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 THE MULTI-LEVEL MARKETING INTERNATIONAL ASSOCIATION

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The Multi-Level Marketing International Association (MLMIA), 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 files these comments. MLMIA opposes the Proposed Rule, recommends that FTC withdraw the rule at the earliest possible moment and recommends that FTC terminate this rulemaking proceeding. As explained in these comments and supported by empirical data and expert analysis provided herein, the Proposed Rule is illegal and inadvisable. If adopted, the Proposed Rule will likely drive the law abiding in the regulated class out of the market, leaving the market more vulnerable to purveyors of fraud, not less. The cost of compliance is estimated at $25,000 to $45,000 the first year and $10,000 to $20,000 per year thereafter for every business opportunity seller in the United States. The typical income derived from business opportunity sales is $418 per month ($5,016 per year). Consequently, first year costs of compliance exceed typical earnings by between $19,984 and $39,984. Each year thereafter costs of compliance will exceed typical earnings by between $4,984 and $ 14,984. There are over 10 million business opportunity sellers in the United States. The overall economic burden of the Proposed Rule is, thus, a staggering $250 billion to $450 billion the first year and $100 billion to $200 billion each year thereafter. The Proposed Rule threatens the stability of the American economy as a whole.

I. Summary

The Proposed Rule violates: (1) the Federal Trade Commission Act, 15 U.S.C. 45 (2000); (Section 5 of the FTCA); (2) the Fifth Amendment Void for Vagueness Doctrine, Keyishian v. Board of Regents of the University of the State of New York, 385 U.S. 589

(1967); (3) the right to privacy, United States v. United States Dist. Court for Eastern Dist., 407 U.S. 297 (1972); (4) the First Amendment prohibition on categorical speech bans, Arkansas Writers Project v. Ragland, 481 U.S. 221, 229-230 (1987)(the First Amendment is hostile to regulatory restraint based on viewpoints as well as prohibition of subject matter); Bantam Books v. Sullivan, 372 U.S. 58, 70 (1963) (prior restraints start with a heavy presumption against constitutional validity); and Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, 425 U.S. 748 (1976); (5) the Federal Trade Secrets Act, 18 U.S.C. 1905 (2000); (6) the Regulatory Flexibility Act 5 U.S.C. 601 et seq. (2000); (7) the Paperwork Reduction Act; (8) the 1996 Small Business Regulatory Enforcement Fairness Act; and (9) the Administrative Procedure Act, 5 U.S.C. 551 et seq. (2000).

II. The Multi-Level Marketing International Association (MLMIA)

The MLMIA is a not-for-profit, worldwide, professional trade association begun in 1985 by industry professionals for network marketing/direct sales/multi-level marketing companies, the independent contractors who sell a company's goods and services to consumers, and the suppliers and vendors who supply both the companies and distributors with those goods and services. MLMIA is the only organization that has members in all categories that serve the network marketing industry and the only association that gives all categories an equal vote on its board of directors. MLMIA's mission is "to strengthen network marketing around the world." The MLMIA and each of its network marketing members and their distributors[1] will suffer the direct adverse effects complained of herein, including (for MLMIA) loss of members and member revenues and (for the network marketing members) loss of distributors and revenues.

[1] MLMIA's member organizations combined have approximately 300,000 distributors.

III. Comments

Overview of the Industry. FTC's Proposed Rule applies to all multilevel marketing companies and their distributors in the United States.[2] FTC erroneously states that there are only "3,200 business opportunity sellers" in the United States of which "150 are multilevel marketing companies." 71 Fed. Reg. at 19082. There are in fact over 10 million business opportunity sellers in the United States. Approximately 55,000 people become business opportunity sellers each week. See Jeffrey Babener, Network Marketing: What You Should Know. Legaline Publications, Portland, Oregon: 2003 at 2.

In the Proposed Rule, FTC states that the business opportunity market is "permeated with fraud." 71 Fed. Reg. 19057. It views the incidence of fraud to be "widespread" in this market. Id. at 19055. According to marketing expert Stephen P. Nowlis, Ph.D., however, the actual evidence of "widespread" fraud in the business opportunity market is sorely lacking. According to Dr. Nowlis:

> ...[T]he FTC conducted a survey called Consumer Fraud in the United States: An FTC Survey. This survey found that of all the specific frauds evaluated, "Purchased a business opportunity where promised earnings were not realized or promised assistance was not provided" was the least likely to be mentioned by respondents (credit card fraud, on the other hand, was the most common). In addition, the FTC noted that the incidents per one hundred adult Americans ranged anywhere from 0 to 0.6, with a 95% confidence interval. Thus, if one is to be 95% confident in how this sample maps on to the population of all Americans, then it is a strong possibility that no one (0) would actually be affected (since the range was from 0 to 0.6 incidents per one hundred people). This statistic alone casts grave doubt on whether there is "widespread" business opportunity "fraud" in America, rather than isolated and comparatively infrequent instances.

Exhibit A at 4. Contrary to FTC's assumptions, credible empirical data reveals the typical business opportunity sellers to be people whose network of purchases include family,

[2] The Proposed Rule defines a "seller" as a person who offers for sale or sells a business opportunity. Id. at 19088. The Proposed Rule makes it an unfair or deceptive act or practice for any seller to fail to furnish a prospective purchaser the disclosures required by the Proposed Rule. Id.

friends and close associates for whom fraudulent transactions are neither proven to exist or likely. See Exhibit C at ¶9 (Affidavit of Steve Wallach); Exhibit D at 6 (Affidavit of George Kerford, Ph.D.) see also Babener at 1,4; see also Exhibit A to Comments of Success in Action. Business opportunity sellers typically supplement their income from a full-time, non-network marketing job with $418 income per month derived from business opportunity sales. Exhibit A at 13. That modest extra income pays for basic needs. Exhibit A at 13; see also Exhibit C at ¶7; Exhibit D at ¶¶6, 9; Exhibit E at ¶7 (Affidavit of Marcie Cook). No empirical evidence exists to establish that fraud is more common among network marketers than in the market for goods and services generally. No proof exists at all that most or even a significant minority of network marketers are regarded as purveyors of fraud, bilking consumers of millions of dollars, as the FTC suggests (void of empirical support).

- There are at least 627 multi-level marketing companies in the United States.[3]
- Every week in the United States more than 55,000 people sign up as network marketers (i.e., purchase a business opportunity).[4]
- In excess of 10 million people in the United States are network marketing distributors (approximately 1 in 10 households).[5]
- Network marketing sales are approximately $30 billion.[6]

[3] Exhibit A at 11.
[4] See Babener at 2-3.
[5] Id.
[6] Id.

- Approximately 80% of network marketing distributors work as distributors "part-time" with the other 20% working 30 hours a week or more in network marketing.[7]
- For the 80% of part-time network marketers, network marketing is a "second job" with common income targets of between \$300-\$500 per month.[8]

While FTC acknowledges that most business opportunities would be considered small businesses (less than six million in average annual receipts), 71 Fed. Reg. at 19082, the fact is nearly all network marketing distributors qualify as small businesses. According to the 2003 figures above, that would be at least 10 million small businesses.

FTC's Stated Purpose for the Rule. The rule's stated purpose is to "prohibit business opportunity sellers from failing to furnish prospective purchasers with material information needed to combat fraud," 71 Fed. Reg. at 19054, and "to address widespread fraud in the sale of business opportunities." Id. at 19056. In short, the rule aims to reduce or eliminate fraud in business opportunity sales. The FTC expresses the following opinion of business opportunities: "many business opportunities are permeated with fraud." Id. at 19057. Based principally on complaints received by the Commission[9] and opinions delivered to the Commission in forums sponsored by it, the FTC identifies two

[7] Id.
[8] Id.
[9] The FTC cites in footnote 39 of its rule one document as the source of complaint data. That reference, Bureau of Consumer Protection staff, Franchise and Business Opportunity Program Review 1993-2000: A Review of Complaint Data, Law Enforcement, and Consumer Evaluation (June 2001) ("Staff Program Review"), expressly removed from FTC's database for assessment all complaints pertaining to multi-level marketing and money-making schemes. Writes the staff: "Complaints that could be accurately identified as concerning MLMs or MMSs were removed." Staff Program Review at 4. Thus, the document cited does not support the charge that complaints to FTC reveal pervasive fraud in the multi-level marketing industry.

kinds of "common" deceptive acts or practices that it seeks to arrest.[10] "By far, the most frequent allegations in Commission business opportunity cases," writes FTC, "pertain to false or unsubstantiated earnings claims." Id. at 19057. The second involves "false testimonials or fictitious references and misrepresentations concerning profitability of locations, availability of support and assistance, nature of the products or services sold, prior success of the seller or locator, full extent of investment costs, and refund policies." Id. The FTC describes these as "alleged material misrepresentations or omissions . . . most frequently mentioned in complaints to the Commission submitted by business opportunity purchasers." Id. As explained in footnote 8 herein, none of the evidence reviewed in the Staff Program Review cited by FTC supports this argument. It is thus the avowed aim, the chosen end, of FTC to reduce the occurrence of fraudulent representations in business opportunity sales.

As explained below, there is no empirical evidence to support, and no sound reason to believe, that FTC's chosen means, mandatory disclosures to prospective business opportunity purchasers, will reduce the occurrence of fraudulent representations in business opportunity sales. Indeed, as explained below, there is every reason to suspect that the rule will produce an opposite and unintended result. Through imposition of unacceptable costs and burdens, it will reduce the number of, if not eliminate all, honest sellers in the market and invite the remaining fraudulent sellers (who violate the very law FTC aims to enforce) to fill the market void, expanding their market presence to the injury of purchasers.

FTC Has Failed to Satisfy Its Burden of Proof.

[10] As Dr. Nowlis explains, the view that there is a "common" degree of fraud in this market is dubious and contradicted by empirical evidence. The market for business opportunity sales hasno provably greater level of fraud in it than in the overall market for goods and services. See Exhibit A at 3-7.

Section 5 (15 U.S.C. § 45(n)) states:

> The Commission shall have no authority under this section or section 57d of this title to declare unlawful an act or practice on the grounds that such an act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination.

The failure to make the disclosures mandated in the rule is not in and of itself an act or practice that is unfair or one that causes or is likely to cause substantial injury to consumers not reasonably avoidable by them. As Dr. Nowlis' report attached hereto makes clear, fraud has not been proven common in this market; indeed the empirical evidence reveals it to be a comparative rarity (far less common than credit card fraud, for example). See Exhibit A at 3-7. Moreover, investments are modest ($25 to $100 typically) with refunds commonly allowed, as FTC recognizes. See Babener at 3; see also 71 Fed. Reg. at 19057 (less costly simple purchase agreements); see also Exhibit C (Wallach Affidavit). Thus, neither the failure to make the disclosures nor the sale of business opportunities is in the ordinary course likely to cause substantial injury to consumers. There is no permanent injury that has been demonstrated and none that is substantial or unavoidable in the ordinary course. Consequently, FTC lacks statutory authority under section 5 (15 U.S.C. § 45(n)) to declare the failure to deliver its mandated disclosures a violation of section 5 because that failure to issue written disclosures in and of itself is not fraud, has nothing to do with fraud, and has not been proven likely to cause substantial injury to consumers (and, logically, cannot be so proven). In addition, FTC's procedural rule implementing section 5, 16 C.F.R. § 3.43(a), mandates that:

> Counsel representing the Commission, or any person who has filed objections sufficient to warrant the holding of an adjudicative hearing pursuant to § 3.13, shall have the burden of proof, but the proponent of any factual proposition shall be required to sustain the burden of proof with respect thereto.

The Proposed Rule avoids this burden, shifting it in effect to the regulated class. The Proposed Rule ultimately circumvents the typical requirement that FTC bring forward party-specific evidence of unfair business practices of consumer injury before it adjudicates a party guilty of a section 5 violation. Instead of following that course, the Proposed Rule unilaterally shifts the burden of proof from FTC to all business opportunity sellers, presuming a section 5 violation solely upon proof that the mandated disclosures were not made. In the course of an adjudicative proceeding, counsel for FTC has an incontrovertible burden of proving the material allegations of the complaint. See Koch v. Federal Trade Com., 206 F.2d 311, 316 (6th Cir. 1953). The Proposed Rule eliminates the necessity of FTC satisfying that substantive burden, presuming proof that the disclosures were not made (or not made to FTC's liking). Consequently, the Proposed Rule fails to satisfy FTC's burden under 15 U.S.C. § 45(a) and thereby violates that section.

Economic Impact of the Proposed Rule. FTC estimates compliance costs to be 5 hours at \$250/hr for legal and clerical costs (\$1,250). It estimates that the annual burden will be 4 hours at \$250/hr (\$1,000). 71 Fed. Reg. at 19082. The attached affidavit of one of MLMIA's attorneys contradicts that estimate with a line by line estimate of costs for all legal services necessary for a client to comprehend the meaning of and obligations imposed by the Proposed Rule. Exhibit B. That affidavit estimates the cost of compliance at between \$19,600 and \$39,300 for the first year and between \$3,850 and \$13,300 for every year thereafter. Exhibit B. Applying FTC's estimated hourly rate of \$250/hr to the time estimates in the affidavit would require $14,000 to $28,250 the first year and $2,750 to $9,500 for every year thereafter. The attached expert report of Dr. Nowlis estimates the marketing analysis needed to comply with the earnings claims substantiation requirements to be $5,000 each year. Exhibit A at 17-18. FTC entirely omits this essential cost item. The combined total legal and marketing representation costs required to be between $25,000 and $45,000 per distributor for the first year and between $10,000 and $20,000 per distributor for each year thereafter. Exhibit A at 18. With over 10 million business opportunity sellers in the market, the compliance cost is thus between $250 billion and $450 billion the first year and between $100 billion and $200 billion each year thereafter.

The compliance costs imposed on each business opportunity seller by the Proposed Rule vastly exceeds the financial ability of virtually every business opportunity seller in the market. See Exhibit A at 18; see also Exhibit B. The Proposed Rule will thus drive the law-abiding who respect the need for rule compliance out of the market and will largely eliminate any new growth in the industry. It is not an exaggeration to say that full implementation of the rule will likely reduce the regulated class to near zero, driving out of existence almost all law-abiding members and leaving the market open to those who presently have no compunction about violating existing deceptive advertising prohibitions (the very purveyors of fraud FTC aims to reduce). Dishonest sellers, who currently engage in deception despite the risk of prosecution under section 5 of the Federal Trade Commission Act (15 U.S.C. § 45), will likely be unimpressed by the mandatory disclosure requirements and will likely violate those requirements without hesitation, for the reasons stated below. Therefore, the rule can be expected to have the perverse contrary effect of increasing the incidence of fraud in the business opportunity market to the great detriment of purchasers because honest sellers will be driven out, leaving the market open to fraudulent sellers.

In the aggregate the economic impact of the Proposed Rule is a loss of nearly $30 billion in business opportunity sale revenue. See Exhibit A at 12. That is equal to approximately 1% of the Gross Domestic Product. Id. The Proposed Rule may actually cause a recession in the United States if fully enforced. Without question, the rule will severely restrict public access to one of the most oft-used means for people at or below the poverty level to find an economic opportunity for achieving greater financial independence outside of the traditional entry level jobs in fast food and retail and to supplement their income in essential ways. See id at 13; see also Exhibit C at ¶¶ 5-11, 16 (Wallach Affidavit); Exhibit D at ¶¶ 6, 9 13, 14, 17 (Kerford Affidavit); Exhibit E at ¶¶ 7-10 (Cook Affidavit). Dr. Nowlis concludes that "the regulatory costs and burdens imposed exceed the ability to pay for a great majority, if not all, business opportunity sellers. The loss of millions of jobs and harm to the welfare of millions of Americans is the likely result." Exhibit A at ¶18. Chief Operating Officer and Chairman-Emeritus of the World Association concludes that the Proposed Rule will cause many with severe disabilities who depend on business opportunity sale (due to its ease of entry and its at home internet and phone operation) to lose an essential source of income, become dependent on welfare and become more isolated from the outside world. See Exhibit D at ¶20.

The Proposed Rule requires disclosures that have the undeniable effect of dissuading prospective business opportunity purchasers from making a purchase. That chilling effect on purchase applies to *all* business opportunity sellers except those who presently engage in false and misleading sales presentations and who reasonably cannot be expected to abide by a rule that would ask them to expose their own frauds with a penalty no different from that under existing law.

The Proposed Rule imposes on *all* in the regulated class, *inter alia*, a seven calendar day waiting period before a business opportunity purchaser may sign a contract or make a payment for the business opportunity, whichever occurs first; a mandatory disclosure of all legal actions against the seller, the seller's employees, and the seller's affiliates, among others, of misrepresentation, fraud, securities law violations, or unfair or deceptive practices for 10 years immediately preceding the date the business opportunity is offered (the obligation to disclose applies to *charges* without need for a final adverse adjudication on the merits); a mandatory disclosure of the name, city, state, and phone numbers of at least 10 purchasers of the business opportunity within the past three years (information regarded by almost all distributors as proprietary trade secrets and confidential business information); and a mandatory disclosure of the total number of purchasers and, of that number, the total who have requested cancellation of the business opportunity for eight quarters preceding the date of disclosure (if a cancellation or refund policy is offered). See Proposed Rule sections 437.2, 437.3.

