Pricing Laws Are No Bargain for Consumers

BY ROBERT PITOFSKY, RANDAL SHAHEEN, AND AMY MUDGE

"$9.99, regularly $15.99!" "20 percent off next week only!" "$14.95 Manufacturers List Price but $11.99 here!" "Year-end sale—all products must go—50 percent off!" "Lowest prices of the year."

LOOK AND SOUND FAMILIAR? It's the substance of aggressive discount marketing. In the 1950s and 1960s, 30 percent of Federal Trade Commission challenges to advertising were related to "fictitious price claims."[1] For example, a company might continuously advertise a price as a reduction off a regular price when few, if any, sales of the product had occurred at the regular price. By the mid-1970s, however, the FTC's enthusiasm for these cases had cooled considerably. The FTC has not brought a single fictitious price case since 1979, and the last two chairs of the FTC—one presiding during a Democratic Administration and the other during a Republican Administration—have indicated that enforcement actions in this area often do more harm than good.[2]

Although the FTC and the state attorneys general have made great strides in narrowing enforcement differences over the years, "fictitious pricing" claims remains an area where enforcement practices differ dramatically. Claims such as those above can be (and often are) challenged under state law because they don't specify "off" of what, or because the product was not at a high price long enough before or after the sale to make it a real "sale." Retailers can be subject to fines and other substantial penalties from actions brought by state AGs or even district, or county attorneys.

Examining the history of FTC regulation of fictitious pricing, and why the FTC abandoned enforcement in this area, supports our view that the states should sharply curtail enforcement as well. The varied landscape of state laws and enforcement actions in this area, as well as practical issues raised in dealing with state enforcement, suggest that the states should repeal their fictitious pricing statutes and regulations and cease enforcement except in the most extreme and egregious circumstances.

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History of FTC Enforcement

Section 5 of the FTC Act authorizes the FTC to bring enforcement actions against deceptive or unfair marketing practices.[3] The FTC, in turn, has defined a "deceptive practice" as one which is (1) likely to mislead a consumer acting reasonably under the circumstances and (2) is material to the consumer's purchase decision.[4] Pursuant to its authority under Section 5, the FTC has issued numerous "Guides" that address specific marketing practices, such as environmental claims and the use of testimonials.

As noted above, pursuant to Section 5, the FTC by the 1950s had begun to bring enforcement actions against retailers allegedly engaging in deceptive pricing. By the late 1950s the FTC had concluded that the practice was serious and widespread enough that it issued first one, and then later a second Guide concerning price advertising. The FTC's "Guides Against Deceptive Pricing"[5] discuss, among other things, former price comparisons, which the Guide calls "one of the most commonly used forms of bargain advertising." The Guides state that the advertising of a "former price" is not deceptive if "the former price is the actual, bona fide price at which the article was offered to the public on a regular basis for a reasonably substantial period of time." The later adopted "Guide Concerning the Use of the Word 'Free' and Similar Representations,"[6] addresses a concern that retailers will overstate the bargain offered to consumers by using an inflated comparison price. The Guide states that when free merchandise is offered if a consumer purchases another product, consumers understand that they are paying "nothing more than the regular price for the article which must be purchased. "Regular" is in turn defined as the price at which the advertiser has openly and actively sold the product in the relevant trade area for a reasonably substantial period of time, i.e., a thirty-day period (except for products whose price fluctuates in which case it is the lowest price at which substantial sales were made during the previous thirty days.)

For a significant period of time the FTC vigorously rooted out what it regarded as fictitious price claims. For example, Southern States Distributing Company entered into a consent order in response to an FTC complaint alleging that its advertised reduction from $1595 to $795 for an economy

pool was not genuine because no sales had been made of the economy pools at the higher price.[7]

FTC enforcement in this area, however, ended rather abruptly. The last enforcement action of which we are aware was brought in 1979 and involved the use of fictitious former selling prices for home appliances.[8] Although the fictitious pricing Guides have never been withdrawn, why did the FTC cease actively enforcing them? In a 1990 interview, then Director of Consumer Protection Barry Cutler suggested that retail pricing claims were a "hot topic" among the states and that it would not be a good use of FTC resources to "duplicate their effort."[9] However, articles by the current and one former FTC chairmen suggest there may have been more compelling reasons why the Commission abandoned enforcement of its pricing guides.

