Consumer *Law*

Summer 2005 Volume III Issue Number 1

IN THIS ISSUE:

DECEPTIVE PRACTICES & FALSE ADVERTISING

Blockbuster Settles "No More Late Fees" Lawsuits 1

Simon Property Group Agrees To Abide By Gift Card Law 2

Recent Lanham Act Decisions On Preliminary Injunctions 3

Federal District Court Dismisses Deceptive Practices and False Advertising Claims Against De Beers 6

PRICE ADVERTISING

Kaufmann's Settles New York Attorney General Investigation into Fictitious Reference Prices 8

Sleepy's Pays $750,000 To Settle Deceptive Practices Charges By New Jersey Attorney General 8

E-TAILING AND DIRECT MARKETING

FTC's Spam Rule Establishing The "Primary Purpose" Of Commercial Emails Takes Effect 9

Internet Marketer Sued For Secretly Installing Spyware On Consumers' Computers 11

BRICKS & MORTAR RETAILING

Macy's Settles Racial Profiling Complaint 12

CONSUMER CREDIT

Payday Loans Disguised as Catalog Sales Found to be Illegal 13

EMPLOYMENT

Court Approves Abercrombie & Fitch Settlement of Federal Employment Discrimination Class Action 14

ANTITRUST

Federated, May Company, Lenox, and Waterford Wedgwood Pay $2.9 Million in Civil Penalties to Settle Charges of Boycotting of Bed, Bath & Beyond 15

BUSINESS TORTS

Sharper Image Settles Product Disparagement Suit 15

NEW LEGISLATION

The New Bankruptcy Code: A Long Awaited Event for Retailers 16

Class Action Fairness Act of 2005 Shifts Most Consumer Class Actions to Federal Court 17

Amendments to the UCC: Liability to "Remote Purchasers" 19

NEWSBITES 20

BLOCKBUSTER SETTLES "NO MORE LATE FEES" LAWSUITS

In March, Blockbuster Inc., the nation's largest movie-rental chain, entered into a settlement with 47 states and the District of Columbia concerning Blockbuster's promotion of a "No More Late Fees" rental policy introduced at the beginning of this year. Blockbuster, without admitting wrongdoing, has agreed to: (i) change the way it promotes the policy to ensure its customers know that they may be charged if they keep videos, DVDs, games or other products seven days beyond their due date; (ii) offer refunds to customers who were charged such fees under the "No More Late Fees" policy; and (iii) pay the states $630,000 to cover costs and attorney's fees.

Under the "No More Late Fees" policy, customers have a one-week grace period after a rental due date. If a movie or game is not returned within the week, the customer is charged for the purchase of the item. If the item is then returned within thirty days, the customer receives a credit, but is charged a "restocking fee" of $1.25.

On February 18, 2005, the New Jersey Attorney General filed the initial lawsuit against Blockbuster, accusing the rental chain of violating New Jersey's Consumer Fraud Act, N.J.S.A. 56:8-1, *et seq.*, and related regulations, by failing to disclose key terms of the policy. The complaint alleged that Blockbuster's ads were fraudulent and deceptive because they failed to: (i) disclose that overdue rentals are automatically converted to a "sale" a week after the due date and that if customers return the items within thirty days after the "sale" date, Blockbuster will charge a restocking fee; and (ii) prominently disclose that some Blockbuster stores were not participating in the policy and therefore were continuing to charge late fees. According to the New Jersey Attorney General, the ads led "people to believe that an overdue rental will cost them absolutely nothing when, in fact, customers were being ambushed" with the additional charges.

The other 49 states and the District of Columbia soon followed New Jersey and challenged Blockbuster, and settlement quickly followed with all but three states. New Jersey, Vermont and New Hampshire did not participate in the settlement.◆

SIMON PROPERTY GROUP AGREES TO ABIDE BY GIFT CARD LAW

Earlier this year, Simon Property Group Inc.—the nation's largest shopping mall owner—settled charges that its gift card practices violated New York General Business Law § 396-i, which took effect on October 18, 2004 and regulates the terms of gift cards sold after that date. Simon sells co-branded, bank-issued gift cards that are redeemable at any Simon Mall and anywhere that Visa Debit Cards are accepted.

The New York statute proscribes gift card service fees until after a year of inactivity and requires that the card's terms be conspicuously disclosed. The statutory remedies for violation include injunctive relief and a civil fine of up to $1,000 per violation. Gift cards issued without consideration as part of awards, rewards, loyalty or promotional programs, or those sold at a discount to nonprofit organizations for fundraising, are exempted from coverage.

Since introducing its nationwide gift card program in 2003, Simon sold some 6.3 million gift cards in the aggregate amount of more than $400 million as of March 2005.

In February of this year, New York Attorney General Eliot Spitzer sued Simon in state court in Manhattan for charging (i) a monthly $2.50 "administrative fee" on gift cards that have not been used or have a cash balance starting six months after purchase; (ii) a $5.00 fee to replace lost or stolen cards; and (iii) a $7.50 fee to reissue expired cards. Simon responded that these practices were not governed by state law because its gift cards are issued by Bank of America, a federally chartered bank.

The following month, Simon settled the lawsuit. Under the settlement Simon will: (i) not charge a service fee on any gift card sold in New York after October 18, 2004 until after a year of dormancy; (ii) disclose on the card itself the $5.00 replacement fee for lost or stolen cards and the $7.50 reissuance fee for expired cards; and (iii) pay the State $100,000 in penalties and $25,000 in costs.

Simon continues to battle other gift card lawsuits brought by the Attorneys General of Massachusetts, New Hampshire, and Connecticut. Additionally, Simon is a defendant in three class action lawsuits relating to its gift card program.

As gift cards increase in popularity and policies vary greatly as to expiration, dormancy fees and other service charges, twenty-one states have enacted laws governing gift card sales and all of the remaining states have bills pending. In addition, Congress is considering legislation. In January 2005, Representative Rodney Frelinghuysen (R-N.J.) introduced the Gift Card Protection Act, H.R. 85, which would require the FTC to issue regulations declaring expiration dates, dormancy fees, and other service charges to be "unfair" or "deceptive." This bill, which was referred to the Subcommittee on Commerce, Trade and Consumer Protection in February, would not preempt state laws and would create another level of regulation.◆

RECENT LANHAM ACT DECISIONS ON PRELIMINARY INJUNCTIONS

Tenth Circuit holds "Compare the Ingredients" Advertising does not Constitute a Representation that the Compared Products have the Same Ingredients in the same Amounts and Denies Preliminary Injunction

Anyone who has ever shopped in a drug store has seen a "Compare to the Ingredients of ____________" advertisement that compares a generic or low-priced product to a more expensive brand. In a recent unpublished decision, *Zoller Laboratories, LLC v. NBTY, Inc*., 111 Fed. Appx. 978 (10th Cir. 2004), the Tenth Circuit addressed the question whether a "Compare the Ingredients" statement on a product's label and advertising constitutes false advertising in violation of the Lanham Act when the compared products are similar but not identical. The district court denied a preliminary injunction because the "compare to" statement could reasonably be interpreted to have multiple meanings, at least some of which were true, and the Tenth Circuit held that this factual determination was not clearly erroneous and affirmed.