Discouraging purchase is the rule's plain (and apparently intended) effect. It thus frustrates, burdens, and reduces market activity by *all* business opportunity sellers (not just those that engage in fraud), erecting barriers to market entry never before present and without any assessment, let alone a reasonable one, of the extent to which those barriers will harm the viability of this market sector, will impose economic burdens on the regulated class beyond their ability to pay, or will alter the welfare of millions directly and indirectly dependent on business opportunity sales to meet their basic needs.

The Commission professes its goal not to be the discouragement of every purchase but of only those purchases predicated on fraud. The rule, however, imposes its regulatory costs upon all. The rule imposes an economic burden on each business opportunity seller of approximately $25,000 to $45,000 the first year and $10,000 to $20,000 per year each year thereafter, while earnings from network marketing are typically $5,016 per year (and rarely exceed $146,604 per year). See Exhibit A at 13. Moreover, the rule necessarily depends on a naïve assumption that those who engage in deceptive promotions will comply honestly with a mandatory disclosure requirement and thus alert consumers of their fraud, averting a fraudulent sale. That assumption is a fanciful one, a non-sequitur. It does not follow that those who presently deceive against the law will be cowed into complying with the law by the threat of invocation of the very same sanctions they currently risk. It also does not follow that those who presently deceive will reveal those law violations through the disclosures required by the rule to the benefit of their victims and to their own legal detriment. The assumption is contradicted by a long history of precedent establishing notice requirements to be ineffectual in ferreting out fraud (for the simple reason that those engaged in deceit are not detained by rules that ask them to be more honest). See e.g., Fairfield, Cracks in the Foundation: the New Internet Legislation's Hidden Threat to Privacy and Commerce 36 Ariz. St. L.J. 1193 (2004)(proposed new law criminalizing computer fraud is redundant of existing harsh state and federal civil and criminal laws; bad actors already facing tough laws would be undeterred by a new law when existing law is no deterrent). There is, in short, no substitute for enforcement of Section 5 of the FTCA (15 U.S.C. §45) against specific deceptive advertisers. Reliance on a costly prior restraint affecting all (the honest majority and the fraudulent minority) merely drives the law-abiding out of the market. The Proposed Rule lands on the heads of the law-abiding, not on the heads of the law violators.[11] It is an irrational regulatory scheme having means that are not logically capable of achieving the desired regulatory ends (fraud reduction).

There is thus an irrational fit between means and ends. The means impose burdens and costs on the entire regulated class, thereby discouraging *all* business opportunity sales except those predicated on fraud which are given no greater disincentive than exists under current law (those who would defraud are the very subset the rule is said to be aimed at discouraging). The means thus lack an empirical basis to support that they will reasonably effectuate the ends. It does not follow that rules compelling disclosures will effectuate the FTC's regulatory ends of discouraging fraud in the business opportunity marketplace precisely because there is no evidence, not one whit of it, that those engaged in fraud will likely be dissuaded from that course by (or induced to comply with) a mandatory disclosure rule that calls on them to disclose their fraud. Indeed, if there is any verity more obvious from FTC enforcement actions, it is that dedicated frauds find warnings, requests for compliance, and consent agreements little obstacle to repeat offense. See e.g., Fairfield, *supra*, at 1215-1223.

FTC has utterly failed to ascertain proof of the likelihood of compliance by those engaged in deceptive acts and practices. Without a reasonable basis to conclude that those who deceive will be dissuaded, the rule is not causally linked to the regulatory ends. The rule is in this respect all burden for the law-abiding and no benefit to

[11] See infra 49-50 concerning the sufficiency of existing law and procedure.

consumers. To the extent that the rule drives the law-abiding out of the market, it will make the purchase of business opportunities and the goods available through network marketing more difficult to obtain from honest sellers – to the detriment of consumers (sacrificing economic opportunity, freedom of choice, and product diversity in one regulatory action). The lack of a requisite nexus between the means and ends cause the Proposed Rule to be arbitrary and capricious within the meaning of the Administrative Procedure Act (APA) and, thus, an illegal action.

Moreover, as explained below, each of the mandatory disclosures causes a perverse effect on the law-abiding. In addition to the chilling effect the disclosures have on sales transactions between law abiding sellers and their buyers, certain of the disclosures require the publication of information that itself will mislead prospective purchasers and defame prospective sellers (thus making the government a promoter of deception, frustrating and disserving achievement of the regulatory ends). Other of the disclosures violate constitutional rights of privacy and existing contractual rights between distributors and parent companies. Still others are unduly vague and effectively shift the burden of proof imposed on FTC by the FTCA to the regulated class. Others violate statutory requirements prescribed by the FTCA on the FTC. And, in the case of the mandatory listing of purchasers of the business opportunity, force disclosure of proprietary trade secrets and confidential business information protected from disclosure by federal law. See Kewanee Oil Co. v. Bicron Corp., et. al., 416 U.S. 470, 474-75 (1974) (quoting "[a] trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers." Restatement of Torts § 757, comment b (1939)). B. F. Goodrich Co. v. Wohlgemuth, 117 Ohio App. 493, 499, 192 N.E. 2d 99, 104 (1963); National Tube Co. v. Eastern Tube Co., 3 Ohio C. C. R. (n. s.) 459, 462 (1902), aff'd, 69 Ohio St. 560, 70 N. E. 1127 (1903) ("The subject of a trade secret must be secret, and must not be of public knowledge or of a general knowledge in the trade or business"). Likewise, disclosure of personal identifying information of business opportunity purchasers together with the disclosure of their involvement in business opportunity sales for particular companies invades their right of privacy and makes them more vulnerable to identity theft. See e.g., United States v United States Dist. Court for Eastern Dist., 407 US 297 (1972). Each of these points is elucidated with particularity herein.

Indeed, as the study of the market provided here by Dr. Nowlis reveals, the vast majority of those who make business opportunities available to others do so in ways that are objectively verifiable and in environments that are not conducive to fraud. See Exhibit A at 4-5. They sell to people they know (with whom they have continuing personal relationships). Id. at 10.[12] They sell by allowing the prospective purchaser to use, and experience the benefits of, the products involved directly as a customer before purchasing a business opportunity. Id. at 9. They rely on a small dollar investment ($25 to $100), one that is almost always refundable in full. See the Proposed Rule, 71 Fed. Reg. at 19057 ("Business opportunity sales are often less costly involving simple

[12] Based on nothing more than one comment FTC erroneously states that "many business opportunity programs have no continuing relationship between the buyer and seller but are a one time purchase of packaged information." 71 Fed. Reg. at 19057. Nothing could be further from the truth. See Babener at 8-11, 79-85, 113.

purchase agreements that pose less of a financial risk for purchasers"); see also Babener at 138-139 (industry trends to a majority of companies offering a standard benefit of a one year 90 percent refund policy). A number of states' multi-level marketing laws mandate buy back arrangements. Id. These hallmark characteristics of the non-franchise, business opportunity market reveal strong built-in disincentives against deception that the FTC fails to weigh in its analysis or comprehend as significant bases upon which to distinguish business opportunity sellers from franchise sellers. It is a common sociological feature of human relationships that those involving neighbors, friends, and social relationships are more transparent than those at arms length. See Exhibit A at 10, 13. Promotions occurring within a home environment among friends in which the products themselves are either used or personally examined allow for far greater discernment by the typical consumer of a business opportunity than does a franchise where many of the most important variables about the business are complex, difficult to discern, or unknown to the purchaser at the time of purchase. Compare Babener generally with Byron Fox and Henry Su, A Symposium on Franchise Law: Franchise Regulation – Solutions in Search of Problems? 20 OKLA. CITY U. L. REV. 241, 254-261 (1995). The dollar amount necessary to purchase a business opportunity is also far less (either nothing at all or but a few hundred dollars) and, consequently, requires far less understanding of market dynamics, likely rates of return, and competition than a franchise. See 71 Fed. Reg. at 19057. Nevertheless, business opportunity purchasers frequently examine, compare, and even try more than one opportunity and, so, acquire much knowledge of the opportunity through comparison shopping. Exhibit C at ¶10

The business opportunity market is thus typified by purchasers who know the actual effects of the products and the benefits of the opportunity through experience and do not depend upon elaborate sales presentations to expend relatively small dollar investments to make a purchase. The business opportunity seller is typically a person who has an existing full-time job, often in fast food, retail, or another entry level occupation. He or she typically earns less than $418 per month from the distributorship but uses that supplemental income to pay for basic needs such as day care; winter heating; lunch for children; clothes for children; gas for family transport; dental care for the family; etc. See Exhibit A at 13; see also Exhibits C-E. The regulated class is typified by a business opportunity seller who relies on the business opportunity as a secondary or tertiary income earning option, not as a substitute for a full-time job. Exhibit A at 13. The regulated class is also typified by a person who cannot afford the legal fees, marketing expert's fees, and administrative costs needed to understand the complexity of and comply with the Proposed Rule. Compare Exhibit A at 18 with Exhibit C at ¶6 (Wallach Affidavit), Exhibit D at ¶18 (Kerford Affidavit), and Exhibit E at ¶6 (Cook Affidavit).

In its Proposed Rule, the FTC presents no demographic evidence to define the regulated class. 71 Fed. Reg. at 19080 (in contrast to its broad definition of "sellers," it estimates that only 150 multilevel marketing companies are subject to the rule, ignoring the over ten million multilevel marketing distributors to whom the rule applies). Babener at 2. FTC cannot perform an accurate economic impact assessment without that information. Under federal law, it is required to perform an accurate assessment to determine the impact of the regulation on small businesses who "bear a disproportionate share of regulatory costs and burdens." See Regulatory Flexibility Act, 5 U.S.C. § 601 et seq. (The RFA requires each federal agency to consider the impact of regulations on small entities and if those regulations have a significant impact on a substantial number of small entities, the agency is required to prepare an initial regulatory flexibility analysis).[13] Were it to do so, FTC would find that its rule imposes an effective regulatory tax on each of over ten million business opportunity sellers of approximately $25,000 to $45,000 the first year and $10,000 to $20,000 each successive year. See Exhibit A at 18. That is an overall economic burden of between $250 billion and $450 billion the first year and between $100 billion and $200 billion each year thereafter. To be sure, that is an intolerable economic burden.

Because the rule makes compliance with its terms a condition precedent to every lawful business opportunity sale, the rule will drive nearly all law-abiding regulatees out of the market—causing the market to collapse as a viable economic alternative for the over ten million who now depend on it. Destruction of a market sector is decidedly beyond the statutory authority of the FTC. FTC is charged with the duty of regulating advertising and business practices in markets to ferret out deception and unfairness on a case by case basis and to impose consumer redress and disgorgement upon those who deceive. See 15 U.S.C. § 45. It is not given authority to eliminate markets altogether whether through banning them outright or, as here, through the insidious imposition of an effective regulatory tax that is far beyond the financial wherewithal of virtually every market seller.

Recoupment of Investments and Mitigation of Damages Is Generally Achievable Through Self-Help without Need for FTC Intervention. Unlike with franchise investments, with business opportunity purchases the harms are largely

[13] See page 43-44 *infra* on FTC's lack of compliance with the small business regulatory requirements.

reversible through self-help without need for FTC intervention. Frequently those who offer business opportunity sales provide a complete refund within 30 days of purchase if the purchaser is dissatisfied. See Babener at 138; see also Exhibit C at 2. Moreover, while each purchaser in the market for franchise opportunities must have the financial wherewithal to make a $500,000 to a multi-million dollar investment,[14] the regulated class in the market for the typical business opportunity need make either no initial investment or one of under $500 and, if the business opportunity proves ultimately unappealing, the party typically may obtain a refund of the purchase price or resell the products obtained to recoup monies expended. See Exhibit C at 2. A large secondary market for resale of business opportunity goods currently exists on Ebay.[15] The market thus has its own self-correcting aspect that makes entry and exit far less difficult than in the case of the much costlier investment that comes with a typical franchise purchase. While entry and exit from this market is easy for the seller, the rule greatly magnifies the costs and burdens that must be borne by the new purchaser, thus erecting substantial regulatory barriers to entry that stultify competition. To compensate the seller for those costs, invariably either the price of goods/services sold or the purchase price of the business opportunity would have to rise to the great detriment of purchasers of the goods and service opportunities. The rule thus shuts down this great engine for moving people out of poverty. There is, thus, far less of a justification for a costly rule than in the

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[14] See http://www.allbusiness.com/articles/Franchise/2182-2206-2213.html From All Business.com, July 14, 2006: "Different business concepts carry different price tags, with lodging franchises requiring the largest initial investment and ongoing expenses (total investments range from $4 million to $6 million), followed by full-service restaurants (from $700,000 to $3.5 million), fast food restaurants (from $250,000 to $1 million) and auto repair (from $200,000 to $300,000). Mobile and home-based business franchises make up the most affordable buy-in category."

[15] A search for "Mary Kay" in the "Health & Beauty" category on http://www.ebay.com yielded 22,373 hits on June 15, 2006. A similar search for "Avon" in the "Health & Beauty" category yielded 12,952 hits.

franchise context. Moreover, there is wholly inadequate revenue derived from business opportunity sales to finance the cost of the Proposed Rule. Rather than extinguish fraud, the legacy of this rule will be that it destroyed economic opportunity for many of the neediest people in America, the poor, the disabled, and the uneducated. See Exhibit A at 3; Exhibit C at ¶¶ 5-11, 16; Exhibit D at ¶¶17-20; Exhibit E at ¶¶12-14.

The Absence of Competent Proof to Support FTC's Assumption that Business Opportunity Sales Fraud Is "Widespread." The Proposed Rule rests on two erroneous assumptions. The rule presumes without any sound basis that the unverified and unadjudicated complaints received by the FTC concerning *certain* business opportunity sellers (1) are competent proof of the injuries alleged despite the fact that the allegations are unverified and unadjudicated and (2) are proof that the alleged deceptive acts and practices complained of concerning specific sellers are indicative of all or nearly all sellers. A conclusion on this basis that deception is "widespread" is bias or prejudice, not that kind of empirically-backed proof borne of objectivity needed to establish the proposition. On the record before FTC there is no direct proof that all, a majority, or even a significant minority of those engaged in the sale of business opportunities do so deceptively. Dr. Nowlis finds empirical proof to the contrary, i.e., that fraud is rare in business opportunity sales. See Exhibit A at 3-5. Unverified complaints do not establish the charges contained therein or the presence of injury and are a very poor indication of how the extraordinarily diverse businesses that form this $30 billion market function. Moreover, empirical evidence does exist that directly contradicts FTC's assumption and reveals fraud in this market to be the rare exception, not the rule. See Exhibit A at 18.

Until such time as charges are verified and adjudicated, they are not evidence sufficient to satisfy the documentation requirements agencies must have to support promulgation of new rules. See American Tunaboat Ass'n v. Baldrige, 738 F.2d 1013, 1015-16 (1984) ("A formal rule-making proceeding is reviewed under the APA's substantial evidence standard, [and] rule-making must be set aside if arbitrary, capricious, or an abuse of discretion"); Shoreham Cooperative Apple Producers Ass'n v. Donovan, 764 F.2d 135, 140-41 (1985) (agency engaged in rulemaking "is obligated to examine the available evidence and to articulate a 'rational connection' between that evidence and its exercise of discretion"). Under our federal rules governing receipt of evidence and evaluation of it, courts routinely reject such unverified and anecdotal evidence as a basis for decision-making. See Tomscha v. Gen. Serv. Admin., No. 04-5905-cv, 2005 U.S. App. Lexis 27385, at *4 (2nd Cir. December 12, 2005) ("only anecdotal evidence" held insufficient to permit FOIA action); King of the Mountain Sports, Inc. v. Chrysler Corp., 185 F.3d 1084, 1093 (10th Cir. 1999) ("handful of anecdotal evidence" held "de minimis" and insufficient to survive summary judgment in patent case); Odom v. Frank, 3 F.3d 839, 849 (5th Cir.1993) (dismissing discrimination claim because "evidence adduced...is at most anecdotal and bare speculation"). In the rulemaking context, the GAO has faulted another federal agency for relying on unverified complaints of injury without proof that the injuries are in fact real and are in fact caused by the alleged malfeasance. See U.S. Gen. Accounting Office, Dietary Supplements: Uncertainties in Analysis Underlying FDA's Proposed Rule on Ephedrine Alkaloids 24 (1999).

