FEDERAL TRADE COMMISSION
Project No. R511993

COMMENT
of
PRIMERICA FINANCIAL SERVICES, INC.
on the
NOTICE OF PROPOSED RULEMAKING
on the
BUSINESS OPPORTUNITY RULE
R511993

FILED JULY 17, 2006

Peter Schneider, Esq.
Alexis Ginn, Esq.
Suzanne Loomis, Esq.
Primerica Financial Services, Inc.
3120 Breckinridge Boulevard
Duluth, GA 30099
(770) 381-1000

Timothy J. Muris, Esq.
J. Howard Beales, III, Consultant
O'Melveny & Myers, LLP
1625 Eye Street, NW
Washington, D.C. 20006
(202) 383-5300

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The proposed Business Opportunity Rule ("Rule") pursues the laudable goal of preventing fraud in the work-at-home, pyramid and vending machine marketplaces. But the Rule does not narrowly define and prohibit the specific practices in which the Commission has observed fraud. Nor is it limited to the types of business opportunities that have given rise to consumer complaints and Commission enforcement activity. Instead, the proposed Rule would broadly apply to legitimate and well-established financial services businesses, such as Primerica, as well as the large and growing U.S. direct selling industry—an industry that generates nearly $30 billion in revenues annually, providing income for more than 13.6 million Americans.[1] As a practical matter, the Commission's goal of eliminating fraudulent work-at-home and pyramid schemes threatens legions of legitimate businesses that contribute greatly to the American economy and to the livelihoods of millions of middle-income Americans. The Commission should revise the Rule to narrow its scope and proposed remedies to address fraudulent practices related to work-at-home, pyramid marketing and vending machine schemes directly, while excluding legitimate businesses from its burdensome requirements.

A. The Rule Should Exclude Licensed Insurance Companies and Registered Broker-Dealers Because They Are Already Subject to Extensive Regulation.

Primerica is a subsidiary of Citigroup, a publicly traded Fortune 100 company. It operates primarily through a life insurance company (rated A+ Superior by A.M. Best) and a securities broker-dealer. Primerica has over 2 million life insurance policies in force for a total of $534 billion in face amount and $27 billion in securities assets under management. Primerica has an excellent record of paying claims on life insurance policies, and paid out almost $700 million last year in claims. Beneficiaries of Primerica's insurance policies included families of victims of the September 11th and Katrina tragedies. The industries in which Primerica operates—insurance, securities and loans—are each heavily regulated not only by an extensive network of federal and state laws, but also by a very active and capable group of federal, state and self-regulatory agencies (e.g., the Securities and Exchange Commission ("SEC"), National Association of Securities Dealers ("NASD") and 50 State Insurance Commissioners). Collectively, these multiple layers of regulation make Primerica an inappropriate candidate for yet another regulator. Any company operating in this highly regulated environment must constantly prove its commitment to honest and fair business practices. The fact that the NPRM makes no mention of fraudulent practices in the insurance or broker-dealer industry underscores the fact that these segments of the economy do not need the proposed Rule.

Moreover, it is questionable whether the Commission even has jurisdiction to apply the Rule to the insurance industry, one of the principal segments of Primerica's business. The McCarran-Ferguson Act[2] provides for the supremacy of state law in regulating the "business of

---

[1] Direct Selling Ass'n, *Fact Sheet*: *U.S. Direct Sellling in 2004*, *available at* http://www.dsa.org/pubs/numbers/05gofactsheet.pdf.

[2] 15 U.S.C. §§ 1011 *et seq*.

insurance" and enforces this policy by preempting federal laws that encroach on state authority in that arena. To the extent the proposed Rule purports to regulate matters governed by state law, it is "reverse preempted" by the McCarran-Ferguson Act. Put simply, although it is doubtful that the Commission has jurisdiction to regulate in the insurance industry, a licensed insurance and registered broker-dealer exemption is appropriate in any event because existing regulators, particularly insurance regulators, already scrutinize the conduct the Rule targets. Primerica is clearly not the type of company that the Commission intends to target by the Proposed Rule.

B. The Burdens Imposed by the Proposed Rule Are Enormous, and Would Fall Disproportionately on Legitimate Businesses.

The burdens created by the proposed Rule would fall disproportionately on legitimate businesses, leaving perpetrators of fraud relatively unaffected. As an initial matter, the compliance costs of the "basic" disclosure requirements are significant. The proposed Rule requires disclosure of litigation without regard to its relevance to any business opportunity. The requirement to disclose litigation of all "affiliated" companies would greatly exacerbate the burden for legitimate companies. Primerica, for example, as a subsidiary of Citigroup, has more than 3,400 affiliated companies whose litigation must be disclosed. The resulting voluminous disclosure would more likely mislead consumers than help them. The litigation disclosure applies to any type of proceeding in which certain types of allegations are made, regardless of whether there was ever any finding of actual wrongful conduct. Even if the forum that heard the case *rejected* the allegations, the case must be disclosed. This listing of cases on a government-required form will encourage readers to infer that the company has done something wrong—an inference that is without foundation. The disclosure tarnishes legitimate business with presumed guilt and provides no way to distinguish between unproven (or disproven) allegations and actual findings of wrongful conduct. In short, there is no rational basis for the breadth of this disclosure requirement as applied to legitimate businesses.

The proposed reference disclosures are likewise extremely burdensome and would harm both the consumer's privacy and business's legitimate interests in protecting confidential information. As currently drafted, the Rule would require companies to create and maintain either a massive listing or a complex database of hundreds of thousands of records, providing a ready conduit for the theft of highly valuable confidential and trade secret information by competitors. These recordkeeping requirements will impose substantial burdens on individual agents, requiring them either to carry around and supply massive listings to every contact or to repeatedly and on a timely basis access, customize and print a "ten nearest" listing for each contact.

The required earnings claim disclosures do not address the crucial distinction between pyramids and legitimate multilevel marketing—i.e., in pyramids, compensation is based on recruitment, rather than sales for consumption. As a result, the vast majority of participants in a pyramid scheme *cannot* earn substantial returns, regardless of the time and effort they devote, because there is no underlying business to sustain returns. The earnings disclosure does not enable consumers to distinguish between legitimate and illegitimate companies and therefore is not an effective remedy. Moreover, false earnings claims are already prohibited by existing laws, both at the federal and state levels. Imposing a new disclosure requirement on Primerica and similarly situated companies that already police earnings claims would add complexity and costs without corresponding consumer benefits.

The most egregious requirement is the waiting period, which is simply regulatory overkill. Most direct selling independent agents work part time, often from their homes, and meet with consumers in their homes or in similar informal locations. Any waiting period will require arranging for and making hundreds of thousands of extra home visits. The significant additional time commitment for both agents and new recruits, as well as added paperwork, creates a substantial disincentive to join, or continue, with a company. American consumers, accustomed to buying automobiles and big screen high definition television sets costing thousands of dollars on instant credit with no delay at all, are unlikely to regard a federally mandated waiting period as a neutral requirement. Instead, they are far more likely to conclude that a mandatory waiting period is an indication that something is seriously wrong that should cause them to avoid exploring an opportunity, even if the commitment is only $199. Thus, a waiting period will likely create a government-generated stigma around becoming a direct selling agent.

C. The Rule Would Crush Small, Independent Businesses.

Primerica's agents are independent contractors that operate their own small businesses. Under the proposed Rule, these independent agencies would be classified as business opportunity sellers. As sellers, they would have to prepare their own disclosure documents, in addition to providing Primerica's disclosures. Even if independent agents are excluded as sellers, they will necessarily bear the burden of compliance. The proposed Rule's many requirements would weigh heavily on independent agents, particularly for the vast majority who work part time from their homes, without corporate infrastructure. These substantial burdens would fundamentally alter the calculus of recruiting for independent agents. By deterring individuals from joining Primerica through the waiting period and the misleading litigation disclosure, the proposed Rule would directly impact agents' ability to continue to prosper in the Primerica sales force.

In addition, the loss of privacy and the misuse of "references" lists by competitors would further harm Primerica's agents. Requiring agents to publicly disclose names and telephone numbers of potential recruits would be the equivalent of handing a competitor a list of potential recruits to target. To be sure, these events will damage Primerica itself, but the first economic victims of the proposed Rule would be the small businesses run by individual Primerica agents.

D. The Impact on Primerica and Its Agents Would Be Devastating.

For the reasons discussed, the proposed Rule would have a substantial impact on Primerica's ability to recruit new agents. For Primerica, its sales force is a primary asset of the company. Because part-time agent turnover is relatively high, the ability to recruit new agents is critical to the company's ability to maintain this asset. The proposed Rule would impose significant and unavoidable new burdens on agents who attempt to recruit, ranging from the complexities of producing customized forms for each potential recruit, to the costs of obtaining and retaining a signed copy of the disclosure, to the problems of attempting to explain the irrelevant litigation of over 3,000 Citigroup affiliates, to the stigma inherent in saying that the Federal Trade Commission requires the potential recruit to wait days before deciding to pursue this opportunity. In this environment, recruiting will surely decline, with a predictable domino effect of falling sales, rating agency reviews, and increasing reserve requirements. Primerica believes that the reduction in recruiting would lead to a revenue loss that it conservatively estimates at $1 *billion* over the next ten years.

E. The Rule Exceeds the FTC's Rulemaking Authority, and Is the Equivalent of Placing an Entire Industry under a Consent Decree.

The proposed Rule threatens the viability of Primerica's well established and highly productive business model. In essence, the proposed Rule places the typically severe restrictions of a consent decree on an entire industry, even in the absence of any record evidence or factual findings that fraud is so widespread that such draconian measures are warranted. The Commission should adopt a narrower approach to preventing the fraudulent work-at-home, pyramid and vending scams that constitute its real concern. If adopted in anything close to its current form, well-established principles of administrative law would subject the Rule to outright reversal by a federal court of appeals.

First, it is likely that the Commission would exceed its authority by adopting the Rule in its current form because it fails to define specifically the deceptive acts and practices targeted by the Rule. The FTC Improvement Act permits the Commission to prescribe rules regulating or prohibiting unfair or deceptive acts or practices only if it "define[s] with specificity [those] acts or practices which are unfair or deceptive."[3] This specificity requirement is essential to preserving the basic statutory principle that a violation is first met with a cease and desist order, not a penalty. In its current form, however, the Rule falls far short of the statutory specificity requirement.

It is clear from the NPRM that the Commission's real targets are work-at-home, pyramid marketing and vending machine scams.[4] Yet the Rule does not define or prohibit any of these schemes. Instead, it imposes sweeping disclosure and waiting period requirements on *all* business opportunity sales, regardless of whether they fall within one of these identified categories. Rather than defining with specificity the conduct it wants to prohibit, the FTC has simply proposed certain requirements putatively intended to prevent the successful operation of pyramid and work-at-home schemes, and then defined violation of *those* requirements as an unfair trade practice. That is impermissible under the FTC Act.

Second, there is no rational connection between the facts the Commission will likely find concerning the scope of the purported frauds and the Rule's current approach to combating them. The Commission does not have any evidence that problems involving unfair or deceptive acts or practices, including fraud, exist among the legitimate companies that are swept in by the proposed Rule, when the source of compensation to members of these companies is product

---

3 15 U.S.C. § 57a(a)(1).

4 *See* 71 Fed. Reg. at 19,059-61.

sales, not recruiting. Without clear record evidence that the business sales opportunity frauds identified in the pyramid and work-at-home contexts extend to and include the life insurance marketplace or the financial services or multi-level marketing industry more broadly, or that fraudulent businesses will predominantly bear the costs of the Rule, it is arbitrary and capricious for the Commission to impose such draconian waiting period and disclosure requirements on legitimate businesses.

The Rule also creates burdens on legitimate businesses that far outweigh any reasonable expectation of reduced fraud in the marketplace. For example, Primerica's routinely used business forecasting tools indicate that the proposed Rule would reduce its revenue by approximately $1 billion over ten years. These costs inevitably would raise prices for the millions of consumers who rely on Primerica for services and products, and would also negatively impact Primerica's agents, who would be forced to incur inordinate administrative and time expenditures of their own and bear the impact of reduced business activity that would inevitably result from the proposed Rule. These costs are not offset by even remotely comparable benefits in protecting consumers from fraud.

Third, the Commission is required by statute to find that the fraudulent practices it has putatively targeted with the Rule are "prevalent." But there is no evidence that problems exist with business plans in which the primary source of compensation to agents is sales for consumption—yet these are the businesses most affected by the Rule. The Commission certainly has not satisfied its statutory obligation of demonstrating that the fraudulent practices targeted by the proposed Rule are prevalent among the legitimate businesses that will bear the Rule's burdens. Without a clear record demonstrating such facts, the Rule fails to satisfy the core statutory requirements of Section 57a.

Because the rule is so overbroad, unduly burdensome and not supported by the record to date, it is likely that a reviewing court would find the Rule adopted in its current form constitutes an "arbitrary and capricious" exercise of the Commission's authority.

F. The Commission Should Modify the Proposed Rule to Cover Only the Fraudulent Transactions It Seeks to Regulate.

The Commission could adopt a variety of approaches to reduce the burden on legitimate businesses and more narrowly tailor the Rule to reach only the fraudulent transactions it seeks to regulate. At minimum, the Commission should exclude licensed insurance companies and regulated securities broker-dealers like Primerica from the proposed Rule. As discussed, these companies are already highly regulated, and the disclosure and waiting period requirements create enormous costs for legions of legitimate businesses while merely replicating (at best) the fraud enforcement authority competently exercised by a host of state and federal regulators. Moreover, as discussed in detail below, there are numerous additional options the Commission should consider for focusing the proposed Rule on the fraudulent conduct it intended to reach. Alone or in combination, these revisions could significantly reduce the proposed Rule's adverse impact on legitimate businesses, and increase the Rule's focus on fraudulent practices.

