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Regulation of pyramid schemes in China

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Abstract: From the outright division between legitimate direct marketing and illegal pyramid schemes in the "Regulations on the Prohibition of Multi-level Marketing Schemes" and the "Regulations on the Administration of Single-level Marketing" to the addition of the crime of "organizing or leading fraudulent pyramid schemes activities" in the Seventh amendment to the Criminal Law, China's legislative regulation of pyramid schemes has undergone a transition from solely administrative means to supplemented criminal regulation. With the advent of the Internet era, online fraudulent pyramid schemes has undergone some new changes in its business model, such as the cloud-based hierarchical compensation system, virtual goods and services, and scroll-based mechanisms, posing significant challenges to judicial and law enforcement efforts in combating pyramid schemes and regulating direct marketing. Nonetheless, the fraudulent nature of pyramid schemes in recruiting members and collecting entry fees remains unchanged, and their uncontrollability continues to challenge legal order. In determining the punishability of pyramid schemes activities, the substantive review standard should be applied, distinguishing between administrative violations involving actual sales of goods supplemented by team-based compensation methods and the elements constituting the crime of organizing or leading fraudulent pyramid schemes activities.

Keywords: regulation of pyramid schemes; crime of organizing or leading fraudulent pyramid schemes activities; online fraudulent pyramid schemes activities; multi-level marketing

1. Introduction

1.1. What are pyramid schemes and related terms in the context of Chinese law?

Foreign researchers have pointed out that the raison d'etre of pyramid schemes for their originators is not only to lure victims to give them cash (or some other material benefit), it is also to turn them into recruiting more victims ad nauseam [1]. It can be said that the above-mentioned studies accurately pinpoint the essential characteristics of pyramid schemes. However, due to differences in linguistic environments, practical circumstances, and legal traditions, pyramid schemes and related terms still vary significantly between countries. To better distinguish these concepts and to better suit their application in China, I will use the following criteria for explanation before embarking on a specific discourse on “regulation of pyramid schemes in China”. The criterion is whether it is legal or illegal. In China, the potentially legitimate form of direct selling is single-level marketing. Its legitimacy requires obtaining approval through a series of administrative approvals, which may involve stringent conditions. In other words, except for certain forms of single-level marketing, current Chinese law does not recognize any form of direct selling as legal. Including a specific form of direct selling, multi-level marketing (MLM), which is legal in countries like the United States and European nations, and fraudulent pyramid schemes, other harmful forms of pyramid schemes, Ponzi schemes, *etc.*, are all illegal. The difference lies in the regulatory measures applied to them. The following text will be elaborated in detail.

In judicial practice and legal provisions, it is quite clear that pyramid schemes prohibited by the Criminal Law of the People's Republic of China are considered "fraudulent pyramid schemes," which constitute a specific type of fraud crime. Based on the principle of legality in criminal law, if the organizers or leaders of a Ponzi scheme, Chain letters or other illegal pyramids forms exhibiting clear characteristics of fraud meet the criteria set forth in Article 224 (I), they will also be convicted and punished accordingly under that provision. If such types of pyramid schemes occur, they are likely to be these types in most cases, which is pyramid schemes constitute “only” an unfair business practice, regulated under consumer protection law, and missing some elements of fraud such as the deception of victims. Alternatively, they may be considered as legal MLM practices in other countries. Both of the above situations contravene specific administrative legal provisions in China. Therefore, to ensure the overall coherence of the text, it is necessary to unify the terminology used in this paper.

Hereafter, 'fraudulent pyramid schemes' will be used to refer to pyramid scheme crimes that should be criminally punished in China; 'multi-level marketing schemes' (MLM schemes) will be used to refer to legal MLM practices in other countries and those pyramid schemes that are still subject to relevant legal regulations in other countries. And detailed legal regulations concerning Chinese-style terms, such as MLM schemes and fraudulent pyramid schemes, will be elaborated in the second section.

1.2. Review of research on pyramid schemes in China

If "Avon" is considered as the starting point of modern direct selling in China, then China began its modern direct selling history on November 13, 1990 [2]. By 1993, Avon's sales had exceeded 100 million YUAN, with a network of 100,000 distributors. Avon's success inspired many similar companies; Amwey, Sunrider, and others subsequently entered the Chinese market. Therefore, as a "foreign import," direct selling in the Chinese context is understood as a marketing model without physical storefronts. It garnered attention from some economists, who initially focused on analyzing the operation of this model itself. Proponents regarded it as an advanced Western experience and advocated for its adoption [2], while others, after objectively analyzing the pros and cons of the pyramid scheme model, still believed that through government regulation, legitimate multi-level marketing could promote market economic development [3].

However, scholars' optimistic attitude towards multi-level marketing did not last long. When the sensational response to multi-level marketing subsided, a large number of market chaos and illegal activities began to spread, planned by speculators. Many domestic multi-level marketing activities lacked substantial products or substantially virtualized products, and they turned into pyramid schemes one after another. As a result, the government's attitude turned cold, and academic attention gradually shifted to a more critical perspective. For example, some scholars regard it as a depiction of the individual's triggering of the 'kill-familiar' attribute and the serious social distrust in the process of arguing against traditional social norms [4]. Some scholars, after the division between single-level marketing and pyramid schemes, paying more attention to the healthy development of the single-level marketing industry [5]. During this stage, although there have been discussions on pyramid schemes in various fields such as economics and management, marketing, sociology, criminology, and finance, most of them have remained at the level of popular science introductions and have not delved deeper. There are also some evaluations and studies conducted from the perspective of law [6].

