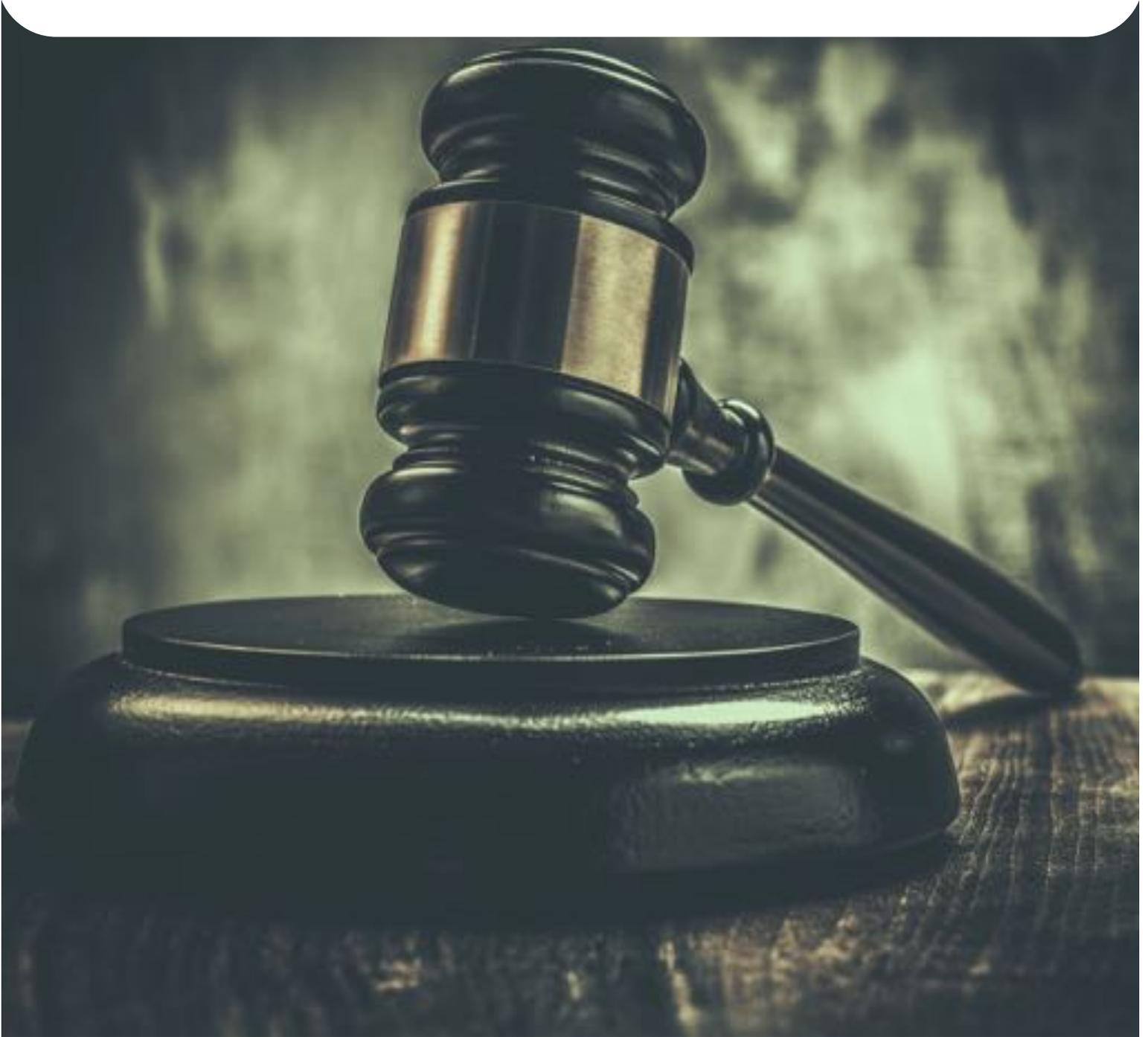


## Promotional Pricing: On the Right Side of the Law



## In December of 2016, Los Angeles prosecutors announced that they were suing four national retailers for **deceptive pricing practices**.

