

Before the
FEDERAL TRADE COMMISSION
Washington, D.C.



In re:)
Notice of Proposed Rulemaking)
Business Opportunity Rule)
R511993)
)

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

COMMENTS OF SUCCESS IN ACTION, INC. AND DAVID STEWART

Jonathan W. Emord
Andrea G. Ferrenz
Emord & Associates, P.C.
1800 Alexander Bell Dr.
Suite 200
Reston VA 20191
Phone: (202) 466-6937
Fax: (202) 466-6938

Success In Action, Inc., and David Stewart, by counsel and in response to the above referenced Notice of Proposed Rulemaking, published in 71 Fed. Reg. 19054 (April 12, 2006) hereinafter “Proposed Rule”), hereby file these comments.

I. SUMMARY

FTC’s Proposed Rule will have a profound and devastating impact on the network marketing (also known as direct sales and multilevel marketing) industry, causing lost income, lost jobs, business closings, and loss of potential business growth throughout the United States, particularly in rural areas and other regions where traditional opportunities for employment are scarce. Instead of preventing fraud and protecting against unfair business practices, the Proposed Rule would cause the hundreds of thousands of individuals who depend upon income from network marketing to be financially crippled by the cost of compliance and loss of business while bad actors will likely not be deterred from continuing to break the existing laws against fraud and unfair business practices (laws unchanged by the Proposed Rule).

There is no widespread fraud in the network marketing industry. Existing law gives FTC all of the power that it needs to combat fraud in the marketplace. The Proposed Rule is unnecessary and will not have the fraud-deterrent effect that FTC intends. FTC’s Proposed Rule is based on assumptions and scant evidence concerning network marketing and fraud in the marketplace. FTC lumps together disparate industries in this rulemaking, such as vending machine sellers with network marketing. FTC ignores the network marketing industry’s characteristics (the characteristics of its sellers and the characteristics of its business practices) and draws assumptions based on a

handfull of prior FTC actions against companies that were pyramid schemes or otherwise engaged in unfair business practices.

FTC's Proposed Rule would mandate a series of disclosures by companies that sell products through network marketing techniques and by the persons that sell the companies' products and business opportunities (typically referred to as "distributors") to purchasers who wish to become distributors themselves. In addition, the Proposed Rule would require a seven day waiting period from the time when the consumer first received the mandatory disclosures until the time the person could lawfully contract to be a distributor.

The mandatory disclosures are compelled speech in violation of the First Amendment and vague and overbroad in violation of the First and Fifth Amendments. Moreover, the Proposed Rule is contrary to the Federal Trade Commission Act (FTCA) as it avoids FTC's burden of proof (wherein it is required to prove that a party has engaged in unfair or deceptive practices before holding them in violation of section 5 of the FTCA). Under the Proposed Rule FTC presumes a failure to issue its mandated disclosures to be proof positive of a deceptive or unfair act or practice under section 5. The Proposed Rule forces all business opportunity sellers to disclose trade secrets that are otherwise closely guarded in this industry and to defame themselves and others by requiring notice of fraud cases even when the charges are unadjudicated and are frivolous, groundless, or dismissed. The Proposed Rule imposes such compliance burdens that the financial requirements to comply would far exceed (in some cases many times over) the income of the typical business opportunity seller. The Proposed Rule invades the privacy right of the business opportunity seller, who typically operates out of

his or her home, by granting FTC a power to inspect for all documentation relating to the mandatory disclosures, permitting government intrusion into a home without procedural safeguards in place to protect the privacy of the home. Thus, for the millions of Americans that meet the definition of a business opportunity seller, the Proposed Rule will cause extreme hardship. Finally, the Proposed Rule in its entirety is a violation of the Administrative Procedures Act (APA) as arbitrary and capricious agency action, agency action contrary to law, and agency action contrary to the Constitution.

Thus, the Proposed Rule is ineffective in achieving FTC's goals, will cause widespread significant loss and hardship, and violates the law and Constitution.

