University of Miami Law Review

Volume 22 | Number 4 Article 6

5-1-1968

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Ronald R. Baird

LET THE "SELLER" BEWARE—ANOTHER APPROACH TO THE REFERRAL SALES SCHEME

RONALD R. BAIRD*

I. INTRODUCTION

In general, a referral sale is a scheme whereby a purchaser is induced to buy a product upon the understanding that he will receive money or credit on his purchase if he induces others to make similar purchases. The utilization of the referral sales device brings into play many different facets of the law. The law of sales governs the seller-buyer relationship. The law of negotiable instruments deals with the rights and obligations of all the parties to the note. Their position after the transfer of the note may be affected by the law of assignments. Deceptive advertising or promotional practices may be subject to action by the Federal Trade Commission. And finally, the law of chattel security operates upon the rights of the dealer and his successor in interest, the financing institution.

The following is a brief example of how the scheme operates. The potential purchaser is told that if he will submit a certain number of names of persons who might make similar purchases, he will receive a specified commission, to be applied against his debt to the seller. The prospects will be given a similar "opportunity."[1] Under a commission agreement the earnings will not only pay for the item purchased, but also will yield an indeterminate amount of profit. After the agreement to purchase is entered into, a promissory note is executed and subsequently assigned to a finance house. Trouble develops when the third-party financing agent claims the status of a holder in due course and attempts to enforce the purchaser's obligation, and is met with the defense that the seller did not in good faith attempt to sell to the list of prospects and the commissions have not been forthcoming.

* Associate Editor, *University of Miami Law Review;* Student Instructor for Freshman Research and Writing.

1. The supply of buyers will be exhausted at the end of only a few rounds. In Norman v. World Wide Distrib., Inc., 202 Pa. Super. 53, 195 A.2d 115 (1953) plaintiffs introduced evidence to show that at the end of 20 months of operation, it would require 17 trillion salesmen to carry on the referral program World Wide described to the plaintiffs. *Id.* at 57, 195 A.2d at 117. *See also* Sherwood & Roberts-Yakima, Inc. v. Leach, 67 Wash. 2d 630, 634, 409 P.2d 160, 163 (1965) (the court explains the phenomenon of market saturation).

This comment is designed to ascertain what protection is afforded the consumer against fraudulent sellers in the area of referral sales with special emphasis upon the two approaches which have met with the most success, namely lotteries and unconscionability.

II. REFERRAL PLANS AS ILLEGAL LOTTERIES

In the relatively few cases reaching appellate courts involving referral sales, divergent results have been reached as to whether the obligations entered into may be enforced by the financing agent to which they have been negotiated. An unexpected, but uniquely successful, argument which has been utilized is that the referral sale is nothing more than a lottery.[2] The Florida Constitution provides that lotteries are prohibited in this state.[3] They are also prohibited by statute.[4] Furthermore, Congress in the exercise of its power to prescribe what may and what may not be carried by the mail, has provided that no letter or circular concerning any lottery, and no lottery ticket, etc., shall be deposited or carried in the mail or delivered at or through any post office, and that any person knowingly violating such provision shall be punished.[5]

Although lotteries are clearly illegal, legislators have been reluctant to define the term. This reluctance is due to the fact that a precise definition would enable ingenious and unscrupulous persons to devise a plan which may not be within the scope of the mischief which the law seeks to remedy.[6] Since there is no precise definition either by the Florida Legislature or case law, the courts must decide what schemes are lotteries on a case by case basis.[7] An examination of judicial decisions indicates that the cases are either criminal proceedings involving injunctions[8] or restraining orders[9] or habeas corpus proceedings against public officials for their acts in suppressing lotteries.[10]

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2. The Federal Trade Commission hopes to abolish the gasoline giveaway games by declaring them to be a lottery and thereby illegal. NEWSWEEK, July 29, 1968, at 69.

3. FLA. CONST. art. IV, § 23.

4. FLA. STAT. §§ 849.09 (1967) *et seq.*

5. 18 U.S.C. §§ 1301-02.

6. Blackburn v. Ippolito, 156 So.2d 550 (Fla. 2d Dist. 1963).

7. Dorman v. Public-Saenger-Sparks Theatres, 135 Fla. 284, 184 So. 886 (1938) (whether the perpetration of certain stated acts under certain stated conditions constitutes the conducting of a lottery is a question of law for the courts to determine, while whether the alleged acts were perpetrated under the alleged conditions is a matter of fact which may be determined by a jury or in chancery by the chancellor).