Zoller Laboratories, which markets a weight-loss dietary supplement called Zantrex TM-3, sued NBTY, Inc. and Nature's Bounty, Inc., which markets a lower-cost competing product Xtreme Lean TM ZN-3 ("ZN-3"). The ZN-3 label and advertising include the statements, "Compare to the Ingredients of Zantrex-3" and "Compare and Save!"

The Tenth Circuit found that a comparison of the products' labels indicates "some similarities," that is, "the same principal ingredients," but also differences in the amounts of some "active ingredients," and the presence of dissimilar "other ingredients." The extent of the differences was unclear because both products contain undisclosed "proprietary blends of ingredients."

The Lanham Act prohibits the false or misleading description or representation of fact in advertising concerning "the nature, characteristics, qualities or geographic origin" of the advertiser's or someone else's "goods, services or commercial activities." 15 U.S.C.A. § 1125(a)(1)(B). Thus, to succeed on a false advertising claim under the Lanham Act, a plaintiff must establish: (i) the defendant made a false or misleading description or representation of fact concerning its own or another's product; (ii) the misrepresentation is material, that is, is likely to influence the purchasing decision; (iii) the misrepresentation actually deceives or has the tendency to deceive a substantial segment of its audience; (iv) the defendant placed the false or misleading statement in interstate commerce; and (v) the plaintiff has been, or is likely to be injured due to the misrepresentation, either by a direct diversion of sales or by a diminution of goodwill associated with the plaintiff's products.

To establish falsity under this test, the plaintiff may show that the defendant's statement was: (i) literally false, either on its face or by necessary implication; or (ii) not literally false, but likely to be mislead or confuse consumers. Zoller adduced no extrinsic evidence of the effect on consumers of the "Compare the Ingredients" statement, so its claim was limited to one that the statement was literally false.

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Literal falsity can be based upon explicit claims in an advertisement or claims conveyed by "necessary implication," that is when the audience, considering the advertisement in its entirety, would recognize the claim as if it had been explicitly stated. Literal falsity by necessary implication will be found only when the false message is unambiguous, that is, will necessarily and unavoidably be received by the consumer from the advertisement. This generally excludes "attenuated" or "merely suggestive" claims.

Thus, the plaintiff's claim was that any consumer seeing the "Compare to the Ingredients" statement would conclude that the two products contain identical ingredients in identical amounts and that the statement was therefore, necessarily false.

The district court found that consumers comparing the two labels would see "nearly identical" ingredients in each product's "proprietary blend," and also see the products were not precisely the same because the amounts of only two principal ingredients were disclosed and those amounts differed, the products contained different "other ingredients," and the recommended dosages differed. The district court further found that while the "Compare to the Ingredients" statement would reasonably be interpreted as meaning the products were similar, the statement could also be no more than an invitation to compare the ingredients. Accordingly, the district court found that: (i) a consumer would not necessarily and unavoidably conclude from the statement that the products were identical; (ii) the doctrine of literal falsity by necessary implication was therefore inapplicable; and (iii) the plaintiff had failed to show likelihood of success on the merits. Accordingly, the court denied the plaintiff's motion for a preliminary injunction.

On appeal, the Tenth Circuit affirmed on the ground that under well-established law a "literally false by necessary implication" claim must fail if the advertisement is ambiguous and can reasonably be understood as conveying different messages including one that is true.

The Tenth Circuit was not troubled that consumers could not always make side-by-side comparisons because the two products were not always sold in the same stores. Nor was the court troubled that advertising also contained the text "Compare and Save!" The "Compare the Ingredients" statement could still be reasonably read as informing consumers that the products were similar rather than identical or simply inviting a comparison, and the district court therefore, did not clearly err in this finding of fact.

Schick Shows Likelihood of Success in Proving that Gillette's Advertisements for its M3 Power Razor Make False Claims and Obtains Preliminary Injunction

On May 11 of this year, the U.S. District Court for the District of Connecticut granted Schick Manufacturing, Inc. a preliminary injunction enjoining The Gillette Company from making certain claims in advertisements for its M3 Power razor system. The men's razor systems and blade market in the United States is worth approximately $1.1 billion per year. Gillette holds approximately 90% of the dollar share of that market, while Schick holds approximately 10%. The parties are engaged in head-to-head competition, and growth in the razor systems market results not from volume

increases but from the introduction of new, high- priced, premium items.

Gillette launched the M3 Power in the United States on May 24, 2004 and began advertising the product on May 17, 2004. The market share of the M3 Power in December 2004 was 42% of total dollar sales.

Schick had launched its new Quattro razor system in September of 2003 and expended many millions of dollars in marketing the product. Although Schick had projected $100 million in annual sales for the Quattro, its actual sales fell short by approximately $20 million. During the period May through December 2004, Quattro's market share fell from 21% of dollar sales to 13.9%.

The original advertising for the M3 Power centered on the claim that to enable a closer shave, battery propelled "micropulses raise hair up and away from skin," and television ads included an animation in which the hairs extended in length and changed angle to a more vertical position.

In November 2004, Schick successfully sued Gillette in Germany and obtained an order enjoining it from making claims that the M3 Power raised hairs, and a German appellate court affirmed. In January 2005, based on the outcome of the German litigation and discussions between the parties, Gillette revised its animation so that the hairs no longer changed direction. It also changed the voice-over from "raise[s] hair up and away from the skin" to "raise[s] the hair."

In moving for the preliminary injunction, Schick argued that the advertising was false in three ways: (i) it asserted that the razor changes the angle of beard hairs; (2) it asserted that the razor raises or extends the beard hairs; and (3) the revised animation in the television ads depicted a false amount of extension, to several times the original length.

