



July 17, 2006

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



Re: Business Opportunity Rule, R511993

Dear Mr. Clark:

I write to express the strong opposition of the Plumbing Manufacturers Institute ("PMI") to the Federal Trade Commission's proposed Business Opportunity Rule (the "Proposed Rule"). Although intended by the FTC to combat fraud in the sale of business opportunities, the Proposed Rule is so broad in scope that its new regulatory requirements will apply to a vast range of product distribution arrangements between manufacturers and their wholesalers and distributors, even though those arrangements are not commonly understood to be "business opportunities" and there is no evidence that those arrangements are subject to the forms of abuse that the FTC is seeking to prevent. If the Proposed Rule is adopted, American manufacturers, including those in the plumbing industry, will be required to comply with disclosure, waiting period and record retention obligations that will serve no practical end other than to burden the nation's product supply chain.

Accordingly, the PMI believes that the Proposed Rule should be redrafted so that it more narrowly targets the true "business opportunity" schemes that have led to consumer abuse. In the alternative, exemptions should be crafted to the Proposed Rule which will relieve manufacturers of the Proposed Rule's burdens when they enter into ordinary distribution relationships with wholesalers and other distributors. Enclosed with this letter is a letter from the PMI's counsel which further elaborates on the PMI's objections to the Proposed Rule.

Very truly yours,

Barbara C. Higgins
Executive Director

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Re: Business Opportunity Rule, R511993

Dear Mr. Clark:

I submit this comment on behalf of the Plumbing Manufacturers Institute ("PMI") in response to the Notice of Proposed Rulemaking (the "NPR") published in the April 12, 2006 issue of the Federal Register. 71 Fed. Reg. 19054-19096. The NPR requested comments on the Federal Trade Commission's ("FTC") proposed trade regulation rule entitled "The Business Opportunity Rule" (the "Proposed Rule"). The PMI strongly opposes the Proposed Rule.

The PMI

The PMI is a voluntary, not-for-profit national trade association of manufacturers of plumbing products. Organized in 1975, the PMI represents the interests of its members in regulatory and legislative matters, advocates for consumer choice and a fair and free marketplace in the supply of plumbing products, and promotes growth and expansion of the plumbing industry. The PMI also promotes the health, safety and quality of plumbing products, as well as water conservation and efficiency in the use of plumbing products.

Member companies of the PMI produce a substantial quantity of the plumbing products in the United States. Manufacturers typically do not sell plumbing products directly to consumers, but instead deal principally with resellers such as wholesalers and "big box" retailers for distribution of their products. As a general matter, wholesalers and other resellers which buy products directly from plumbing fixture and fittings manufacturers are sophisticated, experienced entities which carry multiple product lines from different manufacturers.

The Proposed Rule

The Proposed Rule, if promulgated as a final rule, will regulate the sale of “business opportunities,” requiring sellers of business opportunities to make pre-sale disclosures to prospective buyers and to comply with new record retention obligations. 16 C.F.R. §§ 437.2-437.4, 437.6 (proposed). The purpose of the Proposed Rule is to combat “widespread fraud” in sales of business opportunities. 71 Fed. Reg. 19056. Although the FTC currently regulates business opportunities through its Franchise Rule, and has brought numerous enforcement actions against persons engaged in business opportunity scams—such as vending machine, rack display, Internet kiosk and 900 number schemes—the FTC has concluded that limits in the scope of the Franchise Rule have left substantial forms of business opportunity fraud uncovered. *Id.* at 19055, 19058. Work-at-home and pyramid marketing ventures are examples of such schemes. *Id.* at 19059-61. In drafting the Proposed Rule, the FTC has eliminated limitations and exemptions that had appeared in the Franchise Rule (or guidance interpreting that Rule) so that work-at-home and pyramid marketing schemes, and other forms of business opportunity schemes, do not evade coverage. *Id.*

The PMI does not dispute the need to combat the types of business opportunity fraud identified in the NPR. However, the PMI believes that the Proposed Rule is so broad that it may apply, unnecessarily and unreasonably, to ordinary distribution arrangements between product manufacturers and wholesalers or other distributors. The Proposed Rule’s scope is sweeping. It defines a “Business opportunity” to be any “commercial arrangement” in which (1) a seller solicits a prospective purchaser to enter into a “new business”; (2) the prospective purchaser makes a payment or provides other consideration to a seller, directly or indirectly through a third party; and (3) the seller either (i) makes an “earnings claim” or (ii) represents that it or a designated third party will provide “business assistance” to the purchaser. 16 C.F.R. § 437.1(d) (proposed). In connection with this definition of “Business opportunity”:

- “New business” is defined to be a “business in which the prospective purchaser is not currently engaged, or a new line or type of business,” *id.* at § 437.1(k) (proposed);
- “Earnings claim” is defined as “any oral, written, or visual representation to a prospective purchaser that conveys, expressly or by implication, a specific level or range of actual or potential sales, or gross or net income or profits,” *id.* at § 437.1(h) (proposed); and
- “Business assistance” is defined as “the offer of material advice, information, or support to a purchaser in connection with the establishment or operation of a new business,” excluding any “written product warranty or repair contract, or guidance in the use, maintenance and/or repair of any product to be sold by the purchaser or of any equipment acquired by the purchaser,” *id.* at § 437.1(c)(1) & (2) (proposed).

If a product manufacturer begins to deal with a new wholesaler or distributor, selling products to it for resale, this may constitute the sale of a "business opportunity" under the Proposed Rule if the manufacturer makes an "earnings claim" or offers to provide any form of "business assistance." The same also would appear to be true if a manufacturer offers a new product line to a wholesaler or distributor with which it already had a supply relationship. In either case, a manufacturer easily could engage in conduct that might be deemed to be the making of an "earnings claim" or an offer of "business assistance," as those terms are broadly defined in the Proposed Rule.¹

There is no evidence, however, that ordinary product distribution arrangements, typically involving substantial and experienced businesses on both sides of an ongoing relationship, and essential to the supply chain in many industries, are permeated with the sorts of fraud that warrant regulation by the FTC beyond what already is in place. This concern was raised by a commentator during the 1997 workshops held by the FTC where business opportunity regulation was discussed,² and continues to be valid today. Sellers of fraudulent business opportunities frequently are fly-by-night operators³ that prey upon individuals who, according to the Bureau of Consumer Protection's Staff, are "relatively unsophisticated."⁴ Many business opportunity programs do not involve continuing relationships between buyers and sellers, but instead involve "a one time purchase of packaged information."⁵ Furthermore, a recent report of the Bureau of Consumer Protection reveals that the great majority of consumer complaints of business opportunity schemes involve small amounts, under \$20,000.⁶ These characteristics of business opportunity scams—fly-by-night sellers; one-time transactions; unsophisticated buyers; minor financial investments—simply do not fit the profile of a vast number of wholesale and

¹ Sales planning and other discussions of specific levels of potential sales are common in distribution relationships, particularly in those involving the grant of an exclusive territory, and certainly occur in the setting of sales goals or quotas. In addition, wholesalers and distributors often are provided marketing assistance by their suppliers which goes beyond advice regarding the use, maintenance or repair of the supplier's products.

² 10/20/97 TR at 6 (Snow).

³ NPR, 71 Fed. Reg. 19066.

⁴ Staff of the Bureau of Consumer Protection, "Disclosure Requirements and Prohibitions Concerning Franchising: Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule," at 13-14 (Aug. 2004).

⁵ NPR, 71 Fed. Reg. 19057.

⁶ Staff of the Bureau of Consumer Protection, "Franchise and Business Opportunity Program Review 1993-2000: A Review of Complaint Data, Law Enforcement and Consumer Education," at 5 (June 2001).

distribution arrangements in the United States which may fall within the scope of the Proposed Rule.

The PMI therefore opposes the Proposed Rule because it is vastly over-inclusive in the types of business arrangements it covers, and will impose needless disclosure and record-keeping obligations—with attendant costs and inconveniences—on business arrangements for which there is no substantial risk of business opportunity fraud. The PMI recommends that the Proposed Rule's definition of "business opportunity" (and any related definitions) be substantially revised so that the Proposed Rule will apply, in a much narrower and more tailored fashion, to only the business arrangements for which the FTC has found significant business opportunity abuses, and *not* to traditional wholesale or distribution arrangements which are commonplace in United States product markets. This would be in accord with the direction the FTC indicated it was heading during its 1997 workshops, where a moderator explained that the FTC was seeking then to "focus" a business opportunity rule on only those areas "where there are real problems, either problems that consumers have complained about or where [the FTC's] law enforcement history shows that there are problems," and *not* on "businesses that have not been shown to be prone to fraud or abuse."⁷