8. Victor v. State, 141 Fla. 508, 193 So. 762 (1940).

9. *E.g.* Lee v. Miami, 121 Fla. 93, 163 So. 486 (1935) (a decree restraining defendants from enforcing their vested powers under a statute which regulated coin-operated devices was reversed); *see also* Gibson v. Robinson, 127 Fla. 88, 172 So. 476 (1937) and Little River Theatre Corp. v. State, 135 Fla. 854, 185 So. 855 (1939).

10. Hardison v. Coleman, 121 Fla. 892, 164 So. 520 (1935) (petitioner was entitled to habeas corpus on the ground that the warrant described no offense since a slot machine was not a "lottery").

A lottery has three elements:[11] (1) a prize[12] (2) awarded by chance,[13] (3) for a consideration.[14] Criminal intent is immaterial.[15]

A. *Jurisdictions Applying the Lottery Approach*

The Washington Supreme Court in *Sherwood & Roberts—Yakima, Inc. v. Leach*,[16] found a referral selling agreement illegal and unenforceable. In that case the plaintiff, assignee of a conditional sales contract for the purchase of a home fire alarm system, sued the defendant-purchaser upon default. The assignor-seller obtained the contract using a referral sales scheme, known to the plaintiff at the time of assignment, as an inducement. The contract provided for the seller to pay the purchaser $100 for each sale made to purchaser's sixty referrals. The salesman assured defendants that the commissions would be at least adequate to cover the purchase price of the equipment.[17] Defendants furnished sixty names but received no commissions. The Supreme Court of Washington held that chance permeated the entire scheme of referral selling, that the agreement was contrary to the terms and policy of the lottery statute, and therefore was illegal and unenforceable. The conditional sales contract was found to be so intimately connected with the illegal agreement as to be itself unenforceable. The court found the elements of a lottery (prize, chance, and consideration) to be present. The promised commissions and bonuses constituted the prize; the conditional sales contract provided the consideration; and chance dominated any requirement of skill in the allocation of prizes. The argument that the judgment of defendants in selecting names and the skill of the salesman were the dominant factors in determining whether a commission would be paid was rejected.[18] It is also important to note that lotteries are prohibited in

11. Little River Theatre Corp. v. State, 135 Fla. 854, 185 So. 855 (1939). Blackburn v. Ippolito, 156 So.2d 550 (Fla. 2d Dist. 1963).

12. In United Jewelers' Mfg. Co. v. Keckley, 77 Kan. 797, 90 P. 781 (1907) each purchaser of goods received from the seller, in furtherance of an advertising scheme, a certificate entitling him to a gift of a hat pin, which was the same in each case. The court held that the contract was not void as part of a gift enterprise. Therefore, it would seem, inequality of distribution is the essence of a prize.

13. The weight of authority is to the effect that this requirement is met as long as chance, and not skill or judgment, is the controlling factor. Commonwealth v. Laniewski, 173 Pa. Super. 245, 98 A.2d 215 (1953); State v. Brotherhood of Friends, 41 Wash. 2d 133, 247 P.2d 787 (1952). *Cf.* United States v. Rosenblum, 121 F. 180 (S.D.N.Y. 1903).

14. Glover v. Malloska, 238 Mich. 216, 213 N.W. 107 (1927) (one cent is enough); Blackburn v. Ippolito, 156 So.2d 550 (Fla. 2d Dist. 1963) (following those cases adhering to the contract definition of consideration as opposed to purely pecuniary consideration).

15. Grello v. State, 142 Fla. 236, 194 So. 638 (1940).

16. 67 Wash.2d 630, 409 P.2d 160 (1965).

17. The fire alarm system was priced at $898, but valued at $225.

18. The test of the character of a game or scheme as one of chance or skill is which of these factors is dominant in determining the result. Peoples v. Settles, 29 Cal. App.2d 781, 78 P.2d 274 (1938). *See* Cresh v. State, 131 Fla. 111, 179 So. 149 (1938). *See also* Morse, *The Dominant Element Rule*, 58 DICK. L. REV. 394 (1954).