Former FTC Chairman Robert Pitofsky (one of the authors of this article), noted in a 1977 article that in some limited circumstances fictitious pricing claims cause consumer harm.[10] Consumers may be diverted from more efficient low price sellers and might make purchases that would otherwise never have been made or would have occurred at a later time. At the same time, he argued that "much alleged fictitious pricing is innocuous, either because consumers are in a position to check the validity of exaggerated claims (for example, where comparison shopping is relatively simple) or because the claims are so unlikely ("lowest price ever") or ambiguous ("10 percent off") that they will be ignored by almost all customers."[11]

Pitofsky also noted that

> a natural target for such enforcement has been discount houses, and the usual complainants have been nondiscounters who emphasize service and reliability rather than price. Aggressive enforcement against discounters that forces them to hew close to the line of accurate information may tend to dampen competitive activity. Often, "cents-off," free goods, couponing and other discount promotions are devices that assist new entrants in penetrating concentrated markets and that tend to unsettle stable and rigid pricing patterns. . . . While the same pro-competitive effects can be achieved by accurate price claims in connection with these promotions, the cost to sellers of ascertaining whether particular discount claims are accurate may deter them from making such claims at all.[12]

FTC Chairman Timothy Muris echoed these sentiments in a 1991 article, noting the "difficulties that are inherent in close regulation of allegedly deceptive pricing claims."[13] In particular, he wrote, there is the "risk that such an enforcement campaign will discourage exactly the kind of aggressive price competition that the government should seek to encourage . . . ."[14] He applauded the FTC's abandonment of fictitious price cases, noting that "consumers can hardly afford such protection."[15]

Notwithstanding the above, is it misleading for a retailer to promote an item as "on sale" for fifty-two weeks of the year? Certainly, but the goal of any regulation must be to stamp out bad practices in a way that does more good than harm. Here the FTC has apparently made the judgment, correctly in our view, that the chilling effect of deceptive pricing regulation on retailers, and the inherent subjectivity and difficulty in ascertaining compliance, have brought about more harm than good.

State Enforcement

Nearly all of the states followed the FTC's early lead and passed legislation or adopted regulations that prohibited fictitious pricing claims.[16] Today, at least forty states plus the District of Columbia have statutes or regulations relating to fictitious pricing. In some instances they mimic the FTC's fairly general Pricing Guide language relating to former price comparisons (e.g., "price at which the seller offered the product for a reasonably substantial period of time in the recent regular course of its business.") In other instances fictitious pricing claims are defined with mathematical precision. For example, in Massachusetts, one of several alternative tests a retailer can meet to make a "sale" claim is that a product is offered at a non-sale price for fourteen consecutive business days and then during the next 180 days the product is not offered for sale more than 45 percent of the time.[17]

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Further, some states have requirements even more onerous and arguably more anti-consumer than those imposed by the FTC's Guides. In the mid-1960s the FTC amended its Pricing Guides to make clear that a retailer only had to show a bona fide attempt to sell the product at the former price. The amended Guides state that a "former price is not necessarily fictitious merely because no sales at the advertised price were made." Some states, however, still require a showing of actual sales at the former price. For example, New Jersey requires proof "of a substantial number of sales of the advertised merchandise . . . within the advertiser's trade area in the regular course of business at any time within the most recent 60 days . . . ."[18] In Missouri there is a rebuttable presumption that the former price is fictitious unless 10 percent of the product's sales occurred at the former price (or an even higher price) "during a period of time, not less than thirty days nor more than twelve months, which includes the advertisement."[19]

