - if the object of the direct selling industry is to overcome the misapplication of PCMC Act – then, instead of working for a dedicated statute – work toward creating a situation, in which PCMC Act will not be applied to a genuine Direct Selling Company.

33. It must be noted that, bringing a dedicated law will not resolve the issues in hand. The new law should also imperatively have a regulatory/enforcement agency to implement. This would create another regulatory agency, and until they attain the optimal performing level this burning issue will certainly continue.

34. Bringing another law will not nullify the effect of PCMC Act, which will still continue to operate. Harmonizing the new regime (to be created for the implementation of dedicated law) and other existing regulators is going to be critical; and unless achieved to the perfect level, the present danger of misapplication of PCMC Act might continue.

35. **Notwithstanding all these logical reasons the Central Government might not be interested in sponsoring a law and a regulatory agency.**

36. Therefore, at the cost of repetition it must be mentioned again that, it is myth to think that bringing a new law alone will bring the desired change. In theory this might appear attractive, but practically not achievable. Misapplication of PCMC Act is being diagnosed as the issue for attention. For addressing such an issue – it might not be necessary to have another dedicated law.

37. Dedicated laws do exist in some jurisdictions. Singapore, Malaysia, United Kingdom, some states in USA are examples where dedicated statutes regulate the direct selling industry. Therefore India should also have a similar Act too – would be a weak argument to press for a dedicated law.

38. During our consultations with FICCI (the task force formed for the purpose) and other key members of Direct Selling Industry, this option was heavily seconded and all exhibited unfounded zeal to go for a new-dedicated Central legislation. But it appears to be an idealistic solution only.

THE PRAGMATIC APPROACH

39. Tweaking the existing provisions of PCMC Act may be the pragmatic way to bring clarity to the issue. This will remedy the misapplication of PCMC Act to genuine

direct selling players, of course with far little effort compared to have a dedicated law passed.

40. As referred above Sec. 2(c) of the PCMC Act is pushed for an amendment. Said sub-section defines 'money circulation scheme' and bans money circulation schemes, irrespective of any name that is being used. The definition of 'money circulation scheme' is central to the enactment.

41. The suggestions are that – an exception be created within Sec. 2(c) so that it is clear that, PCMC Act does not get attracted – if it is a genuine 'multi-level marketing' scheme. In addition there is contemplation that, an 'explanation' be added to sub-section [i.e., Sec. 2(c)] to further clarify the point.

42. Sub section (c) of Section 2 is clear and emits the mandate of the PCMC law, that prize chits, money circulation schemes, by whatever name they may be called, which do not bring public value; and where the chance of innocent investors being lured to loose their money – are to be banned. Following extract will bring out the exact intent of the Committee:[7]

[7] The Banking Commission constituted by the Government of India to review *inter alia* 'the role of various classes of non-banking financial intermediaries, to enquire into their structure and methods of operation and recommend measures for their orderly growth', made certain recommendations in 1972. These recommendations were examined by the Reserve Bank of India, and as per its opinion – Government of India decided that the relative provisions of the Reserve Bank of India, 1934 and the directions issued thereunder to non-banking companies may be reviewed to plug loopholes, if any, which were being taken advantage of, particularly by private limited companies. With the view of examining this matter in all its aspects, the Reserve Bank of India by constituted the James S. Raj Committee in 1974.

"From the foregoing discussion, it would be obvious that prize chits or benefit schemes (meaning money circulation schemes) benefit primarily the promoters and do not serve any social purpose. On the contrary, they are prejudicial to the public interest and also adversely affect the efficacy of fiscal and monetary policy. There has also been a public clamor for banning of such schemes; this stems largely from the malpractices indulged in by the promoters and also the possible exploitation of such schemes by unscrupulous elements to their own advantage. We are, therefore, of the view that the conduct of prize chits or benefit schemes by whatever name called should be totally banned in the larger interests of the public and that suitable legislative measures should be taken for the purpose if the provisions of the existing enactments are considered inadequate. Companies conducting prize chits, benefit schemes, etc., may be allowed a period of three years which may be extended by one more year to wind up their business in respect of such schemes and/or switch over to any other type of business permissible under the law".[8]

43. The PCMC Act, as stated above, is direct result of the recommendation of the James Raj Committee. The central focus of the enactment is to ban prize chits and

[8] Para 6.11 (page No. 133-134) of the Committee Report.

money circulation schemes, which do not serve any 'social purpose', or serve the cause of 'public policy'.

