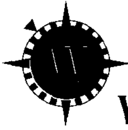

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THE FIRST UNIVERSITY IN THE WEST
COLLEGE OF LAW

Ms. Kathryn Armstrong, Esq.
Mr. Steven Toporoff, Esq.
Division of Privacy and Identity Protection, Bureau of Consumer Protection,
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

November 16, 2009

Dear Ms. Armstrong and Mr. Toporoff:

I write to comment on the proposed changes to the Free Annual File Disclosures Rule. I strongly support the whole of the proposed changes.

I have attached a law review article that offers a suggested change to the entirety of the Commissions approach to the use of the word "free" in advertisements.[1] The instance that the Commission has identified, the free credit report issue, has been particularly notorious for misleading consumers.

There is much support for this instant change. In sum, cognitive psychology and reciprocity theory demonstrate that the power of a free offer will induce consumers to behave differently, making them more likely to engage in a transaction with a free offer than a transaction without a free offer. Stated differently, the serial presentation of an offer in separate pieces can powerfully induce a consumer to engage in a transaction.

Further, implicit reciprocal obligations can form in the consumer mindset when presented with free goods and services. The powerful expressive function of the word "free" tactically puts consumers at a disadvantage even in the situations where current laws and regulations are satisfied.

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[1] David Adam Friedman, *Free Offers: A New Look*, 38 N.M.L. REV. 49 (2008).

I hope the Commission will consider the above points and weigh the supporting literature I have provided.

Sincerely,

David A. Friedman
Assistant Professor of Law
Willamette University College of Law

FREE OFFERS: A NEW LOOK

DAVID ADAM FRIEDMAN*

INTRODUCTION

Free offers—the practice wherein firms market goods, services, and their brand to consumers by claiming that they are "free"[1]—have been overlooked for too long. These offers have become so ingrained into consumer culture[2] that they often go unnoticed, viewed as part of the natural commercial landscape. The courts and the Federal Trade Commission (FTC) have effectively left free offer regulation untouched since the 1950s.[3] Even legal scholarship has largely ignored free offers.[4] This Article argues that advances in the study of human behavior require a new look and a new approach to the half-century-old free offer regulatory regime.

Why do these offers exist? After all, the purpose of a commercial enterprise is not rooted in the altruism of giving away goods and services for free. Free offers exist to lure potential customers to a specific offering, to bring them to the commercial enterprise where an offering can be presented, or to create an often-hidden psychological tie between customers and the enterprise that helps induce a sale.

A truly free offer would be a gift. In contrast, a "free" offer attached to another definite commercial commitment is not free under a common understanding of the word. Under the current legal standard, however, the use of the word "free" is lawful provided there is adequate disclosure of the attached commercial commitment.[5]

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1. Note that the common law does not view advertisements as offers, but merely as invitations to perform. For example,

> if goods are advertised for sale at a certain price, it is not an offer, and no contract is formed by the statement of an intending purchaser that he will take a specified quantity of the goods at that price. The construction is rather favored that such an advertisement is *a mere invitation to enter into a bargain* rather than an offer.

1 SAMUEL WILLISTON, THE LAW OF CONTRACTS § 27, at 33 (1920) (emphasis added). *Cf.* Jay M. Feinman & Stephen R. Brill, *Is an Advertisement an Offer? Why It Is, and Why It Matters*, 58 HASTINGS L.J. 61 (2006) (arguing that the consensus hornbook approach fails to address modern commercial realities). Here the term "free offer" is considered largely in an advertising context and viewed as it would affect consumer behavior through inducement.

2. A Google search on the term "free offer" on June 9, 2007 yielded over 1.3 million results. (search results on file with author.) An examination of a large circulation Sunday newspaper revealed nine uses of the word "free" in commercial advertisements in the "A" section alone. THE OREGONIAN (Jun. 10, 2007). These offers dangled a "free" cell phone; the chance to win a "free" fence; a "free" year of golf; a "free" charcoal starter; a "free" report about back pain; "free" mattress delivery, set-up, and haul-away; a "free" copy of a report on "Who Else Doesn't Want Back or Neck Surgery"; and finally, a "free" million-dollar slot pull at a local casino. *Id.* As early as 1953, a Federal Trade Commissioner acknowledged that "simply because the word 'free' is used so extensively in advertising and selling, that the Commission as a result receives many complaints from consumers and competitors regarding its use." *In re* Walter J. Black, Inc., 50 F.T.C. 225, 237 (Mead, Comm'r, dissenting) (1953).

3. *Walter J. Black*, 50 F.T.C. 225, and *Book-of-the-Month Club v. Federal Trade Commission*, 202 F.2d 486 (2d Cir. 1953), effectively settled today's law, which was codified in 1971 through the FTC's promulgation of guidelines at 16 C.F.R. § 251.1. The case involving buy-one, get-one free regulation, *Federal Trade Commission v. Mary Carter Paint Co.*, 382 U.S. 46 (1965), did not substantively affect the core of the free offer regulatory scheme.

4. For two brief surveys of free offer regulation and law, see 1A RUDOLF CALLMANN, UNFAIR COMPETITION, TRADEMARKS & MONOPOLIES § 5:43 (4th ed.) (2007) and Gene A. Marsh, *If It Sounds Too Good to Be True... Regulation of Unfair or Deceptive Use of the Term "Free,"* 57 CONSUMER FIN. L.Q. REP. 45, 46–48 (2003).

5. *See infra* Part II.

Electronic copy available at: http://ssrn.com/abstract=1010238

At present, free offers are regulated both federally and at the state level. The FTC has promulgated guidelines[6] and some states have passed and promulgated free offer statutes and regulations.[7] The FTC has recently pursued cases in this area,[8] as have many states.[9] In general, the guidelines and regulations state that free offers must not be deceptive, and the component of the offer designated as free must *actually* be free.[10] Although there is law in this regulatory area, there is also a cultural aspect of free offers that should not be ignored.

The commercial culture has imbued certain norms into the economy, and free offers are one of them. The proliferation of free offers has so saturated the commercial environment that some consumers tend to accept them as "puffery"[11] or merely harmless exaggerations. In addition, consumers' intuitive knowledge that there is "no such thing as a free lunch"[12] has become a norm of the commercial culture.

So why wouldn't consumers want "free" goods and services? Rational consumers should indeed want truly "free" goods and services. However, free offers subvert

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6. Commission Guide Concerning Use of the Word "Free" and Similar Representations, 16 C.F.R. § 251.1 (2007).

7. Though some states typically do not provide quite the detailed guidance that the FTC has in 16 C.F.R. § 251.1, some provide for generalized statutory or regulatory guidance. *See, e.g.*, CAL. BUS. & PROF. CODE § 17537.11; CONN. AGENCIES REGS. § 42-110b-10a (3) (2007); FLA. STAT. § 817.415 (2007); IDAHO ADMIN. CODE r. 04.02.01.070 (2007); 815 ILL. COMP. STAT. 505/2P (2007); LA. ADMIN. CODE tit. 16, pt. III, § 315 (2007); 940 MASS. CODE REGS. 6.05 (2007); MONT. ADMIN. R. 23.19.101 (2006); OHIO ADMIN. CODE 109:4-3-04 (2007); OR. ADMIN. R. 137-020-0015 (2007). Other states have enacted statutes and regulations specific to certain industries. *See, e.g.*, COLO. REV. STAT. § 12-33-117 (2007) (regulating use of "free" by chiropractors); MICH. ADMIN. CODE r. 456.136 (2007) (regulating use of "free" in cemetery merchandise and interment and related services); MINN. R. 2810.1300 (prohibiting the advertisement of subdivision lots for free "if purchaser is required to give any consideration whatsoever" and prohibiting lots from being offered and advertised "for closing costs only" when closing costs are substantially more than normal, etc.).

8. For a recent example, in 2005, the FTC settled with Consumerinfo.com, Inc., owner of the www.freecreditreport.com website, for $950,000 for making "misleading claims" about free offers. The free offer of introductory service was accompanied by an automatic, undisclosed sign-up for a paid service. Press Release, Federal Trade Commission, Marketer of Free Credit Reports Settles Commission Charges (Aug. 16, 2005), *available at* http://www.ftc.gov/opa/2005/08/consumerinfo.shtm.

9. For a recent state-level example, in 2006, fourteen states and the District of Columbia settled with Cincinnati businessman Steve Warshak for $2.5 million. Warshak and various companies under his control "enticed consumers with advertisements promising 'free' 30-day trials of their products." (Among the products were a dietary supplement called Enzyte, targeted toward men seeking a certain type of enhancement. The television advertisements featured a nationally renowned fictional product user named "Smiling Bob.") The "free" issue was similar to that of the Consumerinfo.com matter, *supra* note 8, in that, among other problems, the consumers were automatically billed for additional shipments beyond their free trial shipments. Press Release, Illinois Attorney General Lisa Madigan, Madigan Joins Other Attorneys General in Agreement Over Marketing and Sales Practices of Diet Supplements (Mar. 2, 2006), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2006_03/20060302b.html. For another colorful example, see the Ohio Attorney General's 2007 Complaint against Campus Dimensions, Inc. and OSU La Bamba, Inc., alleging that the defendants "through various advertisements, deceptively offered 'free' food and beverage items to college students without disclosing that these 'free' items could be obtained only by completing a credit card application." Complaint at 1, State of Ohio *ex rel.* Marc Dann Attorney General of Ohio v. Campus Dimensions, Inc. and OSU La Bamba, Inc., No. 07CVH09-12592 (In the Common Pleas Court of Franklin County, Ohio Civil Division Sept. 19, 2007) (on file with author).

10. *See* 16 C.F.R. § 251.1.

11. "Puffery is a 'vague statement' boosting the appeal of a service or product that, because of its vagueness and unreliability, is immunized from regulation." David A. Hoffman, *The Best Puffery Article Ever*, 91 IOWA L. REV. 1395, 1397 (2006).

12. Though he did not have available the phrase popularized by Milton Friedman, Judge Learned Hand certainly made this point in his opinion in *Federal Trade Commission v. Standard Education Society*, 86 F.2d 692 (2d Cir. 1936).

Electronic copy available at: http://ssrn.com/abstract=1010238

rationality. Cognitive psychology and reciprocity theory demonstrate that the power of a free offer will induce consumers to behave differently, making them more likely to engage in a transaction with a free offer than a transaction without a free offer. Stated differently, the serial presentation of an offer in separate pieces can powerfully induce a consumer to engage in a transaction.

Further, implicit reciprocal obligations can form in the consumer mindset when presented with free goods and services. A distributive shift of wealth is likely to occur when a party engages in a contract without complete knowledge or symmetric information. The very fact that society regulates free offers at all indicates some concern about such inducements and the resulting impact on the consumer mindset. The powerful expressive function of the word "free" tactically puts consumers at a disadvantage even in the situations where current laws and regulations are satisfied.

This Article argues that the current law and regulations related to the use of the word "free" in advertising and marketing require wholesale reevaluation, especially given the date of their original formation and the advances in understanding of human behavior since then. Moreover, policy makers should even go as far as banning the practice of the free offer completely in certain contexts and seeking other appropriate means to even the playing field between consumers and commercial entities.

Part I of this Article reviews the history and current state of free offer law and regulation and explores the evolution of the law on the subject. Given the barren nature of the literature in this area, this article focuses on the doctrinal development of free offer law. Some of the very basic elements of the core argument offered here were raised by courts and regulators between the 1930s and 1950 and involved clashes between such notable figures as Judge Learned Hand[13] and Justice Hugo Black[14] and an impassioned plea from largely forgotten former New Deal Senator turned Federal Trade Commissioner, James M. Mead. This Article repeatedly revisits Mead's arguments, which question the entirety of the free offer practice. This Article will examine all of the doctrinal arguments raised in that era; put them into a scholarly context; and determine whether, given advances in understanding of human behavior, their arguments are worth reanimating today.

Part II takes what the FTC has defined as a lawful free offer and views the offer through the lens of psychology, human cognition and reciprocity theory to demonstrate that even *lawful* free offers still exact influence on consumers. Part II also examines thoroughly the limited curative effectiveness of additional disclosure. Finally, Part III advocates dramatic changes to the regulation of free offers, including banning them in many contexts, and examines the practicalities of such a change.

Taking this "new look" at free offers first requires an understanding of where free offer regulation stands today and a historical review of the current posture of the law.

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13. *See id.*
14. In one of his first cases on the Supreme Court bench. *See infra* Part I.B.2.

I. REGULATING THE "FREE OFFER"

Milton Friedman helped popularize the timeworn aphorism and admonition that "[t]here's no such thing as a free lunch" in his famous book of the same title.[15] The principle behind this statement is intuitive. Someone, somewhere, is paying for "lunch" regardless of the posted price or absence thereof. If that someone happened to be a rent-seeking commercial enterprise, one would expect that the enterprise made the offer with the expectation of a return somewhere down the line. Free offers, in the spirit of Milton Friedman, cannot really be free.[16] So why are free offers so prevalent in spite of the proliferation of the "no free lunch" admonition? Why would they require regulation?

Free offers require regulation because they are inherently confusing and often internally contradictory. A consumer often looks for the "catch" and, presumably, a rent-seeking provider of free offers seeks a gain from the prospective transaction. Is the free offer merely a commercial charade and are all consumers in on the joke? If consumers are not in on the joke, are they victims? What purpose does the so-called free offer serve?

Commercial enterprises promote free offers for a sound commercial reason: they work. That is, they induce sales and increase enterprise profitability.[17] For a commercial enterprise to exist, there must be an economic return on investment. If managers and owners are rational,[18] they will not make a free offer unless they anticipate some return. Consistent with this concept, the FTC explicitly recognizes that offering free goods and services along with non-free goods and services "has often been found to be a useful and valuable marketing tool."[19]

There are examples of free offer marketing activity dating back as early as the nineteenth century.[20] We also find regulatory controversy regarding free offers emanating from various quarters from their emergence into the marketplace until

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15. MILTON FRIEDMAN, THERE'S NO SUCH THING AS A FREE LUNCH (1975). For a brief anecdotal overview about the use of this phrase, see David A. Hyman, *Consumer Protection in a Managed Care World: Should Consumers Call 911?*, 43 VILL. L. REV. 409, 412 n.11 (1998).

16. An old joke about Friedman speaks to this premise: "Milton Friedman and his acolyte [are] walking down the street. 'Look,' says the acolyte, 'there's a $100 bill in the gutter!' 'Impossible,' says Milton, someone would have picked it up already.'" Robert E. Marks, *There's No Such Thing as Free Lunch*, 31 AUSTRALIAN J. OF MGMT., *available on Westlaw at* 2006 WLNR 23412423.

17. *See* Bob Tedeschi, *Nothing Says "Buy" Like "Free Shipping"*, N.Y. TIMES, Oct. 8, 2007, *available at* www.nytimes.com/2007/10/08/technology/08ecom.html?_r=2&ref=business&oref=slogin&oref=slogin.

18. These players may be altruistic, but there is evidence that most "altruists" desire something other than internal warm feelings in return, such as recognition—or obligation masking as goodwill.

19. 16 C.F.R. § 251.1(a)(1) (2007).

20. The most well-known free offers in the American commercial realm are rooted in the so-called "free lunch." The "folk wisdom" behind the phrase "there's no such thing as a free lunch," often attributed to Milton Friedman, is said to be rooted in the nineteenth century practice of pubs advertising free lunches to lure in customers for libations. Marks, *supra* note 16. In the United States, the brewers of that period built their own saloons to retail their wares and "offer[ed] extras like free newspapers [and] free lunches." Max Rudin, *Beer and America: It Came Over with the Mayflower and Stayed on to Be the Unchallenged Drink of Democracy*, AM. HERITAGE, June 1, 2002, at 28. During this period, in neighborhood grocery stores, food was "displayed at the front and 'beer and booze' was sold in the back room. With time, the situation was reversed, and the groceries were reduced to the elements of a free lunch for boozers." Giles McDonogh, *Shaken and Now and Again, Stirred*, FIN. TIMES, Aug. 17, 2002, at FT Weekend 11. There was also evidence of this practice in Australia up until the 1940s, where, "[a]s one pub memoir of the time recorded 'Boiled mutton, roast beef, pork, potatoes, pumpkin, greens—it was expected that you'd have a pint of beer with your meal.' But not obligatory." Graeme Phillips, *Milking a Good Story in Myth*, SUNDAY TASMANIAN, Oct. 6, 2002, at 60. *See generally* Marks, *supra* note 16.

regulation effectively settled.[21] Even recently, the FTC and the states have enforced regulation of the use of the word "free"[22] and over time, courts have also spoken on the subject.[23]

One theme emerging from these actions, particularly at the state level, is that the free offer is alive and well under the current consumer protection regulatory regime. Any casual exposure to advertising in the United States would bring one to the same conclusion.[24] Because of the continued prevalence of free offers, it is worth exploring how the regulatory regime brought about the current free offer environment and determining which free offers are within safe harbor legal boundaries and which are without. Ultimately, this Article argues that more free offers should be "without" those safe harbors.