Moreover, without verification the charges contained in the complaints may for all we know be false; indeed, they may be the product of unscrupulous competitors, disgruntled former distributors, disgruntled former employees, or others who have reason to misrepresent or fabricate material facts. Finally, even if verified, the complaints are but applicable to the specific institutions in question and may not properly be attributed to the entire regulated class, particularly one so enormous and diverse as that of "business opportunity sellers." See U.S. v. Lane, 474 U.S. 438, 462 (1986) (Stevens, J., concurring in part and dissenting in part) (describing "the independent value of individual responsibility and our deep abhorrence of the notion of 'guilt by association'"); NAACP v. Claiborne Hardware Co., 458 U.S. 886, 932 (1982) ("guilt by association is a philosophy foreign to a free society"); Uphaus v. Wyman, 360 U.S. 72, 80 (1959) ("guilt by association remains a thoroughly discredited doctrine"). Cf. U.S. v. Varela-Rivera, 279 F.3d 1174, 1179 (2002) (abuse of discretion to allow evidence that "unfairly attributes" class-level knowledge to individual defendant); U.S. v. Vallejo, 237 F.3d 1008, 1017 (2001) (holding same); Middle Rio Grande Conservancy Dist. v. Babbitt, 206 F. Supp. 2d 1156, 1184 (2000) (final rule overturned where agency "unfairly attributed" species preservation to one of many protective measures). Attributing them to the entire regulated class is a form of guilt by association antithetical to the basic fairness required for orderly administrative governance. It is a quintessential example of arbitrariness and capriciousness that violates the Administrative Procedure Act. If verified, the complaints do not reveal how every business in this market functions. Accordingly, FTC's reliance upon the unverified complaints it has received and upon the few cases it cites as a foundation for the view that deception is widespread is arbitrary and capricious agency action, one that fails to satisfy the agency's statutory burden of proof and requirements for undertaking action based on rulemaking. See Middle Rio Grande Conservancy Dist., 206 F. Supp. 2d at 1183 (rulemaking is arbitrary and capricious where agency "failed to consider important aspects of the problem before them [and] were predisposed to their conclusions without a thorough examination of the facts or situation presented"); Lloyd Noland Hosp. & Clinic v. Heckler, 762 F.2d 1561, 1668 (1985) (agency actions arbitrary and capricious where rulemaking extends beyond logical conclusions offered by underlying evidence; rule based on scientific study cannot assert broader conclusions than that scientific study); St. Joseph's Hosp. v. Heckler, 583 F. Supp. 1545, 1548 (1984) (arbitrary and capricious to base rulemaking on "one study, the authors of which questioned its validity").

The FTC's Means Are Not Rationally Related to Its Ends. FTC depends on the Proposed Rule principally to reduce or eliminate (1) "false or unsubstantiated earnings claims" and (2) "false testimonials or fictitious references and misrepresentations concerning profitability of locations, availability of support and assistance, nature of the products or services sold, prior success of the seller or locator, full extent of investment costs, and refund policies." 71 Fed. Reg. at 19057. The rule would presumably achieve those objectives not by taking enforcement action against those for whom substantive evidence exists of unfair or deceptive acts or practices pursuant to Section 5 of the FTCA (FTC's statutory charge and duty), but by imposing, in the form of a prior restraint, an extensive disclosure requirement as a condition precedent to a lawful business opportunity sale on all who sell those opportunities (on those who deceive and those who do not), all save those presently covered by the franchise rule. Failure to make the disclosure to each prospective business opportunity purchaser or to do so in a way that FTC regards as unsatisfactory results in a *per se* determination that the business opportunity seller is guilty of unfair or deceptive acts or practices under section 5 of the FTCA (15 U.S.C § 45)(together with all of the regulatory and financial redress or disgorgement such a determination invites). See 71 Fed. Reg. at 19067.

Because the prior restraint method has been chosen, affecting all in the regulated class alike, the costs and burdens of the rule fall not solely upon law violators (an extreme minority) but upon all of the law-abiding (the vast majority). The law violators already flout the strictures of Section 5 of the FTCA despite FTC enforcement of the Act. It is therefore counterintuitive to presume that they will find a threat to impose sanctions under that same section for non-adherence to the disclosure requirements an increase in relative risk sufficient to forego their current law violations. Rather, the disclosure requirement imposes its greatest burden not upon law violators but upon the law-abiding who will endeavor to comply or, more likely, will exit the business to avoid compliance burdens altogether, because, as established in the Nowlis Report (Exhibit A at 18), annual compliance costs vastly exceed income earned for nearly all who sell business opportunities in the United States.

The means FTC has chosen is thus not rationally related to achievement of the ends. It does not follow that a disclosure requirement imposed by prior restraint upon the entire regulated class will cause those who deceive prospective business opportunity purchasers presently to cease deceptive acts or practices. It does not follow that a disclosure requirement imposed by prior restraint upon the entire regulated class will cause the law-abiding to continue in business rather than curb or halt that business to avoid the costs to comply with the rule. See Exhibit A at 18; Exhibit B at 5; Exhibit C at 2.

The likely outcome of the rule is a perverse effect: It will do nothing to stop false or misleading advertising and unfair or deceptive acts or practices by those currently guilty of those offenses but it will dissuade the law-abiding from remaining in business. As a result, as non-deceptive sellers flee the market, those who commit fraud may come to predominate and prey more readily on consumers—precisely the opposite effect of that intended. The purchaser, then, will be more apt to be defrauded if the Proposed Rule is adopted than if the FTC relies on its existing case by case enforcement approach.

The Proposed Rule Violates the FTCA. Under the Proposed Rule, failure to provide the required disclosures using the form specified at least seven days before the sale of a business opportunity is per se a violation of Section 5 of the FTCA (15 U.S.C. §45) (i.e., is a unfair or deceptive act or practice in violation of the Act). 71 Fed. Reg. at 19054 and 19067. The failure to impose upon the FTC a requirement that it prove a reasonable basis for presuming actual deception (given the peculiar facts and circumstances of each case) before deeming a party in violation of Section 5 of the FTCA (15 U.S.C. §45) violates that very section. It is FTC's statutory burden under Section 5 of the FTCA (15 U.S.C. §45 (n)), the very statutory section invoked here as a source of authority for promulgating the rule, to prove acts or practices to be deceptive, not presume them so without proof. It is indeed likely that the typical business opportunity seller will be unaware of the rule until it is vigorously and comprehensively enforced, will fail to comprehend it even if apprised of it, and will fail to comply with it as FTC would like even if an attempt to comply is made.[16] Nevertheless, the failure to make the

[16] Indeed, one of the great ironies is that the typical business opportunity seller is a low income earner who derives, on average, no more than $418 per month from business opportunity sales. He or she is generally not one who obtains professional legal or marketing counsel. The rule is a very sophisticated document resting, in turn, on complex precedents. The FTC deludes itself if it believes lay people such as these will

disclosures required or to make them as FTC would like is not in and of itself proof that a party has engaged in a false or misleading act or practice. A person could, after all, be perfectly forthright in his dealings with another and, through ignorance, ineptitude, or purposeful noncompliance, not supply the disclosures. In such a circumstance, which may predominate if the rule is adopted yet neither vigorously nor comprehensively enforced, the person in question would under the Proposed Rule be guilty of an unfair or deceptive act or practice yet would not in fact be *proven* to have deceived anyone. FTC may not—consistent with its burden of proof under FTCA section 5 (15 U.S.C. §45) — hold any party to have engaged in unfair or deceptive acts or practices for failing to serve the disclosures required by its rule. It must establish by a preponderance of the evidence proof of an actual act or practice that causes or is likely to cause substantial injury which is not reasonably avoidable by consumers and not outweighed by countervailing benefits to consumers or to competition. 15 U.S.C. § 45(n) (FTCA section 5). The mere failure to serve a federal disclosure form or to do so in a way subjectively deigned adequate by FTC is not, in and of itself, proof sufficient to support a finding of a violation of FTCA Section 5 (15 U.S.C. §45), yet the Proposed Rule would deem it so. Consequently, the Proposed Rule exceeds FTC's statutory authority and cannot be enacted. See Duncan v. Walker, 533 U.S. 167 (2001); FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120 (2000); Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984). In addition, the Proposed Rule is arbitrary and capricious because it causes all who fail to make the mandated disclosures to be presumed in violation of section 5 without substantive proof of a deceptive or unfair act or practice.

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understand the rule and comply with it as intended. It is, in short, far too complex and incomprehensible for all but lawyers and experts who study and evaluate federal regulations generally.

Thus, but for the disclosure requirement, those engaged in business opportunity sales would be doing so lawfully, yet the failure to serve the disclosures will automatically transform those so engaged into deceptive advertisers by operation of law—that without requisite proof that the underlying transaction in fact deceives. That avoidance of the burden of proof placed upon FTC by its enabling statute violates the FTCA and is arbitrary and capricious action in violation of the Administrative Procedure Act. See 5 U.S.C. § 706(2)(A). Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402 (1971); Humana of Aurora Community Hospital v. Heckler, 753 F.2d 1579 (10th Cir. 1985); Pactra Industries Inc v. Consumer Product Safety Commission, 555 F.2d 677 (9th Cir. 1977); Public Citizen v. Heckler, 653 F.Supp. 1229 (D.D.C. 1986).

The conclusory finding of a section 5 violation for failure to serve the disclosure form violates the plain and intended meaning of the FTCA which places the burden of proof on the FTC to establish a false or misleading act or practice in every case before a violation of the Act is found. See 15 U.S.C. § 45(a) (FTCA Section 5); see also 16 CFR 3.43. It also violates the Administrative Procedure Act because it presumes a violation of statutory law based on the failure to perform a ministerial act that does not in and of itself prove the offense. Therefore, rather than serve the purposes of section 5 of the FTCA (15 U.S.C. § 45)(a section identified in the rule as the one from which FTC draws its authority to promulgate the rule) and comply with the requirements of the Administrative Procedure Act, the Proposed Rule disserves those purposes (even violates them).

Additional Aspects of the Rule that Violate the First Amendment. Under the rule if the seller, any affiliate or prior business of the seller, any of the seller's officers, directors, sales managers, or any individual who occupies a position or performs a function similar to an officer, director or sales manager of the seller, or any of the seller's employees who are involved in the business opportunity sales activities "has been the subject of any civil or criminal *action* for misrepresentation, fraud, securities law violations, or unfair or deceptive practices within the 10 years immediately preceding the date that the business opportunity is offered," the seller must disclose the action, the caption of each action, the case number, the court, and the filing date. Id. at 19088. The term "action" is defined broadly as "a criminal information, indictment, or proceeding; a civil complaint, cross claim, counterclaim, or third-party complaint in a judicial action or proceeding; arbitration; or any governmental administrative proceeding, including but not limited to, an action to obtain or issue a cease and desist order, and an assurance of voluntary compliance." Id. at 19087. By the terms of the Proposed Rule, the disclosure required pertains not only to final adjudicated matters by courts of competent jurisdiction in which findings of fraud were made that are germane to the business opportunity in issue but also to every claim of misrepresentation, fraud, securities law violations, or unfair or deceptive practices whether adjudicated or not and whether germane to the business opportunity in issue or not. Thus, all unproven and all false claims are given the same credence as proven claims, and all claims irrelevant to the business opportunity in issue are given the same credence as relevant ones. Regardless of merit or lack of connection with the proposed transaction, they are all required to be revealed to every prospective purchaser.

Moreover, the seller is forced to disclose claims made by those other than the seller who are in some way affiliated with the seller without any proof of culpability on the seller's part. Thus, the rule is predicated on the much despised principle of guilt by association—utterly repugnant to basic constitutional requirements applicable to this government. NAACP v. Claiborne Hardware Co., 458 U.S. 886, 925 (1982) ("a 'guilt for association' theory [is not] permissible under the First Amendment"); Id. at 932 ("guilt by association is a philosophy alien to the traditions of a free society … and the First Amendment itself"); Healy v. James, 408 U.S. 169, 186 (1972) ("it has been established that 'guilt by association alone, without [establishing] that an individual's association poses the threat feared by the Government,' is an impermissible basis upon which to deny First Amendment rights"); United States v. Robel, 389 U.S. 258, 265 (U.S. 1967) ("The inhibiting effect [of guilt by association] on the exercise of First Amendment rights is clear"); Elfbrandt v. Russell, 384 U.S. 11, 19 (1966) ("A law which applies to membership without the 'specific intent' to further the illegal aims of the organization infringes unnecessarily on protected freedoms. It rests on the doctrine of "guilt by association" which has no place here").

The sweeping disclosures required will undoubtedly have a profound chilling effect. In those instances where charges have not been adjudicated and convey a false impression, they force the party accused to publish the defamation to all prospective business opportunity buyers, discouraging sellers from presenting the business opportunity and buyers from purchasing it if it is presented. Moreover, where false charges have been made against associates of the seller, they force the seller to defame those associates and, thus, the rule interferes with business relationships. Indeed, to avoid the offense or, if the charges are true, to avoid the stigma, the seller may reasonably choose to fire the associates (even if the associates' actions present no sign of unlawful conduct or mendacity). In addition, Proposed Rule section 437.5(b) defines communication of any information that materially alters the required disclosures to be deceptive. A business opportunity seller is prohibited from making "any claim or representation, orally, visually, or in writing, that is inconsistent with or contradicts the information required to be disclosed . . ." Any effort to explain or refute a false charge required to be disclosed is, thus, foreclosed, further exacerbating the defamatory communication and discouraging the sale of business opportunities.

The mandatory publication of even false and defamatory charges together with the rule prohibition on representations "inconsistent with or contradict[ing] the information required to be disclosed . . ." violates the First Amendment rights of business opportunity sellers. It denies those sellers the right to communicate to the very audience to whom the rule demands disclosure of the charges all facts and opinions contrary to the charges. Categorical speech bans, particularly prior restraints aimed at silencing voices critical of government orthodoxies are forbidden by the First Amendment. See Bantam Books v. Sullivan, 372 U.S. 58 (1963); see also Nebraska Press Ass'n v. Stuart, 427 U.S. 539, 559, 49 L. Ed. 2d 683, 96 S. Ct. 2791 (1976) ("Prior restraints on speech and publication are the most serious and the least tolerable infringement on First Amendment rights"); Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Relations, 413 U.S. 376, 390, 37 L. Ed. 2d 669, 93 S. Ct. 2553 (1973) (a prior restraint should not "sweep" any "more broadly than necessary"); Carroll v. President and Comm'rs of Princess Anne, 393 U.S. 175, 183-184, 21 L. Ed. 2d 325, 89 S. Ct. 347 (1968) (An "order" issued in "the area of First Amendment rights" must be "precise" and narrowly "tailored" to achieve the "pin-pointed objective" of the "needs of the case"); Board of Airport Comm'rs of Los Angeles v. Jews for Jesus, Inc., 482 U.S. 569, 575, 577, 96 L. Ed. 2d 500, 107 S. Ct.

2568 (1987) (regulation prohibiting "all 'First Amendment activities'" substantially overbroad). The speech in issue, while conveyed in a commercial context, is forced speech, compelled by government. A retort to it is thus fully protected political speech that may not be suppressed. See McIntyre v. Ohio Elections Comm'n, 514 U.S. 334, 339 (1995); quoting Roth v. United States, 354 U.S. 476, 484, 1 L. Ed. 2d 1498, 77 S. Ct. 1304 (1957) ("The First Amendment affords the broadest protection to such political expression in order to assure [the] unfettered inter change of ideas for the bringing about of political and social changes desired by the people."); Mills v. Alabama, 384 U.S. 214, 218, 16 L. Ed. 2d 484, 86 S. Ct. 1434 (1966) ("there is practically universal agreement that a major purpose of that Amendment was to protect the free discussion of governmental affairs [...]"); New York Times Co. v. Sullivan, 376 U.S. 254, 270, 11 L. Ed. 2d 686, 84 S. Ct. 710 (1964). Even were the speech commercial, however, the blanket ban here in issue is still a violation of the First Amendment. Truthful commercial speech may not be banned by the government. There is no instance, post-Central Hudson, in which our Supreme Court has ever condoned state action that causes a blanket ban on the communication of truthful information in advertising or promotion. See 44 Liquormart v. Rhode Island, 517 U.S. 484, 500 (1996) citing Central Hudson Gas & Electric Corp. v. Public Service Commission, 447 U.S. 557, 566 n.9 ("We review with special care regulations that entirely suppress commercial speech in order to pursue a nonspeech-related policy...Indeed, in recent years this Court has not approved a blanket ban on commercial speech unless the expression itself was flawed in some way, either because it was deceptive or related to unlawful activity.") Under Central Hudson, government may only regulate speech upon satisfying its First Amendment burden of proof under all four prongs of that decision. In the first instance, the speech in question may be banned outright if it is inherently misleading.

Here, the rule prohibition on communication of inconsistent information causes a particularly cruel suppression of truthful speech in those instances where compelled disclosures of charges defame. The rule prohibition also censors truth in instances where a further explanation would supply material facts omitted from the charge that may lessen its substantive sting. Thus, "inconsistent" speech of this kind passes the first prong. Under the second, the government's interest in regulating must be substantial. Here, the government's interest in combating fraud is substantial but its regulation utterly fails to serve that interest, as explained above. Indeed when it forces publication of defamatory falsehoods or misleading charges (that mislead due to overt falsehood or a lack of material facts), it puts FTC in the position of promoting deceit and defamation. Under the third prong, the government's chosen means must directly and materially advance its ends. The forced disclosure and publication of false or misleading charges and the ban on any representation "inconsistent with or contradict[ing]" those false or misleading charges does not directly and materially advance FTC's interest in combating fraud. Indeed, those means actually deceive prospective business opportunity purchasers and spread by force of law the defamation and misrepresentation, which are ends decidedly beyond (and contrary to) the statutory authority of the FTC. They thus violate the FTCA and the First Amendment rights of business opportunity sellers. Under the fourth prong, the government must establish that there are no obvious, less speech restrictive alternatives to its speech restriction. Here, without question, the alternative of allowing all representations that are truthful to be made regardless of whether they are "inconsistent with or contradict" a required disclosure is an obvious, less speech restrictive alternative that will enhance truthfulness in transactions, thus furthering the regulatory ends rather than frustrating them.

