Connecticut and Federal Business Opportunity Laws

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The Connecticut Business Opportunity Investment Act (the "Act") was initially adopted in 1979. The Act is regulated by the Securities and Business Investments Division of the Connecticut Department of Banking. In the 1970s, legislation adopting the Act became necessary to protect Connecticut investors from scams perpetrated by those sellers of business opportunities who offered "get rich quick" schemes by con artists offering risk free business investments. During this period the Federal Trade Commission adopted comparable legislation by requiring franchisors and business opportunity sellers to provide disclosures to franchisees and business opportunity investors.[1]

The Act was, for the most part, unchanged from its inception in 1979 until 2009 when it went through a number of substantial changes.[2] An article published in *Connecticut Lawyer* in the May 1997 issue[3] discussed the then-current law, but an update to review the current version of this Act and the Federal Rule is in order. They are still not well-known, but can become a trap for the unwary because of their broad scope and the onerous penalties for non-compliance.

The Connecticut Act

The term "Business Opportunity" is far reaching.[4] It covers the sale or lease of any product or service to purchaser—investor ("Investor") to enable the Investor to start a new business in which the seller represents it will do any of the following:

a. provide locations or assistance in finding locations for vending machines (including amusement machines), racks, display cases or similar devises; or
b. buy any or all of the products made or produced by the Investor; or
c. guarantee that the Investor will derive income from the business opportunity or the seller will refund any of the purchase price paid for the products or services supplied by the seller; or
d. provide a sales and marketing program to the Investor, excluding a sales and marketing program made in conjunction with a federally registered trademark.

Any such sale or lease that comes within the preview of the Act must, prior to the sale or offer of sale, be registered with the Banking Commissioner ("Commissioner").[5] Successful registration requires filing with the Commissioner the following:

a. a comprehensive, 27 item Disclosure Statement, including financial statements, which must be delivered to the potential Investor prior to sale;
b. a surety bond of not less than $50,000.00[6] if the seller makes representations that the Investor will derive income from the business opportunity or if the seller agrees to refund the purchase price paid for the business opportunity or repurchase the products sold to the Investor;
c. a sworn statement that the information is true and correct;[7]
d. an irrevocable consent appointing the Commissioner the seller's agent for service of process;[8]
e. payment of a non-refundable fee, currently $400.00.[9]

Exemptions and Exclusions

There are exemptions and exclusions referred to in the Act for non-targeted ventures. For example, excluded are: (i) the sale of an ongoing business and the not-for-profit sale of demonstration equipment, materials and samples for $500.00 or less; and (ii) exempted are transactions in which the initial investment does not exceed $200.00 or the business opportunity offered is sold exclusively to accredited Investors or the business opportunity is exempted by the Commissioner under a regulation or order.[10]

The Business Opportunity Agreement

Any business opportunity agreement, to be in compliance with the Act, must be in writing and contain the following:

a. the terms and conditions of payment;
b. a full description of the acts or services the business opportunity seller undertakes to perform for the Investor;
c. the seller's principal address and the name and address of its Connecticut agent for service of process;
d. the approximate delivery date of any products, equipment, supplies, or operational guidelines that the seller promises to deliver to the Investor.[11]

In addition, the Act requires that the seller must state in the agreement that if the seller fails to deliver products, equipment, or supplies or services to enable the Investor to start the business within 45 days from the stated delivery date, the Investor may demand that the agreement be cancelled.[12]

Post-Sale Registration

If a seller sells, or offers to sell, a non-compliant business opportunity, the seller may, pursuant to the Act, make an application to the Commissioner for post-sale registration.[13] There are a number of steps that must be followed by the seller, beginning with the seller's affidavit containing an explanatory statement and a statement of non-prejudice. The purpose of the statements is to show that no Investor was defrauded.

After completion of the post-sale application process, the Commissioner may, in his/her discretion, permit the business opportunity to be registered. Nevertheless, post-sale registration does not preclude the prosecution of a violation of any of the provisions of § 36b-60 to § 36b-80.

