

**THE FTC FINAL BUSINESS OPPORTUNITY RULE:
STILL WORK TO DO FOR MLM/DIRECT SELLING/NETWORK MARKETING**

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The Mills of the Gods grind slowly, yet exceedingly fine.

Greek philosopher, Sextus Empiricus

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On March 1, 2012, a three decade rulemaking process of the FTC (Federal Trade Commission) will result in the implementation of the final FTC Business Opportunity Rule. Although the FTC's summary of the Rule explicitly states that it is not the intent of the Rule to apply to companies that offer opportunities in the channel of distribution alternatively referred to as MLM/Multilevel Marketing/Direct Selling/Network Marketing, the actual Rule seemingly covers many areas of support provided by MLM companies, leaving the FTC rhetoric at odds with the actual Rule that has been adopted. **The quasi-assurance of MLM industry exemption, granted in the summary text of the Final Business Opportunity Rule, is unfortunately taken back in the "footnotes" to the Rule and the Rule itself.**

The application of onerous disclosure and regulatory coverage leaves the industry in an uncertain position, seemingly at risk of enforcement at the discretion of future FTC staff, notwithstanding the FTC's specific statement that it believes that proper enforcement against deceptive pyramid schemes should be pursued under its Section 5 rule that prohibits "unfair and deceptive practices." For the present, the goodwill and current enforcement plans of the FTC toward the MLM industry is readily apparent. The actual Rule, in the absence of the industry seeking adjustments in the Rule or Congressional exemption, creates an ambiguous future for the MLM/Direct Selling/Network Marketing industry.

In 1978, the FTC (Federal Trade Commission) issued a combined rule regulating disclosures for sellers of franchises and business opportunities. It was principally aimed at the franchise industry to require extensive disclosures to purchasers of franchises. In 1999, the FTC decided to embark on a process to create a stand-alone Business Opportunity Rule. In 2006, the first draft was published for public comment. In 2008, the FTC published an interim Rule followed by a 2011 release of the Final Rule, which would be effective in March, 2012.

The MLM/Direct Selling/Network Marketing Industry is Heard Loud and Clear ... Almost

In April 2006, the FTC released a sweeping proposed change in its FTC Business Opportunity Rule. During the following two-year period, the FTC received more than 17,000 comments on its proposed rule, the majority of which were from companies, representatives and distributors in the MLM industry. The vast

majority of comments raised serious concerns regarding the onerous and burdensome nature of the proposed rule, as well as extending the scope of the Rule to the MLM /Direct Selling industry. In addition, scores of members of Congress weighed in with concerns about the impact on a well-established industry that involved millions of home-based businesses.

On March 18, 2008, the FTC responded favorably to constructive criticism, and announced that it was seeking to modify the Proposed Business Opportunity Rule to exempt MLM companies. The FTC issued a Revised Proposed Business Opportunity Rule for comment. At the very least, the FTC was unequivocal in its stated intent to exempt the MLM industry, noting in its public statement:

On balance, based on this record and its law enforcement experience, the Commission does not believe it is practicable or sufficiently beneficial to consumers to attempt to apply the proposals advanced in this rulemaking against multi-level marketing companies, particularly when considering the burdens upon industry. The Commission, therefore, has determined that at this point, it will continue to use Section 5 to challenge unfair and deceptive acts or practices in the MLM Industry.

In fact, no less than ten references are set forth by the FTC with respect to its intent to exclude application of the RPBOR to MLM/Direct Selling companies. Those comments are couched in such terms as:

"The [Rule] has been pared back to exclude MLMs";

"The Commission takes MLM companies out of the ambit of the Rule";

"... these provisions would no longer apply to MLM companies";

"they [MLM Companies] are excluded from the scope of the [Rule]."

Unfortunately, the actual Revised Proposed Rule was silent on the exemption for MLM/Direct Selling.

