INDEPENDENT BAKERS ASSOCIATION
Post Office Box 3731, Washington, D.C. 20007

May 27, 2008

Federal Trade Commission
Office of the Secretary
Room H-135 (Annex S)
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: **Business Opportunity Rule, R511993**

Ladies and Gentlemen:

The Independent Bakers Association ("IBA") appreciates this opportunity to share with the Federal Trade Commission (the "FTC") our views on the revised proposed Business Opportunity Rule (the "Revised Proposed Rule") described in the FTC's Revised Notice of Proposed Rulemaking (73 Fed. Reg. 16110, 3/26/08) (the "RNPR").

IBA is a Washington, D.C. based national trade association of over 400 wholesale bakeries and allied industry trades. Most of our member businesses are family owned. Our members include regional businesses and businesses with nationwide operations. IBA was founded in 1968 to represent and serve independent wholesale bakers.

1. Introduction

IBA commends the FTC for recognizing that the business opportunity rule proposed in 2006 (the "2006 Proposed Rule")[1] was overly broad in scope. As discussed in IBA's July 17, 2006 comments (and other comments), the 2006 Proposed Rule would have defined as "business opportunities" traditional distributorships and dealerships that are not associated with the fraudulent practices at which business opportunity laws are aimed.

Those distributorships and dealerships would have been "unintentionally swept in" by the 2006 Proposed Rule. (RNPR, 73 Fed. Reg. at 16113.) As

[1] The 2006 Proposed Rule was published at 71 Fed. Reg. 19053, 4/12/06.

outlined in our prior comments and in comments submitted by others, traditional distribution arrangements comprise a broad and essential segment of the U.S. economy. Because "there is little or no evidence that fraud is occurring" in connection with those distribution arrangements, the FTC sought to remove them from coverage in the Revised Proposed Rule. (RNPR, 73 Fed. Reg. at 16113.)

The FTC has specifically requested comment on whether the coverage limitations reflected in the Revised Proposed Rule are "sufficient to keep the rule from covering traditional distributor relationships." (RNPR, 73 Fed. Reg. at 16133.) In our view those limitations, while beneficial, are not entirely sufficient for that purpose. Accordingly, we are writing to suggest certain additional modifications.[2]

2. The Revised Proposed Rule Could Potentially Still Sweep in Traditional Distribution Arrangements.

The Revised Proposed Rule defines "business opportunity" as follows:

(1) A commercial arrangement in which the seller solicits a prospective purchaser to enter into a new business; and

(2) The prospective purchaser makes a required payment; and

(3) The seller, expressly or by implication, orally or in writing, represents that the seller or one or more designated persons will:

(i) Provide locations for the use or operation of equipment, displays, vending machines, or similar devices, on premises neither owned nor leased by the purchaser; or

(ii) Provide outlets, accounts, or customers, including, but not limited to, Internet outlets, accounts, or customers, for the purchaser's goods or services; or

(iii) Buy back any or all of the goods or services that the purchaser makes, produces, fabricates, grows, breeds, modifies, or provides, including but not limited to providing payment for such services as, for example, stuffing envelopes from the purchaser's home.[3]

[2] In this letter, a company that sells its products to distributors or dealers will be referred to as the "supplier."

[3] Revised Proposed Rule Section 437.1(c)

Thus, in order to be considered a “business opportunity,” a business relationship must meet each of three definitional elements. Those three elements are discussed below.

(a) Items (1) and (3): "New Business," "Provide Customers," etc.

In the majority of cases, items (1) and (3) of the definition will apply to a traditional distributorship or dealership. Generally, the distributorship or dealership will constitute a "new business" for the distributor or dealer, thus effectively satisfying item (1).

Item (3) of the definition is also quite broad. In particular, the "provide outlets, accounts or customers" criterion typically will be met. That phrase is deemed to encompass "furnishing the prospective purchaser with existing or potential . . . accounts, or customers . . . " or "assisting the prospective purchaser in obtaining his or her own” accounts or customers.[4]

A supplier of an established product line would be hard pressed to avoid item (3). When such a supplier appoints a distributor or dealer, an established customer base for the products is in place. Arguably, then, that appointment includes a representation (explicit or implicit) that accounts or customers will be "furnished" to the distributor or dealer. Even if the supplier is able to avoid that characterization, it must still try to refrain from representing to the prospective distributor or dealer that it will assist a distributor or dealer in finding accounts or customers.[5]

Because items (1) and (3) of the definition are so broad, most established suppliers will have to look to item (2), the “required payment” element, to exclude their distribution arrangements from coverage.