The suit alleged that customers had been fooled by these retailers (Kohl's, Macy's, J.C. Penney, and Sears) into believing that the discounts they had received were larger than they actually were. In a public statement, Los Angeles City Attorney, Mike Feuer said, "Customers have the right to be told the truth about the prices they are paying, and to know if a bargain is really a bargain." This event points to a very real, and growing risk for retailers: that their promotional practices may be leaving them open to legal action.

Retail promotions are conceived of and executed by merchants and marketers who are largely unfamiliar with the laws and guidelines that apply to advertisements and discounts. They often follow pricing strategies and practices that were established long ago and may have evolved due to competitive pressures, causing these strategies to drift into legal gray area. In addition, the amount of promotion in retail has escalated dramatically. According to a 2013 article in *The Wall Street Journal*, "The number of deals offered by 31 major department store and apparel retailers increased 63% between 2009 to 2012, and the average discount jumped to 36% from 25%..."<sup>1</sup> Imagine how these offers have increased since, given punishing market conditions. This increased frequency of discounts and desire to communicate savings to customers has made it harder to comply with the tangle of laws that govern fair advertising practices. Nevertheless, it is important for retail decision makers to have a basic understanding of the guardrails they should apply to pricing as it relates to promotions.<sup>2</sup>

---

<sup>1</sup> Suzanne Kapner, *The Dirty Secret of Black Friday "Discounts"*, *The Wall Street Journal*, November 25, 2013

<sup>2</sup> **Disclaimer** – Though we have relied on careful review of the relevant materials and consulted with legal counsel familiar with fair advertising practices, The Parker Avery Group is not comprised of lawyers and we do not claim to provide legal advice. We highly recommend discussing advertising and pricing policy with corporate counsel or outside legal representation when setting corporate rules.

## Fair Advertising Statutes

There are two major sources of fair advertising statutes, the federal government and individual states. Unfortunately, this produces a patchwork of disparate perspectives that can be difficult, if not impossible, to reconcile. Federal guidelines are outlined in the Code of Federal Regulations (accessible through the web site: [www.ecfr.gov](http://www.ecfr.gov)) and enforceable by the Federal Trade Commission (FTC). The FTC is an independent agency of the United States government whose main charter is the promotion of consumer protection as well as the elimination and prevention of anticompetitive business practices. The relevant section of the Code of Federal Regulations is titled, “Guides Against Deceptive Pricing” (hereinafter referred to as “The Guides”). However, the FTC is not currently acting to enforce The Guides, and has not done so since the Nixon administration. Instead, the federal government has been relying on individual states and class actions to force retailers to comply. The Guides provide some useful direction around pricing practices, but are worded so vaguely as to be open to interpretation. Let’s take a look at these nuances.

### Current vs. Former Price

The Guides provide parameters for different types of price comparisons. The first one is a comparison of a current price against a former price. This pertains to most “was/now” pricing as well as percentage and dollar savings claims. The key passage dealing with former price comparisons states:

*“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, it provides a legitimate basis for the advertising of a price comparison.”*

The Guides do not define “actual, bona fide price,” “regular basis,” or “reasonably substantial period of time.” The document does provide an example, which helps clarify, though not completely:

*“John Doe is a retailer of Brand X fountain pens, which cost him \$5 each. His usual markup is 50 percent over cost; that is, his regular retail price is \$7.50. In order subsequently to offer an unusual “bargain”, Doe begins offering Brand X at \$10 per pen. He realizes that he will be able to sell no,*



*or very few, pens at this inflated price. But he doesn't care, for he maintains that price for only a few days. Then he “cuts” the price to its usual level—\$7.50—and advertises: “Terrific Bargain: X Pens, Were \$10, Now Only \$7.50!” This is obviously a false claim. The advertised “bargain” is not genuine.”*

This example should sound familiar to many retailers, because it describes a pervasive advertising practice. It identifies the legality of the price comparison as being related to the validity of the original or reference price (actual bona fide price) and the length of time the item was offered at the reference price prior to discounting (regular basis or reasonably substantial period of time).