* * *

Given these concerns, Primerica believes that public hearings are warranted to enable the Commission fully to explore and thoroughly understand the implications of promulgating the proposed Rule, including its negative and costly effects on legitimate businesses. Besides the factual submissions contained in this Comment, Primerica will offer witnesses in support of its position. The proposed testimony will focus primarily on the issues raised in Sections III *infra*, including the burdensomeness of the proposed Rule and the ineffectiveness of the proposed remedies. Primerica also requests its statutory right to present additional relevant facts on any alternative business opportunities rule proposed by the Commission in response to this initial round of public comments.

I. INTRODUCTION AND SUMMARY OF COMMENT

Primerica is a provider of life insurance and financial services, and is a subsidiary of Citigroup Inc., a publicly-traded Fortune 500 company. Primerica has over two million life insurance policies in force and $27 billion in assets under management. Its life insurance business is subject to qualification requirements and regulation by every state insurance commissioner in the United States, and its broker-dealer is regulated by the U.S. Securities and Exchange Commission and the National Association of Securities Dealers. Primerica pays its agents only for sales of insurance and other financial products, and does not pay any compensation to agents for recruiting others into the Primerica sales force. Primerica does not require its agents to purchase any inventory or other goods or services in order to join its sales force. Primerica is simply not the type of business that the proposed Business Opportunity Rule was intended to cover.

Primerica submits this comment in connection with the proposed Business Opportunity Rule ("Rule"), R511993, because it believes that the proposed Rule will have large and wholly unintended consequences. Rather than putting a stop to the fraudulent vending machine scams, work-at-home and pyramid schemes identified in the Notice of Proposed Rulemaking ("NPRM"), the proposed Rule would instead impose crippling burdens on Primerica and numerous other legitimate businesses in the direct selling industry. There are three reasons for this. First, the Rule as currently drafted is so broad that it sweeps far beyond the problem it was intended to combat. Second, the disclosures and waiting period required by the proposed Rule would be exceedingly burdensome for Primerica and other businesses to comply with. Third, at best the disclosures would be of marginal utility to consumers; in some cases the disclosures would likely be harmful.

Large, well-established companies with many participants in their business opportunities are the ones least likely to perpetrate a fraud, but would be the ones affected most by the litigation and "references" disclosures required by the proposed Rule. Con artists who run "fly by night" schemes, if they comply with the Rule at all, would have little to disclose because of their smaller size and far shorter lifespan. And the proposed waiting period envisioned by the Rule would tarnish Primerica and the entire direct selling industry with a stigma sure to drive away many persons who would otherwise benefit from participating in the industry.

The compliance burden and business harm caused by the proposed Rule on Primerica and other direct selling companies are enough to counsel strongly against its adoption, but the damage to the American people would reach far beyond the corporate level. Primerica's agents, like representatives of many direct selling organizations, operate as independent, small businesses, and they would directly suffer from both the compliance burdens and the reduced business opportunities that will surely result from the Rule if it is adopted. These small businesses provide income and opportunities for economic advancement to millions of Americans and their families, and the proposed Rule threatens to cripple this important element of the economy, without any evidence that the insurance or broker-dealer industries, or direct selling industry more generally are experiencing the kind of widespread fraud that might justify regulation.

Put simply, the costs of the proposed Rule will be staggering, and will be felt by large and small businesses alike throughout the United States. The Rule as currently drafted offers insufficient benefits to justify such an immense cost. It would be far preferable for the Rule to focus more narrowly on the specific fraudulent conduct that motivated the Rule in the first instance and provide the Commission with an additional tool to detect and pursue wrongdoers. Broadly covering every business opportunity and imposing the harsh and expensive consequences of the proposed Rule on a global scale will serve no goal other than to inhibit legal, productive and rewarding economic activity that forms an integral part of the lives of millions of frequently marginalized Americans. Primerica thus urges that the Rule not be adopted or be substantially narrowed before adoption.

II. PRIMERICA'S BUSINESS MODEL BENEFITS MILLIONS OF CONSUMERS, AND DOES NOT RAISE THE PROBLEMS THE COMMISSION SEEKS TO ADDRESS.

A. Primerica's History and Business.

Primerica was founded in 1977 by financial services professionals who believed that the best way for middle class Americans to protect their financial security and save for retirement is to forego traditional, cash-value life insurance in favor of buying less-expensive term life insurance, investing the money saved from lower insurance premiums in mutual funds or other market-based investments. (This "buy term and invest the difference" strategy was also the core recommendation of the FTC Staff's Life Insurance Cost Disclosure report in 1979.[5]) Primerica has adhered to this sound financial planning philosophy for almost thirty years, and through a sales force that is far different from the sales channels used by its competitor insurance companies and securities broker-dealers, has made financial planning accessible to an entire segment of the American public that other companies largely ignore. By providing insurance, investments, and other financial products and services through a grassroots sales force that numbers approximately 90,000, Primerica has helped millions of middle to lower income American families obtain the security of life insurance and access to mutual funds and other investments that otherwise would be difficult or impossible for these consumers to acquire.

Access to life insurance, retirement savings vehicles, college savings plans and other financial services is vitally important for this segment of the American public, but the only way that Primerica can effectively reach this widely-dispersed market is through its network of independent sales representatives. Ironically, it is Primerica's use of that very business model that now threatens to bring the company within the scope of the proposed Business Opportunity Rule. Because Primerica's business model is so dependent on the efforts of the Primerica sales force, and because the sales force is organized as independent businesses rather than employees, the burdens and business disruptions of the proposed Rule will inevitably fall most heavily on the members of the sales force themselves. These are primarily part-time, middle income Americans who have the least capability to withstand the damage that the proposed Rule would cause.

---

5 Michael P. Lynch *et al*., Fed. Trade Comm'n, *Life Insurance Cost Disclosure* (July 1979).

Primerica, which is a subsidiary of Citigroup, a Fortune 100 company, is a long established member of the American business community that has distinguished itself for over 25 years by providing real value to consumers. The subsidiary that issues life insurance policies, Primerica Life Insurance Company, is a Massachusetts insurance company with an A.M. Best rating of "A+" (superior)[6] and a Standard & Poor's rating of "AA" (very strong).[7] Primerica is a long-standing member of the Insurance Marketing Standards Association and the American Council of Life Insurers, and is regulated by the insurance commission of every state. Primerica has over 2.3 million insurance policies in force in the United States, for a total face amount of $534 billion. Because the term life insurance offered by Primerica costs less than a cash value policy of a comparable face amount, the average face amount of a Primerica life insurance policy is $282,500, compared to an industry average of only $147,000.[8] Primerica has an excellent record of paying claims on life insurance policies, and paid out almost $700 million last year in claims. Beneficiaries of Primerica's insurance policies included families of victims of the September 11th and Katrina tragedies.

Besides offering life insurance to protect families from the unexpected loss of an income-earner, Primerica offers retirement investments to middle-income Americans through its broker-dealer, PFS Investments, Inc. ("PFSI"). PFSI is registered with and regulated by the SEC under the Investment Company Act of 1940, and is also a member of the NASD, subject to NASD regulation. PFSI has investment programs that make mutual funds accessible to consumers of all income levels, with a minimum initial investment of only $250 and a minimum monthly contribution of only $25. It offers mutual funds from Primerica's sister company, Citigroup Global Markets, Inc. (formerly Salomon Smith Barney), as well as from third-party fund managers such as Van Kampen, Pioneer and AIM. PFSI invests over $2.2 billion per year for its clients, and currently has $27 billion in clients' assets under management.

The third major product Primerica offers to assist families with financial planning is home mortgage loans, frequently used for debt consolidation or refinancing, from Citicorp Trust Bank, fsb, a Primerica affiliate. In 2005, Primerica wrote $4.9 billion in new loans.

Primerica markets its financial services primarily to middle income households. Because term life insurance is less profitable than whole life and because investment transactions are generally smaller than they would be with a higher-income demographic, tight cost control is essential for the company to remain competitive. One key element of controlling costs, and critical to Primerica's sustained, nationwide success, was its early decision to use independent contractors rather than employees. Today, Primerica has a sales force of approximately 90,000 independent licensed life insurance agents in the U.S.[9] The sales force is tiered in its structure, in

---

6 Primerica Life Insurance Company, *Best's Insurance Reports—Life/Health*, at 2513-14 (July 19, 2005) ("Best's Rating: A+ g").

7 Robert A. Hafner & Robert Bowen, *Insurer Credit Report: Primerica Life Insurance Co.* (Standard & Poors Feb. 22, 2005).

8 American Council of Life Insurers, *Life Insurers Fact Book* (2005).

that agents receive commissions not only from their own sales of Primerica's insurance and financial products, but also on the sales made by other Primerica agents who are in sales organizations that they have recruited and trained. Primerica does not pay any compensation to agents solely for recruiting others into the sales force; it pays commissions only on the sales of products to consumers. Primerica paid hundreds of millions of dollars in commissions to its U.S. sales force in 2005.

A key reason that Primerica is able effectively to reach middle-income customers is that it draws agents from the same demographic groups to whom it markets its products. Primerica thereby offers many people that would otherwise never have such an opportunity a chance to participate in the financial services industry and learn about insurance and investments. A vast majority of Primerica's agents work part time, and many continue to work as schoolteachers, firemen, or in other occupations.[10] All Primerica agents regardless of whether they are full time or part time, are independent contractors, free to set their own work hours, devise their own business goals, and to work in any geographic area in which they are licensed to do so. Because agent turnover in the insurance industry is high,[11] the ability to attract new agents into Primerica's business is critical.

Primerica offers people the ability to build their own businesses for an application fee of less than $200 and become licensed insurance and securities professionals. Because of the ease of entry into Primerica's business, Primerica enables people to become financial professionals who otherwise would not have opportunities in this area. As a result, Primerica has a very diverse field force that in turn provides financial services to an underserved market of families who need insurance protection and investment vehicles for retirement and college savings.

B. The Proposed Business Opportunity Rule and the Frauds It Seeks to Curtail.

The Commission announced the proposed Rule in April 2006. In introducing the proposed Rule, the Commission noted the history of the Franchise Rule, which covers only business opportunities that require a significant up-front payment of $500 or more in the first six

---

9 Approximately 23,000 agents are licensed to sell mutual funds, and a similar number can sell variable annuities.

10 Turnover rates are high generally in part-time occupations across the economy, as research institutes, government agencies, and private companies have found. *See*, *e.g*., Douglas P. Shuit, *Turnover in Supermarkets*, Workforce Management, Feb. 2004, at 27-34 (across supermarket companies, median of average turnover rates for part-time supermarket employees was 58.0 percent, compared to 13.3 percent for full time employees), *available at* http://www.workforce.com/archive/feature/23/62/39/236245.php); Basil Talbott, *Officials Say Airport Security Needs to be 'Unpredictable,'* National Journal's Congress Daily, April 4, 2006 (stating that the turnover rate for part-time baggage screeners within the Transportation Security Administration is 50 percent); UPS, *Workforce Development—Part-time* (in 2004, turnover in the UPS part-time workforce totaled 45.3 percent), *available at* http://www.sustainability.ups.com/social/workforce/parttime.html.

11 On this score, Primerica compares favorably to other life insurance companies. Primerica retains 27 percent of new agents after four years. For the industry as a whole, four year retention is 13 percent. Margaret S. Honan, *Agent Production and Survival*, LIMRA International (2005). Nonetheless, Primerica adds roughly 30,000 new licensed agents to its sales force each year.

months.[12] The NPRM also notes that the Franchise Rule is limited in such a way that it does not cover a business arrangement in which the "franchisor" buys the end products from the "franchisee," thereby excluding most work-at-home schemes.[13] The Commission further stated that the intent of the proposed Business Opportunity Rule was to sweep much more broadly than the Franchise Rule, but to impose a "much lighter" compliance burden.[14]

According to the NPRM, the reason for a separate, broader business opportunity rule is that the sale of business opportunities is "permeated with fraud," with the pattern being "[i]ndividuals who go from one business opportunity to the next, violating laws, committing frauds, taking funds without delivering what was promised only to shut down the operation within a year and move on to another one with new officers, new company names, and new products."[15] The NPRM notes that the Commission has had numerous complaints, and has brought many enforcement actions, dealing with "the sale of vending machines, rack displays, public telephones, Internet kiosks and 900-number ventures."[16] The Commission also has observed widespread fraud in connection with work-at-home schemes and pyramid schemes.[17]

Notably absent from the NPRM is any assertion of fraud (prevalent or otherwise) in the insurance or securities industries or in the direct selling industry, of which Primerica is a member. But, rather than defining and prohibiting the specific practices in which the Commission has observed fraud, or even limiting the proposed Rule to the types of business opportunities that have given rise to consumer complaints and Commission enforcement activity, the proposed Rule would cover the large and growing U.S. direct selling industry—an industry that generates nearly $30 billion in revenues annually, providing income for more than 13.6 million Americans.[18] Primerica is not the only well-known and long-standing company that participates in direct selling—the U.S. direct selling industry includes some of America's best known and admired brands,[19] and established leaders of corporate America.[20] The proposed

---

12 Proposed Business Opportunity Rule, 71 Fed. Reg. 19,054, 19,055 (Apr. 12 2006).

13 *Id.*

14 *Id.* at 19,056.

15 *Id.* at 19,057.

16 *Id.* at 19,058 (footnotes omitted).

17 *Id.* at 19,059-60.

18 Direct Selling Ass'n, *Fact Sheet*: *U.S. Direct Sellling in 2004, available at* http://www.dsa.org/pubs/numbers/05gofactsheet.pdf.

19 Avon is consistently selected as one BusinessWeek's Top 100 Global Brands, ranking No. 59 in 2005. *See The 100 Top Brands*, Businessweek, Aug. 1, 2005, at 90. Other brands, such as Tupperware and Mary Kay, also have considerable brand equity.

