

Supporting Statement
Proposed Amended Trade Regulation Rule on Business Opportunities
16 C.F.R. Part 437
(OMB Control No. 3084-NEW)

1. Necessity for Collecting the Information

Since 1978, the Federal Trade Commission (“FTC” or “Commission”) has enforced the Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures (“Franchise Rule”), 16 C.F.R. Part 436 (OMB Control No. 3084-0107). The rulemaking record revealed evidence of widespread deceptive and unfair practices in the sale of franchises and business opportunities. To correct these problems, the Franchise Rule required franchisor and business opportunity sellers to furnish a disclosure document to prospective investors prior to sale. Additional disclosures were required if a seller made earnings representations.

The Commission amended the Franchise Rule on January 23, 2007, separating it into two parts, 16 C.F.R. Parts 436 and 437. Part 436 is the amended Franchise Rule, which covers the sale of business format franchises. Part 437 covers the sale of non-franchise business opportunities (the interim Business Opportunity Rule). The disclosure requirements in Part 437 are essentially identical to those in the original Franchise Rule. Part 437 continues to cover the sale of non-franchise business opportunities, pending completion of the Business Opportunity rulemaking begun on April 12, 2006. The initially proposed Business Opportunity Rule (“IPBOR”) would have expanded the coverage of business opportunity promoters then covered by the original Franchise Rule), such as vending machines and rack display opportunities, to include work-at-home and multilevel marketing programs.

Voluminous comments on the 2006 Business Opportunity proposal led the Commission to issue a Revised Notice of Proposed Rulemaking (“RNPR”). The RNPR noted that although business opportunity fraud is widespread, resulting in significant injury to consumers each year, given the rulemaking record and considering burden on industry members, the Commission determined not to include multi-level marketing companies. Instead, the Commission proposed a revised Business Opportunity Rule (“RPBOR”) expanding coverage only to work-at-home business opportunity promoters.

The RPBOR would require business opportunity sellers to disclose information to prospective buyers and to maintain certain records. The expanded coverage of the RPBOR, however, would be offset by more limited disclosure requirements, which would reduce compliance costs.

The RPBOR would require business opportunity sellers to give prospective buyers four material disclosures in a basic disclosure document. Each required disclosure was intended to help prospective buyers make informed investment decisions. Specifically, sellers would, first, disclose whether or not they make earnings claims. If so, sellers must include the claim in a separate earnings claims statement attached to the basic disclosure document. Second, sellers must disclose prior civil or criminal litigation involving misrepresentation, fraud, securities law

violations, or unfair or deceptive business practices. Third, sellers must disclose their cancellation or refund policy. Fourth, sellers must provide contact information for at least 10 of their purchasers nearest to the prospective purchaser's location.

The RPBOR would require sellers: (1) to furnish disclosures at least seven days before any sale, and (2) to use disclosure documents that comply with the form and content set forth in the RPBOR. The RPBOR would not regulate the substantive terms of the buyer/seller relationship. Nor would the proposal require the registration or filing of disclosure documents with the Commission in connection with the sale of business opportunities. The RPBOR would, however, require sellers to keep for a period of three years copies of: (1) each materially different version of documents required by RPBOR; (2) each purchaser's disclosure receipt and contract; and (3) substantiation for any earnings claims.

2. Use of the Information

Prospective business opportunity buyers use the disclosures both to become better informed about the prospective investment and to verify the seller's representations. The RPBOR's disclosure document must include:

- (1) Identifying information about the business opportunity seller;
- (2) Whether the seller makes any earnings claims and, if so, substantiation for such claims;
- (3) The litigation history of the seller, its directors, and key executives, involving misrepresentation, fraud, securities law violations, and unfair or deceptive business practices;
- (4) Any cancellation or refund policy the seller offers; and
- (5) Contact information for at least 10 purchasers nearest to the prospective purchaser.