44. Further the strategy of law is to impose criminal liability upon those who attempting to run money circulation scheme, in whatever name called.

45. In *State of West Bengal and Others v Swapan Kumar Guha & Others*, the Hon'ble Supreme Court got an opportunity to excavate the true meaning of Sec. 2(c) of the PCMC Act.[9] Although facts leading this case were not from direct selling industry, the court encountered with the challenge of finding the real meaning behind of PCMC Act and more particularly sec. 2(c).

46. The apex court felt that, it is far too vague and arbitrary to prescribe that 'whosoever makes quick or easy money' is to be penalized under the statute. After due deliberation the court laid down as follows:

> *"Two conditions must, therefore, be satisfied before a person can be held guilty of an offence under Sec. 4 read with Sections 3 and 2(c) of the Act. In the first place, it must be proved that he is promoting or conducting a scheme for the making of quick or easy money and secondly, the change or opportunity of making quick or easy money must be shown to depend upon an event or contingency relative or applicable to the enrolment of members into that scheme. The legislative draftsman could have thoughtfully foreseen and avoided all reasonable*

[9] (1982) 1 SCC 561.

controversy over the meaning of the expression 'money circulation scheme' by shaping its definition in this form".[10]

47. In the light of direct selling industry it must be further stated that, merely because the enrollment of members into the selling scheme happens would not entitle the scheme to be brought under PCMC Act. It has to be further proved that, there is no 'social purpose' and detrimental to the 'larger interest of public' as indicated in the James Raj Committee. This logical conclusion be arrived after combined reading of the Supreme Court's judgment and the James Raj Committee's Report.

48. **The PCMC Act, in its true spirit does not apply to Direct Selling Companies, who develop multi-level marketing schemes, with distributors developing their chain by recruitment. The sole motive of the recruitment is to develop a sales chain through these recruiters. The new recruiters are generally advised to purchase the products for cash and then sell them to prospective customers**.

49. However, the problem is determination of law by judiciary after due process; but the time taken by the judicial process, and also the immediate impact after FIR or private complaint is lodged. By the inadvertence of enforcement authority (i.e., the police) if PCMC Act is invoked salvaging the situation become extremely

[10] Para 09 of the judgment.

difficult. The difficulty aggravates further, due to the fact that, the offences of PCMC are non-bailable in nature.

50. Therefore the suggestion of amending Sec. 2(c) may not provide a real solution. It is accepted fact that, there are good numbers of fly-by-night operators against whom the PCMC Act may be effectively used. If an amendment in to the definition is carried out; and direct selling industry' is taken out of the purview of Sec. 2(c) – then containing fake direct selling schemes might become difficult. (add)

51. Moreover, unless the term 'direct selling' or 'multi level marketing' etc., are defined clearly –amending Sec. 2(c), as suggested would become practically impossible.

52. Moreover, like now, if the PCMC Act is invoked by the enforcement agencies like police – then judicial decision, as to whether, Sec. 2(c) in its amended format is applicable or not will take the same tedious route as of now.

