Consumer Products Marketing

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Court decisions, new and pending laws, and regulations arise every day affecting companies that produce and market consumer products. Our Consumer Products Marketing newsletter summarizes notable policy and regulatory developments, as well as court decisions, in the areas of consumer protection, Lanham Act, privacy, and consumer product safety. Our aim is to keep you informed of these issues with a concise overview of selected developments. Attorneys in all practice areas listed are available to answer any questions you may have in regard to any of these issues. To reach the editor for any reason, contact Randal.Shaheen@aporter.com.

CONSUMER PROTECTION[1]

Recent FTC Focus on "Free" Promotions and Continuity Plans

If you sell or are thinking of selling products on a subscription basis, you should be aware of the FTC's renewed interest in such programs of late. These programs can include negative option plans through which goods are sent to customers unless customers elect not to receive the offered goods (e.g., book-of-the-month clubs) and continuity plans through which customers are billed and provided with goods or services each term (e.g., gym memberships). Generally, the terms of such plans -- including details about minimum purchase or term requirements, instructions on how to cancel a plan, and billing information -- must be clear and conspicuous. Two recent enforcement actions challenge the business practices of companies that allegedly offered free products and then enrolled consumers in continuity plans through which they would continue to receive and be billed for products. The FTC has also recently weighed in against a proposed class action settlement agreement under which the proposed compensation to class members includes a negative option feature.

In *FTC v. Conversion Marketing, Inc.*, No. SACV 04-1264 JVS (JTLx) (C.D. Cal. Jan. 17, 2006), the FTC charged the defendants with violations of the FTC Act and the Telemarketing Sales Rule ("TSR"). The FTC alleged that the defendants had represented through the telemarketing of their tooth whitening kit and their weight-loss patch that consumers could obtain a "free trial" or "free sample" but then imposed unauthorized charges on consumers' credit and debit accounts and enrolled consumers in plans through which they would continue to receive and be charged for additional kits or patches without obtaining authorization. Defendants settled these charges by agreeing to pay $979,204 in consumer redress, which was lowered to $463,000 based on an inability to pay.

In a similar complaint filed on January 30, 2006 in the United States District Court for the Southern District of Ohio against dietary supplement marketers, the FTC alleged that the defendants offered consumers free samples and then enrolled them in continuity plans without authorization. The FTC charged defendants with violations of the FTC Act for failing to disclose

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material terms of the continuity plans and for billing consumers without their express, informed consent.

The FTC alleged that the defendants offered free samples on television or web advertisements, and when consumers called the toll-free numbers provided, they were asked to provide billing information to cover only the shipping and handling of their free samples. However, after collecting payment information, the defendants allegedly either told consumers they would be automatically enrolled in a continuity plan, enrolled consumers in continuity plans without informing them that they were being enrolled, or told consumers they must enroll in a continuity plan to receive their free samples. The FTC further alleged that even when defendants told consumers that they were being enrolled in a continuity plan, defendants failed to disclose the details, such as the monthly costs, when subsequent charges would be submitted for payment, or how to cancel. To the extent information on the continuity plans was provided in the advertisements, the FTC alleged the details were buried in the fine print. Finally, the FTC alleged that defendants did not disclose clear instructions on how to cancel the continuity plans and made the cancellation and refund processes inordinately difficult.

The FTC's recent focus on continuity plans is also demonstrated by its amicus brief filed in opposition to the proposed class action settlement agreement in *Chavez v. Netflix, Inc.*, No. CGC-04-434884 (Super. Ct. of S.F. County, Cal.). In *Chavez*, the plaintiffs alleged that Netflix failed to provide unlimited DVD rentals and one-day DVD delivery as promised in its marketing materials. The proposed settlement would give a free one-month upgrade in service to current customers and a free month of service to former customers. In both cases, there was a negative option feature—the upgraded or renewed service would continue unless the customer cancels or modifies the subscription.