Aspects of the Rule that Are Void for Vagueness in Violation of the Fifth Amendment. The Supreme Court has stated that "precision of regulation must be the touchstone in an area so closely touching our most precious freedoms for standards of permissible statutory vagueness are strict in the area of free expression...Because First Amendment freedoms need breathing space to survive, government may regulate in the area only with narrow specificity." Keyishian v. Board of Regents of the University of the State of New York, 385 U.S. 589, 603-604 (1967) citing NAACP v. Button, 371 U.S. 415, 438 (1963). A rule that is both intricate and uncertain works to create an *in terrorem* effect because those who are subject to it cannot reasonably discern what the law requires of them. Keyishian at 601. Under the Rule, a seller must disclose whether he or she will make an earnings claim. Id. at 19058. An earnings claim is broadly defined to include any oral, written or visual presentation to a 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 19087. "Implied" earnings claims include all "statements from which a prospective purchaser can reasonably infer that he or she will earn a minimum level of income." Id. at 19087. In short, because every business opportunity sale involves a purchase predicated on an expectation of earnings and it is logically inconceivable for a business opportunity sale not to include an earnings claim as so defined by FTC, this broad rule makes every business opportunity seller satisfy the earnings claim requirements. The Commission defines it as "a violation of [§ 437.4] and an unfair or deceptive act or practice in violation of section 5 of the FTCA (15 U.S.C. § 45), for the seller to:

(a) Make any earnings claim to a prospective purchaser, unless the seller:
(1) Has a reasonable basis for its claim at the time the claim is made;
(2) Has in its possession written materials that substantiate its claim at the time the claim is made;
(3) Makes the written substantiation available upon request to the prospective purchaser and to the Commission; and
(4) Furnishes to the prospective purchaser an earnings claim statement. The earnings claim statement shall be a single written document and shall state the following information:
    (i) The title "EARNINGS CLAIM STATEMENT REQUIRED BY LAW" in capital, bold type letters;
    (ii) The name of the person making the earnings claim and the date of the earnings claim;
    (iii) The earnings claim;
    (iv) The beginning and ending dates when the represented earnings were achieved;
    (v) The number and percentage of all purchasers during the stated time period who achieved at least the stated level of earnings;
    (vi) Any characteristics of the purchasers who achieved at least the represented level of earnings, such as their location, that may differ materially from the characteristics of the prospective purchasers being offered the business opportunity; and
    (vii) A statement that written substantiation for the earnings claim will be made available to the prospective purchaser upon request.
(b) Make any earnings claim in the general media, unless the seller:
    (1) Has a reasonable basis for its claim at the time the claim is made;
    (2) Has in its possession written material that substantiates its claim at the time the claim is made;
    (3) States in immediate conjunction with the claim:
    (i) The beginning and ending dates when the represented earnings were achieved; and
    (ii) The number and percentage of purchasers during the time period who achieved the represented earnings.
(c) Disseminate industry financial, earnings, or performance information unless the seller has written substantiation demonstrating that the information reflects the typical or ordinary financial, earnings, or performance experience of purchasers of the business opportunity being offered for sale.
(d) Fail to notify any prospective purchaser in writing of any material changes affecting the relevance or reliability of the information condtained in an earnings claim statement before the prospective purchaser signs any contract or makes a payment or provides other consideration to the seller, directly or indirectly, through a third party.

Id. at 19088-89. The disclosures required must be "update[d] . . . at least quarterly to reflect any changes in the required information . . ." Id. at 19088.

The nature, degree, quantity, and quality of substantiation that a seller must have on hand each quarter to corroborate earnings claims is left entirely undefined in the rule, yet the adequacy of the proof will be scrutinized by the FTC to determine whether the seller has complied with the rule or is in violation of Section 5 of the FTCA (15 U.S.C. § 45). Under the Fifth Amendment, no regulation of this kind passes muster because it fails to provide the regulated class with sufficient information to discern lawful from unlawful conduct. See Grayned v. City of Rockford, 408 U.S. 104, 108 (1972) ("It is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined"); Connally v. General Constr. Co., 269 U.S. 385, 391 (1926) ("A statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must guess at its intended meaning and differ as to its application, violates the first essential of due process law.").

It is impossible from the present rule for any member of the regulated class to know with reasonable certitude what kind, degree, nature, and level of earnings claim substantiation will be deemed satisfactory by the FTC to avoid a Section 5 (15 U.S.C. § 45) violation. From the rule, one would presume that FTC would require more proof than an informed estimate of the range of monthly income the "typical" purchaser earns from the opportunity. Indeed, the rule demands the performance of a time sensitive estimation that takes into account "material" characteristics of the purchasers and apprises prospective purchasers of the extent to which those characteristics materially differ from those upon which the earnings claim estimate is based. See 16 C.F.R. §

437.4(a)(4)(vi). That assessment begs a sophisticated economic marketing analysis, one that may be competently performed only by an economist or by a marketing expert experienced in the study and assessment of those factors. The professional would presumably have to evaluate all potentially material variables before coming up with a demographic determination of what elements contribute to earnings. This process would have to be replicated on a quarterly basis and would have to be modified to account for changes wrought by competitive effects upon earnings, demographic effects upon earnings, new characteristics that differentiate sellers, etc. All of those factors require a degree of sophistication in marketing analysis far beyond the ken of the typical business opportunity seller. Nevertheless, based on the rule's total lack of a standard against which to determine the sufficiency of earnings claim substantiation, it is impossible for the regulated class to discern what is expected of it, to know with reasonable certainty when a showing will suffice and thus avoid a Section 5 violation charge and when it will not. Thus, the rule is void for vagueness under the Fifth Amendment. See Reno v. ACLU, 521 U.S. 844, 870 (1997) (finding an act unconstitutional, because, *inter alia,* its provisions are so vague as to create "ambiguities concerning the scope of its coverage"). It is likewise arbitrary and capricious in violation of the Administrative Procedure Act. See e.g., Pearson v. Shalala, 164 F.3d 650 (D.C.Cir. 1999).

In addition, the cost of the assessment cannot be borne by parent companies on behalf of their distributors because a one-size fits all assessment is impossible (the rule requires evaluation and explanation for the characteristics of each specific market and of each deviation from material factors apparent in each prospective purchaser). Thus, the demographic characteristics of each market are so diverse when compared with others that assessments will not be feasible or affordable by the parent companies.

The Proposed Rule Violates the FTCA, the Federal Trade Secrets Act, and the Right to Privacy. Those who sell business opportunities regard the names, location, and phone numbers of their distributors as trade secrets and highly valued business confidences and do not reveal that information to others outside of their companies. See Exhibit C at 2. Even within the companies, that information is not shared across "downlines." Id. at 2. Consequently, it is a trade secret. See 18 U.S.C. § 1905 (federal Trade Secrets Act). The Proposed Rule would compel disclosure of that information to prospective business opportunity purchasers. The rule would thus force disclosure of trade secrets by the regulated class. The FTC is forbidden by its own statute and other federal laws from forcing public disclosure of trade secrets. See 15 U.S.C. § 46(f); 18 U.S.C. § 1905. Accordingly, this aspect of the Proposed Rule is unlawful and may not be implemented.

FTC apparently presumes that disclosure of those who are prior business opportunity purchasers has material significance to present business opportunity purchasers. However, there is no necessary nexus between the two because the motivation for purchase varies greatly from person to person and so does satisfaction with the business opportunity. See Babener generally; see Exhibits C-E. In addition, there is no assurance that representations that were made to prior purchasers as a basis for their entry into the business are the same as those made to prospective business opportunity purchasers. Moreover, one cannot presume that prior purchasers of business opportunities will themselves make accurate and truthful representations to current purchasers and, indeed, prior purchasers may upon contact make deceptive representations including exaggerated earnings claims beyond the control of the business opportunity seller. That would defeat the purpose of the rule. Thus, the rule will in certain instances cause current purchasers to receive false and misleading information concerning a purchase. Finally, the success or lack thereof of any of the 10 prior purchasers is no sure indication of the success of prospective purchasers because the market for business opportunity sales depends heavily on factors that are personal to the seller, affected by the vagaries of the market, and may not be presumed wholly present from the opportunity itself. See Babener at 8. For those reasons, the rule is also arbitrary and capricious in violation of the Administrative Procedure Act.

One's name, city, state, zip code, and telephone number together with information sufficient to identify one's source of income is routinely kept private because is sufficient to enable identity thieves to steal one's identity. See United States Department of Justice, Identity Theft and Fraud, http://www.usdoj.gov/criminal/fraud/idtheft.html (last visited July 14, 2006)(Some criminals ...[through various methods]...obtain copies of your checks, credit card or bank statements, or other records that typically bear your name, address, and even your telephone number. These types of records make it easier for criminals to get control over accounts in your name and assume your identity.) The right to privacy in issue is associational privacy for which special safeguards apply. See e.g., United States v. United States Dist. Court for Eastern Dist., 407 U.S. 297 (1972). Business opportunity purchasers have a reasonable expectation that personal identifying information they convey to business opportunity sellers will be protected from public disclosure so as to avoid identity theft or unwanted solicitation. By forcing public disclosure of this combination of identity elements, the Proposed Rule violates the rights to privacy of business opportunity purchasers. Consequently, the Proposed Rule is invalid and may not be adopted.

Aspects of the Rule that Force the Regulated Class to Defame Itself and Others. The Proposed Rule requires the disclosure of all civil or criminal "actions" for "misrepresentation, fraud, securities law violations, or unfair or deceptive practices within the 10 years immediately preceding the date that the business opportunity is offered" and the disclosure pertains to such "actions" when directed against the seller, any affiliate or prior business of the seller, any of the seller's officers, directors, sales managers, or any individual who occupies a position or performs a function similar to an officer, director, or sales manager of the seller. The term "action" is broadly defined. It includes not just adjudicated final orders against the seller but every legal claim without requiring that it first be the subject of a final and binding adjudication. "Action" includes "a criminal information, indictment, or proceeding; a civil complaint, cross claim, counterclaim, or third-party complaint in a judicial action or proceeding; arbitration; or any governmental proceeding, including, but not limited to, an action to obtain or issue a cease and desist order, and an assurance of voluntary compliance." 71 Fed. Reg. 19087.

The Proposed Rule stigmatizes with allegations of fraud on an entire class of people without a final and binding adjudication. The law compels this government to presume innocent those who are accused but who have not been convicted of any wrongdoing. The Proposed Rule compels notice to others of the presence of unadjudicated and non-final charges. It therefore compels a party to defame him or herself and others in all instances where the charges are either themselves false or misleading. It conveys to the recipient that a charge has merit even if the charge is groundless. It invites others to cause competitive harm to the seller by making false charges so as to compel their disclosure and republication to all prospective business associates. It compels disclosure of all charges without the necessity of proof that the charges involve the same or substantially the same business opportunity sale that is in issue. It causes guilt by association because it compels the seller to publish charges made against employees and associates who may have and have had no influence or control over the business opportunity or the sale of it.

In instances where the disclosure of false charges pertain not to the seller as accused but to the seller's affiliate, officers, directors, sales managers, or others who occupy a function similar to any of them, the rule compels the seller to publish to all defamatory charges about those others, thus transforming the business opportunity seller into a publisher of defamation at the insistence of the FTC and one presumably guilty by association who, under proposed Section 437.5 of the rule, may not contradict in any way the false charges made. The rule thus causes FTC to promote deception beyond and contrary to its enabling statutes. See 15 U.S.C. 45. The rule is thus arbitrary and capricious in violation of the APA. See 5 U.S.C. 706(2)(A).

The Proposed Rule Imposes Costs Beyond the Financial Wherewithal of the Regulated Class. The Proposed Rule is complicated, requiring legal, economic and marketing knowledge beyond the level of expertise of the typical business opportunity seller and beyond the financial wherewithal of that seller.[17] The rule requires every seller

[17] See supra at 23.

of a business opportunity who makes an express or an implied[18] earnings claim (which would mean every business opportunity seller because the implication that earnings or that consideration of some kind will be forthcoming is inherent in all business opportunity sales) to possess *at the time the claim is made* (1) a reasonable basis for the claim (left undefined); (2) written substantiation for the claim (the level, degree, and nature of such proof is left undefined); (3) the beginning and ending dates when the earnings were achieved; (4) the number and percentage of all purchasers who achieved the stated level of earnings; and (5) any characteristics of the purchasers who achieved the earnings that differ materially from those of prospective purchasers (left undefined).

No one can hope to substantiate accurately an earnings claim in a way that would take into account and disclose every factor material to each person's earnings and to contrast that with the characteristics of each prospective purchaser without the expert advice of a person trained in marketing and economics at the graduate level who in addition has experience in making these kinds of assessments (an extremely rare group). Legal and marketing consultants are expensive. Even then the expert will rely on guesswork in many instances due to FTC's lack of defined standards in the rule. <u>See</u> Exhibit A at 17. Moreover, the rule requires business opportunity sellers to modify the information for each prospective purchaser, taking into account the characteristics of that purchaser. The rule also requires that the entire economic assessment be updated quarterly. Those two requirements compel an ongoing consultancy with a marketing and economic expert for every business opportunity seller.

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[18] The definition of "earnings claim" is extraordinarily broad. See 71 Fed Reg at 19087 (proposed section 437.1(h)). Indeed, any suggestion that one who takes the opportunity would increase his or her earnings (a suggestion unavoidable in the sale of any business opportunity) triggers the rule.

The rule is devoid of any standards. What is a reasonable basis for a claim? What level, degree, quality, and quantity of economic evidence is sufficient to support a claim? There are no articulated standards against which the regulated class can judge what is required of it. Consequently, even if those who sold business opportunities could afford the cost of the marketing and economic showing, none would be assured that their investment would suffice under FTC's standards. The rule is thus arbitrary and capricious in violation of the Administrative Procedure Act.

There are several provisions of the rule that compel the regulated class to employ legal counsel to assess whether disclosures satisfy the rule's requirements. The combined economic/marketing and legal fees compelled by the rule greatly exceed the budgets of virtually every person in this market. The rule is thus arbitrary and capricious in violation of the Administrative Procedure Act.

The Record Retention Requirement Invades Rights to Privacy. The typical seller of a business opportunity operates a home-based business. Most of those who make business opportunity sales have no office other than their homes. See Exhibit C at 2. The Proposed Rule requires each business opportunity seller to "prepare, retain, and make available for inspection by Commission officials copies" of "each materially different version of all documents required by" the Rule; "each purchaser's disclosure receipt;" "each executed written contract with a purchaser;" "each oral or written cancellation or refund request received from a purchaser;" and "all substantiation upon which the seller relies for each earnings claim from the time each such claim is made." See 71 Fed Reg at 19089 (proposed section 437.6). Those inspection requirements are onerous for a person making $418 a month from business opportunity sales who views business opportunity sales as a supplemental source of income. Likewise, those inspection requirements create a major disincentive for purchasers who want to sell business opportunities from home (the vast majority of such sellers sell from home). Consequently, they will dissuade prospective purchasers from being involved in the business and will discourage those who are in it from remaining so. Those requirements also invite the FTC for the first time to invade private homes for purposes of inspecting documents. There are heightened standards that apply to administrative actions that call for inspection of the home. Those requirements will be violated through any systematic non-public inspection of homes under this rule.

The rule contains none of the procedural safeguards constitutionally and statutorily required against searches of the home. See Wilson v. Layne, 526 U.S. 603, 610 (1999) ("The Fourth Amendment embodies [the] centuries-old principle of respect for the privacy of the home"); *Illinois v. Rodriguez*, 497 U.S. 177, 181 (1990) ("The Fourth Amendment generally prohibits the warrant-less entry of a person's home, whether to make an arrest or to search for specific objects"); United States v. Verdugo-Urquidez, 494 U.S. 259, 285-86 (1990) ("[W]hen United States agents conduct unreasonable searches, whether at home or abroad, they disregard our Nation's values.... The privacy and sanctity of the home have been primary tenets of our moral, philosophical, and judicial beliefs"); New York v. Burger, 482 U.S. 691, 700 (1987) ("The Court long has recognized that the Fourth Amendment's prohibition on unreasonable searches and seizures is applicable to commercial premises, as well as to private homes... not only with respect to traditional police searches conducted for the gathering of criminal evidence but also with respect to administrative inspections designed to enforce regulatory statutes"); Silverman v. United States, 365 U.S. 505, 511 (1961) ("At the very core [of the Fourth Amendment] stands the right of a man to retreat into his own home and there be free from unreasonable governmental intrusion"). Consequently, lacking any, let alone requisite, safeguards to protect the privacy of the home, the Proposed Rule violates the right to privacy of all business opportunity sellers in America.

