

June 26, 2006

Federal Trade Commission/Office of the Secretary
Room H-159 (Annex W)
600 Pennsylvania Avenue N.W.
Washington, D.C. 20580

Attention: Donald S. Clark
Steven Toporoff



Dear Mr. Clark and Mr. Toporoff:

This firm is pleased to submit comments on the proposed Business Opportunity Rule announced by the Federal Trade Commission on April 5, 2006. Although this letter is not written on behalf of any one company that we represent, our firm does represent numerous manufacturers that will be affected by the proposed Rule. In addition, we are very familiar with the background of the Rule, having represented franchisors and business opportunity sellers for the last 30 years.

As noted in the Background provided with the proposed Rule, certain business opportunity ventures have long been covered by the FTC's Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures (the "Franchise Rule"). We applaud the efforts of the Commission to separate business opportunities from the Franchise Rule. Many of the disclosures required by the Franchise Rule are not apropos for most business opportunities, and require extensive additional work by sellers of business opportunities, while providing little additional benefit to prospective purchasers.

For purposes of this letter, we accept the Commission's statement that there is widespread fraud in the sale of business opportunities. However, in promulgating a new rule to cover business opportunities, such as "vending machines, rack displays, public telephones, Internet kiosks, and 900 number ventures," the proposed Rule addresses the sale of other business arrangements that are currently outside the scope of the Franchise Rule. Once again, we accept the Commission's statement that certain such arrangements "have been shown by the Commission's law enforcement experience and complaint data to be sources of prevalent and persistent problems." Specifically, the Commission noted work-at-home schemes and pyramid marketing schemes.

To address the foregoing types of businesses, the proposed Rule eliminates the minimum investment and inventory exemptions of the Franchise Rule, thus covering "many pyramid schemes" the Commission has concluded are subject to abuse. However, in eliminating the

inventory exemption, the Commission also brings a significant number of additional transactions under the auspices of the proposed Rule; namely, the establishment of distributorships and dealerships by manufacturers of goods who seek to distribute their goods to consumers.

The type of arrangements we are addressing are very prevalent among manufacturers. A company seeking to distribute its products to consumers, typically well known products with a readily available market, frequently do so by establishing distributorships and dealerships.¹

In certain circumstances, a distributorship or dealer network may consist of existing businesses that carry similar lines of products, either on a wholesale or retail basis. We understand that the proposed Rule would not apply to these relationships. However, there are other circumstances in which the manufacturer's product will represent a new line of business for an existing business, or even the only product carried by the distributor or dealer. In these cases, the manufacturer will solicit the person to enter into a new business carrying the manufacturer's products, the person will pay for the products, and the manufacturer will provide promotional assistance that goes beyond guidance in the use, maintenance, and/or repair of the product. We understand the proposed Rule will apply to these relationships.

We do not take a position one way or the other as to whether typical pyramid schemes, or other business opportunities, should be subject to a rule of this nature. As indicated, we accept the Commission's conclusion that such a rule is necessary to deal with abuses among such business opportunity sellers. However, nothing set forth in the Notice of Proposed Rulemaking with respect to the proposed Rule suggests that traditional manufacturers have abused distributors or dealers such that a rule of this nature should apply to these types of relationships. In fact, the public record that accompanied the promulgation of the Franchise Rule concluded just the opposite. It noted that it was not necessary to focus upon purchasers of inventory who could "extricate themselves from [an] unsatisfactory relationship without suffering any financial

¹ While these terms are sometimes used interchangeably, we use the term distributorship to refer to an arrangement whereby an individual or entity will serve as a regional distributor for a product. It will purchase and warehouse the product, and resell it. In some circumstances, a distributor will sell to general retailers. In other circumstances, a distributor will set up its own group of dealers, or "sub-distributors," who also purchase product for resale, and either sell to retailers, or directly to consumers. There also will be situations where manufacturers simply establish dealer networks that purchase products from the manufacturer and sell directly to consumers.

setback” by reselling their inventory.² We would suggest it is not appropriate to include these manufactures within the scope of the Rule.

We understand an argument could be made that the required disclosures under the proposed Rule are not significant, and therefore would not present an unreasonable burden to manufacturers. We do not agree. In fact, we have discussed the matter with a number of our clients, and they have expressed concern over several of the requirements, starting with the requirement that a manufacturer disclose the 10 nearest distributors or dealers to the proposed new distributor or dealer. A company that has a nationwide distribution network will likely have hundreds of existing distributors and dealers, and may add several dozen new ones each year. Given that they would not know ahead of time the location of each prospect, it would be impossible to put together a list of the 10 nearest distributors or dealers. Rather, the proposed Rule would force manufacturers to prepare national or regional lists of distributors and dealers, and provide those lists to prospective distributors or dealers. Unfortunately, those lists would then be readily available to their competitors. Unlike a franchise relationship which is often an exclusive relationship, a distributor or dealer may represent more than one product line, and the last thing a manufacturer wants to do is to give its “customer list” (even if limited to customers who have become distributors or dealers within the last two years) to its competitors (or even non-competitors whose products might represent a distraction to a distributor or dealer). Given that there is little or no evidence on the record that suggests abuse by manufacturers in the establishment of distributorships and dealerships, we believe the detriment of requiring manufacturers to publish customer lists that would be available to competitors outweighs any potential benefits to requiring manufacturers to make these disclosures.

The foregoing is not the only section of the disclosure document that manufacturers find objectionable. None of the manufacturers with whom we discussed the proposed Rule relish the thought of providing earnings claim documents to prospective distributors or dealers, particularly when there is no record of abuses in terms of manufacturers providing earnings information to such persons. In addition, some manufacturers who have chosen not to offer franchises concluded, in some cases, they were willing to forego the benefits of a franchise arrangement in exchange for not having to open their company to disclosure of information they deem confidential and of no concern to other persons, including information as to litigation in which they may be involved. Finally, just as the FTC has concerns about abuses in the sale of business opportunities, manufacturers (and traditional franchisors for that matter) are concerned that abusive litigation can result from a disclosure obligation of this nature. Once again, given the

² To the extent this is not true because a manufacturer “front loads” a distributor with an unreasonable quantity of merchandise, or the purchaser does not pay a reasonable wholesale price for the inventory, the transaction is already covered by the Franchise Rule.

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lack of evidence of abuses in this area, it would not seem appropriate to require that manufacturers face these obstacles in trying to bring their products to market.

For the foregoing reasons, we respectfully suggest that if the Commission continues to feel the proposed Rule is appropriate, there be an exemption created for situations in which the only required payment from a "purchaser" to a manufacturer (or value added reseller) is for the bona fide wholesale price of inventory for resale.

Respectfully submitted,

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