Below, Section A explores the current regulation of the word "free" in the commercial arena and the implications that follow. Section B then reviews the arguments and the evolution of "free offer" law from the pre-New Deal era to the present. The absence of scholarship in this area compels examination of the development of case law and FTC rulings over this period. This section also visits the emergence of free offer disclosure regulations and "Buy One, Get One Free" offers. Section C briefly explains how the consumer mindset remains open to exploitation under the current regime.

A. Federal Trade Commission Guidelines on Use of the Word "Free"

To clarify the existing body of free offer law, in 1971 the FTC promulgated regulations to be used as a "[g]uide concerning the use of the word 'free' and similar representations."[25] This Article focuses on the FTC's regulatory approach, as the FTC's guidelines are by-and-large mirrored at the state level.[26] The FTC's language reflects the tortuous complexity and inherent contradiction embodied in regulating free offers to consumers from profit-seeking entities.

The FTC Guidelines start by acknowledging the power of the free offer and warning offerers to respect that power. The guidelines caution that "[b]ecause the purchasing public continually searches for the best buy and regards the offer of 'Free' merchandise or service to be a special bargain, all such offers must be made with extreme care so as to avoid any possibility that consumers will be misled or deceived."[27] This view was acknowledged quite early in "free offer" action. In the 1938 matter, *In re Samuel Stores*,[28] the FTC proclaimed that free offers were "powerful psychological magnets to draw trade and undoubtedly the merchant expects to benefit thereby...."[29] With this statement, the FTC was sending a

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21. These controversies are described in detail in Part I.B, *infra*. For a brief but encompassing overview of issues involving free offers, including "Buy One, Get One Free," disclosure of terms, combination sales, and "'free' in the context of a breach of contract claim," see Marsh, *supra* note 4; CALLMANN, *supra* note 4, § 5:43.

22. *See, e.g.*, the FTC settlement with freecreditreport.com discussed *supra* note 8 and the multi-state settlement with Warshak, *supra* note 9.

23. *See generally* CALLMANN, *supra* note 4, § 5:43.

24. *See supra* note 2.

25. *See generally* 16 C.F.R. § 251.1 (2007).

26. *See supra* note 7.

27. 16 C.F.R. § 251.1(a)(2) (2007).

28. 27 F.T.C. 882 (1938).

29. *Id.* at 887.

message to merchants, and indirectly to the broader public, to exercise care around the word "free." So what does lawfully "free" mean in the commercial context exactly?

1. The FTC Meaning of "Free"

The FTC Guidelines, in a somewhat circuitous way, define the "meaning of 'free'" for the purpose of guiding merchants and service providers. Curiously, the FTC does so by placing the offeror in the shoes of the purchaser:

> [A]n offer of "Free" merchandise or service is based upon a regular price[[30]] for the merchandise or service which must be purchased by consumers in order to avail themselves of that which is represented to be "Free." In other words, when the purchaser is told that an article is "Free" to him if another article is purchased, the word "Free" indicates that he is paying nothing for that article and no more than the regular price for the other. Thus, a purchaser has the right to believe that the merchant will not directly and immediately recover, in whole or in part, the cost of the free merchandise or service by marking up the price of the article which must be purchased, by the substitution of inferior merchandise or service, or otherwise.[31]

In sum, the FTC seems to rely on the proposition that "free" means "free." The only room in that definition lies in what the consumer has "the right to believe," namely that the merchant may not "directly and immediately" make a recovery of the cost of the free offering. It would follow that a merchant *may* "indirectly," and in a less-than-immediate time frame, pursue such recovery. An offer that would enable the purchaser to believe that recovery would only happen on such terms would be a "lawful free offer."

If a merchant follows the above formula and promotes a lawful free offer, is the offer truly free under the common understanding of the word? Is there a real distinction? Is the offer merely "free" under society's commercial traditions or cultural norms? The guidelines concerning disclosure of conditions for free offers only shed further confusion on the matter.

2. Guidelines for Disclosure of Conditions on Free Offers

The FTC Guidelines concerning disclosure of the conditions on free offers present another puzzle in the quest to gain insight into the definition and exploration of the meaning of "free." The FTC counsels that,

> [w]hen making "free"...offers all the terms, conditions and *obligations* upon which receipt and retention of the "free" item are contingent should be set forth clearly and conspicuously at the outset of the offer so as to leave no reasonable probability that the terms of the offer might be misunderstood.[32]

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30. "Regular price" is defined in 16 C.F.R. § 251.1(b)(2) (2007) as "the price, in the same quantity, quality and with the same service, at which the seller or advertiser of the product or service has openly and actively sold the product or service...for a reasonably substantial period of time...."

31. 16 C.F.R. § 251.1(b)(1) (2007). "Introductory offers" are governed by a separate provision. 16 C.F.R. § 251.1(f)(1) (2007).

32. 16 C.F.R. § 251.1(c) (2007) (emphasis added).

If, however, there are any disclosures that need to be made regarding attached "terms, conditions and obligations," wouldn't these disclosures be necessarily material enough to impact whether the good is *truly free* at all, as set forth in the common understanding of the word? The terms, conditions, and obligations must only be related to indirect and deferred recovery of the free offering, a requirement that may be inconsistent with the common understanding.[33]

One particularly ambiguous word that the FTC uses is "obligation." What is an obligation? Is it a material obligation or could it also be a moral or social obligation? From all indications, the FTC is referring to material obligations of the "indirect and deferred" nature, not any of the hidden but powerful social and psychological obligations obliquely referred to by the FTC in 1938[34] that are created when an individual receives something for free.

Those social and psychological obligations would be difficult to disclose logistically and would probably be the most transaction-destructive disclosures to raise. In Part II, this article explores this category of obligations in some detail. However, an illustration of this category here might prove instructive.

Consider this extreme, but not unfamiliar example of what full social and psychological disclosure relating to a timeshare sale would look like:

> Because you are a discerning traveler, we are offering you a free three night stay at the Acme Aspen Ski Chalet if you will promise to attend a 45 minute seminar from one of our vacation homes professionals.*
>
> * *This free night's stay at our resort may make you feel a primal need or psychological obligation to reciprocate our gesture of personally provided goodwill and unduly influence you when our highly trained sales professionals talk with you tomorrow after you get off the slopes (Lift tickets? Our treat again, of course, aren't we so hospitable?) about buying a timeshare. Our people are trained to be quite hospitable and generous, but also quite persistent in seeking for you to return the favors we have provided for you. You may, indirectly, or at some point in the future, be paying us back multi-fold for that free three night stay.*

The above disclosure example is indeed ripe for well-deserved ridicule. No self-respecting (or self-preserving) sales operation would make such a disclosure unless compelled to do so. In fact, the sales operation might abandon that well-established marketing approach entirely if that disclosure were compelled. But should they have to disclose these types of social obligations? Why does the tangible obligation get all of the focus, but the intangible obligation—which can often be just as, if not more, powerful as a motivator—receive none?

The very use of the word "free" or the provision of a free good or service with the intent of ultimate recovery involves manipulation of cognitive psychology. As explored below,[35] this is not something that disclosure alone can address.

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33. Part I.B.4.a will revisit an argument made by an FTC Commissioner in 1953 that this policy is indeed internally inconsistent.

34. *See In re* Samuel Stores, 27 F.T.C. 882, 887 (1938).

35. *See infra* Part II.A.

Part I.B explores how regulation of the free offer reached its current state and articulates why it should go further. As the case law and FTC decisions reflect, judges and regulators throughout the last century's commercial evolution have struggled to strike a balance between paternalistic and libertarian approaches toward free offers. From a case-driven formalistic perspective, the initial old-line approach toward free offers could be characterized as caveat emptor. The pendulum then swung toward paternalism and protection of consumers, and then slightly retrenched toward caveat emptor. But overall, aside from the occasional lip service (as mouthed in 1938[36] and implicit in the introduction to the FTC Guidelines[37]), almost no substantive attention has been paid to the psychological power of the free offer by the courts or the legal academic literature.

B. The Heritage of the Lawful Free Offer

Enhancing the current understanding of free offers requires revisiting *how* policy developed to the current state. The approach toward the evolution of the current law almost exclusively took place outside the realm of academic thought in the courts and FTC decisions. The FTC and the courts addressed free offer problems beginning with the acceleration of the commercial mass-marketing culture in the 1920s and 1930s, ultimately reaching a state approaching today's regulatory structure by the 1960s.[38]

For a seemingly mundane marketing tactic, the free offer issue surprisingly pressed some hot buttons. Especially in the early cases, the courts engaged in a dialogue about human stupidity,[39] fatuousness,[40] and evil[41] in an attempt to assess just how much protection consumers should be accorded.

The arguments about free offers have a deep heritage. Throughout the evolution of the current rules lie arguments against the current lawful free offer. Subsection 1 illustrates how, until the late 1930s, the courts reflected the commercial culture of the era through their laissez-faire, caveat emptor approach toward free offers.[42] Subsection 2 describes the sharp turn brought about by a new Supreme Court in the Fall Term of 1937, which reined in old thinking about caveat emptor and rebuked the previously unconstrained practices relating to free offers.

Subsection 3 shows how the door was opened to the current practice of "free offer with disclosure" with a 1938 FTC ruling, widely open to interpretation, that free offers were lawful provided they were offered without deception.[43] Unspecified qualifying language was one way an offerer could mitigate exposure under the ruling, but there was no safe harbor. Subsection 4 describes how today's approach,

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36. *See Samuel Stores*, 27 F.T.C. at 887.
37. *See supra* note 25 and accompanying text.
38. For a brief but encompassing summary of FTC and judicial action in this area, see CALLMANN, *supra* note 4, §§ 5:52–54. This Article will address only the cases that set major direction and exposed the thinking of policy makers and the judiciary.
39. John C. Winston, Co. v. FTC, 3 F.2d 961, 962 (3d Cir. 1925).
40. FTC v. Standard Educ. Soc'y (*Standard Educ. Soc'y I*), 86 F.2d 692, 696 (2d Cir. 1936), *rev'd in part*, 302 U.S. 112 (1937).
41. FTC v. Standard Educ. Soc'y (*Standard Educ. Soc'y II*), 302 U.S. 112, 115 (1937).
42. *See* John C. Winston, *infra* Part I.B.1; *Standard Educ. Soc'y I*, 86 F.2d 692.
43. *See In re* Samuel Stores, 27 F.T.C. 882, 887 (1938).

which includes a safe harbor, was developed in the 1950s. This approach permits the use of free offers provided there is disclosure of any attached obligations.

Importantly, subsection 4 offers the vocal minority view of a Federal Trade Commissioner who took the position that a free offer with an obligation was simply not free. According to the Commissioner, a free offer with an attached commercial obligation was in itself a paradox. This Article argues that this critique, offered by Commissioner James Mead, should be reawakened and enhanced in light of what is known today about consumer psychology.[44]

This chronological exploration of the law's evolution provides insight as it reflects the development of some of the overall attitude toward consumer law against the larger backdrop of history. Significantly, free offer law originated in the free-market environment of the 1920s and the jurisprudence that reflected those times.[45]

1. *John C. Winston Co.*: The "Very Stupid Person" Standard

The courts of the 1920s were unsympathetic to complaints about unbridled free offers. The 1925 case *John C. Winston Co. v. FTC*[46] involved the sale of "free" encyclopedias with costly supplements and book clubs. *John C. Winston Co.* did not directly involve an explicit "free offer" in that the actual offer per se did not invoke the use of the *word* "free." Nonetheless, this case offers a glimpse into the caveat emptor approach that courts were taking toward consumers in the 1920s.

In *John C. Winston Co.*, the FTC challenged the practice of offering consumers forty-nine dollars for "encyclopedic[47] and research services" and "the absence of any charge specifically for the [accompanying] encyclopedia."[48] The FTC argued that this approach would "induce...the buyer to think...that he is getting something for nothing."[49] The Third Circuit, responding with a strong outburst of caveat emptor language, rejected the FTC's argument by stating that "[i]t is conceivable that a *very stupid person* might be misled by this method of selling books, yet measured by ordinary standards of trade and by ordinary standards of the intelligence of traders, we cannot discover that it amounts to an unfair method of competition...."[50]

In *John C. Winston Co.*, the word "free" was never actually used by the offerer. Instead, the offerer used a blank term[51] that may have led consumers to believe the encyclopedia was free. One can speculate whether use of the word "free" would have changed the court's analysis, specifically with regard to whether such an offer might mislead a "less than" very stupid person. Future judicial action, as explored in the next subsection, could lead one to conclude that the *John C. Winston Co.* court's analysis would have been the same, given the laissez-faire environment of

44. *See id.*
45. See *infra* Part I.B.1.
46. 3 F.2d 961 (3d Cir. 1925).
47. These products were described as "loose leaf" supplements, a term of the trade at the time. *Id.* at 961.
48. *Id.* at 962.
49. *Id.*
50. *Id.* (emphasis added).
51. *Id.* at 961.

that time. Though the *John C. Winston Co.* case was not on all fours as a "free" case, it does communicate quite clearly how the FTC's mindset was clashing with that of the commercial caveat emptor tradition.[52]

2. Combating "Evil": The New Dealer Vanquishes Caveat Emptor

The next major "free" case of note, *Federal Trade Commission v. Standard Education Society*,[53] ultimately decided by the Supreme Court in 1937, took a different turn. In fact, the turn could be described as a sharp U-turn, even within the confines of this particular piece of litigation, as the Second Circuit was reversed bluntly and dramatically. The use of the word "free" in offers would forever forth be burdened with a measure of accompanying honesty.

The *Standard Education* Court intervened in a manner highly protective of consumers. The free-offerers in this case, the Standard Education Society, set out on a much brasher course than their encyclopedian brethren at John C. Winston Company. Standard Education Society's offer contained a number of flagrant misrepresentations about their product, and the sales process and offer were psychologically devious and highly misleading by any standard. The free offers were so misleading that Justice Hugo Black even went so far as to label the company's trade practices "evil."[54]

The pitch to consumers began with unsavory but highly effective appeals to the human ego.[55] Prospective buyers were told that they were chosen from a "small list" of "well connected...people" to receive "an artcraft deluxe edition" of the New Standard Encyclopedia.[56] The company's sales force represented to prospective buyers that they were "not selling anything; that the books [were] free; [and] that the books [were] being given free as an advertising plan."[57] The only return asked for in exchange from the prospects was permission to use their names for "advertising purposes and as a reference."[58]

But of course, there was a catch.[59] The prospects would indeed be charged in the course of this exchange, not for the encyclopedias, but for the accompanying ten-year "loose leaf extension service" for the "reduced price" of \$69.50.[60] The

52. This tension between contract law and consumer protection regulation persists, with consumer protection appearing to pull contract law forward. *See* Stewart Macaulay, *Bambi Meets Godzilla: Reflections on Contract Scholarship and Teaching v. State Unfair and Deceptive Trade Practices and Consumer Protection Statutes*, 26 HOUS. L. REV. 575, 582–89 (1989).

53. 86 F.2d 692 (2d Cir. 1936), *rev'd in part*, 302 U.S. 112 (1937).

54. *Standard Educ. Soc'y II*, 302 U.S. 112, 116 (1937).

55. There were also a series of misrepresentations regarding "exaggerated and garbled" testimonials that may have flavored the Court's tone but are not relevant to concerns about the free offer. *See id.* at 114.

56. *Id.*

57. *Id.*

58. *Id.* Note that certain companies use this timeless tactic today. A well-known door-to-door knife sales company gathers references from prospects, often from those that don't buy. The salesperson then uses the reference (and the name of the referrer) as a powerful psychological tool when pitching the product. *See* ROBERT LEVINE, THE POWER OF PERSUASION 58–64 (2003) (discussing the training program for selling Cutco Knives).

59. There is always a catch.

60. *Standard Educ. Soc'y II*, 302 U.S. at 114. To put this in more current terms, \$69.50 in 1936 dollars would equate to over \$1,000.00 in 2007, according to the calculator provided by the Federal Reserve Bank of Minneapolis, *available at* http://www.minneapolisfed.org/research/data/us/calc/ (last visited Feb. 29, 2008).

salespeople told the prospective buyers that "the regular price of the books and the extension service" ranged between $150.00 and $200.00.[61]

On first appellate review, taking the prevailing *caveat emptor* approach, the Second Circuit rejected the FTC's claim that Standard Education Society had engaged in unfair trade practices with regard to its sales methods.[62] None other than Judge Learned Hand reasoned that the FTC should not

> [s]olicit[] a censorship...worse than any evils it may correct, and a community which sells for profit must not be ridden on so short a rein that it can only move at a walk. We cannot take seriously the suggestion that a man...will be fatuous enough to be misled by the mere statement that the first are given away, and that he is paying only for the second. Nor can we conceive how he could be damaged were he to suppose that that was true. Such trivial niceties are too impalpable for practical affairs, they are will-o'-the-wisps, which divert attention from substantial evils.[63]

Justice Black's opinion reversing the Second Circuit could not have delivered a more tonally oppositional decision to Judge Hand's worldview. The dialogue between the two giants on this issue reveals the divide between a purist caveat emptor, "*only the very stupid*" approach and the soon-to-emerge, more paternalistic, protective approach toward consumers.[64] In developing this new approach, Justice Black countered Judge Hand directly:

> The fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced. There is no duty resting upon a citizen to suspect the honesty of those with whom he transacts business. Laws are made to protect the trusting as well as the suspicious. The best element of business has long since decided that honesty should govern competitive enterprises, and that the rule of *caveat emptor* should not be relied upon to reward fraud and deception....To fail to prohibit such evil practices would be to elevate deception in business and to give to it the standing and dignity of truth.[65]

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61. *Standard Educ. Soc'y II*, 302 U.S. at 114.

