



# Federal Register

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**Wednesday,  
March 26, 2008**

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**Part II**

## **Federal Trade Commission**

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**16 CFR Part 37  
Business Opportunity Rule; Proposed Rule**

**FEDERAL TRADE COMMISSION****16 CFR Part 437**

RIN 3084-AB04

**Business Opportunity Rule****AGENCY:** Federal Trade Commission.**ACTION:** Revised Notice of Proposed Rulemaking.

**SUMMARY:** The Federal Trade Commission (the "Commission" or "FTC") is publishing a revised Notice of Proposed Rulemaking to amend Part 437, the trade regulation rule governing sale of business opportunities that are not covered by the amended Franchise Rule. The revised proposed Business Opportunity Rule (or "the Rule") is based upon the comments received in response to an Advance Notice of Proposed Rulemaking ("ANPR"), a Notice of Proposed Rulemaking ("NPRM"), and other information discussed in this notice. The revised proposed Business Opportunity Rule would require business opportunity sellers to furnish prospective purchasers with specific information that is material to the consumer's decision as to whether to purchase a business opportunity and which should help the purchaser identify fraudulent offerings. The proposed rule also would prohibit other acts or practices that are unfair or deceptive within the meaning of Section 5 of the Federal Trade Commission Act (the "FTC Act").

**DATES:** Written comments must be received on or before May 27, 2008. Rebuttal comments must be received on or before June 16, 2008.

**ADDRESS:** Interested parties are invited to submit written comments. Comments should refer to "Business Opportunity Rule, R511993" to facilitate the organization of comments. A comment filed in paper form should include this reference both in the text and on the envelope, and should be mailed or delivered, with two complete copies, to the following address: Federal Trade Commission/Office of the Secretary, Room H-135 (Annex S), 600 Pennsylvania Avenue, NW, Washington, DC 20580. Comments containing confidential material, however, must be filed in paper form, must be clearly labeled "Confidential," and must comply with Commission Rule 4.9(c).<sup>1</sup>

<sup>1</sup> The comment must be accompanied by an explicit request for confidential treatment, including the factual and legal basis for the request, and must identify the specific portions of the comment to be withheld from the public record. The request will be granted or denied by the Commission's General Counsel, consistent with

The FTC is requesting that any comment filed in paper form be sent by courier or overnight service, if possible, because U.S. postal mail in the Washington area and at the Commission is subject to delay due to heightened security precautions. Moreover, because paper mail in the Washington area and at the Agency is subject to delay, please consider submitting your comments in electronic form, as prescribed below.

Comments filed in electronic form should be submitted by using the following weblink: <https://secure.commentworks.com/ftc-bizopRNPR/> (and following the instructions on the web-based form). To ensure that the Commission considers an electronic comment, you must file it on the web-based form at the weblink <https://secure.commentworks.com/ftc-bizopRNPR/>. If this notice appears at <http://www.regulations.gov>, you may also file an electronic comment through that website. The Commission will consider all comments that regulations.gov forwards to it. You may also visit the FTC website at <http://www.ftc.gov/opa/index.shtml> to read the Revised Notice of Proposed Rulemaking and the news release describing this proposed Rule.

The FTC Act and other laws the Commission administers permit the collection of public comments to consider and use in this proceeding as appropriate. The Commission will consider all timely and responsive public comments that it receives, whether filed in paper or electronic form. Comments received will be available to the public on the FTC website, to the extent practicable, at <http://www.ftc.gov>. As a matter of discretion, the FTC makes every effort to remove home contact information for individuals from the public comments it receives before placing those comments on the FTC website. More information, including routine uses permitted by the Privacy Act, may be found in the FTC's privacy policy, at <http://www.ftc.gov/ftc/privacy.htm>.

Comments on any proposed filing, recordkeeping, or disclosure requirements that are subject to paperwork burden review under the Paperwork Reduction Act should additionally be submitted to: Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for the Federal Trade Commission. Comments should be submitted via facsimile to (202) 395-6974 because U.S. Postal Mail is subject

applicable law and the public interest. See Commission Rule 4.9(c), 16 CFR 4.9(c).

to lengthy delays due to heightened security precautions.

**FOR FURTHER INFORMATION CONTACT:** Monica Vaca (202) 326-2245, Division of Marketing Practices, Room 286, Bureau of Consumer Protection, Federal Trade Commission, 600 Pennsylvania Avenue, NW, Washington, DC 20580.

**SUPPLEMENTARY INFORMATION:** This Revised Notice of Proposed Rulemaking seeks comment on a revised proposed Business Opportunity Rule. In addition to minor wording and punctuation changes to improve clarity, the revised proposed rule modifies the initial proposal in six significant ways:

- It narrows the scope of the proposed Rule to avoid broadly sweeping in sellers of multi-level marketing opportunities, while retaining coverage of those business opportunities sellers historically covered by the FTC's original Franchise Rule (and by the FTC's interim Business Opportunity Rule), as well as coverage of sellers of work-at-home schemes;

- It cures a potential overbreadth problem that may have inadvertently swept in companies using traditional product distribution arrangements;

- It eliminates the previously-proposed requirement that a covered business opportunity seller disclose the number of cancellation and refund requests it received;

- It eliminates the requirement to disclose litigation history of certain sales personnel (while retaining the requirement to disclose litigation history of the seller, its principals, officers, directors, and sales managers, as well as any individual who occupies a position or performs a function similar to an officer, director, or sales manager);

- It adds a requirement to include a citation to the Rule in the title of the required disclosure document; and

- It prohibits misrepresenting that the government or any law forbids providing prospects with a list of prior purchasers of a business opportunity.

The Commission invites interested parties to submit data, views, and arguments on the proposed Business Opportunity Rule and, specifically, on the questions set forth in Section J of this notice. The comment period will remain open until May 27, 2008. To the extent practicable, all comments will be available on the public record and placed on the Commission's website: <http://www.ftc.gov/os/publiccomments.htm>. After the close of the comment period, the record will remain open until June 16, 2008, for rebuttal comments. If necessary, the Commission also will hold hearings with cross-examination and post-

hearing rebuttal submissions, as specified in Section 18(c) of the FTC Act, 15 U.S.C. 57a(c). Parties who request a hearing must file a comment in response to this notice and a statement explaining why they believe a hearing is warranted, how they would participate in a hearing, and a summary of their expected testimony, on or before May 27, 2008. Note that because the NPR has been revised, parties interested in a hearing must resubmit their request in comments to this Revised NPR. Parties testifying at a hearing may be subject to cross-examination. For cross-examination or rebuttal to be permitted, interested parties must also file a comment and request to cross-examine or rebut a witness, designating specific facts in dispute and a summary of their expected testimony, on or before June 16, 2008. In lieu of a hearing, the Commission will also consider requests to hold one or more informal public workshop conferences to discuss the issues raised in this notice and comments.

### Section A. Background

The Commission is publishing this Revised Notice of Proposed Rulemaking pursuant to Section 18 of the FTC Act, 15 U.S.C. 57a *et seq.*, and Part 1, Subpart B, of the Commission's Rules of Practice. 16 CFR 1.7, and 5 U.S.C. 551 *et seq.* This authority permits the Commission to promulgate, modify, and repeal trade regulation rules that define with specificity acts or practices that are unfair or deceptive in or affecting commerce within the meaning of Section 5(a)(1) of the FTC Act. 15 U.S.C. 45(a)(1).

On December 21, 1978, the Commission promulgated a trade regulation rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" (the "Franchise Rule") to address deceptive and unfair practices in the sale of franchises and business opportunity ventures.<sup>2</sup> Based upon the original rulemaking record, the Commission found that franchise and business opportunity fraud was widespread, causing serious economic harm to consumers. The Commission adopted the Franchise Rule to prevent fraudulent practices in the sale of franchises and business opportunities through pre-sale disclosure of specified items of material information.

The purpose of the Franchise Rule was not to regulate the substantive terms of a franchise or business

opportunity agreement but to ensure that sellers disclose material information to prospective buyers. The Franchise Rule was posited on the notion that a fully informed consumer can determine whether a particular offering is in his or her best interest.

As part of the Commission's overall policy of periodic review of its trade regulation rules, in 1995 the Commission commenced a regulatory review of the Franchise Rule.<sup>3</sup> From the outset of that review proceeding, the predominant theme sounded by commenters and other participants was that the Rule, insofar as it concerned sales of business format franchises, should be more closely harmonized with state franchise regulations—i.e., the Uniform Franchise Offering Circular ("UFOC") Guidelines. A corollary theme was that business opportunity sales should be governed by a separate regulation, in accordance with the approach followed generally at the state level.

Moreover, early in the review the issue arose as to whether the Franchise Rule's extensive disclosure requirements were well-suited to business opportunity sales and whether the Franchise Rule imposed unnecessary compliance costs on both business opportunity sellers and buyers. To ensure that the required disclosures protect prospective business opportunity purchasers, while minimizing overall compliance costs, the Commission solicited comment on whether any of the Rule's disclosures should be eliminated as unnecessary in the business opportunity context and whether any additional material disclosures should be required.<sup>4</sup>

At the conclusion of the Rule Review, the Commission determined to retain the Franchise Rule with modifications designed to harmonize it better with state franchise requirements. At the same time, the Commission determined to seek additional comment on whether to address the sale of business opportunities through a separate narrowly tailored new trade regulation rule.

<sup>3</sup> Rule Review, 60 FR 17656 (Apr. 7, 1995). References to the Rule Review comments are cited as: the name of the commenter, RR comment number (e.g., NASAA, RR 43). References to the Rule Review workshop conferences are cited as: name of commenter, Sept95 Tr or March96 Tr, respectively (e.g., D'Imperio, Sept95 Tr, and Ainsely, March96 Tr). A list of the Rule Review commenters and the abbreviations used to identify each in this notice is cited in the Notice of Proposed Rulemaking for the Business Opportunity Rule ("Business Opportunity Rule NPR"). See 71 FR 19054, 19092–93.

<sup>4</sup> 60 FR at 17658 (Question 14).

In 1997, the Commission published an Advance Notice of Proposed Rulemaking ("ANPR") in the **Federal Register**,<sup>5</sup> seeking further comment on several proposed Franchise Rule modifications, including the separation of disclosure requirements for sales of business opportunities from those for sales of franchises. The Commission also sought comment on the proper scope of the term "business opportunity,"<sup>6</sup> the types of business opportunities that are known to engage in deceptive or fraudulent conduct,<sup>7</sup> and the types of disclosures that are material to business opportunity purchasers.<sup>8</sup>

After assessing the comments received in response to the ANPR, the Commission decided to amend the Franchise Rule to harmonize it better with the UFOC. Accordingly, the Commission published a Franchise Rule Notice of Proposed Rulemaking ("Franchise Rule NPR"), soliciting comment on proposed revisions to the Franchise Rule,<sup>9</sup> and simultaneously announcing the intention to conduct a separate rulemaking to address business opportunity sales.<sup>10</sup> Agreeing with the overwhelming view of the commenters who discussed this issue during the Rule Review and in response to the ANPR, the Commission found that franchises and business opportunities are distinct business arrangements that require separate disclosure approaches.

After addressing each of the required stages of rulemaking under Section 18 of the FTC Act, the Commission announced adoption of an amended Franchise Rule on January 23, 2007, and published the amended rule and accompanying Statement of Basis and Purpose on March 30, 2007.<sup>11</sup> In that **Federal Register** notice, the Commission also separated the Franchise Rule into two distinct CFR parts—part 436 governing the sales of business format franchises, and a new part 437, governing the sales of non-franchise business opportunities. Part

<sup>5</sup> ANPR, 62 FR 9115 (Feb. 28, 1997). References to the ANPR comments are cited as: the name of the commenter, ANPR, comment number (e.g., NASAA, ANPR 120). References to the ANPR workshop conferences are cited as: name of commenter, ANPR, date Tr (e.g., Bundy, ANPR, 6Nov97 Tr). A list of the ANPR commenters and the abbreviations used to identify each is cited in the NPR. See 71 FR at 19093-19095.

<sup>6</sup> 62 FR at 9116-117 and 9121 (Question 12).

<sup>7</sup> *Id.* at 9121 (Questions 8–10).

<sup>8</sup> *Id.* at 9121 (Questions 15–16).

<sup>9</sup> Franchise Rule NPR, 64 FR 57294 (Oct. 22, 1999).

<sup>10</sup> *Id.* at 57296.

<sup>11</sup> Amended Franchise Rule Statement of Basis and Purpose ("Amended Franchise Rule SBP") 72 FR 15444 (March 30, 2007) (Amended Franchise Rule codified at 16 CFR 436).

<sup>2</sup> Statement of Basis and Purpose ("SBP"), 43 FR 59614 (Dec. 21, 1978) (Franchise Rule codified at 16 CFR 436).

437 is identical to the original Franchise Rule, with all of the definitional elements and references regarding business format franchising deleted.<sup>12</sup> Part 437 will continue to govern sales of non-franchise business opportunities, pending completion of the Business Opportunity rulemaking proceedings advanced in a Notice of Proposed Rulemaking published April 12, 2006.<sup>13</sup>

### Section B. The Notice of Proposed Rulemaking

Having determined to create a separate rule for business opportunities, in 2006 the Commission published in the **Federal Register** a Notice of Proposed Rulemaking ("NPR") on a Business Opportunity Rule,<sup>14</sup> which would amend what is now designated as 16 CFR Part 437. The NPR explained the need for a Business Opportunity Rule separate from the Franchise Rule, noting particularly that business opportunities and franchises are distinct business arrangements that pose very different regulatory challenges. For example, franchises typically are expensive and involve complex contractual licensing relationships, while business opportunity sales are often less costly, involving simple purchase agreements that pose less of a financial risk for purchasers.

Yet, the Commission's law enforcement experience in conducting numerous sweeps of the business opportunity industry demonstrates that fraud is not only prevalent but persistent, and many comments also sounded this theme.<sup>15</sup> Just in the period since 1990, the Commission has brought

<sup>12</sup> The interim Business Opportunity Rule differs from the original Franchise Rule in three respects. First, references to "franchisor" and "franchisee" in the original Franchise Rule have been changed to "business opportunity seller," and "business opportunity purchaser," respectively. Second, the original definition of "franchise" set out at 436(a)(2) has been changed to "business opportunity," and the first part of the original definition—the "franchise" elements—has been deleted; the definition now focuses on the second part of the original definition—the business opportunity elements. Third, part 437 sets forth a new exemption for franchises that comply with or are exempt from part 436. Amended Franchise Rule SBP, 72 FR at 15444.

<sup>13</sup> Business Opportunity Rule NPR, 71 FR 19054 (April 12, 2006).

<sup>14</sup> *Id.*

<sup>15</sup> *E.g.*, Baer, ANPR 25, at 5; Wieczorek, 21Aug97 Tr at 35; DSA, *id.*; Finnigan, *id.* at 90; Kestenbaum, RR 14, at 3-4; Wieczorek, RR 23, at 2-3; Lewis, RR 40, Attachment at 3; CA BLS, RR 45, at 5-6; D'Imperio, Sept95 Tr at 130; Kezios, *id.* at 365, 631. *But see* MLMIA, at 7 & Exhibit A (comment submitted in response to the NPR and its attached declaration argue that fraud is not widespread in the business opportunity sector). The exhibit attached to the MLMIA's comment is belied by the Commission's law enforcement experience, described above, as well as that of the Department of Justice, described in its comment. DOJ, at 1.

some 150 Franchise Rule cases against vending machine, rack display, and similar opportunities. Since 1995, the Commission has conducted more than 15 business opportunity sweeps,<sup>16</sup> many with other federal and state law enforcement partners, to combat persistent business opportunity frauds violating the Franchise Rule, such as those involving the sale of vending machines,<sup>17</sup> rack displays,<sup>18</sup> public telephones,<sup>19</sup> Internet kiosks,<sup>20</sup> and 900-number ventures,<sup>21</sup> among others. The great majority of these cases alleged

<sup>16</sup> *E.g.*, Project False Hope\$ (2006); Project Biz Opp Flop (2005); Project Busted Opportunity (2002); Project Telesweep (1995); Project Bizillions\$ (1999); Operation Money Pit (1998); Project Vend Up Broke (1998); Project Trade Name Games (1997); and Operation Missed Fortune (1996). In addition to joint law enforcement sweeps, Commission staff has also targeted specific business opportunity ventures such as envelope stuffing (Operation Pushing the Envelope 2003, medical billing (Operation Dialing for Deception 2002, and Project Housecall 1997); seminars (Operation Showtime 1998); Internet-related services (Net Opportunities 1998); vending (Project Yankee Trader 1997); and 900 numbers (Project Buylines 1996).

<sup>17</sup> *E.g.*, *FTC v. American Entm't Distribs., Inc.*, No. 04-22431-CIV-Martinez (S.D. Fla. 2004); *FTC v. Pathway Merch., Inc.*, No. 01-CIV-8987 (S.D.N.Y. 2001); *U.S. v. Photo Vend Int'l, Inc.*, No. 98-6935-CIV-Ferguson (S.D. Fla. 1998); *FTC v. Hi Tech Mint Sys., Inc.*, No. 98 CIV 5881 (JES) (S.D.N.Y. 1998); *FTC v. Claude A. Blanc, Jr.*, No. 2:92-CV-129-WCO (N.D. Ga. 1992). *See also* FTC News Release: FTC Announces "Operation Vend Up Broke" (Sept. 3, 1998) (available at <http://www.ftc.gov/opa/1998/09/vendup2.htm>) (FTC and 10 states announce 40 enforcement actions against fraudulent vending business opportunities).

<sup>18</sup> *E.g.*, *U.S. v. Elite Designs, Inc.*, No. CA 05 058 (D.R.I. 2005); *U.S. v. QX Int'l*, No. 398-CV-0453-D (N.D. Tex. 1998); *FTC v. Carousel of Toys*, No. 97-8587-CIV-Ungaro-Benages (S.D. Fla. 1997); *FTC v. Raymond Urso*, No. 97-2680-CIV-Ungaro-Benages (S.D. Fla. 1997); *FTC v. Infinity Multimedia, Inc.*, No. 96-6671-CIV-Gonzalez (S.D. Fla. 1996); *FTC v. O'Rourke*, No. 93-6511-CIV-Ferguson (S.D. Fla. 1993). *See also* FTC News Release: Display Racks for Trade-Named Toys and Trinkets are the Latest in Business Opportunity Fraud Schemes (Aug. 5, 1997) (available at <http://www.ftc.gov/opa/1997/08/tradenam.htm>) (FTC and 8 states file 18 enforcement actions against sellers of bogus display opportunities that use trademarks of well-known companies).

<sup>19</sup> *E.g.*, *FTC v. Advanced Pub. Commc'ns Corp.*, No. 00-00515-CIV-Ungaro-Benages (S.D. Fla. 2000); *FTC v. Ameritel Payphone Distribs., Inc.*, No. 00-0514-CIV-Gold (S.D. Fla. 2000); *FTC v. ComTel Commc'ns Global Network, Inc.*, No. 96-3134-CIV-Highsmith (S.D. Fla. 1996); *FTC v. Intellipay, Inc.*, No. H92 2325 (S.D. Tex. 1992).

<sup>20</sup> *E.g.*, *FTC v. Bikini Vending Corp.*, No. CV-S-05-0439-LDG-RJJ (D. Nev. 2005); *FTC v. Network Service Depot, Inc.*, No. CV-SO-05-0440-LDG-LRL (D. Nev. 2005); *U.S. v. Am. Merch. Tech.*, No. 05-20443-CIV-Huck (S.D. Fla. 2005); *FTC v. Hart Mktg. Enter. Ltd., Inc.*, No. 98-222-CIV-T-23 E (M.D. Fla. 1998). *See also* *FTC v. FutureNet, Inc.*, No. CV-98-1113 GHK (BQRx) (C.D. Cal. 1998); *FTC v. TouchNet, Inc.*, No. C98-0176 (W.D. Wash. 1998).

<sup>21</sup> *E.g.*, *FTC v. Bureau 2000 Int'l, Inc.*, No. 96-1473-DT-(JR) (C.D. Cal. 1996); *FTC v. Genesis One Corp.*, No. CV-96-1516-MRP (MCX) (C.D. Cal. 1996); *FTC v. Innovative Telemedia, Inc.*, No. 96-8140-CIV-Ferguson (S.D. Fla. 1996); *FTC v. Ad-Com Int'l*, No. 96-1472 LGB (VAP) (C.D. Cal. 1996).

Franchise Rule violations. To attack other forms of business opportunity fraud—notably, work-at-home and pyramid schemes—the Commission used Section 5 of the FTC Act, because these schemes were not covered by the original Franchise Rule.<sup>22</sup>

The NPR highlighted features of the original Franchise Rule that excluded from its coverage certain types of schemes, such as pyramid schemes and work-at-home schemes.<sup>23</sup> The Commission noted that many of these schemes fell outside the ambit of the Franchise Rule because: (1) the purchase price was less than \$500, the minimum payment necessary to trigger coverage under the original Franchise Rule; (2) required payments were primarily for inventory, which did not count toward the \$500 monetary threshold; (3) the scheme did not offer location or account assistance; or (4) the scheme involved the sale of products to the business opportunity seller rather than to end-users, a further limitation on coverage under the original Franchise Rule.<sup>24</sup>

To bring the wide array of fraudulent business opportunities within the scope of the Rule, the NPR proposed an expansive definition of "business opportunity." In addition to those business opportunities that had been covered by the original Franchise Rule, the Initial Proposed Business Opportunity Rule (the "IPBOR") aimed to cover work-at-home schemes and pyramid schemes.<sup>25</sup>

To reach these schemes, the NPR proposed a broad definition of "business opportunity" that would have included commercial arrangements where the seller made "earnings claims" or offered "business assistance."<sup>26</sup> The Commission recognized that the most frequent allegation in its law enforcement actions against business opportunity frauds has been that the seller made false and unsubstantiated earnings claims. Therefore, the IPBOR incorporated the broad definition of "earnings claims" from the original Franchise Rule.<sup>27</sup>

The IPBOR also defined a new term, "business assistance," in a broad manner, using five illustrative examples

<sup>22</sup> Likewise, they are not covered under 16 CFR Part 437.

<sup>23</sup> Two types of work-at-home schemes mentioned in the NPR were product assembly schemes and envelope-stuffing schemes. 71 FR at 19059-19060.

<sup>24</sup> The limits on coverage of the original Franchise Rule and the effects of those limitations are discussed in detail in the NPR. *See* 71 FR at 19055.

<sup>25</sup> *Id.* at 19059.

<sup>26</sup> IPBOR, 437.1(d)(3).

