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**FTC'S BUSINESS OPPORTUNITY RULE -**  
**REDUCED DISCLOSURE BUT INCREASED COVERAGE**

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## **FTC'S BUSINESS OPPORTUNITY RULE - REDUCED DISCLOSURE BUT INCREASED COVERAGE**

Effective March 1, 2012, the FTC's new Business Opportunity Rule<sup>1</sup> became effective (the "New Biz Op Rule"). The New Biz Op Rule significantly reduces a business opportunity seller's disclosure obligation to a prospective purchaser, as the previous format (the FTC Disclosure Statement containing 20 items of required information) has been changed and reduced to a 1-page form requiring 5 items of information the seller is required to disclose. However, the New Biz Op Rule applies to more companies as, not only business opportunity sellers currently covered by the Interim Biz Op Rule will be subject to the New Biz Op Rule, but also work-at-home programs such as jewelry assembly and envelop stuffing will meet the expanded definition of a business opportunity. While the New Biz op Rule is silent on the subject, this author believes that the New Biz Op Rule does not apply to sales made outside of the United States or its Territories.

### **A. Companies Subject to the New Biz Op Rule**

The definition of a "business opportunity" under the New Biz Op Rule involves a commercial arrangement that has the following 3 required elements:

1. The seller must solicit a prospective purchaser to enter into a new business (one in which the prospective purchaser is not currently engaged or a new line or type of business).

2. The purchaser must make a "required payment," that is, all consideration paid by the purchaser to the seller or an affiliate as a condition to obtaining or commencing the operation of the business opportunity except for payments for the purchase of a reasonable amount of inventory at bona fide wholesale prices for resale or lease.

3. The seller must represent that the seller or a designated person (such as a locator or lead generating company) will provide any of 3 types of assistance: (i) providing locations for the purchaser's use or operation of equipment, displays, vending machines, or similar devices that the Purchaser controls; (ii) providing outlets, accounts or customers to the purchaser; or (iii) buying back any of the goods or services that the purchaser makes, including providing payment for such services such as stuffing elements from home or jewelry assembly.

The New Biz Op Rule continues to apply to those types of business opportunities covered by the Interim Biz Op Rule including vending machines, rack displays such as greeting cards, payphones and Internet kiosks. However, the definition of a business opportunity has been expanded to include work-at-home schemes and has eliminated the definitional element of the "payment of \$500 or more on or before the first 6 months of operations" that was a required element of a "business opportunity venture" under the Interim Biz Op Rule. The New Biz Op Rule exempts franchisors covered by the FTC Franchise Rule. The New Biz Op Rule exempts multi-level marketing ("MLM") arrangements.

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<sup>1</sup> See FTC Press Release 11/22/2011 <http://www.ftc.gov/opa/2011/busopp.shtm>; 12 C.F.R Part 437

## **B. FTC Biz Op Disclosure Document**

The New Biz Op Rule requires the business opportunity seller to provide to a prospective purchaser a 1-page written disclosure document containing 5 items of information (the “FTC Biz Op Disclosure Document”) at least 7 calendar days (instead of the previous 10 business days) before a prospective purchaser may sign any documents or pay any money to the seller. The form of FTC Biz Op Disclosure Document produced by the FTC is included at the end of this article<sup>2</sup>. The FTC Biz Op Disclosure Document must include:

1. **Information Regarding Seller.** The seller’s identifying information including its name, business address, telephone number, the name of the salesperson offering the business opportunity and the date when the FTC Biz Op Disclosure Document is furnished to the purchaser.

2. **Earnings Claim.** The seller must disclose whether it makes an earning claim. The seller is not obligated to make an earning claim and can check the “no” box. However, if the seller does make an earnings claim, the seller must check the “yes” box and provide the purchaser with a separate earnings claim statement titled ‘EARNINGS CLAIM STATEMENT REQUIRED BY LAW’ setting forth:

- (i) the name of the person making the claim;
- (ii) the date of the claim;
- (iii) the actual earnings claim;
- (iv) the beginning and ending dates during which the represented earnings were achieved;
- (v) the number and percentage of purchasers who achieved the represented level of earnings;
- (vi) any characteristics that distinguish purchasers who have achieved the represented level of earnings from those characteristics of the prospective purchasers; and
- (vii) other substantiating information.

