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July 17, 2006

Federal Trade Commission
Office of the Secretary
Room H-135 (Annex W)
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: **Business Opportunity Rule, R511993**

Ladies and Gentlemen:

We appreciate the opportunity to submit comments to the Federal Trade Commission ("Commission") regarding its Notice of Proposed Rulemaking (16 C.F.R. Part 437) ("NPR") with respect to the proposed "Business Opportunity Rule" ("Proposed Bus. Op. Rule") published in the Federal Register on April 12, 2006. 71 F.R. 19053. These comments reflect the views of the authors and not this law firm or any client. Several of the authors have over 25 years of experience advising clients regarding federal and state laws regulating the sale of franchises and business opportunities. The authors also regularly represent manufacturers, suppliers, distribution companies and other sellers that conceivably could be covered by the Proposed Bus. Op. Rule.

These comments respond to some of the NPR's requests for comments and also to several other important matters that we believe deserve further attention by the Commission.

I.
General Comments

We agree with the Commission's assessment that it is preferable to regulate the sale of business opportunities in a separate narrowly tailored rule apart from the existing trade regulation rule governing franchise and business opportunity sales ("Existing Franchise Rule"). The NPR does an excellent job focusing on the key abuses in business opportunity sales. However, while the Commission proposes to streamline the disclosure burden when compared to franchisors, it has dramatically increased the number of companies subject to the Proposed Bus. Op. Rule and thus would impose a new disclosure burden on companies not previously covered by either the Existing Franchise Rule or any state business opportunity law. Among other persons, the Commission would regulate manufacturers, suppliers and other traditional distribution firms that have relied solely on the bona fide wholesale price exclusion to avoid coverage as a franchise. Furthermore, the Commission has significantly underestimated the paperwork burden which the Proposed Bus. Op. Rule would impose on covered entities.

While the Commission estimates "that there are approximately 3,200 business opportunity sellers" consisting of 2,500 in the vending machine/rack display category, 550 in "work at home" activities, and 150 in multilevel marketing (71 F.R. 19080), the broad coverage of the Proposed Bus. Op. Rule easily leads one to believe that it will apply to a substantially larger number of firms. Indeed, as noted below, application of terms such as a "new line or type of business" and "business assistance" will have the unintended effect of bringing thousands of ordinary distribution arrangements within the Proposed Bus. Op. Rule's ambit that have not been the source of enforcement complaints. Without clear definitions, exemptions and exclusions, the Proposed Bus. Op. Rule is likely to have this effect. The risk of this unintended consequence is magnified even further in light of the fact that, under many state consumer protection and unfair practice statutes, an alleged violation of Federal Trade Commission rules can give rise to state regulatory action and, in many jurisdictions, to private rights of action by litigants whose interests are not aligned with the NPR's public policy objectives. Thus, it is critical that the Commission draft the Proposed Bus. Op. Rule circumspectly. The definitions should be crafted to encompass those specifically known categories of business opportunity activity that have generated a significant number of enforcement actions, yet be flexible enough to reach other forms of deceptive behavior. At the same time, the Proposed Bus. Op. Rule should exclude traditional distribution arrangements, distribution relationships involving substantial and/or long-standing sellers, relationships involving sophisticated and experienced buyers, and several other categories where there is no enforcement justification for regulation.

We urge the Commission to consider the following comments in connection with the rulemaking process. We will first respond to a number of specific questions raised by the Commission and then address several other critical matters.

II.
Responses to Specific Questions

Section K of the NPR invites the public to comment on 27 specific questions. 71 F.R. 19088. Our comments below are keyed to the Commission's numbered questions.

1. ***Definitions -- Limit to New Businesses.*** We believe proposed Section 437.1(k) should limit the Proposed Bus. Op. Rule to persons entering into a new business, and should not apply to persons entering into "a new line or type of business" thereby covering persons who already own a business or who have sufficient general business experience. People already in

business for themselves are sufficiently sophisticated and do not require the protection of this anti-fraud rule. The Commission's enforcement history shows most victims of business opportunity frauds are unsophisticated and lack any business ownership experience. Consequently, we suggest that the Commission delete the phrase "or a new line or type of business" from proposed Section 437.1(k).

