FEDERAL TRADE COMMISSION
Project No. R511993

COMMENT
of
PRIMERICA FINANCIAL SERVICES, INC.
on the
NOTICE OF PROPOSED RULEMAKING
on the
BUSINESS OPPORTUNITY RULE
R511993

FILED SEPTEMBER 29, 2006

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I. INTRODUCTION AND SUMMARY OF REBUTTAL COMMENT

The overwhelming majority of comments submitted in response to the Commission's Proposed Business Opportunity Rule evidences three critical points: (1) the rulemaking record contains no evidence supporting such a broad rule that will undeniably sweep in a huge number of legitimate companies and individuals, (2) the Proposed Rule would have a devastating impact on the viability of these legitimate business and the individuals who support their families through participating in them, impacting the American economy by an estimated $57.6 billion per year and reducing competition and consumer choice in numerous market sectors, and (3) the costs of the Proposed Rule (both economically and in terms of the loss of privacy) are dramatically greater than estimated in the Notice of Proposed Rulemaking ("NPRM") and will greatly outweigh any possible benefit. The Proposed Rule will cut off the American dream of entrepreneurial opportunities for millions of Americans, many of whom participate in direct selling because it is more accessible to them than traditional employment.

In its original comment in response to the Proposed Rule, Primerica offered several alternatives for modifying the Proposed Rule to ameliorate its overbreadth and limit its harmful impact on legitimate businesses. Many other companies and trade associations have proposed such modifications to the Rule. Many of these proposals have merit, but they are merely tinkering with a proposal that needs a major overhaul. Back-end fixes cannot correct a rule that is so fundamentally unrelated to the unlawful conduct it purports to address without creating a rule that creates exemptions or exclusions for the vast majority of what it purports to cover.

The Commission should return to the premise that the Rule should be designed to combat fraud and tailor the Rule accordingly.[1] It should issue a new proposed rule narrowly tailored to address fraud. Further comment can then identify any problems that remain, as well as the additional procedures – whether hearings or workshops – that are necessary.

The current Proposed Rule will make either workshops or hearings unmanageable. Either approach will inevitably focus on the numerous defects of the current proposal in the many circumstances in which it was never intended to apply. Neither will elicit what this proceeding now needs – a new starting point, one that excludes legitimate business, and can become the basis for a productive process to help the Commission fashion a useful tool to combat fraud. Comment and either hearings or workshops could then identify any legitimate businesses that inadvertently remain subject to the Rule, and can explore the practicality of the remedies the Commission chooses to propose. For these reasons, Primerica suggests that the Commission publish a new Proposed Rule aimed squarely – and solely – at fraudulent conduct, and use that refined proposal as the basis for further rulemaking proceedings.

[1] *See* Comment of Chamber of Commerce of the United States, No. 522418-07418, at 2.

II. THE RECORD REVEALS THAT THERE IS NO BASIS FOR COVERING THE WIDE RANGE OF LEGITIMATE COMPANIES THE PROPOSED RULE REACHES

The clear message of the numerous comments submitted in this proceeding is that the Rule and its effects will cover large parts of the American economy. Far beyond fraudulent work-at-home schemes and "business opportunities" such as vending machines and other frauds, the Proposed Rule will reach the entirety of the American direct selling industry, regulating 13.6 million individuals working as representatives for thousands of companies.[2] The Rule would also reach traditional product distribution relationships,[3] educational opportunities, and even the sale of financial "self help" books.[4] The Proposed Rule would regulate numerous industries, from insurance and financial services to cosmetics,[5] plumbing materials,[6] newspapers,[7] petroleum products,[8] baked goods,[9] kitchenware,[10] and other consumer products. The Proposed Rule's broad sweep is the inevitable result of the incredibly broad language used to define a "business opportunity."

A. There Is No Evidence of Widespread Fraud in the Direct Selling Industry.

The record evidences the fundamental disconnect between the extremely broad scope of the Proposed Rule and the Commission's relatively modest goals. The NPRM contained no indication of fraud in the direct selling or the other legitimate industries that the Proposed Rule would cover, and the comments have not filled that gap – *there is still no evidence* that such a broad rule is necessary. Of the more than 17,000 comments submitted in response to the NPRM, only a handful (just over 1%) supported the Rule. Given the size of the direct selling industry in the United States (involving over 13

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[2] Comment of the Direct Selling Association ("DSA Comment"), No. 522418-12055, at 8.

[3] Comment of Sonnenschein Nath & Rosenthal LLP, No. 522418-12035; Comment of The Timberland Co., No. 522418-70031; Comment of Cosmetic, Toiletry and Fragrance Ass'n, No. 522418-70012, at 4; Comment of Larkin Hoffman Daly & Lindgren Ltd., No. 522418-70009.

[4] Comment of Chadbourne & Parke LLP, No. 522418-11898; Comment of Venable LLP, No. 522418-11909.

[5] Comment of Avon Products, Inc., No. 522418-70001; Comment of Mary Kay Inc., No. 522418-11952; Comment of Cosmetic, Toiletry and Fragrance Ass'n, No. 522418-70012.

[6] Comment of Plumbing Manufacturers Institute, No. 522418-11868.

[7] Comment of Newspaper Ass'n of America, No. 522418-70035.

[8] Comment of Amsoil, Inc., No. 522418-08265.

[9] Comment of Independent Bakers Ass'n, No. 522418-11945.

[10] Comment of the Pampered Chef, Ltd., No. 522418-11906.

million Americans), the number of commenters expressing problems with legitimate companies is truly miniscule.

Rather than identifying problems, the vast majority of the comments are from representatives of various direct selling companies, who overwhelmingly supported the opportunities in which they were participating, emphasizing the benefits of those opportunities. For example, Primerica agents ranging from relatively new recruits[11] to individuals who have been associated with the company for decades[12] submitted comments, corroborating the fact that Primerica offers a personally rewarding opportunity to its agents. The Primerica agents also reported that deceptive tactics to recruit would be counterproductive. Because Primerica does not pay agents for recruiting, and persons recruited under false pretenses will simply leave the company, deceptive practices will generate no sales to customers, and no commissions for the recruiting agent.[13] Primerica's Office of General Counsel carefully reviews its company-created recruiting materials to ensure that no misrepresentations are made to potential recruits, and would take disciplinary action if it discovered that an agent was doing so. Further, the lack of any payment for recruiting removes any incentive for individual agents to make such misrepresentations. There is no basis for regulating Primerica, or any company with a similar structure.

Many distributors for other direct selling companies also submitted comments to the Proposed Rule, either individually or through distributors' organizations.[14] As with Primerica agents, these comments overwhelmingly support the business opportunity in which the individual participates. Moreover, these comments consistently report that up-front costs are very small, and subject to refund policies that allow a prospective participant to recover virtually all up-front costs if the opportunity is not right for them.[15] Compared to this avalanche of comments supporting various direct selling companies, almost no comments complained of any fraud in those companies' recruiting processes. Even companies that at least some commenters complained about received vastly more favorable comments from satisfied distributors. Moreover, some comments allege problems that the Proposed Rule – overbroad as it is – simply would not address.[16] The

[11] Comment of Mike Lacombe, No. 522418-12761.

[12] *E.g.,* Comment of Robert Buisson, No. 522418-11978; Comment of Harold Crafter, No. 522418-11550.

[13] Comment of Andy Young, No. 522418-08879; Comment of Dan Defeo, No. 522418-11793.

[14] *See, e.g.*, Comment of MLM Distributor Rights Ass'n, No. 522418-70055; Comment of IBOA International, No. 522418-11922.

[15] *See also* DSA Comment at 41 (discussing refund policy required by DSA Code of Ethics).

[16] Indeed, one theme repeated in several comments is the perceived unfairness of distributors in certain direct selling companies profiting from the sale of "tools" such as motivational tapes or printed material. *See* Comments 522418-04681, 522418-05860, 522418-06851. The Proposed Rule would do nothing to address the sale of "tools" within direct selling companies' sales forces.

absence of any significant number of complaints belies any conclusion that any fraud or deception in the direct selling industry is common enough to warrant a new rule.

B. The Comments Submitted Provide Further Evidence of the Positive Impact of Primerica and Other Direct Selling Companies.

The comments also validate the positive impact that Primerica has had in the lives of its agents. Primerica representatives reported that their income and the flexible work schedule inherent in an independent small business have allowed them to provide for their families.[17] Such stories illustrate the multiple dimensions of direct selling opportunities. Average income is not the sole determinant of a valuable opportunity – flexibility and the ability to enter an otherwise inaccessible industry like financial services[18] are also key attributes.[19] The comments also illustrate the critical role of direct selling agents in making products available to American consumers. For example, Primerica sells insurance and financial services to middle-income Americans who are not served by traditional insurance and financial services companies.[20] Nothing in the rulemaking record suggests the need for a regulation covering such businesses, particularly where they are already heavily regulated by the U.S. Securities and Exchange Commission ("SEC"), the National Association of Securities Dealers ("NASD"), and state insurance and securities regulators.

Comments describing other direct selling companies highlight the fact that such opportunities are especially important to women,[21] people with disabilities,[22] seniors,[23] and African-Americans.[24] For these groups and many others, easy entry and exit, the flexibility of work hours, and the opportunity to work from home all combine to make direct selling particularly attractive. These comments sound a warning that the effects of the Proposed Rule will fall disproportionately on segments of the American population who are least able to withstand them.

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[17] *E.g.,* Comment of Bob Martufi, No. 522418-12638.

[18] Comment of Jimmy Meyer, No. 522418-11825; Comment of Robert Buisson, No. 522418-11978; Comment of John Roig, No. 522418-11443.

[19] DSA Comment at 11.

[20] Comment of Robert Buisson, No. 522418-11978; Comment of John Sanders, No. 522418-12214.

[21] *See* Comment of Avon Products, Inc., No. 522418-70001; Comment of Mary Kay Inc., No. 522418-11952, at 3; Comment of Professor Lawrence Chonko, No. 522418-07555, at 2; Comment of Shaklee Corp., No. 522418-70017, at 4.

[22] Comment of World Association of Persons with Disabilities, No. 522418-70033; Comment of Multi-Level Marketing Int'l Ass'n, No. 522418-70007, at 95 (Affidavit of George Kerford).

[23] *See, e.g.,* Comment of Coni Dutka, No. 522418-02259; Comment of Marlene Robertson, No. 522418-03535; Comment of Gerry White, No. 522418-03814; Comment of Marlene Dreifke, No. 522418-09941.

[24] Comment of National Black Chamber of Commerce, No. 522418-11921; Comment of Dudley Products, Inc., No. 522418-11830.

C. The Arguments Advanced in the Few Comments Supporting the Rule Do Not Justify Regulation of Legitimate Companies Like Primerica.

Almost all of the substantive commentary supporting the Proposed Rule came from two affiliated organizations that submitted several comments each.[25] These comments have a single-minded focus on pyramid schemes. They are unconcerned with fraudulent work-at-home schemes, vending machine route scams, and the other specific frauds targeted in the NPRM. Instead, they allege that many direct selling companies are really illegal pyramids. To reach this conclusion, these commenters string together a series of unfounded assertions and "data" that is both unrepresentative and unreliable. The commenters then opine, again without supporting evidence or even logic, that this pattern of fraud is hidden from view not because the alleged victims do not report it, but rather because they *cannot recognize it*. According to one of these commenters, it is "extremely rare for MLM victims to recognize the fraud in an MLM program without intensive de-programming by a knowledgeable consumer advocate."[26]

Importantly, even these commenters do not appear to support the Commission's proposed remedies. They make little or no effort to support litigation or references disclosures or the waiting period. Instead, they advocate very specific and plainly unworkable earnings disclosure schemes, whether or not there is an earnings claim even under the Proposed Rule's broad concept of a claim. In effect, these commenters are not supporting the NPRM, but instead, support a rule that bears little resemblance to what the Commission proposed.

Primerica endorses Commission efforts to pursue enforcement actions against pyramid schemes. Its comment suggested that setting forth a reasonable definition of pyramid schemes was one sensible way to narrow the Proposed Rule. If the Commission wishes to address pyramid schemes through rulemaking, it should fashion a definition of such schemes, and narrow the Rule to businesses falling within that definition. Neither the comments nor the NPRM, however, provide any basis for imposing a sweeping, burdensome rule on legitimate businesses in the hope that pyramid schemes will reveal themselves. Certainly, the disclosures the Commission has proposed will not accomplish that task.

The comments supporting anti-pyramid provisions assert that pyramid schemes are widespread, and present themselves in the "disguise" of direct selling companies. Their evidence for this assertion is completely unreliable. One "study," for example, relies on a survey of selected tax preparers about their clients' incomes. Aside from the fact that such a sample necessarily excludes those who prepare their own taxes, even the

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[25] Comments of Jon Taylor (Nos. 522418-70056, 522418-10266, 522418-12585, 522418-12748, 522418-12684, 522418-12262, 522418-10058, 522418-10051, 522418-09731); Robert Fitzpatrick (Nos. 522418-70036, 522418-06786, 522418-70056, 522418-06415, 522418-70047, 522418-70037, 522418-09379); and Bruce Craig (No. 522418-12306).

[26] Comment 522418-12585 at 11.

comment admits it is unethical for the tax preparers to disclose this information.[27] Another "study" is a quarter century old analysis of the tax returns of distributors for a single company in a single state – a company that the Commission determined was *not* a pyramid.[28] Moreover, these commenters allege losses based in part on counting as *costs* what the record makes plain is a *benefit* for many participants – the ability to purchase for personal consumption products they like at a significant discount.[29] Other comments offer better evidence that flatly contradicts these claims. One comment, for example, reports an independent survey that finds an "average" distributor earns $418 per month, an above average distributor earns $2,523 per month, and a top distributor earns $12,217 per month.[30]

It is one thing to say that many participants in direct selling do not make very much money. That point is not in dispute, and in fact is freely discussed in the comments of many direct selling companies. The reality is that many participants work part-time, some do so only seasonally in certain businesses, and others participate for a short time and then decide that the opportunity is not a fit for them. Low incomes do not reflect fraud, they reflect the reality that most people who work part-time or sporadically will not earn much money.

It is another thing to assert that almost all participants lose money. The facts in the record provide no basis for deducting assumed "costs" from the available income estimates and jump to the conclusion that participants actually *lose money.* For Primerica's business, there is no basis for such an assumption. As discussed in Primerica's principal comment, new agents pay a $199 fee that is used solely to pay for insurance pre-licensing training and the cost of insurance licensing tests required by state insurance departments. After receiving an insurance license, the new agent can then sell Primerica's insurance products in any jurisdiction in which she is licensed to do so. Most entry-level agents do not work full-time, and are not required to maintain an office nor incur any other expense to continue in the business.[31] There is no "inventory" to buy, because life insurance policies are issued to individual insureds, and cannot be stockpiled

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[27] Taylor Comment, No. 522418-12684, at 3.

[28] Taylor Comment, No. 522418-12585 at 5.

[29] Taylor Comment, No. 522418-12748 at 1.

[30] Coughlan and Grayson, Network Marketing Organizations: Compensation Plans, Retail Network Growth, and Profitability, *15 International Journal of Research in Marketing* 401 (1998), cited in Multi-Level Marketing International Association Comment, 155081-013, Appendix A at 13.

