Legal Risks Facing Retailers Amid Pandemic Market Shifts

By **Stephanie Sheridan, Meegan Brooks and Lia Metreveli** (May 8, 2020)

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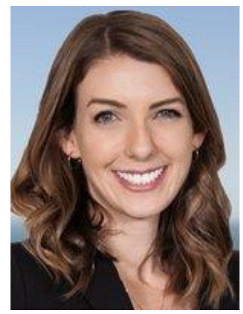

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Even before COVID-19 brought retail to a screeching halt, the industry was already facing unprecedented challenges, including a shift online from brick-and-mortar stores. The shutdown has accelerated this transition, with consumers forced online for even their most basic shopping needs.

As retailers struggle to not just remain competitive, but to survive, it is imperative that they proactively prepare for the inevitable legal risks that will arise once the economy reopens. While much has been written on privacy and employment issues, for example, the pandemic will have a much broader impact on the retail industry.

Below, we provide a glimpse into the anticipated challenges retailers will face in the months and years ahead, and identify potential opportunities for those that position themselves to be ahead of the curve.

Auto-Renewal Laws

Given concerns about leaving the house, as well as depleted inventories of crucial food and sanitizing products, many customers are turning to subscription programs to ensure that needed items are delivered to their homes on regular schedules. Retailers interested in launching subscription programs should comply with the federal Restore Online Shoppers' Confidence Act[1] and the patchwork of state laws imposing detailed notice and consent requirements.

Retailers large and small have been targeted with class actions under California's Automatic Renewal Law,[2] which requires retailers to clearly and conspicuously disclose the terms of the agreement or subscription to customers, receive the customer's "affirmative consent to the agreement" containing the terms, and provide an acknowledgment to customers that includes the terms.[3]

While some of the ARL's requirements may be intuitive, such as obtaining customers' consent before automatically charging their credit cards on a recurring basis, others catch retailers off-guard and lead to lawsuits, such as the requirement to send the customer "acknowledgment that includes the automatic renewal offer terms or continuous service offer terms, cancellation policy, and information regarding how to cancel in a manner that is capable of being retained by the consumer."[4]

Ensuring Compliance With Gift Card Laws

Retailers have been promoting the purchase of gift cards as a way for consumers to support their brands while storefronts remain closed. Gift cards implicate numerous state and federal issues, including restrictions on expiration dates and dormancy fees, escheatment, and cash-back requirements. The most heavily litigated issue by far with respect to gift card laws concerns cash redemptions for remaining card balances.

In California, where most gift card litigation is based, a gift card with a value of less than $10 is redeemable for its cash value. Since this law took effect in 2008, well over 130 gift card lawsuits have been filed in California state and federal courts. Other jurisdictions have enacted similar provisions with varying refund thresholds, including Colorado, Connecticut, Hawaii, Maine, Massachusetts, Montana, New Jersey, Oregon, Rhode Island, Texas, Vermont, Washington and Puerto Rico. The Hawaii statute just took effect on Jan. 1.

Sponsored Endorsement Rules — Uptick in FTC Enforcement

Social media — Instagram, Twitter, blogs, etc. — have been a modern boon to retailers: They not only augment traditional advertising programs, but also offer brands an inexpensive and easy way to connect with consumers. Before enlisting influencers to post sponsored endorsements, however, retailers should review the Federal Trade Commission's Guides Concerning the Use of Endorsements and Testimonials in Advertising,[5] which require that any material connections between an endorser and a brand must be fully disclosed in the sponsored content.

Over the last few years, the FTC has brought numerous enforcement actions and sent warning letters to well over 100 brands and influencers over sponsored content. The commission has issued guidance on this issue, and is currently accepting public comment on whether and how the endorsement guides should be revised to better address the use of social media endorsements. Because of COVID-19, the deadline for comment was extended to June 22.

In support of the request for comment, Commissioner Rohit Chopra issued a statement that makes clear he is interested in cracking down further on brands: "[W]hen companies launder advertising by paying an influencer to pretend that their endorsement or review is untainted by a financial relationship, this is illegal payola." Chopra also said that the FTC would need to "take bold steps to safeguard our digital economy from lies, distortions, and disinformation," and that it should consider codifying elements of the endorsement guides into formal rules so that violators can be liable for civil penalties.