<sup>27</sup> IPBOR, 437.1(h).

of the types of assistance that would trigger coverage.<sup>28</sup> Among these examples, the IPBOR included “buy back” assistance, which refers to a seller’s offer to buy back products that consumers have assembled at home.<sup>29</sup> Another example captured the tracking of payments and commissions, a type of assistance that pyramid schemes routinely offer.<sup>30</sup> Additionally, the definition of “business assistance” expressly included assistance in the form of training.<sup>31</sup>

At the same time, the IPBOR excised two features of the original Franchise Rule that limited the scope of its coverage: the \$500 minimum payment threshold, and the exemption for purchases of inventory at bona fide wholesale prices. By eliminating the \$500 minimum payment requirement, the IPBOR would have included within its scope the various types of fraudulent business opportunity sellers that have evaded coverage under the disclosure requirements of the Franchise Rule by pricing their schemes below \$500. Envelope stuffing, product assembly, medical billing schemes, and other schemes frequently are priced below the monetary threshold of Franchise Rule coverage.<sup>32</sup> Additionally, the IPBOR would have ensured coverage of pyramid schemes by eliminating the inventory exemption.

In response to the NPR, the Commission received more than 17,000 comments.<sup>33</sup> The overwhelming majority of these comments came from the multilevel marketing<sup>34</sup> (“MLM”) industry, including industry representatives, companies, and individual distributors. These commenters urged the Commission to

narrow the scope of the IPBOR, to implement various safe-harbor provisions, and/or to reduce the required disclosures. Thousands of comments were form letters<sup>35</sup> submitted by participants in various MLM operations, including Quixtar, Shaklee, PartyLite, Xango, among others.<sup>36</sup> The Commission also received approximately 187 comments, primarily from individual consumers or consumer groups, in favor of the IPBOR.<sup>37</sup> Only a handful of comments came in from non-MLM companies and industry groups, expressing various concerns about obligations that the IPBOR would impose upon them.

### Section C. Scope of the Proposed Rule

The revised proposed Business Opportunity Rule (“RPBOR”) is more narrowly tailored than the IPBOR. The RPBOR expressly excludes from coverage training and/or educational organizations that, as the comments showed, may have been inadvertently covered. In addition, the revised proposal does not attempt to cover MLMs. Instead, the Commission will continue to use Section 5, a flexible and effective weapon, against MLMs that engage in unfair or deceptive practices.

In recognition of the prevalence of fraud in the sale of business opportunities, including work-at-home and pyramid schemes, the Commission had designed the IPBOR with an expansive scope in order to reach various fraudulent practices. While expanding the scope of the original Franchise Rule’s coverage of business opportunities, the IPBOR greatly reduced the compliance burden that the original Franchise Rule imposed on business opportunity sellers. The Commission recognized that the extensive disclosures of the original Franchise Rule would entail disproportionate compliance costs for comparatively low-cost transactions

involving the sale of business opportunities.<sup>38</sup> Therefore, in an attempt to strike the proper balance, the Commission mitigated the compliance burden by including in the IPBOR substantially simplified and streamlined disclosure requirements.

However, the streamlining did not fully achieve the Commission’s purpose. Two key problems emerged with the IPBOR’s breadth of coverage. First, the IPBOR would have unintentionally swept in numerous commercial arrangements where there is little or no evidence that fraud is occurring. Second, the IPBOR would have imposed greater burdens on the MLM industry than other types of business opportunity sellers without sufficient countervailing benefits to consumers.

#### 1. Traditional Product Distribution Arrangements and Others

Several commenters contended that the IPBOR would have regulated a wide range of legitimate and traditional product distribution arrangements that are not associated with the types of fraud that business opportunity laws are designed to remedy.<sup>39</sup> As one commenter described it, the IPBOR would have swept in traditional arrangements for distribution of “food and beverages, construction equipment, manufactured homes, electronic components, computer systems, medical supplies and equipment, automotive parts, automotive tools and other tools, petroleum products, industrial chemicals, office supplies and equipment, and magazines.”<sup>40</sup> For example, one commenter, a footwear manufacturer, suggested that the IPBOR could be read to cover the commenter’s product distribution through retail stores simply because the retailer pays for inventory and the manufacturer provides sales training to its retail accounts.<sup>41</sup> Thus, this aspect of the commenter’s operations would meet the definition of “business opportunity” in the IPBOR because: (1) the “payment”

<sup>28</sup> IPBOR, 437.1(c).

<sup>29</sup> IPBOR, 437.1(c)(1)(iii).

<sup>30</sup> IPBOR, 437.1(c)(1)(iv).

<sup>31</sup> IPBOR, 437.1(c)(v).

<sup>32</sup> See *infra* Section D.1.a.1.i.

<sup>33</sup> References to the comments responding to the Business Opportunity Rule NPR are cited by the name of the commenter and the page number. Individual commenters are identified by their first and last names. Companies and organizations are identified by abbreviated names. A list of companies and organization that are cited herein and the abbreviations used to identify each is attached as Attachment A.

<sup>34</sup> Multi-level marketing is one form of direct selling, and refers to a business model in which a company distributes products through a network of distributors who earn income from their own retail sales of the product and from retail sales made by the distributors’ direct and indirect recruits. Because they earn a commission from the sales their recruits make, each member in the MLM network has an incentive to continue recruiting additional sales representatives into their “down lines.” See Peter J. Vander Nat and William W. Keep, *Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes*, 21 J. of Pub. Pol’y & Marketing (Spring 2002), (“Vander Nat and Keep”) at 140.

<sup>35</sup> Some commenters provided information demonstrating that certain MLM companies solicited their distributors to submit letters in their proposed form or template to the FTC. See e.g., James Kellogg (Quixtar); Smith (Arbonne); Anonymous (PartyLite).

<sup>36</sup> In addition, the Commission received form letters from participants in AdvoCare, Tastefully Simple, Nature’s Sunshine, Arbonne, Lia Sophia, Mannatech, Cookie Lee Jewelry, Sunrider, Scent Station, Neways, Synergy Worldwide, Freelif, Young Living Essential Oils, and Vemma. In addition, the Commission received thousands of letters that were individualized but followed a template that covered the same issues as the form letters.

<sup>37</sup> Numerous letters came from individuals with negative experience with various MLMs, including Quixtar, 4Life, Mary Kay, Arbonne, Liberty League International, Financial Freedom Society, Herbalife, Xango, Melaleuca, EcoQuest, Pre-Paid Legal, PartyLite, Shaklee, Vartec/Excel, and Vemma.

<sup>38</sup> 71 FR at 10057.

<sup>39</sup> E.g., IBA, at 1, 5; PMI, at 2; Timberland, at 1; Sonnenschein, at 1-2 (stating that the rule would cover “manufacturers, suppliers and other traditional distribution firms that have relied on the bona fide wholesale price exclusion to avoid coverage” under the rule). The Cosmetic, Toiletry and Fragrance Association posits that the IPBOR would cover the relationship between a manufacturer and an independent contractor who sells the product to beauty supply companies, salons, and others. CTFA, at 4. See also LHD&L at 2 (noting that the IPBOR could cover the relationship between a manufacturer and a regional distributor of products).

<sup>40</sup> IBA, at 5; Timberland, at 1 (noting that numerous manufacturers structure their retail distribution in this manner).

<sup>41</sup> Timberland, at 1.

prong of the definition did not exempt voluntary purchases of inventory; and (2) providing retail staff with sales training would satisfy the "business assistance" prong of the definition.<sup>42</sup> Moreover, review of the comments suggests that even if a company provides no "business assistance," a product distribution arrangement still easily could have fallen within the scope of the IPBOR if the company made some representation about sales or profits sufficient to constitute an "earnings claim."<sup>43</sup> One trade association notes, "[a]s a practical matter, suppliers will find it difficult to enter into a business relationship with a distributor or dealer without at least discussing possible sales volumes or profit levels."<sup>44</sup>

Other commenters argued that the IPBOR would have been broad enough to cover: bona fide educational programs offered by colleges and universities;<sup>45</sup> the sale of certain books by publishers or book stores;<sup>46</sup> and even the relationship between newspapers and independent carriers who distribute the papers to homes and businesses.<sup>47</sup> Because application of the IPBOR to these types of arrangements was unintended, the Commission has narrowed the proposed definition of the term "business opportunity," to exclude from coverage distribution arrangements in which the only required payment is for reasonable amounts of inventory at bona fide wholesale prices. In addition, the proposed definition of "business opportunity" has been substantially narrowed as explained in Section D, *infra*.

## 2. The MLM Industry

The second problem with the breadth of the IPBOR's coverage relates to the Commission's attempt to reach pyramid schemes with the Business Opportunity Rule. An overwhelming majority of commenters<sup>48</sup> argued that the IPBOR failed to differentiate between unlawful pyramid schemes and legitimate companies using an MLM business model. These commenters argued that the requirements of the IPBOR simultaneously would have been

insufficient to curb pyramid fraud<sup>49</sup> yet devastating to MLM companies and individual MLM distributors. Criticism was not confined to industry comments. Two consumer groups also filed comments asserting that, although MLMs should be covered, the disclosures the Commission proposed in the IPBOR would be inadequate to remedy deceptive earnings claims.<sup>50</sup> On balance, based upon this record and its law enforcement experience, the Commission does not believe it is practicable or sufficiently beneficial to consumers to attempt to apply the proposals advanced in this rulemaking against multi-level marketing companies, particularly when considering the burdens upon industry. The Commission, therefore, has determined that at this point, it will continue to use Section 5 to challenge unfair and deceptive acts or practices in the MLM industry.

### a. Industry comments

MLM industry representatives, MLM companies, and independent distributors for those companies submitted numerous comments. The strongly stated theme common to all these comments was that the low economic risks of participating in a typical MLM do not justify imposing burdensome regulations that would threaten to strangle the MLM industry.

These commenters pointed out that the fees top MLM companies charge prospective distributors for the right to sell products are low—often less than \$100.<sup>51</sup> Furthermore, commenters argued, the risk that consumers will lose money through large purchases of inventory is low. The Direct Selling Association ("DSA"), a national trade association of direct selling firms that claims to account for 95% of the industry's sales in the United States,<sup>52</sup> asserts that its members offer a 90% refund on resalable inventory and on other start-up costs, as well.<sup>53</sup> Certain

MLM companies commented that they do not require distributors to purchase any inventory in advance of selling it.<sup>54</sup> As one commenter put it, purchasing a direct selling opportunity "is less complicated and carries less financial risk for a participant than purchasing a flat-screen TV set."<sup>55</sup> Commenters contended that the low-risk nature of the distributorship is essential to facilitate ease of entry because the MLM industry relies on part-time and seasonal distributors.<sup>56</sup> Furthermore, these commenters argued that there is no evidence that the MLM industry is permeated with fraud.<sup>57</sup>

The MLM industry commenters also sharply criticized each of the primary requirements of the IPBOR. They argued that, balanced against the low risk of financial loss, it would be excessively burdensome to mandate a seven-day waiting period and the various disclosure and recordkeeping obligations. The seven-day waiting period would require sellers to wait seven days after presenting disclosure documents to the prospective purchaser before collecting any money or obtaining an executed contract.<sup>58</sup> The provision is designed to allow prospective purchasers the opportunity to review required disclosures thoroughly or to speak with an advisor. The proposed seven-day waiting period drew intense criticism from industry groups, and was characterized as "regulatory overkill" by Primerica Financial Services, Inc.<sup>59</sup>

MLM industry commenters argued that the waiting period would undercut the basic MLM business model, characterized by minimal risk of financial loss and maximum ease of entry. The DSA submitted a survey showing that the level of interest in becoming a direct salesperson drops at least 33% and as much as 57% when a waiting period is imposed.<sup>60</sup> Commenters opined that the waiting

<sup>49</sup> DSA, at 21 (positing that compliance with the new mandates would be ignored by fraudulent pyramid schemes).

<sup>50</sup> The Consumer Awareness Institute and Pyramid Scheme Alert each submitted comments and rebuttal comments.

<sup>51</sup> Shaklee, at 3 (\$19.95); Avon, at 10 (\$10 or \$60); Quixtar, at 5 (\$45); Pampered Chef, at 2 (\$90); Mary Kay, at 3 (\$100).

<sup>52</sup> DSA, at 4. According to the DSA, 84% of direct selling firms use some form of multilevel compensation. DSA, at 9, 13 (defining direct selling as "the sale of a consumer product or service, in a face-to-face manner, away from a fixed retail location").

<sup>53</sup> DSA, at 24 n. 45 (describing the Code of Ethics that members must follow). *See also, e.g.*, Shaklee, at 6 (stating it has a 90% buy back requirement for its products and start-up kit purchased within the last two years); Quixtar at 3.

<sup>54</sup> Primerica Rebuttal, at 6; Avon, at 4; Quixtar, at 5; Mary Kay, at 4.

<sup>55</sup> Primerica Rebuttal, at 17.

<sup>56</sup> *E.g.*, Mary Kay, at 4 (estimating that 80% of its sales force members are part-time); Avon, at 3 ("With its low cost / low risk design, many Representatives take advantage of its ease of entry and exit to come and go as their needs / goals change."); CTFA, at 2.

<sup>57</sup> *E.g.*, SIA, at 5; Primerica, at 34; DSA, at 18–20.

<sup>58</sup> IPBOR, 437.2.

<sup>59</sup> Primerica Rebuttal, at 16. *See also* MLM DRA, at 5 (stating that "the majority of MLM distributors are very small mom and pop businesses" and that "this burden would very likely ruin their business."). United States Congressman Tom Cole also submitted a comment expressing the opinion that the seven-day waiting period is inappropriate for business opportunity sales costing less than \$500. Cole, at 1.

<sup>60</sup> DSA, at 24.

<sup>42</sup> IPBOR, 437.1(d)(2); IPBOR, 437.1(c)(v).

<sup>43</sup> IPBOR, 437.1(d)(3)(i).

<sup>44</sup> IBA, at 4. *See also* PMI, at 3 n. 1.

<sup>45</sup> Chadbourne, at 7 - 13 (illustrating the point with numerous course offering descriptions that could arguably fall within the definition of "business opportunity"); Venable, at 3-5 (same).

<sup>46</sup> Venable, at 2 - 3.

<sup>47</sup> NAA, at 1-3.

<sup>48</sup> Of the more than 17,000 comments that the Commission received, it is fair to estimate that well over 95% came from members of the MLM industry expressing opposition to the IPBOR. As noted above, many of these were form letters.

period would make entry into this business much harder; moreover, some commenters stated that the waiting period would significantly burden recruiting because multiple visits would be necessary for each potential recruit.<sup>61</sup>

Industry commenters also contended that the various disclosure obligations of the IPBOR are ill-suited to the MLM business model. For example, industry commenters assert that an MLM's list of distributors is proprietary information<sup>62</sup> that is kept strictly confidential because distributors necessarily compete with each other to recruit additional distributors into their "down lines."<sup>63</sup> The IPBOR would have required an MLM distributor to provide to every potential recruit a disclosure document that includes a list of other distributors as references.<sup>64</sup> As one commenter put it, furnishing a list of distributors to every individual who inquires about an MLM distributorship, "would be like requiring a salesman to introduce his customer to ten competing salesmen and then wait seven days before attempting to close a sale."<sup>65</sup> The Commission notes that another characteristic of the MLM model may undermine the utility of the list of references that the IPBOR would have required MLMs to disclose. Specifically, a previous purchaser on the reference list likely would stand to receive a financial benefit if a prospect who contacts them were successfully recruited by that previous purchaser. Under these circumstances, information from such a reference might not be the most reliable basis for the prospect's purchasing decision.

Other disclosure obligations of the IPBOR, industry commenters contended, "will paint all direct selling companies in a falsely negative light."<sup>66</sup> For example, according to one commenter, the proposed obligation to disclose legal actions<sup>67</sup> would cast successful and long-established companies in a worse light than a fly-by-night fraudulent business

<sup>61</sup> DSA, at 25–26 (positing that three visits would be required to sign up a prospective participant); Shaklee, at 6 (stating that a waiting period would be "as though regulators had painted a big 'X' on the backs of direct selling companies, warning consumers 'not to go there.');" Avon, at 14.

<sup>62</sup> Shaklee, at 7 ("a company's distributor and customer lists are its most important and confidential information which competitors must be kept from accessing."); DSA, at 30 (stating that the list of sellers has been kept confidential even from the IRS); Avon, at 16–17;

<sup>63</sup> Avon, at 16–17 (stating that direct selling companies compete for same recruits); DSA, at 30–31.

<sup>64</sup> IPBOR, 437.3(a)(6).

<sup>65</sup> Quixtar, at 31–32.

<sup>66</sup> Pre-Paid Legal, at 8.

<sup>67</sup> IPBOR, 437.3(a)(3).

opportunity promoter "simply because bigger companies with more sales representatives and more years of operation are likely to get involved in a larger number of cases."<sup>68</sup> Some commenters pointed out that as publicly-traded companies, information about their legal actions is already publicly available.<sup>69</sup>

Similarly, according to these commenters, the obligation to disclose refund requests and cancellations<sup>70</sup> would penalize MLM industry members who deliberately structure their business model to facilitate ease of entry by offering refunds. Because companies with liberal refund policies are more likely to have refund requests than those offering no refunds, disclosure of refund requests could mislead consumers into thinking that the company offering liberal refunds is less reputable than the company offering no refunds.<sup>71</sup> The rule would create a perverse incentive to discontinue refund policies.<sup>72</sup>

Some industry commenters contended that the IPBOR's earnings claim disclosure requirement<sup>73</sup> would itself be misleading or incomplete. While some commenters stated they already make an earnings disclosure, they opposed the IPBOR's provisions for a variety of reasons.<sup>74</sup> For example, some industry commenters argued that only the earnings of so-called "active" distributors should be considered because many individuals use their distributorship as a "buyers club" and are only interested in purchasing goods at a wholesale price for their own use,

<sup>68</sup> Quixtar, at 34. See also SPC, at 3 (stating that it is a subsidiary of Time, Inc., and the litigation disclosure of affiliate companies would encompass all of Time Warner, which includes hundreds of companies).

<sup>69</sup> Avon, at 10, 15; Pre-Paid Legal, at 14.

<sup>70</sup> IPBOR, Section 437.3(a)(5).

<sup>71</sup> E.g., Pre-Paid Legal at 15–16; DSA, at 29 (stating that because individuals enter and exit direct selling each year to meet short term goals, the number of cancellation requests is likely to be artificially high and misleading). See also Quixtar, at 39 (asserting that because individuals join and leave for various personal reasons, information on cancellations would be "of little, if any, benefit"); PANM, at 3 (stating that reporting cancellations and refunds serves no purpose at all where the fee is nominal).

<sup>72</sup> MLMIA, at 51–52, Pre-Paid Legal, at 16; Herbalife, at 10. See also Carico, at 1 (stating that because dishonest companies would not honor an agreement to make refunds, the IPBOR would only have a negative effect on legitimate companies).

<sup>73</sup> IPBOR, 437.3(a) and 437.4.

<sup>74</sup> E.g., Quixtar, at 25–26 (proposing an earnings disclosure that would include only "active" distributor earnings and would allow the company to "infer a reasonable level of 'retail' profit"); Melaleuca, at 9–10 (stating that it publishes income statistics but opposing a federally mandated disclosure); FreeLife, at 4 (preferring disclaimers to the IPBOR's requirements).

not for resale.<sup>75</sup> Commenters argued that those who use the distributorship in this way do not expect to earn money, and so the earnings of these inactive distributors should not be counted.<sup>76</sup> Further, one commenter stated that a disclosure of average earnings may unfairly suggest that distributors achieve low earnings when, in fact, those earnings are substantial given the amount of time spent selling.<sup>77</sup>

Furthermore, many industry commenters argued that the IPBOR's required earnings disclosure would be far too complicated because it would require a disclosure of the material characteristics of purchasers who earned the claimed income.<sup>78</sup> As such, some industry commenters expressed concern that the proposed earnings disclosure would unnecessarily complicate a simple and low-risk transaction.<sup>79</sup> Furthermore, other commenters pointed out that it would be extremely burdensome for legitimate businesses that attempted to comply,<sup>80</sup> but it would not be helpful to consumers in evaluating the opportunity or in distinguishing fraudulent claims.<sup>81</sup> One commenter went further, stating that: "the required disclosures do not address the crucial distinction between pyramids and legitimate multi-level marketing—i.e., in pyramids, compensation is based on recruitment, rather than sales for consumption."<sup>82</sup>

Finally, echoing the concerns raised above, industry commenters uniformly asserted that the cost of compliance with the IPBOR would be extremely high, much higher than the Commission

<sup>75</sup> E.g., Shaklee, at 3 (stating that 85% of individuals who sign up with Shaklee do so as "wholesale buyers" rather than distributors); Quixtar, at 8; Herbalife, at 2.

<sup>76</sup> E.g., Quixtar, at 25 & n. 30; Primerica Rebuttal, at 34.

<sup>77</sup> Avon, at 19. See also DSA, at 33 (questioning the relevance of earnings statistics to an individual who enters as discount buyer or for short term supplemental income).

<sup>78</sup> The IPBOR would require disclosure of "any characteristics of the purchasers who achieved at least the represented level of earnings, such as their location, that may differ materially from the characteristics of the prospective purchasers being offered the business opportunity." IPBOR, 437.4(a)(4)(vi).

<sup>79</sup> Avon, at 18; Quixtar, at 21 (stating that the goal should not be "to provide a maze of intricate calculations and disclosures but to instead put across the simple point that most participants in the business opportunity earn modest incomes").

<sup>80</sup> E.g., DSA, at 33; HIG, at 3; Pre-Paid Legal, at 10. Some commenters contend that it would be impossible to comply with this requirement. Shaklee, at 10; Xango, at 6; Vector, at 3.

<sup>81</sup> E.g., DSA, at 33; Xango, at 6; Mary Kay, at 10; Synergy, at 2. See also Xango, at 6 ("[s]uch complicated compilations will only serve to confuse prospective purchasers"); Symmetry, at 2.

<sup>82</sup> Primerica, at 26.

estimated.<sup>83</sup> The costs of complying would arise, first, from the burden of developing, providing, and keeping records of the proposed disclosures, and second, from the impaired ability to recruit. With regard to the first point, industry commenters contended that the burden of making the proposed disclosures would fall disproportionately on established, legitimate businesses.<sup>84</sup> For example, the single page disclosure would be simple for a new—possibly fraudulent—company that has no litigation history and fewer than 10 references.<sup>85</sup> For long-established MLMs, however, the costs would be quite high: having polled its members on this issue, the DSA states that the median total compliance cost for a small firm would be approximately \$130,000 annually, and more than \$567,000 annually for a large firm.<sup>86</sup> DSA further estimates that because about 5 million people are recruited into direct selling each year, the paperwork burden would include distributing over 750 million pages of disclosure documents annually.<sup>87</sup> Furthermore, according to the DSA, the IPBOR's requirement to retain documents for three years would require 2.25 billion pieces of paper to be generated and warehoused.<sup>88</sup>

Second, and apart from the direct cost of complying, industry commenters contend that the IPBOR's requirements would impose high costs because it would significantly impair the ability to recruit.<sup>89</sup> According to Primerica, "[b]ased on a conservative estimate that the Proposed Rule would reduce Primerica's recruiting by 25 percent,

<sup>83</sup> Mary Kay, at 9 (estimating that the record keeping requirement would cost "between \$300,000 and \$500,000 per year in additional expenses, software and training").

