

The FTC's Proposed Business Opportunity Rule

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There has been a lot of chatter in direct sales circles about the FTC's new proposed business opportunity rule. From what I have seen, the impact of the rule is the subject of less uninformed speculation within direct sales circles than most other laws and rules impacting the direct selling industry. Unfortunately, there's a good reason for this: industry has done a good job of communicating its impact to the field because the proposed rule indeed has serious consequences for the industry. So let's analyze this most recent challenge to the direct sales industry.

The proposed rule represents such a serious challenge for direct sellers because it contains onerous obligations that will restrict their flexibility in recruiting new distributors and dramatically compromise the confidentiality distributors.

Consider the provisions of the proposed rule:

1. The Disclosure Document.

At least seven days before a new distributor can sign a distributor application or make any type of payment to join a program, the sponsor or parent company must provide the prospective distributor with a disclosure document. This document must disclose:

Identifying information.

This includes the name, address and telephone number of the direct selling company, the name of the sponsor, and the date on which the disclosure document is provided to the prospect.

Earnings claim information.

If the company or distributor makes earnings claims (which includes "quality of life" claims such as pictures of boats, expensive cars, homes, etc.), an earnings claim statement must be provided which discloses the beginning and ending dates when the represented earnings were achieved, the number and percentage of all distributors who achieved that level of earnings within such time period, and any specific characteristics applicable to the person making the earnings claim that differ from the characteristics of the prospect (e.g., a different geographic location).

If earnings claims are published in the media, in conjunction with the claim, the person or company making the claim must publish the beginning and ending dates when the represented earnings were made, the number and percentage of distributors during the given time who achieved the represented earnings, and industry financial information unless the seller has written substantiation demonstrating that the information reflects the typical earnings or performance experience of other business opportunity buyers.

The company or distributor making the claim must provide written notification to prospects of any material changes affecting the reliability of information contained in the earnings claim before the prospect signs up or pays any money.

Legal Claim Disclosures.

If the seller, or any affiliate or prior business of the seller, or any of the seller's officers, directors, managers or similar individuals have been the subject of any civil or criminal action involving misrepresentation, fraud, securities law violations, or unfair or deceptive practices in the prior ten years, the seller must disclose the name of the action, the caption, the court, case number, and the names of the parties.

Refund Policy.

The seller must disclose the terms of its refund policy.

Cancellation and Refund Requests.

The seller must disclose the total number of purchasers who have cancelled their business within the preceding two years.

Reference List.

The seller must state the name, city, state, and telephone numbers of ten people who have purchased the business opportunity within the last three years who are located nearest to the prospect's location. Otherwise, the company can disclose all of its distributors. The company's application must also disclose to prospects that if they join, their personal contact information may be disclosed to other future buyers.

2. Record Retention.

Direct sales companies must archive for three years:

1. Each materially different version of all disclosure and earnings claim documents;
2. Each purchaser's disclosure receipt;
3. Each oral or written cancellation or refund request;
4. All substantiation upon which the seller relies for earnings claims.

The impact of the proposed rule will be different from company to company depending on how they do business. However, some universal problems are: (1) the advance seven day disclosure will cause a reduction in enrollments; (2) providing 10 references closest to an applicant will require a significant investment in advanced software systems; (3) the reference requirement creates an enormous confidentiality problem. First, it completely ignores distributors' right to have their personal information maintained confidential. Secondly, the identity of companies' distributors is universally deemed a trade secret. It is outrageous that the FTC would require the disclosure of a company's trade secrets; (4) the earnings claim disclosures also require the disclosure of information such as differing "characteristics" which are vaguely defined and provide little useful information; and (5) the disclosure of legal claims within the specified categories applies to even those claims that were settled without admission of liability, and even applies to disclosure of claims in which the company prevailed on the claims.

The industry is not taking this lying down, and neither should individual distributors. The rule is still just a proposed rule. It is currently in the "comment" period during which the FTC is accepting comments from those who wish to make a submission. Comments can be submitted to the FTC at <https://secure.commentworks.com/ftc-bizopNPR/> and must be received by the FTC no later than July 17, 2006. While comments can be submitted directly on the comment form, the FTC affords personal responses more weight than stock comments. Therefore, it is best to draft a personal response in a letter and attach it to the response. For distributors that elect to submit a comment (and you are strongly encouraged to do so), the response should include your personal story of how your direct sales business has benefited you and a well reasoned analysis of how the proposed rule would injure your business. A suggested outline would follow this format:

1. Describe your Personal Story, including your years selling products, and how this contributes to your family finances, and

how selling products has developed you as person (building self confidence, public skills, etc.).

2. Discuss the seven day waiting period, and how it unfairly casts direct selling plans in a negative light. Further discuss how the record keeping and administrative problems cause unnecessary delays and excessive record keeping requirements for home businesses.

3. Emphasize how the litigation reporting is unfair that it does not distinguish between winning and losing lawsuits and settlements without an admission of liability as it constitutes a taint on a business.

4. With respect to the references, discuss how it is impractical to find 10 nearest distributors and regularly update the list since it changes from day-to-day, and even hour-to-hour. Also discuss the concerns you have with your personal information being publicly disclosed due to identity theft, safety concerns, having your name and personal information harvested for mailing and prospecting lists.

5. Express that you appreciate FTC's goal of reigning in fraudulent programs, but the FTC's proposed rule would unfairly catch legitimate direct selling businesses in its scope and cripple your legitimate business.

The threat of the proposed rule is real, but the outcome is far from certain. Every company and every distributor has an opportunity to influence its outcome by filing a comment with the FTC, and the industry needs to come forward with a strong response. The time for action is now, because if you delay and miss the July 17th deadline, our opportunity will pass, so don't miss this call to action.



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To learn more about Spencer and his law firm Grimes & Reese (and take advantage of the articles in their Law Library) visit their website: <http://www.mlmlaw.com/>.