II. DESCRIPTION OF THE COMMENTERS

Success In Action, Inc. Success In Action, Inc. (hereinafter "Success In Action") is based in Scottsdale, Arizona. For 25 years it has offered training and consulting services to the network marketing industry. It has served over seventy-eight corporate network marketing clients. In addition, it offers through direct internet retail sales audio, video, print and other network marketing training materials.

David Stewart. David Stewart is the President and CEO of Success In Action. For thirty-five years he has worked in network marketing to build distributorship networks as well as organizing, support, operating, and administering network marketing companies in his role at Success In Action. Mr. Stewart has been a distributor for network marketing companies, including in one instance where he developed a single organization of 100,000 distributorships (business opportunities). In his role in Success In Action, he has been involved in the creation and development of industry policies and

procedures for network marketing companies. In addition he has served as President and CEO of five network marketing (both public and privately held) companies.

III. COMMENTS

A. **The Network Marketing Industry Is Not Rife With Fraud**

FTC offers scant evidence and points to a few prior FTC actions against bad actors as evidence that all of the industries lumped together under the Proposed Rule (including the network marketing industry) are awash in a sea of fraudulent practices. 71 Fed. Reg. at 19057. However, FTC's complaint database analysis, used as the primary justification for the rule, does not reflect any consumer complaints made concerning the network marketing industry. See FTC, Franchise and Business Opportunity Program Review 1993-2000 at 4 (June 2001) ("Complaints that could be accurately identified as concerning MLMs ... were removed.") Complaints, if any, concerning the network marketing industry were removed from the initial pool of complaints that were analyzed in FTC's report, the report that is arguably the principal basis for FTC's conclusions concerning fraud. Thus the Proposed Rule's recitation of typical complaints justifying the rule is wholly unrepresentative of the network marketing industry, 71 Fed. Reg. at 19057, yet that industry is subject to the rule's heavy burdens, 71 Fed. Reg. at 19080 (estimating 150 network marketing companies to be among the 3,200 business opportunity sellers it estimates subject to the Proposed Rule).

Contrary to FTC's assumptions and conclusory statements concerning the nature of this industry (as being equivalent to vending machines and other sellers in terms of fraudulent practices and consumer deception), the network marketing industry actually is best characterized by the millions of individuals who work as network marketing

distributors throughout the United States out of their homes in pursuit of a supplemental income with companies that they have chosen based on their satisfaction and belief in the products sold by the company. Stewart, D., Network Marketing Action Guide, 7-13 113-122(1991, 1996); see also attached Exhibit A (affidavit of David Stewart) at ¶¶ 6-9. It is an industry with a long history, see Stewart at 6-29, where success is based on the individual abilities and ambitions of the distributors, see Stewart at 33-63, with involved relationships with parent companies and distributors that include continuous training and support services, see Stewart at 205-224, also Stewart D., Network Marketing, One Plus One Equals Four. Network Marketing vs. "Pyramid Schemes" (1991, 2003). Moreover, sellers promote products and business opportunities in open and transparent environments selling to people they know or people brought by people they know. See id. at 1; see also Exhibit A generally. Thus the existing network marketing marketplace has strong built-in disincentives against deception that are unique to its nature and distinguish it from other industries.

B. The Proposed Rule Is Ineffective Against Fraud

Assuming *arguendo* that the network marketing industry was not only filled with fraudulent actors but also relied on business practices that lent themselves to fraud, the Proposed Rule would be ineffectual in reducing fraud; it would serve as no deterrent and would have little or no effect on fraudulent practices. Additional law and regulation that is the same as existing law (same violation and same penalties) has time and again been shown to be no deterrent to those who already break existing law. See e.g., Joshua Fairfield, Cracks in the Foundation: the New Internet Legislation's Hidden Threat to Privacy and Commerce, 36 Ariz. St. L. 1193, 1220-1230 (2004) (proposed new law is

redundant; bad actors would be undeterred when existing law is no deterrent). It is only enforcement of the existing law against those bad actors that can act as a deterrent to other bad actors in the marketplace. See e.g. id. at 1239. Additional laws that increase investigatory burdens on an entire industry are grossly inefficient when only a minority are engaged in fraud and take away from resources that would be better spent in targeted case by case enforcement. See e.g. id. at 1238 (enforcement resources should be spent on bad actors).

