

FTC Issues Staff Report On Negative Option Plans

Staff of the Federal Trade Commission's Division of Enforcement ("FTC Staff") issued a report this week regarding negative option marketing programs ("Staff Report"). The Staff Report was a follow-up to the FTC's January 2007 workshop that brought together industry representatives, consumer groups and members of the academic community to discuss negative option marketing.

The Staff Report highlights many of the consumer benefits provided by negative option plans. It also reviews pitfalls of these programs, including failures to disclose adequately terms of the offer, obtain properly consumers' consent before billing and provide effective means for cancellation. In addition, the Staff Report raises unique issues related to internet-based negative option plans. For example, FTC Staff points out that research suggests that people interact with web pages differently than print materials and may not read the same notices and disclosures online that they would offline. In response, the FTC Staff provides a series of recommendations to ensure that marketers of negative options comply with federal law.

What is a Negative Option Plan?

The term "negative option plan" generally refers to transactions in which sellers interpret a customer's failure to take an affirmative action, such as rejection of an offer or cancellation of an agreement, as assent to be charged for goods or services. Most negative options fall into one of the following categories:

Pre-Notification Negative Option Plans

A pre-notification program is when a consumer receives periodic notices offering goods or services and

will receive the goods or services and pay a fee unless the offer is affirmatively rejected. Pre-notification plans are the most well-known of the negative options and are best identified with monthly book and music clubs.

Continuity Plans

In a continuity program, a consumer agrees to receive periodic shipments of goods or provisions of services. The agreement continues, and payments to the merchant are made, until and unless the consumer cancels the plan. Examples of continuity programs include movie rental programs and gym memberships.

Automatic Renewals

Automatic renewal plans generally are used in situations where a consumer enters into an annual agreement to purchase goods or services, such as an annual cell phone contract or office equipment lease. If the consumer does not contact the company who supplies the good or service to cancel the arrangement prior to the cancellation deadline, the contract will be renewed for another term, and the consumer is required to pay the requisite fee.

Free-To-Pay or Nominal Fee-To-Pay Plans

Free-to-pay and nominal fee-to-pay plans occur when a marketer provides a consumer with a free trial program or a low introductory price. The consumer will only incur a fee or pay a higher charge if she does not contact the company and affirmatively cancel the program, reject the offer, or return the goods or services before the end of the free or low-cost period. Free-to-pay and nominal fee-to-pay offers are likely the most popular and most used types of negative option plans.

Many negative option plans, regardless of type, include a bundled or upsell offer. A bundled offer is when a marketer combines two products or services into a sin-

gle package, requiring consumers to purchase both. An upsell offer occurs when a consumer completes a primary transaction and then receives a solicitation for an additional product or service. In some cases, the upsell is offered from a third-party and billing information is transferred to that party from the primary merchant.

Pros and Cons of Negative Option Plans

Negative option plans, if used properly, can be beneficial for marketers and consumers alike. Companies benefit by lowering costs through better inventory management and avoidance of costs related to renewals, including expensive mailings. Consumers also benefit in several significant ways. For example, consumers seemingly enjoy the convenience of uninterrupted service or product shipments and easy renewal processes. Consumers who enroll in free-to-pay or nominal fee-to-pay programs also benefit by being able to examine products before incurring substantial (if any) fees or, in some cases, receive free gifts regardless of whether they participate in the program.

Despite these numerous benefits, the Staff Report points out a number of potential problems for consumers who enroll in negative option plans. A vast majority of the problematic aspects of negative option plans fall into one of the following categories: (1) failure to disclose adequately or misrepresenting the material terms of the offer; (2) failure to obtain the express informed consent of consumers prior to billing; and (3) failure to provide effective means for consumers to cancel the plan. These pitfalls are particularly relevant with online transactions (where consumers may be less likely to notice and read disclosures) and external upsells where the first company shares a consumer's billing information with a second company.

FTC Staff's Negative Option Plan Marketing Principles

Based on recommendations provided during the FTC workshop and recent cases brought by the Commission, FTC Staff have developed the following principles to guide negative option marketers in compliance with Section 5 of the FTC Act. While following these recommendations will increase the likelihood of compliance, each negative option marketing

plan should be assessed to ensure that the overall net impression of the advertisement complies with the FTC Act.