[31] Agents who decide to work full-time at the level of Regional Vice President and above are required to maintain an office at their own expense, but their payments for office space and other related items are made to third parties unaffiliated with Primerica, such as lessors of office space. By the time that an agent has reached the level of sales and income necessary to become a Regional Vice President, he or she will have all the information to determine whether the likely income from the Primerica business justifies making a full-time commitment and incurring the expenses of maintaining an office. Most importantly, the costs associated with being a Regional Vice President are not paid to Primerica or anyone within its sales force, but to wholly unaffiliated third parties.

in an agent's garage. Nor can a Primerica agent buy multiple insurance policies for herself – participants in the business are obviously not the primary "consumers" of insurance policies or the other financial products that Primerica offers.

Under such circumstances, the Primerica agent is free to sell as many or few insurance policies (and other products as well, assuming the appropriate licenses), without any outlay of money. It is simply not possible that agents are required to pay more money to Primerica than they receive in commissions, because there is no requirement that they buy anything from Primerica. Other direct selling companies also allow distributors to place consumer orders directly with the company after those orders have been received.[32] In any direct selling company with a similar structure, the assumption that inventory purchases from the company reduce income simply evaporates, providing no justification for applying the Proposed Rule.

The handful of comments critical of direct selling also assert that many direct selling companies exist solely by virtue of "internal consumption" (sales of products to participants in the business), and are therefore illegal pyramids. This commentary simply ignores the fact that some direct selling businesses have many participants who regard the opportunity as a "buyers club," allowing them to obtain products for personal consumption at a discounted price.[33] The Commission staff itself has recognized the legitimacy of this organizational form.[34] The fact that buyers clubs exist does not convert legitimate direct sellers into illegal pyramids.

Any reasonable definition of illegal pyramids needs to recognize that buyers clubs exist, and are perfectly legitimate. It would be a grave error to assume that internal consumption evidences a pyramid across the board and therefore regulate all businesses with significant internal sales.[35] The real issue is consumption, not the consumer's organizational affiliation. For example, in Primerica's case, a life insurance policy offers real value to a real insured consumer, even if the consumer is also a Primerica agent. There is no record evidence to support the contention that internal-consumption based

[32] *See, e.g.,* Comment of Avon Products, Inc., No. 522418-70001, at 4; Comment of Mary Kay Inc., No. 522418-11952, at 3.

[33] *See, e.g.,* Comment of Shannon Harris, No. 522418-12112; Comment of Roberta Crowell, No. 522418-00672; Comment of Ruth Kutz, No. 522418-01458.

[34] Letter from James A. Kohm, Acting Director of Marketing Practices, Fed. Trade Comm'n to Neil H. Offen, President, Direct Selling Ass'n, at 1 (Jan. 14, 2004) (noting that in a buyers club "the purchase of goods and services is not merely incidental to the right to participate in a money-making venture, but rather the very reason participants join the program.").

[35] As a practical matter, it may be difficult or impossible for some types of legitimate direct selling companies to track information about whether products are ultimately consumed by distributors or by unaffiliated members of the public; Primerica has the advantage of knowing the identities of its customers by virtue of the nature of the products it offers, but consumer goods may be much more difficult to track. This difficulty may militate against including a measure of internal consumption in any definition of a pyramid.

business opportunities are so widespread that the Commission should regulate the entire direct selling industry in the manner the commenters desire.

One comment sets forth five purported "red flags" to identify that an arrangement is a pyramid scheme. These "flags" ask whether a person is required to "pay to play" to participate in the arrangement,[36] participants are rewarded solely for recruiting, and compensation is greater for recruiting than it is for selling products to retail customers.[37] These may be relevant elements of a pyramid scheme. These "red flags" do not apply to Primerica because, for example, it does not require any payments for the *right* to be an agent; as noted above, the only required payment is for insurance licensing training and licensing examinations, which provide the new agent with the regulatory certifications necessary to participate in the business. Moreover, Primerica's compensation system is based on sales of insurance and financial products.

The "five red flags" also include arbitrary and unsupported criteria involving the number of levels of an organization (more than five levels is a red flag) and the relationship between commissions to the distributor making the sale and others in the organization (more total commissions to higher levels than to the agent who makes the sale is a red flag). There is no basis for these "criteria." Entirely conventional organizational forms have substantially more than five levels of employment relationships. A manufacturer who sells to a wholesaler who sells to retailers may appear to involve three levels. But the manufacturer has (at least) a CEO, a manager, an assistant manager, and a production worker. The distributor and the retailer have a similar structure. If the different levels are revealed explicitly – as they are in the contracts that organize a multi-level marketer – there could be at least 12 levels between the top of the organization and the consumer.[38] The red flag based on commissions faces similar problems. It would be highly unusual for the retail clerk who makes the final sale in a conventional distribution arrangement to earn a commission that exceeded the total payments to his or her "upline" – the higher levels of the economic organization.[39] Again, what is commonplace in multilevel marketers also exists in other organizational forms. There is no basis whatsoever for the Commission to second guess these organizational arrangements simply because multilevel marketers are organized through contracts rather than employment relationships.

[36] As noted in Primerica's original comment, this notion of "pay to play" is considerably narrower than the proposed Rule's concept that *any* consideration creates a covered business opportunity. *See* Comment No. 522418-11929 at 40-41.

[37] Comment No. 522418-12585.

[38] It is perhaps worth noting that the Commission's organizational structure has six levels – The Commission, the Bureau Director, the Deputy Director, the Associate Director, the Assistant Director, and the staff attorney.

[39] The Commission fails this test for pyramid schemes as well. The total income of a staff attorney's "upline" far exceeds his or her income. The fact that the incomes are salary rather than commissions has no economic significance whatsoever.

More fundamentally, a compensation system is not "pyramid-like" if the reward for making a sale is greater than the reward for recruiting a new participant. Again, with respect to Primerica, no money is earned simply by recruiting a new agent. In Primerica, regardless of the number of levels of override commissions or the aggregate total of those commissions, an individual agent *always* will earn a greater commission if she sells an insurance policy or other product herself than if she recruits a downline agent (for which she is paid nothing) or if a recruited agent makes the identical sale, for which the recruiting agent receives only a percentage of the commission. Downline agents are only attractive if they *increase* sales.

In summary, the comments do not present persuasive evidence of widespread fraud in the direct selling industry, nor do they establish a sufficient factual basis for subjecting legitimate companies like Primerica to the Proposed Rule. At best, the comments may support an effort by the Commission to define what constitutes a pyramid scheme, if the Commission believes that such a definition would assist its enforcement efforts. If the Commission wishes to depart from the flexible standards under Section 5 of the FTC Act and attempt to define pyramids with specificity, it may certainly do so. But it cannot, and should not, cripple an entire industry to ferret out pyramid schemes that only exist in the minds of the commenters.

D. If the Commission Proceeds with Hearings, Issues of Fact Must Be Designated Regarding Absence of Any Record Justifying the Breadth of the Proposed Rule.

Should the Commission continue to pursue the present proposal, Primerica continues to invoke its statutory rights to hearings and cross-examination. Because the Commission has not followed its usual procedures for Section 18 rulemakings, the required factual predicates for a rule are incomplete. There is no Staff Report presenting the staff's view of the facts; there is only the Commission's rather general statement in the NPRM. Because neither the Commission nor the staff have presented their view of the facts, determining which facts are in dispute is difficult.

Initially and as discussed above and in its principal comment, Primerica believes the record lacks any evidence justifying the scope of the current Proposed Rule, and lacks any factual support for key propositions. Primerica, therefore, phrases most of the potential designated issues as statements of fact that, in Primerica's view, are established in the current record. Each of these facts is either discussed in the text of this rebuttal comment, with citations to other comments supporting the proposition, or, in some cases, in Primerica's principal comment.[40]

Further, a number of facts focus on the additional benefits – usually nonexistent -- that the Commission might achieve by including a group of companies or industries within the scope of the Rule (e.g., proposed issue No. 7 below). These additional or incremental benefits are the critical issue in determining whether coverage of such a

[40] Primerica has not reiterated all of the facts in its principal comment. If not otherwise discussed in this rebuttal comment, facts identified in the list of designated issues are identified in Primerica's principal comment.

group is appropriate. If there are no incremental benefits from covering a particular group of companies or a particular industry, there is no basis for including them in the Proposed Rule's coverage.

Finally, each section of this rebuttal comment presents a list of the facts relevant to that section of the comment that Primerica believes are established in the present record. If the Commission disputes these facts, or believes that other commenters dispute them, Primerica believes that hearings and cross-examination are necessary to resolve the issues, if only because the Commission's view of the facts is not, at this point, a part of the record. The threshold issues of fact include:

1. There is no evidence of widespread business opportunity fraud, or unfair or deceptive acts or practices, among licensed life insurers and registered broker-dealers.

2. There is no evidence of widespread business opportunity fraud, or unfair or deceptive acts or practices, in the direct selling industry.

3. Based on the Commission's enforcement experience, the only prevalent business opportunity frauds are work-at-home schemes, schemes involving the sale of vending machines, rack locations, or ATMs, and schemes in which compensation to participants is based primarily on payments for recruiting others into the scheme.

4. Businesses paying compensation based on product sales without requirements for large up-front fees or the purchase of non-refundable inventory have not been the subject of a significant number of consumer complaints or Commission enforcement actions.

5. Consumers will not, or will not be able to, differentiate between legitimate and fraudulent business opportunities based on their compliance with the Rule.

6. The record provides no indicia of the prevalence of pyramid schemes in the marketplace, compared to legitimate multilevel marketing or direct selling opportunities.

7. There is no incremental benefit of the Rule including businesses that pay commissions based primarily on sales, with no minimum purchase requirement, and no payments for recruiting.

8. The benefits (if any) of including such businesses under the Rule do not justify the costs.

9. There is no evidence that unfair or deceptive acts or practices are prevalent among direct selling companies in business five years or more.

10. There is no incremental benefit of the Rule including companies that have been in business for five years or more, or companies that otherwise post a bond.

11. The benefits (if any) of the Rule including companies in business five years or more, or that otherwise post a bond do not justify the costs.

12. There is no incremental benefit of deviating from the definition of business opportunity used in the Franchise Rule and expanding it beyond demonstrated problems, such as covering sales back to the franchisor (to cover work-at-home schemes).

13. There is no incremental benefit of the Rule defining "consideration" to cover nearly every independent business agent relationship, rather than only payments for the right to participate in a business opportunity.

III. THE COMMENTS SUBMITTED DEMONSTRATE THE HARM THAT THE RULE WILL CAUSE TO DIRECT SELLING COMPANIES AND TO THE MILLIONS OF AMERICANS WHO PARTICIPATE IN THEM

A. The Comments Dispute the NPRM's View of the Rule's Overall Economic Impact

In its principal comment, Primerica detailed the specific ways that the Proposed Rule would severely harm Primerica and its 90,000 agents in the United States. In addition to the substantial costs of compliance with the Proposed Rule's onerous requirements, the Rule will inhibit the ability to recruit new agents. On this point, the comments are virtually unanimous. Further, the relatively high turnover of part-time participants in direct selling will amplify the economic significance of reduced ability to recruit, because it takes multiple part-time agents to generate the same commissions as a single full-time agent. Simply put, direct sellers will be unable to maintain the sales forces critical to their ability to do business. Based on a conservative estimate that the Proposed Rule would reduce Primerica's recruiting by 25 percent, Primerica projected an economic loss of *$1 billion for Primerica alone* over the next ten years if the Proposed Rule is promulgated.

Evidence submitted in other comments demonstrates that this estimate was indeed conservative. In particular, the Direct Selling Association ("DSA") conducted a survey about the extent to which the Proposed Rule would reduce the willingness to participate in direct selling.[41] The results of the DSA survey showed that participation would be *reduced by as much as 85 percent* if the current proposal is promulgated.[42] A reduction of this magnitude likely would cause *several billion dollars* of damage to the company over the next ten years. Primerica would not be alone in suffering such great harm; the DSA study suggests an *annual* impact on the U.S. economy of $57.6 billion from the Proposed Rule. The DSA survey, together with the comments of many other direct selling companies and participants, reveals that the Commission's estimate of the

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[41] *See generally* DSA Comment, No. 522418-12055.

[42] DSA Comment at 23.

economic impact of the Proposed Rule was far too low.

The economic damage would not end with direct selling companies themselves. Instead, it would flow directly to the 13.6 million Americans who participate in such businesses.[43] As discussed in Primerica's principal comment, its independent agents would necessarily bear the substantial compliance burdens of the Proposed Rule, even if, contrary to the Rule's current language, they are excluded from the definition of "business opportunity sellers." Providing the litigation disclosure and retaining the associated paperwork, as well as creating, providing, and keeping copies of the references disclosure, would directly cost Primerica's agents time and money. Moreover, any waiting period would require multiple visits with potential recruits, imposing further costs. Along with the dramatic reduction in their ability to recruit new agents into the business, these costs would make the Primerica opportunity untenable for many agents. The supplemental income they receive from Primerica, which is critical to meeting their personal financial goals and supporting their families, would simply vanish.[44] Other comments make clear that distributors affiliated with other direct selling companies are similarly situated.[45] The Proposed Rule would directly affect the household incomes of millions of American families.

Because the Proposed Rule will reduce or eliminate the competition that direct sellers provide in numerous sectors of the economy, it will also adversely affect consumers. Primerica's competitors are primarily traditional insurance companies and broker-dealers. For insurance and financial services, Primerica provides consumers with an alternative to traditional firms, and offers a distribution network that reaches a segment of the American population that its competitors have historically ignored. The inevitable reductions in Primerica's sales force would make insurance and financial services less available to this segment of the American people.

Similarly, the comments make clear that other direct selling companies promote competition in different sectors of the economy. For example, one direct selling company competes with large petroleum companies in selling motor oils;[46] others provide consumers with a channel to purchase kitchenware separate from department stores;[47] while still others offer cosmetics and other household goods.[48] The Proposed

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[43] DSA Comment at 8.

[44] *See, e.g.,* Comment of Rebecca Bundy, No. 522418-11781; Comment of Julio Bramon, No. 522418-11890; Comment of Harold Crafter, No. 522418-11550.

[45] *See* Comment of Multi-Level Marketing Int'l Ass'n ("MLMIA Comment"), No. 522418-70007, at 9; Comment of Avon Products, Inc., No. 522418-70001, at 14; Comment of Mary Kay Inc., No. 522418-11952.

[46] Comment of Amsoil, Inc., No. 522418-08265.

[47] Comment of the Pampered Chef, Ltd., No. 522418-11906.

[48] Comment of Avon Products, Inc., No. 522418-70001; Comment of Mary Kay Inc., No. 522418-11952; Comment of Shaklee Corp., No. 522418-70017; Comment of Carico Int'l, Inc., No. 522418-70039.

Rule would reduce competition in each of these areas, limiting consumer choice and unfairly strengthening the market position of their non-direct-selling competitors. The Rule will therefore harm not only the millions of Americans who participate in direct selling businesses, but also the far larger population of American consumers who buy their products. If the Proposed Rule continues to cover traditional manufacturer and distributor/dealer relationships, the impact will be even greater.[49] This is not a reasonable burden to impose in pursuit of a small group of fraudsters.