After a four day hearing, Gillette conceded that the M3 Power's "micropulses" do not cause hair to change angle on the face. Gillette also conceded that the animated depiction of the hair extension effect was "somewhat exaggerated," but argued that such exaggeration does not constitute falsity. The court found that the animation was not even a reasonable approximation and stated, "a defendant cannot argue that a television animation is 'approximately' correct."

As to the claim of hair extension generally, the court stated, in what is the most interesting part of the decision, "putting forth credible evidence that there is no known biological mechanism to support Gillette's contention that the M3 Power raises hairs is insufficient to meet Schick's burden. Such evidence is not affirmative evidence of falsity. Further *while Schick successfully attacked Gillette's testing, that attack did not result in evidence of falsity.* Unlike in [*McNeil – P.C.C., Inc. v. Bristol – Myers Squibb Co.*, 938 F.2d 1544 (2d Cir. 1991], here Gillette's own tests do not provide hair extension does not occur. *Schick merely proved that Gillette's testing is inadequate to prove it does occur.* (emphasis added)" *[Editor's Note:* Compare this to the standard under Section 5 of the FTC Act where a claim can be deceptive, even if true, where the advertiser did not possess prior substantiation at the time the claim was disseminated.] The court did go on to state, however, that while it could not make a finding of literal falsity with respect to the hair

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extension claim at this stage, it did have "doubts" about that claim.

On the Lanham Act elements of actual deception, materiality, injury, and interstate commerce, the court made the following findings, respectively: 1) Schick did not need to prove actual deception with respect to the claims regarding angle change and magnitude of extension, since those claims were found to be "literally false" as opposed to not literally false but "likely to deceive;" 2) the claims were material based on testimony by Gillette's own employees that TV advertising time is too valuable to include unimportant things and aims to provide consumers a "reason to believe;" 3) injury would be presumed based on the ad's literal falsity, the fact that the parties are head-to-head competitors, and recent declines in the sale of Schick's Quatro system; and 4) interstate commerce was not disputed.

The court also found that Schick had proven irreparable harm based on the decline in sales of Quattro, the fact that the parties were head-to-head competitors, and the difficulty of determining what percentage of lost sales was attributable to the false advertising. The court rejected Gillette's argument that the nine month delay between the initial airing of the advertisement and the filing of the suit demonstrated an absence of irreparable harm, since Schick had spent most of this time constructing and conducting its own tests on the MP Power, which it initiated immediately upon the launch of the MP3 Power.

Schick was required to post a $200,000 preliminary injunction bond.◆

FEDERAL DISTRICT COURT DISMISSES DECEPTIVE PRACTICES AND FALSE ADVERTISING CLAIMS AGAINST DE BEERS

State law claims of deceptive practices and false advertising leveled against certain divisions and senior officers of De Beers Group, the world-wide diamond supplier, in a class action complaint, were dismissed by a Federal district court in New York. *See Leider v. Ralfe*, 01 CV 3137, 2005 WL 152025 (S.D.N.Y. Jan. 25, 2005). The court rejected a magistrate judge's recommendation to grant class certification of a damages claim filed under the deceptive practices provision of New York General Business Law §349 on the ground that the challenged conduct was public knowledge and not hidden from consumers. The court also affirmed the magistrate judge's recommendation that a class could not be certified on the false advertising claim under §350 of the New York General Business Law because the plaintiffs failed to allege that they relied on any of the advertisements.

In April 2001, the plaintiffs filed a class action complaint on behalf of all purchasers of diamonds and diamond jewelry who reside in New York City against certain divisions and officers of the De Beers Group for alleged: (i) monopolistic and other anticompetitive practices under federal and state antitrust law; (ii) tariff violations; (iii) fraud; (iv) false advertising in violation of federal common law and the Lanham Act; and (v) state deceptive practices and false advertising as described above. In their complaint, the plaintiffs alleged that from 1995 to 2001, De Beers entered into collusive and anticompetitive agreements with other diamond suppliers which violated the antitrust laws by restricting the production of synthetic diamonds and causing already-mined diamonds to be stockpiled and kept off the market, with the effect of artificially depleting the supply and increasing the prices of diamonds in the United States. Plaintiffs further alleged that during that same period, De Beers engaged in an extensive marketing campaign which was – as most campaigns are – engineered to boost demand. According to plaintiffs, De Beers' anticompetitive behavior

polluted the marketplace and its advertisements distorted the public perception of diamonds, *i.e.*, "while De Beers touted diamonds as precious, rare, and symbolic of love, they are commonplace and are obtained as a result of slave labor and torture."

De Beers Centenary defaulted and a judgment was entered against it on August 16, 2001. On January 15, 2003, the court entered default judgments against the remaining defendants and referred to the magistrate judge the plaintiffs' motions for class certification and damages. The magistrate judge recommended that the motions be denied. The court adopted part of the magistrate judge's recommendation and dismissed the monetary damages claims under the antitrust and tariff laws. However, the court permitted class certification for injunctive relief under the federal antitrust and tariff claims and remanded the remainder of the class certification motions back to the magistrate judge who then issued the subsequent report recommending certification under General Business Law §349 but not under §350.

The court began its analysis by addressing the required elements to state claims under §§349 and 350. To state a claim under either §349 or §350, a plaintiff "must show (1) that the act, practice or advertisement was consumer-oriented; (2) that the act, practice or advertisement was misleading in a material respect; and (3) that the plaintiff was injured as a result of the act, practice or advertisement." A §350 claim requires the additional element that the plaintiff in fact relied on the alleged false advertising.

The defendants argued that neither claim should be certified because: (i) there was no allegation that the conduct occurred in New York; (ii) the plaintiffs did not allege deceptive conduct; rather they alleged anticompetitive conduct which could be redressed by other laws; (iii) De Beers' advertisements were not false; (iv) the plaintiffs did not satisfy the requirement under §350 of alleging the plaintiffs' reliance on the advertisements; and (v) even if the claims were sufficient, individual issues and claims would so predominate that certification should be denied.

In ruling on the motion, the court found that the plaintiffs had alleged conduct with a sufficient nexus to New York State since the agreements and advertisements were created within the Southern District of New York, De Beers maintained a 1-800 phone number in the Southern District and plaintiffs purchased diamonds and suffered damages in New York City. However, the court upheld the second objection to certifying a class under General Business Law §349, *i.e.*, that the plaintiffs failed to allege the requisite "deceptive conduct." Judge Baer stated that a §349 claim based on alleged anticompetitive conduct could not be sustained unless the allegations are "imbued with a degree of subterfuge that I find lacking in this case" and found that no matter how reprehensible the alleged conduct, there was no deception since "De Beers' monopolistic practices were public knowledge."