Because future earnings are at the heart of any business opportunity purchase, the RPBOR would require sellers to provide further information about any earnings claims. This information is to enable the buyer to assess the accuracy or reliability of such claims. For example, a seller might represent that the buyer could expect annual sales of \$50,000. Without some context, such a claim may mislead the prospective buyer. To allow the prospective purchaser to independently judge the reliability of the claim, the RPBOR would require the seller to: (1) provide the number and percentage of sellers whose performance equaled or exceeded the claim; and (2) save and offer to show prospective purchasers the basis for the claim. Such disclosures also would discourage unrealistic earnings claims, since the seller knows that the purchaser can determine whether an earnings claim is credible by examining the background material. The RPBOR would also require that any background material must be available to the Commission in a compliance investigation.

3. Consideration of Using Improved Information Technology to Reduce Burden

Consistent with the aims of the Government Paperwork Elimination Act, Pub. L. 105-277, Title XVII, 112 Stat. 2681-749, 44 U.S.C. § 3504 note, the RPBOR permits business opportunity sellers great latitude in using new technologies, in particular the Internet, to reduce compliance costs. Business opportunity sellers would be able to reduce significantly printing and distribution costs through the expanded use of email and the Internet to furnish disclosure documents. The RPBOR would also permit the use of electronic signatures and electronic recordkeeping.

4. Efforts to Identify Duplication/Availability of Similar Information

Approximately twenty two states have some kind of business opportunity sales regulations. These state regulations, however, are not uniform, varying widely both in their coverage and in the disclosure requirements. Accordingly, coordination with states to reduce duplication efforts would be difficult. The Commission intends to keep the disclosure obligations arising from the RPBOR to a minimum. In most instances, business opportunity sellers complying with the RPBOR would be able to furnish a single-page disclosure document, with appropriate attachments. Indeed, the additional disclosures required by the earnings claims provisions are only necessary if sellers elect to make earnings information available to purchasers. Moreover, the single-page disclosure document could be provided as a cover page to any additional disclosures required by state law, thus reducing compliance burdens.

Similarly, the RPBOR would reduce duplication by enabling business opportunity sellers to comply with the RPBOR by using existing materials. For example, rather than repeating its cancellation or refund policy in the disclosure document, a seller could simply check a box indicating that it offers a cancellation or refund policy and then attach to the disclosure document a brochure or other document that already sets forth the required information.

5. Efforts to Minimize Burden on Small Businesses

Unlike business opportunity regulations in many states, the RPBOR – like the interim Business Opportunity Rule – does not require a seller to register or file disclosure documents with the government as a prerequisite to a sale. Thus, compliance with the RPBOR does not invoke the fees usually associated with registering or filing disclosure documents, a consideration that might be especially important to small businesses.

In addition, the RPBOR is intended to limit burden on small businesses by keeping required disclosures to a minimum, permitting sellers to reference existing materials, and permitting electronic disclosure. Further, in lieu of extensive disclosures, common in some state business opportunity regulations, the RPBOR would prohibit misrepresentations that have arisen frequently in business opportunity sales. Thus, the RPBOR would prohibit sellers from misrepresenting: (1) costs and the quality or nature of goods or services offered for sale; (2) assistance provided; (3) the nature of any exclusive territories; and (4) any third-party

endorsements, among others.

6. Consequences of Conducting Collection Less Frequently

Any reduction in compliance is not an appropriate alternative to the RPBOR. The purpose of the RPBOR is to ensure that all prospective business opportunity purchasers receive valuable pre-sale information about proposed investments.

7. Circumstances Requiring Collections Inconsistent with Guidelines

The collection of information in this RPBOR is consistent with all applicable guidelines contained in 5 C.F.R. § 1320.5(d)(2).

