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July 27, 2009

BY OVERNIGHT MAIL
The Honorable Donald S. Clark
Secretary, Federal Trade Commission
Room H-135 (Annex Q)
600 Pennsylvania Avenue, NW
Washington, DC 20580

RE: Prenotification Negative Option Rule Review
Matter No. PO64202

Dear Secretary Clark:

The Attorney General of the State of Washington ("Attorney General" or "Washington") submits these comments on negative option plans and on the existing Federal Trade Commission ("FTC") rule concerning the use of Prenotification Negative Option Plans, found at 16 C.F.R. Part 425 (hereinafter referred to as the "PNOR"), from a consumer protection standpoint. The Attorney General is the primary state official who responds to consumer complaints and enforces state laws designed to protect consumers from unfair and deceptive business practices.

The existing PNOR was originally promulgated in 1973 with technical amendments being made in 1998. This rule regulates only one type of negative option marketing – the so-called prenotification negative option plan – for the delivery of merchandise where consumers receive periodic announcements that merchandise will be delivered unless they decline the items within a set time frame.

Washington's experience supports the retention of the existing rule but with some important changes to address the growing breed of negative option plans commonly called "free-to-pay conversions." The PNOR has focused on sellers making certain material disclosures relating to negative option plans. In Washington's view, however, disclosures alone have been insufficient to adequately protect consumers from inadvertently enrolling in programs for which they incur continuing automatic charges.

The Attorney General believes that new provisions should be added to the PNOR to regulate free-to-pay conversions. In addition to requiring disclosure of all material facts of the offer, the Attorney General recommends that the new provisions (1) require the seller to obtain the consumer's financial account information directly from the consumer during the free-to-pay transaction, (2) require the seller to obtain verifiable authorization from the consumer to be billed

on the account provided, (3) require acceptance of an offer to be evidenced only by an unambiguous affirmative action on the part of the consumer expressing acceptance of the offer under the terms and conditions disclosed, (4) set a cap on the number of months that a consumer can be automatically charged before the seller has to obtain from the consumer his or her authorization to the continuing enrollment and charges, (5) require the seller to identify itself clearly on the billing statements, and (6) include the term "services" in the rule.

I. BACKGROUND

The FTC uses the term "negative option marketing" broadly, referring to commercial transactions in which sellers interpret a customer's failure to take an affirmative action, either to reject an offer or to cancel an agreement, as affirmative assent to be charged. As the FTC has recognized, these kinds of transactions change the typical relationship between buyer and seller in which the buyer responds affirmatively to each offer made by the seller. *See* Negative Options: A Report by the Staff of the FTC's Division of Enforcement, Federal Trade Commission, January 2009, p. 2 (hereinafter referred to as the "Report").

The common law of Washington reflects the basic proposition that in order for a binding contract to exist, the offeree must affirmatively accept the terms of the offer. *See* 2 Samuel Williston & Richard Lord, A Treatise on the Law of Contracts 6:50 (4th ed. 2007); *see also Troyer v. Fox*, 162 Wash. 537, 546, 298 P. 733, 736 (1931) ("Mere silence when an offer is made does not constitute an acceptance of the offer. The failure to reject an offer is not equivalent to assent.") Ordinary consumers govern their behavior based on the idea that they must in effect say "yes" before a deal is made. Negative option marketing ignores this economic reality by deeming silence to be acceptance.

More importantly, Washington, like all other states, has enacted a consumer protection law, the Consumer Protection Act ("CPA"), which goes beyond common law principles to protect consumers and ensure fairness in market transactions. *See* RCW 19.86.010 *et seq.*; *Hangman Ridge Training Stables v. Safeco Title Ins. Co.*, 105 Wn.2d 778, 783-844 (1986) ("The purpose of the Washington CPA was set forth in RCW 19.86.920. That section reveals the Legislature's intent 'to protect the public and foster fair and honest competition.'") A central purpose of the CPA is to provide "'an efficient and effective method of filling the gaps'" in the common law and statutes. *Short v. Demopolis*, 103 Wn.2d 52, 62, 691 P.2d 163, 169 (1984) (quoting Craig C. Beles & Daniel Wm. Wyckoff, *The Washington Consumer Protection Act vs. The Learned Professional*, 10 Gonz. L. Rev. 435, 437 (1975)). Like the Federal Trade Commission Act, the CPA is intended to provide broader protection than exists under the common law or statute. *Panag v. Farmers Ins. Co. of Wash.*, 166 Wn.2d 27, 54 (2009)(quoting *Short*, 103 Wn.2d at 62).

