



LEGAL RISKS AND ETHICAL OBLIGATIONS IN SETTING SHIPPING AND HANDLING CHARGES

A Direct Marketing Association Tele-seminar

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Presented By:

George S. Isaacson, Esq.
Matthew P. Schaefer, Esq.
Brann & Isaacson
184 Main Street, PO Box 3070
Lewiston, ME 04243-3070
Phone: (207) 786-3566
Fax: (207) 783-9325
(www.directmarketinglaw.com)

With:

Curt Barry
F. Curtis Barry & Company
(www.fcbarry.com)



THE MONSTER AT THE DOOR . . .

- **The single biggest threat for direct marketers with regard to imposing a separate charge for delivery of products to consumers is exposure to class action lawsuits challenging shipping and handling charges as deceptive and excessive.**
- **Recent case law has supported the plaintiffs' theory that shipping and handling charges levied by a direct marketer is a "pass through" charge, for which a direct marketer is entitled to recover only the actual costs incurred in connection with delivering products to customers.**
- **This presentation will examine the elements of the legal theory which threatens direct marketers with substantial liability and legal expense, discuss several recent class action decisions and settlements, and focus on the best preventative practices and defenses that direct marketers can employ to reduce the risks they face.**
- **Poor practices in establishing and charging for shipping and handling also raise serious ethical and business considerations important to direct marketers. These considerations are heightened in the electronic commerce environment, which presents issues of unique importance with respect to shipping and handling charges.**



THE BIG PICTURE: WHY DIRECT MARKETERS MUST EXERCISE SOUND JUDGMENT IN SETTING SHIPPING AND HANDLING CHARGES

- ***Although Charging Separately for Shipping & Handling is Commonplace, the Practice is Not Risk Free***
- ***The Widespread Consumer Belief That Shipping & Handling Charges Represent A “Pass-Through” Of Actual Costs Is Gaining Acceptance In Recent Court Decisions***
- ***The Stakes Are High -- Poor Practice In Setting and Disclosing Shipping & Handling Charges Can Cost A Direct Marketer Customers and Expose It to Significant Liability and Legal Expense***
- ***It’s Just Good Business – The DMA Recommends that Direct Marketers Establish Fair, Clear and Justifiable Shipping & Handling Charges For the Benefit of Both Consumers and Direct Marketers***




THE HEART OF THE ISSUE: DIRECT MARKETERS AND CONSUMERS OFTEN PERCEIVE SHIPPING AND HANDLING CHARGES DIFFERENTLY

- **No One Questions That There Are Real Costs Associated With Delivering Products To Consumers. However:**
 - The manner in which many direct marketers charge for shipping and handling differs substantially from the way consumers believe such charges should be determined.
 - Over 50% of retailers base their S&H charges on the dollar amount of the order but only 10% of consumers agree that practice is appropriate.
 - Instead, many consumers feel setting charges based on weight is most appropriate
 - In the Internet age, many consumers expect that direct marketers should be able to determine the precise cost of shipping at the time of ordering
 - The frequency of “free” shipping promotions in connection with online shopping sites increases consumer skepticism of S&H charges generally, and hostility toward S&H charges they perceive to be excessive
 - Excessive shipping charges remains the number one complaint of online shoppers and the number one reason consumers abandon an online shopping cart
 - Consumers often perceive S&H charges very negatively (a sampling of consumer complaints online includes “wildly inconsistent,” “bogus”, and even “obscene”)
 - Industry consultants and researchers agree that online sellers who impose inflated shipping and handling charges in order to make a profit can expect to lose customers.



THE HEART OF THE ISSUE: DIRECT MARKETERS AND CONSUMERS PERCEIVE S&H CHARGES DIFFERENTLY (cont.)

- **Most Consumers – And Plaintiffs’ Class Action Attorneys – Understand Shipping And Handling Charges To Be A Pass-Through Of Actual Delivery-related Expenses Incurred by the Direct Marketer. However:**
 - Many direct marketers have no cost justification for their shipping and handling charges
 - The most common approaches to setting S&H charges are not based on actual fulfillment costs, e.g.:
 - Setting S&H charges based on a comparison with other direct marketers’ rates – while this approach may result in an S&H rate schedule that is familiar to consumers, it offers no protection when S&H charges are challenged as deceptive and excessive
 - Testing demand sensitivity and setting S&H charges according to what the market will bear unrelated to actual costs – has revenue maximization as its express goal, rather than cost recovery
 - Even those direct marketers who believe that their S&H charges are justified by actual costs may not be able to withstand scrutiny
 - Some direct marketers include costs that are not delivery-related when measuring S&H costs against revenues.
 - The disclosures made to consumers are often limited to a single word or phrase (e.g. “shipping” or “shipping & handling”) which may be inadequate to support recovery of all costs the direct marketer includes.
 - Very few direct marketers successfully set their S&H charges to reflect actual fulfillment costs
 - Research in 2001 showed that 45% of retailers lose money on their S&H fees, 45% make money, and 10% break even (Source: Jupiter (2001)).
 - At that time, some 11% of direct marketers acknowledged using S&H charges as a profit center (Source: E&Y (2001)).