After the promulgation of Amendment (VII) to the Criminal Law of the People's Republic of China in 2009, the legislative trend of criminalizing fraudulent pyramid schemes aroused high attention in the legal academic community, marking the beginning of a hot period of analysis surrounding fraudulent pyramid scheme crimes in terms of legal doctrine and empirical legal studies. During this period, research focused on three main aspects. Firstly, some scholars conducted analyses at the level of legal doctrine, filling the gaps in domestic legal research in this field through discussions on fundamental issues related to criminal law theory such as the concept of fraudulent pyramid scheme crimes pyramid schemes, constitutive elements, criminal subjects, and criminal objects [7]. Secondly, some scholars conducted research from the legislative perspective, analyzing and examining aspects such as legislative choices, the rationality of criminalization, and the accuracy of charges regarding the provisions on fraudulent pyramid scheme crimes in Amendment (VII) to the Criminal Law and its drafts [8]. Thirdly, there was contemplation from a judicial perspective. With the formal implementation of Amendment (VII) to the Criminal Law, some difficult issues arose in practice that urgently needed to be addressed. Driven by practical needs, research on the guiding application of crimes related to organizing and leading fraudulent pyramid schemes has emerged one after another. Examples include the studies conducted by scholars such as Li Xiang [9] and Wang Enhai [10].

After 2014, with the increasing emergence of pyramid schemes in China, they gradually began to exhibit some localized characteristics. Consequently, new forms of fraudulent pyramid scheme crimes emerged. Research on fraudulent pyramid schemes adapted to these developments and yielded some research outcomes. Firstly, with the increasingly deep integration of Internet technology and the financial sector, 'Internet+' products have become increasingly prevalent in the market. This has led to a surge in online fraudulent pyramid scheme crimes, correspondingly leading to a continued rise in research on online fraudulent pyramid schemes [11]. In addition to analyzing the internal structure of crimes related to organizing and leading fraudulent pyramid schemes, some scholars have also discussed the criminal nature of online fraudulent pyramid scheme activities, believing that the focus should not be confined to this particular crime [12]. Some scholars also believe that the existing definition of crimes related to organizing and leading fraudulent pyramid schemes is no longer adequate to address the needs of punishing online fraudulent pyramid scheme crimes, Therefore, they argue that changes should be made at the legislative level [13].

Secondly, after the issuance of the ‘Opinions of the Supreme People's Court, the Supreme People's Procuratorate and the Ministry of Public Security on Several Issues concerning the Application of Law in the Handling of Criminal Cases of Organizing or Leading Fraudulent Pyramid Schemes’, (Later in the text, referred to as the 'Opinions'), there has been an increase in focused discussions on the concept subtype of 'multi-level marketing' within pyramid schemes. Some scholars believe that neither organizing and leading pyramid selling activities nor illegal business operations are suitable for defining 'multi-level marketing.' They argue that its risks are administratively controllable [14]. Other research indicates that legislation and policy documents should be adjusted to prevent the criminalization of multi-level marketing [15]. Thirdly, the related research findings have continuously become more refined, presenting a higher degree of technicality and disciplinary integration and crossover, leading to a more diverse consideration of fraudulent pyramid scheme behaviors. Compared to earlier research perspectives, after over twenty years of accumulation and sedimentation, domestic research on pyramid schemes has been able to inherit the former, continuously refining it [16]. The richness of empirical research tools has greatly facilitated innovative expansion in research models, providing significant assistance to pyramid scheme studies as well [17].

Looking back on the thirty-year development history of pyramid schemes in China since their introduction, research in academia has evolved from the initial introduction of pyramid scheme models and the introduction of relevant experiences from the United States, to the chaos caused by pyramid scheme operations in the market and the publication of literature on fraudulent pyramid scheme crimes, marking distinct waves of research fervor and concentrated research periods.

However, there are still several research challenges that urgently need to be addressed: Firstly, there is a tendency towards a single and rigid research perspective, with relatively few studies on the scope of fraudulent pyramid scheme crimes, criteria for criminality, handling procedures, evidence, and judicial rules. Secondly, there is a lack of research on regulating pyramid schemes outside of China, with only a few countries introducing relatively outdated systems, and a lack of systematic research and discussion on international ethical guidelines and industry norms. Thirdly, there is a scarcity of summarizations regarding China's national conditions, the development of pyramid schemes, and their new characteristics, with a lack of targeted responses to qualitative issues arising from new types of fraudulent pyramid schemes, especially new forms of online pyramid schemes, in judicial practice.

In light of these challenges, this article aims to supplement and organize research in two ways: Firstly, based on a chronological timeline, it will introduce China's regulations on fraudulent pyramid schemes, providing an overview of the systems for combating MLM schemes and regulating single-level marketing activities from both administrative and criminal perspectives. Secondly, it will explore new forms of online fraudulent pyramid schemes in recent years, using specific cases to further clarify the external characteristics and essential features of fraudulent pyramid schemes, thereby aiding judicial case handling in distinguishing between 'guilt and innocence' more effectively.

