

BEFORE THE
FEDERAL TRADE COMMISSION

COMMENTS OF
THE DIRECT SELLING ASSOCIATION
ON THE
NOTICE OF PROPOSED RULEMAKING FOR THE BUSINESS
OPPORTUNITY RULE

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Joseph N. Mariano
Misty Fallik
Dean A. Heyl
John W. Webb
Neil H. Offen

Direct Selling Association
1667 K Street, NW, Suite 1100
Washington, DC 20006-1660
www.dsa.org

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EXECUTIVE SUMMARY

The following is a summary of the key points raised by the Direct Selling Association (DSA) in our submission, points supported by surveys, data, experience, interviews and legal analysis. DSA is the non-profit national trade association of the leading firms that manufacture and distribute goods and services sold directly to consumers by personal presentation and demonstration, primarily in the home. More than 200 companies are members of the association, including many well-known brand names, doing approximately 95 percent of the industry's U.S. sales. There are also over 1,300 direct selling companies that are not members of the association.

Legitimate direct sellers play an important role in the national economy. For example, they permit providers of new products and services to enter the market more economically, offer a flexible, part-time opportunity for individuals to supplement their income, and broaden the array of product and service choices available to consumers. Unfortunately, fraudulent and unscrupulous businesses have often either passed themselves off as, or been confused with, the many legitimate companies that use the direct selling business model. DSA understands that the proposed business opportunity rule is intended to protect the public from the unfair and deceptive practices of these fraudulent operators, particularly those that operate work at home and pyramid schemes. Any meaningful and effective business opportunity regulation must recognize the fundamental differences between such business opportunity frauds and legitimate direct selling activities. However, the rule proposed by the FTC fails to do so and as a result of that failure would unnecessarily subject legitimate direct sellers to onerous requirements that would impose significant financial and administrative burdens while at the same time reducing the attractiveness and therefore success of direct selling.

There are several ways that the FTC could revise the proposed rule to ensure that legitimate direct selling companies are excluded. For example, the FTC might:

- Exclude from the rule's provisions those business opportunity sellers whose opportunities carry minimal (or no) cost or risk.
- Retain the definition of business opportunity contained in the Franchise Rule, which does not include most or all direct sellers.
- Better define "business opportunity" to cover to work at home, vending machine, and similar schemes, and not include direct sellers.
- Exempt companies that adopt and adhere to a set of industry best practices, including, for example, requirements relating to who lesale inventory purchases protected by buyback policies and/or a "cooling-off" right for salespeople.
- Exempt companies that are subject to a self-regulation process such as that offered by DSA.

DSA cannot overstate the harm to legitimate direct sellers that would result from the proposed rule. The rule presents two potential costs to legitimate direct sellers – the expenses associated with compliance and the impact of decreased business activities. With respect to compliance, the FTC has dramatically underestimated the time, effort, and expense necessary to collect information and provide disclosures for the array of issues addressed in the proposed rule. One company alone estimates that it would be faced with the responsibility to print and distribute some 15 million pieces of paper over a three year period as a result of the proposal. The FTC has also failed to acknowledge the significant harm to legitimate direct sellers, i.e., the loss of business that would occur if they were subjected to the requirements of the proposed Rule. Several of the most problematic requirements are addressed below.

The waiting period requirement in the proposed Rule is impractical and will fundamentally and adversely alter the way in which direct selling operates. The proposed rule requires that individuals wait at least seven days after they first express interest before they can sign up as a direct seller. Much legitimate direct selling recruiting takes place in personal, social meetings, often in a customer’s home and often in a group. Interested recruits are ordinarily signed up on the spot. Imposing a waiting period would significantly increase the amount of time direct salespeople, most of whom work part time, would have to devote to recruiting activities, would divorce the transaction from the social interaction to which it relates, and would delay the earning opportunity for the prospective direct salesperson. Moreover, because one of the hallmarks of the direct selling business model is its ease of entry, this change would certainly result in the loss of interest by many recruits. Indeed, a recent survey of the general public indicated that the level of interest in direct selling by a prospective direct seller would drop at least 33 percent if a waiting period were instituted, and among those expressing the greatest likelihood of entering direct selling, the interest level would drop 57 percent. If the FTC continues to pursue a business opportunity rule, DSA urges the FTC not to include any waiting period, but instead to consider more realistic and less burdensome alternatives such as providing “cooling off periods” in which direct salespeople have an opportunity to cancel their relationship and receive a full refund.

The legal action disclosure requirement in the proposed rule is overbroad and unmanageable and will likely produce significant unintended consequences. The proposed rule requires that sellers of business opportunities disclose a list of civil or criminal legal actions for misrepresentation, fraud, securities law violations or unfair or deceptive practices involving the seller, its affiliates, officers, directors, sales managers or potentially, the millions of individuals who sell for them dating back ten years. Much of the legal action required to be disclosed by the proposed rule will be irrelevant to a prospective purchaser, most notably those actions which are unrelated to business opportunity sales. Moreover, while it is not clear, the proposed rule could be interpreted to require a direct selling company to disclose litigation involving any member of its independent contractor sales force. Many DSA members, some of whom have sales forces of hundreds of thousands, would have no feasible way to comply with such a requirement. Also, requiring direct selling companies to disclose legal actions to recruits encourages unscrupulous competitors to file more suits to gain a competitive advantage. The overall effects will again be to unnecessarily discourage recruits from pursuing legitimate direct selling activities and to harm the businesses of current direct

salespeople. The mere listing of legal actions, including ones won by the company, would have a chilling effect on potential recruits, 90 percent of whom are seeking modest goals from their involvement in direct selling. A recent survey indicated that the level of interest in direct selling by a prospective direct seller would drop at least 29 percent if this burdensome disclosure was instituted, and among those expressing the greatest likelihood of entering direct selling, the interest level would drop 43 percent. If the FTC continues to pursue a business opportunity rule, DSA urges the FTC not to include any legal action disclosure requirement.