Alternatively, we urge the Commission to exempt sales to buyers with reasonably recent prior business ownership experience, which we would propose to define as owning a business of any kind (or a majority interest in an entity that owns a business) for at least 24 months at any time during the prior seven years. In Section III., we propose an additional exemption akin to an accredited investor standard for sales to buyers that meet a net worth/income test.

Another possible way of exempting persons already in business is to adopt the following exclusion, which appears in the Nebraska Seller-Assisted Marketing Plan Act (Rev. Stats. Neb. §59-1718) and in the business opportunity laws of several other states:

> "A seller-assisted marketing plan shall not include a sale or lease to an ongoing business enterprise which also sells or leases equipment, products, or supplies or performs services which are not supplied by the seller and which the purchaser does not utilize with the equipment, products, supplies, or services of the seller."

2. ***Definitions -- Earnings Claims.*** The Proposed Bus. Op. Rule is overbroad in covering relationships where the seller promises "business assistance" *or* makes an "earnings claim." Rather than the disjunctive, coverage under the rule should require the presence of both alternatives. Proposed Section 437.1(d) should define a business opportunity as an arrangement where the seller provides, or promises to provide, business assistance *and* makes an earnings claim. Earnings claims are the most prevalent type of claim raised by victims of business opportunity fraud. However, if the only activity required for jurisdiction of the Proposed Bus. Op. Rule is making an earnings claim, the Proposed Bus. Op. Rule might inadvertently reach the sale of an ongoing business, the solicitation of investors who will take an active role in a new or ongoing business, or other distribution relationships not resembling the classic work-at-home schemes that have, by far, generated most of the enforcement cases identified by the NPR.

Furthermore, as discussed below in response to Question 4, if the only activity required for a business opportunity is offering or furnishing "business assistance," the Proposed Bus. Op. Rule will swallow a broad array of ordinary distribution relationships that have not been the source of fraud complaints. As we explain below, not only should the definition of business opportunity require the combination of business assistance *and* an earnings claim, but the scope of activities that constitute "business assistance" should be narrowed.

Finally, unless jurisdiction of the Proposed Rule requires both the delivery or promise of both "business assistance" *and* an "earnings claim," the only substantive distinction between a franchise under the proposed revised Franchise Rule and a business opportunity under the Proposed Bus. Op. Rule will be that the former allows a $500 minimum monetary threshold for non-inventory and excludes inventory payments at bona fide wholesale prices, while the latter does not. All distribution and licensing arrangements not classified as franchises potentially could be swept up as business opportunities. Although we endorse the Commission's policy decision to regulate franchises and business opportunities in separate rules, we note that the Commission must possess an adequate evidentiary basis to justify expanding the scope of federal regulation. We do not believe such a basis exists for the entire range of entities that would be covered by the Proposed Bus. Op. Rule.

3. ***Definitions -- Need for a Monetary Threshold.*** We believe the Proposed Bus. Op. Rule should have both minimum and maximum monetary thresholds to trigger applicability of the Proposed Bus. Op. Rule.

The Commission proposes to eliminate any monetary threshold for the Proposed Bus. Op. Rule despite retaining the minimum $500 non-inventory monetary threshold in the proposed revised Franchise Rule. The $500 threshold has been part of the Existing Franchise Rule (and therefore part of the Commission's definition of arrangements constituting business opportunities) since the Existing Franchise Rule was adopted in 1978. The threshold figure has never been changed despite accumulated inflation of over 210% since that time. A number of state business opportunity laws exempt minimum payments for non-inventory materials. *See, e.g.*, Illinois Act, 815 ILCS 602/5-5.10(b). Some states also exclude payments for non-inventory materials sold at cost or fair market value without dollar limit. *See, e.g.*, New Hampshire Distributor Disclosure Act, Section 358-E:1.VII, which excludes from the definition of distributorship fee "payments for the purchase of sales demonstration equipment and materials furnished on a non-profit basis for use in making sales and not for resale" without regard to amount. We are not aware of any state that counts payments for reasonable quantities of inventory at bona fide wholesale prices in the minimum payment threshold. *See, e.g.*, Illinois Act, 815 ILCS 602/5-5.10(g).