Subject again to its belief that rulemaking hearings are premature and that a more narrowly-focused proposed rule should precede any such hearings, Primerica proposes the following designated issues of fact relating to the economic impact of the Proposed Rule for any hearings conducted with respect to the Proposed Rule as it currently stands:

14. The Rule will dramatically and negatively impact the 13.6 million Americans who participate in legitimate direct selling to generate income for their households.

15. Direct selling businesses make a large contribution to the American economy, totaling approximately $72 billion.

16. The Rule will dramatically and negatively affect the contribution of the direct selling industry to the American economy.

17. The Rule will circumscribe consumers' ability to use direct selling opportunities to meet their needs, particularly those who desire flexible part-time earnings opportunities or supplemental income.

18. The Rule will reduce direct sellers' recruiting by at least 25 percent, and as much as 40-80 percent, thereby adversely affecting their ability to maintain or grow their sales forces and businesses.

19. The reduction in direct sellers' ability to attract new agents will substantially reduce their product and service sales, adversely affecting both the direct selling companies and the income earned by individuals participating in them.

20. The reduction in direct sellers' ability to attract new agents will also impact consumers who rely on direct selling for goods and services that are not available elsewhere.

21. Undermining Primerica's ability to maintain its sales force will cause middle-income consumers who have traditionally not been served by the insurance and financial services industry to lose a substantial point of access for life insurance protection in the event of the death of a breadwinner, retirement savings, and other financial services.

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[49] *See* Comment of Newspaper Ass'n of America, No. 522418-70035; Comment of Independent Bakers Ass'n, No. 522418-11945; Comment of Plumbing Manufacturers Institute, No. 522418-11868; Comment of Larkin Hoffman Daly & Lindgren Ltd., No. 522418-70009.

22. The Rule's substantial burdens and the costs of complying with its requirements would make recruiting more onerous for individuals involved in direct selling, and would therefore give some companies the incentive to compensate agents for recruiting activities, a result opposite of the intended effect of the Rule.

23. Very few, if any, legitimate companies could comply with the Rule using a simple one-page disclosure form; rather, for most legitimate companies, the disclosure form would be lengthy and complicated.

24. Perpetrators of business opportunity fraud would be more likely than legitimate businesses to use a one-page form, if they complied with the Rule at all.

25. For the average direct selling company, the length of the disclosures required by the Rule, including the litigation disclosure, the earnings claim disclosure, the refund disclosure, and the reference disclosure, would consume many pages. For a large multi-national direct-selling company like Primerica that is part of a larger corporate family, the required disclosures could be thousands of pages long.

26. The Rule would require disclosures to be given to many millions of consumers each year.

27. The reference disclosure, and potentially the earnings claim disclosure, require customization for each prospect who receives the disclosures. The cost of preparing these customized disclosures will be large, and will not be matched by any commensurate benefit to consumers.

28. The NPRM estimates that there are 150 multilevel marketing companies, but in reality, there are at least 1,500 direct selling companies that would be subject to the Rule.

29. The NPRM's estimate of the total number of hours for covered businesses to initially comply underestimates the cost of the Rule by several orders of magnitude.

30. Legitimate direct selling companies, as opposed to fraudulent schemes, will bear the vast majority of compliance costs required by the Rule.

31. Based on the record before the Commission, including the DSA survey that forecasts a decline in recruiting in the range of 40-80% and cost estimates from companies such as Primerica that estimate the revenue loss from reduced recruiting will be $1 billion over ten years, the cumulative expected cost of the Proposed Rule (including direct costs and lost revenue) will be orders of magnitude higher than the Commission's estimate.

32. The Rule's definition of "seller" makes individual agents "sellers" subject to all the required disclosures on a personal level.

33. Requiring individual agents to meet these personal disclosure requirements will cause the individual agents to incur cost and burdens that they are ill-equipped to handle, and will further increase the compliance burden on companies that monitor their agents' compliance.

34. For most established direct selling companies, the information in the disclosures will not materially change each quarter.

35. Requiring quarterly updates to the required disclosures would not provide any benefit commensurate with the added cost of updating the disclosures quarterly, as opposed to annually.

36. Individual agents will not have sufficient knowledge to respond to consumers' questions regarding each of the disclosures, such as the litigation disclosure, refund disclosure, earnings claim disclosure, and reference disclosure.

37. Individual agents' lack of a response or inability to respond to questions about the disclosures will discourage prospective recruits from participating in direct selling companies.

38. Individual agents will incur costs based on the Rule's required disclosures that they are likely not capable of bearing without incurring net losses in their businesses, including costs in time and resources to potentially customize, print, and provide disclosures to all potential recruits, as well as store copies of signed disclosures.

B. Comments Dispute the Efficacy of the Rule to Combat Fraud.

In light of the far-reaching unintended consequences of the Proposed Rule, it is unfortunate that it may not even accomplish its intended result of reducing fraud. Specifically, there is no evidence in the record to suggest that a disclosure-based approach would be effective to stop the fraudulent schemes that the Proposed Rule addresses. As one comment notes, perpetrators of business opportunity fraud, which have false earnings claims at their very core, already violate both the FTC Act and analogous state unfair and deceptive trade practice statutes.[50] There is no reason to believe that a new disclosure rule, subject to essentially the same enforcement mechanisms and penalties,[51] would change their behavior. It is even more unrealistic to believe that a perpetrator of fraud will make disclosures designed to warn a victim of the fraudulent nature of a transaction. In this way, "the rule necessarily depends on a naïve assumption that those who engage in deceptive promotions will comply honestly with a

[50] *See* MLMIA Comment at 12.

[51] Although the rule would allow the Commission to seek civil penalties, it already has the authority to obtain far more money in redress or disgorgement than fraudulent actors can pay. What limits the ability to obtain money in such cases is the defendant's solvency, not a shortfall in the Commission's authority.

mandatory disclosure requirement and thus alert consumers of their fraud."[52]

The more likely consequence of the Proposed Rule is that legitimate companies will comply, suffering the costs and business disruptions that inevitably will follow. Perpetrators of fraud either will ignore the disclosure requirements or will provide false disclosures, then point to the disclosures made by legitimate companies to argue that the fraud is actually the safer and more reliable opportunity. Thus, the Proposed Rule would have the perverse consequence of benefiting perpetrators of fraud and making consumers more vulnerable to fraudulent business opportunity schemes.

With the same caveats expressed above regarding the premature nature of hearings, Primerica proposes the following designated issues relating to the Proposed Rule's efficacy in combating fraud:

39. Perpetrators of business opportunity fraud will not comply with the Rule, including making the required disclosures truthfully, observing the seven-day waiting period or refraining from making false earnings claims and promises of assistance.

40. The effect of the Rule's required disclosures on legitimate businesses, combined with the lack of compliance by fraudulent actors, will be to cause consumers to believe that legitimate businesses are more risky and more deserving of suspicion than fraudulent business opportunity schemes.

41. Fraudsters will use written disclosures as a shield to defend themselves against claims of oral misrepresentation, making it more difficult for the Commission and other enforcement agencies to successfully pursue those committing fraud.

C. Any Waiting Period Would Be Highly Detrimental to Direct Selling Businesses and is Completely Unnecessary.

One of the clearest examples of regulatory overkill is the Proposed Rule's seven-day waiting period before a person can participate in a business opportunity. In its principal comment, Primerica devoted substantial discussion to the highly damaging nature of this requirement, the compliance burden associated with it, and the unprecedented nature of applying a seven-day waiting period to an expenditure of $200 or less. The comments submitted by others in response to the Proposed Rule support these conclusions. For example, the DSA survey concluded that the waiting period, *by itself*, would reduce participation in direct selling businesses by 60 percent.[53] Many commenters echoed the theme that because a waiting period is virtually unheard of in the American marketplace, it would inevitably imply that a relationship subject to such a

[52] MLMIA Comment at 12.

[53] DSA Comment at 23.

waiting period must be very dangerous indeed.[54]

More important, the overwhelming weight of comments, many from individual participants in direct selling businesses, is that a waiting period is not necessary because the initial outlay to participate in direct selling businesses is so small, generally less than \$200.[55] In any event, most direct sellers will refund even this modest amount in whole or in large part. Primerica, for example, offers an 80 percent refund within the first 120 days if the new agent has not yet participated in the pre-licensing training and insurance licensing test.[56] Companies selling tangible goods overwhelmingly follow the DSA's requirement that initial outlays and purchases of inventory are subject to a 90 percent buy-back policy.[57] Simply put, participants have very little at risk. Under such circumstances, there is no justification for the highly unusual waiting period. Business opportunities are not mini-franchises. No substantial, irrevocable investments and long-term ongoing payment obligations are required. In a franchise, where such substantial obligations are present, careful analysis of the business proposition is essential. But there is simply no rational basis to apply a waiting period to a direct selling opportunity, which is less complicated and carries less financial risk for a participant than purchasing a flat-screen TV set.

Even the proponents of the Proposed Rule seem disinterested in the seven-day waiting period. One consumer group suggested that a post-transaction right of rescission would be sufficient to achieve the same goal.[58] The other pro-rule commenters emphasized defining pyramid schemes and devising complicated and ultimately unworkable earnings disclosure requirements, rather than attempting to provide any real support for a waiting period.[59] Thus, there is nothing in the record to support such a requirement, and it should be abandoned.

Primerica proposes the following designated issues of fact relating to the seven-day waiting period for any rulemaking hearing held with respect to the current version of the Proposed Rule:

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[54] *See, e.g.,* MLMIA Comment at 49 ("the requirement of a seven-day advance notices carries with it a stigma – a government onus against entry into the purchase").

[55] *See, e.g.,* Comment of the Pampered Chef, Ltd., No. 522418-11906, at 2 (\$90); Comment of Mary Kay Inc., No. 522418-11952, at 3 (\$100); Comment of Neways International, No. 522418-70019 (\$25); Comment of Shaklee Corp., No. 522418-70017, at 3 (\$19.95); Comment of Carico International, Inc., No. 522418-70039 (\$60).

[56] As noted in Primerica's principal comment, agents are required to begin training within 90 days of signing the contract.

[57] DSA Comment at 24 n.45.

[58] Comment of National Consumer League, No. 522418-02380, at 3.

[59] *See* Comments cited *supra* in note 25.

42. A waiting period will impose immense compliance burdens on legitimate direct selling businesses and the small independent businesses that participate in direct selling.

43. Perpetrators of business opportunity fraud will not comply with a waiting period.

44. A waiting period in connection with an initial monetary outlay of less than $200 is not commensurate with the way other, similar commitments are regulated.

45. Potential participants in direct selling businesses will interpret the government-required waiting period as an indication that the business is disreputable, risky, or otherwise undesirable, and will therefore be less likely to participate.

46. The economic impact on legitimate direct selling companies of a waiting period will be enormous, because the decline in direct sellers' ability to attract and retain agents will reduce their sales forces, and reduce sales by billions of dollars.

47. The economic impact on the small, independent businesses run by representatives of direct selling companies of a waiting period will be equally severe, as it will directly reduce the incomes of individuals who rely on direct selling for some (or all) of their household incomes.

48. There is no need for a waiting period if those signing up for a business opportunity can receive a refund of most or all of their initial investment pursuant to a refund policy.

49. There are no incremental benefits of a waiting period as compared to a right of rescission that would give a person an opportunity to cancel their participation in the business opportunity and receive a full refund.

50. Prospective part-time business opportunity agents are far less likely to use the waiting period for due diligence than prospective franchisees, because the amounts at stake are small. Consumers are unlikely to use the waiting period to do additional research into a business opportunity.

51. The waiting period will make it necessary for a direct selling representative to conduct additional in-person visits with prospective recruits in most instances, imposing significant time and resource costs.

52. There are no incremental benefits from requiring a second, or additional visit, with a potential recruit.

D. The Litigation Disclosure Would Be Unfair to Legitimate Companies, Would Impose Massive Compliance Costs, and Would Provide No Benefit to Consumers.

Another element of the Proposed Rule that would impose an enormous hardship on any legitimate company is the litigation disclosure. The disclosure covers all lawsuits,

arbitrations and regulatory proceedings alleging any kind of fraud, misrepresentation, or violation of securities laws involving a company, its management or any "affiliates" over a ten-year period. Primerica's principal comment noted the immense number of litigation matters it would have to disclose because it is part of a large, publicly-traded family of companies engaged in diverse lines of business. Other commenters expressed similar concerns, especially direct selling companies that are large and have been in business for many years.[60]

The comments also reinforced the misleading nature of requiring disclosure of litigation matters without regard to whether they involved a finding of any wrongdoing.[61] Readers of a litigation disclosure will likely infer guilt from the fact that allegations were made, an inference contrary to the very foundation of our legal system.[62] One commenter, a retired Kansas District Court judge who is now a distributor for a large direct selling company, emphasized this point: "[n]o court of law would allow a prior arrest (which is only an allegation) to be presented to prove propensity to commit a current charged crime."[63] Another commenter pointed out that the requirement to disclose actions against a wide variety of employees, regardless of conviction, could expose direct sellers to charges of unlawful employment practices.[64] Companies cannot even counteract this unfair insinuation, because the Proposed Rule prohibits business opportunity sellers from providing any explanation about the matter whatsoever.[65] The lack of any meaningful information leaves recipients with only two practical choices: assume guilt or ignore the disclosure. Neither response advances the interests of consumers.

Moreover, nothing in the comments suggests that the litigation disclosure would provide any benefit to consumers. Without knowing the subject matter, the identity of the plaintiff, the course of proceedings, and the ultimate resolution of the matter, a recipient of the litigation disclosure will not learn anything relevant or even helpful about the company making the disclosure. Moreover, as with many other elements of the Proposed Rule, perpetrators of short-lived "fly by night" business opportunity schemes will either ignore the disclosure requirement altogether, or will truthfully have little or no litigation to disclose. The litigation disclosure thus favors those who perform vanishing acts to escape justice over large, long-lived direct selling companies (who carry the least risk of fraud and the highest probability of being held responsible if they break the law). This is not a rule that will serve the goal of eliminating fraud.

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[60] *See, e.g.,* Comment of the Kirby Company, No. 522418-11981, at 4; Comment of Southern Progress Corp., No. 522418-11891, at 3.

[61] *See, e.g.,* Comment of Mary Kay Inc., No. 522418-11952, at 8-9; Comment of Shaklee Corp., No. 522418-70017, at 9-10.

[62] *See* MLMIA Comment at 29.

[63] Comment of D. Keith Anderson, No. 522418-12245.

[64] Comment of Chadbourne & Parke, LLP, No. 522418-11898, at 20.

[65] *See* MLMIA Comment at 30.

Primerica proposes the following designated issues of fact relating to the litigation disclosure requirement for any rulemaking hearings conducted under the Proposed Rule as it currently stands:

53. The cost of complying with the litigation disclosure requirement in the Proposed Rule for legitimate companies will be very large, especially for companies that have been in business for a significant period of time, or which are part of a larger family of affiliated companies.

54. The litigation disclosure will place significant compliance burdens on small independent businesses run by representatives of direct selling companies.