(b) Item (2): "Required Payment"

The Revised Proposed Rule defines "required payment" as follows:

> *. . . all consideration that the purchaser must pay to the seller or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the business opportunity. Such payment may be made directly or indirectly through a third-party. A*

[4] Revised Proposed Rule Section 437.1(l)

[5] In addition, the "buy back" component of the definition may apply to suppliers who permit returns of damaged products or out-of-date products by distributors or dealers.

required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.[6]

IBA agrees with the FTC's decision to restore an "inventory exemption" to this definition. That exemption is found in the last sentence of the definition. The RNPR states that this change " . . . effectuates the Commission's determination that traditional product distribution arrangements should not be covered by the Business Opportunity Rule." (RNPR, 73 Fed. Reg. at 16122.)

The inventory exemption is a necessary and important limitation on the rule's coverage. However, we are concerned that the revised "required payment" element could still cause traditional distribution arrangements to be deemed "business opportunities."

(i) Potential Ambiguity Regarding Payments to Third Parties

The Revised Proposed Rule's definition of "required payment" is the same as the definition of that term in the recently amended FTC Franchise Rule,[7] except that the following sentence appears only in the Revised Proposed Rule's definition: "Such payment may be made directly or indirectly through a third-party." The RNPR indicates that the sentence covers " . . . situations where a payment is made either directly to the seller or indirectly through a third party." (RNPR, 73 Fed. Reg. at 16122.) In this respect, the definition is consistent with the FTC's historic policy that payments which are funneled through a third party to the supplier (or to an affiliate of the supplier) can be deemed "required payments."[8]

However, the RNPR goes on to state that "[w]ithout such a provision, fraudulent business opportunity sellers could circumvent the Rule by requiring payment to a third party with which the seller has a formal or informal business relationship." (RNPR, 73 Fed. Reg. at 16122, n. 162.) We presume that sentence is intended to emphasize the purpose of including payments that are made to third parties and then remitted to the supplier (or to an affiliate of the supplier). Presumably the FTC does not intend for the definition to encompass payments to third parties that are not remitted to the supplier (or to an affiliate). The RNPR, however, could have been a bit more clear on this point.

We have some concern that the sentence quoted above from footnote 162 of the RNPR could call into question payments to third parties which are routinely made in connection with traditional distribution arrangements.

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[6] Revised Proposed Rule Section 437.1(o)

[7] See 16 CFR 436.1(s)

[8] See, e.g., Advisory Opinion to General Motors Corp. dated 8/17/79 (if dealer makes payments to third parties who in turn make payments to General Motors, then "required payment" element is met).

Distributors and dealers, of course, often must acquire equipment or other items in order to conduct their business. A product distributor, for example, may need to acquire a sales vehicle, computer, and other equipment in order to operate the distributorship. Those needs may be stated in a contract with the product supplier or may arise from practical necessity.

In addition, the product supplier may well have a "formal or informal" business relationship with a vendor of equipment used by the distributor. Such a relationship could exist if the product supplier also uses equipment from that vendor in the supplier's own business, or under other possible circumstances. Including payments made to such a vendor as “required payments” would subject many traditional distribution arrangements to regulation as a business opportunity, in contravention of the FTC's stated goal.

(ii) No Minimum Payment Threshold

The Revised Proposed Rule, unlike the current business opportunity rule, includes no minimum payment threshold. A $1 payment to the supplier could trigger coverage under the Revised Proposed Rule.

A product supplier may have a legitimate need to receive relatively small payments, for items other than inventory, from a distributor or dealer. For example, the supplier may need to make available product literature, samples, or other items to the distributor or dealer. The supplier may also reasonably wish to recover (in whole or in part) the cost of doing so. Many established product suppliers rely on the current $500 minimum payment threshold in this regard.