<sup>84</sup> Primerica, at 15–16.

<sup>85</sup> *Id.*

<sup>86</sup> DSA, at 21–22 (stating that 26 firms responded to its July 2006 survey on compliance costs). See also Shaklee, at 9 (estimating that the cost of compliance would likely exceed \$100 million for the industry); MLMIA, at 12 (estimating that cost of compliance for each MLM distributor would be between \$25,000 to \$45,000 for the first year and \$10,000 to \$20,000 per year thereafter).

<sup>87</sup> *Id.* at 21 (reporting that respondents estimate disclosing 15 pages of documents under the IPBOR). See also Vector, at 3 (estimating that the proposed disclosure would require Vector to provide over 100 million pieces of paper annually to potential recruits).

<sup>88</sup> *Id.* at 21. See also Melaleuca, at 5 – 6 (estimating that Melaleuca would need to store 1.8 million disclosure documents over a rolling three-year period).

<sup>89</sup> "If a new application, disclosure document and seven-day waiting period were required for a Member to become a Distributor, the number of Members who choose to build a small home-based business would dramatically decline." Shaklee, at 6 (stating that recruitment dropped when Shaklee introduced two applications instead of one).

Primerica projected an economic loss of \$1 billion for Primerica alone over the next ten years if the [IPBOR were] promulgated."<sup>90</sup> The cost of impaired recruiting, some commenters argued, would be borne by the millions of individual MLM distributors who would find their home businesses adversely affected.<sup>91</sup> Indeed, the MLM Distributors Rights Association ("DRA") warned that the IPBOR would put "millions out of business," and concluded with a plea to "come up with a new rule that will protect without damaging the little guy in America trying to make a living."<sup>92</sup> Numerous letters submitted by individual MLM participants echo this theme, as well.<sup>93</sup>

#### b. Consumer group comments

The Commission received comments from two consumer groups, the Consumer Awareness Institute ("CAI") and Pyramid Scheme Alert ("PSA"),<sup>94</sup> a few other consumer advocates,<sup>95</sup> individuals who regret becoming involved in MLMs,<sup>96</sup> and other

<sup>90</sup> Primerica Rebuttal, at 11 (emphasis in original).

<sup>91</sup> MLM DRA, at 2, 5 (estimating that there are between 13 million and 15 million MLM distributors in the United States); Babener, at 3 (the IPBOR would cripple "the livelihoods of 14 million Americans that look to direct selling to help support their families").

<sup>92</sup> DRA, at 2, 7. The DRA demands that the Commission drop the IPBOR in its entirety. DRA, at 2.

<sup>93</sup> *E.g.*, Tina Bailey, at 1 ("This bill would kill my business and I would loose [sic] my ability to be a stay at home mom with an income."); Eric Gang, at 1 ("If adopted, the Rule would destroy my small business that I have worked so hard to develop."); Anne Trevaskis, at 1 ("As a person with a disability, unable to go out to work, if [the IPBOR] is adopted, I will be prevented, continuing as an independent distributor"); Marian Warshauer, at 1 ("Please don't penalize and ruin and honest earning opportunity for tens of thousands of people with legitimate companies"); Noelle Marino, at 1 ("I'm very concerned about [the IPBOR], because I believe it will jeopardize my business.").

<sup>94</sup> CAI and PSA each submitted comments with numerous reports attached. Citations to their comments will specifically note the submitting entity and the name of the report.

<sup>95</sup> See Eric Scheibeler (author of *Merchants of Deception*, a book ostensibly warning the public about Quixtar); Bruce Craig (former Assistant Attorney General for the State of Wisconsin); Douglas Brooks (law practitioner who has represented class actions against MLM companies).

<sup>96</sup> *E.g.*, Katy Li ("If I had been given basic statistics about the company I never would have joined"); Marshelle Hinojosa ("Please pass the BUSINESS OPPORTUNITY LAW and stop these pyramid schemes!"); Valerie Andersen ("Words cannot express the humiliation, financial loss and lost respect and trust from friends and family members ... whom [sic] were persuaded by me because they trusted me ... to join the MLM ..."); J Padgett (describing his wife's involvement in an MLM); Robin Smith (stating that she would not have joined an MLM if she had known the background of the principals); David McHenry ("Make these MLMs legally responsible for their claims with documentation that is accurate from the beginning."); James Kenny; Charles Wagner; Brian

individual MLM participants in favor of a Business Opportunity Rule that would cover MLMs.<sup>97</sup> Consumer advocates contend that the MLM industry is comprised primarily of pyramid scheme operators masquerading as legitimate companies.<sup>98</sup> While commenters lauded the Commission's efforts to impose a business opportunity rule that would cover MLM firms, they argued that the rule's earnings disclosure requirements were insufficient to expose a fraudulent MLM company as a pyramid scheme.<sup>99</sup> CAI expressly recommended a different disclosure for MLM companies than for all other forms of business opportunities.<sup>100</sup>

According to these consumer groups, virtually all MLMs are pyramid schemes that enrich those at the top through the endless recruitment of new participants.<sup>101</sup> These commenters contended that the purported sale of products to end users (i.e., typical customers) is just a mirage, because the MLM sales force seldom engages in retail selling.<sup>102</sup>

Further, according to these commenters, MLMs deceptively market distributorships as a low-risk opportunity with high earnings potential. In fact, the cost of participating in an MLM can be quite high, including not only the registration fees, but also the cost of product purchases, training and seminars, and other features purported to enhance a recruit's performance in an MLM.<sup>103</sup> The typical earnings, by contrast, are extremely small and cannot be

Wess; Kelly Boucher, Rebuttal; Carol Franklin, Rebuttal.

<sup>97</sup> *E.g.*, Barbara Avery ("Direct selling or mmlm CAN be a good program if done with honesty and integrity- enacting laws to protect the consumer would be a welcome change!!"); Kristine Keesler ("I think this new legislation would be very beneficial. If I had seven days to consider my decision and 10 references I would not have jumped into the ... business so quickly.").

<sup>98</sup> CAI, at 2 ("I can certify that MLM (sic) are not direct selling programs, but chain selling programs"); CAI Rebuttal of DSA Comments, at 3 ("The Direct Selling Association (DSA), recently taken over by chain sellers now promotes chain selling (pyramid marketing) - even more than legitimate direct selling"). See also Brooks, at 2 ("In my opinion, most MLM firms operate in a deceptive or fraudulent manner").

<sup>99</sup> CAI, at 3; PSA, at 2. See also Douglas Brooks, at 3 (stating that disclosures will not prevent consumer injury caused by pyramid schemes).

<sup>100</sup> CAI, at 6.

<sup>101</sup> CAI, at 2 ("out of hundreds of MLM programs we have evaluated, no more than a (sic) three of them could qualify as legitimate retail-based programs."). See also PSA, at 1.

<sup>102</sup> PSA, *The Myth of Income Opportunity in Multi-Level Marketing*, at 4.

<sup>103</sup> PSA, *The Myth of Income Opportunity in Multi-Level Marketing*, at 4 (pointing to Amway/Quixtar's sale of books, tapes and seminar registrations to new recruits); Douglas Brooks, at 4, 5; Scott Johnson, at 1.

considered anything but a net loss when business expenses are considered.<sup>104</sup> In fact, these commenters contended, more than 99% of individuals who participate in MLMs lose money.<sup>105</sup>

These consumer groups recommended implementing a number of changes to the disclosure requirements in the IPBOR. To begin with, the IPBOR would have required business opportunity sellers to state whether they make any earnings claim, and if they do, to have written substantiation for the claim.<sup>106</sup> PSA argued that MLMs are presented to consumers as income opportunities, and therefore, should not be allowed the option of asserting that they make no earnings claim.<sup>107</sup> With regard to the earnings disclosure itself, they recommended two changes to the IPBOR. First, they recommended that the earnings disclosure state the average *retail-based* income that participants achieve.<sup>108</sup> They argued that, by focusing on dollars earned from retail sales, the disclosure document would highlight the key feature that distinguishes a legitimate company from a pyramid scheme—the sale of products to end users.<sup>109</sup>

Second, these commenters asserted that the earnings disclosure should state not only the revenue paid to participants, but also should reveal the payments by participants for products and services.<sup>110</sup> CAI argued that product purchases—necessary to advance in the MLM hierarchy—are often a major element of the overall investment in an

MLM; typically, the initial registration fee is nominal, and is just the beginning of the total investment.<sup>111</sup> PSA also argued that the earnings disclosures that some MLMs make are deceptive because they fail to include the money participants pay out to the MLM.<sup>112</sup> In addition, according to PSA, MLMs routinely include only the income of “active” participants in their averages, and thus conceal ongoing and mounting losses of new investors.<sup>113</sup>

Regarding the other provisions of the IPBOR, CAI supported the requirement of disclosing refund history, but noted that it is not particularly useful in the MLM context, inasmuch as “[i]t is extremely rare for MLM victims to recognize the fraud in an MLM program without intensive de-programming by a knowledgeable consumer advocate.”<sup>114</sup> CAI also recommended that the ten referrals to prior purchasers should include at least five *ex-participants* in the business,<sup>115</sup> and that there should be a three-day waiting period that includes a recommendation to search the internet for information about the company.<sup>116</sup>

### 3. Analysis

Section 18(d)(2)(B) of the FTC Act, 15 U.S.C. 57a(d)(2)(B), states that “[a] substantive amendment to, or repeal of, a rule promulgated under subsection (a)(1)(B) shall be prescribed, and subject to judicial review, in the same manner as a rule prescribed under such subsection.” The standard for amending or repealing a section 18 rule is identical to that for promulgating a trade regulation rule pursuant to section 18.

When deciding whether to amend a rule, the Commission engages in a multi-step inquiry. Initially, the Commission requires evidence that an existing act or practice is legally unfair or deceptive. The Commission then requires affirmative answers, based upon the preponderance of reliable evidence, to the following four questions:

- (1) Is the act or practice prevalent?<sup>117</sup>
- (2) Does a significant harm exist?
- (3) Would the rule provisions under consideration reduce that harm? and
- (4) Will the benefits of the rule exceed its costs?

<sup>111</sup> CAI, *Red Flags*, at 10.

<sup>112</sup> PSA, at 2.

<sup>113</sup> PSA, *The Myth of Income Opportunity in Multi-Level Marketing*, at 3.

<sup>114</sup> CAI, *Red Flags* at 11; CAI, at 7.

<sup>115</sup> CAI, at 7.

<sup>116</sup> CAI, at 6.

<sup>117</sup> See 15 U.S.C. Section 57a(b)(3) (stating that prevalence may be established if information available to the Commission indicates a widespread pattern of unfair or deceptive acts or practices).

See Credit Practices Rule, 49 FR 7740, 7742 (Mar. 1, 1984).<sup>118</sup>

The discussion below addresses, first, the question of whether there are widespread unfair or deceptive acts or practices that cause consumer harm. Second, the discussion reviews the various proposals for reducing consumer harm and the adequacy of case-by-case law enforcement under sections 5 and 13(b) of the FTC Act to address existing problems. To summarize, while there is a significant concern that some pyramid schemes masquerade as legitimate MLMs, assessing the incidence of such practices is difficult. In any event, commenters broadly concur that the IPBOR would not help consumers make an informed decision about the risks of joining a particular MLM. Further, the comments do not provide sufficient information about how to tailor the proposed rule so that disclosures assist in the purchase decision in a manner that is likely to reduce consumer harm. Moreover, it appears that the burden of complying with the IPBOR would be costly to legitimate companies using the MLM business model without the promise of sufficient offsetting benefits to prospective purchasers of MLM distributorships.

#### a. Prevalence of deceptive practices causing significant consumer harm

In considering whether to impose an industry-wide rule covering MLMs, the threshold inquiry is identifying the unfair or deceptive practices at issue. If such practices exist, the Commission evaluates whether such practices are prevalent and cause significant consumer harm. While these are separate areas of consideration, these inquiries overlap and are discussed together to avoid unnecessary redundancy.

There are two related but distinct allegations of deceptive practices regarding MLM companies. The debate about the legitimacy of MLM companies typically centers on whether an MLM operates as a pyramid. By their very nature, pyramid schemes are deceptive and violate the FTC Act. Equally serious, however, is the question of whether an MLM is engaged in making false earnings claims. These allegations are clearly related in that any claim that the average participant in a pyramid

<sup>118</sup> See also 15 U.S.C. Section 57a(d)(1)(A)—(C) (requiring in the Statement of Basis and Purpose accompanying the rule a statement as to prevalence, the manner in which the acts or practices are unfair or deceptive, and the economic effect of the rule); Federal Trade Commission Organization, Procedures and Rules of Practice, 16 CFR 1.14(a) (i)–(iv).

<sup>104</sup> PSA, *The Myth of Income Opportunity in Multi-Level Marketing*, at 3 (stating that 99% of all sales representatives in the sample of companies analyzed earned less than \$14 per week, a figure that does not count any business expenses, such as inventory purchases).

<sup>105</sup> PSA, at 2; CAI, *The 5 Red Flags*, at 15-16. One commenter, noting that some MLMs require no advance purchases of inventory, strongly disagreed with this conclusion: “The facts in the record provide no basis for deducting assumed ‘costs’ from the available income estimates and jump to the conclusion that participants actually *lose money*. ... It is simply not possible that agents are required to pay more money to Primerica than they receive in commissions, because there is no requirement that they buy anything from Primerica.” Primerica Rebuttal at 6 (emphasis in original).

<sup>106</sup> 437.3(a)(2) & 437.4(a)(2).

<sup>107</sup> PSA at 2. Several individuals filed form comments, with small variations, making this point as well. *E.g.*, Jean Smith; Douglas Konkol; Harold Ducre; Rachel Quill; N Gursahani; Petteiri Haipola; Bradford Chase; Curtis Marburger; Joel Rolfe; Marshall Massengill; Marcus Batte. See also CAI, at 6 (asserting that if MLMs present themselves as offering an “income opportunity,” they should have to disclose earnings).

<sup>108</sup> PSA, at 2.

<sup>109</sup> PSA, at 2. CAI, *Red Flags* at 5 (acknowledging that an MLM may be legitimate if it allows a person to earn a significant income from retailing products to end users).

<sup>110</sup> CAI, at 7; PSA, at 2.

scheme will make money is necessarily false. But even if an MLM is not operating as a pyramid scheme, it violates the FTC Act if it makes false earnings projections to consumers.

The comments received about the legitimacy of MLMs, discussed above, demonstrate sharply divergent points of view. The record in this proceeding to date is largely comprised of thousands of letters from consumers who operate as MLM distributors.<sup>119</sup> Many of these commenters extolled the benefits of the products they sell and overwhelmingly urged the Commission not to impose a rule that would hamper their ability to run their small businesses.<sup>120</sup> Organizations representing distributors also voiced strong opposition to the IPBOR.<sup>121</sup> In addition, the National Association of Consumer Agency Administrators (“NACAA”), after canvassing its members nationwide, stated that they “reported there was no appreciable number of complaints filed against direct sellers that are member companies of the Direct Selling Association.”<sup>122</sup> One comment presented a survey finding that an “average” distributor earns \$418 per month,<sup>123</sup> and DSA presented another survey<sup>124</sup> finding that 85% of direct

<sup>119</sup> In response to the NPR, the Commission received comments from approximately 16,700 individual MLM distributors. While several thousands of these were form letters, thousands more included individual recitations of positive personal experiences with the MLM distributorships.

<sup>120</sup> *E.g.*, Tom Hadley, at 1 (pastor stating that he uses the income he receives from his XanGo distributorship to pay his childrens’ college expenses); Gary Minor, at 1 (distributor of Young Living Essential Oils states he believes the product is exceptional and he makes money from selling product); Kelly Radke, at 1 (Tastefully Simple distributor stating that direct selling is a way for moms to stay home with their kids, pay off bills, and even save for vacations and retirement).

<sup>121</sup> The Commission received comment from the World Association of Persons with disAbilities, Inc., the MLM Distributor Rights Association, and the Professional Association for Network Marketing, expressing opposition to the IPBOR.

<sup>122</sup> NACAA, at 1 (stating that “NACAA currently represents more than 160 government agencies and 50 corporate consumer offices in the United States and abroad.”). The Chamber of Commerce of the United States of America also filed a comment stating that in “coordination with key industry leaders,” it has concluded that the IPBOR would “impose a tremendous burden on legitimate businesses with little benefit to consumers.” CC USA, at 1. Although it does not expressly mention the DSA, the Commission believes that the CC USA is referring to the direct selling industry. Similarly, the National Black Chamber of Commerce filed a comment urging the Commission to tailor the IPBOR more narrowly because of the impact on direct selling companies. NBCC at 1-2.

<sup>123</sup> MLMIA, Appendix A at 13 (Coughlan and Grayson, *Network Marketing Organizations: Compensation Plans, Retail Network Growth, and Profitability*, 15 International Journal of Research in Marketing 401 (1998)).

<sup>124</sup> DSA Rebuttal, at 3.

sellers say that direct selling meets or exceeds their expectations as a good way to supplement their income.<sup>125</sup> Given the overwhelming number of comments from consumers who operate as MLM distributors and from organizations representing such distributors, the Commission does not dispute the proposition that MLM companies can operate legitimately.

Sharply diverging from the comments of industry advocates are those of consumer advocates who argued that by and large, MLMs victimize consumers by claiming to provide an opportunity to earn money that cannot realistically be achieved. The Commission’s law enforcement experience shows that some MLMs have violated the law by making false earnings representations and have operated as pyramid schemes. In the last ten years, the Commission has sued fourteen pyramid schemes that purported to be legitimate MLM businesses selling products to end-users.<sup>126</sup> *FTC v. Equinox International Corp.* provides a prime example of how a pyramid scheme could masquerade as a legitimate MLM. Equinox purported to offer distributorships to sell products, including water filters, vitamins, nutritional supplements, and skin care products.<sup>127</sup> However, the company emphasized to new distributors that the real way to make money was through recruiting additional distributors, not through product sales. The company extracted money from its recruits by encouraging them to enter the MLM at the “manager” level, which required a purchase of \$5,000 worth of products; to rent desk space for \$300 to \$500 per

<sup>125</sup> PSA argued to the contrary, pointing to its study of seven companies which ostensibly shows that 99% of MLM distributors earn no profit from company rebates, and further stating that it is practically impossible for distributors to earn money through product sales. PSA, *The Myth* at 24, 29 (reviewing pay-outs that seven MLM companies made to distributors between 1998 and 2004). *But see* Primerica Rebuttal, at 5 (characterizing the data as “both unrepresentative and unreliable.”).

<sup>126</sup> *FTC v. BurnLounge*, No. 2:07-cv-03654-GW-FMO (C.D. Cal. 2007); *FTC v. Mall Ventures, Inc.*, No. CV 04-0463 FMA (PLAx) (C.D. Cal. 2004); *FTC v. NexGen3000.com*, No. 03-120 TUC WDB (D. Ariz. 2003); *FTC v. Trek Alliance, Inc.*, No. CV-02-9270 (C.D. Cal. 2002); *FTC v. Streamline Int’l, Inc.*, 01-6885-CIV-Ferguson (S.D. Fla. 2001); *FTC v. Bigsmat.com*, No. CIV 01- 0466 PHX ROS (D. Ariz. 2001); *FTC v. Netforce Seminars, Inc.*, No. 00 2260 PHX FJM (D. Ariz. 2000); *FTC v. 2Xtreme Performance Int’l, LLC*, No. Civ. JFM 99CV 3679 (D. Md. 1999); *FTC v. Equinox Int’l, Corp.*, No. CV-S-99-0969-JBR-RLH (D. Nev. 1999); *FTC v. Five Star Auto Club, Inc.*, No. CIV-99-1693 McMahan (S.D. N.Y. 1999); *FTC v. FutureNet, Inc.*, No. CV-98-1113 GHK (C.D. Cal. 1998); *FTC v. JewelWay, Inc.*, No. 97-383 TUC JMR (D. Ariz. 1997); *FTC v. World Class Network, Inc.*, No. SACV-97-162-AHS (C.D. Cal. 1997); *FTC v. Mentor Network, Inc.*, No. SACV 96-1104 LHM (Eex) (C.D. Cal. 1996).

<sup>127</sup> See <http://www.ftc.gov/opa/1999/08/equinox1.shtm>.

month; to subscribe to a phone line so they could recruit others; and to attend trainings and seminars at a cost of \$300 to \$1,000.

Equinox had ostensibly implemented safeguards to show it was not a pyramid scheme. For example, Equinox purported to link compensation to retail sales, including requiring distributors to produce receipts showing retail purchases. However, the evidence revealed that such policies were not enforced.<sup>128</sup> Like other members of the DSA, Equinox purported to offer refunds on inventory purchases. Yet, the net loss to consumers who participated in Equinox was more than \$330 million.<sup>129</sup> Indeed, pyramid schemes masquerading as legitimate MLMs can implement numerous purported safeguards to appear legitimate.<sup>130</sup>

Apart from operating as illegal pyramids, MLMs also could be engaged in making false earnings representations. In the Commission’s law enforcement experience, all of its pyramid cases<sup>131</sup> against purportedly legitimate MLMs alleged that the defendant made false earnings representations. Notably, at least one other case the Commission brought against an MLM company alleged false earnings representations.<sup>132</sup> Nevertheless, MLM industry advocates

<sup>128</sup> See also *FTC v. Trek Alliance, Inc.*, CV-02-9270 (C.D. Cal. 2002); <http://www.ftc.gov/opa/2003/08/trek.shtm>.

<sup>129</sup> Documented proof of claim forms received from consumer-victims of Equinox reveal that the net loss to consumers was at least \$330 million. The defendants settled FTC charges by paying cash, corporate and individual assets in the amount of nearly \$50 million, which comprised virtually all the assets of the defendants. As part of the settlement, the individual defendant, William Gould was barred permanently from engaging in any multi-level marketing operations. See <http://www.ftc.gov/opa/2000/04/equinox.shtm>.