THE GROWING CONSENSUS: THERE IS WIDE ACCEPTANCE THAT SHIPPING AND HANDLING CHARGES SHOULD BE BASED ON ACTUAL COSTS

- Consumers Have Long Believed That Shipping & Handling Charges Are Only Justified as a Pass-Through of Actual Delivery Costs
- *The DMA Guidelines for Ethical Business Practices* Provides That Shipping and Handling Charges “Should Bear A Reasonable Relationship To Actual Costs”
- Recent Court Decisions in S&H Class Action Litigation Expressly Adopt the Plaintiffs’ Contention That Delivery Charges Represent A Pass-Through of Actual Costs



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS TARGETING S&H PRACTICES

- **Why Class Action Lawsuits Are Ideal for Attacking S&H Charge Practices**
 - Class actions are designed to allow a single lawsuit on behalf of a large number of commonly situated individual plaintiffs (e.g., all customers of a merchant over a given time period).
 - A standard S&H schedule, applicable to all customers, is the perfect target, because it eliminates most issues specific to individual plaintiffs that might be used to challenge class certification.
 - Class actions are well-suited for small dollar injury to large numbers of plaintiffs – when the “excessive” or “deceptive” portion of S&H charge is multiplied thousands or perhaps millions of times, potential damages become enormous. (Recent cases expressly adopt this means of calculating damages.)
 - A standard offer (catalog or internet) to consumers nationwide permits forum shopping by plaintiffs’ lawyers for venues with favorable laws and class action procedures (e.g. aggressive consumer protection statutes, reduced class notice obligations). (California, Florida, and Illinois are the most-favored venues.)
 - Six- and seven-figure attorneys’ fees awards are standard – cases are driven by opportunistic class action lawyers



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

■ Strategies of Plaintiffs' Class Action Attorneys

- Basic Theory of Liability: By Adding a S&H Charge, The Direct Marketer is Representing to the Consumer that the Direct Marketer is Merely Passing Through Actual Delivery Costs
 - Sampling of allegations from earlier class actions
 - “Compaq Computer Corp. (“defendant”) deceptively charged and continues deceptively to charge consumers for the delivery of defendant’s products because its shipping fee exceeds the actual cost of shipping the goods ordered and bears no reasonable relationship to the actual costs. . . . Defendant’s secret profit scheme takes advantage of hundreds of unsuspecting consumers every day, who are given no reason to believe anything other than that the “shipping” fee they are charged reflects the shipping costs defendant actually incurs.” [Complaint filed in California Superior Court, 2002]
 - “Hundreds of thousands of Buy.com customers have purchased, and continue to purchase, goods from Buy.com with the expectation that, in order to receive the goods, they bear the actual costs of shipping. In fact, Buy.com intentionally and deceptively requires consumers to pay inflated charges – labeled “shipping” charges by Buy.com – which allow Buy.com to collect additional profits for itself.” [Complaint filed in Florida Circuit Court, 2002]
 - Until recently, defendants’ decisions to settle, coupled with procedural delays in certain cases, and a smattering of defense victories left the theory untested in the courts -- no longer

- Plaintiff’s Counsel Can Rely on a Multitude of Legal Theories
 - State consumer fraud statutes are most favored
 - Often provide for multiple damages
 - Some relax or eliminate elements of proof (such as reliance)
 - Often provide independent basis for attorneys’ fee award
 - Common law theories abound (e.g., fraud, breach of contract, unjust enrichment, constructive trust)



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

■ Strategies of Plaintiffs' Class Action Attorneys

- Win by Extortion (Motivate Defendant Company to Settle)
 - Danger of runaway jury verdict makes total potential exposure huge (plus attorney fees)
 - Home court advantage - forum shopping allows choice of favorable venue for plaintiff
 - Expensive to defend - broad ranging discovery covering millions of transactions; class action procedural issues dominate; cases more closely scrutinized by courts
 - Adverse publicity – allegations alone can damage a company's goodwill; mailed notice of litigation to customer list is high impact adverse advertising
 - Business disruption – sweeping allegations covering millions of transactions can tie-up company resources

- Win by Inflaming the Jury
 - Play on juror perception that S&H charge should only be a pass-through to recover actual shipping costs
 - Basic themes:
 - Consumers were charged for something they did not receive (overcharging), and direct marketer pockets the proceeds (profiting at consumers' expense)
 - Consumers were deceived as to the true price of goods and/or services