Unlike the FTC, the states have slowed but not abandoned enforcement of fictitious price claims. Within the past year Kay-Bee Toys was alleged to have displayed regular prices with a slash through them and then an implied discounted price. Kay-Bee paid $1.2 million to settle allegations by the Napa District Attorney[20] that it misled consumers

because the slashed-through price was not a price at which it had sold the product. Another $4 million was paid to settle a private class action.[21] The State of Colorado fought a lengthy court battle against the May Company for, among other things, not selling enough housewares at the regular price.[22] Levitz Furniture paid a $1.12 million fine and entered into a multi-state consent decree that required it to maintain a "regular" price for 60 percent of the time and to make 20 percent of its sales at that higher price.[23] J.C. Penney agreed to pay the state of Washington $150,000 to settle a fictitious pricing claim that it offered window blinds at 40 percent off but sold only a few at the regular price.[24] And the list goes on. Sears, Macys, Kohls, Burdines, Nordstroms, and Montgomery Ward, all have felt the sting of state fictitious pricing laws long after the FTC ceased enforcing its own pricing guides.[25]

Our neighbors to the north also continue to enforce their own deceptive pricing laws. Last year a Canadian retailer paid a $1 million fine to settle an alleged deceptive pricing case. In that case Suzy Shier was alleged to have misleadingly advertised sales prices on certain products when only 12.5 percent of its total product sales had been at the regular price and the products had been offered at the regular price only 11 percent of the time.[26]

Practical Difficulties

Continued enforcement of these laws by the states raises several practical difficulties. First, many retailers are now at least regional and often national in scope. State fictitious pricing laws often vary from state to state. For example, in Oregon the "former" price must be one that was offered to consumers in good faith within the preceding thirty days. In Washington state, however, the state attorney general has issued guidelines stating that the reference price must be one at which the goods were openly and actively offered for more than 70 percent of the prior six month period. A multi-state retailer either must create different advertisements for different states or reduce its advertising practices to the least common denominator. In the first instance the retailer's costs are raised, while in the second, consumers in states without restrictive pricing laws may be denied the benefits of more zealous discounting.

Further, many of these laws are routinely ignored, leading to problems of selective compliance and enforcement. One need only look at a copy of the Sunday *New York Times*, to recognize that many retailers are not complying with New Jersey's requirement that sale advertisements for products priced over $100 must also include the regular price. Some retailers, wishing to avoid any risk, attempt to comply with state fictitious pricing laws even though the risk of state enforcement is low. Other retailers opt to advertise prices as the marketplace demands, viewing the risk of any state enforcement action as acceptable. The playing field ought to be level, and a retailer's marketing practices should not depend upon its willingness to violate state law.

Even without these practical issues, enforcement of these state regulations usually is the wrong policy for the very reasons that led the FTC to stop enforcing its own Pricing Guides. Aggressive price discounting often is chilled. Further, many of the state laws create additional problems. As noted above, some states set out a specific number of weeks during which the product must have been offered at the non-sale price. Obviously, this is of no benefit to consumers who happen to be shopping during one of the required non-sale weeks. Further, it permits competing retailers to predict with more certainty when and if their rivals will be able to advertise a product as on sale and adjust their own pricing practices accordingly.

Some states also require not only that the product be offered for sale at the former price but that substantial sales also have been made at the former price. As a result, the more successful a retailer is at selling a product at the advertised sale price, the harder it has to work to make additional sales at the regular price. Further, for many products consumers have learned to time their purchases to coincide with sales, making it even harder for a retailer wishing to advertise a sale price to first persuade sufficient consumers to purchase the product at the regular price. In essence, the states are requiring the retailer to persuade some consumers to purchase the product at a higher price so that it can offer the product at a lower price to other consumers.

The obvious conclusion is that as long as consumers are accurately informed as to the selling price, they are in a good position to mitigate any harm from unscrupulous pricing practices by comparing the values offered by one retailer to those offered by another. Without ever leaving home, it is now possible for a consumer not only to check advertising circulars, but to check the value of the bargain being offered at competing retailers' Web sites, perhaps compare the cost at Amazon.com, and even find out what it might cost to buy the item used on eBay. At least for a substantial subset of consumers, "consumer protection" in this area is less useful than ever.

