DIRECT SELLING ASSOCIATION

Submitted Electronically

January 31, 2023

Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue, NW
Suite CC-5610 (Annex B)
Washington, DC 20580

RE: Business Opportunity Rule ANPR, Project No. R511993

Dear Federal Trade Commission:

Thank you for the opportunity to comment on the Advanced Notice of Proposed Rulemaking ("ANPR") on the Business Opportunity Rule ("BOR"). Our association represents direct selling companies and more than 7.3 million active direct sellers who sell to 44.6 million preferred customers, discount buyers and many other consumers. Direct sellers contributed $42.7 billion in estimated retail sales to the American economy in 2021. Sales increased 6.4% from 2020-2021 and have grown almost 22% since 2019.

For more than a century, the Direct Selling Association ("DSA") has served as the national trade association for companies that offer entrepreneurial opportunities to individuals who market and sell products and services, typically outside of a fixed retail establishment. The association serves to police, promote and protect direct selling through advocacy, networking and education for member executives and salesforce.

DSA believes the Federal Trade Commission ("FTC") should finalize its actions on the Trade Regulation Rule on the Use of Earnings Claims[1] ("Earnings Claims Rule") before considering changes to the BOR. If the FTC decides to continue reviewing the BOR, it should refer to the Commission's decision over a decade ago to specifically not cover direct sellers under the BOR. The Commission should also consider updates in consumer protection and technology since 2011 that operate to guard against concerns posed by the FTC in its ANPR on the BOR.

[1] 87 Fed. Reg. 13951 (March 11, 2022)

Direct Selling Provides a Part-Time, Low-Cost Business for Millions of Americans

Direct selling is a significant business model that serves Americans who desire flexibility and prefer personal relationships to sell products and services. These individual sellers are respected by their peers, consumers, and customers.

Direct selling provides a low-cost path to starting a flexible, part-time business in the United States. For the 7.3 million direct sellers, 6.8 million work the business only on a part-time basis to earn modest extra income on the side.[2] This allows individuals to engage in their own business as much or as little as they want depending on their schedule and individual financial goals. Practically any individual can start a direct selling business for an average cost of $82.50[3], which enables them to grow a business on their own terms.

Of particular interest to the FTC, as stated in the ANPR and comments during the open meeting, direct selling is overrepresented compared with the United States population by women (76%) and Hispanics (23%).[4] Direct selling provides a low-cost opportunity for millions of Americans and direct sellers who want to continue operating their business without unduly burdensome regulations. The business serves as a supplemental income source for many underserved communities the rule seeks to regulate.

The FTC Should Finalize Action on the Earnings Claims Rule Prior to Proceeding with Review of the Business Opportunity Rule

The FTC released the Earnings Claims ANPR less than a year ago in March 2022. Nine months later, the Commission released this ANPR on the BOR. A large aspect of BOR is standards and disclosures regarding earnings claims that will likely be impacted by the ongoing Commission rulemaking regarding earnings claims. Review of the BOR should not proceed until the FTC finalizes actions on the Earnings Claims Rule.

The Commission has acknowledged that the BOR, earnings claims, and the Earnings Claims Rule are closely interwoven. In 2021, when the agency announced its initiation of the BOR review, former Commissioner Chopra cited false earnings claims as a primary reason for reviewing the rule.[5] As such, a review of the BOR without completing the earnings claim rule seems untimely.

Additionally, during the FTC's Open Meeting on November 17, FTC staff further recognized the overlap between these rulemakings, saying:

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[2] Direct Selling Association 2022 Growth & Outlook Study. Available at https://www.dsa.org/statistics-insights

[3] DSA 2018 Evolving Marketplace Study, https://www.dsa.org/docs/default-source/research/dsa-ipsos-2020-consumerattitudesinfographic2-27.pdf?sfvrsn=68ddfa5_2

[4] Women are 50.8% and Hispanics are 18.5% of the United States population according to the most recent Census data, https://www.census.gov/quickfacts/US

[5] Statement of Commissioner Chopra Regarding the Business Opportunity Rule, https://www.ftc.gov/system/files/documents/public_statements/1591046/statement_of_commissioner_rohit_chopra_regarding_the_business_opportunity_rule.pdf

> "…[I]mplicitly recognizing some possible overlap between the two initiatives. For that reason, the agency would consider any relevant comments submitted in response to the Commission's Advance Notice of Proposed Rulemaking on Earnings Claims. As such, commentors do not need to resubmit those comments as part of this ANPR. In staff's view, seeking comment on entity's deceptive earnings claims in connection with the Earnings Claims ANPR and this current proposal allows flexibility in determining whether any rulemaking is warranted and if so, how to proceed in an efficient and effective manner."[6]

As the Commission said they will consider any comments previously submitted in the Earnings Claims ANPR, we are re-attaching DSA's comments submitted to that rulemaking (Appendix A) for your reference.

While the Commission recognizes there is overlap between these rules and believes moving forward with parallel rulemakings will give the agency flexibility in considering a rule, this is untenable for millions of small businesses that could potentially be covered by both rulemakings. Staying compliant with the earnings claims provisions of the BOR would be extremely difficult as the Earnings Claims Rule is being considered. Standards and compliance could shift until action is finalized on the rule.

For the FTC, knowing what to include in the BOR regarding earnings claims would also be difficult until consideration of the earnings claims rule has been finalized. Since the regulations would be overlapping, standards could change. The FTC should not only consider efficiency in their consideration of these rulemakings, but also those small businesses that would potentially be regulated and the confusion of difficulty to achieve compliance that would ensure for such small businesses.

Any Expansion in Coverage Should Not Broadly Cover Direct Sellers

As the FTC is aware, direct sellers are not exempted from the current BOR. Although the final BOR rule released in 2011 did not specifically cover direct sellers, the requirements of the rule could still be triggered under certain circumstances. DSA continues to believe the rule remains appropriately scoped as applicable to direct sellers to the extent contemplated by the 2011 BOR.

DSA urges the FTC to carefully consider whether expanding the scope of the BOR to broadly cover direct sellers is needed. Chair Khan recognized the importance of specifically considering businesses that were not considered in 2011. In her statement approving this ANPR, she said, "But it's written in a way that doesn't necessarily capture some business models and practices that have become more widespread in the decade since it was last amended."

When the final Business Opportunity Rule was released in 2011, the FTC said:

[6] November 17, 2022 FTC Open Meeting—Comments of Christine Todaro. Available at, https://www.ftc.gov/media/ftc-open-commission-meeting-november-17-2022

> "The Commission determined that the IPBOR was unworkable with respect to MLMs[7] and would have imposed greater burdens on the MLM industry than other types of business opportunity sellers without sufficient countervailing benefits to consumers."[8]

The final rule went on to say, "The Commission decided that that the proposed rule was too blunt an instrument to alleviate fraud in the sale of MLMs."[9] The FTC stated in its notice that it will continue to challenge unfair and deceptive practices in the industry through its Section 5 authority—which it has done, and has indicated it will continue to do, despite its limitations since the *AMG* decision.[10] This is sufficient FTC purview on direct selling companies, especially when combined with the industry's strong self-regulation and other consumer protections that are already available.

In 2011, the FTC also cited the overwhelming majority of comments received by individual direct sellers (approximately 17,000) that the proposed rule failed to differentiate between unlawful pyramid schemes and legitimate companies using an MLM model in response to the proposed rule.[11]

Direct selling in the United States has substantially increased in the last decade. Growing by almost 44% since 2011.[12] Meaning the impact on small businesses would likely increase with any attendant BOR change. In parallel, the industry's strong self-regulation has increased and developed, dictating against the necessity of broadening the BOR to cover direct sellers.

More recently, Commissioner Bedoya recognized the need to protect small businesses while considering updating the BOR. In Question for the Record responses following his confirmation hearing in the Senate Commerce, Science and Transportation Committee he said regarding the BOR, "I am, however, sympathetic to the specific needs of small businesses and will of course work to ensure they are not met with unnecessary burdens."[13] All direct sellers are micro-entrepreneurs.

DSA hopes the FTC keeps the scope of the BOR narrowly tailored to not broadly cover direct sellers. Rather than revisiting placing burdensome requirements on businesses that have been previously considered, the Commission should refer to its prior discussions on and defer to its previous decisions on this issue.

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[7] Many direct selling companies utilize multilevel compensation structures
[8] 76 Fed. Reg. 76819 (December 8. 2011)
[9] Id at 76822
[10] *AMG Capital Management, LLC v. FTC* (2021)
[11] FR at 76818
[12] 2011 Sales were $29.9 billion.
[13] Questions for the Record, U.S. Senate Committee on Commerce, Science and Transportation "Nomination of Alvaro Bedoya to be a Commissioner of the FTC" November 17, 2021. https://www.commerce.senate.gov/services/files/C092EF26-55AE-4ED3-97CB-12E1AE0BB426

Consumer Protection in Direct Selling Has Increased the Last Decade

Further lessening the need for expansion of the BOR to direct sellers is the significant increase of consumer protections in direct selling since 2011. Expanding the scope of the BOR would not only be inconsistent with past determinations made by the FTC, but would ignore vast improvements in consumer protection made by the industry in the last decade.

Most notably, in 2019, the BBB National Programs ("BBBNP") launched and began administering the Direct Selling Self-Regulatory Council ("DSSRC") as a self-regulatory program. As part of the BBBNP, the DSSRC is entirely independent of DSA, although the association funds the program and supports its tenets and principles. The program monitors the entire direct selling industry in the United States, not just DSA members—and articulates clear standards on many issues, including product, earning, and lifestyle representations.

As one of BBBNP's six advertising self-regulatory programs, the DSSRC is operated solely by the BBBNP and administered by Vice President and DSSRC Executive Director Peter Marinello who brings a wealth of legal and self-regulatory experience from the National Advertising Division and Electronic Retailing Self-Regulation Program. The BBBNP's other notable staff includes Executive Vice President, Policy, Mary Engle, who formerly directed the FTC's Division of Advertising Practices.

The DSSRC was launched at the suggestion of the FTC with DSA executives and member companies over the course of many years. It represents a good example of how private industry, trade industry groups, and government worked together to craft a solution. The DSSRC has referred nineteen cases to the FTC. The FTC should act on these referrals using their Section 5 authority instead of expanding the scope of the BOR.

On top of the greatly significant establishment of the DSSRC to enhance consumer protection in direct selling since 2011, DSA has also updated self-regulatory requirements for our members. Provisions of the Code of Ethics have been greatly updated in the past eleven years in areas of standards for earnings and product substantiation, and inventory repurchase programs, as well as increased transparency regarding complaints to the DSA Code Administrator.[14]

Because of these updates, past determinations regarding coverage of the BOR as it applies to direct sellers should stay consistent. The Commission should consider these significant improvements in consumer protection for direct sellers and their customers over the last decade as it determines proceeding with an ANPR and the expanded scope of a potential update.

There are Sufficient Regulatory Tools to Seek Refunds for Defrauded Consumers

The ANPR cites the *AMG* decision[15] as rationale for reviewing the BOR. Further stating that the unanimous United States Supreme Court decision made it difficult to seek refunds for defrauded

[14] Direct Selling Association Strengthens Its Self-Regulatory Framework with Additional Consumer Safeguards and Greater Transparency, https://www.dsa.org/events/news/individual-press-release/direct-selling-association-strengthens-its-self-regulatory-framework-with-additional-consumer-safeguards-and-greater-transparency

[15] AMG Capital Management, LLC v. FTC (2021)

consumers. The current BOR and other regulatory mechanisms by the FTC provides the Commission many additional avenues to protect consumers outside of an action under Section 13(b) of the FTC Act. Additionally, working with state law enforcement officials, many of which enforce business opportunity laws, can result in refunds for consumers. DSA's comments on the Earnings Claims Rule go further into these mechanisms.[16]

Current Regulatory and Self-Regulatory Standards Protect Consumers

The concerns raised by direct sellers in 2006 when the scope of the BOR was broad and could have covered millions of micro-entrepreneurs are still present and, in some cases, would be even more burdensome now if the BOR were to be expanded to direct sellers. The FTC acknowledged these concerns in 2011 when the final rule was released and specifically did not cover direct sellers.

The issues raised in these comments, technological advancements, and increased self-regulatory standards, combine to further decrease the need to expand the scope of the BOR to direct sellers.

<u>The Disclosure Document Continues to be Burdensome for Direct Sellers, Creates Inequity in American Businesses and Technological Advancements Have Made the Disclosure Moot</u>

The major compliance obligation under the BOR is to furnish a written document for each potential business opportunity participant. As understood by the FTC in 2006 and 2011, the disclosure document and the contents of it would impose undue burdens on direct sellers.

DSA raised these concerns in 2006 when the scope of the BOR was broad and could have swept in direct sellers. To remind the FTC of those concerns, we are attaching DSA's comments on the 2006 BOR NPRM (Appendix B). DSA conducted a study on the negative impacts the disclosure document could have had on prospective business participants. The study surveyed American consumers and demonstrated that the requirements that could have been imposed under the BOR substantially chilled the interest for being involved in direct selling. Potentially taking away a part time earning opportunity for millions of Americans. This remains true.

The chilling and confusion experienced by prospective business owners could outweigh any protection the disclosure document would provide to consumers. We are attaching the study "*Potential Impacts of the FTC's Proposed Business Opportunity Rule on the Direct Selling Industry*, Nathan Associates Inc., Jul. 14, 2006." (Appendix C) which further articulates the significant negative impact these requirements could have on direct sellers.

Interest and opinions of direct selling have remained stable the last decade. Seventy-nine percent of Americans have a favorable opinion of direct selling and see the business as an attractive option for entrepreneurship.[17] Perception has remained high with the growth of technology that has allowed direct sellers to establish and grow their businesses with an online presence. The

[16] Appendix A

[17] 2020 DSA/IPSOS Consumer Attitudes & Entrepreneurship Study, https://www.dsa.org/docs/default-source/research/dsa-ipsos-2020-consumerattitudesinfographic2-27.pdf?sfvrsn=68ddfa5_2%27

disclosure document could prevent individuals from engaging in a business that has a positive perception.

As previously mentioned, most direct selling businesses can be started for under $100. According to the Small Business Administration, the average cost to start a franchise is typically $20,000 or $50,000.[18] The FTC's franchise rule requires the same or similar requirements such as a seven-day pre-sale waiting period and document that discloses litigation and other business participants.[19] Requiring a disclosure document with similar requirements for direct sellers could result in a chilling and inequity of business opportunities across the American economy.

The FTC should also consider that technology has rendered many of these requirements outdated. The internet and social media have resulted in more informed consumers who can easily and quickly research other consumer experiences in the business to make an informed decision. Those factors combined with the pendency of the Earnings Claims Rule further illustrate the scope of the BOR should not be expanded to direct sellers. Please find below a brief discussion of the current requirements under the BOR and how they they remain burdensome and moot in modern businesses.

Consideration of the Earnings Claims Rule Should be Finalized

Ensuring that prospective salesforce members fully understand the earnings potential of direct selling is of paramount importance to DSA and our members. High standards exist to follow FTC guidance on informing potential direct selling participants of business costs and expected outcomes and the association has worked with the Commission on further refining this guidance.

As previously discussed, DSA believes the FTC should not proceed with review of the BOR until it concludes reviewing the Earnings Claims Rule. DSA agrees with the FTC that direct sellers should have a reasonable basis and substantiation for all earnings claims made as articulated under the current BOR. This is mirrored in the direct selling industry's successful self-regulation. In 2011, the FTC acknowledged in the final BOR that "the varied and complex structure of MLMs make it difficult to make an accurate earnings disclosure."[20]

Although there is much guidance on the definitions of reasonable basis and substantiation, the FTC has sought further clarity on creating standards for permissible earnings claims through the ANPR on Earnings Claims. Since earnings claims are such a large aspect of the BOR, and could create conflicting or duplicative standards and disclosures, the FTC should conclude its parallel rulemaking on that subject prior to proceeding further on the BOR.

Self-Regulatory Standards Provide Better Protection than a Seven Day Waiting Period

The requirement under the BOR that a disclosure document must be furnished at least seven calendar days prior to the execution of a contract or payment would be burdensome for direct

[18] Small Business Administration, Franchise Fees: Why Do You Pay Them And How Much Are They? https://www.sba.gov/blog/franchise-fees-why-do-you-pay-them-how-much-are-they
[19] 16 CFR § 436 and 437
[20] FR 76823

sellers. Many direct sellers engage in the business for specific periods of time and purposes, such as around the holidays. Imposing a seven-day waiting period before being able to sell would delay the earning opportunities for potential participants who may want to start selling immediately to meet these needs. More importantly, as cited above, self-regulatory standards in direct selling already exist and are enforced that protect consumers without burdening legitimate businesses.

The Commission deemed the seven-day waiting period necessary to enable a prospective purchaser to review the information contained in the disclosure document and conduct due diligence in contacting references.[21] The inherent harm the waiting period aims to guard against is consumers losing money by entering into a business transaction with little knowledge of the business.

However, this protection is already embedded in DSA self-regulation of the direct selling industry that covers the vast majority of Americans who enter into a direct selling business. The DSA Code of Ethics requires all companies to repurchase marketable inventory, promotional materials, sales aides, tools and kits within twelve months from the salesperson's date of purchase at not less than 90 percent of the original net cost.[22]

This provides salespeople significantly longer than seven days after engaging in the business to prevent potential losses from the business. Also, states laws in Louisiana[23], Maryland[24], Massachusetts[25] and Wyoming[26] require companies to repurchase inventory consistent with the provision in the Code of Ethics. Participants may experience the business for a year and decide if it meets their needs with minimal financial risk. This kind of standard provides more consumer protection in direct selling than making business participants wait seven days before engaging in the business, thereby obviating the need for such a waiting period.

Disclosure of Legal Actions is Overbroad and Unnecessary

The requirement to disclose legal actions of key personnel being "subject to" any criminal or civil action in the last 10 years remains overbroad. Many of these lawsuits are irrelevant to the structure or viability of the business. Under the broad breadth of the current BOR, companies could be required to disclose lawsuits that are completely irrelevant to the business opportunity. For example, lawsuits regarding intellectual property disputes. These kinds of litigation have no bearing on the business opportunity. Although the FTC narrowed the scope in the final rule to not include salespeople of companies, this disclosure would still be unworkable for direct sellers.

The requirement that direct sellers create, monitor, maintain update and consistently provide a document with such a breadth of information, most of which is potentially irrelevant to the business opportunity the participant is engaging in, is impractical and overly burdensome. In the

[21] 76 Fed. Reg 76839
[22] DSA Code of Ethics, A(7)
[23] La. Adm. Code tit. 16, Part III, § 503 (2022)
[24] Md. Code Ann., Bus. Reg. § 14-302 (2022)
[25] Mass. Gen. Laws Chapter § 93 Section 69 (2022)
[26] WY Stat § 40-3-104 (2022)

over ten years since this requirement has been implemented, there are also more informed consumers that can search the internet for many legal actions. Not only is this legal disclosure requirement unnecessary, it also has become obsolete.