In its *amicus* brief, the FTC opposed the settlement on two grounds. First, the FTC argued that the class action settlement notice is inadequate because it is "insufficiently conspicuous to put consumers on fair notice of its terms" and because it does not disclose all of the material terms of the settlement's negative option feature. The FTC also pointed out that the proposed settlement did not require Netflix to make additional disclosures to the class members. Second, the FTC viewed the proposed settlement as more of a promotional vehicle for Netflix than as compensation for the class members. The FTC feared that those class members who understood the negative option feature and opted out of the settlement to avoid the inconvenience and risk of canceling the subscription would be left without a remedy because the likely remedy would be exceedingly small compared to the costs of litigation. The FTC also feared that class members who opted into the settlement would end up in a worse position as a result of paying for the upgraded or renewed service after the free month because they did not understand the negative option feature or because of the inconvenience of canceling.

The bottom line is that continuity, negative option, and subscription plans are of current interest to the FTC Staff. Tread carefully in this area. How much information is required about such plans and how it must be presented to meet the "clear and conspicuous" requirement will depend on a number of factors, including the advertising channel used and the level of sophistication of the target audience.

2005 Top Consumer Complaints

What do consumers complain about to the FTC? The news is out; the FTC has released its annual report on consumer complaints of fraud and identity theft for 2005. Of the 686,683 total complaints filed with the FTC in 2005, about 255,000, or just over 37percent, were related to identity theft. The other top fraud complaints categories were Internet auctions (12 percent), foreign money offers (8 percent), shop-at-home/catalog sales (8 percent), and prizes/sweepstakes and lotteries (7 percent).

The report found that the major metropolitan areas with the highest per capita rates of consumer fraud were Washington,

[1] Arnold & Porter's Antitrust & Trade Regulation Group has extensive experience in consumer protection matters before the Federal Trade Commission (FTC), State Attorneys General, and the National Advertising Division. Members of our group include Bob Pitofsky, former FTC Chairman and Director of the Bureau of Consumer Protection; Mike Sohn, former FTC General Counsel; Bill Baer, former FTC Bureau of Competition Director; Debbie Feinstein, former Assistant to the FTC Bureau of Competition Director and Attorney Advisor; Randy Shaheen and Amy Mudge who collectively have practiced in this area for over 25 years. In our EU offices, Tim Frazer and Susan Hinchliffe have advised clients on numerous consumer protection matters.

D.C.; Tampa, St. Petersburg, and Clearwater, Florida; and Seattle, Washington. Phoenix, Mesa, and Scottsdale, Arizona; Las Vegas and Paradise Nevada; and Riverside, San Bernardino, and Ontario, California had the highest per capita rates of identity theft. The most common type of identity theft reported was credit card fraud, followed by phone or utilities fraud, bank fraud, and employment fraud. Internet-related complaints accounted for 46 percent of all fraud complaints. How do consumers lodge their gripes with the FTC? The report details complaints that are filed online or through a toll-free number. The complaints are accessible to over 1,400 federal, state, and local law enforcement agencies and law enforcement and consumer protection agencies in Canada and Australia. Complaints can be filed at the FTC's website, http://www.ftc.gov.

FTC Competes with Gameboy?

The FTC is trying new media to reach consumers and educate them about fraud and deception. The FTC held its eighth annual National Consumer Protection Week (NCPW), February 5-11. As part of NCPW, the FTC released the "Grand Scam Challenge," a series of three online games that "test your consumer IQ." In "Spot that Scam" and "Welcome to Bargainville," hosts Monty Spectacular and Mayor Mae present players with multiple choice questions on topics including scholarships scams, debt relief, identify theft, weight-loss scams, and money making seminars. "Fact or Fiction" asks players to answer a series of true or false questions on similar topics. In addition to warning consumers about common scams, the games also provide information about other issues including debt collection, liability for fraudulent credit card purchases, and the National Do Not Call Registry. The "Grand Scam Challenge" can be found online at http://www.consumer.gov/ncpw.

NCPW is a joint effort of the FTC and other federal, state, and local agencies along with national consumer advocacy organizations. In addition to unveiling its online games, this year's NCPW included a commitment by the FTC, the United States Postal Inspection Service, the Royal Canadian Mounted Police, Phonebusters, and Canada's Competition Bureau to work together to combat cross-border fraud.

