*Guiding You Through the Legal Maze.*SM

THE FTC IS BUZZING – DON'T GET STUNG

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THE PAST

Based on the nature of the complaints filed with the Federal Trade Commission from 1993 to 2000 contained in a report published by the FTC's Bureau of Consumer Protection entitled "Franchise and Business Opportunity Program Review 1993-2000[1]", the FTC will continue to pay increasing attention to business opportunity sellers. Here's why:

1. During period from 1993 to 2000, the FTC recorded 4,512 complaints, 3,392 complaints (75%) involved 949 business opportunity sellers. Vending machine schemes accounted for more than 12% of the claims.

2. More than 92% of the complaints involved claims of less than $20,000.

3. There has been a steady increase of complaints over time.

4. The most common complaint about goods was non-delivery, cited in more than 10% of the cases.

5. Another 10% involved earnings claims and another 5% related to lack of support or promised locations.

6. Nearly 25% of the complainants indicated they wanted to cancel a purchase. Another 20% identified a refund policy issue or the inability to obtain a requested refund.

7. The FTC brought 273 investigations of business opportunity seller, of which 148 cases were filed.

8.

9. The most significant reason for FTC action was unsubstantiated earnings claims. This included earnings claims made without providing an earnings claim disclosure document; unsubstantiated earnings claims and/or earnings claims made in the general media without the Rule's required disclosures.

10. Failure to disclose was the second most cited reason for action.

11. Business opportunity investigations comprised 82% of the FTC investigations. In all instances where a business opportunity remaining in business generated 18 or more complaints, the FTC Staff opened an investigation. Where there were 5 to 17 complaints, the FTC Staff opened investigations against 33% to 50% of the companies provided they were still in business. The FTC Staff also opened 68 business opportunity investigations where only a single complaint was filed.

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[1] The entire 61-page Report may be obtained at http://www.ftc.gov/bcp/menufran.htm.

Each year the FTC conducted major joint law enforcement projects with state and other federal agencies including sting operations: 1994 - Trade Show Sweeps; 1995 - Project Telesweep; 1996 - Operation Missed Fortune; 1997 - Project Trade Name Games; 1998 – Project Vend Up Broker; and 1999 – Project Biz-illions$.

<u>THE PRESENT</u>

On June 20, 2002, the FTC announced that the FTC, the Department of Justice and 17 state law enforcement agencies launched a law enforcement sting operation and consumer education campaign targeting business opportunity seller who use deceptive earnings claims and "shills" to violate federal and state law called "Operation Busted Opportunity." At least 77 business opportunity sellers have been stung. At least 3 individuals have had criminal charges brought against them.

The regulatory authorities are using undercover investigators and special computer tools to identify business opportunity investments that made earnings claims without the cautionary language required by the FTC Franchise Rule. The investigators also posed as prospective purchasers to determine if disclosures are properly and timely given and to listed to salespersons' sales pitches to determine compliance with the law. In addition, the list of references were checked out to determine if the references actually owned and operated the business and derived the income the represented they earned. Actions have been filed against several "shills."

On June 25, 2002, J. Howard Beales, III, Director of the FTC's Bureau of Consumer Protection testified before a Congressional panel and stated: "Based upon the Commission's two decades of experience in enforcing the Franchise Rule, it is clear to us that deceptive business opportunity sales, rather than … franchise sales, remains a persistent cause of significant injury to American consumers." Mr. Beales presented the details of the 1993-2000 Report discussed above and concluded: "The Commission will continue to dedicate significant law enforcement resources to targeting business opportunity fraud."

<u>HOW NOT TO GET STUNG</u>

For those business opportunity sellers who are not "scam artists" and are trying to sell a real product or service to prospective purchases to enable them to get into business for themselves, the following action needs to be taken to avoid being caught up the a future federal and/or state sting operation.

1. **<u>Hire a Biz Op Attorney</u>.** I have seen many business opportunity sellers who are oblivious to the fact that they are subject to federal/and or state disclosure and registration laws and have no FTC Disclosure Statement or state business opportunity disclosure document. Not having a properly prepared disclosure document is a "slam dunk" for regulators and knowledgeable attorneys representing unhappy purchasers. It also creates personal liability for the principals of the business opportunity seller both civilly and criminally. I have also witnessed business opportunity sellers who prepare their own disclosure document, usually plagiarizing a competitor's documents without really understanding if a FTC Disclosure Statement is required and what states require registration. In addition, the purchase order or other contract does not fully protect them.

2. **<u>Use a Disclosure Document and Register</u>.** There are 25 states that require all business opportunity sellers to use some form of disclosure document. Most of these states require that the business opportunity seller register and be approved before the seller can advertise, offer or sell the opportunity in the state or to residents of the state. In addition, sellers of vending machines, display racks coin operated devices and similar products, who provide any sort of site location assistance including providing the name of locating companies to purchasers or listing suitable locations in brochures, are subject to the FTC Franchise Rule. These business opportunity sellers are required to use a FTC Disclosure Statement that includes 20 items of required disclosure including a 3-year phase-in of audited financial statements and the names, addresses and telephone numbers of purchasers While there is no registration with the FTC or other federal agency, the FTC Disclosure Document must be used for all sales with the US and its territories including the non-registration states. The prospective purchaser must have the FTC Disclosure Statement for at least 10- business Days before the seller can accept any money or have the purchase sign the purchase order or other contract.

3. **<u>Comply with the Earnings Claims Rules</u>**. Business opportunity sellers are not required to make earnings claims but if they do there are special rules that must be strictly followed. The sellers who most get into trouble are usually those who violate the earnings claims rules. These include: (i) making an earnings claim orally (such a a salesperson's claim) and not in writing in a separate Earnings Claim Disclosure Document; (ii) making an earnings claims that cannot be substantiated (*e.g.,* "make $100,000 in your spare time" when no purchaser is achieving this number); (ii) use of a multiplication table; (iv) violating the special rules on media claims. The best course of action is to either not make an earnings claim either orally or in writing or retain an accountant and attorney to assist in preparing an earnings claim based on actual historical numbers that can be substantiated or based on a financial forecast or projection prepared in accordance with AICPA Standards and the FTC Franchise Rule and applicable state law.

4. **<u>Sell a Viable Product or Service</u>**. Make sure the product or service you offer makes economic sense for the purchasers and not just a profit for you. While you can't guarantee success and will not bat 1.000, those purchasers who diligent work the business should be able to make money. Company owned and operated units of the seller can demonstrate the product's or service's viability and can assist in the preparation of a true earnings claim.

5. **<u>Honor Your Promises</u>**. Make sure you honor all of your promises contained in your purchase order, contract or other materials. Delivery any goods and equipment within the promised delivery time assuming no circumstances beyond your control. Failure to do so may result in breach on contract, breach of warranty or other claims by the purchaser including filing a complaint with the FTC, the state, the Better Business Bureau, etc.

6. **<u>Don't Use Singers or Shills</u>.** This should be a no-brainer. The best advice I give prospective purchasers is to contact as many existing purchasers as possible and see how well they are doing. The FTC is doing this as well.

Remember - the FTC and others are watching you!

Keith J. Kanouse, Esq.