The Commission's reason for eliminating the $500 minimum non-inventory threshold from the Proposed Bus. Op. Rule is that a business opportunity seller's compliance burden will be significantly less than a franchisor's. We believe the Commission underestimates the practical impact of the Proposed Bus. Op. Rule on the greatly expanded category of business opportunity sellers. The Commission's estimates (NPR, p. 19081-2), of up to 5 hours and $1,250 to prepare the initial disclosure document and up to 4 hours and $1000 to update and maintain necessary records, are unrealistic, in our view, even with the Proposed Rule's streamlined disclosure format. This is especially true for a seller that chooses to make an earnings claim and for those that may have a substantial number (but not necessarily relevant or helpful) of litigation cases to disclose. Although the disclosure form is fashioned as a series of check-off boxes requiring relatively little original drafting of information (except when a seller makes an earnings claim), the work underlying the check-off disclosures still requires a seller to compile and organize considerable information. Based on our years of experience preparing disclosure documents under state franchise and business opportunity laws, the process of collecting, assimilating, verifying, updating and certainly drafting information of the kind included within the Proposed Bus. Op. Rule's categories rarely takes just a couple of hours, particularly for a seasoned seller that has been operating for a reasonable length of time.

The impression one gets from the NPR's tone is that the Commissions believes sellers are fraudulent if they price their opportunities under the current $500 minimum threshold in order to avoid rule coverage. (71 F.R. 19079) ("... a monetary threshold simply provides scam operators a means to circumvent the [Franchise] Rule...."). The Commission's motivation for eliminating the monetary threshold seems to be to plug this perceived escape hatch. This loses sight of the threshold's purpose, which is not to allow scandalous business opportunities to escape regulation, but to strike an appropriate regulatory balance.

If "work at home" schemes generate the greatest number of enforcement actions, the Commission may want to define these particular arrangements specifically without regard to any $500 minimum threshold. However, there is no reason to discard the $500 threshold for all other distribution programs that may qualify as business opportunities when there is no enforcement history showing any abuse of the $500 minimum threshold. To address the "work at home" situation specifically, the Commission could add the following language to the definition of "business assistance" in Section 437.1(c)(1):

> "Providing the tools, equipment, components, parts, inputs, software, data, instructions, directions or guidance to enable the purchaser to make, produce, fabricate, grow, breed, modify or produce goods or services from a location of the purchaser's choice, including the person's home;"

A maximum monetary threshold is equally important because it will operate to exclude sophisticated buyers who do not need the Proposed Bus. Op. Rule's protections. Sophisticated buyers often have prior business experience, but even if they do not, they have the means to seek advice from a business advisor or attorney. Therefore, they are less apt to be victims of fraud.

Using a maximum threshold to exclude opportunities from regulatory coverage is not unprecedented among state business opportunity laws. As noted below, the California Seller Assisted Marketing Plan Act exempts from coverage investments requiring an initial cash payment of $50,000 or more. Cal. Civ. Code §1812.201(a).

4. ***Definitions – Revise the Definition of "Business Assistance".*** We believe the list of activities set forth in the definition of "business assistance" should be inclusive and exhaustive, and the training provision should either be eliminated or limited to training for which a specific separate payment is made.

Although the NPR states that the Commission has relied on the Illinois Act of 1995 ("Illinois Act") to prepare its definition, the Proposed Bus. Op. Rule does not similarly draw upon the Illinois Act's limiting language. Section 5-5.10(a) of the Illinois Act limits what the Commission describes as business assistance to six prescribed activities. 815 ILCS 602/5-5.10(a). We believe the Commission should do likewise by changing the introductory clause in proposed Section 437.1(c)(1) to read: "Business assistance means that the seller is either:" and changing the word "and" in proposed Section 437.1(c)(1)(iv) to "or."

Furthermore, the Illinois statute does not include anything equivalent to the extraordinarily broad category proposed in Section 437.1(c)(1)(v), *i.e.*, advice or training in the "promotion, operation, or management of a new business" or "operational, managerial, technical, or financial guidance in the operation of a new business." Under this definition, any kind of advice or representation about training, no matter how nominal the offer, could trigger the Rule. Specifically, furnishing any type of sales kit, manual or even non-proprietary accounting software might be enough to constitute "business assistance" even if the buyer has no obligation to use the materials. Companies that sell products or services through independent contractors routinely also train their distributors in how to use or market the product or service. The exclusion for product warranty commitments is not broad enough to exclude these companies from coverage. Interestingly, rather than discuss training by itself as one of the elements of what constitutes a business opportunity, most state business opportunity laws refer to a "marketing plan" as the triggering activity, not training. We suggest deleting proposed Section 437.1(c)(l)(v) or, at a minimum, narrowing it to advice or training germane to marketing the opportunity that requires the payment of a separate fee. For example, Section 437.1(c)(1)(v) could be appropriately narrowed by adding the following words at the beginning of the subsection: "(v) For a separate payment for such services,".

