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July 17, 2006

**VIA E-MAIL**

Donald S. Clark  
Secretary  
Federal Trade Commission  
Room H-135 (Annex W)  
600 Pennsylvania Avenue, NW  
Washington, DC 20580

**Re: Comment submitted by Quixtar Inc. to the Federal Trade Commission  
in response to the proposed Business Opportunity Rule, R511993**

Dear Mr. Clark:

I enclose for your consideration a Comment Submitted by Quixtar Inc. ("Quixtar") to the Federal Trade Commission in Response to the Proposed Business Opportunity Rule ("Comment").

Quixtar supports the concept of a Business Opportunity Rule ("Rule") that would strengthen the FTC's ability to protect consumers from pyramid schemes and other deceptive activities. As the comment makes clear, however, Quixtar believes that the proposed Rule should be revised to avoid imposing undue burdens on millions of Americans who rely on business opportunities for some or all of their income. Several of the Rule's provisions appear to target abuses stemming from high-risk business opportunities that involve large, non-refundable expenses. Because these provisions serve little, if any, purpose in connection with low-risk opportunities that offer refunds, Quixtar proposes a safe harbor provision for opportunities that, like Quixtar, offer new participants at least a 90 percent refund of their initially required payment, plus at least a 90 percent refund of unsold inventory that is neither used nor damaged. As described in the enclosed Comment, entities falling within the safe harbor would be required to make simple, easy to understand, standardized disclosures. Quixtar believes that its proposed safe harbor approach will serve the Commission's goal of protecting consumers without unduly burdening legitimate direct sellers.

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Quixtar formally requests that the FTC hold several workshops around the country to enable participation in the rulemaking proceeding by a large cross section of individuals and businesses that would be impacted by the Rule.

Sincerely yours,

J~~o~~an (Jodie) Z. Bernstein



**BEFORE THE  
FEDERAL TRADE COMMISSION**

**COMMENT SUBMITTED BY**

**QUIXTAR INC.**

**TO THE  
FEDERAL TRADE COMMISSION**

**IN RESPONSE TO  
THE PROPOSED BUSINESS OPPORTUNITY RULE  
R511993**

**July 17, 2006**

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## **I. Executive Summary**

Quixtar Inc. (“Quixtar”) supports the concept of a Trade Regulation Rule that would strengthen the Federal Trade Commission’s (“FTC’s” or “Commission’s”) ability to protect consumers from pyramid schemes and other illegal and deceptive activities while at the same time promoting transparency in recruiting by legitimate business opportunities. We believe such a rule can be designed in a way that does not penalize or impose undue burdens on the millions of Americans who rely on Quixtar and other independent business opportunities for some or all of their income. However, significant changes in the originally proposed rule are necessary. We believe the “safe harbor” approach suggested in Quixtar’s comments would make the Rule more effective while removing provisions that would impose catastrophic burdens on millions of small entrepreneurs.

For nearly half a century, Quixtar and its sister company Amway Corporation (“Amway”) have offered a successful business opportunity in the United States, Canada and dozens of foreign countries. Transparency has been one of the keys to this success. From our beginnings in 1959 to the present, we have provided prospective participants with truthful and meaningful information about our business opportunity so that they can make an informed decision. We could not have succeeded and grown without being fair and open with everyone who tries our business, including people who stick to it as well as those who decide for whatever reason that it is not something they wish to pursue. It can cost as little as \$45 to try the Quixtar business, and most of that money is refundable if the customer decides not to continue. Hundreds of thousands of Americans today have their own Quixtar businesses and benefit from the opportunity to earn extra income. Today, Quixtar in North America is a \$1 billion business annually, and Amway and Quixtar worldwide sales total over \$6 billion each year.

Since 1979, Amway (and then Quixtar) have carried out an income disclosure program in close cooperation with the FTC, pursuant to a Commission Order that sunset on May 28, 2006 (“Order”).<sup>1</sup> For more than 20 years, neither the FTC nor any state agency has accused Quixtar or Amway of misleading anyone about the potential of our business opportunity. However, the experience Quixtar has gained while complying with remedial FTC disclosure requirements should inform the rulemaking record, and can serve as a useful point of reference in designing an effective business opportunity disclosure rule as effective as, though substantially less burdensome than, the 1979 *Amway* Order.

FTC Act Section 5 as well as other federal and state laws, already prohibit misrepresentation and unfair and deceptive practices. The enforcement record of the Commission, together with other federal and state law enforcement agencies, against boiler rooms, pyramid schemes, and other fraudulent activities shows that existing laws are effective.<sup>2</sup> We further agree that the approach taken in the Franchise Disclosure Rule (“Franchise Rule”) is inappropriate for business opportunities. Business opportunities are not tiny franchises. The facts and circumstances that persuaded the Commission to undertake a separate rulemaking show the need for a Business Opportunity Rule (“Rule”) fundamentally different from the Franchise Rule, not just a “Franchise Rule Lite.” A properly crafted business opportunity trade regulation rule could provide additional protection against business opportunity fraud without penalizing millions of independent business owners or crippling the opportunities that enable them to earn extra income.

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<sup>1</sup> *In re Amway Corp.*, No. 9023, 93 FTC 618, 1979 FTC Lexis 390 (May 8, 1979).

<sup>2</sup> Business Opportunity Rule; Notice of Proposed Rulemaking, 16 C.F.R. part 437, available at 71 Fed. Reg. 19079, at n. 252.

Quixtar does *not* believe that the Commission should impose remedial disclosure requirements like those in the 1979 *Amway* Order on business opportunities that already voluntarily provide consumers with the information they need.<sup>3</sup> Several of the provisions in the current proposal appear to target abuses that only occur when the opportunity involves large non-refundable expenses. As discussed in greater detail below, these provisions would serve little purpose in connection with low cost, low risk opportunities like Quixtar, but they would impose catastrophic costs on millions of independent business people. There is another approach that will be as effective, if not more effective, in penalizing unfair and deceptive practices while allowing such legitimate small businesses to prosper.

Quixtar proposes a safe harbor provision for business opportunities that, like Quixtar, offer new participants at least a 90 percent refund of their initially required payment, plus at least a 90 percent refund of unsold inventory, during at least the first year of participation. Companies that chose to make such an offer would fall within the safe harbor. Business opportunities falling within the safe harbor would be required to make simple and standardized disclosures, including information about how to claim a refund, how to get comprehensive information about the business opportunity, and some meaningful indication of the typical or average income of active participants. Other requirements of the proposed Rule such as the seven-day waiting period, the list of references, the list of allegations made in litigation, and the number of cancellation or refund requests, would not apply to business opportunities within the safe harbor. We will show why the safe harbor approach would work to get solid business and earnings claim disclosures to

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<sup>3</sup> It would be bizarre if the Commission were to subject all business opportunities to disclosure requirements even more burdensome than those it imposed on a Respondent found liable for Section 5 violations. Yet in some ways that is what the proposed Rule, in its present form, would do.

consumers, enabling them to go into any income-earning opportunity with “eyes wide open,” while enabling the Commission to impose more stringent requirements on business opportunities failing to qualify for the safe harbor. We believe this approach will draw an appropriate bright line of distinction between legitimate direct sales opportunities posing low risks to consumers and opportunities involving large financial risks or questionable practices, which clearly should be held to a more rigorous standard. This approach offers the greatest benefit for consumers: protection from fraud as well as free access to the broadest scope of legitimate business opportunities.

## **II. Quixtar**

It is necessary to understand the basic characteristics of the Quixtar business opportunity in order to assess how it could be impacted by the proposed Rule.

### **A. Quixtar and Amway**

Quixtar commenced operations in 1999 as an innovative, web-based multilevel marketing business opportunity in North America. Quixtar’s roots go back to 1959, when Quixtar’s sister company Amway was founded. Amway began by selling one household cleaner through a few highly motivated distributors. The product lines of Amway and Quixtar have greatly expanded since to include such diverse items as health and beauty products, nutritional supplements, personal electronics, and apparel.<sup>4</sup> Quixtar, Amway, and their parent company Alticor Inc. (“Alticor”)<sup>5</sup> together comprise one of the world’s oldest and most successful direct selling business enterprises, operating in more than 80 countries, employing more than 13,000

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<sup>4</sup> For a list of products produced and marketed by Quixtar see <http://www.quixtar.com/products/content.aspx?pid=4416&ctg=9516> (last viewed July 17, 2006).