20 Primerica's parent Citigroup ranked No. 8 in the Fortune 500 for 2006, The Pampered Chef's parent Berkshire Hathaway was ranked No. 13 in the Fortune 500, *see*

Rule would cover all of these businesses, and more. In terms of economic impact, the Commission's commendable goal of eliminating fraudulent work-at-home and pyramid schemes would become the tail wagging a far larger dog of legitimate businesses that contribute greatly to the American economy and to the livelihoods of millions of middle-income Americans. This fundamental disconnect between the scope of the Rule and the underlying fraudulent conduct it seeks to prevent is what makes the proposed Rule so harmful.

The legitimate businesses that the proposed Rule sweeps under its scope, including Primerica, are dramatically different from the businesses regulated under the Franchise Rule that provided the starting point for the current proposal. Prospective franchisees invest tens, and sometimes hundreds, of thousands of dollars. In one recent sample of almost 1,900 franchisors listed in Bond's Franchise Guide, the median franchisee made an up-front investment of $112,500, with $50,900 in initial equity, a $20,000 up-front fee to the franchisor, and two weeks of required off-site training. The median continuing fees included a 5 percent royalty and a 1.5 percent advertising fee. The median franchisor has 36 units.[21] In contrast, Primerica charges $199 to cover training and a prospective agent's state insurance exam and license fees. The dramatic contrast in the transactions at issue requires the Commission to rethink the scope of the proposed Rule.

C. Primerica's Business Model Does Not Raise the Problems the Proposed Rule Is Intended to Address.

Primerica does not "sell" a business opportunity. Because there are costs associated with providing new agents with pre-licensing training and with taking their state-required licensing examinations, new agents pay $199 to join the Primerica sales force. The company uses this initial fee to provide the necessary pre-licensing training and to pay the fees charged by state insurance regulators for licensing examinations.[22] Although may agents may sell other products at any point when they obtain the appropriate license, Primerica requires new agents to obtain an insurance license within 9 months. If a new agent fails to obtain the license, her contract is terminated. After providing pre-licensing training, Primerica then assists its new agents in registering to take the appropriate state insurance examinations to obtain their licenses. The fee paid by new agents is used solely for training and licensing-related expenses, and does not result in any profit for the company. None of it is paid to other Primerica agents in any form. New Primerica agents are not required to purchase any other product or service from Primerica to

---

http://money.cnn.com/magazines/fortune/fortune500/full_list/; and No. 7 among Fortune's America's Most Admired Companies 2006, *see* http://money/cnn.com/magazines/fortune/mostadmired/top20/.

[21] James A. Brickley, *et. al*., *Contract Duration: Evidence from Franchising*, 49 J. L. & ECON. 173, 182 (2006).

[22] Since Primerica agents are independent contractors, they are responsible for their own expenses including training and exam fees. Preserving the independent contractor status of its agents is essential to the Primerica economic business model. If the Company were to pay for the training and state licensing exam without charge, it could jeopardize this status, because the payment of training by a company is one of the common law factors distinguishing employees from independent contractors. The $199 application fee facilitates the agent's training and licensing, but preserves the independent contractor principle since it is paid for by the agent.

become affiliated with the company. Moreover, unlike multilevel sellers of goods, there is no possibility of stockpiling life insurance policies in someone's garage.

Recruits contractually agree to take steps to obtain a life insurance license within 90 days. If they opt not to begin the training process with Primerica, then they are able to obtain a refund of the $199, less a $40 processing fee, within 120 days of the application.[23] The refund policy is clearly and conspicuously disclosed on the signature page of the application, immediately above the signature block.

Given the market costs of pre-licensing training and state licensing fees, Primerica's introductory fee compares favorably. An analysis of the fees charged by three well-known providers [24] of license exam preparation alone in the top 15 states[25] in 2005 found that fees averaged $176, ranging from $109 to $275 depending on the state and the provider. In addition to covering pre-licensing training, Primerica's initial application fee covers the state-imposed examination and licensing fees that these third-party providers do not cover. These fees averaged $186, ranging from $70 (Michigan) to $463 (New Jersey). Using the average cost of the third party providers in each state and the required state fees, the total cost of obtaining an insurance license in these 15 states ranged from $223 (for a life insurance only license in Virginia) to $681 (New Jersey). Thus, compared to the market cost of comparable services, Primerica's $199 fee is very reasonable.

Primerica requires its agents to use with prospective recruits only literature that is screened and approved by Primerica's in-house attorneys, who ensure that the literature does not contain any unsubstantiated or misleading claims. Moreover, unlike a traditional "sale" of a business opportunity in which the "buyer" may have no personal contact with other participants in the opportunity, Primerica agents are recruited by other agents through in-person meetings, and Primerica agents maintain 3,800 offices spread nationwide and are almost always listed in the yellow pages. A prospective new agent therefore has easy access to others who have already joined the Primerica sales force, and can therefore find out directly about their experiences with Primerica.

It is important to note that neither Primerica nor its agents earns money from recruiting new agents. At any level of the hierarchy, the sole source of compensation for agents is commissions on the sale of products to consumers. There is no payment to agents for recruiting, and there are no minimum sales requirements to earn either personal commissions or a share of commissions on sales by recruits.

---

23 Any amounts that have already been paid on the recruit's behalf to a state insurance department or testing service are deducted from the refund.

24 The providers surveyed were Kaplan, ABLE and A D Banker.

25 The states included were California, Florida, Georgia, Illinois, Massachusetts, Maryland, Michigan, Missouri, North Carolina, New Jersey, New York, Ohio, Pennsylvania, Texas and Virginia.

In Primerica's structure, the total commission paid out by the company for the sale of a product such as life insurance is the same regardless of the level in the hierarchy of the agent making the sale; the division of that total commission depends on the level of the agent who actually made the sale. The concept of an insurance company paying commissions not only to the selling agent, but also to agents above the selling agent in the sales hierarchy ("override commissions") is very common and has been a standard industry practice for decades. Commissions at all levels are paid from the first dollar of sales.

Finally, the benefit the new agent receives from his or her payment of the initial fee—a state-issued insurance license—has value whether the agent stays with Primerica or not. Having an insurance license qualifies the agent to sell insurance on behalf of any company. Unlike money spent to learn a particular marketing system or to purchase inventory from a particular company, an insurance license is portable and is not rendered useless to the agent if he or she decides to discontinue an affiliation with Primerica.[26]

In short, Primerica is not "selling" a business opportunity in any meaningful sense. Indeed, state insurance licenses are not Primerica's to sell. Instead, Primerica is facilitating the licensure of its recruits. It is recruiting agents, organizing them through contractual relationships,[27] and providing those agents with the training needed to obtain the requisite license to pursue the business.

III. COMMENTARY ON THE PROPOSED RULE

A. The Impact on Primerica and Its Agents Would Be Devastating.

For the reasons described in detail in the following sections, the proposed Rule would have a substantial impact on Primerica's ability to attract new agents. For Primerica, its sales force is a primary asset of the company. Because turnover is typical in the insurance industry, including among part-time agents, a streamlined business system to attract part-time agents is critical to the Primerica's ability to maintain this asset.

Although Primerica cannot determine with precision the impact the proposed Rule would have on recruiting, it is plainly substantial. The rule imposes significant and unavoidable new burdens on agents who attempt to recruit, ranging from the complexities of producing customized forms for each potential recruit, to the costs of obtaining and retaining a signed copy of the disclosure, to the problems of attempting to explain why Citigroup's thousands of affiliates collectively have many litigation matters, to the stigma inherent in saying that the

---

26 Thus, although the insurance license is an industry specific asset, it is not firm specific. Primerica is training agents that can, and sometimes do, work for its competitors.

27 The fundamental economics of Primerica's commission structure are no different than paying a single commission to an independent business with its own employees. Whether they were compensated via salary or commission, more experienced sellers would presumably earn more than new and inexperienced ones, and agents with managerial responsibilities would earn more. The independent business could profit from recruiting more agents, but only if those agents increased total sales. Primerica's business model is a network of independent businesses organized by contract, rather than a single business organized by employment relationships.

Federal Trade Commission requires the potential recruit to wait days before deciding to pursue this opportunity.

Recruiting will surely decline. No other result is possible. As recruiting declines, the sales force will decline. With a smaller sales force, sales will decline. This decline in sales will reduce the income of Primerica's agents, and will correspondingly leave the segment of the American public that they serve without any effective access to insurance and financial services. Declining sales will also reduce Primerica's rating from independent rating agencies, increase its required reserves under state insurance regulations, increase its costs and further reduce sales.

As part of its ordinary planning process, Primerica regularly projects its future revenues and profits over the next ten years based in part on its current sales force and expected growth, and compares those projections to possible alternative plans that might enhance new agent growth. Actuaries can determine the likely revenue impact of different scenarios with considerable confidence. These projections provide the basis for critical business decisions about whether, and how, recruiting plans and policies should change.

The critical unknown is the precise sales force losses the proposed Rule would create for Primerica. Estimates within Primerica vary, with many believing that the Rule's requirements would reduce the number of new agents by 50 percent or more. Admittedly, these estimates are judgments, and there is no apparent way to obtain more precise estimates without undertaking a potentially disastrous experiment in compliance. Even using a 25 percent reduction in new agents as the assumed impact, the proposed Rule would reduce Primerica's revenue by $1 *billion* over the ten-year planning horizon.

Although the estimated impact is substantial, Primerica, and certainly its parent Citigroup, will survive. What the proposed Rule will most severely impact are the hopes, expectations and income of tens of thousands of Primerica agents who are seeking to build a better future in their Primerica business. Ironically, the primary victims of the Rule the Commission proposes will be the very consumers the rule purports to protect.

B. The Burdens Imposed by the Proposed Rule Are Enormous, and Will Fall Disproportionately on Legitimate Businesses.

The Commission has stated that the proposed Business Opportunity Rule "calls for streamlined disclosures that, compared to the Franchise Rule, substantially reduce the compliance burden."[28] Unfortunately, the "basic" disclosure document required by the proposed Rule imposes a drastically heavy compliance burden—one that may not be less than the Franchise Rule at all, let alone substantially less. The following discussion demonstrates that the disclosure required under the proposed Rule is neither simple nor brief, and that the burdens from the proposed Rule will fall disproportionately on legitimate businesses, leaving perpetrators of fraud relatively unaffected. The litigation disclosures alone are debilitating, particularly for legitimate businesses within the financial services sector. The exorbitant time and other compliance costs of the reference disclosures, including privacy concerns and other business

---

28 71 Fed. Reg. at 19,055.

risks, are unwarranted and would seriously jeopardize hundreds of legitimate companies that the proposed Rule sweeps under its requirements. The waiting period, which would drastically increase the logistical and economic burdens of in-home recruiting efforts with relatively small amounts at stake, is simply regulatory overkill.

1. This Is Not a Simple One-Page Disclosure.

The proposed Rule does not reduce the practical compliance burden below that required by the Franchise Rule. Fewer items to disclose does not automatically mean the proposed Rule's requirements are less burdensome, because many firms covered under the proposed Rule will have much more information to disclose for each item.

Although the Commission has proposed a one page disclosure form, that form would simply be the cover page for a much more substantial document for Primerica and many other companies. The single page would suffice only for a company that has no litigation, offers no refunds, makes no earnings claims, and has 10 or fewer references. Those circumstances are most likely limited to new entrants in the business of fraud; they simply do not apply to legitimate direct sellers. In contrast to the simple disclosure form for a new con artist, the proposed Rule would place an extremely heavy compliance burden on the hundreds of legitimate companies that fall within its scope. As described in more detail below, the compliance costs the proposed Rule would impose on legitimate companies in the aggregate would be astronomical.

2. The Waiting Period Is a Substantial Burden and Will Debilitate Primerica's Recruiting Efforts.

The most egregious requirement in the proposed Rule is the waiting period, which is simply regulatory overkill. Most direct selling independent agents work part time, often from their homes, and meet with consumers there or in similar informal locations. Any waiting period will require arranging for and making hundreds of thousands of extra home visits. The significant additional time commitment for both agents and new recruits, as well as added paperwork, creates a substantial disincentive to join, or continue, with a company. American consumers, accustomed to buying automobiles and big screen high definition television sets costing thousands of dollars on instant credit with no delay at all, are unlikely to regard a federally mandated waiting period as a neutral requirement. Instead, they are far more likely to conclude that a mandatory waiting period is an indication that something is seriously wrong that should cause them to avoid exploring an opportunity, even if the commitment is only $199. Thus, a waiting period will likely create a government-generated stigma around becoming a direct selling agent.

The waiting period is drawn from the Franchise Rule.[29] As noted earlier, however, business opportunities are not franchises. Waiting periods before making the initial median franchisee investment of more than $100,000 appear reasonable; waiting periods before

[29] 71 Fed. Reg. at 19,067.

committing $199 to obtain a state insurance license do not. Any waiting period would place a devastating burden on both independent agents and Primerica itself, without providing any corresponding utility to prospective purchasers. This is because waiting periods are virtually unknown to the American public; the pattern of commerce in the United States is to purchase something, and if the consumer is not satisfied with it, return it for a refund. Government-imposed waiting periods are extraordinary, and will be perceived by consumers as an indication that a business opportunity is so dangerous and suspicious that the normal course of business is somehow inadequate. But there is nothing in the NPRM that suggests that such a waiting period is necessary for legitimate business opportunities. The natural and unavoidable consequence of the waiting period will be to devastate the recruiting efforts of Primerica and its agents, and therefore to impair severely the future viability of not only Primerica's business, but the small independent businesses operated by its agents.