Under Washington's CPA, the general rule is that neither the intention to deceive nor actual deception must be proven; rather, the prosecuting authorities need only show that the acts and practices have the capacity to deceive a substantial portion of the public. *State v. Ralph Williams' North West Chrysler Plymouth, Inc.*, 87 Wn.2d 298, 553 P.2d 423 (1976), appeal dismissed, 430 U.S. 952 (1977); *Testo v. Russ Dunmire Oldsmobile, Inc.*, 16 Wn. App. 39, 554

P.2d 349, 83 A.L.R.3d 680 (1976); *Haner v. Quincy Farm Chems., Inc.*, 97 Wn.2d 753, 649 P.2d 828 (1982). The purpose of the capacity-to-deceive test is to deter deceptive conduct before injury occurs. *See* 60 Wash. L. Rev. 925, 944 (1985).

The Attorney General agrees with the FTC's observation that "some negative option practices generate significant consumer dissatisfaction." Report, p. ii. The consumer complaints that our office has received over the course of the last four years strongly indicate that negative option marketing is being used in an overwhelmingly deceptive manner.

Based upon our review of our complaints and other data, including records we have obtained in the course of confidential investigations, we have observed a number of significant problems in negative option marketing, including that:

o Consumers lack the understanding that acceptance of a free trial will subject them to automatic and ongoing periodic charges to a credit card, bank account, or telephone account in connection with a negative option offer, because, in most free-to-pay conversion offers, the consumer never has to provide his or her financial account information in the course of the transaction;

o Consumers experience great difficulty in identifying and contacting the seller of the goods or services associated with free-to-pay conversions to cancel or otherwise terminate any ongoing or recurring obligation;

o Sellers continue to fail to clearly and conspicuously disclose in a meaningful manner the terms and conditions of free-to-pay conversion offers; and

o Sellers use the words "free" or "trial offer" in marketing free-to-pay conversions in a manner that misleads consumers to believe that they do not have to take further action in order to avoid ongoing charges.

II. WASHINGTON'S OBSERVATIONS

The Attorney General's Office has been able to identify over 500 consumer complaints filed with our office since January 1, 2005, that relate to deceptive marketing of products and services by means of free trials, free-to-pay conversion offers, and negative option plans. These complaints identify more than 32 separate firms and/or products being marketed using these types of offers. These numbers are consistent with the trend in national complaints regarding free-to-pay conversions. For example, the Better Business Bureau ("BBB") reports that in the last 36 months, there have been over 7,000 consumer complaints concerning unauthorized charges to consumers' credit cards against Vertrue, WebLoyalty, and Affinion, three companies that market membership programs through free-to-pay conversion offers.

Free-to-pay conversions are marketed in a variety of ways. The following are typical scenarios involving free-to-pay conversion offers:

1. A consumer purchases a product on a Web site. After transmitting his credit card information, the consumer is taken to a Web screen offering the consumer $10 cash back on his purchase. The consumer is asked to fill in his email address and click on a button that says "Yes and complete my purchase." By clicking on the button ostensibly to claim $10 cash back on his purchase, the consumer is unwittingly enrolled in a membership program that will be billed to his credit card number that he supplied to purchase the product.

2. A consumer goes to a wireless company's store and purchases wireless service. After the consumer makes the wireless purchase, the customer sales representative asks if the consumer wants a free trial of a roadside assistance service without any further disclosures. The consumer says yes, and then the wireless company, at the end of the free trial period, automatically adds a charge for the roadside assistance service onto the consumer's wireless bill.

3. A consumer calls her bank to open up a credit card account with the bank. In the middle of the application process, the customer sales representative offers the consumer a free trial in a credit monitoring service. The company that provides the credit monitoring service then bills the consumer automatically at the end of the trial period on the credit card account that the consumer opened with the bank.

4. A consumer receives a brochure in the mail that offers a free trial of a new health drink. The consumer sends in a postcard accepting the free trial of the new health drink. The health drink company has obtained the consumer's credit card information by purchasing it from a marketing company. The consumer does not know that the health drink company has her financial information and believes that the free trial is risk-free. At the end of the free trial period, the consumer is automatically billed for the health drink on her credit card.

5. A consumer receives a $10 "rebate" check in the mail from a computer company. The consumer believes that it is a rebate for a computer he recently purchased. The consumer cashes the check. By cashing the check, the consumer is unwittingly enrolled in a membership program run by a company that bought the consumer's financial information from the computer company. The consumer is automatically billed for the membership program on the credit card he used to purchase the computer.