Direct Selling Companies Have Written and Robust Refund Policies

The current BOR requires the cancellation or refund policy to be included in writing with a transaction. As previously mentioned, for DSA members, the association Code of Ethics requires that companies shall repurchase marketable inventory, promotional materials, sales aids, tools and kits within twelve months from the salesperson's date of purchase at not less than 90 percent of the original net cost.[27]

This protection provided to most consumers engaging in direct selling largely removes the harm the BOR seeks to remedy. Like the requirements under the BOR, the DSA Code of Ethics requires the cancellation and refund policy be in writing as well.[28] So consumers are fully aware of the protections provided so they can minimize financial loss.

DSA agrees with the BOR that consumers should have a robust refund policy and be fully informed of their rights to cancel. However, this principle is already implemented as a part of all DSA membership requirements to member businesses. The BOR would make disclosure in a separate document duplicative and again, overly burdensome.

The Rise of Social Media has Made Ten References Requirement Superfluous

A more informed consumer in the internet age as well as increasing concern and action about consumer data security and privacy makes the requirement to provide ten references superfluous and compromising to consumer data. The internet has resulted in a very informed consumer who can research and access the experience of other past and current business participants quickly and efficiently, not just those potentially curated by the entity offering the opportunity. Additionally, the risk of compromising consumer privacy rights by requiring this information could have broad implications for consumer data privacy.

In the 2011 final rule, the FTC said that that imposing this requirement [ten references] on direct sellers would make "little sense" as it "would not provide prospective MLM participants with an accurate account of the MLM experience or with the information necessary to make an informed purchasing decision."[29] This remains true. The Commission should stand by its decision and recognize that since 2011, consumers have even more access to individuals who have engaged in the business through the internet to make an informed decision—further lessening the need for this requirement.

The risk of compromising sensitive consumer information has also increased in the last decade. Recognizing this, Congress and the FTC have made creating standards to protect consumer data

[27] DSA Code of Ethics, Section A(7)
[28] Id.
[29] FR 76823

a priority the past year. The Commission just closed a comment period on an ANPR[30] and legislation that has passed the House of Representatives last year[31] that seeks to give consumers more control over their data. State governments are active in this area of law as well.

Although consent is required to share data in the BOR, the more times information is shared the more likely it is to be compromised. Senior FTC staff have acknowledged the risk that could be presented with massive accumulations of consumer data that could be required for direct sellers under the BOR.

The ten references requirement could result in more consumer data being stored and disseminated. Bureau of Consumer Protection Director Sam Levine recently said, "The accumulation and maintenance of massive stores of consumer data creates an inviting target to cyber threat actors."[32] Additionally, a consumer also may not allow their information to be used, not because they did not have a positive experience in the business, but because they don't want their information shared. Both factors could complicate the disclosure requirement.

According to a 2021 study by Pew Research Center, roughly seven-in-ten Americans say they use a form of social media.[33] The number grows to over eight-in-ten when looking at consumers between the age of 18 to 49.[34] The rise of the internet and social media specifically have given American consumers the ability to easily contact others who are involved in a business they are considering and gain insights. The ten references requirement has become more perilous and moot since 2011.

Further Collaboration on Business Opportunity Rule

DSA has enjoyed collaborating with the FTC over many years to ensure that current and prospective direct sellers as well as consumers are protected. A rulemaking to amend the BOR should not proceed until actions on a rule regarding Earnings Claims has concluded. Moving both rules concurrently would create a confusing regulatory landscape for millions of micro-entrepreneurs in the United States.

Additionally, the FTC should rely on its analysis from 2011 on why the rule specifically did not cover direct sellers over a decade ago in the BOR. Those arguments are still relevant today and the harm this rule would cause the direct selling industry has not changed. In many cases, technology and how Americans get information has made some of the BOR requirements moot.

The direct selling commitment to consumer protection has only increased in the last decade. This has been reflected by updates the industry and association have made in self-regulation since the FTC's last consideration of the BOR, which emerged from public-private collaboration between

[30] 87 Fed. Reg. 63, October 20, 2022

[31] H.R. 8152—The American Data and Privacy Protection Act (117th Congress)

[32] Keynote Remarks of Samuel Levine, Cleveland Marshall College of Law Cybersecurity and Privacy Protection Conference, https://www.ftc.gov/system/files/ftc_gov/pdf/Remarks-Samuel-Levine-Cleveland-Marshall-College-of-Law.pdf

[33] https://www.pewresearch.org/internet/2021/04/07/social-media-use-in-2021/

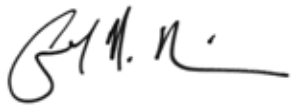
[34] Id. 18 to 29 is 84% and 30 to 49 is 81%

the DSA and the FTC. The above considerations should be controlling in the Commission's decision to expand the scope of the rule as applicable to direct sellers, which it should not for the reasons discussed.

If the Commission determines if it will proceed with a rulemaking to amend the BOR, we hope it will take an approach that preserves the ability of millions of American small direct selling businesses to provide great products to consumers and billions of dollars in economic impact.

DSA is happy to answer any questions or provide additional information and look forward to our continued work together.

Sincerely,



Joseph N. Mariano
President
Direct Selling Association

APPENDIX A

DIRECT SELLING ASSOCIATION

May 10, 2022

Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue NW
Suite CC-5610 (Annex B)
Washington, DC 20580

Re: Advanced Notice of Proposed Rulemaking: Trade Regulation Rule on the Use of Earnings Claims

Dear Federal Trade Commission:

Thank you for the opportunity to comment on the Advanced Notice of Proposed Rulemaking ("ANPR") to address deceptive earnings claims. Our association represents more than 7.3 million active direct sellers and 44.6 million preferred customers and discount buyers that contributed $42.7 billion in sales to the American economy in 2021. Sales increased 6.4% from 2020-2021 and have grown almost 22% since 2019.

For more than a century, the Direct Selling Association ("DSA") has served as the national trade association for companies that offer entrepreneurial opportunities to individuals who market and sell products and services, typically outside of a fixed retail establishment. The association serves to police, promote and protect direct selling through advocacy, networking and education for member executives and salesforce.

We share the goals of the Federal Trade Commission ("FTC") that any earnings claims made by businesses, including direct selling companies and their independent salesforce members should not be deceptive or misleading to ensure potential and current business participants have a reasonable expectation of income that can be earned. DSA and our members work tirelessly to protect consumers. We also work diligently to abide by existing laws, rules, guidance, and supervisory requirements that prohibit such practices and protect consumers.

As the FTC considers moving forward with a rule, it should balance the goal of protecting consumers with measures already in place without disrupting the ability of millions of micro-entrepreneurs in the United States to establish their own small businesses and provide beneficial products and services to their consumers.

Because strong ethics, self-regulation and compliance mechanisms are already used in direct selling, we believe a rule on deceptive earnings claims is not warranted. The Commission has also not provided adequate legal or statistical information in the record to justify proceeding with a rule. However, if the rulemaking does proceed, it should follow years of FTC precedent

and advertising principles to ensure a predictable regulatory framework for businesses and consumers.

Background of Direct Selling

Direct selling is a significant business model that serves Americans who desire flexibility and prefer personal relationships to purchase products. These individual sellers are respected by their peers, consumers, and customers.

Industry Statistics

Direct selling provides a low-cost path to starting a flexible, part-time business in the United States. For the 7.3 million direct sellers, 6.8 million work the business only on a part-time basis to earn modest extra income on the side. This allows individuals to engage in their own business as much or as little as they want depending on their schedule and individual financial goals.

Practically any individual can start for an average of $82.50, which enables them to grow a business on their own terms.[1] Direct selling is overrepresented compared with the United States population by women (76%) and Hispanics (23%).[2] Once established, direct sellers may choose to build their business by introducing it to others and can share the business with their friends, family and customers.

Americans Have a Favorable Opinion of Direct Selling

Seventy-nine percent of Americans have a favorable opinion of direct selling and see the business as an attractive option for entrepreneurship. These perceptions have remained stable for the last decade.[3] Perception has remained high with the growth of technology that has allowed direct sellers to establish and grow their businesses with an online presence.

The stability in perception is also notable because technology has resulted in a more informed consumer. They have choices of where they shop and with whom and increasingly are choosing direct sellers. Research has shown that true harm is mostly absent from direct selling.[4] DSA and its member companies share the FTC's goal to protect consumers and engage robust compliance practices to effectuate this goal.

Ethics, Self-Regulation and Compliance Within Direct Selling

As the FTC considers whether to proceed with a new rule, it should acknowledge the extensive self-regulatory and compliance practices that already exist in direct selling. For

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[1] DSA 2018 Evolving Marketplace Study, https://www.dsa.org/docs/default-source/research/dsa-ipsos-2020-consumerattitudesinfographic2-27.pdf?sfvrsn=68ddfa5_2

[2] Women are 50.8% and Hispanics are 18.5% of the United States population according to the most recent Census data, https://www.census.gov/quickfacts/US

[3] 2020 DSA/IPSOS Consumer Attitudes & Entrepreneurship Study, https://www.dsa.org/docs/default-source/research/dsa-ipsos-2020-consumerattitudesinfographic2-27.pdf?sfvrsn=68ddfa5_2%27

[4] Anne Coughlan, *Consumer Harm from Voluntary Business Arrangements: What Conditions are Necessary?* Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3488105

decades, DSA and its member companies have developed a variety of compliance activities with successfully. These mechanisms have proven to be effective and can be backstopped by government enforcement action for the most egregious actions.

The DSA's organizational structure supports self-regulation not only for DSA members, but the entire direct selling business model. As described below, members are held to strict standards as a condition of DSA membership through our Code of Ethics. Understanding the importance of investing in self-regulation, the association also funds an independent entity for that purpose, the Direct Selling Self-Regulatory Council ("DSSRC").

The DSSRC is one of the largest annual line items for the association and applies to the entire direct selling business, not just DSA members. DSA also conducts extensive educational training and assures that its members implement and enforce customer protection laws and regulations through rules, guidelines, and standards.

DSA Code of Ethics

For 40 years, the DSA has had a Code of Ethics[5] that is required for all members. Consumers and salespeople can file complaints with the independent Code Administrator if they believe a provision of the Code of Ethics has been violated. In 2021, the DSA Code Administrator received ninety-six cases that were found to be under its purview and received another thirty-five that were deemed to not be under their authority because they were personal complaints not based on the business, were not DSA members, or it was an issue originating from outside the United States. Most complaints were resolved within 30 days, and only 1% of allegations were related to earnings claims.[6]

In alignment with FTC guidance[7], the DSA Code of Ethics states that earnings claims made by member companies and their independent salespeople must be truthful, accurate, and presented in a manner that is not false, deceptive, or misleading. Additionally, the Code of Ethics requires that independent salespeople are provided with sufficient information to enable a reasonable evaluation of the opportunity to earn income and that any information presented is substantiated.[8] The provisions of the Code of Ethics have been updated regularly to remain consistent with regulatory guidance and have received substantial substantive updates many times over the last 40 years.

To ensure consumer protection, the DSA Code of Ethics requires its members adhere to a 90% inventory repurchase agreement. The policy requires all DSA members to repurchase on reasonably commercial terms currently marketable inventory in possession of the salesperson within twelve months from the salesperson's date of purchase at not less than 90 percent of the

[5] DSA Code of Ethics, https://www.dsa.org/docs/default-source/code-of-ethics/dsa-code-of-ethics-december-2018.pdf?sfvrsn=5598cda5_10

[6] 2021 Code of Ethics Compliance Report, https://www.dsa.org/docs/default-source/code-of-ethics/dsa_coe-compliance2021_generic_v2.pdf?sfvrsn=ec72d7a5_2

[7] Business Guidance Concerning Multi-Level Marketing, https://www.ftc.gov/business-guidance/resources/business-guidance-concerning-multi-level-marketing

[8] DSA Code of Ethics, Section A(8), https://www.dsa.org/docs/default-source/code-of-ethics/dsa-code-of-ethics-december-2018.pdf?sfvrsn=5598cda5_10

salesperson's original net cost.[9] Thus, if a consumer comes into possession of products based on a false or deceptive earnings claim, they have a remedy to ensure minimal harm. The DSA Code of Ethics requires the buyback to be published in multiple formats and locations in a manner easily understood by a typical independent salesperson.

Direct Selling Self-Regulatory Council

In 2019, the BBB National Programs ("BBBNP") launched and began administering the DSSRC as a self-regulatory program. As part of the BBBNP, the DSSRC is entirely independent of DSA, although the association funds the program and supports its tenets and principles. The program monitors the entire direct selling industry in the United States—not just DSA members—and articulates clear standards on many issues, including product, earning, and lifestyle representations.

As one of BBBNP's six advertising self-regulatory programs, the DSSRC is operated solely by the BBBNP and administered by Vice President and DSSRC Executive Director Peter Marinello who brings a wealth of legal and self-regulatory experience from the National Advertising Division and Electronic Retailing Self-Regulation Program. The BBBNP's other notable staff includes Executive Vice President, Policy, Mary Engle, who formerly directed the FTC's Division of Advertising Practices.

The DSSRC was launched at the suggestion of senior FTC staff with DSA executives and member companies over the course of many years. It represents a good example of how private industry, trade industry groups, and government worked together to craft a solution.

In 2020, the DSSRC released Earnings Claims Guidance in alignment with FTC guidance.[10] The guidance serves as an additional educational resource for companies and independent salespeople. It educates them on presenting truthful claims on social media to ensure a reasonable consumer has access to information and does not carry unrealistic expectations of earnings or lifestyle potential. This is especially important for consumers deciding whether to join a direct selling company and which company to join.

Self-Regulation Has Proven to Be Effective

In its first full three years of operation, the DSSRC has demonstrated how self-regulation not only ensures consumers are protected, but also provides data demonstrating how self-regulation is working to monitor false and misleading claims. The DSSRC has reviewed an average of 300,000 URLs per year. Within those 900,000 URLs, 784 were earnings claims deemed to be potentially deceptive to a reasonable consumer and removed from social media. That is only .0008% of the total URLs reviewed contained an earnings claim.

Moreover, the .0008% is far too large in terms of number of postings. The DSSRC reviewed only URLs that raised potential violations. Given the number of social media postings on various social media outlets made by 7.3 million independent salespeople in the direct selling industry daily, the number of posts are likely in the millions annually. As a result, the percentage

[9] DSA Code of Ethics, Section A(7)

[10] https://bbbnp-bbbp-stf-use1-01.s3.amazonaws.com/docs/default-source/dssrc/dssrc_guidanceonearningsclaimsforthedirectsellingindustry_2020.pdf?sfvrsn=4ecfcd36_8

of violative claims extrapolated is likely far smaller than .0008%, and thus the overall scope of claims that could potentially cause consumer harm is minute.

Of the 325 total cases that DSSRC has opened to date, a total of 180 included earnings claims—that is, 55.4% of the total. Of that number, approximately 85% of these 180 cases are claims that completely omitted a disclosure or disclaimer. In 2021, DSSRC brought 709 representative claims to the attention of direct selling companies, 378 were related to earnings claims.[11] They were either immediately removed and sent to an administrative closure or the subject of a public case decision.

In addition to its robust case work and industry education, the DSSRC employs a strong enforcement mechanism by referring cases to the FTC. In the past three years, seventeen cases have been directly referred to the FTC by the DSSRC for potentially deceptive earnings and product claims. The DSSRC spends considerable time, effort and resources on each case referred to the FTC, including by providing the FTC a case summary, legal points and authorities, and an evidence file.

Compiling these cases and referring them to the FTC saves the Commission valuable time and resources when searching for claims that could harm consumers as these matters have been investigated by an independent and reliable body that provides significant work without expending government resources.

DSA Collaboration and Education

DSA has also provided education programs for decades and has expanded its consumer protection education. In 2021, DSA launched the Direct Selling Compliance Professional Certification Program for individual member executives. In its first three offerings, over three hundred executives have become certified through the program, which has sharpened the industry's understanding of key concepts related to company compliance programs. A major aspect of the program is education regarding current laws, regulations and guidance related to earnings claims to ensure that member company executives have the same basic understanding of key concepts sharing compliance, consumer protection, and effective self-regulation.

Likewise, to increase information sharing regarding compliance best practices and collaboration amongst our member executives about applicable regulations and to ensure good compliance practices in the marketplace, the DSA Board of Directors approved the establishment of the Compliance Officers Council. The Council is currently working on proposals to augment and bring consistency to compliance practices across the direct selling industry for members and non-members alike.

Company Rules, Guidelines, Standards, and Enforcement

In addition to the guidance and rules promulgated by DSSRC and the DSA Code of Ethics, member companies often exceed these requirements. Companies use their own customized methods designed to foster and ensure ongoing compliance and education regarding the importance of presenting their business appropriately. In addition to protecting their

[11] DSSRC 2021 Year End Activity Report, https://www.dsa.org/docs/default-source/dssrc/dssrc-2021-annual-activity-report.pdf?sfvrsn=244ad7a5_2

reputation and their independent sales force, companies want to ensure compliance to protect customers.

Companies engage with independent salesforce members to ensure an understanding about the policies and procedures that govern the contractual relationship between them and the company. For example, companies focus on educating their independent salesforce members on the applicable laws, rules and regulations. These educational efforts are ongoing with salesforce members to ensure any earnings claims made are not false, deceptive, or misleading for consumers and also serve to protect consumers from harm.

Companies also monitor the marketplace, especially social media, for claims that violate their rules and guidelines. Many companies use webcrawlers to flag potential violations of company policies regarding earnings and lifestyle claims and assist them in having such claims immediately removed. For more serious and repeat violators, companies regularly penalize, suspend, and even terminate salesforce members for violations of their policies.

There are Sufficient Regulatory and Self-Regulatory Tools to Address Deceptive Earnings Claims

Although the ANPR suggests that the recent unanimous Supreme Court decision in *AMG Capital Management v. FTC* is one of the key reasons why the Commission is considering a rule regarding earnings claims, the FTC already has many tools to prohibit these claims. Despite the loss of Section 13(b) of the FTC Act as a way to recover money, the Commission still has many effective authorities that allow it to stop unlawful conduct and recover money for consumers, and at times obtain penalties, including in actions involving deceptive earnings claims. These should continue to be utilized instead of proceeding with a rulemaking.