5. ***Definitions -- Sales Representatives Should Not Be Covered.*** By identifying "tracking or paying" commissions as an example of "business assistance" in order to capture pyramid marketing programs, the Proposed Bus. Op. Rule will also cover ordinary sales representative relationships where the sales representative buys a representative sample of the seller's product line for display purposes and is compensated by the seller on a commission basis. Sales representatives are already adequately protected by 35 state laws. See *Sales Representative Law Guide (CCH)*. We suggest deleting Section 437.1(c)(1)(iv) or revising it in such a way that these legitimate arrangements are not needlessly covered by the Proposed Bus. Op. Rule. For example, Section 437.1(c)(1)(iv) could be revised to focus on commissions paid for the recruitment of other persons to sell goods or services.

6. ***Definitions -- Do Not Cover Persons Already in Business.*** As discussed in response to Question 1, persons already in business do not need the protections of the Proposed Bus. Op. Rule simply because they are adding a new line of business to their existing business. In response to Question 1, we recommend exempting sales to buyers with reasonably recent prior business ownership experience. Additionally, in Section III, we recommend adding a fractional exemption.

7. ***Timing Provision - Seven Days is Too Long.*** A seven calendar day waiting period before the purchaser can sign a contract or pay any consideration is too long and will unreasonably interfere with legitimate direct selling activities. If a waiting period approach is to be used, we suggest a five calendar day waiting period. Several states use the equivalent or shorter waiting period. *See, e.g.*, California Seller Assisted Marketing Plan Act, 1812.206 (48 hours); Florida Sale of Business Opportunities Act. Section 559.803 (3 working days); Maine Sale of Business Opportunities, Section 4692 (72 hours).

Alternatively, instead of a pre-sale waiting period, we recommend that the Commission adopt a five day post-sale right of cancellation, following the approach of a number of state business opportunity laws. *See, e.g.*, California Seller Assisted Marketing Plan Act, 1812.208 (3 business days); Iowa Business Opportunity Promotions, Section 5512.A6 (3 business days); Ohio Business Opportunity Purchasers Protection Act, Section 1334.05 (5 business days). In order to protect investors against post-sale claims involving the failure to return money, the Commission may want to adopt a bond requirement, which many state business opportunity laws require in connection with a post-sale cancellation offer. As we doubt the Commission would want to undertake the burden of holding bonds, this may be something that an industry trade group would undertake as part of its self-regulatory agenda.

8. ***Liability - Seller's Obligation.*** Although the Commission's questions reveal its concern over defining "seller" too narrowly, we have the opposite concern. We feel the definition of "seller" is not sufficiently articulate and could be read to capture every downline direct seller involved in a multilevel marketing program. We do not believe the Commission

intends this result, nor are we aware of any enforcement history against downline sellers for deceptive conduct perpetrated entirely independent of, and not in collaboration with, an upline direct selling firm. However, nowhere does the NPR consider "seller" in the context of multilevel relationships, *i.e.*, according to which party enters into the contract with the purchaser, pays commissions, supplies start up materials or sells inventory. The Proposed Bus. Op. Rule defines "seller" as the confluence of just three things which downline sellers that recruit would easily satisfy: (i) solicitation to enter into a new business, which occurs through a downline seller's normal recruiting activities; (ii) a direct or indirect payment, which downline sellers would receive, for example, when they sell a demonstration kit or inventory to their recruits; and (iii) an earnings claim or offer of business assistance, which downline sellers would meet, for example, by providing their recruits with a copy of the direct selling firm's sales manual even if the purchaser has no obligation to use it or pay for it.