1. Marketers should disclose the material terms of the offer in an understandable manner.

Section 5 of the FTC Act requires that marketers clearly and conspicuously disclose the material terms of an offer. The FTC Staff Report recommends that to comply with this requirement, marketers should disclose, at a minimum, information regarding the existence of the negative option plan, the total cost of the program, whether a consumer's billing information is being transferred to a third-party and cancellation instructions. FTC Staff also recommends that disclosures be understandable, short and consistent with other terms found in the offer.

2. Marketers should make the appearance of disclosures clear and conspicuous.

In order to meet Section 5's clear and conspicuous standard, FTC Staff recommends that companies focus on three areas. First, disclosures should be placed on a webpage where consumers are most likely to focus their attention. Consideration should be given to distracting features such as banner ads and hyperlinks that may take away from a disclosure, limitations on the length of disclosures and disclosures that do not require consumers to scroll.

Second, disclosures and hyperlinks should be labeled properly to attract consumers' attention and relay the relevance of the information. FTC Staff recommends not using labels such as "terms of use," "home delivery plane" and "click here to see how this offer works" because these labels do not adequately inform consumers of the existence of material terms of the negative option plan. Lastly, FTC Staff believes that hyperlinks should not be used for the most important terms of the offer and should be limited to lengthy disclosures.

Third, marketers should use text that is easy to see and read. FTC Staff recommends that marketers avoid text that is small, in long, single-spaced or all capital letter passages, or in non-contrasting colors.

3. *Marketers should disclose the offer's material terms before consumers pay or incur a financial obligation.*

Section 5 requires that all of the material terms, including cost, must be disclosed to a consumer prior to the agreement to make a purchase. With regard to most internet negative option plans, the marketer should provide the terms before the consumer clicks the “submit my order” or similar button. FTC Staff also support including the most important disclosures multiple times in certain advertisements.

4. *Marketers should obtain consumers' affirmative consent to the offer.*

FTC Staff recommends that marketers require consumers to take an affirmative step, like clicking “I agree,” to evidence consent to billing for a negative option program. Companies should not rely upon pre-checked boxes to obtain consent.

5. *Marketers should not impede the effective operation of promised cancellation procedures.*

The FTC has brought a series of Section 5 enforcement actions against companies who had ineffective cancellation procedures. Marketers should clearly disclose cancellation procedures and should make cancellation simple and effective. FTC Staff notes that facts indicative of an ineffective cancellation process are long-hold times, incorrect cancellation directions, and unnecessary delays in canceling accounts.

Going Forward

Given the volume of negative option offers in the market, we should expect the FTC to be vigilant in bringing additional cases against marketers who fall short of the FTC Staff's recommendations. It is imperative that each offer be reviewed to ensure that it complies with Staff's recommendations and additional Section 5 considerations.

It is also important to note that the FTC has informally requested additional research to assist the FTC in

better advising online marketers and consumers and to target deceptive practices and fashion appropriate relief. Specifically, the FTC is interested in research regarding consumer behavior, including where consumers look, what they read and what they are likely (or unlikely) to click. The FTC also is interested in research regarding the use of negative option plans on mobile devices and the impact of follow-up notices to consumers enrolled in programs. Lastly, research regarding cancellation procedures would be helpful to the FTC in developing guidelines for appropriate means of cancellation.

Please contact a member of Kelley Drye's Advertising Law Group if you would like to discuss any aspect of negative option plans, including assessments of campaigns or research that may be helpful to the FTC.

KELLEY DRYE & WARREN LLP

The attorneys in Kelley Drye & Warren's Advertising Law Practice Group have broad experience at the FTC, the offices of state attorneys general, the National Advertising Division (NAD), and the networks; substantive expertise in the areas of advertising, promotion marketing and privacy law, as well as consumer class action defense; and a national reputation for excellence in advertising litigation and NAD proceedings. We are available to assist clients with developing strategies to address issues contained in this Advisory.

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