The cancellation and refund disclosure requirement in the proposed rule would be difficult to comply with and would provide prospects with little useful information.

The proposed Rule requires direct selling companies to record and track all opportunity sales transactions. Because of the sheer number of transactions (a function of, among other things, the ease of entry into and exit from the industry, recording and tracking that information would impose a significant, new burden on direct sellers. At the same time, that information would likely be of relatively little use to recruits because even a high turnover rate likely is a reflection of the nature of the industry, instead of an indication of a problematic seller. If the FTC continues to pursue a business opportunity rule, DSA urges the FTC not to include disclosures about direct selling cancellations and refunds, as they are not indicators of fraud or deceit in our industry. On the contrary, our high turnover rate is a sign of the vitality of our industry and the ease of entry and egress.

The references requirement in the proposed rule disregards the privacy and property rights of recruits and sellers, respectively, and is simply not workable.

The proposed rule would require direct sellers to disclose the names and contact information of current members of their sales forces without those members' authorization, and to disclose such information for future salespersons based on a simple disclaimer in the proposed disclosure document. This requirement provides woefully inadequate protection for direct salespeople's personal information and flies in the face of the FTC's commitment to protecting privacy. In addition, the names and contact information of their salespersons constitute a direct selling company's most valued trade secret and therefore should not be subject to compulsory disclosure. Finally, the option in the proposed rule to disclose the ten closest prior "purchasers," while arguably appropriate for business opportunities as historically understood is simply unworkable for direct sellers, at least for those direct selling companies with sizeable sales forces. Not surprisingly, the references requirement would significantly harm direct selling. A recent survey indicated that the level of interest in direct selling by a prospective direct salesperson would drop at least 38 percent if this reference requirement were instituted, and among those expressing the greatest likelihood of entering direct selling, the interest level would drop 71 percent. If the FTC continues to pursue a business opportunity rule, DSA urges the FTC not to include any references disclosure requirement.

Finally, the earnings claims disclosure requirement is too complicated and not useful *vis a vis* direct sellers. For example, the proposed rule requires disclosure of "[a]ny characteristics of the purchasers who have achieved at least the represented level of earnings, such as their location, that may differ materially from characteristics of the prospective purchasers being offered the business opportunity...." Because it is impossible to know with any degree of certainty what demographic/geographic and other

factors might affect the earnings of direct sellers, and what impact they might have, direct sellers will have no practical way to comply with this provision. The Commission should allow greater flexibility in the form and substance of any earnings disclosures. If the FTC continues to pursue a business opportunity rule, it should consider allowing multiple forms of earnings disclosures and substantiation, including the prominent use of disclaimers in connection with earnings claims. DSA also urges the FTC to adopt a narrower more and specific definition of “earnings claims” than the one that has been proposed.

Conclusion

DSA supports and shares the FTC’s goal of ridding the marketplace of fraudulent business opportunities. The proposed rule, however, would cast far too wide a net and in doing so would harm and possibly destroy many legitimate, lawful direct sellers. The proposed rule would also likely unnecessarily discourage many prospects from pursuing beneficial direct selling activities. Therefore, if the FTC continues to pursue a separate business opportunity rule, DSA urges the FTC to exclude from its requirements those legitimate, lawful companies that use the direct selling business model. DSA also urges the FTC to remove and/or limit many of the onerous or misguided requirements in the proposed rule, including those relating to a waiting period, legal action disclosures, cancellation and refund disclosures, references, and earnings claims. Direct selling companies are not sellers of business opportunities and should be exempted from any business opportunity fraud rule. DSA looks forward to continued participation in the rulemaking process.

I. Introduction and General Background

The Direct Selling Association (DSA) is pleased to have this opportunity to provide comments on the Notice of Proposed Rulemaking for the Business Opportunity Rule to the Federal Trade Commission published in the Federal Register on April 12, 2006. DSA believes it critical to eliminate business opportunity fraud, as well as any confusion that might exist between legitimate direct selling activities and such frauds. In that spirit, the goal of our comments is to:

- Explain why legitimate direct sellers should not be covered by any new business opportunity rule,
- Describe the practical difficulties for direct sellers if subjected to the rule as drafted,
- Offer ways in which the rule might be more narrowly drafted to cover only those business opportunities that are truly likely to defraud potential purchasers, and
- Discuss the limitations of the proposal in reducing or eliminating true business opportunity fraud.