C. The Proposed Rule Forces Sellers to Violate the Law, Disclose Trade Secrets, Defame Themselves and Others, and Bear Unreasonable Financial Burdens for Compliance

The Proposed Rule defines “seller” as “a person who offers for sale or sells a business opportunity.” 71 Fed. Reg. at 19088. That seller must furnish the Proposed Rule’s mandatory disclosures at least seven days before the prospective purchaser signs a contract or makes a payment to purchase a business opportunity. Id. The seller must disclose: (1) name, city and state, and telephone number of all purchasers who purchased the business opportunity within the last three years (or at least 10 purchasers if there were more than 10 buyers); (2) case information for any civil or criminal action for misrepresentation, fraud, securities law violations, or unfair or deceptive practices within the last 10 years to which the seller; affiliate or prior business of the seller; the seller’s officers, directors, sales managers, or any individual occupying a similar position; or any of the seller’s employees were subject. Id. The disclosure of identifying information for at least 10 purchasers within the last three years of sales violates the law. It forces the disclosure of information sellers regard as confidential, trade secrets: the identities of distributors in their downlines (permitting a competitor to gain an advantage in

recruitment simply by posing as persons interested in business opportunity purchases). Exhibit A at ¶¶ 24-26. The disclosure of all legal actions regardless of their ultimate outcome or merit is when the charges are false or misleading state - compelled defamation of not only the seller but of all of the parties that FTC mandates in that disclosure.

The Proposed Rule mandates that any earnings claim be substantiated with an up to date market analysis. 71 Fed. Reg. 19088-19089. Marketing expertise is required to prepare that substantiation and legal counsel is needed to understand and comply with the rule. The requirements and implications of the Proposed Rule are too vague and indecipherable for the average distributor without consulting experts. That requirement imposes a heavy financial burden on distributors who may typically earn less than \$500 per month, money that is typically used for household and living expenses to supplement a primary income. Exhibit A at ¶¶ 7-8; see also Comments of Multilevel Marketing International Association and report of expert Dr. Steve Nowlis attached thereto (estimating the per distributor cost of compliance at \$25,000-\$45,000 the first year and \$10,000 to \$20,000 for every year thereafter).

In addition, the majority of distributors work from their homes and store their business records in their homes. See Exhibit A generally. Thus the requirement that the seller retain documents for three years and make them available for FTC inspection is burdensome. It requires distributors to retain more documents in their homes for more time than typical businesses. It also requires distributors to purchase storage equipment such as filing cabinets to retain the additional documentation. It also opens the homes of distributors to inspectors without first obtaining a search warrant upon proof of probable

cause before an impartial judge. Wilson v. Layne, 526 U.S. 603, 610 (1999). Thus, the record retention burden on distributors is significant and entails a loss of personal freedoms, privacy, and the privacy right to be left unmolested in one's home.¹

D. The Proposed Rule Violates the Constitution

The Proposed Rule regulates speech by forbidding the communication to prospective business opportunity purchasers of “any claim or representation...that is inconsistent with or contradicts the information required to be disclosed by section 437.3 (basic disclosure document) and 437.4 (earnings claims document) of this Rule” or to include “any materials or information other than what is explicitly required or permitted.” Proposed Rule at 437.5(b), (c). The rule thus prohibits a person from revealing material information not conveyed in the actions disclosed that may be needed to avoid deception, eliminate defamation, or eliminate a misleading connotation (such as guilt by association). The rule thus prohibits a protest to its requirements or a written explanation of any kind that would elucidate the meaning of any disclosure. Regulations on speech must be precise as American jurisprudence has long recognized pursuant to the First Amendment's principles. Keyishian v. Board of Regents of the University of the State of New York, 385 U.S. 589, 603-604 (1967)(citations omitted). By banning all speech contrary to the orthodoxy created by the rule, FTC forbids speech that could disabuse purchasers of a bias or sting that the disclosures might otherwise convey. The rule is thus a categorical ban on speech coupled with a compelled speech requirement. See Bantam Books v. Sullivan, 372 U.S. 58 (1963) and International Dairy Foods Association v.