2. Administrative and criminal regulations on pyramid schemes

Direct selling is not indigenous to China. Initially emerging as a new business model, they came into the view of the Chinese people. In November 1990, the Sino-American joint venture Guangzhou Avon Co., Ltd. was officially established through registration, becoming the first direct selling company on the mainland. Subsequently, companies such as Amway, Mary Kay, and Oriflame also entered the market successively, practicing the model of selling goods directly to customers by reducing intermediate links. Since then, the direct selling industry has gone through a period of ‘barbaric growth’. Stimulated by huge profits and the desire for wealth, the expansion of the direct selling market has led to illegal activities, which has attracted government attention. Since 1993, the administrative departments of industry and commerce have gradually implemented measures to rectify the direct selling market in an attempt to strengthen management. However, due to the inherent lag of the new system, there was still a lack of specialized regulations to regulate it for a period of time.

In 1997, In order to regulate the multi-level marketing, the State Administration for Industry and Commerce for the first time defined the direct selling in Article 2 of the ‘Regulations on the Administration of Direct Selling’ (hereinafter referred to as the ‘Regulations’), dividing the concept of ‘direct selling’ into multi-level and single-level based on the level of distributors, and explicitly adopting a registration system for the administrative management of direct selling enterprises in Article 3, and subsequently detailed a series of supporting measures such as the threshold for enterprise registration.

It can be seen that during this period, the official tendency was to use the term ‘pyramid selling’ to refer to the point-to-point, direct business model without stores. ‘Direct selling’ was also used as a synonym in research literature. Whether multi-level or single-level marketing, they are legitimate business practices and are equal to other market operating models such as retail. However, considering the high transaction activity, flexibility, and fast dissemination speed of direct selling, and the immature domestic environment, special restrictions have been placed on participants in direct selling. However, the good times did not last. In May 1998, the Chinese government halted the operations of all direct selling firms, in part because of the government’s inability to stop the growth of pyramid schemes [18]. Time to 2005, in order to fulfill China's commitment made upon officially joining the WTO, to “remove market access restrictions, including ‘non-fixed-location sales’ including direct selling, within three years”, the "Regulations on the Prohibition of Multi-level Marketing Schemes" and the "Regulations on the Administration of Single-level Marketing" were promulgated, delineating legality as the boundary, attempting to administratively distinguish between MLM from direct selling.

Specifically, Article 2 of the “Regulations on the Prohibition of Multi-level Marketing Schemes” defines MLM schemes behavior, and Article 7 enumerates three specific behaviors: recruiting others, collecting entrance fees, and team-based compensation. This article stipulates that ‘MLM schemes’ refer to behaviors where “organizers or operators develop personnel, calculate and pay rewards based on the number of personnel directly or indirectly developed by the developed personnel or based on sales performance, or require the developed personnel to pay a certain fee as a condition for obtaining membership qualifications, *etc.*, to seek illegal gains, disrupt economic order, and affect social stability.” On the other hand, the "Regulations on the Administration of Single-level Marketing" introduced a clear definition of single-level marketing and aimed to differentiate it from MLM. It clearly states that “single-level marketing enterprises recruit direct sellers, who promote products directly to end consumers outside of fixed business premises.”

The “Regulations on the Prohibition of Multi-level Marketing Schemes” define MLM scheme behavior to include both illegal pyramid schemes and legal MLM practices, also known as team-based compensation, which has been legalized in some countries with high levels of direct selling openness [19]. Because the “Regulations on the Administration of Single-level Marketing” require that the calculation of compensation for direct sellers must be based solely on their own terminal sales, it explicitly outlines the characteristics of the legal single-level direct selling model. As a result, the concept of lawful MLM no longer exists in the legal context, and the legal attributes of MLM are artificially separated. It is worth noting that although the original term “multi-level marketing” has been replaced by “team-based compensation pyramid schemes”, there is a substantive difference in the conceptual connotations before and after this evolution.

“Multi-level marketing” emphasizes that the number of levels of developed pyramid scheme personnel is two or more, and there is no necessary connection between the performance of pyramid scheme personnel and their levels or other pyramid scheme personnel. On the other hand, “team-based compensation pyramid schemes” require developers to actively recruit and bind new recruits downstream. While encouraging the developed personnel to recruit new members, the organization calculates and pays compensation to upstream based on the sales performance of the downstream. This compensation method inevitably creates a linkage between the compensation of pyramid scheme personnel at different levels.

Strictly speaking, it can be said that team-based compensation pyramid schemes are necessarily multi-level marketing, but multi-level marketing are not necessarily team-based compensation pyramid schemes in Chinese context. As Chinese regulation system does not recognize the legality of multi-level marketing, this article aims to maintain coherence and consistency by unifying the term 'team-based compensation pyramid schemes' as 'multi-level marketing' to avoid discrepancies in terminology between domestic and international contexts.