It would be one thing if every downline direct seller is required to furnish the same disclosure document with information pertaining to the direct selling firm. However, given the ambiguities in the definition of "seller," it is unclear if the Commission intends for each downline seller to create its own disclosure document with information about that downline seller's earnings claims, legal actions, cancellation or refund policies, and references. We understand that the Direct Selling Association, a national trade association of over 200 of the leading direct selling firms, states that its members collectively have 13.7 Million Americans in varying levels of downline direct selling. If each downline seller is expected to create its own disclosure document, purchasers of the business opportunity would receive vastly different information not germane to the direct selling firm depending on the particular seller who recruits them. To the extent the Proposed Bus. Op. Rule applies to multilevel marketing firms, only the multilevel marketing firm should be required to prepare a disclosure document. Otherwise, the Commission's estimated paperwork burdens would need to be multiplied by the thousands, if not by the hundreds of thousands. The Commission should better articulate who is a "seller" in order to avoid this unplanned outcome.

11. ***The Disclosure Document - Earnings Claims Are Not Required.*** The title "Earnings" after the first set of check-off boxes on the one page disclosure form may mislead buyers into assuming that earnings claims are mandated, when in fact they are not. The form should incorporate language indicating that earnings claims are voluntary and no negative inference should be drawn when a business opportunity seller chooses not to make one.

12. ***The Disclosure Document - Previous Business Opportunity Activities Should be Disclosed.*** To preserve a streamlined disclosure document, we suggest confining "seller" to the company and omitting disclosure of principal officers and affiliates. However, we suggest adding a check-off box regarding prior business experience and require the seller to attach a list of previous business opportunities offered by the seller and/or its principal officers, affiliates or predecessors during the prior five years.

13 to 15. ***The Disclosure Document - The Litigation Disclosure Burden is Excessive.*** Proposed Section 437.3(a)(3), which requires disclosure of "certain litigation information" (71 F.R. 19085), is likely, in our view, to create a significant burden on firms that are part of large business enterprises and may have wide-ranging business operations with little connection to the business opportunity or germane to the interests of a proposed purchaser. In today's environment, claims of "fraud", "unfair or deceptive practices" and "misrepresentation" have, unfortunately, become an automatic part of a complaining party's arsenal. They flow easily from the pleaders' pen without any effective restraint. When the scope of disclosure is expanded to affiliates, and the time frame set at 10 years, there is a substantial risk that the compilation of litigation information will be extensive and costly to update and its informative value will be reduced by the bulk of information being presented to buyers. On top of that, the information provided (whatever the scope of disclosure) is likely to be as misleading as it may be informative, since there is no way for the prospective purchaser to gauge whether the litigation is or is not germane to the transaction under consideration.

In our view, disclosure should be limited to the selling entity or its predecessors, and to affiliates *if* the litigation directly involves claims in U.S. courts that pertain to the business opportunity. While pending actions should be noted (with an opportunity to briefly state the seller's position), we believe that settled or dismissed actions should be listed for a limited period of time (*e.g.*, two years following resolution). By way of contrast, where the litigation has resulted in an adverse judgment, that judgment should be disclosed for a longer period (*e.g.*, 5 years, or while any remedial order is in effect and 5 years thereafter.)

We would also note that inclusion of "affiliates" in the scope of the litigation disclosure requirement may create a significant barrier in international trade, inasmuch as companies considering entry into United States markets will typically utilize subsidiary or affiliated companies. Where such new entrants are part of major multinational business operations, the burden of disclosure (and the potential irrelevance of the information being disclosed) can be substantial.

16. to 20. ***Disclosure Document - The Commission's Information Goals Can Be Achieved With Fewer Disclosure Requirements.*** While the information discussed in Questions 16 to 20 may be useful for the prospective buyer, we believe that those disclosure requirements are too burdensome for most sellers. The requirement to provide at least 10 references *and* information on the number of cancellation requests is redundant. Both required disclosures provide similar information about other purchasers' experience post-sale with the buyer. If prospective buyers can talk to 10 or more references, they can obtain information about cancellations that will assist them in evaluating the seller and their own chances of success. Thus, the information about the number of cancellations is unnecessary. Accordingly, even if the Commission arguably may meet its burden of showing that each requirement is rationally related to the goal of preventing deceptive practices and consumer injury, cumulatively the two categories are duplicative. The Commission should require only one or the other or it should give sellers the option to provide one of these categories of information.

Additionally, we would recommend that if a seller has a cancellation or refund policy, the seller should only have to disclose the number of *written* cancellation and refund requests submitted during its prior fiscal year. Oral requests are too uncertain and should be excluded from reporting requirements.