62. *Standard Educ. Soc'y I*, 86 F.2d 692 (2d Cir. 1936), *rev'd in part*, 302 U.S. 112 (1937).

63. *Id.* at 695–96.

64. This emerging approach, in the spirit of the New Deal, from which Justice Black emerged as a towering figure, also sought to protect "the best element of business" from the unscrupulous. Stephen M. Feldman, *Unenumerated Rights in Different Democratic Regimes*, 9 U. PA. J. CONST. L. 47, 77 (2006) (citing WILLIAM E. LEUCHTENBURG, THE SUPREME COURT REBORN: THE CONSTITUTIONAL REVOLUTION IN THE AGE OF ROOSEVELT 180–85 (1995)). The short-lived New Deal cornerstone, the National Industrial Recovery Act (NIRA), enabled creation of codes within industry groups to promote high standards and enable "fair" competition. National Industrial Recovery Act, ch. 90, § 3, 48 Stat. 195, 196–97 (1933). The Court, of course, struck down the NIRA in 1935 in *A.L.A. Schechter Poultry, Corp. v. United States*, 295 U.S. 495 (1935). Justice Black joined the Court in August 1937, only two months before *Standard Education Society* was argued. Justice Black's call out to the "best element of business" is consistent with New Deal and NIRA ideals.

65. *Standard Educ. Soc'y II*, 302 U.S. at 116.

This debate mirrored the larger New Deal controversies of that era,[66] and it is worth examining the debate in light of whether modern policy makers should fully extend and apply today's knowledge of the free offer's impact on consumer behavior.

The lines that Learned Hand attempted to draw may have been drawn in the wrong place, as Black put it quite bluntly. But as this Article proposes, a more radical approach (perhaps beyond any intent or imagination of Justice Black) that revisits Judge Hand's balancing framework may be a worthy exercise. Would banning all free offers be "too solicitous a censorship worse...than any evils it may correct?"[67] Would requiring aggressive "psychological impact disclosure" slow the business community to a "walk"?[68] Would such requirements merely be "trivial niceties...too impalpable for practical affairs"?[69]

As this Article explores the often-ignored impact of free offers on consumer behavior and proposes appropriate countermeasures, the timeless questions Hand raised—albeit in less strident form—about balancing efficiency and the burden on offerers and enterprises may still be the right questions to pose.

To be consistent with the course of the jurisprudence, Justice Black's admonitions should also be revisited and accorded greater weight. This Article argues that lawful free offers, while not necessarily evil, "elevate deception in business"[70] and "that the rule of *caveat emptor* should not be relied upon to reward fraud and deception."[71] How can today's consumers, many of whom may be more sophisticated than their counterparts from the 1920s,[72] be evaluated against the

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66. Many of the exchanges that we see relating to regulation of free offers appear to echo the political and jurisprudential change in the late 1930s, with New Dealers engaging their predecessors and vice-versa. This free offer debate could be viewed through the larger lens of the transformation of the Court during Franklin Delano Roosevelt's (FDR) second presidential term. Before 1937, the Court "broadly rejected both federal and state attempts to regulate the economy....Federal legislation was struck down as beyond the federal commerce power [and] [s]tate welfare regulations were invalidated under the doctrine of liberty of contract." Kurt T. Lash, *The Constitutional Convention of 1937: The Original Meaning of the New Jurisprudential Deal*, 70 FORDHAM L. REV. 459, 459 (2001). By 1937, the Court struck down substantial portions of FDR's New Deal agenda, pushing Roosevelt toward considering what came to be known as his "court-packing scheme" (and also known as not one of FDR's finest hours). With Justice Owen Roberts' abrupt conversion of judicial propensities in 1937 ("a switch in time saves nine" was the refrain used in reference to Roberts) and Justice Black's installation,

> the Supreme Court initiated the modern tradition of judicial deference to economic and social welfare legislation. Some aspects of the story are still debated, including whether...the Court's shift in doctrine was triggered by external political events....Both the traditional story and the debates, however, focus on the pre-1937 doctrines which stood in the way of the New Deal and the abandonment of those doctrines (the switch in time) which allowed the New Deal to proceed.

Id. at 459, 460. Some of these debates appear to be between died-in-the-wool New Dealers and their political predecessors. Also, in this particular case, note that future FDR Supreme Court appointees (and New Dealers) Stanley Reed (then Solicitor General) and Robert H. Jackson (Assistant Attorney General) were on the FTC's brief. *See* Brief for the Petitioner at 83, *Standard Educ. Soc'y II*, 302 U.S. 112 (1937) (No. 14).

67. *Standard Educ. Soc'y I*, 86 F.2d at 695.

68. *Id.*

69. *Id.* at 696.

70. *Standard Educ. Soc'y II*, 302 U.S. at 116.

71. *Id.*

72. Though Justice Black notes that rather sophisticated citizens were drawn into the Standard Education Society's scheme, citing testimony from "citizens of ten states—teachers, doctors, college professors, club women, [and] business men [sic]" that they had been "deceived and deluded." *Id.* at 117. The FTC certainly picked a case to try that had the best facts.

backdrop of a consumer economy so complex and rapidly innovating? How should policy makers determine how to address free offers in this context?

Continuing to explore the evolution of the law will permit visibility into what kind of burden must be overcome to address the totality of the "free offer" issue. The FTC and the courts moved on in the 1950s to tackle whether and how disclosure impacted the lawfulness of free offers. In the course of doing so, they may have granted merchants and advertisers more free rein. As this Article addresses the psychological and behavioral impact of free offers and hearkens back to the exaggerated example, *supra*, of the Acme Aspen Ski Chalet timeshare offer, one must consider whether disclosure is a practical answer to the free offer problem.

3. *Samuel Stores*: "Free" Is Acceptable, Provided No "Deception"

After the 1937 *Standard Education Society* ruling, one can see a safe harbor, which exists in more definitive form today in the FTC's Guidelines, slowly developing for merchants in the form of disclosure—namely, language qualifying the free offer. In the first landmark FTC action following *Standard Education Society*, *In re Samuel Stores*,[73] the FTC set the first basic, but broad ground rules requiring that commercial use of the word "free" was lawful unless deceptive and that qualifying language about offer conditions *could* mitigate deception. This mention of qualifying language was the first hint about a safe harbor. One Commissioner noted in a later ruling that this qualifying language was nothing more than a requirement that the "qualifying statement should describe fully, conspicuously and clearly the '*gimick*.' [sic]"[74]

The same Commissioner would later observe that prior to 1938, the qualifying language in free offer advertisements seemed to be getting smaller and more distant from the "free" language:[75]

> The qualifying language was treated very much as are poor relations at the family dinner table—who are usually placed at the end of the table in a very inconspicuous place, almost out of the dining room and into the kitchen....[In] the *Samuel Stores* policy...the [FTC] tried very valiantly to bring the qualifying words from the kitchen into the dining room where they could be seen.[76]

In this particular matter, Samuel Stores, an operator of clothing apparel chain stores, "represented that for a limited time it would give certain specified merchandise free with the purchase of any other merchandise in a specified amount."[77] The terms of the offer and obligations associated with receiving the free goods were displayed clearly and conspicuously, and Samuel Stores internally accounted for the free goods as a promotion, not raising prices on the for-sale goods

73. 27 F.T.C. 882 (1938).
74. *In re* Walter J. Black, 50 F.T.C. 225, 238 (1953) (emphasis added).
75. *Id.*
76. *Id.*
77. *Samuel Stores*, 27 F.T.C. at 886.

to recoup the value of the free goods.[78] As such, the FTC ruled that Samuel Stores was not engaged in "an unfair method of competition."[79]

Following the spirit of Justice Black and perhaps foreshadowing a controversy that would emerge in the 1950s,[80] the FTC added dicta in *Samuel Stores* expressing concern about the "first impression" consumers received from an advertisement of a free offer.[81] Specifically, the FTC was concerned that free offers would be presented in such a way as to "at first impression" lead the consumer to thinking that the offer was unconditional.[82] The FTC was concerned about conditions being "obscured" or "minimized" in a deceptive manner at the "contact advertising stage[]."[83]

The FTC emphatically rejected the notion that it would be "sufficient that the purchaser be made fully aware" of all conditions only *just prior to the completion* of the sale.[84] Instead, the consumer "should be fully apprised of all of the terms and conditions of the offer at its very *inception*" to ensure that no deception corrupted the sale.[85]

Apart from that, the FTC's decision set a broad standard that the lawfulness of a free offer would depend on offer terms and other "underlying and surrounding facts."[86] Specifically, if a purchaser received free goods at "no additional cost over the ordinary and customary selling price of the merchandise required to be purchased," and essentially without deception, the offer was lawful.[87] This finding, following directly in the line of *Standard Education Society*, would prove to be an important foundation in matters, cases, and guidelines to come. Nonetheless, James Mead, a 1950s-era Commissioner,[88] later described that the problem with the *Samuel Stores* regime was compliance, because the ready agreement of advertisers "not to use the word 'free' in a manner to deceive the public...[was] only a general promise."[89]

What is key is the FTC's acknowledgment in *Samuel Stores* that *consumer psychology* and *cognition* carry significant import in these free offer contexts.[90] The FTC warned against deception at any stage of the transaction, including the "initial attraction" of consumer "attention" to the offer and using the word "free."[91]

In later rulings and guidelines, the FTC grew more lax about the role of disclosure, explicitly endorsing simultaneous declaration of a "free offer" with

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78. *Id.*
79. *Id.* at 888.
80. *See Walter J. Black*, 50 F.T.C. 225; *In re* Book-of-the-Month Club, Inc., 50 F.T.C. 778 (1954) (modified order in light of *Walter J. Black*).
81. *Samuel Stores*, 27 F.T.C. at 888.
82. *Id.* at 888.
83. *Id.*
84. *Id.*
85. *Id.* (emphasis added).
86. *Id.* at 887.
87. *Id.*
88. For Mead's background, see *infra* note 125.
89. *In re* Walter J. Black, 50 F.T.C. 225, 237 (1953) (Mead, Comm'r, dissenting).
90. *Samuel Stores*, 27 F.T.C. at 887.
91. *Id.* at 888.

associated disclosure of obligations and conditions.[92] But here, without the benefit of the explosion of social science research that would come, the FTC simply acknowledged the common sense notion that free offers were to be treated with caution due to their psychological impact.

4. Book Clubs, "Free Books," Disclosure, and End-State

As noted, in the wake of *Samuel Stores*, disclosure became the focus in the further development of "free offer" regulation. Formalizing and distilling some of the aforementioned established decisions, the FTC issued an interpretation in 1948 that goods and services offered as "free" must be a "gift or gratuity" and "given... without requiring the purchase of other merchandise or requiring the performance of some service inuring directly or indirectly to the benefit" of the offerer.[93] This interpretation, along with the *Samuel Stores* ruling, still left an opening for deciding precisely how much "disclosure" would suffice to satisfy the non-deception requirement.

The disclosure focus in this era and beyond was on language content and how clearly, conspicuously, and proximate the obligation language was juxtaposed in the offer with the word "free." With the exception of one Commissioner in one ruling,[94] no court or FTC ruling fully addressed the contradiction of how an offer could be declared "free" when accompanied by a mandatory commercial obligation. The psychological attraction of the word "free," even with disclosed conditions, in engaging the consumer to initiate a transaction would also largely be ignored in years to come.

a. *Book-of-the-Month Club*

Disclosure served as the terminus for the development of free offer law. The next significant "free" case involved the adequacy of disclosure of an accompanying obligation to a free offer. That case, *Book-of-the-Month Club v. Federal Trade Commission*,[95] was decided in 1953. In an ironic coincidence, Learned Hand's cousin, Judge Augustus Hand, sat on the Second Circuit panel, which still expressed pangs of annoyance with Justice Black's opinion in *Standard Education Society*.[96]

Book-of-the-Month Club, Inc. (the Book Club) engaged in a practice still fairly recognizable to consumers today.[97] The Book Club was in the business of selling

92. *See Walter J. Black*, 50 F.T.C. 225; 16 C.F.R. § 251.1 (2007).

93. CALLMANN, *supra* note 4, § 5:43 (citing *In re* Book-of-the-Month Club, Inc., 48 F.T.C. 1297, 1315 (1952)).

94. *Walter J. Black*, 50 F.T.C. at 239 (Mead, Comm'r, dissenting).

95. 202 F.2d 486 (2d Cir. 1953).

96. In his opinion, Judge Frank noted that "[w]e feel obligated by [*Standard Education Society*] to deny the relief sought by petitioners...." The opinion went on to restate the 1936 words of Judge Hand about "pedantic scrupulosity," the censorship being worse than the evils it may correct, fatuousness, and, of course, "will-o'-the-wisps." *Book-of-the-Month Club*, 202 F.2d at 488. Then, the panel grumbled that "the Supreme Court held [that the Second Circuit was] mistaken" back then and the panel expressed "regret" that there was no distinction between the facts of the case before them and *Standard Education Society*. *Id.* "[O]nce the Commission began the proceeding, it could not help deciding as it did, thanks to that Supreme Court decision." *Id.* at 489. The tension between the caveat emptor view on the "free" issue and the modern view *still* lived on, at least as a debate, although judicially settled.

97. *See* The Literary Guild, *available at* http://www.literaryguild.com (last visited Mar. 1, 2008) (The Literary Guild, an eighty-year-old enterprise owned by Doubleday Direct, puts forth similar offerings for books

books through published advertisements. Typically, the Book Club placed the word "Free" in large print at the top of their print advertisements, associated with a statement to the effect that new members of the Book Club would a receive a free copy of a certain promotional book.[98]

At the very bottom of these advertisements, however, in very fine print, appeared a "coupon which, when signed and sent to the Club, constituted a contract between it and its new 'member.'"[99] This contract stated that the consumer would "'receive free' the designated book" and would also "'purchase at least four books-of-the-month a year from the Club.'"[100] If the customer accepted the "free" book and did not purchase four "books-of-the-month" within a year of accepting the book, the Book Club would demand from the customer the full price of the free book, occasionally "relinquish[ing] this demand, provided the free book" was returned.[101]

Bound by precedent and rather reluctantly siding with the FTC's position that the Book Club's practices did not conform with the standards set out by the Supreme Court in *Standard Education Society*, the Second Circuit panel could not resist a dig back at the Court by noting in dicta that the Book Club's practices "involved no moral impropriety."[102] The rule of law obviously prevailed, but not without some judicial whining echoing the basic tension between caveat emptor philosophy and the apparently more consumer-oriented regulatory state.

Disclosure of the conditions relating to free offers quickly became the next area of focus after *Book-of-the-Month Club*. Later that year, the FTC engaged in a ruling involving another mass purveyor of literary wares[103] and subsequently codified disclosure rules.[104]

b. Detective Books and Disclosure: the *Walter J. Black* Matter

By late 1953, the FTC was forced to confront more specific issues related to the simultaneous use of the word "free" with the contradictory disclosure that there were strings attached to an offer. The matter, *In re Walter J. Black*,[105] involved a marketer of classics and detective novels (trading as The Classics Club and The Detective Books Club) that openly used the word "free" but also provided a fair degree of disclosure about the "real deal," which involved the accompanying

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today, though they typically evade free regulation by requiring a nominal payment. On October 30, 2007, the company ran the following promotion on the web, "Join now and GET 5 BOOKS FOR 99 cents, Plus a FREE gift! WITH MEMBERSHIP"). For another illustration, on the same date, BMG Music Service offered "12 CDS for the price of 1" but broke out the deal as "1) pick 7 FREE CD's today; 2) buy 1 at regular Club price; 3) then get 4 more FREE." *See* http://www.bmgmusic.com/acq/test/44/c/ (last visited Mar. 1, 2008).

98. *Book-of-the-Month Club*, 202 F.2d at 489. Ironically, these schemes were targeted at the literate demographic of the consumer economy. When exploring the distributive economic impact of lawful free offer deception, we will revisit this point.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. The FTC resolved an action against Walter J. Black, Inc., a company that sold classics and detective books. *In re* Walter J. Black, 50 F.T.C. 225 (1953).

104. *See* CALLMANN, *supra* note 4, § 5:43 n.16 (referencing the subsequent FTC guidelines released December 3, 1953, 4 CCH Trad Reg. Rep. ¶ 40210).