### Comparable Values

Next, The Guides handle comparable value comparisons. This covers references to other retailers’ prices (“Price Elsewhere \$10, Our Price \$7.50”) or to other products of “similar grade or quality” (“Compare at \$15”). Here the chief concern is to assure the relevance of the comparison. When comparing an advertised price to another retailer’s price, the higher price claim must be fact-based, as outlined in this key passage:

*“Whenever an advertiser represents that he is selling below the prices being charged in his area for a particular article, he should be reasonably certain that the higher price he advertises does not appreciably exceed the price at which substantial sales of the article are being made in the area—that is, a sufficient number of sales so that a consumer would consider a reduction from the price to represent a genuine bargain or saving.”*



When comparing a price, whether advertised or not, to a comparable product, that product must be highly similar in value and quality, as well as be available in the same trade area. The Code of Federal Regulations illustrates the point with this example.

*“Retailer Doe advertises Brand X pen as having “Comparable Value \$15.00.” Unless a reasonable number of the principal outlets in the area are offering Brand Y, an essentially similar pen, for that price, this advertisement would be deceptive.”*

Notice the specificity of the comparable product in the example. Most retailers that communicate “compare at” prices fail to comply with this guideline. That is because those “compare at” prices are not based on real, specific items, but rather on conceptual comparable products.

### Manufacturer’s Suggested Retail Price

The Guides then turn to comparisons against manufacturer’s suggested retail prices (MSRPs) or list prices. The Guides state:

*“Many members of the purchasing public believe that a manufacturer’s list price, or suggested retail price, is the price at which an article is generally sold. Therefore, if a reduction from this price is advertised, many people will believe that they are being offered a genuine bargain. To the extent that list or suggested retail prices do not in fact correspond to prices at which a substantial number of sales of the article in question are made, the advertisement of a reduction may mislead the consumer.”*



Here again, the verbiage is maddeningly vague. The phrase, “substantial number of sales” is not clearly defined, leaving the rule open to interpretation. Nevertheless, retailers should be aware that references to savings off list prices or MSRPs should only be considered legitimate if a recent track record of sales occurred in the market at that

price. This dictum is widely violated, though the automobile industry, where cars nearly never sell for the MSRP, skirts legal issues by not advertising specific prices.

### Purchase of Other Qualifying Items

Promotions requiring the purchase of other qualifying items are the subject of the next section of The Guides.

*“Frequently, advertisers choose to offer bargains in the form of additional merchandise to be given a customer on the condition that he purchase a particular article at the price usually offered by the advertiser.”*

These guidelines deal with “buy one, get one” type sales, as well as “gift with purchase” promotions. The chief concern with these offers is that the retailer not artificially raise

the price of the qualifying item to defray the cost of the discounted or free item accompanying it, especially temporarily for the promotion. In addition, this section aims to ensure that advertisers disclose any other conditions or qualifications to receive the discount in the language of the advertisement. That way, customers cannot be lured with appealing looking offers only to discover onerous strings attached to the bargain.

### **Miscellaneous Price Comparisons**

Finally, The Guides wrap up with a section entitled, “Miscellaneous price comparisons.” This section exhorts the advertiser to follow the general principles outlined earlier in the document to avoid deceptive practice. It includes prohibitions against price comparisons to false “wholesale prices” and “factory prices,” as well as stipulates that prices of factory seconds, irregulars, or damaged merchandise not be compared to first quality prices.

In general, The Guides read as being slightly quaint and alarmingly non-specific. Despite this, the document does provide some direction as to which advertising practices represent good faith. In general, it defines rules based on a combination of the validity of the reference price, and/or the length of time items are offered in the market at that reference price. These federal guidelines absolutely should be considered when developing a promotional strategy and the related policies.