Washington under its constitution[19] and by statute.[20] In addition, the argument was made that since the assignee was not a party to the transaction, he was not in *pari delecto* and could maintain the action.[21] The court rejected this contention by saying that a finance company's participation is required, and the financing company agreed at the time of contracting that the conditional sale contract would be assigned.

A recent Florida case involved a similar factual situation.[22] Defendants purchased a vacuum cleaning unit on a conditional sales contract. As part of the transaction a commission agreement was executed, whereby defendants were to furnish the seller-assignor with a list of prospective purchasers in return for a commission of $50 for each sale to anyone so referred. In addition, each prospect submitted by the purchasers would be offered the same proposal. For each person referred by the second level prospects, the original purchasers would be paid an additional sum of $50. The salesman assured defendants that the commissions would pay for the vacuum cleaning unit and in addition yield an indeterminate amount of profit despite the fact that the vacuum unit was priced at $975, but valued at $180. The note was assigned to the plaintiff-finance company, which, after defendants defaulted on their payments, brought suit for the unpaid purchase price. The District Court of Appeal, First District did not deem it necessary to decide whether the referral sales plan constituted a lottery within the constitutional concept of that term because of the enactment of Florida statute section 849.091.[23] It was the conclusion of the court that the plan used in the promotion and sale of the vacuum units fell within the purview and intent of the statute and constituted a lottery.[24]

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19. WASH. CONST. art. 2, § 24.

20. WASH. REV. CODE § 9.59.010 (1961) (a criminal statute providing for punishment of up to five years in prison or $1,000 fine, or both, for anyone conducting a lottery).

21. Where the contract is illegal, so that both parties are involved in the illegality, but are not in *pari delecto*—that is, both have not, with the same knowledge, engaged in the same transaction—a court of equity may aid the one who is comparatively the more innocent. 3 J. POMEROY, EQUITY JURISPRUDENCE § 942 (5th ed. S. Symons 1941).

22. M. Lippincott Mortgage Inv. Co. v. Childress, 204 So.2d 919 (Fla. 1st Dist. 1967).

23. Chain letters, pyramid clubs, etc., declared a lottery; prohibited; penalties—

> The organization of any chain letter club, pyramid club, or other group organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members, is hereby declared to be a lottery, and whoever shall participate in any such lottery by becoming a member of, or affiliating with, any such group or organization or who shall solicit any person for membership or affiliation in any such group or organization shall be guilty of a felony, and upon conviction thereof shall be punished by a fine of not less than 100 dollars, nor more than 5000 dollars, or by imprisonment in the county jail for a period of not more than two years or in the state penitentiary not less than one nor more than ten years.

24. M. Lippincott Mortgage Inv. Co. v. Childress, 204 So.2d 919, 923 (Fla. 1st Dist. 1967).

Along with Washington[25] and Florida,[26] the courts of Kentucky,[27] and New York[28] have reached similar conclusions on analagous factual situations. It is important to note that in all of these cases state constitutional provisions and statutes were held to be applicable.

However, the courts of Ohio[29] and Oklahoma[30] have reached a different conclusion. In *DeWitt Motor Company v. Bodnark*,[31] the purchaser of an automobile was engaged by the seller as an independent salesman and was to receive a commission of $100 for each prospective customer who ultimately purchased automobiles from the retailer. In answering the question as to whether the contract had a dominating element of chance the court said:

> If Bodnark purchaser does nothing, he gets nothing. If he exercises his powers of reason and planning, he may realize a fulfillment of the contingency of receiving money as a commission or bonus from DeWitt retailer. This contract, in my opinion, is one that rewards diligence, initiative and industry. It is a contract by which commission can only be earned, not through chance "as is contained in the definition of letter" but by reason of the volition of Bodnark and the application by him of judgment, plan and will.[32]

A similar result was reached in Ohio in *First Discount Corp. v. Cua*.[33]

In *Yoder v. So-Soft of Ohio, Inc.*,[34] the plaintiffs entered into a contract with defendants whereby they agreed to pay defendant $938 for a water softener. In addition they were to receive $100 for each name they submitted to the defendant who consummated a contract. In validating the agreement, the court stated that: "The act of purchasing a share of General Motors stock has more of the element of a gambling transaction than does the one before us."[35]

Finally, in *A. A. Murphy, Inc. v. Taylor*,[36] the seller granted to the purchaser the privilege of securing one or more persons to make a similar purchase; for each additional sale the original purchaser would receive a specified sum of money. The court held that since there was no evidence