105. 50 F.T.C. 225.

purchase of merchandise.[106] The FTC majority was satisfied with the lawfulness of Walter J. Black's free offer practices,[107] a result that effectively yielded the modern free offer regime.

i. The Majority Opinion

The previous decisions by the courts and the FTC left merchants without a true safe harbor. The majority of the FTC wanted to resolve for "[t]he businessmen of the United States...a clear and unequivocal answer to [the] question":[108]

> May a businessman...be charged with engaging in unfair or deceptive acts or practices in violation of the [FTC] Act if he uses the word "free" in his advertising to indicate that he is prepared to give something to a purchaser free of charge upon the purchase of some other article of merchandise?[109]

The FTC answered this question "clear[ly] and unequivocal[ly]"[110] by falling back on commercial norms and traditions. In *Standard Education Society*, the FTC had pushed against a scheme which may indeed have been, according to the lower court,[111] the acceptable norm.[112] In *Walter J. Black*, by contrast, the FTC took a different tack by noting that

> [t]he practice in question [use of the word free with full disclosure that the free item is conditional on another purchase] is by no means new[[113]]....This continuous use, however, in and of itself, is not reason enough for [the FTC] to condone the practice if...any law require[s] its discontinuance. Absent such legislation, [no] administrative agency should take it upon itself to change a business practice which has been so long prevalent....[114]

In resolving the *Walter J. Black* matter, the FTC embraced its 1937 Supreme Court brief arguments in *Standard Education Society* as still making "good sense"[115] but wished to clarify its position further to improve public guidance.[116] The FTC made it plain that "[i]f a businessman desires to use the word 'free' in his advertising, he must use it honestly."[117] "If an advertiser either lies as to the facts or tells only part of the truth in his advertising, and such lies or omissions have the tendency or capacity to mislead or deceive the public, [the FTC] must inhibit such use of the word 'free' in advertising."[118]

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106. *See id.* at 226–31.
107. *Id.*
108. *Id.* at 232.
109. *Id.*
110. *Id.*
111. *See Standard Educ. Soc'y I*, 86 F.2d 692 (2d Cir. 1936), *rev'd in part*, 302 U.S. 112 (1937).
112. *See Standard Educ. Soc'y II*, 302 U.S. 112 (1937).
113. *Walter J. Black*, 50 F.T.C. at 232 (The court noted that "[this business practice] has been used by businessmen...for almost 100 years.").
114. *Id.*
115. *Id.* at 235.
116. *Id.*
117. *Id.* Without investigation, it is fair to declare that this was not the boldest position adopted in Federal Trade Commission history.
118. *Id.*

After a lengthy and pedantic discourse on the definition of "free" in various historical, non-commercial legal contexts, the FTC again fell back on its 1937 arguments to the Court. In citing the old brief, and engaging in some significant cherry-picking to bolster their argument, the FTC emphasized that:

> "[i]t is a commonplace that persons may be induced to buy if they think they are getting a bargain....[This inducement] is a powerful incentive to purchase.... [Consumers] know that the purpose of the gift is to induce them to purchase another article, and they assume that the donor expects ultimately to recover the cost of the gift...."[119]

Furthermore, the FTC restated that when a free offer is made with an accompanying obligation, "'the word 'free' causes [the consumer] to understand that he is paying nothing for that article and only the usual price for the other. *If this is not the true situation, there is no free offer and [the] customer is misled by the representation that he is to be given something free of charge.*'"[120]

What follows is the basis for the regulatory regime of today. The FTC contended that until an act of Congress or an appeals court ruled otherwise:

> The use of the word "Free"...to designate or describe any article of merchandise...is considered...to be an unfair or deceptive act or practice under the following circumstances:
>
> (1) When all of the conditions, obligations, or other prerequisites to the receipt and retention of the "free" article...are not clearly and conspicuously explained or set forth at the outset so as to leave no reasonable probability that the terms of the advertisement or offer might be misunderstood; or
>
> (2) When, with respect to the article...required to be purchased in order to obtain the "free" article, the offerer either (1) increases the ordinary and usual price; or (2) reduces the quality; or (3) reduces the quantity or size of such article....[121]

In other words, after *Walter J. Black*, the use of the word "free" was lawful as long as the strings attached (i.e., the "conditions, obligations and other prerequisites") were clearly and conspicuously disclosed.[122] The FTC framed this in the negative, so that "free" would be an unfair designation or description of merchandise *unless* certain conditions that would make an article less than free were declared so. In contrast, today's guidelines are framed in the positive, as mentioned *supra*, declaring that "terms, conditions and obligations...*should* be set forth clearly and conspicuously...."[123]

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119. *Id.* at 234 (quoting Brief for the Petitioner at 38, FTC v. Standard Educ. Soc'y, 302 U.S. 112 (1937) (No. 14)). I will discuss the psychological impact and effect of reciprocity in Part II, *infra*.

120. *Walter J. Black*, 50 F.T.C. at 235 (quoting Brief for the Petitioner at 39, FTC v. Standard Educ. Soc'y, 302 U.S. 112 (1937) (No. 14) (emphasis added)).

121. *Id.* at 235–36.

122. The FTC's action in *Walter J. Black* caused the FTC to modify *Book-of-the-Month Club* to permit the company to follow the same rules as Walter J. Black. *In re* Book-of-the-Month Club, 50 F.T.C. 778 (1954). Essentially, *Walter J. Black* set many of the basic ground rules that govern "free offer" advertising and commerce today.

123. 16 C.F.R. § 251.1(c) (2007) (emphasis added).

However phrased, there is an essential contradiction established within the FTC Guidelines beginning with *Walter J. Black* and continuing to the present. How can something be declared "free" if there are commercial obligations attached, regardless of whether they are disclosed? Psychologically and socially, what are merchants actually trying to put to work? What about the powerful obligations that are hidden and go unspoken? Is simply raising these questions "bring[ing the] pedantic scrupulosity" to commerce that Justice Hand sternly predicted would occur?[124]

In line with these questions, Commissioner James M. Mead[125] wrote a dissenting opinion in *Walter J. Black* that brought some plain reading and common sense to the "free" offer analysis.[126] Mead's opinion went directly against the grain.[127] This Article reaches even further than Mead by proposing an outright ban, with few exceptions, on the use of the word "free" as an inducement in the commercial context.

ii. The Mead Dissent: These Free Books Were Not Free!

In the face of the FTC's endorsement of the free books offer with disclosed conditional obligations to purchase other items, James Mead declared outright that, "[t]his is a case about 'free' books which were not free."[128] Mead also observed that the promise of getting something for free powerfully "spring[s] eternal in the human breast,"[129] indicating some lay observations about the psychology at work.

In vox clamantis in deserto,[130] a disillusioned Mead noted the obvious truth about what the merchant advertisers were truly attempting to accomplish. "The value of the word 'free' is that it is a short expressive word which can be used in headlines and in bold print to catch the eye of the reader."[131] He also expressed alarm at how just a mere "perusal of advertisements in any daily paper"[132] would lead one quickly

124. *See supra* note 96.

125. Mead's tenure on the FTC was preceded by a lengthy service in Congress, serving as the Democratic Senator from New York from 1938 to 1947. BIOGRAPHICAL DIRECTORY OF THE UNITED STATES CONGRESS, *Mead, James Michael*, *available at* http://bioguide.congress.gov/scripts/biodisplay.pl?index=M00061 (last visited Mar. 2, 2008). Mead was also regarded as a died-in-the-wool New Dealer. *See While the War Waits*, TIME, July 20, 1942, *available at* http://www.time.com/time/magazine/article/0,9171,795986,00.html?iid=chix-sphere (last visited Mar. 2, 2008).

126. *Walter J. Black*, 50 F.T.C. at 236–41 (Mead, Comm'r, dissenting).

127. In reading Mead's dissent, one can pick up the tone of Jimmy Stewart's character of Senator Jefferson Smith in *Mr. Smith Goes to Washington*. MR. SMITH GOES TO WASHINGTON (Columbia Pictures 1939). Mead concludes his FTC dissenting opinion with a breathless, desperate, populist appeal. "Public law...[i]s concerned with the general public interest and must therefore reflect the will of the people. I am reminded of the inscription on the Archives Building in Washington which reads 'What Is Past Is Prologue.'" *Walter J. Black*, 50 F.T.C. at 241 (Mead, Comm'r, dissenting). In the context of an FTC opinion, this is a quite dramatic reference and use of language. (Indeed, the engravers of that inscription were of course quoting William Shakespeare's *The Tempest*.) This flair may reflect Mead's political background as a U.S. Senator.

128. *Walter J. Black*, 50 F.T.C. at 236 (Mead, Comm'r, dissenting).

129. *Id.* at 239 (citing Mead's opinion in *In re* Book-of-the-Month Club, 48 F.T.C. 1297, 1309 (1952)).

130. "In the voice of one crying in the wilderness."

131. *Walter J. Black*, 50 F.T.C. at 237 (Mead, Comm'r, dissenting).

132. *Id.* at 238.

to see the various tricks employed by "advertising specialists,"[133] including the "free" gambit.[134]

Mead referenced the old opinion he wrote in the original FTC *Book-of-the-Month Club* case, which was later reviewed by the Second Circuit panel.[135] His logic cut to the core of what a free offer with disclaiming language involving a related commercial obligation is really about:

> The...books are either free or they are not free. They cannot be both. The advertisements [represent that] the books are free. Elsewhere...is the statement which indicates that such books are not free. At best, these statements are contradictory. One of the statements must therefore be contrary to fact. This is obviously the statement that the books are free....
>
> A seller may not make one representation in one part of his advertisement and withdraw it in another part since there is no obligation on the part of the customer to protect himself against such a practice by pursuing an advertisement to the bitter end.[136]

This latter statement reiterates some of the concerns about the whole of the advertisement expressed by the FTC in *Samuel Stores*.[137] The entirety of Mead's statements, however, return to the premise that psychological obligations aside, there may be no such thing as a "free offer" because the "free offer" is a paradox.

Mead goes even further concerning the encompassing psychology of the free offer, again reiterating powerful language he used in his own *Book-of-the-Month Club* FTC opinion. Applying common sense, not needing technical psychology or social science to make his point, he restated that

> [t]he word "free" is one of those dynamic terms in our language which alerts us and calls to action certain emotions within us. It has both political and monetary connotations. Cynics[[138]] may say that all of us should know that we cannot get something for nothing, yet the hope of getting something free has the habit of springing eternal in the human breast....[139]

Through this statement, Mead articulated two primary principles. The first is simply that an offer is either free or it is not. The second is that any use of the word "free" in conjunction with an obligation or condition psychologically induces consumers to engage in a transaction that they might otherwise not. The hope of the "free lunch" may indeed "spring[] eternal"[140] and sellers use that to their advantage.

This Article echoes and expands upon Mead's points. On its face, how can a free offer with conditions attached be free? How did the commercial culture come to

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133. *Id.* Amateur psychologists, masquerading as advertising executives, perhaps?

134. For the results of a casual perusal of advertisements involving the word "free" in a regional large circulation Sunday newspaper, see *supra* note 2.

135. 48 F.T.C. 1297 (1952), *aff'd*, Book-of-the-Month Club v. FTC, 202 F.2d 486 (2d Cir. 1953).

136. *Walter J. Black*, 50 F.T.C. at 239 (Mead, Comm'r, dissenting) (quoting Mead's opinion in *Book-of-the-Month Club*, 48 F.T.C. at 1311).

137. *In re* Samuel Stores, 27 F.T.C. 882, 888 (1938).

138. A reference to Learned Hand, perhaps?

139. *Walter J. Black*, 50 F.T.C. at 239 (Mead, Comm'r, dissenting) (quoting Mead's opinion in *Book-of-the-Month Club*, 48 F.T.C. at 1309).

140. *See id.*

accept this contradiction? Why should regulators permit goods and services to be advertised or promoted as such? Why should regulators permit advertisers to exploit emotional responses to a representation that is essentially false? This Article at its essence advocates an outright ban or an effective neutralization of the "free offer" because there is simply no such thing.

5. *Mary Carter Paint*: "Buy One, Get One Free"

The "free offer" with disclosure (or any bundled good offer) can distort a certain part of consumer perception. But one special type of "free offer" that has been sealed in the commercial consciousness for decades is the ubiquitous "buy one, get one free" (BOGO) offer. No examination of free offers would be complete without an exploration of the history of this specific type of free offer. BOGO is as much a part of consumer culture as the supermarket itself. Legally, however, BOGO had not been completely sealed and certified as a practice until the 1965 Supreme Court decision *FTC v. Mary Carter Paint Co.*[141]

Figuratively, BOGO offers are as common in an American supermarket as gallons of milk and cans of condensed soup.[142] Even a cursory glance at a major supermarket chain's website revealed almost one hundred separate BOGO offers.[143] Under current FTC Guidelines, a BOGO would be the equivalent of a fifty-percent price reduction from the regular price.[144] This is because, as noted above, "when the purchaser is told that an article is 'Free' to him if another article is purchased, the word 'Free' indicates that he is paying nothing for that article and no more than the regular price for the other."[145]

Why do merchants and service providers use BOGO offers when they can simply mark an item as "50% off" or simply mark the item down? The answer is simple:

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141. 382 U.S. 46 (1965).

142. For a discussion of Wal-Mart pressures that led to the rise of BOGOs in supermarket chains in the late 1990s, see Margaret Webb Pressler, *Get One You Don't Want Free!*, WASH. POST, Sept. 21, 2003, at F5.

143. Search performed on Safeway chain at http://shop.safeway.com/superstore/ on June 14, 2007. 27 snack item BOGO offers, 47 health product offers, 14 beverage offers, and 10 produce offers. I did not search the other dozen product categories on the page (web page print-outs on file with author).

144. With the condition that multiple items be purchased. "Regular price" is defined by the FTC, *supra* note 30. The federal standard is that the regular price would have been the price for a "substantial period of time." Some states define the period more precisely. In Oregon, for example, the time period for the regular price is thirty days. OR. ADMIN. R. 137-020-0015 (2007).

145. 16 C.F.R. § 251.1(b)(1) (2007). *See In re* Kalwajtys, 52 F.T.C. 721 (1956), *enforced by* Kalwajtys v. FTC, 237 F.2d 654 (7th Cir. 1956) (holding that an item cannot be marketed as "free" if the regular price is included in the total product price). In *Kalwajtys*, a manufacturer and seller of photograph albums offered the albums to new parents for "free" if a $39.95 photography shooting subscription was simultaneously purchased. "As part of the transaction, the salesmen [would] turn over to purchasers, certificates which are to be presented to a designated local studio, with whom respondents have made previous arrangements." *Id.* at 727. Kalwajtys claimed "that the album was given free and that the $39.95 was for the making of the pictures. The written instructions to the salesmen refer to the album as 'in reality, a gift' and...[consumers]...were told they were receiving the album free." *Id.* at 729. The FTC found that

> in actuality, the albums were not given free, that respondents' charge was in large part the price of the album, which, accordingly was not in fact free....The transaction did not involve a gift of the album as that term is commonly understood. Instead, it was a sale for $39.95 of one album, plus certain contract rights set out in the certificate.

Id.

BOGO offers induce the consumer to buy two items at that marked down price rather than just one. To get the discount, the proposition is all or nothing.[146]

The BOGO offer implies that the consumer must take two (or more) items from a merchant to benefit from the discount. This strategy constitutes not only an inducement to buy more, but also a use of the word "free" to exploit the consumer mindset that the consumer is getting a good deal, when in fact a better deal would be just to receive a fifty-percent discount on the purchase price with the option to buy only one item.

Mary Carter Paint is the landmark BOGO case and, significantly, the last important case in the forty-year trek that shaped modern free offer regulation.[147] Put simply, the FTC ruled[148] and the Supreme Court ultimately affirmed[149] that an advertiser could not promote a BOGO offer if the total price of the offer[150] was greater than the regular price for the individual item of the same quality[151] because the "One" that the consumer "Got Free" was not entirely free. In reaching this decision, the FTC and the Court effectively endorsed BOGO offers that complied with this limitation.[152] Henceforth, BOGO offers would continue to spread across the retail landscape.[153] BOGO offers displace simple disclosures of an item's actual price and substitute for the provision and disclosure of percentage discounts.

As section C explores below, free offers, including BOGOs, have a hidden impact that transcends any disclosure. In fact, the curative effect of disclosure in and of itself is questionable.

C. *The Hidden Impact of the Lawful Free Offer*

As discussed previously,[154] a lawful offer may use the word free, even if terms, conditions, or obligations (generally, "strings") are attached.[155] That obligation might involve buying an item of equal price or it might involve registering for a subscription, as in *Book-of-the-Month*. These obligations, as discussed in the case law and regulatory context, are expressly commercial.

So, to paraphrase Commissioner Mead, why use the word "free" when clearly something is not free? How can one reconcile the paradox of the lawful free offer, which permits the use of the word "free" as long as the price is disclosed? Why use "free" when the real intent is to provide a discount in a dollar amount?

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146. *See* Pressler, *supra* note 142.

147. *See* CALLMANN, *supra* note 4, § 5:43.

148. 60 F.T.C. 1827 (1962).

149. FTC v. Mary Carter Paint Co., 382 U.S. 46 (1965), *rev'g* 333 F.2d 654 (5th Cir. 1964).

150. In this case, one can of paint with a free can of paint.

151. *Mary Carter Paint*, 382 U.S. at 48. Further complicating the problem for Mary Carter Paint was that they had never engaged in the practice of selling single cans of paint. *Id.* at 48.