Most direct selling independent agents work part time, often from their homes, and meet with consumers in their homes or in similar informal locations. Any waiting period will require arranging for and making hundreds of thousands of extra home visits. Most Americans have little free time; for many it is the flexibility and efficiency of direct selling that attracts them. A waiting period would change this dynamic. Any time an independent agent meets with a prospect, they would have to arrange a second meeting, coordinating times, locations and rescheduling to accommodate the inevitable delays. This meeting could be across town or even in a neighboring city or state. Each time an independent agent meets with a new prospect he or she will need to bring along multiple, customized, voluminous disclosures, let their direct selling company know of their first meeting and the provision of the disclosures (so that the company can track compliance), reschedule a second meeting, return with the necessary paperwork and obtain signatures, leaving one signed copy and taking another for the direct selling company. From the new recruit's perspective, a second visit with no new purpose other than FTC required paperwork could turn-off or annoy the potential recruit.

Today, an agent can meet with a new prospective recruit, explain the business opportunity, present and review the independent business application agreement, and have the new agent sign-up. For Primerica and most other direct selling companies, independent agents do not need to notify the company of their initial meetings; the company first receives notice of a new agent when it receives a signed agreement. Under the proposed Rule, the significant additional time commitment for both agents and new recruits, as well as added paperwork, creates a significant disincentive to join, or continue, with a company. In addition, much of direct selling relies on building excitement about an opportunity, often when someone has purchased a product or service themselves and recognizes its appeal. Any delay will inevitably mean the loss of new agents—even among those who are the most interested initially.

A delay is particularly inappropriate given the relatively small commitments that are typically involved in direct selling. For Primerica, for example, consumers can invest as much as they want in a mutual fund ($250 minimum) with no wait,[30] but they would be forced to wait a week and schedule a second visit to sign up as an agent for $199. American consumers, accustomed to buying automobiles and big screen high definition television sets costing

[30] SEC rules require that consumers receive a prospectus if they invest in a new mutual fund, but they do not require a waiting period. 15 U.S.C. § 77a *et seq*.

thousands of dollars on instant credit with no delay at all, are unlikely to regard a federally mandated waiting period as a neutral requirement. Instead, they are far more likely to conclude that a mandatory waiting period is an indication that something is seriously wrong that should cause them to avoid exploring an opportunity, even if the commitment is only $199. Thus, a waiting period will likely create a government-generated stigma around becoming a direct selling agent. Primerica in particular would be put at a disadvantage, with the waiting period casting a shadow on the company, its products, and sales force, while its competitors such as AIG, Prudential and Merrill Lynch face no waiting period for signing new recruits.

Independent agents would bear the burdens of additional meetings if a waiting period is required, but the provision would also impose substantial costs on direct selling companies themselves, including Primerica. To ensure compliance, companies would have to require agents to report all initial meetings with prospective recruits, and maintain this information in a tracking database. With millions of new recruit contacts made annually, this burden is substantial. When newly executed agreements are sent to the company, they too must be entered into the database and checked to assure compliance with the waiting period before the new recruit could receive additional materials or begin any training or selling. Each company would have to establish complex and costly communication and audit procedures to ensure compliance. Independent agents, accustomed to the freedom of scheduling their own meetings without reporting to the company, will likely find the new requirements onerous.

The typical direct selling opportunity is not a complex relationship requiring sophisticated advisers and elaborate financial analysis. It is not a franchise, or even a complex installment payment transaction. Consumers can purchase a car costing $20,000 or $30,000, with loan payments stretching for as long as seven years, instantly—with no waiting period at all. Americans can even pledge their homes as security for a loan subject only to a three-day right of rescission.

In stark contrast, under the proposed Rule even payments under $200 for a direct selling opportunity would *require* a consumer to wait seven days before he or she could begin to participate, through training, selling, or any other activity. Joining a direct selling company to host a Tupperware party, sell household goods to friends, or life insurance products to contacts, carries neither the risk nor the complexity of a consumer risking his or her home as security for a loan. It hardly justifies the more drastic requirement the Rule would impose. The small amounts at stake and relative simplicity of the relationships should compel the opposite conclusion—that no waiting period should apply to a direct selling opportunity. This conclusion is especially warranted in light of the tremendous harm that the waiting period will cause to Primerica and other direct selling businesses and the 13.6 million individuals who derive part or all of their livelihoods from direct selling.

3. The Litigation Disclosure Is Extremely Burdensome and Highly Misleading, Particularly for Legitimate Businesses in the Financial Services Sector.

We live in a society in which, for better or worse, many disputes are resolved through litigation. Any large company will be in litigation, some likely involving allegations of misrepresentations. The larger and more established that companies are, the more litigation they likely will have to disclose, even if that litigation is *completely unrelated* to the business opportunity they offer. As part of Citigroup, ranked No. 8 in the Fortune 500 list for 2006, Primerica will have to disclose litigation involving more than 3,400 affiliated companies.

Three aspects of the litigation disclosure combine to create a substantial burden for any legitimate company. First, the proposed Rule requires disclosure without regard to the relevance of the litigation to any business opportunity that is being offered, or ever has been offered. Second, the burden is greatly exacerbated, particularly for legitimate companies, by the requirement to disclose litigation of all "affiliated" companies. Third, the litigation disclosure applies to any type of proceeding in which certain types of allegations are made, regardless of whether there was ever any finding of actual wrongful conduct. The mere listing of litigation matters on a government-required form will encourage readers of the information to believe that the existence of litigation supports an inference that the company has done something wrong—an inference that is without foundation. The disclosure tarnishes legitimate business with presumed guilt and provides no way to distinguish between unproven (or disproven) allegations and actual findings of wrongful conduct. In short, there is no rational basis for the breadth of this disclosure requirement as applied to legitimate businesses.

Thus, the proposed Rule's litigation disclosures are broader than those required under the Franchise Rule, a context in which recipients of the disclosures have far more at stake.[31] Unlike the proposed Business Opportunity Rule, the Franchise Rule litigation disclosure applies to litigation involving the principal and certain of its executives, as well as to its parent company, but *not to all affiliates*.[32] In the 2004 Staff Report to the Commission, the Staff recommended limiting the parent litigation disclosure to circumstances in which the parent guarantees the franchisor's performance, because this litigation is actually material to prospective franchisees. The Staff recognized that other "litigation involving a parent (which may be sizeable in the case of a publicly-traded parent) may have little bearing on the operation of the franchise system itself."[33]

Moreover, the Staff Report specifically rejected the idea of requiring disclosure of "all affiliate" litigation, finding that "requiring franchisors to disclose all affiliate litigation would be too broad and burdensome, especially for large companies with multiple brands."[34] Instead, the Staff's recommended Franchise Rule limits disclosures of civil litigation to affiliates selling franchises under the franchisor's principal trademark.[35] Even for cases involving the government, affiliates are included only if they have offered or sold franchises within the last 10

31 *See* 16 C.F.R. § 436.1.

32 Bureau of Consumer Protection, Fed. Trade Comm'n, *Disclosure Requirements and Prohibitions Concerning Franchising* (Aug. 2004).

33 *Id.* at 104.

34 *Id.* at 105.

35 *Id.*

years.[36] As the Staff stated, "This would compel the disclosure of prior history of fraud by the franchisor in most instances without overburdening franchisors or unnecessarily complicating the disclosure document for prospective franchisees."[37] Without such limitations, however, the proposed Business Opportunity Rule covers all affiliate litigation and imposes a drastic and undue burden on firms within its scope—particularly on large publicly-traded companies, which naturally have much litigation with little or no bearing on the business opportunity.

The requirement that the disclosure include litigation involving affiliates as well as principals substantially increases the already heavy burden on legitimate companies. As noted previously, Primerica, for example, as a subsidiary of Citigroup, has 3,484 affiliated companies whose litigation must be disclosed. Even if each affiliate has only one case to disclose over the last 10 years, Primerica's disclosure document would be huge. There is no rational connection between the harm the Commission seeks to prevent and the burden it would impose on any business opportunity provider that happens to be a subsidiary of a complex publicly traded company.

The burden of the litigation disclosure is particularly egregious for any company with an affiliate in the financial services sector. As a subsidiary of Citigroup, Primerica is therefore an affiliate of Smith Barney. Most, if not all, litigation or arbitration proceedings against Smith Barney likely involve securities law issues arising from market losses, even though in many instances the losses are the result of economic factors alone. Such disputes are routinely resolved through arbitration—which, under the proposed Rule, must be disclosed as litigation. The affiliation with Citigroup, combined with the requirement to disclose all proceedings involving alleged securities law violations, would result in a litigation disclosure that includes a tremendous number of irrelevant cases.

Although the required disclosures would be massive, they would be virtually useless to potential purchasers. Indeed, they would be affirmatively misleading if purchasers make the likely assumption that more cases indicate more risk in the business opportunity or serve as an indication of wrongful conduct. Moreover, any company's disclosure would consist primarily of listing cases merely based on *allegations*, rather than any findings of wrongdoing, leading a recipient of the disclosure to assume that the very existence of such allegations is relevant, important information in evaluating a business opportunity, even if the allegations are never proven or, indeed, *rejected* by the forum in which the allegations are made. The disclosure therefore tarnishes legitimate business with presumed guilt, and gives the recipient of the disclosures no way to distinguish between unproven (or disproven) allegations and actual findings of wrongful conduct.

In contrast, even if the fraudulent business opportunity promoters the Commission has sued comply with the proposed litigation disclosure—a dubious assumption, to say the

---

36 *Id.*

37 *Id.*

least[38]—they would not have had extensive litigation to disclose. As the NPRM notes, many business opportunity sellers are "individuals who go from one business opportunity to the next, violating laws, committing frauds, taking funds without delivering what was promised only to shut down the operation within a year and move on to another one with new officers, new company names, and new products."[39] This is not a *modus operandi* that is likely to generate large amounts of litigation. By the time consumers discover that they have been defrauded, the perpetrator has disappeared and moved on—precisely to minimize the risk of litigation. Consumers are unlikely to undertake the probably-fruitless endeavor of attempting to locate and sue an individual with questionable ability to pay any eventual judgment.

Indeed, a key reason for FTC enforcement actions to address fraud is the limited efficacy of individual lawsuits. Fraud artists move on quickly to make litigation difficult. Individual consumers seldom have enough money at stake to make litigation worth the cost, particularly against perpetrators who have moved to another jurisdiction. The very reasons that make FTC enforcement actions against fraudulent business opportunity promoters important mean that they would disclose minimal litigation, even if they choose to comply with the proposed Rule.[40]

Despite being motivated by an intent to provide helpful information, the litigation disclosure will likely be counterproductive. In sheer volume, legitimate companies will make

---

38 *See, e.g.,* Legislative Efforts to Combat Spam: Hearing Before the Subcomm. on Commerce, Trade and Consumer Protection of the House Comm. on Energy & Commerce, 108th Cong. (July 9, 2003) (comments of FTC Consumer Protection Bureau Dir. J. Howard Beales, III, stating "we are skeptical about labeling e-mail as a solution, because we think what ends up happening, and it certainly showed up in our false claims in spam study, is you get compliance and ADV label by legitimate marketers, but you don't get compliance by the people who are the problem."), *available at* http://energycommerce.house.gov/108/Hearings/07092003hearing1008/print.htm; National Do Not Email Registry A Report to Congress, Fed. Trade Comm'n, at 26 (June 2004) (explaining why a National Do Not Email Registry will not work, stating "[t]he success of the National Do Not Call Registry stems in large measure from the fact that most telemarketers and their clients are law abiding businesses that care about their reputations and want to follow the law. . . . In contrast, most bulk emailers appear to be spammers who have shown little concern for their reputations and even less inclination to obey the law."), *available at* http://www.ftc.gov/reports/dneregistry/report.pdf.

39 71 Fed. Reg. 19,057 (quoting Christopher, ANPR 115, at 1).

40 Ironically, if a perpetrator of fraud does comply with the Rule's written disclosures, the disclosures could become a shield for the wrongdoer that would make litigation by the Commission more difficult. The pitch to an individual purchaser ultimately is a one-on-one, verbal presentation. Assuming fraudulent operators provide the disclosures the proposed Rule requires, as in other fauds the Commission has addressed, the most harmful representations may be verbal, not written. As the Commission well knows, such cases are often difficult to prove. A fraudulent operator may spend his or her time with the purchaser making false claims, yet provide properly completed required disclosures at the end of the discussion. To the consumer, the fraudulent operator will likely dismiss the disclosures as legally required mumbo jumbo--"You can read it if you want, but I've told you what it says; just sign here." Even with a week to review, many, and perhaps most, consumers will not read or study the documents. If the FTC then brings suit, the defendant will likely use the disclosure documents as a shield, asserting that all required information was provided and should have made clear to reasonable consumers the wildly speculative nature of the opportunity. Defendants also will deny making different verbal claims, and the Commission will have to prove the contrary. Although additional disclosures in the hands of those perpetrating illegal schemes may do little to prevent consumer harm from fraud, they could make it more difficult for the Commission to sue such operators successfully.

large disclosures. Fraud artists will have little to disclose. Indeed, the con artist who spent 10 years in jail for his last scheme will have a completely clean litigation record.[41] Consumers will likely infer, incorrectly, that the legitimate company poses the greater risk.

The limited amount of information that the disclosure provides will reinforce this natural, if erroneous, inference. The full caption of each case may provide some information to attorneys about which cases merit further investigation. For the typical consumer of a part-time business opportunity, however, the caption will convey little beyond the fact that the litigation exists. Even if a consumer were inclined to seek additional information, in most cases they will not know how to obtain access to the relevant documents, even with Internet access and Google. They may not even recognize, from the caption alone, the difference between a civil and a criminal case.[42] Similarly, a consumer may not be able to discern whether a case is a state enforcement action or private litigation.[43]

Again, the difference in context from the typical franchise transaction is critical in assessing the likely impact of the litigation disclosure. Potential franchisees, with large amounts at stake, frequently hire advisers such as attorneys or accountants.[44] Such advisers would likely recognize that an opportunity with a Citigroup subsidiary poses less risk than one with an unknown promoter with a clean litigation record. Most potential franchisees hire lawyers or accountants who would know how to find additional information if it seemed warranted. Without this expertise, however, the litigation disclosure will likely fail to accomplish its intended purpose for most people.