## **State Pricing Regulations**

A survey of state regulations regarding pricing in advertising reveals some startling similarities and a few major differences. Nearly every state has a statute prohibiting the making of false or misleading statements about the reasons for, existence of, or amounts of price reductions. In fact, many state regulations employ the exact same language to describe prohibited activities. Many states also have adopted rules related to former price comparisons as well (“was/now” pricing), but unfortunately there is little commonality of specifics across states. Alaska insists that regular prices be established for at least fourteen days prior to a discount. Meanwhile, in Massachusetts a former price comparison is considered valid if one of these three conditions apply:

- 1. during the six months preceding the dissemination date of an advertisement of a price comparison, the former price was charged with respect to 40% of sales of the item;*
- 2. the former price was offered openly and in good faith for the 14 days immediately preceding the dissemination date of an advertisement of a comparison price; or*

3. *the former price was offered openly and in good faith for at least 28 days during the 90 days immediately preceding the dissemination date of an advertisement of a price comparison, or during any other 90-day period within the 12 months preceding the dissemination date of an advertisement of a price comparison, provided the advertisement clearly discloses the date, time or seasonal period of such offer (e.g.: last season).*<sup>3</sup>

The Massachusetts guidelines are so complex that it is hard to imagine a retailer being able to keep them in mind when trying to determine if a price break is lawful.

### Defining Regular Price in...

#### Massachusetts

1. during the six months preceding the dissemination date of an advertisement of a price comparison, the former price was charged with respect to 40% of sales of the item;

{or}

2. the former price was offered openly and in good faith for the 14 days immediately preceding the dissemination date of an advertisement of a comparison price;

3. the former price was offered openly and in good faith for at least 28 days during the 90 days immediately preceding the dissemination date of an advertisement of a price comparison, or during any other 90-day period within the 12 months preceding the dissemination date of an advertisement of a price comparison, provided the advertisement clearly discloses the date, time or seasonal period of such offer (e.g. last season).

#### California

...must have been the prevailing market price within three months preceding the publication of the ad or “unless the date when the alleged former price did prevail is clearly, exactly and conspicuously stated in the advertisement.”

#### Ohio

the price offered in 31 of the preceding days or the price where “substantial” sales were made

{or}

the price at which the goods or services are openly and actively sold on a continuing basis for a substantial period of time

<sup>3</sup> 940 Mass. Code Regs. 6.04(4)

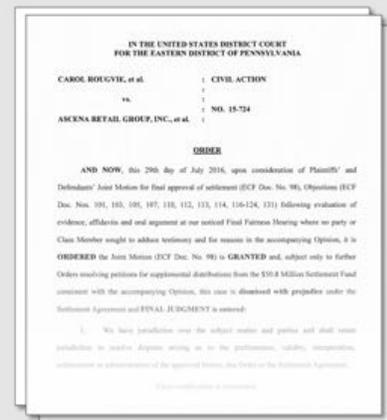
California stipulates that to be valid, a comparison price must have been the prevailing market price within three months preceding the publication of the ad or “unless the date when the alleged former price did prevail is clearly, exactly and conspicuously stated in the advertisement.”<sup>4</sup>

The state of Ohio regulations slightly contradict themselves. One stipulates that a regular price is the price offered in 31 of the preceding days or the price where “substantial” sales were made.<sup>5</sup> The other defines regular price as “the price at which the goods or services are openly and actively sold by a supplier to the public on a continuing basis for a substantial period of time.”<sup>6</sup> As with the federal guidelines, key phrases such as “substantial sales” and “substantial period of time” are not clearly defined. Nevertheless, the state guidelines generally deal with the same matters as the federal guidelines, specifically the legitimacy of the reference price and/or the period of time the item was available at the reference price.