<sup>130</sup> In *Webster v. Omnitrition Int’l, Inc.*, distributors sued Omnitrition, an MLM company, alleging that it was a pyramid scheme. The Ninth Circuit reviewed the safeguards that the MLM purportedly used to ensure retail sales. *Webster v. Omnitrition Int’l, Inc.*, 79 F.3d 776 (9th Cir. 1998). These included requiring no payment to become a distributor; imposing no quota of products that distributors were required to buy from the MLM; imposing an affirmative obligation that distributors certify that 70% of products they ordered have been resold and that they have made sales to at least 10 retail customers in the past month; and affording a 90% refund on resaleable inventory if the distributor resigns from the company. *Id.* at 780. In spite of these safeguards, the Ninth Circuit concluded that summary judgment in favor of Omnitrition was inappropriate because “the structure of the scheme suggests that Omnitrition’s focus was in promoting the program rather than selling the products.” *Id.* at 782. The Court further noted that Omnitrition failed to show that it enforced its 70% resale rule or its buy-back rule on distributors. *Id.* at 784.

<sup>131</sup> See *supra* note 126.

<sup>132</sup> *In re Nu Skin Int’l Inc.*, Docket C-3489, 117 F.T.C. 316, 324 (1994).

argue that a government regulation is not needed to protect individuals taking low financial risks, such as the great many MLM distributors who participate on a part-time or seasonal basis.

However, while MLM commenters contended that the cost of joining is typically very small, they often referred only to the minimum required fees, and did not mention all costs necessary to qualify for higher levels of compensation.<sup>133</sup> Such costs are problematic to the extent that MLM firms market their distributorships with lifestyle representations<sup>134</sup> that do not correlate to the small part-time income that active MLM distributors primarily earn.<sup>135</sup>

On the basis of its law enforcement experience and the rulemaking record, the Commission concludes that some MLMs engage in unfair or deceptive acts or practices. These practices include operation of pyramid schemes and false or unsubstantiated earnings claims. It is beyond a doubt that where they occur, these practices cause significant consumer harm. The Equinox case alone illustrates that the harm to consumers resulting from such practices is enormous—not just in the aggregate, but individually.

The further question as to whether such deceptive practices are prevalent, however, is elusive. It is difficult to gauge the incidence of such practices among MLMs. As noted in more detail below, determining whether a company operates as a pyramid requires a fact-specific inquiry that depends on evaluating a number of factors. Even if deceptive practices were established as prevalent in the MLM industry, however, the Commission has determined at this time that neither the IPBOR nor the alternative proposals that commenters advanced appear likely to

<sup>133</sup> In *Webster v. Omnitrion*, the Ninth Circuit observed that while there was no cost to becoming a distributor in the MLM company, the cost of qualifying for higher compensation was “substantial.” 79 F.3d at 782.

<sup>134</sup> Depending upon the particular representations, touting grandiose lifestyles may be considered an earnings claim—rather than mere puffery—that must be substantiated. The Commission has long held that an earnings claim includes statements from which a prospective purchaser could reasonably infer “a specific level or range of income,” such as “earn enough money to buy a new Porsche.” See Franchise Rule Final Interpretive Guides, 44 FR 49965, 49982 (Aug. 24, 1979).

<sup>135</sup> E.g., MLMIA, Appendix A at 13 (presenting a survey finding that earnings for an average distributor are \$418 per month); DSA at 15 (“A direct seller’s median annual gross income from direct selling is about \$2,400 per year.”); Avon, at 19 (“those selling on a part-time basis may show low earnings, which, in fact, may be quite substantial given the amount of time they spend selling Avon products.”).

be sufficiently effective to remedy these practices.

*b. Whether the IPBOR or other proposals would reduce consumer harm*

After careful consideration, the Commission believes that the consumer harm flowing from deceptive practices in the MLM industry can more effectively be addressed at this time through targeted law enforcement under Section 5. Commenters on all sides generally agree that the IPBOR’s required disclosures would not help consumers identify a fraudulent scheme. As discussed below, a simple earnings disclosure is unlikely to enable consumers to determine whether an MLM company is operating lawfully. Further, at this time, the record indicates that the proposed alternatives that various commenters suggested would not effectively counter deceptive practices and would not enable consumers to avoid a fraud.

As commenters noted, an earnings disclosure, such as the one proposed in the IPBOR, will not help prospective purchasers determine whether an offering is a pyramid or is a legitimate MLM because it does not reveal the source of the income.<sup>136</sup> The main difference between a pyramid scheme and a legitimate MLM is that the legitimate company actually derives its income primarily from the retail sale of products to end users, while the pyramid scheme supplies income to participants at the top of the pyramid primarily through fees that new participants pay for the right to participate in the venture.<sup>137</sup> In a pyramid scheme, a participant can reap rewards only by obtaining a portion of the fees paid by those who join the scheme later. People who join later, in turn, pay their fees in the hope of profiting from payments of those who enter the scheme after they do. In this way, a pyramid scheme simply transfers monies from losers to winners. For each person who substantially profits from the scheme, there must be many more losing all, or a portion, of their investment to fund those winnings. Absent sufficient sales of goods and services, the profits in such a system hinge on nothing more than recruitment of new fee-paying participants into the system.

As the Commission’s cases demonstrate, the sale of goods and services alone does not necessarily render a multi-level system legitimate.

<sup>136</sup> See PSA, at 2; CAI, Red Flags at 5; Primerica at 26.

<sup>137</sup> See Staff Advisory Opinion—Pyramid Scheme Analysis, January 14, 2004.

Modern pyramid schemes display endless ingenuity in finding ways to disguise payment of participation fees to appear as if they are for the sale of goods or services. The source of the income typically is not easy to discern from a facial examination of a company’s compensation structure and the safeguards it purportedly has in place. Economic analysis of the MLM business model suggests a continuum with clearly legitimate MLMs at one end and clearly fraudulent pyramid schemes at the other. With some basic company information, a company residing at one pole or the other can be identified. Nevertheless, in the middle is a substantial gray area where differentiating the two is much more difficult because the source of income is both sales of products or services and participation fees.<sup>138</sup> Indeed, the question of whether a purportedly legitimate MLM is, in reality, only a pyramid scheme in masquerade is a highly fact-intensive inquiry. That being the case, the issue is a particularly difficult one to address via industry-wide rulemaking, as opposed to case-by-case enforcement.

Commenters have advanced three main alternatives to the specific elements of the IPBOR: (1) granting a safe-harbor to companies that implement certain safeguards; (2) requiring detailed earnings information; and (3) defining what constitutes a pyramid scheme. As explained in more detail below, at this time, the Commission is not persuaded that any of these proposals would likely lead to a rule that would not unfairly burden legitimate companies while rooting out pernicious frauds dressed in the garb of legitimacy.

*i. MLM comments advocating a safe harbor to exempt legitimate companies would not adequately distinguish between pyramids and legitimate companies*

MLM industry commenters suggest limitations on the rule so that it would exclude firms that require very low registration fees;<sup>139</sup> firms that offer refunds on inventory purchases;<sup>140</sup> firms that are publicly-traded;<sup>141</sup> firms that have been in business for a

<sup>138</sup> Vander Nat and Keep, at 149.

<sup>139</sup> Avon, at 10 (advocating that the Commission impose a monetary threshold for required payments and that the rule not apply to transactions below that threshold); Pre-Paid Legal, at 1 (advocating a monetary threshold of \$250).

<sup>140</sup> Quixtar, at 5; Melaleuca, at 7.

<sup>141</sup> Pre-Paid Legal, at 1; Avon, at 10; Herbalife, at 16.

significant number of years;<sup>142</sup> or firms that are members of a self-regulatory body, such as the DSA.<sup>143</sup> However, none of these factors is determinative of whether a company is, in fact, a pyramid scheme or otherwise engaged in deceptive conduct. Furthermore, the effort to craft a workable rule using these criteria could undermine law enforcement efforts if pyramid schemes masquerading as MLMs were able to manipulate their corporate structure—as Equinox did—to meet safe harbor provisions while continuing, in fact, to operate illegally.

*ii. Imposing the earnings disclosures that consumer groups suggest on MLMs is fraught with problems and complexity*

Consumer advocates advanced a requirement to disclose the retail-based earnings of active and inactive participants, deducting the costs distributors paid.<sup>144</sup> There are several problems with this approach. Given the complexities of each MLM's compensation schedule, developing a standard, useful, understandable, and straightforward earnings disclosure that would serve industry-wide is elusive. Further complicating the problem are the practical considerations of whether MLMs could, using an industry-wide format, gather reliable information on retail earnings.

More broadly, a number of issues would make it difficult to craft an industry-wide rule on a proper earnings disclosure, as proposed above. A meaningful earnings claim disclosure likely would require different disclosures for different levels of participation in the company. For example, how should such a disclosure treat inactive participants who have joined merely to purchase product for their own use as opposed to active participants in the earnings figure? How would one identify participants who are inactive because they only wanted to obtain access to the product at wholesale prices rather than those who are inactive because they concluded that the business was not suitable for them?<sup>145</sup> How long after a participant's last sale should he or she be considered "inactive"?<sup>146</sup> MLM companies often have complicated compensation

schedules that offer greater compensation for greater sales volume. Moreover, because there likely is an earnings disparity between new MLM recruits and distributors who have well-established down-lines, an additional issue arises as to whether a disclosure of participants' *median* income rather than *average* income is most appropriate. In pyramids, a disclosure of average income would suggest that all participants have the ability to make the claimed earnings, when in reality, the earnings figure is skewed to reflect the lavish profits reaped by those at the top of the pyramid. New recruits to the pyramid scheme would not have any possibility of reaping such profits. Median income, by contrast, would eliminate the outliers, thus providing a more realistic picture of what the majority of participants earn in a pyramid. Whether that is the most appropriate measuring stick for a legitimate MLM company where earnings are based on retail sales is unclear.

Second, it may be difficult to determine retail income. While an MLM firm may provide distributors with products, the MLM may not be able to verify the extent to which a distributor has resold the product at retail, is warehousing the product, or bought the product for his or her own personal consumption. Even where an MLM has policies in place purportedly to ensure that a portion of its distributors' income comes from retail sales—as opposed to inventory loading—the company may still lack accurate figures on the true amount of its distributors' retail income.<sup>147</sup> For example, such policies could go unenforced, or even if they were ostensibly enforced, could be circumvented by distributors, who may have an incentive to "certify" their sales in order to qualify for higher level of commissions.<sup>148</sup> Indeed, the potential collusion between MLM companies and distributors to fake the true level of retail sales would undermine the utility of an earnings disclosure based on retail income.

The deduction of costs also is problematic. Primerica argued that the

proposal to deduct a distributor's costs, in particular, is "administratively impossible" because it "require(s) information that companies do not routinely possess and cannot easily obtain."<sup>149</sup> For example, business-related expenses could include independent costs that an MLM could not track, such as costs for computers, office equipment, leasing office space and other facilities.<sup>150</sup> In addition, many commenters point out that MLM participants use their membership to purchase products at a discount for their own personal consumption.<sup>151</sup> Deducting "costs" that members pay to the MLM would be too broad insofar as it would include inventory that distributors choose to purchase for themselves.<sup>152</sup>

In view of these difficulties, the Commission at this time believes it is more cost-effective to challenge deceptive MLM practices through targeted law enforcement under Section 5.<sup>153</sup>

*iii. Crafting a definition of "pyramid scheme" would be counter-productive*

Some commenters advocated crafting a definition of "pyramid scheme" that would avoid the problems of overbreadth in the IPBOR by excluding legitimate MLMs from coverage while keeping pyramid schemes covered.<sup>154</sup> There are two practical difficulties with this approach. First, as noted above, there is no bright-line, universal test for the particular quantity of retail sales that in every case would suffice to fund the payment of commissions for every MLM company. While economic analysis can reveal if an individual company clearly is operating legitimately or if it clearly is a pyramid scheme, it is difficult to draw an appropriate line in the gray area.<sup>155</sup>

<sup>149</sup> Primerica Rebuttal, at 34.

<sup>150</sup> Primerica Rebuttal, at 35.

<sup>151</sup> See *supra*, note 75.

<sup>152</sup> Primerica Rebuttal, at 6 ("Moreover, these commenters allege losses based in part on counting as *costs* what the record makes plain is a benefit for many participants—the ability to purchase for personal consumption products they like at a significant discount.").

<sup>153</sup> Regardless of whether it is covered by the proposed rule, if a business makes earnings claims, including through the use of testimonials, such claims must be truthful and must be substantiated, under Section 5 of the FTC Act.

<sup>154</sup> E.g., Craig, at 7-8 (former Assistant Attorney General with the State of Wisconsin); Primerica, at 38.

<sup>155</sup> See VanderNat and Keep, *Marketing Fraud: An Approach to Differentiating Multilevel Marketing from Pyramid Schemes*, 21 J. of Pub. Pol'y & Marketing, at 149. See also Primerica Rebuttal, at 35 ("As the extensive analysis contained in [consumer group] comments demonstrates, identifying a pyramid scheme (or, at least, one that attempts to disguise itself as a legitimate business

<sup>142</sup> Primerica, at 41.

<sup>143</sup> DSA, at 42.

<sup>144</sup> PSA, at 2; CAI, at 7.

<sup>145</sup> The issue of inactive participants who are only interested in obtaining product at wholesale prices appears to be unique to MLMs. As far as the Commission is aware, this complication does not arise in other forms of business opportunities. In the MLM context, the record does not reveal the extent to which individuals join MLMs to buy products at wholesale.

<sup>146</sup> E.g., Primerica Rebuttal at 34-35.

<sup>147</sup> *Webster v. Omnitrition International, Inc.*, 79 F.3d 776, 783 (9th Cir. 1996) (stating that Omnitrition produced no evidence that it enforced its rule ostensibly requiring its distributors to sell at wholesale or at retail 70% of the products they bought).

<sup>148</sup> In the *Omnitrition* case, the Ninth Circuit commented on the requirement that distributors certify their sale of the product, stating: "There is no evidence that this 'certification' requirement actually serves to deter inventory loading." 79 F.3d at 783. Similarly, in the Commission case against Equinox, it was alleged that the MLM looked away when distributors wrote their own receipts to fake retail sales to consumers.

Second, any definition of “pyramid scheme” would provide bad actors with a road map for restructuring their businesses to skirt the definition, at least facially, and thereby providing them with a safe harbor that could undercut law enforcement efforts.

The benefit of using Section 5 to prosecute pyramid schemes is that it is a flexible instrument that allows the Commission to pursue bad actors no matter how they choose to manipulate their corporate structure. At this time, and on the basis of evidence in the record, the Commission declines to define “pyramid scheme” through rulemaking but will continue to use Section 5 to attack such schemes.

### *c. Benefits and Burdens of the IPBOR*

As set forth above in greater detail, MLM industry commenters contend that the burdens of making the IPBOR’s disclosures would be devastating. Some of these concerns are overblown and clearly misunderstand the intent of the IPBOR, which would not require individual MLM distributors to disclose their personal litigation histories, for example, to prospective purchasers.<sup>156</sup> However, numerous commenters made valid points about the direct cost of complying and the indirect cost of loss recruitment. As one commenter noted, with a dwindled sales force, there would be a consequent drop in the sale of product, and the cost to one MLM, Primerica, would be \$1 billion over ten years.<sup>157</sup> Even if this figure grossly overestimates the cost to individual MLM companies, millions of MLM distributors, according to distributors and groups representing MLM distributors, would individually bear the cost of lost recruitment and would find their home businesses adversely affected.

Commenters also argued that the burdens are unjustified because the disclosure requirements are ill-suited to the MLM industry and would fail to help consumers identify a risky opportunity. For example, the requirement that business opportunity sellers disclose a list of prior purchasers would be costly for covered companies but would not help consumers analyze the possibility of loss because every prior purchaser has an incentive to sell

opportunity) entails an in-depth examination of the compensation structure and the actual manner in which compensation flows within an organization.”).

<sup>156</sup> *E.g.*, Mary Kay, at 8, 9; MLMIA, at 9-10 (estimating that there are 10 million business opportunity sellers in the marketplace, and further stating: “The Proposed Rule may actually cause a recession in the United States if fully enforced.”).

<sup>157</sup> Primerica, at 3, 4; Primerica Rebuttal, at 11.

the opportunity in order to recruit additional distributors into their “down lines.” Thus, they might not provide a very reliable assessment of participating in the opportunity offered. Similarly, to the extent individuals join MLMs only to purchase products at wholesale, the waiting period would be an unnecessary obstacle. And, as noted above, the earnings claim disclosure requirement would itself be incomplete and possibly misleading because it would be unlikely to capture and accurately portray the actual source of compensation.

### *d. Conclusion*

The deceptive practices of some companies using the MLM business model, which operate as pyramids or disseminate false earnings claims, remain a troubling consumer hazard. On the question of whether such practices are prevalent, however, it is difficult to gauge the incidence of such practices among MLMs. Even if the troubling practices were established to be prevalent, the Commission is not persuaded at this time that the proposed remedies would significantly redress consumer harm in a cost-effective manner. The Commission believes that the burdens that would be imposed upon legitimate business operations would not appear to be justified by possible benefits to consumers. To fashion a proper approach to combat fraud in the MLM industry, the Commission will continue to examine the MLM industry and individual companies, particularly the degree to which product sales fund the compensation that distributors earn. At this time, however, the Commission believes that the proposed rule is too blunt of an instrument to cure fraud in the MLM industry. The Commission has determined that it will use the flexibility inherent in Section 5 of the FTC Act to address particular frauds in the MLM industry.

### **Section D. The Proposed Rule**

To limit the proposed rule’s scope, as discussed above, the Commission now proposes a significantly revised Section 437.1, redefining “business opportunity.” In addition, the Commission proposes three changes to Section 437.3, which prescribes the content of the basic disclosure document. Finally, the Commission also proposes minor changes to Section 437.5, which addresses deceptive claims and practices in connection with business opportunity sales. Each of these proposals is discussed in detail below. In addition, this section discusses commenters’ recommendations for specific changes

and the Commission’s reasons for adopting or not adopting them. As noted below, the Commission continues to solicit commentary on all aspects of the RPBOR.

### *1. Proposed Section 437.1: Definitions*

As with the IPBOR, the RPBOR begins with a “definitions” section. With the exception of the terms discussed specifically below, the definitions in the RPBOR are the same as in the IPBOR. As noted, the Commission proposes to narrow the scope of the proposed rule by redefining the term “business opportunity.” The RPBOR eliminates the previously defined term “business assistance” and adds a new term, “required payment.” In addition, the RPBOR slightly modifies the definition of “designated person” and of “providing locations.”

#### *a. Proposed Section 437.1(c): “Business opportunity”*

The definition of “business opportunity” establishes the parameters of the Rule’s coverage. In the RPBOR, the Commission proposes a tailored definition of “business opportunity” that will reach those business opportunities that have, in the Commission’s law enforcement experience, persistently caused substantial consumer injury. These include business opportunities promoting vending machine, rack-display, work-at-home, medical billing, and 900-number schemes, among others.

The three definitional elements of the term “business opportunity” in the RPBOR are: (1) a solicitation to enter into a new business; (2) a “required payment” made to the seller; and (3) a representation that the seller will provide assistance in the form of securing locations, securing accounts, or buying back goods produced by the business. The RPBOR incorporates and builds on the definition of “business opportunity” used in the original Franchise Rule and the interim Business Opportunity Rule<sup>158</sup> to cover these particular types of schemes.<sup>159</sup>

The changes to the IPBOR’s definition of “business opportunity” are three-fold. First, the RPBOR definition includes a prong limiting coverage to opportunities for which “the

<sup>158</sup> As noted previously, the interim Business Opportunity Rule, found at 16 CFR 437, is the portion of the original Franchise Rule that applied to business opportunities. It will remain effective until the current rulemaking proceedings conclude.

<sup>159</sup> See Primerica, at 39 (suggesting that the Commission should “[r]etain the existing definition from the Franchise Rule that covers business opportunities and expand [it] based on demonstrated problems.”); DSA, at 39-40.

prospective purchaser makes a required payment” for the purchase of the business opportunity. This change will exclude from the definition business relationships in which the only required payment is for inventory at bona fide wholesale prices. Second, the RPBOR definition eliminates two types of “business assistance” that formerly would have triggered the Rule’s strictures and disclosure obligations, namely tracking payments and providing training. Third, the RPBOR no longer links the definition of “business opportunity” to the making of an earnings claim. Each of these changes is discussed in detail below.

### 1. Required payment

#### i. Inventory exemption

The RPBOR definition reaches only those opportunities where the prospective purchaser of a business opportunity makes a required payment to the seller. Proposed section 437.1(o) specifies that a “required payment” includes “all consideration that the purchaser must pay to the seller or an affiliate, either by contract or 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 required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.”

The exclusion from the definition of inventory purchases at bona fide wholesale prices of “required payment” effectuates the Commission’s determination that traditional product distribution arrangements should not be covered by the Business Opportunity Rule.<sup>160</sup> Accordingly, the definition of “required payment” is substantially similar to that employed in the recently amended Franchise Rule,<sup>161</sup> but also incorporates language from the IPBOR that reaches situations where a payment is made either directly to the seller or indirectly through a third party.<sup>162</sup>

The inventory exemption was originally set forth by the Commission in its 1979 Final Interpretative Guide to

the Franchise Rule.<sup>163</sup> The point of excluding payments for inventory was to exclude “agency relationships in which independent agents, compensated by commission, sell goods or services (e.g., insurance salespersons).”<sup>164</sup> Indeed, as numerous commenters point out, manufacturers, suppliers, and other traditional distribution firms “have relied solely on the bona fide wholesale price exclusion to avoid coverage as a franchise.”<sup>165</sup>

The IPBOR had eliminated this concept in an attempt to bring pyramid schemes that engaged in “inventory loading” within the ambit of the Rule. As discussed above, however, the Commission has determined that challenging such practices in targeted law enforcement actions under Section 5 of the FTC Act is a more cost-effective approach than attempting to address pyramid schemes as proposed in the IPBOR.

#### ii. Monetary threshold

Only business opportunities costing the purchaser at least \$500 are covered by the interim Business Opportunity Rule. The RPBOR, however, would eliminate any monetary threshold for the required payment. Many commenters, including MLM industry members as well as non-MLM product distributors, urged the Commission to establish a minimum threshold.<sup>166</sup> A common theme in many comments submitted by the MLM industry is that mandatory disclosures are not necessary or appropriate for small investments.<sup>167</sup> On the other hand, some commenters, such as the National Consumers League (“NCL”) strongly support the proposal to drop the financial threshold to zero, as a means of closing gaps that would allow perpetrators of fraud room to avoid making disclosures.<sup>168</sup>

<sup>160</sup> See Franchise Rule Final Interpretive Guides, 44 FR at 49967 (“the Commission will not construe as ‘required payments’ any payments made by a person at a bona fide wholesale price for reasonable amounts of merchandise to be used for resale. The Commission will construe ‘reasonable amounts’ to mean amounts not in excess of those which a reasonable businessman normally would purchase by way of a starting inventory or supply or to maintain a going inventory or supply.”).

<sup>161</sup> *Id.* at 49967-68.