LANHAM ACT[2]

Successful Plaintiff Can Obtain "Defendant's Profits" As Damages

Recent cases make clear that a Lanham Act plaintiff who successfully proves deceptive advertising can obtain money damages that include "defendant's profits"—potentially "all" profits—from the relevant product and during the relevant time. Older cases held that the plaintiff could not obtain money damages unless an ad "actually harmed" the plaintiff's business. Given the difficulty of proving this, many Lanham Act plaintiffs typically pursued injunctive relief only and rarely proceeded to a trial on the merits to obtain money damages. That trend is changing. Newer cases hold that once the plaintiff proves liability, the defendant must disgorge its profits unless the defendant shows that such damages should be reduced as inequitable. In *Wildlife Research Center, Inc. v. Robinson Outdoors, Inc.*, 2005 WL 3676530 (D. Minn. Oct. 25, 2005), the court affirmed a $5 million award, which reflected the defendant's profits and actual damages proven. Noting its authority to adjust any award that is either "inadequate or excessive," the court concluded that no equitable reason existed to disturb the award. The court also held that the plaintiff was not required to prove that the defendant committed a "willful" violation of the Lanham Act in order to obtain money damages—as the defendant had argued.

Provider of Advertising Medium Is Not Responsible for Content

A recent Eighth Circuit decision held that companies that "provide[s] the advertising medium"—but not the ad content—cannot be sued under the Lanham Act. In *American Association of Orthodontics v. Yellow Book USA, Inc.*, 434 F.3d 1100 (8th Cir. 2006), the court affirmed a dismissal of a false advertising complaint brought by an orthodontists' trade organization against Yellow Book. The court initially addressed the issue of trade association standing. It noted a Circuit split with some Circuits strictly limiting Lanham Act standing to actual competitors and excluding trade organizations, while others use a multifactor test from antitrust cases, which focuses on "protection of commercial interests and the prevention of

[2] Arnold & Porter LLP attorneys have significant experience with Lanham Act deceptive advertising counseling and representing both plaintiffs and defendants in deceptive advertising litigation. The firm has represented companies and advertising agencies in diverse product areas (including some seminal cases in the pharmaceutical sector) and has handled both literal-falsehood cases and implied-falsehood cases, which require scientifically designed surveys. Attorneys in the firm with Lanham Act experience include Randy Miller, Chuck Ossola, Helene Madonick, Suzy Wilson, Randy Shaheen, and Roberta Horton.

competitive harm." The court avoided the issue of whether the *plaintiff* had standing by concluding that the defendant could not be sued. The *defendant*, Yellow Book, "is not the advertiser of orthodontic services." Yellow Book published the ad but did not create the advertising content. The Court affirmed the dismissal of the complaint on this basis.

The Statute of Limitations for Lanham Act Cases Looks to State Law

The limitations period for a Lanham Act deceptive advertising case follows the "state statute of limitations applicable to fraud cases." *Dontigney v. Paramount Pictures Corp.*, 2006 WL 155882 (D. Conn. Jan. 20, 2006). In *Dontigney*, the plaintiff was a Native American who alleged that Paramount's 1970 film "A Man Called Horse" "falsely" portrayed Native Americans as "savages." The court did not comment on the merits of the plaintiff's complaint, but instead simply dismissed it as time-barred. Connecticut's statute of limitations for fraud is three years. Under the Lanham Act, 15 U.S.C. § 1125(a)(1)(B), the statute of limitations is derived from the state statute. The court's decision raises the question of whether the statute of limitations will bar a claim based on an advertising message first disseminated prior to the limitations period, even if an advertising message continued to run in the marketplace during the period, or whether the statute could be equitably tolled. Presumably, the state law on such matters also would be incorporated to evaluate the timeliness of a Lanham Act claim.

PRIVACY[3]

ChoicePoint Settles with FTC

ChoicePoint, a consumer data collection company, agreed to pay a $10 million civil penalty and $5 million for consumer redress to settle charges that it had violated the Fair Credit Reporting Act (FCRA) and the FTC Act. The FTC alleged that ChoicePoint failed to maintain reasonable and appropriate security measures to protect the personal information that it collects and sells and made false or misleading statements concerning the security measures it employs to protect that information.