Current Authority Used by the FTC to Collect Monetary Damages

The FTC can file administrative complaints alleging violations of the FTC Act and use Section 19 of the FTC Act to obtain monetary relief after the administrative action is complete. Section 19 provides that once there is a final cease and desist order in the administrative litigation, the FTC can seek to establish that "the act or practice to which the cease and desist order relates is one which a reasonable [person] would have known under the circumstances was dishonest or fraudulent" and pursue monetary relief."[12]

Indeed, the FTC has recently seen a notable increase in the volume of administrative litigation, demonstrating this as a viable tool for the Commission to use. In a recent case, the FTC filed two actions against the same company, one in federal court in order to obtain preliminary relief and one in administrative court.[13] The FTC Act, and Sections 13 and 19 in particular, afford the FTC great flexibility in how it can bring and structure lawsuits and the

[12] That relief can include "rescission or reformation of contracts, the refund of money or return of property, the payment of damages, and public notification respecting the rule violation or the unfair or deceptive act or practice, as the case may be; except that nothing in this subsection is intended to authorize the imposition of any exemplary or punitive damages."

[13] Press Release, FTC Sues Intuit for Its Deceptive TurboTax "free" Filing Campaign (March 29, 2022) https://www.ftc.gov/news-events/news/press-releases/2022/03/ftc-sues-intuit-its-deceptive-turbotax-free-filing-campaign.

types of relief it can obtain. The FTC can bring an action under Section 13 for injunctive remedies and Section 19 for monetary relief. The Commission is not powerless to collect money for consumers.

And yet there are still more tools available to the Commission short of promulgating a rule. The FTC has a long history of working cooperatively with states and bringing joint actions. The states' ability to obtain monetary relief was not affected by *AMG,* and the FTC continues to bring joint actions with the states, where the states focus on obtaining monetary relief. The Commission has taken this course of action frequently, both before and after the *AMG* decision with respect to earnings claims. In June 2021, the FTC filed a joint complaint with the state of Arkansas against an alleged pyramid "blessing loom" scheme.[14] In 2018, the FTC joined the state of Minnesota to go after a money-making operation that was based out of Minnesota.[15] Thus, the FTC is using the authority already provided to obtain monetary and injunctive relief to address consumer protection and harm issues.

It is also worth noting that although most, if not all the law enforcement cases cited in the ANPR were brought by the FTC before the *AMG* decision was issued, the FTC could have brought many if not all of these cases through the same combination of the authorities and processes discussed above. The Commission could have achieved the same or comparable results without the use of 13(b) or a specific rule designed to address earnings claims.

Other Authorities Used by the Commission to Quickly Remove Claims

In addition to Sections 13 and 19 of the FTC Act, there are still additional tools at the FTC's disposal the Commission can use to quickly remove deceptive earnings claims, including through the Penalty Offense Authority. In October 2021, the Commission sent 1,100 letters and notices to companies warning them of potential civil penalties if the companies misrepresented, among other things, "that a substantial number of participants have made or can make the represented profits or earning."[16]

As the FTC explained in its press release, the letters suggested strongly that this is a highly effective tool for the Commission to use against companies that make deceptive earnings claims, stating that companies that use deceptive earnings claims would pay "a heavy price."[17] Direct selling companies have heeded these letters, taking them with the seriousness they deserve and have certainly been informed that the Commission will seek to use its penalty authority

[14] Press Release, FTC and the State of Arkansas Charge Operators of "Blessing Loom" With Running an Illegal Pyramid Scheme (June 17, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/06/ftc-state-arkansas-charge-operators-blessing-loom-running-illegal-pyramid-scheme.

[15] Press Release, FTC and State of Minnesota Halt Sellers Playbook's Get Rich Scheme (Aug. 6, 2018), https://www.ftc.gov/news-events/news/press-releases/2018/08/ftc-state-minnesota-halt-sellers-playbooks-get-rich-scheme.

[16] FTC Notice of Penalty Offenses Concerning Money-Making Opportunities, https://www.ftc.gov/system/files/attachments/penalty-offenses-concerning-money-making-opportunities/mmo-notice.pdf.

[17] Press Release, FTC Puts Businesses on Notice that False Money-Making Claims Could Lead to Big Penalties (Oct. 26, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/10/ftc-puts-businesses-notice-false-money-making-claims-could-lead-big-penalties ("Preying on consumers and workers with bogus promises of big earnings should never be profitable," said Samuel Levine, Director of the FTC's Bureau of Consumer Protection. "Today's announcement helps ensure that companies that cheat struggling Americans will pay a heavy price.")

under Section 5(m)(1)(B) if there are future law enforcement actions involving false or unsubstantiated earnings claims.

The Commission has also used warning letters as a mechanism to contact businesses to quickly remove false or deceptive earnings claims from the marketplace and thus prevent harm in a timely manner. The FTC has sent warning letters to companies advising them to remove claims within 48 hours and these deadlines are taken seriously and have always been followed by responsible companies. The letters and published notices are an effective means to further consumer protection without the need for further rulemaking.

Indeed, in April 2021, Acting Director of the Bureau of Consumer Protection Daniel Kaufman said in written testimony for a congressional hearing:

> "Warning letters can be issued more quickly than a court complaint and proved to be overwhelmingly successful in removing potentially dangerous claims from markets. The Commission has monitored responses to these warning letters closely and has been pleased to see that in a vast majority of cases, letter recipients removed problematic claims quickly."[18]

The FTC has been given a panoply of tools to remove deceptive earnings claims from the marketplace expeditiously and collect money for consumers. The Commission should continue using these tools instead of promulgating a new rule.

The FTC's Authority Should be Delegated by Congress

The Commission also has a variety of tools given to it by Congress over the years and should continue relying on those. Working with elected leaders who represent members of their communities to pass legislation in these areas is a vital element to determine what additional tools are needed or valid.

Congress continues to debate whether and how to reform Section 13(b) that will allow the FTC to seek monetary relief more generally in federal court. That discussion continues, and the FTC should let Congress do its proper assessment and not move forward with a rule without knowing the extent of the 13(b) authority Congress will provide to the Commission. To the extent that Congress wants to amend Section 13(b) to provide the FTC with the means to recover additional monetary redress in federal court, Congress should make that assessment and legislate accordingly.

For example, in 2020, Congress enacted the COVID-19 Consumer Protection Act[19] which provides that marketers who make deceptive claims about the treatment, cure, prevention, or mitigation of COVID-19 are subject to civil penalties of up to $46,517 per violation. The Act provides the FTC with avenues to easily collect monetary damages from consumers allegedly harmed by these claims and provides a good example where Congressional legislation has provided tools to protect consumers and guard against consumer harm.

[18] Curbing COVID Cons: Warning Consumers about Pandemic Frauds, Scams, and Swindles of the United States Senate Committee on Commerce, Science and Transportation Subcommittee on Consumer Protection, Product Safety, and Data Security, 117th Congress (2021) (testimony of Daniel Kaufman)

[19] Section 1401, Division FF of the Consolidated Appropriations Act, 2021, Pub. L. No. 116-260

DSA supports the FTC having tools to bring enforcement actions against frauds and scams with appropriate safeguards. Specifically, earlier this year, DSA and other national trade associations signed a letter to the United States Senate Commerce, Science and Transportation Committee supporting S. 3410 "The Consumer Protection and Due Process Act," sponsored by Senator Mike Lee.[20] DSA will continue to support efforts to ensure there are appropriate, common sense tools to adequately address and prevent against consumer frauds and scams.

The Record Does Not Support the Need for a New Rule or any Prohibition Against Atypical Earnings Claims

The ANPR, for the first time, raises the prospect of the FTC dramatically changing its approach regarding how it oversees claims made for money making opportunities. It has approached such claims in the ANPR that is fundamentally at odds with Commission advertising principles and jurisprudence that has been in place for decades.[21]

The ANPR concedes that the FTC already has specific tools regarding earnings claims, in the TSR, the Franchise Rule and the Business Opportunity Rule. And notably, none of those rules flatly prohibit atypical earnings claims. Despite a history of successful law enforcement and self-regulation in this area, the FTC is considering targeting earnings claims for prescriptive regulation and treating these claims as fundamentally different than all other advertising claims.

<u>The Law Enforcement Actions Cited Do Not Attempt to Disclaim or Disclose Atypical Earnings</u>

After decades of jurisprudence and guidance that has greatly benefited consumers and businesses, the Commission is now proposing a rule that would, among other things, take the unprecedented step of implementing a blanket ban on atypical earnings claims and preclude the use of clear and conspicuous disclosures which could clarify and qualify these claims to avoid providing any misleading impressions that could be caused. [22]

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[20] https://www.uschamber.com/assets/documents/220201_Coalition_S3410ConsumerProtection_Sen-CST.pdf

[21] The term "atypical claims" frequently appears in this comment and is used to describe any earnings representations that may exceed what the typical distributor achieves in the program. This includes specific numerical amounts as well as lifestyle claims, which the ANPR describes as "getting to go on expensive vacations, quitting your job, or buying a luxury car." Lifestyle claims, however, can be far more mundane, and can express far less extravagant goals. It is worth noting that many of the cases cited in the ANPR challenged both express earnings claims as well as lifestyle claims. See, e.g., Success by Health Complaint, FTC v. Noland, Case Mo. CV-20-0047-PHX-DWL (filed D. Ariz. 2020) (recruiting materials "includes a 'Lifestyle' section picturing a luxury car and highlighting 'exotic reward trips and vacations' and 'luxury and living incentives'").

[22] "The Commission also is interested in exploring disclaimers: Specifically, whether a disclaimer can be sufficient to correct a misleading impression from an atypical earnings claim, and, if so, what features such a disclaimer must have, and in what contexts will it suffice. In the Commission's experience, we have not seen probative evidence that disclaimers effectively cure atypical earnings claims. In Commission enforcement actions where defendants have argued that disclaimers or disclosures cured any deceptive earnings claims, courts have repeatedly found otherwise. Further, research by the Commission has found that even clear and prominent disclaimers of "Results not typical" or the stronger "These testimonials are based on the experiences of a few people and you are not likely to have similar results," are not sufficient to dispel the implication that a testimonial depicts typical results. Yet, some companies continue to use disclaimers with such language. Based on the foregoing, the Commission seeks comment, information, and evidence on whether a disclaimer can be sufficient to correct an otherwise misleading impression created by earnings claims, and, if so, whether and how the issue should be addressed in a rule."

Such a body of case law does not provide the evidence legally required to support the need for a new rule. A rule that would ban the use of anything other than typical earnings claims would reflect a fundamental shift in FTC jurisprudence, and there has been no authority cited supporting any reason to single out earnings claims for such special treatment while allowing the use of disclaimers in other contexts.

Notably, the FTC would be making this seismic shift only with respect to earnings claims without any clear rationale as to why earnings claims would or should be treated differently from the broad array of other advertising claims that also have the potential to create deception if clarifying information is not adequately disclosed.

Relatedly, the ANPR suggests that the Commission would also propose a rule that included a vague blanket ban on "lifestyle claims." As discussed more below, these actions would conflict with core First Amendment protections afforded to commercial speech and do not comport with the Supreme Court's directive that such restrictions should be a last resort and not a first.

Advertisers in every industry, from direct sellers to car manufacturers, to insurance companies, to telecommunicators, to travel companies use clear and conspicuous disclaimers to effectively qualify claims. The ramifications of a rule based upon a false premise that disclaimers are ineffective to qualify claims would be contradictory to years of advertising precedent and practices.

The ANPR appears to base this proposal in large part on the FTC's track record of law enforcement in this area. Indeed, the ANPR is replete with successful cases brought by the FTC that involve allegedly unsubstantiated earnings claims. Some are settlements and some are the result of extensive litigation. The cases cited and results achieved in these cases for consumers is impressive and commendable, but given the DSSRC data referenced above, the claims cited in these cases likely represent less than 1% of all existing earnings claims that exist. This also demonstrates the FTC's ongoing activity in these areas is effective without the need for more and distinct regulations.

While one could superficially look at these cases and view them as supporting the need for some or all of a new rule, the opposite is the case. In virtually every one of the cases cited by the FTC in the ANPR, the defendants either made no disclaimers at all when presenting atypical claims about earnings claims (similar to the approximately 85% of recent cases monitored by the DSSRC) or, in a few cases, made disclosures that were clearly inadequate in terms of content and/or prominence and do not come close to the type of disclosures that would meet the direct selling industry's own standards for clear and conspicuous.[23]

For example, in footnote 35, the FTC cites to *FTC. v. Medicor*, a 2002 case regarding a medical billing business with an inadequate "results may vary" disclaimer. Medicor advertised to individuals the opportunity to work from home and perform medical billing for doctors' offices. The advertisements told consumers they could earn "$20,000 to $45,000 per year" with Medicor

[23] Guidance on Earnings Claims for the Direct Selling Industry, https://bbbnp-bbbp-stf-use1-01.s3.amazonaws.com/docs/default-source/dssrc/dssrc_guidanceonearningsclaimsforthedirectsellingindustry_2020.pdf?sfvrsn=4ecfcd36_8

telemarketers informing customers that they could "make $20 to $40 per hour or $300 to $600 per week, at a rate of approximately $3 per claim processed."[24]

Medicor's advertisements featured the sole disclaimer that "results may vary," with no further information. Obviously this disclaimer is insufficient given the claims being made by Medicor and not at all typical to the disclaimers used currently. Similar issues were raised in the FTC's actions against Advocare and Success by Health. In the *Advocare* complaint, the FTC describes claims touting six and seven-figure earnings possibilities.[25] Disclaimers, however, "appear in small print and not in close proximity to the claims made."[26] Similarly, in *Success by Health*, the complaint states that "income-related disclaimers frequently are inconspicuously disclosed in fine print" and that defendants would "regularly undermine these disclaimers."[27] *See also* Complaint, *FTC* v. *Ragingbull.com, LLC,* No. 1:20-cv-3538 (filed D. Md. 2020) (Defendants frequently include disclaimers on their services' purchase pages in a small "Terms & Conditions" text box that appears below the purchase button. The text box contains several pages worth of text and requires several minutes to scroll through."); Complaint, *FTC v. Vemma Nutrition Co*., No. 2:15-cv-01578 (filed D. Ariz. 2015) ("While Defendants sometimes attempt to provide disclaimers when making these and other income claims, their attempts are inadequate. Vemma typically dilutes purported disclaimers, such as "results may vary," with statements implying that negative results are due to the inadequate efforts of the Affiliate."); Preliminary Injunction, *FTC* v. *World Patent Mktg.*, No. 17-cv-20848, 2017 WL 3508639 (filed S.D. Fla. 2017) ("[E]ven if the disclaimers contained unambiguous disclosures, they failed to change the net impression created by Defendants' salespeople who verbally promised financial gain.")

Notably, the FTC has failed to cite a single case in which a company made a serious effort to use qualifications to present atypical earnings claims in a way that is not misleading to consumers. Presumably, because disclosures can and often are quite effective at qualifying claims for any potentially misleading claims to the reasonable consumer. Indeed, the effectiveness of the disclaimers is likely the reason why the record is devoid of such cases. In case after case where the FTC has brought law enforcement actions the advertising at issue either contained no disclosures at all, or in the few cases where disclosures were used the disclosures were clearly inadequate on their face because of an egregious lack of prominence, clarity or conspicuousness.

The FTC has itself stated these can be effective. The letters of Penalty Offense Authority state:

> "It is an unfair or deceptive trade practice to misrepresent, explicitly or implicitly, that the represented profits or earnings are the ordinary, typical, or average profits or earnings made by participants. This includes by means of the representation of an earnings figure or the attribution of earnings figures to specific participants, both of which impliedly represent that such figures are likely, are earned by a substantial number of participants, or are the typical, ordinary, or average results, absent clear and conspicuous disclosure of the relevant context, such as the time

[24] *FTC. v. Medicor LLC.*, 217 F. Supp. 2d 1048, 1054 (C.D. Cal. 2002).
[25] Complaint*, FTC v. Advocare Int'l, L.P.*, Case No. 4:19-cv-00715 (filed E.D. Tex. 2019)
[26] *Id.* at ¶ 37. Further, the complaint notes that the company's income disclosure statement was also inaccurate.
[27] Complaint, *FTC v. Noland*, Case Mo. CV-20-0047-PHX-DWL (filed D. Ariz. 2020).

> and effort actually expended by participants who made the amount represented, the percentage of participants making the amount represented, and the amount typically and ordinarily made by participants."

As implied in these letters, a clear and conspicuous disclosure can be effective.

The First Amendment Provides Substantial Protections for Commercial Speech, As Reflected by Countless FTC Documents Over the Years

The FTC, through many presidential Administrations, has consistently observed and respected the important constitutional protections for commercial speech and has advocated against its suppression. Despite this history, the ANPR surprisingly makes no mention of the First Amendment and solicited no specific comments on this vital constitutional freedom.

The First Amendment at its core provides substantial protections for truthful commercial speech, whether that consists of advertising about health products or advertising about income opportunities for consumers. Restrictions placed on commercial speech must be closely scrutinized, and any such restrictions should be narrowly tailored. Indeed, as discussed in more detail below, First Amendment jurisprudence has long expressed a strong preference for the use of disclosures in advertising in order to modify statements that might otherwise be construed as misleading.[28]

Many of the FTC's own comments and related documents have elaborated upon these important issues and have been sensitive to these essential constitutional protections. To the extent that the FTC decides to proceed with this proposed rulemaking, we urge the Commission to heed well-established Constitutional limitations relating to commercial speech restrictions. These principles have been adopted and described in many FTC documents over the years and are discussed in more detail below.

A 1999 FTC report on alcohol advertising emphasized the important role that self-regulation plays when evaluating restrictions on commercial speech.[29] The report observed that "The Commission regards self-regulation as particularly suitable in this area, where government restriction --especially if it involves partial or total advertising bans -- raises First Amendment issues." The report lays out the well-established four-part test set forth in *Central Hudson*:

> A governmental restriction on speech that proposes a commercial transaction must satisfy four criteria to survive First Amendment scrutiny: 1) the speech must concern lawful activity and not be misleading; 2) the asserted governmental interest in restricting it must be substantial; 3) the restriction must directly and materially advance the governmental interest asserted; and 4) the restriction must be no more extensive than necessary to serve that governmental interest. *Central Hudson Gas & Elect. Corp. v. Public Serv. Comm'n of New York*, 447 U.S. 557, 566 (1980). *See also Greater New Orleans Broadcasting Association, Inc. v. United States*, No. 98-387, 1999 U.S. LEXIS 4010 (June 14, 1999) (striking down FCC regulation prohibiting broadcast advertising of lawful private casino

[28] *See, e.g. Pearson v. Shalala,* 164 F.3d 650 (D.C. Cir. 1999).