<sup>162</sup> Sonnenschein, at 1-2. See also NAA, at 1-3; Timberland, at 1 (noting that numerous manufacturers structure their retail distribution in this manner); CTFa, at 4.

<sup>163</sup> E.g., DSA, at 37; Avon, at 10; Pre-Paid Legal, at 1; Sonnenschein, at 5; Herbalife, at 15; IBOAI, at 4-5; IBA, at 9.

<sup>164</sup> E.g., Xango, at 4; Avon, at 12; Herbalife, at 3; Shure, at 1-2; Symmetry, at 1.

<sup>165</sup> NCL, at 1, 2 (“[F]or many work-at-home victims, even losses of less than \$100 can have significant impacts. Some mention living on fixed disability or retirement incomes, others are desperately trying to supplement their wages in order to make ends meet.”). See also ASTA, at 2.

Many pernicious frauds, including typical work-at-home schemes, have fallen outside the ambit of the original Franchise Rule’s disclosure obligations because it covered only a franchise or business opportunity costing at least \$500.<sup>169</sup> These frauds have often targeted vulnerable populations, such as the disabled, elderly, and immigrant populations.<sup>170</sup> Some commenters asserted that a monetary threshold simply provides scam operators a means to circumvent the Rule, noting that business opportunities sometimes charge \$495 to skirt the original Franchise Rule’s disclosure requirements. For example, NCL stated that the:

\$500 minimum investment . . . leaves many consumers without the disclosures and other protections that they need. Nearly one-third of the consumers who reported to the NFIC last year that they had lost money to fraudulent or deceptive business opportunities paid less than \$500. . . . Whatever minimum amount might be set, fraudulent operators will price their services below it, and consumers will be victimized.<sup>171</sup>

Based upon this record and its law enforcement experience, the Commission concludes that the scope of

<sup>169</sup> See e.g., *FTC v. Med. Billers Network, Inc.*, No. 05 CIV 2014 (RJH) (S.D.N.Y. 2005) (\$200-295 fee); *FTC v. Sun Ray Trading*, No. Civ. 05-20402-CIV-Seitz/Bandstra (S.D. Fla. 2005) (\$160 fee); *FTC v. Wholesale Marketing Group, LLC*, No. 05 CV 6485 (N.D. Ill. 2005) (\$65 to \$175 registration fees); *FTC v. Vinyard Enterprises, Inc.*, No. 03-23291-CIV-ALTONAGA (S.D. Fla. 2003) (\$139 fee); *FTC v. Leading Edge Processing, Inc.*, 6:02-CV-681-ORL-19 DAB (M.D. Fla. 2002) (\$150 fee); *FTC v. Healthcare Claims Network, Inc.*, No. 2:02-CV-4569 MMM (AMWx) (C.D. Cal. 2002) (\$485 fee); *FTC v. StuffingforCash.com, Corp.*, No. 92 C 5022 (N.D. Ill. 2002) (\$45 fee); *FTC v. Kamaco Int'l*, No. CV 02-04566 LGB (RNBx) (C.D. Cal. 2002) (\$42 fee); *FTC v. Medicor LLC*, No. CV01-1896 (CBM) (C.D. Cal. 2001) (\$375 fee); *FTC v. SkyBiz.com*, No. 01-CV-0396-EA (X) (N.D. Okla. 2001) (\$125 fee); *FTC v. Para-Link Int'l*, No. 8:00-CV-2114-T-27E (M.D. Fla. 2000) (\$395 to \$495 fee).

<sup>170</sup> E.g., *FTC v. Juan Matos*, No. 06-161429 CIV-Altonaga (S.D. Fla. 2006) (\$110 fee); *FTC v. USS Elder Enterprises, Inc.*, No. SACV-04-1039 AHS (Anx) (C.D. Cal. 2004) (\$50 to \$180 fees); *FTC v. Castle Publishing, Inc.*, No. A03CA 905SS (W.D. Tex. 2003) (\$59 to \$149 fees); *FTC v. Esteban Barrios Vega*, No. H-04-1478 (S.D. Tex. 2003) (\$79 to \$149 fees).

<sup>171</sup> NCL, ANPR 35, at 11. See also SBA Advocacy, ANPR 36, at 6 (“[T]hreshold should be lowered to \$100 in order to curtail the number of unsavory companies that are beyond the reach of the FTC because they sell their scandalous ‘business opportunities’ for \$495.”); M. Garceau, 20Nov97 Tr at 53 (“[I]t should be one dollar”); D’Imperio, Sept95 Tr at 130 (“I don’t care if it’s \$10, fraud is fraud.”); Purvin, *id.* at 280 (“[C]ompanies use that threshold to avoid regulation and consequently have their entry fee be under \$500, which seems to me forces the amount of money that a prospective purchaser can lose within a very acceptable norm.”).

<sup>160</sup> See *supra* C.1.

<sup>161</sup> See 16 CFR 436.1(s).

<sup>162</sup> As noted in the NPR, this provision is designed to close a potential loophole that would subvert the proposed rule’s anti-fraud protections. Without 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. While this concept appeared in the IPBOR’s definition of “business opportunity,” it is now incorporated into the definition of “required payment.”

the RPBOR should be broad enough to reach business opportunities that our anti-fraud law enforcement history and consumer complaints show are a widespread and persistent problem. To make the Rule sufficiently broad to reach persistent frauds, such as work-at-home schemes and envelope stuffing schemes, the RPBOR eliminates the monetary threshold. Expansion of the Rule's coverage to reach these particular types of fraud is balanced by significantly streamlined disclosure obligations, which result in drastically reduced compliance costs. At the same time, the RPBOR's more limited definition of the types of business assistance that trigger coverage of the Rule, *see infra*, D.1.a.2., will avoid blanket coverage of commercial arrangements for the purchase of a business venture costing less than \$500.

## 2. Limiting the type of business assistance that would trigger coverage of the Rule

"Business assistance" was a key definitional element of the term "business opportunity" in the IPBOR, and remains so in the RPBOR, but with certain modifications intended to correct the IPBOR's overbreadth. The IPBOR defined the term "business opportunity," in relevant part, as "a commercial arrangement in which . . . the seller . . . either makes an earnings claim or represents that the seller or one or more designated persons will provide the purchaser with *business assistance*."<sup>172</sup> In turn, the IPBOR defined "business assistance" as "the offer of material advice, information, or support to a prospective purchaser in connection with the establishment or operation of a new business," and included five illustrative examples of the kinds of activities considered to be "business assistance": securing locations; securing accounts; buying back goods produced by the business; tracking or paying commissions or other compensation for recruitment or sales; and training or advising for the business.

The RPBOR streamlines and narrows the scope of the definition of "business opportunity" by, among other things, incorporating the concept of "assistance" into the "business opportunity" definition itself, rather than cross referencing a separate "business assistance" definition. Also, to cure the overbreadth of the IPBOR, activities specified as fulfilling the "assistance" prong of the "business opportunity" definition of the RPBOR

do not include: tracking or paying commissions or other compensation for recruitment or sales; or generalized training or advising.

The RPBOR retains the scope of the original Franchise Rule (as currently set forth in the interim Business Opportunity Rule), in that it includes location and account assistance in the definition of "business opportunity." Indeed, the Commission's enforcement experience shows that the offer of location assistance is the hallmark of fraudulent vending machine and rack display route opportunities,<sup>173</sup> while account assistance is typical of medical billing schemes.<sup>174</sup>

Similarly, the RPBOR retains the example of "buy back" assistance in the proposed definition of "business opportunity" because it is a characteristic feature of work-at-home schemes promoting product assembly and envelope stuffing schemes.<sup>175</sup> The term, however, would be broadened slightly to make explicit that any payments or promise of payments for home-based envelope stuffing schemes come within the parameters of the Rule. As such, the definition of "business opportunity" is modified expressly to include: "providing payment for such services as, for example, stuffing envelopes from the purchaser's home."<sup>176</sup> This is necessary because hucksters who offer envelope stuffing opportunities commonly represent them as employment or quasi-employment opportunities in which they will compensate participants according to the number of envelopes they stuff.<sup>177</sup>

<sup>173</sup>E.g., *FTC v. Am. Entm't Distribs.*, No. 04-22431-CIV-Huck (S.D. Fla. 2004); *FTC v. Advanced Pub. Comm'ns Corp.*, No. 00-00515-CIV-Ungaro-Benages (S.D. Fla. 2000); *FTC v. Ameritel Payphone Distribs., Inc.*, No. 00-0514-CIV-Gold (S.D. Fla. 2000); *FTC v. Mktg. and Vending Concepts*, No. 00-1131 (S.D.N.Y. 2000).

<sup>174</sup>E.g., *FTC v. Mediworks, Inc.*, No. 00-01079 (C.D. Cal. 2000); *FTC v. Home Professions, Inc.*, No. 00-111 (C.D. Cal. 2000); *FTC v. Data Med. Capital, Inc.*, No. SACV-99-1266 (C.D. Cal. 1999). *See also* *FTC v. AMP Publ'n, Inc.*, No. SACV-00-112-AHS-ANx (C.D. Cal. 2000).

<sup>175</sup>E.g., *FTC v. Misty Stafford*, No. 3: CV 05-0215 (M.D. Pa. 2005); *FTC v. USS Elder Enter. Inc.*, No. SACV-04-1039 AHS (ANx) (C.D. Cal. 2004); *FTC v. Holiday Magic*, No. C. 93-4038 VRW (N.D. Cal. 1994).

<sup>176</sup> RPBOR, Section 437.1(c)(3)(iii).

<sup>177</sup>E.g., *FTC v. Group C Marketing, Inc.*, No. CV-06-06019 (C.D. Cal. 2006) (defendants represented they would pay \$7 for every envelope consumers stuffed); *FTC v. Gregory Bryant*, No. 3:04-CV-897-J-32MMH (M.D. Fla. 2004) (defendants represented they would pay \$4 for every envelope consumers stuffed and mailed); *FTC v. America's Shopping Network, Inc.*, No. 02-80540-CIV-Hurley (S.D. Fla. 2002) (promising to pay \$635 per week for processing mail); *FTC v. Darrell Richmond*, No. 3:02-3972-22 (D.S.C. 2002) (offering to pay \$2 per envelope stuffed); *FTC v. Financial Resources Unlimited*, No. 03-C-8864 (N.D. Ill. 2003) (offering to pay \$10 per envelope).

The RPBOR would exclude from its scope those commercial arrangements where the only assistance the seller provides is tracking payments. By so doing, the Commission takes MLM companies out of the ambit of the Rule. Likewise, the RPBOR would exclude those sellers that offer assistance only in: "Advising or training, or purporting to advise or train, the purchaser in the promotion, operation, or management of a new business, or providing, or purporting to provide, the purchaser with operational, managerial, technical, or financial guidance in the operation of a new business."<sup>178</sup> While the Commission's law enforcement experience shows that the promise of such assistance is a feature of many fraudulent business opportunity ventures, such as vending opportunities, rack display schemes, and medical billing work-at-home schemes,<sup>179</sup> these schemes are captured adequately within the scope of the RPBOR. Defining "business assistance" to include such advising or training would incorporate such a broad array of traditional activities in legitimate commercial relationships that the costs would outweigh the benefits that would be generated as a result of including these

<sup>178</sup>*See* IPBOR, 437.1(c)(5). Similarly, the RPBOR also eliminates the term "training" from the IPBOR's definition of the term "providing locations, outlets, accounts, or customers." *See* IPBOR, 437.1(n). In the RPBOR, "providing locations" remains a form of business assistance that would trigger the coverage of the rule. *See* RPBOR, 437.1(c)(3)(ii) and 437.1(l). This change avoids the possibility that the use of the term "training" in the definition of "providing locations," at Section 437.1(l), could be interpreted as a "catch-all" inadvertently sweeping into the ambit of the rule such businesses as manufacturers that provide sales training or educational institutions. However, the elimination of the word "training" from the definition of "providing locations" does nothing to erode the long-standing interpretation of "location assistance" in the original Franchise Rule to reach, potentially, circumstances where a seller "instructs investors on how to find their own profitable locations." Staff Advisory Opinion 95-10, Bus. Franchise Guide (CC) ¶ 6475 (1995) (noting that assistance must be more than nominal). The Commission solicits comment on whether the revision to Section 437.1(l) cures potential overbreadth without sacrificing the full extent of coverage of the original rule, as described in Staff Advisory Opinion 95-10.

<sup>179</sup>E.g., *FTC v. Inspired Ventures, Inc.*, No. 02-21760-CIV-Jordan (S.D. Fla. 2002); *FTC v. Inv. Dev. Inc.*, No. 89-0642 (E.D. La. 1989); *FTC v. Home Professions, Inc.*, No. 00-111 (C.D. Cal. 2000); *FTC v. Star Publ'g Group, Inc.*, No. 00-023 (D. Wyo. 2000); *FTC v. Hi Tech Mint Sys., Inc.*, No. 98 CIV 5881 (JES) (S.D.N.Y. 1998); *FTC v. Fresh-O-Matic Corp.*, No. 96-CV-315-CAS (E.D. Mo. 1996); *FTC v. Joseph Hayes*, No. 4:96CV06126SNL (E.D. Mo. 1996). *See* Illinois Act, 815 ILCS at § 602/5-5.15 (The seller offers a marketing plan, defined as "advice or training . . . includ[ing], but not limited to . . . training, regarding the promotion, operation or management of the business opportunity; or operational, managerial, technical, or financial guidelines or assistance.").

<sup>172</sup> IPBOR, § 437.1(d), 71 FR 19054 at 19087 (Apr. 12, 2006). (Emphasis supplied.)

types of business assistance. For example, it could introduce the unintended and unappealing specter of regulating certain educational offerings.<sup>180</sup> It also could include manufacturers who provide product and sales training to third-party retailers.<sup>181</sup> Therefore, the RPBOR excludes “advising or training” as a form of assistance that would trigger application of the Rule.

### 3. Earnings claims

One major revision to the IPBOR is that the making of an earnings claim no longer is sufficient to bring a commercial arrangement within the definition of “business opportunity.” This revision addresses the concerns that numerous commenters articulated, namely, that because the definition of “earnings claim” is very broad, the IPBOR’s definition of business opportunity would transform common commercial transactions into “business opportunities.”<sup>182</sup>

The Commission considered but does not believe that narrowing the definition of “earnings claims” effectively addresses concerns with over breadth. Moreover, narrowing the definition of “earnings claims” could weaken protections on the most salient feature of the sales presentation by allowing sellers to avoid disclosing the numbers of people who, for example, earned enough money to “buy a Porsche,” or earned the top level of compensation on an earnings matrix.<sup>183</sup> Earnings claims lie at the heart of business opportunity fraud, and are typically the enticement that persuades consumers to invest their money. The disclosure obligations in the RPBOR, as in the Franchise Rule, are designed to help a consumer identify and evaluate an earnings claim, if one is made, or to arouse suspicion if an earnings claim is made orally but is disclaimed in writing. If the RPBOR were to create opportunity for a potential loophole on this critically important issue, certainly unscrupulous business opportunity sellers would be very quick to exploit it, to the great detriment of consumers.

Therefore, the Commission believes a better approach is to tailor the substantive scope of the Rule rather than to narrow or restrict the definition of “earnings claims.” The RPBOR is intended to cover all variations of earnings representations that the Commission’s law enforcement

experience shows are associated with business opportunity fraud. Indeed, the definition of earnings claims is longstanding, as it is taken from the description of earnings claim in the original Franchise Rule, and incorporates examples taken from the UFOC Guidelines as well as the Interpretive Guides to the Franchise Rule.<sup>184</sup>

The Commission does not believe that this change undermines the utility of the RPBOR in addressing fraud in connection with earnings claims. It simply unlinks the definition of “business opportunity” from the making of an earnings claim.

#### b. Proposed Section 437.1(d): “Designated person”

The RPBOR makes a minor modification to the IPBOR’s definition of “designated person.” The IPBOR’s definition ended with an example of the type of person who could be considered a “designated person,” which included, without limitation, “any person who finds or purports to find locations for equipment.” The RPBOR eliminates this concluding language because the definition of “business opportunity” lists the types of assistance a “designated person” might render or purport to render. To avoid any possibility of confusion by including one example but not all three in the definition of “designated person,” the Commission deletes the example. A “designated person” is defined in the RPBOR as “any person, other than the seller, whose goods or services the seller suggests, recommends, or requires that the purchaser use in establishing or operating a new business.”

#### c. Proposed Section 437.1(l): “Providing locations”

Section 437.1(l) of the RPBOR differs in some respects from the analogous provision in the IPBOR. It would define “providing locations, outlets, accounts, or customers” as:

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.

The RPBOR would alter the definition of “providing locations, outlets, accounts, or customers,” slightly by adding the phrases “providing a list of locator companies” and “offering to furnish a list of locations.” In its comment, the United States Department of Justice, Office of Consumer Litigation (“DOJ”), which has a long history of cooperating with the Commission to enforce the Franchise Rule,<sup>185</sup> pointed out that many fraudulent business opportunities simply provide lists of locators or locations. DOJ noted that while the definition included in the IPBOR could be read to include such scenarios, it would be useful to make the rule cover such practices explicitly. Indeed, DOJ’s concerns resonate with the Commission’s law enforcement experience, and the Commission agrees that the rule text should explicitly address this specific practice. Further, the definition is also modified to incorporate the term “lead generator” into the third clause, thus adding symmetry to the definition, which refers to “lead generators” in all other clauses. Thus, the third clause in Section 437.1(l) now includes: “providing a list of locator or lead generator companies.”

Finally, the words “or training” are deleted from the last clause of Section 437.1(l) to avoid the possibility that it could be interpreted as a “catch-all” capturing any business offering to provide training. The revision leaves intact the phrase “or otherwise assisting the prospective purchaser in obtaining his or her own locations, outlets, accounts, or customers.” To determine whether a seller provides the requisite assistance in providing locations, outlets, accounts or customers, 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>186</sup>

#### 2. Proposed Section 437.3: The Basic Disclosure Document

Proposed Section 437.3 specifies the items of material information that must be included in the basic disclosure document. As explained in the NPR, the seller of the business opportunity is the

<sup>185</sup> As it points out in its comment, between 1995 and July of 2006, DOJ filed 61 lawsuits alleging Franchise Rule violations by 145 defendants. DOJ, at 1 n. 1.

<sup>186</sup> See Staff Advisory Opinion 95-10, Bus. Franchise Guide (CC) ¶ 6475 (1995). See also supra note 178.

<sup>180</sup> See supra note 45.

<sup>181</sup> See Timberland, at 1.

<sup>182</sup> E.g., IBA, at 4; PMI, at 2; MMS, at 2; Venable, at 1-2.

<sup>183</sup> See RPBOR, 437.1(f).

<sup>184</sup> See UFOC Guidelines, Item 19; Staff Advisory Opinion, Handy Hardware Centers, Bus. Franchise Guide (CCH) ¶ 6426 (1980); Interpretive Guides, 44 FR at 49982.

party responsible for providing the basic disclosure document to prospective purchasers, and the seller must present the required information in “a single written document in the form and using the language set forth in Appendix A to part 437.” The Commission has retained an expert to assess the basic disclosure document as proposed, with the objective of achieving a format and content that communicates the material information to consumers. The Commission welcomes comments on all aspects of the RPBOR; commentary on the proposed form, however, would be most useful if accompanied by quantitative or qualitative studies on the effectiveness of the form, with specific suggestions for potential improvement.

The RPBOR makes three modifications<sup>187</sup> to the IBPOR with respect to the information that must be presented on this document: (1) a citation to the Rule would be added to the title of the form; (2) the disclosure of legal actions pertaining to a seller’s sales representatives would be deleted from the form; and (3) the disclosure of the number of cancellations and refund requests would be deleted from the form. These changes are discussed below.

*a. Proposed Section 437.3(a): Form of the basic disclosure document*

The form and language of the basic disclosure document is set forth in Appendix A to the RPBOR. While the Commission received a plethora of commentary on the substantive disclosures to be included in the basic disclosure document, it received hardly any commentary on the language used in the proposed form. The Commission received a persuasive comment by DOJ, advising the Commission to add to the title a citation to the legal authority requiring the seller to provide the basic disclosure document. The Commission has decided to adopt this suggestion.

As discussed above, DOJ has substantial expertise in enforcing the Franchise Rule, and has the authority to seek civil penalties for violations of trade regulation rules issued pursuant to the FTC Act.<sup>188</sup> To obtain civil penalties for infractions of an FTC rule, however, the government must prove “actual knowledge or knowledge fairly implied on the basis of objective circumstances

<sup>187</sup> Additionally, the “earnings” section of the disclosure document is modified slightly to include a disclosure of earnings claims the seller “has stated or implied.” The use of the past tense makes clear to a seller completing the form that it must identify earnings claims made over the course of marketing the business opportunity to the consumer, and not just those claims made at the moment of providing the disclosure document.

<sup>188</sup> 15 U.S.C. § 56(a)(1); § 45(m)(1)(A).

that such act is unfair or deceptive and is prohibited by such rule.”<sup>189</sup> According to DOJ, its experience is that individuals who market business opportunities sometimes claim that they simply copied their disclosure documents from a previous employer, suggesting that they did not know their disclosure documents were in violation of any rule. Including a short reference to the rule would “eliminate[ ] any significant question as to whether the defendant had actual or implied knowledge as required by the statute.”<sup>190</sup>

The Commission agrees with DOJ. As numerous commenters have noted, law enforcement is critical to eliminating malfeasance from the marketplace.<sup>191</sup> DOJ’s suggested minor modification to the form promises to advance the government’s ability to enforce the law through the use of civil penalties. Therefore, the title of the proposed form on Appendix A has been modified to add the language “Required by Federal Trade Commission, 16 C.F.R. Part 437.”

*b. Proposed Section 437.3(a)(3): Legal Actions*

Proposed Section 437.3(a)(3) would address fraud in the sale of business opportunities by requiring the disclosure of material information about certain prior legal actions<sup>192</sup> involving the company, its directors, and certain sales employees. This requirement is based on analogous provisions of the original Franchise Rule.<sup>193</sup> Commenters raised two distinct issues regarding the disclosure of prior legal actions. First, some commenters, primarily members of the MLM industry, argued that this disclosure obligation would not result

<sup>189</sup> 15 U.S.C. § 45(m)(1)(A).

<sup>190</sup> DOJ at 2.

<sup>191</sup> *E.g.*, Haynesboone, at 5 (urging the Commission to focus more resources on enforcement); DRA, at 2.

<sup>192</sup> The Commission notes that the definition of “actions” in the RPBOR is different from that employed in the amended Franchise Rule. The reason for that and other differences is that the two rules were crafted to achieve different objectives and to govern different types of business transactions. To provide one example, a major objective of the amended Franchise Rule was to harmonize it with various state law requirements and, thus, maximize uniformity of laws at the federal and state level governing business-format franchises. That objective is not present in the effort to amend the interim Business Opportunity Rule. Therefore, there should be no negative inferences drawn from the inclusion in or exclusion from the RPBOR of any particular terms used in the amended Franchise Rule.