55. The perpetrators of fraudulent business opportunity schemes likely will not comply with the litigation disclosure requirement.

56. Even if they do comply, the perpetrators of fraudulent business opportunity schemes will not have significant litigation to disclose.

57. Recipients of the litigation disclosure will understand litigation as a signal that the opportunity is untrustworthy or risky, or that the company making the disclosure has engaged in unlawful conduct, even if none of the matters involved a finding of liability or violation of any law.

58. Fraudulent business opportunities will receive a competitive advantage from either not complying with the litigation disclosure, or from having a shorter litigation disclosure. Fraudsters likely will promote their apparent superiority over legitimate businesses in having less litigation to disclose.

59. Consumers will not derive any practical benefit from a litigation disclosure that includes the caption of a case without further information. Readers will not have the motivation or means to investigate the matters disclosed to determine what inference, if any, is appropriate about the company making the disclosure.

60. Consumers will not have the ability to distinguish litigation that is relevant and meaningful to the business opportunity from irrelevant litigation.

61. The existence of litigation, as defined in the Proposed Rule, does not provide meaningful, relevant information to a person considering entering into a business opportunity.

62. Litigation that is outside the scope of disclosure required by the Franchise Rule is not material to a potential participant in a business opportunity.

63. There is no practical utility to consumers of knowing about litigation that has no relevance to any business opportunity.

64. There is no practical utility to consumers of knowing about litigation filed against affiliated companies of a business opportunity provider, especially if those affiliates are not engaged in providing business opportunities themselves.

65. There is no practical utility to consumers of knowing about litigation in which there has been no finding of wrongdoing or the company has prevailed on the merits.

66. The burden of the litigation disclosure is not warranted in light of the minimal risks involved in a business opportunity in which the up-front costs are less than $200.

E. The References Disclosure Contemplated by the Proposed Rule Would Impose Even Further Compliance Burdens, Would Undermine Privacy Interests, and Would Require the Disclosure of Confidential Business Information.

The Proposed Rule offers two equally unworkable alternatives for disclosing references: creating either a customized list of the "ten nearest" persons to each potential recruit or maintaining a massive list of every person who signed up to participate in a business opportunity in the preceding *three years*. Primerica's principal comment identified three overarching problems with this requirement: (a) the massive cost of compliance, both to Primerica and its agents; (b) the invasion of privacy that the requirement imposes on Primerica's agents; and (c) the forced disclosure of lists of agents, which Primerica considers and treats as confidential, trade secret information.

The comments make clear that the Commission has failed to appreciate the scale of the reference disclosure problem. To disclose all participants, direct selling companies with sales forces numbering into the tens or hundreds of thousands would have to provide a disclosure document that resembled a sizeable phone book, constantly update the book, and ensure that distributors did not use an outdated version of the book with potential recruits.[66] Comments from direct selling companies, as well as individual participants, also emphasized the problems of the "ten nearest" alternative. Commenters agreed that creating customized lists for every prospective recruit would impose a tremendous administrative burden that would fall principally on individual direct selling participants, who would be responsible for physically creating and providing them lists.[67] Direct selling companies would have to create new computer systems to develop the lists, and

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[66] *See, e.g.,* Comment of Pre-Paid Legal Services, No. 522418-70002 at 3 (468,000 representatives); Comment of the Pampered Chef, Ltd., No. 522418-11906, at 1 (70,000 representatives); Comment of Mary Kay Inc., No. 522418-11952, at 2 (700,000 representatives); Comment of Herbalife International, No. 522418-11711 at 1 (250,000 representatives); Comment of Shaklee Corp., No. 522418-70017, at 7 (235,000 representatives).

[67] *See, e.g.,* Comment of Shaklee Corp., No. 522418-70017, at 7, at 7-8; Comment of Melaleuca, Inc., No. 522418-12030, at 7; Comment of Pampered Chef, Ltd., No. 522418-11906, at 7-8; Comment of Suzanne Parker, No. 522418-07729.

would have to monitor distributors' compliance with the disclosure requirement.[68] Given DSA's estimate that 5 million individuals are successfully recruited into direct selling organizations each year, and that 10 presentations are made to achieve one recruit, some 50 million customized forms would be required each year -- in duplicate, with one signed by the consumer and the other retained by the company for three years.[69]

The costs of the References Disclosure do not end with the monumental undertaking to create and maintain such vast quantities of paper. Disclosing the names of participants in the business opportunity directly impacts their privacy rights, placing their names and contact information in the public domain and subjecting them to the risk of telemarketing and other invasions of their privacy.[70] A number of female commenters cautioned that the disclosure could compromise women's safety and result in potential harassment,[71] a concern of greater weight in an industry where women comprise nearly 80 percent of the workforce.[72] This loss of privacy would be a powerful deterrent to participation in direct selling businesses. The DSA survey revealed that this requirement *alone* would reduce interest in participating in direct selling by as much as 76 percent.[73]

The Proposed Rule also would reduce the ability of companies to safeguard the confidentiality of their most sensitive and valuable information: the identities of their sales forces. As noted in Primerica's principal comment, Primerica considers information about its agents to be confidential, trade secret information. If lists of Primerica agents in the form required by the Proposed Rule were readily available, competitors could use those lists to target Primerica agents for recruitment, "free riding" on Primerica's efforts to identify individuals with the interest and ability to participate in its businesses. The direct selling companies that commented unanimously stated that agent information was valuable and confidential information, and that providing such easy access to it through the Proposed Rule's disclosure would cause competitive harm.[74] Even worse, direct selling distributors whose names appeared on the Proposed Rule's references lists would become targets for perpetrators of business opportunity fraud, who would undoubtedly believe that persons already participating in direct selling businesses

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[68] *Id.*

[69] *See* DSA Comment at 21 (estimating that all disclosures required by the Proposed Rule would generate 2.25 billion pages of disclosures per year).

[70] Many individual participants in direct selling businesses echoed these fears. *See, e.g.,* Comment of Dennis and Shawn Valliant, No. 522418-11617, at 2; Comment of Michael J. Evans, No. 522418-11732, at 2-3; Comment of Wallace Murphy, No. 522418-09425, at 3; Comment of Bob Martufi, No. 522418-12638, at 1-2.

[71] A representative comment is that of Brooks Walton, No. 522418-10599.

[72] DSA 2004 Fact Sheet.

[73] DSA Comment at 23.

[74] *See, e.g.,* Comment of Pre-Paid Legal Services, No. 522418-70002 at 12; Comment of Shaklee Corp., No. 522418-70017, at 7; DSA Comment at 30-31.

would be more likely to be interested in an attractive alternative "business opportunity" than would be members of the general population.[75]

The comments also explain that a reference disclosure is unnecessary. Several comments noted that, in direct selling, people are recruited by in-person contact, frequently by someone they know, which gives them immediate access to a participant who can answer questions.[76] Moreover, like Primerica (whose full-time agents have offices that are listed in telephone books across the nation), many direct selling companies offer potential recruits and customers tools to help them locate nearby distributors, providing another source of information to potential recruits with questions.[77]

Primerica proposes the following designated issues of fact relating to the references disclosure requirement for any rulemaking hearings conducted under the Proposed Rule as it currently stands:

67. The "references" disclosure will impose substantial compliance burdens and costs on legitimate direct selling companies.

68. Given the high incidence of part-time employment and turnover among direct-selling participants, there would be little or no value to consumers of references disclosures that include people no longer associated with the business opportunity.

69. The references disclosure will impose substantial compliance burdens and costs on individual participants in direct selling companies.

70. Perpetrators of business opportunity frauds will not likely comply with the references disclosure, or will "comply" by giving out lists of paid "shills" to promote their "opportunity."[78]

71. Even without a government-required disclosure, prospective participants in legitimate direct selling companies have sufficient access to others who have participated in the business opportunity if they feel the need to contact other participants.

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[75] *See* Comment of IBOA International, No. 522418-11922, at 8; Comment of The Kirby Company, No. 522418-11981, at 4.

[76] Comment of Melaleuca, Inc., No. 522418-12030, at 1; Comment of Pampered Chef, Ltd., No. 522418-11906, at 1-2.

[77] Comment of the Pampered Chef Ltd., No. 522418-11906, at 7; Comment of Mary Kay Inc., No. 522418-11952, at 7; Comment of Shaklee Corp., No. 522418-70017, at 12. Distributors located through such means may not be the ten nearest, and they will not be former distributors who no longer participate, but there is no basis in the record for concluding that this additional information has any particular value to recruits.

[78] *See* Comments 522418-02552, 522418-12553.

72. The references disclosure would have a substantial negative impact on the privacy of the millions of persons who participate in direct selling businesses for three years.

73. Consumers whose telephone numbers and addresses are disclosed will be called by telemarketers on the theory that the number is a business telephone number, effectively requiring consumers to sacrifice their Do Not Call rights.

74. The loss of privacy and potential safety concerns from the references disclosure requirement would make individuals less likely to participate in direct selling companies. Many consumers would not wish to sacrifice their privacy for three years in order to make a few hundred dollars for the holidays or other short-term goals characteristic of the motivations of participants in many direct selling opportunities.

75. The references disclosure would drastically undermine the efforts of direct selling companies to protect their representatives' identities as confidential, trade secret information and would make direct selling companies who comply with the disclosure requirement vulnerable to unfair competitive conduct by rivals.

76. Direct-selling participants contacted by consumers as a reference may attempt to recruit the consumer into a different participant's organization, creating confusion for the consumer and conflict among participants.

77. Because preparing millions of customized references disclosures from a centralized location is not feasible, the burden of creating customized disclosures will fall on individual agents. It is unlikely that agents who recruit on an informal basis will have this information available to them when needed.

78. The "list everyone" option for complying with the references disclosure is not a feasible alternative for anyone other than fraudsters, because legitimate direct selling companies have large sales forces and seek to minimize disclosure of confidential and trade secret information.

79. Because a legitimate direct selling company cannot prepare and publish a list of all participants for the preceding three years without risking the loss of the proprietary status of the information, such companies likely will require representatives to prepare and publish customized disclosures.

80. To comply with the references disclosure requirement, legitimate direct selling companies would have to incur the cost of creating and maintaining a central reference database that would be accessible to agents and that would be capable of creating the customized disclosures required by the Rule.

IV. THE COMMENTS HAVE PROVIDED MANY ALTERNATIVES FOR NARROWING THE PROPOSED RULE

In its principal comment, Primerica provided several alternatives for the Commission to narrow the Proposed Rule, and to allow the Rule to focus on the specific fraudulent schemes described in the NPRM. Other comments support many of Primerica's proposals, and several propose additional modifications to achieve similar goals. This section discusses the modifications to the Proposed Rule that Primerica raised in its principal comment in the context of other comments, and discusses several additional proposed modifications to the Proposed Rule suggested by other comments.

A. The Record Continues to Provide No Basis For Including Licensed Insurance Companies and Registered Broker-Dealers in the Proposed Rule.

Primerica's businesses – insurance, investments, and mortgage loans – place it under the supervision of numerous federal and state regulatory agencies. These highly credible regulatory agencies, including the SEC, the NASD, and the securities and insurance commissions of every state, effectively police against the kind of "fly by night" schemes that are the target of the Proposed Rule. These are not enterprises based on fraud that will ultimately collapse. Rather, to maintain the registrations and licenses necessary to operate a broker-dealer and an insurance company, Primerica must establish financial responsibility and stability, and must pass the numerous examinations required by its regulators.

These regulatory agencies provide ample assurance that a company able to qualify for a license cannot pose the risk of fraud to the public identified in the NPRM. In addition to regulatory supervision to prevent fraud, the regulatory requirements for financial responsibility ensure that any participant in Primerica's business opportunity will have recourse for perceived wrongs.

Nothing in the comments submitted in connection with the Proposed Rule suggests otherwise. No comments suggested any fraud by insurance companies or broker-dealers. The proponents of the Proposed Rule focused on companies selling consumer products, not insurance and financial services. There is simply no evidence in the record from which the Commission could conclude that there is any need to cover insurance companies or broker-dealers in the scope of the Proposed Rule.

Primerica hereby proposes the following designated issues of fact relating to the inclusion of insurance companies and broker-dealers within the scope of the Proposed Rule for any rulemaking hearings conducted under the Proposed Rule as it currently stands:

81. Given the degree of regulatory oversight and the history of vigilance by the SEC, the NASD, and state insurance commissioners, it is highly unlikely that licensed insurance companies and/or registered broker-dealers will engage in business opportunity fraud.

82. Existing regulatory schemes and regulatory bodies are sufficient to detect, prevent, and redress business opportunity fraud by insurance companies and broker-dealers.

83. There are no substantial benefits to including licensed insurance companies and registered broker-dealers in the Rule.

84. Any benefits of the Rule covering licensed insurance companies and registered broker-dealers would not justify the costs.

Excluding insurance companies from the Proposed Rule also would avoid intruding into the regulation of insurance companies – an area reserved to the states under the McCarran-Ferguson Act.[79] As discussed in Primerica's principal comment, the Act provides for the supremacy of state law in regulating the "business of insurance" and enforces this policy by preempting federal laws that encroach on state authority in that arena. To the extent the Rule regulates aspects of the business of insurance already governed by state law, it is "reverse preempted" by the McCarran-Ferguson Act. No other comments discussed this analysis.

The Proposed Rule runs afoul of the McCarran-Ferguson Act in three ways, all of which would need to be the subject of Commission fact-finding at any rulemaking hearing. First, the waiting period interferes with state laws governing the licensing process for insurance agents, rendering state-granted licenses ineffective for seven days. Second, the Proposed Rule inadvertently intrudes on state regulation of the insurance agent recruiting process. Third, the Proposed Rule directly impacts the market for insurance, with the likely effect of reducing competition and increasing premiums.

The Commission must analyze the effect of the Proposed Rule on state insurance agent licensing laws and regulations in each of the 51 state jurisdictions to determine whether the Rule "invalidate[s], impair[s] or supersede[s]" any of those regimes. The analysis must include also the *de facto* regulatory oversight and enforcement practices of those authorities to determine whether the Proposed Rule "inadvertently" intrudes on the state regulation of insurance. And it must assess the likely effects the compliance and organization costs the Rule would have on insurance premiums.

Primerica designates the following issues of fact relating to the McCarran-Ferguson Act for any rulemaking hearings conducted under the Proposed Rule as it currently stands:

85. As applied to insurance companies, the Proposed Rule will impair, invalidate or supersede laws enacted for the purpose of regulating the business of insurance in one or more of the 51 jurisdictions in the United States.

86. As applied to insurance companies, the Proposed Rule will intrude into an area reserved for exclusive state regulation (i.e., the insurance agent licensing process).

[79] 15 U.S.C. §§ 1011 *et seq.*

87. The Rule will affect the "business of insurance" by reducing competition, impeding the agency relationships of insurance agents and increasing prices for insurance.