In 2005, ChoicePoint notified approximately 163,000 consumers that it may have improperly disclosed their personal information, including dates of birth, Social Security numbers, and credit reports. According to the FTC, these improper disclosures resulted from ChoicePoint's failure to screen adequately applications of those seeking to buy consumer information. Choicepoint approved applications that should have raised red flags, including applications with key information missing, such as the applicant's last name and contact information . Other applications that apparently slipped through contained illogical or facially contradictory information, such as different business addresses on tax forms and utility statements, or articles of incorporation showing that the business was suspended or inactive. These errors allegedly occurred despite ChoicePoint's claim that every customer "must successfully complete a rigorous credentialing process."

In addition to the monetary penalty, the settlement requires ChoicePoint to take affirmative steps to prevent future violations. These steps include implementing procedures to ensure that ChoicePoint sells consumer reports only to those who have a permissible purpose to receive them—as required by the FCRA, establishing a comprehensive information security program to protect personal information collected from or about consumers, and obtaining audits from an independent third-party professional every two years for the next twenty years.

Reining In Data Brokers Will Likely Impact Telecommunications Companies And Many Others

Public outrage at reports that Internet data brokers are selling private telephone records for as little as $100 has prompted fast action both on Capitol Hill and at regulatory agencies. The legislative and regulatory solutions likely to be adopted will affect telecommunications companies and potentially many more businesses as issues surrounding customer billing records and other data privacy concerns continue to arise.

[3] Arnold & Porter's Privacy Team provides legal and strategic counsel to help clients meet their privacy obligations in a demanding, evolving, and competitive marketplace. Our attorneys have held significant senior government positions, including Jeff Smith, former General Counsel of the CIA; Bob Pitofsky, former Chairman of the FTC; Ron Lee, former General Counsel of the National Security Agency; and Rick Firestone, Chief of the Common Carrier Bureau of the FCC. Others with extensive experience in this area include Nancy Perkins and Scott Feira in our DC office; Gregory Fant in our LA office; and Sarah Kirk in our London office.

Current Scrutiny

The Federal Trade Commission and Federal Communications Commission are investigating the practices of data brokers offering to sell telephone call detail records and other personal information. Many of these records reportedly are being obtained through "pretexting," a practice by which the data brokers call customer service personnel at the victim's phone carrier, pretend to be the victim, and request copies of the victim's records. Some have suggested that brokers may also be hacking into carriers' account-management web sites or bribing carriers' employees to obtain access to records. Reports about the easy availability of telephone records have produced a flurry of legislative proposals in recent weeks with more on the way.

Managing Customer Data

The scrutiny that the telecommunications industry is receiving due to the recent concern about disclosures of personal telephone records makes it critical for carriers to review their data security procedures and to make any necessary adjustments to ensure that their practices meet the expectations of a customer base that is increasingly sensitive to privacy issues.

Additionally, all businesses should review their data privacy policies to address customer expectations and to prepare for the possibility that some of their practices may be limited by forthcoming legislation or regulations. For example, depending on the particular wording of any new statutes or regulations, businesses that collect information from calls to their toll-free numbers may find that they will be required to adjust significantly their privacy procedures to afford greater protection for call details. New rules may also limit the ability to sell or otherwise transfer such customer data. Businesses that sell lists of phone numbers, email addresses, or other personal information should ensure that their collection and distribution procedures meet current privacy expectations. Companies that buy such lists in order to market their products or services should be sensitive to and protect themselves against any abusive practices by list vendors with whom they deal.

All telecommunications carriers and any business that acquires, stores, or transfers personal telephone information should review and where necessary change operating policies to meet their customers' privacy concerns. The sudden eruption of this front-page controversy over the easy availability of customer phone records should also prompt review by each business of its protection of other sensitive customer information. Businesses should consider the following steps:

- Review and update privacy and security policies, procedures, and documentation in this area, including procedures for verifying the bona fides of requests for such information, both to prevent violations of the law and to bolster the defense of possible litigation related to any claims of improper disclosure.
- Review and update applicant screening and employee training and monitoring procedures for employees who have access to sensitive customer information.
- Ensure that contractual arrangements with service providers and vendors adequately protect against disclosure of sensitive customer information, and provide for (1) appropriate monitoring of these obligations, (2) enforcement, and (3) remedies for breach of compliance or weaknesses in compliance with contractual obligations.
- Consider participating in the legislative and regulatory rulemaking processes to influence the provisions that are ultimately adopted.