State Penalties

The penalties for violating the Act are both severe and sweeping.[14]

The Commissioner may issue a cease and desist order against a seller who may, or "is about to," violate any of the sections of § 36b-60 to § 36b-80, or any regulation, rule, or order adopted pursuant to the Act.[15] In addition, the Commissioner may seek injunctive relief in the Superior Court of the Hartford Judicial District, seek an order imposing a fine not to exceed $100,000 per violation, seek an order of restitution plus interest or, within the Commissioner's discretion, seek to enter into a consent decree.[16]

Criminal penalties are available as well. A violation of § 36b-67 (selling or offering to sell an unregistered business opportunity, using a false trademark or one not owned by the seller, advertising that the business opportunity is lawful, engaging in fraud or deceit) is a felony. A fine of up to $25,000 or imprisonment of up to ten years can be imposed.[17] Violations of any of the sections § 36b-60 to §36b-80 are subject to a fine of up to $3,500 or imprisonment of not more than two years or both.[18]

Self-help remedies are available for the injured Investor as well. If the seller commits fraud or fails to provide the required disclosures or fails to deliver the equipment, supplies, products, or materials within 45 days from the date promised in the agreement, the business opportunity agreement is voidable at the Investor's option, if exercised within two years from the date of the agreement.[19]

Finally, the Investor may:

a. sue the seller in Superior Court in the Hartford Judicial District for the seller's failure to comply with the Act or for breach of contract;
b. may claim monetary damages or seek injunctive relief; and
c. may seek an award of legal fees.

The statute of limitations is six years.[20]

Case Law

There is not a plethora of cases interpreting the provisions of the Act.

Beverly Hills Concepts, Inc. et al v. Schatz and Schatz, Ribicoff and Kotkin et al.,[21] is a pre-2009 case in which a law firm committed malpractice for failing to properly advise the Plaintiff, a retail format franchisor, who was selling franchises without a registered federal trademark, i.e. a business opportunity. This case is still relevant. Another earlier case (prior to the 2009 Amendment) that considered the Act is: *Eye Associates PC v. IncomRx Systems Ltd.*[22] (discussed below). A significant post-2009 case is *Cohen, et al v Roll-A-Cover, LLC, et al.*[23]

In the *Cohen* case, supra. the defendants were found to have committed multiple violations of the Act. The defendants were engaged in the manufacture and sale of retractable enclosures for pools and spas in Bethany. The plaintiff, a New Jersey resident, wanted to acquire an exclusive distributorship in that state.

The defendants did not own a federal trademark. Their marketing and sales brochure contained false and misleading information. Nevertheless, Cohen paid a $75,000.00 fee to purchase the distributorship.

The defenses raised by the defendants to the alleged business opportunity violations were: (i) they did not sell a business opportunity, and (ii) they were exempt from the Act's provisions.

The defendants claimed the products they sold to the plaintiffs were only a few of several products plaintiffs were already selling so they were not starting a new business, as required by the Act. The court held that the language of this distributorship agreement clearly demonstrated that the plaintiffs were buying a new business.

The exemption defense was based upon allegations that the Plaintiffs were accredited Investors, thereby relieving the Defendants from complying with the Act. The court held, however, that the accredited Investor exemption set forth in § 36b-65 did not apply under § 36b-67 (6) (B) (Prohibited Sales Activities) to the sale of a business opportunity in which the seller makes untrue statements of material fact or omits to state material facts, so as to be misleading.

The provision of the Act that seems to trip up business opportunity sellers the most is § 36b-61(2)(D), a section of the definition of "Business Opportunity," which addresses the seller's offer of a sales and marketing program to an Investor. The following case explains the reason for this phenomenon.

In 1990, *Eye Associates PC,* supra, stated that the terms "sales program" and "marketing program" are not defined by the Act. The Banking Commissioner has stated in interpretive opinions that there is no traditional or broad based definition of a "sales program" or "marketing program" that would apply to all business opportunity agreements. Rather, the application of Sec. 36-504(6) D [now Sec. 36b-61(2)(D)] "is based on a case by case analysis."[24]

The Federal Business Opportunity Rule

The FTC Business Opportunity Rule[25] became effective March 1, 2012. It replaced the FTC's business opportunity laws found in the original FTC Rule known as "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures."[26] The original Rule was ultimately replaced by the new Rule to simplify the disclosures and "streamline" the disclosure process.

Because the new Rule is based upon federal law, it applies to all states in the union and its territories regardless of whether a state has, or does not have, a state mandated business opportunity act.

The federal definition of a Business Opportunity is, in some respects, similar to Connecticut's Act. It is defined as a commercial arrangement that possesses the following elements:

a. the seller must solicit a prospective investor to enter into a "new business;" and
b. the investor must make a "required payment" as consideration for obtaining or starting the new business.