21. ***The Disclosure Document - Clarify the Scope of Disclosure.*** The Commission should confine the required disclosure information to activities conducted in the United States, not foreign countries. There should also be an exclusion for sales made to a foreign buyer to operate a business opportunity in a foreign country. In addition, sellers should be free to annotate the outcome of concluded actions if they desire (as long as they uniformly do so for all concluded actions) without running afoul of the Proposed Bus. Op. Rule's prohibition on including non-required information as stated in proposed Section 437.5(c).

24. ***Prohibited Acts and Practices - Some Categories of Sellers Should Only be Covered by the Anti-Fraud Provisions.*** We believe that proposed Section 437.5, which sets forth a number of prohibited acts or practices, is the real heart of the Proposed Bus. Op. Rule. A reasonable regulatory balance would be to limit the disclosure duties only to "work at home" schemes, since they have produced the most enforcement activity, but have Section 437.5 apply to all business opportunity sellers. Section 437.5 would need to be appropriately modified to take into account that only certain sellers are required to furnish a disclosure document. This approach would properly balance the regulatory burdens while simplifying the Commission's prosecutorial burden of proof in bringing enforcement actions against any seller of a business opportunity for which there is substantial evidence showing unfair or deceptive acts and practices.

26. ***Federal and State Regulation - Preemption is Essential.*** The failure to provide for preemption may make the paperwork burden excessive for many legitimate business opportunity sellers. Currently, business opportunity sellers under most state laws have the option of using one document nationally (the UFOC permitted under the Existing Franchise Rule) or, alternatively, the state's specific business opportunity disclosure statements. Because state business opportunity disclosure statements are different for each state, most national business opportunity sellers use the UFOC. By failing to preempt state business opportunity laws, a business opportunity seller that finds itself covered by both the Proposed Bus. Op. Rule and a state business opportunity law will have to prepare both the Commission's business opportunity disclosure document and the state-specific business opportunity disclosure document (unless each state amends its statute to permit use of the Commission's new business opportunity disclosure statement, a process that could take years). It is far more preferable for purchasers throughout the country to receive one uniform document that would consistently be used by business opportunity sellers. Accordingly, we urge the FTC to preempt all state business opportunity laws. States would be able to bring actions against deceptive sellers who violate the Proposed Bus. Op. Rule to the extent their consumer protection laws incorporate the Commission's rules or treat violations of the Commission's rules as a predicate act in violation of their state law.

III.
Other Critical Revisions Are Needed

We have a number of additional suggestions for focusing the definition of "business opportunity" so that the regulated activities are consistent with the types of enforcement complaints that the Commission has addressed over the years.

Continue to Exclude the Purchase of Goods at a Bona Fide Wholesale Price. Whether or not the Commission opts to reinstate the $500 minimum threshold for non-inventory or exclude payments for materials at no more than fair market value as previously proposed, the Commission should, at a minimum, continue to exclude purchases of reasonable quantities of inventory at no more than a bona fide wholesale price. As noted earlier, we are not aware of any state that includes inventory purchases in the minimum payment threshold. *See e.g.*, Illinois Act, 815 ILCS 605/5-5.10(b)(7) (excluding "cash payments made by a purchaser not exceeding $500 and the payment is made for the not-for-profit sale of sales demonstration equipment, material or samples, or the payment is made for product inventory sold to the purchaser at a bona fide wholesale price").

While the Commission's Interpretative Guides to the Existing Franchise Rule recognize that "required payment" is intended to capture all sources of hidden franchise fees, the

Commission has articulated a policy not to construe as "required payments" "any payments made by a person at a bona fide wholesale price for reasonable amounts of merchandise to be used for resale." See FTC Informal Staff Advisory Opinions 93-6 (June 1, 1993) and 93-7 (June 1, 1993). The rationale for excluding payments for reasonable quantities of inventory bought at a bona fide wholesale price is that the purchaser can resell the inventory at wholesale or higher and thereby recoup its investment. The policy appropriately allocates regulatory resources. An unhappy buyer of inventory can look to the marketplace to recover its costs and, consequently, is not overly dependent on the seller and in need of government supervision.

The NPR cites no enforcement reason for eliminating the inventory exemption in the business opportunity context. The Commission's enforcement history shows no abuses with the inventory exemption in effect since 1979. Without an enforcement justification, the Commission should respect the policy rationale for the inventory exemption and incorporate the exemption in the Proposed Bus. Op. Rule.