152. Justice Harlan's dissent in *Mary Carter Paint* hearkens back to the pre-New Deal era. He argued that, "[a]t the very least, the [FTC] should be required to demonstrate real deception and public injury" relating to Mary Carter Paint's offer. *Mary Carter Paint*, 382 U.S. at 51 (Harlan, J., dissenting). Justice Harlan also noted that there was "no suggestion that any volume of consumer complaints ha[d] been received, which further deepens the mystery why this frail proceeding was ever initiated." *Id.* at 52.

153. *See, e.g.*, David Sharp, *A Shipping Free-for-All: Online Retailers Boost Promotions to Get You to Open Wallet*, CHI. SUN-TIMES, Nov. 13, 2005, at A43 (anecdotal illustration of trend).

154. *Supra* Part I.A.1.

155. 16 C.F.R. § 251.1(c) (2007).

The answer is simple. Over time, merchants, service providers, marketers, and advertisers have discovered a psychological glitch that works to their advantage. Use of the word "free" and the illusion of "gifting" in a commercial context can impact consumer behavior in ways not readily apparent.

One example of this, which will later be expanded upon in more detail,[156] is the way in which the brain calculates the value of bundles. When a consumer is presented with an unbundled "gain"—that is, a split package of goods—the consumer will value the goods more than if they were bundled.[157] Another way free offers impact and distort behavior is through creation of an atmosphere where the powerful noncommercial obligation of reciprocity is required.

Part II will explore the "free offer paradox" and analyze the effectiveness of disclosure, making clear that lawful free offers work to the disadvantage of consumers. Ultimately, this raises the question of whether policy makers should ban outright or otherwise enhance regulation of free offers in commercial marketing and advertising and whether the commercial use of the word "free" should be relegated to the Madison Avenue dustbin—a dustbin that contains discarded marketing and advertising tactics like false claims[158] and endorsements,[159] subliminal advertising,[160] advertisements for tobacco products,[161] and advertisements that contain discriminatory provisions for housing[162] and employment.[163]

II. THE PSYCHOLOGY OF FREE OFFERS

There is a thread woven through the decisions of the FTC and the courts[164] that leads to today's regulatory posture on the use of the word "free." Simply stated, use of the word "free" is lawful, at the federal level, if there is adequate disclosure about terms, conditions, and obligations attached to the free good.[165] In addition, a good or service cannot be advertised as a free part of a bundle if the total asking

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156. *Infra* Part II.A.

157. Part II will visit the famous work of Tversky and Kahneman on this subject, among others.

158. *See, e.g.*, Press Release, Federal Trade Comm'n, FTC Garners $2.75 Million Civil Penalty in Settlement of False Advertising Charges Against Maker of "Miracle-Ear" Hearing Aids (Nov. 21, 1995), *available at* http://www.ftc.gov/opa/1995/11/dahl2.shtm (last visited Mar. 2, 2008) (Manufacturer falsely claimed that hearing aid would only amplify sounds that listener wanted to hear and reduced all other background noise.)

159. *See* Guides Concerning Use of Endorsements and Testimonials in Advertising, 16 C.F.R. § 255 (2007).

160. *See infra* Part III.B.

161. *See* Public Health Cigarette Smoking Act of 1969, 15 U.S.C. § 1331 (2000) (banning cigarette advertising on radio and television).

162. This Article certainly does not place a ban on use of the word "free" in the same category as civil rights violations, though civil rights advertising restrictions point to the notion that wording in advertising is important, high-impact speech. Free offer regulation could certainly fit into the same category of other advertising restrictions. Specifically, free offers should be restricted in the same manner as false claims, unfair trade practices, and other types of unfair and economically unproductive psychological manipulation. *See* Fair Housing Act, Title VIII of the Civil Rights Act of 1968, 42 U.S.C. § 3604(c) (2000).

163. *See, e.g.*, Civil Rights Act of 1964, 42 U.S.C. § 2000e-2 (2000) (regarding unlawful employment practices); 42 U.S.C. § 2000a (2000) (regarding prohibitions against discrimination in places of public accommodations); Age Discrimination in Employment Act of 1967, 29 U.S.C. § 623 (2000) (regarding prohibition against age discrimination).

164. *See supra* Part I.

165. *See supra* Part I.B.4.b.i.

price for the bundle exceeds the combined "regular price" of the individual components.[166]

Either way, the federal regulations permit the use of "free" despite the fact that the first scenario has a catch and the second is merely the functional equivalent of a discount. Social and cognitive psychology explain the power of the word "free" and may explain to a certain extent the widespread use of the term in marketing. Reconciling all of behavioral law and economics,[167] bounded rationality and cognitive psychology[168] (specifically numerical cognition[169]) would be a challenging task for any article, let alone a portion of an article.[170] Instead, this Article focuses on applying a limited set of generally accepted theories and well-supported experiments and illustrations to the specific problems associated with the use of the word "free."

Section A focuses on the cognitive psychology related to human miscalculation involving prices and bundling. Section B focuses on reciprocity theory and how social obligations may accrue subconsciously with certain free offers[171] or elements of the sales process that give the illusion that a good or service is being offered for free out of generosity.[172] Section C examines the impact of disclosure on the free offer, providing a new voice for the "paradox" argument of Commissioner Mead. The section revisits established arguments about disclosure effectiveness in the Truth in Lending Act context, a typical consumer setting. Section C also advocates viewing a reciprocal or social obligation as carrying at least the equivalent weight

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166. *See supra* Part I.B.5.

167. For a basic grounding in the field of behavioral law and economics, cognition, and bounded rationality, see Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998) (discussing the behavioral approach as applied to bans on certain economic transactions and private behaviors); Daniel Kahneman, *A Psychological Perspective on Economics*, 93 AM. ECON. REV. 162 (2003); Daniel Kahneman, *Maps of Bounded Rationality for Behavioral Economics*, 93 AM. ECON. REV. 1449 (2003); Russell Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051 (2000). For the broadest look at the pre-2000 literature, see BEHAVIORAL LAW AND ECONOMICS (Cass R. Sunstein ed., 2000) (A collection presenting a comprehensive overview of the subject, arguing how behavior that could be deemed as irrational [e.g., unwarranted optimism, impulsiveness, selfless behavior, and over-reliance on heuristics that can lead to miscalculations] is quite prevalent.) Sunstein boldly claims that this collection comprises "the first book to analyze law by looking at how people actually behave." *Id.* For general critiques of behavioral law and economics, see Gregory Mitchell, *Taking Behavioralism Too Seriously? The Unwarranted Pessimism of the New Behavioral Analysis of the Law*, 43 WM. & MARY L. REV. 1907 (2002); Gregory Mitchell, *Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence*, 91 GEO. L.J. 67 (2002); Robert E. Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 VA. L. REV. 1603 (2000). As one scholar wrote, "Legal scholarship...stands to benefit from any...deepen[ed]...understanding of human behavior...[b]ut behavioralism's insights should augment our understanding of economic models, not supplant them." Thomas A. Lambert, *Two Mistakes Behavioralists Make: A Response to Professors Feigenson et al. and Professor Slovic*, 69 MO. L. REV. 1053, 1060 (2004).

168. For a helpful overview of the intersection between psychology and economics, see Matthew Rabin, *Psychology and Economics*, 36 J. ECON. LITERATURE 11 (1998).

169. One argument that should be dismissed in this context is the notion that systematic, random cognitive error will self-cancel, yielding no real net social impact change. *See* Larry T. Garvin, *Small Business and the False Dichotomies of Contract Law*, 40 WAKE FOREST L. REV. 295, 313–14; 313 n.73 (2005). In the free offer instance, one set of players is attempting to induce non-random erratic behavior that works to their favor, so this argument carries no heft here.

170. Sunstein's essay collection only began to scratch the surface of existing work and marked the dawn of further study. BEHAVIORAL LAW AND ECONOMICS, *supra* note 167.

171. For example, the free stay in the timeshare, the token free gift given to induce a donation, etc.

172. For example, a free taste of ice cream, a free test drive, etc.

of a commercial obligation and treating it with the same accord. Disclosure may not be effective in the reciprocity context, but the section will explore other potentially curative tactics.

In sum, Part II builds an argument that lawful free offers can mislead consumers on several levels. In the case that disclosure is deemed ineffective, the problem of the free offer may prove less of a candidate for mitigation. Policy makers would then have to contend with restructuring the entire free offer concept rather than focusing on efforts to salvage it.

A. "Free" and Consumer Perception of Pricing and Bundling

Free offers exist within the context of a bundle. There is a free item or service and an attached obligation, which quite often is a purchase. Valuing bundles can be an opaque exercise and can cause consumers to make purchase decisions differently depending on presentation. This phenomenon appears to be universal across consumers, as illustrated by the wide range of high society victims in *FTC v. Standard Education Society*[173] and the near universality of innumeracy.[174] Further, prospect theory informs an understanding of how free offers trigger a primal impulse to transact.[175]

Just as all motion is relative,[176] pricing and value are relative from the consumer eye, especially with regard to the evaluation of bundles.[177] Prospect theory, as famously developed by Kahneman and Tversky,[178] demonstrates that consumer gains and losses have less of a psychic impact as they increase relative to the consumer's baseline of expected value from a transaction, or "reference point,"[179] and that losses of an equivalent absolute nature loom larger than equivalent gains.[180] Research shows that there may even be "a neurological explanation of loss aversion in humans" influenced by serotonin levels in the brain.[181] Further research shows that when losses are bundled, the utility loss or perceived total loss is diminished. Conversely, when gains are segregated, they prove to be valued more.[182] Richard

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173. 302 U.S. 112, 115 (1937).

174. *See* JOHN ALLEN PAULOS, INNUMERACY: MATHEMATICAL ILLITERACY AND ITS CONSEQUENCES (2001).

175. *See* Chris Eliasmith et al., *Why Losses Loom Larger Than Gains: Modeling Neural Mechanisms of Cognitive-Affective Interaction*, *in* PROCEEDINGS OF THE TWENTY-EIGHTH ANNUAL MEETING OF THE COGNITIVE SCIENCE SOCIETY 495, 495–500 (Ron Sun & Naomi Miyake eds., 2006).

176. ALBERT EINSTEIN, THE SPECIAL AND GENERAL THEORY OF RELATIVITY (1920).

177. *See* Manjit S. Yadav, *How Buyers Evaluate Product Bundles: A Model of Anchoring and Adjustment*, 21 J. CONSUMER RES. 342, 342 (1994) ("[E]xperiments suggested that people tend to examine bundle items in a decreasing order of perceived importance and make adjustments to form their overall evaluation of the bundle.").

178. *See* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263 (1979) [hereinafter Kahneman & Tversky, *Prospect Theory*]; Daniel Kahneman & Amos Tversky, *Advances in Prospect Theory: Cumulative Representation of Uncertainty*, 5 J. RISK & UNCERTAINTY 297 (1992).

179. Gerald E. Smith & Thomas T. Nagle, *Frames of Reference and Buyers' Perception of Price and Value*, 38 CAL. MGT. REV. 98, 103 (1995).

180. *See* Kahneman & Tversky, *Prospect Theory*, *supra* note 178, at 263.

181. Eliasmith et al., *supra* note 175, at 495.

182. Richard Thaler, *Mental Accounting and Consumer Choice*, 4 MKTG. SCI. 199, 202–08 (1985) (a seminal work on this point).

Thaler aptly described the "moral" of this principle to marketers: "[D]on't wrap all the Christmas presents in one box."[183]

Thaler identified some striking marketing implications from that principle and "provide[d] advice for sellers."[184] The key implication for the purposes of the free offer is that segregation of gains enhances the perceived value of a bundle that is associated with a large "loss."[185] Multidimensional offerings are best sold if each dimension is presented and evaluated separately.[186] Thaler gives the example of the "late-night television advertisements for kitchen utensils."[187] Presenting the different uses of the sales object can be a form of effective gain segregation.[188] Directly on point is the example of the typical offer of "free" bonus items with the core package.[189] This is classic segregation designed to make the consumer value the bundle of goods at a higher level.

Another example of this phenomenon is the automobile rebate, which is a free offer of sorts.[190] The consumer receives the automobile and the separate payment, which enhances the value of the benefit relative to the loss (price of the automobile) paid.[191] Rebates are used to segregate the saving (free cash) from the car (a benefit).[192] Rebates were originally put in place by the automobile industry as insulation against price controls.[193] Price control is no longer a live issue in the industry,[194] but the sales practice remains—and Thaler suggests that benefit segregation may be the likely reason for the continued practice. After all, a direct discount from the dealer would certainly simplify the entire transaction.[195]

Other illustrations of this gain segregation practice abound. Magazine marketers can make an offering more appealing by splitting benefits. Offering a special free gift in conjunction with the paid subscription is often more appealing than offering a discount on the subscription or an extension of the number of magazine issues. Again, the benefits from the offer are more starkly split and the consumer is likely to attach a higher value to the bundle.[196]

The above examples—the kitchen utensils, the auto rebates, and the magazines—all could deftly comply with current FTC regulations on free offers. There could be clear disclosure about the offering, the extras could be characterized as free, and the offering on the whole would be completely legitimate. The question is whether or not this legitimacy is to society's benefit. That question will be explored later in Part II.D.

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183. *Id.* at 202.
184. *Id.* at 208.
185. *Id.*
186. *Id.*
187. *Id.*
188. *Id.*
189. *Id.*
190. *See id.* at 208–09.
191. *See id.*
192. *See id.* at 209.
193. *Id.* at 208.
194. *See* LEVINE, *supra* note 58, at 117. Price controls were introduced during the Nixon administration as a means to combat inflation between 1971 and 1974. This experiment was a notorious failure. DANIEL YERGIN & JOSEPH STANISLAW, THE COMMANDING HEIGHTS 60–64 (1998).
195. Thaler, *supra* note 182, at 209.
196. Smith & Nagle, *supra* note 179.

Given that these offers are designed to play on a human impulse—an impulse that has physiological roots in the brain—is this tactic fundamentally fair? Is it different from any other form of manipulative marketing or advertising? Certainly, these offers would not be made if they did not accrue to the benefit of the offerer—which essentially means that there is likely a redistributive impact from the consumer to the offerer. Nonetheless, if this is the way consumers are wired, what is wrong with offers that simply make them happier? If an individual gains more utility from receiving a five-dollar free watch with a subscription to a magazine than from simply receiving a free lengthening of the magazine subscription worth six dollars, should there be intervention to "correct" this? Perhaps the transaction fails with the subscription extension but works with the free watch. What then? Is this a transaction that accrues to the general welfare or not?

This Article argues that consumers should be able to receive a complete accounting of offers like the ones described above. Enhanced disclosure of the value of the offer would be a good place to start. Occasionally, advertisers may disclose the value of the free component of the offer so that the consumer will know with some certainty what exactly it is that they are receiving and how much it is worth. With auto rebates, that is true. But what about enhanced disclosure of *the entire tactic* of the free offer? Perhaps policy makers should find a way to require gain segregators to disclose and expose their tactics with some safe-harbor boilerplate. Or perhaps the FTC could counter-educate the public in the same spirit that various entities counter-educate American youth about tobacco use.[197]

The current regime accounts for the notion that people understand the basic premise that a free good comes with an obligation. But does this tactic of gain segregation cause the consumer to make a fundamental miscalculation of the terms of the offer? Or is she maximizing her serotonin level?[198] One thing is clear—the offerer recognizes that this practice inures to the offerer's benefit. The evidence, both direct and circumstantial, indicates so.[199]

Disclosure may be costly for advertisers and may reduce utility for the consumer and prevent transactions from occurring. Fair play, however, dictates that consumers understand the true terms, nature, calculations, and ultimate value of the agreement.

In the bundling situations just examined, the consumer is at least conscious of the components in the exchange. There are some elements of free offers—some declared openly as free, others simply not declared—that have dramatic effects on consumer behavior. Next, the Article examines the practice of artificially creating the primal obligation to reciprocate.

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197. *See* Colleen Medill, *Transforming the Role of the Social Security Administration*, 92 CORNELL L. REV. 323, 350–54 (2007).

198. Perhaps this whole phenomenon is best summarized by singer-songwriter Sheryl Crow: "If it makes you happy / it can't be that bad / If it makes you happy / then why the hell are you so sad." SHERYL CROW, *If It Makes You Happy*, on SHERYL CROW (A&M Records 1996).

199. Again, the very prevalence and continued use of the free offer tactic, as described *supra* Part II.A, indicates so.

B. "Free" and the Impact of the Reciprocity Norm

As noted, lawful free offers must disclose all accompanying obligations. Commissioner Mead contended that this was paradoxical because something labeled free that is accompanied with a mandatory obligation should not be "free."[200] What further intensifies the Mead Paradox is that the human instinct to reciprocate when a concession is given actually creates an *extra* layer of obligation.

Reciprocity theory has been well-developed and applies in the free offer context.[201] Under this theory, when a good or service is offered for free, an instinctive obligation magnifies the actual tangible obligation.[202] When no tangible obligation is attached to the free offer—as in the scenario where a free sample is offered or a free product demonstration is given—an intangible but quite real obligation accrues to the detriment of the offeree. Yet this powerful intangible obligation, this feeling for the need to reciprocate, does not entail mandatory disclosure.