<sup>5</sup> For a brief description of Alticor see [http://www.alticor.com/news/pop\\_alticor\\_fact.html](http://www.alticor.com/news/pop_alticor_fact.html) (last viewed July 17, 2006).

individuals, and generating over \$6 billion in annual sales through 3.6 million independent business owners worldwide.<sup>6</sup>

### **B. The Quixtar Business Opportunity**

Quixtar sells its products exclusively through a multilevel network of independent distributors known as Independent Business Owners (“IBOs”). A prospect can register as a Quixtar IBO for as little as \$45. Although a Quixtar IBO is under no obligation to buy any inventory or meet any sales quota, new IBOs typically choose to spend about \$60 in optional Quixtar products (for a sample kit) at or near the time they initially register.<sup>7</sup> The entire package, ordered by most persons signing up as a Quixtar IBO, is approximately \$125. Every IBO executes a written, annually renewable contract with Quixtar.

Quixtar does not recruit new IBOs directly. Instead, existing IBOs are authorized to recruit and “sponsor” new IBOs. The IBO “sponsor” can earn commissions based on sales generated by the sponsored IBOs. There is no single standardized approach to recruiting. Sometimes an individual IBO or IBO couple explains the Quixtar opportunity to a prospect in either the sponsor’s or the prospect’s home. Sometimes a more experienced IBO (often the sponsor’s sponsor) assists. Sometimes a group of IBOs invite several prospects to a group presentation on the Quixtar opportunity. All of these approaches, among others, have proven effective methods to explain the Quixtar opportunity to prospects. In all of these approaches, the Quixtar.com website enables the prospect choosing to try Quixtar to sign up immediately

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<sup>6</sup> For a general overview of Amway’s worldwide growth *see* [http://www.alticor.com/pdf/alticor\\_timeline\\_05.pdf](http://www.alticor.com/pdf/alticor_timeline_05.pdf) (last viewed July 17, 2006).

<sup>7</sup> <http://www.quixtar.com/Documents/IWOV/VIS/010-en/pdf/IBORegistrationForm.pdf> (last viewed July 17, 2006).

online.<sup>8</sup> In the course of the online registration process, which was designed in close consultation with the FTC Bureau of Consumer Protection in 1999,<sup>9</sup> the new IBO receives additional important disclosures and information before being asked to sign any contract or spend any money.

The relationship between the sponsoring IBO and the sponsored IBO, who in turn can sponsor others, creates Quixtar sales organizations whose backbone is the “line of sponsorship” (“LOS”) created and maintained by Quixtar to track sales and compensate the IBO sales force. The LOS is Quixtar’s unique, proprietary distribution channel, without which the Quixtar business opportunity could not exist.

IBOs are truly independent entrepreneurs, subject only to contractual Rules of Conduct that apply equally to every IBO in Quixtar’s LOS.<sup>10</sup> Quixtar does not assign sales territories or require IBOs to keep set business hours or sell any particular mix of products. IBOs can set their own resale prices, and are not required to charge Quixtar’s suggested retail prices. Quixtar does not require or even recommend any specific level of effort or style of doing business. Quixtar never requires an IBO to meet any sales quota or maintain any inventory. IBOs are not bound by any long-term contract but must review annually in order to continue in business.

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<sup>8</sup> IBOs can also register using a paper application form and/or telephone registration.

<sup>9</sup> *In re Amway Corp.*, Docket No. 9023, Amway Corporation’s Program of Compliance with Paragraph II of Order in FTC Docket No. 9023.

<sup>10</sup> <http://www.quixtar.com/Documents/IWOV/VIS/010-EN/PDF/compendium.pdf> (last viewed July 17, 2006).

The cost to enter and to remain in the Quixtar business is minimal. The total *required* payment is \$45 per year.<sup>11</sup> Typically a new IBO also chooses to purchase some products and publications, bringing the initial cost to about \$125.00. The breakdown is as follows:

Quixtar Business Services & Support.....	\$31.00
IBOAI <sup>12</sup> Support* .....	\$ 9.00
IBOBA <sup>13</sup> Insurance* .....	\$ 5.00
TOTAL ANNUAL BUSINESS FEE.....	\$45.00
Product Intro Pack** .....	\$60.00
IBO Publications** .....	\$20.00
SUBTOTAL (excluding sales tax & delivery) .....	\$125.00

\* Annual support and insurance fees are included, however you may request a refund

\*\*Optional

However, new IBOs do not place \$125, or even \$45, at risk. Quixtar’s Rules, incorporated in its contract with every IBO, guarantee that if an IBO leaves the business for any reason, he or she is entitled to sell back all unwanted, unused products purchased within the past year for full purchase price less a 10 percent restocking fee.<sup>14</sup> Subscription items like publications are refundable on a prorated basis. Moreover, if a new IBO decides to leave the business in the first year and asks for a refund of the entire \$45 paid to Quixtar, Quixtar normally provides the full refund.<sup>15</sup>

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<sup>11</sup> Up to \$14 of the \$45 is refundable immediately if an IBO opts out of an optional insurance program and IBO trade association membership dues.

<sup>12</sup> Independent Business Owners Association International.

<sup>13</sup> Independent Business Owners Benefits Association.

<sup>14</sup> Rules of Conduct Section 5.3.6, in Business Reference Guide Section D-9, <http://www.quixtar.com/Documents/IWOV/VIS/010-EN/PDF/compendium.pdf> (last viewed July 17, 2006).

<sup>15</sup> If large numbers of IBOs asked for such a refund at some future time, Quixtar reserves the right to prorate the refund or otherwise reduce it to cover reasonable costs and prevent manipulation; but Quixtar would still provide a reasonable refund. As stated above, the

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Because Quixtar's direct fulfillment business model requires IBOs to carry very little inventory, IBOs leaving the business have typically consumed or resold most of the products for which they might claim a refund. Fewer than 20,000 North American<sup>16</sup> IBOs formally resign each year, and almost two-thirds of them claim and receive a refund of their original registration payment. A much larger number of IBOs leave the business without any formal resignation, simply by not renewing their business authorization for the next year. Many who leave have found that the Quixtar business – or being in business for oneself – simply is not for them. Undoubtedly, many people may leave the Quixtar business due to changes in their family circumstances, job circumstances, health circumstances and so forth - and they are not required to notify Quixtar when they leave.

The flexibility of the Quixtar opportunity attracts an extraordinarily diverse variety of people, who approach the business in many different ways. For example, some individuals register with Quixtar to buy products at the wholesale or discount price given to IBOs, choosing not to participate in the sale of products or the recruitment of other persons to become IBOs. Other IBOs enter the business to help meet short-term financial goals, such as making the down payment on a new car, replacing a worn out appliance, or earning extra money for holiday gifts. In many cases, the IBO is a stay-at-home mother who works a few hours a week to improve the financial situation of her family. Other times, both husband and wife may work outside the home but sell Quixtar products to make up for their inadequate income. Still others, many of them parents of young children or stay-at-home parents who do not wish to return to the 9-5

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\$9 IBOAI Support and \$5 IBOBA insurance are optional and a full refund is available whether or not an IBO decides to leave the business.

<sup>16</sup> "North America" refers to the United States and Canada in addition to offshore markets such as the Dominican Republic. It does not include Mexico.

workforce, are seeking a steady source of extra income with flexible working hours. In many cases, individuals also join Quixtar to increase their social contact with colleagues, which often results in respectful treatment and recognition of the IBOs efforts. In other situations, IBOs may decide to pursue the Quixtar business full-time, and often build large sales organizations over time and earning, substantial incomes.