With respect to the §350 false advertising claim, Judge Baer affirmed the magistrate judge's recommendation that the plaintiffs had failed to satisfy the required element that they had relied on De Beers' advertisements. According to the court, since the defendants did not control all information about diamonds, the plaintiffs had an opportunity to learn the truth about De Beers' diamonds. [Editor's Note: Was not the court confusing the requirement of reliance in fact under GBL §350 with the reasonable reliance requirement under common law fraud?] In any event, the court also found that there was no evidence that the plaintiffs purchased diamonds as a result of De Beers' advertisements or that all of the plaintiffs even saw the advertisements. The court would not allow the plaintiffs to show alleged reliance through a survey of class members, finding a survey to be "unwieldy."

Since the court was able to dispose of the state claims on legal grounds, the court did not reach the certification issue. The court did note, however, that there were "significant barriers to class certification," including the lack of any feasible method for computing damages.◆

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KAUFMANN'S SETTLES NEW YORK ATTORNEY GENERAL INVESTIGATION INTO FICTITIOUS REFERENCE PRICES

Earlier this year, Kaufmann's, a division of The May Department Stores Company, entered into an Assurance of Discontinuance with the New York Attorney General to resolve an investigation into its advertising and retail sales practices in New York.

After a fifteen month investigation of Kaufmann's advertisements and sales promotions, the Attorney General concluded that sales advertised by Kaufmann's in newspapers, on television and over the radio were not, in fact, sales. Specifically the Attorney General alleged that because Kaufmann's merchandise is almost always "on sale," the so-called "sale price" is in fact Kaufmann's regular price. For example, according to the Attorney General, during a twenty-eight week period, Kaufmann's offered a KitchenAid mixer for a "sale price" of $169.99 discounted from a "regular price" of $219.99. Similarly, for an eight month period, each of 1,805 sales of a "George Forman" outdoor grill, 1,056 sales of a Peugeot watch and 568 sales of a Cuisinart coffeemaker were made at a "sale price." None of these three items were sold at the "regular price" during this period.

In its settlement with the Attorney General, Kaufmann's agreed not to advertise or sell any item at a sale or discount from a regular price unless the item had been offered at that price for a reasonably substantial period of time. The agreement provides for Kaufmann's to pay investigative costs and civil penalties of $400,000.

This is clearly an area of interest to the Attorney General. In 2004, Jos. A. Bank Clothiers, Inc. entered into a similar Assurance of Discontinuance and paid investigative costs and civil penalties of $475,000 to settle claims that it misrepresented regular prices as sale prices. In 2002, The Bon-Ton Department Stores paid investigative costs and civil penalties of $100,000 to settle claims that it misrepresented regular prices as sale prices. ◆

SLEEPY'S PAYS $750,000 TO SETTLE DECEPTIVE PRACTICES CHARGES BY NEW JERSEY ATTORNEY GENERAL

In December 2004, Sleepy's, one of the largest mattress retail chains in the Northeast, agreed to pay $750,000 and alter its business practices to settle a suit brought by the New Jersey Attorney General. After several years of receiving complaints from Sleepy's customers about defective merchandise, refunds, and misleading advertising, the state filed suit alleging numerous violations of various New Jersey consumer protection laws. Among the remedial measures included in the settlement, Sleepy's agreed:

- To specify the duration of its sales in its advertising;
- When advertising its offer to "beat anyone's price by 20% or it's free," to indicate to consumers by way of example in a footnote the type of proof of a competitor's price necessary to take advantage of the offer;
- To offer refunds to customers who received defective merchandise and

refrain from telling customers that its policy was "no refunds;"

- To refrain from advertising that its sale prices were "The Lowest Prices in our History" or "Our Lowest Prices Ever Guaranteed," when this was, in fact, not true;

- To refrain from using the term "coupon sale" or depict "coupons" which state "save an extra $400," for example, when the coupons cannot be used for additional savings on Sleepy's price, but were actually meant to imply a comparison with an unidentified competitor.

Of the settlement amount, $90,000 will be set aside for restitution to New Jersey consumers who complained about Sleepy's practices. ◆

FTC'S CAN-SPAM RULE ESTABLISHING THE "PRIMARY PURPOSE" OF COMMERCIAL EMAILS TAKES EFFECT

On March 28 of this year, the Federal Trade Commission's Final Rule, 16 C.F.R. Part 316.3, defining the criteria to determine the "primary purpose" of an email message under the Controlling the Assault of Non-Solicited Pornography and Marketing Act, the CAN-SPAM Act, 15 U.S.C. §§ 7701-13, took effect. The term "primary purpose" is contained in the Act's definition of a "commercial electronic mail message," which encompasses "any electronic mail message the primary purpose of which is the commercial advertisement or promotion of a commercial product or service (including content on an Internet website operated for a commercial purpose)."

The FTC distinguishes between emails that are primarily "commercial" in purpose and those that have a primarily "transactional or relationship" purpose. Under the CAN-SPAM Act, commercial content is defined as the "commercial advertisement or promotion of a commercial product or service." By contrast, "transactional or relationship" content is that which (i) facilitates, confirms or completes a transaction; (ii) provides information about a change in services, warranties, or other options; (iii) provides account information or information about a subscription, membership, or other relationship involving an ongoing purchase or use of goods or services; (iv) provides information directly related to an employment relationship or related benefit plan in which the recipient is currently involved or enrolled; or (v) delivers goods or services, including upgrades and updates, that the recipient has already agreed to receive under a previous transaction or relationship. This distinction between "commercial" email messages and "transaction or relationship" email messages is important because only commercial email messages must comply with all the requirements of the CAN-SPAM Act. "Transactional or relationship" email messages may not contain false or misleading routing information, but are otherwise exempt from most other provisions of the Act.

Under the FTC's Final Rule, all email messages containing commercial content are divided into categories based on whether they are single-purpose emails with only commercial content or with only "transactional or

relationship" content, or dual-purpose emails containing commercial and non-commercial content. The entire email message, including the subject line and body of the email, must be analyzed to determine the "primary purpose" of the message. The FTC has provided the following criteria for determining the "primary purpose" of an email message:

- If an email message contains only commercial content, its primary purpose is obviously commercial.
- If an email message contains only transactional or relationship content, its primary purpose is obviously transactional or relationship.
- If an email message contains both commercial content and transactional or relationship content, it is deemed primarily commercial if either (i) a recipient reasonably interpreting the subject line of the email likely would conclude that the message contains commercial content; or (ii) the email's transactional or relationship content does not appear in whole or substantial part at the outset of the body of the message.
- If an email message contains both commercial and non-commercial content, it is deemed primarily commercial if either (i) a recipient reasonably interpreting the subject line of the message likely would conclude that the message contains commercial content; or (ii) a recipient reasonably interpreting the body of the message likely would conclude that the primary purpose of the message is commercial.