[29] Self-Regulation in the Alcohol Industry: A Federal Trade Commission Report to Congress (Sept, 1999), https://www.ftc.gov/sites/default/files/documents/reports/self-regulation-alcohol-industry-federal-trade-commission-report-congress/1999_alcohol_report.pdf.

gambling); *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996) (striking down state ban on alcohol price advertising).[30]

One year later, in connection with the release of the FTC's report to Congress on the marketing of violent entertainment to children, the FTC included an appendix that featured an analysis of First Amendment issues involving commercial speech.[31] Consistent with the alcohol report cited above, the violence entertainment report emphasized that "to restrict commercial speech that concerns lawful activity and is not misleading, the government must prove that its interest is substantial, that the regulation directly advances the governmental interest asserted, and that it is not more extensive than is necessary to serve that interest."[32]

The report notes that:

> The government bears the burden of identifying a substantial interest and justifying the challenged restriction: "The government is not required to employ the least restrictive means conceivable, but it must demonstrate narrow tailoring of the challenged regulation to the asserted interest – a fit that is not necessarily perfect but reasonable; that represents not necessarily the single best disposition but one whose scope is in proportion to the interest served."[33]

In addition to its own reports, the FTC has often educated other agencies about its First Amendment experience and the limited ability of the government to restrict commercial speech, particularly with respect to banning qualifications and disclosures in advertising.

For example, in a 2005 FTC staff comment to the Department of the Treasury United States Mint, the FTC described concerns about suppressing commercial speech, and the preference for disclosure over banning potentially misleading claims.[34] The Mint was considering a rule that would impose penalties for the misuse of words and symbols related to the Mint. The proposed rule would have determined the existence of violations "without regard to any use of a disclaimer of affiliation with the United States Government."[35] The FTC comment supported the rule but raised concerns about the aspect of the rule that ignored the important role of disclosures in commercial speech. Indeed, the FTC's comment notes that "the treatment of disclaimers of affiliation in this process may raise some potential legal and policy issues." The comment observes that recent federal court opinions "further define the bounds of

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[30] *Id.* Note 7.

[31] Marketing Violent Entertainment To Children: A Review of Self-Regulation and Industry Practices in the Motion Picture, Music Recording & Electronic Game Industries Appendices A-K (Sept. 2000), https://www.ftc.gov/sites/default/files/documents/reports/marketing-violent-entertainment-children/appendicesviorpt.pdf.

[32] *Id.* Appendix C at 2-3.

[33] *Id.* at 4 (quoting *Greater New Orleans Broad. Ass'n v. United State*s, 119 S. Ct. 1923, 1932 (1999) (internal quotation marks omitted).

[34] Press Release, Federal Trade Commission Staff Supports U.S. Mints Efforts To Curb Deceptive Ads for Collectible Coins (Mar. 12. 2005) (unanimous Commission vote), https://www.ftc.gov/news-events/news/press-releases/2005/03/federal-trade-commission-staff-supports-us-mints-efforts-curb-deceptive-ads-collectible-coins

[35] FTC Staff Comment to the United States Mint Concerning Civil Penalties for Misuse of Mint Words, Letters, Symbols, and Emblems at 3 (March 11, 2005), https://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-united-states-mint-concerning-civil-penalties-misuse-mint-words-letters-symbols/050315usmintcomment.pdf

government regulation of commercial speech in general, and consideration of disclaimers in particular."[36]

The 2005 FTC staff comment then outlines the well-accepted First Amendment jurisprudence and provides a detailed discussion of the D.C. Circuit's 1999 decision in *Pearson v. Shalala*.[37] In that seminal case, the FDA had refused to allow a dietary supplement manufacturer to use disclosures to prevent certain health claims from being misleading. The D.C. Circuit held that it was a First Amendment violation for the FDA to not consider "whether disclaimers could have eliminated the potential for misleading consumers."[38] As the comment notes, the D.C. Circuit held that the government had not met its burden "of proving that there was a reasonable fit between banning these claims and the government's interest in the prevention of fraud. The court explained that the First Amendment commercial speech doctrine embodies 'a preference for disclosure over outright suppression.'"[39] Indeed, *Pearson* confirms that in the absence of a real showing that disclosure does not cure if it is misleading, the government has demonstrated that there is indeed a far less restrictive means of advancing its interest.[40]

The 2005 FTC staff comment further explains that the Commission "generally has favored disclosures over banning claims as a means of curing deception" but did note that "disclosures do not always work.[41] The comment then explains FTC principles on making sure that disclaimers or disclosures are clear and prominent.[42] *See also Bellion Spirits, LLC v. United States*, 393 F. Supp 3d 5, 26 (D.D.C. 2019) (Pearson "makes the more limited point that an Commission cannot, consistent with the First Amendment, refuse to consider disclaimers at all as possible less restrictive alternatives to prohibitions on speech.")

Similarly, in a 2002 comment to the FDA, the FTC also repeated the important role that the First Amendment plays when considering a regulation that will impact commercial speech.[43] In this comment, the Commission was responding to an FDA request generally raising First Amendment compliance. In a lengthy response, the FTC touted its post-market review of advertising as a way to curb deception "without overly restricting truthful commercial speech, thus promoting the goals embodied in the First Amendment."[44]

In the 2002 comment, the FTC observed that "First Amendment law looks in part to the availability of less restrictive alternatives, such as mandated disclosures, in assessing the legality

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[36] *Id.*at 4.
[37] 164 F.3d 650 (D.C. Cir. 1999).
[38] FTC Staff Comment, *supra* note __ at 5-6
[39] *Id.* (quoting *Pearson*).
[40] FTC Comment at 6. *Pearson* at 658.
[41] FTC comment at 9.
[42] The Mint appears to have heeded the FTC's counsel, as the rule at issue does not appear to prohibit the use of disclaimers. *See* https://www.usmint.gov/news/consumer-alerts/business-guidelines 31 CFR § 92.17 (NEED TO VERIFY THIS)
[43] Press Release, FTC Staff Provides the FDA with Comments On First Amendment Commercial Speech Doctrine (Sept 20, 2002) (unanimous Commission vote), https://www.ftc.gov/news-events/news/press-releases/2002/09/ftc-staff-provides-fda-comments-first-amendment-commercial-speech-doctrine.
[44] FTC Staff Comment Before the Food and Drug Administration Concerning First Amendment Issues at 3 (Sept. 13, 2002), https://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-food-and-drug-administration-concerning-first-amendment-issues/fdatextversion.pdf.

of outright bans on potentially misleading commercial speech."[45] The comment discusses disclosures at length, noting that "disclosures can qualify claims in many instances," particularly when they are clear and prominent.[46] Of course, it explains that disclosures can't be used to "remedy a false headline" or there may be concerns if a company directs attention away from the disclosures.

The 2002 comment also discusses *Pearson* and *Thompson v. Western States Medical Center*, a 2002 U.S. Supreme Court case that struck down an FDA regulation that exempted compounded drugs from the ordinary drug approval process as long as pharmacists did not advertise promote or solicit prescriptions for them.[47] According to the FTC comment,

> "[e]ven assuming [a] substantial governmental interest, the Court concluded that they were more extensive than necessary. If the government "could have achieved its interests in a manner that does not restrict speech, or that restricts less speech," then a prohibition on commercial speech is more extensive than necessary. The Court concluded that there were a number of alternatives the government could have used to distinguish between small-scale compounding and large-scale drug manufacturing, including prohibiting equipment that can be used to compound drugs on a commercial scale, barring pharmacists from offering compounded drugs at wholesale, or imposing an absolute limit on interstate sales of compounded drugs by a pharmacist."[48]

Indeed, as the Supreme Court noted in *Western States Medical Center*, "(i)f the First Amendment means anything, it means that regulating speech must be the last - not first – resort."[49] *See also* FTC staff letter regarding Supreme Court of Tennessee proposed amendments related to attorney advertising ("The Commission has consistently taken the position that, while unfair or deceptive advertising by lawyers should be prohibited, consumers do not benefit from the imposition of overly-broad restrictions that prevent the communication of truthful and non-misleading information that some consumers value.")[50]

We urge the FTC as it considers whether to proceed with a rulemaking on deceptive earnings claims to ensure it meets the four-part test as laid out in *Central Hudson*. Additionally, that any rule is consistent with its longstanding interest and adherence to not infringe on commercial free speech under the First Amendment. If the rulemaking is to proceed, the Commission needs to articulate why a rule is not violative of this constitutional protection, prior guidance and judicial rulings.

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[45] *Id.* at 4.

[46] *See also* FTC Comment at 16 (Vague qualifiers that a food or nutrient "may" have a certain health benefit had little or no impact on consumers' perception of the certainty of the science. By contrast, disclosures that stress the need for further research and alert consumers to ongoing scientific debate are most effective in conveying that the science is not yet established.").

[47] 535 U.S. 357 (2002).

[48] FTC Comment at 10 (quoting *Western States Medical Center*)

[49] 535 U. S. at 373 (2002).

[50] FTC Staff Letter to the Supreme Court of Tennessee, Concerning Proposed Amendments to the Tennessee Rules of Professional Conduct Relating to Attorney Advertising (Jan. 24, 2013), https://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-letter-supreme-court-tennessee-concerning-proposed-amendments-tennessee-rules-professional/130125tennesseeadvertisingletter.pdf.

Disclosures Have Been an Accepted Component of Advertising Jurisprudence for Decades

The use of clear and prominent disclosures in advertising has been accepted for decades and indeed, the acceptable use of disclosures is pervasive throughout FTC guidance and jurisprudence. These concepts are embedded in countless FTC guidance documents throughout all areas of consumer protection, including just a few described below:

> Dietary Supplements An Advertising Guide for Industry[51]
> "Thus, if an ad would be misleading without certain qualifying information, that information must be disclosed. For example, advertisers should disclose information relevant to the limited applicability of an advertised benefit."
>
> Enforcement Policy Statement Concerning Negative Option Marketing[52]
> "First, marketers must clearly and conspicuously disclose the material terms of a negative option offer including, at a minimum, key terms such as the existence of the negative option offer, the offer's total cost, and how to cancel the offer."
>
> .com Disclosures: How to Make Effective Disclosures in Digital Advertising[53]
> "This document provides FTC staff guidance concerning the making of clear and conspicuous online disclosures that are necessary pursuant to the laws the FTC enforces."
>
> Soliciting and Paying for Online Reviews: A Guide for Marketers[54]
> "If you offer an incentive for a review, don't condition it, explicitly or implicitly, on the review being positive. Even without that condition, the review should disclose the incentive, because its offer may introduce bias or change the weight and credibility that readers give the review."
>
> Guides for the Use of Environmental Marketing Claims ("Green Guides")[55]
> "To prevent deceptive claims, qualifications and disclosures should be clear, prominent, and understandable. To make disclosures clear and prominent, marketers should use plain language and sufficiently large type, should place disclosures in close proximity to the qualified claim, and should avoid making inconsistent statements or using distracting elements that could undercut or contradict the disclosure."

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[51] Dietary Supplements An Advertising Guide for Industry, https://www.ftc.gov/system/files/documents/plain-language/bus09-dietary-supplements-advertising-guide-industry.pdf.
[52] Enforcement Policy Statement Concerning Negative Option Marketing, https://www.ftc.gov/system/files/documents/public_statements/1598063/negative_option_policy_statement-10-22-2021-tobureau.pdf.
[53] .com Disclosures: How to Make Effective Disclosures in Digital Advertising, https://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-staff-revises-online-advertising-disclosure-guidelines/130312dotcomdisclosures.pdf
[54] Soliciting and Paying for Online Reviews: A Guide for Marketers, https://www.ftc.gov/business-guidance/resources/soliciting-paying-online-reviews-guide-marketers.
[55] Guides for the Use of Environmental Marketing Claims, https://www.ftc.gov/sites/default/files/documents/federal_register_notices/guides-use-environmental-marketing-claims-green-guides/greenguidesfrn.pdf

Guides Concerning the Use of Endorsements and Testimonials in Advertising[56] "If the advertiser does not have substantiation that the endorser's experience is representative of what consumers will generally achieve, the ad should clearly and conspicuously disclose the generally expected performance in the depicted circumstances, and the advertiser must possess and rely on adequate substantiation for that representation."

In addition to guidance documents, the ability to use disclaimers as a method to prevent ads from being misleading is deeply embedded within FTC jurisprudence. The Notice of Penalty Offense letters regarding earnings claims sent to companies this past fall relies upon principles set forth in FTC cases going back decades.[57] These cases are, however, built upon the fundamental precept that disclaimers can be used in the context of atypical claims. In other words, disclaimers are effective and the use of appropriate disclaimers affords robust consumer protection regarding earnings claims.

Nowhere is this more clear than in *National Dynamics*, one of the cases prominently featured in the Notice of Penalty Offense documents, which states claims can be deceptive, but only "absent clear and conspicuous disclosure of the relevant context."[58]

In that case, the Commission had initially prohibited the use of atypical earnings claims, but the Court of Appeals of the Second Circuit thought otherwise and remanded. The Second Circuit stated "We likewise do not see why NDC should be limited to advertising only the average sales or earnings of its distributors rather than be permitted to state ranges for various types of distributors, provided it does not make deceptive use of unusual earnings realized only by a few." On remand, the Commission modified the order allowing for certain clear and conspicuous disclaimers. *See also Macmillan, Inc*., 96 FTC 208, 326-329 (1980) (Commission order allowing for the use of disclaimers in connection with testimonials used in advertisements). And many FTC consent orders have generally allowed for the use of disclosures to modify or clarify advertising claims.[59]

Any Proposed Rule is Incapable of Keeping Up with Marketplace Trends

Further, the overall approach to this rulemaking reflects a far more prescriptive approach than the Commission typically takes. The FTC has traditionally understood that while rules can be important and valuable, it is also vital that companies have the flexibility to adapt their practices to the appropriate bounds of a rule.

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[56] Guides Concerning the Use of Endorsements and Testimonials in Advertising, https://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-publishes-final-guides-governing-endorsements-testimonials/091005revisedendorsementguides.pdf

[57] Press Release, FTC Puts Businesses on Notice that False Money-Making Claims Could Lead to Big Penalties (Oct. 26, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/10/ftc-puts-businesses-notice-false-money-making-claims-could-lead-big-penalties.

[58] 82 FTC 488, 511-13, 543, 564, 568 (1973); 85 FTC 1052, 1059-60 (1975).

[59] *See, e.g.* Decision and Order, *Dun & Bradstreet, Inc.,* Docket No, C-4762 (April 7, 2022) (order includes specific disclosure requirements); Order, *U.S. v. Vision Path, Inc*. (Jan. 25, 2022 D.D.C.) (order provision requires disclosures of material connections in advertising); Stipulated Order, *FTC. v. Lending Club Corp.,* Case No. 3:18-cv-02454 (July 7, 2021 N.D. Cal.) (order requires disclosures of fees and monetary disbursements); (Stipulated Order, *FTC v. Teami, LLC*, Case No. 8:20-cv-518-T-33TGW (March 17, 2020 M.D. Fla.) (order provision requires disclosures of material connections in advertising).

We have seen that approach across the Commission's consumer protection portfolio, such as the rules implementing the Children's Online Privacy Protection Act and TSR, regardless of whether the rules were Magnuson-Moss rulemaking or rules that were drafted using Administrative Procedure Act rulemaking. Similarly, when finalizing the Business Opportunity Rule in 2011, the Federal Register Notice noted that "The final Rule does not specify any particular format or formula for an earnings claim. This is intended to allow flexibility in presenting earnings information in the manner that is appropriate for each opportunity, provided that any such claim has a reasonable basis and that there is written substantiation for the claim at the time it is made."[60]

In one of the FTC's latest rulemaking efforts, The Gramm-Leach Bliley Act's Safeguard Rule, Commissioners Phillips and Wilson dissented on numerous grounds, including the new rule's prescriptiveness and inflexibility, expressing a preference for the earlier rule's flexibility.[61] The majority statement, however, questioned the premise that the new rule was overly prescriptive, and certainly seemed to indicate that flexibility remained an important principle to consider in the rulemaking. When discussing how the rule would apply to small businesses, the majority statement noted that "[t]here is also no support for the dissent's notion that the amendments eliminate financial institutions' flexibility in a way that will hurt smaller businesses. The amendments require that information security programs address certain aspects of security, but do not prescribe any particular method for doing so." [62] Thus, the Commission has noted that it remains important to craft any new rule with flexibility and without unnecessary prescriptive methodology.

Any Proposed Rule Should be Narrowly Tailored and Consistent with Current Legal Standards

If the FTC elects to proceed with a proposed earnings rule, it must ensure consistency with First amendment principles described above, ensure that any proposed earnings rule be narrowly tailored to address the specific conduct at issue that the Commission has found to be deceptive, ensure that any proposed rule provides adequate notice to industry regarding compliance, and provide sufficient flexibility within any proposed rule to address diversity of industry participants in this area of the economy. In this regard, any proposal should be harmonized across existing rules previously mentioned.

To begin, any new proposal must properly assess the burden to millions of American small businesses. The ANPR states up front that "the Commission believes that initiating a rulemaking to address the use of earnings claims could benefit consumers and could provide

[60] Federal Register Notice, Business Opportunity Rule (Dec. 8, 2011), https://www.ftc.gov/sites/default/files/documents/federal_register_notices/16-c.f.r.part-437-disclosure-requirements-and-prohibitions-concerning-business-opportunities-final-rule/111122bizoppfrn.pdf.

[61] Joint Statement of Commissioners Noah Joshua Phillips and Christine S. Wilson in the Matter of the Final Rule amending the Gramm-Leach-Bliley Act's Safeguards Rule (Oct, 27, 2021), https://www.ftc.gov/system/files/documents/public_statements/1597994/joint_statement_of_commissioners_phillips_and_wilson_in_the_matter_of_regulatory_review_of_the_1.pdf.

[62] Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter Regarding Regulatory Review of the Safeguards Rule (Oct. 27, 2021), https://www.ftc.gov/system/files/documents/public_statements/1598006/statement_of_chair_lina_m_khan_joined_by_commr_slaughter_regarding_regulatory_review_of_safeguards_0.pdf.

useful guidance without burdening businesses."[63] Prohibiting direct sellers from speaking about truthful earnings that go beyond the typical experience would greatly burden millions of American small businesses. DSA believes these messages can be communicated with appropriate disclosures consistent with pre-existing regulatory and self-regulatory guidance.

Any proposed rule should incorporate fundamental concepts from the FTC's jurisprudence—principles that have survived the test of time. The ANPR does not warrant or justify treating earnings or lifestyle claims differently from any other advertising claims. This is especially important because the FTC has developed its advertising jurisprudence through decades of case law. In particular, advertising claims – including earnings and lifestyle claims -- should be viewed and analyzed based on the overall net impression conveyed by the advertisement.

As the Commission evaluates going forward, it should heed the wisdom of the FTC's 1983 Deception Policy Statement. As the Commission stated, "[a]s it has in the past, the Commission will evaluate the entire advertisement, transaction, or course of dealing in determining how reasonable consumers are likely to respond. Thus, with regard to advertising the Commission will examine "the entire mosaic, rather than each tile separately."[64]

The FTC should also consider corporate structures that encourage robust training, compliance and monitoring while not punishing companies in the event that a small number of distributors make problematic statements. Monitoring and compliance, however, is never 100 percent successful at locating and preventing problematic claims. The FTC understands it is unrealistic for a company to be aware of every claim being made by its independent salesforce members.[65]

Earnings Claims Should be Permitted with Appropriate Disclosures

If a rule is promulgated, the FTC can look at the DSSRC Earnings Claims guidance as a roadmap for allowing atypical claims. There should be flexibility to make atypical claims if certain disclosures and disclaimers are present and meet other principles of longstanding FTC jurisprudence on advertising. For example, the DSSRC says disclosures must follow the "four P's" of FTC precedent.