8. Consultation with Outside Sources

The Commission has had a long history of seeking outside input regarding the Franchise Rule and the Business Opportunity Rule. In 1995, the Commission conducted a review of the Franchise Rule as part of its program to review periodically all Commission trade regulation rules and guides, and published in the Federal Register a Notice for Comment on the Rule. See 60 Fed Reg. 17,656 (April 7, 1995). Among other things, the Commission sought comment on: (1) the continuing need for the Rule; (2) the costs and benefits of the Rule; and (3) what changes, if any, should be made to the Rule to reduce the burdens and costs imposed on the firms subjected to its requirements. In addition, the Commission sought comment on whether the Franchise Rule's disclosures are appropriate for business opportunity sellers, whether there should be a separate business opportunity trade regulation rule and, if so, the scope of coverage. In response, the Commission received numerous comments from franchisors, franchisees, business opportunity sellers, state regulators, trade associations, law firms, and academicians. The Commission also held two public workshop conferences on the Rule, in which 56 individuals participated in round table discussions on the Rule or otherwise made statements for the record. All of the comments and the transcripts of the public workshop conferences were placed on the public record.

Subsequently, the Commission published an Advance Notice of Proposed Rulemaking ("ANPR") in the Federal Register, announcing its intention to consider amending the Franchise Rule. See 62 Fed. Reg. 9,115 (February 28, 1997). In the ANPR, the Commission summarized the Rule Review record on the continuing need for the Franchise Rule. At the same time, the Commission proposed promulgating a separate business opportunity rule. The commenters overwhelmingly expressed support for promulgating a separate business opportunity rule.

Through the ANPR, the Commission also sought comment on a number of issues on the scope of a separate business opportunity rule, including: (1) the proper scope of any business opportunity sales rule; (2) how to define the term “business opportunity”; and (3) the types of disclosures that are warranted for business opportunity sales.

In response to the ANPR, the Commission received 167 comments in writing, through e-mail, and through a telephone message line. In addition, the Commission has held six public workshop conferences throughout the United States, three of which focused exclusively on business opportunity sales issues. Sixty-four individuals participated in the workshops, including franchisees and franchisee representatives, franchisors, business opportunity sellers and representatives, state franchise and business opportunity regulators, and computer consultants. The workshop conferences generated transcripts totaling 1,548 pages. As with the responses to the Rule Review, commenters continued to express wide support for separating the disclosure requirements for franchisors and for business opportunity sellers through the promulgation of a separate business opportunity rule.

As noted above, the Commission issued an NPR on the Business Opportunity Rule that published on April 12, 2006. In response to the NPR, the Commission received over 17,000 comments. The comments primarily came from members of the multi-level marketing industry arguing that the IPBOR would provide few protections for consumers considering joining an MLM while imposing heavy burdens upon legitimate industry. In addition, the Commission received comments from trade associations, consumer advocates, other companies, and the Department of Justice. Although many commenters voiced criticism for the scope of the IPBOR, they largely supported the goal of protecting consumers from fraudulent schemes.

The RPBOR is narrowly tailored to address fraud by business opportunity sellers. The RPBOR would not broadly sweep in MLMs or certain other sellers that were inadvertently included in the Rule and further simplifies sellers’ disclosure obligations.¹

9. Payment or Gift to Respondents

Not applicable.

10. Assurances of Confidentiality

No assurance of confidentiality is necessary, because the RPBOR would not require business opportunity sellers to register or file any documents with the Commission. To the extent that information covered by a recordkeeping requirement is collected by the Commission for law enforcement purposes, the confidentiality provisions of Sections 6(f) and 21 of the FTC Act, 15 U.S.C. §§ 46(f), 57b-2, will apply.

¹ If the Commission ultimately amends the interim Business Opportunity Rule, FTC staff will seek all necessary PRA clearances and/or adjustments.

11. Sensitive or Private Information

Under the provisions in the RPBOR, a business opportunity seller would have to disclose certain purchaser's names, business addresses and telephone numbers. This information lets prospective purchasers conduct their own due diligence investigation of the business opportunity seller's claims; in particular, earnings claims. No other information about individual purchasers must be disclosed. For example, sellers who choose to make an earnings claim based upon the earnings history of current purchasers need not identify in the disclosure document the individual purchasers whose information formed the basis of the earnings claim, or the earnings of any individual purchaser.