As a possible alternative to replacing the proposed definition of "business opportunity" with a new, narrower definition, the FTC perhaps could create exemptions to the Proposed Rule which would have the effect of removing ordinary wholesale and distribution relationships from its scope.⁸ The following forms of exemption could be appropriate for this purpose:

- Substantial seller exemption. A seller of a business opportunity which has a sizeable net worth is less likely to be a fly-by-night operator that practices fraud; and, if it does, is much more likely to be able to satisfy a judgment against it. The Model Business Opportunity Sales Act (the "Model Act") contains an exemption for sellers which have a minimum net worth of \$1 million, as reported on audited financial statements, and this exemption also appears in Illinois's business opportunity law, which is based on the Model Act. North American Securities Administration Association, Model Business Opportunity Sales Act § 200(C); 815 ILCS 5-10(c). Because many product manufacturers have substantial net worth, a properly-crafted exemption of this nature could remove many ordinary wholesale and distribution arrangements from coverage.

⁷ 11/20/97 TR at 72-73 (Toporoff).

⁸ Given the possibility that unusual circumstances may result in a scenario where a traditional distribution arrangement may fall within the Proposed Rule's broad definition of a "business opportunity" yet not meet specific criteria established for any exemption, revision of the Proposed Rule's definition of "business opportunity," as urged above, is the preferable alternative.

- Sophisticated buyer exemption. Buyers of business opportunities which have a substantial net worth likely have sufficient resources and sophistication, and sufficient access to legal counsel and other advisors, to be able to investigate and assess the legitimacy of a business opportunity without needing the disclosures required by the Proposed Rule. Consistent with this, the Model Act exempts buyers of “business opportunities” which have a substantial net worth. Model Act § 200(D); *see also* 815 ILCS 602/5-10(d). Many product wholesalers and distributors, particularly those carrying substantial inventory or product lines, may qualify for an exemption of this nature.

- Multi-line buyer exemption. Buyers of “business opportunities” which carry multiple lines of products, including products that may be are similar to those offered by the seller of a business opportunity, should be exempted from coverage because they are presumed to have sufficient industry and product experience to make an informed decision whether to do business with the seller. *See, e.g.*, Model Act § 200(D); 815 ILCS 602/5-5.10(b)(2); Tex. Bus. & Comm. Code § 41.004(b)(5). Multi-line wholesalers and distributors would qualify for this exemption, if crafted properly.

- Substantial investment exemption. Sales of “business opportunities” which involve, either in initial stages or over time, substantial payments by the buyer should be exempt from coverage because the buyers likely have sufficient net worth and sophistication to make informed decisions about business opportunities without use of the disclosures prescribed by the Proposed Rule. A number of state business opportunity statutes, and the Model Act, utilize an exemption of this nature. *See, e.g.*, 815 ILCS 602/5-10(a) (\$25,000); Model Act § 200(A) (\$25,000); 13 Ohio Rev. Code § 1334.01(D)(2) (\$50,000). The PMI recommends the addition of such an exemption which would apply to wholesale or distribution arrangements involving the purchase, over time, of inventory which exceeds a substantial monetary value (perhaps \$25,000).⁹

⁹ Because the Proposed Rule includes within its scope a broader range of business arrangements than is typical of state business opportunity laws, exemptions found in those laws perhaps should be expanded under the Proposed Rule.

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The PMI hopes that the foregoing comments are helpful to you. The PMI supports the FTC's goal of preventing business opportunity fraud, but believes that any new regulation should be carefully tailored to apply only to the forms of business arrangements which have the subject of abuse. The Proposed Rule, in covering ordinary wholesale and distribution relationships, goes far beyond what is necessary to combat business opportunity fraud. Accordingly, the PMI opposes the Proposed Rule and recommends that its definition of "business opportunity" be replaced with a narrower, more targeted definition. In the alternative, exemptions such be provided in order to remove ordinary wholesale and distribution arrangements from the Proposed Rule's coverage.

Sincerely,

Erik F. Dyhrkopp