The Proposed Rule Violates the Paperwork Reduction Act, the Regulatory Flexibility Act and the Small Business Regulatory Fairness Act of 1996. The FTC argues that the Proposed Rule lessens the burden on the multi level and network marketing industry by clarifying and reducing the number of disclosures that will need to be made, in comparison to the Franchise Rule. In their submission to the Office of Management and Budget, FTC appealed for approval under the Paperwork Reduction Act (44 U.S.C. § 3501 et. seq.) citing that the Proposed Rule has a lesser amount of variable disclosure requirements than the Franchise Rule, particularly concerning past lawsuits, cancellation and refund request disclosures, and electronic data collection and dissemination method. The FTC's argument, however, completely fails to note the crucial distinction that franchise owners are in an entirely different category of business operators than independent business opportunity sellers. Franchise owners regularly invest hundreds of thousands of dollars to millions into their business enterprises and have the resources, personnel, and expenditure margins to comply with the minute requirements of FTC's regulatory scheme. Business opportunity sellers, on the other hand, earn an average income of $418 a month and rely on their network marketing activities as supplemental income to help pay for basic living needs. Exhibit A at 13, see also Dole v. United Steelworkers of America, 494 U.S. 26 , 32 (1990) ("Agencies are [...] required to minimize the burden on the public to the extent practicable"); see 44 U.S.C. § 3507(a)(1) (1982 ed. and Supp. V).

The Paperwork Reduction Act, 44 U.S.C.S. § 3501 et seq., prohibits any federal agency from adopting regulations which impose paperwork requirements on the public unless the information is not available to the agency from another source within the federal government, and the agency must formulate a plan for tabulating the information in a useful manner. Agencies are also "required to minimize the burden on the public to the extent practicable." 44 U.S.C.S. § 3507(a)(1). In addition, the act institutes a second layer of review by the Office of Management and Budget (OMB) for new paperwork requirements. After an agency has satisfied itself that an instrument for collecting information, termed an "information collection request," is needed, the agency must submit the request to OMB for approval. 44 U.S.C.S. § 3507(a)(2). If OMB disapproves the request, the agency may not collect the information. 44 U.S.C.S. § 3507(a)(3). See Dole at 32-33. The primary purpose of the Act was "to reduce and minimize the burden Government paperwork imposes on the public." S. Rep. No. 930, 96th Cong., 2d Sess. 2 (1980), reprinted in 1980 U.S. Code Cong. & Admin. News 6241, 6242. In the Proposed Rule, FTC flouts congressional intention by establishing a bifurcated system of mandated disclosures that forces upon network marketers working from their home an extensive and overwhelming regulatory paperwork collection and storage burden. The proposed disclosure measures will not only increase the number of paperwork transactions that will result from the rule, but will also have the collateral consequence of forcing business opportunity sellers from the market from sheer inability to keep up with all of the federally mandated record-keeping and reporting requirements. By setting up a system where franchise owners and network marketing agents are forced to comply with intersecting oversight measures, the FTC confounds the administration of standard business practices by forcing individuals operating on a very small entrepreneurial scale to comprehend and comply with regulatory measures that require costly legal aid and marketing analysis expertise. Such a result destroys, rather than regulates, a vital channel of free enterprise and contravenes the intended purpose of the Paperwork Reduction Act.

Contrary to FTC's assertions, the Proposed Rule will have a devastating impact on small businesses. It will threaten the existence of at least 10 million of them across the United States. Assuming the 2003 figures reflect the current multilevel marketing industry (a conservative estimate to be sure), over 10 million business opportunity sellers in the United States will be subject to the Proposed Rule's documentation, disclosure and record-keeping requirements. In order to comply with those requirements with a reasonable expectation of satisfying the FTC, those sellers will have to make substantial initial and annual investments in marketing research, legal counsel, and record-keeping. See Exhibit A at 18; Exhibit B at 5; Exhibit C at 2. Thus, FTC's analysis of the impact of the Proposed Rule on small entities grossly underestimates the actual costs and thereby violates the Regulatory Flexibility Act, 5 U.S.C. § 603. Moreover, FTC does not describe any significant alternatives to the Proposed Rule that would accomplish the stated objectives of the applicable statute (the FTCA) and that would minimize the significant economic impact of the Proposed Rule on small entities. Id. at § 603(c)(1-4).[19] See Thompson v. Clark, 741 F.2d 401, 408-409 (App. D.C. 1984) ("[t]hus, if data

[19] Section 603(c) suggests alternatives such as: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the

in the regulatory flexibility analysis -- or data anywhere else in the rulemaking record -- demonstrates that the rule constitutes such an unreasonable assessment of social costs and benefits as to be arbitrary and capricious, 5 U.S.C. § 706(2)(A), the rule cannot stand. Moreover, as we said in Small Refiner Lead Phase-Down Task Force v. EPA, 227 U.S. App. D.C. 201, 705 F.2d 506 (D.C. Cir. 1983), a defective regulatory flexibility analysis 'may lead a court to conclude that the rule is unreasonable," id. at 538 (emphasis added), and 'a reviewing court should consider the regulatory flexibility analysis as part of its overall judgment whether a rule is reasonable and may, in an appropriate case, strike down a rule because of a defect in the flexibility analysis,' id. at 539 (emphasis added)"). The Proposed Rule unreasonably underestimates costs as stated herein. Thus, it is unreasonable and cannot stand.

The preamble to the 1996 Small Business Regulatory Enforcement Fairness Act states that the requirements of the Regulatory Flexibility Act "have too often been ignored by government agencies, resulting in greater regulatory burdens on small entities than necessitated by statute." Pub. L. No. 104-121, Tit. II, 110 Stat. 847, 868, Sec. 202 (1996). Under that law, the FTC is required to provide small business entities compliance guides for this Proposed Rule when finalized. Id. at § 212(a). Moreover, FTC must consider reduction or waiver of civil penalties for all small entities faced with an enforcement action for violation of the Proposed Rule's requirements in accordance with section 223.

The Seven Calendar Day Advance Notice Is Arbitrary and Capricious. Under Proposed Rule section 437.2, the obligation to furnish the disclosure document occurs

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clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities; (3) the use of performance rather than design standards; and (4) and exemption from coverage of the rule, or any part thereof, for such small entities. 5 U.S.C. § 603(c).

"seven calendar days before the earlier of the time that the prospective purchaser . . . (a) signs any contract in connection with the business opportunity sale; or (b) makes a payment or provides other consideration to the seller, directly or indirectly through a third party." At the outset, it is indeed remarkable that the FTC requires a five business day advance notice for a person to make an investment of, commonly $500,000 to many millions of dollars in a franchise, yet would insist on effectively the same period of advance notice in the context of a zero to a few hundred dollar investment in the typical business opportunity. Moreover, in the vast majority of cases, the few hundred dollar investment for a business opportunity is completely refundable if the purchaser is dissatisfied. See Babener at 138-139; see also Exhibit C at ¶17. Thus, there is no comparable injury for a dissatisfied purchaser.

The Commission offers the following justification for requiring advance notice: "The Commission believes that seven calendar days is sufficient to enable a prospective purchaser to review the basic disclosure document and any earnings claims statement, as well as conduct a due diligence review of the offering, including contacting references." 71 Fed. Reg. at 19067. The Commission's belief is unsupported and is, thus, sheer speculation. The Commission performs no assessment of the impact of its requirement on the willingness of prospective business opportunity purchasers to make a purchase. It therefore fails to weigh the very negative consequences that will flow from its advance notice requirements.

In the first instance, the supposition of the need for a written notice arises from the FTC's presumption that those who purchase business opportunities are ignorant of information necessary to make the purchase. That supposition is without any empirical foundation. Indeed, the typical business opportunity purchaser has tried the product, has evaluated the business, has discussed the opportunity with friends, and has an understanding of his or her own selling ability and contacts. See Babener at 1-4; see also Exhibit A at 9; Exhibit C at ¶10. Consequently, when a business opportunity purchaser pays for the opportunity, receives the goods, and begins selling them, he or she possesses all essential information needed for conducting the business (that as compared to the far more sophisticated and less tangible benefit that may be presumed to come from a costly investment in a franchise). If a purchaser has erred in his estimation in any respect he or she can relinquish the business opportunity with virtually no economic cost. In this circumstance there is no justification for an advance notice requirement.

Moreover, the FTC must calculate the impact of the requirement on business opportunity sales. Purchasers of business opportunities depend on ease of entry into the market. Moreover, the requirement of a seven day advance notice carries with it a stigma—a government onus against entry into the purchase, an obvious implication that there are factors that may not have been revealed or pondered at the initial presentation that are weighty and may justify not making a purchase. The overall psychological effect on a prospective purchaser is undeniably to discourage the purchase. The FTC does not take that likely effect into account but ignores it in total. In addition, few who seek the typical $418 per month in extra earnings from a business opportunity will be willing to accept the encumbrance of a seven day waiting period in their future sales of the business opportunity. The effect will undoubtedly retard and discourage every business opportunity sale, taxing this market without any sound justification. On balance the costs and burdens of the seven day notice requirement greatly exceed any potential benefit to the actual purchaser and interfere with the market, disabling it and threatening its very existence.

The seven day advance notice requirement is not rationally related to the goal of protecting purchasers from being defrauded. As explained elsewhere herein the entire rule lacks that necessary foundation. There is no logical nexus between postponement of a purchase for seven days and assurance that the purchaser will avoid buy induced by fraud. There is no empirical evidence in this context that a seven day delay will prevent fraud. The rule is thus arbitrary and capricious in violation of the Administrative Procedure Act.

The Cancellation or Refund Request Disclosure Is Arbitrary and Capricious. Under Proposed Rule section 437.3(a)(4),(5), the FTC requires business opportunity sellers to disclose if the seller offers a refund and, if so, to state the terms of the refund or cancellation policy in an attachment and, to "[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 the "total number of oral and written cancellation requests during that period for the same type of business opportunity." The FTC justifies its requirement of disclosing the total number of purchasers who cancelled their requests for the business opportunity with the following rationale: "This information is material to prospective purchasers because it goes to the viability of the business, the success of past purchasers, and their satisfaction with the business opportunity." This is yet another unsupported supposition. In addition the FTC presumes "in many instances" that business opportunity sellers "make false or deceptive claims about the success of prior purchasers." It offers no proof to support that charge either. It offers a cite to cases involving allegations of this kind, but no empirical evidence that this form of deception does in fact occur "in many instances" or is common in business opportunity sales.

FTC fails to take into account any of the negative consequences that flow from its mandatory disclosure of "drop-outs." In the first instance, the disclosure requirement only applies if a refund or cancellation policy exists. Therefore, removal of such a policy would negate the need for the disclosure. That would also be to the great detriment of purchasers, yet the rule creates a perverse incentive for just such an action. To avoid the negative connotation that would arise from revealing the number of those who had cancelled a business opportunity purchase, a seller may reasonably elect to end its cancellation or refund policy. There is good reason for that choice to be made by honest sellers.

The FTC does not evaluate the impact this disclosure requirement will have on honest sellers. An honest seller may well experience a significant drop-out rate. Often people underestimate the amount of time and effort needed to make any new business a success or they lose interest in it either because another more attractive multi-level marketing opportunity comes along or because circumstances beyond their control necessitate a greater devotion of time than anticipated at the time of purchase. Those effects, peculiar to the circumstances of the purchaser, may lead to a decision to cancel the opportunity and/or to seek a refund for reasons having nothing at all to do with the "viability of the business, the success of past purchasers, and their satisfaction with the business opportunity." Consequently, in such circumstances the requirement that a drop-out rate be disclosed will tend to discourage purchase of a business opportunity, thereby interfering with the underlying transaction, without providing any benefit to the purchaser. Misleading the purchaser into believing there to be grounds for the drop-outs that are related to the "viability of the business, the success of past purchasers, and their satisfaction with the business opportunity" when there are not, will cause the purchaser to forego a needed business opportunity to his or her own economic detriment (and, of course, to the detriment of the seller). It is, in short, a non-sequitur to presume that drop-outs are proof of the viability of the business, the success of past purchasers, and their satisfaction with the business opportunity. The rule thus does not further the goal of apprising prospective purchasers of accurate information that could discourage a fraudulent sale. The conveyance of the information itself discourages a purchase regardless of the bona fides of the purchase and that obfuscates reality rather than elucidate it. The rule is thus arbitrary and capricious in violation of the Administrative Procedure Act.

The Proposed Rule Violates the Administrative Procedure Act (APA). Under the APA, an agency action is unlawful if it is arbitrary and capricious, in violation of statutory law, or in violation of constitutional right. 5 U.S.C. § 706(2)(A-C). The Proposed Rule is arbitrary and capricious because, as explained above, the means chosen are not rationally related to the ends desired. In addition, the rule imposes costs that will greatly diminish the presence of law-abiding business opportunity sellers in the market, while effecting no provable or reasonably likely reduction in the presence of deceptive business opportunity sellers in the market. Indeed, deceptive sellers can reasonably be expected to fill the void left by the departure of the law-abiding. The rule thus exacerbates the very fraud it is supposed to reduce or eliminate. The regulatory scheme is thus irrational and cannot be reasonably expected to combat fraud in the sale of business opportunities. As explained above, the rule violates the Federal Trade Commission Act; the Regulatory Flexibility Act; the Paperwork Reduction Act, the 1996 Small Business Regulatory Enforcement Fairness Act and the Federal Trade Secrets Act. Violation of statutory law renders administrative action unlawful under Section 706(2)(C) of the APA. As explained above, the rule violates the First and Fifth Amendments to the United States Constitution and the right to privacy. Violations of constitutional right render administrative actions unlawful under Section 706(2)(B) of the APA. For the foregoing reasons, the Proposed Rule is unlawful under Section 706(2)(A-C) of the APA.

The Sufficiency of Existing Law and Procedure. To "combat fraud" and to "address widespread fraud," FTC's proposed aims, there is no substitute for enforcement action case-by-case pursuant to FTCA Section 5 (15 U.S.C. §45). While, as explained above, reliance on the disclosure rule is unlikely to affect any change in the instances of fraud, certainly the employ of Commission resources to enforce Section 5 (15 U.S.C. §45) case by case against the purveyors of fraud would bring about that change. Consequently, existing law is both a necessary and a sufficient alternative, if only enforced. Indeed, it is a vastly superior alternative to the Proposed Rule because reliance upon it should not impose any undue burden on honest sellers absent FTC malfeasance or prosecution void of requisite proof. Enforcement of existing law will not likely drive honest sellers out of the market in droves as will the Proposed Rule. Moreover, enforcement of existing law will not unjustly impose costs and burdens and erect new barriers to market entry upon all as will the Proposed Rule. In the face of existing law, reliance on the Proposed Rule as a new means to combat fraud is an arbitrary and capricious agency action. The means have not been shown and are not logically likely to reliably achieve the ends, but the means have been shown to burden substantially those who are not properly subject to adverse Commission action: honest business opportunity sellers.

Conclusion. For the foregoing reasons, the MLMIA respectfully requests that the Commission withdraw the Proposed Rule, terminate the rulemaking, and rely on existing law as both a necessary and sufficient means to ferret out and combat those rare instances of actual fraud in the business opportunity marketplace.

Respectfully submitted,

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Exhibit A: Report of Steve Nowlis, Ph.D.
Exhibit B: Affidavit of Andrea G. Ferrenz, Esq.
Exhibit C: Affidavit of Steven Wallach
Exhibit D: Affidavit of George Kerford, Ph.D.
Exhibit E: Affidavit of Marcie Cook

Exhibit A

Report of Dr. Stephen M. Nowlis
In Support of the Comments of the
Multilevel Marketing International Association
To FTC's Business Opportunity Rule; Notice of Proposed Rulemaking,
71 Fed. Reg. 19054 (April 12, 2006)

This report was paid for by the Distributor Rights Association
A 501(c)(6) Organization

The Distributor Rights Association works to improve communication, terms, and relationships between distributors and multilevel marketing companies

Statement of Dr. Stephen M. Nowlis

I. Background and Qualifications

I am the AT&T Distinguished Research Professor of Marketing in the W. P. Carey School of Business at Arizona State University. A copy of my curriculum vitae, which includes a complete list of my publications, is attached as Exhibit A. It includes a list of cases in which I provided expert witness consulting services. I am being compensated at the rate of $500 per hour.

I hold a Ph.D. in Marketing and a Master's degree in Business Administration (MBA) from the University of California at Berkeley, Haas School of Business, and a Bachelor's degree in Economics from Stanford University. My field of expertise is marketing, consumer behavior, survey methods, and decision making. I have received several awards, including (a) the 2001 Early Career Contribution Award from the Society for Consumer Psychology – Sheth Foundation, which is given annually to the most productive young scholar in the field of consumer behavior/marketing, (b) the 2001 O'Dell Award, given to the *Journal of Marketing Research* (the major journal on marketing research issues) article that has had the greatest impact on the marketing field in the previous five years, and (c) a finalist for the 2002 O'Dell Award.

I currently serve as an Associate Editor at the *Journal of Consumer Research* (the major journal on consumer behavior research). In this capacity, I review many papers and help determine whether they are acceptable for publication. I also serve on the editorial review boards at the *Journal of Marketing Research*, *Journal of Marketing* and *Marketing Letters*. At Arizona State University, I have taught undergraduate and MBA courses on marketing management, covering such topics as buyer behavior, developing marketing plans, advertising, sales promotions, retailing, and product development. I have also taught several doctoral courses. One course focused on various methods for conducting research projects. A second course dealt with buyer behavior, covering such topics as buyer decision making processes, influences on purchase decisions, and persuasion. After completing my undergraduate studies and before starting the MBA program, I worked for two years as an Assistant Buyer for a major retail chain.