  Relevant factors for interpreting the body of the email include whether the commercial content is in whole or in part at the beginning of the message; the proportion of the message dedicated to commercial content; and the manner in which color, graphics, and type style and size are used to highlight the message's commercial content.

Email messages that are primarily commercial must contain: (i) a clear and conspicuous identification that the message is an advertisement or solicitation; (ii) a "clear and conspicuous notice of the opportunity" to opt-out; (iii) a functioning opt-out mechanism (i.e., a return email address or other Internet-based mechanism); and (iv) a valid physical postal address of the sender. ◆

INTERNET MARKETER SUED FOR SECRETLY INSTALLING SPYWARE ON CONSUMERS' COMPUTERS

New York Attorney General Eliot Spitzer recently sued Intermix Media, Inc., a California-based Internet marketing company, alleging deceptive trade practices, false advertising and trespasses based on the company's surreptitious installation of spyware on the computers of millions of unsuspecting New York consumers. Spyware delivers "pop-up" advertising, installs toolbars on users' Internet browsers with links to advertisers' websites, redirects website requests and creates other nuisances.

The complaint alleges that Intermix Media was able to install its spyware by offering free software, such as screensavers and games, through its more than forty Web sites. When a consumer downloaded a screensaver or a game, the spyware secretly bundled with the free screensaver or game would also be installed on the consumer's computer. The consumer was given little or no notice of the hidden spyware, and when notice was given, it was hidden in lengthy license agreements.

The complaint also alleges that Intermix Media's spyware was designed to avoid detection and removal by installing these programs in uncommon directories, failing to include its own "uninstall" utility, and preventing the programs from appearing in the "Add/Remove Programs" utility in Microsoft Windows, the most common method of computer program removal. To make matters worse, even if the consumer deleted some of the spyware, unless the consumer also located and deleted the spyware updater program, that program would reinstall the previously deleted spyware.

The Attorney General seeks an injunction enjoining Intermix Media from installing these spyware or similar programs on any consumer's computer, an order directing Intermix to provide the Attorney General with records of all installations of spyware on consumers' computers, an accounting of all revenues generated from the distribution of the spyware, civil penalties in the amount of $500 per unlawful practice, and $2,000 in costs. ◆

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MACY'S SETTLES RACIAL PROFILING COMPLAINT

Macy's East, Inc., which operates the 29 Macy's Stores in New York State, has agreed to pay the State $600,000 and revise its store security policies and practices to settle an action brought by the New York Attorney General. The lawsuit alleged that Macy's targeted African Americans and Latinos as suspected shoplifters and unlawfully handcuffed shoppers detained on suspicion of shoplifting.

The Attorney General began investigating Macy's security practices in July 2003, after receiving complaints from African American and Latino shoppers who said they were followed, questioned, and searched based on their race or ethnicity. The Attorney General investigated five stores and found that most of the people detained were African American or Latino. The investigation concluded that neither customer demographics nor local crime rates could explain this.

The investigation also found unlawful Macy's policies and practices with respect to handcuffing detainees. While Macy's official policy was to handcuff detainees only after first determining dangerousness, in a number of New York City stores almost everyone was handcuffed. In one upstate store, Latinos were about five more times likely and African Americans about three times more likely to be handcuffed than white detainees.

In addition to the $600,000 payment, the settlement also requires Macy's to implement a number of internal reforms, including:

- Appointing an internal security monitor to train store security employees and personnel, and to monitor and investigate security related complaints;
- Training security employees and sales associates more extensively on avoiding discrimination when detecting and preventing shoplifting;
- Hiring an outside auditor to assess whether employees treat shoppers differently based on race or ethnicity; and
- Permitting handcuffing of detainees based only upon an individualized assessment of danger.

The settlement affects only the Macy's stores in New York State, but the company may implement the changes nationwide. The New York State Attorney General has urged other department stores to reevaluate their own security policies and practices to ensure that shoppers are not targeted based on race or ethnicity.◆

PAYDAY LOANS DISGUISED AS CATALOG SALES FOUND TO BE ILLEGAL

In a suit brought by New York Attorney General Eliot Spitzer, a New York court found earlier this year that the lending practices of a company providing "payday loans" constituted illegal loansharking. JAG NY LLC, doing business as N.Y. Catalog Sales, offered loans of up to $500 and engaged in a scheme by which bogus sales of catalog merchandise and gift certificates were used to disguise the usurious interest rates charged. The court enjoined the company from making such loans, declared null and void any outstanding loans with an interest rate exceeding the 16% limit in New York, and ordered restitution to consumers. The company operated three stores in upstate New York, two of which were just outside the U.S. Army base at Fort Drum.

A payday loan is a small-dollar, short-term unsecured loan that the borrower promises to re-pay from of his or her next paycheck. Upon receipt of the loan proceeds, the borrower gives the lender a postdated check for the amount of the loan plus the interest, and the lender agrees not to deposit the check until the borrower's next payday. The lender does not usually check the borrower's credit, requiring only proof of a checking account and a regular income. If the borrower cannot re-pay the loan on the next payday, the lender will often extend the loan for an additional "rollover" fee.

N.Y. Catalog Sales required that for every $50 borrowed, the consumer had to purchase $15 in gift certificates or merchandise from the store's catalog. However, the gift certificates often went unused, and the merchandise was overpriced trinkets and other items commonly available elsewhere at much lower prices. Thus, the Attorney General alleged and the court agreed, that the charges for these purchases were actually disguised interest charges.

A referee will review each loan and award restitution to the borrowers in the amount of interest in excess of 16% annualized. The company's owner, John Gill, who has been under investigation for what are believed to be similar practices in several other states, was also held personally liable.