Consequently, eliminating the minimum payment threshold will likely cause traditional distribution arrangements to be regulated as business opportunities.

3. The FTC Should Take Additional Steps to Insure that Traditional Distribution Arrangements Are Not Covered.

The FTC has never regulated traditional distribution arrangements as business opportunities, and the RNPR makes clear that the FTC does not now intend to change that policy. The RNPR states, quite properly, that the agency will instead focus on the schemes which have a history of fraudulent and abusive practices.

Further, that coverage limitation is critical to the policy rationale underlying the Revised Proposed Rule. For example, the RNPR's Regulatory Analysis assumes that approximately 3,050 businesses would be subject to the Revised Proposed Rule. (RNPR, 73 Fed. Reg. at 16129.) If, however, traditional distribution arrangements are covered, the number of affected businesses would be far greater.

It is therefore essential that those distribution arrangements continue to be excluded from business opportunity regulation. Experience has shown that if they are not clearly excluded from coverage, lawyers will later seize upon available openings and ambiguities. A result of that activity, of course, will be increased costs imposed on the many products sold by distributors and dealers. Another result may be a reduced focus on the truly problematic schemes that business opportunity laws are intended to address.

Following are three suggestions for avoiding those unintended adverse consequences.

(a) Clarify that payments to third parties, which are not remitted to the supplier or its affiliates, do not trigger regulation as a business opportunity.

As explained above, if payments to third parties that are not remitted to the supplier are deemed "required payments," then many traditional distribution arrangements will be regulated as business opportunities. Such regulation would mark a major break with the FTC's historic policy.

From the beginning, the FTC's view has been that payments made to third parties constitute "required payments" only if the third party collects those payments on behalf of the supplier and remits them to the supplier.[9] The FTC reiterated that policy as recently as 2007, when it published the revised franchise rule.[10]

For almost thirty years, businesses have relied on that policy in structuring distribution relationships. For this key definition, it would be unwise to introduce ambiguity and inconsistency with the FTC's long-standing interpretation.

[9] See Final Interpretive Guides to the Franchise Rule ("Interpretive Guides"), 44 Fed. Reg. at 49967 (4/24/79).

[10] 72 Fed. Reg. at 15467 (3/30/07)

Such a policy change clearly could not be justified on the grounds that the business opportunity rule's disclosure requirements are less extensive than those of the franchise rule. As discussed in the comments submitted previously by IBA and others, the proposed requirements for business opportunities are in fact quite substantial.

Further, the fact that compliance costs associated with the franchise rule (or any other rule) may be higher than those associated with the business opportunity rule does not establish the appropriateness of regulating any particular activity as a business opportunity. In the case of traditional distributorships and dealerships, the FTC has correctly decided that such regulation is not justified. An appropriate definition of "required payment" is necessary to the implementation of that decision.

Consequently, we request the FTC clarify that it is maintaining its historic policy that payments made to third parties, which are not remitted to the supplier or its affiliates, do not trigger regulation as a business opportunity.

(b) Retain a minimum payment threshold.

The business opportunity rule currently includes a $500 minimum payment threshold.[11] IBA and other commenters on the 2006 Proposed Rule requested that some type of minimum payment threshold be retained. The FTC, however, is proposing to eliminate the threshold, so that a $1 payment could trigger coverage. As discussed above, eliminating the minimum payment threshold is inconsistent with the stated goal of not regulating traditional distribution arrangements.

The RNPR justifies this change on the grounds that fraudulent schemes may involve relatively small sums. The RNPR adopts the view of commenters who argue that the business opportunity rule must cover all such activity. In the words of one such commenter, "I don't care if it's $10, fraud is fraud." (RNPR, 73 Fed. Reg. at 16122, n. 171.)

It is certainly true that small dollar amounts should not excuse fraudulent conduct. It is also true, however, that trade regulation rules should strike a reasonable balance. It seems to us that a rule which would deem an ordinary distribution arrangement to be a business opportunity, on the grounds of a $1 payment, does not meet that test.