6. In response to a catalogue received in the mail, a consumer calls to order a product from the catalogue company. After agreeing to purchase the product, he is asked whether he wants a free trial membership in a discount buying club. The consumer doesn't know that by agreeing to the free trial membership, he will be charged for a paid membership with the credit card he used to purchase the product from the catalogue.

The hallmark of most of the deceptive free-to-pay conversion offers is that the seller does not have to obtain the consumer's financial account information directly from the consumer for the consumer to "accept" the offer because the seller has preacquired financial account information of the consumer. The FTC recognized the inherent potential for consumer deception in sales

situations in which the seller had preacquired account information of the consumer when it created the requirement in the Telemarketing Sales Rule (TSR), which implements the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. §§ 6101-6108, as amended, that sellers must audiotape transactions involving free-to-pay conversions where the seller has preacquired account information of the consumer.

Free-to-pay conversions typically involve a free trial period during which the consumer is able to try out the service or product. After the expiration of the trial period, which is typically between 7 and 30 days, if a consumer does not advise the company that he or she wishes to cancel, the consumer's previously provided or acquired credit or debit card is automatically billed for the program. In addition, the consumer's credit or debit card will be automatically billed either monthly or annually for the renewals of the program unless the consumer cancels in a timely manner. In many cases, the credit card information was provided to the seller by a third-party affiliate of the seller. These offers previously were most frequently made through telemarketing and direct mail channels.

Free-to-pay offers are now more and more frequently used in the marketing and sale of products and services over the Internet. Businesses in nearly every industry use such marketing offers, from online booksellers, to banks, to online travel agencies.

Since December 2005, our office has filed at least seven major cases or settlements including allegations of violations relating to deceptive free-to-pay conversions and variations of free offers. Such cases include:

State of Washington v. Secure Computer, *et al.*
State of Washington v. SoftwareOnline, *et al.*
State of Washington v. High Falls Media, *et al.*
State of Washington v. Movieland, *et al.*
State of Washington v. Consumer Digital Services, *et al.*
State of Washington v. SubscriberBase, *et al.*
In re AT&T Mobility, LLC

These cases alone involved hundreds of thousands of Washington consumers who were subjected to deceptive marketing practices. We recovered well over one million dollars in consumer restitution, penalties, and attorneys' fees in these cases. In *State v. Consumer Digital Services,* for example, over 13,000 Washington consumers found themselves signed up for recurring monthly charges of at least $14.95 on their telephone bills for a service called Privasafe or Surfsafe Internet Services. This service was marketed on the Internet using an offer for an unrelated "free" item. Consumers found themselves unwittingly signing up for a service they did not want when they were trying to claim their "free" item. Of the over 13,000 Washington consumers who were billed by Consumer Digital Services, over 50 percent asked for refunds once they discovered the charges on their phone bills, only 5 percent ever made use of the service, and only 1 consumer received the "free" item.

Our office also has conducted and is conducting confidential investigations into a number of major companies that are using deceptive marketing of products and services by means of free trials, free-to-pay conversion offers, negative option plans, and other "free" offers. Those investigations reveal potentially close to one million Washington consumers who have been victims of such deceptive marketing and the loss of several million dollars.

The experience of Washington has been that many sellers who use negative option plans do not make it clear in the advertising of the plan or anywhere in the transaction that there are significant "strings" attached to such negative option offers or they obscure the disclosures through their distracting and prominent use of the terms "free" or "risk-free trial offer" in the ads. Sellers deceptively lead consumers to believe that they are simply engaging in a "one shot" transaction wherein they will receive a free item or, at most, pay a nominal amount for shipping and handling for an otherwise free item. Consumers fail to realize that they will automatically incur a charge or will pay an even greater amount within a certain number of days if they do not take affirmative action to return the unused portion of the "free" product or otherwise cancel the plan. Consumers are typically not reminded of this obligation after the initial transaction.

On the Internet, sellers have devised numerous clever, deceptive ways of leading the consumer's eyes to the button that, if pushed, will enroll the consumer in a free-to-pay program, including placing the "decline" option below the screen, so that only by scrolling to the bottom of the screen will the consumer see the option to decline the offer. Sellers also place their ads for free-to-pay offers in the middle of the consumer's transaction for another product and require the consumer to take an affirmative step with regard to the offer in order to complete the transaction the consumer is trying to make.

Compounding the initial deception at the point of sale in Internet offers is the seller's subsequent failure to provide consumers with a meaningful ability to cancel the service or product, either prior to the expiration of the trial period or once they realize their accounts have been charged. Although the consumer may have accepted the offer on the Internet or by email, sellers often do not make available cancellation mechanisms on the Internet or by email. Consumers are forced to call a telephone number, which is not always toll free. In many instances, consumers complain of being put on hold for unreasonable lengths of time. Also, they often find it difficult to get confirmation of a cancellation in writing from the seller. Such difficulties in cancellation compound the consumer harm caused by negative option plans.