<sup>193</sup> The Commission stated in the original Franchise Rule’s SBP that litigation history is material because it bears on the “integrity and financial standing of the [seller].” 43 FR at 59649. A disclosure of litigation history is also incorporated into the interim Business Opportunity Rule. 16 CFR 437.1(a)(4).

in consumers receiving meaningful information, and could unfairly tarnish the image of a seller who has been sued but has not been found liable.<sup>194</sup> Second, some commenters argued that state laws conflict with the requirement in the IPBOR that sellers report the litigation histories of their sales employees.<sup>195</sup>

With respect to the first point, the Commission disagrees that the disclosure of prior legal actions does not impart meaningful information to consumers. This and other proposed material disclosures on the form are intended to help consumers understand and assess the risks of their prospective investment. The Commission believes that information about litigation history in the areas of “misrepresentation, fraud, securities law violations, or unfair or deceptive practices,” is material to assessing that risk. Indeed, discovering that a seller has a history of violating laws and regulations is perhaps the best indication that a particular business opportunity is a high-risk investment. In the Commission’s law enforcement experience, business opportunity promoters have failed to disclose such material information to prospective purchasers, to the detriment of those purchasers.<sup>196</sup> Regarding the concern that businesses will be unfairly tarnished, nothing in the RPBOR prevents the seller from speaking with the consumer to explain the nature or outcome of any legal action disclosed on the form.<sup>197</sup>

<sup>194</sup> *E.g.*, Melaleuca, at 6; Quixtar, at 35; Amsoil, at 2; Babener, at 2.

<sup>195</sup> Venable, at 11; Chadbourne, at 20; Shaklee, at 10, 12.

<sup>196</sup> *E.g.*, *FTC v. Success Vending Group, Inc.*, No. CV-S-05-0160-RJ-PAL (D. Nev. 2005) (failure to disclose guilty plea for mail fraud and previous injunction); *FTC v. Netfran Development Corp.*, No. 1:05-cv-22223-UU (S.D. Fla. 2005) (failure to disclose FTC injunction against principal); *FTC v. American Entm’t Distribs., Inc.*, No. 04-22431-Civ-Martinez (S.D. Fla. 2004) (failure to disclose prior FTC injunction); *United States v. We The People Forms and Serv. Centers USA, Inc.*, No. CV 04 10075 GHK FMOx (C.D. Cal. 2004) (failure to disclose prior lawsuits); *FTC v. Joseph Hayes, No. Civ. 4:96CV02162SNL (E.D. Mo. 1996)* (failure to disclose prior state fines and injunctive actions); *FTC v. WhiteHead, Ltd.*, Bus. Franchise Guide (CCH) ¶ 10062 (D. Conn. 1992) (failure to disclose fraud action); *FTC v. Inv. Dev. Inc.*, Bus. Franchise Guide (CCH) ¶ 9326 (E.D. La. 1989) (failure to disclose insurance fraud convictions).

<sup>197</sup> As noted above, some members of the MLM industry voiced concern about making extensive litigation disclosures because they are affiliated with numerous other companies. In the context of such an MLM, it could be impractical for a consumer to ask about every legal action listed on the disclosure form, and thus, the form itself may be unduly prejudicial to the MLM. Given the RPBOR as now tailored, such concerns are unlikely

With respect to the second issue concerning the disclosure of legal actions pertaining to sales employees, IPBOR, 437.3(a)(3)(D), the Commission believes it would be appropriate to exclude these employees from the disclosure requirement. Some commenters suggested that this provision would be inconsistent with state employment laws, but they did not cite to specific statutes in which a conflict would necessarily arise.<sup>198</sup> The IPBOR's requirement to disclose the litigation history of sales employees was intended to enable a prospective purchaser to evaluate the representations made by a sales person. The Commission now believes that the burden of collecting litigation histories for every sales person is not outweighed by the corresponding benefit to prospective purchasers. In the Commission's law enforcement experience, sales representatives often work from sales scripts that someone with supervisory authority has developed. A problem emerges when companies conceal the litigation history of the person with supervisory authority by claiming that individual is just a sales person. The Commission believes that it is sufficient to require business opportunity sellers to disclose the litigation histories of their principals, officers, directors, and sales managers, as well as any individual who occupies "a position or performs a function similar to an officer, director, or sales manager of the seller." In this way, the RPBOR is sufficient to enable prospective purchasers to ferret out situations where recidivists, ostensibly employed as sales personnel, in fact function as de facto officers or directors. Therefore, in the RPBOR, the Commission deletes paragraph (D) from section 437.3(a)(3) of the IPBOR.

*c. Proposed Section 437.3(a)(4):  
Cancellation or refund history*

Section 437.3(a)(4) of the IPBOR would have required a seller both to state on the basic disclosure document whether it has a cancellation or refund policy, and to disclose the number of purchasers who had asked to cancel or who had sought a refund in the two previous years.<sup>199</sup> This second disclosure was included as a remedy

to be raised in the context of typical business opportunity schemes.

<sup>198</sup> Venable, at 11; Chadbourne, at 20; Shaklee, at 10, 12. A California statute forbids employers from inquiring into histories of arrests that did not result in convictions. Cal. Lab. Code Ann. § 432.7(a) (Deering 2007). It is not clear how this would conflict with the RPBOR, which would not require disclosure of arrest records.

<sup>199</sup> IPBOR, 437.3(a)(5).

against false representations about the success of prior purchasers. This is a misrepresentation the Commission has observed in many of its law enforcement actions against fraudulent business opportunity sellers.<sup>200</sup> In the NPR, the Commission specifically sought comment on the proposed disclosure of the seller's refund history, particularly on the likely effect this disclosure might have on the willingness of sellers to offer refunds.<sup>201</sup> Based upon the arguments articulated in the comments to the NPR, the Commission no longer believes this second disclosure is useful, and revises 437.3(a)(4) accordingly.

Some commenters persuasively argued that requiring disclosure of a seller's refund history would have the perverse effect of discouraging legitimate businesses from offering refunds.<sup>202</sup> Commenters argued that legitimate businesses often have liberal refund policies so they can provide a low-risk opportunity. If they were required to track and disclose the number of purchasers who took advantage of the refund policy, however, the disclosure of such information might create a misleading impression of general dissatisfaction. It might cause prospective purchasers to misinterpret risk, and therefore eschew a safe opportunity.

The Commission is persuaded that the disclosure of refund history could be unduly prejudicial to business opportunities that offer and liberally provide refunds to prior purchasers. Indeed, a prospective purchaser might compare the refund requests of a fraudulent seller with no refund policy against a legitimate seller with a liberal refund policy and inappropriately conclude that the legitimate seller offers a riskier business venture. Thus, the disclosure would not reliably remedy deception on this issue. Furthermore, the most important piece of information for consumers is not how many individuals sought refunds, but what are the particular requirements of the refund or cancellation policy. This information is not likely to create perverse results or mistaken impressions. Therefore, Section 437.3(a)(4) of the RPBOR requires disclosure of the refund policy, but

<sup>200</sup> *E.g.*, *FTC v. National Vending Consultants, Inc.*, CV-S-05-0160-RCJ (PAL) (D. Nev. 2005); *FTC v. Fidelity ATM, Inc.*, No. 06-CIV-81101 (S.D. Fla. 2006).

<sup>201</sup> 71 FR at 19070.

<sup>202</sup> *See supra* note 72. The comments on this issue came from members of the MLM industry. While the RPBOR has been pared back to exclude MLMs, the Commission is persuaded that their commentary on this issue can be applied to business opportunities that remain within the scope of the Rule.

eliminates section 437.3(a)(5) of the IPBOR, which would have required disclosure of the seller's refund history.<sup>203</sup>

*d. Proposed Section 437.3(a)(6):  
References*

After analyzing commentary to Section 437.3(a)(6) of the RPBOR, the Commission leaves intact the IPBOR's language requiring the disclosure of a limited number of prior purchasers as references.<sup>204</sup> The Commission believes that the disclosure of prior purchasers is very important to prevent fraud because it enables prospects to evaluate the seller's claims based on information from an independent source with relevant experience. The Commission had solicited comment and suggestions on balancing the need to enable prospective purchasers to verify sellers' claims with privacy concerns.<sup>205</sup> In addition to seeking comment on possible alternatives, the Commission sought comment on whether the Rule should permit purchasers the opportunity to opt-out of the disclosure of their contact information.<sup>206</sup>

The MLM industry articulated concerns peculiar to its business model, but these provisions would no longer apply to MLM companies inasmuch as these companies, and their representatives, are excluded from the ambit of the RPBOR.

The MLM comments also suggested, more broadly, that the reference disclosure requirement raised privacy and security concerns.<sup>207</sup> The Commission believes that the very limited proposed reference disclosure does not raise security concerns because the required disclosures include no sensitive personal information whatsoever, no social security numbers, birth dates, or financial account numbers. The disclosure requirement of nothing more than name, city, state, and telephone number—covers less information than may be commonly available in public telephone books.

On the topic of privacy concerns, the Commission received a few comments in support of allowing individual business opportunity purchasers to opt

<sup>203</sup> This change reverts back to the requirements of the original Franchise Rule which did not require a business to tally the number of refund or cancellation requests but did require disclosure of refund policies. *See* 16 CFR 437.1(a)(7) (interim Business Opportunity Rule).

<sup>204</sup> The requirement to disclose prior purchasers was in original Franchise Rule, and is now in the interim Business Opportunity Rule. *See* 16 CFR 437.1(a)(16)(iii).

<sup>205</sup> NPR, 71 FR at 19071.

<sup>206</sup> *Id.*

<sup>207</sup> *E.g.*, Quixtar, at 33; Babener, at 2; Pre-Paid Legal, Rebuttal, at 8; DRA, at 6.

out of having their contact information disclosed.<sup>208</sup> DOJ, however, urged the Commission to reject any opt-out: “The Rule should not permit such an opt-out. It would be an easy matter for telemarketers to talk consumers into opting out, describing to them what a hassle it becomes for those who do not opt-out because of all the demand that arises for their time and attention.”<sup>209</sup> The Commission agrees with DOJ that it is critical to provide prospective purchasers with a true list of prior purchasers. By investing in a business opportunity, these purchasers are entering the world of commerce and embarking upon the establishment of a business. Businesses generally hold themselves out as offering goods and services to the public.<sup>210</sup> Therefore, the Commission believes that the value to prospects of information about prior purchasers outweighs any potential detriment to prior purchasers of the disclosure of their contact information. The RPBOR leaves intact section 437.3(a)(6).

### 3. Proposed Section 437.4: The Earnings Claim Document

Apart from the comments submitted by the MLM industry, the Commission received little comment on the provisions in the proposed earnings claim document. The one aspect of these provisions that drew the most scrutiny from commenters was section 437.4(a)(vi), which requires sellers who make earnings claims to disclose “any characteristics of the purchasers who achieved at least the represented level of earnings, such as their location, that

<sup>208</sup> E.g., Scarlet Leverton (affiliated with Lia Sophia); Kay Gidley (affiliated with Universa Life Sciences); Joseph McGarry (affiliated with Quixtar). These comments express generalized privacy concerns.

<sup>209</sup> DOJ, at 3.

<sup>210</sup> Notably, federal law often focuses on privacy concerns affecting individuals, not businesses. For example, Congress specifically focused on the need to respect “the consumer’s right to privacy,” in enacting the Fair Credit Reporting Act (“FCRA”). 15 U.S.C. 1681(a)(4). The FCRA requires various protections for consumer information, including provisions addressing identity theft, but there is no comparable statute that protects business information. Similarly, Congress enacted the Graham-Leach-Bliley Act to protect personal financial information of individual consumers but excluded from the ambit of the law the protection of information pertaining to businesses. Graham-Leach-Bliley Act, 15 U.S.C. 6809 (9) (defining “consumer” to include individuals who obtain financial products or services for personal, family or household purposes). See also Privacy of Consumer Financial Information, 16 CFR 313.1(b) (expressly stating that it “does not apply to information about companies or about individuals who obtain financial products or services for business, commercial, or agricultural purposes.”); Standards for Safeguarding Customer Information, 16 CFR 314.2(b) (defining “customer” by reference to Part 313).

may differ materially from the characteristics of the prospective purchasers being offered the business opportunity.” Here, commenters—primarily from the MLM industry—argued that it would be extremely costly to undertake an analysis of the various characteristics that successful purchasers had in common.<sup>211</sup> MLM companies peculiar concerns are no longer relevant inasmuch as they are excluded from the scope of the RPBOR.

The Commission has decided to retain this provision in the RPBOR because the information disclosed is material; it is intended to enable the prospect to determine whether the claimed earnings of prior purchasers are typical in the prospect’s market. Furthermore, the business opportunity seller is in the best position to know what set of characteristics, such as location in densely-populated areas, tend to make their purchasers successful. The amended Franchise Rule imposes an analogous obligation,<sup>212</sup> and indeed, the RPBOR’s earnings disclosure obligation is similar to what the interim Business Opportunity Rule already requires.<sup>213</sup> The Commission continues to seek comment on this topic, particularly on the question of the burdens upon business against the benefit to prospective purchasers.<sup>214</sup>

On its own initiative, the Commission has decided to modify slightly another provision of the IPBOR, section 437.4(a)(4)(v). Section 437.4(a)(4)(iv) requires sellers who make earnings claims to disclose the “beginning and ending dates when the represented earnings were achieved,” and section 437.4(a)(4)(v) of the IPBOR further required disclosure of the “number and percentage of all purchasers during the stated time period who achieved at least the stated level of earnings.” The revision clarifies a potential ambiguity: the purchasers who must be counted are

<sup>211</sup> E.g., MLMIA, at 41 (“No one can hope to substantiate accurately an earnings claim in a way that would take into account and disclose every factor material to each person’s earnings and to contrast that with the characteristics of each prospective purchaser without the expert advice of a person trained in marketing and economics at the graduate level who in addition has experience in making these kinds of assessments.... Legal and marketing consultants are expensive.”).

<sup>212</sup> 16 CFR 436.5(s)(3)(ii)(A).

<sup>213</sup> The interim Business Opportunity Rule requires earnings claims be presented with a statement of the material bases and assumptions upon which the claim is made. 16 CFR 437.1(b)(3); 437.1(c)(3).

<sup>214</sup> As noted earlier, even without the RPBOR, any seller who makes an earnings claim must be truthful in that assertion and must substantiate the claim. If a seller makes an earnings claim that is only relevant to a narrow subset of purchasers and the seller fails to disclose that fact, the claim would violate Section 5 of the FTC Act.

all those who purchased the business opportunity before the ending date when the represented earnings were achieved, not just individuals who purchased the business opportunity during the stated time period. Thus, under the RPBOR’s section 437.4(a)(4)(v), the seller must disclose: “The number and percentage of all persons who purchased the business opportunity prior to the ending date in (iv) above who achieved at least the stated level of earnings.”

### 4. Proposed Section 437.5: Other Prohibited Practices

In addition to mandating disclosures to prospective purchasers, the IPBOR would have prohibited sellers from engaging in a number of deceptive practices. The RPBOR retains these prohibitions, and would add: (1) a substantive prohibition to section 437.5(e), and (2) clarifying language to section 437.5(r). Each of these changes is discussed immediately below.

#### a. Proposed Section 437.5(e): Misrepresenting the Law

The IPBOR would have prohibited sellers from “[m]isrepresenting that any governmental entity, law, or regulation prohibits a seller from furnishing earnings information to a prospective purchaser.” The RPBOR would add a second numbered clause, further prohibiting misrepresentations that any governmental entity, law or regulation prohibits a seller from “disclosing to prospective purchasers the identity of other purchasers of the business opportunity.” DOJ suggests the above modification because, in its law enforcement experience, it has encountered “numerous fraudulent business opportunity sellers who deflect consumer requests for current distributors by falsely claiming that the law forbids disclosing their identity, which of course, is exactly the opposite of the truth.”<sup>215</sup> The Commission agrees that such a prohibition is appropriate, and will help consumers understand that if the seller supplies no references, it is because none exists or because the seller chooses not to make such information available, which would contravene the RPBOR. Furthermore, the prohibition on making false statements imposes no costs on legitimate companies, and as such, serves simply to confer a significant benefit to consumers.

<sup>215</sup> DOJ, at 2.

*b. Proposed Section 437.5(r): Failure to Disclose Payment of References*

The RPBOR is intended to prohibit sellers from failing to disclose payments to individuals identified as references or personal relationships with such individuals. However, the language of the second clause of this paragraph in the IPBOR does not state that what must be disclosed is the relationship between the seller and the reference.<sup>216</sup> Therefore, the RPBOR adds clarifying language to the opening clause of section 437.5(r), so that it prohibits a failure to disclose, “with respect to any person identified as a purchaser or operator of a business opportunity offered by the seller,” any consideration paid, any personal relationship, or other unrelated business relationship.

*c. Proposed Section 437.5(c): Extraneous Materials*

Like the IPBOR, the RPBOR’s Section 437.5(c) would prohibit the inclusion of any additional information in a disclosure document that is not explicitly required or permitted by the Rule. The point of the prohibition is to preserve the clarity, coherence, readability, and utility of the disclosures by ensuring that the seller does not clutter the disclosure document. The Commission sought comment on whether it is appropriate to prohibit sellers from including in their disclosure documents additional disclosures required by state business opportunity laws.

DOJ urged the Commission to exclude state disclosures from the proposed form. In DOJ’s experience, “[p]urveyors of fraudulent business opportunities will seek every opportunity to water down this document with extraneous information to hide any negative information it may contain.”<sup>217</sup>

The original Franchise Rule permitted the inclusion of state mandated disclosures in the federal disclosure document, where the state disclosures provided equal or greater protection to prospective purchasers.<sup>218</sup> However, the original Franchise Rule required a very lengthy disclosure, which included more than 20 categories of information. Any additional state disclosures that afforded greater protections to prospective purchasers were generally minor additions that could be easily accommodated.<sup>219</sup>

The Commission agrees with DOJ that state disclosures should not be bundled in to the same document with the proposed federal disclosure, and therefore, the RPBOR retains Section 437.5(c) of the IPBOR. One important goal of revising and tailoring the disclosure requirements of the Franchise Rule for business opportunity promoters is to simplify and streamline the disclosures into a single page document. Allowing business opportunity promoters to mix federal and state disclosures into one document would be an invitation to sellers to present lengthy and confusing information to prospective purchasers. Such a result would be contrary to the Commission’s goal of providing a simple, clear, and concise disclosure document.

*5. Proposed Section 437.7: Exemptions*

Section 437.7 of the IPBOR identifies entities that would be exempt from complying with the Business Opportunity Rule. The exemption applies to business opportunities that constitute franchises, and it was designed to eliminate the possibility that a business would face duplicative compliance burdens under the Business Opportunity Rule and the amended Franchise Rule. However, it was also designed to ensure that certain franchises exempt from the requirements of the Franchise Rule—namely, those falling under the minimum payment exemption or the oral agreement exemption<sup>220</sup>—would be covered by the Business Opportunity Rule. To add precision and clarity to this provision, the RPBOR revises Section 437.7 to adopt the language of the amended Franchise Rule describing the relevant exemptions and to add specific citations to the relevant provisions of Part 436.

Many commenters argued for additional changes to the IPBOR, including changing the definition of “new business,” exempting purchasers of sufficient net worth, excluding transactions above a monetary threshold, such as \$50,000.<sup>221</sup> These commenters essentially argued that the Rule’s application should encompass only those transactions involving the vulnerable or unsophisticated purchasers that they posited the Rule seeks to protect, and that exemptions should be written into the Rule for

sophisticated businesses that do not need its burdens or protections.<sup>222</sup>

Having narrowed the scope of the proposed Rule considerably, the Commission believes it has tailored the Rule’s application to cover only those business opportunities where fraud is most likely to occur. In the Commission’s law enforcement experience, these business opportunities can cost tens of thousands of dollars, and seldom, if ever, involve seasoned purchasers with sufficient expertise to negotiate the terms of the transaction. There is an insufficient basis at this time to conclude that further exemptions are necessary to avoid covering transactions between sophisticated business people. However, the Commission continues to solicit comment on whether the proposed modifications to the scope of the Rule adequately capture the marketplace in which fraud is prevalent or whether it is needlessly over-inclusive.

**Section E Rulemaking Procedures**

Pursuant to 16 CFR 1.20, the Commission will use the following rulemaking procedures. These procedures are a modified version of the rulemaking procedures specified in Section 1.13 of the Commission’s Rules of Practice.

First, the Commission is publishing this Revised Notice of Proposed Rulemaking. The comment period will be open until May 27, 2008, followed by a rebuttal period until June 16, 2008. Interested parties are invited to submit written comments. Written comments must be received on or before May 27, 2008. Rebuttal comments must be received on or before June 16, 2008. All comments should be filed as prescribed in the **ADDRESSES** section above.

Second, pursuant to Section 18(c) of the Federal Trade Commission Act, 15 U.S.C. 57a(c), the Commission will hold hearings with cross-examination and rebuttal submissions only if an interested party requests a hearing by the close of the comment period. In view of the substantial revisions to the NPR, the Commission has held in abeyance the hearing requests submitted in response to the NPR. Individuals who continue to be interested in a hearing should, therefore, renew and resubmit their requests in comments responding to this Revised NPR. Parties interested in a hearing must submit within the comment period the following: (1) a comment in response to this notice; (2) a statement how they would participate in a hearing; and (3) a summary of their expected testimony. Parties wishing to

<sup>216</sup> This omission was noted in DOJ’s comment, at 2.

<sup>217</sup> DOJ, at 3.

<sup>218</sup> Original Franchise Rule, 16 CFR 436.1(a)(21).

<sup>219</sup> See Informal Staff Advisory Opinion, Bus. Franchise Guide (CCH), Paragraph 6410 (April 15, 1980) (noting that there were only three additional

disclosures that Florida required affording greater protection than the Franchise Rule).

<sup>220</sup> Amended Franchise Rule, 16 CFR 436.8(a)(1) & (a)(7).

<sup>221</sup> Sonnenschein, at 2, 5, 6; Snell, at 2, 4.

<sup>222</sup> *Id.*

cross-examine witnesses must also file a request by the close of the 20-day rebuttal period, designating specific facts in dispute and a summary of their expected testimony. If requested to do so, the Commission may hold one or more informal public workshop conferences in lieu of hearings. After the close of the comment period, the Commission will publish a notice in the **Federal Register** stating whether hearings (or a public workshop conference in lieu of hearings) will be held and, if so, the time and place of the hearings and instructions for those wishing to present testimony or engage in cross-examination of witnesses.