In short, because individuals or small firms perpetrate many fraudulent schemes, their disclosures as compared to established firms with extensive business operations will be vastly smaller. The likelihood that fraudulent operators will fail to comply or comply only partially, while legitimate direct selling business list all required litigation, will further distort whatever inferences consumers may draw from the disclosures. Thus, the litigation disclosure could provide the substantiation for highly misleading comparative claims by fraudulent operations,

---

41 The criminal prosecution would have been adjudicated prior to the proposed Rule's ten-year cut-off, and thus would not be listed.

42 *Compare People v. SFPP, L.P.*, Case No. FCR223544 (Cal. Super. Ct. Apr. 26, 2005) (California Attorney General criminal case charging Santa Fe Pacific Pipeline with illegally discharging diesel fuel and failing to promptly report and notify officials); *People v. Sempra Energy Trading Corp.*, Case No. 85AS05115 (Cal. Super. Ct. Nov. 16, 2005) (California Attorney General civil case charging Sempra Energy with engaging in unlawful, unfair, fraudulent and manipulative trading schemes to the detriment of the people of California.).

43 *Compare Freedom Holdings, Inc. v. Spitzer*, 408 F.3d 112 (2d Cir. 2005) (affirming district court motion denying preliminary injunction involving suit by private party against Attorney General Eliot Spitzer and State of N.Y.) *and Conroy v. Spitzer*, 83 Cal. Rptr. 2d 443 (Cal. Ct. App. 1999) (requiring party to pay attorneys fees and costs in civil defamation case involving private parties). Moreover, many consumers, particularly those outside of New York, may not recognize that "Spitzer" is an Attorney General.

44 In the FTC's 1984 survey to evaluate the franchise rule, 69 percent of franchisees obtained outside assistance before signing the contract. *See* Beales and Muris, *The Foundations of Franchise Regulation: Issues and Evidence*, 2 J. of Corp. Fin. 157, 164 (1995).

such as "Some companies list hundreds of pages of litigation, but we've only been sued twice." The ultimate impact of the litigation disclosure will be more misleading than helpful; and undermine rather than advance the Commission's intent of preventing fraud and the resulting consumer harm.

4. The Reference Disclosure Is Extremely Burdensome and Will Harm Privacy and Business Confidentiality Interests.

The proposed Rule offers two options for providing reference disclosures: identify everyone who has purchased the opportunity in the past three years or list the ten buyers nearest to the person being offered the business opportunity.[45] Regardless of the option selected, direct selling companies will be required to create and maintain either a massive listing or a complex database of hundreds of thousands of records.[46] In addition to the massive cost associated with complying with the Rule, the disclosure of this information will harm both the privacy interests of the persons whose names and telephone numbers are required to be provided and would provide a ready conduit for the theft of highly valuable confidential and trade secret information by competitors.

Direct selling business opportunities are not franchising. The median franchisor has a grand total of 36 outlets.[47] McDonald's, surely one of the largest has 18,000 franchised restaurants worldwide,[48] and only approximately 2,400 franchisees.[49] Nearly 18,000 people apply to join Primerica *every month*. In contrast to franchises, large direct sellers can have tens of thousands of independent agents, and, across the industry, millions. Moreover, individual agents, largely part-time workers, who are the point of contact with prospective purchasers, will necessarily be responsible for providing the required information. Compliance with the Business Opportunity Rule will impose substantial burdens on individual agents, requiring them to either carry around and supply massive listings to every contact, or to repeatedly and on a timely basis access, customize and print a "ten nearest" listing for each contact.

(a) *The "list everyone" option would include hundreds of thousands of contacts.*

Listing all business opportunity sales for the last three years—covering the purchaser's name, city, state and phone number—is a substantial burden. For large and established direct sellers, listing all purchasers for a period of three years would require a list of hundreds of

---

45 71 Fed. Reg. at 19,071.

46 Primerica currently has approximately 90,000 life insurance agents in America; in the past three years, Primerica had hundreds of thousands of recruits. Consumer product direct selling companies will have similar or even larger numbers of agents to include in their databases.

47 Brickley, *et al*., *supra* note 21.

48 McDonald's Corp., *2005 Annual Report*, at 11.

49 *See* http://www.mcdonalds.com/content/corp/franchise/franchisinghome.html.

thousands of contacts. Primerica provides an illustration of the burdens associated with the references disclosure. In the past three years, the company had hundreds of thousands of recruits. It is not reasonable, or feasible, to disclose this list. Printed in six point type, in two columns, and 100 lines per page, Primerica's disclosure would be well over 2,000 pages. The company would have to update and reprint this massive book quarterly, every one of Primerica's 90,000 active agents would need numerous copies—and Primerica would somehow have to assure that no one inadvertently used last quarter's listing. Giving what amounts to a large phone book—just for the disclosure of references—to every new recruit is obviously impractical, and useless to the potential recruit.

(b) *The "ten nearest" option involves creating and maintaining a complex database with individual agents customizing and printing hundreds of forms.*

To use the "ten nearest" option, Primerica or any other direct seller would have to create and maintain a database with, as the proposed Rule requires, the name, city, state, and phone number of each new business opportunity purchaser. Companies would also have to either buy or develop in-house location software to provide search and custom form capabilities for all agents, providing them secure access.

Although Primerica runs most corporate functions from its headquarters, it relies on its 90,000 agents to identify and recruit prospective agents. Because agents choose their own prospective recruits, Primerica does not and cannot have the information to produce and distribute customized reference disclosure forms for each consumer who receives a recruiting presentation.

Other direct selling companies' agents will face the same problem. For every contacted prospect, individual agents, mostly part-time workers, by necessity would have to use a personal computer, access a central database through the Internet, conduct a search and print a customized form for each contact—two copies for every prospect, repeated dozens of times**.** The scale of the problem of producing customized "ten nearest" lists for every consumer who receives a presentation is overwhelming. In 2005 alone, Primerica recruited almost 200,000 potential agents, and presentations were made to a far larger number of potential recruits. The rule of thumb among experienced Primerica agents is that inviting 10 to a business presentation will produce four attendees, and one will proceed with process of joining. Even in the unlikely event that disclosure forms could be confined to only those who sign up, in 2005 alone, Primerica's agents would have needed to produce 2 copies of nearly 200,000 customized forms to use the "ten nearest" disclosure option. At ten pages per minute, it would take almost 28 days of printer time per year for Primerica's agents simply to print the forms. If disclosure forms are needed for the four attendees, the total would be nearly 800,000 customized forms (in duplicate) and more than 110 days of printer time. With the many other required disclosures—an earnings claim disclosure, a refund policy and history document, and a very lengthy litigation disclosure—printing would be around the clock year-round. If the agent is considered a seller and must make his or her own disclosures, the required number of customized "one page" disclosure forms would double—along with the necessary printer time. All of this burden would fall on Primerica's sales force of largely part-time agents *who receive no compensation at all for* *recruiting*. Unless Primerica changes its compensation structure to increase rewards for recruiting compared to sales, the result would inevitably be substantially less recruiting, and in very short order, a substantially smaller Primerica sales force.

(c) *The reference disclosure presents significant privacy concerns for independent agents, and a significant risk to Primerica of competitors misusing confidential and trade secret information.*

In requiring that individual agent's personal reference information, including their phone number, be available and distributed to prospective new agents, the proposed Rule requires direct selling agents to compromise their privacy. Even with a disclosure statement informing business opportunity purchasers that their personal contact information can be disclosed, the proposed Rule's requirement creates a significant privacy cost for these buyers. The NPRM requires massive disclosure, not selective provision of information where the information has particular value. New recruits will not know to whom or how often their personal information may be disclosed. The proposed Rule also requires Primerica to continue disclosing this information even after recruits terminate their relationship with the company. Moreover, because the telephone number listed is presumably the number for a business, part-time agents working from their home may be subject to unwanted harassment from telemarketers, even if their number is on the Do Not Call Registry.[50]

Disclosure of agent information also creates significant business risk to Primerica by making it impossible for the company to protect the confidentiality of information about its agents—information that is a highly valuable trade secret. Primerica invests significant resources to convert raw recruits into licensed life insurance agents, who are legally eligible to work for Primerica's competitors and contractually free to do so. Primerica's competitors frequently see Primerica as a source for new recruits that will allow the competitor to avoid the costs of identifying, training and licensing potential agents. The competitors therefore have every incentive to target Primerica agents for recruitment, thereby allowing the competitor to "free ride" on Primerica's recruiting, training and licensing efforts. In fact, federal court decisions have recognized that Primerica's agent lists are a trade secret, and entitled to legal protection.[51] Controlling unfair competitive activity is an important element to Primerica's business success, and the company therefore takes many measures designed to safeguard the confidentiality of its agents' identities and other information about the agents, including requiring agents to agree to keep such information confidential and limiting access to the

---

[50] Business to business calls are exempt from the do not call provisions of the Telemarketing Sales Rule. 16 C.F.R. 310.6(b)(7).

[51] *See Ernest Bustos v. Primerica Fin. Servs.*, No. SA-98-CA-605-HG (W.D. Tex.), *aff'd*, 214 F.3d 1451 (5th Cir. 2000) (preliminary injunction entered in Primerica's favor on, *inter alia*, trade secret claim, and affirmed by the U.S. Court of Appeals for the Fifth Circuit); *Primerica Fin. Servs., Inc. v. Palmer*, No. 1:04-CV-2229-JEC (N.D. Ga. 2004) (preliminary injunction entered against former Primerica agent under, *inter alia*, trade secret claim, restraining former agent from retaining or using confidential information regarding the identities of Primerica's agents).

information on a "need to know" basis.[52] Regardless of the method Primerica used to comply with the proposed Rule's disclosure requirements, the Rule would eviscerate Primerica's efforts to safeguard this confidential and valuable information, and would give competitors a ready way to target Primerica agents for recruitment. This competitive harm to Primerica would be in addition to the burden of devising and maintaining a system to make the disclosures required by the proposed Rule.

5. Disclosure Related to Earnings Claims Would Not Distinguish Legitimate Businesses from Frauds.

If sellers make earnings claims, the NPRM requires the seller to state the particular earnings claim and the specific time period during which the earnings were achieved.[53] The proposed Rule also requires the seller to disclose the number and percentage of all purchasers during the relevant time period who achieved at least the claimed earnings.[54] In addition, the seller must disclose any unique characteristics that distinguish purchasers who are included in the claim from other prospective purchasers.[55] Finally, the proposed Rule would require a seller making an earnings claim to disclose to the prospective purchaser that, upon request, the seller will make available written substantiation for the earnings claim.[56]

Unfortunately, the required disclosures do not address the crucial distinction between pyramids and legitimate multilevel marketing—i.e., in pyramids, compensation is based on recruitment, rather than sales for consumption. As a result, it does not enable consumers to distinguish between legitimate and illegitimate companies and therefore is not an effective remedy. Moreover, false earnings claims are already prohibited by existing laws, both at the federal and state levels. Imposing a new disclosure requirement on Primerica and similarly situated companies that already police earnings claims would add complexity and costs without corresponding consumer benefits.

Although the earnings claim disclosure is substantially similar to that recommended in the Staff Report on the Franchise Rule, it would operate in a very different context when applied to business opportunities. Franchise investments typically require a substantial commitment of the franchisee's time and effort. Business opportunity sales do not. Indeed, a key attraction of direct selling is the ability to work part time to supplement income. DSA estimates that 85

---

52 Indeed, Primerica has periodically considered creating a Web site that would allow potential customers to locate the nearest Primerica agent. Despite the obvious marketing advantages of such a site, Primerica decided that the risk of competitor raids on its agents was too great if such a site existed. This was a business decision, unaffected by regulatory compliance considerations. It evidences Primerica's clear conclusion that even if potential buyers cannot find the closest agent, preservation of the confidentiality of its list of agents is worth the cost.

53 71 Fed. Reg. at 19,072.

54 *Id.*

55 *Id.* at 19,073.

56 *Id.*

percent of direct selling participants work part time.[57] In Primerica's case, roughly 95 percent of agents begin working part time.

Disclosures that most participants do not earn very much, if true, are highly material to the potential franchisee planning to work substantially full time. They have limited relevance to potential part time workers, who likely understand that rewards are dependent on the time and effort they devote to the enterprise. The disclosure that few earn as much as full time workers is easily explained by the fact that most workers are part time. Any direct selling participant talking to a potential new recruit can, and truthfully, offer that explanation.

Earnings disclosures simply do not address the crucial distinction between pyramids and legitimate multilevel marketing—i.e., in pyramids, compensation is based on recruitment, rather than sales for consumption.[58] As a result, the vast majority of participants in a pyramid scheme *cannot* earn substantial returns, regardless of the time and effort they devote, because there is no underlying business to sustain returns. In legitimate businesses with many part-time workers, many people do not earn very much, primarily because they do not work very many hours. In an illegal pyramid, many people do not earn anything because the scheme is fundamentally fraudulent. The symptom is the same—few earn any amount that might be relevant to a full-time worker—but the cause is fundamentally different. Thus, the earnings disclosure does not enable consumers to distinguish between legitimate and illegitimate companies and therefore is not an effective remedy.

Of course, no firm should misrepresent the likely earnings of potential recruits, whether full time or part time. In fact, Primerica has a clear company policy against misrepresentations to recruits about their potential earnings. It instructs its agents in the policy, carefully monitors performance, including a survey of new recruits, and if necessary takes disciplinary action against agents that violate the policy. The written materials used by Primerica's agents for recruiting are reviewed by the company's in-house counsel to ensure that they do not contain unsubstantiated claims. Moreover, making false earnings claims is already prohibited by existing laws, both at the federal and state levels. There is no practical or legal need for imposing a new disclosure requirement on Primerica and similarly situated companies that already police earnings claims. For these companies, the proposed Rule will offer no practical benefits to consumers.