IBOs also frequently change their focus and level of interest in the business over time as their personal goals and circumstances change. For example, IBOs who get laid off from their regular jobs often increase their Quixtar activity to replace lost income. Thus, there is no “standard” Quixtar IBO. The IBO choosing to work 10 hours a week for six weeks each year to save up for holiday gifts is in the same Quixtar business as the IBO who spends 50 hours a week for five years, but their effort and expectations are profoundly different. Yet each of them began in the business by signing the same standard distributorship agreement. They are bound by the same contractual rules, and their compensation is calculated according to the same sales-based formula.

Consumers also benefit from Quixtar’s business model. The FTC recognized that such person-to-person marketing provides consumers with “home delivery, explanation and demonstration of guarantees” as well as information concerning “product characteristics and use.”<sup>17</sup> These time-intensive services are often not provided by traditional brick-and-mortar retail outlets. Furthermore, retail stores that do provide some of these services are often incapable of providing them with the flexibility inherent in person-to-person marketing. For example, it is typical for Quixtar IBOs who speak Vietnamese to provide Vietnamese-speaking

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<sup>17</sup> 93 F.T.C. 618, 1979 FTC LEXIS 390 at \*193 (May 8, 1979).

consumers with product explanations, demonstrations, and information in their native language, and the same is true in other immigrant communities where English fluency may be limited. A Quixtar IBO whose customers are working mothers might provide those consumers with product explanations, demonstrations, and information during the evening at the customer's home, or a Quixtar IBO might service consumers who must remain home because of their limited physical mobility. Others may do product demonstrations and sales in a group setting, such as a skin care and cosmetics "makeover" party. The beauty of direct selling is that it offers products and services to customers on their own terms – when and where they wish to purchase them.

Quixtar's person-to-person marketing also benefits competition. The FTC has recognized that multilevel marketing can overcome "near insurmountable barriers" to product entry in oligopolistic markets.<sup>18</sup> For example, in some industries, incumbents' large advertising expenditures may prevent new companies, incapable of generating the capital necessary to disseminate information concerning their products through traditional media, from entering the market. Further, direct selling avoids the "shelf wars" found in traditional stores, that often serve as barriers to new products coming on line. In short, person-to-person marketing provides a relatively low-cost means of introducing new products to consumers. The result is that direct selling can "interject[] a vigorous new competitive presence" in "highly concentrated market[s]."<sup>19</sup>

### **C. Compliance History**

In the early and mid 1970s, the FTC investigated Amway's income and profit claims. The Initial Decision, adopted by the Commission, together with the Commission's Opinion,

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<sup>18</sup> *Id.* at \*192.

<sup>19</sup> *Id.*

takes up over 100 printed pages and includes meticulous fact findings.<sup>20</sup> The Commission concluded that only certain types of income representations should trigger mandatory disclosures. Earnings claims that consist of “references to the achievement of one’s dreams, having everything one always wanted, etc.” which are “surrounded by warnings that hard work is required” are “primarily inspirational and motivational” and do not require any additional disclosures.<sup>21</sup> Claims that an hypothetical distributor could make a *stated* amount of money (e.g., \$200 per month) create an “impression” that the amount of money stated is “typical or average” of what most distributors earn.<sup>22</sup> The Commission’s recognition that some types of earnings claims require additional disclosures, while others do not, formed the basis of the Commission’s final order for Amway.

The first income-related requirement of the 1979 Order broadly prohibited “misrepresenting in any manner the past, present, or future profits, earnings or sales” from participation in Amway.<sup>23</sup> This provision recognized that no earnings claim, regardless of its form, should misrepresent actual earnings potential. The second income-related requirement prescribed a standard disclosure triggered only by claims that a distributor could earn a “stated amount” of income above the average. The 1979 Order (along with a subsequent consent decree in 1986) directed Amway to disclose the average income of its active distributors in connection with any claim of a stated amount of income above the average.<sup>24</sup> Some additional disclaimers

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<sup>20</sup> *Id.* at \*24.

<sup>21</sup> *Id.* at \*237-38.

<sup>22</sup> *Id.* at \*240.

<sup>23</sup> *Id.* at \*255-56.

<sup>24</sup> The 1979 Order required some additional disclaimers under specified and limited circumstances, including the “number or percentage” who achieved very high claimed

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were required under specified and limited circumstances, including the “number or percentage” who achieved very high claimed performance numbers, but the average income figure remained the standard and by far the most significant disclosure for present purposes.<sup>25</sup> In limiting the affirmative disclosure requirement to specifically stated earnings claims, the Commission recognized that it would be inappropriate, even as a remedial “fencing in” provision, to require burdensome and repetitive disclosures in connection with every truthful anecdote about the income potential of the Amway business.

Since 1979, disclosures of average income have been a positive force on the business. They have helped Amway, and now Quixtar, manage the expectations of those choosing to participate in the business opportunity. Regulators have readily accepted these disclosures as ample information in response to complaints received. Likewise, litigants have a hard time making a case for claims of exaggerated income claims.

Although the Order has now sunset, Quixtar intends to maintain an effective disclosure program. Long-term success is only possible when the business opportunity is capable of consistently meeting or exceeding the expectations of participants. If prospects see the Quixtar opportunity as a get-rich-quick scheme, they will inevitably be disappointed. Success in Quixtar requires hard work, often over a period of years, and no one is guaranteed of success. Since Quixtar involves little financial risk and no long-term commitment, IBOs can leave the business immediately and get all or nearly all their money back. Our business has survived and indeed thrived over nearly half a century because the vast majority of our independent business owners

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performance numbers, 93 F.T.C. 618, 1979 FTC LEXIS 390 at \*255-56 (May 8, 1979), but the average income figure remained the standard and by far the most significant disclosure for present purposes.

<sup>25</sup> 93 F.T.C. 618, 1979 FTC LEXIS 390 at \*255-56 (May 8, 1979).

do understand what kind of opportunity we offer, and remain in the business because it rewards their effort. Honesty with distributors has been at the core of Amway and Quixtar's success since 1959.

### **III. Comments on the Proposed Business Opportunity Rule**

The proposed Rule seeks to cover a wide range of business opportunities, including work-at-home opportunities and other opportunities that resemble franchises but fall below the \$500 threshold of the current Franchise Rule.<sup>26</sup> Quixtar is not commenting on the suitability of the proposed Rule for business opportunities that require large, non-refundable payments, or promise to provide a market for products assembled or manufactured by participants. We do, however, believe strongly that several of the proposed requirements should not apply in their present form to Quixtar and similar business opportunities.

The Commission has long recognized the importance of crafting consumer protection measures that match consumers' risk with the appropriate level of business regulation. For instance, when crafting the Franchise Rule, the Commission

sought to strike the proper balance between prospective purchasers' need for pre-sale disclosure and the burden imposed on those selling business arrangements . . . when the required investment to purchase a business opportunity is comparatively small, prospective purchasers face a relatively small financial risk. In such circumstances, compliance costs may outweigh the benefits of pre-sale disclosure.<sup>27</sup>

The one-size-fits-all approach of the proposed Rule does not address the fact that consumers of different business opportunities are subject to different risks, and, therefore, require different levels of protection. Similarly the proposed Rule's approach ignores the fact

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<sup>26</sup> 71 Fed. Reg. 19055 & 19059-9061.

<sup>27</sup> 71 Fed. Reg. 19055.

that smaller business opportunities are less able to absorb the cost of administrative compliance than larger business opportunities. Indeed, for the smallest personal businesses, and for new entrants in almost any small business, administrative burdens may make legitimate opportunities either unprofitable or virtually impossible to operate, thereby harming both consumers and competition. In short, the Rule should impose burdens proportional to consumer risk.

**A. Safe Harbor for Low-Risk Business Opportunities Offering Buy-Back of at Least 90 Percent of Initially Required Purchases and Unsold Product Inventory during the First Year<sup>28</sup>**

Quixtar proposes a “safe harbor” imposing streamlined disclosure requirements on business opportunities that pose low consumer risks. We make this proposal for several important reasons. First, our experience has been that friction between any direct selling opportunity and its customers and plan participants is largely resolved when there is conspicuous disclosure of accurate information about products and prospective plan earnings. Second, we believe that full disclosure and transparency manages expectations and should be priority number one for maintaining good reputation and avoiding misunderstandings and complaints. Quixtar’s experience has been that when prospects are told immediately that future reward is directly commensurate with sales effort – and when prospects are given accurate disclosures about past experiences as well as important information on the opportunity – a much higher rate of satisfaction is achieved.