Further, to ensure that purchasers understand that their contact information may be disclosed, the RPBOR would require sellers to include in the disclosure document the following privacy statement: "If you buy a business opportunity from the seller, your contact information can be disclosed in the future to other buyers." Armed with such information, a purchaser concerned about the release of their contact information may elect not to make the purchase.

12. Hours Burden: 14,000 hours, rounded to the nearest thousand

The currently approved estimates for disclosure and recordkeeping burden under the Franchise Rule includes 16,750 hours under Part 437 for business opportunity sellers. That was based on an estimated 2,500 non-exempt business opportunity sellers.²

Based on a review of trade publications and information from state regulatory authorities, the Commission staff now estimates that there are approximately 3,050 business opportunity sellers, comprised of some 2,500 vending machine, rack display, and related opportunity sellers and 550 work-at-home opportunity sellers that would be covered by the RPBOR.

For the 2,500 vending machine, rack display, and related opportunity sellers currently covered by the interim Business Opportunity Rule (and, previously, the original Franchise Rule), the RPBOR would reduce required disclosures from 20 categories of information to five (seller-identifying information, earnings claims, lawsuits, refund policy, and references). For the 550 business opportunity sellers currently exempted from the interim Business Opportunity Rule (and, previously, the original Franchise Rule), the disclosures, as noted below, are streamlined to minimize compliance costs.

1. Reduced Mandatory Disclosures

The RPBOR contains five required disclosures: seller-identifying information, earnings

² See 71 Fed. Reg. 19,054, 19,081 (April 12, 2006); 70 Fed Reg. 51,818, 51,819 (August 31, 2005). As discussed further in item #15, the hour total reflected strictly year one totals, not an annualizing projected over a 3-year PRA clearance period.

claims, lawsuits, refund policy, and references. The seller must tell the prospective buyer whether or not it is making any earnings claims; of course, whether it makes such claims is up to the seller. The disclosures of references and earnings claims largely follow existing requirements, but the disclosures about lawsuits would be streamlined.

The interim Business Opportunity Rule (and, previously, the original Franchise Rule) requires an extensive list of suits that must be disclosed including those involving allegations of fraud, unfair or deceptive business practices, embezzlement, fraudulent conversion, misappropriation of property, and restraint of trade. Franchise sellers also must disclose suits filed against them involving the franchise relationship. 16 C.F.R. at § 436.1(a)(4). In contrast, the RPBOR's lawsuit disclosure requirements are limited to suits for misrepresentation, fraud, securities law violations, and unfair or deceptive business practices.

2. Incorporation of existing materials

The RPBOR would also reduce collection and dissemination costs by permitting sellers to reference in their disclosure documents materials already in their possession. For example, a seller need not repeat its refund policy in the text of the disclosure document, but may incorporate its contract or brochures, or other materials that already provide the necessary details.

3. Use of electronic dissemination of information

The RPBOR redefines the term "written" to include electronic media. Accordingly, all business opportunities covered by the RPBOR would be permitted to use the Internet and other electronic media to furnish disclosure documents. Allowing this distribution method could greatly reduce sellers' compliance costs over the long run, especially costs associated with printing and distributing disclosure documents. As a result of this proposal, the Commission expects sellers' compliance costs will decrease substantially over time.

4. Use of computerized data collection technology

Finally, because of advances in computerized data collection technology, the Commission staff anticipates that the costs of collecting information and recordkeeping requirements imposed by the RPBOR will be minimal. For example, a seller can maintain a spreadsheet of its purchasers, which can be sorted by location. This would enable a seller to comply easily with the proposed reference list requirement (at least 10 prior purchasers in the last three years who are located nearest the prospective purchaser, or, if there are not 10, then all prior purchasers). In the alternative, the RPBOR would permit a seller to maintain a national list of purchasers. Such a list could be posted on the seller's website, for example.