B. The Record Supports Exclusion of Legitimate Companies That Do Not Exhibit the Key Elements of Pyramid Schemes.

Primerica suggested that the Rule be modified to exclude companies that are legitimate because their operations do not have the characteristics of pyramid schemes. Thus, for example, Primerica suggests excluding companies that do not pay participants for recruiting, pay compensation solely based on sales of products or services, and which have no minimum purchase requirements at any level. Even the small group of commenters who support a rule addressing pyramid schemes would not advocate regulating companies that meet these criteria. Indeed, a key element in one commenter's proposed definition of pyramid schemes (modeled after state anti-pyramid laws) is the payment of compensation to participants for recruiting others into the organization.[80] Another anti-pyramid comment identifies "five red flags" of pyramid schemes, which include payments for recruiting and the requirement to "pay to play" by purchasing minimum amounts of products to attain higher levels in an organization.[81] Thus, Primerica's proposed exclusion finds support even from those commenters.

Similarly, Primerica suggested an approach under which companies would be excluded from the Rule if the primary source of compensation to participants was retail sales. The comments concerned about pyramids define retail sales as the key fact that separates a legitimate direct selling company from a pyramid scheme, suggesting a threshold of 70 percent of sales being made to retail customers as a benchmark.[82] To make such a threshold workable, however, the Commission would need to recognize that "business opportunities" that function as "buyers clubs" are also legitimate, and do not pose the risks of pyramids.[83] The comments suggest that some direct selling companies have a large number of "distributors" who join the organization solely to receive a discount on goods purchased for personal consumption.[84] Because Primerica's financial products must be associated with a customer's name and other identifying information, it would be relatively well-situated to prove that it meets a 70 percent "outside sales"

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[80] Comment No. 522418-12306, at 7-8.

[81] Comment No. 522418-12585.

[82] Comment No. 522418-70036, at 30.

[83] Letter from James A. Kohm, Acting Director of Marketing Practices, Fed. Trade Comm'n to Neil H. Offen, President, Direct Selling Ass'n, at 1 (Jan. 14, 2004) (noting that "a multilevel compensation system funded primarily by payments made for the right to participate in the venture is an illegal pyramid scheme.").

[84] *See, e.g.,* Comment of Herbalife International, Inc., No. 522418-11711, at 2; Comment of Shannon Harris, No. 522418-12112; Comment of Roberta Crowell, No. 522418-00672; Comment of Ruth Kutz, No. 522418-01458.

threshold.[85] Applying a quantitative threshold is much more difficult when products are not subject to identification with particular customers, because there is no ready way for the company to observe whether a particular sale was to an insider or an outsider. Because the real issue is consumption, and establishing sales to outsiders is only one way to demonstrate consumption, it may be advisable to include a 70 percent retail sales test as one of several alternatives to exclude companies from the Rule.

C. The Comments Support An Effort to Define Pyramid Schemes.

Primerica's principal comment also suggested that the Commission propose an explicit definition of what constitutes a pyramid scheme, and then apply the Rule only to arrangements meeting that definition. The group of commenters who expressed great concern about pyramid schemes all urged the Commission to adopt a definition that could be used to identify and prosecute the perpetrators of such schemes easily.[86] In Primerica's view, the key elements of a pyramid scheme are the payment by participants for the right to participate in the scheme, and the promise of compensation to participants that is funded by the initial fees paid by new participants. The state statutes these commenters cite as models incorporate these concepts.[87]

The principal challenge in using a regulation, rather than enforcement efforts, to define pyramid schemes is drawing bright-line tests that will allow the business community to structure arrangements in compliance with the Rule. The Commission may determine that the flexibility inherent in Section 5 of the FTC Act is preferable to any attempt to fashion a definition of pyramid schemes. If not, however, it must exclude legitimate business arrangements that are not pyramids from the scope of the Rule. As noted in Primerica's principal comment, rulemaking is an exercise in drawing lines by defining covered practices with specificity.

D. Expanding the Existing Franchise Rule to Address the Frauds Identified in the NPRM Remains a Viable Approach.

Rather than starting over with an entirely new definition of business opportunities, as the current Proposed Rule does, it would be far preferable to adjust the existing definition in the Franchise Rule that covers business opportunities to address the specific areas of fraud the Commission wishes to reach. As noted in Primerica's principal comment, several relatively modest changes to the Franchise Rule could address the fraudulent schemes that motivated the Business Opportunity Rule. For example, the

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[85] However, no company would be able to measure compliance with such a threshold as enunciated by the anti-pyramid commenters. They suggest that sales of goods or services to past, present, *or future* participants in the business opportunity be excluded from "retail sales." It is patently impossible for a company to compile statistics that are subject to change because of what a customer may do in the future by joining the organization. It would be more workable and more realistic to measure retail sales by whether the customer is a member of the organization at the time the purchase is made.

[86] *See* Comments listed in *supra* note 25.

[87] *See* Comment of Bruce Craig, No. 522418-12306, at 7-8.

Franchise Rule could be modified to cover arrangements under which the "franchisor" buys goods from the "franchisee," which would directly cover work-at-home schemes. Another potential adjustment would be to reduce the $500 payment threshold somewhat, or to count inventory purchases toward the $500 investment threshold. Or, if the Commission wishes to supplement the Franchise Rule to combat pyramid schemes, a definition of pyramids could be added as discussed above.

The strength of this incremental approach is that it would serve to capture the fraudulent schemes identified in the NPRM, without the massive overbreadth of the current Proposed Rule. The Commission would know what it was adding to the existing rule's coverage, rather than painting with a broad brush and inadvertently sweeping in wide sectors of the economy. This narrower approach would be particularly appropriate because the comments to the Proposed Rule did not identify any significant areas of fraud beyond those listed in the NPRM, but did identify widespread harm arising from the Proposed Rule's coverage of direct selling companies and traditional product distribution arrangements.[88]

E. Narrowing the Definition of Consideration Would Alleviate Much of the Overbreadth.

The one change to the Proposed Rule that would most significantly reduce the Rule's overbreadth and coverage of legitimate businesses would be to narrow the definition of "consideration" to target the foundational component of a fraudulent scheme: a payment or investment for the *right to participate* in a "business opportunity." A fraudulent scheme that sells worthless products has no underlying economic demand to sustain its compensation model, and must necessarily rely on payments by new participants *solely* for the right to participate. These payments are then used to pay compensation to other participants and to line the pockets of the perpetrators of the scheme. In a pyramid scheme, these up-front payments provide nothing of value to the new participant, but fuel the engine that produces the profits reaped by the architects of the scheme.

In contrast, legitimate businesses provide value for up-front fees, and do not base their compensation system on, or earn profits from, such fees. As noted in Primerica's principal comment, the $199 fee paid by new Primerica agents is not distributed in any part to other, existing agents, but rather pays for insurance pre-licensing training (which is required by state insurance laws) and for the fees charged by state insurance agencies for the administration of licensing examinations. Primerica does not earn a profit from the $199 fee, but rather incurs a net loss when recruiting a new agent. Most importantly, however, the $199 is not a fee paid for the right to participate, but rather is paid for training and licensing, from which the new agent receives something of value – the

[88] *See* Comment of Sonnenschein Nath & Rosenthal LLP, No. 522418-12035; Comment of Newspaper Ass'n of America, No. 522418-70035; Comment of Plumbing Manufacturers Institute, No. 522418-11868; Comment of The Timberland Co., No. 522418-70031; Comment of Cosmetic, Toiletry and Fragrance Ass'n, No. 522418-70012, at 4; Comment of Larkin Hoffman Daly & Lindgren Ltd., No. 522418-70009.

prerequisites to participate in the business with Primerica or any other insurance company.

The wisdom of excluding from "consideration" payments for educational materials or instruction is reinforced by two comments, each of which highlighted the fact that the current Proposed Rule would cover the sale of self-help financial advice publications and business classes offered by educational institutions.[89] Such arrangements were surely not contemplated as targets of the Proposed Rule, but the broad definition of "consideration" nevertheless sweeps them in because it covers any type of payment to the "business opportunity seller." Defining "consideration" as a payment for a right to participate in a business opportunity, and excluding payments for educational materials or instruction would eliminate this unintended consequence.

Including payments for inventory at *bona fide* wholesale prices as consideration is another way in which the Proposed Rule sweeps in vast numbers of legitimate businesses. Legitimate direct selling companies commonly charge new distributors fees for sales "starter kits," which typically contain a small sample of inventory and other items necessary for the new distributor to engage in the business successfully.[90] These small up-front inventory purchases are typically subject to a 90 percent buy-back policy, as required by the DSA's Code of Ethics.[91] Like the fee paid by new Primerica agents, these purchases are not payments for the right to participate in the business opportunity, but rather are for the tools and products needed to engage in the business. Their inherent value and the refundability of the initial purchases distinguish them from the up-front payments charged by fraudulent schemes.

Including payments for inventory under the definition of "consideration" also results in the Proposed Rule covering traditional wholesale distribution/dealer agreements between product manufacturers and retailers.[92] Narrowing the definition of consideration to exclude payments for inventory at *bona fide* wholesale prices would eliminate this overbreadth from the Rule. As noted in Primerica's principal comment, evaluating the inventory question may be difficult, because one of the features of pyramid schemes – inventory loading – may lead the perpetrators of such schemes to attempt to exclude themselves from the Rule under any inventory exception. One way to prevent such circumvention of the Rule would be to regard purchases of inventory as "consideration"

[89] Comment of Chadbourne & Parke LLP, No. 522418-11898, at 7-14; Comment of Venable LLP, No. 522418-11909, at 3-6.

[90] Comment of Mary Kay, Inc., No. 522418-11952, at 3; Comment of Herbalife International, Inc., No. 522418-11711, at 4.

[91] DSA Comment at 41.

[92] Comment of Sonnenschein Nath & Rosenthal LLP, No. 522418-12035; Comment of the Timberland Co., No. 522418-70031.

if they are not subject to at least a 90 percent refund policy for a period of at least one year, as DSA's Code of Ethics requires.[93]

The commenters who urged the Commission to address pyramid schemes proposed definitions based on language used in state anti-pyramid statutes. These definitions recognize that a pyramid scheme cannot exist without a new participant's payment for the right to participate in the scheme.[94] Because such payments form the backbone of any pyramid scheme, as well as the other types of frauds listed in the NPRM, one obvious solution to the Proposed Rule's overbreadth would be to define "consideration" to include only the types of payments that are the hallmarks of fraudulent schemes, i.e., payments for the right to participate, and explicitly exclude payments for training, instruction, educational materials, and inventory purchases at *bona fide* wholesale prices subject to a one-year 90 percent buyback policy. Doing so would serve the Commission's objectives, would satisfy the proponents of a rule against pyramid schemes, and would greatly reduce the tremendous overbreadth of the Proposed Rule.

F. Excluding Large, Long-Lived, and Financially Responsible Companies Is Supported by the Rulemaking Record.

Because the frauds described in the NPRM are offered by "fly by night" operators who disappear after defrauding victims, only to spring up again elsewhere, Primerica suggested excluding from the Proposed Rule companies that have been in business for a stated period (five years, for example), or who posted a performance bond to demonstrate financial responsibility for their promises of support for new recruits. Several other commenters agreed with these concepts, but suggested different approaches to establishing trustworthiness and financial reliability.

For example, several commenters suggested an exclusion for companies with a certain net worth, patterned after similar exclusions in various state business opportunity statutes.[95] A large, financially stable business is much less likely to commit fraud through the recruiting process, and much more likely to follow the law, honor a refund policy, and be accountable. Primerica fully supports such an exclusion.

Many commenters suggested another measurement of size and accountability, proposing to exclude publicly-traded companies and their subsidiaries from the Proposed

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[93] DSA Comment at 41. The record is not clear about how such an exclusion would affect traditional manufacturer-wholesaler-retailer distribution agreements.

[94] *See* Comment of Bruce Craig, No. 522418-12306 at 7-8 (state statutes defining pyramid schemes as arrangements under which "a person, upon a condition that the person make an investment, is granted a license or right to recruit for profit one or more additional persons" or "a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme").

[95] Comment of Sonnenschein Nath & Rosenthal LLP, No. 522418-12035, at 14; Comment of The Indep. Bakers Ass'n, No. 52241-11945, at 11 and Exhibit A; Comment of The Plumbing Mfrs. Inst., No. 52241-11945, at 4-5.

Rule.[96] Exempting publicly-traded companies would exclude only large, well-established, and easily located companies. Moreover, the strict reporting requirements of federal securities laws (and the stiff penalties for violating those laws) assure that publicly-traded companies provide a great deal of information about their business operations, finances, and material litigation in regular, publicly available SEC filings. A prospective participant wishing to gather information about such a company offering a business opportunity can do so quite easily. Primerica, which has been a member of a publicly-traded family of companies since 1990, supports such an exclusion.

Primerica supports any of the available options to exclude well-established, financially responsible companies from the Proposed Rule. Regardless of which alternative the Commission chooses, excluding business opportunity offerings of companies with a demonstrated track record of successful, sustainable business operations fits perfectly with the focus of the Proposed Rule – to allow the Commission to combat the true perpetrators of business opportunity fraud.

G. Primerica Supports a 90 Percent Refund / 90 Percent Buy-Back Exclusion.

One large direct selling company, Quixtar, suggested a "safe harbor" in the Proposed Rule for any company that offers a 90 percent refund of any up-front fee paid by a new participant, as well as a 90 percent buy-back policy for inventory purchased.[97] Under this approach, prohibitions against false earnings claims, disclosures relating to such claims, and prohibitions on various other misrepresentations would be generally applicable to all companies that fall within the Proposed Rule's incredibly overbroad coverage.[98]

Primerica believes that companies legitimately offering a 90 percent refund and a 90 percent buy-back for inventory should not be subject to the Rule *at all*. There is simply no evidence of significant problems among companies that meet these criteria. Thus, even the "light" rule that Quixtar proposes is without a reasonable evidentiary foundation. As discussed in Section II above, there is no record evidence of widespread, or even significant, fraud in the direct selling industry, and hence no justification for a new regulation to govern the industry. Certainly Quixtar's comment does not offer such evidence.

Primerica fully supports the requirements of existing law that prohibit false and unsubstantiated earnings claims, along with a wide variety of other false claims. It fully supports FTC enforcement actions to stop such claims. No new regulation is needed to

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[96] *See, e.g.,* Comment of Pre-Paid Legal Services, No. 522418-70002 at 1; Comment of Avon Products, Inc., No. 522418-70001, at 11-12; Comment of Sonnenschein Nath & Rosenthal LLP, No. 522418-12035, at 14.

[97] *See* Quixtar Comment, No. 522418-12039, at 14. Primerica does not have any "inventory" for agents to buy, so only the refund of the initial fee would be applicable to Primerica.

[98] *See* Quixtar Comment, No. 522418-12039, at 16-27.

make these claims unlawful, however, and the Commission has no legal basis for adopting such a regulation. As discussed at length in Primerica's principal comment, the Commission cannot satisfy the statutory requirements governing FTC rulemaking by finding that a particular misrepresentation is common in a narrow corner of the economy, such as pyramid schemes, and adopting what amounts to an economy-wide prohibition on that claim, as the present proposal does. The Commission must tailor any rule's coverage to the problem it has identified, or the rule is arbitrary and capricious. Quixtar may wish to impose on its competitors the requirements that have applied to it since the FTC's 1979 enforcement action against Amway, but without facts to support widespread fraud, there is no basis for applying those remedies to every company with a structure that *resembles* Quixtar, however vaguely.