C. The Rule Would Crush Small, Independent Businesses.

Primerica's agents are independent contractors that operate their own small businesses, sometimes as sole proprietorships and sometimes through more formal business entities like corporations or LLCs. Under the proposed Rule, these independent agencies would be classified as business opportunity sellers. The proposed Rule defines a "seller" as "a person who offers for

---

[57] Direct Selling Ass'n, *Fact Sheet*: *U.S. Direct Sellling in 2004, available at* http://www.dsa.org/pubs/numbers/05gofactsheet.pdf.

[58] Letter from James A. Kohm, Acting Director of Marketing Practices, Fed. Trade Comm'n to Neil H. Offen, President, Direct Selling Ass'n, at 2 (Jan. 14, 2004) ("Absent sufficient sales of goods and services, the profits in such a system hinge on nothing more than recruitment of new participants (i.e., fee payers) into the system.").

sale or sells a business opportunity."[59] Independent agents offer and often sell the business opportunity in which they participate.[60] The proposed Rule's many requirements for direct sellers would weigh heavily on independent agents, particularly those that work part-time. Using Primerica's approximately 90,000 U.S. life insurance agents as an example, the burdens and issues created quickly become apparent—involving multiple levels of complicated disclosures (company and individual agent) that may conflict and confuse.

Most direct selling opportunities involve recruiting, because many participants work part time and turnover is high. Thus, direct sellers provide the opportunity for advancement and increased revenue to agents who expand product or service sales through recruiting other agents. In large companies, sales district managers usually receive expanded bonuses or increased commissions when their district sales increase; independent agents that recruit other successful agents similarly increase their sales revenues. Within legitimate direct selling operations, an agent increases his or her revenue primarily from increased product or service sales, not from recruiting. As "sellers," independent agents would have to disclose their own personal litigation records, their personal refund policies, and the agents they have recruited directly, as well as any personal earnings claims or refunds requests.

To illustrate the problems involved, Primerica has approximately 90,000 independent life insurance agents in the United States, with approximately 90 percent of these agents working part-time. Because they are independent businesses, each of them is a "seller" under the proposed Rule.[61] When an agent recruits others she would need her own disclosure form. Individual agent and company disclosure forms may not match. Individual and company litigation disclosures would differ substantially. With multiple agents in a given geographic area, the "ten nearest" references for the company may differ from the "ten nearest" for a particular independent agent. Consumer confusion arising from these separate, different sets of disclosures is inevitable.

Even if independent agents were not considered business opportunity sellers, independent agents make the new business opportunity presentation, and much of the debilitating effect of compliance would necessarily fall on them. Independent agents are the only available conduit for companies such as Primerica to comply with the proposed Rule. Thus, regardless of business opportunity companies' efforts to mitigate the proposed Rule's burdens on their agents, at a minimum these individual agents would face the task of scheduling and holding multiple meetings with potential new recruits to comply with the waiting period; regularly supplying information to Primerica to keep disclosure databases current; customizing forms to supply to new recruits; providing the multiple printed disclosures that would change and require replacement every quarter (litigation, earnings claims and refund statistics disclosures); and

---

[59] 71 Fed. Reg. at 19,088.

[60] *See id.* at 19,063 (defining "business opportunity" by three definitional elements "(1) A solicitation to enter a new business; (2) payment of consideration, directly or indirectly through a third party; and (3) either an earnings claim or an offer to provide business assistance." In recruiting a new agent for a business opportunity, a current agent would fall under this business opportunity definition).

[61] *Id*.

printing two copies of the customized “ten nearest” forms (one for the potential buyer to keep and one to be signed and returned).

Because the vast majority of independent agents work part time from their homes, without corporate infrastructure, these burdens become more substantial. Moreover, the litigation disclosure and the requirement that each business opportunity purchaser provide a phone number and other personal contact information for potentially broad availability would reduce the privacy of millions of independent agents.

These negative consequences of the Rule would fundamentally alter the calculus of recruiting for independent agents. With the much greater burdens prescribed by the proposed Rule—involving multiple meetings with any new recruit as well as extensive disclosures—a simple comparison of the gains from selling versus the gains from recruiting will give each agent less incentive to recruit.[62]

Moreover, in addition to suffering the costs inherent in complying with the new rule, the small independent businesses operated by Primerica agents will be on the front line that suffers the greatest business harm from the effects of the proposed Rule. By deterring individuals from joining Primerica through the waiting period and the misleading litigation disclosure, the proposed Rule would directly impact agents’ ability to continue to work in the Primerica sales force. Many agents would likely quit altogether, and would therefore lose the income that they derive from selling Primerica’s products and services. Those that tried to carry on their small independent Primerica agencies would be forced to work even harder to attempt to achieve the same level of recruiting success, which would require them to spend more time on their Primerica business for less return, and would lessen the time available to spend in making sales presentations to clients. Because commissions are paid only upon the sale of insurance policies or other financial products, the requirement of greater time commitment to recruiting would directly reduce the agents’ income. The proposed Rule would, quite simply, require agents to work harder and make less money.

In addition, the business harm from the loss of privacy and the misuse of “references” lists by competitors would also directly affect Primerica’s agents. Their names and telephone numbers would be the ones forced into the public domain by the proposed Rule, exposing them personally to a loss of privacy and solicitations from telemarketers, competitors and others. And requiring a Primerica agent publicly to disclose names and telephone numbers of persons that he or she personally recruited would be the equivalent of handing a competitor a list of potential recruits to target. Having spent the time and energy to identify, recruit and help train and motivate a new agent, the Primerica agent would then be constantly exposed to having that new agent recruited away by a competitor, and thereby losing the substantial time investment made by the agent. To be sure, these events will damage Primerica itself, but the first economic victims of the proposed Rule would be the small businesses run by individual Primerica agents.

[62] To maintain their sales forces in the face of the inevitable high turnover that characterizes part-time employment, companies will search for ways to increase incentives for recruiting. This creates a perverse incentive for companies.

The thousands of American families who rely on Primerica to provide or supplement their household income will lose that income, and their families will therefore suffer.

D. The Rule Exceeds the FTC's Rulemaking Authority, and Is the Equivalent of Placing an Entire Industry under a Consent Decree.

The harsh consequences of the proposed Rule on Primerica and the direct selling industry in general are so great that the Rule will cause the entire industry to restructure its operations and will greatly reduce the business viability of the industry. Such penalties might be appropriate to remedy specific acts of fraud or other illegal conduct by a proven wrongdoer, but the level of burden and business disruption that the proposed Rule would cause are inappropriate for a Rule that will apply so broadly to so many legitimate businesses who have not been found to have engaged in any unfair, deceptive or fraudulent conduct. In essence, the proposed Rule places the kind of severe restrictions of a punitive decree on the entire direct selling industry, and does so in the absence of any record evidence or factual findings by the Commission that fraud is so widespread in the industry that such a draconian measure is warranted. The Commission should adopt a narrower approach to preventing fraudulent work-at-home, pyramid, and vending scams. If the Rule were adopted in anything close to its current form in terms of overbreadth and burden, well-established principles of administrative law would subject the Rule to outright reversal by a federal court of appeals.

1. The Rule Exceeds the Commission's Authority under the FTC Act.

If the proposed rule is adopted, the Commission will have exceeded its authority by failing to define specifically the deceptive acts and practices targeted by the Rule. The FTC Improvement Act permits the Commission to prescribe rules regulating or prohibiting unfair or deceptive acts or practices only if it "define[s] with specificity [those] acts or practices which are unfair or deceptive."[63] This specificity requirement is essential to preserving the basic statutory principle that a first violation is met with a cease and desist order, not a penalty. In particular, 15 U.S.C. § 45 provides that, when the Commission identifies a particular unfair or deceptive act or practice, its first remedy is to issue a cease and desist order against that practice.[64] Only if that order is later violated can the Commission seek civil penalties for its violation.[65] Absent a specificity requirement, 15 U.S.C. § 57a would enable the Commission to gut this structure by promulgating a rule prohibiting any unfair or deceptive act or practice, thereby enabling the Commission to seek penalties upon a first finding that a particular act was unfair or deceptive. To avoid this result, and to preserve the basic statutory structure, Congress made clear that any unfair or deceptive act or practice proscribed by rule had to be defined with specificity, so that businesses would have ample notice of precisely what practices were now impermissible—in effect, a "cease and desist" order addressed to the business community at large. As currently written, the Rule falls far short of the statutory specificity requirement.

---

63 15 U.S.C. § 57a(a)(1)(b).

64 *See* 15 U.S.C. § 45(b).

65 *See id*. § 45(1).

It is clear from the NPRM that the Commission's real targets are work-at-home, pyramid marketing, and vending machine scams.[66] Yet, as currently written, the Rule does not define or prohibit any of these schemes. Instead, it imposes sweeping disclosure and waiting period requirements on *all* business opportunity sales, regardless of whether they fall within one of these two identified categories. Thus, instead of defining with specificity the conduct it wants to prohibit, and against which it has obtained numerous cease and desist orders, the FTC has simply adopted certain requirements putatively intended to prevent the successful operation of pyramid and work-at-home schemes, and then defined violation of *those* as unfair trade practices. This is not a permissible strategy under the Statute.[67]

2. The Rule is an Arbitrary and Capricious Exercise of the Commission's Authority.

There is no rational connection between the facts the Commission will likely be able to find concerning the scope of the purported frauds and the Rule's current approach to combating them. Because the rule is so overbroad, unduly burdensome, and not supported by the record to date,[68] it is likely that a reviewing court would find the Rule adopted in its current form constitutes an "arbitrary and capricious" exercise of the Commission's authority.[69]

(a) *The Rule is arbitrary and capricious because it is overbroad*.

The Commission does not have any evidence that problems involving unfair or deceptive acts or practices, including fraud, exist with Primerica, the life insurance marketplace in general, or multilevel marketing arrangements when the primary source of compensation to members is sales for consumption. Indeed, the NPRM makes clear that the Commission's only evidence of

---

66 *See* 71 Fed. Reg. at 19,059-61.

67 *See, e.g*., *Katharine Gibbs School, Inc. v. Fed. Trade Comm'n*, 612 F.2d 658, 662 (2d Cir. 1979) ("Instead of defining with specificity those acts or practices which it found to be unfair or deceptive, the Commission contented itself with treating violations of its 'requirements prescribed for the purpose of preventing' unfair practices as themselves the unfair practices. We think Congress expected more than this." (footnote omitted)).

68 Of course, the Rule ultimately will be judged on the final rulemaking record. But the NPRM strongly indicates the Commission's current direction in the Rulemaking and Primerica's comment is based on our analysis of the NPRM.

69 In evaluating agency action under the arbitrary and capricious standard, a "court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Citizens to Preserve Overton Park Inc. v. Volpe*, 401 U.S. 402, 416 (1971). "Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 29, 43 (1983). No matter how narrow the scope of review, "the agency must explaint the evidence which is available, and must offer a 'rational connection between the facts found and the choice made.'" *Id*. (quoting *Burlington Truck Lines Inc. v. United States*, 371 U.S. 156, 168 (1962)).

problems not currently regulated under the Franchise Rule exists with respect to work-at-home and pyramid schemes.[70] There is no mention—none—of insurance or the insurance marketplace in the NPRM. Likewise, there is no evidence to suggest that the businesses responsible for the fraud risk that motivated the Rule in the first place will predominantly bear the costs of compliance (as well as the more general economic costs of reduced business activity). Without clear record evidence that the business sales opportunity frauds identified in the pyramid and work-at-home contexts extend to and include the life insurance marketplace, or the multi-level marking industry more broadly, or that fraudulent businesses predominantly bear the costs of the Rule, it is arbitrary and capricious for the Commission to impose such draconian waiting period and disclosure requirements on legitimate businesses.[71] Absent such a record, the Commission cannot justify promulgating the Rule as currently drafted.

(b) *The Rule is arbitrary and capricious because it imposes costs on legitimate businesses that vastly exceed the value of any reasonable expectation of reduced fraud in the marketplace*.

As discussed in detail in the preceding sections of this comment, the Rule creates inordinate burdens on legitimate businesses that far outweigh any reasonable expectation of reduced fraud in the marketplace. For this independent reason, the proposed Rule constitutes an arbitrary and capricious exercise of the Commission's rulemaking authority.

In reviewing Commission rulemaking actions, courts consistently look to whether the rulemaking record demonstrates that the benefits of FTC trade regulation rules outweigh their associated costs. (Indeed, the statute requires the Commission to include with any Rule a "statement as to the economic effects of the rule, taking into account the effect on small businesses and consumers."[72] When courts have found high costs and little benefit, or insufficient evidence of a net benefit to a proposed rulemaking, they have vacated or supported the Commission's omission of these portions of trade regulation rules.[73]

---

[70] *See* 71 Fed. Reg. at 19,059-61.

[71] Courts previously have overturned similarly overbroad or burdensome trade regulation rules as arbitrary and capricious. For example, in *Katharine Gibbs School Inc. v. FTC*, 612 F.2d 658 (D.C. Cir. 1979), the D.C. Circuit set aside a Commission rule that required vocational and home-study schools to follow certain requirements in making refunds to students who dropped out. The requirements made student refunds financially onerous for the schools; the intent of the rule was to discourage schools from recruiting and accepting students they did not believe would complete the courses in which they had enrolled. The court held, however, that the rule swept too broadly. Even "[a]ssuming . . . that the Commission ha[d] the power to alter the schools' incentive structure for engaging in high pressure or deceptive sales and enrollment practices," the court observed, "its Rule was clearly not so limited in its scope." *Id*. at 664. Instead, the Rule penalized "*every* vocational school for *every* student dropout, regardless of cause." *Id*. (emphases added). This result was improper: "This Court is obligated to take a close look at what the Commission has done and to determine whether it has articulated a rational connection between the facts found and the choice made. We have taken a close look, and we find no rational connection between the Commission's universally applicable refund requirements and the prevention of specifically described unfair and deceptive enrollment practices." *Id*. (internal citations omitted).

