



**SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
(COMPANY LAW DIVISION)
CORPORATIZATION & COMPLIANCE DEPARTMENT**

Before

Nazir Ahmad Shaheen
Executive Director (C&CD)

Present for the Company: Mr. Babar Siddiqui, Company Manager,
alongwith Mr. Walid Iqbal, Advocate and
Zeeshan Ijaz from KPMG

Dates of hearing August 18, 2011, October 5, 2013 and July 24,
2013

In the matter of

**M/s Oriflame Cosmetics Pakistan (Private) Limited
Sanction under Section 309(b) of the Companies Ordinance 1984**

M/s. Oriflame Cosmetics Pakistan (Pvt) Limited (the "Company") was incorporated on 09.09.2008, with the Company Registration Office, Lahore (hereinafter referred to as the "CRO"). Its registered office is situated at 130-A-E-1, Main Boulevard, Gulberg-III, Lahore. The authorized capital of the Company is Rs. 50,000,000 divided into 5,000,000 shares of Rs. 10/- each and paid up capital is Rs. 49,854,520 divided into 4,985,452 shares of Rs. 10 each. The principal business activities of the Company as mentioned in its Memorandum of Association are as follows:

- (i) To purchase, sell, import, marketing, distribution, wholesale, retail, and deal in natural skincare, cosmetics, accessories, clothing and nutrition products as well as any other activity not prohibited under the laws of Pakistan.



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- (ii) To own, run, manage and open stores, etc in and outside Pakistan and to buy, sell, import and export all kinds of natural skincare, cosmetics, accessories, clothing and nutrition products.

2. The Securities & Exchange Commission of Pakistan (hereinafter referred to as the "Commission") received a complaint from Syed Waseem Fawad through an email dated 08.02.2011 wherein it was alleged that the Company was involved in the business of launching, promoting, offering, etc. of Multi-Level Marketing (MLM)/Pyramid scheme. On which, the CRO conducted a preliminary inquiry to probe the matter and to see if the Company was actually involved in the business of illegal MLM/Pyramid Schemes. From the perusal of the report, it was noticed that the Company had started the registration of members by persuading them to invite others to join and to earn money on group sales. It was also observed that the Company was carrying on MLM/Pyramid Schemes business which is *ultra vires* and beyond the scope of its objects set forth in its Memorandum of Association.

3. Subsequently the CRO sent a reference to this office on 05.05.2011 and sought previous sanction of the Commission in terms of section 309 (b) of the Companies Ordinance, 1984 ("the Ordinance") to file a winding up petition before the Honorable Lahore High Court, Lahore in terms of section 305 (f) (i), (ii) of the Ordinance.

4. After considering the contents of the reference sent by the CRO, a notice dated 23.06.2011 was issued to the Chief Executive and the Directors of the Company in order to afford an opportunity of being heard before granting the sanction to present winding up petition in terms of proviso to Clause (b) of Section 309 of the Ordinance. The contents of the Notice *inter alia* stated that the Company is engaged in dubious activities like MLM/Pyramid schemes which are not permitted by its Memorandum of Association where people are induced to enroll after paying a membership fee of Rs. 498. On becoming a member, members are motivated to sell the Company's products as well as to broaden the network by introducing more members. The members are told that they can earn additional income in two ways; first to purchase the cosmetic



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products from the Company at a discount of 25% and then sell them to people as per their own prices and secondly by introducing new members and redeem their sales. This system is points based and on each product sold by the member and the members introduced by him/her or on each new member introduced, the parent member earns bonus points. These points are calculated at the end of specified periods and converted into monetary rewards in typical pyramid style, which is hallmark of multi-level marketing. At every hearing the Company was advised to do the business in prudent manner.

5. In response to the aforesaid notice, the Company filed a reply vide its letter dated 17.08.2011. A hearing was conducted on 18.8.2011 at Islamabad. Subsequently another hearing was held on 05.10.2011 at CRO and on 24.07.2013 at Islamabad when detail arguments were made by Mr. Walid Iqbal, Counsel for the Company (the "Counsel") who also filed written arguments and also argued the case verbally in length as well.