## Promotional Pricing Policies & Financial Liability

To arrive at a set of promotional pricing policies, retailers need to understand the sources of potential financial liability associated with non-compliance with federal and state pricing rules. As stated above, for decades the FTC has not played an active role in policing fair advertising practices. Given the current anti-regulatory environment in Washington, D.C., that apathy is unlikely to change soon. On the other hand, state Attorneys General and even city prosecutors may file suit against retailers based on the applicable laws. The motivation of these officials is not just to protect consumers or punish a transgressing retailer, but also to create an object lesson for

In 2016 Ascena Retail Group **settled a fair advertising practice class action suit** against its subsidiary, the tween apparel retailer, Justice, for **\$50.8 million**.



<sup>4</sup> Cal. Business and Professions Code § 17501

<sup>5</sup> Ohio Admin. Code 109.4:3-01

<sup>6</sup> Ohio Admin. Code 109.4:3-12 and 109.4:3-04

other retailers to motivate them to comply with the rules. As such, larger retailers with national standing tend to be targeted more often than small local players. Some states, such as California and Michigan have a reputation for being particularly aggressive in enforcing fair advertising practices. Because of this, certain state regulations should be treated as more influential on a retailer's policies than others.

Perhaps the most significant source of potential liability comes from exposure to class action lawsuits. Class action is a type of lawsuit where one of the parties is a group of people who are represented collectively by a member of that group. These lawsuits can be brought in either state or federal courts. Class action lawsuits are sometimes initiated by members of the aggrieved group; in the case of the retail sector, this is typically dissatisfied customers. More often, attorneys identify a potential defendant based on current promotional practices and seek to identify a lead plaintiff that credibly can claim harm from the practice. Rather than seeking to create an example, class action attorneys are motivated by the desire to right a perceived wrong or to collect fees associated with a large settlement or judgement. As such, they tend to target retailers that are particularly vulnerable or likely to choose to negotiate a settlement rather than battle a lawsuit.

The stakes in class action lawsuits can be immense. For example, in 2016 Ascena Retail Group settled a fair advertising practice class action suit against its subsidiary, the tween apparel retailer, Justice, for \$50.8 million.

In addition to financial liability, shady promotional pricing practices and the legal actions based on them can lead to customer backlash against a retailer. No retailer wants to be forced to publicly admit to misleading consumers or to accrue a reputation for deceptive pricing. The cost in terms of customer perception can be more damaging than any settlement or judgement.

## Not all promotions are created the same when it comes to discounting



Legal guidelines for promotional pricing deal with two factors: the legitimacy of the comparative or reference price and the time period that the item was available at the reference price. As an example, for "was/now" pricing, the item must have been available for sale at the "was" price on a "regular basis" or for a "reasonably substantial period of time" prior to the discount period, according to the FTC guidelines. Many state guidelines go on to further define the precise period of time that the item was available at the "was" price. To illustrate, adherence to the Ohio state guideline means that any item must be offered at the regular retail ("was") price for 28 days out of every 90 days. The remaining 62 days out of 90, a retailer is free to promote and discount from the "was" price.



In today's environment, however, evaluating the pre-discount time period is complicated by the increasing prevalence of coupon offers. These may take the form of actual paper coupons, emails, or promotional codes shown in banners on a website. Examples of these types of promotions are an email that contains a code giving a 40% discount off a single item or a banner on a website that communicates a code that discounts all sweaters by 30%. These types of promotions are rarely directed toward a single item. Instead they may be applied to a group of items or all items in the assortment. The items to which the discounts are applied are controlled by the customer.

Promotions that can be applied to many different items at the discretion of the customer typically may be treated as regular price sales for purposes of evaluating non-discount time period. Non-product-specific promotions may generally be ignored when determining whether an item was available at the "was" price for a sufficient time. These include BOGO offers (since the customer could always elect to only buy one item), gift with purchase offers, basket offers (such as save \$20 when you spend \$60), free shipping, and free returns.

## Tactically Navigating Promotional Regulations

So how can a multi-state or national retailer navigate these choppy waters with such a regulatory cross sea?