Payday lenders are often found near military bases and have become an especially acute problem for the families of military personnel deployed overseas. As a result, payday lending has come under scrutiny in a number of states. In 2004, Georgia enacted a law capping the interest rate on consumer loans of $3000 or less at 16%. ◆

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COURT APPROVES ABERCROMBIE & FITCH SETTLEMENT OF FEDERAL EMPLOYMENT DISCRIMINATION CLASS ACTION

A federal judge in the Northern District of California recently approved a settlement of three consolidated employment discrimination class actions against Abercrombie & Fitch. Hispanic and Asian groups and the NAACP brought the first lawsuit in June 2003. The plaintiffs' class action complaint alleged Abercrombie & Fitch's employment policies disproportionately favored whites and denied Latinos, Asian Americans, and African Americans job opportunities. In November 2004, the Equal Employment Opportunity Commission filed its own class action discrimination lawsuit asserting claims similar to the pilot class action and adding a claim of gender discrimination. In February 2004, a private gender discrimination class action was filed against Abercrombie.

The settlement, which contains no admission of wrongdoing, requires Abercrombie to implement a consent decree designed to promote diversity and prevent discrimination. The consent decree enjoins Abercrombie from discriminating against African Americans, Asian Americans, Latinos and women and requires Abercrombie to make the same employment opportunities available to minority and female employees and applicants. Furthermore, Abercrombie must maintain non-discrimination and non-harassment policies and an internal complaint procedure designed to assure equal employment opportunity.

Abercrombie will establish a $40 million settlement fund for awards to class members. And Abercrombie will pay $7.85 million in attorneys' fees, costs and expenses, and for implementing the settlement.

The consent decree will be in effect for six years. During that time, Abercrombie must provide training on equal employment opportunity and compliance with the provisions of the decree. Abercrombie will also create an Office of Diversity and hire a Diversity Vice President to ensure compliance.

The consent decree requires Abercrombie to create and implement a Protocol to recruit and hire job applicants for all hourly in-store positions and the Manager-In-Training position. The Protocol must require that Abercrombie affirmatively seek out applications from qualified African Americans, Asian American, and Latinos of both genders. Abercrombie's recruitment and operations materials must reflect diversity. If the parties to the settlement cannot agree on the Protocol, the dispute will be submitted to an appointed special master, whose determination is final and not subject to appeal. In addition to the Protocol, Abercrombie's advertisement and recruitment efforts must specifically target African Americans, Asian Americans, and Latinos of both genders.

The consent decree sets hiring benchmarks that establish selection rates of African Americans, Latinos, Asian Americans and women. The benchmarks do not establish maximum or minimum rates. The consent decree also requires Abercrombie to use best efforts to promote African Americans, Latinos, Asian Americans and women at set rates. ◆

FEDERATED, MAY COMPANY, LENOX, AND WATERFORD WEDGWOOD PAY $2.9 MILLION IN CIVIL PENALTIES TO SETTLE CHARGES OF BOYCOTTING OF BED, BATH & BEYOND

In July 2004, New York Attorney General Eliott Spitzer entered into Assurances of Discontinuance with Federated Department Stores, Inc., The May Department Stores, Inc., Lenox, Inc., and Waterford Wedgwood U.S.A., Inc., to settle allegations that since May 2001, the companies conspired among themselves to restrain the sale of tabletop products, such as china, crystal stemware, glassware, flatware and giftware, to Bed, Bath & Beyond, which had planned to introduce a tabletop department in its stores. The Attorney General alleged that as a result of this conspiracy, Bed, Bath and Beyond dropped its plans to offer tabletop products.

The Attorney General's investigation began in January 2002. Under the Assurances, the companies agreed to cease any acts respecting tabletop products in violation of the state's antitrust law, the Donnelly Act, and they also agreed to cooperate in any further investigations or proceedings concerning anticompetitive conduct, to allow the Attorney General to inspect the companies' records concerning compliance with the Assurances and to interview the companies' employees concerning compliance, to report promptly upon learning about any acts prohibited under the Assurances, and to annually certify the completeness of such reports.

The Assurances provide for a total of $2.9 million in penalties, with Federated to pay $900,000; May Company to pay $800,000; Lenox to pay $700,000; and Waterford to pay $500,000.

In January 2005, the Attorney General obtained an indictment of James Zimmerman, the former Chairman and CEO of Federated, for perjury. According to the indictment, Zimmerman repeatedly falsely testified under oath that he had never discussed Bed Bath & Beyond with anyone at Waterford. Zimmerman has entered a plea of not guilty.◆

SHARPER IMAGE SETTLES PRODUCT DISPARAGEMENT SUIT

In February of this year, the Sharper Image agreed to pay $525,000 in attorney's fees, settling a product disparagement suit it had brought against the Consumers Union, publisher of the magazine *Consumer Reports*. The suit related to the high-end gadget retailer's popular Ionic Breeze Quadra Air Purifier and was filed in 2003 in the Northern District of California after *Consumer Reports* ran two articles reporting that the air purifiers did not effectively remove unwanted particles from the air. In November 2004, the complaint was dismissed, with the court finding that "Sharper Image [had] not demonstrated a reasonable probability that any of the challenged statements were false." Soon after appealing to the Ninth Circuit, Sharper Image agreed to settle the action.

Sharper Image agreed to pay Consumer Union's attorney's fees because the law suit had been dismissed pursuant to California's Anti-

SLAPP (strategic lawsuit against public participation) law. Sharper Image, a San Francisco based chain, filed the suit in federal court but because it was a California federal court, Sharper Image exposed itself to the provisions of the California Anti-SLAPP law. The law is aimed at protecting defendants who have been sued while exercising their First Amendment free speech rights relating to an issue of public concern. A defendant may make a special motion to strike the complaint, as Consumers Union successfully did, which will be granted unless the plaintiff establishes a reasonable probability that the plaintiff will prevail. The California Civil Code provides that a prevailing defendant on an Anti-SLAPP special motion to strike is entitled to recover its attorney's fees.

The case arose out of two articles *Consumer Reports* published in 2002 and 2003 comparing the features and efficacy of various air purifiers on the market. The first article ranked the Sharper Image Ionic Breeze last out of 16 models tested, and the later article ranked the Sharper Image model next to last out of 18 models tested. Sharper Image claimed that the measure of air cleaner performance used by Consumers Union was inapplicable to the Ionic Breeze, a contention the court rejected. The court held that Consumers Union had in fact applied a standard measurement used for all air cleaners and had assessed criteria that experts agreed should be assessed in determining "effectiveness," such as how quickly the device removed dust and other particles.

This April, soon after the case was settled, *Consumer Reports* published a third article, this one reporting that the Ionic Breeze and other ionizing air cleaners were not only ineffective but actually emitted ozone, a potentially harmful irritant. Indoor ozone can aggravate asthma, raise sensitivity to allergens, and cause lung damage—the very problems many purchasers of air purifiers are seeking to avoid or alleviate.