6. It has been argued by the learned Counsel that the Company is not involved in any dubious activities or running of pyramid schemes. In fact the Company is doing the business of the import, marketing, distribution and sale of cosmetics and skincare products in Pakistan under an entirely lawful, legitimate, and globally recognized multilevel marketing (MLM) mechanism. The Company is engaged in achieving through an MLM arrangement, which has been designed to extend incentives to the Company's independent sales consultants to enhance sales. It was submitted that the products are available at warehouse and are ready for inspection. As regard the enrollment fee of Rs. 498 being collected from members, it was contended that such fee hardly contributes 4% to 5% of the annual revenue of the Company. There is no illegality or prohibition under any law involved in charging membership or enrolment fee by the manufacturer, importer, indenter or stockiest of products from its distributors, agents, consultants or franchisees. The learned Counsel also referred to the



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publications of the Company in the shape of a Success Plan-Leadership Edition, Catalogue No. 4 of 2011 and Starter Kit issued by the Company for use of its members.

7. The learned Counsel denied that Company is engaged in pyramid schemes or doing business beyond the scope of its memorandum of association. It has been stated that the objects for which the Company is established include but are not limited to the import, indenting, marketing, distribution, and sale of cosmetics, skincare accessories, clothing and nutrition products in Pakistan, and the Company is entitled to carry on such business in any lawful manner. However, the Company's involvement in MLM business through lawful, legitimate, and globally recognized method has not been denied by him. He also explained the difference between an MLM based business and a Pyramid scheme and submitted that these both are completely distinguishable from each other and submitted that MLM is a lawful method of business as compared to a Pyramid Scheme.

8. The learned Counsel of the Company also stated that the provisions of Sections 305 (f) (i), (ii) and 309 (b) of the Ordinance are not applicable in the instant circumstances as no law has been cited whereby the Company is said to be conceived or has been carrying on unlawful or fraudulent business. It was contended that the allegation of fraud against the Company is baseless and unfounded. The Counsel submitted that the fraudulent activity means and includes a suggestion of a fact by one who does not believe it to be true and which is not true, active concealment of a fact by one having knowledge or belief of the fact, a promise made without any intention of performing it, any other act fitted to deceive, or any such act or omission which the law specifically declares to be fraudulent, however, the Company's business does not fall within the ambit of the foregoing explanation.

9. The learned Counsel of the Company also explained about the international scope of business of the Company. It has been stated that the Company is a wholly owned subsidiary of Oriflame Cosmetics S.A, a company incorporated under the laws



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of Luxembourg. The parent company is in operation for 45 years and has a sales network in 60 countries. It has been further stated that M/s KPMG Taseer Hadi & Co, Chartered Accountants (the KPMG) is the Oriflame's global auditors and, therefore, in Pakistan, the Company's financial statements are also audited by the KPMG.

10. It has been further argued by the Counsel that Company is involved in legitimate business of direct selling through MLM method and the money earned by the Consultants or Leaders is derived solely from the sale of the products and not from any other sources. It was also pointed out that there are no laws in Pakistan which differentiates illegal pyramid scheme from lawful MLM business. It has been stated that MLM is legal business method which uses a network of independent distributors to sell consumer products. The sale through MLM method is not done by sale clerks but by independent businessmen (called Consultants and Leaders), through their network of personal and business contacts. In this way, the Consultant builds and manages his or her own sales force by recruiting, motivating, supplying and training others to sell these products of the Company. The compensation of the Consultant includes a percentage of the sales of his or her entire group sales as well as earnings on his or her own sales to end users. The further upward and individual progress within the ranks the Company's MLM hierarchy, as a Consultant and as a Leader, his or her increased income does not come at the expense of the groups below him or her, but at the expense of the Company sharing its own profit margins with such Consultant or Leader. It was lastly submitted that the Notice may be withdrawn and no further action against the Company may be taken.