53. Instead of Sec. 2(c), Sec. 11 of PCMC Act may be amended to add another sub-clause to the existing category. Section 11 of the Act exempts certain prize chits or money circulation schemes promoted by – (i) a State Government or any officer or authority on its behalf; or (ii) a company wholly owned by a State Government which does not carry on any business other than the conducting of a prize chit or money circulation scheme, whether it is in the nature of a conventional chit or otherwise; or (iii) a banking company as defined in the

Banking Regulation Act, 1949 or a banking institution notified by the Central Government under section 51 of the Act or the State Bank of India constituted under Sec. 3 of the State Bank of India Act, 1955; or a subsidiary bank constituted under sec. 3 of the State Bank of India (Subsidiary Banks) Act, 1959; or a corresponding new bank constituted under Sec. 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970; or a Regional Rural Bank established under Sec. 3 of the Regional Rural Banks Act, 1976; or a Co-operative bank as defined in clause (b)(ii) of Section 2 of the Reserve Bank of India Act, 1934; or (iv) any charitable or educational institution notified in this behalf by the State Government, in consultation with the RBI.

54. **By amendment – another additional clause exempting 'any direct selling scheme duly certified as may be prescribed' be added as sub-clause (e) to Section 11.**

55. Further to the amendment an executive agency may be identified to study the direct selling schemes of the companies. After due study and verification such executive agency may certify that the scheme to be a genuine direct selling scheme. Once certified by such 'competent authority' (i.e., the government agency) vide above contemplated amendment – the application of PCMC Act is taken out.

THE ROLE OUT STRATEGY

56. The PCMC Act is a Central legislation; with rule making power under the Act has been delegated to the concerned State Governments. Therefore, although passed by Parliament, the law is to be enforced by the State Governments at the ground level. Sec. 13 of the PCMC Act delegates to the State Governments to frame necessary rules, in consultation with the Reserve Bank of India.

57. The proposed amendment to the Sec. 11, as proposed by this Report, of the PCMC Act has to be by the Parliament. The move to amend the statute may move from the concerned department of Ministry of Finance.[11] Otherwise Ministry of Consumer Affairs or Ministry of Industry & Commerce can also initiate the move for amendment as well.

58. A suitable executive agency has to be identified, at a state level, which can study the 'direct selling models' and certify that, the PCMC Act's application is eliminated.

59. For such certification – the State Consumer Councils[12] may be identified as a 'Competent Authority'.

60. **For the sake of clarity – it is stated that there is no need to amend any of the provisions of either the Sale of Goods Act, 1930 or The Consumer Protection Act, 1986. The same is the case with the Constitution of India as well.**

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[11] The Department of Financial Services is currently pilots the PCMC Act, and deals in 'chit funds'.

[12] Established by the concerned State Government under Sec. 7 of the Consumer Protection Act, 1986.

61. Finally the reward/commission etc., to the distributors is concerned – it has to be made clear that, the issue is purely a perceptional one. Therefore may not be combated effectively by law.

62. However, the observation of the Apex Court in *State of West Bengal v Swapan Kumar Guha & Others* is worth noting in this regard:

> *"Besides, speaking of law and morals, it does not seem morally just or proper to say that no person shall make quick or easy money, especially quick. A person who makes quick money may do so legitimately by the use of his wits and wisdom and no moral turpitude may attach to it. One need not travel after to find speaking examples of this. Indeed, there are honourable men (and now women) in all professions recognized traditionally as noble, who make quite quick money by the use of their talents, acumen and experience acquired over the years by dint of hard work and industry. A lawyer who charges a thousand rupees for a Special Leave Petition lasting five minutes (that is as far as a judges imagination can go), a doctor who charges a couple of thousands for an operation of tonsillitis lasting ten minutes, an engineer, an architect, a chartered accountant and other professionals who charge likewise, cannot by any stretch of imagination be brought into the drag-net of clause (c). Similarly, there are many other vocations and*

business activities in which, of late, people have been notoriously making quick money as, for example, the builders and real estate brokers. I cannot accept that the provisions of Clause (c) are directed against any of these categories of persons. I do not suggest that law is powerless to reach easy or quick money and if it wills to reach it, it can find a way to do it. But the point of matter is that it will verge upon the ludicrous to say that the weapon devised by law to ban the making of quick or easy money is the provision contained in Sec. 2(c) of the Prize Chits and Money Circulation Schemes (Banning) Act".

END OF THE REPORT.