Product Giveaways

Giveaways have been a successful and favorite marketing tool for many brands and retailers, particularly on Instagram. With the deepening impact of COVID-19, many brands have stepped up donation of products, such as hand cream, slippers and even wedding dresses, to front-line workers. But amid financial uncertainty and fear for public health, brands and retailers should be careful when advertising product giveaways.

On April 2, Draper James, the popular lifestyle brand launched by celebrity Reese Witherspoon, announced that it would be giving away dresses to teachers working hard in virtual classrooms across America. The company posted the following message to its Instagram account: "Dear Teachers: We want to say thank you. During quarantine, we see you working harder than ever to educate our children. To show our gratitude, Draper James would like to give teachers a free dress."

Teachers were instructed to apply before a deadline by submitting a form, which stated that the giveaway was valid "while supplies last." All "winners" would be notified.

Unfortunately for Draper James, the Instagram post went viral. Around a million teachers applied — the company had 250 dresses available for the giveaway. By the time company realized its error and tried to backtrack, the damage had already been done.

The backlash against Draper James was swift and unforgiving, as many criticized the brand for using the giveaway as a "scheme" and "marketing ploy." Headlines in the New York Times, Chicago Tribune and other major publications were quick to cover the giveaway gone "awry," referring to it as a "disaster" and a "mess."

Not only can giveaway promotions damage a brand's reputation and goodwill, it can also create legal risk for lawsuits by competitors, consumers or government officials, alleging unfair or deceptive conduct. Brands can mitigate risk by drafting written rules or terms for giveaways that clearly define eligibility, the method of entry, supply amounts and any other limitations.

These written rules or terms should also address potential liability and conflict resolution. Marketing materials, including posts to Instagram and other social media platforms where giveaways are being promoted, should be vetted carefully to ensure they are consistent with the rules and terms and that they include any necessary disclosures.

Buy Now, Pay Later — Retail Installment Contracts

Old-school "layaway" plans have been modernized with new programs like Afterpay, which have seen a surge in popularity. These retail installment sales contracts, or RISCs, allow customers to obtain items without paying the full price upfront. Instead, they split their purchases into several smaller — often four — payments. The retailer, however, gets the full payment right away.

We expect these programs to become even more popular post-COVID, in light of customers' budgetary restraints and retailers' attraction to upfront payment. Before implementing RISCs, however, retailers should consider potential legal and customer experience implications.

RISCs are designed to avoid application of certain federal and state laws, but in recent months, RISC providers Afterpay and Sezzle were each fined in California for operating without a state financing lender license. Both have since obtained the requisite licenses, but the enforcement actions signal that state regulators are now taking a much closer look at these arrangements.

Especially in this volatile market, some customers who sign up to pay through RISCs may not be able to make their installment payments, resulting in late fees or harm to their credit scores, which they may negatively associate with the retailer. To protect against potential claims, retailers should consider appropriate disclosures that the RISC agreement is with a third-party service provider, not the retailer, and, to the extent possible, adding indemnification provisions to the service agreements.

Conclusion

When retailers reopen their businesses, it will be to a transformed marketplace. Retailers will need to adapt to stay competitive. Before implementing changes, however, retailers should consider the legal risks from changing how they communicate with and sell to consumers.

While COVID-19 has been, and will continue to be, a devastating blow to much of the industry, there is likely an upside for retailers that remain nimble and identify creative solutions. Indeed, some of the greatest retail brands in the world — including General Electric, General Motors, IBM and Hyatt — were born out of periods of economic downturn. The Great Recession gave rise to prominent "startups" that are now part of our daily lives, including Airbnb, Square, Groupon, Zendesk, thredUP, Task Rabbit, WhatsApp and Venmo.

Now, too, retailers that can creatively respond to consumers' changing needs will be rewarded. People will always need to buy things, and there will always be a need for retailers. It will just look different in the future.

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Disclosure: thredUP is a Steptoe & Johnson client.

[1] Restore Online Shoppers' Confidence Act, https://www.ftc.gov/enforcement/statutes/restore-online-shoppers-confidence-act.

[2] California Business and Professions Code, Article 9. Automatic Purchase Renewals [17600 - 17606] https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=BPC&division=7.&title=&part=3.&chapter=1.&article=9.

[3] California Business and Professions Code, Article 9. Automatic Purchase Renewals [17602] https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?lawCode=BPC§ionNum=17602.

[4] Ibid.

[5] Federal Trade Commission Guides Concerning the Use of Endorsements and Testimonials in Advertising https://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-publishes-final-guides-governing-endorsements-testimonials/091005revisedendorsementguides.pdf.