11. After the hearing conducted on 05-10-2011, the CRO was directed to submit a report regarding the nature and method of business of the Company. It was also advised to CRO to scrutinize if the Company was involved in any illegal MLM/pyramid scheme while conducting its business. The officials of CRO visited the registered office of the Company wherein the methodology of the business was explained to them by representative of the Company. In the report submitted by CRO, it



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was observed that the Company was involved in MLM/pyramid business. It was informed by the representatives of the Company that the Company has adopted the MLM/pyramid method so that it will not require to hire distributors and numerous other intermediaries to run the business and therefore the MLM method is cost effective to sell their products. It has been reported that the Company is involved in registering the members for sale of its products.

12. The *modus operandi* of the business of the Company is that an individual can become its member through an introducer and by paying a membership fee of Rs. 498. At the time of registration, the applicant is required to provide the registration number of the introducing consultant ("introducer/Leader"). If a person does not have an 'Introducer/Leader', he is assigned to the new recruit on random basis. According to the Company, the membership is only charged in order to attract customers/consultants who are serious in buying the Oriflame products and selling them to their own customers. The amount of Rs. 498 is charged against a high quality catalogue and a welcome pack at the time of registration of a member. After the enrollment, the applicant is entitled to purchase Oriflame products for his own use or for selling onwards to others. All the members are eligible to a 25% discount every time they purchase a product. The Company strongly encourages the consultants to develop their own down line team and work towards group sales. The Company also arranges training for new consultants and provides supervision/guidance to enhance their network as well as develop Group. It has been informed by the Company that in Pakistan, there are approximately 3000 consultants enrolled with the Company till September, 2011. If a member remains inactive for one year his membership becomes invalid. The enrollment fee is renewable every year at a cost of Rs. 498.

13. It has been pointed out by the CRO Officials that the Scheme is based on a pyramid structure with a few people at the top and an increasing number of members in each layer below. The Scheme offers single as well as multilevel marketing opportunities. The Company encourages people to join below in a potentially endless



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chain. However, commission is paid only on sale of products rather than on bringing in new entrants. The business focus is on sale of products to end-users through consultants. Therefore, it can be stated that the main source of profit is from sale of products by Groups/ Consultants. Though the members can earn money without signing up new members, however, in this case in order to generate higher income, high level of individual effort is required. Therefore, it may be said here that the members do not have a fair chance to make money from the Company on equitable basis unless one creates his own group.

14. It has been also added that the Company has five production facilities throughout the world. The products are 100% imported and, therefore, are more expensive than the local products. It has been claimed by the Company that as its products are of daily use, so these have high demand in the market. Prices of the products are usually revised once in a calendar year. Product is sold to the consultant at a catalogue price; however, the Company has no control over the price being charged by the consultant to the end user. The Company after registering the members pay the commission on the sale of a product. An individual is required to earn at least 200 Bonus Points ("BP") in a month to be entitled for commission. However, this requirement is reduced to 100 BP in a month for a group leader. If a group leader does not earn 100 BP or more in a month, where his group sales exceed 200 BP, the leader is entitled to any commission. The commission is paid in the first week of the next month through a cross cheque but if the commission is less than Rs.1000, it is posted to a prepaid account of the consultant rather than monthly payment to the consultant. It is worth mentioning here that the bonus points/credit cannot be carried forward from one month to the next.

15. It was concluded in the report that as claimed by the Company itself the Company is operating as an MLM business. The Company has adopted a marketing strategy in which sales force (consultants) is compensated not only for the sales they personally generate, but also from the sales to others they refer and recruit creating a



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down line of distributors and a hierarchy of multiple levels of compensation. It is evident that the Company is engaged in MLM business which is inconsistent with the objects of the Company as stated in Memorandum & Articles of Association in contravention of instruction No. 6 of 2005 dated 14-07-2005 issued by the Commission.