 First and foremost, retailers would be wise to **understand the relevant laws** for the markets in which they do business and their application to advertising practices. There is no substitute for good legal counsel versed in retail pricing to help evaluate your current promotional pricing practices. Counsel can assess your legal exposure and perhaps put a potential dollar amount to the risk of legal action. In addition to pure legal advice, external industry expertise in retail pricing policies and processes may be required to interpret the law in the context of a particular retailer's business model.

 Second, retailers should **develop succinct guidelines or policies** that dictate comparative pricing practices. These guidelines should comply with the applicable statutes in a way that reduces or minimizes risk of legal action, as recommended by their attorneys. These policies should specifically deal with the different types of price comparisons used in promotion, whether to an item's prior price, the prevailing market price, or an MSRP (list) price. In addition, these rules should lay out the minimum period that an item must be available for sale at the non-discounted price for the discount claim to be valid.

It's not enough to develop a policy statement, however. Merchants and marketers must be trained in these pricing practices. Adherence to pricing guidelines must be embedded into the promotions planning and development process. To support compliance, retailers should perform periodic audits of internal pricing practices and develop remedial actions and training when necessary.

 Third, retailers should always **strive to act in good faith** with regards to pricing. Employing outright deceptive price comparisons, or even ones that are in the legal gray area, may generate short term benefits, but have been shown repeatedly to have negative longer-term consequences. Sketchy pricing tends to harm the brand perception and add a whiff of charlatanry to a retailer's reputation. In addition, academic research shows that implausible reference prices have no measurable impact on consumer price perception.<sup>7</sup> This should reduce the temptation

---

<sup>7</sup> Bruce L. Alford, Brian T. Engelland, Mississippi State University, *Advertised Reference Price Effects on Consumer Price Estimates, Value Perception, and Search Intention* (Journal of Business Research 48, 93-100, 2000).

to display a bogus reference price to be able to claim an 80% savings. Worse yet, exposure to an implausible reference price may drive the customer to shop elsewhere for the desired item, since the entire pricing structure of the item – or worse, the whole assortment – at that retailer is called into question.



Finally, retailers should be **selective and planful with their promotional price discounting**. Even when comparative prices are valid, if items are promoted too much, then customers come to treat the advertised price as the “everyday” price. Sales at the full price diminish dramatically. Customers become “trained” never to purchase without a substantial discount. They come to expect larger discounts and lower prices in the future. In addition, not all items respond to promotional offers the same way. Promoting items that demonstrate little sales lift from a discount only serves to reduce the margin associated with the sale.

## Final Word

By understanding the federal and state statutes dealing with pricing for promotion, as well as the legal implications, a retailer can define strategies and set policies that obey the law, determine processes that reinforce those policies, and reduce or avoid legal and financial exposure. Additionally, retailers who fully understand the laws and demonstrate pragmatic pricing approaches are in a better position to strengthen customer trust and loyalty to their brand. These actions are best undertaken with the help of legal counsel and may benefit from the partnership of an experienced and trusted retail industry advisor who has the ability to structure policies and processes to support healthy promotional pricing practices.

## The Parker Avery Group

The Parker Avery Group is a boutique strategy and management consulting firm that is a trusted advisor to leading retail brands. We combine practical industry experience with proven consulting methodology to deliver measurable results. We specialize in merchandising, supply chain and the omnichannel business model, integrating customer insights and the digital retail experience with strategy and operational improvements. Parker Avery helps clients develop enhanced business strategies, design improved processes and execute global business models.

Learn more about us at:

[www.ParkerAvery.com](http://www.ParkerAvery.com)

for more details  
contact:

**Clay Parnell**

President & Managing Partner | [clay.parnell@parkeravery.com](mailto:clay.parnell@parkeravery.com)

**Josh Pollack**

Associate Partner | [josh.pollack@parkeravery.com](mailto:josh.pollack@parkeravery.com)

770.882.2205