CONSUMER PRODUCTS SAFETY COMMISSION[4]

CPSC Accelerates International Outreach

On February 14, 2006, the U.S. Consumer Product Safety Commission announced the signing of a "Memorandum of Understanding" (MOU) with the Republic of Korea. The MOU's aim is to improve the safety of consumer products traded between the United States and South Korea. It provides for an information exchange on product safety, the development

[4] Arnold & Porter has several attorneys with broad experience on matters involving the U.S. Consumer Product Safety Commission, including two former General Counsels of the agency—Eric Rubel and Jeff Bromme—and Blake Biles, formerly with the Environmental Protection Agency. We take a proactive approach to product safety issues, helping clients establish and audit internal controls. We represent clients in CPSC enforcement actions, as well as in private litigation that can result from CPSC matters.

of training programs, and the exchange of personnel to carry out safety programs.

This MOU represents just the most recent chapter in the CPSC's "product diplomacy," which has resulted in similar memoranda of understanding or statements of intent with Canada, China, Costa Rica, Chile, the European Commission, India, Israel, Taiwan and Mexico.Many of these nations signed in recent months.

Several of these agreements are fairly modest, with their chief impact likely to be limited to the "raising of consciousness" within CPSC and its counterpart agency about the availability of a communication channel through which safety information can be more efficiently exchanged.

Other agreements may have a more substantive impact. For example, the agreement with Canada announced last June states that Health Canada will provide advance notification to CPSC when a product intended for export to the United States violates a Canadian safety standard or poses a danger to Canadian consumers. That type of notice obviously has the potential for a substantial practical impact. The Canadian agreement builds on informal information-sharing that has occurred between the two governments for many years---primarily through monthly conference calls between officials at CPSC and Health Canada.

The CPSC also has devoted an enormous amount of attention to China in the past several months. China, of course, is a major source for toys, appliances and other electronics items, fireworks, and other products that fall squarely within CPSC's jurisdiction.

For a number of years, CPSC personnel have visited China and made presentations regarding CPSC safety requirements and provided information about ways in which manufacturers can ensure that their products destined for the United States comply with the law. Recently, such contacts have increased and have reached higher levels within the agency.

In April 2004, CPSC signed a memorandum of understanding with China's General Administration of Quality Supervision, Inspection and Quarantine, and last August, CPSC Chairman Hal Stratton traveled to China for a "Sino-U.S. Safety Summit." Stratton already had become the first agency chair to visit China on official business, signaling his keen interest in attempting to coordinate official U.S. and Chinese safety efforts. The August summit featured presentations by officials from both countries and industry leaders. Issues discussed at the summit included the acceleration of education and information sharing, including retailer conferences, comparative standards studies, and collaboration on the translation of U.S. and Chinese safety standards.

These international outreach efforts are conducted through the agency's new Office of International Programs and Intergovernmental Affairs, the creation of which was just formalized in a Federal Register notice on February 1, 2006. Joseph Mohorovic, a close associate of Chairman Stratton from his days in New Mexico politics, runs the office.

Negotiations targeting new memoranda of understanding with other countries are apparently under way. This week's announcement about the agreement with South Korea certainly will not be the last.

What does it all mean? It is possible that these agreements may have little substantive effect and may be seen as nothing more than window dressing. Only if CPSC and a particular counterpart agency devote time and resources to the information exchange, training programs, and other aspects of their agreements will there be concrete results after the signing ceremony has ended and the press has gone home. Following through will be difficult for CPSC because it continues to carry out its far-reaching mission with a diminishing workforce, stemming from a small budget that is shrinking in real dollars.

On the other hand, we would expect the agency to devote particular attention to countries, such as China, that are responsible for significant exports of consumer products to the United States. Greater enforcement by the agency's Office of Compliance and Field Operations may be brought to bear in regard to such products, both with respect to the U.S. importers, distributors, and retailers of the products and perhaps also through greater coordination with regulators in the country where the manufacturing occurs.