1) Presentation: Worded in a way so that consumers can reasonably understand it
2) Prominence: The disclosure is big enough for consumers to read easily
3) Placement: The disclosure is where consumers are likely to look
4) Proximity: The disclosure is close to the claim it is disclosing

[63] ANPR (emphasis added).
[64] FTC Policy Statement on Deception at 3-4 (Oct 14, 1983), https://www.ftc.gov/system/files/documents/public_statements/410531/831014deceptionstmt.pdf (quoting FTC v. Sterling Drug, 317 F.2d 669, 674 (2d Cir. 1963)
[65] The FTC's Endorsement Guides: What People Are Asking. "It's unrealistic to expect you to be aware of every single statement made by a member of your network. But it's up to you to make a reasonable effort to know what participants in your network are saying. That said, it's unlikely that the activity of a rogue blogger would be the basis of a law enforcement action if your company has a reasonable training, monitoring, and compliance program in place."

The DSSRC guidance also states that a disclosure of typically expected results should account for any significant costs incurred by the salesforce member along with any necessary costs of participating in the opportunity.[66] However, it would be difficult if not impossible to accurately determine and quantify the other types of expenses generally required or available to running a business as those can vary considerably depending upon the individual consumer or location as well as a myriad of other factors. There would be an additional burden if companies were required to monitor and substantiate these varying costs as well. Any adoption of a future rule should provide flexibility to adapt to changing technologies, and differing factors and circumstances.

Alternatives to Earnings Claims Rulemaking

The FTC has long supported industry self-regulation as an efficient way to secure effective consumers protection and promote a robust and competitive marketplace.[67] DSA hopes the FTC will take under serious consideration alternatives to any forthcoming rulemaking or consider factors to mitigate the burden for companies and businesses that strive to prevent deceptive earnings in the marketplace.

Increased Reliance on Independent Self-Regulation

Harnessing the effectiveness of self-regulation is an important way of achieving the deterrence and swiftness of action that the ANPR sets forth as goals of this rulemaking. In this regard, the DSSRC is an important adjunct to the law enforcement presence of the FTC. It has a strong track record of monitoring the market for potentially problematic claims and engaging in quick and effective follow-up to address the relatively rare instances where it finds that distributors are making questionable claims, usually in social media.

Effective self-regulation can help the FTC fulfill its consumer protection mandate without the need for more resources so the Commission can focus its attention on severely egregious conduct that causes material harm. DSA is fully committed to independent self-regulation and this framework. The independent self-regulatory bodies and the sectors of the American economy such as direct selling that embrace self-regulation should be given more attention if a rule is to be considered. References sent by self-regulatory agencies such as the DSSRC to the FTC should be prioritized.

This commitment to self regulation could be further solidified by recognizing the value of self-regulation to businesses that are subject to it and embrace its core tenet—broader and more effective consumer protection. For example, the FTC could add a process whereby if a company is in an industry subject to self-regulation then there will be an option for a safe harbor under certain prescribed circumstances or lowered damages if an enforcement proceeding takes place.

Emphasizing Company Compliance as a Mitigating Factor

Efforts by companies to regulate their own business could also serve as a mitigating factor when assessing potential damages under a forthcoming rule. Our companies track compliance metrics, which are specific to every company, but could be provided to the FTC. Companies

[66] DSSRC Earnings Claims Guidance, Example 5

[67] FTC Business Guidance Concerning Multi-Level Marketing, https://www.ftc.gov/business-guidance/resources/business-guidance-concerning-multi-level-marketing

strive to abide by the law and serve to communicate current legal standards and best practices to their independent salesforce members. If a company is able to document specific compliance practices and concrete actions taken to protect consumers, this should be considered by the Commission before proceeding with a violation under a potential forthcoming rule.

We would also welcome more specifics details on what the FTC views as effective compliance practices. If the FTC views certain approaches or strategies more favorably, then such information will be important to companies as we fulfill our ongoing commitment to consumer protection.

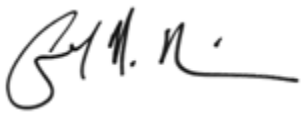
Further Collaboration on Earnings Claims Rule

DSA has enjoyed our collaboration with the FTC over many years to ensure current and prospective salespeople as well as consumers are protected. As we engage with the Commission, we hope you will confirm the value and importance the Commission has previously stated regarding self-regulation.

If the Commission determines that a forthcoming rule meets legal standards, we hope any rule will be narrowly tailored and consistent with existing legal precedent. DSA hopes you will consider the proposals and alternatives described in these comments, demonstrating that atypical income and lifestyle claims can be made under certain circumstances in a way that ensures consumer protection.

If the Commission determines it will proceed with a proposed rule, we hope it will take an approach that preserves the ability of millions of American small businesses to provide great products to consumers and billions of dollars in economic impact. We are happy to answer any questions or provide additional information and look forward to our continued work together.

Sincerely,



Joseph N. Mariano
President
Direct Selling Association

APPENDIX B

BEFORE THE

FEDERAL TRADE COMMISSION

COMMENTS OF

THE DIRECT SELLING ASSOCIATION

ON THE

NOTICE OF PROPOSED RULEMAKING FOR THE BUSINESS OPPORTUNITY RULE

Project No. R511993

July 17, 2006

Joseph N. Mariano
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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 wholesale 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 contractors[1] 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

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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.

c. Multilevel and Single Level Compensation

Multilevel marketing, also known as network marketing, is a compensation structure, not a sales strategy. In a multilevel compensation plan, independent consultants are compensated based not only on one's own product sales, but on the product sales of one's downline (those individuals the direct salesperson has recruited, or recruits of recruits.) In contrast, in a single level compensation plan, independent consultants are compensated based solely on one's own product sales. Companies using a multilevel compensation structure may use either a person-to-person or party plan sales strategy. Eighty-four percent of direct selling firms use some form of multilevel compensation, and virtually all new companies entering direct selling are using some form of multilevel compensation.

One thing all firms regardless of structure or compensation plan have in common is the continuing need to recruit new salespeople to their organizations. Recruiting is the lifeblood of the industry, with the vast majority of salespeople working only a few hours per week, with modest financial goals in mind.

B. Individual Direct Sellers and Their Characteristics

i. Seven Types of Salespeople

There are fundamentally seven types of salespeople in direct selling. The types are based on individual motivations for becoming a direct salesperson and staying affiliated with a direct selling corporation. Individuals can belong to more than one type at the same time and can easily move from one type to another. Hence, we do not have data that would allocate the percentages of salespeople into individual categories. These types are:

- Wholesale or Discount Buyers: These individuals technically are salespeople in that they sign up as salespeople but do so primarily to buy the company's products at the wholesale or discount price accorded members of the salesforce. Generally, they do not sell or recruit.
- Short Term/Specific Objectives: These are individuals who join a company to earn extra money for a specific objective. Examples of these people are women who join a company in the fall to earn extra income to spend on their own families' Christmas presents. Another example is when an individual joins one of our firms to earn enough money to replace a worn-out appliance, such as a refrigerator, or to buy a television set. Their normal family income is inadequate for them to be able to afford the purchase, so they take advantage of the income-earning opportunity and ease of entry and egress from the salesforce that our firms offer.[14] Some sellers in this

[14] *See, e.g.,* the comments of Pam Heller, an Avon salesperson for 14 years:

> "My husband was serving in the military when I joined Avon. When he was transferred, I needed to change jobs so I wanted something that could be flexible and move with me from base to base and direct selling was the perfect answer for my needs and lifestyle. I wanted to support my husband's career in the military and do something that was satisfying for myself as well. The freedom, the flexibility of direct selling, as well as the ability to move when my husband was

category will leave the business after achieving their goals, but may return again as necessary. Some also enjoy direct selling so much that they decide to continue with their direct selling activities.

- Quality of Life Improvement: These are people whose family income is inadequate to give them the quality of life they want. Both husband and wife may work outside the home or, in cases where one spouse stays home to care for the children, the couple may find a single income to be inadequate. One spouse, usually the wife, will devote a few hours per week to direct selling activities, to earn enough money to improve their quality of life. [15]
- Careerists: These are the people who work full-time at their direct sales business. They are micro-entrepreneurs with their own small businesses.
- Social Contacts: Some individuals join direct sales firms for the social contact direct selling provides both with their customers and with their colleagues. [16]
- Recognition: Many individuals become direct salespeople for the respect and recognition they earn for their efforts.
- Product Advocates: Some people choose direct selling because they love a particular product or service and want to tell others about its attributes.

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transferred, has kept me involved for almost 14 years. Not having to start over every time we have moved was fantastic; the portability was key."
View this video clip online at
http://interface.audiovideoweb.com/lnk/ny60win16091/clip3.wmv/play.asx (Jul. 10-11, 2006)(on file with DSA).

[15] *See, e.g.,* the comments of Leigh Funderbank, Country Bunny Bath & Body, with 3 years in the direct selling industry :

"I was in advertising at a newspaper until our first child was born. We chose to have me home vs. straining to work to help pay the bills and struggle with handing our baby to someone else every day. Direct sales changed my life completely. Until I learned about working this way, I thought that I had to stay at home and make sacrifices and then to find that I could run a business from home and that those sacrifices were just not necessary."
View this video clip online at
http://interface.audiovideoweb.com/lnk/ny60win16091/clip5.wmv/play.asx (Jul. 10-11, 2006)(on file with DSA).

[16] *See e.g.*, the comments of Gigi Balido a direct salesperson with Saladmaster, with 18 years in the direct selling industry. "I like to meet new people and talk to them, really get to know them. My experience with Saladmaster allows me to earn money while doing things I love, like talking to people and educating them. Education is very important to me and I like to pass that on to others."
-- View this video clip online at http://interface.audiovideoweb.com/lnk/ny60win16091/clip8.wmv/play.asx (Jul. 10-11, 2006)(on file with DSA).

ii. The Demographic, Income and Earnings Profile of a Direct Seller

a. Demographics

The ability of direct selling to meet the needs and expectations of so many people make it difficult to describe an "average" direct seller. Looking at the raw numbers as reported in the 2002 National Salesforce Survey conducted by Research International, one finds that the average direct salesperson is a female, about 45 years of age, married with children, working less than 10 hours per week on her direct selling business, with modest income goals. However, this does not begin to represent the diverse population of direct sellers that include people of all ages, nationalities, economic background, and education level.[17]

About 53 percent of direct sellers work 10 or fewer hours per week; about 86 percent work less than 30 hours per week. Approximately 14 percent sell for more than 30 hours per week, while less than 5 percent work 40 or more hours per week.[18]

About 80 percent of direct sellers are female; about 64 percent of full-time sellers are female. Fifty-four percent of sellers are between the ages of 35 and 54. About 22 percent of all direct sellers – and about 34 percent of full-time sellers – are over age 55, many of whom enjoy the opportunity to stay active.[19]

Half (49 percent) of all direct sellers have an overall household income of more than $50,000. Some of these individuals have a full-time job in addition to their direct selling pursuits, while others use their direct selling income to supplement the income of their spouse.[20]

b. Direct Selling Income

A direct seller's median annual gross income from direct selling is about $2,400 per year. This number rises to $25,390 when considering direct sellers who work 30 or more hours per week. Fifty-nine percent of direct salespeople make less than $10,000 per year from direct selling.[21]

[17] *DSA 2002 National Salesforce Survey* at 90.
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.* at 70.

II. Any New Business Opportunity Rule Must be Directed at Fraudulent Opportunities and Should Not Cover Legitimate Direct Sellers

A. Direct Sellers' Interest in Eliminating Business Opportunity Fraud

The FTC has described significant fraud in two market segments – work-at-home schemes and pyramid schemes – that have successfully misrepresented and deceived the public as to their true fraudulent nature. At times, these schemes achieve this confusion by comparing themselves to legitimate direct selling companies.

Because of our strong interest in protecting the public from these frauds, DSA supports many of the *concepts* behind provisions of the proposed Rule. Some of these provisions are reflected in DSA's own Code of Ethics.[22] Nonetheless, we are troubled that the specific requirements of the proposal could exacerbate confusion between fraudulent opportunities and legitimate direct selling by including legitimate direct selling activity within the proposed Rule's coverage.[23] If the rule is finalized as proposed, direct sellers would be subjected to a rigorous new regulatory regime that poses significant risk to and

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[22] *See Appendix D,* Pertinent portions of the Code and similar concepts of the proposed rule include:

Identifying Information (Section 437.3) – DSA agrees that identifying information should be provided to the prospective purchaser. Section A (5) of the DSA Code of Ethics states that "[s]ellers shall truthfully identify themselves, their company, their products and the purposes of their solicitation." As an additional protection we require that all written orders or receipts shall contain "the name and address of the salesperson or the member firm represented" (DSA Code of Ethics, Section A (3) (b)).
Misrepresentation of Sales or Profits (Section 437.5 (d)) – DSA concurs that no sellers should misrepresent the amount of sales or profits that a prospective purchaser may earn. In fact, DSA prohibits members from misrepresenting "the actual or potential sales or earnings of its independent salespeople." (DSA Code of Ethics, Section A (8)).
Misrepresentation of Terms/Conditions of Refunds/Cancellation Policies (Section 437.5(k)) – DSA concurs that all refunds and cancellation policies should be clearly disclosed to purchasers of the opportunity. In fact, DSA requires that all member companies incorporate and clearly describe in their materials, the DSA-mandated one-year, 90 percent return requirement for all resalable inventory, promotional materials, sales aid and kits.
Requirements Not Expressly Reflected in the DSA Code – In addition to the proposals reflected in its Code of Ethics, DSA concurs with the idea that sellers should not misrepresent "how or when commissions, bonuses, incentives, premiums, or other payments from the seller to the purchaser will be calculated or distributed" (Section 437.5(g)). In fact, direct selling company materials provide detailed, unambiguous explanations of their commission structure, bonuses and other incentive programs. We fully support the proposition that this information should not be misrepresented or distorted in any way. Additionally, we believe that material aspects of assistance offered to a prospective purchaser should not be misrepresented in any form (Section 437.5(i)). When presenting the opportunity, direct sellers should clearly explain their role in the process and provide truthful information regarding any and all assistance offered.

[23] The Commission itself seems ensnared in this tangle. Pyramid schemes are clearly illegal under Section 5 of the FTC Act, the Securities Act of 1933 (as amended) and the Securities Exchange Act of 1934, postal regulations and one way or another by all 50 states, and are vigorously attacked by law enforcement authorities. Such schemes are not immune from prosecution by virtue of the minimum investment threshold of the current Franchise Rule, which the Commission now seeks to abolish in the context of the proposed Rule.

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 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.*

there is a market for goods that the individuals produce. Direct selling companies might in fact make available certain training and assistance, but not with regard to materials that an individual produces.

Additionally, DSA shares the FTC's interest in eliminating pyramid schemes from the marketplace, but believes that accurate distinctions need to be drawn between complaints and losses generated by pyramids and those related to legitimate companies. Pyramid schemes often masquerade as legitimate direct selling companies. DSA has been active in support of clear standards under which pyramids can be prosecuted. Indeed, the FTC has set out the fundamental rules for identifying pyramid schemes[31] and has successfully taken actions against such schemes for many years. A pyramid - in which participants pay money in return for the right to receive compensation that is based on the recruitment of others into the scheme – is typified by headhunting fees, large upfront payments and inventory loading. In contrast, a *bona fide* marketing plan gives compensation based not on the mere recruitment of others into the plan, but instead pays compensation based on sales to real consumers and users of the product. Additionally, a legitimate company using multilevel compensation (in which one is rewarded not only for his own sales, but also the sales of recruits) typically offers other significant distinguishing features from a pyramid scheme. Chief among these features is that no large non-returnable investment in inventory is required to start or stay in the business, there is no large unreasonable start-up fee, and the company will repurchase inventory from a departing salesperson (a so-called "buyback").

The proposed Rule fails in its stated intent to address the evils of pyramid schemes, in that it recognizes none of the hallmarks of a pyramid nor the distinguishing features of legitimate companies. The result is a remarkably broad and cumbersome definition of a "business opportunity" which would not make pyramid schemes any more illegal than they already are, but would instead place extraordinary new burdens on legitimate companies and their salespeople.

DSA conducted a comprehensive review of complaints against all 193 active DSA member companies, as reported by local Better Business Bureaus.[32] The data showed that on average there was only one complaint for every $55 million in retail sales or one complaint for every 23,765 individual direct sellers per year. Of those complaints, 97 percent were resolved. The data further indicated that there were on average only 17 unresolved complaints per year. That calculates to one unresolved complaint for every $1.76 billion in retail sales or one unresolved complaint for every 764,705 individual direct sellers. By any measure, this is an extraordinarily low level of consumer

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[31] *See, In re. Amway Corp*., 93 F.T.C. 618 (1979) and *In re. Koscot Interplanetary, Inc*., 86 F.T.C. 1106 (1975), *aff'd sub. nom. Turner v. FTC*, 580 F.2d 701 (D.C. Cir. 1978).

[32] DSA staff reviewed the reliability reports for all DSA active member companies http://search.bbb.org/ (May 31, 2006).

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*).

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[33] http://www.bbb.org/about/stat2005/us05reposort.pdf (lasted visited on Jul. 16, 2006)(3.3 percent of multilevel complaints were not pursuable).

[34] NPR at 76.

The proposed Rule and its accompanying comments grossly underestimate the number of companies and independent contractors that will be affected by the proposal, as well as the practical impact that the proposed requirements would have on our channel of distribution. While DSA's roster of active and pending members currently stands at approximately 275 companies,[35] we have identified at least 1,500 direct selling companies that will be affected by the new proposed Rule. Most of these are small companies, most likely to be vulnerable to the burdens created by the proposed Rule. Additionally, the more than 13.6 million people who sell as direct sellers will be affected by the provisions of the proposal.

Ironically, while compliance with the new mandates might be relatively simple for work at home schemes and will be ignored by fraudulent pyramid schemes, compliance would prove much more challenging and extremely burdensome for legitimate direct sellers.

The proposed Rule presents two potential costs to legitimate direct sellers – the direct and indirect expenses associated with compliance and the impact of decreased business activities.

i. The Costs of Compliance

To better assess the potential direct costs that might be incurred by direct selling companies in their efforts to comply with the proposed Rule, DSA polled member companies requesting that each company describe what, if any, additional resources might be required in order to comply with the proposed requirements, including personnel and any new necessary infrastructure.[36]

Respondents were categorized as small and large firms, with the expectation that costs for companies with varying salesforce sizes would vary. Median total costs were $130,000 per year for small firms, to more than $567,000 annually for large firms (see table below).

