

BEFORE THE  
FEDERAL TRADE COMMISSION

COMMENTS OF  
PRE-PAID LEGAL SERVICES, INC.

TO THE  
REVISED NOTICE OF PROPOSED RULEMAKING FOR  
THE BUSINESS OPPORTUNITY RULE, R511993

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Pre-Paid Legal Services, Inc. (“Pre-Paid”) hereby respectfully submits its comments to the Federal Trade Commission’s (“Commission”) Revised Notice of Proposed Rulemaking (the “Revised Notice”) for the Business Opportunity Rule, R511993, 16 C.F.R. 437 (the “Revised Rule”). Pre-Paid believes that the Revised Rule is a highly sensible means of protecting American consumers from fraudulent business opportunities, while also protecting legitimate companies from onerous requirements that could significantly impact their businesses. Pre-Paid believes, however, that although the Commission has stated that it does not intend to have the Revised Rule apply to direct marketing companies like Pre-Paid, and it appears to have done so in the Revised Rule, the Revised Rule should nonetheless be more express in its exemption of direct selling companies such as Pre-Paid, and it therefore submits these comments to ask that the Commission further clarify certain definitions in the Revised Rule.

#### **I. Pre-Paid Legal**

Pre-Paid is located in Ada, Oklahoma, a small town of approximately 15,000 people, and it designs, underwrites, and markets legal expense plans to more than 1.5 million households throughout the United States and Canada. In 1972, Pre-Paid’s CEO and President, Harland Stonecipher, founded Pre-Paid after he suffered a head-on car accident that left him with costly legal fees for which he had no legal protection. Mr. Stonecipher decided after that experience to start a company that would provide individuals and families with access to low-cost quality legal services if they needed them.<sup>1</sup>

Pre-Paid began as a small business and initially employed only three salesmen to solicit new members and service existing accounts. Today, Pre-Paid is publicly traded on the New York

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<sup>1</sup> On August 8, 1972, Harland Stonecipher created Pre-Paid’s predecessor, The Sportsman’s Motor Club, which offered legal expense reimbursement services.

Stock Exchange (Symbol: PPD) and had total revenues in excess of \$457 million in 2007.<sup>2</sup>

It also has approximately 450,000 “vested” Independent Associates nationwide and almost 900 employees in Oklahoma.<sup>3</sup> Indeed, Pre-Paid is one of the largest employers in Ada, with approximately 700 employees. In 2003, it moved into a six-story state-of-the-art campus in Ada on a road named “1 Pre-Paid Way.” It has 90 employees in Duncan, Oklahoma and 90 employees in Antlers, Oklahoma. Pre-Paid has engaged more than 1,200 attorneys, called “Provider Attorneys,” to be available to provide covered legal services to its more than 1.5 million members.

Pre-Paid’s legal expense plans (referred to as “Memberships”) provide a variety of legal services, in a manner similar to health maintenance organization plans. Members pay a monthly fee, (an average of approximately \$20), which includes a number of legal services, as well as a discount on legal services that the Membership does not cover. Pre-Paid markets its Memberships through a multilevel marketing program that encourages Independent Associates to sell Memberships and allows these individuals to recruit and develop their own sales organizations. Many of these individuals become Independent Associates because they want or need to supplement their income by working part-time. As of December 31, 2007, Pre-Paid had 442,361 “vested” Independent Associates.<sup>4</sup> An individual becomes an Independent Associate by paying a modest enrollment fee. During the past two years, enrollment fees have generally been less than \$150. Upon enrollment, the Independent Associate is provided with a “new associate kit,” which includes sales materials, information about Pre-Paid’s products, and promotional materials.

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<sup>2</sup> See Pre-Paid Legal Services, Inc. Form 10-K for the fiscal year ending December 31, 2007 (“Pre-Paid 2007 10-K”) at 16.

<sup>3</sup> A sales associate is considered to be “vested” if he or she has personally sold at least three new Memberships per quarter or if he or she retains a personal Membership. Pre-Paid 2007 10-K at 8.

<sup>4</sup> Pre-Paid 2007 10-K at 8.

Since approximately 1999, Pre-Paid has had a refund policy which allows a newly enrolled Independent Associate to receive a full refund of the enrollment fee upon request within thirty days of his or her enrollment, if he or she has not sold any Memberships within that period.<sup>5</sup>

In light of its use of a multilevel marketing program, Pre-Paid was deeply concerned with the original Notice of Proposed Rulemaking (the “Original Notice”) for the Rule, published in the Federal Register on April 12, 2006. Pre-Paid expressed concern in its comments to the Original Notice that the proposed Rule would impose onerous disclosure requirements on legitimate businesses, without regard for its legitimate nature, the low cost of the opportunity sold, or the presence of a refund policy for purchasers.<sup>6</sup> To address these concerns, Pre-Paid suggested that the Rule exempt publicly-held companies and large privately-held companies that have a strong refund policy in place. Alternatively, Pre-Paid suggested an exemption for opportunities costing less than \$250.<sup>7</sup>

## **II. The Revised Rule**

In light of the thousands of comments that it received from the public in response to the Original Notice, the Commission published a Revised Notice of Proposed Rulemaking in the Federal Register on March 26, 2008. The Commission has attempted to address the concerns of consumers, multilevel marketing companies and their associates, and other interested parties. The Revised Notice proposed a Revised Rule that differs in many significant respects from the originally-proposed Business Opportunity Rule. Most importantly, the Commission has

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<sup>5</sup> See Associate Agreement, Policies and Procedures ¶ 7.