25. Sherwood & Roberts-Yokima, Inc. v. Leach, 67 Wash.2d 630, 409 P.2d 160 (1965).
26. *See* cases cited note 22 *supra*.
27. Commonwealth v. Allen, 404 S.W.2d 464 (Ct. App. Ky. 1966); Commonwealth v. Campbell, 406 S.W.2d 730 (Ct. App. Ky. 1966).
28. State v. ITM, Inc., 52 Misc.2d 39, 275 N.Y.S.2d 303 (Sup. Ct. 1966).
29. DeWitt Motor Co. v. Bodnark, 169 N.E.2d 660 (Ct. C.P. Ohio 1960); First Discount Corp. v. Cua, 117 Ohio App. 105, 190 N.E.2d 695 (Ohio Ct. App. 1962).
30. Krehbeil v. State, 378 P.2d 768 (Okla. 1963); A. A. Murphy, Inc. v. Taylor, 383 P.2d 648 (Okla. 1963).
31. *See* cases cited note 29 *supra*.
32. 169 N.E.2d 660, 668 (Ct. C.P. Ohio 1960).
33. 117 Ohio App. 105, 190 N.E.2d 695 (Ct. App. Ohio 1962).
34. 202 N.E.2d 329 (Ct. C.P. 1963).
35. Id. at 331 N.E.2d 329 (Ct. C.P. 1963).
36. 383 P.2d 648 (Okla. 1963).

that the purchaser *agreed* to secure other persons to participate in the plan, the referral agreement was not a lottery.[37]

B. *Is the Assignee a Holder in Due Course?*

An extensive review of the rights of a holder in due course as it relates to consumer installment credit paper is beyond the scope of this article.[38] However, it is important to consider this argument as it relates to referral sales.

The Uniform Commercial Code protects a financial institution that buys negotiable paper as a holder in due course,[39] unless the consumer can prove: (1) that the holder had notice that . . . the instrument is overdue or has been dishonored or of any defense against or claim to it on the part of any person;[40] or (2) the consumer signed the note under such misrepresentation that he had neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms.[41] The problem arises in the following manner: a retail buyer agrees with a retail seller to purchase personal property (such as a vacuum cleaning unit) on the installment plan. He makes a down payment and gives a negotiable promissory note for the balance secured by a conditional sales contract. The note along with the security device are then transferred by the seller to a finance company or bank. If the buyer defaults in the payment of the note, the finance company will bring suit claiming to be a holder in due course free from any personal defenses which the buyer may have against the original seller. Thus, the courts have to decide the policy question as to where the loss will fall. On the one hand the consumer should be protected from unscrupulous merchants. On the other hand, encouragement of commerce through easy negotiability of commercial paper is desirable. There are indications of increasing judicial concern for consumer protection in the kind of situation where a financial institution is an active participant in the credit transaction between a retail seller and buyer.[42]

37. See also Krehbeil v. State, 378 P.2d 768 (Okla. 1963) (similar result on similar facts).

38. King, *The Unprotected Consumer-Maker Under the Uniform Commercial Code*, 65 DICK. L. REV. 207 (1961); Dodge. *Referral Sales Contracts: To Alter or Abolish?*, 15 BUFFALO L. REV. 699 (1966). *See also* Comment, *Finance Companies and Banks as Holders in Due Course of Consumer Installment Credit Paper*, 55 NW U.L. REV. 389 (1960); Comment, *Translating Sympathy for Deceived Consumers into Effective Programs for Protection*, 114 U. PA. L. REV. 395 (1966).

39. FLA. STAT. §§ 673.3-302, 673.3-305 (1967).

40. FLA. STAT. § 673.3-305(1)(c) (1967).

41. FLA. STAT. § 673.3-305(2)(c) (1967).

42. In the landmark case of Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940) the buyer executed a promissory note and a conditional sales contract in the installment purchase of an automobile. The buyer had a defense of fraud which he wished to assert when he was sued on the note by the finance company, to whom the note and contract had been transferred by the automobile dealer. The court held that the finance company was not a holder in due course of the negotiable note despite the fact that it had no actual notice of the fraud.