Even assuming that a "light" rule is appropriate for Quixtar, it is not appropriate for Primerica and similarly situated companies. If there are no payments for recruiting, no minimum sales requirements to qualify for override commissions, and all compensation is based on retail sales, there is no possibility of the harms the Commission is seeking to address, and thus no reason for covering Primerica.

H. The Earnings Claims Disclosure Will Not Benefit Consumers.

There is no evidence to suggest that an earnings disclosure would actually benefit consumers. As detailed in Primerica's principal comment, as well as in other comments, the vast majority of participants in direct selling businesses work part-time, often only seasonally.[99] With this limited work effort comes limited compensation, leading to the undisputed fact that many participants in direct selling earn only limited income. The Proposed Rule seeks to impose a complicated set of earnings disclosures on a wide range of businesses, supposedly to allow consumers to differentiate frauds based on false earnings claims from legitimate businesses. There is, however, no evidence in the record that suggests that such disclosures will achieve this intended effect.

Rather, the comments show two reasons why such a disclosure would fail. First, companies and individuals willing to make false earnings *claims* are, in all probability, equally willing to make false earnings *disclosures*. There is no rational basis for the Commission to assume that a fraudster would honestly comply with a disclosure requirement that would reveal the fraud. The most likely outcome is that perpetrators of fraud would either ignore the earnings disclosure requirement or would populate it with additional false information, generating no benefit whatsoever for consumers.

Second, because many participants in direct selling limit their effort in ways that naturally limit their income from direct selling, consumers could not use earnings disclosures to distinguish between a fraudulent pyramid scheme and a legitimate company. In a legitimate direct selling company, a large number of people earn a limited amount, while a smaller number of people who devote full-time to the business and have an aptitude for it earn much more. Likewise, if a pyramid scheme were to make an

[99] *See* DSA Comment at 15; Comment of Mary Kay Inc., No. 522418-11952, at 3.

honest earnings disclosure, it would show a large number of people earning little or no money, and a few making much more. Without knowing the reasons for the disparities in compensation, a consumer would be powerless to differentiate a pyramid scheme from a legitimate business based on such numerical information, because the key difference between the two is the structure of the compensation system, not the amounts actually earned by participants. Indeed, that is the way the Commission prosecutes pyramid cases – it focuses on the inherent characteristics of the structure of compensation, rather than surveying the results for individual consumers.[100] What consumers need is accurate information about the *structure* of compensation, whether hypothetical or not. They need to know whether recruiting individuals who make no additional sales will increase their income – the hallmark of a pyramid. They do not need to know the fraction of participants who earned more or less than an arbitrarily selected amount, a fact that confounds the essential structure with the imponderables of individual effort, motivation, and ability.

The comments of the anti-pyramid groups carry earnings disclosures to an outlandish extreme.[101] They suggest that the earnings disclosure for any direct selling company must include "inactive" members of an organization (i.e., people who receive no compensation because they have not made any sales) and that expenses of participating in the business must be subtracted from earnings.[102] Because these proposals require information that companies do not routinely possess and cannot easily obtain, they are administratively impossible. Moreover, they would do nothing to allow consumers to differentiate between pyramid schemes and legitimate businesses.

For example, there is no basis for including inactive participants in an earnings disclosure. Although they earn no income, they would not have any expenses.[103] Even assuming a consumer product direct selling company as postulated by these commenters, a person who earns no commissions also buys no inventory and thus pays nothing to the company offering the business opportunity. These consumers suffer no continuing harm from their participation, and the fact that they earn no money because they made no sales

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[100] The structural approach to identifying pyramid schemes is set forth in Peter J. Vander Nat and William W. Keep, "Marketing Fraud: An Approach for Differentiating Multilevel Marketing from Pyramid Schemes," 21 J. Public Policy & Marketing 139 (Spring, 2002).

[101] For example, one comment identified more that 20 alleged deceptions or misrepresentations in a direct selling company's FTC required earnings disclosure form. Taylor, Comment 522418-70056, at July 13 letter at 3.

[102] Taylor Comment, No. 522418-12262, at 3-4.

[103] Moreover, any determination about how many inactive participants to include is inherently arbitrary. Is it only those who signed up in the last year? Why not, given the proposed Rule's quarterly update requirement, just those who signed up in the last quarter? Or, given the time frames of the reference and litigation disclosures, should it include all inactive participants who signed up in the last three years? Choosing the number of zeros to include in the average offers no information to consumers, but lets the advocate achieve any average he wishes. Including inactive participants is conceptually equivalent to the requirement that vocational schools disclose their dropout rates – a requirement that the Commission, with an assist from the courts, ultimately rejected. *See Katharine Gibbs School Inc. v. FTC*, 612 F.2d 658 (D.C. Cir. 1979).

is hardly a revelation that must be illustrated through numbers in order for consumers to understand it.

The proposal to include expenses in earnings claims is similarly misguided. Primerica serves as an excellent example of why such a requirement would be unworkable. Lower-level Primerica agents generally do not have any substantial business-related expenses; they work from home or are provided an office to use by their full-time supervisor. They are not required to purchase any goods or services from Primerica, and the insurance and financial products they sell are paid for directly by the client making the purchase. For agents who are full-time managers of offices, there are businesses expenses associated with leasing office space, providing computers and other facilities for themselves and their downline agents, and the like. Because these expenses are not paid to Primerica or any affiliate of Primerica or recommended by Primerica, Primerica has no way of tracking such expenses. There would be no practical way for Primerica to comply with these requirements.

More importantly, the disclosures these commenters suggest would not allow consumers to distinguish between pyramid schemes and legitimate businesses. As the extensive analysis contained in these comments demonstrates, identifying a pyramid scheme (or, at least, one that attempts to disguise itself as a legitimate business opportunity) entails an in-depth examination of the compensation structure and the actual manner in which compensation flows within an organization. The commenters claim to be able to draw these distinctions because of their years of study of pyramid schemes, but consumers are unlikely to have either the information at their disposal or the background and expertise to know what facts are critical for identifying a pyramid scheme.

Primerica hereby proposes the following designated issues of fact relating to the earnings disclosure requirement for any rulemaking hearings conducted under the Proposed Rule as it currently stands:

88. There is little or no incremental benefit of the disclosures under the Rule compared to the current prohibitions against misrepresentations of earnings claims, because false earnings claims can be pursued by the Commission, other federal and state agencies, and private litigants.

89. The earnings claims disclosures will not provide meaningful information to consumers in the context of legitimate direct selling companies where many representatives work part-time and therefore earn comparatively small amounts of money.

90. Perpetrators of business opportunity frauds likely will not comply with the earnings claims disclosure requirement in the Rule; according to the NPRM, these fraudsters already make abundant false earnings claims, even though such misrepresentations are plainly illegal.

91. If fraudsters do comply, the disclosure will not provide consumers with information that will enable them to distinguish frauds from legitimate business opportunities.

92. Consumers are unlikely to ask to see the underlying substantiation supporting earnings claims, and if they do, will not garner substantial useful information from it.

93. It will be impractical for individual agents to make the required disclosures when they provide information about their earnings experiences in response to a prospective participant's specific questions.

V. CONCLUSION: THE ISSUES CONNECTED WITH THE PROPOSED RULE ARE NOT SUFFICIENTLY DEVELOPED TO ALLOW FOR A FAIR, EFFICIENT RULEMAKING PROCESS

The comments submitted in response to the NPRM establish that the effects of this Proposed Rule are far broader, and will affect far more Americans, than the NPRM suggested. The comments demonstrate a dramatic mismatch between the stated purpose of the Proposed Rule – to combat certain narrowly identified types of fraud – and the actual scope and effect of the Rule. The Proposed Rule would severely undermine a large segment of the American economy and sharply curtail an opportunity currently enjoyed by approximately 13.6 million Americans.

Conducting workshops or hearings to further analyze the current Proposed Rule would be unproductive because of the very large number of constituencies affected and the equally large number of factual issues that must be addressed if the Commission wishes to proceed with the current proposal. Forcing Primerica and other parties to participate in the workshop and hearing process where the issues are so broad and undefined would be wasteful and inefficient, and would only delay any rule that might actually aid the Commission in fighting fraud.

The Commission has done little to define the issues under the Proposed Rule, or to provide the public with any evidence or logical justification for the breadth of the proposal. Unlike prior rulemakings under Section 18, there is no Staff Report to focus the issues, and the NPRM provides little detail to fill that gap. As a result, the number of participants and issues in further proceedings, whether hearings or workshops, would make them extremely unwieldy.

The Proposed Business Opportunity Rule stands in stark contrast to previous major rulemaking efforts by the Commission. In those proceedings, the Commission engaged in an extensive "funneling" process designed to narrow the scope of issues to be addressed *before* hearings were held. Table 1, attached hereto, provides summary information regarding the procedures the Commission has employed in past rulemakings. Appendix A provides more detailed descriptions of the procedural history of the rules listed in Table 1.

These details about the Commission's previous rulemaking efforts highlight just how premature hearings would be in connection with the Proposed Business Opportunity Rule. Rather than forcing a series of hearings with no limitations on the scope of necessary factual inquiry, it would be far more efficient – and far more fair to the public and the affected businesses – for the Commission to publish a new proposal based on the comments submitted in this proceeding to date. Such a proposal also would be far more likely to protect the rights of Primerica and other parties that are detailed in the FTC Act for rulemakings.

If the Commission wishes to move forward with the current version of the Proposed Rule, Primerica believes that hearings are necessary. There is no other way to explore and narrow the issues that the Commission must ultimately resolve. Moreover, given the limited availability of the factual foundations of the claims in many critical comments, cross-examination to test their validity is essential as well. Therefore, Primerica invokes its statutory right to hearings, as discussed in its principal comment, and requests its statutory right to cross examination. It proposes the designated factual issues listed in this rebuttal comment for examination in such hearings.

It is Primerica's recommendation and hope, however, that the Commission will narrow the Proposed Rule, thereby focusing the issues that must be explored, and perhaps even eliminating the need for hearings, before this rulemaking proceeds further.

TABLE 1

FTC PAST RULEMAKING PROCEEDINGS

RULE	DATE OF NPRM	DATE OF FINAL RULE	HEARINGS	NUMBER OF WITNESSES	PAGES OF TRANSCRIPT	NUMBER OF DESIGNATED ISSUES
CHILDREN'S ADVERTISING	April 27, 1978	October 2, 1981 Rulemaking terminated (2.5 years after NPRM)	January 1979 through March 1979	23 parties submitted briefs	--	3
FRANCHISE RULE 1	October 11, 1971 (Not a Magnuson-Moss Rule)	December 21, 1978 (7 years after NPRM)	February 14, 1972 through March 1, 1972	nearly 100	1,757 pages	n/a
FRANCHISE RULE 2	February 28, 1997 (ANPR) October 22, 1999 (NPRM)	August 25, 2004 (Staff Report; 9 years after NPRM)	2 workshops; no hearings	67 participated	1,548 pages	n/a
CREDIT PRACTICES	April 11, 1975 (initial)	March 1, 1984 (9 years after NPRM)	September 12, 1977 through January 30, 1977	319	--	14
R VALUE	November 18, 1977	August 27, 1979 (2 years after NPRM)	February 13, 1978 through March 9, 1978	50	--	--
VOCATIONAL SCHOOL	August 15, 1974	December 28, 1978 (3.5 years after NPRM)	44 days of hearings	400	--	--
FUNERALS	August 29, 1975	September 24, 1982 (7 years after NPRM)	April 20, 1976 through August 6, 1976	315	14,719 pages and 4,000 exhibits	30

TABLE 1

(Cont'd)

RULE	DATE OF NPRM	DATE OF FINAL RULE	HEARINGS	NUMBER OF WITNESSES	PAGES OF TRANSCRIPT	NUMBER OF DESIGNATED ISSUES
CARE LABELING	November 4, 1969 (Not a Magnuson-Moss Rule)	December 16, 1971 (2 years after NPRM)	6 days of hearings between January and March 1970;	--	--	n/a
	Amendment: January 26, 1976		Hearings for 2 weeks in November 1976; then for 1 week in January 1977	30	--	6
		As amended: August 2, 2000	Amendment workshops starting January 29, 1999	--	--	n/a
USED CARS	January 6, 1976 (initial)		December 6, 1976 through May 4, 1977	--	--	2
	August 9, 1983 (reconsideration)	November 19, 1984 (revised and final, 8 years after NPRM)				

Note: Information about hearings, witnesses, transcript pages, and designated issues was complied from the procedural histories presented in the Statement of Basis and Purpose for a final rule, or in some cases from Staff Reports on the Proposed Rule. Because those histories do not always present the same information, some information is missing. Missing information is indicated with a "–." Information that is not applicable in a particular proceeding is indicated by "n/a."

APPENDIX A - PAST FTC RULEMAKING PROCEEDINGS

This Appendix provides an overview of previous FTC rulemaking proceedings to illustrate the various procedures, procedural challenges, and the timeline/logistics typically associated with such rulemakings. The list is selective, indented to emphasize the procedures employed in major rules that the Commission voted to promulgate under the procedures of Section 57a. In one case, Vocational Schools, the Rule was remanded and eventually terminated. The only rules that the Commission originally promulgated under Section 57a that are not included in this review are the Ophthalmic Practices Rule (Eyeglasses Rule) and the subsequent Eyeglasses II proceeding that was reversed on appeal. Although there have been other amendment proceedings under Section 57a, they involved rules (such as the Mail or Telephone Order Merchandise Rule) that were originally adopted before Section 57a was enacted. Children's advertising is included because it was uniquely controversial, and effectively marked the end of extensive rulemaking under Section 57a. The Franchise Rule is included because of its unique relationship to the present Business Opportunities proposed Rule.

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Children's Advertising

On April 27, 1978, the FTC promulgated a NPRM related to children's advertising issues.[104] The Commission found that the public interest required "expeditious procedures" for the rule and, as here, exercised its authority under 16 C.F.R. 1.20 to employ modified hearing procedures. Specifically, the Commission adopted modified procedures based on the proceedings employed by the Environmental Protection Agency in implementing the Toxic Substances Control Act, 15 U.S.C. § 2605.

Among other things, these modified procedures provided that: (1) all information relevant to the proposed rule to be submitted during the written comment period or at a legislative-style hearing (more on the schedule below); (2) no participants in the rulemaking would be allowed to cross-examine other participants at the hearing, although participants were permitted to submit written questions to the presiding officer who could then ask those questions during the hearing; (3) the Commission could convene a second hearing if, after the initial hearings, the Commission determined that there were disputed issues of material fact necessary to resolve before issuing the final rule; and (4) cross-examination and presentation of rebuttal evidence would be permitted at the disputed issues hearing.[105]

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[104] 43 F.R. 17,967.

[105] *Id.* at 17,968.

The NPRM proposed the following schedule with an initial legislative-type hearing and a second adjudicative-type hearing on certain disputed issues of material fact:

- **October 24, 1978.** Deadline for submitting general written comments, exhibits and requests to appear at a legislative hearing.

- **November 6, 1978**. Legislative hearing in San Francisco, CA.