<sup>6</sup> See Comments of Pre-Paid Legal Services, Inc. to the Notice of Proposed Rulemaking for the Business Opportunity Rule, R511993 (“Pre-Paid Comments”) at 6-7.

<sup>7</sup> Pre-Paid was not alone in its concern that the Rule failed to protect legitimate businesses while attacking fraud: thousands of comments, the majority from the multilevel marketing industry, attested to the danger that the proposed Rule could negatively affect businesses with multilevel marketing programs. See Revised Notice at 15-16.

expressly stated that it seeks to exclude multilevel marketing programs from the scope of the Rule, on the ground that none of the measures set forth in the original proposed Rule would prevent fraud while still protecting legitimate companies from onerous disclosures.<sup>8</sup>

Pre-Paid fully supports the Commission's decision and the Revised Rule. Pre-Paid does, however, have some concern about the Revised Rule as currently proposed. Pre-Paid thus would specifically like to address Questions (1) and (2) in the Revised Notice, which concern the scope of the definition of the term "business opportunity" and, by extension, of the Rule itself.

"Business opportunity" would be defined in section 437.1(c) of the Revised Rule 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.

The Commission has asked whether this "business opportunity" definition may cause the Revised Rule to inadvertently cover offerings that the interim Business Opportunity Rule does

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<sup>8</sup> See 73 Fed. Reg. at 16119.

not cover.<sup>9</sup> The Commission has also asked, more specifically, whether the definition of “providing locations, outlets, accounts, or customers” has been crafted in such broad terms it could capture numerous unintended businesses. Pre-Paid believes there is indeed the potential that subsections (ii) and (iii) of section 437.1(c) could be misinterpreted, to encompass direct marketing programs that the Commission has stated should not be included within the scope of the Revised Rule.

Subsection (ii), quoted above, turns on the definition of “providing locations, outlets, accounts, or customers,” a term that Pre-Paid believes is crafted too broadly. The term is defined in section 437(l) of the Rule as follows:

Providing locations, outlets, accounts, or customers means furnishing the prospective purchaser with existing or potential locations, outlets, accounts, or customers; requiring, recommending, or suggesting one or more locators or lead generating companies; providing a list of locator or lead generating companies; collecting a fee on behalf of one or more locators or lead generating companies; offering to furnish a list of locations; or otherwise assisting the prospective purchaser in obtaining his or her own locations, outlets, accounts, or customers.<sup>10</sup>

The Commission has made clear its determination that the Revised Rule should not cover multilevel marketing opportunities.<sup>11</sup> To that end, the Commission has specifically deleted the words “and training” from the last clause of the definition “to avoid the possibility that it could be interpreted as a “catch-all” capturing any business offering to provide training.”<sup>12</sup>

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<sup>9</sup> 73 Fed. Reg. at 16133. The interim Business Opportunity Rule, found at 16 C.F.R. 437, is the portion of the original Franchise Rule that applied to business opportunities. *See* 73 Fed. Reg. at 16121, n.158.

<sup>10</sup> 73 Fed. Reg at 16135.

<sup>11</sup> *Id.* at 16110.

<sup>12</sup> 73 Fed. Reg. at 16124. Further to this end, the Revised Notice deletes proposed section 437.1(c)(5), which would have extended the definition of “business opportunity” to include advising or training of purchasers. *See* 73 Fed Reg. at 16134.

The Commission also has signaled that the Revised Rule should not cover multilevel marketing opportunities by stating that the Commission “will continue to apply its longstanding analysis, which considers the kinds of assistance the seller offers and the significance of that assistance to the prospective purchaser (*e.g.*, whether the assistance is likely to induce reliance on the part of the prospective purchaser).”<sup>13</sup> The Commission cites a Staff Advisory Opinion stating that, with respect to the kind of assistance offered, “the Commission will apply a flexible standard.”<sup>14</sup> The Commission furthermore will analyze the significance to the potential purchaser in context, focusing particularly on whether the seller’s offer is “reasonably likely to have the effect on the seller to provide a successful pre-packaged business”:

Applying this standard, we previously stated that [Franchise] Rule coverage might be found, for example, where the seller introduces investors to an unaffiliated person who will secure locations or accounts for them; provides investors with lists of persons able to furnish location services; or instructs investors on how to find their own profitable locations.<sup>15</sup>

While this statement from the Commission is helpful, it could be considered somewhat vague. Therefore, despite the removal of the words “or training” from the Rule and the Commission’s statement, Pre-Paid is concerned that there is nonetheless the potential for misinterpretation. Under the final clause of this definition, “assisting” a purchaser to obtain his or her own customers could potentially bring the transaction within the Business Opportunity Rule. Such a reading would defeat the Commission’s clearly-stated intent, but it is nonetheless at least possible, if the proposed text of the Rule is broadly interpreted in the abstract.