Florida has accepted the "active participation" doctrine in refusing to permit finance companies to claim the status of a holder in due course in similar situations.[43]

In *Federal Credit Bureau v. Zelkor Dining Car Corp.*,[44] the court construed the note and accompanying security device as one instrument, the note thus becoming subject to all the terms and defenses of the accompanying security device. In effect, this makes the note non-negotiable in this type of consumer credit transaction.

In addition to the developing case law, several commentators have suggested that in the area of commercial paper under the Code, the consumer-maker lacks sufficient protection in dealings involving negotiable paper.[45]

In the area of referral sales, the holder in due course argument has either not been raised, or, where it has been raised, it has not met with success.

In *Matthews v. Aluminum Acceptance Corp.*,[46] the defendant was found to be a holder in due course. In an action by the purchaser of aluminum house siding to enjoin enforcement of a note and secured mortgage, it appeared that the payee of the note represented that the makers had been chosen as demonstrators of the siding, that they would receive an immediate loan, and would receive $100 for each potential customer brought by the seller to the house. No potential customers appeared. The court held that the mortgage was procured by fraud and that the contract was unenforceable.

In *Norman v. World Wide Distributors, Inc.*,[47] the purchaser of a note, executed by a buyer under a referral sales plan, had dealt with the referral seller over a period of one year. The court held that the purchaser of the note clearly had enough knowledge to put it on inquiry as to the seller's fraudulent acts, had not acted in good faith, and was denied the defense of a holder in due course.

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43. Mutual Fin. Co. v. Martin, 63 So.2d 649 (Fla. 1953); *accord*, Palmer v. Associated Discount Corp., 124 F.2d 225 (D.C. Cir. 1941); Schuck v. Murdock Acceptance Corp., 220 Ark. 56, 247 S.W.2d 260 (1952); Commercial Credit Corp. v. Orange County Mach. Wks., 34 Cal.2d 766, 214 P.2d 819 (1950); Industrial Credit Co. v. Mike Bradford & Co., 177 So.2d 878 (Fla. 3d Dist. 1965); Matthews v. Aluminum Acceptance Corp., 1 Mich. App. 570, 137 N.W.2d 280 (1965); Taylor v. Atlas Security Co., 213 Mo. App. 282, 249 S.W.2d 746 (1923); Local Acceptance Co. v. Kincade, 361 S.W.2d 830 (Mo. 1962); Buffalo Industrial Bank v. De Marzio, 162 Misc. 742, 296 N.Y.S. 783 (1937), *rev'd on other grounds*, 6 N.Y.S.2d 568 (1937); Wilson Bros. Sand & Gravel v. Cheyenne Nat'l Bank, 389 P.2d 681 (Wyo. 1964); *contra*, Citizen's & So. Nat'l Bank v. Stepp, 126 F. Supp. 744 (N.D. Fla. 1954).

44. 238 App. Div. 379, 264 N.Y.S. 723 (1933).

45. *See* note 38 *supra.*

46. 1 Mich. App. 570, 137 N.W.2d 280 (1965). *See also* Pennsylvania Secur. Comm'n. v. Consumers Research Consultants, Inc., 414 Pa. 253, 199 A.2d 428 (1964).

47. 202 Pa. Super. 53, 195 A.2d 115 (1963) *following* Mills v. World Wide Distributs., Inc., 202 Pa. Super. 59, 195 A.2d 118 (1963).

Finally, in *Taylor v. Brookline Savings & Trust Co.*,[48] the court in applying a Tennessee statute found that a bank was not a holder in due course because the notes had been filled in after they had been signed and because the bank, through its long experience with the construction company, must be charged with knowledge of its fraudulent procedures.

A different result occurred in a situation where the buyer had agreed in a conditional sales contract not to assert defenses he had against the seller if sued by a purchaser of the contract.[49] Case law has generally held that parties to a retail installment agreement may contract to waive certain defenses, so long as public policy is not contravened.[50]

"Consumer goods" are defined by Florida statute section 679.9-109 (1967) as those articles used for personal, family or household purposes. Florida Statutes, section 679.9-206(1) provides that when the installment buyer as part of the same transaction executes both a security agreement and a negotiable instrument, he is deemed as a matter of law to have agreed not to assert against the assignee or holder of the instrument any claim or defense that may exist between the buyer and seller of the goods, absent state statutes or judicial decisions to the contrary.