[72] 15 U.S.C. § 57a(d)(1)(C).)

[73] *See Am. Optometric Ass'n v. Fed. Trade Comm'n*, 626 F.2d 896, 910-911, 916 (D.C. Cir. 1980) (vacating the majority of the Eyeglasses I rule, finding that a Supreme Court decision had diminished the need for the rule by

Here, the NPRM significantly underestimates the burdens created by the Rule. Although the Commission's rationale for the Rule concerns fraud, not legitimate businesses such as Primerica or the vast bulk of the direct selling industry that currently provides income to more than 13.5 million Americans, the Rule in fact imposes an immense burden on those businesses. As discussed, the disclosure regime currently contemplated (in particular, the cataloguing of litigation for all subsidiaries, affiliates, officers and directors, and the "ten nearest" requirement) and the cost of monitoring and enforcing compliance with the waiting period will vastly exceed the $3,200,000 of annual compliance costs currently estimated in the Rule.[74] Indeed, it is estimated that the proposed Rule would reduce Primerica's revenue by $1 billion over the next ten years. These costs, of course, affect not only legitimate businesses in the direct selling industry, but also inevitably would raise prices for the millions of consumers who rely on the industry for services and products, and would also negatively impact Primerica's agents, who would be forced to incur compliance costs of their own and bear the impact of reduced business activity that the proposed Rule would inevitably cause.

These costs are not offset by even remotely comparable benefits in protecting consumers from fraud. As discussed above, the disclosures required by the Rule will actually *favor* perpetrators of fraud and place legitimate businesses at a disadvantage in the marketplace. The costs of the proposed Rule, therefore, cannot be justified by the Rule's putative benefits, which are highly uncertain at best with the proposed Rule in its current form.

(c) *The Rule is arbitrary and capricious because disclosure requirements and a waiting period are not a reasonable means of addressing fraud*.

The Rule's proposed disclosure requirements and waiting period are not reasonable means of addressing the narrow problem identified by the Commission. As discussed, the NPRM only expressly targets *fraudulent* work-at-home and pyramid schemes. Defining the targeted conduct in this way underscores the obvious point that the business opportunity sales practices of legitimate businesses are not harming consumers. Rather, the Commission's concern involves wholly illegitimate fraud schemes masquerading as legitimate multilevel marketing plans. The proposed disclosure and waiting-period requirements fail to address this issue.

For example, there is no reason to expect that operators of fraudulent schemes—who by definition are lying to consumers about what they are doing—will comply honestly with the litigation and other disclosure requirements. Any problems of these individual companies are best handled via individual cases, not a rule. Moreover, the waiting period is similarly irrational,

---

effectively proscribing the harmful practices that the rule was designed to ameliorate, and finding that the rule, aside from the one provision upheld, provided little consumer benefit); *Consumers Union of the U.S. Inc. v. Fed. Trade Comm'n*, 801 F.2d 417, 425-26 (2d Cir. 1986) (upholding the FTC's decision to omit from its final Used Car Rule the "known defects" provision, supporting the Commission's finding that the benefits of such a provision were indeterminate at best, and that such a provision would involve massive enforcement costs, as well as potentially frustrate the central objective of the Rule).

[74] *See* 71 Fed. Reg. at 19,082.

because its purpose is to give consumers time to review these required disclosures, which perpetrators of fraud will likely either fabricate or simply ignore. Unlike, say, a securities law context in which consumers benefit from greater disclosures of accurate information, the basic problem here is not the lack of disclosure, but the underlying fraud itself. A more appropriate regulatory response would be specifically to define the fraudulent work-at-home and pyramid schemes that are the focus of the NPRM and prohibit those schemes, not to broadly impose disclosure requirements with the hope that fraudulent operators will admit that their sales practices are fraudulent.[75]

(d) *The litigation disclosure requirement is arbitrary and capricious because it effectively benefits companies that are actually engaged in fraud, while harming companies engaged in legitimate direct selling*.

Finally, the Rule's litigation disclosure requirement is arbitrary and capricious for the additional reason that it effectively undermines the purposes of the Rule by favoring companies engaged in actual fraud relative to legitimate businesses. Requiring mandatory disclosure of all litigation (including administrative actions) involving all parent, subsidiary, and affiliate entities and any directors or officers of those entities penalizes large, legitimate businesses while favoring small or recently-formed business opportunity sellers. Large, established businesses will likely have voluminous litigation in the normal course of business—the disclosure of which will raise consumer suspicions regardless of the legitimacy of the company and its activities—while small, recently-formed sellers, including true bad actors, will have little or no litigation to disclose. Thus, the proposed disclosure regime will effectively create the false impression that small, fly by night business are more legitimate than larger and better established ones.[76]

3. The Factual Predicates for the Rule Are Not Supported by Substantial Evidence.

The Commission is required by statute to find that the fraudulent practices it has putatively targeted with the Rule are "prevalent."[77] As discussed, however, there is no evidence that problems exist with multilevel marketing plans in which the primary source of compensation to members is sales for consumption—yet these are the main group of businesses affected by the Rule. Moreover, the Commission has not pointed to any evidence that the fraudulent practices exist in the insurance marketplace and certainly has not satisfied its statutory obligation of

[75] *See Consumers Union of U.S., Inc. v. Fed. Trade Comm'n*, 801 F.2d 417, 425 (D.C. Cir. 1986) (upholding the Commission's decision to omit the mechanical defects disclosure requirement from its Used Car Rule, because "'[t]he extensive evidence of dealer misrepresentations concerning the mechanical condition of their cars,' gave [the Commission] little cause to hope that dealers would" faithfully comply with such a requirement).

[76] *See Katharine Gibbs*, 612 F.2d at 665 (setting aside job-placement and graduation rate disclosure requirement because it increased, rather than reduced, consumer deception); *Consumers Union*, 801 F.2d at 425 (finding that the Commission was correct in omitting a rule provision that unethical dealers would be unlikely to obey and that would likely affirmatively mislead consumers).

[77] *See* 15 U.S.C. § 57a(d)(1)(A) (Commission shall include "a statement as to the prevalence of the acts or practices treated by the rule").

demonstrating that the fraudulent practices targeted by the Rule are prevalent among the legitimate businesses that will bear the Rule's burdens. Without a clear record demonstrating such facts, the Rule fails to satisfy the core statutory requirements of Section 57a.

IV. THE COMMISSION SHOULD MODIFY THE PROPOSED RULE TO COVER ONLY THE FRAUDULENT TRANSACTIONS IT SEEKS TO REGULATE.

The Commission could adopt a variety of approaches to cover only the fraudulent transactions it seeks to regulate. The following section covers several solutions the Commission could adopt to avoid unnecessarily sweeping in legitimate businesses with no significant risk of fraud.

A. The Rule Should Exclude Licensed Insurance Companies and Registered Broker-Dealers Because They Are Already Subject to Extensive Regulation.

1. Regulatory Qualification Requirements and Supervision by Regulators Make It Highly Unlikely that Insurance Companies and Registered Broker-Dealers Will Engage in Business Opportunity Fraud.

The industries in which Primerica operates—insurance, securities and loans—are each heavily regulated not only by an extensive network of federal and state laws, but also by a very active and capable group of federal, state and self-regulatory agencies. With respect to its securities business, Primerica is regulated by the United States Securities and Exchange Commission under the Investment Company Act of 1940, and also by the National Association of Securities Dealers, of which Primerica's subsidiary broker-dealer is a member. With respect to its insurance business, Primerica is subject to supervision and regulation by the insurance commissioner of every state in the United States. Primerica's lending business is also subject to extensive regulation by various state agencies.

Collectively, these multiple layers of regulation make it unnecessary and inappropriate for Primerica, or any insurance company or securities broker-dealer for that matter, to be covered under the proposed Business Opportunity Rule. As an initial matter, it is out of the question for a company to obtain—and maintain—the necessary licenses, business qualifications and registrations with all of these regulatory agencies without demonstrating substantial assets and financial stability. It is simply impossible for someone to operate a "fly by night" fraudulent scheme that can qualify as a life insurance company to the satisfaction of state regulators, that can register under the Investment Company Act of 1940 and can be a member of the NASD. Moreover, each of these regulatory bodies takes its supervisory responsibilities seriously, and these regulators collectively have demonstrated their commitment to preventing fraud and deceptive practices by the companies subject to their jurisdiction. By operating in this highly regulated environment, Primerica must constantly prove its commitment to honest and fair business practices. And each agency serves as a conduit for an agent to make a complaint if he or she believes that something improper has occurred. The fact that the NPRM makes no mention of fraudulent practices by insurance companies or registered broker-dealers further indicates that the proposed Rule should not apply to such entities.

2. As Applied to Insurance Companies, the Proposed Rule Runs Afoul of the McCarran-Ferguson Act.

Another flaw in the proposed Rule is that the Commission lacks jurisdiction to apply the Rule to the insurance industry, one of the principal segments of Primerica's business. The McCarran-Ferguson Act[78] provides for the supremacy of state law in regulating the "business of insurance" and enforces this policy by preempting federal laws that encroach on state authority in that arena. To the extent the Rule purports to regulate matters governed by state law, it is "reverse preempted" by the McCarran-Ferguson Act. State law governs the licensing and appointment of insurance agents, and the proposed Rule would directly interfere with those matters by imposing additional and inconsistent requirements from those prescribed under state insurance laws.

The McCarran-Ferguson Act, § 2(b), states, in relevant part:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance.[79]

Section 2(b) provides two separate bases for "reverse preemption": (1) the exemption for laws "enacted by any State for the purpose of regulating the business of insurance," (the so-called "general exemption") and (2) the exemption from the federal antitrust laws to the extent "the business of insurance" is regulated by state law (the "antitrust exemption"). The general exemption contained in the first clause of section 2(b) has been interpreted more broadly than the antitrust exemption.[80]

The general exemption applies here because the Rule does not involve the federal antitrust laws. Accordingly, the McCarran-Ferguson Act will prevent application of the Rule over state law if the Rule (1) does not "specifically relate to the business of insurance," and it (2) "invalidate[s], impair[s], or supersede[s]" any state law that was (3) "enacted . . . for the purpose of regulating the business of insurance."[81] Because the proposed Business Opportunity Rule does not "specifically relate to the business of insurance," application of the McCarran-Ferguson Act will turn on whether the Rule "invalidates, impairs, or supersedes" state law or policy

---

78 15 U.S.C. §§ 1011 *et seq*.

79 15 U.S.C. § 1012(b).

80 *See United States Dep't of Treasury v. Fabe*, 508 U.S. 491, 504 (1993) ("Both *Royal Drug* and *Pireno*, moreover, involved the scope of the antitrust immunity located in the *second* clause of § 2(b). We deal here with the *first* clause, which is not so narrowly circumscribed.") (emphasis in original).

81 *Id.* at 501.

regulating the business of insurance, "frustrate[s] any declared state policy," or "interfere[s] with a State's administrative regime."[82]

Most states have comprehensive statutory regimes regulating the business of insurance, including insurer agent licensing and supervision. To determine whether state insurance laws preempted the proposed Rule, the Commission would need to evaluate independently the insurance codes of all 51 state jurisdictions to determine whether the Rule "invalidate[s], impair[s], or supersede[s]" any state insurance law. Absent such comprehensive analysis, there is a strong presumption that the Commission simply lacks authority to enact sweeping rules that directly regulating the insurance industry.

At the very least, many states establish licensing requirements for insurance agents.[83] Under state law, once agents are licensed, they can sell insurance. Under the proposed business opportunities rule, however, even licensed insurance agents are prohibited from selling insurance for seven days. By itself, this prohibition is far from trivial. For example, Primerica estimates that approximately 5 percent of its newly-signed agents already are licensed to sell insurance. Accordingly, in 2005, the Rule would have prevented approximately 1,785 licensed insurance agents from selling insurance for Primerica during the proposed waiting period. Without question, that added requirement "invalidates, impairs, or supersedes" state laws enacted for the purpose of regulating the business of insurance. McCarran-Ferguson prohibits the Commission from imposing such a requirement.

Moreover, state insurance regulators have the authority to examine the insurance agent recruiting process as part of the process under which they supervise and audit insurance companies. For example, over the last three years Primerica received a total of nine department of insurance inquiries related to its recruiting process.[84] Although none of these inquiries identified any fraudulent conduct (indeed, all of the inquiries were resolved with Primerica's initial response to the state insurance departments), it is important to emphasize that, as a practical matter, state insurance regulators assert control over insurance agent conduct and recruiting. Similarly, the NASD extensively regulates the relationship between "members" (like Primerica) and "associated persons" (i.e., registered representatives like Primerica's agents) and has the authority and willingness to address any deceptive or unfair conduct. Put simply, although it is doubtful that the Commission has jurisdiction to regulate in the insurance industry,

---

82 *Id.*

83 *See, e.g.,* Ariz. Rev. Stat. § 20-282; Alaska Stat. § 21.27.010; Fla. Stat. § 626.785; Iowa Code § 522B; Mich. Comp. Law. § 500.1201a; Minn. Stat. § 60K.32; Mo. Rev. Stat. § 375.014; Mont. Code Ann. § 33-17-201; NY Ins. Law § 2103; N.C. Gen. Stat. § 58-33-5; Ohio. Rev. Code. § 3905.02; Or. Rev. Stat. § 744.001 *et seq*.; Va. Code Ann. §§ 38.2-1822, 1815.

84 For example: in December 2003, the Iowa Insurance Division contacted Primerica in response to a complaint that Primerica retained the $40 administrative fee charged in connection with new agent licensing. Primerica provided the Insurance Division with documentation concerning the solicitation and its refund policies and no follow-up action was taken. In April 2006, the New York State Insurance Department contacted Primerica with a complaint from a prospective agent alleging that Primerica had failed to disclose that a prior criminal history would disqualify any potential agent. Primerica provided the Department with the Independent Business Application forms which request this information and no follow-up action was taken by the Department.

an exemption for insurance companies and registered broker-dealers is appropriate here for the independent reason that existing regulators already scrutinize the conduct the Rule targets.