16. A close observation of the nature of business reveals that the business hierarchy is some-how based on pyramid nature in which people at the top in hierarchy earn more than those at the lower end of the hierarchy. However, the leaders of each level/group have to attain certain level of target each month in order to be eligible for compensation, therefore the consultants working under a leader may also have the opportunity to earn more than their leaders. It is not out of place to mention that MLM schemes have great potential to be turned as Pyramid Schemes when the product disappears or stops being the focal point in the scheme.

17. I have gone through all relevant record, documentary evidence, arguments made by the counsel of the Company and reply filed by the Company and various reports filed by the CRO. I have also taken into consideration the publications in the shape of catalogues and other published material of the Company and am of the view that the business of the Company is not based on the sale of products in a normal fashion but in fact is being carried out through MLM method. I have also given anxious consideration to the submissions of the Counsel of the Company that MLM is not an unlawful or fraudulent business.

18. The Company is registered with the Commission as a private limited company and as such come within its regulatory regime. Under the Securities and Exchange Commission of Pakistan Act, 1997 (the "SECP Act") which created it, the role of the regulator is not restricted to the corporate record of the companies but to monitor all the activities of a company in a larger context to investigate if it is doing any business which is detrimental to the interest of public at large. The preamble of the SECP Act, 1997 empowers the Commission for the beneficial regulation of the capital market, and superintendence and control of corporate entities. Pursuant to its mandate as given by



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the SECP Act, the Commission has been keeping a close eye on the business of companies which are involved in the MLM/Pyramid Schemes so that interest of general public could be safeguarded. In this regard the Commission had issued an instruction No. 06 Of 2005 for the companies that are involved in MLM business. The Commission has also issued a number of public warnings in the newspapers by advising the public at large to remain vigilant in dealing with entities which are involved in illegal MLM/Pyramid schemes business.

19. It is an admitted fact that the Company is involved in the business of marketing various products relating to cosmetics through an MLM method. This method of marketing differs from the conventional sale through a distribution and the retail network. Under the scheme of MLM, the Company sells products to the customers and the consumers in turn sell the products to their peers and earn commission out of the sale. In fact it avoids many middlemen, and cost of advertisement, etc. The marketing process is carried out directly by recruiting the customers themselves as distributors of the products and services. The scheme is in fact focused at recruitment of customers through referral method rather than sale of products. People are encouraged to take up the distributorship of the products and are suitably registered as member of the Company. The Company also charges from the individuals a fee of Rs. 498 to become a member/distributor of the Company. After becoming a member, commission is paid as per the volume of sales made by the individual distributor and his team.

20. According to the scheme, when a person purchases any product from the Company, he has to first make an application on a printed format (Consultant Application Form). In addition to other information, it is required to give two user names (names of persons who are registered with the Company), sponsor name and consultant number in the application. He has to sign a declaration that he has entered into this agreement as a Consultant. In addition to the agreement, they are bound by the conditions mentioned on the reverse of the Form and the terms set put in Company's Success Plan and Policy Manual ("the Published Material"). The Published Material also



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includes several catalogues which are circulated by the Company containing product price list for the cosmetics. There also exists a Consultant Manual through which the Company offers the public at larger to earn money in two ways, one to show the catalogue and take orders -earn an immediate profit of 25%. Two invite others to join-earn upto 21% extra on your personal sales and the sales of the consultants in your Group.

21. After becoming a member, the Consultant is entitled to buy the products of the Company on 25% discount. The Consultant pays the amount to the Company because he is made to believe that when he sells these goods to others, he will get 25% immediate profit and if he enrolls others and develop a team, he will also share the commission on the group sales. Such Commission depends upon the total volume of business that he generates by himself and his team by persuading others to get enrolled in the scheme as a group, which progresses like a chain; the amount of commission depends on volume of sales made by each group. It is abundantly clear that the promise of the possible commission is the reason for one's enrolment and the person purchasing the product is less interested in consuming the goods as a normal consumer.

