

FTC—WHAT WERE YOU THINKING?

by Gerald P. Nehra

Brief overview: The Federal Trade Commission (FTC) has issued a Notice of Proposed Rulemaking dealing with business opportunities. If adopted, this rule could have a devastating impact on our industry, requiring direct selling companies to drastically alter their sales methods and placing additional unnecessary burdens on direct sellers in order to comply with federal law. It appears NO consideration was given to network marketing, where even modest sales kit entry costs of \$29 or \$49 now trigger the new rule, because of the proposed \$1 threshold.

The most potentially damaging requirements of the proposed rule would:

- require that those disclosures be given at least seven days **before** any prospective purchaser signs a contract or makes payment to the seller;
- require that the seller of a business opportunity (definitional threshold lowered from \$500 to \$1) provide a “disclosure statement,” which would include information such as previous lawsuits, the number of direct sellers who cancel within two years, and a list of “references,” that is, purchasers of the opportunity in the previous three years; and
- require business opportunity sellers who make earnings claims to provide an additional “Earnings Claim Statement” to prospective distributors, which would include extensive earnings disclosures, which would need to be frequently updated.

The deadline for the initial round of comments is July 17, 2006. I refer you to Emord’s excellent article in the last issue of this publication. Note that the comment deadline in his article was extended after press time to July 17, 2006. I urge you to affiliate or connect with one or more of the industry associations to stay abreast of developments and decide if you want to submit comments yourself: The Direct Selling Association (DSA) is at www.dsa.org; the Multilevel Marketing International Association (MLMIA) is at www.mlmlia.com; the Direct Selling Women’s Alliance (DSWA) is at www.mydswa.com; the Distributor Rights Association (DRA) is at www.mlm-dra.com; and the Professional Association for Network Marketing (PANM) is at www.panm.org.

If you want sample distributor or company comment letters from me, just ask me via e-mail at gnehra@comcast.net. This publication’s—*Network Marketing Business Journal*—website, www.nmbj.com, is a resource, and contains a link to the Federal Register version of the Proposed Rule. (If you print it, it will fit on 44 pages, because it is condensed into a three-column format.) The rest of this article refers by page number to the 116 page initial version of the Proposed Rule. Both versions are only in .pdf format.

The underlying basis of this Proposed Rule is so flawed that I have to ask, “FTC—What were you thinking?” I have issues to bring up—many issues. I only have time and space for four: The 150 multilevel companies issue; the five hours of extra work issue; the privacy and women’s safety issue; and the preemption issue.

THE 150 MULTILEVEL COMPANIES ISSUE

On Pages 78 and 79

“The proposed Rule is designed to streamline and reduce substantially the quantity of information required to be disclosed by business opportunity sellers. The proposals would impact sellers differently, depending upon whether they are currently covered by the Franchise Rule. The Commission staff estimates that there are approximately 3,200 business opportunity sellers, comprised of some 2,500 vending machine, rack display, and related opportunity sellers, 550 work-at-home opportunity sellers, and 150 multilevel marketing companies.”

And on Page 83

“The staff estimates that there are approximately 3,200 business opportunity sellers, including some 2,500 vending machine, rack display, and related opportunity sellers; 550 work-at-home opportunity sellers; and 150 multilevel marketing companies.”

FTC—WHAT WERE YOU THINKING? How can you make the above statement—TWICE—that there are 150 multilevel marketing companies, when there are over 1,500 such companies? I have commitments of two industry experts who will help me name them in the appropriate forum. How can you miss this one by an order of magnitude—by a factor of ten? Today’s DSA-US website—www.dsa.org—lists 198 direct selling companies, with well over 150 of them having multilevel compensation. And only about one multilevel marketing company in ten is a member of the DSA. When the number is approximately 1,500, how can the 150 number be passed up to your superiors? How can you send the 150 number to the FTC Commissioners? How can the 150 number be sent to the Office of Management and Budget? WHAT WERE YOU THINKING?

THE FIVE HOURS PER YEAR OF EXTRA WORK ISSUE

On Page 52

“In lieu of a drop-out rate, the Commission proposes that sellers disclose cancellation or refund requests made by prior purchasers during the past two years. Specifically, proposed section 437.3(a)(5) would require sellers to state first the number of purchasers of the business opportunity during the two years prior to the date of disclosure. This number would serve as a base line. Second, the seller would disclose the number of those purchasers who, during the same two-year period, asked to cancel their purchase

or sought a refund, whether or not the purchaser has the contractual right to receive a cancellation or refund. This two-fold disclosure is reflected in Appendix A to the proposed Rule, setting forth the required format and language of the disclosure requirement. The Commission believes that this proposed disclosure is narrowly tailored and would impose minimal compliance costs.”

And on Page 54

“The Commission has taken care to limit the scope of proposed section 437.3(a)(6). The seller need only disclose the name, city and state, and telephone number of each prior purchaser (if fewer than 10), or at least the 10 prior purchasers nearest to the prospective purchaser’s location. In order to minimize compliance costs further, the proposed Rule provides an alternative: in lieu of a list of the 10 prior purchasers nearest the prospect, a seller may provide a prospect with a national list of all purchasers. For example, the seller making disclosures online could maintain a master list of purchasers on its website that can be updated periodically. This would enable the seller to avoid having to tailor the disclosure to each prospective purchaser. Proposed section 437.3(a)(6) specifies that sellers selecting the national option must insert the words “See Attached List” and attach a list of the references to the disclosure document.