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<sup>13</sup> 73 Fed. Reg. at 16125.

<sup>14</sup> *See id.* (citing Staff Advisory Opinion 95-10, Bus. Franchise Guide (CC) 6475 (1995)).

<sup>15</sup> Staff Advisory Opinion 95-10, Bus. Franchise Guide (CC) 6475 (1995).

Pre-Paid also has some concern with section 437.1(c)(iii) of the Revised Rule, which would extend the definition of “business opportunity” to commercial arrangements where sellers represent that they will “[b]uy back any or all of the goods or services that the purchaser . . . provides.”<sup>16</sup> Pre-Paid is concerned that, despite the Commission’s intent to exclude direct marketing companies such as Pre-Paid, the meaning of this provision could be stretched to include unintended actions by sellers. For example, Pre-Paid offers its new Independent Associates a refund if, after reviewing Pre-Paid’s new associate materials and before selling any legal expense plans, they are no longer interested in selling the service.<sup>17</sup> While use of the word “buy” in the phrase “buy back” does suggest that the purchaser would be providing to the seller a good with some sort of value added—such as where the purchaser would assemble something from components for the seller—the use of the word “back” could suggest that the seller is merely providing a refund of the money originally paid by the purchaser. Pre-Paid would like more certainty that a company will not, by virtue of a liberal refund policy, which should be encouraged, be broadly swept within the ambit of the Rule.

### **III. Recommendations**

In light of its concerns, Pre-Paid suggests that the Commission modify the Revised Rule’s definition of “business opportunity” language in three ways. First, Pre-Paid suggests that the language in subsection (2) be changed to read: “The prospective purchaser makes a required payment of \$250 or more. . . .” This language would create a “safe harbor” provision to the rule that would provide sellers with assurance that they will not be captured by the Revised Rule. In its Revised Notice, the Commission expressed concern that the safe harbor would not adequately distinguish between pyramid schemes and legitimate companies, and would result in

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<sup>16</sup> 73 Fed. Reg. at 16134

<sup>17</sup> See Pre-Paid Comments at 3-4.



manipulation to meet safe harbor provisions.<sup>18</sup> The purpose of the safe harbor provision, however, is to recognize that some direct selling programs require such a low start-up cost that the administrative burdens of the Rule would outweigh the benefit to consumers, direct selling companies, and the Commission, especially combined with the other weapons at the Commission's disposal to combat fraud against consumers.

Pre-Paid's second recommendation is that the Commission state more clearly that advisement and training are not covered by the Revised Rule. To accomplish this goal, the Commission should consider adding a new section 437.1(c)(4) to the Revised Rule, which would read as follows:

*(4) The term "business opportunity" shall not apply to a commercial arrangement in which the seller solicits a prospective purchaser to enter into a new business by offering assistance only in advising or training the purchaser in the promotion, operation, or management of a new business, or providing the purchaser with operational, managerial, technical, or financial guidance in the operation of a new business.*

Pre-Paid believes that this language would confirm for the public and companies that use multilevel marketing programs that their programs do not fall within the Revised Rule. Furthermore, this proposed new subsection would not inhibit the Commission's power to compel disclosures from dishonest companies, as most companies engaged in fraudulent business opportunities promise significantly more than mere training or advisement.<sup>19</sup>

Pre-Paid's third recommendation is that the Commission modify proposed section 437.1(c)(3)(iii) to read as follows:

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<sup>18</sup> 73 Fed. Reg. at 16119, 16122-23.

<sup>19</sup> See 73 Fed. Reg. at 16123 (stating that "fraudulent business opportunity ventures, such as vending opportunities, rack display schemes, and medical billing work-at-home schemes . . . are captured adequately" within the scope of the Revised Rule, even without coverage for training opportunities).

(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, *but not including the refund of any required payment to the purchaser.*

This modification would make clear that the Revised Rule would not apply to standard refunds by sellers to purchasers, for example because the purchaser is no longer interested in the product.

In sum, Pre-Paid believes that the Commission's Proposed Business Opportunity Rule has been revised in a sensible manner that will protect honest businesses, while also providing the Commission with the ability to force disclosures in situations where fraud is a significant concern. Pre-Paid urges the Commission to further clarify that the Rule would not apply to businesses that employ multilevel marketing programs. Pre-Paid also requests that, should there be a hearing on the Revised Rule, that it be allowed to have the opportunity to testify at that hearing.<sup>20</sup>

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<sup>20</sup> Pre-Paid's comments to the Revised Rule are based upon the Revised Rule as published in the Federal Register on March 26, 2008, at 73 Fed. Reg. 16110. To the extent the Commission further revises the Business Opportunity Rule, Pre-Paid would like to reserve the right to further comment on any such revisions.