The safe harbor’s chief criterion for measuring risk would be the buy-back policy applicable to new participants during their first year. Any business opportunity could qualify for the safe harbor by offering participants leaving the business during their first year the right to

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<sup>28</sup> This section of comments responds, among others, to Question 1(c) in the NPR.

claim at least a 90 percent refund of the *required* initial outlay (currently \$45 for Quixtar), plus a 90 percent refund on any unsold, unused, or undamaged products (whether purchased voluntarily or involuntarily).

We are mindful of the staff's concerns that unscrupulous sellers can and sometimes do offer illusory refund policies.<sup>29</sup> This can be addressed by: (a) requiring every company seeking safe harbor treatment to publish a detailed refund policy and (b) making failure to honor a published refund policy an independent violation of the Rule.<sup>30</sup> We are confident this would substantially reduce the incidence of phony refund policies while encouraging (though not requiring) consumer-friendly refund policies. Companies that choose not to offer refunds would not thereby violate the Rule; they would simply fall outside the safe harbor.

Generally speaking, the proposed safe harbor would require clear and simple disclosures by business opportunities within the safe harbor. Focusing on the key element, the refund element, if the required initial payment were \$500, a 90 percent refund would ensure that the participant could claim and receive at least a \$450 refund if he or she decided to quit the business for any reason in the first year. For a business like Quixtar, where the initial requirement is only about \$45, the consumer would risk (at most) \$4.50 in required initial cost. Similarly, if the consumer purchased any inventory (whether required or optional), he or she would be assured of recovering at least 90 percent of the purchase price for any portion purchased during the first year that was not consumed, resold, or damaged.<sup>31</sup> This would minimize the risk taken by new

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<sup>29</sup> 71 Fed. Reg. 19069-9070.

<sup>30</sup> Proposed Rule Section 437.5(k) would help accomplish this.

<sup>31</sup> Quixtar does not mean to suggest that it or any business opportunity should deny refunds for unsold inventory on commercially reasonable terms after a participant's first year in business.

participants in legitimate low-risk opportunities while effectively preventing inventory loading by pyramid schemes and other law violators masquerading as direct sellers. Companies whose business models do not provide refunds for unsold inventory would not violate the Rule; they would simply fall outside the proposed safe harbor. Because they expose consumers to a greater level of risk, such business opportunities would be required to provide more extensive disclosures.

**B. Disclosure Requirements for Business Opportunities Falling Within the Safe Harbor<sup>32</sup>**

Business opportunities falling within the proposed safe harbor would be required to make streamlined disclosures to prospective participants, including all of the following:

- The name and location of the corporation offering the business opportunity;
- The cost of participating in the business opportunity (*i.e.* the initial required start-up cost);
- The compensation plan;
- The refund policy for start-up and future purchases;
- The average earnings experience placed into context;<sup>33</sup> and
- A reference or link to where the prospective purchaser can find all the terms of the contract.

As a practical matter, these could be presented easily in a one-page fact sheet, on a publicly accessible website, or in some other effective way, at the option of the affected company.

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<sup>32</sup> This section of comments responds, among others, to Questions 1(b), 9, 10, 11 and 22 in the NPR.

<sup>33</sup> *See infra* note 47 (providing an explanation of what it means to place earnings experience into context).

The website, fact sheet or other effective disclosure would be subject to proposed Rule Section 437.5(a), which parallels the proposed Franchise Rule's prohibition against disclaimers and waivers. However, the requirements of proposed Rule Section 437.5(b) and (c) would not apply to disclosures made by business opportunities falling within the safe harbor. Subsection (b) is unnecessary because the streamlined disclosures would all include typical income information and the terms "inconsistent and contradictory" are ambiguous and largely redundant with existing prohibition against false, misleading or deceptive content. Subsection (c) is inappropriate for law abiding business opportunities, which should be permitted to craft their disclosure and marketing materials to place their chosen disclosures in an appropriate context, including audio, video and interactive features on websites and information permitted or required by state law. The standard disclosures required under the proposed safe harbor are not "bad news" that should be presented in a stigmatizing format. To the contrary, for Quixtar and other business opportunities that share Quixtar's core values, disclosures are an integral part of the "good news" that will inform prospective IBOs about our business so they can decide whether to pay \$45-\$125 (with 90 percent or more refundable) to try Quixtar for themselves.

The following sections describe in greater detail both the specific disclosure requirements supported by Quixtar, and the basis for exempting business opportunities within the safe harbor from more burdensome requirements in the proposed Rule.

## 1. **Income Disclosures**<sup>34</sup>

### a. **Burden of Current Proposal**<sup>35</sup>

The proposed Rule imposes affirmative disclosure requirements on the “Seller” of a business opportunity, a term broadly and somewhat ambiguously defined as any “person who offers for sale or sells a business opportunity.”<sup>36</sup> This definition is impractical in the business opportunity setting. In the franchise context, there is usually only one “Seller” - the franchisor. Without a doubt Quixtar would be considered a “Seller” under the proposed Rule, as Quixtar sells to third parties the right to distribute Quixtar products. But it is IBOs, not Quixtar, who directly recruit new IBOs. For example, it is common for groups of Quixtar IBOs to invite prospects to an “opportunity meeting” in which several IBOs explain the Quixtar business opportunity. Each one of these IBOs could be considered as “offer[ing] for sale” the Quixtar opportunity, and each one may make different, truthful income claims based on their individual knowledge and experience, or on the specific goals of the individual prospect. In order for the proposed Rule to be effective, it appears that both Quixtar and hundreds of thousands of IBOs would need to be covered.

The Commission estimated that the proposed Rule would impose regulatory costs of \$750 on each “Seller” of a business in the first year of disclosures and \$500 each year after that. This calculation assumes that there are 3,200 total business opportunity “Sellers” within the United States,<sup>37</sup> a number that apparently corresponds to the number of companies that organize

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<sup>34</sup> This section responds, among others, to Questions 1(b), 9, 10, 11, and 22 in the NPR.

<sup>35</sup> This section responds, among others, to Question 1(b) in the NPR.

<sup>36</sup> 16 C.F.R. § 437.1(q), *available at* 71 Fed. Reg. 19088.

<sup>37</sup> 71 Fed. Reg. 19080.

and support business opportunities – not the number of entrepreneurs offering the opportunity for sale. It is obvious that Quixtar’s total incurred cost of compiling and disseminating all the various income disclosures would be many orders of magnitude greater than \$750 per year. In a survey conducted by the Direct Selling Association (“DSA”),<sup>38</sup> member companies were asked to describe the additional expenses that would be incurred to comply with the proposed rule. According to the survey, a single, mid-size direct selling company would spend thousands of worker hours and hundreds of thousands of dollars each year to comply.

Quixtar believes that the Commission did not expect for the definition of “Seller” to extend to distributors involved in a multilevel marketing plan. However, it appears that the current version of the proposed Rule would treat every Quixtar IBO as a “Seller.” If it does, it would, by the Commission’s own estimate, subject every IBO to annual compliance costs on the order of \$500-\$750.<sup>39</sup> Since the average monthly gross income of an active IBO is \$115, compliance costs of the Rule as proposed would consume more than half of the average gross revenue of an active IBO. About 380,000 IBOs in North America<sup>40</sup> earned a bonus from Quixtar in 2005. This is a reasonable proxy for the number of IBOs actively providing the opportunity,

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<sup>38</sup> See Survey Results in Comments of the Direct Selling Association on the Notice of Proposed Rulemaking for the Business Opportunity Rule.

<sup>39</sup> Quixtar believes the Commission has substantially underestimated the compliance cost of the Rule as proposed. The \$750 initial and \$500 annual estimate includes only the calculation of required disclosures. There would be additional costs due to record-keeping and, more importantly, a potentially catastrophic loss of business due to the seven-day waiting period, required disclosure of meritless legal claims, and other issues discussed in greater detail below.