In addition, proposed section 437.3(a)(6) would limit the disclosure of references to those who have purchased the business opportunity within the last three years. The Commission believes that purchasers within the last three years—as opposed to those who purchased the business opportunity earlier than that—are likely to have the most current information about the seller and its business operation. Limiting the disclosure of references to a three-year period will also minimize compliance costs.”

And on Page 84

“As discussed in section H above, FTC staff estimates that the total number of hours initially to comply with the proposed rule to be approximately 16,000 (3,200 sellers x 5 hours), with a total initial legal and clerical cost of \$4,000,000 (16,000 hours x \$250). FTC staff expects that the annual burden will diminish after the first year, however, to approximately 12,800 hours (3,200 sellers x 4 hours) or fewer, for a total average of annual legal and clerical labor costs of \$3,200,000 (12,800 hours x \$250), or less.”

FTC—WHAT WERE YOU THINKING? How can you describe maintaining records of a two-year look back on cancellation requests and maintaining records of a three-year look back on purchases (or the ability to identify the ten prior purchases nearest the prospect), and then state your estimate of the initial and continuing legal and clerical cost of WHAT? Did I read this correctly? Note that this is just a part of the new record keeping and disclosure required. But for ALL of the new record keeping and disclosure required, the FTC estimates five hours of legal and clerical time—total—FOR THE ENTIRE FIRST YEAR for each company, and then four hours total—PER YEAR—

after the first year. And the FTC sent these figures to the Office of Management and Budget. Many companies will be submitting powerful evidence of how wrong this estimate is. I know of one company with evidence of error, not by a factor of 100, but by a factor of 1,000. WHAT WERE YOU THINKING?

THE PRIVACY AND WOMEN'S SAFETY ISSUE

On Page 55

“The Commission has concerns about privacy protection with respect to requiring the disclosure of prior purchasers’ contact information—notwithstanding the fact that this type of information is often readily available and in the public domain from such sources as telephone directories. To address this concern, the Commission proposed that sellers be required to state the following language clearly and conspicuously in their disclosure document and in immediate conjunction with the list of references: ‘If you buy a business opportunity from the seller, your contact information can be disclosed in the future to other buyers.’”

FTC—WHAT WERE YOU THINKING? How about this choice: Make your entire purchaser list for the last three years available to anyone, or identify the ten prior purchases nearest the prospect—the competition has access to all your customers, or a possible bad guy gets the names and addresses of ten customers (that would be eight women in this industry, which is 80 percent women), who live real close and recently purchased a business opportunity. What might he (the bad guy) do with such a list? Let’s not even go there. But the FTC even has a “be warned” requirement—stated above—but it is worth repeating for its outrageousness: “To address this concern, the Commission proposed that sellers be required to state the following language clearly and conspicuously in their disclosure document and in immediate conjunction with the list of references: ‘If you buy a business opportunity from the seller, your contact information can be disclosed in the future to other buyers.’” Isn’t that SPECIAL! Our government looking out for . . . who ARE they looking out for? WHAT WERE YOU THINKING?

THE PREEMPTION ISSUE (Especially for the lawyers)

On Page 103

“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 the Rule.”

FTC—WHAT WERE YOU THINKING? How can you make the above statement, when you know ALL state business opportunity statutes (22 of them being the FTC number and 23 of them being my number) have a threshold BELOW which the law does not apply and the lowest threshold in the nation is \$200? The FTC proposed rule

lowers the threshold to \$1 and therefore preempts ALL state business opportunity statutes. You CANNOT say you do “not intend to preempt” and at the same time set your threshold at \$1. And what about the 46 states that have some form of anti-pyramid statute (I have the citations) that, while outlawing pyramids and endless chains, permit expressly or by custom and usage the required purchase of an at-cost, non-commissionable sales or starter kit by a multilevel participant? Did you intend to preempt any of those 46 state statutes? Well, with your \$1 threshold, you preempted ALL 46 of them. WHAT WERE YOU THINKING?

AND IN CONCLUSION

On Page 6

“ . . . the proposed Rule is much broader than that of the Franchise Rule, while the compliance burden is much lighter.”

On Page 80

“ . . . the costs of collecting information and recordkeeping requirements imposed by the Rule will be minimal.”

On Page 85

“ . . . the Commission believes that the proposed Rule will not have a significant economic impact upon small businesses.”

I could not disagree more; so I will answer the question in my title, FTC—WHAT WERE YOU THINKING? The answer—YOU WEREN'T.

Gerald P. Nehra is an MLM-specialist, private practice attorney. He is one of only a few attorneys nationwide whose practice is devoted exclusively to direct selling and multilevel marketing issues. His 36 years of legal experience includes nine years at Amway Corporation, where he was Director of the Legal Division. He can be reached at