Founded in 1910, DSA is the non-profit national trade association of the leading companies that manufacture and distribute goods and services sold directly to consumers by personal presentation and demonstration, primarily in the home. More than 200 companies are members of the association, including many with well-known brand names. DSA's mission is "To protect, serve and promote the effectiveness of member companies and the independent business people they represent. To ensure that the marketing by member companies of products and/or the direct sales opportunity is conducted with the highest level of business ethics and service to consumers." DSA addresses federal and state legislative and regulatory issues, conducts an independently administered code of ethics program that protects both customers and salespeople, serves as a clearinghouse for information, develops executive educational seminars, conferences and workshops, conducts industry research, develops advocacy programs, and provides industry leadership in addressing issues of public concern. Over 13.6 million individuals sold for direct selling companies as independent contractors¹ with estimated retail sales

¹ Direct sellers are treated as independent contractors for federal income tax purposes under 26 U.S.C. Sec. 3508. The term "direct seller" means any person if - (A) such person -(i) is engaged in the trade or business of selling (or soliciting the sale of) consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis which the Secretary prescribes by regulations, for resale (by the buyer or any other person) in the home or otherwise than in a permanent retail establishment, (ii) is engaged in the trade or business of selling (or soliciting the sale of) consumer products in the home or otherwise than in a permanent retail establishment, or (iii) is engaged in the trade or business of the delivering or distribution of newspapers or shopping news (including any services directly related to such trade or business), (B) substantially all the remuneration (whether or not paid in cash) for the performance of the services described in subparagraph (A) is directly related to sales or other output (including the performance of services) rather than to the number of hours worked, and (C) the services performed by the person are performed pursuant to a written contract between such person and the person for whom the

of \$29 billion in 2004.²

A. Direct Selling is Well-Known and Respected in the American Marketplace

DSA defines direct selling as:

The sale of a consumer product or service, in a face-to-face manner, away from a fixed retail location.

Direct selling is conducted in more than 150 countries, through some 58 million salespeople, with retail sales in excess of \$100 billion.³ The average age of our DSA member companies is more than 22 years. Many of our firms, both in the United States and abroad, are over 25, 50, 75 and even 100 years old. DSA itself will celebrate its 100th birthday year in 2010.

In addition, the industry enjoys solid growth, due both to new companies choosing the direct selling model, and established retailers finding direct selling to be an effective way to reach new consumers. Within the past several years, direct selling as a channel of consumer product distribution has been “discovered” by investment firms, venture capitalists, manufacturers, retailers and direct marketers, both foreign and domestic. The press has also shown increasing interest in our business from the business pages to the lifestyle section.⁴ During the last five years, we have seen dozens of the biggest firms in consumer product marketing enter our industry, expand their positions, or join DSA as subscriber members to seriously investigate entry into our ranks.

Every country that hosts a direct sales firm has indigenous direct sales firms as well, often in start-up modes or fairly young. These will be particularly and dramatically overburdened by many of the provisions of the Rule. The burdens applied to us here, must be calculated and weighed against the *de minimis* value to investors in business opportunities in the United States.

Nearly every culture shares a heritage of direct selling. In the United States, the earliest direct sellers were Yankee Peddlers who carried their wares across the prairie. They traveled by land primarily until rivers and lakes became connected by canals. Then, direct selling in early America branched out to the frontiers of the West and the Canadian territory in the north.

The selling tradition continued to thrive through the end of the 19th century and into the 1900s. The advent of the home party in the 1950s added a new dimension to direct selling as customers gathered at the homes of hostesses to see product demonstrations

services are performed and such contract provides that the person will not be treated as an employee with respect to such services for Federal tax purposes.

Similarly, direct sellers are considered independent contractors under other federal and state law.

² DSA 2005 Growth and Outlook Survey.

³ *Worldwide Direct Sales Data*, WFDSA, May 17, 2006.

⁴ See, Appendix J.

and socialize with friends. Direct selling offered opportunities for many who had previously run into barriers because of age, education, or gender. The growth of the industry allowed many to become successful where no opportunity had existed before.

i. Economic and Social Impact of Direct Selling

The direct selling industry's economic contributions can be measured in terms of income, sales and workforce impact, including independent contractor activity and employment. Based on a Social and Economic Impact Study conducted by Ernst & Young,⁵ it is estimated that the direct, indirect, and induced economic effects of the industry's activities in the United States totaled more than \$72 billion in 2004,⁶ highlighted by the following data:

a. Income

The industry's direct income impact of \$13.0 billion generated an estimated additional \$14.8 billion of indirect and induced United States personal income through indirect and induced effects. This means that, when combined with the direct income of \$13.0 billion, the total income impact is \$27.8 billion.⁷

b. Sales

While direct selling companies generated an estimated \$29.7 billion of sales, the additional impact of production activities, capital investment, and purchases by direct sellers generates an additional \$2.7 billion of output, resulting in total direct sales of \$32.4 billion. When combined with the \$39.7 billion of indirect and induced effects from supplier purchases and employee consumption, the industry's total sales impact in the United States is \$72.1 billion.⁸

c. Workforce Impact (Including Independent Contractor Activity and Jobs)

As noted previously, more than 13.6 million people participated in the direct selling industry as independent contractors selling products and services. The purchases of direct selling companies and the spending of their employees and independent contractor direct sellers generated an additional 334,700 jobs. Thus, the total workforce impact of the direct selling industry is 13.9 million people.⁹

⁵ Estimated Social and Economic and Social Contributions of the U.S. Direct Selling Industry, Ernst & Young, Feb. 15, 2006.

⁶ *Id.* at iii.

⁷ *Id.* at 5.

⁸ *Id.* at 4.

⁹ *Id.* at 3.

d. Indirect and Induced Contributions

The direct selling industry makes additional contributions to employment and income through economic linkages with other industries. As the direct selling industry grows, the firms that supply the industry also grow. These linkages result in the “indirect” economic contribution, which occurs as the direct selling industry buys products and services from other United States companies (e.g. suppliers of merchandise, office supplies, shipping services, etc.). The direct selling industry’s purchases contribute to a higher level of economic activity among supplier firms. As these firms expand their sales, they require additional employees and operating inputs.