- **November 20, 1978 through December 16, 1978**. Legislative hearings in Washington, D.C.

- **January 15, 1979**. Deadline for submitting proposed disputed issues of fact that are material and necessary to resolve at disputed issues hearing, requests to cross-examine at disputed issues hearing witnesses who appeared at the legislative hearing, and requests to present oral rebuttal at disputed issues hearing.

- **February 27, 1979**. Deadline for Commission's publication of disputed issues and presiding officer's rulings on requests for cross-examination and rebuttal. Designation of group representatives to follow thereafter.

- **March 29, 1979**. Deadline for submission of verbatim rebuttal statements for disputed issues hearing.

- **April 2, 1979**. Disputed issues hearing.

- **Twenty-days** after completion of disputed issues hearing. Deadline for submission of written rebuttal statements.

- **July 27, 1979**. Deadline for issuing staff report.

- **September 12, 1979**. Deadline for release of Presiding Officer's report.

- **October 12, 1979**. Deadline for receiving comments on report.

The legislative-style portion of the rulemaking extended well-beyond the original schedule. In the end, the Commission conducted approximately six weeks of legislative-type hearings between January and March of 1979. All questioning was conducted by the Presiding Officer although, pursuant to the modified hearing procedures, the parties were permitted to present to the Presiding Officer suggested questions for cross-examination of witnesses. Upon the conclusion of the legislative-style hearing, all parties were requested to submit briefs and responses to the Presiding Officer proposing issues to be designated as disputed and necessary to resolve. Twenty-three parties submitted briefs listing issues to be designated as disputed. Most of these parties also filed responses to the disputed issues briefs.

On July 30, 1979, the Presiding Officer issued an order identifying disputed issues of material fact that were necessary to resolve at adjudicative-type hearing. Specifically, the Presiding Offer concluded that disputed issues hearings should focus on three issues:

1. To what extent can children between the ages of 2 and 11 distinguish between children's commercials and children's programs to the point that they comprehend the selling purpose of television aimed at children?

2. To what extent can children between the ages of 2 and 11 defend against the persuasive techniques used in these commercials, such as fantasy or cartoon presenters, premiums, limited information, and various associated appeals?

3. What health effects, actual or potential, attach to any proven lack of understanding of selling intent or inability to defend against persuasive techniques?

Most parties, including the Commission staff, filed responses to the order. Before the Commission made a decision with regard to the proposed disputed issues, Congress enacted the FTC Improvements Act of 1980, which removed the Commission's authority to continue the rulemaking in its then-current posture. The Improvements Act suspended the children's advertising rulemaking proceeding and set forth certain conditions that needed to be satisfied before the rulemaking could resume. Specifically, the Improvements Act provided that the rulemaking could resume only under a theory of deception, although it was initiated under theories of both deception and unfairness. In addition, the Act provided that the rulemaking could not be continued unless the Commission published "the text of the rule, including any alternatives, which the Commission proposes to promulgate," and allowed public comment on the text.

Thereafter, the Commission staff initiated informal meetings with major parties to the proceedings to explore courses of action other than rulemaking. By notice in the Federal Register on April 8, 1981, the Commission solicited public comment on the staff's recommendation that the rulemaking be terminated. On October 2, 1981, the Commission terminated the rulemaking.

Franchise Rule

On November 11, 1971, the Commission announced a rulemaking relating to disclosure requirements and prohibitions concerning franchising.[106] The Commission held public hearings in Washington, D.C., from February 14, 1972 through March 1, 1972. Public hearings were originally scheduled to be held from February 14, 1972 through February 16, 1972, but the Commission extended the dates due to great interest

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[106] 36 F.R. 21,607.

in the proceeding. Nearly 100 witnesses testified at the hearings, which produced 1,757 pages of transcript, exclusive of exhibits.

The Commission published a revised proposed rule on August 22, 1974, and received written comments on the proposed rule.[107] The Commission further modified the revised proposed rule and promulgated the final Rule on December 21, 1978.[108] The Commission asserted that these modifications did not raise any new issues of law or fact and declined to invite further comment on the modified rule.[109]

Although it was promulgated after the Magnuson-Moss FTC Improvements Act went into effect, the original Franchise Rule was not subject to the new procedural requirements.[110] The 1975 Act included a savings clause that excluded any rule proposed under section 6(g) of the FTC Act that was "substantially completed" before the date of enactment (Section 202(c)(1) of the Magnuson-Moss Warranty—FTC Improvement Act) from the new procedural requirements. Because the record on the Franchise Rule closed in 1974, challenges to the original rule would have been made under the Administrative Procedures Act. After the D.C. Circuit ruled that the FTC did have rulemaking authority[111] and the Supreme Court denied review, any challenge based on the FTC's lack of rulemaking authority would have been quite speculative.

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The Commissioned revisited the Franchise Rule in 1995. On April 7, 1995, as part of its continuing review of FTC trade regulation rules, the Commission issued a request for comment to determine the Franchise Rule's current effectiveness and impact.[112] The Rule Review Notice sought comment on standard statutory regulatory review questions, such as the cost and benefits of the Rule, recommended changes to the Rule to increase the Rule's benefits to consumers, assessment of how those changes would affect compliance costs, and how changes in the marketplace and new technologies may affect the Rule. The Commission held two workshops and no hearings on the Rule Review.

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107 39 F.R. 30,360.

108 43 F.R. 59,614.

109 *Id.* at 59,622.

110 We note that the current Franchise Rule amendment proceeding is not proceeding under the full procedures of the 1975 Act either. The reason is that the amendment has always been focused on reducing inconsistencies between federal and state franchise regulation, an approach with considerable support in the franchise industry.

111 *See National Petroleum Refiners Assoc. v. FTC*, 482 F. 2d 672 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974).

112 60 F.R. 17,656.

Based on comments received during the Rule Review, the Commission tentatively determined to retain the Franchise Rule, but sought additional comment on possible amendments. To that end, on February 28, 1997, the Commission published an ANPRM,[113] seeking comment on several issues. The ANPR elicited 166 written comments.

The Commission held six public workshop-conferences on the Rule in Washington, D.C., Chicago, New York City, Dallas, and Seattle. Sixty-seven individuals participated in the workshops, which generated 1,548 pages of transcripts. The Commission issued a NPRM to amend the Rule on October 22, 1999.[114] The Commission received 40 comments in response to the NPRM.[115] No commenter specifically requested a hearing, although some suggested a public workshop(s) and expressed interest in participating if a workshop was held.[116] The Commission staff believed that the current record was sufficient and did not hold a workshop or hearing.[117] On August 25, 2004, the Commission published the Staff Report on the proposed revised rule, and accepted comments on the Staff Report until November 12, 2004.[118]

The Commission has taken no further action on the proposed revised Franchise Rule.

Credit Practices

The Commission published an Initial Notice of Rulemaking on the Credit Practices Rule[119] on April 11, 1975 after an eighteen month investigation of the consumer finance industry to determine whether the use of certain collection remedies violated Section 5 of the FTC Act. The Notice contained a list of 12 questions the Commission deemed particularly pertinent and upon which comment was specifically invited. A Final Notice of Rulemaking was published on June 24, 1977, setting forth the time and place for public hearings and designating 14 issues for public comment. The Commission received written comments through August 5, 1977.

Hearings were conducted in Dallas, Texas; Chicago, Illinois; San Francisco, California; and Washington, D.C., from September 12, 1977, to January 30, 1978. Three

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113 62 F.R. 9115.

114 64 F.R. 57,294.

115 *See* Disclosure Requirements and Prohibitions Concerning Franchising, Bureau of Consumer Protection, Staff Report to the FTC and Proposed Revised Trade Regulation Rule at 3 (August 2004).

116 *Id.* at 3-4.

117 *Id.* at 4.

118 69 F.R. 53661.

119 16 C.F.R. Part 444, 49 F.R. 7740.

hundred and nineteen witnesses appeared during these ten weeks of hearings. In all, 508 hearing exhibits were placed on the record. Rebuttal submissions were received until May 1, 1978.

After receipt of rebuttal statements, the Presiding Officer and Commission staff prepared reports to the Commission. The Presiding Officer made findings on designated issues, and the Commission staff summarized and analyzed the record evidence and made recommendations to for a revised Trade Regulation Rule. The Bureau of Economics also submitted comments and recommendations to the Commission for a revised rule.

Publication of the Final Staff Report initiated a sixty-day comment period which afforded the public an opportunity to comment on the reports of the Presiding Officer and the staff. This comment period was extended and closed on January 16, 1981. A summary of post-record comments was placed on the public record.

On April 14, 1983, the rulemaking staff's memorandum recommending a final modified proposed rule, and memoranda from the staff of the Bureau of Economics, and the Directors of the Bureaus of Consumer Protection and Economics were placed on the public record. On June 6 and 7, 1983, the Commission heard oral presentations from prior rulemaking participants who had been invited to present their views directly to the Commission.

On June 13, 1983, the Commission met to consider whether to adopt a final rule, and if so, what form the rule should take. Although as to the rule as a whole no final determination was made during that meeting, the Commission deleted the provisions of the staff proposed rule concerning attorneys' fees and deficiency balances and directed the staff to draft proposed disclosures for the remaining provisions of the rule. The Commission further directed the staff to draft alternative proposals for a limitation on household goods security interests and third party contacts. The staff was instructed to draft a modified disclosure for cosigners. The Commission indicated tentative support for a ban on confessions of judgment and wage assignments. The Commission further indicated support for the late charges provision subject to clarification of the language to focus more clearly on the "pyramiding" problem.

On July 20, 1983, the Commission tentatively adopted the portions of staff's revised proposed rule banning confessions of judgment, waivers of statutory property exemptions, wage assignments, pyramiding late charges, and blanket security interests in household goods. The Commission also tentatively adopted staff's revised proposal requiring that potential cosigners to be furnished with a "Notice to Cosigner" which explains their obligations and liability. The Commission rejected the provisions of the proposed rule pertaining to third party contacts and cross collateralization. The Commission determined that the effective date of the rule was to be one year from the date of promulgation.

In response to the invitation to comment on the proposed rule the Commission received over 1,300 written comments. The Commission received an additional 358

post-record comments were received during the 1980-81 reopening for comments on the Presiding Officer and Staff Reports.

The final rule was published on March 1, 1984.

Labeling and Advertising on Home Insulation

On November 18, 1977, the Commission published a proposed trade regulation rule governing the labeling and advertising of residential thermal insulation materials.[120] The Commission found that rising fuel prices and an increased demand for residential insulation made it in the public interest to employ its expedited rulemaking procedures under 16 C.F.R. 1.20. As a practical mater, the most significant departure from the Rules of Practice involved the abandonment of the two-notice procedure for designating disputed issues of material fact.

The Commission solicited written comments for two months following publication of the proposed rule. The Commission conducted hearings in Washington, D.C. from February 13 to March 9, 1978. Approximately 50 witnesses participated in the hearings. In addition to Commission staff, nine group representatives from various industries were permitted to examine and cross-examine all witnesses. A 30-day rebuttal period followed the hearings during which hearing participants were permitted to submit written comments on the hearing record.

In July 1978, the staff issued a report analyzing the record evidence and recommending a proposed rule. In August 1978, the Presiding Officer published his report noting several areas of disagreement with the staff's recommendations. The public comment period, initially limited to 30-days following the Presiding Officer's report, was extended and the public invited to submit comments after the issuance of the staff report. The Commission received more than 100 written comments by the close of the comment period on September 22, 1978.

The Commission convened a special meeting to permit interested persons to make presentations directly to the Commissioners. The Commission promulgated the trade regulation rule on August 27, 1979.[121] There have been subsequent amendments, which we do not discuss in detail.

Proprietary Vocational and Home Study Schools

On August 15, 1974, the Commission published for comment and public hearings a proposed trade regulation rule for proprietary vocational and home study schools. Hearings on the proposed rule were originally scheduled for six cities, but ultimately were held in Boston, New York and Washington, D.C. prior to the postponement of all

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[120] 44 F.R. 50219.

[121] *Id.*

rulemaking hearings by the enactment of the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act. The Commission republished the proposed rule on May 15, 1975 with any invitation for interested parties to comment on the proposed rule. During the comment period prior to the public hearings, the Commission received over 900 written comments.

On September 29, 1975, the Presiding Officer published in the Federal Register a public notice listing the dates and locations of public hearings to be conducted under the new procedures of the Magnuson-Moss Act. The Presiding Officer conducted public hearings in San Francisco, Los Angles, and Chicago. Including both the pre- and post-Magnuson-Moss hearings, over 400 witnesses offered testimony on the proposed rule over a span of 44 days of hearings. At the conclusion of the second set of hearings, the Commission opened another comment period to permit comment on the testimony received during the hearings.

At the conclusion of the public hearings, the Presiding Officer prepared a report presenting the findings on issues that had been designated by the Commission as the focus of the public hearings. The Commission staff recommended that the Commission promulgate a revised trade regulation rule requiring proprietary vocational schools to inform their prospective students of the school's graduation and placement rates, to make pro rate refunds to students in the event of student cancellations, and to obtain "reaffirmations" of enrollment contracts.

Publication of the staff report initiated a post-record comment period. The comment period commenced on January 7, 1977, and concluded on May 31, 1977 after two time extensions had been granted by the Commission at the request of industry groups. During this time, the Commission received an additional 200 written comments.

At the close of the comment period, the Commissioner convened a special Commission meeting to permit interested persons to make direct presentations to the Commissioners themselves. The Commission promulgated the final rule on December 28, 1978.

The Katharine Gibbs School successfully challenged the Vocational School Rule in the Second Circuit Court of Appeals in 1979.[122] The court struck down key provisions of the Rule and remanded it to the Commission for further proceedings.[123] The Commission did not take up again the Vocational School rulemaking on remand. In 1988, after the rulemaking record had been closed for twelve years, the Commission terminated the rulemaking proceeding.[124]

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122 *See Katharine Gibbs School, Inc. v. FTC*, 612 F.2d 658 (2d Cir. 1979).

123 *See id.* at 670.

124 *See* 53 F.R. 29482.

Funeral Rule

In December of 1972, at the direction of the Commission, the Commission's Bureau of Consumer Protection began an initial investigation of practices in the funeral industry. During the initial investigation, the Commission's staff interviewed consumers, funeral directors, memorial society members, attorneys, state officials, and others, and also visited funeral homes. These efforts led the staff to conclude that a more detailed examination of the industry's practices was warranted.[125] The Commission subsequently approved a full industry-wide investigation and authorized the use of compulsory process. The Commission published an Initial Staff Report by the staff of the Bureau of Consumer Protection based on the industry-wide investigation in August, 1975. In that report, the staff recommended that the Commission initiate a rulemaking proceeding.

After reviewing the Initial Staff Report, the Commission published an Initial Notice of Proposed Rulemaking on August 29, 1975.[126] The Commission received more than 9,000 separate written comments on the NPRM through March 6, 1976. On February 20, 1976, the Presiding Officer published the Final Notice of Rulemaking[127] which identified 30 disputed issues of fact to serve as the focus for the public hearings on the proposed rule.[128]

From April 20 through August 6, 1976, the Commission held public hearings on the proposed rule in 6 cities.[129] Over the course of 52 days of hearings, 315 witnesses presented testimony and exhibits and were subject to cross-examination by the various participating parties. The hearings produced 14,719 pages of transcript and about 4,000 additional pages of exhibits. The Commission staff and various parties filed 47 separate submissions during the rebuttal period following the public hearing.