<sup>40</sup> “North America” refers to the United States and Canada in addition to offshore markets such as the Dominican Republic. It does not include Mexico.

who would incur compliance obligations. Based upon the Commission's own estimate that initial compliance with the proposed Rule would take each "Seller" approximately five hours (one to three hours to prepare an initial disclosure document, and one to two hours per year to maintain the necessary records), the burden on Quixtar IBOs alone would be millions of hours and close to half a billion dollars!<sup>41</sup>

The proposed Rule would also have a negative impact on recruitment and sales. For example, in a Harris Survey that was conducted of the general population between July 5, 2006 and July 7, 2006, the percentage of adults in the U.S. interested at some level in the direct selling opportunity was 21 percent without the requirements in the Rule, but falling to only 12 percent when the seven-day waiting period, litigation list, and reference list requirements were included. This was a decline of over 40 percent. Of those adults who were "extremely interested" or "very interested," the decline in interest was 66 percent. In a survey of direct sellers, 40 percent stated they would consider joining a direct selling opportunity with the seven-day waiting period requirement, 29 percent with the reference list requirement, and only 20 percent with the litigation list requirement. When asked if they would join if all three requirements were in effect, only 15 percent said they would join. This would be an 85 percent reduction in potential recruits.

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<sup>41</sup> (380,000 Quixtar "Sellers") x (5 hours/Seller) = 1,900,000 total hours. The Commission's staff assumes that "in many instances an attorney likely would prepare or update the disclosure document" and, therefore, believes that \$250 represents an accurate labor cost. 71 Fed. Reg. 19081. (1,900,000 total hours) x (\$250) = \$475,000,000 total.

**b. Earnings Disclosures Should Consist of Simple Baseline Information<sup>42</sup>**

The objective of the proposed Rule's income disclosure requirements should not be to provide a maze of intricate calculations and disclosures but to instead put across the simple point that most participants in the business opportunity earn modest incomes, while providing good, basic information that the consumer can understand.

**i. Practical Effectiveness<sup>43</sup>**

Quixtar believes that prospective purchasers are unlikely to find the complex disclosure information required by the proposed Rule useful. A person deciding whether or not to try a business opportunity costing \$45 to \$125, with the right to a refund of 90 percent or more should he or she decide to resign from the business, is unlikely to engage in (and very unlikely to benefit from) an extended or refined financial analysis. Consumers want and need simple, easily understood information that will enable them quickly to grasp what kind of opportunity they are considering. For example, the Amway and Quixtar disclosure program required by the FTC since the 1980s has centered on a single, simple disclosure that: "The average monthly gross income of active IBOs is \$X."<sup>44</sup> This has been effective. Baseline disclosures such as this can provide information that is actually more useful and less confusing at a fraction of the cost of providing overly-precise, frequently updated calculations for every different truthful income claim.

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<sup>42</sup> This section of comments responds, among others, to Questions 10, 11 and 22 in the NPR.

<sup>43</sup> This section of comments responds, among others, to Questions 10, 11 and 22 in the NPR.

<sup>44</sup> The calculated average has varied over the years from \$56 to \$115.

## ii. Frequency of Updates<sup>45</sup>

The simple disclosure of average monthly gross income required in the 1979 *Amway* Order imposed a substantial burden on Quixtar and Amway. This burden was mitigated by the fact that the FTC did not require the calculation to be repeated every year. The Order gave Amway the option to disclose performance in “any recent year.” In practice, the calculation has been revised about every five years since 1986. Even so, the cost has been substantial. In 2001 the most recent year in which Quixtar conducted the survey, it cost the company in excess of \$100,000. Obviously, requiring quarterly or annual updates would impose a substantially greater burden between five and twenty times larger even on a company the size of Quixtar. The burden on a smaller company or new competitive entrant would be proportionately even greater in comparison to sales and represent an additional substantial barrier to entering the marketplace.

The proposed Rule’s requirements that a “Seller” calculate both the number and the percentage of purchasers achieving each specific level of earnings, and that a “Seller” identify and disclose characteristics of the purchasers achieving earnings differing materially from the characteristics of prospective purchasers, will deter the dissemination of useful information to consumers. Smaller business opportunity sellers likely lack the capability to calculate the “characteristics” of purchasers achieving specific income levels. Even-industry leading firms like Quixtar may find it prohibitively costly to maintain current earnings information in a format allowing for statistical calculation for all permutations and “characteristics” of prospective distributors. As a result, the Rule as proposed would restrict the quantity, and type, of information that sellers can convey to potential purchasers. Instead of providing the largest

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<sup>45</sup> This section of comments responds, among others, to Question 22 in the NPR.

amount of truthful information so that a purchaser will have the tools to make an informed decision, sellers, in many instances, would provide only information for which calculating overall percentages is relatively easy. This would in effect set up a “lowest common denominator” scenario.

The problem is worse to the extent that the proposed Rule would include each independent distributor as a “Seller” of the business opportunity. For example, it is typical for current Quixtar IBOs to share personal information about their own experiences with prospects. For instance, an IBO might say “I made enough after one year to buy a new car” or “everyone in my group qualifies for a bonus check every month.” Such truthful first-hand claims can be extremely useful when people decide whether a particular business opportunity is for them. Not only does this provide prospective purchasers with real-life examples from individuals with whom the prospective purchasers may already have formed relationships, but they allow prospective purchasers to ask personalized and specific questions concerning the experiences of others. For instance, a prospective Quixtar IBO with a particular interest in cosmetics sales might ask a current Quixtar IBO “How much did you make from cosmetics sales last year” or “How was your cosmetics business in your second year?”

If IBOs are covered as “Sellers” by the proposed Rule, each individual IBO would have to prepare, in advance, a written Earnings Claim Statement for each and every piece of information or anecdote they might decide to share with a prospect. This would effectively prevent IBOs from answering most prospective purchasers’ questions about their personal experiences. For example, if a prospective IBO asked a current IBO: “How much money did you make in cosmetics sales last year?” the latter would be forced to answer “I can’t tell you, because I don’t have data on the number and percentage of people who did just what I did in the

time frame you asked about.”<sup>46</sup> The proposed Rule thus would perversely work to limit the amount of truthful information made available to prospects.

### **iii. A Practical Baseline Disclosure<sup>47</sup>**

In situations where an income disclosure is necessary, average gross income or some comparable normative figure can simply and effectively put other earnings claims into context.<sup>48</sup> The simplicity of a baseline disclosure is the key to its effectiveness. Prospects immediately understand, regardless of their level of interest or sophistication, that Quixtar is not a get-rich-quick opportunity. Without having to analyze complex statistical comparisons or engage in elaborate business planning, prospects know from the single standard disclosure that \$1,000 a year is attainable in Quixtar, \$10,000 a year is ambitious and \$100,000 or more is attainable only with exceptional dedication, effort and hard work.

Quixtar proposes that the Rule contain the following language to be followed when disclosing earnings:

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<sup>46</sup> Theoretically an IBO could go to Quixtar and ask Quixtar for the “number and percentage of all purchasers” achieving the IBO’s level of cosmetics sales the following year. Upon getting the answer, the IBO could then prepare a written Earnings Claim Statement as mandated under the Rule, and contact the prospective IBO and let them know that they can now answer their particular question. As a practical matter, however, Quixtar does not keep data that would correspond to the multitudinous number of specific questions that a prospective IBO might ask. Even if Quixtar had the applicable data, few, if any, IBOs would undertake the time and expense of preparing an Earnings Claim Statement based upon this data in order to respond to a prospective IBO’s questions. Compliance costs would be astronomical.

<sup>47</sup> This section of comments responds, among others, to Question 22 in the NPR.

<sup>48</sup> Quixtar does not believe that average gross income is the only baseline disclosure that would work, and urges the Commission to allow promoters of business opportunities the necessary latitude to devise baseline disclosures most appropriate to each business opportunity.

No seller or salesperson shall misrepresent the actual or potential earnings of its salespeople. Any earnings representation made by a seller or salesperson shall be based on documented facts. If a seller or salesperson promotes a level of earnings that exceeds the average or typical earnings of all salespersons actively pursuing an income opportunity, then the seller or salesperson must disclose information to put such income claims into a context that fairly discloses the likelihood of achieving the promoted earnings level.