Taking into account the provisions of the Code[51] and Florida case law,[52] the following caveat is posed: If a buyer has agreed in a conditional sales contract not to assert defenses he has against the seller if sued by an innocent purchaser for value of the contract, how would a Florida court decide the case in an action between the buyer and an innocent purchaser for value? It is the opinion of this writer that the Florida courts may be sympathetic toward the buyer in view of *Mutual Finance Co. v. Martin*,[53] but the better view which recognizes the commercial need for freely negotiable or assignable paper would allow the innocent purchaser of the conditional sales contract to prevail.

III. UNCONSCIONABILITY—A WORKABLE ALTERNATIVE

A workable alternative to the lottery approach to the referral sale scheme lies in the "Unconscionability" provision of the Uniform Commercial Code.[54] The most important case to date in this area is *Williams v. Walker-Thomas Furniture Co.*[55] The plaintiff, an operator of a retail

48. 405 S.W.2d 590 (Tenn. App. 1964).

49. Lundstrom v. Radio Corp., 17 Utah 2d 114, 405 P.2d 339 (1965); *See* Annot., 44 A.L.R.2d 162 (1955).

50. Annot., 44 A.L.R.2d 162 (1955).

51. FLA. STAT. § 679.9-206 (1967).

52. *See* cases cited note 43 *supra*.

53. 63 So.2d 649 (Fla. 1953). This solution, if too widely applied, conflicts with the commercial need for freely negotiable or assignable paper.

54. FLA. STAT. § 672.2-302 (1967). *See also* Davenport, *Unconscionability and the Uniform Commercial Code*, 22 U. MIAMI L. REV. 121 (1967).

55. 350 F.2d 445 (D.C. Cir. 1965).

furniture store, sold a $500 stereo set on an installment contract to the defendant Williams. The defendant was a woman of limited education and maintained herself and seven children on public assistance payments of $218 per month, as plaintiff knew. The plaintiff utilized an "add-on" provision under an installment contract which credited each payment pro rata against all outstanding accounts, thereby allowing plaintiff to retain a collateral interest in all items until every purchase had been paid in full. After having paid most of the installments, the defendant defaulted and the plaintiff sought to replevy all purchases. Defendant contended that plaintiff's knowledge of her precarious financial position should preclude recovery on the contract. The trial court found no ground for denying recovery and the appellate court affirmed.[56] On appeal, the United States Court of Appeals reversed and remanded to determine whether the contract was unconscionable. The appellate court stated that the contract would be unenforceable if there was present an element of unconscionability at the time the contract was made. Although the Uniform Commercial Code was not enacted in the District of Columbia until after the contract in issue had been executed,[57] the court reasoned that enactment of section 2-302 did not necessarily change the law, nor preclude the court from adopting a similar rule "in the exercise of its power to develop the common law."[58] Section 2-302 supplied persuasive authority for following the rationale of the cases from which the section was derived.[59] The court cited *Henningsen v. Bloomfield Motors, Inc.*,[60] as supporting its position. In *Henningsen*, the Supreme Court of New Jersey held that a manufacturer's disclaimer of liability was against public policy because of unequal bargaining power,[61] lack of meaningful choice,[62] and lack of notice of the disclaimer.[63] The court in *Williams* directed the trial court to consider similar factors in determining whether the contract was unconscionable.[64] In addition, the court suggested that sellers of consumer goods may have a duty to import to purchasers an understanding of the contract's consequences.

The term "unconscionable" is obviously rather inexact[65] and is not

56. Williams v. Walker-Thomas Furniture Co., 198 A.2d 914 (D.C. Ct. App. 1964).

57. The U.C.C. was enacted on Dec. 30, 1963, and went into effect on January 1, 1965. 77 Stat. 630 (1963). The contract in question was executed in April of 1962.

58. 350 F.2d at 449.

59. *See* U.C.C. § 2-302, Comment 1.

60. 32 N.J. 358, 161 A.2d 69 (1960).

61. *Id.* at 358, 388, 161 A.2d at 85.

62. *Id.* at 390, 161 A.2d at 87.

63. *Id.* at 399, 161 A.2d at 92.

64. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 450 (D.C. Cir. 1965).