Additionally, respondents also estimated that a median 15 pages of disclosure documents could be required under the proposal. DSA estimates that approximately 5 million people are successfully recruited into direct selling each year; poll respondents indicated that an estimated 10 presentations are made for each person who actually enters direct selling. Thus, we calculate that **750 million pages** of disclosure documents would have to be produced and distributed as a result of the proposed Rule. During the three year retention period required by the proposal, some **2.25 billion pieces of paper** would be generated and warehoused.

[35] DSA estimates that its members represent approximately 95 percent of direct selling sales volume in the United States.
[36] DSA Executive Poll (Conducted Jul. 9-14, 2006).

Median Reported Compliance Costs by Proposed Rule Requirement

Proposed Rule Requirement	Small Firms	Large Firms
Disclosure Document:		
Legal Actions Disclosure	$7,750	$25,000
Cancellation/Refund Policy	$1,550	$3,050
Earnings Claims	$11,000	$5,500
References Requirement	$37,000	$195,000
Entire Disclosure Document a/	$51,000	$328,401
Record Keeping	$32,015	$122,800
Sales Force Education	$25,000	$75,000
Total a/	$130,000	$567,500

a/ Medians of reported totals may not sum to medians of reported component costs.
Note: Small firms defined as those with 10,000 or less new direct sellers in 2005. Large firms defined as those with more than 10,000 new direct sellers in 2005. Twenty-six firms responded to the compliance cost survey, 14 small firms and 12 large firms.

ii. The Effect of the Proposed Rule on Recruiting and Sales in Direct Selling

a. The General Public's Receptiveness to Direct Selling if Subject to the Requirements of the Proposed Rule – Survey Results

The most significant and devastating cost of the proposed Rule would be its negative impact on recruitment and attendant sales by those recruited. Two thousand fifty-six (2,056) people were surveyed in a Harris Interactive[37] Survey of Adults in the United States ("Harris Survey") to measure their level of interest in the direct selling opportunity with and without the three requirements (i.e., waiting period requirement, references requirement, legal disclosures requirement) in the proposed Rule. The survey was fielded during July 5-7, 2006, and the results were weighted to represent the U.S. adult population. Analysis of the responses was conducted by Nathan Associates.[38] Not unexpectedly, the percentage of U.S. adults who were "extremely interested," "very

[37] Harris Interactive is one of the largest market research and consulting firms in the world and the global leader in conducting online research.

[38] Nathan Associates is an economic consulting firm established in 1946 that has extensive experience and expertise in economic policy, economic impact analysis, regulatory issues, damages analysis, and international trade issues.

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]

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[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*.

Ironically, by making recruitment of new salespeople that much more difficult for the direct seller, the proposed Rule will have the perverse effect of forcing individuals (and companies) to focus even more energy on recruitment activities, rather than all-important sales of products or services.

d. The Waiting Period is Unnecessary, Impractical and Unworkable for Direct Sellers, and Will Have Disastrous Consequences on Recruiting and Sales

While DSA supports providing ample information to individuals interested in direct selling, we believe that the requirement of Section 437.2 (that certain disclosures be given at least seven calendar days **before** any prospective purchaser signs a contract or makes payment to the seller) is impractical and will fundamentally and adversely alter the way in which direct selling operates. The Commission envisions that, like the franchise disclosure review period, this seven day waiting period will afford prospective business opportunity purchasers the opportunity to review the basic disclosure document, any earnings disclosures, and otherwise perform due diligence about the opportunity.

Ease of ingress and egress from our industry is a hallmark of our successful business model. Any barrier to entry would be extremely damaging. The barriers posed by the proposed Rule would be disastrous.[43] The Harris Survey indicated that the level of interest in direct selling by a prospective direct salesperson would drop at least 33 percent if a waiting period were instituted. Among those expressing the greatest likelihood of entering direct selling, the interest level drops more than 57 percent.[44]

Unlike the franchising opportunity, in which large amounts of money are at stake, direct selling requires little or no up front payment. Individual direct sellers are able to return inventory and sales aids, training aids and the like; additionally, start-up costs are also refundable for a period of time upon cancellation by the salesperson.[45]

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[43] *See, e.g*, the comments of Pam Heller:

> "I understand wanting to protect consumers, but having a waiting period before someone decides to spend $10 to join Avon could seriously harm my business. My business thrives and grows by bringing in new salespeople. With the low cost of entry, Avon's full money-back unconditional guarantee, and the fact that we don't ask people to pay us for products until they have been paid by their customers -- new Avon recruits are fully protected and can get a fast start on their Avon business."
> --Pam Heller, Avon, 14 years in the direct selling industry.
> View this video clip online at
> http://interface.audiovideoweb.com/lnk/ny60win16091/clip6.wmv/play.asx (Jul. 10-11, 2006)(on file with DSA).

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

[45] As a condition of association membership, DSA members are required to provide their sales force with the opportunity to sell back any inventory purchased from the direct selling company. Salespeople may also return any currently marketable company-produced promotional materials, sales aids or kits which are required to be purchased or whose purchase provides a financial benefit to the recruiter. Protected by this minimum 9 percent "buyback" mandated under the DSA Code of Ethics, a direct salesperson's risk of financial loss is quite limited, particularly in light of the minimal up front costs otherwise involved with beginning in direct selling.

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
View this video clip online at http://interface.audiovideoweb.com/lnk/ny60win16091/clip1.wmv/play.asx (Jul. 10-11, 2006)(on file with DSA).

because of the low cost and minimal risk afforded by the direct selling activity. Under the proposed Rule, during this initial encounter a direct salesperson would need to get the prospect's contact information, including her address. The direct salesperson would then need to relay this information to the direct selling company so that they can make the individualized disclosure statement for that prospect. (This would be necessary because of the 10-reference requirement.) They would then need to get the disclosure statement to the prospect before the seven-day waiting period can start. The direct salesperson would then need to follow up with the prospect after the seven-day waiting period is over. By virtue of the proposed Rule, what initially would have been one contact to sign up a new direct salesperson has potentially become three. This could mean instead of one car trip, three might be necessary. This could significantly increase the time and cost of recruiting direct salespeople.

Additionally, we are concerned that legitimate direct selling activities will be cast inappropriately in a suspicious light by the disclosure and waiting period. Indeed, the FTC has described business opportunities as "permeated with fraud."[47] Direct selling is not. Eighty-nine percent of direct sellers report a positive experience,[48] having entered the industry with very modest goals and because of their interested in the activity because of its limited nature, the small scale of its initial phases, and the non-threatening nature of its requirements and regulations. The proposed Rule would suggest a level of risk that simply does not exist, and, due to the initial modest goals of prospective entrants, puts up a psychological and actual barrier to entry that would threaten the viability of the entire industry.

Given the part-time and seasonal nature of direct selling activities of many direct sellers, we are concerned that any delay in the entry and sales activity of a new direct salesperson will significantly decrease income potential. Take for example, the salesperson who enters into direct selling in mid-November to earn extra income for Christmas presents. She has a four week window to sell and earn. A delay of seven days (at least) under the proposed Rule would effectively reduce her earning potential by 25 percent. This would be an unfortunate consequence of the proposed Rule.

The Commission should consider an alternative approach that will afford *post*-sale protections to purchasers. This approach will encourage companies to offer such protections and will avoid the disastrous consequences to direct sellers described above. DSA suggests that the obligations to furnish written documents of Sec. 437.2 might be replaced with a requirement that each covered seller of a business opportunity be required to provide each participant entering the plan with a written contract or statement which describes the material terms of the agreement and provides the participant an opportunity to cancel. Upon cancellation within the time specified in the agreement and the return of all items required by the agreement, the participant would be entitled to a refund of all payments required by the agreement.

[47] NPR at 9.
[48] DSA 2002 National Salesforce Survey at 34.

Such a right of rescission or "cooling off" is not only analogous to the FTC's home solicitation sales rule[49] 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.asx (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 manger…"

[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

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> "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.

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[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).

from participation in direct selling (no matter how positive the reference's experiences.) Ironically, the disclosure might result in the prospect (if she becomes a direct salesperson) being solicited by other competing direct salespeople. Confusion might arise about who recruited whom, and when, (an important matter for direct salespeople whose compensation can depend in part on the strength of sales from their personal "downline"). A deceitful individual may obtain a list of potential recruits (salespeople from another direct selling company) under the pretense of being a prospect and use it to solicit them for product, services, or another opportunity. Finally, the value of the ten purchaser list is undermined in that it does not take into account the length of time that the reference has been involved with a company.

Practical Concerns – The proposed Rule would present a practical problem regarding when the references must be given. Given the informal and social nature of many direct selling activities, recruiting discussions are often spontaneous and initiated by the prospective recruit at a home party or some other venue. The direct selling "recruiter" would be literally unable to provide a list of the ten nearest "purchasers" at the same time a disclosure statement must be given. She would be unable to prepare such a list in advance because she will not know who might attend the direct selling event or express interest there. In fact, the direct salesperson might not even be aware of other salespeople who are in the area but not in her immediate sales organization.

The proposed Rule apparently does not contemplate such a circumstance and thus provides no guidance about when the references must be given or when the waiting period is tolled. Additionally, unlike franchisees, the cast majority of direct sellers have no assigned geographic territories; the geographically closest direct salespeople may therefore have less relevance to a prospective recruit. Finally, given the part-time nature of many direct sellers and the variety of motivations for their involvement (i.e., discount buyers, desire for social contacts and recognition, discussed *supra*), the ten closest references might have little helpful, relevant information to offer the prospective direct salespeople. Additionally, as mentioned *supra*, the names of other direct sellers able to provide information about their experience is readily available in any telephone directory, either in print or online.

Privacy Concerns – The FTC has rightly noted in other proceedings that "consumers must be given options with respect to whether and how personal information collected from them may be used."[59] We believe that the requirements of proposed section 473.3 (6) do not afford consumers those options. Individual direct sellers would have their names, telephone numbers and locations revealed. [60] They would have no option to avoid

[59] Online Profiling: A Report to Congress, Part 2: Recommendations, http://www.ftc.gov/os/2000/07/onlineprofiling.htm (July 2000).

[60] *See, e.g.*, the remarks of Joanne Nistico a Shaklee salesperson with 35 years in the direct selling industry: "I'm happy to talk about direct selling to anyone, but in this day when identity theft is a major concern, I'm uncomfortable giving out the personal information of other Shaklee distributors."
View this video clip online at http://interface.audiovideoweb.com/lnk/ny60win16091/clip7.wmv/play.asx

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 Commissions' 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).

Description of Earners' Characteristics –The proposed Rule (see Section 437.4 (a) (4) (iv-vi)) would mandate potentially complex compilations of statistical information of time periods, demographic data and earnings claims. We are concerned that this approach will be ineffective in preventing true business opportunity fraud in that truly fraudulent business opportunity offerors will not provide accurate data. On the other hand, legitimate businesses, such as DSA members, which will try to faithfully comply, will have the difficult, if not impossible, challenge of interpreting and meeting the proposed requirements.

Additionally, the relevance and utility of the information for most people interested in direct selling is questionable, given the multiple motivations of individuals who enter into direct selling. Someone who enters as a discount buyer or for short term supplemental income, for example, may ultimately consider a very modest amount of income to be a successful outcome of their involvement.

Specifically, Section 437.4(a)(vi) of the proposed Rule represents a particularly daunting challenge in that it 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..."(emphasis added). Millions of people who are interested in direct selling enter and exit the business at will, the timing determined by their own goals and motivations. It is impossible to know with any degree of certainty, what demographic/geographic factors play in the earnings of direct sellers. Direct selling companies try mightily (without consistent result) to identify the very characteristics that make standout, successful salespeople who might be likely to move from part-time sales activities to full-time direct selling careers. Moreover, even if one could identify those characteristics, it would be hard to determine how a direct selling company could know and compare those characteristics to the traits of its entire existing salesforce or potential salespeople.

Given the varying demographic, experiential, geographic, and motivational profiles of direct sellers from company to company, we believe the Commission should allow greater flexibility in the form and substance of any earnings disclosures. Ultimately, what is most critical in informing any prospective direct salesperson is the accurate context of information that is provided about potential earnings. The Commission should consider allowing multiple forms of earnings disclosures and substantiation, including the prominent use of disclaimers in connection with earnings claims.

Substantiating Non-Direct Earnings Claims – Direct sellers may also be practically challenged to comply by virtue of the breadth of definition of "earnings claims." Proposed Sec. 437.1(h) defines non-direct, implied earnings (such as photographs of cars) as covered claims subject to the disclosure requirements of 437.4(a)(iv-vii). As with direct earnings claims, we suggest that it could be difficult or impossible to describe "any characteristics" of purchasers that differ materially from the prospective direct salespeople, particularly when earnings are only generally implied. We ask that the

Commission provide clarification in this regard. In any case, we believe that the definition of "earnings claims" should be less broad and more concrete. The Commission should consider alternative forms of substantiation and/or the use of disclaimers in connection with implied earnings claims.

General Media Earnings Claims – Again, DSA strongly supports the proposition that earnings claims should be substantiated. We believe this to be particularly true in claims made through the general media, the audience of which will invariably include individuals less experienced in business and financial matters.

However, proposed section 437.4(b) presents identical challenges with regard to general media "earnings claims" as those described above regarding the earnings disclosure document. Indeed, given the broad definition of "earnings claim," this proposed section could apply to virtually every communication from a direct selling company or individual (including any non one-on-one communication, e.g., classified ads or Internet communications). We question whether or not such information as this section would require (beginning and ending dates of earnings, as well as number and percentages of purchasers who achieved those earnings) would be noticed or valued given the amount of advertising and information clutter facing today's casual reader/viewer/listener. Furthermore, given the "EARNINGS CLAIM STATEMENT REQUIRED BY LAW" mandated under Section 437.4 (a)(4) which will be provided to anyone directly solicited to purchase a business opportunity, the disclosures suggested for general media earnings claims seem superfluous.

Compliance Costs of Earnings Disclosures – The FTC suggests the compliance costs incurred in connection with earnings disclosures would be "strictly optional." However, the FTC's proposed definition of "earnings claims" is quite broad and would trigger an earnings claim disclosure for almost any representation. Given the extraordinary paperwork obligations described (*supra*) (i.e., 750 million documents per year will need to be produced and distributed) we expect the attendant costs to be quite high.

Industry Statistics – Proposed section 437.4(c) might limit the use by DSA member companies of valid industry earnings data, in that the seller must offer substantiation that the industry statistics reflect typical earnings of business opportunity purchasers. Industry-wide data may in fact *not* be typical of any particular company's earnings experience and could be valuable for just that reason. We believe it important that DSA continue periodic survey of direct sellers regarding earnings and earnings expectations as part of the association's on-going industry research activities. DSA-produced earnings research, we trust, can be an important supplement to earnings information otherwise available from individual companies.

iii. The Proposed Rule Will Have Negative International Consequences for Direct Selling

Direct selling is conducted in more than 150 countries, through some 58 million salespeople, with retail sales in excess of $100 billion. The direct selling industry is truly

a global business. More than 70 percent of all direct sales occur outside of the United States and are carried out by approximately 44.3 million salespeople (*Worldwide Direct Sales Data,* World Federation of Direct Selling, and May 17, 2006). There are 56 national Direct Selling Associations and one regional federation – Federation of European Direct Selling Associations.[66] ("FEDSA"). FEDSA and all 56 Direct Selling Associations are members of the World Federation of Direct Selling Associations ("WFDSA"), the mission of which is to "build understanding and support for direct selling worldwide."[67] As a requirement of WFDSA membership, all Direct Selling Associations must establish individual Codes which comply with the requirements of the WFDSA Codes of Conduct. Each individual Code must be fully reviewed and accepted by WFDSA before an applicant is approved for membership. In particular, the WFDSA requires that these codes prohibit members from "us[ing] misleading, deceptive or unfair sales practices,"[68] and "refer[ing] to any testimonial or endorsement which is not authorized, not true, obsolete or otherwise no longer applicable, not related to their offer or used in any way likely to mislead the consumer."[69] Similarly, WFDSA restricts members from "misrepresent[ing] the actual or potential sales or earnings of their Direct Sellers,"[70] discourages inventory loading[71] and requires the repurchase of unsold inventory and other sales materials at 90 percent of the original price paid by the seller.[72] Each WFDSA member must also establish complaint handling procedures and appoint a Code Administrator to settle unresolved complaints and breaches of the Code.

It is clear that the proposed Rule in its present form would have untold international consequences. The legislative and regulatory bells that ring in Washington, DC are heard from Brussels to Beijing to Brasilia. Foreign governments have long looked to the United States for guidance not only on legal issues of first impression, but also when amending their current codes. The publication by the Commission of this proposed Rule has already been transmitted, *inter alia,* to various government entities across the globe. Unfortunately, a number of countries will misconstrue the proposal as if it were US law on the subject. Others will look to the proposal as a model for them to enact similar laws or regulations in their own countries. This is now the nature of our electronic, Internet age. The potential burdens and damage that we assume is already in progress abroad due to the maladroit drafting of this proposal can only be mitigated if the Commission's final Rule reflects the reality that direct selling companies are not sellers of business

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[66] The WFDSA affiliated national DSAs are located in the following counties: Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Columbia, Costa Rica, Czech Republic, Denmark, Ecuador, El Salvador, Estonia, Finland, France, Germany, Guatemala, Honduras, Hong Kong, Hungary, Lithuania, India, Indonesia, Ireland, Israel, Italy, Japan, Korea, Malaysia, Mexico, Netherlands, New Zealand, Norway, Panama, Peru, Philippines, Poland, Portugal, Romania, Russia, Singapore, Slovenia, South Africa, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, Ukraine, United Kingdom, United States, Uruguay and Venezuela.

[67] http://www.wfdsa.org/about_wfdsa/index.cfm?fa=mission (last visited Jul. 15, 2006).
[68] WFDSA Code of Conduct Toward Consumers, Sec. 2.1.
[69] *Id*. at Sec. 2.10.
[70] Any earnings or sales representations made shall be based upon documented facts. *Id*. at Sec. B(d).
[71] *Id.* at Sec. B(h).
[72] *Id.* at Sec. B(g).

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.

III. The Proposed Rule Should Be Clarified to More Accurately and Specifically Define "Business Opportunity" and Remove Direct Sellers from Inappropriate Coverage

In light of the extraordinary negative effect the proposed Rule will have on legitimate direct sellers, and the negligible utility of the requirements of the proposed Rule for prospective direct sellers, DSA urges that direct selling not be included as a covered "business opportunity" under the proposed Rule. Direct selling companies do not sell business opportunities. They sell products and services to ultimate consumers through more than 13.6 million independent contractor direct salespeople. We suggest that the final rule should not include those situations in which potential participants are given sufficient information about the company and/or are otherwise at little or no risk of financial loss. DSA believes the final Rule should be more precisely drawn to define and cover those business opportunities likely to result in fraud and loss, without impacting legitimate direct sellers. Accordingly, DSA urges that one or more of the following five approaches be considered as ways of distinguishing legitimate direct selling businesses from business opportunities likely to result in fraud or loss to participants.