22. It may not be out of place to mention that the prices of the products are fixed in a way that the Company expects profit even after paying 21% so called profit to the Consultants. In a hypothetical example that means that goods actually worth Rs. 60 are sold to the customers on Rs. 100. As the Company gets Rs. 79, the Consultant will receive his commission of Rs. 21. In this way the profit earned by the Company covers not only the profit on the goods, but also expenditure involves for the administration of the Company. The Company lures the general public to become a 'Consultant' only on the hope or expectation that they may get more money by way of commission if they sell the products to others. It is also important to note that the Company receives membership fee of Rs. 498 from everyone who wants to become a Consultant. It is most likely that, few persons are earning lot of commission in this manner and the chain of Consultants is likely to progress for some time. At one point of time the progress of the chain will stop. On that day persons who buy the product may not find any further



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consultant or member to purchase from them. By the time, the Company would have earned enormous profits but a very large number of persons would be left cheated and would remain hopeless due to the unacceptable marketing tactics adopted by the Company.

23. It is also noticed that only under promise or expectation of getting huge commission (easy or quick money), the public are lured to invest more money in such of the schemes. It is only considered imaginary profits that are offered by the Company. Every one cannot sell all the products to someone else. If a person is unable to get purchasers or consultants at one point of time, very large number of people would be left at that stage, unable to find a purchaser or distributor and that would result in stocking of the product.

24. As pointed by the learned Counsel of the Company that there exists no law in Pakistan to regulate the business of MLM methodology, it is incumbent upon the regulators like SECP to keep the surveillance against such companies so that their business activities could be controlled. Mere fact that there is no law directly prohibiting the MLM business does not make an act of MLM/pyramid schemes *ipso facto* legal. In these case element of fraud cannot be ruled out.

25. I have also considered the fact that the commission received by the Consultant depends upon the volume of business generated by him and his Group. From the scheme of MLM, as reflected in the published material of the Company, the commission is generated only if the Consultant sells the product, which he purchases and so on. In this manner, if more number of persons in the next stages come into the scheme, the person through whom those persons get enrolled gets maximum commission within the Group.

26. It is clear that the scheme, as stated above, creates chain of customers and only when the chain progresses, the principal consultant gets more commission. The progress of the chain of customers, at some point of time, would get saturated and the consultant, who purchases the goods, will not find any purchaser/sub-distributor to



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sell or enroll afresh. At that time, due to the progress of the chain, in the manner stated above, such persons who would not find new members. In this way, a large number of people are likely to loose their entire savings.

27. From the close study of the MLM methodology, it transpired that it is structured in a manner that people may want to earn quick and easy money. The business of the Company is being done on two scores, one by registering member at the cost of Rs. 498 and secondly by selling its product on profit and on the provision of bonus points. In this case, there is enrolment of members into the scheme; there is also a promise made that on such enrolment of large number of persons into the scheme, one would make quick money or easy money through group sales. There cannot be any doubt that by enrolling new members and by the process of selling the goods to new people this chain progresses; the person who became such members earlier get maximum commission on the group sales including his own and his team members but with personal minimal efforts at one stage; getting such a commission is nothing but getting quick and easy money. Therefore, such schemes/the so called 'Multilevel Marketing', definitely fall within the definition of fraudulent activities as provided in section 305 (f)(i) of the Ordinance.

28. It is also worth mentioning that the direct marketing network marketing or multi-level marketing (MLM) business nearly resembles with pyramid schemes as some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure. Pyramid schemes also referred to as franchise fraud or chain referral schemes are marketing and investment frauds in which an individual is offered a distributorship or franchise to market a particular product.

30. I am of the view that leaving these companies free from any scrutiny would render the large number of persons cheated. Therefore, there is a need to take preventive action so that people involved in such business should be accounted for and interest of innocent general public be safeguarded and protected.