I was asked and commissioned by the Distributor Rights Association, Inc. (DRA) to provide my opinion on the Federal Trade Commission Business Opportunity Rule, R511993, 71 Fed. Reg. 19054 (April 12, 2006). Throughout my expert report, I will refer to this Notice of Proposed Rulemaking as the Proposed Rule. In my report, I rely on independent research (both academic and industry) to analyze the impact that the Proposed Rule would have on the business opportunity sector of the economy. As I continue to receive and review additional information, I reserve the right to supplement, revise, or further explain the opinions contained in this report.

II. Summary of Conclusions

Based on a careful review of the marketing strategies of those who sell business opportunities, and the demographics of those who purchase such opportunities, I conclude that the Proposed Rule would have a devastating impact on the business opportunity sector of the US economy. This is a large and important sector of the economy, and this Proposed Rule needlessly imposes significant burdens. These burdens are likely to retard, if not halt, the growth and operations of this sector. In addition, I do not find any sound empirical evidence of widespread fraud within this sector.

My analysis reveals that this Proposed Rule will impose regulatory costs beyond the ability of the vast majority of regulatees to pay and will harm the lives and livelihood of millions of Americans, who have not been proven to have engaged in any false or misleading advertising or any unfair or deceptive acts or practices.

Thus, this Proposed Rule must be revoked.

III. Analysis

Actual Extent of Fraud

The Proposed Rule mentions that, "Based upon the original rulemaking record, the Commission found that franchise and business opportunity fraud was widespread, causing serious economic harm to consumers."[1] However, there appears to be a great deal of evidence which casts serious doubt on the validity of this statement. In particular, the FTC conducted a survey called *Consumer Fraud in the United States: An FTC Survey.*[2] This survey found that of all the specific frauds evaluated, "Purchased a business opportunity where promised earnings were not realized or promised assistance was not provided" was the least likely to be mentioned by respondents (credit card fraud, on the other hand, was the most common).[3] In addition, the FTC noted that the incidents per one hundred adult Americans ranged anywhere from 0 to 0.6, with a 95% confidence interval. Thus, if one is to be 95% confident in how this sample maps on to the population of all Americans, then it is a strong possibility that no one (0) would actually be affected (since the range was from 0 to 0.6 incidents per one hundred people). This statistic alone casts grave doubt on whether there is "widespread" business opportunity "fraud" in America, rather than isolated and comparatively infrequent instances.

Furthermore, the FTC notes in this report, in a footnote, that "Given that the survey was limited to purchases that had been made in the last year, it is possible that some business-opportunity purchasers who indicated that they had not realized the promised level of earnings will do so in the future. It is not uncommon for a business to have lower earnings when it is just getting started than after the business has been in operation for some period of time. Of 19 participants who said that they had purchased a business opportunity other than a pyramid, seven said that they had been led to believe that they would earn a certain amount of money from the business. Of these, five said that they had earned as much as they had

[1] Page 19055 of Proposed Rule
[2] http://www.ftc.gov/reports/consumerfraud/040805confraudrpt.pdf
[3] Page 32 of *Consumer Fraud* survey

been promised. Seven of the 19 also said that they had been promised assistance in locating customers and, of those, six said that the promised assistance had been provided."[4] Thus, of the 2500 people who participated in this survey, it appears that only two people claimed they had not made as much money as promised from a business opportunity.[5] However, as the FTC notes, these people may have in fact made the money they wanted in the second or third year of their business. In addition, the majority of respondents (five out of seven) in fact did make as much money as promised. Also, only one person in the entire survey of 2500 people said he or she had not received the assistance promised from a business opportunity. Furthermore, the majority (five out of six) had received the assistance they were promised. Finally, the survey asked respondents, "In the past year, have you paid anyone for the opportunity to operate your own business, such as a work-at-home plan, a business opportunity or a franchise?"[6] Thus, the three people who were not satisfied (two for earnings and one for assistance) may in fact have been responding to a franchise that they had purchased, which says absolutely nothing about the types of business opportunities that the FTC claims in the Proposed Rule to be so frequently fraudulent.

In sum, the results of the FTC's own survey show that fraud in the business opportunity sector is simply not "widespread." In fact, the great majority of people did make as much money as promised and did in fact receive the support they wanted. There were only three people in the entire survey (two regarding promised earnings and one regarding promised support) who claim they were harmed. Again, however, with a 95% confidence interval, this

[4] Page 15 of *Consumer Fraud* survey
[5] Furthermore, there was a "don't know/refused" response which these two people may have said, instead of the "no" response (since it is not clear in the survey how this was coded).
[6] Page 11 of Appendix A of *Consumer Fraud* survey

number could actually be zero within the population. In addition, these people may have been referring to a franchise, since the survey also included this possibility. Also, this type of "fraud" was the least likely to be mentioned of all the types of fraud that the survey was measuring. Finally, it is possible that the two people who claim they did not make as much as promised either misunderstood the offer, or in fact did make the amount promised in the second or third year of business (as the FTC admits). Based on this analysis (which is direct empirical evidence as opposed to the unverified complaints to the FTC cited in the Proposed Rule), the FTC lacks a sound basis for concluding that fraud is "widespread" in the business opportunity sector. Instead, it appears that this sector is quite efficient, and does not suffer from atypically high or widespread problems with fraud. Thus, imposing costly regulatory burdens on this sector simply does not make any rational sense.

In addition, the FTC published a report called the *Franchise and Business Opportunity Review 1993-2000* (June 2001).[7] This report tallied a total of 4512 complaints over this eight-year period (so about 500 per year), some of which were related to franchises, and some of which were related to business opportunities. This report notes that, "...most complaints involved isolated incidents: where the company could be identified from the complaint, 74% of the records represented a single complaint against a company. Only a few companies appeared to exhibit any pattern of problematic behavior."[8] Indeed, the number of business opportunity cases filed was 4 in 1993, 10 in 1994, 40 in 1995, 25 in 1996, 12 in

[7] Available at http://www.ftc.gov/reports/franchise93-01.pdf
[8] Page 5 of the Review

1997, 17 in 1998, 5 in 1999, and 35 in 2000.[9] Thus, it appears hard to argue, at least from the number of cases actually filed, that fraud is somehow "widespread."

It is also interesting to note the specific types of complaints that were registered against business opportunity goods. The greatest number of complaints were related to non-delivery or other problems with the goods themselves.[10] But, amazingly, only two complaints (over this entire eight-year period) were about suspected fraud. Thus, the FTC's argument that fraud is rampant in this industry is itself a gross distortion – surely, were fraud "widespread," there would be a greater number of consumers complaining about fraud than only two over an eight-year period.

In conclusion, the results of two of the FTC's own surveys show that fraud is quite rare in the business opportunity sector, belying the representation in the Proposed Rule that fraud is "widespread."

FTC Perceptions about Business Opportunities

Given that the actual likelihood of fraud in the business opportunity sector is extremely low, one must wonder why the FTC wants to impose costly regulatory burdens on this important sector of the economy. I next consider independent, academic research which has also noted that sometimes perceptions of this industry are at odds with the reality.

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[9] Page 35 of the Review
[10] Page 22 of the Review

As the Proposed Rule notes, the entire business opportunity market consists of both multilevel marketing (also known as network marketing), as well as vending sales and work-at-home opportunities. Independent research indicates that, while it is true some people have negative perceptions of the business opportunity market, in fact it is a thriving and healthy market, populated by sincere and well-meaning sellers.

An independent, published academic paper states that, "Network marketing carries negative connotations in many marketplaces worldwide. This is because it is often incorrectly associated with deceptive 'pyramid schemes', which frequently result in financial ruin for participants and legal action against the investigators. In contrast, true network marketing involves the development of a legitimate retail selling and distribution network that grows via social networks. Our analysis has examined the unique marketplace tensions that an NMO [network marketing organization] executive must balance in order to create and manage a compensation structure that both motivates distributors and achieves the company's business goals. Our work also illustrates that the successful management of an NMO does not require deception or fraudulence, but instead requires the standard managerial concerns for salesperson satisfaction, company growth, and net profitability."[11] Another academic paper notes that, "Network Marketing Organizations (NMOs) like Amway have been very successful in recent times. Even more surprising than the success of these organizations is the controversy they seem to attract."[12] This paper goes on to list the many real benefits available to those who participate in business opportunities. Finally, there are

[11] Coughlan, Anne T. and Kent Grayson (1998), "Network Marketing Organizations: Compensation Plans, Retail Network Growth, and Profitability," *International Journal of Research in Marketing*, 15, 401-426.
[12] Bhattacharya, Patralekha and Krishna Kumar Mehta (2000), "Socialization in Network Marketing Organizations: Is It Cult Behavior?," *Journal of Socio-Economics*, 29, 361-374.

clearly ways to differentiate real business opportunities from fraudulent ones, and this is what the FTC should consider in going forward, rather than requiring the satisfaction of costly new regulatory burdens, which would stymie industry growth. For example, one academic research team has developed models to differentiate multilevel marketing from illegal pyramid schemes.[13] As this paper implies, such models and enforcement practices do not need to rely on additional, time-consuming and expensive regulations imposed on the entire industry by the FTC.

Business Opportunity Market Characteristics

There are built-in disincentives for fraud in the business opportunity sector that the FTC fails to credit in the Proposed Rule. In particular, people selling direct have usually used the product, and liked it, before deciding to sell it. Indeed, one academic paper on network marketing notes that "...most people would not enter the distributorship business unless they genuinely liked the products and believed in their qualities."[14] Furthermore, as mentioned in an independent, published survey of 1600 people selling direct, over 90% responded that they "like and believe in the product."[15] Thus, ordinarily the products sold through business opportunities are real and liked by those who sell them. They are not phantom products or services that the seller knows nothing about and is tricked into buying and trying to sell.

[13] Vander Nat, Peter J. and William W. Keep (2002), "Marketing Fraud: An Approach for Differentiating Multilevel Marketing from Pyramid Schemes," *Journal of Public Policy & Marketing*, 21 (1), 139-151.
[14] Bhattacharya, Patralekha (1999), "Network Marketing: A Product Characteristic Approach," *American Marketing Association Proceedings*, p. 59.
[15] Bartlett, Richard C. (1994), *The Direct Option*, Texas A&M University Press, College Station: TX, p. 29.

In addition, those involved with business opportunities will often sell the products to friends or acquaintances. It is even less likely that someone will want to cheat a friend than a complete stranger. Indeed, as one published paper notes, "While the distributor might make a few extra dollars by cheating his friends he also stands to lose their friendship and trust." [16] Thus, business opportunities involve selling real products or services to real people whom the seller often knows well and is not likely to defraud.

In sum, the types of markets described in the Proposed Rule are less conducive to fraud than many other markets regulated by the FTC. That is because business opportunity markets depend on people using and liking the products before purchasing the business opportunity, and because these products or services are often sold to friends of the seller.

Impact on the Overall Economy

I next consider the impact that the Proposed Rule will have on the US economy. The FTC seems to imply that business opportunities represent a very small and insignificant sector of the economy. That is far from reality. In fact, business opportunity sales are a large and vibrant sector of the economy, involving millions of sellers – sellers of business opportunities include the parent companies and all of their individual distributors.

[16] Bhattacharya, Patralekha (1999), "Network Marketing: A Product Characteristic Approach," *American Marketing Association Proceedings*, p. 59.

The FTC estimates that only 550 work-at-home opportunity sellers, and 150 multilevel marketing companies, would be affected by this Proposed Rule.[17] However, it is entirely unclear as to how this number of firms was "estimated," as the FTC does not offer any justification, or cite any industry sources or research reports to come up with this number.

The *Network Marketing Business Journal* offers a paid directory of companies that offer multilevel marketing opportunities.[18] On July 6, 2006, I counted the number of firms listed in this directory, and found 627 such opportunities listed. Of course, this is only one source, and this only includes paid listings of parent companies. Thus, there is most likely a far greater number of firms than 627 engaged in multilevel marketing opportunities, yet the FTC claims that only 150 multilevel marketing companies would be affected. In addition, *Work at Homes Job Information* notes that they have over 25,000 companies that offer work at home opportunities.[19] Yet, the FTC claims that only 550 work-at-home opportunity sellers would be affected. Furthermore, the FTC ignores the fact that the definitions and scope of the Proposed Rule are so broad as to include all distributors that sell distributorships to be "sellers" under its terms. In conclusion, the FTC has vastly underestimated the number of individuals and firms that would be affected by the Proposed Rule.

In addition to looking at the number of firms that would be affected, it is also possible to consider the total impact that this Proposed Rule would have on dollar sales in the direct marketing industry. In particular, the Direct Selling Association conducts yearly surveys to determine the size of the direct marketing industry. According to the 2004 survey (which

[17] Page 19080 of the Proposed Rule
[18] http://mlmdirectory.nmbj.com
[19] http://www.workathomejobsinformation.com

was the latest available), over 82% of people involved in this industry were paid according to a multilevel structure.[20] Such a multilevel structure is akin to what is found in network marketing and multilevel marketing organizations, which the FTC claims are a small part of the economy (supposedly only 150 of these firms). Furthermore, total U.S. direct sales were almost $30 billion in 2004.[21] According to the *Wall Street Journal*, that is close to 1% of all U.S. sales.[22] In addition, over 13 million people in the U.S. were employed in the direct sales industry.[23] It would therefore be a devastating blow to the U.S. economy if this industry were negatively affected by the Proposed Rule. Furthermore, it is apparent that the FTC has dramatically underestimated the effect that the Proposed Rule will have on an important and large sector of the US economy.

Impact on Individual Workers and Families

I next consider the impact that the Proposed Rule would have on individual people and families. As mentioned above, over 13 million people in the US are involved in business opportunity sales. These people are motivated to sell products and services in such opportunities to supplement their incomes as well as for other, more intangible reasons. I next consider these reasons to show that they are significant, and that a loss of income from the sale of business opportunities would have adverse repercussions on tens of millions of Americans involved in, or who benefit from, income generated by business opportunity sales.

[20] http://www.dsa.org/pubs/numbers
[21] http://www.dsa.org/pubs/numbers
[22] Bounds, Gwendolyn (2004), "Enterprise: Direct-Sales Operations Gain, with Boost from the Internet; House Parties Also Help Businesses Compete in Product Distribution," *Wall Street Journal*, October 26, 2005, p. B4.
[23] http://www.dsa.org/pubs/numbers

An independent, published research paper conducted a survey of network marketing organization presidents to determine the amount of money that distributors made.[24] This independent survey revealed that, as might be expected, distributors earned a range of income. An average distributor earned $12 per hour, and worked an average of 34 hours a month. This resulted in earnings of $418 per month. An above-average distributor earned $33 per hour, and worked an average of 76 hours a month. This resulted in earnings of $2,523 per month. A top distributor earned $72 an hour, and worked an average of 169 hours a month. This resulted in earnings of $12,217 per month. Of course, it is also possible that below-average distributors earned nothing. Thus, distributors earned on average, anywhere between $0 per month to $12,217 per month, with an average earnings of $418 per month. Such supplemental income is vital to pay for such basic living expenses as food, transportation costs, housing, and child care expenses.

Another academic study of 362 recruits and 189 sponsors in a multilevel marketing organization found that the recruits sold an average of $682 worth of merchandise per month.[25] This survey also found that most respondents worked from 10 to 20 hours per week on their distributorship. The average age was 25 to 34 years old, and the vast majority were married women. It is also interesting to note that over 50% of respondents did not have any other employment, so this business opportunity represented their only source of direct income (of course, this would be in addition to any income earned by their spouse). Thus, the amount they made would be critical in helping to pay for basic living expenses.

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[24] Coughlan, Anne T. and Kent Grayson (1998), "Network Marketing Organizations: Compensation Plans, Retail Network Growth, and Profitability," *International Journal of Research in Marketing*, 15, 401-426.
[25] Sparks, John R. and Joseph A. Schenk (2006), "Socialization Communication, Organizational Citizenship Behaviors, and Sales in a Multilevel Marketing Organization," *Journal of Personal Selling & Sales Management*, 26 (2), 161-180.