The seller must have a reasonable basis for the claim at the time the earnings claim is made. The seller can make an earnings claim in the general media. A seller can use industry information only if the seller is able to measure the performance of existing purchasers and documents those the existing purchasers’ typical performance equals or exceeds the average performance of other business opportunities available in the industry. The use of a chart, table or mathematical calculation that demonstrates possible results based on a combination of variables constitutes an earnings claim.

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<sup>2</sup> Appendix A to 12 C.F.R. Part 437 (English version) and Appendix B to 12 C.F.R. Part 437 (Spanish version)

3. **Legal Actions.** The seller must disclose whether the seller, its affiliates (including a parent or subsidiary) or key personnel (including in a prior business) have been involved in any civil or criminal “legal action” against the seller or its representatives (any sales manager, or individual who occupies a position or performs a function similar to an officer, director or sales manager of the seller) within the past 10 years that “involve fraud, misrepresentation, securities law violations, or deceptive or unfair practices including violation of any FTC rule.” This includes matters in arbitration or governmental actions. It does not include a bankruptcy filing. If there is any such legal action, the seller must include a separate page setting forth the full caption of each action and may choose to include a brief (not to exceed 100 words) description of the action.

4. **Cancellations or Refunds.** The seller must disclose its cancellation or refund policies, if any. The New Biz Op Rule does not give a purchaser a post-sale right to rescind. If the seller does not have a cancellation or refund policy, it will mark the “no” box. If the seller has a cancellation or refund policy, it will mark the “yes” box and attach a separate page describing the material terms of the seller’s cancellation or refund policy. This includes the period of time the purchaser has to cancel a purchase or request a refund; the specific steps necessary to cancel a purchase or request a refund; any fees or penalties incurred for cancellation; and where unused inventory must be returned to and by what method.

5. **List of Purchasers.** The seller must include a list of the 10 purchasers of the business opportunity closest to the prospective purchaser’s home, or in the alternative, a list of all purchasers during the last 3 years. The list must include only the prior purchasers’ name, state (not address) and telephone number.

The seller does not file the FTC Biz Op Disclosure Document with the FTC and the FTC does not approve it but the seller has the burden of proving compliance with the New Biz Op Rule. As discussed further below, the New Biz Op Rule does not preempt (eliminate) state business opportunities laws. A seller cannot include disclosures required by state law in the FTC Biz Op Disclosure Document. If a seller is subject to both the New Biz Op Rule and a state’s business opportunity law, it must prepare and provide the purchaser with both disclosure documents. The seller is required to attach a duplicate copy of the FTC Biz Op Disclosure Document and any attachments, which is to be signed and dated by the Purchaser. The seller can send the FTC Biz Op Disclosure Document to the Purchaser electronically and an electronic or digital signature of the purchaser is allowed. A new requirement provides that, if the seller conducts sales of its business opportunities in languages other than in English, the FTC Biz Op Disclosure Document must be in the same language.

### **C. Updating the FTC Biz Op Disclosure Document**

The FTC Biz Op Disclosure Document must be updated quarterly (January 1, April 1, July 1 and October 1) except if the seller has fewer than 10 purchasers, the seller must update the list of purchasers monthly until the seller has at least 10 purchasers. If there has been a material change in an earnings claim given to a prospective purchaser before the purchase, the seller must disclose the material change to the prospective purchaser before the purchase.

### **D. Prohibitions**

The Seller is subject to the following prohibitions:

1. Disclaiming or requiring a prospective purchaser to waive reliance on, any statement made in any document including the disclosure document or attachment that is required or permitted to be disclosed by the New Biz Op Rule.
2. Making any representation, whether orally, visually or in writing, that is consistent with or that contradicts any statement in the disclosure document, earning claim disclosure statement or other attachment.
3. Including any extraneous materials in the disclosure document.
4. Making a false earnings claim.
5. Stating that any law or regulation prohibits the Seller from making an earnings claim or disclosing the list of purchasers.
6. Failing to provide written substantiation of the earnings claim upon the Purchaser's or the FTC's request.
7. Misrepresenting how or when commissions, bonuses, incentives, premiums or other payments or other payments from the Seller to the Purchaser will be calculated or distributed.
8. Misrepresenting costs, performance, efficacy or material characteristics of the business opportunity.
9. Misrepresenting Seller's post-sale assistance to the Purchaser.
10. Misrepresenting locations, outlets, accounts or customers.
11. Misrepresenting the Seller's cancellation or refund policy.
12. Failing to provide a refund or cancellation when a refund or cancellation right is given.
13. Misrepresenting the business opportunity as an employment opportunity.
14. Misrepresenting the exclusivity of territories.
15. Assigning a purported exclusive territory to another purchaser.
16. Misrepresenting third party endorsements or other affiliation.
17. Misrepresenting references including using skills or singers.
18. Failing to disclose any consideration paid to a reference or prior purchaser or the personal relationship with a reference or a prior purchaser.