In providing earnings disclosures, sellers should observe the following guidelines:

- (1) They must make the information available on a web site or in publications that are easily accessible by potential salespersons.
- (2) They must disclose whether or not the income level promoted includes or excludes an assumption of the expenses incurred by the salesperson in the pursuit of the income opportunity.
- (3) They must provide a context<sup>49</sup> for the income representation to provide a fair statement of the likelihood of achieving an income level comparable to the earnings level that is promoted.
- (4) They may use, in determining average earnings levels, a denominator<sup>50</sup> that is based on the number of sales representatives who actively pursue an income opportunity within an identified time frame.

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<sup>49</sup> A reasonable context should include information such as the average length of time taken by the company's salespersons to achieve similar income levels, the percentage of those actively pursuing an income opportunity achieving similar levels of income or any other information that may help a prospective salesperson understand the level of effort required or the number of others similarly situated who achieve similar results.

<sup>50</sup> Many customers become distributors in order to purchase products at wholesale prices. These distributors typically do not sponsor other distributors or engage in other business building activities. These distributors may receive overrides on their personal purchases but are, in reality, consumers rather than business-builders, as such these distributors need not be included in determining a denominator for average income calculations of those actively pursuing an income opportunity. In addition, in creating a denominator for average earnings, distributors who may otherwise be defined as pursuing an income opportunity but have not purchased products or otherwise actively engaged in business-building activities during the time period for which a calculation of average earnings is being determined may be excluded from the calculation.

- (5) They may infer a reasonable level of "retail" profit from salesperson activities.

We respectfully submit that ethical direct sellers striving to protect reputation and regulators can be aligned around reasonable earnings disclosure policies, as laid out here in the context of this best practices safe harbor. Reasonable earnings disclosures represent good public policy as well as good business strategy.

**c. The Entity Responsible for the Business Opportunity Should Determine and Calculate the Standard Disclosure<sup>51</sup>**

Quixtar has always required its IBOs to disclose to every prospect the average monthly gross income of Quixtar IBOs. Making a simple, standard disclosure is not unduly burdensome. The 1979 Amway Order imposed just such a uniform, standardized disclosure requirement.<sup>52</sup> Orders in other MLM cases have imposed similar standardized disclosure requirements.<sup>53</sup> Everyone involved in marketing a business opportunity should share the responsibility for *making* required disclosures. But only one entity, the entity responsible for the business opportunity, should be responsible for *calculating* the standard disclosure figure.

To avoid any confusion, Quixtar believes that the term "Seller" should be narrowly defined as "the entity responsible for a particular business opportunity." This definition would include the corporate principals that develop, provide, and sell business opportunities such as Quixtar, Mary Kay, Avon, Herbalife, NuSkin, Pampered Chef, Longaberger and the like. This change would place the burden on the corporate principals – the entities that control the business

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<sup>51</sup> This section of comments responds, among others, to Question 22 in the NPR.

<sup>52</sup> See generally, 93 F.T.C. 618, 1979 FTC LEXIS 390 at \*255 (May 8, 1979).

<sup>53</sup> See generally, *United States v. Bestline Products Corp.*, 412 F. Supp. 754 (N.D. Cal. 1976); *FTC v. FutureNet, Inc.*, Civil No. 98-1113 GHK (AIJx) (C.D. Cal. 1998).

opportunity – to calculate standard disclosures. Although distributors promoting an opportunity might be required to ensure that all of the principal’s disclosures were given to prospective purchasers, they would not be required to make additional individual disclosures or compute additional earnings calculations.<sup>54</sup>

It is essential for any final rule to distinguish between the obligation to make standardized disclosures and the obligation to calculate them.

**d. The Rule Should Unambiguously Permit Disclosures Online or in Multimedia Form<sup>55</sup>**

The proposed Rule contains internal ambiguities concerning the permissible form of the required disclosures. The disclosure document required by section 437.3 (the “Disclosure Document”) must be “a single written document” using specific forms and language “set forth in Appendix A to part 437.”<sup>56</sup> By using the phrase “single written document,” the Commission appears to incorporate the definition of “written” contained in section 437.1(r), *i.e.*, “in any form capable of being downloaded, printed, or otherwise preserved in tangible form and read,” including “on computer disk,” “CD-ROM,” “e-mail,” or “posted on the Internet.”<sup>57</sup> But the proposed Rule also requires that a seller “attach a duplicate copy of the disclosure page to be signed and dated by the purchaser.”<sup>58</sup> The requirement that a “duplicate copy” of the disclosure page be “attach[ed]” is inconsistent with the proposed Rule’s recognition that electronic media

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<sup>54</sup> In addition, of course, deceptive and unfair conduct by an independent distributor would violate section 5 of the FTC Act.

<sup>55</sup> This section responds, among others, to Question 9 in the NPR.

<sup>56</sup> 16 C.F.R. § 437.3.

<sup>57</sup> 16 C.F.R. § 437.1(r).

<sup>58</sup> 16 C.F.R. § 437.3(a)(7).

and online disclosure are effective, and with the FTC's statement in its Dot Com Disclosures publication that "[f]or the most part . . . Commission rules and guides that use the words 'written,' 'writing,' and 'printed' will apply online."<sup>59</sup>

Quixtar has found that its IBOs overwhelmingly prefer communication over the Internet, and, therefore, believes that the best method for Quixtar to use to communicate with prospects and current IBOs is by the Internet. It is entirely possible that participants in other business opportunities may prefer or expect a different method of communication. To alleviate any ambiguity, and allow necessary flexibility, Quixtar recommends that the Commission modify section 437.3 so that it clearly permits disclosures and contracting via all types of media, as illustrated in section 437.1(r).

**e. The Rule Should Provide for Less Frequent Updates of Disclosure Documents for More-Established Businesses**

The proposed Rule requires that the information contained in the Disclosure Document be updated "at least quarterly to reflect any changes in the required information."<sup>60</sup> For established sellers such as Quixtar, the information contained in the Disclosure Document is unlikely to change dramatically over the course of a single year. As a result, Quixtar believes that sellers that have been in business for at least five years should be allowed to update any Disclosure Document annually.

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<sup>59</sup> <http://www.ftc.gov/bcp/online/pubs/buspubs/dotcom/> (last viewed July 17, 2006).

<sup>60</sup> 16 C.F.R. § 437.3(b).

## **2. The Seven-Day Waiting Period Should Not Apply<sup>61</sup>**

The proposed Rule imposes a seven-day waiting period after a seller provides a prospective distributor with a Disclosure Document and Earnings Claim Statements; during this time, the prospective distributor is not permitted to sign a contract or make a payment to the seller. This seven-day waiting period was borrowed from the Franchise Rule.<sup>62</sup> Although the waiting period may confer benefits where franchises are concerned, within the context of low-risk business opportunities, a seven-day waiting period would be unnecessary and burdensome.

### **a. A Waiting Period Would Confer No Benefit in Low-Risk Business Opportunities**

Business opportunities like Quixtar are fundamentally different from franchises. Franchises involve major expense, long-term contractual commitments, complex relationships between multiple vendors and the franchisee, and often difficult issues of the likely performance at a specified location. It is entirely appropriate to allow franchisees several days during which to conduct their “due diligence” assessment of a venture that may well involve their life savings and several years of their lives. Quixtar is different. The amount of money required to begin is less than many families spend on dinner and a movie. Furthermore, under Quixtar’s 90 percent buy-back policy, the purchaser can receive a 90 percent refund of the initial outlay, plus a 90 percent refund for any unsold, unused, or undamaged products, during the first year of participation. Also, there is no long-term contractual obligation and there are no territorial issues. For all these reasons, there is nothing to gain by making interested prospects cool their

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<sup>61</sup> This section responds, among others, to Question 7 in the NPR.

<sup>62</sup> The NPR indicates that the Franchise Rule requires a waiting period of at least five business days which “typically works out to be seven calendar days.” 71 Fed. Reg. 19067.

heels for a week before they begin; to the contrary, there is much for legitimate direct sellers to lose through placing a significant burden on their businesses.