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31. It may be noted that the Company was issued the Notice primarily under section 305 (f) (i) and (ii) of the Ordinance as the activities of the Company were found to be in contravention to the aforementioned provisions of law. The relevant portion of the said provision is reproduced hereunder for ease of reference:

“305. Circumstances in which company may be wound up by Court.- A company may be wound up by the Court-

(f) If the company is-

- (i) conceived or brought forth for, or is or has been carrying on, unlawful or fraudulent activities;
- (ii) carrying on business not authorized by the memorandum;.....”

32. I have closely observed the business activities of the Company and noticed that its activities broadly fall within the definition of ‘fraudulent activities’ as described in section 305 (f)(i) of the Ordinance. The word ‘fraud’ as defined in Section 17 of the Contract Act, 1872 is as follows:

"Fraud" means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract :---

- (1) the suggestion, as to a fact, of that which is not true by one who does not believe it to be true;
- (2) the active concealment of a fact by one having knowledge or belief of the fact;
- (3) a promise made without any intention of performing it;
- (4) any other act fitted to deceive; and
- (5) any such act or omission as the law specially declares to be fraudulent.

33. The definition of the word “Fraud” as per Black’s Law Dictionary Fifth Edition is as follows:

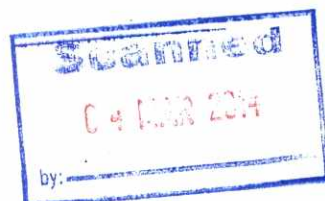
“Fraud” : “A false representation of a matter of fact, whether words or by conduct, by false or misleading allegations, or by concealment of that which should have been disclosed, which deceive and is intended to deceive another so that he shall act upon it to his legal injury”.....“A generic term, embracing all multifarious means which human ingenuity can devise, and when are resorted to by one individual to get advantage over another by false suggestions or by suppression of truth, and includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated”.



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34. From the foregoing definitions, it can be inferred that fraud is committed wherever one man causes another to act on a false belief by a representation which he does not himself believe to be true. He needs not to have definite knowledge or belief that it is not true. It is clear that the Company is doing sale of products through MLM method by inducing the people to get enrolled with the Company after paying a fee of Rs. 498/-. After taking the membership, the Consultant is required to sell the products mentioned in the Catalogues after buying from the Company on 25% discount. The facts and figures given in the success plan of the Company are imaginary and illusionary and are not at all realistically achievable. In such a manner the Company is using the MLM methodology as a trick to cheat the people and wrongfully induce the general public to get involved in the scheme by offering them an exorbitant profit on the products of the Company.

35. Additionally, it has been clearly mentioned in the object clause of the Memorandum of Association of the Company that the Company shall do the business of purchase, sell, import, marketing, distribution, wholesale, retail, and deal in natural skincare, cosmetics, accessories, clothing and nutrition products as well as any other activity not prohibited under the laws of Pakistan. However, the Company is involved doing its business by involving itself in registering of members through MLM methodology and inducing the public at large to buy the products of the Company. I have also noticed that the word "marketing" provided in the object clause of the Company should only be construed to mean that the Company intends to market its product in a proper, prudent and lawful manner. The term marketing as stated in the object clause cannot be construed as referring to MLM methodology. Therefore, it is clear that the Company is doing its business in contravention to section 305 (f)(ii) of the Ordinance by not doing the business in the spirit of the object clause of the Memorandum of Association.



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36. Under the circumstances and the facts noted above, I am of the opinion, that it would be appropriate to initiate winding up proceedings against M/s Oriflame Cosmetics Pakistan (Private) Limited. I, therefore, in public interest and in exercise of the powers conferred by proviso (b) of Section 309 of the Ordinance, hereby grant sanction to the Additional Registrar, CRO, Lahore to file a winding up petition before the Hon'ble Lahore High Court for winding up of M/s Oriflame Cosmetics Pakistan (Private) Limited.

Announced:
August 28, 2013
Islamabad.


(Nazir Ahmed Shaheen)
Executive Director(C&CD)

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