27.4: Unfair Trade Practices

Learning Objectives

By the end of this section, you will be able to:

- Explain how unfair trade practices are different from deceptive trade practices.
- Name three categories of unfair trade practices, and give examples.

We turn now to certain practices that not only have deceptive elements but also operate unfairly in ways beyond mere deception. In general, three types of unfair practices will be challenged: (1) failing to substantiate material representations in advertisements before publishing them or putting them on the air, (2) failing to disclose certain material information necessary for consumers to make rational comparisons of price and quality of products, and (3) taking unconscionable advantage of certain consumers or exploiting their weakness. The Federal Trade Commission (FTC) has enjoined many ads of the first type. The second type of unfairness has led the commission to issue a number of trade regulation rules (TRRs) setting forth what must be disclosed—for example, octane ratings of gasoline. In this section, we focus briefly on the third type.

Contests and Sweepstakes

In 1971, the FTC obtained a consent order from Reader’s Digest barring it from promoting a mail-order sweepstakes—a sweepstakes in which those responding had a chance to win large monetary or other prizes by returning numbered tickets—unless the magazine expressly disclosed how many prizes would be awarded and unless all such prizes were in fact awarded. Reader’s Digest had heavily promoted the size and number of prizes, but few of the winning tickets were ever returned, and consequently few of the prizes were ever actually awarded. Reader’s Digest Assoc., 79 F.T.C. 599 (1971).
Beginning in the 1960s, the retail food and gasoline industries began to heavily promote games of chance. Investigations by the FTC and a US House of Representatives small business subcommittee showed that the games were rigged: winners were “picked” early by planting the winning cards early on in the distribution, winning cards were sent to geographic areas most in need of the promotional benefits of announcing winners, not all prizes were awarded before many games terminated, and local retailers could spot winning cards and cash them in or give them to favored customers. As a result of these investigations, the FTC in 1969 issued its Trade Regulation Rule for Games of Chance in the Food Retailing and Gasoline Industries, strictly regulating how the games may operate and be promoted.

Many marketers use contests, as opposed to sweepstakes, in merchandising their products. In a contest, the consumer must actually do something other than return a ticket, such as fill in a bingo card or come up with certain words. It is an unfair practice for the sponsoring company not to abide by its own rules in determining winners.

### Door-to-Door, Direct Mail, and Unsolicited Merchandise

In 1974, the FTC promulgated a TRR requiring a three-day cooling-off period within which any door-to-door sales contract can be cancelled. The contract must state the buyer’s right to the cooling-off period.

For many years, certain unscrupulous distributors would mail unsolicited merchandise to consumers and demand payment through a series of dunning letters and bills. In 1970, Congress enacted legislation that declares any unsolicited mailing and subsequent dunning to be an unfair trade practice under Section 5 of the FTC Act. Under this law, if you receive an unsolicited product in the mail, you may treat it as a gift and use it; you are under no obligation to return it or pay for it.

Another regulation of mail-order sales is the FTC’s TRR concerning mail-order merchandise. Any direct-mail merchandiser must deliver the promised goods within thirty days or give the consumer an option to accept delayed delivery or a prompt refund of his money or cancellation of the order if it has not been prepaid.

### Negative-Option Plans

The “negative option” was devised in the 1920s by the Book-of-the-Month Club. It is a marketing device through which the consumer responds to the seller only if she wishes not to receive the product. As used by book clubs and other distributors of goods that are sent out periodically, the customer agrees, when “joining,” to accept and pay for all items unless she specifically indicates, before they arrive, that she wishes to reject them. If she does nothing, she must pay. Difficulties arise when the negative-option notice arrives late in the mail or when a member quits and continues to receive the monthly notices. Internet users will recognize the negative option in current use as the “opt out” process, where you are “in” unless you notice what’s going on and specifically opt out.

In 1974, the FTC issued a TRR governing use of negative-option plans by sellers. The TRR laid down specific notice requirements. Among other things, a subscriber is entitled to ten days in which to notify sellers that she has rejected the particular item about to be sent. If a customer has cancelled hers membership, the seller must take back and pay the former member’s mailing expenses for any merchandise mailed after cancellation. The former member may treat any shipments beyond one after cancellation as unsolicited merchandise and keep it without having to pay for it or return it.
Breach of Contract

Under certain circumstances, a company’s willful breach of contract can constitute an unfair trade practice, thus violating section 5 of the FTC Act. In one recent case, a termite and pest exterminating company signed contracts with its customers guaranteeing “lifetime” protection against termite damage to structures that the company treated. The contract required a customer to renew the service each year by paying an unchanging annual fee. Five years after signing these contracts, the company notified 207,000 customers that it was increasing the annual fee because of inflation. The FTC challenged the fee hike on the ground that it was a breach of contract amounting to an unfair trade practice. The FTC’s charges were sustained on appeal. The eleventh circuit approved the FTC’s three-part test for determining unfairness: (1) the injury “must be substantial,” (2) “it must not be outweighed by countervailing benefits to consumers,” and (3) “it must be an injury that consumers themselves could not reasonably have avoided.” In the termite case, all three parts were met: consumers were forced to pay substantially higher fees, they received no extra benefits, and they could not have anticipated or prevented the price hike, since the contract specifically precluded them. *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354 (11th Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989).

Key Takeaway

Market efficiency is premised on buyers being able to make rational choices about their purchases. Where sellers fail to substantiate material representations or to disclose material information that is necessary for buyers to act rationally, the FTC may find an unfair trade practice. In addition, some sellers will take “unconscionable advantage” of certain buyers or exploit their weakness. This takes place in various contests and sweepstakes, door-to-door and mail-order selling, and negative-option plans. The FTC has issued a number of TRRs to combat some of these unfair practices.

Exercises

1. The FTC receives over ten thousand complaints every year about sweepstakes and prizes. Using the Internet or conversations with people you know, name two ways that sweepstakes or contests can be unfair to consumers.

2. As economic hard times return, many scam artists have approached people in debt or people who are in danger of losing their homes. Describe some of the current practices of such people and companies, and explain why they are unfair.

3. With regard to Exercise 2, discuss and decide whether government serves a useful public function by protecting consumers against such scam artists or whether use of the common law—by the individuals who have been taken advantage of—would create greater good for society.