**b. A Waiting Period Would Burden Consumers as Well as Entrepreneurs**

Quixtar believes that a waiting period akin to that used in the Franchise Rule would interfere with the business operations of legitimate direct sellers and with prospective purchasers' right to contract. The normal practice in Quixtar, and most other MLM opportunities, is for prospects to sign up and begin selling immediately. This allows prospects to quickly gain valuable personal experience with which to decide if they wish to continue with the opportunity and, if so, how much of their time and energy they want to dedicate to it.

**c. For Business Opportunities that do Not Already Provide a Buy-Back Policy, a "Cooling-Off Period" Would be More Effective Than a Waiting Period**

This is not the first time the Commission has designed protections for consumers involved in person-to-person and in-home sales. The "Rule Concerning Cooling-Off Period For Sales Made at Homes or at Certain Other Locations" ("Direct Selling Rule")<sup>63</sup> established a post-sale "cooling-off period" during which the shop-at-home consumer may cancel the transaction without "penalty or obligation" within three business days.<sup>64</sup>

To the extent the Commission determines that prospective purchasers need additional time to evaluate a business opportunity before incurring financial risk, Quixtar recommends that the Commission adopt a "cooling-off period" similar to that used in the Direct Selling Rule.

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<sup>63</sup> The Rule was originally promulgated on October 26, 1972, 37 Fed. Reg. 22933. Since that time the Commission has periodically reviewed and revised the Rule. 38 Fed. Reg. 30105 (November 1, 1973); 53 Fed. Reg. 45455 (Nov. 10, 1988); 60 Fed. Reg. 54180 (Oct. 20, 1995).

<sup>64</sup> 16 C.F.R. § 429.1(b).

Specifically, a Business Opportunity Rule might allow new distributors a trial period during which they would be able to seek a substantially full refund of their investment. This would be similar to Quixtar's buy-back policy under which an IBO can return unused inventory for the purchase price minus a commercially reasonable service charge of 10 percent. A "cooling-off period" would allow prospective purchasers a type of risk-free (or substantially reduced-risk) business opportunity trial period. If a new distributor chooses, after gaining first-hand experience, not to continue with the opportunity, he or she has put very little money at risk.

### **3. The Disclosure Document Should Not Require a List of References<sup>65</sup>**

The proposed Rule would require that business opportunity sellers include in the Disclosure Document the "name, city and state, and telephone number of at least the 10 purchasers within the past three years who are located nearest to the prospective purchaser's location," or a list of "all purchasers nationwide within the last three years."<sup>66</sup>

#### **a. This Requirement Would be Anticompetitive for Quixtar and Similarly Organized Multilevel Marketing Businesses**

Quixtar IBOs can earn significant income by recruiting new IBOs into their LOS, if the new recruits generate significant product sales. IBOs thus compete with one another to recruit new IBOs and motivate those recruits to generate sales. The proposed Rule would, in effect, require a sponsoring IBO to introduce each prospect to ten other IBOs, each of whom would then have seven-days to try to persuade the prospect to sign up in their LOS instead of the LOS of the IBO who originally recruited the prospect. This would be like requiring a salesman to introduce

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<sup>65</sup> This section responds, among others, to Questions 19 and 20 in the NPR.

<sup>66</sup> 16 C.F.R. § 437.3(a)(6).

his customer to ten competing salesmen and then wait seven days before attempting to close a sale.

There would also be little if any benefit in providing references in a business like Quixtar. Each new IBO joins an existing LOS where he or she can meet and ask questions of other similarly situated IBOs. Since a new IBO is not tied to a long-term contract and can recoup 90 percent of the money spent if dissatisfied with the Quixtar opportunity, meeting other IBOs in the LOS is a viable and vastly preferable alternative to mandatory lists of references.

**b. The Requirement to Provide a List of References Violates the Privacy Interests of Every IBO**

As written, the Rule would require every IBO to give permission to have his or her name, address and telephone number disclosed to every nearby prospect being recruited by any Quixtar IBO. This would violate the IBOs' privacy interests. IBOs are not franchisees. While a few may, most IBOs do not usually have business addresses and business telephone numbers for their Quixtar businesses. In most cases, the only contact information available to disclose would be personal, residential contact information.

Furthermore, providing a list of references would violate all of the Quixtar privacy policies that have existed since 1999. The current privacy policy states in relevant part:<sup>67</sup>

**Sharing Your Information**

Except as disclosed in this Privacy Statement, we do not sell, trade, rent, or otherwise retransmit any Personally Identifiable Information we collect online unless we have your permission. Any Personally Identifiable Information you provide to us will be stored in our databases in the United States.

**1. IBOs**

With a business powered by Quixtar, you'll receive advice and information from your own personal business advisory team -- a support network consisting of your

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<sup>67</sup> <https://www.quixtar.com/Quixtar/PrivacyStatement/> (last viewed July 17, 2006).

sponsoring IBO and upline organization. To allow such communication, we may share your contact information with your sponsoring IBO and upline organization. They have agreed not to share your information with any non-affiliated third parties, and are obligated to observe the intent of this Privacy Statement.

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### **3. General**

We may share Personally Identifiable Information you provide online with other Quixtar-related entities and/or trusted business partners with whom we collaborate, as well as those that provide services to our Site. Where we engage non-affiliated third-party agents or contractors, we require them also to observe the intent of this Privacy Statement.

From time to time, we may be required to provide Personally Identifiable Information in response to court order, subpoena, or government investigation. We also reserve the right to report to law enforcement agencies any activities that we in good faith believe to be unlawful. We may release Personally Identifiable Information when we believe that such release is reasonably necessary to enforce or apply our Terms of Use or to protect the rights, property, and safety of others and ourselves.

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### **Your Choices**

Your permission is always secured first. We will not use or share the Personally Identifiable Information collected on our Site in ways unrelated to the purpose for which you provided the information, including those described above, without providing you a choice whether to permit any such unrelated uses.

The Rule would violate Quixtar's privacy policy regarding the use of personally identifiable information. Last year, 380,000 Quixtar IBOs in North America received bonuses, and all of these IBOs are covered by Quixtar's privacy policy. When individual IBOs join Quixtar, they provide their contact information to be registered as an IBO. They are informed that the information will not be disseminated for purposes that are not contained in the privacy policy.

It is not necessary to explain to the Commission how great are the risks of fraud, invasion of privacy, identity theft, and even crimes of violence that would follow any such mandatory,

wholesale dissemination of personal information. Privacy and personal safety concerns alone would likely deter many, many prospects from trying the Quixtar opportunity.<sup>68</sup>

**c. Requiring a List of References Would be Burdensome for Quixtar**

The mandatory disclosure of a seller's distribution list would raise grave competitive concerns. Quixtar protects its list of IBOs as highly sensitive competitive information. It is both a list of Quixtar's customers and a map of Quixtar's distribution chain. Requiring Quixtar to divulge the full list, or geographic segments of the list, would enable Quixtar's competitors to obtain competitive information concerning Quixtar's organizational structure by merely requesting it through straw men prospects.

Finally, as mentioned previously, 380,000 IBOs in North America earned bonuses from Quixtar last year. Compiling the information required for every IBO would be extremely costly and time-consuming, with little attendant benefit to consumers.

**4. The Disclosure Document Should Not Require a List of Litigation Claims<sup>69</sup>**

The proposed Rule requires that the Disclosure Document list all litigation in which the seller has participated that might relate to "misrepresentations, fraud, securities law violations, or unfair or deceptive practices within the 10 years immediately preceding the date that the business

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<sup>68</sup> To address privacy concerns related to dissemination of current distributors' contact information, the NPR suggests stating within a Disclosure Document that "If you buy a business opportunity from the seller, your contact information can be disclosed in the future to other buyers." 71 Fed. Reg. 19071. As an initial matter, were this suggestion adopted it would not address the privacy concerns of current business owners who entered into a business opportunity without waiving their privacy rights. Second, and most importantly, it would effectively condition participation in a business opportunity upon an individual's waiver of their personal privacy. This would impose an unusual and highly restrictive burden upon the right of individuals to start new businesses.

