

The New FTC Business Opportunity Rule Makes Waves: Impact on Franchise Systems

Disclosure obligations may be as light as a one-page document, but the rule is now broader.

BY BEATA KRAKUS



The Federal Trade Commission Business Opportunity rule used to be so limited in scope that it rarely posed an issue for franchisors or those distribution systems structured to avoid franchise laws. If it did apply, the business opportunity seller had to prepare a disclosure document as broad in scope as a franchise disclosure document. This was a major hassle for low-investment business opportunity systems. A significantly revised federal business opportunity rule (the “FTC Business Opportunity Rule”) went into effect March 1, 2012. 16 C.F.R. 437 (2011). It flips the old rule on its head: Disclosure obligations may be as light as a one-page document, but the rule is now broader and will cover some distribution systems and even franchise systems that have previously been able to avoid federal disclosure regulation.

“Business Opportunity”

There are three elements to the business opportunity definition under the FTC Business Opportunity Rule. First, the buyer must be entering into a new business. Second, the buyer must make a required payment. Third, the seller must be providing the buyer with some type of assistance, such as providing locations for vending machines or display racks, or providing outlets or customers for the products or services to be sold, or there must be a promise made to buy back goods or services the buyer makes, produces, fabricates, grows, breeds, modifies or provides.

Initially, the revised rule was also supposed to cover assistance tracking or paying commissions or other compensation based on the buyer’s sale of goods or services or recruitment of others to sell goods or services. This last part was stricken after almost 17,000 comments were received from representa-



tives for multi-level marketers who would have been covered by the rule. The FTC found that these forms of assistance would sweep too many businesses within its scope and removed them from the definition.

The Sections of the Disclosure Document

Business opportunity sellers must use a special form for their disclosure. There are only five sections on the form and, at least for a franchisor used to the franchise disclosure document, the required information is both obvious and minimal:

- **Identifying Information.** The business opportunity seller must disclose its name, business address and telephone number.
- **Earnings Claims.** A business opportunity “earnings claim” and a franchise “financial performance representation” are substantially similar. Just as under the FTC Franchise

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Rule, earnings claims are permitted, but not required. A business opportunity seller who doesn't make an earnings claim simply has to check a box "no" on the disclosure document. A seller who makes an earnings claim checks the box "yes" and must attach the earnings claim to the disclosure document.

- **Legal Actions.** Legal actions that are the most likely to impact a buyer's decision whether to invest, such as civil and criminal actions within 10 years of the disclosure date, have to be disclosed in short form: no more than 100 words each.

- **Cancellation and Refund Policies.** The FTC has found that many business opportunity sellers who promise buyers money back or some other type of refund if they are unhappy with the business opportunity never make good on such promises, or make the conditions for receiving a refund unattainable. Therefore, sellers who make such promises must include the material terms of the refund or cancellation policies in an attachment to the disclosure document.

- **References.** The name, state and telephone number of the buyers who purchased the business opportunity in the last three years must be disclosed.

Separate State and Federal Disclosure Document

Just like with the FTC Franchise Rule, 16 C.F.R. 436 (2007), the FTC Business Opportunity Rule doesn't preempt state law, other than state laws that offer business opportunity buyers lesser protections than the federal rule. This causes some issues for a business opportunity seller whose system fits both the federal and state law business opportunity definitions. The FTC doesn't allow additional disclosures beyond the five categories required by the federal rule in the disclosure document. It also doesn't allow making the federal disclosure document part of state business oppor-

tunity disclosure documents. As a result, business opportunity sellers required to provide a disclosure document under state law must provide prospective buyers with two disclosure documents—a state document and the federal one. At least one state, Washington, is exploring whether business opportunity sellers should be permitted to use the federal disclosure document in lieu of the state document. It is doubtful whether other states will follow this initiative. Many state business opportunity statutes require sellers to include state specific disclaimers and a fair amount of information not required by the FTC Business Opportunity Rule, making it impossible to comply with both state content requirements and the federal requirement prohibiting additional disclosures.

Not All Franchises Excluded

Because the business opportunity definition is similar, but narrower than both federal and state franchise definitions, technically a franchise is also a business opportunity and would be subject to both the FTC franchise and business opportunity regulation. The FTC Business Opportunity Rule contains a franchise exemption for this purpose. However, the exemption doesn't cover all franchises. The FTC Business Opportunity Rule and the FTC Franchise Rule are at odds in two regards: The FTC Franchise Rule exempts from its application those franchises where the required payment payable by the franchisor within the first six months after commencing operation is less than \$500. The FTC Business Opportunity Rule has no minimum payment exemption. The FTC Franchise Rule also exempts those arrangements that are completely oral, while the FTC Business Opportunity Rule does not distinguish between written and oral agreements. The conflict was resolved by exempting franchises subject to the FTC Franchise Rule from the FTC Business Opportunity Rule, except for those that are exempted from the FTC

Franchise Rule because of the minimum payment or the oral agreement exemptions. As a result, those franchise systems that have been avoiding the FTC Franchise Rule by keeping initial fees below \$500 or not charging fees above \$500 until after six months of operations will carefully need to review the FTC Business Opportunity Rule to ensure that they are not now subject to the federal rule.

The FTC Business Opportunity Rule is certainly better suited than the old rule was for business opportunities that typically only require low initial investments. Through limiting its scope to those types of industries where consumers are most likely going to be exposed to fraud, the FTC strikes a balance between putting unnecessary burdens on businesses where fraud is not as likely to occur and not making compliance cost and time prohibitive for those within its scope. The changed scope of the rule may, however, be a trap for the unwary. It is primarily those franchise systems that have been able to avoid the applicability of the FTC franchise rule by charging very low initial fees, or deferring payments for six months that need to be careful to make sure that they don't inadvertently fail to provide buyers with a disclosure document. There is no private cause of action under the FTC Business Opportunity Rule, but state "mini FTC Acts" may still provide disgruntled buyers their day in court. ■

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