The seller must represent that the seller or one or more designees will provide any of three types of business assistance: (i) locations for display racks, equipment, vending machines or similar devices; (ii) outlets, accounts, or customers for the investor; (iii) buy back any or all of the goods or services that the investor makes, including payment for home-based services like jewelry assembly, internet services, and 900 number ventures.[27]

The Disclosure Document

The "streamlined" document under the Rule, consisting of one page on a special form, is limited to five disclosure items; (i) the seller's identifying information; (ii) a 10 year history of civil or criminal legal action;; (iii) earnings claims, the details of which, are attached to the form (iv) the seller's cancellation and refund policies; (v) a list, by name, address, and phone number of buyers who purchased the business opportunity within the last three years.[28]

The Disclosure Statement must be given to the investor at least seven days before execution of a contract or payment of any consideration. Engaging in any deceptive practices by the seller is a violation of Section 5 of the FTC Act.[29]

Updates: the Disclosure Document must be updated quarterly unless the seller has fewer than ten investors in which case it must be updated monthly until there are ten investors.[30]

Exemptions: The Rule expressly exempts from its purview those business arrangements covered by the Amended FTC Rule.[31]

Registration: Unlike Connecticut law, the Federal Business Opportunity Disclosure Form cannot be registered. The FTC does not have an approval process either. The accuracy, truthfulness, and completeness of the document is the seller's responsibility.

Federal Pre-emption: The Rule provides that the FTC does not intend to pre-empt state business opportunity laws unless they conflict with the Rule. So long as the state's business opportunity laws afford investors equal or greater protection, such as more extensive disclosures or registration, the state law will not conflict with federal law.[32] There is no reason to believe that the Connecticut Act will conflict with the Rule as the required Connecticut Disclosures go far beyond what the Rule requires. In addition, Connecticut does require registration of the Disclosures. A valid and effective state business opportunity Disclosure Document, even if it contains all Disclosures mandated by the Rule, cannot replace the separate, one-page form required under the Rule. Nor can it be appended to the state Disclosure Document because the Disclosures under the Rule must be contained in a separate document. So, if the seller is located in Connecticut, it not only has to register its business opportunity with the Commissioner, it will also have to provide the Investor with the Disclosures required by the Rule.

Federal Penalties

Most of the penalties for violations of the Rule are found in 15 U.S.C. §45 where the FTC is granted the following enforcement powers:

a. issue cease and desist orders;[33]
b. bring civil actions;[34]
c. inforce civil penalties of up to $10,000 per violation;[35]
d. issue mandatory injunctions;[36] and
e. enforce penalties for violating orders of the Commission of up to $10,000.[37]

As a caveat, it should be noted that there is no post-sale cure for violating the Rule as is available under the post-sale registration provisions of Connecticut law.

Conclusion

In an effort to protect unsuspecting purchasers from falling prey to unscrupulous sellers of business ventures, the FTC and 25 states have passed business opportunity laws. Both federal and state legislation have made noncompliance by nonconforming business opportunity sellers a treacherous experience, exposing them to fines, incarceration, damages, cease-and-desist orders, injunctions, and civil penalties.

Suffice it to say that any business scheme or arrangement (other than a sale of an existing enterprise) deserves extra scrutiny as it may, in disguise, involve the sale of a State of Connecticut Business Investment Opportunity, a Federal Rule Business Opportunity, or both. CL

Notes

1. "FTC Rule." Promulgated on December 21, 1978 with an effective date of July 21, 1979. 16 C.F.R. Part 436
2. Connecticut Public Act 09-160
3. *Connecticut Lawyer*, May 1997, Volume 7, Number 8.
4. Sec 36b-61(2)
5. Sec. 36b-62(b)
6. Sec 36b-64
7. Sec 36b-62b(4)(J)
8. Sec 36b-62(e)
9. Sec 36b-62(b)(4)(K)
10. Sec 36b-65(a)(1)(B)
11. Sec 36b-66(b)(4)
12. Sec 36b-63(c)(23)
13. Sec 36b-62(g),(h),(i)
14. Sec 36b-72; Sec 36b-73(a)(b)
15. Sec 36b-72(a)
16. Sec 36b-72(c)
17. Sec 36b-73(b)
18. Sec 36b-73(b)
19. Sec 36b-74(a)
20. Sec 36b-74(b),(c) and (g)
21. 247 Conn 48 (1998)
22. 912 F2d 23 (2nd cir. 1990)
23. Cohen, et al v Roll-A-Cover, LLC, et al, 131 Conn. App. 443(2011)
24. Eye Associates, P.C. v IncomeRX Systems Limited Partnership (p. 28) 912 F.2d 23,28 (1980)
25. 16 C.F.R. Part 437 (2011)
26. 16 C.F.R. Part 436 (1979)
27. Sec 437.1(6)
28. Sec 437(a)(1),(2),(3),(4) and (5)
29. Sec 437.2
30. Sec 437.3(b)
31. Sec 437.8
32. Sec 437.9(b)
33. Sec 45(b)
34. Sec 45(m)
35. Sec 45(m)
36. Sec 45 (l)
37. Sec 45(l)