Indoor air purifiers are not regulated by the Environmental Protection Agency, which only regulates outdoor air. Nor are the purifiers considered medical devices by the Food and Drug Administration. Despite the negative publicity, the Ionic Breeze has at least until now remained a strong seller for Sharper Image, and the company reports that its customers are generally very satisfied with the product. ◆

THE NEW BANKRUPTCY CODE: A LONG AWAITED EVENT FOR RETAILERS

The recently-enacted Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 contains the most significant changes to federal bankruptcy law since the enactment of the Bankruptcy Code in 1978. Most of these changes will take effect on October 17, 2005.

The Act will lower the exposure of retailers who offer store credit or credit cards by tightening the standards for filing personal bankruptcy under Chapter 7. Debtors will now be required to pass a "means test" to qualify for Chapter 7 and the ultimate goal for debtors: the bankruptcy discharge. Under the means test, debtors will have to demonstrate that their

income is below the state's median and that they cannot afford to pay at least $100 per month toward their unsecured debt after necessary expenses. The United States Bankruptcy Trustee or any creditor can seek dismissal of an individual debtor's Chapter 7 case, or with the debtor's consent, conversion to a Chapter 11 or 13 case (which would lead to a repayment plan), based on a showing that the debtor did not satisfy the means test.

The changes to Chapter 13 cases toughen the repayment rules. Individual debtors whose income is above the state median will be required to repay their creditors over a longer period—five years instead of three—and develop a household budget using Internal Revenue Service expense standards.

The Act also addresses "serial filings" by limiting the number of times personal bankruptcy relief will be available within a specified period and limiting the duration of automatic stay in multiple filings. Specifically, debtors must wait eight (rather than six) years following a discharge to file a new Chapter 7 petition. A discharge will not be granted to a Chapter 13 debtor who previously received a discharge under Chapters 7, 11 or 12 within a four-year period prior to filing the subsequent case (or a two-year period for a prior Chapter 13 case). If an individual debtor's prior case had been dismissed within one year prior to the commencement of the subsequent case, the automatic stay will terminate thirty days after the new case is commenced. While the debtor can preserve the stay by showing "good faith," multiple statutory presumptions must be overcome to do this.

The Act contains additional restrictions. Mandatory creditor counseling and debtor education requires debtors to participate in a credit counseling session within 180 days of filing. Release is not allowed until debtors complete a personal financial management course. And limits are placed on state law homestead exemptions.

In the ten years preceding this new legislation, the number of personal bankruptcy filings doubled.◆

CLASS ACTION FAIRNESS ACT OF 2005 SHIFTS MOST CONSUMER CLASS ACTIONS TO FEDERAL COURT

The Class Action Fairness Act of 2005 ("CAFA") was enacted in February 2005, and governs all actions commenced on or after February 18, 2005. The CAFA makes two main changes in federal class action law: (1) when a settlement agreement provides that the class be awarded coupons, the attorney's fee must be based on the value to class members of the coupons actually redeemed by class members, and (2) "minimal" federal diversity jurisdiction exists, so that if any member of a class of plaintiffs is a citizen of a state different from any defendant, the case can be brought in federal court.

Prior to the CAFA, companies would frequently offer coupons redeemable for their products as settlement of a class action. The class attorney would be happy to accept the terms of this settlement, as fees were pegged to the value of the settlement, *i.e.*, the value of the

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coupons issued in the settlement. By providing that the class attorney's fee must be based on the value of the coupons actually *redeemed* by class members, the CAFA effectively reduces the class attorney's fees because many class members never actually redeem their coupons. By making coupon settlements less attractive to class attorneys, the CAFA makes it less likely that coupons will be agreed to as an acceptable settlement currency. This is bad news for companies that favored coupons as an inexpensive way to settle class actions.

In addition, the CAFA creates new "minimal" federal diversity jurisdiction. This makes it easier for class actions to be litigated in federal courts, which are commonly believed to be more hospitable to corporate defendants. Previously, for there to be diversity jurisdiction in a class action, every class member had to be a citizen of a different state from every defendant. This was a difficult test to meet, and it resulted in most class actions being brought in state court. The new "minimal" federal diversity jurisdiction instead provides diversity jurisdiction if *any* member of the class is a citizen of a state different from *any* defendant. Under the CAFA, very few class actions would not qualify for federal diversity jurisdiction.

The CAFA structures class action jurisdiction on a three-tiered basis, depending on how many members of the plaintiff class are citizens of the state in which the action was originally filed.

The first tier consists of cases in which fewer than one-third of the members of the proposed class reside in the state where the action was originally filed. Under these circumstances, the case is subject to the new federal "minimal" diversity jurisdiction. The federal court *must* exercise jurisdiction in such cases.

The second tier consists of cases within the "Home State" exception, a permissive exception under which the district court *may* decline jurisdiction over a class when: (a) between one-third and two-thirds of the members of the proposed class, and (b) the primary defendants, are citizens of the state in which the action was originally filed. The district court uses six statutory factors to determine whether to decline jurisdiction. These factors are geared to ensure that the action relates most closely to the state in which was filed.

The third tier consists of cases within the "Local State" exception, which applies to two types of class actions: (1) those class actions in which (a) more than two-thirds of the members of all proposed plaintiff classes are citizens of the State in which the action was filed, and (b) at least one defendant is a defendant from which "significant relief" is sought, from whose alleged conduct arises a "significant basis" of the class' claims, and who is a citizen of the state in which the action was originally filed; and (c) the "principal injuries" were injured in the State in which the action was originally filed; or (2) more than two-thirds of the members of the proposed class, and the "primary" defendants, are citizens of the State in which the action was originally filed. When this exception is satisfied, the federal court *must* decline jurisdiction.

The Local State exception is very limited. A corporation's citizenship is based on the state of incorporation, and the state where the corporation has its principal place of business. Major corporations are frequently sued in states in which they are neither incorporated nor maintain their principal place of business. In those cases, the Local State Exception is not available to the plaintiffs, and the case must be heard in federal court.