As mentioned earlier, administrative authorities have issued a series of administrative regulations and normative documents to distinguish between MLM and pyramid schemes, aiming to regulate the former and suppress the latter. However, the regulatory effectiveness of these administrative measures is limited. Especially when facing severe pyramid schemes or disguised pyramid schemes, they often proliferate due to the absence of criminal legislation. In the process of cracking down on pyramid schemes that seriously disrupt social stability, judicial authorities in various regions may act independently, leading to further fragmentation of prosecution and adjudication, thereby affecting judicial credibility. To clarify attitudes, standardize law enforcement, optimize governance, and promote fairness, the "Amendment (VII) to the Criminal Law of the People's Republic of China" adds Article 4, which criminalizes the organization and leadership of pyramid selling activities, located after Article 224 "Contract Fraud" of the Criminal Law, presented as one of its provisions. The article stipulates: "Whoever organizes or leads the pyramid selling activities to cheat the participants of property and disturb the economic and social order, in which, in the name of marketing commodities, providing services or any other business operation, the participants are required to obtain the qualification for participation by paying fees, purchasing commodities or services or any other means, the participants are classified into different levels according to a certain order, the calculation of remunerations or kickbacks to participants is directly or indirectly dependent on the number of persons recruited, and the participants are induced to continue or coerced into continuing recruiting others to participate, shall be sentenced to fixed-term imprisonment not more than five years or limited incarceration, and be fined; or if the circumstances are serious, shall be sentenced to fixed-term imprisonment not less than five years, and be fined." From the literal meaning of this article, it is evident that it only criminalizes pyramid selling activities that deceive and defraud property by "recruiting members" and "collecting entry fees", and does not explicitly include "multi-level marketing" in its enumerated charges.

So far, significant progress has been made in addressing pyramid schemes through legislative means, formally establishing China's dual-track system for regulating pyramid schemes. However, there remains a lack of unified understanding and judicial practice regarding pyramid schemes among law enforcement agencies in China, particularly in determining whether "multi-level marketing" should be considered a criminal offense. In 2013, the Supreme People's Court, the Supreme People's Procuratorate, and the Ministry of Public Security issued the "Opinions on Several Issues Concerning the Application of Law in Handling Criminal Cases of Organizing and Leading Pyramid Selling Activities". The opinions further elaborated on the specific determination and handling of pyramid schemes regarding the hierarchy and number of participants, individuals involved in pyramid schemes, "deception for financial gain," and "seriousness of circumstances." Article 5, paragraph 2 of the Opinions states that "pure multi-level marketing, which aim to sell products and base compensation on sales performance, shall not be treated as criminal offenses." In the same year, the Judicial Committee of the Supreme People's Court issued the "Decision of the Supreme People's Court on Abolishing Some Judicial Interpretations and Interpretative Documents (Batch 10) Issued from July 1, 1997, to December 31, 2011," clarifying that the "Reply on How to Qualify Serious Circumstances of Pyramid Schemes or Disguised Pyramid Schemes" (hereinafter referred to as the "Reply") conflicts with the provisions of the Criminal

Law. Therefore, it is no longer applicable from the date of the decision, resulting in a lack of direct legal basis for prosecuting pyramid schemes under the crime of illegal business operations.

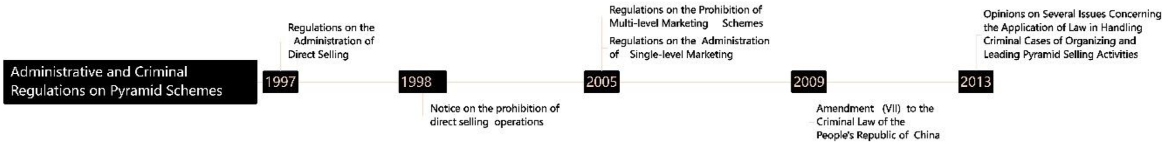

Figure 1. Legal review of China's regulations on pyramid schemes (Timeline).

However, even after the issuance of the "Opinions," there are still judicial practitioners who consider pyramid schemes conducted through "multi-level marketing" methods as criminal offenses punishable by law. For instance, in the case of Liu Haibo, when the Intermediate People's Court of Siping City explained its legal reasoning for rejecting an appeal [20], It is believed that the appellant, Liu Haibo, established the "China Aid Business Welfare Network in the name of Baiyitong Company, adopting a multi-level marketing model, and encouraged others to join and develop additional members under the guise of consumer rebates." By forming hierarchical relationships and establishing a performance- based compensation network, he illegally profited. His actions meet the elements of the crime of organizing and leading pyramid schemes. Similar reasoning and arguments can also be found in the indictments and judicial explanations of cases such as Dan Suzhi and Wu Jizhang [21]. The disconnection between judicial interpretations and their application, coupled with significant discrepancies in the handling of similar cases, particularly in terms of nature, hierarchy, purpose, and outward appearance, reflects the inherent complexity of pyramid schemes. Consequently, there is a lack of unified understanding in the conviction and sentencing practices for pyramid schemes crimes.

Generally speaking, China's regulation of pyramid schemes stems from the practical needs of governance and follows the institutional design philosophy of combining administrative and criminal measures, which possesses certain scientific and practical attributes. However, the law tends to lag behind, leaving room for interpretation within legal texts. Consequently, the application of the law may not always fully reflect the legislative intent. Moreover, given the variety of forms that pyramid schemes can take and the MLM layers of disguise they often employ, judicial practitioners often find it challenging to distinguish between genuine and deceptive practices. This difficulty has resulted in challenges in the judicial determination of the illegality and criminality of pyramid schemes in China.