Second, the income earned by the direct sellers and employees of direct selling companies and their suppliers generates consumer spending. Additional household consumption (increased demand) generates economic activity when merchants, service providers, and other firms that supply household consumption increase their sales. The increased level of sales creates additional demand for inputs from suppliers and labor from households.¹⁰ Direct selling as an alternative channel of distribution also increases competition in the marketplace, thereby helping to reduce costs of products and services to consumers.

e. Fiscal Contributions

The direct selling industry’s contributions to jobs, income, investment and research and development also result in increased tax collections. The direct selling companies, their employees and direct sellers are estimated to pay nearly \$2.2 billion in tax payments. Indirect economic impacts from supplier purchases and consumer purchases generate more than \$4.4 billion in taxes. The combined total contribution of additional tax payments resulting from indirect and induced employment, investment, and research and development activity is estimated to be \$6.6 billion in 2004.¹¹

f. Social Contributions

The direct selling industry makes a substantial economic contribution to the United States economy. While economic contributions are more easily measured, the industry also contributes considerably to the quality of life enjoyed by many Americans. Supplementary income, work schedule flexibility, and the entrepreneurial aspects of the profession are some of the major benefits cited by direct sellers.¹² These social contributions are no less important than the economic contributions discussed above.

In addition, direct selling companies gave an estimated \$90 million to charitable causes in 2003. When asked if they contribute any money, goods or services to social programs, 89

¹⁰ *Id.* at 10-11.

¹¹ *Id.* at 12.

¹² *Id.* at 14.

percent of the direct seller respondents said they contributed to human services programs and charities.¹³

ii. The Well-Known Direct Selling Business Model

Direct selling is a well-known and frequently cited business model. The Direct Selling Association typically refers to two different types of sales strategies when describing the direct selling business model: person-to-person and party plan. Additionally, there are several ways of compensating direct sellers.

a. Person-to-Person Sales

Person-to-person sales typically involve one seller and one or two customers in a sales demonstration. The seller of the product has typically made an appointment with the customers in advance, most often through a referral or other similar method of prior contact. Sales often take place in the home, but can take place in other location such as an office, over the internet, or any other mutually-agreeable location. Products often sold through a person-to-person strategy include vacuum cleaners, wellness and nutritional products, as well as services such as financial services and utilities.

Door-to-door selling is also a sales strategy used by a few companies, although what many typically envision when thinking of door-to-door selling has become rare in today's society. Traditional door-to-door selling involves a salesperson "cold-calling" on residents in a particular neighborhood. Companies that use this sales strategy have begun to rely more and more on referrals and appointments to meet with customers. "Cold-calling" is defined as knocking on a door to sell a product without a prior appointment.

b. Party Plan Selling

In a party plan scenario, the independent consultant will typically go to the home of a hostess who has invited her friends and family to see the sales demonstration. The event is usually social in nature, and food and beverage are often provided. After the demonstration, guests can place orders with the consultant. In the party plan scenario, the consultant typically receives a commission from the sales made at the party, while the hostess often receives free or discounted products based on party sales. Products sold through a party plan model can include just about any consumer product from cosmetics and spa products to scrapbooking supplies, housewares and pet products. Often, charitable and civic organizations use a party plan firm to conduct the demonstration and sales as a fundraiser for the organization.

¹³ *Id.* at 23.

places undue burden on legitimate direct selling businesses. Direct selling companies provide ethics and sales training for both salesforce regarding effective, ethical selling and recruiting practices via audio and video tapes, in-person seminars, workbooks, conference calls, Internet-based training, and other resources. Ironically, the training practices of direct selling companies might very well constitute “business assistance” as broadly defined in the proposal and would trigger the requirements of the proposed Rule, thus penalizing the companies which have demonstrated their commitment to avoid the very problems the proposal seeks to address.

Of course, when true business opportunity frauds described by the Commission compare themselves to direct sellers, the members of the Direct Selling Association, their customers, salesforces, employees, and ultimately the public, are harmed. DSA supports the Commission and other authorities in their continuing efforts to combat fraud. While we believe that there are many tools available for the prosecution of these frauds,²⁴ we have not hesitated to work with policy makers to strengthen the legal arsenal that might be used against them. Thus, DSA has argued forcefully for many years that while the Franchise/Business Opportunity rule should be strengthened, it should also distinguish legitimate direct selling companies from business opportunity frauds.

In comments to the Commission in both 1995 and 1997,²⁵ DSA expressed its support for a refined, limited definition of “business opportunity” separate from that of a franchise. DSA also urged that any new definition not include legitimate direct sellers (including those that used a multilevel form of compensation) and should follow the example of state laws in this regard (none of which define direct selling activities as business opportunities.)²⁶ We continue to believe that any franchise or business opportunity regulation(s) should recognize the fundamental differences between legitimate direct selling activities and business opportunity fraud. Such regulations(s) should be careful not to impose unnecessary and overly burdensome requirements on legitimate activity. The NPR notes the importance of this balance in its description of the history of the current Franchise Rule:

[The Commission] therefore sought to strike the proper balance between prospective purchasers’ need for pre-sale disclosure and the burden imposed on those selling business arrangements....

²⁴ State laws include; Georgia (Ga. Code Ann Sec.16-12-38); Kentucky (Ky. Rev. Stat. Ann Sec.367.830); Louisiana (La. Rev. Stat. Ann. Sec. 51:361 to 363); Maryland (Md. Ann. Code Sec. 27-233D); Montana (Mont. Code Ann. Sec. 30-10-324 to 325); North Carolina (N.C. Gen. Stat. Sec. 14-291.2); Oklahoma (Okla. Stat. Ann. Sec. 1072); Texas (Tex. Bus. & Comm. Code Ann. §17.461); Utah (Utah Code Ann Sec. 76-6a-1 to 76-6a-1); Virginia (Va. Code Ann. Sec. 18.2-239); Washington (Chapter 65 – Laws of 2006). Similarly on a federal level, Sec. 5 of the FTC Act exists.