65. Section 2-302 has been criticized for vagueness and interference with contractual freedom. *See, e.g.*, Babb, *The Proposed Uniform Commercial Code*, 14 ME. L. REV. 1, 9-10 (1962); King, *Suggested Changes in the Uniform Commercial Code*, 33 ORE. L. REV. 113, 114 (1953); Comment, *Policing Contracts Under the Proposed Commercial Code*, 18 U. CHI. L. REV. 146, 152 (1951); *But see* Hart, *In Defense of Certain Provisions of the Uniform Commercial Code Relating to Formation of Sales Contracts: A Partial Reply to Professor Babb*, 15 ME. L. REV. 21 (1961).

easily applied to specific contractual provisions. The test suggested by the comment to section 2-302 is "whether, in the light of the general commercial needs of the particular trade or use, the clauses involved are so one-sided as to be unconscionable . . . ."[66] Although this test provides some guidance, only judicial decisions will be able to define the limits of unconscionability in specific cases.

It is the writer's opinion that the unconscionable approach to business promotional schemes would be better suited for the purpose than the lottery approach. This approach would enable the court to focus its attention on the unfairness and deception of a particular scheme as opposed to concentrating on the elements (prize, chance and consideration) necessary for a lottery. Also, a finding of "unconscionability" would not render the business promoter or the purchaser participant a felon.[67] The lottery concept is ill-suited for the commercial world, whereas the unconscionability doctrine is especially applicable to a business setting and for the regulation of economic activity. Furthermore, a sweeping statement that referral sales are lotteries implies that all such plans are abusive and unfair. This may not be a fair generalization. For example, what if the purchaser pays cash for the personal property and, in addition, is to receive commission payments or refunds for providing the seller with additional buyers? This plan may have substantial economic merit but would probably be stricken.

IV. OTHER ALTERNATIVES

A. *Tort Theory of Misrepresentation*

The referral sales scheme could be attacked by using the tort theory of misrepresentation.[68] To constitute fraud a (1) misrepresentation must be of a (2) specific material fact that it is (3) untrue and (4) known to be so and (5) stated for the purpose of inducing another to act, upon which statement the other (6) relies in action to his (7) injury.[69] In *Stackpole v. Hancock*,[70] the court held that a party negotiating for the purchase of property need not reveal facts solely within his knowledge as to the property value, but that if he undertook to do so, he must disclose the whole truth.

In the recent Florida case, *M. Lippincott Mortgage Investment Co.*

66. FLA. STAT. § 672.2-302 (1967), Comment 1 (1967).

67. FLA. STAT. § 849.091 (1967) provides that:

> [W]hoever shall participate in any such lottery by becoming a member of, or affiliating with, any such group or organization or who shall solicit any person for membership or affiliation in any such group or organization shall be guilty of a felony . . . .

68. *See generally* W. PROSSER, TORTS §§ 100-05 (3d ed. 1964).

69. Ball v. Ball, 160 Fla. 601, 36 So.2d 172 (1948); Sutton v. Gulf Life Ins. Co., 138 Fla. 692, 189 So. 828 (1939); Nixon v. Temple Terrace Estates, Inc., 97 Fla. 409, 122 So. 274 (1929); Huffstetler v. Our Home Life Ins., 67 Fla. 324, 65 So. 1 (1914).

70. 40 Fla. 362, 24 So. 914 (1898).

v. Childress,[71] the representation by the salesman that the prospective purchasers would yield commissions sufficient in amount to pay in full the promissory note plus unlimited amounts of gain[72] would seem to meet the above requirements. However, in order for a misrepresentation to be the basis of a claim for relief it must relate to a past[73] or existing[74] fact. Statements of expectation are not grounds for fraud, where the parties are dealing at arm's length.[75] Since the misrepresentation (sufficient commissions to pay in full the promissory note) is predicated upon a future event, the misrepresentation theory may not provide a satisfactory defense. The same problem would result with a false pretense statute.[76]

B. *The Post Office*

The two postal fraud statutes—the one providing for criminal penalties for use of the mail to defraud,[77] and the other, an administrative statute giving the Postmaster General the power to stop incoming mail from reaching the fraudulent operator[78]—have been effective governmental protections for the consumer.

In *Pereira v. United States*,[79] the court stated:

> The elements of the offense of mail fraud under U.S.C. (Supp. U) § 1341 are (1) a scheme to defraud, and (2) the mailing of a letter, etc., for the purpose of executing the scheme contemplates the use of the mails as an essential element.[80]

There is no requirement that anyone be defrauded or even that a likelihood exist that someone will be defrauded.[81] However, proof of intent to defraud is a requisite for conviction under both the criminal statute[82] and the administrative statute.[83]

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71. 204 So.2d 919 (Fla. 1st Dist. 1967).