3. Empirical identification of internet-based pyramid crime in China: its model and case

As previously mentioned, within the context of jurisprudential discourse in our country, the illegality and criminal nature of pyramid schemes have been firmly established. However, the legal establishment of a legitimate single-level marketing industry does not align with the current developmental trajectory. Essentially, pyramid scheme crimes are inexorably linked to characteristics such as “recruitment” and “entry fees”. Yet, from an empirical perspective, analyzing pyramid schemes, especially the prevalent online pyramid scheme activities, reveals a myriad of reward systems, operational models, and packaging strategies. Understanding these diverse characteristics is crucial for accurately distinguishing between fraudulent pyramid scheme warranting criminal penalties and multi-level marketing schemes subject to administrative penalties or even deemed non-punishable. This understanding will better adapt to changes in the national context and align with international mainstream trends.

It is generally believed that there are five main types of online pyramid schemes: Traditional network pyramid schemes, which disguise themselves as selling goods but recruit members through online platforms; E-commerce network pyramid schemes that use consumer rebates and free shopping as bait; Network virtual commodity pyramid schemes, which operate under the guise of virtual currencies, blockchain technology, online gaming, and similar concepts; Online labor pyramid schemes, where participants are compensated for clicking on advertisements or performing similar tasks; Network financial pyramid schemes, which involve internet finance, online investment, and financial management [14].

Traditional network pyramid schemes and online labor pyramid schemes merely utilize the Internet as a tool for recruitment and expanding their down-lines. Their effectiveness relies on the inherent nature of the Internet, with no significant innovation in their operational models. However, in recent years, e-commerce network pyramid schemes, network virtual commodity pyramid schemes, and network financial pyramid schemes have spawned new practices such as “Plus Token Platform”, “Cloud Star Station Premium”, and “Global Expo”, which deserve particular attention. This article aims to summarize certain standardized characteristics of pyramid scheme activities by narrating these typical pyramid scheme stories, providing reference for relevant legislative and judicial personnel.

3.1. E-commerce network pyramid scheme: "internet plus ranking system" by Cloud Star Company

E-commerce network pyramid schemes often masquerade under the guise of consumer rebates, free shopping, and similar incentives, using intricately designed reward mechanisms to imply and encourage participant recruitment. Such pyramid scheme activities typically manifest as illegal forms of "multi-level marketing" and fraudulent schemes that exploit goods as props for deception. In practice, these two types can interchangeably exhibit characteristics of each other: considering factors such as recruitment structure, hierarchical profit relationships, repeat consumption levels, and disparities in bonus distribution, the likelihood of transforming into pyramid scheme crimes generally follows the order: Dual- track System > Matrix System > Ranking System [15]. In practice, the more traditional and conservative Ranking System has been combined with the Internet to create the “Internet Plus Ranking System”, resulting in greatly increased dissemination speed and scope. The following sections will further analyze this in conjunction with the case of the “Cloud Star Station Premium” platform, suspected of involvement in pyramid schemes. Below is the company's operating and reward model:

The Cloud Star Station company markets and sells products through its self-operated mini-program “Cloud Star Station Premium”, which includes three main sections: the featured zone, the preferred zone, and the live streaming zone. The products for sale include health supplements, food items, cosmetics, daily necessities, and small household appliances. In the featured zone, 13 flagship products are offered, mainly focusing on health and skincare products. Apart from the Shi Beiji Rich Hydrogen Skin Bathing Integrated Machine, priced at 25,143 yuan, the retail price of other products is 493 yuan, with a purchase price of 443 yuan for VIP and star-level users.

The company employs a reward distribution system based on eight levels from VIP to Seven Star CEO, with rewards coming from agent differentials and group purchase rebates. The agent differential is primarily linked to the agent's level and constitutes a specific plan for profit sharing between the agent and their team. Agents receive bonuses for recommending customers to purchase, such as a 50 yuan reward for VIP referrals, 120 yuan for One Star referrals, 150 yuan for Two Star referrals, 180 yuan for Three Star referrals, 210 yuan for Four Star referrals, and 240 yuan for Five Star, Six Star, and CEO referrals. Additionally, VIP and higher-level members receive discounts when purchasing products themselves. The higher the level, the greater the discount on purchased products (VIP and above members purchase products at 443 yuan, saving 70 yuan for One Star, 100 yuan for Two Star, 130 yuan for Three Star, 160 yuan for Four Star, 190 yuan for Five Star, 190 yuan for Six Star, and 190 yuan for CEO). For agents who purchase a large number of products or generate high sales, the company also offers group purchase rebates, ranging from 2% to 6% based on sales every 300,000 yuan.

