

Online Deal Programs and Merchant Liability

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Unknown only a few years ago, online daily deal sites such as Groupon and LivingSocial have become a ubiquitous phenomenon, touted as being of considerable benefit to participating merchants. That may be so, but they also carry a risk of legal exposure that merchants would do well to consider and take prudent steps to mitigate. Already, Groupon's program has reportedly become the subject of several investigations by state attorneys general and more than a dozen state and federal class action lawsuits. In some of these class actions, participating merchants have also been sued, so it's not just the promoter's problem.

THE WAY THEY WORK

The online promoter emails its subscribers notice of short-fuse deals that the promoter has solicited from participating merchants. The deals must conform to certain general criteria established by the promoter and, typically, are for a substantial discount on specified goods or services. If interested, the consumer clicks through to the promoter's website, where the terms of the deal are more fully explained. The consumer completes the purchase on the website, and receives an email confirmation of the purchase that is then printed and presented to the merchant in return for the proffered goods or services. Typically, the certificate expires if not used within a designated time.

PROSPECTIVE LEGAL HAZARDS

As is often the case with new products, the applicability of existing law is unsettled. Here are at least some of the issues that should be considered.

Gift Card Statutes and Federal Regulations: Many states and the federal government have laws governing the issuance of "gift cards," including with respect to their expiration date, mandatory redemption for cash in certain circumstances and what fees may be charged. There are also an increasing number of potentially applicable federal "gift certificate" or "prepaid access" regulations, including Regulation E, administered by the new federal Consumer Financial Protection Bureau, and new regulations issued by the Treasury Department's Financial Crimes Enforcement Network that become effective on September 27, 2011. Much of the recent litigation and investigatory activity regarding Groupon has focused on the applicability of state and/or federal gift card laws.

Unfair Competition and False Advertising Laws: Online daily deals and their associated advertising are clearly subject to general consumer protection laws prohibiting false or misleading advertising and unfair competition. These laws, too, have been the source of much of the recent Groupon litigation and regulatory activity. Compliance in this regard can be complicated by the merchant's lack of direct control over the presentation of the deal to the consumer, as well as screen space limitations (especially for mobile devices) and the preferences of marketing departments for punchy messaging.

Privacy Laws: Internet privacy is an increasingly hot issue both federally and among the states. To the extent consumer activity with respect to daily deal offers is tracked and personal information is collected – either by the promoter or the merchant – there is a risk of getting crosswise with the growing number of these laws.

Escheat Laws: Every state has a law regarding the disposition of unclaimed property. These laws vary in their terms and impact, but under some circumstances can operate to require the merchant at some point to pay the value of the unused coupon to the state.

WHAT'S A MERCHANT TO DO?

The legal shoals in this area are navigable, but different circumstances are likely to require different approaches, so there is no substitute for having your particular proposed offer and promoter contract vetted by competent counsel. Among things to consider are the following:

Negotiate Appropriate Indemnification Terms. Since these programs are the promoter's own service offering, it is reasonable to expect the promoter to alert you to the risks and to stand behind the legal sufficiency of at least the standard terms that the promoter requires or recommends. But, surprise! You may find that the promoter's standard merchant contract actually provides for the merchant to indemnify the promoter in all circumstances. So, read the contract and negotiate with an eye towards shifting the risk to the promoter.

Design the Deal to Comply with Gift Card Laws. It may be possible to design your offer to avoid gift card characterization at all, or at least to comply with the limitations of these laws by including particular provisions: for example, entitlement to a refund of the deal's purchase price if the deal is not claimed before its expiration date.

Conspicuous Disclosure of Substantive Terms. Ensuring that all material terms of the deal are fairly disclosed is the best inoculant against false advertising and related consumer protection claims. But what this actually requires in a particular case, particularly in the Internet and mobile device environments, is not always readily apparent, so get the advice of counsel familiar with these issues.

Geographical Limits. The gift card and consumer laws of the states vary widely in their terms and onerousness. So, one strategy for reducing exposure could be to limit your offer to more "friendly" jurisdictions.

Advertising Insurance. Generally, violations of law are not insurable, but an appropriate E&O/Cyberliability policy might be useful to mitigate exposure, particularly if liability associated with regulatory action is covered and if the policy includes "final adjudication" language so that defense costs and coverage apply up to the point of judgment. Consult a qualified business insurance broker as to the specific policies and endorsements available to you.

Mandate Individualized Arbitration of Customer Disputes. Recent U.S. Supreme Court decisions have endorsed appropriately-framed mandatory arbitration provisions in consumer contracts as a means of thwarting class-wide litigation or arbitration of claims. As a practical matter, since the value of any individual consumer claim is often too small to be worthwhile, barring the aggregation of claims in this way may spare a merchant any claims at all, let alone meaningful exposure. There would appear to be no reason in principle why such a limitation could not be included in online daily deal terms, provided its provisions were objectively fair. But, beware. The jurisprudence as to what is "fair" in this context is still evolving.

In today's challenging retail environment, new ways of attracting customers are enticing, if not indispensable. But they can also contain legal traps, and their very novelty can make it difficult to spot the risks and figure out how to deal with them. The flip side of mass marketing exposure can be mass legal exposure. So, if you're contemplating working with an online daily deal site, or whatever the next innovation is in e-marketing, take nothing for granted and be sure you have adequate legal review.

If you have questions about any of the issues raised in this alert, contact [Dirk Schenkkan](mailto:Dirk.Schenkkan@iln.com) at 415.677.6233, [Barry Abbott](mailto:Barry.Abbott@iln.com) at 415.677.6470, [Thomas Magnani](mailto:Thomas.Magnani@iln.com) at 415.677.6464 or your usual Howard Rice attorney.