A. Do Not Cover Companies in Which Individuals Have Minimal Start-up Costs

i. Minimum Investment Threshold - The Commission argues that the elimination of the minimum payment exemption of the existing rule is warranted because of the "comparatively lighter burden" posed by the proposed Rule as compared to the Franchise Rule.[73] The proposed Rule would extend even to purchasers of business opportunities whose financial risk is as little as $0.01. We note with interest the Commission's discussion of DSA's earlier comments recommending that the minimum payment threshold of the existing rule be maintained or even increased.[74] We continue to believe that the minimum payment threshold is an effective distinguishing feature between low risk commercial activities, (like those of direct sellers)[75] and high-risk business opportunity frauds. Accordingly, we affirm our earlier comments that any Rule should include such a threshold investment amount, below which the requirements of the Rule would not apply, particularly if the new, broad definition of "business opportunity" is maintained.

DSA has consistently argued that a minimum threshold amount should be included in any franchise or business opportunity rule, and continues to believe that low-cost, low-risk activities should not fall within the scope of the proposed Rule. The FTC notes that its promulgation of a new business opportunity rule "is consistent with . . . the regulatory approaches adopted in most states."[76] In fact, direct selling is not considered a "business

[73] NPR at 6.
[74] NPR at 75.
[75] According to a DSA internal survey of member company websites and materials, the average cost to become involved in a direct selling company is $134.
[76] NPR at 8.

opportunity" under current state law and all states with business opportunity laws have minimum payment thresholds which effectively exclude direct sellers from coverage.[77]

Additionally, the North American Securities Administration Association has developed a model Business Opportunity Sales Act, which has a $500 threshold exemption for payments made for the not-for-profit sale of sales demonstration equipment, material, or samples or for product inventory sold to the purchaser at a *bona fide* wholesale price. Similarly, the National Conference of Commissioners on Uniform State Laws has a Model Franchise and Business Opportunity Act with a $500 threshold.[78] DSA recommends that the FTC look to the policy considerations contemplated by these organizations, as well as the states, as it considers the maintenance of a threshold in the proposed Rule.

ii. Wholesale Inventory Purchases with Buyback – The Commission notes that the existing Franchise Rule's exclusion of voluntary purchases of reasonable amounts of inventory (at *bona fide* wholesale prices for resale) had the consequence of eliminating many pyramid marketing plans from the Franchise Rule.[79] In order to ensure that legitimate businesses are not covered inappropriately by the proposed Rule, yet not allow pyramid frauds to escape appropriate government action, DSA recommends that application of any new rule not be triggered by payments for the purchases of inventory at a *bona fide* wholesale price, when such purchases are subject to repurchase for at least 90 percent of the net cost.

An effective and enforced buyback, as included in the DSA Code of Ethics, can eliminate the central risk of a business opportunity – significant financial loss. A *bona fide* buyback eliminates this possibility by ensuring that purchasers will be able to recoup most or all of their payments for the inventory. A pyramid scheme cannot offer and honor a *bona fide* buyback policy, particularly if the sales and training aids are subject to repurchase as inventory. Likewise, business opportunity frauds do not offer real and enforced buybacks of these types of materials.[80] Thus we argue that *bona fide* wholesale purchases subject to such a buyback not trigger the other burdensome provisions of the Rule.[81]

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[77] *See*, Appendix I.

[78] UNIFORM FRANCHISE AND BUSINESS OPPORTUNITIES ACT, National Conference of Commissioners on Uniform Laws (1987).

[79] NPR at 5. DSA notes again that pyramid marketing schemes are illegal under section 5 of the Federal Trade Commission Act and can be prosecuted effectively. The FTC itself reports many successful enforcement actions against pyramids schemes (*See*, NPR at 22).

[80] Work at home schemes often deceive purchasers with the promise of an ongoing relationship in which the seller will buy the output that the purchaser produces. Additionally, the business opportunity seller often misrepresents that there is a market for this output. This deception should not be confused with a *bona fide* buyback policy of a legitimate company in which inventory and sales materials can be returned to the company. The Commission acknowledges this difference in its comments. (*See*, NPR at 29).

[81] DSA understands that law enforcement officials seek a straightforward, uncomplicated standard for compliance and enforcement actions. A company or operation that promises a buyback and does not meet

iii. Purchase of Sales Materials on a Not-for-Profit or Fair Market Value Basis and Subject to a Buyback – DSA recommends that the FTC rule not be triggered by payments for the purchase of demonstration kits, equipment and materials related to the operation of the business, made on a not-for-profit or at-cost basis, or sold at fair market value, and subject to a buyback as described above, in that these purchases present little risk of loss to purchasers.

iv. Optional Purchases or Payments Subject to a Buyback – DSA strongly suggests that the rule be amended to clarify that optional purchases of products or materials, i.e., payments that are not required in order to participate in the enterprise, subject to a *bona fide* buyback as described above, not be considered payments or purchases that would trigger application of the rule.

B. Utilize Existing Definition of Business Opportunity from the Franchise Rule

In FTC materials that describe the existing Franchise Rule, the FTC defines a business opportunity as one in which:

- the seller simply offers the right to sell any goods or services supplied by the seller, its affiliate, or a supplier with which the seller requires the "franchisee" to do business;
- the seller offers to secure retail outlets or accounts for the goods or services to be sold, to secure locations or sites for vending machines or rack displays, or to provide the services of someone who can do so; and
- the purchaser is required to make any payment to the seller or an affiliate, or a commitment to make a payment, as a condition of obtaining the business opportunity.[82]

DSA suggests that the existing definition of business opportunity from the current rule be maintained. Direct sellers do not qualify as "business opportunities" under this definition and thus would not be covered by the requirements of any new rule which also used this definition.

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that promise could be the subject of an effective enforcement action for that misrepresentation, just as easily as it might be for non-compliance with the requirements of the proposed Rule.

[82] *See*, http://www.ftc.gov/bcp/franchise/netrule.htm (last visited Jul. 16, 2006).

C. Craft a Definition of "Business Opportunity" in the Proposed Rule to Cover Only Work at Home Schemes, Vending Machine Operations and Similar Schemes

As discussed earlier, [83] direct sellers are clearly not the work-at-home schemes of concern to the Commission. Accordingly, DSA respectfully suggests that if the current Franchise Rule definition of "Business Opportunity" is not maintained, that any final Rule be focused on those work at home and other schemes likely to result in fraud, based on those characteristics which the Commission identified.

For example, a "business opportunity" might be defined as follows:

> A) *Business Opportunity* means a commercial arrangement in which the Seller solicits a prospective purchaser to enter into a new business; and
>
> (1) The prospective purchaser makes a payment or provides other consideration to the seller, directly or indirectly through a third party; and
>
> (a) the seller provides some or all of the tools, equipment, components, parts, inputs, software, data, instructions, directions or guidance to make, produce, fabricate, grow, breed, modify or provide goods or services, and
>
> (b) the seller buys back, or purports to buy back, any or all of the goods or services that the purchaser makes, produces, fabricates, grows, breeds, modifies, or provides.
>
> or
>
> (2) The Seller provides, or purports to provide, locations for the use of operation of equipment, displays, vending machines, or similar devices on premises neither owned nor leased by the purchaser.

DSA welcomes further discussion with the Commission about how the definition of "business opportunity" might be crafted to cover actual business opportunity frauds.

D. Do Not Cover Companies Engaged in "Best Practices"

Any rule should encourage companies to provide relevant, helpful information to prospective participants in an effective, efficient, and complete manner. We believe that the rule can and should encourage the adoption of "best practices" by legitimate companies. Accordingly, companies which, on their own initiative, or as a condition of

[83] *Supra at* 17

membership in a self-regulatory organization, provide such information should not be subject to the additional (and superfluous) regulation of any new rule.

Specifically, DSA believes that any final rule should not cover companies with the following attributes:

- *The company provides each salesperson entering the plan with a written contract or statement which describes the material terms of the agreement and provides the participant an opportunity to cancel. Upon cancellation within the time specified in the agreement and the return of all marketable, resalable items required by the agreement, the participant would be entitled to a refund of all payments required by the agreement.*

This provision would recognize those companies which give a purchaser the material terms of the agreement in writing when he or she enters into the plan, and also provide the purchaser a "cooling-off" period, a period of time during which one may cancel the agreement in its entirety. Upon cancellation of the agreement and return of all materials received unless waived, the purchaser would receive a refund of all required payments made pursuant to the agreement. This provision would recognize those companies that ensure that purchasers make informed decisions, which they can cancel without risk of financial loss.

- *The company does not require salespeople to purchase goods or services in an amount which unreasonably exceeds that which can be expected to be resold or consumed within a reasonable period of time.*

This provision would recognize those companies that do not engage in "inventory loading" practices, i.e., requiring participants to buy more goods or services than they can either use or resell within a reasonable period of time. The language is consistent with the U.S. Direct Selling Association's Code of Ethics and World Federation of Direct Selling Associations World Code of Conduct.

- *The company enters into an agreement with each salesperson to buy back, on reasonable commercial terms, marketable goods and services purchased from the company.*

This provision recognizes those companies that follow the U.S. DSA's Code of Ethics and WFDSA's World Code of Conduct which provide participants leaving the business a buyback of purchased goods and services at the participant's request. This buyback covers currently marketable goods and services (those which are current and salable) purchased by the participant within the 12 months prior to the salesperson's departure from the company, notwithstanding whether the goods or services are intended for resale or for personal use/consumption. The amount refunded would be at least 90 percent of the participant's original net cost less appropriate set-offs and legal claims, if any.

- *The company owns or is the licensed user of a federally registered trademark or servicemark which identifies the company promoting the plan, the goods or services it sells, or the plan itself.*

One indicia of legitimacy for a company or organization is that it has properly registered the trademark or servicemark which identifies its business, its marketing plan, or its products. Such marks enable the public and law enforcement authorities to easily identify the company or organization responsible for product or distribution-related issues.

E. Do Not Apply the Rule to Companies That are Adherents to Effective Self-Regulatory Regimens

DSA believes that industry self-regulation can and should provide an important supplement to government regulation in that self-regulation can provide a more immediate, knowledgeable, and cost-effective solution to marketplace problems. While not necessarily a replacement for all government action, self-regulation can be an important, experience based, and powerful mechanism for protecting consumers, while supplementing the often stretched government resources available for consumer protection. FTC Chairman Deborah Platt Majoras has eloquently noted that self-regulation, like that demonstrated by DSA's Code of Ethics, is an important and powerful mechanism for protecting consumers.[84]

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[84] *See, e.g.,* the remarks of FTC Chairman Deborah Platt Majoras:
"Well-constructed industry self-regulatory efforts may offer several advantages over government regulation. First, self-regulation is likely to be more prompt, flexible, and responsive… Self-regulatory organizations often have the ability to move faster and in more directions than traditional government regulators. They may or sometimes can adapt to market changes and consumer needs more readily than can major regulatory systems, which generally only get reconfigured, if at all, years after initial implementation. Self-regulatory organizations also may be better able to narrowly tailor their reach to a particular category of businesses. Government regulation, conversely, cannot always adapt as easily to focus on issues affecting small groups of similarly situated firms… rather, it tends to paint with a broader brush.
If self-regulatory organizations have obtained the support and participation of member firms, the regulatory outcomes will likely be well-attuned to the realities of the market. They can be conceived with the accumulated judgment [sic] and hands-on experience of the industry members who are likely able to devise workable rules in areas in which it might be difficult for the government to draw bright lines. That can result in restrictions that are at once more effective and less burdensome for firms. And often the rules or guidelines developed will represent a broad cross-section of industry views, because participants will not want to risk significant refusals to participate, which would undermine the entire scheme.
Compliance can be just as high under a coordinated self-regulatory system as under command and control regulation, … Further, the "sticks" of public recognition for non-compliance and of government intervention if the self-regulation fails can be quite effective..."
Self Regulatory Organizations and the FTC, Address Before the Council of Better Business Bureaus (Apr. 11, 2005) http://www.ftc.gov/speeches/majoras/050411selfregorgs.pdf (last visited Jul. 16, 2006).

i. DSA Code of Ethics

The Direct Selling Association has long recognized that as guests in our customers' homes, direct salespeople and the companies whose products they sell have a special obligation to consumers. The association has promulgated standards of sales behavior for its companies and salespeople for more than 60 years. In the 1970's those standards were enhanced and formalized into the DSA Code of Ethics, a self regulatory program originally designed to set out specific standards for our members, as well as a redress process for consumers who felt those standards had not been met. In 1993 the Code was expanded to provide similar standards for our salespeople and recruits.[85]

a. Key Provisions

The Code protects consumers by requiring that: no statements be made that would be likely to mislead the consumer;[86] all terms of sale be unambiguous;[87] all warranties or guarantees be provided and adhered to;[88] and that direct sellers "truthfully identify themselves, their company, their products and the purposes of their solicitation to the prospective customer."[89]

The Code also protects protect both the active and prospective direct seller. Pyramid schemes are prohibited under the Code,[90] of course; thus companies operating pyramids are not permitted to be members of the DSA. All companies are required to ensure that "no statements, promises or testimonials are made which are likely to mislead…prospective salespeople."[91] Additionally, to discourage inventory loading and protect direct sellers from significant financial loss, DSA requires that all member companies incorporate a "buyback" policy which mandates that companies repurchase inventory (including required and/or commissionable promotional materials, sales aids and kits) purchased during the year prior to the salesperson's departure. The buyback amount must be at least 90 percent of the original net cost of the items to the salesperson.[92] Finally, the Code prohibits companies from misrepresenting the actual or potential sales or earnings of its independent salespeople and requires that any earnings or sales representations made shall be based on documented facts.[93]

[85] *See*, Moral Suasion, Appendix F, a history of the DSA Code.
[86] DSA Code of Ethics, Sec. A (1).
[87] The Code requires that total amo unts (including interest); service charges and fees the name and address of the salesperson or member firm represented and any other costs and expenses as required by federal and state law to be include in all written orders or receipts. DSA Code of Ethics, Sec. A(3).
[88] DSA Code of Ethics, Sec. A(4).
[89] DSA Code of Ethics, Sec. A(5).
[90] Id. at Sec. A(6).
[91] Id. at, Sec. A(1).
[92] Id. at Sec. A(7)(b).
[93] Id. at Sec. A(8).

If the consumer or direct salesperson believes that a DSA member company has dishonored any of the above requirements, they may file a complaint through DSA's Code complaint process, as discussed below. The DSA Code also requires that all member companies provide a link to the Code on their Web sites, so that both consumers and sellers may learn about the Code and how to file a complaint.[94]

b. Independent Code Administration

One element of our industry's self-regulation efforts is the independent enforcement of the Code by an outside Code of Ethics Administrator. The Administrator is appointed by the DSA Board of Directors and "shall be a person of recognized integrity, knowledgeable in the industry, and of a stature that will command respect by the industry and from the public."[95]

c. The DSA Code Complaint Process

If the complaint is first lodged with the company itself, the Code requires that all members "shall promptly investigate the complaint and shall take such steps as it may find appropriate…to cause the redress of any wrongs which its investigation discloses to have been committed."[96] However, if the complainant believes his or her concerns have not been sufficiently addressed, he or she may file a complaint through the DSA Code complaint process.

As stated above, and as required by the Code, each member company[97] must post a direct link to the DSA Code of Ethics on its Web site, wherein lies information as to how to file a code complaint. Once a complaint is filed, the administrator first determines whether the complaint concerns potential violations of the Code. If so, he then promptly forwards the complaint to the member company's Code Responsibility Officer, with a corresponding letter notifying the member of the complaint and requesting any necessary information or documentation. After his investigation, the Administrator reaches a decision as to whether the complaint has sufficient merit and, if so, determines the appropriate remedy.

If the member refuses to cooperate or does not consent to the determined course of action, the Administrator "shall serve upon the member…a notice affording the member an opportunity to appear before the Appeals Review Panel."[98] This panel consists of five representatives from active member companies, as selected by the DSA's Executive Committee.[99] The panel then reviews all relevant documents and determines whether to

[94] Id. at Sec. B(2).
[95] Id. at Sec. C(2).
[96] Id. at Sec. B (1).
[97] This includes "pending members;" companies that have not undergone their full one-year legal review nor have been approved by the DSA Board of Directors.
[98] DSA Code of Ethics, at Sec. C(2).
[99] When an appeal is made, the Chairman of the DSA Board of Directors selects three of the five members (none of which can work for a company whose interests compete with that of the Appellant). *Id.*at Sec.D (4).

affirm, amend or dismiss the administrator's decision. If the company continues noncompliance, the DSA Board of Directors may vote to terminate the membership of the company.[100]

Additionally, the DSA Code requires that member companies "shall voluntarily not raise the independent contractor status of salespersons…as a defense against Code violation allegations…"[101]

d. Pending/Active Member Review Process

To ensure the highest ethical and legal business practices, all DSA members undergo a rigorous review process, both when applying for membership and again as active members. When conducting company reviews, DSA examines all submitted materials complaints and other relevant information to in our efforts to ensure compliance with the DSA Code of Ethics.

All direct selling companies applying for membership must undergo a one year legal review process before they may be considered for full membership. During this period, companies are classified as "pending members" and must not only pledge to abide by the Code but publicize this pledge by posting an link to the Code that is easily accessible to both customers and their sales force on their Web site. When a company applies for membership, DSA requests information from the Attorney General and Better Business Bureau of the state in which the applicant is located. Additionally, DSA requests that relevant consumer agencies) including the FTC provide information regarding complaints, actions or other relevant records regarding the potential member.

After applying, the company must provide all applicable materials to DSA, including but not limited to: customer receipts, brochures, audio and video tapes, distributor agreements, recruiting brochures, information involving legal actions and documents regarding international operations. DSA also requires pending members to provide schedules of upcoming training sessions and/or opportunity meetings and advises applicants that DSA staff may anonymously attend these meetings. DSA also reviews media reports, and other available information. Throughout the process, DSA attorneys are in contact with pending members to inform them of their status, request additional information, provide appropriate legal information and inform companies of various concerns regarding their materials. If the materials reviewed are not in compliance with the DSA Code, the company is asked to amend there policies to do so. If the company does not agree to amend their policies, or if there are outstanding legal questions regarding the applicant's marketing practices, the company will not be presented to the Board for full membership consideration until all matters are resolved or answered.