The organizational form of the Ranking System, which matches the sun-line differential reward mechanism, is exemplified by companies like Amway. As the name suggests, the Ranking System refers to the horizontal width of the organization line, which can develop without limits. Each line of the organization develops independently within the system, and the higher the sales performance, the higher the level and the higher the bonus commission ratio. Additionally, secondary distribution of level bonuses corresponding to the overall sales performance of distributors and their down-line development is carried out, deducting the total level bonuses corresponding to each down-line before returning to the distributor themselves. Cloud Star Station Company utilizes Internet means for radiation and expansion, employing the Ranking System in its organizational structure and reward system. This "Internet Plus Ranking System" compared to the traditional Amway-style team compensation model, has new advantages such as faster organizational formation and wider sun-line radiation, to some extent compensating for the shortcomings of the latter.

From the perspective of the risk of transforming into pyramid scheme crimes: Cloud Star Station does not limit the number of direct down-line developments by individuals. In terms of hierarchical benefit distribution, the range of benefit radiation is limited. High-level agents mainly earn bonuses from group purchase rebates and team commissions. This profit distribution method largely separates "recruits" from "products". That is, for every set sold, whether through repurchase or recommending new recruits, there are benefits to be gained. The obsession of agents to recruit new members without restrictions will decrease. Moreover, when conducting market promotion externally, the platform is promoted in terms of purchase price. Increasing the star level results in rebates obtained from the purchase price difference.

People have inertia and self-interest, hoping to achieve maximum output and return with minimal effort and investment. In this extreme differential system, there are no bonuses generated from regional collisions as seen in binary and matrix systems, lacking direct incentives for recruiting. These characteristics reflect that the marketization level of the Cloud Star Station platform is higher compared to other team compensation models, and it has a greater connection with the products themselves. The more closely linked it is with the products and the less with individuals, the further away it is from pyramid scheme crimes.

Regarding repeat consumption, the platform sets a repurchase margin, enabling savings even for self-purchases without promoting the market. For those who have actual demand for products, saving money is making money, which also demonstrates a tendency for conservative organizational expansion. In terms of bonus distribution gap, internal team members share rewards of 240 yuan or 190 yuan. The formation of teams and performance markets is conveyed directly, with lower levels receiving higher shares closer to actual buyers, after removing rebates from lower levels, becoming their actual income. Regarding internal competition, because the Ranking System does not set requirements for collision and performance, it does not directly promote malignant competition for recruiting.

It is worth noting that, although from the perspective of organizational structure and bonus distribution, the Internet Plus Ranking System has advantages in terms of legality compared to other team-based compensation MLM operating models, determining whether a specific situation constitutes illegal multi-level marketing or pyramid scheme crimes requires a specific analysis. Simply operating under the "Internet Plus Ranking System" does not necessarily absolve one from potential criminal liability. Rather, the evaluation of infringement and its severity should be based on three aspects: the infringement of consumer rights resulting from hierarchical bonus distribution and interpersonal relationship realization, the obstruction of market competition order, and the harm to market security and social stability [22].

3.2. Online virtual commodity pyramid scheme: the scam of selling virtual currency and related value-added services

The so-called network virtual goods pyramid scheme exploits investors' profit-seeking mentality by using blockchain technology, virtual currencies, *etc.*, as bait to defraud. It mainly manifests as two types of virtual currency pyramid schemes: non-genuine services and non-genuine goods. The core concept of virtual currencies based on blockchain technology lies in the limited total mining quantity, which guarantees their corresponding scarcity, decentralized characteristics, and good liquidity, among others. However, issuing and mining virtual currencies are not easy tasks. There are high cognitive and technical barriers for the general public, making them vulnerable to exploitation by pyramid scheme criminals. This section will introduce cases of the aforementioned two types of virtual currency pyramid schemes separately.

In virtual currency projects involving pyramid scheme crimes, perpetrators often do not use the blockchain technology they claim or the virtual currency they sell to the public does not exist. A typical example of this type is the counterfeit Dash-coin pyramid scheme that occurred domestically [23]. The case is as follows:

Dark-coin, also known as Dash-coin, is an early and popular virtual currency in the cryptocurrency market, with its selling price reaching as high as $1462 at the end of 2017. In 2014, two individuals from Hong Kong, Liu and Du, began establishing an "official website" and online platform for Dark-coin, taking advantage of its skyrocketing popularity to aggressively promote it. They used the sale of Dark-coin as a guise to recruit down-lines and unlawfully profit from collecting entry fees. The actual total mining quantity of Dark- coin is around 22 million, while Liu and Du distributed over 100 million "Dark-coins" to members, even exceeding four times the expected mining total. Until the time of the case, their company was receiving daily funds of tens of millions yuan, with a total involved amount nearing 1.5 billion yuan. Ultimately, the Intermediate People's Court of Xuzhou ruled that the Dark-coin operated by Du and others had no actual connection to the genuine international virtual currency Dark-coin, which was the primary reason for their guilty verdict.