B. Exclude Legitimate Companies.

The Commission could incorporate language to exclude legitimate companies that are not pyramids from the proposed Rule's requirements. There are several possible solutions. A purely structural test would exclude companies that pay commissions based solely on sales, with no minimum purchase requirements at any level, and with no payments for recruiting. Essentially the only difference between a company structured in this fashion and an ordinary employer is that the organization is coordinated via contracts with independent agents. Such organizations raise none of the problems that concern the Commission.

Another possibility is to focus on actual compensation to participants. The Commission could exclude companies if the primary source of compensation to participants is retail sales. Retail sales should include sales for bona fide personal consumption. Companies meeting this standard are not pyramids under the law, and the Commission would not sue them.[85]

If it uses a compensation-based test, the Commission should also exclude from the proposed Rule's coverage organizations in which consumers pay a fee for the right to purchase goods at discounted prices. The primary motivation for consumers to join such an organization is the ability to purchase desired goods at lower prices. The fact that there may be some incidental sales to outsiders as both consumers and the seller profit from resale does not convert what is essentially a buying club into a business opportunity.[86]

Using exclusions such as these, the Commission could place the burden on sellers to prove that they meet the exemption for legitimate companies that are not pyramids. Carefully structured exclusions would provide a powerful incentive to firms to organize themselves in ways that avoid the problematic elements of pyramid schemes. Attempts to avoid the Rule's coverage would result in structural changes that would advance the Commission's consumer protection objectives. This would be a positive outcome, reducing the pyramid problem.

C. Define Pyramids and Cover Only Pyramids.

The Commission states in the NPRM that the proposed Business Opportunity Rule targets work-at-home schemes and pyramid marketing schemes.[87] Yet, the proposed Rule does not define pyramids. Under the heading "Pyramid Marketing Schemes," the Commission lists several prior cases, but offers no specific definition of the conduct the proposed rule targets.[88]

---

85 Letter from James A. Kohm, Acting Director of Marketing Practices, Fed. Trade Comm'n to Neil H. Offen, President, Direct Selling Ass'n, at 1 (Jan. 14, 2004) (noting that "a multilevel compensation system funded primarily by payments made for the right to participate in the venture is an illegal pyramid scheme.").

86 *Id.* at 2.

87 71 Fed. Reg. at 19,060.

88 *Id.* at 19,059-60.

This lack of a specific definition creates the overbreadth of the proposed Rule, which, instead of narrowly covering firms carrying out unfair or deceptive practices, sweeps hundreds of legitimate companies under its scope.

Rulemaking is an exercise in drawing lines—defining specific conduct as illegal and therefore subject to civil penalties. At least since the Amway decision in 1979, the Commission has recognized that there are legitimate multi-level marketers.[89] Concerned about litigation risks and circumvention, the Commission has resisted drawing bright lines. But the Commission cannot have it both ways. A rule requires bright lines, or it is abusive—imposing significant costs on legitimate businesses with little gain in fighting fraud.

The unfair and deceptive practices that the Commission cites as the basis for expanding the coverage of the rule are fraudulent work at home schemes and "true pyramids" (in which essentially all of the income of participants comes from the sale of memberships to still more participants). Defining pyramids with specificity and limiting the proposed Rule's scope to pyramids only, would tailor the proposed Rule to address the only demonstrated problem.[90]

D. Retain the Existing Definition from the Franchise Rule that Covers Business Opportunities and Expand Based on Demonstrated Problems.

The breadth of the proposed Rule stems from the fact that the proposal creates an entirely new, and extremely expansive, definition of "business opportunities." The current Franchise Rule has a definition of business opportunities that has served the Commission well. Although the NPRM argues that the current definition does not reach the problems the proposed Rule seeks to address, relatively straightforward changes to the existing definition can reach those problems, without creating the enormous overbreadth of the proposal. Thus, the Commission could retain the existing definition from the Franchise Rule that covers business opportunities, and expand it to reach demonstrated problems.[91] Covering sales back to the franchisor would reach many work-at-home schemes.[92] Many other work-at-home schemes would be covered because they offer to provide accounts. Some adjustment of the current Rule's threshold of $500 would be far less sweeping than the proposed new definition.

The current definition could be modified to reach pyramid schemes as well, again in ways that would sweep in far less legitimate business activity. One possibility would be to cover significant payments for recruiting. Another would be to add a definition of pyramids, as discussed above. Simply changing the way that the Commission accounts for inventory would

---

89 *In re Amway Corp*., 93 F.T.C. 618 (1979).

90 Presumably, such a definition would build on the Staff Advisory Opinion cited *supra*.

91 *See* 16 C.F.R. § 436.

92 The current Franchise Rule only applies if the franchisee makes sales to users other than the franchisor. *See* 16 C.F.R. 436.2(a)(1)(ii)(A). Work at home schemes in which the promoter promises to buy back goods from the franchisee are therefore not covered.

make a major difference in enforcement; for example, counting inventory toward the $500 investment threshold under the Franchise Rule framework would address many of the pyramids that the FTC has prosecuted.

E. Narrow the Consideration Provision.

The proposed Rule's definition of a business opportunity requires the payment of consideration. Its definition of consideration—any payment, share of profits, or a current obligation to make a payment at a future date[93]—covers nearly every independent agent business relationship, however. It also appears to cover payments made by independent distributors of new products, such as new lines of automotive parts, office equipment, and many other product lines. Payments by students enrolling in for-profit vocational schools to obtain jobs as computer technicians, medical assistants, cosmetologists, or a myriad of other opportunities similarly could also be covered.

The proposed Rule would cover Primerica agents and essentially any personal selling activity. For Americans seeking a new opportunity and income stream, personal selling offers ease of entry and exit, with little financial exposure.[94] Nonetheless, all would be swept under the Rule's expansive definition of consideration. Modest fees would trigger the proposed Rule's requirements, making simple legitimate business opportunities much more complex and potentially more expensive, even though the NPRM identifies *no* problems affecting these businesses.

Many companies charge their distributors for the tools and training necessary to conduct the business, not for the right to participate in it. For example, Primerica accrues no profit from the $199 fee it charges prospective agents for training and licensing. The fees are paid not for the right to participate in the Primerica sales force, but rather to provide state-required pre-licensing training and to pay state-imposed fees for insurance licensing examinations. This use of fees is far different from fraudulent pyramid marketing, work-at-home, or vending machine schemes that profit from upfront fees charged consumers for the opportunity itself or for goods of little or no value.

The fraudulent schemes the Commission seeks to address all charge for the right to participate—whether vending machine route sales, pyramid schemes, or work-at-home scams. Con artists only profit through such payments; there are no underlying legitimate business or products to generate profits. Some payments to participate are express, but fraudulent operators also mask these payments through charges for goods or large amounts of inventory at rates well

---

93 71 Fed. Reg. 19,063.

94 The Direct Selling Association requires that all member companies incorporate a "buyback" policy that members return 90 percent of the cost of all inventory and required and/or profitable promotional materials, sales aids and kits, purchased within one year of termination. Direct Selling Ass'n, *Code of Ethics* §A(7)(b), *available at* http://www.dsa.org/ethics/code/#inventory. Primerica does not face any inventory buyback issues, because it has no inventory and does not require agents to purchase anything from the company. And, as noted above, the $199 fee paid by a new Primerica agent is refundable, less $40, within 120 days of payment.

in excess of value. In seeking to reach these frauds, however, the NPRM's definition of consideration includes *any* monetary payment, share of profits, or current obligation to pay in the future.[95] Although Primerica supports the Commission's efforts to prevent fraud, a much narrower definition of consideration would better serve this objective.

The Commission should define consideration to reach only payments for a right to participate. Payments at fair market value for the tools, training, and products required for new agents to execute the opportunity successfully are not payments to participate, and should not constitute consideration. Fraudulent offers that provide trivial tools or training of no, or almost no, value would be classified as payments to participate. Additionally, to prevent fraudulent schemes that rely on inventory loading, any payment for inventory not refundable at 90 percent of initial cost within one year (with a shorter period for perishable food items) should constitute consideration.[96] This definition would cover fraudulent operations that cause consumer harm, while excluding the operations of legitimate businesses. It would not cover companies such as Primerica that use new recruit fees to provide recruits with substantive training and pay their state insurance exam and license fees. Drawing the line between payments for participation and payments for the legitimate costs of entering the business, admittedly difficult, is critically important.

F. Exclude Companies That Have Been in Business for a Significant Number of Years, or That Post a Performance Bond.

Con artists cannot perpetuate a fraudulent operation for an extended period of time. Pyramid schemes do not persist because there are no underlying business operations to sustain compensation to the participants. Thus, the majority of fraud the Commission cites in the NPRM, as well as its history of enforcement actions, involve businesses that form and dissolve frequently. The shifting nature of these businesses make it difficult for consumers to have adequate information, and for consumers or enforcement agencies to obtain redress. In contrast, there is little history or evidence of fraud among established direct sellers. Stable companies that have been in business for a significant time are unlikely to pose a problem. They have survived because they satisfy consumer and market needs. They have an ongoing business with significant value, which serves as both an incentive to avoid problems and a source of compensation for consumers if problems occur. An exemption for companies that have been in business for a significant time, for example five years, would largely exclude the legitimate direct selling industry, but would still reach the fraudulent operators the proposed Rule seeks to address.

Alternatively, or potentially as part of an exclusion based on the number of years in business, the Commission could exempt companies that post a performance bond. Requiring a

---

95 71 Fed. Reg. at 19,063

96 This formulation reflects the policy of the DSA Code of Ethics. *See* Direct Selling Ass'n, *Code of Ethics* §A(7)(a) ("For purposes of this Code, 'reasonable commercial terms' shall include the repurchase of marketable inventory within twelve (12) months from the salesperson's date of purchase at not less than 90 percent of the salesperson's original net cost less appropriate set offs and legal claims, if any."), *available at* http://www.dsa.org/ethics/code/#inventory.

performance bond, which serves to assure resources for consumer redress should a problem occur, creates an added incentive to avoid problems. Legitimate direct selling companies, whether newly formed or more established, would post the performance bond based on sound business models and consumer practices. Such an exemption or exclusion would leave fraudulent operators, who are not likely to place funds within the reach of regulators, covered under the proposed Rule's expanded disclosures and enforcement, while enabling legitimate direct sellers to avoid the proposed Rule's burdens and added costs. Even if bad actors posted bonds in some cases, these resources would help cover any consumer losses.

V. CONCLUSION AND REQUEST FOR HEARINGS

The proposed Business Opportunity Rule represents an effort by the Commission to combat fraud, but the rule sweeps far too broadly and, as a result, will not accomplish the goal that motivated it in the first instance. The proposed Rule, if adopted, would cripple many direct selling businesses and would impair the livelihoods of millions of Americans who work in the industry. The appropriate course of action would be for the Commission to modify the proposed Rule to narrowly target the fraudulent conduct that the Commission has observed through its enforcement efforts, or to simply pursue the perpetrators of fraudulent schemes under existing law.

To ensure that it is able to present evidence of the proposed Rule's negative impacts, and pursuant to 15 U.S.C. § 57a(c)(2), Primerica requests that the Commission conduct informal hearings on the proposed Rule and provide Primerica with the opportunity to present oral testimony at these hearings.[97] As the Commission is aware, the presiding officer is required by statute to conduct (or allow to be conducted) examinations, including cross-examinations of oral presentations and rebuttal submissions on "designated issues"[98] and the presentation and rebuttal of information, as well as cross-examination of persons at the Commission's determination. Primerica requests the opportunity to examine, cross-examine and present rebuttal submissions on any disputed issues of material fact.

In addition to the factual submissions contained in this Comment, Primerica is prepared to offer witnesses to support its position. The proposed testimony will focus primarily on the issues raised in Section III *supra*, including the burdensomeness of the proposed Rule and the

---

97 If a party timely requests a hearing, the Commission *must* conduct one. *See* 15 U.S.C. § 57a(c)(2)-(3).

98 Interested parties may petition the Commission for the addition, modification, or deletion of a designated issue. 16 C.F.R. § 1.13(c)(3)(ii). Issues that are disputed issues of fact that are determined by the Commission or presiding officer to be material and necessary to resolve must be designated. *Id*. § 1.13(d)(1)(i). Either the Commission or the presiding officer may designate other issues for consideration in accordance with the provisions of 1.13(d)(5) and (d)(6). *Id*. § 1.13(d)(1)(ii). By itself, the Commission's failure to allow rebuttal submissions or cross examination is a basis for judicial reversal if the court finds that the failure "precluded disclosure of disputed material facts which was necessary for fair determination by the Commission of the rulemaking proceeding taken as a whole." 15 U.S.C. § 57a(e)(3)(B).

ineffectiveness of its proposed disclosures and other requirements. Primerica believes that full hearings are warranted to enable the Commission to explore fully and thoroughly understand the implications of promulgating the Rule, including its negative and costly effects on legitimate businesses.

Based on the Commission's extensive history with these procedures, Primerica anticipates the hearings would allow for full discussion of the many issues this important proposal raises. Whether intended or not, the proposed Rule would likely necessitate a substantial restructuring of the $30 billion direct selling industry as it currently exists. This proposal is at least as sweeping as many of the prior rulemaking proceedings under Section 57a in which the Commission conducted weeks of hearings with dozens, and in some cases hundreds, of witnesses. Notably, even before the procedural requirements of Section 57a were enacted, the Commission conducted hearings on major rulemakings such as the original Franchise and Care Labeling Rules.

Primerica also requests that it be provided the opportunity to present additional relevant facts in the form of written comment and/or witness testimony at public hearings on any alternative Business Opportunity Rule proposed by the Commission in response to this initial round of public comments.