¹ Similarly for parent companies the record retention requirement would present a massive undertaking. Three year document storage of all of the documents identified in the Proposed Rule goes far beyond most typical company information retention practices. What may be stored as electronic data entry now must be stored as complete documents. 71 Fed. Reg. at 19089. Thus for parent companies the same burdens apply.

Amestoy, 92 F.3d 67 (2d Cir. 1996). Both are in violation of the sellers' First Amendment rights.

Under the Fifth Amendment a regulation must inform the regulated class with sufficient information to determine what is and is not lawful conduct. Grayned v. City of Rockford, 408 U.S. 104, 108 (1972). It is impossible for any seller to determine the level of substantiation necessary to justify an earnings claim, clearly an enforcement focus of the agency.

E. The Proposed Rule Violates the FTCA

The Proposed Rule unlawfully causes FTC to avoid its burden of proof. The FTCA places the burden of proof on the Commission when it alleges an unfair or deceptive act or practice. FTCA Section 5 (15 U.S.C. § 45(n)). The rule avoids that requirement by presuming the mere fact of a failure to issue the mandated disclosures to be proof positive of a Section 5 violation (without any substantive proof that the act or practice in issue is in fact unfair or deceptive). Consequently the rule exceeds FTC's statutory authority. E.g., Duncan v. Walker, 533 U.S. 167 (2001); Chevron USA Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

F. The Proposed Rule Violates the APA

The Administrative Procedure Act prevents federal administrative agencies from issuing regulations that are arbitrary and capricious, contrary to constitutional right, and in excess of statutory authority. 5 U.S.C. § 706(2)(A-C). The regulatory means do not prevent or reduce fraud, the regulatory end. The mandated disclosures do not in and of themselves have any effect on acts of fraud. There is no logical basis for believing those who presently commit deceptive acts or practices will be any less likely to commit those

acts or practices in future because the present penalty for a section 5 violation and the future penalty under the Proposed Rule are the same and the Proposed Rule dose nothing to arrest fraud. The Proposed Rule is a regulation that is not rationally related to effectuation of its fraud prevention aim. It lacks a causal nexus between the means and the ends. It is, further, arbitrary and capricious because the agency has not relied upon accurate information concerning the size and extent of fraud present in network marketing as the basis for its determination to issue the regulation severing network marketers. 5 U.S.C. § 706(2)(A); Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402 (1971); see also Humana of Aurora Community Hospital v. Heckler, 753 F.2d 1579 (10th Cir. 1985). Moreover, as stated above, the Proposed Rule violates the Constitution. It is contrary to the First and Fifth Amendment constitutional rights and the privacy rights of all sellers, thus causing it also to violate the APA. 5 U.S.C. § 706(2)(B); see e.g., Mission Group v. Kansas Inc v. Riley, 146 F.3d 775 (10th Cir. 1998). Finally, as stated above, the Proposed Rule is in excess of FTC's statutory authority, altering the statutorily required evidentiary standard and burden (thereby causing it to be agency action in violation of the APA). 5 U.S.C. §. 706(2)(C); see e.g., In Home Health Inc. v. Shalala, 188 F.3d 1043 (8th Cir. 1999).