It is also important to keep in mind that business opportunity regulation is not the FTC's only weapon against fraud. The RNPR cites several examples of

[11] 16 CFR 437.2(a)(3)(iii)

enforcement actions involving amounts under $500. (RNPR, 73 Fed. Reg. at 16122, n. 169 and 170.) The FTC successfully brought such actions despite the fact that the business opportunity rule did not apply.[12] It appears that in most or all of these cases, the agency proceeded under Section 5 of the FTC Act.

Also noteworthy is the FTC's decision, explained in the RNPR, to use Section 5—and not business opportunity regulation—against abusive multilevel marketing schemes. The RNPR points out that Section 5 is a "flexible and effective weapon" for that purpose. (RNPR, 73 Fed. Reg. at 16113.) The agency has concluded that "targeted law enforcement under Section 5" against such schemes would be more cost effective than business opportunity regulation. (RNPR, 73 Fed. Reg. at 16120.)

We strongly believe that the same reasoning should apply to matters involving small dollar amounts. An appropriate cost/benefit analysis dictates that the agency use Section 5, and not the business opportunity rule, in those cases.

Therefore, we request that the FTC retain a minimum payment threshold of at least $500.

(c) Add an Exemption Based on the Supplier's Net Worth.

As discussed above, it is important that the FTC's decision not to convert traditional distribution arrangements into business opportunities be clearly reflected in the regulatory language. Otherwise, that decision will be undermined.

An exemption based on the supplier's net worth would be an appropriate tool to "fence out" distributorships and dealerships that have not been associated with the types of abuses seen with business opportunities.[13] IBA would support a minimum exemption net worth level of $5 million, $10 million, or even $25 million or $50 million. The key would be to set the level so that the supplier is a substantial entity which is clearly not the type of "fly-by-night" operator that peddles business opportunity schemes.[14]

Suggested language for such an exemption is attached as Exhibit A. We request that the FTC add this exemption to the business opportunity rule.

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[12] See, e.g., *FTC v. Vinyard Enterprises, Inc.*, No. 03-23291-CIV-ALTONAGA (S.D. Fla. 2003); *FTC v. Leading Edge Processing, Inc.*, 6:02-CV-681-ORL-19 DAB (M.D. Fla. 2002).

[13] As detailed in IBA's July 17, 2006 comments, many state business opportunity laws, and both model business opportunity acts, include such an exemption.

[14] Note that such a supplier's activities could always be challenged under Section 5 of the FTC Act.

4. Conclusion

Thank you for your consideration of IBA's comments on the issues raised by the Revised Proposed Rule. Those issues are of critical importance to many of our members, and to the many other suppliers that sell products to distributors or dealers. If there is a public hearing or workshop on the Revised Proposed Rule, we would like to participate.

Sincerely,

/s/ Nicholas A. Pyle
Nicholas A. Pyle
President

cc: IBA Executive Committee
IBA Board of Directors

Exhibit A

§ 437.8 **Substantial Seller Exemption**

(a) The provisions of this rule shall not apply to the offer for sale, sale, or promotion of a business opportunity by a seller that:

(1) has a net worth of at least five million dollars ($5,000,000) according to the seller's audited balance sheet as of a date not earlier than the 18th month before the date of such offer for sale, sale, or promotion; or

(2) is at least 80 percent owned by another person who:

(i) in writing unconditionally guarantees performance by the seller; and

(ii) has a net worth of at least five million dollars ($5,000,000) according to an audited balance sheet as of a date not earlier than the 18th month before the date of such offer for sale, sale, or promotion.

(b) Upon written request from the Commission, net worth shall be verified by a certification to the Commission from an independent certified public accountant that the audited balance sheet reflects a net worth of at least five million dollars ($5,000,000). This certification shall be provided within 30 days following receipt of a written request from the Commission.

NOTES ON THIS SUGGESTED EXEMPTION:
A supplier with a sufficiently high net worth is not the type of fly-by-night operator at which business opportunity laws are aimed.

This exemption takes a straightforward and simple approach. It would minimize administrative burdens.

Although IBA believes that the $5 million exemption level is reasonable, we could also support a level of $10 million, or even $25 million or $50 million.

The certification arrangement under paragraph (b) would permit the Commission to verify the seller's net worth, while enabling non-public companies to protect the confidential nature of their financial statements.

Current Sections 437.8 and 437.9 of the Revised Proposed Rule would be renumbered accordingly.