<sup>69</sup> This section responds, among others, to Questions 13, 14 and 15 in the NPR.

opportunity is offered.”<sup>70</sup> The Notice of Proposed Rulemaking (“NPR”) indicates that “litigation history is material because it bears on the ‘integrity and financial standing of the [seller]’” and that “knowledge of actions of this nature against the seller or other persons associated with the seller would obviously affect a prospective purchaser’s decision to go forward with” the business opportunity.<sup>71</sup>

Quixtar strongly disagrees with this characterization and with the requirement to disclose litigation claims. The proposed litigation history is not limited to “material” claims. It is not limited to meritorious claims. It gives the same weight to the frivolous allegation that is dismissed at the outset as it gives to a criminal conviction. It is structured so that the largest, most successful and longest-established companies will generate the longest list of litigation, simply because bigger companies with more sales representatives and more years of operation are likely to get involved in a larger number of cases. Moreover, fraudsters and operators of deceptive and illegal business opportunities are unlikely in any case to comply with the litigation disclosure requirement.

The potential for prospective purchasers to be misled into believing that litigation on the Disclosure Document indicates a seller’s poor character is compounded by the fact that the proposed Rule appears to prohibit sellers from explaining to prospective distributors the nature of the allegation or the outcome of the litigation.<sup>72</sup> A meritless “unfair practices” claim

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<sup>70</sup> 16 C.F.R. § 437.3(a)(3)(i).

<sup>71</sup> 71 Fed. Reg. 19068, and n.154.

<sup>72</sup> 16 C.F.R. § 437.5(c) prohibits “includ[ing] in any disclosure document . . . any materials or information other than what is explicitly required or permitted by this Rule.” Section 437.3(3)(ii) implies that the only information a seller may provide concerning litigation is “the full caption of each action (names of the principal parties, case number, full name of court, and filing date).”

dismissed early in civil litigation would have exactly the same weight as a criminal conviction. Prospective distributors are unlikely to invest the time (and expense) of researching all the litigation referenced in the Disclosure Document and are far more likely to assume, incorrectly, that every case on the list is another occasion in which the seller engaged in materially unfair practices or fraud.

The proposed Rule requires the disclosure of confidential proceedings, including court cases under confidentiality order and arbitrations in which the parties have contracted for confidentiality. The risk that the proposed Rule might conflict with a court's protective order or an order regarding filing under seal is obvious. The proposed Rule also would require any seller participating in confidential arbitration during the past ten years to breach its agreement of confidentiality with the opposing party. As a practical matter the proposed Rule would prevent business opportunity sellers from entering into confidential arbitration agreements in the future, since the opposing party could destroy the confidentiality of any such arbitration merely by adding a conclusory and meritless allegation of unfair business practices. This would effectively deny business opportunity sellers a form of alternative dispute resolution available to competitors that use more "traditional" methods of distribution. This cannot be the intent of the Commission.

Finally, a litigation list is simply unnecessary for business opportunities that provide a buy-back policy. Since the purchaser will have up to a year or more to exit the business almost risk-free, engaging in a thorough due diligence is not as critical.

## 5. The Rule Should Not Require Public Disclosure of Earnings Substantiation Data<sup>73</sup>

Quixtar agrees with a Rule requiring all individuals and corporations making claims about business opportunities to possess adequate substantiation for their claims. But there should be no requirement to make the underlying substantiation records public.

The proposed Rule requires a seller to provide “written substantiation” documents to anyone who requests them.<sup>74</sup> This would be a marked and unjustified departure from the Commission’s long-established policy of requiring that sellers *possess* substantiation before making a particular claim to the public, but *produce* that substantiation only under appropriate confidentiality protection when required to do so in a law enforcement proceeding.<sup>75</sup> At the heart of this approach has been “tailored, firm specific requests” for substantiation, instead of requirements that firms “industry-wide” produce substantiation for their claims.<sup>76</sup>

For example, Quixtar currently discloses a specific calculation of the average monthly gross income of “active” IBOs. This calculation is based on proprietary and competitively sensitive market research. This information is and always has been available to the Commission and other law enforcement agencies under proper procedures and protections. It could also be discoverable, subject to an appropriate confidentiality protective order, in civil litigation. But requiring its production anytime a competitor or other member of the public requests it would place Quixtar at an unfair competitive disadvantage. The same would be true of every other

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<sup>73</sup> This section of comments responds, among others, to Question 22 in the NPR.

<sup>74</sup> 16 C.F.R. § 437.4(a)(4)(vii).

<sup>75</sup> FTC Policy Statement Regarding Advertising Substantiation Program, 49 Fed. Reg. 30999 (August 2, 1984) *reprinted at* <http://www.ftc.gov/bcp/guides/ad3subst.htm> (last viewed July 17, 2006).

<sup>76</sup> *Id.* at 31000.

business opportunity company. Such a requirement would actually tend to deter business opportunity firms from providing truthful information about the performance and potential of their opportunities, since all such claims would trigger the requirement to disclose the underlying proprietary data publicly. Such an incentive cannot possibly be in the interest of consumers or in the interest of the Commission.

Such requirement to disclose substantiation publicly would also penalize individual distributors. In the Quixtar business opportunity and, we believe, in most MLM businesses, new recruits get much of their information about the income potential of the business from the current distributors who recruit them. Much of this information is personal and anecdotal. It would not be uncommon for a current IBO to make a truthful claim such as “I made enough to buy a new car” or “I am making enough money to cover my house payment.” What written documentation would the sponsor have to disclose to substantiate such a claim? Income tax returns? Mortgage payments? The invoice for a new car? Their tax returns? Personal knowledge claims must, of course, have a factual basis, but requiring distributors to turn over their income details, bank statements or tax filings to prospects or anyone else who requests them is unworkable and inappropriate. Few, if any, distributors would share their personal income experience with prospective distributors if by doing so they were required to publish their personal financial records.

**6. The Requirement to Provide the Number of Cancellation or Refund Requests is Unnecessary and Burdensome, With No Attendant Benefits<sup>77</sup>**

According to Section 473.3 (5) of the proposed Rule, the sellers must “[s]tate the total number of purchasers of the same type of business opportunity offered by the seller during the two years prior to the date of disclosure . . . [and] the total number of oral and written cancellation requests during that period for the sale of the same type of business opportunity.”<sup>78</sup> Under this requirement, Quixtar would have to maintain a database with all purchases and cancellations. As mentioned previously, fewer than 20,000 Quixtar IBOs formally resign each year but a much larger number leave informally by not renewing their annual contract. Because some IBOs work part time and others join to achieve short term goals, such as extra money for holiday gifts, individuals are constantly entering and exiting Quixtar. As a result, the data would have to be recalculated on a daily basis, something which would obviously be extremely burdensome for Quixtar. Also, given the fact that individuals join and leave for various personal reasons unrelated to Quixtar, any information on cancellations that is provided to prospective purchasers would be of little, if any, benefit.

**IV. Conclusion**

Millions of Americans participate today in legitimate, non-deceptive business opportunities where the initially required payment is very low and financial risks are far below the threshold of the old Franchise Rule. Quixtar requests that the Commission hold an appropriate number of regional workshops to ensure that all interested individuals have a full opportunity to be heard, and the Commission is able to understand as fully as possible the vast

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<sup>77</sup> This section of comments responds, among others, to Question 16 in the NPR.

<sup>78</sup> 16 C.F.R. § 437.3(a)(5), *available at* 71 Fed. Reg. 19088.

and diverse universe of small businesses that would be impacted by the proposed Rule. No doubt some affected individuals will submit written comments, but others will be uncomfortable doing so. Moreover, because the scope of the proposed rule is so broad, it is difficult for any written comment, of any length, to deal with all the relevant issues. Many of the most important issues will be better explored in a setting where the Commission staff can ask follow-up questions or workshop panel members can engage in dialog. It is essential for the Commission to understand as fully as possible the nature and operations of the many legitimate business opportunities currently operating (not just Quixtar) so that the final proposed Rule will prevent unfair and deceptive practices without stifling competition, innovation, and opportunity for millions of current and future American entrepreneurs.

Respectfully Submitted,

Alticor Inc. (on behalf of Quixtar Inc.)

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