Reciprocity theory rests on "a large body of evidence...that reciprocity is a powerful determinant of human behavior."[203] At its essence, positive reciprocity, the phenomenon relevant to free offers, describes the urge to "reward...kind treatment" with kind treatment.[204] Reciprocity was formally identified as a universal norm by sociologist Alvin Gouldner in 1960.[205] Gouldner posited that the "norm of reciprocity is...no less universal and important an element of culture than the incest taboo."[206]

Reciprocity is not simply part of a long-term game plan where repeat players attempt to cooperate. The theory is appropriate to apply to even one-off transactions[207] and interactions.[208] Strangers reciprocate favors. This was formally evinced from an oft-cited study and experiment by psychologist Dennis Regan in which he demonstrated that an actor's provision of a favor (in this experiment, provision of a free soft drink) enhanced the likelihood that the recipient of the favor

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200. *See supra* note 136 and accompanying text.

201. *See generally* Krongjit Laochumnanvanit & David H.B. Bednall, *Consumers' Evaluation of Free Service Trial Offers*, 9 ACAD. MKTG. SCI. REV. 1 (2005), *available at* http://www.amsreview.org/articles/laochumnanvanit11-2005.pdf (applying the norm of reciprocity and perceived obligation to free service trial offers).

202. *See* LEVINE, *supra* note 58, at 70–74.

203. Armin Falk & Urs Fischbacher, *A Theory of Reciprocity*, 54 GAMES & ECON. BEHAV. 293, 294 (2006). Falk and Fischbacher outline a summary of the broad stretch of scholarship in this area in the introduction of their earlier working paper. Reciprocity theory spans "labor economics,...tax compliance, organization theory, contributions to public goods, gift-giving and strike breaking." Armin Falk & Urs Fischbacher, *A Theory of Reciprocity* 2 (Inst. for Empirical Res. in Econ., U. Zurich, Working Paper No. 6, July 2000) (citations omitted) [hereinafter Falk & Fischbacher, Working Paper No. 6], *available at* http://www.iew.uzh.ch/wp/iewwp006.pdf. For an accessible description of the reciprocity phenomenon from an academic psychologist, see ROBERT B. CIALDINI, INFLUENCE 17–56 (rev. ed. 2007).

204. Falk & Fischbacher, Working Paper No. 6, *supra* note 203, at 2.

205. *See* Laochumnanvanit & Bednall, *supra* note 201, at 5.

206. Alvin W. Gouldner, *The Norm of Reciprocity: A Preliminary Statement*, 25 AM. SOC. REV. 161, 171 (1960). Gouldner draws upon the observations of Kingsley Davis about reciprocity in "legitimate sexual relations" as opposed to exploitative relations. KINGSLEY DAVIS, HUMAN SOCIETY 403 (1949).

207. Transactions where the transactors are unlikely to meet or transact again. *See* Andreas Diekmann, *The Power of Reciprocity*, 48 J. CONFLICT RESOL. 487, 491 (2004).

208. *See id.*

would comply with the actor's request to buy raffle tickets.[209] Later, this section will revisit the Regan experiment, in the context of offers of free goods, to demonstrate how the donation of a favor can produce a disproportionately generous—and perhaps "unfair"[210]—response.

Anecdotally, evidence of the power of reciprocity abounds. A familiar example cited by social psychologists illustrating the power of reciprocity involves the spectacularly successful 1970s-era fundraising technique employed by the Hare Krishna Society[211] in highly trafficked public places.[212] After testing methods that proved ineffective for raising money, members of the society settled upon the following method. They would give passers-by gifts before asking them for a donation. Flowers were typically pressed into an individual's hand or pinned to their clothing. The recipients were not permitted to return the item, despite any protestations—they were told it was a gift. In effect, this created an "uninvited debt" on the ledger of the recipients.[213]

After this gifting transaction was brought to bear, a member would request a donation to the Society from the flower-recipient. The tactic proved "wildly successful," especially when compared against the Society's previous fundraising efforts.[214] In fact, the Hare Krishna Society so powerfully harnessed the power of reciprocity that airport managers resorted to making announcements to inform the public of the Society's "true identity and intent" in order to neutralize the tactic.[215] The Society's tactics were so sophisticated and successful that eventually their rights to solicit were brought before the U.S. Supreme Court, which upheld restrictions on the Society's solicitation in public spaces.[216]

The Hare Krishna Society model rests in a donative context. What about the commercial context? Free samples of goods and services are frequently offered. Does this commercial practice merely permit the consumer to have the advantage of better information about a potential transaction, or does it also trigger the reciprocity norm?

Before even addressing free samples, the notion that reciprocity can be triggered without a free offer of anything tangible must be addressed. One study even showed a demonstrable impact on sales from providing customers with a mere verbal expression of appreciation upon entry to a retail store.[217] The authors suggested that a gift was not required to trigger reciprocity. Rather, "even a warm, friendly

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209. Dennis T. Regan, *Effects of a Favor and Liking on Compliance*, 7 J. EXPERIMENTAL SOC. PSYCHOL. 627 (1971).

210. CIALDINI, *supra* note 203, at 33.

211. "The Hare Krishna Society is an Eastern religious sect with centuries-old roots traceable to the Indian city of Calcutta." *Id.* at 22.

212. *Id.* at 23. Robert Levine also discusses the Hare Krishna tactics. LEVINE, *supra* note 58, at 70–71.

213. *See* CIALDINI, *supra* note 203, at 30.

214. *Id.* at 23–24.

215. *Id.* at 24.

216. *See* Heffron v. Int'l Soc'y for Krishna Consciousness, Inc., 452 U.S. 640 (1981).

217. *See* Hershey H. Friedman & Esther M. Friedman, *The Effect of an Appreciatory Comment on Sales: Reciprocity in a Retailing Context*, 15 CENT. BUS. REV. U. CENT. OKLA., Summer 1996, at 1, *available at* http://www.busn.ucok.edu/cbreview/1996sum/friedman.htm.

comment of gratitude will activate the obligation to reciprocate...."[218] What power is invoked when an actual tangible free good is proffered, rather than mere niceties?

1. Free Goods

Returning to Regan's formal research, there is not only evidence of the power of reciprocity when a free good is provided, but also a strong suggestion that the recipient of the free good can be motivated to return the favor disproportionately.[219] Stanford students were recruited to participate in a psychology experiment "on aesthetics" for $1.75.[220] In the course of the "aesthetics" experiment, the subjects were offered a free can of Coca-Cola[221] by a planted confederate. Later, the confederate would request a favor from the subject. Specifically, the confederate would pass a note[222] that read,

> Would you do me a favor? I'm selling raffle tickets for my high school back home to build a new gym. The tickets cost 25 cents each and the prize is a new Corvette. The thing is, if I sell the most tickets I get 50 bucks and I could use it. If you'd buy any, would you just write the number on this note and give it back to me right away so I can make out the tickets? Any would help, the more the better. Thanks.[223]

The results from this experiment were stunning. The mean number of raffle tickets purchased by the subjects doubled from one ticket to almost two if the favor of the Coke was provided by the confederate.[224] Bear in mind that each ticket cost roughly two and one-half times that of the retail price of the favor.[225] Some subjects even purchased up to seven tickets (conveniently equating the subjects' compensation), causing Regan to adjust the data to prevent a skew.[226] Obviously, the donor of the Coke can receive quite an imbalanced return in exchange.

When the entirety of Regan's experimental transaction is viewed (the Coke for the tickets), it can be surmised that uneven distributional results can follow, perhaps even to the point of "unfairness."[227] This landmark study underpins the problem with free offers. If the results of this widely cited experiment hold true in the context of a tangible offer of a free good, then this "unfairness" can certainly be exploited in a controlled retail environment.[228]

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218. *Id.* ¶ 8.
219. Regan, *supra* note 209, at 632–35.
220. *Id.* at 630.
221. A serving of Coca Cola in the late 1960s generally retailed for ten cents. CIALDINI, *supra* note 203, at 34. This price can also be interpolated by data available at http://www.foodtimeline.org/foodfaq5.html#cocacola, which indicates that in 1972 a six pack of ten ounce Pepsi cans retailed for sixty-nine cents in suburban New Jersey. This roughly foots with Cialdini's research.
222. A note was used to keep the message consistent. A verbal message could create inconsistencies. Regan, *supra* note 209, at 632.
223. *Id.*
224. *Id.* at 632–33.
225. CIALDINI, *supra* note 203, at 34.
226. Regan, *supra* note 209, at 633.
227. CIALDINI, *supra* note 203, at 33.
228. *Id.* at 27.

There is an obviously powerful role for the free sample of a good.[229] Sampling enables the consumer to try an item before purchase without risk, and merchandisers with confidence in their product are willing to make that investment.[230] However, the free item also engages the reciprocity norm.[231] After accepting a free product sample, a consumer is more likely to buy the product—or at least feel an obligation to do so—than if the product was just sitting for sale on a shelf.[232]

The sales and marketing tactics of the Amway Corporation provide an excellent illustration.[233] Amway provided its legendary sales force with a free sample kit designed to serve as a tactical lure. The Amway representatives were guided to leave a basket of household goods to potential customers "for 24, 48 or 72 hours, at no cost or obligation to her. Just tell [them] you would like [them] to try the products....That's an offer no one can refuse."[234] The representatives would then return to the customer, who often had tried at least one of the goods, with the intent to ask the customer for an order.[235] The power of reciprocity was put to work. After this initiative was put into place, state distributors reported back to Amway:

> Unbelievable! We've never seen such excitement. Product is moving at an unbelievable rate, and we've only just begun....The most fantastic retail idea we've ever had!...On the average, customers purchased about half the total amount of [the dropped off goods] when [they] are picked up....We've never seen a response...like this....[236]

Amway's success was unsurprising given the findings of the Regan study and the well-established foundations of reciprocity theory. What is striking is that the Amway sample kit gambit even worked in a context where consumers likely knew that a sale was the ultimate goal of the freebie, and not altruism, as Regan's subjects may have suspected.

There is even a reciprocal element to the Buy One Get One Free offers. The store provides an additional free item instead of a percentage reduction in price. The retailer's "loss" (one entire item) is perceived as a greater loss than in the case of an overall percentage reduction as it is a "total loss" for one item. The

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229. *See* Laochumnanvanit & Bednall, *supra* note 201, at 9 (discussing free service trial offers); *see also* DeAnna S. Kempf & Russell N. Laczniak, *Advertising's Influence on Subsequent Product Trial Processing*, 30 J. ADVER. 27 (2001); DeAnna S. Kempf & Robert E. Smith, *Consumer Processing of Product Trial and the Influence of Prior Advertising: A Structural Modeling Approach*, 35 J. MKTG. RES., 325 (1998); Lawrence J. Marks & Michael A. Kamins, *The Use of Product Sampling and Advertising: Effects of Sequence of Exposure and Degree of Advertising Claim Exaggeration on Consumers' Belief Strength, Belief Confidence, and Attitudes*, 25 J. MKTG. RES., 266 (1988).

230. CIALDINI, *supra* note 203, at 27.

231. *Id.*

232. *Id.* (citing VANCE PACKARD, THE HIDDEN PERSUADERS (1957)). Packard's best-selling popular psychology book noted "the Indiana supermarket operator who sold an astounding one thousand pounds of cheese in a few hours one day by putting out the cheese and inviting customers to cut off slivers for themselves as free samples." *Id.*

233. *Id.* at 27–28.

234. *Id.*

235. *Id.* at 28.

236. *Id.* at 28–29.

accompanying feeling of customer obligation is therefore more obvious in a BOGO offer than in a percentage reduction.[237]

The psychological obligations incurred with a BOGO offer are almost certainly to be in the form of goodwill. The customer may be more likely to return to the store because they felt like they were given something of value on this trip. Although the reciprocity norm exhibits power in the free goods context, as illustrated above, the norm should also be examined in the free *service* context.[238]

2. Free Services

Free services also trigger the reciprocity norm, perhaps even more than free goods. Two marketing researchers have hypothesized that the reciprocity phenomenon is more "likely to occur in service trials rather than product sampling because the co-production or personal aspect of a service trial is the basis of reciprocity and exchange."[239] Namely, the free service trial exposes the consumer to the "psychological risk" of receiving a subsequent sales pitch and an accompanied obligation to purchase.[240] This psychological risk is similar to that of free goods.

Distinct aspects to the free service trial, however, enhance the reciprocity norm even beyond the instance of free goods. Perceived obligation rises with the degree of "interpersonal service" in the free service trial.[241] Though there is an element of interpersonal service in some of the free goods examples examined above, some services are purely personal. One example of this would be if a landscaper offered to mow someone's lawn for free—as a "no obligation" trial to see if the property owner wished to sign up for regular lawn mowing and care.[242] After mowing the lawn for an hour and breaking a sweat, the landscaper rings the property owner's doorbell with a sign-up sheet for regularly scheduled mowing in the future. Is it more difficult to turn the mower away, face-to-face, after that hard, personally-provided free work? Is it more difficult than without the free trial?

Some go as far as suggesting that consumers are "urge[d]...to assess the obligation likely to occur in redeeming a free service trial offer to determine whether it is worthwhile to try out the free service."[243] This suggestion is consistent with reciprocity theory but it is wholly inconsistent with how free offers are regulated. Heightened perceived psychological obligations associated with reciprocating personal service are not required for disclosure.

The question remains as to whether enhanced disclosure would be effective in evening out any distorted obligation imbalance. Returning to the mower example, would full disclosure up-front, or upon sign-up, that there is no obligation, moral or otherwise, prove effective? Would a cooling-off period between the free service

237. *See* Laochumnanvanit & Bednall, *supra* note 201, at 5.
238. *Id.*
239. *Id.*
240. *Id.* at 6.
241. *Id.*
242. A similar illustration is the fire alarm salesperson who performs a no obligation fire inspection of a consumer's home—and then creates a sense of obligation to purchase a fire alarm system from that salesperson. CIALDINI, *supra* note 203, at 53–54.
243. Laochumnanvanit & Bednall, *supra* note 201, at 6.

and the sign-up prove effective? As a category, these questions must be addressed to determine whether enhanced disclosure can remedy the free offer imbalance. Before that determination is made, a review of the literature of the general effectiveness of disclosure is required.

3. Potential Neutralization of Reciprocity Effect

To briefly summarize, the obligation to reciprocate when presented with a free good or service strongly influences consumer behavior, presenting distorted transactions that can be unfair. Would disclosure or a cooling-off period remedy the situation? What would reciprocity-neutralizing disclosures look like? Would they prove effective?

Free sampling plays a legitimate role in the dissemination of information to consumers—with both goods and services. Beyond a cursory "no obligation to purchase" disclosure, as required by 16 C.F.R. § 251.1(c),[244] what else could be effectively disclosed? Would the "no obligation" disclosure work if it were merely required to be more emphatic? Would the "no obligation" disclosure work if it were expanded to explicitly disclose the reciprocity phenomenon? What would this reciprocity obligation disclosure look like?[245] Would this disclosure have to include a plain English warning about the reciprocity phenomenon? Would the disclosure really work? This analysis requires both a brief, general review of the efficacy of disclosure in other contexts and specific consideration of disclosure in the free offer contexts.

C. Disclosure in the Free Context and Its Limitations

Disclosure is a potential solution to the free offer problem—in fact, elements of disclosure are built right into the FTC Guidelines on the use of the term "free."[246] The question is whether disclosure would prove effective in leveling the playing field in the various free offer contexts. First, Part 1 will broadly explore disclosure effectiveness, relying on the literature about disclosure and the Truth in Lending Act,[247] a closely examined field. Part 2 will acknowledge the cost-benefit tradeoffs involved with a disclosure cure. Part 3 will first explore the potential impact of incremental disclosure on Commissioner Mead's concern about the paradox of the lawfulness of promoting an item as "free" when it is attached with conditions. Next, Part 3 will address the potential impact of disclosure on numerical cognition and on the obligations accruing from the trigger of the reciprocity norm. Part 4 will acknowledge that there are cost-benefit and practicality concerns that enter into disclosure.

244.
> When making 'Free' or similar offers all the terms, conditions and obligations upon which receipt and retention of the 'Free' item are contingent should be set forth clearly and conspicuously at the outset of the offer so as to leave no reasonable probability that the terms of the offer might be misunderstood.

16 C.F.R. § 251.1(c) (2007).

245. One is (painfully) guided by Barry Manilow's words, "Don't fall in love with me / I'll only break your heart." BARRY MANILOW, *Don't Fall in Love with Me*, *on* IF I SHOULD LOVE AGAIN (Arista Records 1981).

246. 16 C.F.R. § 251.1(c) (2007).

247. 15 U.S.C. § 1601 et seq. (2000).

1. Effectiveness of Disclosure: The Truth in Lending Act Experience

Much has been written on the broad issue of effectiveness of disclosure in the commercial context and this Article will not attempt to address that thorny problem as a whole.[248] However, some of the literature has examined disclosure specifically in the realm of the Truth in Lending Act (TILA).[249] TILA and its accompanying promulgated regulations (Regulation Z)[250] mandate disclosure of certain, specific pieces of information related to consumer credit transactions.[251] Given that this Article speculates about the wholly unexplored impact of disclosure on the free offer recipient, looking to a well-plowed field like TILA, Regulation Z and consumer credit can offer at least a modicum of guidance.