The revised draft, announced with the intent of exempting MLM companies, was unfortunately still flawed in that its wording may still inadvertently create applicability to many leading MLM companies because proposed "definitions" section 437.1(c)(3)(ii) may mistakenly include MLM/Direct Selling companies that assist in customer gathering on the web, in print, institutional or co-op advertising campaigns or other customer lead generation programs. However, industry commentators noted that the proposed rule represents a good faith start to narrow the scope of the Proposed FTC Business Opportunity Rule and invite comments from the public to assist in this process.

The response of the industry was one of appreciation and concern, all at once. It was noted that the expressed intentions of the FTC were much appreciated by the MLM/Direct Selling Industry.

Unfortunately, the industry could take very limited comfort in the FTC comments, in that, at no place in the Revised Proposed Business Opportunity Rule is the MLM/Direct Selling exemption "called out," nor was it even addressed. If adopted, as is, future statutory interpretation within the "four corners" of the actual Rule, will find no guidance as to the FTC intention to exempt MLM/Direct Sellers from the Rule.

In its polite criticism, industry representatives pointed out that, although the drafters may perceive that "business assistance" as defined in the proposed draft is quite different for the classic "business opportunity" compared to MLM opportunities, there actually is a substantial "blur" as to the distinction. The proposed Rule is triggered by an offeror who "provides outlets, accounts, or customers, including, but not limited to, Internet outlets, accounts, or customers, for the purchaser's goods or services." In today's direct selling world, it is not uncommon for direct selling companies to offer lead generation, assistance in customer acquisition, institutional and co-op advertising to drive customers and prospects to distributors, web-branded sites that drive customers and prospects to distributors and replicating websites for distributors that are fed by company web and other media promotion. In other words, unless MLM/Direct Selling companies are exempted from the definition of "business assistance" or, unless the definition of "business assistance" is fundamentally changed, MLM/Direct Selling companies will likely be snared in the net of the Rule's definition. Industry professionals would likely conclude that it is impractical to redefine "business assistance," as the provided definition is quite typical of existing state business opportunity legislation.

And there the matter stood from 2008 to 2011, awaiting publication of the FTC Final Business Opportunity Rule.

Close, But No Cigar

The FTC Heard the MLM/Direct Selling/Network Marketing Industry ... Almost

And so, the industry waited patiently, with the hope that the FTC's Final Business Opportunity Rule would match exemption intent with actual exemption language.

In 2011, the FTC released the Final Business Opportunity Rule, to be effective March 1, 2012. In its 200 page release, the FTC rhetoric, time and time again, clearly indicated its intent to exempt the MLM industry from broad sweeping coverage of the new Rule. Its position was succinctly expressed at page 33 of the Release:

Accordingly, while the Commission recognizes that problems may exist within the MLM industry, it continues to find that the Business Opportunity Rule is not the appropriate vehicle through which to address them. Rather, the Commission will continue to challenge unfair or deceptive practices in the MLM industry through Section 5 of the FTC Act. Thus, the final Rule has been crafted to avoid broadly sweeping in MLMs.

As applied to MLM/Direct Selling/Network Marketing Companies, the FTC Final Business Opportunity Rule, under section 437.1 (c) offered a definition of a "business opportunity" that required three prongs to trigger applicability:

1. Solicitation to enter a new business;
2. A required payment of any amount (whether "at cost" or not);
3. Providing assistance in acquiring customers or accounts.

The problem: Almost all federal and state franchise, business opportunity and MLM legislation exempt, from coverage, offerings with entry fees below threshold amounts (typically \$500) as well as "not for profit" or "at cost materials." The Final Rule contains no such exemptions.

Thus, absent an exemption for entry fees below a threshold amount, or for "at cost" materials, under the Final Rule, MLM/Direct Selling/Network Marketing Companies clearly trigger the first and second prongs. Thus, unless the FTC reconsiders number two, the third prong was the only possible "out" for MLM/Direct Selling/Network Marketing companies. The industry sought relief and exemption here for both prongs two and three, but it was unsuccessful ... and notwithstanding the FTC's good faith intent to not pull MLM companies into enforcement of the new Rule, in reality, they are "pulled in."

Unfortunately, the goodwill exemption so clearly offered in the FTC's generalized discussion, was effectively retracted in footnotes and rejection of the MLM/Direct Selling/Network Marketing industry's constructive comments and request for a specific called out exemption that matched the FTC's stated goals.