As a result of these proposals, the Commission staff estimates that the 3,050 business opportunity sellers will require between three and five hours each to develop a Rule-compliant disclosure document. On the higher end, the staff estimates that for existing businesses that have

not previously been covered by the interim Business Opportunity Rule but will be covered by the RPBOR, such as work-at-home schemes, the time required for making a new disclosure document is approximately 5 hours. These businesses have experience that they will be required to disclose, including litigation histories, lists of prior purchasers, and earnings experience of prior purchasers (if they choose to make earnings claims). On the other hand, businesses that have been covered by the interim Business Opportunity Rule (and, previously, the original Franchise Rule) will already have a disclosure document that will solely need updating to meet the requirements of the RPBOR. The staff estimates that these 2,500 businesses will likely need only 3 hours to prepare the disclosure statement and perform necessary updating. Therefore, the hours required to develop a disclosure document in the first year would be 10,250 ((550 x 5 hours) + (2,500 x 3 hours)). In addition, these entities likely will require between one and two hours per year to file and store records, for a total of 6,100 hours (3,050 x 2 hours).

Staff estimates that in subsequent years, sellers will require no more than approximately two hours each to update the disclosure document (6,100 hours) and between one and two hours to file and store records (6,100 hours). Thus, the average cumulative burden for a period of three years is 14,000 hours [(10,250 hours + 6,100 hours) + 2(6,100 hours + 6,100) ÷ 3], rounded to the nearest thousand.

Labor Costs: Labor costs are determined by applying applicable wage rates to associated burden hours. Staff assumes that an attorney likely would prepare or update the disclosure document at an estimated hourly rate of \$250. FTC staff estimates that the total number of hours initially to comply with the Rule would be 16,350, at a total cost of \$4,087,500 (16,350 x \$250). FTC staff expects that the annual burden will diminish after the first year, however, to approximately 12,200 hours (3,050 sellers x 4 hours for recordkeeping and disclosure) or fewer, for a total average of annual legal costs of \$3,050,000 (12,200 hours x \$250), or less. Thus, the average cost for a period of three years is \$3,396,000 rounded to the nearest thousand [(\$4,087,500) + (\$3,050,000 x 2) ÷ 3]. Should disclosure or recordkeeping obligations be performed by clerical staff, the total labor costs would be significantly less.

13. Estimated Capital and Other Non-Labor Costs: \$3,050,000

Business opportunity sellers must also incur costs to print and distribute the single-page disclosure document, plus any attachments. These costs vary based upon the length of the attachments and the number of copies produced to meet the expected demand. Staff estimates that 3,050 business opportunity sellers will print and mail approximately 1,000 disclosure documents per year at a cost of \$1.00 per document, for a total cost of \$3,050,000. This is a conservative estimate because staff anticipates that these costs will be reduced by many business opportunity sellers electing to furnish disclosures electronically, such as via email or the Internet.

14. Estimate of Cost to Federal Government

Staff estimates that the annualized cost to the Commission (per year over the 3-year clearance renewal being sought) to administer and enforce the Rule will be approximately \$250,000. This estimate includes attorney, clerical, and other support staff costs.

15. Changes in Burden

FTC staff estimates that the annual burden for the RPBOR will approximate 14,000 hours, which is a decline from its prior estimate of 16,750 hours for business opportunity ventures under the interim Business Opportunity Rule (and the original Franchise Rule). The prior subtotal, though based on a lower population estimate of business opportunity sellers (2,500 versus the 3,050 now estimated), overstated hours because it did not reflect annualized hours projected over the three-year PRA clearance sought; rather, it strictly accounted for the relatively higher burden hours of the initial year of clearance.

16. Statistical Use of Information

There are no plans to publish any information for statistical use.

17. Failure to Display of the Expiration Date for OMB Approval

Not applicable.

18. Exceptions to the Certification for Paperwork Reduction Act Submissions

Not applicable.