²⁵ See, Appendix C.

²⁶ See, Appendix I.

[W]hen 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**²⁷ (emphasis added).

The Commission acknowledges in its NPR that the “scope of coverage of the proposed Rule is **much broader** than that of the Franchise Rule,”²⁸ (emphasis added) and justifies this extraordinary, proposed expansion with its assertion that the new “compliance burden is much lighter.” We challenge this assertion. In fact the requirements of the proposed Rule represent an entirely new and extraordinary burden for direct selling.

Thus, we urge the Commission to strike the proper balance between the Rule’s utility and its burdens and costs; legitimate direct sellers should not be covered by any new business opportunity rule.

Section III of this submission sets out a number of alternatives, that if adopted by the Commission, will more accurately define the business opportunity frauds the Commission seeks to address or otherwise clarify that legitimate direct selling companies will not be covered by any final Rule.

B. Legitimate Direct Sellers are Not the Source of Business Opportunity Fraud

The FTC has described “work-at-home schemes” as being rife with fraud and misrepresentation. The Commission describes such schemes in some detail:

Sellers of fraudulent work-at-home opportunities deceive their victims with promises of an ongoing relationship in which the seller will buy the output that opportunity purchasers produce. These sellers often misrepresent that there is a market for a purchaser’s goods and services, just as sellers of fraudulent vending machine and rack display opportunities falsely claim that profitable vending locations are available. Work-at-home opportunity sellers often claim to provide ongoing training and other assistance...²⁹

The Commission cites envelope-stuffing and medical billing work-at-home schemes as examples.³⁰

Clearly, direct sellers are not engaged in these types of activities. Direct selling companies do not promise an ongoing relationship in which the company will purchase what an individual direct salesperson produces. Indeed, individual direct sellers do not “produce” such goods. Direct selling companies thus cannot and do not represent that

²⁷ NPR at 4.

²⁸ NPR at 6.

²⁹ NPR at 18.

³⁰ *Id.*

complaints and demonstrates the level of DSA member commitment to consumer protection and satisfaction.

Similarly, a review of 2005 *Council of Better Business Bureaus* data reveals that over 755,000 general consumer complaints were received. Multi-level companies accounted for 215 of those complaints, and were ranked 456th in complaints. Only 49 percent of those complaints were not resolved, a 74 percent settlement rate. By contrast, work-at-home schemes were ranked 37th in the number of complaints and business opportunities were ranked 82nd in complaints, with settlement rates of only 50 percent and 59 percent, respectively.³³

C. Legitimate Direct Sellers Will be Unnecessarily and Greatly Damaged by Imposition of the Proposed Requirements

DSA believes that in its effort to protect the public from business opportunity frauds costing less than \$500, the FTC has proposed a rule which will impose enormous, potentially devastating costs on legitimate direct sellers. Further, we believe that these costs far outweigh any potential benefit that might accrue from this way of addressing business opportunity fraud. While the public policy goal of protecting prospective purchasers from business opportunity frauds is a laudable one, we fear that the proposed Rule would enact new regulation at the cost of overly burdening legitimate businesses, while not significantly affecting fraudulent activity. We question the Commission's assertion that the "expansion of Rule coverage...would be balanced by drastically reduced compliance costs"³⁴ in that direct selling activities will now be subject to a rigorous new set of requirements. Where before there were no compliance costs for direct sellers as a result of the Franchise Rule, there will in fact now be dramatic *new* costs, both in direct expenses and effects on our business.

The proposal would eliminate the existing required payment threshold and would broaden the definition of a "business opportunity" by specifying that either the making of an earnings claim or the promising of "business assistance" will trigger coverage. The definitions of "business assistance" and "earnings claim" are so broad as to result in potentially all direct selling companies being pulled within the proposed Rule coverage. The imposition of a new regulatory regime would be challenging for any business; the effect of this proposal on direct selling would be devastating.

The process of becoming a direct salesperson is now relatively simple for the company, the recruiting salesperson, and the prospective salesperson. This ease of entry into (and exit from) direct selling explains the continued appeal of direct selling in the United States, and the large number of people who come in and out of our business as they meet their typically limited financial goals (*see* the discussion of the seven types of direct salespeople *supra*).

³³ <http://www.bbb.org/about/stat2005/us05reposit.pdf> (lasted vis ited on Jul. 16, 2006)(3.3 percent of multilevel complaints were not pursuable).

³⁴ NPR at 76.

interested,” or “interested” in the direct selling opportunity declines more than 40 percent if all three requirements were to be imposed. When the analysis is narrowed to U.S. adults who were “extremely interested” or “very interested” in the direct selling opportunity (the adults most likely to become direct sellers), the decline in interest with the three proposed requirements is even more pronounced (almost 66 percent).³⁹

b. The Reaction of Direct Sellers to the Requirements – Survey Results

In addition to the Harris Survey of U.S. adults, a survey was conducted of U.S. direct sellers about the FTC’s Proposed Business Opportunity Rule. The survey was conducted online, and direct selling companies were invited at the end of June 2006 to distribute to some of their direct sellers a link to the Web page with the survey. By July 10, 2006, 6,951 direct sellers had submitted complete surveys; again, results were analyzed by Nathan Associates.⁴⁰