In one clear, but somewhat buried, footnote, (footnote 91, page 33) the FTC effectively took back what it had granted in its text:

91 The final Rule, however, does not explicitly exempt MLMs from coverage, but instead contains a narrow definition of "business opportunity."

In all fairness to the FTC, it clearly improved its earlier draft, at the request of the industry to narrow the scope of "business assistance" that forms an important third prong required to trigger application of the Rule to MLM. It specifically removed as examples of business assistance both generalized business training and tracking and paying commission ... also noted in footnote 91, page 33:

As discussed in Section III.A.3 infra, the final Rule's definition of "business opportunity" eliminates two types of business assistance that previously would have triggered the Rule's coverage of MLMs:

(1) tracking or paying commissions or other compensation for recruitment or sales; and

(2) providing generalized training or advice for the business. The final Rule is thus more narrowly tailored to those types of deceptive business assistance representations that are the hallmark of fraudulent business opportunity schemes: location, account, and "buy back" assistance.

73 FR at 16123.

And true to its word, the FTC's Final Business Opportunity Rule provided for a specific exemption from the triggering third prong of a "business opportunity" in which a company provides outlets, accounts or customers to those involved in the opportunity ... going a long way, but not far enough to encompass the services provided to MLM distributors:

Section 437.1(m)

Providing locations, outlets, accounts, or customers means furnishing the prospective purchaser with existing or potential locations, outlets, accounts, or customers; requiring, recommending, or suggesting one or more locators or lead generating companies; providing a list of locator or lead generating companies; collecting a fee on behalf of one or more locators or lead generating companies; offering to furnish a list of locations; or otherwise assisting the prospective purchaser in obtaining his or her own locations, outlets, accounts, or customers, provided, however, that advertising and general advice about business development and training shall not be considered as “providing locations, outlets, accounts, or customers.”

However, the FTC specifically rejected requests by the industry to extend the exemption to otherwise typical assistance provided by almost all leading MLM/Direct Selling/Network Marketing Companies, including replicated websites, referral of customers, lead generation, etc. In failing to call out in the Rule its intent to not cover MLM opportunities or to further exempt typical MLM Company assistance, prong three is triggered, and the industry is left vulnerable. In fact, at page 83, footnote 222, the FTC specifically noted such industry raised concerns, although ultimately granting no specific exemption relief in the Final Business Opportunity Rule:

222 E.g., Avon-RNPR at 3 (noting that this practice is designed to help potential customers find a sales representative, not to help sales representatives find potential customers); Mary Kay-RNPR at 7 (suggesting that merely providing the ability to search for a sales associate on the company’s website should not trigger the “providing locations” factor of the “business opportunity” definition); DSA-RNPR at 5; MelaleucaRNPR at 2.

In the end, the FTC did not grant the exemption relief that the MLM/Direct Selling/Network Marketing industry was seeking. In the future, enforcement will clearly be in the discretion of FTC staff and not in the control of the industry. If any comfort was to be offered by the FTC, it was to be found in the FTC discussion of the standard it may choose to enforce or not enforce its new Rule against MLM/Direct Selling/Network Marketing companies that offer typical non-exempted business assistance to distributors, i.e., the significance of assistance in inducing a potential distributor to enter the business:

*The Staff Report noted a concern with narrowing the definition in the ways the commenters suggested, because it would allow promoters of fraudulent schemes to craft their sales pitches carefully to evade the Rule. The staff disagreed with commenters who recommended excising the word “customers” from the definition or diluting it in some fashion. **Instead, the Staff Report recommended that the Commission continue its longstanding policy of analyzing the significance of assistance in the context of the specific business opportunity, focusing on whether the seller’s offer is “reasonably likely to have the effect of inducing reliance on [the seller] to provide a prepackaged business.”*** (at page 85.)