We believe it is time for the FTC to formally abandon its Pricing Guides and for the states, perhaps through the leadership of the National Association of Attorneys General, to repeal their deceptive pricing statutes and regulations. Failure to do so will continue to chill the pricing practices of discount chains and will only legitimize even more chilling consumer class actions against retailers, such as the recent case brought against Kay-Bee Toys.[27]

Repeal of these statutes, however, does not mean that retailers will be free to engage in truly outrageous pricing conduct. For example, there can be no legitimate justification for advertising a product as "on sale" every single day of the year. Section 5 of the FTC Act, as well as each state's general laws on deception and unfair trade practices, will remain available to keep such conduct in check. Consumers will benefit; unscrupulous retailers can still be held accountable. It is a bargain no state can afford to pass up. ■

[1] Timothy Muris, *Economics and Consumer Protection*, 60 ANTITRUST L.J. 103, 112 (1991).

[2] *See id.*, Robert Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661 (1977).

[3] 15 U.S.C. § 45 *et seq.*

[4] FTC Policy Statement on Deception (Oct. 14, 1983), *available at* http://www.ftc.gov/bcp/policystmt/ad-decept.htm.

[5] 16 C.F.R. § 233 (1958).

[6] 16 C.F.R. § 251 (1971).

[7] See Southern States Distrib. Co., FTC Docket No. 8882 (1973).

[8] See Home Centers, Inc., 94 F.T.C. 1362 (1979).

[9] *See FTC Gives States Job of Policing Ad Price Claims, Capital Cities Media Inc.* (Oct. 3, 1990) (on file with authors).

[10] Pitofsky, *supra* note 2, at 687–88.

[11] *Id.*

[12] *Id.*

[13] Muris, *supra* note 1, at 113.

[14] *Id.*

[15] *Id.* at 115.

[16] However, as late as 1990, Massachusetts adopted one of the strictest and most comprehensive fictitious pricing schemes in the country. See MASS. REGS. CODE 940 § 6.04 *et seq.*

[17] MASS. REGS. CODE 940 § 6.05(3)(a)(2).

[18] N.J. ADMIN. CODE TIT. 13. § 45.A-9.6.

[19] MO. CODE REGS. ANN. 15 § 60-7.060(2).

[20] California v. Southdale Kay-Bee Toy Inc., Case No. 26-15784 (Super. Ct. Aug. 2003).

[21] DeGradi v. KB Holdings, Inc., Case No. 02 CH 15838 (Cir. Ct III 2003).

[22] Colorado v. May Dept Stores Co., 849 P.2d 802 (Colo. Ct. App. 1992).

[23] *Levitz Settles Deceptive Ads Claim—Furniture Chain to Pay $1.2 Million to Ariz., 7 States*, ARIZ. REPUBLIC, June 26, 1996.

[24] *J.C. Penney, State Resolve Suit over Window Blind Ads*, PORTLAND OREGONIAN, Jan. 7, 1993, at D13.

[25] See California v. Nordstrom, Case No. 736092 (Super. Ct. Aug. 31, 1989); Florida v. Burdines, Inc., Case No. 96-008229 (Fla. Cir. Ct. Mar. 18, 1997); *Rich Pays State $25,000 over Ads; Agency Threatens Macy's*, ATL. J & CONST., Feb. 25, 1989, at A01; *As Retailers' Sales Crop Up Everywhere, Regulators Wonder If the Price Is Right*, WALL ST. J., Feb. 15, 1990, at B1; Missouri v. Montgomery Ward & Co., Case No. 189-1244CC (Cir. Ct. Nov. 13, 1989); Kansas ex rel. Nola Foulston and Carla J. Stovall v. Kohl's Dep't Stores Inc., Case No. 006 4110 (Kan. Dist. Ct. 2000).

[26] *Misleading Discounts Can Cost You*, McMillan Binch Advertising & Marketing Bulletin (Oct. 2003), http://www.mcmillanbinch.com/upload/publication/misleading1003.pdf.

[27] See *supra* note 20.

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