To measure the potential impact of the three proposed requirements, the survey asked if the direct salesperson would consider signing up with a direct selling company if the three requirements were in effect. Sixty percent said they would not consider signing up with the waiting period requirement; 76 percent would not with the references requirement, and 80 percent would not sign up were there a legal disclosures requirement. If all three requirements were in effect, only 15 percent would have considered signing up. This 85 percent reduction in possible recruits would be devastating in impact on direct selling. Even more disturbingly, those respondents with the greatest recruitment success or the longest tenure were the most likely to say they would be discouraged by the proposed requirements. This suggests that that people with the will and ability to become sales leaders would not sign up with direct selling companies if these three requirements were in effect.⁴¹

c. Reduction in Sales and Economic Impact

To illustrate the impact of the potential reduction in recruitment and sales activity, consider that an 80 percent reduction in recruitment and attendant sales would cut direct retail sales volume by \$24 billion with a decrease in the economic impact of direct selling on the US economy of \$57.6 billion. A 30% reduction in recruitment and attendant sales would cut direct retail sales volume by \$9 billion with a decrease in the economic impact of direct selling on the US economy of \$21.6 billion. Even a 10 percent reduction in sales would mean some \$3 billion in lost direct retail sales volume and a decrease in the impact on the economy of \$7.2 billion.⁴²

³⁹ *Potential Impacts of the FTC’s Proposed Business Opportunity Rule on the Direct Selling Industry*, Nathan Associates Inc., Jul. 14, 2006.

⁴⁰ *Id.* at 4.

⁴¹ *Id.*

⁴² *See*, economic impact discussion, *supra*.

In a franchising operation, a prospective franchisee is considering starting a full-time business and investing significant funds; thus the prospective franchisee is motivated to review the disclosure statements and follow-up. In direct selling, the interaction between prospect and the current direct salesperson is frequently a social one. The prospective direct salesperson will be part-time, makes only a very small (and often refundable) investment, and is not intent on researching a business. She would thus be far less likely than the prospective franchisee to need or want to review the disclosures and then follow-up.

Unfortunately, any waiting period is likely to inconvenience enthusiastic individuals anxious to participate in direct selling opportunities that present little or no risk, or otherwise create an “air of suspicion,” as one concerned direct salesperson has put it,⁴⁶ around the activity that could be highly discouraging to existing and prospective direct sellers.

Many people become involved in direct selling not because they are looking for a business or franchise opportunity, but because they have experienced the enjoyment of a direct selling home party, have seen the effectiveness of personal explanation and demonstration of a product, or witnessed the satisfaction of a customer purchasing through direct sales. They are attracted to direct selling because they know that it is an easy, low-risk way to quickly earn some additional income for a myriad of personal reasons. During the direct sales presentation, many are inspired to participate and are thus recruited into direct selling. The review period contemplated by proposed Section 437.2 would divorce this experience from the act of becoming a direct seller, would introduce a delay into the process that would dampen the prospective direct sellers’ initial interest, fog her recollection of the appeal of direct selling, and complicate and delay the interaction of recruiter with prospect so as to lessen the chance of the individual’s participation.

Consider this scenario – a direct salesperson might encounter a prospective recruit in almost any setting, including an organized direct selling party, at work or at other social events. Often a prospect may sign up after an initial conversation and presentation

⁴⁶ “The proposed rules from the FTC create an air of suspicion about direct selling and removes the spontaneity of the industry. I think this air of suspicion creates a negativity and a fear that closes people’s minds. When a person is considering making a change or going in a new direction, they have natural apprehensions and reservations. I don’t think it helps them to add an air of suspicion unnecessarily and unfairly. The proposed rule will most assuredly make people think twice about direct selling. In fact, it will result in a dramatic reduction in recruiting new independent salesforce members. Even as a Harvard Business School graduate, I’m not sure I would have gotten involved in direct selling had I been presented with excessive reporting and paperwork, and pages and pages of litigation history. What a major loss that would have been in my life and the lives of others.”

--Gloria Mayfield Banks, Mary Kay, 18 years in the direct selling industry

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Such a right of rescission or “cooling off” is not only analogous to the FTC’s home solicitation sales rule⁴⁹ but is one familiar to the direct selling industry. When adopted in June 1974, the rule effectively put an end to the perception (and sometime reality) of high pressure door-to-door sales by allowing a consumer three business days to rescind the transaction. That rule was welcomed by direct sellers because it struck an appropriate balance between the need to protect consumers and the need to impose the least burdensome regulation possible on legitimate businesses. A “cooling off” for business opportunities would, we suggest, achieve that same balance.

- e. The Requirement for Disclosure of Legal Actions Is Drafted Too Broadly, Will Be Impossible to Effectively Comply With, and Could Be Confusing to Users of the Information

Section 437.3 (3) of the proposed Rule requires that sellers of business opportunities provide disclosures regarding all legal actions (regardless of outcome) concerning “misrepresentation, fraud, securities law violations, or unfair or deceptive practices” over the previous ten years. This disclosure would include civil court cases and arbitrations, all governmental actions including criminal matters and administrative law actions, including cease and desist orders or assurances of voluntary compliance. This requirement that direct sellers create, monitor and maintain, update and then make available, a report on such a broad scope of “litigation” would be an impracticable burden. The rule would require disclosure of litigation *potentially unrelated*⁵⁰ to the business opportunity transaction, as well as litigation that was favorably resolved for the business opportunity seller, settled, or otherwise completed in such a way as to be irrelevant to the recipient of the report. Many commercial enterprises today face the challenge of frequent litigation.⁵¹ These legal actions might involve claims of misrepresentation, yet have no relevance to the purchase or sale of a business opportunity. Annette Pelliccio, Owner of The Happy Gardener, a small direct selling business, with three years in the direct selling industry describes the potential difficulties with such a requirement:

As an inexperienced businesswoman, I was put in a very unfortunate situation with a dishonest bookkeeper a year ago. I was fortunate that the suit was dropped and never did end up in court. If it had gone to court even though the outcome would have been in our favor, my company’s credibility and my customers’ trust

⁴⁹ 16 CFR Part 429.