People become involved with, and are satisfied from, business opportunities for a variety of reasons, some of which involve increased earnings, and some of which involve social benefits. One independent survey of 1600 people showed the top three reasons to sell direct were: "Like and believe in the product" (91%), "Being their own boss, working their own hours" (73%), and "Supplement family income or make a little extra money for myself" (64%).[26] A survey conducted by the Direct Selling Association showed the main reason for becoming a direct sales representative to be, "Additional income" (36%), "It's your business and making money through direct sales is important to you" (31%), and "Discount/wholesale/free products" (29%).[27]

Besides being a source of additional income, business opportunities provide a means for social stimulation and recognition. In particular, direct marketing often involves selling to family and friends. As one academic paper concludes, "...although some members join MLMs primarily for additional income, many connect their MLM participation to a variety of 'higher-order values' that extend beyond profit-making or financial success," and that "Other members view MLMs as a way to strengthen family ties by working from home."[28] One academic paper found that the greater the social ties that bond the seller with the purchasers, the greater the likelihood of purchasing the seller's products.[29] Another academic paper concluded that individuals involved with network marketing organizations

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[26] Bartlett, Richard C. (1994), *The Direct Option*, Texas A&M University Press, College Station: TX, p. 29.
[27] http://www.dsa.org/pubs/numbers
[28] Sparks, John R. and Joseph A. Schenk (2001), "Explaining the Effect of Transformational Leadership: An Investigation of the Effects of Higher-Order Motives in Multilevel Marketing Organizations," *Journal of Organizational Behavior*, 22, p. 852.
[29] Frenzen, Jonathan K. and Harry L. Davis (1990), "Purchasing Behavior in Embedded Markets," *Journal of Consumer Research*, 17, 1-12.

consume both social and economic output.[30] A further independent research paper reports that "..network marketing organizations often emphasize that distributing can be a source of strong and meaningful friendships."[31] Still another published research paper, which surveyed 491 direct salespeople, found that they were motivated by five factors: Social recognition and organizational identification, income and career growth, attention and approval, personal fulfillment and job challenge, and autonomy and control.[32]

In sum, people become involved with business opportunities as a way to help pay for basic living expenses, and as a means for social support and recognition. The typical income earned is not sufficient to make business opportunity sales the sole source of income, yet invariably the income derived is indispensable to support basic family needs, as opposed to discretionary spending. People also view such opportunities as a way to strengthen family ties. Thus, costly new regulatory burdens imposed by the Proposed Rule would have a widespread and negative impact on the lives of tens of millions of Americans who rely on business opportunity sales for additional income and for social connections.

Compliance costs

I next consider the specific types of compliance costs that the Proposed Rule would impose unnecessarily on business opportunity sellers. In particular, the Proposed Rule requires all

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[30] Bhattacharya, Patralekha and Krishna Kumar Mehta (2000), "Socialization in Network Marketing Organizations: Is It Cult Behavior?," *Journal of Socio-Economics*, 29, 361-374.
[31] Pratt, Michael G. and Jose Antonio Rosa (2003), "Transforming Work-Family Conflict Into Commitment in Network Marketing Organizations," *Academy of Management Journal*, 46 (4), p. 405.
[32] Wotruba, Thomas R. and Pradeep K. Tyagi (1992), "Motivation to Become a Direct Salesperson and Its Relationship with Work Outcomes," *Journal of Marketing Channels*, 41-56.

business opportunities (regardless of size) to make disclosures in five key categories of information.

At the outset, there is no sound proof presented in the Proposed Rule to establish the inadequacy of the current practice of voluntary disclosures by sellers. In particular, in an FTC report, *Franchise and Business Opportunity Review 1993-2000*,[33] it was determined that "A relatively small number of consumers specifically indicated either that they had received no disclosure document or that some other substantive disclosure had not been made prior to the sale of the franchise or business opportunity."[34] In particular, only 1.53% of complaints about business opportunities were related to "no disclosure document" while only 1.95% were about "disclosure issues."[35] Thus, the FTC wants to mandate a certain type of business opportunity disclosure for all sellers, despite the fact that the FTC's own evidence reveals that only a small number of people actually believe themselves injured by the absence of a disclosure document.

The FTC staff has estimated that there are only 3200 business opportunity sellers who will be affected by this ruling.[36] This number consists of 2500 vending machine, rack display, and related opportunity sellers; 550 work-at-home opportunity sellers; and 150 multilevel marketing companies. As mentioned earlier, in fact a much greater number of sellers will be affected.

[33] Available at http://www.ftc.gov/reports/franchise93-01.pdf
[34] Page 26
[35] Page 57
[36] Page 19082 of the Proposed Rule

The Proposed Rule would require that sellers provide the names of ten references, even though this is held as a business confidence or trade secret. In addition, the seller needs to customize the information to each market in which a potential seller operates. The seller also must list any legal actions, even though no judgment need to have been rendered. The seller must also provide information on potential earnings, and on cancellation and refund policies. The FTC estimates that this task will take each seller only five hours to complete, at a cost of only $50 per hour. However, this information will in fact take much longer to complete, and will clearly cost more than $50 an hour. Specifically, the cost of compliance for legal counsel is estimated to be from $19,600 to $39,550 in the first year, and $3,850 to $13,300 each year thereafter.[37] In addition, I estimate the marketing analysis required by the Proposed Rule to cost roughly $5,000 per year (10 hours of work X $500 per hour, which is what a marketing expert such as myself charges). This would include an analysis of a number of factors, which the FTC seems to believe would be simple and easy to collect, but which in fact require a certain level of expertise to accomplish. First, it would include an analysis of the "closest" 10 prior purchasers to the prospective purchaser. This is no trivial task, as retail locations can be analyzed in many different ways, and the "closest" purchasers may not necessarily be those closest geographically, but closest in other ways that make them more relevant (e.g., closest in terms of type of products sold, closest in terms of other competitors, closest in terms of target markets, etc.). The marketing analysis would also include help in forming the earnings claim statement. In particular, the "proposed Rule would require the disclosure of the number and percentage of all purchasers during the relevant time period who have achieved at least the claimed earnings."[38] This also may

[37] Affidavit of Andrea G. Ferrenz, Esq.
[38] Page 19072 of the Proposed Rule

require a detailed analysis, and verification of, the purchasers that earned this amount. In addition, the marketing analysis would need to consider whether or not a seller could use industry statistics. In particular, the Proposed Rule mentions that, "Accordingly, before a seller could use industry statistics, it must be able to measure the performance of existing purchasers and document that the industry statistics reflect the existing purchasers' typical performance."[39] This is also not a simple task, and would require a detailed analysis of how the performance of the current sellers of a business opportunity relate to general industry statistics.

Consequently, the costs of the Proposed Rule will be approximately $25,000 to $45,000 for the first year, and $10,000 to $20,000 per year thereafter, per business opportunity seller. That amount will exceed the total estimated earnings of a great many business opportunity sellers. Thus, complying with the Proposed Rule entails costs that are prohibitively expensive for most involved in this important sector of the US economy.

IV. Conclusion

My analysis of the Proposed Rule shows that it is unnecessary because fraud is actually quite rare in the business opportunity sector of the economy. In addition, the regulatory costs and burdens imposed exceed the ability to pay for a great majority, if not all, business opportunity sellers. The loss of millions of jobs and harm to the welfare of millions of Americans is the likely result.

[39] Page 19073 of the Proposed Rule

7-12-2006

Stephen M. Nowlis

Date

Exhibit A

Vita of Stephen M. Nowlis

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Home:
9298 E. Davenport Dr.
Scottsdale, AZ 85260
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Education

Ph.D. Business Administration (Marketing concentration), Haas School of Business, University of California at Berkeley, 1994

Thesis: Competitive Brand Strategies of High-Tier and Low-Tier Brands: A Consumer Choice Perspective

M.B.A. Haas School of Business, University of California at Berkeley, 1990

B.A. Economics, with Distinction, Stanford University, 1986

Academic employment

AT&T Distinguished Research Professor of Marketing, WP Carey School of Business, Arizona State University, Tempe, AZ, 2004-

Professor, WP Carey School of Business, Arizona State University, Tempe, AZ, 2003

Dean's Council Distinguished Scholar, WP Carey School of Business, Arizona State University, 2002-2004

Center for Services Leadership Distinguished Research Fellow, WP Carey School of Business, Arizona State University, Tempe, AZ, 2001-2002

Associate Professor, WP Carey School of Business, Arizona State University, Tempe, AZ, 2000-2003

Assistant Professor, WP Carey School of Business, Arizona State University, Tempe, AZ, 1996-2000

Assistant Professor, Washington State University, Pullman, WA, 1994-1996

Professional service

Associate Editor, *Journal of Consumer Research*, 2002-
Editorial Review Board, *Journal of Marketing*, 2005-
Editorial Review Board, *Journal of Consumer Research*, 2000-2001
Editorial Review Board, *Marketing Letters*, 2001-
Editorial Review Board, *Journal of Marketing Research*, 2001-

Ad-Hoc Reviewer, *Journal of Marketing, Marketing Science, Journal of Consumer Psychology, Management Science, Journal of Retailing, Current Anthropology, Nonprofit & Voluntary Sector Quarterly, Industrial and Corporate Change,* Reviewer for Association for Consumer Research conferences, American Marketing Association conferences, AMA John A. Howard Doctoral Dissertation Competition, Society for Consumer Psychology conferences. Program Committee, Association for Consumer Research conference, 2001 and 2003. Representative of the Society for Consumer Psychology at the main meeting of the American Psychological Association, 2001. Advisory Board for the MSI-JCP Research Competition on Product Assortment and Variety-Seeking in Consumer Choice, 2004.

Honors and Awards

Co-Chair of AMA doctoral consortium, 2007

Co-Chair of ACR doctoral symposium, 2006

Ferber Award Judge, 2005

Finalist for Paul Green Award, 2005

Outstanding Reviewer Award, *Journal of Consumer Research*, 2002.

Winner of the 2001 William F. O'Dell Award. Given for the article appearing in the *Journal of Marketing Research* in 1996 that has made the most significant long-term contribution to the marketing discipline in the five year period 1996-2001.

Finalist (top 4) for the 2002 William F. O'Dell Award. Given for the article appearing in the *Journal of Marketing Research* in 1997 that has made the most significant long-term contribution to the marketing discipline in the five year period 1997-2002.

Winner of the 2001 Early Career Contribution Award from the Society for Consumer Psychology – Sheth Foundation, Division 23, American Psychological Association. Given annually to the most productive researcher in the field of consumer behavior/marketing who has been a faculty member for less than ten years.

Winner of Best Theoretical Paper award (Stephen M. Nowlis and Deborah B. McCabe), "Online vs. Off-line Consumer Decision Making: The Effect of the Ability to Physically Inspect Merchandise," at 2nd INFORMS "Marketing Science and the Internet: Understanding Consumer Behavior on the Internet," conference, sponsored by Andersen Consulting and the Marshall School of Business, April 29 - 30, 2000. Prize paid $2500.

AMA Consortium faculty participant, 2003 and 2004

Association for Consumer Research Doctoral Symposium speaker, 2002 and 2004

Nominated by the Arizona State University Marketing Department and Finalist (top 4), College of Business Undergraduate Teaching Excellence Award, 1997-1998 and 1998-1999.

Voted Outstanding Graduate Student Instructor, Haas School of Business, University of California at Berkeley, 1992-1993

Winner of Delbert Duncan Award for Best Marketing MBA student, 1988-1990

Publications

Kahn, Barbara E., Mary Frances Luce, and Stephen M. Nowlis (2006), "Debiasing Insights from Process Tests," with Barbara Kahn and Mary France Luce, *Journal of Consumer Research,* forthcoming.

Nowlis, Stephen M. and Baba Shiv (2005), "The Influence of Consumer Distractions on the Effectiveness of Food Sampling Programs," *Journal of Marketing Research*, 42 (May), 157-168.

Shiv, Baba, Alexander Fedorikhin, and Stephen M. Nowlis (2005), "Interplay of the Heart and Mind in Decision Making," in *Inside Consumption: Frontiers of Research on Consumer Motives, Goals, and Desire*, ed. Ratti Ratneshwar and David Mick, forthcoming.

Nowlis, Stephen, Naomi Mandel, and Deborah Brown McCabe (2004), "The Effect of a Delay Between Choice and Consumption on Consumption Enjoyment," *Journal of Consumer Research*, 31 (December), 502-510.

Shiv, Baba and Stephen M. Nowlis (2004), "The Effect of Distractions while Tasting a Food Sample: The Interplay of Informational and Affective Components in Subsequent Choice," *Journal of Consumer Research*, 31 (December), 599-608.

Dhar, Ravi and Stephen M. Nowlis (2004), "To Buy or Not to Buy: Response Mode Effects on Consumer Choice," *Journal of Marketing Research*, 41 (November), 423-432.

Nowlis, Stephen M. and Deborah B. McCabe (2004), "The Effect of Examining Actual Products or Product Descriptions on Consumer Preference," *Journal of Consumer Psychology*, 13 (4), 431-439.

Nowlis, Stephen M., Barbara E. Kahn, and Ravi Dhar (2002), "Coping with Ambivalence: The Effect of Removing a Neutral Option on Consumer Attitude and Preference Judgments," *Journal of Consumer Research*, 29 (December), 319-334.

Lemon, Katherine and Stephen M. Nowlis (2002), "Developing Synergies Between Promotions and Brands in Different Price-Quality Tiers," 39 (May) *Journal of Marketing Research*, 171-185.

Itamar Simonson, Ziv Carmon, Ravi Dhar, Aimee Drolet, Stephen M. Nowlis (2001), "Consumer Research: In Search of Identity," *Annual Review of Psychology*, 52, 249-275.

Simonson, Itamar and Stephen M. Nowlis (2000), "The Role of Explanations and Need for Uniqueness in Consumer Decision Making: Unconventional Choices Based on Reasons," *Journal of Consumer Research*, 27 (June), 49-68.

Dhar, Ravi, Stephen M. Nowlis, and Steven J. Sherman (2000), "Trying Hard or Hardly Trying: Context Effects in Choice," *Journal of Consumer Psychology*, 9 (4), 189-200.

Nowlis, Stephen M. and Itamar Simonson (2000), "Sales Promotions and the Choice Context as Competing Influences on Consumer Decision Making," *Journal of Consumer Psychology*, 9 (1), 1-16.

Dhar, Ravi, Stephen M. Nowlis, and Steven J. Sherman (1999), "Comparison Effects On Preference Construction," *Journal of Consumer Research*, 26 (December), 293-306.

Ravi Dhar and Stephen M. Nowlis (1999), "The Effect of Time Pressure on Consumer Choice Deferral," *Journal of Consumer Research*, 25 (March), 369-384.

Nowlis, Stephen M. and Itamar Simonson (1997), "Attribute-Task Compatibility as a Determinant of Consumer Preference Reversals," *Journal of Marketing Research*, 34 (May), 205-218. This paper was a finalist for the 2002 O'Dell Award.

Nowlis, Stephen M. and Itamar Simonson (1996), "The Effect of New Product Features on Brand Choice," *Journal of Marketing Research*, 33 (February), 36-46. This paper won the 2001 O'Dell Award.

Nowlis, Stephen M. (1995), "The Effect of Time Pressure on the Choice Between Brands that Differ in Quality, Price, and Product Features," *Marketing Letters*, 6(4), 287-295.

Simonson, Itamar, Stephen M. Nowlis, and Katherine Lemon (1993), "The Effect of Local Consideration Sets on Global Choice Between Lower Price and Higher Quality," *Marketing Science*, 12 (4), 357-377

Simonson, Itamar, Stephen M. Nowlis, and Yael Simonson (1993), "The Effect of Irrelevant Preference Arguments on Consumer Choice," *Journal of Consumer Psychology*, 2 (3), 287-306.

Industry experience

Assistant Buyer, May Company Department Stores, Los Angeles, CA, 1986-1988
Expert Witness Consulting, 2001-

College service

Department

Doctoral Studies Coordinator, 2004-
Coordinator for Faculty Speaker Series, 2004-
Marketing Department Planning Committee member, 2004-
Faculty Recruiting Co-Chair, 2004-
Research Series coordinator, 2004-
Doctoral Studies Committee and Recruiting Sub-committee, 1996-2002
Faculty Recruiting Committee 2001-2002
Doctoral Exam Committee, 1998-2002
Personnel Committee, 1996-1997, 2003-2005
Performance Review Committee, 1996-1997 and 1998-1999
Curriculum Teams: Fundamentals, 1996-1999
Curriculum Teams: Retailing, Services, Promotion, 1996-1999
Curriculum Teams: Mkt502, 2000-2004, coordinator
Assessment response committee, ad-hoc, serving as co-chair,1999
E-learning and E-marketing team, 1998-2002
PhD program coordinator, 2004

College

College of Business (COB) Assessment Committee, 1998-1999.
EBusiness Task Force, 1999-2000. Meets to determine how to infuse ecommerce into the COB curriculum.
Search Committee for the Russell Chair, 2000-2002.
Co-chair of Search Committee for WP Carey Chair, 2003-2004.
Departmental naming committee, 2004.