Although the NPR discusses the Commission's experience with "work at home" and pyramid schemes that have been excluded from the Existing Franchise Rule by its minimum investment requirement and inventory exemption, the abuses associated with these arrangements do not justify broadly expanding regulation to other distribution models. As mentioned earlier, if "work at home" schemes generate the greatest number of enforcement actions, the Commission can define "work at home" arrangements without regard to the inventory exemption, but preserve it for all other distribution programs.

More Exemptions or Exclusions Are Merited. We urge the Commission to consider additional exemptions or exclusions to conform the Proposed Bus. Op. Rule to the Commission's limited evidence about abuses in direct selling and other ordinary distribution models that would otherwise be covered. As proposed, Section 437.7 would limit the only available exemption to business opportunities that qualify as a franchise, have a written contract and meet the minimum payment requirement of the Existing Franchise Rule. Many companies currently excluded or exempt from the "franchise" definition, but which will not be specifically excluded or exempt under the proposed revised Franchise Rule, such as cooperatives, run the risk of being deemed a business opportunity under the Proposed Bus. Op. Rule. The Proposed Bus. Op. Rule should include a specific exclusion or exemption for cooperatives and other arrangements which are expressly exempt from the "franchise" definition under the Existing Franchise Rule.

Further, the exemption provision of the Proposed Bus. Op. Rule is much too limited and ignores the guiding policy that absent substantial evidence of illegal activity, the Commission should not regulate. In this regard, the Commission should be guided by the experiences of the states. Specifically, exemptions or exclusions currently included in many state business opportunity laws should be added to the Proposed Bus. Op. Rule. Some of the exemptions or exclusions used at the state level that should be considered for inclusion are:

All of the exclusions listed in the Illinois Act (§5-10) (from which state law the Commission took its definition of business opportunity). Illinois Act, 815 ILCS 602/5-5.10(b).

All of the exclusions listed in the California Seller Assisted Marketing Plan Act (§1812.201(b)), including the exclusion for investments above a maximum threshold. Cal. Civ. Code, §1812.201(b).

An exclusion for cooperatives which appears in the business opportunity laws of several states and currently as an exclusion in the Existing Franchise Rule. *See, e.g.*, Georgia Business Opportunity Sales, Section 10-1-410(2)(B)(ii)(II); 16 C.F.R. §436.2(a)(4).

Not-for-profit sales, where the seller sells non-inventory materials to the buyer at the seller's cost so the buyer can use them for display, which is currently provided in a number of existing state business opportunity laws. *See, e.g.*, Virginia Business Opportunity Sales Act, Section 59.1-263.B.6; Illinois Act, Section 815 ILCS 605/5-.10(b)(7).

Sales of non-inventory materials to the buyer at no more than a fair market value, which is excluded from the definition of a franchise fee by numerous states regulating franchise sales. *See, e.g.*, Hawaii Revised Statutes, Title 26, Chapter 482E, Section 482E-2.

We urge the Commission to include a "fractional" exemption comparable to the one in the Existing Franchise Rule (16 C.F.R. §436.2(a)(3)(i) and §436.2(h)) and which will be carried on in the proposed revised Franchise Rule. The NPR rejects a "fractional" exemption as unnecessary based on the Commission's assessment that the Proposed Bus. Op. Rule's compliance burdens are modest. 71 F.R. 19066. As noted above, we disagree with that assessment and find no enforcement justification for eliminating the "fractional" exemption in the business opportunity context. By definition, the fractional exemption would apply only in the case where a person already in business buys an opportunity that is not reasonably expected to account for more than 20% of its total revenue. Not only is such a person sufficiently sophisticated in business, but the person is not so overly dependent on the seller as to warrant government supervision. The policy reasons for the fractional exemption in the franchise context equally apply to the business opportunity context.

We also urge the Commission to exempt other "sophisticated investor" transactions comparable to that which the Commission proposes to add to the proposed revised Franchise Rule (*i.e.*, "large investments," "large franchisees," and "insider transactions"). These proposed exemptions (whether fashioned as an exemption or an exclusion) would enable the Commission to strike an appropriate regulatory balance and extend protection to the buyers that most need protection.