**E. Record Retention**

The Seller and its principals must retain the following 5 types of records for at least 3 years:

1. Each materially different disclosure document and attachments.
2. Each purchaser's disclosure receipt.
3. Each signed written contract with the purchaser.
4. Each oral or written cancellation or refund request received from a purchaser.
5. All substantiation upon which the seller relies from the time the earnings claim is made.

**F. Penalties for Failure to Comply**

A person's failure to comply with the New Biz Op Rule will constitute a violation of Section 5 of the FTC Act, thereby entitling the FTC to bring an action. While there is no private right of action for violation of the New Biz Op Rule, a failure to comply with the New Biz Op rule may also violate a state's unfair and deceptive practices law and give rise to a private right of action by the purchaser. This may entitle the Purchaser to various remedies, which may include rescission of the transaction and a suit for damages, including court costs and attorneys' fees.

**G. State Business Opportunity Laws**

The New Biz Op Rule does not preempt (replace) state business opportunity laws, except to the extent of any conflict with the New Biz Op Rule. Currently, 25 states regulate business opportunities (the "Biz Op States")<sup>3</sup>. Since these state business opportunity laws afford equal or greater protection and require more extensive disclosure than required by the New Biz Op Rule, the seller must comply with state business opportunity laws. A state's business opportunity law may apply if the seller advertises in a Biz Op State, the purchaser is a resident of the Biz Op State or the business opportunity is to be operated in a Biz Op State. The Biz Op States have dollar investment amount thresholds from \$200 to \$500 that may enable sellers to avoid their application in the dollar threshold is not satisfied.

In addition, the definition of a business opportunity may be more extensive than the definition under the New Biz Op Rule. Several different types of business opportunities are covered by state laws including:

1. sellers of vending machines, racks, display cases, and currency operated amusement machines that provide locations or location assistance;
2. sellers that buy back the items that the buyer produces, grows, fabricates, or assembles;
3. sellers that guarantee in writing that the buyer will derive income;
4. sellers that provide the buyer with a sales or marketing program; and

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<sup>3</sup> Alaska, California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia and Washington.

5. sellers that represent to the buyer the existence of a market for the goods or services.

These laws generally require, among other things, the preparation of a disclosure document to be given to a prospective buyer for presale review between 48 hours to 10 business days before the purchaser can sign any contract with the seller or give the seller any money. Most of these states also require the registration and approval of the business opportunity offering by a state regulatory body.

The Biz Op Rule does not require the seller to disclose its financial condition (or to have a minimum net worth requirement). The Biz Op States may require such disclosure. Some Biz Op States require all business opportunity sellers to post a security bond. Some Biz Op States prohibit the seller from taking the entire purchase price before the items are delivered to the purchaser. California, Michigan, and South Carolina require that the seller appoint a person or company located in that state, other than a governmental official, to act as a registered agent to receive service of process. Certain Biz Op States require either salespeople to register or the seller to provide a list of salespeople. A number of Biz Op States require that all advertising materials directed toward prospective purchasers, including advertisements intended to appear in publications located in that state, be filed with the state as part of the registration process. Certain Biz Op States require sellers to provide a post-sale right to cancel. Most Biz Op States require the seller's contract to provide that the items being purchased as part of the business opportunity must be delivered within a specified time (*e.g.*, 45 days). Otherwise, the purchaser has a right to cancel the contract.

As a result, sellers of business opportunities that operate in the Biz Op States will need 2 types of disclosure statements: (1) the FTC Biz Op Disclosure Document, and (2) a state-specific disclosure document. Sellers operating in multiple states may need even more forms of state-specific disclosure documents.

## **H. Conclusion**

Companies that sell products or services to persons to enable the person to start a business should consult their counsel to see if their business arrangement now meets the 3 elements of a business opportunity.

*Keith J. Kanouse, Esq.*