Advertising Client Advisory

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# FTC's Workshop on Negative Option Marketing

## EXECUTIVE SUMMARY

On January 25, 2007, the Federal Trade Commission ("FTC") held a workshop, "Negative Options: An FTC Workshop Analyzing Negative Option Marketing," which discussed business and legal trends with negative option marketing, including FTC enforcement and corporate best practices. This Client Advisory summarizes key points discussed in the workshop and recommendations for negative option marketing best practices.

## NEGATIVE OPTIONS

### TYPES OF NEGATIVE OPTION PLANS

A negative option offer is an opportunity for a consumer to consent in advance to continue to receive products or services in the future. Generally, the consumer's silence or failure to take affirmative action to decline the product or service, or cancel the agreement, is considered acceptance of the offer. Four types of negative option plans were the focus of the FTC's workshop.

#### *Pre-notification Plans*

Original form of negative option marketing in which the consumer receives periodic announcements of upcoming product shipments and has a set period of time to inform the seller that he/she does not want the product, such as traditional record or book clubs.

#### *Continuity Plans*

Common form of negative option in which the consumer provides advance consent to receive a product on a regular basis, and the seller does not provide notice before the product is sent, such as fruit or flower of the month clubs.

#### *Automatic Renewal Plans*

Similar to continuity plans, except that the consumer has requested that the service, such as a magazine subscription, automatically renew at the end of the specified term without further notice from the seller.

#### *Free or Trial Offers*

Also known as free-to-pay conversion plans, the consumer accepts a free trial offer for a product or service for a limited time period at no or reduced cost, after which the offer converts to a paid plan for either a specified term or term with automatic renewal, such as a magazine subscription with a free trial issue.

### PROS AND CONS OF NEGATIVE OPTION MARKETING

The FTC has acknowledged that negative option marketing, in its various forms, can be beneficial to both consumers and businesses by providing increased convenience and economic efficiency. Thus, negative option marketing is a tool that can be used effectively as long as it complies with FTC law. The potential risk of negative option marketing is the possibility of consumer confusion or uninformed consent to the negative option offer, especially when the consumer is unaware of the existence of the offer and/or when the seller has the consumer's credit card information. In these instances, the FTC may allege that the marketing is unfair or deceptive, as further explained below.

## FTC ENFORCEMENT

Since 1999, the FTC has brought 45 negative option cases against 208 corporate and 106 individual defendants, averaging six cases per year.[1] The forms of negative option marketing that were most common in these enforcement actions were free trial offers and continuity or auto-renewal plans. Since 2002, the vast majority of these cases involved *both* free trial offers and continuity plans. Only three pre-notification cases were brought by the FTC since 1999. The abuse of pre-acquired account information in connection with negative option marketing was also common in many of these enforcement actions; since 2002, the vast majority of FTC complaints alleged this abuse. Alleged abuse of "upsell" offers has declined more recently in FTC actions.

Most of the defendants in these cases used telemarketing to market negative options to consumers; however, cases involving online offers have increased significantly in recent years, accounting for close to 50 percent of cases in 2005 and 2006. Cases involving direct mail offers have declined significantly in recent years. The most common types of billing methods used by defendants in these cases were direct billing, telephone cramming, and invoicing. Since 2002, however, the vast majority of these cases involved only direct billing of consumers.

## STATUTORY AND RULE VIOLATIONS

The vast majority of these cases alleged violations of Section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices. The FTC also has brought a number of cases alleging violations of the Telemarketing Sales Rule ("TSR"), particularly since 2002 after the TSR was amended to cover negative option marketing and upselling. These enforcement actions most frequently alleged that the defendants failed to disclose or misrepresented material terms, such as the existence of a negative option, the terms of the negative option, or payment terms. The FTC also alleged that the defendants failed to obtain express informed consent from consumers or failed to provide consumers with a reasonable means to cancel. A smaller number of cases also have been brought under the Negative Option Rule, the Unordered Merchandise Statute, and the Electronic Funds Transfer Act.

The FTC announced its most recent enforcement action on negative option marketing at the workshop. The agency obtained a temporary restraining order in federal district court against Think-All Publishing, L.L.C., and its principal, halting their marketing practices and freezing their assets. The company allegedly advertised "free software CDs" on its website, but billed consumers for the "free" software

[1] The FTC recently studied its federal district court cases involving alleged unlawful negative option marketing from the previous ten years (1996 – 2006), but no such cases were found from 1996 to 1998.

without their authorization. The FTC noted that language contradicting the free software claim was buried in the "terms of use" for the software offer. Thus, the FTC alleged that the defendants' practices were unfair and deceptive in violation of the FTC Act. Additionally, the FTC charged that the defendants violated the Unordered Merchandise Statute, which prohibits billing recipients for merchandise they did not order. This case is currently pending in district court.

## COMPLIANCE WITH FTC STANDARDS

### FTC CONCERNS

Negative option marketing may be considered unfair or deceptive, or otherwise unlawful, if the seller:

(1) fails to disclose or adequately disclose the material terms of the offer;

(2) fails to obtain the consumer's express informed consent to the offer; or

(3) fails to provide adequate cancellation procedures.

### NEGATIVE OPTION MARKETING BEST PRACTICES

#### *Clear and Conspicuous Disclosures*

Disclosures are often used to inform consumers of the existence of a negative option offer and its material terms. To ensure that the material terms of the offer are adequately disclosed, the disclosures should be clear and conspicuous. The disclosure's prominence, presentation, placement, and proximity (to the claim it qualifies) are important factors in determining whether the disclosure is clear and conspicuous. There are additional considerations for online advertising, including the prominence of the disclosure in relation to screen size (for example, a computer screen vs. a cell phone screen), the use of pre-checked boxes on order forms, and the wording of hyperlinks to the terms section, as well as the number of clicks to get to the terms.[2] The FTC emphasized that there is no one-size-fits-all approach to evaluating the adequacy of a disclosure, however, the above-named factors assist in the evaluation.

#### *Industry Self-Regulation*

The FTC has recognized that industry self-regulation is an important tool for developing best practices in this area, providing guidance, and aiding compliance with the law. At the FTC's suggestion, the Electronic Retailing Association ("ERA") created guidelines for negative option or "advanced consent" plans, that emphasize two key principles – notice and consent. Another industry association that provides guidance on negative option marketing is the Direct Marketing Association ("DMA"). Both associations recommend, as a best practice, that businesses engaging in negative option marketing:

(1) disclose the offer and provide consumers with material terms and conditions of the offer in a clear and conspicuous manner;

[2] The FTC's guide, "Dot Com Disclosures" provides more detailed information regarding considerations for online advertisements and clear and conspicuous disclosures online. Available at http://www.ftc.gov/bcp/conline/pubs/buspubs/dotcom/index.html.

(2) obtain consumers' advance consent;

(3) inform consumers of their right to cancel and specify how to cancel; and

(4) accept cancellations as final and promptly honor them.

## REQUEST FOR COMMENTS

The FTC is accepting comments regarding the topics and issues addressed in this Client Advisory through February 26, 2007.

## FOR MORE INFORMATION

For more information about this Client Advisory, please contact:

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