Time to Go to Work: The MLM/Direct Selling/Network Marketing Industry: Operation: Get it Right ... Put it to Bed

The industry clearly has the goodwill of the FTC at a time when the Final Business Opportunity Rule is launching, March, 2012. But it enters a new era with a shadow of uncertainty over its head and an

enforcement that is subject to the discretionary decision making of future FTC staff. If it is looking for some ultimate peace and security, the industry, through leading companies, leading commentators and legal experts and associations, such as the DSA or MLMIA, should continue the good and respectful fight for changes to the FTC Final Rule or Congressional legislation to memorialize the exemption. It will not be the first time; in 1982, Congress amended the Internal Revenue Code to recognize independent contractor status of direct sellers ... sending a clear message on enforcement and interpretation to the IRS.

Five recommendations are respectfully suggested to achieve the intent of the FTC that will further FTC objectives, create consistency with a long-standing state tradition of regulation of business opportunities, and finally, address the goals and needs of the MLM/Direct Selling industry:

(1) Specifically call out the exemption for MLM/Direct Selling/Network Marketing in the Final Business Opportunity Rule. (*A total exemption consistent with FTC implied intent*);

(2) Adopt a threshold exemption for required payments in the first six months, preferably \$500, but perhaps as low as \$200. (*Eliminates the "required payment" prong of the Rule's definition of a "business opportunity"*);

(3) Adopt an exemption from the definition of "required payment" for the purchase of "at cost" or "not for profit" sales kits and marketing support materials and marketing systems support such as replicating websites or "back office" distributor systems for analyzing commissions, productivity and communication. (*Eliminates the "required payment" prong of the Rule's definition of a "business opportunity"*);

(4) In the alternative, adopt a specific exemption for MLM/Direct Selling companies as follows:

MLM/Direct Selling companies are exempted from this Rule so long as any required payment during the first six months of distributor participation is below \$_____, and so long as the required purchase is for "at cost" or systems support such as replicating websites or lead referral or "back office" distributor systems for analyzing commissions, productivity and communication. (*Eliminates the "required payment" prong of the Rule's definition of a "business opportunity"*);

(5) Expand the MLM exemption from the business assistance prong of "providing locations, outlets, accounts or customers" as follows:

Providing locations, outlets, accounts, or customers means furnishing the prospective purchaser with existing or potential locations, outlets, accounts, or customers; requiring, recommending, or suggesting one or more locators or lead generating companies; providing a list of locator or lead generating companies; collecting a fee on behalf of one or more locators or lead generating companies; offering to furnish a list of locations; or otherwise assisting the prospective purchaser in obtaining his or her own locations, outlets, accounts, or customers, provided, however, that for MLM/Direct Selling/Network marketing companies, advertising and general advice about business development and training,

replicated websites, back office support, customer or distributor referral programs and lead generation programs, shall not be considered as "providing locations, outlets, accounts, or customers."

In Conclusion ...

In conclusion, the MLM/Direct Selling/Network Marketing industry is certainly entitled to celebrate a continuing positive dialogue and cooperation with the Nation's top consumer protection agency, the FTC. In its commentary on the Final Business Opportunity Rule, the FTC could not have been more clear that it did not intend to apply its new Rule to the MLM channel of distribution. Instead, the commentary opined that the current regimen of prohibition on "deceptive" practices should be the appropriate vehicle for enforcement.

Unfortunately, the new Final Rule language does not match the "staff" commentary. And unfortunately, staffs come and go ... and administrations come and go. And commentaries are just that ... commentaries. In the end, it is the actual Rule that reigns. And the actual language of the Final Business Opportunity rule opens the door to significant enforcement of the Rule to the MLM/Direct Selling/Network Marketing industry should a future staff so choose. In that regard, the Industry, in the absence of clarification of the Rule, should not sleep quite as peacefully as it would like. And it may take limited comfort in the FTC staff commentary and good rapport that exists between the Industry and the FTC at the time of adoption of the Final Business Opportunity Rule.

In other words, there is work to be done.

For a complete copy of the FTC Final Business Opportunity Rule, together with extensive FTC staff commentary, please see: [**FTC Final Business Opportunity Rule**](#).

<http://www.mllegal.com/FTC%20Business%20Opportunity%20Rule/FTCFinal%20Bus%20Opp%20Rule.html>