⁵⁰ *E.g.*, two businesses may litigate an intellectual property issue. In the context of such claims (which might have no relationship to business opportunity issues) allegations of misrepresentation might arise. Such litigation must be reported under the proposed rule.

⁵¹ The United States Chamber of Commerce’s Institute for Legal Reform reports, *e.g.*, that more than 17 million cases were filed in state courts alone in 1997.

<http://www.instituteforlegalreform.org/newsroom/index.php?p=factsfigures> (last visited Jul. 16, 2006).

would have greatly decreased if we had to report this situation. We are building a company that is based on doing what's right and the FTC's proposed rule could indicate that we are doing something wrong.

-- View this video clip online at

<http://interface.audiovideoweb.com/lnk/ny60win16091/clip10.wmv/play.aspx> (Jul. 10-11, 2006).

Under the proposal, a ten-year rolling record of such litigation would have to be maintained and distributed to all potential purchasers of a business opportunity. A small direct selling company, which promotes itself to 10,000 individuals per month that experienced a single lawsuit against that company, would be forced to make more than 120,000 disclosures in one year. A larger enterprise, with more litigation to report, and more potential recruits, would suffer a significantly magnified obligation. The vast number of persons annually contacted by our salesforce and solicited to become distributors is massive. Over a given year, we estimate that in excess of 50 million Americans will be so approached, with five million signing up. Each person approached as a prospect would have to be given this disclosure (and others). The practical burdens of complying with this provision will be monumental. While the proposed Rule purports to create a one page disclosure document, the broad (and possibly irrelevant) information required by this provision alone could result in a multi-page form.

Additionally, the proposed Rule as currently drafted is unclear in its scope. A direct selling company, if covered by the rule, might be obligated to report not only litigation involving the company itself,⁵² but also litigation involving any member of its independent contractor salesforce, parent companies, and sister companies (even though those companies may have nothing to do with the offering of the business opportunity.) If thus interpreted, the proposed Rule would create a truly unmanageable burden with regard to this disclosure alone, in that a company would be forced to track such litigation over a ten-year period, maintain a database of that docket, and distribute the information. Again, much of the litigation could be unrelated to the business opportunity.

Finally, the rule may actually encourage litigation in that competitors, detractors, or even extortionists would recognize that such legal action would have to be reported, and might bring unwarranted litigation in an effort to harm the recruiting and sales efforts of the subject company.

The Harris Survey indicated that the level of interest in direct selling by a prospective direct salesperson would drop at least 29 percent if this burdensome disclosure was instituted. Among those expressing the greatest likelihood of entering direct selling, the interest level drops 43 percent.⁵³ Among direct sellers, 80 percent report that they would

⁵² See, Section 437.3 (a)(3)(i)(B) requiring that legal actions involving any "affiliate" of the business opportunity seller be reported. See also, Section 437.3(a)(3)(i)(C) requiring such a report regarding a "sales manager" or "any individual who ... performs a function similar to [a] sales manager..."

⁵³ *Potential Impacts of the FTC's Proposed Business Opportunity Rule on the Direct Selling Industry* at 3.

not have signed up with their direct selling company, had this requirement been in place.⁵⁴

f. The Requirement to Provide Disclosures Regarding Cancellations and Refunds Would Be Difficult to Comply With and Could Actually Mislead Users of the Information

Section 473.3 (5) of the proposed Rule would require that sellers of business opportunities “[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 to] [s]tate the total number of oral and written cancellation requests during that period for the sale of the same type of business opportunity.” Given the large number of people who enter and exit direct selling each year (a well understood, accepted and valued attribute of this sales method), this requirement, if applied to direct sellers, would mandate that each direct selling enterprise maintain an enormous database of all business opportunity sales transactions.

Considering the part-time nature of the sales activities of most individual direct sellers and the likelihood that the independent contractors who sell direct often do so to achieve specific, short term objectives, “cancellation” is likely to be artificially high, and misleading in and of itself. No matter the number, the maintenance of this data, and its frequent recalculation, is likely to be an impracticable burden for direct selling companies. Additionally, in light of the large number of people who enter and exit direct selling over the course of two years, the practical utility of the information to individuals who might be interested in becoming a direct salesperson is dubious.

g. The Requirement to Provide References Could Be Impossible to Effectively Comply With, Would Violate Individuals’ Expectations of Privacy, and Could Be Counterproductive

If applied to direct sellers, Sec. 473.3 (6) of the proposed Rule would require that each company maintain a geographically manageable, comprehensive database of individuals who have sold for it for the last three years, including names, cities, states, and telephone numbers. The proposal would require the disclosure of all of these individuals to prospective salespeople, or alternatively, that the identities of ten geographically nearest purchasers be revealed to the prospect.

We are concerned that the proposed Rule could place direct salespeople in the unenviable position of violating privacy laws and revealing confidential, personal information to prospective purchasers, even though persons who are engaged in direct selling are easily located without infringement upon their privacy.⁵⁵ While

⁵⁴ *Id.* at 4.