The second type of pyramid scheme involves claiming to provide value-added services for virtual currencies to participants. However, the services they purportedly offer do not actually exist, and the purpose of their actions is still to unlawfully profit by collecting entry fees from participants. A typical example of such cases is the Plus Token platform, which collapsed in 2019 [24]. The case is as follows:

In May 2018, Chen, who had previously participated in pyramid schemes with only a junior high school education, combined blockchain, virtual currency, smart arbitrage technology, and pyramid schemes to establish the "Plus Token platform." Chen falsely claimed that his product could conduct smart arbitrage, automatically making profits from the price difference through software. Users only needed to deposit their virtual currency into his platform to receive regular returns, with returns reaching an annualized rate of 700%. Additionally, recommending others to deposit coins could earn commission income, ranging from 5% to 15%, increasing by level. In just over a year, the Plus Token platform swept across more than 100 countries and regions worldwide, with over 2 million participants and involving a total amount of 400 billion yuan. Until the Plus Token platform collapsed in 2019, investigations by the authorities revealed that the platform had no actual operational activities. The platform's so-called digital currency value-added services and smart arbitrage function did not exist in reality, constituting typical false services in virtual currency pyramid scheme crimes. Ultimately, Chen was sentenced to 11 years in prison, while other key offenders received sentences ranging from 2 to 10 years. The court confiscated 190,000 bitcoins, 830,000 Ethereum, and 27.24 million EOS tokens.

As mentioned earlier, this type of online pyramid scheme utilizes special "virtual goods" as a medium for marketing scams. It typically presents itself as an emerging product of the Internet age, exploiting information asymmetry to entice investors with high rebates. Pyramid schemes serve as a means to expand the user base, attracting and retaining "customers". The combination of the two makes it more deceptive and harmful. The characteristics of pyramid scheme behavior include: offering static rewards such as membership bonuses and dynamic rewards for recommending down-line participants, virtual goods and service values being abstracted and controlled by the organizers, and once static rewards are insufficient, users will incur losses when withdrawing, compelling them to further develop down-lines to gain more platform profits.

3.3. Network financial pyramid schemes: The "scroll-type" capital trap of "Global Expo"

Due to the absence of product transactions, Network financial pyramid schemes promote financial management and investment as selling points, bearing a striking resemblance to illegal activities such as unauthorized collection of public deposits and illegal fundraising [25]."Scroll-type" fund pools are a recently emerged pyramid scheme business model. The following text will summarize the operational routines and characteristic patterns of the "scroll-type" fund pool through the introduction of the "Global Expo" pyramid scheme case.

Each participant downloads and uses an app called “Global Expo”, and spends 1.5 yuan to register for a “token”. By watching 3 minutes of news daily, they can earn 0.385 GT. GT, or “Global Tokens”, are the platform's provided unit of points. For example, if you have 20 GT and the platform's GT trading price is 10 yuan, you can earn 200 yuan after trading on the Global Expo trading platform. The free trial period is 30 days. After joining, participants can accumulate 11.5 GT per month by reading daily. At this point, the app requires participants to exchange 10 GT for the so-called "advanced reading package" to continue earning GT. In addition, the platform stipulates that GT trading will only be opened once the threshold of 20 GT is reached.

There are several channels to earn GT: Firstly, through reading, with only 0.385 GT available daily, the earnings are relatively slow. Secondly, through investment, participants can directly purchase GT through the app to quickly accumulate GT and earn more dividends. Thirdly, by "recruiting and finding down-lines" to earn GT rewards. For each new recruit brought in, their up-line can earn a certain amount of GT as referral income. Fourthly, through commodity trading, allowing companies to provide goods and directly trade with the platform based on the GT trading price to earn GT.

Table 1. Reward mechanism and achievement standards.

Level	Personal Activity	Alliance Activity	Link Sharing	Link Department Alliance Activity	Link Status Requirements	Enjoy Global Daily Trading Dividend Rate	Reward Reading Package	Enjoy GT Conversion Rate
G1	None	None	None	None	None	None	Newbie Reading Package 1	2%
G2	300	20,000	10	100	None	30%	Low-Level Reading Package 1	2.5%
G3	600	100,000	10	100	3 G2	25%	Intermediate Reading Package 1	3%
G4	2000	500,000	10	100	3 G3	15%	High-Level Reading Package 1	3.5%
G5	21,000	2,000,000	10	100	3 G4	10%	Supreme Reading Package 1	4%

In addition to investing tokens to obtain task packages and reinvest income, participants can also earn promotion income by recruiting others. When reaching a certain level of activity value (down-line), they can become leaders of different levels (G1-G5), as detailed in the table above (Table 1).

As mentioned earlier, new users can obtain so-called original points for free or at a low cost after registration. These points can be used to purchase task packages commonly referred to as "scrolls". Upon completing these scroll tasks, users can earn more points. In addition to this, points can also be obtained through dynamic earnings, which essentially involve recruiting others. This is reflected in various forms such as direct referral rewards, indirect referral rewards, team rewards, and leadership rewards. The more people recruited, the higher the earnings. Points can be circulated among participants and can also be used for cashing out or reinvesting in the platform. To prevent runs on the platform, the organizing platform sets lock-up periods (time) and redemption ratios (quantity) as thresholds. Additionally, the platform vigorously promotes and propagates its appreciation potential and redemption capabilities, forming a so-called "consensus" to make participants recognize the value of the points, thereby inducing them to continue investing. With more participants under the scroll system, the value of points also increases. However, the fund pool itself does not have a self- generating function and must borrow new funds to repay old ones. While the number of points may continuously increase, those who hold and trade points cannot expand indefinitely. Similar to the principle of inflation, when the circulation of points rises to a certain level or there are too many points in circulation, a point bubble will form. At this point, the fund pool cannot continue to sustain itself, ultimately leading to a large number of participants will be played for a sucker.