Expert Witness Consulting

Critique of Alcohol Labelling Survey conducted by the Center for Science in the Public Interest
- Wine Institute, San Francisco, CA
- Expert report
- July 2001

Platypus Wear v. Bad Boy Entertainment
- Luce, Forward, Hamilton & Scripps, Los Angeles, CA
- Expert report
- October 2001

Marcia Spielholz v. Los Angeles Cellular Telephone Company
- Gibson, Dunn & Crutcher, Los Angeles, CA
- Expert report, deposition
- April 2002

California Consumers v. BMG Direct Marketing, Inc.
- Coblentz, Patch, Duffy & Bass, San Francisco, CA
- Deposition
- November 2002

UMG Recordings, Inc., et al. v. Sinnott
- Mitchell, Silberberg & Knupp, Los Angeles, CA
- Expert report, deposition
- November 2003

Kinetic Concepts, Inc. v. BlueSky Medical
- Rothschild, Barry & Myers, Chicago, IL
- Expert report, deposition
- April 2005

Arista Records, Inc., et al. v. Flea World, Inc., et al.
- Mitchell, Silberberg & Knupp, Los Angeles, CA
- Expert report, deposition
- September 2005

Federal Trade Commission v. Basic Reseach LLC et al.
-Emord & Associates, Washington, DC
-Expert report
-November 2005

Classic Foods v. Kettle Foods
-Ropers, Majeski, Kohn & Bentley, Los Angeles, CA
-Conducted survey
-Februrary 2006

EXHIBIT B

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

AFFIDAVIT OF ANDREA G. FERRENZ, ESQ. IN SUPPORT OF THE COMMENTS OF THE MULTI-LEVEL MARKETING INTERNATIONAL ASSOCIATION

I, Andrea G. Ferrenz, declare under penalty of perjury that the following is true and correct to the best of my knowledge, information, and belief:

1. I am a principal in the law firm Emord & Associates, P.C.

2. Since 1997, I have represented clients before the Federal Trade Commission.

3. My hourly rate is $350.00 per hour. All legal counseling estimates in this affidavit are for providing advice and analysis in writing.

4. I have analyzed the FTC's proposed Business Opportunity Rule, published in 71 Fed. Reg. 19054 (April 12, 2006).

5. The rule includes the following parts that require legal counsel for those in network marketing: proposed rule sections 16 C.F.R. §§ 437.1, 437.2, 437.3, 437.4, 437.5, 437.6, 437.7, 437.8, and 437.9.

6. To comprehend the requirements of the Business Opportunity Rule, clients must understand the requirements of 15 U.S.C. §§ 41-58, interpretations of those actions in applicable precedent, nonpublic investigation procedures, FTC's civil investigative demand procedure, FTC's consent orders, FTC's hearing procedures, and federal judicial procedures and standards in the review of FTC actions pursuant to 15 U.S.C. §§ 41-58. The estimated time for researching those issues and briefing a client would be 4-6 hours of attorney time.

7. In order to facilitate compliance with section 437.1, clients would require legal counsel to advise them on all of the definitions contained within that section, and what those

definitions mean when applied to them in their individual business context. That assessment is estimated to require 1 hour of attorney time.

8. Section 437.1 contains multi-part components that would require extensive and detailed explanations, such as all of the elements enumerated in the "Business Assistance" (437.1(c)), "Business Opportunity" (437.1(d)), "Earnings Claim" (437.1(h)), and "Prior Business" (437.1(m)) provisions. The estimated time for providing legal counsel on section 437.1 is 1 hour.

9. To comprehend the requirements of section 437.2, clients would need legal counsel to advise them on the necessity of furnishing purchasers with the disclosure statement described in section 437.3 prior to the purchaser signing any contract in connection with the business opportunity sale, or prior to the purchaser making a payment or providing consideration to the client, whether directly or indirectly. The estimated time for providing legal counsel concerning this section 437.2 is 1 hour.*

10. To comprehend the requirements of section 437.3, clients would need legal counsel to assist them in compiling listed information and completing the disclosure document. This process would require counsel to assist the client in:

    a. Obtaining current identifying information for the business opportunity seller;
    b. Understanding what constitutes express and implied earnings claims and the need for substantiation in support of such claims;
    c. Determining whether the seller, any of the seller's affiliates, prior businesses, officers, directors, sales managers, or employed individuals have been the subject of any civil or criminal action for misrepresentation, fraud, securities law violations, or unfair or deceptive practices within the 10 years immediately preceding the date that the business opportunity is being offered.
    d. Advising the seller on the decision of whether to offer cancellation or refund requests;
        i. If the seller chooses to offer cancellation or refund requests, reviewing and reporting all cancellation or refund requests made to the seller in previous business sale opportunities for two years prior to the date of the current disclosure document;
    e. Gathering references that include the name, city, state, and telephone number of all purchasers who purchased the business opportunity within the last three years.
    f. Advising the seller on the different disclosure standards that apply to references depending on the number of sales made and the geographical distribution of purchasers.
    g. Obtaining and reviewing documentation required in support of the disclosures made and assisting with the review and amending of disclosures to keep business opportunity purchasers apprised of all material changes on a quarterly basis;
    h. Advising the seller that if their purchaser list is less than 10 individuals total, the seller is required to make disclosure updates on a monthly basis.

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* This is a legal fee that will recur for each client every year into the future.

11. The estimated time for providing legal counsel concerning section 437.3 is 15 to 30 hours, depending on client's record-keeping practices and client's decision of whether to make an earnings claim and whether to offer cancellation and refund requests.*

12. The estimated time for providing legal counsel including reviewing records created during the prior period concerning the quarterly or monthly disclosure statements required by section 437.3(a)(7)(b) is 1-3 hours.*

13. In order to facilitate compliance with section 437.4(a)(1)-(3), clients would require legal counsel to advise them on the following components, which must be disclosed in conjunction with making an earnings claim:

    a. The requirement of a reasonable basis for the earnings claim at the time that it is made;
    b. Written substantiation that supports the earnings claim at the time that it is made;
    c. The requirement to provide the written substantiation materials upon request to the prospective purchaser or the Commission;
    d. The extent and quality of the written substantiation required to satisfy the Commission's standards;
    e. The requirement of providing the prospective purchaser with an earnings claim statement containing all of the elements enumerated in section 437.4(a)(4).

14. The estimated time for providing legal counsel concerning section 437.4(a)(1)-(3) is 5-10 hours.

15. Section 437.4(a)(4) also mandates that the earnings claim statement must contain specific information. Clients would require legal counsel to work with one or more experts in marketing and economics to assess the material characteristics of purchasers and the extent to which prospective purchasers have characteristics that differ and the significance of such differences. The following would have to be researched and assessed by legal counsel:

    a. Substantiated earnings figures;
    b. The beginning and ending dates for the represented earnings;
    c. The number and percentage of all purchasers in the time period that attained the earnings figure;
    d. Material characteristics of the earning purchasers listed that may differ from the prospective purchasers; and
    e. Substantiation materials available upon request.

16. The estimated time for providing legal counsel concerning section 437.4(a)(4) is 10-35 hours.*

* This is a legal fee that will recur for each client every year into the future.

17. Counsel would also have to research and explain to their clients the additional limitations contained in section 437.4(b)-(c), which include the following:

    a. Restrictions on making earnings claims in the general media;
    b. Restrictions on disseminating industry financial earnings or performance information; and
    c. Penalties for failure to notify all prospective purchasers in writing of any material changes affecting the relevance or reliability of the information contained in the earnings claim statement prior to the formation of the sales contract.

18. The estimated time frame for providing legal counsel in regard to section 437.4(b)-(c) is 2-6 hours.

19. To comprehend the requirements of section 437.5, clients would require legal counsel to research and explain the details of the prohibited practices contained in the provision and the penalties for violation of the FTC Act. Counsel would specifically have to research and explain the following:
    a. The prohibitions against prospective purchaser disclaimers or waivers of reliance on any statement made in accordance with the proposed rule;
    b. The prohibitions against making any claim or representation that is inconsistent or contradictory with the information required to be disclosed in other provisions of the proposed rule;
    c. The prohibition on the inclusion of extraneous materials in the disclosure statement;
    d. The prohibition on misrepresenting amount of sales, income, or profits that can be potentially earned or that have been earned by purchasers in the past;
    e. The prohibition on misrepresenting that sellers cannot furnish information to prospective purchasers on the basis of restrictions made by governmental entities, laws, or regulations;
    f. Penalties for failure to provide purchasers or Commission with substantiation materials;
    g. Prohibition on misrepresenting commissions, bonuses, incentives, premiums, or other payments by seller to purchaser;
    h. Prohibition on misrepresenting the cost, performance, efficacy, nature, or central characteristics of a business opportunity;
    i. Prohibition on misrepresenting any material aspect of seller assistance;
    j. Prohibition on misrepresenting the likelihood that a seller, locator, or lead generator will find locations, outlets, accounts, or customers for the purchaser;
    k. Prohibition on misrepresenting the details of the seller's cancellation or refund policies;
    l. Penalties for failing to provide cancellation or refunds;
    m. Prohibition on misrepresenting a business opportunity as an employment opportunity;
    n. Prohibition on misrepresenting the terms of any territorial exclusivity or protection offered to a prospective purchaser;
    o. Prohibition on assignment of overlapping sales territories;

p. Prohibition on misrepresenting that any person, intellectual property holder, or governmental entity benefits from the sale of the product;
q. Prohibition on misrepresenting information about direct sales.

20. The estimated time frame for providing legal counsel in regard to section 437.5 is 10-15 hours.

21. To comprehend the requirements of section 437.6, clients would require legal counsel to research and advise them on the rule's record retention provisions, including the detailed explanation of the need to maintain the following records for a period of three years, and the necessity of making them available for inspection by the Commission upon request:

    a. Each materially different version of the documents required by the proposed rule;
    b. Each executed written contract with individual purchasers;
    c. Each oral or written cancellation or refund request received; and
    d. All substantiation upon which the seller relies for each earnings claim at the time of making the claim.

22. The estimated time for providing legal counsel concerning section 437.6 is 2 hours.

23. Clients would require legal counsel to research and explain their obligations under section 437.7, and differentiate them from the obligations required under the Franchise Rule. The estimated time for providing legal counsel concerning section 437.7 will ultimately vary depending on whether the client qualifies for certain provisions of the Franchise Rule, but the preliminary explanation will take approximately 2 hours.

24. Clients would require legal counsel to research and explain the provisions of section 437.8 for the purposes of understanding preemption standards and the petition process. The estimated time for providing legal counsel concerning section 437.8 is 1 hour.

25. **The Total Estimated Hours for Legal Counsel concerning the proposed rule are: 56-113 hours in the first year of counsel and 11-38 hours each year thereafter.**

26. **The Total Estimated Legal Expenses applying my $350/hr rate are: $ 19,600.00 – 39,550.00 in the first year and $ 3,850.00-13,300.00 each year thereafter.**

SIGNED

DATE: 7/10/2006

EXHIBIT C

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

AFFIDAVIT OF STEVEN WALLACH IN SUPPORT OF THE COMMENTS OF THE MULTI-LEVEL MARKETING INTERNATIONAL ASSOCIATION

I, Stephan Wallach, 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 General Manager of Youngevity, a multi level/network marketing company.

2. I have occupied my position as the General Manager of Youngevity for 9 years.

3. I have been involved in network marketing as both a distributor and company executive for over 15 years.

4. In the span of my career in network marketing, I have established relationships with numerous friends and colleagues in the multi level marketing industry.

5. The income derived from network marketing is typically a supplementary income and not the primary income for distributors.

6. If costs of rule compliance exceed $1,000 per year, they would be unaffordable for nearly all of the distributors who sell business opportunities for my company.

7. In vast majority of the cases, the income derived from network marketing operations goes to pay for basic living needs, such as medical care, groceries, childcare, and transportation costs.

8. Most of the people that benefit from business opportunity sales and network marketing lack college educations, work in the retail, fast food, or other middle- or low-paying job sectors.

9. Most of the people involved in network marketing and business opportunity sales work from home.

10. Most of the people involved in network marketing remain distributors for a number of years, and while they may switch parent companies if they become dissatisfied with a product, they do not typically leave network marketing.

11. Business opportunity sales and network marketing are 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.

12. I have read and analyzed the FTC's proposed Business Opportunity Rule, published in 71 Fed. Reg. 19054 (April 12, 2006).

13. 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.

14. 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.

15. Knowledge of a competitor's distributors' information, even in part, is a competitive advantage for recruitment and other purposes.

16. A point of interest is that MLM is simply a distribution method as a way of getting products to consumers. If MLM becomes obsolete due to these proposed additional regulations, Direct Marketing will increase eliminating yet another opportunity for the entry level Entrepreneurs further protecting larger companies. This is contrary to the free enterprise principle our great country was founded upon.

17. It is common for MLM companies to offer money back guarantees. For example if anyone would like a refund of either the ten dollar Youngevity membership fee or request a product refund with in 30 days of purchase, we offer a 100% money back guarantee.

SIGNED: ____________________

DATED: 7/13/2006

EXHIBIT D

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

AFFIDAVIT OF GEORGE B. KERFORD, PH.D. IN SUPPORT OF THE COMMENTS OF THE MULTI-LEVEL MARKETING INTERNATIONAL ASSOCIATION

I, George B. Kerford, representing the Board of Directors of the World Association of Persons with Disabilities, 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 Chairman-Emeritus and Chief Operating Officer of the World Association of Persons with Disabilities ("WAPD").

2. WAPD is a non-profit, nonpartisan organization dedicated to promoting financial independence and self-sufficiency for people with disabilities (approximately 56 million people in North America alone).

3. Approximately 20% of people living in the United States have some form of a physical or psychological disability.

4. WAPD advances the interests of persons with disabilities at national, state, local and home levels.

5. WAPD provides information, motivation, assistance, and advocacy for the physically and mentally disabled people of the world.

6. WAPD works with networking marketing companies to encourage them to provide people with disabilities opportunities to become independent distributors, operating from their homes. Many of these opportunities involve jobs that involve multi-level marketing and work-at-home opportunities, which enable people with disabilities to be financially independent.

7. Approximately 10 % of all people with disabilities are severely disabled and cannot function in a typical work environment.

8. WAPD works with disabled people to help them find employment opportunities where they can work from home by using the phone and the computer for network marketing.

9. We have found network marketing an indispensable means to bring people with disabilities income for basic needs and vital social interaction. Without network marketing, they would need to depend on welfare and public assistance and would be largely isolated from the outside world.

10. WAPD has launched a new initiative in the form of the "Prosperity Team" that helps individuals to find gainful employment opportunities in network marketing.

11. WAPD maintains connection with top multi-level marketing companies who offer opportunities for people with disabilities

12. WAPD provides assistance and counsel in helping people with disabilities select the network marketing niches that fit their lifestyle and abilities. This assistance includes providing literature and website assistance for all disabled individuals interested in achieving financial independence.

13. Many caregivers and parents seek help for their disabled adult children to become financially independent through business opportunity enterprises.

14. Income derived from business opportunity sales provides them with an opportunity for economic self-sufficiency because of the flexibility of the arrangement and the ability to work from home.

15. To date, WAPD has helped many people with disabilities and able-bodied people to join multi-level marketing and network marketing companies.

16. I have read and analyzed the FTC's proposed Business Opportunity Rule, published in 71 Fed. Reg. 19054 (April 12, 2006).

17. For most of the people with disabilities who have home-based network marketing businesses, approximately 80 % of those depend upon business opportunity sales to pay for their basic needs such as medical care; groceries; dental care; rent and mortgages; and transportation costs.

18. If costs of rule compliance exceed $ 5,000 per year, most of the disabled persons who depend upon business opportunity sales would be forced out of that business and would in almost every instance not be able to find substitute income. Nearly all would lose their independence, self-esteem, and many social contacts, and would be forced to depend entirely on welfare and public assistance to survive.

19. Having reviewed the proposed Business Opportunity Rule, I am convinced that the required legal fees and expert marketing fees required to attempt to comply with it will exceed the financial wherewithal of every person with a disability who is now engaged in network marketing.

20. I estimate that if the proposed Business Opportunity Rule is adopted, the vast majority, if not all, of people with disabilities will leave network marketing, will lose income required to satisfy basic needs, and will be forced to go on welfare and public assistance to pay costs now covered by income from network marketing. An intangible, yet equally severe consequence of the loss of this business opportunity for our members will be greater isolation from the rest of the world and attendant psychological hardships resulting therefrom.

SIGNED:

DATED: 13 July 2006

EXHIBIT E

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

AFFIDAVIT OF MARCIE COOK IN SUPPORT OF THE COMMENTS OF THE MULTI-LEVEL MARKETING INTERNATIONAL ASSOCIATION

I, Marcie Cook, 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 Treasurer of the Distributor Rights Association ("DRA").
2. I have occupied my position as Treasurer of DRA for the last 2½ years.
3. For the last 14 years, I have worked in the network marketing industry building field distributorships and organizing, supporting, operating, and administrating companies.
4. The typical earnings of the distributors working in multi-level marketing are approximately $ 500.00 per month.
5. This income is typically a supplementary income and not the primary income for these distributors.
6. If costs of rule compliance exceed $10,000 per year, they would be unaffordable for nearly all of the distributors who sell business opportunities in network marketing.
7. In vast majority of the cases, the income derived from network marketing operations goes to pay for basic living needs, such as medical care, groceries, childcare, and transportation costs.
8. Most of the people that benefit from business opportunity sales and network marketing lack college educations, work in the retail, fast food, or other low-paying job sectors.

9. Business opportunity sales and network marketing are 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. Approximate # 10% of network and multi level marketing distributors are shut-ins or people with disabilities. For them, the opportunity to participate in network marketing or business opportunity sales is vital for social interaction, self-esteem and mental health.

11. I have read and analyzed the FTC's proposed Business Opportunity Rule, published in 71 Fed. Reg. 19054 (April 12, 2006).

12. 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.

13. 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.

14. Knowledge of a competitor's distributors' information, even in part, is a competitive advantage for recruitment and other purposes.

SIGNED: Treas ___

DATED: 7-13-06