⁵⁵ For example, this long-time direct seller is fearful that this requirement will significantly impact her successful direct selling business:

the Commission might be correct that “business opportunity purchasers are not readily identifiable” and that they cannot be found “by looking in the yellow pages,”⁵⁶ this is clearly not true regarding direct salespeople, as a quick survey of any hard copy or Internet based-telephone directory demonstrates.

Each reference alternative posed by the FTC is problematic.

Comprehensive Database – Direct selling companies hold the lists of their salespeople as confidential, proprietary information. Indeed, the list of sellers is considered one of a direct selling company’s greatest assets and has been held not subject to disclosure to even government entities for licensing, tax or other purposes.⁵⁷ The proposed Rule would effectively make these lists available to competitors, cranks, solicitors, and any other interested parties.

The potential for breaches of salesforce privacy and confidentiality is incalculable. The proposed Rule would require that existing members of the salesforce be notified that their personal information (including telephone number) “can be disclosed in the future to other buyers.”⁵⁸ We believe that this notice alone could have a significant “chilling effect” on the willingness of an individual to engage in direct sales for fear that they will be subject to invasion of their privacy. Additionally, we do not believe that the dissemination of this information will be limited to other “buyers.” Direct selling companies would be forced to give this information to *anyone* who might claim to be interested in selling; the information could then be used for any purpose. Additionally, given the frequent entry and exit of salespeople from our business, an individual whose name is revealed might no longer be in the business, and not welcome this intrusion.

Ten Purchaser List - Many of the same concerns are raised by the alternative permitted under the proposal that allows for a list of ten purchasers to be provided to a prospective purchaser. By providing such a list to a prospective direct salesperson for the clear purpose of contacting them, there will likely be unintended consequences resulting in confusion, violations of privacy interests of many parties, and ultimately discouragement

“Based on my understanding of the FTC proposed rule, I think, initially, recruiting will come to a standstill which would be disastrous from a business standpoint. I’m also concerned about having to share the names of others. It’s not only a privacy issue, but it may make the recruit feel like there’s no room for them in the business. It’s my experience that there’s a place for everyone who wants to be in this industry. You know, in fact, I wonder if I would have ever joined if I was presented with all that information.”

--Judi Daugherty, Tupperware, 14 years in the direct selling industry.

View this video clip online at <http://interface.audiovideoweb.com/lnk/ny60win16091/clip9.wmv/play.aspx> (Jul. 10-11, 2006)(on file with DSA).

⁵⁶ NPR at 53-54.

⁵⁷ See, e.g., *U.S. v. Duke*, 379 F.Supp. 545 (N.D. Ill. 1974), in which the Court denied a demand by the Internal Revenue Service that a direct selling company give it access to the names of thousands of their independent contractor salespeople.

⁵⁸ See, Proposed Rule Sec. 437(a)(1).

such revelation other than to not participate in direct selling in the first place. We believe the Commission has seriously underestimated the legal, practical, and economic consequences of revealing the identities of these individuals and strongly urge this matter to be more fully considered. As the Commission states, “privacy is a central element of the FTC’s consumer protection mission.”⁶¹ Disclosure of the identity of these individuals is at odds with the privacy rights and considerations of those individuals and the FTC’s own stated standards regarding privacy.

The Harris Survey indicated that the level of interest in direct selling by a prospective direct salesperson would drop at least 38 percent if this reference requirement were instituted. Among those expressing the greatest likelihood of entering direct selling, the interest level drops 71 percent.⁶² Among direct sellers, 76 percent said that if faced with this requirement they would not have begun direct selling.⁶³

h. The Commission’s Proposed Definition of “Earnings Claim” is Too Broad and Attendant Disclosures Unclear

DSA Initiatives on Earnings Claims – DSA strongly supports the proposition that earnings claims should be substantiated and has long required that its members adhere to a firm standard regarding such claims. The DSA Code of Ethics requires that no member company shall “misrepresent the actual or potential sales or earnings of its direct sellers [independent salespeople]. Any earnings or sales representations [that are] made [by member companies] shall be based on documented facts.”⁶⁴ The requirements of the DSA Code were adopted in 1993 and reflect the industry understanding of the standard of federal law regarding such claims.⁶⁵

The DSA Code Administrator responsible for handling complaints under the Code, reports that since 2002, fewer than ten percent of complaints have related to the payment of commissions to salespeople. DSA is aware of the Commission’s focus on misleading earnings claims in business opportunity fraud; despite the relatively low percentage of DSA Code complaints related to such claims, the association has continued to monitor the issue. In 2002, we established an Earnings Claims Task Force to review state, federal, and international standards regarding such claims as well as industry practices. DSA has previously offered to work with the Commission to develop potential self-regulatory standards regarding earnings claims. The Commission has not responded to the association’s initiative.

Despite the similarities in DSA’s self-regulatory approach and certain aspects of the Commission’s proposed earnings disclosures, there are significant and problematic variances.

(Jul. 10-11, 2006)(on file with DSA).

⁶¹ FTC Privacy Initiatives, <http://www.ftc.gov/privacy/index.html> (last visited July 15, 2006).

⁶² *Potential Impacts of the FTC’s Proposed Business Opportunity Rule on the Direct Selling Industry*, Nathan Associates Inc., Jul. 14, 2006 at 3.

⁶³ *Id.* at 4.

⁶⁴ DSA Code of Ethics, Sec. A(8).

⁶⁵ *See*, DSA Code Comment, Sec. A(8).

opportunities. Any final Rule should recognize that in the United States and throughout the world, direct selling can provide extremely low to no risk micro-entrepreneurial opportunities for people to earn supplemental family incomes or to build a career, and serves as an alternative consumer product distribution system that increases competition and consumer choices.