III. CONCLUSION

There is no pervasive fraud in the network marketing industry. FTC proposes to regulate that industry without any sound evidence of widespread fraud, relying on incomplete evidence from other industries. Existing law and enforcement powers of the FTC are more than adequate to deter and prevent bad actors from using fraud and unfair business practices in any business opportunity sale, including network marketing. The

EXHIBIT A

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**AFFIDAVIT OF DAVID STEWART IN SUPPORT OF THE COMMENT OF
SUCCESS IN ACTION, INC.**

I, David Stewart, declare under penalty of perjury that the following is true and correct to the best of my knowledge, information, and belief:

1. I am the President and Chief Executive Officer of Success In Action, Inc. ("SIA").
2. I have occupied my position as President and CEO of SIA for the last 25 years.
3. For the last 35 years, I have worked in the network marketing industry building field distributorships and organizing, supporting, operating, and administrating companies.
4. In my role as a distributor, I have developed an organization of over one hundred thousand (100,000) distributorships.
5. The typical earnings of most distributors who develop and work their business is on average between \$300 and \$400 a month.
6. This income is generally a supplementary income and not the primary income for these distributors.
7. In most of the cases, the income derived from network marketing businesses goes to pay for basic living needs, such as medical care, groceries, childcare, and transportation costs.
8. Many of the people that benefit from network marketing businesses lack college educations, work in the retail, fast food, or other low-paying job sectors.

9. Network marketing is one of the only opportunities left in America for individual entrepreneurial success, where the cost of initial investment is small, barriers to entry are minimal, and the potential earnings can exceed the cost of the initial investment many times over.
10. In my role as a consultant to the industry since 1979, I have been involved in the creation and development of industry policies and procedures for many Network Marketing companies. Throughout this time period, I have worked closely with state attorney generals and legal practitioners nationwide on network marketing issues.
11. My consulting and publishing company, SIA, has been exclusively serving the network marketing industry for over twenty-five years.
12. In addition to my involvement and leadership in SIA, I have served as President and CEO to five (two private and three public) network marketing companies.
13. I have read and analyzed the FTC's proposed Business Opportunity Rule, published in 71 Fed. Reg. 19054 (April 12, 2006).
14. The proposed rule mischaracterizes network marketing business opportunities by comparing them to rack display and vending machine businesses.
15. Rack displays, vending machine, and franchise business sales are premised on the principle that the prospective purchaser is buying an established and successful business method or model with a proven formula of operation. The initial investment fee covers the systems, equipment, and/or materials needed to launch the business into operation.
16. In the context of network marketing, companies provide fundamental guidelines of policies and procedures, as well as support literature and materials to someone who wants the opportunity or possibility of building a business. Rather than equipment, materials or systems of operation to make a business, the individual supplies the initiative and work to "network" a business into fruition.
17. This guidance is communicated through literature, enrollment applications, audio, video and training programs typically provided by most if not all business building companies or organizations in my experience.
18. For network marketing business opportunities that involve start-up kits, prospective purchasers are afforded the opportunity to create a business with an at-cost initial investment.
19. The start-up kit and materials are supplied at cost by the parent company. The sponsoring distributor does not receive compensation for initial purchase of the start-up kit.

20. The required cost to signup as a distributor in most companies is nominal (\$50.00 or less). This nominal fee is generally recovered rather quickly by the new distributor through savings from wholesale pricing.
21. The effect of the proposed rule will act as a deterrent for new network marketing entrants and will force out current business opportunity sellers that will be unable to bear the annual cost of compliance with the rule.
22. The three year record retention requirement would be a tremendous burden on distributors and parent companies due to the expenses involved with renting storage space, training administrative personnel, and maintaining the storage system.
23. The requirement that business opportunity sellers provide references is fiscally unsound and could promote identity theft, giving rise to liability by sellers who comply with that requirement.
24. References or disclosures of previous business opportunity purchasers' successes or failures are irrelevant because they are not indicative of potential accomplishment based on individual performance.
25. Disclosure of references would be the disclosure of trade secrets and highly confidential information that is not typically disclosed to the public in this industry. In my experience, that information is closely guarded by owners with access strictly limited to persons on a necessity basis.
26. Knowledge of a competing distributor's information, even in part, is an unwarranted business advantage.
27. Based on my 35 years of experience in the network marketing industry, this rule will have a severely detrimental effect on millions of network marketing participants and consumers.

SIGNED: _____

DATED: July 13, 2006