Despite the unusually high cancellation rates, sellers reap enormous profits from the use of free-to-pay conversions because consumers often do not discover the charges until after many months of paying the fees. Many consumers never discover the charges.

Having witnessed the extent of such problems in Washington, we believe that our consumers' experiences with free-to-pay conversions are typical and representative of national trends. With such high numbers of consumer complaints and general dissatisfaction with this type of marketing, there is a clear need for strong regulation of free-to-pay conversions.

III. SPECIFIC SUGGESTIONS

The Attorney General therefore recommends that the following requirements, at a minimum, be added to the PNOR:

A. Obtain Financial Information Directly From Consumer at Point of Offer and Acceptance

At the heart of the deception of most free-to-pay offers is the seller's ability to enroll and bill the consumer without obtaining the consumer's financial account information directly from the consumer at the time of the free-to-pay offer and the consumer's acceptance. Sellers frequently pre-acquire consumers' financial information in agreements with third parties, e.g., banks, or obtain the consumer's financial information from an affiliate with whom the consumer has transacted business just prior to the free-to-pay offer being presented. To prevent consumers from being billed without their authorization due to the seller's acquisition of their financial information from a third party or for a different product or service, the Attorney General recommends that sellers be required to obtain the consumer's financial information directly from the consumer at the time of making the free-to-pay offer and directly from the consumer for each individual transaction.

B. Verifiable Authorization To Place Charges

The Attorney General recommends that the seller be required to obtain verifiable authorization from the consumer to be charged on the account that the consumer provides during the transaction. Without verifiable authorization from the consumer, the seller will have no proof that the consumer ever agreed to be charged or debited for the product or service following the free trial period. This requirement in fact protects both the consumer and the seller.

C. Affirmative, Unambiguous Acceptance

The Attorney General recommends that in free-to-pay conversion offers, acceptance of the offer must be evidenced by an affirmative, unambiguous action taken by the consumer to accept the offer under the terms and conditions disclosed to the consumer. This requirement could very likely be met in conjunction with obtaining the consumer's financial account information and authorization to be charged on that account.

D. Outer Time Limits

The Attorney General recommends the creation of an outer time limit on charges for a trial conversion continuity plan as a "backup" safeguard for consumers who may not be aware of the charges to their accounts. Our suggested time limit is eighteen (18) months.[i] At the expiration

[i] The Telemarketing Sales Rule states that an "*established business relationship* means a relationship between a seller and a consumer based on: the consumer's purchase, rental, or lease of the seller's goods or services or a financial transaction between the consumer and seller, within the eighteen (18) months immediately preceding the

of the time limit, the company offering the plan would be required to seek a new affirmative agreement and authorization to be charged from the consumer. If no new agreement is obtained, the continuity plan would be cancelled.

E. Ease of Cancellation Process

Often, cancellation of negative option plans is made extremely difficult for consumers. Consumers who enroll via an Internet pop-up advertisement are sometimes required to cancel registration by telephone. To reduce the difficulties in plan cancellation, the Attorney General recommends that sellers be required to provide consumers the ability to cancel their membership in the same method as their enrollment, while still offering other methods of cancellation. If a consumer enrolled on the Internet, the seller should provide an Internet cancellation option.

F. Clear Identification of Seller on Billing Statement

The Attorney General recommends a requirement that the seller provide information sufficient to identify itself on the billing statement to enable consumers to identify and contact the seller. All too often, the only identifying information next to charges associated with free-to-pay conversions that appear on billing statements are mysterious and undecipherable letter, number, and symbol combinations.

G. Inclusion of "Services" Under the Negative Option Rule

Finally, as written, the current PNOR only prohibits the negative option marketing "in connection with the sale, offering for sale, or distribution of goods and merchandise." 16 C.F.R. § 425.1(a). Many of the offerings promoted via negative option plans could be considered services and thus would not fall under the law's current provisions. To fully guard against the dangers of negative option marketing, the Attorney General suggests that this definition be broadened to include "services."

By instituting these further protective measures, the dangers of negative option plans can be mitigated. In closing, Attorney General thanks the Federal Trade Commission for considering these comments and hopes that they provide useful information in our joint goal of consumer protection.

Sincerely yours,

ROBERT M. MCKENNA
Attorney General

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date of a telemarketing call." 16 C.F.R. § 310.2(n). Washington recommends a similar eighteen-month period for establishing a relationship between a consumer and a negative option plan provider.