72. *Id.* at 920.

73. Stokes v. Victory Land Co., 99 Fla. 795, 128 So. 408 (1930).

74. Williams v. McFadden, 23 Fla. 143, 1 So. 618 (1887).

75. Hart v. Murphy, 82 Fla. 317, 90 So. 173 (1921).

76. It is generally held that to constitute a false pretense there must be an "assertion of an existing fact, not a promise to perform some act in the future." Commonwealth v. Moore, 99 Pa. 570, 574 (1882). California is the only state whose courts have held that false pretenses include all promises made with intent not to perform. People v. Ashley, 42 Cal. 2d 246, 265, 267 P.2d 271, 283, (1954) *cert. denied*, 348 U.S. 900 (1954).

77. 18 U.S.C. § 1341 (1964).

78. 74 Stat. 654 (1960), 39 U.S.C. § 4005 (1964).

79. 347 U.S. 1 (1954).

80. *Id.* at 8.

81. Hermansen v. United States, 230 F.2d 173-74 (5th Cir. 1956), *cert. denied*, 351 U.S. 924 (1956); United States v. Sylvanus, 192 F.2d 96, 106 (7th Cir. 1951), *cert. denied*, 342 U.S. 943 (1952).

82. 18 U.S.C. § 1341 (1964) provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by fraudulent pretenses . . . shall be fined not more than 1000 dollars or imprisoned not more than five years or both.

83. The United States Supreme Court in Reilly v. Pinkus, 338 U.S. 269, 277 (1949) held that the Federal Trade Commission has the authority to issue cease and desist orders with-

Although hampered by a small staff and an increasing number of charges of mail fraud, the postal authorities have great potential in curbing fraudulent mail practices.

C. *Federal Trade Commission*

The Federal Trade Commission's jurisdiction over "deceptive acts or practices"[84] in advertising is another major governmental effort in the fraud prevention area. The Supreme Court has remarked that the Federal Trade Commission has wide discretion in the choice of remedies to cope with deceptive advertising practices.[85] As a result, the Commission has devised a variety of devices to end an unlawful practice.[86]

Generally, the FTC's efforts have been curtailed because of the limited scope of the enforcement power and its inability to make expeditious determinations.[87]

V. *Conclusion*

The lawyer representing a buyer who has been the victim of a referral sales scheme has at least two avenues of approach, either of which is likely to result in success, i.e., the lottery approach and the unconscionability approach.

Dodge has suggested[88] as an alternative method of handling referral sales contracts that states pass specific legislation that would (1) prohibit selling or offering for sale any consumer goods or services at a price unreasonably higher than the usual or ordinary price and (2) limit either the percentage of sales made on referral or limit the buyer's debt by referral commission payments.[89] It is the opinion of this author that the unconscionability approach can give the same result and in addition is more satisfactory since it avoids the doctrinal problems of the lottery and tort approaches. The effectiveness of the unconsionability approach will depend upon the judicial attitude of the courts. It is hoped that the attitudes of the Florida courts will be favorable.

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out proof of fraudulent intent, but that the FTC order "does not approach the severity of a mail order fraud."

84. 52 Stat. 111 (1938), *as amended*, 15 U.S.C. § 45(a)(1) (1964).

85. Jacob Siegel Co. v. FTC, 327 U.S. 608, 611-612 (1946).

86. In addition the power to seek temporary injunctions in cases involving the advertising of foods, drugs, and cosmetics, the Commission, under its cease and desist power, sometimes merely requires a change in the wording of an advertisement. *See, e.g.*, Keele Hair & Scalp Specialists, Inc., 55 F.T.C. 1840 (1959), or requires that explanatory language be added in order to remove deception, American Medicinal Prods., Inc., v. FTC, 136 F.2d 426 (9th Cir. 1943).

87. Note, *The Regulation of Advertising*, 56 COLUM. L. REV. 1018, 1035 (1956).

88. Dodge, *Referral Sales Contracts: To Alter or Abolish?*, 15 BUFFALO L. REV. 669 (1966).

89. *Id.* at 692-96.