The effects of disclosure are regarded by many as generally limited. As Ralph Rohner summarized:

> Nothing...compels consumers to read, understand and respond to...disclosures. There is no...elixir to cure *consumer illiteracy, "innumeracy," or plain disinterest.* [Disclosure] *cannot force economic rationality into a consumer's consciousness.* About all that can be expected is that adequate...information [is made] available...so that consumers wanting to use it can do so....
>
> ...
>
> It cannot protect consumers from true fraud or over-reaching.[252]

Disclosure of any kind will face the above described hurdles in the free context. Numeracy and rationality cannot be forced, even with disclosure, though regulators

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248. For some highly generalized representative discussions regarding this problem, see, for example, Jeffrey Davis, *Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts*, 63 VA. L. REV. 841 (1977); Melvin Aron Eisenberg, *Text Anxiety*, 59 S. CAL. L. REV. 305, 309–10 (1986); Larry T. Garvin, *Small Business and the False Dichotomies of Contract Law*, 40 WAKE FOREST L. REV. 295, 324–25, 372–73 (2005); ; Norman I. Silber, *Observing Reasonable Consumers: Cognitive Psychology, Consumer Behavior and Consumer Law*, 2 LOY. CONSUMER L. REP. 69 (1990).

249. *See, e.g.*, Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1417–20 (2004); Stephanie E. Dreyer & Peter G. Weinstock, *Less Is More: Changing the Regulator's Role to Prevent Excess in Consumer Disclosure*, 123 BANKING L.J. 99 (2006); Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL'Y 199 (2005); Ron Harris & Einat Albin, *Bankruptcy Policy in Light of Manipulation in Credit Advertising*, 7 THEORETICAL INQUIRIES L. 431 (2006); Jonathan M. Landers & Ralph J. Rohner, *A Functional Analysis of Truth in Lending*, 26 UCLA L. REV. 711 (1979); Ralph J. Rohner, *Whither Truth in Lending?*, 50 CONSUMER FIN. L.Q. REP. 114 (1996); Symposium, Federal Reserve Bank of Philadelphia, *Federal Consumer Protection Regulation: Disclosures and Beyond*, Conference Summary (June 10, 2005), *available at* www.philadelphiafed.org/pcc/conferences/2005/consumerprotectionsymposium-summary.pdf; Symposium, *Re-examining Truth in Lending: Do Borrowers Actually Use Consumer Disclosures?*, 52 CONSUMER FIN. L.Q. REP. 3 (1998); Julie L. Williams & Michael S. Bylsma, *A Renewed Federal Focus on Credit Card Disclosures*, 61 BUS. LAW. 867 (2006); Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707 (2006). In the bankruptcy context, see Richard L. Wiener, et al., *Psychology and BAPCPA: Enhanced Disclosure and Emotion*, 71 MO. L. REV. 1003 (2006). Securities regulation has also been gifted with a vast body of literature on behavioral psychology and disclosure. *See, e.g.*, James D. Cox & John W. Payne, *Mutual Fund Expense Disclosures: A Behavioral Perspective*, 83 WASH. U. L.Q. 907 (2005). For a view about internet commerce and standard forms, see Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429 (2002).

250. 12 C.F.R. § 226 (2007). This article will not delve into the details of TILA, but will borrow some of the disclosure analysis performed in that context.

251. Edwards, *supra* note 249, at 202–03.

252. Rohner, *supra* note 249, at 114–15 (emphasis added). Noted consumer scholars Dee Pridgen, John Spanogle, and Jeff Sovern "mostly concur" in this view. JOHN A. SPANOGLE, RALPH J. ROHNER, DEE PRIDGEN & JEFF SOVERN, CONSUMER LAW 220 (3d ed. 2007).

can aid the innumerate, as this section will explore. There also remains the question in the free context about whether there can be *too much* disclosure.[253]

A "controversial and multifaceted concept borrowed from the social sciences" further complicates the picture.[254] Prior to the Truth in Lending Simplification and Reform Act,[255] an empirical claim was that excessive disclosures were leading to "information overload,"[256] leaving consumers "cognitively unable to cope with the voluminous nature of mandated...disclosures."[257] Though consumer advocates expressed reservations with this conclusion, Congress seized upon the notion of overload in passing the Simplification Act.[258] Requiring additional disclosures in the free context must be balanced against ensuring that the most critical disclosures actually permeate through to the consumer.

On a more positive note, Rohner points out that disclosure can impact the marketplace through the education of a small number of consumers.[259] In the free context, firms might change their behavior to capture these additional consumers.[260] Additionally, disclosure can provide "psychological reassurance" and enable a gradual accumulation of consumer sophistication over time.[261] Rohner warns, however, that disclosure in this commercial transaction context cannot achieve much more than this.[262]

Can these TILA conclusions about the ineffectiveness of disclosure be applied to free offers? While, again, this Article does not invoke the entire field of disclosure literature, the general notion can be invoked, with some confidence, that disclosure simply does not cure all. With that in hand, this Article can revisit the core problems with free offers and speculate about disclosure as a potential cure.

2. Disclosure and the Commissioner Mead Paradox

As explored in Part II.B, free offer jurisprudence and regulation evolved from the *laissez-faire–caveat emptor*–Learned Hand approach toward the more paternal *Standard Education Society*–Hugo Black regime, and eventually culminated with the *Walter J. Black* model, which effectively is in place today. Again, as Commissioner Mead noted in dissent, *Walter J. Black* was a case about "free books" that were not "free."[263] As Mead argued, any item offered as "free" with a condition or obligation attached was by definition not free.

The question here is whether disclosure can mitigate the Mead Paradox. The only change that would satisfy the Mead Paradox lies not in the disclosure of the accompanying condition or obligation, but rather in the core claim itself. The Mead

253. *See* Edwards, *supra* note 249, at 221 nn.118–20.
254. *Id.* at 221.
255. Passed as Title VI of the Depository Institutions Deregulations and Monetary Control Act of 1980. Pub L. No. 96-221, 94 Stat. 168 (1980).
256. Edwards, *supra* note 249, at 221 nn.118–20.
257. *Id.* at 221.
258. *See supra* note 255. The Act attempted to clear much of the clutter around excessive disclosure to enable consumers to access the truly critical terms.
259. Rohner, *supra* note 249, at 114–15.
260. *Id.*
261. *Id.* at 115.
262. *Id.*
263. *In re* Walter J. Black, 50 F.T.C. 225, 236 (1953) (Mead, Comm'r, dissenting).

Paradox can only be solved with elimination of the use of the word "free." This Article has explored several reasons why a firm would prefer to use that word in marketing and advertising, and why Mead wanted to eliminate any disadvantage created for the consumer from this tactic.

More emphatic disclosure of conditions and obligations would not make the "free books" any more "free"—it would highlight the degree to which the "free" component and the disclosure are contradictory. This hardly addresses the core problem. Disclosure does not provide an adequate solution. Only a ban on the practice would obliterate the paradox, a consideration to be explored in Part III.

3. Challenges with Disclosure of the Cognitive and Psychological Impact

As noted in Part II, some free offers are well-designed and carefully targeted marketing devices that tamper with human perception, particularly numerical cognition and the reciprocity norm. While lawful, these distortions of perception obviously work to the advantage of the offerer. If these types of offers are permitted, would it be possible to counteract and neutralize those devices with disclosure? The challenges of using disclosure to cure the impact of gain segregation and reciprocity will be addressed in turn.

a. "True Value" of the Bundle

Part II.A discussed prospect theory and the human instincts around valuing bundles and the primal positive reaction to segregation of gains. Consumers miscalculate the value of bundles and will overvalue them if the component items to be received are each treated as separate gains. Here, disclosure may provide somewhat of a solution, though Rohner's admonitions about TILA should be heeded.

If advertising and merchandising were regulated such that every free offer or prototypical late-night television ad structured in the infamous "but that's not all" format involved a disclosure, the cognitive impact might be neutralized. What would the disclosure be: a statement that unveils the cognitive trick? Perhaps the admonition would look like the following:

> *Warning: The offer you are about to hear [or have just heard] was presented in a manner that may cause you to overvalue the goods being offered. The FTC recommends that you carefully examine the price of the entirety of this offer relative to the value you will be receiving.*

Cognitively, a disclosure of this sort may have some impact. Certainly, the behavior of sophisticated consumers could change or an education campaign could have some impact at the margin of behavior, as Rohner noted above.[264] The innumeracy issue does not disappear, however. The challenge may simply be too great to use disclosure to overcome innumeracy and illiteracy when the offers themselves are too enticing. After all, as discussed above,[265] this is a tactic that tampers with the serotonin levels in the brain. Is a clear and conspicuous disclaimer

264. *See supra* Part II.B.
265. *See supra* Part II.A.

in print or on air going to overwhelm something that powerful? Even if it could, how long would the effect of the disclosure last? Would consumers become so inured to disclosures that the words would devolve into meaningless boilerplate? One can only speculate.

Rather than counter-disclosure,[266] perhaps a different approach would work more effectively. Regulators could simply mandate that offers like these be presented in their entirety. Instead of presenting the bundle in a sequence, advertising (particularly audio-visual advertising) would be required to disclose the value of the bundle all at once, without the use of the word free or extra. This would end the late-night "NOW how much would you pay?" advertising that has been so ingrained into the commercial and popular culture. This would also help consumers overcome a cognitive obstacle that disclosure might not be able to help them avoid.

Closely related to the core bundling concern is the BOGO tactic mentioned *supra*. Perhaps an effective disclosure that would negate this tactic would contain a clearly and conspicuously posted statement to the effect of *Buy-One Get-One Free Offers Are Employed to Entice Customers to Buy More. Be Sure That You Are Buying an Amount That You Need.* Perhaps this would help expose the tactics behind this very specific type of bundling.

In contrast with the explicit unbundling shell game, social and reciprocal obligations are more hidden and ephemeral, though quite problematic. Will disclosure prove effective there? Are there any other ways to help consumers bypass the reciprocity norm?

b. Disclosing Social and Other Reciprocal Obligations

As explored in Part II.B, social science has established that there is a reciprocal norm and that the reciprocal norm plays a powerful role in the "free" context. The provision of free goods and services creates a strong obligation in the mind of the recipient to reciprocate. This very real and very powerful obligation is certainly not the type of obligation that the FTC Guide requires a consumer marketer to disclose as part of the "deal."

The question here is familiar. Would disclosure be a necessary and effective neutralizer in this context? Earlier, in Part I.A, this Article presented a potential (somewhat exaggerated) disclaimer for a timeshare presentation, disclosing the reciprocity obligation. The same factors may work to hamper disclosure effectiveness. The strength of the obligation, indifference to the disclosed caveat, and information overload, for example, all weigh against disclosure.

Some have hypothesized that skeptical consumers are generally less likely to accept a free service offer.[267] Some consumers may also instinctively know better. They feel the reciprocity and know the trick. "Put simply, the lack of available experience...[with] a service implies to the consumer that the free trial is offered as a means to create an obligation rather than to create a trial experience."[268] Even

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266. Meaning a presented offer's misleading effects being countered by disclosure.

267. Laochumnavit & Bednall, *supra* note 201, at 4.

268. *Id.* at 4–5. This hypothesis was made in the familiar context of "credence services such as dental or auto repair services" where consumers are less equipped with the knowledge and judgment to assess the quality of services rendered after the free test run.

with the highly successful fundraising efforts of the Hare Krishna Society, the instant reaction of some people was to return the flower that was given to them so that they would not feel any obligation to donate.[269] Note again that the effectiveness of the Hare Krishna Society tactic eroded after airports "initiated a number of procedures designed to forewarn...about the [Society's]...[fundraising] intent."[270] Airport administrators posted signs and made announcements about the nature of the solicitations.[271] As Robert Cialdini wrote,

> It is a testament to the social value of reciprocation that we have chosen [to address the Society's fundraising strategy] mostly by seeking to avoid rather than to withstand the force of their gift giving. The reciprocity rule that empowers their tactic is too strong...for us to want to violate it.[272]

In some circumstances, particularly where the recipient is unaware of the reciprocal favor sought, knowledge on the part of the recipient can be powerful. But if the modern-day encyclopedia sales representative spends an hour showing someone's child the wonders of her product, doesn't the consumer already know that they will feel a sense of obligation? Would a disclaimer be effective? What about the Amway products example? Can policy makers distinguish which situations are commercially acceptable with current "no obligation" disclosure and which situations would require incremental disclosure?

i. Reciprocity Disclosure Alternatives: Door-to-Door Sales Example

The reciprocity norm does not have to be taken head-on through disclosure, nor does there have to be full disclosure about reciprocity for balance to be restored. For example, the FTC[273] and every state[274] have placed restrictions on door-to-door sales, perhaps partially to address the reciprocity imbalance inherent in such person-to-person sales. These restrictions avoid awkward and potentially ineffective reciprocity disclosure by countering invocation of the norm through other means, typically cooling-off periods.[275]

In Texas, door-to-door salespeople are required to disclose, both orally and in writing, that there is a three-day period with a right to cancel.[276] Also, they must provide a contract or receipt that includes an address where a cancellation notice

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269. Direct observations of Robert Cialdini. CIALDINI, *supra* note 203, at 31–32.

270. *Id.* at 24.

271. *Id.*

272. *Id.*

273. FTC Rule Concerning Cooling-Off Period for Sales Made at Homes or at Other Certain Locations, 16 C.F.R. § 429.0 et seq. (2007).

274. States started to pass cooling-off laws in the 1960s. SPANOGLE, ROHNER, PRIDGEN & SOVERN, *supra* note 252, at 252 n.2 (citing DEE PRIDGEN & RICHARD M. ALDERMAN, CONSUMER CREDIT AND THE LAW app. 15 A); *see also* UNIF. CONSUMER CREDIT CODE §§ 3.501–3.505 (amended 1974), 7 U.L.A. 443 (2002) (Uniform Consumer Credit Code's cooling-off provision); Byron D. Sher, *The "Cooling-Off" Period in Door-to-Door Sales*, 15 UCLA L. REV. 717 (1968) (noting the emergence of cooling-off statutes throughout various state legislatures).

275. *See* Posting of Jeff Sovern to Consumer Law & Policy Blog, http://pubcit.typepad.com/clpblog/2007/02/on_the_relevanc.html (Feb. 21, 2007, 17:28 EST). *See supra* note 274.

276. This applies generally. *See* TEX. BUS. & COM. CODE ANN. § 39.001 et seq. (2002). The Texas Attorney General cites this section in a guide for the public. *See* Greg Abbott, Attorney General of Texas, *Door-to-Door Sales*, *available at* http://www.oag.state.tx.us/AG_Publications/pdfs/door_to_door.pdf.

can be sent.[277] This cooling-off period enables consumers to reject an order when the individual contact and presence of the salesperson has evaporated. In effect, the cooling-off period is designed to diminish the power of the reciprocity norm. The FTC's regulations are similar and provide specific guidance with regard to the nature and form of disclosure required for the cooling-off period.[278]

Most of these "door-to-door" regulations cover transactions within the swath of the FTC's territory. With some exceptions, the covered locations for these regulated transactions include "sales at the buyer's residence or at facilities rented on a temporary or short-term basis, such as—motel rooms, convention centers, fairgrounds[,] restaurants[,]...the...workplace [and]...dormitory lounges."[279] For the purposes of this Article, the regulation of door-to-door sales provides a compelling example of how regulators can enable consumers to circumvent the reciprocity norm without confronting it head on. However, the vast share of consumer commerce obviously takes place outside of this context[280] and solutions are required in that much larger modern arena.

ii. Reciprocity Disclosure Alternatives in the General Commercial Arena

With free goods and services offers, regulators must take care to preserve the legitimate commercial function of these marketing techniques while considering steps to undo the reciprocity imbalance created by them. Here, disclosure would exclude any instances that would be covered by the Mead Paradox, where "free" goods and services are provided with an attached commercial obligation.

Consider the example of the free sample of food handed out in a supermarket[281] or a three-month offer of an internet service.[282] The food sample may serve multiple purposes. The sample could be intended to induce the customer to purchase the whole of the item from the person providing the sample (reciprocity norm invoked), get the customer hungry, or keep the consumer in the store longer. That scenario contains no obligation to buy, but the merchant offers the free goods to enhance the sales opportunity. The benefits of disclosure are unclear in this type of situation. Consumers may already inherently know the "deal," reminding consumers may not even the playing field, and the costs of disclosure may outweigh the societal benefit.

Sampling a free good is a discrete experience that allows a consumer to make better-informed decisions before purchasing the good. Sampling a free service may be more powerful (and thus more objectionable) because consumers will be solicited again to determine whether they wish to continue a service—one that has already been provided. Using an internet service for a free trial may or may not invoke the reciprocity norm, but acclimation to the usage (independent of service quality) may tilt the balance. Using a highly personalized free introductory service

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277. *See* TEX. BUS. & COM. CODE ANN. § 39.001 et seq.

278. 16 C.F.R. § 429.1 (2007).

279. 16 C.F.R. § 429.0 (2007).

280. *See, e.g.*, Sovern, *supra* note 275 (deliberating about whether to include door-to-door sales in the latest edition of his casebook).

281. *See supra* note 232 (discussing the free cheese sample example).