Finally, after the conclusion of the rebuttal period, and any hearings or additional public workshop conferences, Commission staff will issue a Report on the Business Opportunity Rule ("Staff Report"). The Commission will announce in the **Federal Register** the availability of the Staff Report and will accept comment on the Staff Report for a period of 75 days.

#### **Section F Communications to Commissioners and Commissioner Advisors by Outside Parties**

Pursuant to Commission Rule 1.18(c)(1), the Commission has determined that communications with respect to the merits of this proceeding from any outside party to any Commissioner or Commissioner advisor shall be subject to the following treatment. Written communications and summaries or transcripts of oral communications shall be placed on the rulemaking record if the communication is received before the end of the comment period. They shall be placed on the public record if the communication is received later. Unless the outside party making an oral communication is a member of Congress, such oral communications are permitted only if advance notice is published in the Weekly Calendar and Notice of "Sunshine" Meetings.<sup>223</sup>

#### **Section G Paperwork Reduction Act**

The Commission is submitting this proposed Rule and a Supporting Statement for Information Collection Provisions to the Office of Management and Budget ("OMB") for review under the Paperwork Reduction Act ("PRA"), 44 U.S.C. 3501-3521. In this notice, the Commission proposes to amend a trade regulation rule governing business opportunity sales. The proposed Rule would cover those business opportunities currently covered by the

interim Business Opportunity Rule (and formerly covered by the original Franchise Rule, as explained above), as well as certain others not covered by the interim Business Opportunity Rule, including work-at-home programs. The proposed Rule would require business opportunity sellers to disclose specified information and to maintain certain records relating to business opportunity sales transactions.

The currently approved estimates for disclosure and recordkeeping burden under the interim Business Opportunity Rule, Part 437, includes 16,750 hours for business opportunity sellers. That estimate was based on an estimated 2,500 non-exempt business opportunity sellers.<sup>224</sup> As discussed below, the proposed Rule would reduce the burden on business opportunity sellers by streamlining disclosure requirements to minimize compliance costs.<sup>225</sup>

The proposed Rule is designed to streamline and reduce substantially the quantity of information business opportunity sellers would be required to disclose. The proposals would impact such sellers differently, depending upon whether they are currently covered by the interim Business Opportunity Rule. The Commission staff estimates that there are approximately 3,050 business opportunity sellers, comprised of some 2,500 vending machine, rack display, and related opportunity sellers, and 550 work-at-home opportunity sellers.

For the 2,500 vending machine, rack display, and related opportunity sellers presently covered by the interim Business Opportunity Rule, the proposed Rule would reduce the number of disclosures from 20 categories of information to four mandatory disclosures pertaining to earnings claims, lawsuits, refund policy, and references. For the 550 business opportunity sellers presently exempted from the interim Business Opportunity Rule, the disclosures, as noted below, are streamlined to minimize compliance costs.

##### **1. Reduced Mandatory Disclosures**

The RPBOR contains four mandatory disclosures pertaining to earnings claims, lawsuits, refund policy, and references. With respect to earnings claims, business opportunity sellers must disclose whether or not they make earnings claims. However, the decision

<sup>224</sup> 71 FR at 19,081; 70 FR 51,818, 51,819 (August 31, 2005).

<sup>225</sup> If the Commission ultimately amends the interim Business Opportunity Rule, FTC staff will seek all necessary PRA clearances and/or adjustments. The amended Franchise Rule and interim Business Opportunity Rule have OMB clearance through October 31, 2008.

to make an earnings claim is optional. While the disclosures of references and earnings claims retain, for the most part, the interim Business Opportunity Rule requirements, the required disclosure of lawsuits is reduced from the interim Business Opportunity Rule.

As noted above, the interim Business Opportunity Rule requires an extensive list of suits that must be disclosed including those involving allegations of fraud, unfair or deceptive business practices, embezzlement, fraudulent conversion, misappropriation of property, and restraint of trade. Business opportunity sellers also must disclose suits filed against them involving the business opportunity relationship. 16 CFR at 437.1(a)(4). In contrast, the proposed Rule's lawsuit disclosure requirements are limited to suits for misrepresentation, fraud, or unfair or deceptive business practices only.

##### **2. Incorporation of existing materials**

The RPBOR also reduces collection and dissemination costs by permitting sellers to reference in their disclosure documents materials already in the possession of the seller. For example, a seller need not repeat its refund policy in the text of the disclosure document, but may attach its contract or brochures, or other materials that already provide the necessary details.

##### **3. Use of electronic dissemination of information**

The RPBOR defines the term "written" to include electronic media. Accordingly, all business opportunities covered by the RPBOR are permitted to use the Internet and other electronic media to furnish disclosure documents. Allowing this distribution method could greatly reduce sellers' compliance costs over the long run, especially costs associated with printing and distributing disclosure documents. As a result of this proposal, the Commission expects sellers' compliance costs will decrease substantially over time.

##### **4. Use of computerized data collection technology**

Finally, because of advances in computerized data collection technology, the Commission anticipates that the costs of collecting information and recordkeeping requirements imposed by the RPBOR will be minimal. For example, a seller can easily maintain a spreadsheet of its purchasers, which can be sorted by location. This would enable a seller to comply easily with the proposed reference disclosure requirement (at least 10 prior purchasers in the last

<sup>223</sup> See 15 U.S.C. 57a(i)(2)(A); 45 FR 50814 (1980); 45 FR 78626 (1980).

three years who are located nearest the prospective purchaser, or, if there are not 10 prior purchasers, then all prior purchasers). In the alternative, the RPBOR permits a seller to maintain a national list of purchasers.

As a result of these proposals, the Commission estimates that the 3,050 business opportunity sellers will require between three hours and five hours each to develop a Rule-compliant disclosure document.<sup>226</sup> On the lower end, the staff estimates that for existing businesses that have not been covered by the interim Business Opportunity Rule but will be covered by the RPBOR, such as work-at-home schemes, the time required for making a new disclosure document is approximately 5 hours. By contrast, businesses that have been covered by the interim Business Opportunity Rule will already have a disclosure document which will just need updating to meet the requirements of the RPBOR. The staff estimates that these 2,500 businesses will likely need only 3 hours to perform the necessary updating to the disclosure document. Therefore, the hours required to develop a disclosure document in the first year would be approximately 10,250 ((550 x 5 hours) + (2,500 x 3 hours)). In addition, staff estimates these entities will require between one and two hours to file and store records per year, for a total of 6,100 hours (3,050 x 2 hours). Staff assumes that in many instances an attorney likely would prepare or update the disclosure document, at an estimated hourly rate of \$250. The Commission estimates that the total number of hours initially to comply with the Rule would be approximately 16,350 (10,250 disclosure-related hours + 6,100 recordkeeping hours), at a total cost of \$4,087,500 (16,350 x \$250).

FTC staff expects that the annual burden will diminish after the first year to two hours to prepare disclosures and between one and two hours of recordkeeping, resulting in approximately 12,200 hours per year (3,050 x 4 hours) or fewer, for a total cost of \$3,050,000 (12,200 hours x \$250). To the extent that disclosure or recordkeeping obligations are performed by clerical staff, the labor costs initially and thereafter would be significantly less.

The Commission invites comments that will enable it to:

1. Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical utility;
2. Evaluate the accuracy of the Commission's estimate of the burden of the collection of information, including the validity of the methodology and assumptions used;
3. Enhance the quality, usefulness, and clarity of the information to be collected; and
4. Minimize the burden of collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques, or other forms of information technology, for example, permitting electronic submission of responses.

Comments on any proposed filing, recordkeeping, or disclosure requirements that are subject to paperwork burden review under the Paperwork Reduction Act should additionally be submitted to: Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for the Federal Trade Commission. Comments should be submitted via facsimile to (202) 395-6974 because U.S. Postal Mail is subject to lengthy delays due to heightened security precautions.

OMB will act on this request for review of the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives the comment within 30 days of publication. This does not affect the deadline for the public to comment to the FTC on the proposed regulation.

#### Section H Regulatory Analysis

Section 22 of the FTC Act, 15 U.S.C. 57b, requires the Commission to issue a preliminary regulatory analysis when publishing a Notice of Proposed Rulemaking, but requires the Commission to prepare such an analysis for a rule amendment proceeding only if it:

- (1) estimates that the amendment will have an annual effect on the national economy of \$100,000,000 or more; (2) estimates that the amendment will cause a substantial change in the cost or price of certain categories of goods or services; or (3) otherwise determines that the amendment will have a significant effect upon covered entities or upon consumers. To the extent that

this Document constitutes a Notice of Proposed Rulemaking, the Commission has set forth in Section I below, in connection with its Initial Regulatory Flexibility Analysis ("IRFA") under the Regulatory Flexibility Act, and has discussed elsewhere in this Document: (1) the need for and objectives of the proposed Rule (see IRFA ¶ 2); (2) a description of reasonable alternatives that would accomplish the Rule's stated objectives consistent with applicable law (see IRFA ¶ 6); and a preliminary analysis of the benefits and adverse effects of those alternatives (see *id.*). The Commission has determined that the proposed amendments to the Business Opportunity Rule will not have such an annual effect on the national economy, on the cost or prices of goods or services sold through business opportunities, or on covered businesses or consumers. As noted in the Paperwork Reduction Act discussion above, the Commission staff estimates each business affected by the Rule will likely incur only minimal compliance costs. Specifically, approximately 3,050 businesses will spend not more than \$1,750 (7 hours x \$250 each) to comply with the proposed Rule and not more than \$1000 (4 hours x \$250 each) to update the four required disclosures on an annual basis. These figures reflect a change in the estimated number of affected businesses, since the estimate now excludes MLM companies. As explained above, the RPBOR no longer sweeps in MLM companies or their networks of distributors. To ensure that the Commission has considered all relevant facts, however, it requests additional comment on these issues.

#### Section I Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601—612, requires an agency to provide an IRFA with a proposed rule and a Final Regulatory Flexibility Analysis ("FRFA") with the final rule, if any, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. See 5 U.S.C. 603—605. The FTC does not expect that the RPBOR will have a significant economic impact on a substantial number of small entities. The abbreviated disclosure and recordkeeping requirements of the RPBOR are the minimum necessary to give consumers the information they need to protect themselves and permit effective enforcement of the rule. Companies previously covered by the original Franchise Rule and now covered by the interim Business Opportunity Rule, will experience a reduction in their compliance burden,

<sup>226</sup> While commenters from the MLM industry argue that the costs of complying would be significantly higher, see *supra* Section C.2.a., their estimates are based on assumptions that would not apply to more narrow field of the business opportunities that are within the scope of the proposed Rule.

while companies not previously covered will have minimal new disclosure obligations. As such, the economic impact of the RPBOR will be minimal. In any event, the burdens imposed on small businesses are likely to be relatively small, and in the Commission's enforcement experience, insignificant in comparison to their gross sales and profits.

This document serves as notice to the Small Business Administration of the agency's certification of no effect. Nonetheless, the Commission has determined that it is appropriate to publish an IRFA in order to inquire into the impact of the proposed Rule on small entities. Therefore, the Commission has prepared the following analysis, based on the IRFA set forth in the Commission's earlier notice of proposed rulemaking, after a review of the public comments submitted in response to that notice and additional information and analysis by Commission staff.

#### *1. Description of the Reasons that Action by the Agency Is Being Considered*

The Commission's law enforcement experience provides ample evidence that fraud is pervasive in the sale of many business opportunities marketed to consumers. Yet, the Commission believes that the current requirements of the interim Business Opportunity Rule are more extensive than necessary to protect prospective purchasers of business opportunities from deception. The pre-sale disclosures provided by the RPBOR will give consumers the information they need to protect themselves from fraudulent sales claims, while minimizing the compliance costs and burdens on sellers.

#### *2. Succinct Statement of the Objectives of, and Legal Basis for, the Proposed Rule*

The objective of the RPBOR is to provide consumers considering the purchase of a business opportunity with material information they need to investigate the offering thoroughly so they can protect themselves from fraudulent claims, while minimizing the compliance burdens on sellers. The legal basis for the proposed Rule is Section 18 of the FTC Act, 15 U.S.C. 57a, which authorizes the Commission to promulgate, modify, and repeal trade regulation rules that define with specificity acts or practices in or affecting commerce that are unfair or deceptive within the meaning of Section (5)(a)(1) of the FTC Act, 15 U.S.C. 45(a)(1).

#### *3. Description of and, Where Feasible, Estimate of the Number of Small Entities to Which the Proposed Rule Will Apply*

The RPBOR primarily applies to "sellers" of business opportunities, including vending, rack display, medical billing, and work-at-home (e.g., craft assembly, envelope stuffing) opportunities. The Commission believes that many of these sellers fall into the category of small entities. Determining the precise number of small entities affected by the RPBOR, however, is difficult due to the wide range of businesses engaged in business opportunity sales. The staff estimates that there are approximately 3,050 business opportunity sellers, including some 2,500 vending machine, rack display, and related opportunity sellers and 550 work-at-home opportunity sellers. The previous IRFA estimated a total of 3,200 business opportunity sellers, including 150 multilevel companies, which are no longer covered by the proposed rule. Most established and some start-up business opportunities would likely be considered small businesses according to the applicable SBA size standards.<sup>227</sup> The FTC staff estimates that as many as 70% of business opportunities, as defined by the Rule, are small businesses. The Commission invites comments and information on this issue.

#### *4. Projected Reporting, Recordkeeping and Other Compliance Requirements, Including an Estimate of the Classes of Small Entities that Will Be Subject to the Requirement and the Type of Professional Skills Necessary for Preparation of the Report or Record*

The RPBOR imposes disclosure and recordkeeping requirements, within the meaning of the Paperwork Reduction Act, on the "sellers" of business opportunities and their principals. These requirements are fewer in number and lesser in extent than requirements currently applicable to such entities now covered by the interim Business

<sup>227</sup> Since October 2000, SBA size standards have been based on the North American Industry Classification System ("NAICS"), in place of the Standard Industrial Classification ("SIC") system. In general, a company in a non-manufacturing industry is a small business if its average annual receipts are \$6.5 million or less. See <http://www.sba.gov/size/indexguide.html>. Thus, the size standard for vending machine operators is \$6.5 million in annual receipts (NAICS 454210), and the same size standard applies to other direct selling establishments (NAICS 454390), marketing consulting services (NAICS 541613), other management consulting services (NAICS 541618) and other business support services (NAICS 561499).

Opportunity Rule and formerly covered by the original Franchise Rule. Section 437.2 of the proposed Rule would require "sellers" of covered business opportunities to provide potential purchasers with a one-page disclosure document, as specified by Section 437.3 and Appendix A, at least seven calendar days before they sign a contract or pay any money toward a purchase. If a seller elects to make an earnings claim, Section 437.4 would require that written substantiation for the claim be provided to the purchaser in a separate "earnings claim statement" document. However, the proposed Rule would not require sellers to make an earnings claim, and thus any compliance costs incurred in connection with such claims are strictly optional.

Section 437.6 of the RPBOR prescribes recordkeeping requirements necessary for effective enforcement of the Rule. Specifically, sellers of a covered business opportunity, and their principals, must retain for at least three years the following types of documents: (1) each materially different version of all documents required by the Rule; (2) each purchaser's disclosure receipt; (3) each executed written contract with a purchaser; and (4) all substantiation upon which the seller relies for each earnings claim made. The RPBOR requires that these records be made available for inspection by the Commission, but does not otherwise require production of the records. The Commission is seeking clearance from the Office of Management and Budget ("OMB") for these requirements, and the Commission's Supporting Statement submitted as part of that process will be made available on the public record of this rulemaking.

As discussed in section H above, FTC staff estimates that the total number of hours initially to comply with the Rule would be 16,350, at a total cost of \$4,087,500 (16,350 x \$250), or less. FTC staff expects that the annual burden of complying with the rule will diminish after the first year, however, to approximately 12,200 hours, at a total cost of \$3,050,000 (12,200 hours x \$250). To the extent that disclosure or recordkeeping obligations are performed by clerical staff, the total labor costs would be substantially less. The change in these estimates from the previous IRFA reflect that the total estimated number of sellers no longer includes multilevel companies.

#### *5. Other Duplicative, Overlapping, or Conflicting Federal Rules*

There are no other federal statutes, rules, or policies that would conflict with the RPBOR, which would amend

the Commission's interim Business Opportunity Rule, 16 CFR Part 437.1.

The Commission notes, however, that it is aware that 22 states have statutes specifically governing the sale of business opportunities. The Commission therefore seeks comment and information about any state statutes or rules that may conflict with the proposed requirements, as well as any other state, local, or industry rules or policies that require covered entities to implement practices that conflict or comport with the requirements of the RPBOR.

*6. Description of Any Significant Alternatives to the Proposed Rule That Would Accomplish the Stated Objectives of Applicable Statutes and That Minimize Any Significant Economic Impact of the Proposed Rule on Small Entities, Including Alternatives Considered, Such as: (1) Establishment of Differing Compliance or Reporting Requirements or Timetables That Take Into Account the Resources Available to Small Entities; (2) Clarification, Consolidation, or Simplification of Compliance and Reporting Requirements Under the Rule for Such Small Entities; and (3) Any Exemption From Coverage of the Rule, or Any Part Thereof, for Such Small Entities*

The RPBOR's disclosure and recordkeeping requirements are designed to impose the minimum burden on all affected business opportunity sellers, regardless of size. In formulating the RPBOR, the Commission has taken a number of significant steps to minimize the burdens it would impose on large and small businesses. These include: (1) limiting the required pre-sale disclosure to a one-page document, with check boxes provided to simplify disclosure responses; (2) allowing the disclosure to refer to information in other existing documents to avoid needless duplication; (3) permitting the disclosure document itself to be furnished in electronic form to minimize printing and distribution costs; and (4) employing specific prohibitions in place of affirmative disclosures whenever possible. Moreover, because the majority of sellers covered by the RPBOR are already required to comply with the Commission's interim Business Opportunity Rule and the business opportunity laws in 22 states, FTC staff anticipates that the RPBOR will drastically reduce their current compliance costs, while imposing exceedingly modest ongoing compliance costs on all covered sellers. Consequently, the Commission believes

that the RPBOR will not have a significant economic impact upon small businesses.

The RPBOR would require business opportunity sellers to provide only four affirmative disclosures in a one-page disclosure document. This is a significant reduction from the 20 disclosures now required by the Commission's interim Business Opportunity Rule, with which many business opportunity sellers are now obligated to comply. The RPBOR limits required disclosures to information about the sellers' litigation history, refund policy, prior purchaser references, and a statement about whether the seller makes an earnings claim. Because the RPBOR does not require sellers to make information about potential earnings available to potential purchasers, such earnings claims are entirely optional. Thus, if sellers make no earnings claims whatsoever, they can avoid the RPBOR's requirement that any person making an earnings claim provide a potential purchaser with an earnings claim representation in writing that provides substantiation for the claim.

Thus, the Commission does not believe that the RPBOR will impose a significant economic impact on a substantial number of small businesses. Nonetheless, the Commission specifically requests comment on the question whether the RPBOR imposes a significant impact upon a substantial number of small entities, and what modifications to the rule the Commission could make to minimize the burden on small entities. Moreover, the Commission requests comment on the general question whether new technology or changes in technology can be used to reduce the burdens mandated by the Act.

In some situations, the Commission has considered adopting a delayed effective date for small entities subject to a new regulation in order to provide them with additional time to come into compliance. In this case, however, in light of the RPBOR's flexible standard and modest compliance costs, the Commission believes that small entities should feasibly be able to come into compliance with the RPBOR by the proposed effective date, six months following publication of the final Rule. Nonetheless, the Commission invites comment on whether small businesses might need additional time to come into compliance and, if so, why.

In addition, the Commission has the authority to exempt any persons or classes of persons from the Rule's application pursuant to Section 18(g) of the FTC Act. The Commission therefore

requests comment on whether there are any persons or classes of persons covered by the RPBOR that it should consider exempting from the Rule's application pursuant to Section 18(g). However, the Commission notes that the RPBOR's purpose of protecting consumers against fraud could be undermined by the granting of a broad exemption to small entities.

*7. Questions for Comment to Assist Regulatory Flexibility Analysis*

a. Please provide information or comment on the number and type of small entities affected by the RPBOR. Include in your comment the number of small entities that will be required to comply with the RPBOR's disclosure and recordkeeping requirements.

b. Please provide comment on any or all of the provisions in the RPBOR with regard to: (a) the impact of the provision(s) (including benefits and costs to implement and comply with the RPBOR or any of its provisions), if any; and (b) what alternatives, if any, the Commission should consider, as well as the costs and benefits of those alternatives, paying specific attention to the effect of the RPBOR on small entities in light of the above analysis. In particular, please provide the above information with regard to the disclosure and recordkeeping provisions of the RPBOR set forth in sections 437.2, 437.3, 437.4, and 437.6, and describe any ways in which the RPBOR could be modified to reduce any costs or burdens for small entities consistent with the RPBOR's purpose, and costs to implement and comply with provisions of the RPBOR, including expenditures of time and money for: any employee training; attorney, computer programmer or other professional time; preparing relevant materials (*e.g.*, disclosure documents); and recordkeeping.

c. Please describe ways in which the RPBOR could be modified to reduce any costs or burdens on small entities, including whether and how technological developments could further reduce the costs of implementing and complying with the RPBOR for small entities.

d. Please provide any information quantifying the economic costs and benefits of the RPBOR on the entities covered, including small entities.

e. Please identify any relevant federal, state, or local rules that may duplicate, overlap or conflict with the RPBOR.

**Section J Request for Comments**

The Commission invites members of the public to comment on any issues or concerns they believe are relevant or

appropriate to the Commission's consideration of the RPBOR. The Commission requests that factual data upon which the comments are based be submitted with the comments. In addition to the issues raised above, the Commission will continue to accept public comment on the specific questions identified in the Notice of Proposed Rulemaking.<sup>228</sup>

Furthermore, the Commission solicits comment on the following specific questions.

In response to each of the following questions, please provide: (1) detailed comment, including data, statistics, consumer complaint information, and other evidence, regarding the issues addressed in the question; (2) comment as to whether the proposal does or does not provide an adequate solution to the problems it is intended to address; and (3) suggestions for additional changes that might better maximize consumer protections or minimize the burden on business opportunity sellers.