The CAFA also adds a new, specialized removal provision, which makes it easier to remove class actions to federal courts on the basis of "minimal" federal diversity jurisdiction. While the federal removal statute provides that under no circumstances may a case be removed after one year, the CAFA removal provision does not contain such a one-year limitation. Furthermore, actions may be removed by any defendant, without the consent of all defendants. This is a significant change from the general removal procedure, and it will make it easier for corporate defendants to defend against class actions in friendlier federal courts. ◆

AMENDMENTS TO THE UCC: LIABILITY TO "REMOTE PURCHASERS"

The Uniform Commercial Code is the product of a joint committee of the National Conference of Commissioners on Uniform State Laws and the American Law Institute. The joint committee UCC occasionally proposes amendments, which the various states may then consider for enactment.

The 2003 Amendments to the UCC add two new sections, 2-313A and 2-313B, which extend a seller's liability with respect to "remote purchasers." These provisions contemplate at least three parties to a transaction: (i) the seller or original manufacturer of goods; (ii) the "immediate buyer," who is "a buyer that enters into a contract with the seller," and (iii) the "remote purchaser," who is "a person that buys or leases goods from an immediate buyer or other person in the normal chain of distribution." These sections have considerable overlap, but 2-313A is designed to extend liability to sellers when there is a "record packaged with or accompanying the goods," whereas 2-313B is designed to extend liability based on a seller's "communication to the public." *To date, no state has enacted any of the proposed changes to the UCC.*

The Official Comments to 2-313A explain that the section is designed to regulate what are commonly referred to as "pass-through warranties." In the paradigm situation, "a manufacturer will sell goods in a package to a retailer and include in the package a record that sets forth the obligations that the manufacturer is willing to undertake in favor of the ultimate party in the distributive chain, the person that buys or leases the goods from the retailer." Thus, where there is an accompanying record, a seller may incur liability to the remote purchaser based on the representations made in that record. Examples of a "record" include a label affixed to the outside of a container, a card inside a container, or a booklet handed to the remote purchaser at the time of purchase.

The key difference between 2-313A and 2-313B is that the former deals with records included with a packaged good, while the latter extends liability to cover advertisements or other similar communication to the public wherein a seller makes an affirmation of fact or promise that relates to the goods, provides a description that relates to the goods, or makes a remedial promise, and the remote purchaser enters into a transaction of purchase with knowledge of, and with the expectation that the goods will conform to the affirmations, promises or descriptions made. The drafters understood themselves to be following the approach of cases like *Randy Knitwear, Inc. v. American Cyanamid Co.*, 11 N.Y.2d 5, 226 N.Y.S.2d 363 (1962). As the Official Comments

state, "a manufacturer will engage in an advertising campaign directed towards all or part of the market for its product and will make statements that if made to an immediate buyer would amount to an express warranty or remedial promise." Thus, statements made to the public that would amount to an express warranty or remedial promise if made to the immediate buyer will create a similar obligation on the part of the seller to the remote purchaser. However, if the seller's advertisement is made to the immediate buyer and not the public at large, whether the seller incurs any liability will not be controlled by this provision, but rather by 2-313, which controls express warranties.

Three final points. First, the drafters deliberately used the term "remote purchaser" as opposed to "remote buyer" to include a customer who leases an item. Second, the sections apply only to a remote purchaser who purchases an item in the "normal chain of distribution." That term is not defined in the UCC, but the Official Comments to the section provide that "the concept is flexible, and determining whether goods have been sold or leased in the normal chain of distribution requires consideration of the seller's expectations with regard to the manner in which its goods will reach the remote purchaser." Last, both sections state that "it is not necessary to the creation of an obligation under [these two sections] that the seller use formal words such as 'warrant' or 'guarantee' or that the seller have a specific intent to undertake an obligation." However, "an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create an obligation."◆

NEWSBITES

Junk Fax Protection Act of 2005 Signed Into Law

On July 8, 2005, President Bush signed the Junk Fax Protection Act of 2005. The Act was designed to overrule the FCC's amended rules under the Telephone Consumer Protection Act of 1991, scheduled to go into effect on July 1st, which would have required businesses which send advertisements over fax machines to first obtain a written consent from the recipient, thus eliminating the "established business relationship" exception to the ban on unsolicited faxed advertisements. The new Act provides a statutory "established business relationship" exception that allows a business to fax an unsolicited ad if the recipient made a purchase from the business within the preceding 18 months or made an inquiry within the preceding 3 months. To utilize the exception the business must give an opt-out notice and provide a cost-free opt-out mechanism.◆

NEWSBITES (CONTINUED)

Effective June 1st, 2005, the FTC's Disposal Rule Protects the Privacy of Consumer Information

As we reported in the Spring, 2004 issue of the Newsletter (*The Fair Credit Reporting Act is Amended to Take Account of Identity Theft*), Congress amended the Fair Credit Reporting Act via the Fair and Accurate Credit Transactions Act of 2003 ("FACTA" or the "Act") to combat identity theft and other forms of consumer fraud. Section 216 of the Act requires the FTC and other federal agencies to issue regulations governing the disposal of consumer credit information. In November 2004, the FTC issued its final rule (the "Disposal Rule"), codified at 16 C.F.R. § 682, which became effective on June 1, 2005.

The purpose of the Disposal Rule is "to reduce the risk of consumer fraud and related harms, including identity theft, created by improper disposal of consumer information." 16 C.F.R. § 682.2(a). "'Consumer information' means any record about an individual, whether in paper, electronic, or other form, that is a consumer report or is derived from a consumer report. Consumer information also means a compilation of such records. Consumer information does not include information that does not identify individuals, such as aggregate information or blind data." 16 C.F.R. § 682.1(b). "Consumer report" includes any information obtained by a consumer reporting agency that is used, or expected to be used, in determining the consumer's eligibility for credit, insurance, employment, or other purposes. 15 U.S.C. § 1681a(d)(1)(A)-(C). Credit reports, credit scores, information relating to employment background, check writing history, insurance claims, residential or tenant history, and medical history are all examples of information found in consumer reports.

The Disposal Rule applies to anyone under the FTC's jurisdiction who maintains or possesses consumer information for a business purpose. 16 C.F.R. § 682.3(a). Compliance with the Rule requires "taking reasonable measures to protect against unauthorized access to or use of the information in connection with its disposal." Id. These "reasonable measures" include such measures as: (1) burning, pulverizing, or shredding of physical documents; (2) erasure or destruction of all electronic media; and (3) entering into a contract with a third party engaged in the business of information destruction. 16 C.F.R. § 682.3(b)(1)-(3). These examples are intended as "illustrative only and are not exclusive or exhaustive methods for complying with the rule." 16 C.F.R. § 682.3(b). In addition, "reasonable measures" would often require creating disposal policies and procedures, and employee training. 69 Fed. Reg. 68,693. ◆

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