282. *See* Laochumnanvanit & Bednall, *supra* note 201, at 3.

like haircuts, massage services, or guitar lessons may invoke more of a reciprocity norm, depending on how the introductory service is presented.[283]

As briefly noted in Section II.A.1, the FTC regulates introductory offers with a provision spelling out that such an offer must be made with the expectation of "discontinu[ing] the offer after a limited time and to commence selling the product...at the same price at which it was promoted with the 'free' offer."[284] Enforcement of this provision prevents abuse of the proffering of introductory offers, but it does not address any potential imbalance from the reciprocity norm. No disclosure of any sort is required, including disclosure regarding the inducement of a moral obligation.

Some free offers are comparatively benign. For example, if a sporting goods chain provides free bottle openers with the chain's logo to fans at a professional baseball game as part of a promotion, that bottle opener is free if it was gifted without condition. The chain is not providing services or obligating anyone to purchase. The chain, quite likely, is merely trying to build brand awareness or establish goodwill, much in the way that a friend might do so with a gift. The attenuation here between gift and transaction almost equates to the cooling-off period in extremis.

If there is no commercial obligation, the provider of the free introductory offer has no disclosure obligation under the federal regulations.[285] Often, in the course of inducing a consumer to take the free bait, an offerer might affirmatively disclose that there is no accompanying obligation. However, given what is known about disclosure—and given that this particular type of disclosure is omnipresent—we can see that disclosure has an uncertain or limited effect.[286]

Given the cost of disclosure in the reciprocity context, both for the regulators and for those who must comply, the costs must be weighed against the benefits and the efficacy of alternatives.

D. *Cost-Benefit of Correcting the Free Offer Problem*

Those who would be mandated to take or enforce measures to mitigate the cognitive or reciprocal norm effects of free offers might take the position that "regulations are like snowflakes. Each one by itself may not be much, but when you add it all up, it could crush the building."[287] The quantifiable benefits from

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283. Trying to commit the consumer immediately after the free introduction, for example, would essentially run contrary to the spirit of cooling-off periods, so well-preserved in the door-to-door sales context. *See supra* note 275 and accompanying text.

284. 16 C.F.R. § 251.1(f)(1) (2007).

285. *See* 16 C.F.R. § 251.1 (2007) (describing disclosure obligations required when there is a commercial obligation).

286. For example, lengthy credit card agreements, mutual fund statements, internet boilerplate, and rental car agreements would take a significant time investment for consumers to read and to understand fully. *See* Katie Hafner, *It May Be Boilerplate, but Read Before You Click*, N.Y. TIMES, Apr. 16, 1998, at G3. Though consumers do rely on the imprimatur of disclosure regulation to protect them, this reliance may not always be well-founded. Again, TILA is the area where we find the most research on disclosure. *See supra* Part II.C.1 on TILA disclosure effectiveness.

287. Dreyer & Weinstock, *supra* note 249, at 99 (quoting *Cutting Through the Red Tape: Regulatory Relief for America's Community Based Banks: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the House Comm. on Financial Services*, 108th Cong., 1 (2004)).

disclosure requirements are unclear, but this Article posits that there are likely significant qualitative benefits. These benefits, of course, must be measured against the costs of additional regulation of businesses.

1. Redistribution, Efficiency, and the Stakes for Consumers

The stakes for consumers in free offer regulation are non-trivial. If firms are able to use tactics like free offers to shift out (through artifice) the demand curve for their goods and services, they acquire the ability both to charge a higher price and to sell a higher quantity than they would without the free offer. Obviously, these firms are trying to maximize profits and extract more value from consumers. This has a clearly positive revenue result for firms, directly out of the pockets of the purchasers. There is also a concern about the distributional impact in most cases, assuming that consumers are less well-off than the capital-holders (the sellers or producers).[288] In terms of basic microeconomics, this is illustrated by the downward shift in consumer surplus and the corresponding upward shift in producer surplus.[289] The unsurprising net result of this basic, generic illustration is that free offers produce a distributional problem.

Further, there may be efficiency issues to consider. Do free offers induce transactions that *should not happen* because of consumer miscalculation? If so, this presents a resource misallocation. With cognitive error in the air, consumers make transactions where the marginal cost exceeds the true marginal benefit. As noted, this can be a subjective analysis. If consumers feel that they have made a good deal, but only due to cognitive error, maybe utility is maximized and this concern evaporates. However, basic microeconomic theory dictates that overspending on Good A due to cognitive error or the reciprocity norm will have an aggregate income effect and fewer resources will be available to consume Good B. Income effects have a larger ripple throughout the economy. Taken together, resource misallocation, when the dust settles,[290] likely reduces consumer utility and potentially reduces wealth. The prevalence of the free offer should therefore draw concern.

2. Potential Solutions

Given that the stakes are significant, options for mitigating or eliminating the distributional shift should be considered. Unfortunately, a temptingly elegant, one-size-fits-all solution simply does not exist. This Article advocates a customized approach where some forms of free offer marketing are outright prohibited, some are regulated through disclosure or bypass techniques like a cooling-off period, and others are permitted.

288. If Bill Gates makes a cognitive error in dealing with a caviar salesman, we are less concerned distributionally than in the instance of a minimum-wage earner making a cognitive error at a jewelry store.

289. Consumer surplus represents the "difference between what a consumer has to pay...and the most that he or she would be willing to pay." JEFFREY L. HARRISON, LAW AND ECONOMICS 618 (2007). A reduction in that difference harms consumers. Producer surplus describes the differential between what a producer would be willing to sell a good for and the price actually received. An increase benefits producers.

290. In the instance where consumers obtain perfect information after the sale.

III. CHANGING FREE OFFER POLICY

Distributional fairness and efficiency concerns require changes in policy. As discussed above, much of free offer policy solidified by the 1950s and has not been revisited since.[291] The FTC promulgated the Guide Concerning Use of the Word "Free" in 1971, which essentially reflected what the courts and the FTC had decided previously.[292]

Given the enhanced understanding of cognition and reciprocity today, policy makers should revisit the treatment of free offers, starting with the very essence of the free offer with attached obligation. Section A argues for eliminating the use of the word "free" in situations covered by the Mead Paradox. Section B advocates changes in the presentation of pricing and bundling in an effort to reduce consumer cognitive error. Section C addresses the power of reciprocity and suggests that bypassing reciprocal situations remains a superior solution to disclosure. This section also accepts free sampling and introductory free offers as a legitimate commercial feature. Section D addresses the practicality of this change.

A. Eliminating the Mead Paradox

Even though Commissioner Mead did not have the benefit of an additional half-century of research into human perceptions and decision making, he had certainty, as expressed in *Walter J. Black*, that the free offer with an attached commercial obligation was a paradox. Use of the word "free" in conjunction with a commitment to transact value simply does not make sense.

As such, this Article advocates reanimating the arguments made by Mead in *Walter J. Black* and in the FTC's ruling in *Book-of-the-Month Club*.[293] Consumers will be less confused if the "free" trigger is not pulled in the inducement to make a commitment. Consumers can then operate with a clearer sense of the true offer.

Under this proposal, merchants and providers would be banned from using the word free, unless it is in a sampling or introductory context, as set forth in Section C. This admittedly represents a radical departure from current practices. Section D addresses whether such a change would be possible or practical. Banning use of the word free when attached to a commercial obligation also takes care of some of the problems raised when gains are segregated and consumer perception of pricing and bundling altered. Free offers that come without obligation and are sufficiently attenuated from any further transactions would remain lawful under this proposed regime.

B. Addressing Consumer Perception of Pricing and Bundling

Elimination of the Mead Paradox takes care of the use of the word "free" in the segregated gains context. For example, advertising a free knife with the purchase of a vegetable juicer would no longer be an acceptable presentation in a late-night advertisement. "Throw-ins" without the use of the word "free" would also be a prohibited practice. An illustration here would be a television ad for a juicer for

291. *Supra* Part I.B.
292. *Supra* part I.A.
293. *See supra* Part I.B.4.b.ii.

$49.99 where, at the end of the ad, a knife will be thrown in if the viewer "acts now." Requiring separate, consolidated disclosures of the price and the offered goods or services would prevent the phenomenon resulting from gain segregation to influence the consumer.

However, the elimination of all efforts to induce consumer cognitive error would prove burdensome to regulate. For example, the discounting of certain items presented in serial fashion to induce the purchase of a larger bundle would be difficult to monitor. Nevertheless, policy makers can remove the powerful word "free" from these scenarios and can mandate bundling of presentations. This might compel offerers to pursue other creative innovations in consumer deception, but those would have to be addressed in turn.

After eradication of the Mead Paradox in these contexts, many of the other free offer situations are covered, including some of the reciprocity scenarios. However, reciprocity would remain significant.

C. Addressing Reciprocity

As explored at some length, the reciprocity norm is quite powerful when invoked. The reciprocity norm, rooted in human behavioral patterns, creates a feeling of moral obligation to return a favor when an item or service is provided for free. Disclosure of the reciprocity effect would be burdensome and, as discussed in Part II, likely would be ineffective.

In many cases with free offers, the "no obligation" disclosure is already being noted and emphasized by offerers. If that proves ineffective, it is unclear what additional disclosure about reciprocity will accomplish. Also, if implemented, a disclosure requirement might only change the form of some presentations (e.g., the time-share gambit), but these presentations may simply be reworked. Reciprocity's ubiquity would require a massively broad disclosure—and the repetition of the disclosure may have the effect of inuring consumers to the warning.

There are alternatives that can bypass the reciprocity problem. As noted, the FTC and the states require cooling-off periods in close-contact consumer transactions to attenuate the ultimate decision on a transaction until the offerer is no longer in sight. Providing distance in time and space can enhance judgment. One way to address reciprocity would be to enhance the cooling-off period requirements. Instead of providing rights of rescission or cancellation—which are negative actions—the cooling-off periods could be framed more positively for the consumer. After the cooling-off period, the consumer, in certain circumstances, could be required to "opt-in" rather than "opt-out" of an agreement.

A more extreme solution would involve limiting the interpersonal contacts in certain consumer sales situations. For example, wholesale elimination of door-to-door solicitation would eradicate a category of problems. A less extreme solution might be to mandate that one personal visit from a door-to-door company representative per company be permitted per quarter-year. This tactic would provide for a super-cooling-off period, with the consumer left to try the free samples with some distance from the person who provided them. Leaving behind samples with

a mail-in order form would not trigger the reciprocity norm as heavily.[294] Generally, tightening the rules for highly interpersonal sales interactions that take place at high-pressure locations, like residences or the workplace, should be the primary focus of de-fanging the reciprocity norm.

Turning away from the highly interpersonal sale, the reciprocity norm triggered by "no obligation" trial offers of services or offers of free goods is also quite real. However, the benefit to the consumer of having the opportunity to sample a free good in a retail store, test drive a car, or try out an internet service likely outweighs the burden that would be associated with additional regulation. Further, if a purchase ultimately occurs because the buyer has more perfect information, the exchange can be characterized as socially desirable. The weight of reciprocity disclosure would chill this useful practice and that could prove quite costly.

D. *Practicality of Changing Free Offer Regulation*

Eliminating free offers that fall into the Mead Paradox category would represent a substantial regulatory change in marketing and advertising. The question remains as to whether this type of change is possible because of the absence of an intense constituency to change the status quo and the presence of a strong, well-financed constituency that would take care to preserve it.

As noted earlier, however, regulation of advertising and product promotion has changed quite heavily along a number of dimensions since the era of *Walter J. Black*. For example, product and service endorsements are closely regulated,[295] as are advertisements for specific products deemed risky or dangerous (like tobacco)[296] and advertisements for housing[297] and employment.[298] Tobacco television promotion took a particularly precipitous journey from omnipresent to absent. The National Broadcasting Company's first nightly news broadcast in 1949, entitled "The Camel News Caravan,"[299] was hosted by "cigarette pitchman" John Cameron Swayze.[300] By 1969, cigarette advertising was entirely banned from the airwaves.[301]

Regulation of so-called subliminal advertising could prove somewhat instructive for free offer regulation. Just like free offer advertising, concealment of cognitive and psychological tactics was at issue. The government intervened. In 1974, the Federal Communications Commission issued a public notice stating, "We believe that use of subliminal perception is inconsistent with the obligations of a licensee... [and] such techniques are contrary to the public interest. Whether effective or not,

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294. For example, rather than putting the burden on the consumer to cancel, enable consumers to take three days to decide whether they want the product and then pay for it. This would effectively flip the dynamic of the right of rescission.

295. *See* Guides Concerning Use of Endorsements and Testimonials in Advertising, 16 C.F.R. § 255 (2007).

296. *See* Public Health Cigarette Smoking Act of 1969, 15 U.S.C. § 1331 (2000) (banning cigarette advertising on radio and television).

297. *See* Fair Housing Act, Title VIII of the Civil Rights Act of 1968, 42 U.S.C. § 3604(c) (2000).

298. *See, e.g.*, Civil Rights Act of 1964, 42 U.S.C. § 2000e-2 (2000) (employment); Age Discrimination in Employment Act of 1967, 29 U.S.C. § 623(e) (2000).

299. This replaced *Camel Newsreel Theater*, also sponsored by the R.J. Reynolds Tobacco Co. David Shedden, *Early TV Anchors: A History of Network Evening News*, Poynter Online, Apr. 5, 2006, http://www.poynter.org/content/content_print.asp?id=99440&custom=.

300. Terry Teachout, *If the Nightly News Goes Out, It's with a Whimper*, N.Y. TIMES, Mar. 24, 2002, at S2.

301. *See* Public Health Cigarette Smoking Act of 1969, 15 U.S.C. § 1331.

such broadcasts clearly are intended to be deceptive."[302] The Television Code Board of the National Association of Broadcasters had previously prohibited use of "[a]ny technique whereby an attempt is made to convey information to the viewer by transmitting messages below the threshold of normal awareness. . . ."[303] Further, and more narrowly, the Bureau of Alcohol, Tobacco, Firearms, and Explosives went further than the FCC and expressly *prohibited* "subliminal or similar" advertising techniques for distilled spirits.[304]

In this case, there was a catalyzing event—a defining moment for subliminal television advertising that enhanced free offer regulation would almost require. The 1974 FCC public notice was driven by consumer outrage from a holiday-season advertising campaign for a product that contained the subliminal message "Get it."[305] Outrage on the subliminal practice has remained intact since then. In 2001, there was an outcry from segments of a politically interested public, embodied in a letter to the FCC from Senators Ron Wyden and John Breaux, that the Republican National Committee had aired a subliminal message "display[ing] the word 'RATS' as it attack[ed] Vice President Gore's prescription drug proposal."[306] After a factual review, the FCC decided to take no action,[307] leaving the matter without true resolution, but the hue and cry about this particular tactic was certainly heard.

The 1970s attacks on subliminal advertising apparently countered what were perceived as attempts to use hidden psychology to the advertiser's advantage. Why not, then, an outright ban on free offers for similar reasons?

Free offer regulation needs a "Get it!" moment. The main obstacles to reform would be institutional alignment against change and the cultural norm. It is likely that a substantial array of interests would line up against such a ban, perhaps even under the auspices that banning free offers would be *anti-consumer*. "We want to give stuff away! And the regulators won't let us give it to you!" This Article has explored what the counterargument should be.

IV. CONCLUSION

As a familiar part of commercial practice for a few centuries, free offers have received somewhat of a free ride from regulators. Until the 1930s, merchants were not even required to disclose the accompanying obligations of a free offer. Even with a more progressive, consumer-friendly regime that required disclosure, free offers have continued to proliferate. They are powerful marketing tools that often work to the disadvantage of consumers, playing on psychology and social norms—and, of course, the eternal quest for the "free lunch."

302. *In re* Public Notice Concerning the Broadcast of Information by Means of "Subliminal Perception" Techniques, 44 F.C.C.2d 1016, 1017 (1974).

303. *Id.*

304. 27 C.F.R. § 5.65(h) (2007).

305. *Concerning the Broadcast of Information*, 44 F.C.C.2d at 1017.

306. Letter from David H. Solomon, Chief of Enforcement Bureau, Federal Communications Commission, to Ron Wyden, U.S. Senator, and John B. Breaux, U.S. Senator, 16 F.C.C.R. 5853 (Mar. 9, 2001) (citing Letter from Ron Wyden, U.S. Senator and John B. Breaux, U.S. Senator to William E. Kennard, Chairman of the Federal Communications Commission (Sept. 12, 2000)).

307. *Id.* at 5854.

The free offer with accompanying obligation by definition should no longer be considered free and should generally be an unlawful practice. Rules attenuating consumers from offerers to diminish the pull of the reciprocity norm should be strengthened. Regulators should also pursue means of reducing consumer cognitive error from bundling tactics.

In sum, free offers require a new look in light of the social-science knowledge acquired since *Walter J. Black* in 1953 and the subsequent promulgation of the FTC's Guide. Policy makers should consider changes in the regulatory approach toward the various types of free offers—including bans on wide swaths of this advertising and marketing practice.

While such changes in policy may seem sweeping (they are), they are just as achievable as other regulatory reforms in the marketing and advertising arena. In order to gain political traction, however, free offer reform may need to await that catalytic defining moment.