1. Proposed section 437.1(c) limits the scope of coverage to sellers who offer to provide location assistance, account assistance, or buy-back assistance. Do the enumerated categories of assistance that are necessary to trigger coverage of the rule adequately cover the field of business opportunity promoters who are most likely to engage in fraud? Why or why not? What alternatives, if any, should the Commission consider? What would be the costs and benefits of each alternative? The RPBOR covers all business arrangements currently covered by the interim Business Opportunity Rule, as well as certain others currently not covered, such as work-at-home offerings (e.g., envelope stuffing or craft assembly schemes), and offerings costing less than \$500. Are there other types of offerings not covered by the interim Business Opportunity Rule that inadvertently may be covered under the RPBOR? In particular, are the limitations to the RPBOR's coverage sufficient to keep the rule from covering traditional distributor relationships? Why or why not? Are there industries where there are significant numbers of people who work at home and are paid on a piece-work basis? Would firms that employ such workers become subject to the provisions of the RPBOR? Why or why not? What alternatives should the Commission consider to avoid covering arrangements that should not be covered by the RPBOR?

2. The definition of "providing locations, outlets, accounts, or customers" includes "otherwise

assisting the prospective purchaser in obtaining his or her own locations, outlets, accounts, or customers." Does this language adequately cover all of the business opportunity arrangements that should be within the scope of the rule? Why or why not? Will the inclusion of "otherwise assisting" in the definition cause traditional product distribution arrangements, educational institutions, or how-to books to be subject to the proposed Rule? Will it result in the inclusion of multi-level marketing relationships that would otherwise not be covered? Why or why not? How could the language be refined to achieve the proper scope?

3. The one-page disclosure document set forth in Appendix A is intended to provide prospective purchasers with material information with which to make an informed investment decision. The Commission has retained an expert to evaluate the proposed form to ensure that it appropriately conveys to the consumer information that is material to the transaction. Can the overall presentation of the information in the one-page disclosure document be improved to make it more useful and understandable? Are there specific sections that can be improved by simplifying the presentation to make it easier for prospective purchasers to understand? How could the presentation be improved? What would be the costs and benefits of each alternative? Please submit quantitative or qualitative analysis to support specific recommendations.

4. Proposed section 437.3(a)(3) would require sellers to furnish certain litigation information. Specifically, the seller would disclose information about itself, as well as any affiliates and prior businesses, any of the seller's officers, directors, and sales managers, but not of sales employees. Does this provision adequately capture the types of individuals whose litigation should be disclosed? Why or why not? What alternative language, if any, should the Commission consider? What would be the costs and benefits of each alternative?

5. Proposed section 437.3(a)(6) would enable a seller to furnish prospective purchasers with a national list of prior purchasers. Is this a viable option? Why or why not? Under what circumstances should the Rule permit a seller to post a national list of purchasers on its website? What protections should be put in place to limit access to the list? What protections might be sufficient to prevent those who merely want to sell fraudulent business opportunities from accessing such a list? What other options, if any, should the Commission

consider? Would these options enable the seller to select only those prior purchasers who are successful or who otherwise would give a favorable report on the seller? What would be the costs and benefits of each alternative?

6. Proposed Sections 437.4(a)(4)(v) and 437.4(b)(3)(ii) would require business opportunity sellers who make earnings claims to disclose "the number and percentage of all persons who purchased the business opportunity prior to the ending date [of the period when the represented earnings were achieved] who achieved at least the stated level of earnings. Does this requirement create difficulties for a business opportunity seller who is attempting to inform consumers accurately of their likely experience if they purchase the business opportunity being offered? Is such a disclosure going to be useful to consumers who are considering the purchase of the business opportunity? Why or why not? Are there alternative approaches—for example, limiting the set of purchasers to be included in the percentage calculation—that would limit the difficulties? How would any such proposals affect the usefulness of the resulting information to prospective purchasers?

7. Proposed section 437.4(a)(4)(vi) would require sellers who make earnings claims to disclose "any characteristics of the purchasers who achieved at least the represented level of earnings, such as their location, that may differ materially from the characteristics of the prospective purchasers being offered the business opportunity." Does this provision adequately capture the relevant earnings information that should be disclosed? Why? What alternative language, if any, should the Commission consider? What would be the costs and benefits of each alternative?

8. Proposed section 437.7 identifies two categories of franchises that are exempt from the requirements of the RPBOR. Is the exemption overly broad or overly narrow? Why? What alternative language, if any, should the Commission consider?

#### List of Subjects in 16 CFR Part 437

Reporting and recordkeeping requirements, Trade practices.

#### Section K Text of Proposed Rule

For the reasons set forth in the preamble, the Federal Trade Commission proposes to amend 16 C.F.R. chapter I by adding part 437 to read as follows:

<sup>228</sup> 71 FR at 19083 - 87.

**PART 437—BUSINESS OPPORTUNITY RULE**

Sec.

437.1 Definitions.

437.2 The obligation to furnish written documents.

437.3 Disclosure document.

437.4 Earnings claims.

437.5 Other prohibited practices.

437.6 Record retention.

437.7 Franchise exemption.

437.8 Outstanding orders; preemption.

437.9 Severability.

Appendix A to Part 437: Business

Opportunity Disclosure Document

**Authority:** 15 U.S.C. 41–58.**§ 437.1 Definitions.**

The following definitions shall apply throughout this part:

(a) *Action* means a criminal information, indictment, or proceeding; a civil complaint, cross claim, counterclaim, or third-party complaint in a judicial action or proceeding; arbitration; or any governmental administrative proceeding, including, but not limited to, an action to obtain or issue a cease and desist order, and an assurance of voluntary compliance.

(b) *Affiliate* means an entity controlled by, controlling, or under common control with a business opportunity seller.

(c) *Business opportunity* means:

(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.

(d) *Designated person* means any person, other than the seller, whose goods or services the seller suggests, recommends, or requires that the purchaser use in establishing or operating a new business.

(e) *Disclose or state* means to give information in writing that is clear and

conspicuous, accurate, concise, and legible.

(f) *Earnings claim* means any oral, written, or visual representation to a prospective purchaser that conveys, expressly or by implication, a specific level or range of actual or potential sales, or gross or net income or profits. Earnings claims include, but are not limited to:

(1) Any chart, table, or mathematical calculation that demonstrates possible results based upon a combination of variables; and

(2) Any statements from which a prospective purchaser can reasonably infer that he or she will earn a minimum level of income (e.g., “earn enough to buy a Porsche,” “earn a six-figure income,” or “earn your investment back within one year”).

(g) *Exclusive territory* means a specified geographic or other actual or implied marketing area in which the seller promises not to locate additional purchasers or offer the same or similar goods or services as the purchaser through alternative channels of distribution.

(h) *General media* means any instrumentality through which a person may communicate with the public, including, but not limited to, television, radio, print, Internet, billboard, website, and commercial bulk email.

(i) *New business* means a business in which the prospective purchaser is not currently engaged, or a new line or type of business.

(j) *Person* means an individual, group, association, limited or general partnership, corporation, or any other entity.

(k) *Prior business* means:

(1) A business from which the seller acquired, directly or indirectly, the major portion of the business' assets, or

(2) Any business previously owned or operated by the seller, in whole or in part, by any of the seller's officers, directors, sales managers, or by any other individual who occupies a position or performs a function similar to that of an officer, director, or sales manager of the seller.

(l) *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.

(m) *Purchaser* means a person who buys a business opportunity.

(n) *Quarterly* means as of January 1, April 1, July 1, and October 1.

(o) *Required payment* means 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 required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.

(p) *Seller* means a person who offers for sale or sells a business opportunity.

(q) *Written or in writing* means any document or information in printed form or in any form capable of being downloaded, printed, or otherwise preserved in tangible form and read. It includes: type-set, word processed, or handwritten documents; information on computer disk or CD-ROM; information sent via email; or information posted on the Internet. It does not include mere oral statements.

**§ 437.2 The obligation to furnish written documents.**

In connection with the offer for sale, sale, or promotion of a business opportunity, it is a violation of this Rule and an unfair or deceptive act or practice in violation of Section 5 of the Federal Trade Commission Act (“FTC Act”) for any seller to fail to furnish a prospective purchaser with the material information required by §§ 437.3(a) and 437.4(a) of this part in writing at least seven calendar days before the earlier of the time that the prospective purchaser:

(a) Signs any contract in connection with the business opportunity sale; or

(b) Makes a payment or provides other consideration to the seller, directly or indirectly through a third party.

**§ 437.3 Disclosure document.**

In connection with the offer for sale, sale, or promotion of a business opportunity, it is a violation of this Rule and an unfair or deceptive act or practice in violation of Section 5 of the FTC Act, for any seller to:

(a) Fail to disclose to a prospective purchaser the following material information in a single written document in the form and using the language set forth in Appendix A to this part:

(1) Identifying information. State the name, business address, and telephone number of the seller, the name of the salesperson offering the opportunity,

and the date when the disclosure document is furnished to the prospective purchaser.

(2) Earnings claims. If the seller makes an earnings claim, check the "yes" box and attach the earnings statement required by § 437.4. If not, check the "no" box.

(3) Legal actions.

(i) If any of the following persons has been the subject of any civil or criminal action for misrepresentation, fraud, securities law violations, or unfair or deceptive practices within the 10 years immediately preceding the date that the business opportunity is offered, check the "yes" box:

(A) The seller;

(B) Any affiliate or prior business of the seller; or

(C) Any of the seller's officers, directors, sales managers, or any individual who occupies a position or performs a function similar to an officer, director, or sales manager of the seller.

(ii) If the "yes" box is checked, disclose all such actions in an attachment to the disclosure document. State the full caption of each action (names of the principal parties, case number, full name of court, and filing date).

(iii) If there are no actions to disclose, check the "no" box.

(4) Cancellation or refund policy. If the seller offers a refund or the right to cancel the purchase, check the "yes" box. If so, state the terms of the refund or cancellation policy in an attachment to the disclosure document. If no refund or cancellation is offered, check the "no" box.

(5) References.

(i) State the name, city and state, and telephone number of all purchasers who purchased the business opportunity within the last three years. If more than 10 purchasers purchased the business opportunity within the last three years, the seller may limit the disclosure by stating the name, city and state, and telephone number of at least the 10 purchasers within the past three years who are located nearest to the prospective purchaser's location. Alternatively, a seller may furnish a prospective buyer with a list disclosing all purchasers nationwide within the last three years. If choosing this option, insert the words "See Attached List" without removing the list headings or the numbers 1 through 10, and attach a list of the references to the disclosure document.

(ii) Clearly and conspicuously, and in immediate conjunction with the list of references, state the following: "If you buy a business opportunity from the

seller, your contact information can be disclosed in the future to other buyers."

(6) Receipt. Attach a duplicate copy of the disclosure page to be signed and dated by the purchaser. The seller may inform the prospective purchaser how to return the signed receipt (for example, by sending to a street address, email address, or facsimile telephone number).

(b) Fail to update the disclosures required by paragraph (a) of this section at least quarterly to reflect any changes in the required information, including, but not limited to, any changes in the seller's refund or cancellation policy, or the list of references; *provided, however*, that until a seller has 10 purchasers, the list of references must be updated monthly.

#### § 437.4 Earnings claims.

In connection with the offer for sale, sale, or promotion of a business opportunity, it is a violation of this Rule and an unfair or deceptive act or practice in violation of Section 5 of the FTC Act, for the seller to:

(a) Make any earnings claim to a prospective purchaser, unless the seller:

(1) Has a reasonable basis for its claim at the time the claim is made;

(2) Has in its possession written materials that substantiate its claim at the time the claim is made;

(3) Makes the written substantiation available upon request to the prospective purchaser and to the Commission; and

(4) Furnishes to the prospective purchaser an earnings claim statement. The earnings claim statement shall be a single written document and shall state the following information:

(i) The title "EARNINGS CLAIM STATEMENT REQUIRED BY LAW" in capital, bold type letters;

(ii) The name of the person making the earnings claim and the date of the earnings claim;

(iii) The earnings claim;

(iv) The beginning and ending dates when the represented earnings were achieved;

(v) The number and percentage of all persons who purchased the business opportunity prior to the ending date in paragraph (a)(4)(iv) of this section who achieved at least the stated level of earnings;

(vi) Any characteristics of the purchasers who achieved at least the represented level of earnings, such as their location, that may differ materially from the characteristics of the prospective purchasers being offered the business opportunity; and

(vii) A statement that written substantiation for the earnings claim

will be made available to the prospective purchaser upon request.

(b) Make any earnings claim in the general media, unless the seller:

(1) Has a reasonable basis for its claim at the time the claim is made;

(2) Has in its possession written material that substantiates its claim at the time the claim is made;

(3) States in immediate conjunction with the claim:

(i) The beginning and ending dates when the represented earnings were achieved; and

(ii) The number and percentage of all persons who purchased the business opportunity prior to the ending date in paragraph (b)(3)(i) of this section who achieved at least the stated level of earnings.

(c) Disseminate industry financial, earnings, or performance information unless the seller has written substantiation demonstrating that the information reflects the typical or ordinary financial, earnings, or performance experience of purchasers of the business opportunity being offered for sale.

(d) Fail to notify any prospective purchaser in writing of any material changes affecting the relevance or reliability of the information contained in an earnings claim statement before the prospective purchaser signs any contract or makes a payment or provides other consideration to the seller, directly or indirectly, through a third party.

#### § 437.5 Other prohibited practices.

In connection with the offer for sale, sale, or promotion of a business opportunity, it is a violation of this part and an unfair or deceptive act or practice in violation of Section 5 of the FTC Act for any seller, directly or indirectly through a third party, to:

(a) Disclaim, or require a prospective purchaser to waive reliance on, any statement made in any document or attachment that is required or permitted to be disclosed under this Rule;

(b) Make any claim or representation, orally, visually, or in writing, that is inconsistent with or contradicts the information required to be disclosed by §§ 437.3 (basic disclosure document) and 437.4 (earnings claims document) of this Rule;

(c) Include in any disclosure document or earnings claim statement any materials or information other than what is explicitly required or permitted by this Rule. For the sole purpose of enhancing the prospective purchaser's ability to maneuver through an electronic version of a disclosure document or earnings statement, the

seller may include scroll bars and internal links. All other features (e.g., multimedia tools such as audio, video, animation, or pop-up screens) are prohibited;

(d) Misrepresent the amount of sales, or gross or net income or profits a prospective purchaser may earn or that prior purchasers have earned;

(e) Misrepresent that any governmental entity, law, or regulation prohibits a seller from:

(1) furnishing earnings information to a prospective purchaser; or

(2) disclosing to prospective purchasers the identity of other purchasers of the business opportunity;

(f) Fail to make available to prospective purchasers, and to the Commission upon request, written substantiation for the seller's earnings claims;

(g) Misrepresent how or when commissions, bonuses, incentives, premiums, or other payments from the seller to the purchaser will be calculated or distributed;

(h) Misrepresent the cost, or the performance, efficacy, nature, or central characteristics of the business opportunity or the goods or services offered to a prospective purchaser;

(i) Misrepresent any material aspect of any assistance offered to a prospective purchaser;

(j) Misrepresent the likelihood that a seller, locator, or lead generator will find locations, outlets, accounts, or customers for the purchaser;

(k) Misrepresent any term or condition of the seller's refund or cancellation policies;

(l) Fail to provide a refund or cancellation when the purchaser has satisfied the terms and conditions disclosed pursuant to §437.3(a)(4);

(m) Misrepresent a business opportunity as an employment opportunity;

(n) Misrepresent the terms of any territorial exclusivity or territorial protection offered to a prospective purchaser;

(o) Assign to any purchaser a purported exclusive territory that, in fact, encompasses the same or overlapping areas already assigned to another purchaser;

(p) Misrepresent that any person, trademark or service mark holder, or governmental entity, directly or indirectly benefits from, sponsors, participates in, endorses, approves, authorizes, or is otherwise associated with the sale of the business opportunity or the goods or services sold through the business opportunity;

(q) Misrepresent that any person:

(1) Has purchased a business opportunity from the seller or has operated a business opportunity of the type offered by the seller; or

(2) Can provide an independent or reliable report about the business opportunity or the experiences of any current or former purchaser.

(r) Fail to disclose, with respect to any person identified as a purchaser or operator of a business opportunity offered by the seller:

(1) Any consideration promised or paid to such person. Consideration includes, but is not limited to, any payment, forgiveness of debt, or provision of equipment, services, or discounts to the person or to a third party on the person's behalf; or

(2) Any personal relationship or any past or present business relationship other than as the purchaser or operator of the business opportunity being offered by the seller.

#### § 437.6 Record retention.

To prevent the unfair and deceptive acts or practices specified in this Rule, business opportunity sellers and their principals must prepare, retain, and make available for inspection by Commission officials copies of the following documents for a period of three years:

(a) Each materially different version of all documents required by this Rule;

(b) Each purchaser's disclosure receipt;

(c) Each executed written contract with a purchaser; and

(d) All substantiation upon which the seller relies for each earnings claim from the time each such claim is made.

#### § 437.7 Franchise exemption.

The provisions of this Rule shall not apply to any business opportunity that

constitutes a "franchise," as defined in the Franchise Rule, 16 CFR Part 436, *provided however*, that the provisions of this Rule shall apply to any such franchise if it is exempted from the provisions of Part 436 because, either

(a) Under § 436.8(a)(1), the total of the required payments or commitments to make a required payment, to the franchisor or an affiliate that are made any time from before to within six months after commencing operation of the franchisee's business is less than \$500, or

(b) Under § 436.8(a)(7), there is no written document describing any material term or aspect of the relationship or arrangement.

#### § 437.8 Outstanding orders; preemption.

(a) If an outstanding FTC or court order applies to a person, but imposes requirements that are inconsistent with any provision of this regulation, the person may petition the Commission to amend the order. In particular, business opportunities required by FTC or court order to follow the Franchise Rule, 16 CFR Part 436, may petition the Commission to amend the order so that the business opportunity may follow the provisions of this part.

(b) The FTC does not intend to preempt the business opportunity sales practices laws of any state or local government, except to the extent of any conflict with this part. A law is not in conflict with this Rule if it affords prospective purchasers equal or greater protection, such as registration of disclosure documents or more extensive disclosures. All such disclosures, however, must be made in a separate state disclosure document.

#### § 437.9 Severability.

The provisions of this part are separate and severable from one another. If any provision is stayed or determined to be invalid, it is the Commission's intention that the remaining provisions shall continue in effect.

BILLING CODE 6750-01-S

## APPENDIX A to Part 437.

**BUSINESS OPPORTUNITY DISCLOSURES**  
**Required by Federal Trade Commission, 16 C.F.R. Part 437**

Seller: [Name] \_\_\_\_\_ [Address] \_\_\_\_\_

[Phone] \_\_\_\_\_ Salesperson: \_\_\_\_\_ Date: \_\_\_\_\_

**The following information can help you in deciding whether to buy a business opportunity. Note, however, that no governmental agency has verified the information. To learn more about business opportunities, call the FTC at 1-877-FTC-HELP (877-382-4357) or visit the FTC's website at [ftc.gov/bizopps/](http://ftc.gov/bizopps/). Also, check with your state's Attorney General.**

Yes No (Either the "YES" or "NO" box must be checked for the following three disclosures)

**EARNINGS:** The seller or its representatives states or implies, or has stated or implied, a specific level of sales, income, or profit you can make or that current or former purchasers have earned. If so, the information must be set forth in an "Earnings Claims Statement" attached to this page. Read this statement carefully. You may wish to show this information to an advisor or accountant.

**LEGAL ACTIONS:** The seller or its key personnel involved in the sale of business opportunities have been the subject of a civil or criminal action involving misrepresentation, fraud, securities law violation, or unfair or deceptive practices within the past 10 years. **If so, the seller must attach a list of all such legal actions.**

**CANCELLATION OR REFUND POLICY:** The seller offers a cancellation or refund policy. **If so, the seller must attach a statement describing its policy.**

**REFERENCES:** The seller must provide you with contact information for at least 10 of its purchasers located nearest to you (or, if there are fewer than 10, all purchasers). You may wish to contact them to verify the seller's claims. If you buy a business opportunity from the seller, your contact information can be disclosed in the future to other buyers.

	Name	City	State	Zip	Telephone Number
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
9.					
10.					

Received by:

Date:

By direction of the Commission.

**Donald S. Clark**

*Secretary*

**Attachment A**

**Cited NPR Commenters**

Avon Products, Inc. (“Avon”)  
 American Society of Travel Agents,  
 Inc. (“ASTA”)  
 Amsoil, Inc (“Amsoil”)  
 Babener and Associates (“Babener”)  
 Carico International (“Carico”)  
 Chadbourne & Parke LLP,  
 (“Chadbourne”)  
 Chamber of Commerce of the United  
 States of America (“CC USA”)  
 Consumer Awareness Institute  
 (“CAI”)  
 The Cosmetic, Toiletry and Fragrance  
 Association (“CTFA”)  
 Direct Selling Association (“DSA”)  
 Freelif International (“Freelif”)  
 Venable, LLP (“Venable”)  
 Haynes & Boone, LLP  
 (“Haynesboone”) Herbalife International  
 of America (“Herbalife”)

Home Interiors & Gifts Inc. (“HIG”)  
 Independent Bakers Association  
 (“IBA”)  
 International Business Owners Ass’n  
 Int’l, (“IBOAI”)  
 Larkin Hoffman Daly & Lindgren Ltd.  
 (“LHD&L”)  
 Maclay Murray and Spens LLP  
 (“MMS”)  
 Mary Kay, Inc. (“Mary Kay”)  
 Melaleuca, Inc. (“Melaleuca”)  
 MLM Distributor Rights Ass’n (MLM  
 DRA)  
 Multilevel Marketing International  
 Association (“MLMIA”)  
 National Association of Consumer  
 Agency Administrators (“NACAA”)  
 National Black Chamber of Commerce  
 (“NBCC”)  
 National Consumers League (“NCL”)  
 Newspaper Association of America  
 (“NAA”)  
 Pampered Chef, Ltd. (“Pampered  
 Chef”)  
 Pre-Paid Legal Services, Inc. (“Pre-  
 Paid Legal”)  
 Primerica Financial Services, Inc.,  
 (“Primerica”)

Plumbing Manufacturers Institute  
 (“PMI”)  
 Professional Association for Network  
 Marketing (“PANM”)  
 Pyramid Scheme Alert (“PSA”)  
 Quixtar, Inc. (“Quixtar”)  
 Shaklee Corporation (“Shaklee”)  
 Snell & Wilmer (“Snell”)  
 Sonnenschein Nath & Rosenthal LLP  
 (“Sonnenschein”)  
 Southern Progress Corporation  
 (“SPC”)  
 Success In Action (“SIA”)  
 Shure Pets (“Shure”)  
 Symmetry Corporation (“Symmetry”)  
 Synergy Worldwide (“Synergy”)  
 The Timberland Co. (“Timberland”)  
 United States Department of Justice,  
 Office of Consumer Litigation (“DOJ”)  
 Venable LLP (“Venable”)  
 World Association of Persons with  
 disAbilities, Inc. (“WAPAI”)  
 Xango, LLC (“Xango”)

[FR Doc. E8-6059 Filed 3-25-08; 8:45 am]

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