Similarly, 20 percent of active DSA member company materials are reviewed every year. Companies that have already been "approved" by the DSA Board of Directors must submit to random reviews at least once every five years. In fact, companies are randomly

[100] *Id.* at Sec. E(3)
[101] *Id.* at Sec.B(1)

chosen as much as three times per five year cycle. Ultimately, all member company materials are re-reviewed every five years to ensure continued compliance with the Code. As with pending members, all member companies are required to provide a link to the Code, with a "clear, bold-faced statement as to how to make the connection."[102] After reviewing all updated materials, DSA provides each member company with an updated legal analysis.

e. Value of the Code

Through continuing reviews and enforcement of the Code complaint process, DSA's self-regulatory mechanism seeks to ensure that our members are abiding by the highest business practices. DSA Code provisions, in some respects, exceed current state and federal regulatory and statutory requirements. [103]

ii. FTC Recognition of Self-Regulation

We believe that there is no reason to apply the proposed Rule to companies which are adherents to self-regulatory regimens that provide effective protections against the types of fraud that the FTC described in its NPR. Those regimens should be effective, approved, and administered by non-profit entities. DSA is aware of other industry self-regulation programs that have been cited by the FTC and other agencies as exemplars of such initiatives.[104] Indeed, we believe that the DSA Code and self-regulation program

[102] DSA Code of Ethics, Sec. B(2). This is also required of pending members.

[103] *E.g.*, DSA requires the buyback of inventory (discussed *supra*); there is no corresponding federal legal requirement to do so.

[104] *See, e.g.*, the FTC's recognition of the Funeral Rule Offenders Program ("FROP"), of the National Funeral Directors Association (NFDA). FROP allows funeral homes which have not met the requirements of the Rule to enroll in a compliance program administered by NFDA, which includes training, testing and certification. Once completed, the funeral homes are exempt from the fines, litigation and penalties associated with non-compliance. In remarks before Congress, FTC Associate Director for Marketing Practices Eileen Harrington noted that that association's efforts "in advancing its certification and training proposal represented a meaningful commitment to self-regulation that promised to do more to benefit consumers than would continued reliance only on case-by-case enforcement.. .[That self-regulation program] has enabled the Commission to achieve better compliance with the Funeral Rule while expending fewer resources." *See,* Prepared Statement of the Federal Trade Commission, For the Committee on Health, Education, Labor and Pensions (Apr. 26, 2002) http://www.ftc.gov/os/2002/04/funeraltest020426.pdf (last visited Jul. 16, 2006).

See also, Remarks of Chairman Deborah Platt Majoras regarding the National Advertising Review Board of the Council of Better Business Bureaus at 10.

See also, the National Association of Securities Dealers (NASD). NASD regulates all U.S. brokers and dealers that conduct securities transactions with the public by requiring training, licensing, registration, and dispute resolution and investor education, among other requirements. Federal law gives NASD the authority to discipline securities firms and individuals in the securities industry who violate the rules; they have the power to fine, suspend or even expel them from the industry. See U.S. Securities and Exchange Commission. Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets, http://www.sec.gov/news/studies/techrp97.htm (last visited Jul.16, 2006).

meet the criteria set out by Chairman Majoras in her April 11, 2005 remarks. More specifically:

- Our Code offers an opportunity to be more prompt, flexible, and responsive than government regulation,
- The Direct Selling industry's self-regulation may be able to adapt to market changes and consumer needs more readily than government regulation,
- Our industry is better able to narrowly tailor the reach of self-regulation to our particular category of businesses, unlike the "broad brush" approach reflected in the proposal, and
- DSA members have supported and participated in DSA's Code, [105] the provisions of which have been conceived with the accumulated judgment and experience of those members.

We look forward to discussing this matter more fully with the Commission.

See also Testimony of Robert Glauber, Chairman and C.E.O., before the Subcommittee of Capital Markets, Insurance and Government Sponsored Enterprises (Nov. 17, 2005).

See also, http://www.nasd.com/RegulatoryEnforcement/NASDEnforcementMarketRegulation/index.htm (last visited Jul. 16, 2006).

[105] "Perceptions of Direct Selling Corporate Officers Regarding Codes of Ethics" in Direct Selling Ethics at the Top: An Industry Audit and Status Report, Journal of Personal Selling and Sales Management, Spring 2002 (*See,* Appendix G).

IV. Conclusion and Summary/ Request for Workshops or Hearings

In conclusion, DSA respectfully asks the Commission to consider the concerns raised in this submission. We ask the FTC to maximize the effectiveness and efficiency of the proposed Business Opportunity Rule by narrowly tailoring it to regulate those activities presenting the greatest threat of consumer harm, while not unduly affecting direct selling and the benefits it offers to literally millions of Americans.[106]

For the above stated reasons in this submission, DSA does not believe direct selling firms as represented by those in our association should be defined as business opportunity sellers.

DSA believes that public hearings and/or workshops will be necessary to ensure that the Commission fully appreciates and understands the implications and shortcomings of the proposed rule. DSA reserves the right to request to participate in any such hearing or workshop to address the foregoing issues or to rebut any issues raised in comments submitted by other parties. DSA anticipates that its participation in any such hearing or workshop would involve testimony and/or presentation on the issues addressed herein.

[106] According to the "Direct Selling Tracking Study: General Public Attitudes Toward Direct Selling," 63 percent of consumers report having "purchased items through direct selling." Additionally, 65 percent of those surveyed stated they were "extremely, very or somewhat" interested in purchasing via direct selling in the future. DSA Public Attitude Survey 2003.

APPENDIX C

Potential Impacts of the FTC's Proposed Business Opportunity Rule on the Direct Selling Industry

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July 14, 2006

INTRODUCTION

The Federal Trade Commission (FTC) proposed in April 2006 a new regulation called "The Business Opportunity Rule" with the goal of reducing fraudulent business opportunities. The proposed Rule would require a seller of a business opportunity to provide certain information to a prospective purchaser. Two of the several disclosures that a seller would be required to provide to a prospective purchaser are (1) a list of legal actions against the seller or its representatives involving fraud, misrepresentation and certain other illegal activities (the "legal disclosures requirement") and (2) a list of purchasers of the business opportunity, including contact information, to serve as references (the "references requirement"). In addition, once these disclosures are provided by the seller, seven days must elapse before the prospective purchaser may make any payment or sign any contract to purchase the business opportunity (the "waiting period requirement").

The direct selling industry and direct sellers would be regulated by the proposed Rule. Direct selling is a method of marketing and distributing products and services. Direct selling companies supply products and services for distribution to independent contractor direct sellers. In turn, direct sellers sell the products and services to retail customers through home parties and person-to-person sales methods. As independent contractors, direct sellers have the ability to control the amount of time they devote to their direct selling activities that is consistent with their other interests, such as spending time with their families.

As with any new law or regulation that changes the rules of commerce and the marketplace, the proposed Rule may have a substantial impact on the direct selling industry. To ascertain the potential impacts of the waiting period, references, and legal disclosures requirements on the direct selling industry, two surveys were conducted to measure how the level of interest of actual and potential direct sellers in the direct selling opportunity would change if the proposed requirements were in effect. The first survey was of U.S. adults and the second was of direct sellers. The remainder of this report describes these surveys and their findings.

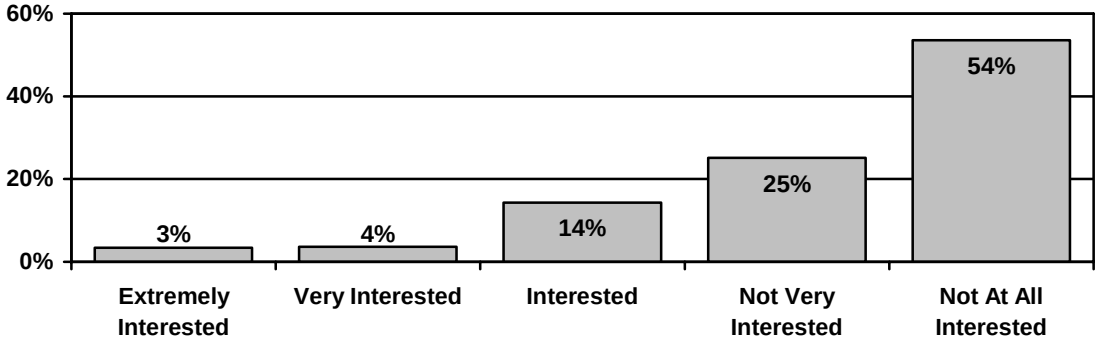
SURVEY OF U.S. ADULTS

Over two thousand (2,056) U.S. adults were surveyed online by Harris Interactive to measure their level of interest in the direct selling opportunity with and without the waiting period, references, and legal disclosure requirements in the FTC's proposed Rule. The survey was fielded during July 5-7, 2006, and the results were weighted to represent the U.S. adult population.

Of the two questions that were asked in the survey, the first question measured the level of interest of U.S. adults in the direct selling opportunity without the proposed requirements. The question and a summary of respondent answers are presented below in Figure 1. Three percent reported they were extremely interest; 4%, very interested; and 14%, interested. Overall, 21% were extremely interested, very interested, or interested in the direct selling opportunity.

Figure 1

Question: *If you were presented with a compelling product or service and business opportunity, how interested would you be in becoming a part-time or full-time sales representative for a direct selling company such as Mary Kay, Arbonne, The Pampered Chef or Cutco, where you could work from home and earn money on the sales of products and services made by you and/or those you recruit as sales representatives?*



The second question in the survey measured what the level of interest of U.S. adults in the direct selling opportunity would be with the three proposed requirements, separately and combined. The question and a summary of respondent answers are presented below in Table 1.

Table 1.

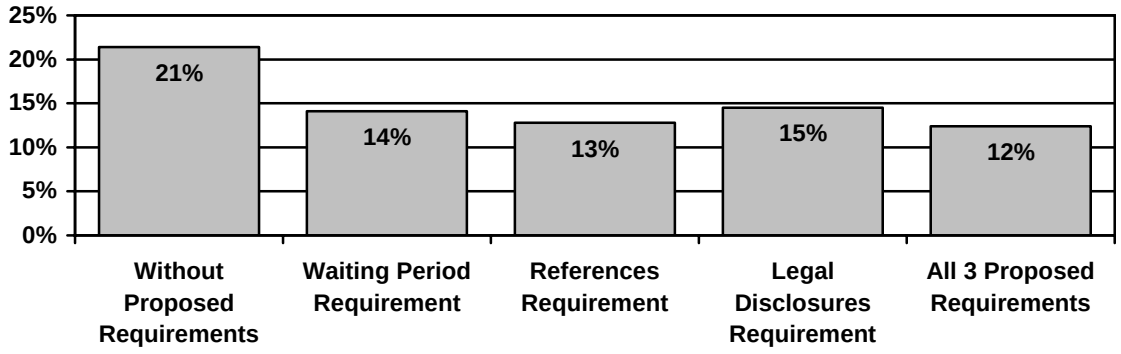
Question: *How interested would you be in becoming a sales representative if you were told the following, or you were required to tell your potential recruits the following?*

	Extremely Interested	Very Interested	Interested	Not Very Interested	Not At All Interested	Total
"Now that I have explained the business opportunity to you, you must wait 7 days before you can sign up."	1%	2%	11%	18%	68%	100%
"As a representative, your personal contact information (name, address, phone number) might be given to potential recruits as a reference."	1%	1%	11%	17%	70%	100%
"As a representative, you will be required to provide potential recruits with a list of any legal actions against yourself or others in your group or sales organization, or against the company you represent, involving misrepresentation or fraud."	2%	2%	11%	16%	69%	100%
If you were told or were required to tell your potential recruits each of these statements.	1%	1%	10%	17%	71%	100%

Based on the data in Figure 1 and Table 1, Figure 2 compares the percentages of U.S. adults extremely interested, very interested, or interested in the direct selling opportunity with and without the proposed requirements. The level of interest in the direct selling opportunity decreases with each requirement, falling from 21% without the requirements to 14% with the waiting period requirement, to 13% with the references requirement, and to 15% with the legal disclosures requirement. Moreover, the percentage of U.S. adults extremely interested, very

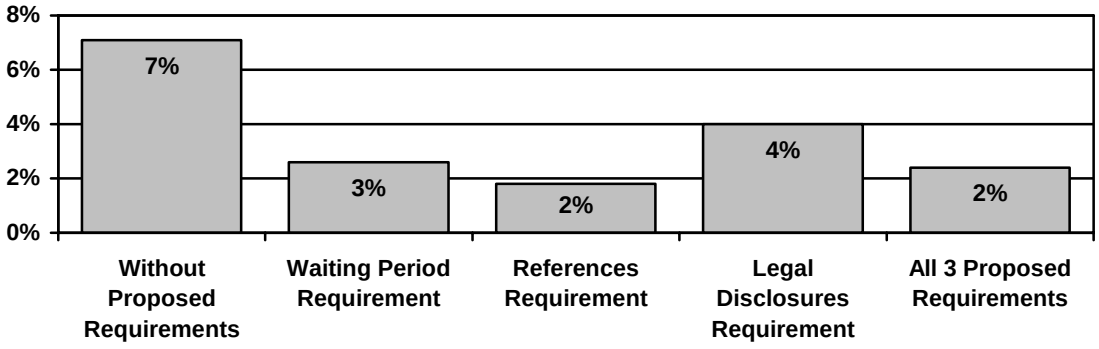
interested, or interested in the direct selling opportunity decreases from 21% without the requirements to 12% with all three requirements, a decrease of over 40%.

Figure 2.
Percentages of U.S. Adults Extremely Interested, Very Interested, or Interested in the Direct Selling Opportunity with and without the Proposed Requirements



When the analysis is narrowed to U.S. adults who are 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 requirements is even more pronounced (Figure 3). The percentage of U.S. adults extremely interested or very interested in the direct selling opportunity declines from 7% without the requirements to 2% with the three requirements, a decline of about two-thirds.

Figure 3.
Percentage of U.S. Adults Extremely Interested or Very Interested in the Direct Selling Opportunity with and without the Proposed Requirements



SURVEY OF DIRECT SELLERS

In addition to the survey of U.S. adults, a survey was conducted of U.S. direct sellers about the three requirements in the FTC's proposed Rule. The survey was conducted online, and direct selling companies were invited at the end of June 2006 to distribute to their direct sellers a link to the Web page with the survey. By July 10, 2006, just under seven thousand (6,951) direct sellers had submitted complete surveys.

As background information, direct sellers completing the survey were asked to identify the primary direct selling company they represented, how long they had represented that direct selling company, and how many direct sellers they had personally recruited over the past year. Table 2 summarizes the sample of 6,951 respondents by these three characteristics.

Table 2
Summary of Respondents by Selected Characteristics

Primary Company	%	Time with Primary Company	%	Number of Recruits in Past Year	%
Firm 1 (large firm with person-to-person sales strategy)	6%	Under 1 year	24%	Two or less	63%
Firm 2 (large firm with person-to-person sales strategy)	23%	1 to 5 years	55%	3 to 20	27%
Firm 3 (large party plan firm)	47%	6 to 10 years	12%	Over 20	9%
Firm 4 (medium-sized party plan firm)	12%	Over 10 years	9%	Total	100%
Other firms (over 100 firms)	11%	Total	100%		
Total	100%				

Note: Totals may not sum to 100% due to rounding.

The sample of 6,951 includes a variety of direct sellers, in terms of how long they have represented their primary direct selling company and the number of direct sellers they have personally recruited over the past year. While over 100 direct selling companies are represented in the sample, four firms account for most of the sample; two of the four are party plan companies and the other two use person-to-person sales methods, so the sample accounts for direct sellers using either sales strategy (i.e., party plan or person-to-person).

To measure the potential impact of the three proposed requirements, the survey asked if the direct seller would consider signing up with a direct selling company if the three requirements were in effect. The question and a summary of respondent answers are presented below in Table 3. Forty percent said they would consider signing up with the waiting period requirement; 24% with the references requirement, and 20% with the legal disclosures requirement. If all three requirements were in effect, only 15% would consider signing up.

Table 3
Question: *If you were being approached today by a representative of a direct selling company for the first time ever, would you consider signing up for the business opportunity if the representative told you the following?*

	Yes	No	Total
"Now that I have explained the business opportunity to you, you must wait 7 days before you can sign up."	40%	60%	100%
"As a representative, your personal contact information (name, address, phone number) might be given to potential recruits as a reference."	24%	76%	100%
"As a representative, you will be required to provide potential recruits with a list of any legal actions against yourself or others in your group or sales organization, or against the company you represent, involving misrepresentation or fraud."	20%	80%	100%
If the representative had told you all three of the statements above.	15%	85%	100%

Table 4 presents the percentages of direct sellers that would consider signing up with a direct selling company if all three proposed requirements were in effect, by primary company, length of time with primary company, and number of direct sellers recruited during the past year. For each

of the subgroups shown in Table 4, less than one-fourth of the direct sellers would consider signing up with a direct selling company if all three requirements were in effect.

Table 4
Percentages of Direct Sellers that Would Consider Signing Up with a Direct Selling Company If All Three Requirements Were in Effect

Primary Company	%	Time with Primary Company	%	Number of Recruits in Past Year	%
Firm 1 (large firm with person-to-person sales strategy)	5%	Under 1 year	21%	Two or less	17%
Firm 2 (large firm with person-to-person sales strategy)	17%	1 to 5 years	15%	3 to 20	13%
Firm 3 (large party plan firm)	16%	6 to 10 years	10%	Over 20	7%
Firm 4 (medium-sized party plan firm)	20%	Over 10 years	5%		
Other firms (over 100 firms)	8%				

It is notable that two of the lowest percentages are reported by direct sellers who have represented their primary direct selling company for more than ten years (5%) and by direct sellers who personally recruited over 20 direct sellers over the past year (7%). Many of the direct sellers in these two subgroups of the sample are probably sales leaders for the direct selling companies that they represent. Sales leaders account for a substantial part of the sales volume and new recruits of direct selling companies, and provide the leadership and entrepreneurial spirit for building the networks of direct sellers that are necessary to successfully distribution the products and services of direct selling companies. These two low percentages suggest 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.

CONCLUSION

The two surveys described in this report reveal that the level of interest of actual and potential direct sellers in the direct selling opportunity would decline substantially if the waiting period, references, and legal disclosures requirements in the FTC's proposed Rule were to come into effect. More specifically, if all three requirements were in effect, the surveys found the following:

- The percentage of U.S. adults extremely interested, very interested, or interested in the direct selling opportunity would decrease from 21% to 12%, a decrease of over 40%.
- The percentage of U.S. adults extremely interested or very interested in the direct selling opportunity, the adults most likely to become direct sellers, would decline from 7% to 2%, a decline of two-thirds.
- If they were approached by a representative of a direct selling company for the first time ever, less than one-quarter of current direct sellers would have considered signing up for the direct selling opportunity.
- If they were approached by a representative of a direct selling company for the first time ever, less than one-tenth of current sales leaders of direct selling companies would have considered signing up for the direct selling opportunity.