We would reduce the thresholds for what constitutes a "large" investment or "large purchaser" from the levels used in the proposed revised Franchise Rule recognizing, as the Commission does, that business opportunities typically require a much lower initial investment than franchises. For "large" investments, we would draw upon the experience of states regulating business opportunities and exempt business opportunities that require an investment during the first six months of $50,000 or more. This follows the California Seller Assisted Marketing Plan Act, which exempts from coverage investments requiring an initial cash payment of $50,000 or more. Cal. Civ. Code §1812.201(a).

For "large" business opportunity purchasers, we would propose exempting transactions where the purchaser has a net worth of not less than $250,000, exclusive of principal residence, furnishings, and automobiles. *See e.g.*, Illinois Act, 815 ILCS 602/5-10(d).

We would also recommend an "insider" exemption comparable to that in the proposed revised Franchise Rule for the same reasons which make it a reasonable addition in the franchise context. We realize that most business opportunity sales and buyers may not qualify for these sophisticated investor exemptions, but for the few that do, there is no reason not to exempt them.

In addition, we also recommend the following:

> Exclude business opportunity sellers that are public companies since they are already subject to extensive regulation and public disclosure of financial, operational and management information; and
>
> Exclude non-public business opportunity sellers with a net worth of at least $1 million. Section 5-10(c) of the Illinois Act is a good model. Illinois Act, Section 815 ILCS 602/5-10(c).

The foregoing proposals for new exemptions or exclusions are consistent with the Commission's articulated policies that sophisticated sellers are less likely to skirt government regulations and sophisticated investors can protect their own interests in making investment decisions and do not require costly federal regulation to protect them.

IV.
The Commission's Burden of Proof

The Commission published its NPR for the Proposed Bus. Op. Rule pursuant to Section 18 of the FTC Act, 15 U.S.C. § 57a *et seq.* and Part 1, subpart B, of its Rules of Practice. 16 C.F.R. § 1.7 and 5 U.S.C. § 551, *et seq.* As a proposed Magnuson-Moss rulemaking proceeding, the Commission needs substantial evidence of the prevalence of deceptive practices by those it proposes to regulate to support the scope of its rulemaking. As discussed above, we believe the NPR is devoid of substantial evidence on the need to regulate as business opportunities manufacturers, suppliers and others involved in ordinary distribution programs. The Commission has cited, at best, limited evidence of abuse outside of the "work at home" industry segment. Further, as noted previously, certain of the Commission's proposed remedies, individually and cumulatively, are overly broad and not reasonably related to the goal of preventing deceptive practices.

V.
Projected Compliance Costs

Not only do we believe, for the reasons previously stated, that the Commission's projected compliance costs are unrealistically low, but the Commission's estimates ignore the costs associated with the quarterly updating requirement. For example, the task of calculating the number of purchasers each quarter and the number of oral and written requests for cancellation and updating the information for the prior eight quarters (we urge that this be reduced to the prior four quarters) are substantial and time-consuming. For those sellers that make earnings claims, the updating obligations are particularly onerous. The Commission's yearly estimates more likely approximate the paperwork burden sellers will face each quarter (not annually), and even then they probably are too low based on our experience.

Further, the Proposed Bus. Op. Rule fails to provide a grace period for updating the disclosures. As drafted, once the quarter ends, the very next day the seller would have to begin using an updated disclosure document reflecting changes during the quarter just ended. Although we recognize that the Commission may exercise prosecutorial discretion and choose not to penalize sellers who do not produce updated disclosure documents instantaneously, the preferable course would be to allow a reasonable time to create the required updated documents comparable to the 90 day period allowed by the Existing Franchise Rule (which the proposed new Franchise Rule will change to 120 days for the annual update and keep at 90 days for quarterly updates, although we think in the business opportunity context 90 days/quarter is all that is needed).

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We believe that the benefits of requiring frequent updates should be balanced against the burden and costs this requirement imposes. The Commission should require updates no more frequently than annually (except for reference for sellers who have fewer than 10 purchasers). Further, we recommend that sellers be allowed 90 days in which to complete the updating of their disclosure documents.

VI.
Request for Workshop

We believe it would be appropriate for the Commission to hold a workshop to address the issues raised in these comments and by the comments of other persons.

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Thank you for the opportunity to provide comments on the Proposed Bus. Op. Rule. If there is a workshop or public hearing, we would like the opportunity to participate.

Very truly yours.

Rochelle B. Spandorf

John R. F. Baer

Elaine Kolish

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