At the conclusion of the public hearing and rebuttal process, the Presiding Officer prepared reports to the Commission based on the rulemaking record and making findings on the issues that had been designated for the public hearings.[130] The Commission staff

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[125] Division of Evaluation, Bureau of Consumer Protection, *Unfair Practices in the Funeral Industry: A Planning Report to the Federal Trade Commission*, June 29, 1973.

[126] 40 F.R. 39,901.

[127] 41 F.R. 7787.

[128] Prior to the hearings, the National Funeral Directors Association sought to enjoin the hearings in federal court, alleging a number of procedural improprieties and Commission action in excess of its statutory authority. The court denied the injunction. *NFDA v. FTC*, 76-0615 (D.D.C. Apr. 14, 1976).

[129] Hearings took place in Atlanta, Chicago, Los Angeles, New York City, Seattle, and Washington, D.C.

[130] Report of the Presiding Officer on Proposed Trade Regulation Rule Concerning Funeral Industry Practices (16 C.F.R. Part 453), July 1977.

also analyzed the record evidence and made recommendations to the Commission for final action.[131] Of particular interest to the current rulemaking, the staff recommended a revised trade regulation rule that differed from the initial proposed rule in several respects.

Following publication of these reports, the Commission opened a second public comment period.[132] The Commission extended the original 60-day comment period to 90-days.[133] During this time, the Commission received over 1,300 separate comments.[134] On February 2, 1979, the Commission's staff forwarded to the Commission their final recommendations. On February 27 and 28, 1979, the Commission heard oral presentations from selected rulemaking participants invited by the Commission to present their views directly to the Commission.

On March 23, 1979, the Commission met in open session and tentatively approved a final Funeral Rule. Prior to promulgation, two events occurred that required the Commission to revise the rule. ***First***, Congress adopted the FTC Improvements Act of 1980.[135] As discussed *supra*, Section 19 of the Act established certain procedural and substantive limitations on the Commission's rulemaking authority. Accordingly, pursuant to Section 19(c)(2)(A) of the Act, the Commission was required to republish a proposed rule in the Federal Register for public comment before promulgating the final rule.

Second, in December of 1979, the Second Circuit issued its Vocational School Rule decision. In *Katharine Gibbs School, Inc. v. FTC*, 612 F.2d 658 (2d Cir. 1979) ("*Gibbs*"), the Second Circuit held that the Magnuson-Moss Act requires the Commission to include in the actual text of a rule a description of the underlying unfair or deceptive acts or practices that serve as its basis.[136] Because, the pending Funeral Rule addressed only remedial issues, *Gibbs* required the Commission to further revise the Rule.

The Commission met on December 17, 1980 to consider revisions of the proposed Funeral Rule in light of *Gibbs* and the FTC Improvements Act. The Commission published a notice on January 22, 1981 with text of a revised version and announcing a

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[131] Funeral Industry Practices, Final Staff Report to the Federal Trade Commission and proposed Trade Regulation Rule (16 C.F.R. Part 453), June 1978.

[132] 43 F.R. 28,588.

[133] 43 F.R. 34,500 (1978).

[134] Summary of Post-Record Comments on the Funeral Industry Practices Rule, January 25, 1979, XIV-1368.

[135] Public Law 96-252, 94 Stat. 391.

[136] 612 F.2d at 662.

60-day comment period, followed by a rebuttal period.[137] On July 7 and 8, 1981, the Commission heard oral presentations from major participants.

On July 22, 1981, the Commission met in open session and approved language of the Funeral Rule for purposes of submitting the Rule's recordkeeping requirements to the OMB for review. OMB approved the recordkeeping requirement on June 7, 1982.

The Commission voted to promulgate the Funeral Rule and published its final Rule on September 24, 1982—seven years after the Initial Staff Report.[138]

Care Labeling Rule

It is worth noting that in promulgating the original Care Labeling Rule, the Commission used the normal informal hearing procedures set forth in 16 C.F.R. 1.13. However, in amending the Rule in 2000, the Commission invoked 16 C.F.R. 1.20 to use modified procedures.

On November 4, 1969, the Commission published three proposed rules, and gave notice of hearings to be held beginning in January 1970.[139] The Commission received written comments and held six days of hearings between January and March, 1970. The Commission promulgated the final Care Labeling Rule on December 16, 1971.[140]

On January 26, 1976, the Commission published a proposed amended rule in the Federal Register and requested comment.[141] The Commission also appointed a Presiding Officer. Drawing on the responses to the January 26, 1976 notice, the Presiding Officer published six designated issues.[142] The Commission held hearings in Washington, D.C. beginning November 8, 1976, for two weeks, and in Los Angeles, California, beginning January 10, 1977, for one week. The record remained open for rebuttal of oral testimony until March 1, 1977.

After reviewing the record, the Presiding Officer published a report in July 1977 containing his findings and conclusions and recommending that the Commission

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137 46 F.R. 6976.

138 47 F.R. 42,260.

139 34 F.R. 17,776.

140 36 F.R. 23,883. This proceeding predated the procedural requirements of the Magnuson-Moss FTC Improvements Act.

141 41 F.R. 3747.

142 41 F.R. 35,863.

promulgate a revised rule.[143] The Commission published a staff report analyzing the record and making recommendations in May 1978.[144] After a public comment period on these two reports, the Commission held an oral presentation during which representatives of major interested parties directly presented their views to the Commissioners.[145] The Commission then held a mark-up session at which it approved in substance an amended care labeling rule. In January 1981, the Commission published its proposed final amended rule for technical comments.[146] Finally, in June 1982, after reviewing the record, the Commission found that there was sufficient evidence to support the amendments that clarified the requirements of the rule. In 1983, the Commission amended the Rule to clarify its requirements by identifying in greater detail the washing or dry cleaning information to be included in care labels.[147]

The Commission published a Federal Register Notice on June 15, 1994, seeking comment on the costs and benefits of the Rule and related questions, such as what changes in the Rule would increase the Rule's benefits to purchasers and how those changes would affect the costs the Rule imposes on firms subject to its requirements.[148] The Commission decided to retain the Rule, but requested public comments on possible amendments. On December 28, 1995, the Commission published an ANPR.[149]

On May 8, 1998, the Commission published a NPRM, proposed specific amendments to the Rule, and sought additional public comment. The Commission invoked its discretion under 16 C.F.R. 1.20 to adopt alternative rulemaking procedures for the amendments to the Care Labeling Rule.[150] The modified procedures included: (1) a single NPRM; (2) no designation of disputed issues; and (3) a public workshop-conference to discuss the issues raised by the NPRM. The Commission stated it would hearings with cross-examination and rebuttal submissions if requested.[151] Although the

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143 Report of the Presiding Officer on Proposed Revised Trade Regulation Rule Regarding Care Labeling of Textile Products and Leather Wearing Apparel (Jul. 11, 1977).

144 Staff Report and Proposed Revised Trade Regulation Rule, (May 1978).

145 Notice of Oral Presentation Before the Commission, 44 F.R. 30,570 (1979).

146 Notice of Opportunity for Technical Comment on Proposed Rule, 46 F.R. 935 (1981).

147 48 F.R. 22,733.

148 *See* 59 F.R. 30,733.

149 60 F.R. 67,102. Issues for comment were: the standards for water temperature, the desirability of a home washing instruction, and a professional wetcleaning instruction for certain items, and the Rule's reasonable basis standard. *See id.*

150 *See* 63 F.R. 25,425-26 ("The Commission has decided to employ a modified version of the rulemaking procedures specified in Section 1.13 of the Commission's Rules of Practice.").

151 *See id.*

Commission received 38 comments in response to the NPRM, no party requested hearings and, accordingly, no hearings were held.

The public workshop took place on January 29, 1999 at the Commission's Headquarters, featuring 28 participants representing 20 different interests, and approximately 30 observers, some of whom contributed to the workshop discussion upon the request of the Presiding Officer. The Commission accepted post-workshop comments until March 1, 1999.

The Commission promulgated the final rule on August 2, 2000.[152]

Used Car Rule

The Used Car rulemaking proceeding stemmed from an investigation that the Commission's Seattle Regional Office began in 1973. That investigation resulted in a 1973 report recommending that the Commission, pursuant to its authority under Section 6(g) of the FTC Act, regulate the sale of used cars through a system of required inspections of dealers, disclosure of defects, and mandatory warranties on parts found to be without defects.[153] The staff at the Bureau of Consumer Protection conducted the investigation.

In 1975, Congress directed the Commission to initiate a rulemaking proceeding dealing with "warranties and warranty practices in connection with the sale of used motor vehicles."[154] This statutory directive expressly authorized the Commission to proceed under both Title I of the Magnusson-Moss Act and any other statutory authority available to the Commission.

In December 1975, the Bureau of Consumer Protection published an Initial Staff Report recommending that the Commission initiate a rulemaking proceeding. The Commission published an Initial NPRM on January 6, 1976.[155] The Initial Notice proposed a Rule designed to remedy the allegedly unlawful practices through (1) a "window sticker" posted on each used car disclosing warranty terms, warranty disclaimers, prior use of the vehicle, mileage, prior repairs, and dealer identification information; and (2) a specified form of warranty disclaimer to be used in "as is" sales contracts. Additional remedies suggested for public comment in the Initial Notice included disclosure of mechanical defect information and a "pre-purchase inspection opportunity" which would have given consumers the right to take a car to a third party for

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152 63 F.R. 47,261.

153 Seattle Regional Office Used Car Analytical Programming Guide (Sept. 17, 1973).

154 15 U.S.C. § 2309(b).

155 41 F.R. 1089.

inspection prior to purchase. The Commission amended the Initial NPRM by publishing additional questions for public comment on May 21, 1976.[156]

Following publication of the second notice, the staff circulated to the parties a suggested format (in the form of a window sticker) for the disclosures proposed in the initial and second NPRMs.[157] The Commission published a Final NPRM establishing the dates and locations of public hearings, setting the final date for receipt of written comments, and designating disputed issues for consideration.[158]

The Commission received written comments on the initial and second NPRMs and on the suggested format through October 22, 1976. The Commission held public hearings in six cities (Boston, Cleveland, Dallas, Los Angeles, San Francisco, and Washington, D.C.) from December 6, 1976 through May 4, 1977. All witnesses were given an opportunity to make an opening presentation followed by cross-examination conducted by Commission staff and by designated representatives of used car dealers, the auto rental and leasing industries, and consumer groups. Rebuttal statements were accepted after the hearings until August 31, 1977. After receiving rebuttal comments, the Presiding Officer prepared a report making findings on the designated issues;[159] the Commission prepared a report summarizing and analyzing the record evidence and making recommendations to the Commission for a trade regulation rule.[160]

Publication of the Final Staff Report initiated a 60-day comment period for comments on the Presiding Officer and staff reports. The Commission extended the post-record comment period for 30 days until February 13, 1979.[161]

On July 26, 1979, the staff's summary of post-record comments, memorandum recommending modifications of the proposed rule, and a memo from the Director of the Bureau of Consumer Protection outlining an alternative "optional inspection" rule were forwarded to the Commission.

On September 25, 1979, the Commission heard oral presentations from selected rulemaking participants who the Commission invited to present their views directly to the Commission.

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[156] 41 F.R. 20,896. The publication of the second notice resulted from early comment criticizing the initial proposed rule.

[157] *See* Sale of Used Motor Vehicles, Final Staff Report to the Federal Trade Commission and Proposed Trade Regulation Rule (16 C.F.R. Part 455), at Appendix D, September 1978.

[158] 41 F.R. 39,337.

[159] Report of the Presiding Officer on Proposed Trade Regulation Rule for Sale of Used Motor Vehicles (16 C.F.R. Part 455), May 22, 1978.

[160] Sale of Used Motor Vehicles, Final Staff Report to the Federal Trade Commission and Proposed Trade Regulation Rule (16 C.F.R. Part 455), September 1978.

[161] 44 F.R. 914.

On October 11, 1979 the Commission rejected the mandatory inspection approach recommended by the staff and directed the staff to analyze an optional inspection rule. The Commission also eliminated from further consideration the staff's proposals for disclosure of prior use and mileage of used cars. On April 4, 1980, the staff forwarded the Commission a memo recommending adoption of an optional inspection rule.

On May 16, 1980, the Commission met to consider the redrafted rule and tentatively adopted the staff recommendations, with certain modifications. The Commission instructed the staff to prepare a request for technical comment by the public on likely effectiveness of the optional inspection proposal, the format and comprehensibility of the proposed disclosure form, and any drafting errors in the text of the proposed rule.

On August 7, 1980, the Commission published the request for comment; the Commission received comments through November 7, 1980. The comment period was extended 30 days to November 7, 1980.

On January 14, 1981, staff forwarded the Commission a summary of the technical comments and final recommendations for modifying the proposed optional inspection rule. On February 20, 1981, the staff forwarded a supplemental recommendations memo.

On April 14, 1981, the Commission met and determined not to adopt the optional inspection rule, but instead to approve in substance a different final rule, requiring, by means of a window sticker, the disclosure of warranty information, and of certain major defects known to the dealer at the time of sale.

The Commission promulgated the final Used Car Rule on August 14, 1981—6 years after the Initial Staff Report.[162]

In 1982, pursuant to Section 21 of the FTC Improvements Act, 15 U.S.C. 57a-1 (Supp. IV 1980), Congress by concurrent resolution exercised the power of legislative veto of the Used Car Rule.[163] On July 6, 1983, the U.S. Supreme Court struck down the legislative veto provision in Section 21 of the FTC Improvements Act[164] which had the effect of invalidating the Congressional veto of the Used Car Rule. Prior to the legislative veto, however, several parties had sought judicial review of the Rule in the Court of Appeals for the Second Circuit.[165] On August 9, 1983, the Commission determined to reexamine the Rule. On September 14, 1983, the Second Circuit entered

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162 46 F.R. 41,328.

163 *See* 128 Cong. Rec. Section 5402 (May 18, 1982); 128 Cong. Rec. H2882-83 (May 26, 1982).

164 *See U.S. Senate v. FTC*, 463 U.S. 1216 (1983); *U.S. House of Representatives v. FTC*, 463 U.S. 1216 (1983).

165 *See Miller Motor Car Corp. v. FTC*, 2d Cir. No. 81-4144.

an order remanding the Used Car Rule proceeding to the Commission. The remand order directed the Commission to reopen the rulemaking record and receive comments and rebuttal with respect to 16 C.F.R. § 455.2(c) and related sections, dealing with disclosure of known defects, and any other issues that the Commission might elect to consider pursuant to the Federal Register notice of August 9, 1983. After the comment and rebuttal period, the Commission on July 10, 1984 adopted a revised rule that eliminated provisions of the proposed rule that required that dealers disclose known defects, and that modified the disclosures for the required window sticker. After a 30-day period receiving additional comments, the Commission promulgated a final revised Used Car Rule on November 19, 1984.[166]

[166] 49 F.R. 45,725.