Of particular concern is that the pyramid scheme behavior of the scroll-type fund pool, which utilizes points as a "bridge" to continuously expand the fund pool through "consensus", has already surpassed the restrictions of the "Regulation on Prohibition of Pyramid Selling" due to its decentralized nature. According to Article 2 of the "Regulation on Prohibition of Pyramid Selling", the identification of pyramid selling requires two conditions: first, the formation of interpersonal relationship networks between superiors and subordinates, known as the "personnel chain"; second, the ability for superiors to obtain various monetary rewards through subordinates and continuously developing personnel, known as the "monetary chain". The aforementioned behavior of profiting illegally, disrupting economic order, and affecting social stability is considered pyramid selling. However, in the scroll-type fund pool, using points as a means of circulation, the valuation of earning points is almost entirely determined by the so-called fund pool market. Moreover, blockchain technology is applied to such projects precisely to decouple "recruitment" from "bonus provision" on the surface, constructing a decentralized "new pyramid selling structure" to evade punishment. This makes it difficult to classify it as any existing type of pyramid scheme, such as recruitment, entry fees collection, or team rewards, under the three existing types of pyramid schemes in the "Regulation on Prohibition of Pyramid Selling," thereby evading punishment. To effectively punish and govern this new type of pyramid scheme, law enforcement officers not only need rich experience as a basis for identification but also require legislative coordination and joint efforts from the judiciary to gradually improve and optimize relevant legal components, keeping pace with the times.

4. Conclusion

From the "Regulations on the Prohibition of Multi-level Marketing Schemes" and the "Regulations on the Administration of Single-level Marketing" which used a one-size-fits-all approach to classify legitimate single-level marketing and illegal pyramid schemes, to the addition of the crime of "organizing and leading pyramid selling activities" in Amendment (VII) to the Criminal Law, China's legislative regulation of pyramid schemes has undergone a transformation from solely administrative means to the supplementary criminal regulation means, reflecting the indigenous evolution process. With the advent of the Internet age, pyramid schemes, especially online pyramid schemes, have seen many new developments, posing significant challenges to judicial workers and law enforcement officers in combating pyramid schemes and regulating single-level marketing activities.

Using specific cases as guidance, different types of online pyramid schemes have adopted new disguises: In e-commerce network pyramid schemes, the "Internet Plus Ranking System" is a new model of team-based marketing rewards and organization, with a lower risk index of transformation into pyramid schemes compared to traditional dual-track systems; In network virtual goods pyramid schemes, selling virtual currencies and other virtual goods, as well as related value-added services, to market scams. In these pyramid schemes, the Internet is not only a means of recruitment but also the domain of existence for virtual goods. Thus, it becomes the "main battlefield" and a high-risk area for "Internet + pyramid schemes"; meanwhile, network financial pyramid schemes have also innovated their models, using a core "scroll-type" system based on points exchange. They claim to offer high annualized returns that are difficult to achieve with general financial investments and wealth management products, thus attracting investment and continuously driving up the market value and expectations of points. Once the time is ripe, the organizers will exit with the funds, leaving the bottom-level participants empty-handed. This type of pyramid scheme is highly deceptive and enticing. In particular, the impact of the "scroll-type" fund pool pyramid scheme, with its decentralized new characteristics, has had a significant impact on the application of the "Regulation on Prohibition of Pyramid Selling" and the existing regulatory system for pyramid schemes based on it appears somewhat outdated.

However, no matter how innovative the methods of pyramid schemes become, they cannot escape the essence: regardless of how complex the system design may be, as long as it relies on recruiting new members and collecting entry fees as the main source of funds, and uses the funds injected by the later investors to pay profits to the earlier ones, thus repeating the cycle, when the number of participants saturates and no longer increases, the entire pyramid structure will inevitably collapse. In a word, pyramid schemes by their very nature aim to involve large numbers of persons [26]. In addition, the commonality among the aforementioned new types of pyramid schemes is also reflected in their high degree of uncontrollability in operation: the entire fund pool pyramid scheme operation is highly uncontrollable, with uncontrollable risks, participants, and profits. Organizers, as individual entities not endorsed by state authorities, often lack the ability to resist risks, leading to the inevitable collapse of the fund pool. The negative effects and chain reactions that may arise from this are also uncontrollable. Such disorderliness is intolerable under the law. Therefore, when determining the nature of highly complex pyramid schemes, it is essential to grasp substantive examination standards and differentiate between administrative violations involving actual sales of goods supplemented by multi-level marketing and the constitutive elements of organizing and leading pyramid scheme criminal activities.

Conflicts of interests

The authors declare no conflicts of interest.

Authors' contribution

Conceptualization, Haiyuan Liu and Bo Yin; methodology, Haiyuan Liu and Bo Yin; formal analysis, Haiyuan Liu and Bo Yin; investigation, Haiyuan Liu and Bo Yin; resources, Haiyuan Liu and Bo Yin; data curation, Haiyuan Liu; writing—original draft preparation, Haiyuan Liu; writing—review and editing, Bo Yin; visualization, Haiyuan Liu; supervision, BoYin. All authors have read and agreed to the published version of the manuscript.

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