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

- **Significant New Development of Concern to Direct Marketers: Two Recent Court Decisions Have Expressly Adopted the Plaintiffs' Pass-Through Theory Tied to Actual Delivery-Related Costs**
 - Smith, Allen, Mendenhall, Emons & Selby et al. v. The Thomson Corporation, et al., No. 99-L-120, 3rd Judicial Circuit, Madison County, Illinois (2005)
 - Facts and result
 - Lead defendant West Publishing Company sold publications on CD-ROM pursuant to subscription agreements that provided for “transportation and handling charges” to be added to the price of the CD
 - Subscribers were charged a \$6 transportation and handling charge per CD
 - The plaintiffs alleged that:

“The defendants concealed from, and did not disclose to, the plaintiffs and the members of the class the actual cost of transportation and handling and concealed from, and did not disclose to, the plaintiffs and the members of the class the fact that transportation and handling surcharges over and above actual cost were being added to the shipping charges made to plaintiffs and members of the class for each CD-Rom delivered.”
 - The court found court found that the “fair, reasonable and actual charge” for transportation and handling based on actual costs did not exceed \$1.10
 - The court determined that the difference was a “secret and unauthorized charge” and concluded members were “proximately damaged in the amount of these secret charges”
 - Court certified class of over 61,000 members and awarded damages of over \$8.5 million
 - Broader importance
 - Direct marketers should not dismiss the case as an example of clearly excessive S&H charge
 - Court found that West’s notice that “transportation and handling charges shall be added” caused class members to believe that such charges were based on actual costs, adopting the plaintiffs’ theory of the case
 - The inclusion of a term such as “handling” will not insulate a direct marketer from potential liability for excessive and deceptive charges absent cost justification



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

■ Significant New Development (cont.)

□ Turner Greenberg Associates, Inc. v. Pathman, 885 So.2d 1004 (Fla. App. 2004)

■ Facts and result

- Class action against furniture retailer alleging that defendant was making “undisclosed profits on shipping charges” in violation of Florida’s Deceptive and Unfair Practices Act
- Plaintiff sought certification of class based in part on the common question of “whether a reasonable consumer would interpret the term ‘freight/insurance’ to reflect actual shipping costs – not costs plus a margin of profit”
- Class certified by trial court, upheld by Florida Court of Appeal

■ Broader importance

- Florida Court of Appeal expressly found that the “freight/insurance” charge was properly understood by the customers as a “pass through”
- The Court found that, because the charge should be understood to be a pass through, payment of the charge alone satisfied any necessary reliance by the customers necessary to make out a claim under Florida’s unfair practices act
- The court held that the damages to the class members was the difference between the defendants’ actual costs and the charge imposed



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

- **Plaintiff Victories in Class Action Litigation (Verdicts and Settlements)**
 - West Publishing Case (IL) (2005) [discussed above]
 - Total award over \$8.5 million
 - One-third of the award goes to plaintiffs' counsel
 - Defendants have appealed
 - Columbia House (CA and NY) (2002)
 - The plaintiffs alleged that Columbia House added an inadequately disclosed and excessive S&H charge to customer orders in connection with a promotional offer.
 - Settlement:
 - \$5 million attorneys fees
 - \$200,000 costs
 - Each class member to receive a redemption certificate for a CD or cassette at reduced price, with no S&H charges
 - Columbia House to change language to “shipping and processing”
 - Columbia House to explain fee in new member agreements: “The shipping and processing charge is designed to compensate Columbia House for the services we provide that enable our members to enjoy the convenience of home selection and delivery of our products as well as overhead costs associated with these services.”



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

■ Plaintiff Victories (cont.)

□ Viking Office Products (IL, OK, TX) (2002)

- Viking included a charge for “insurance” on delivery of products -- Plaintiffs alleged that the charge was deceptive because Viking did not actually purchase insurance on each shipment.
- Viking voluntarily eliminated the word “insurance” from its charge during the litigation.
- Settlement:
 - \$16.074 million in credits to class members on future orders. Class members received one-time credits of \$5, \$15 or \$20, depending on the date of the purchase that qualified them for class membership
 - \$5.7 million cash payment – \$20,000 to each named plaintiff in the suit, and over \$5 million in attorneys’ fees
 - \$1.25 million for administering the settlement

□ BMG Music Service (IL) (2005)

- Suit alleged that defendant music club engaged in deceptive and unfair marketing and sales practices in regard to its shipping and handling charges and its advertised costs to consumers of CDs
- Settlement
 - Class of members and former members who paid shipping and handling charges each receive a voucher for a 75% discount on purchase of one or two CDs and free shipping on purchase of such CDs
 - Defendant agrees not to object to an attorneys fee award of up to \$1 million
 - Defendant to ensure that membership guide includes clear and conspicuous language indicating that “shipping and handling” charges cover all associated costs and services, including labor, materials, packaging and postage.



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

■ **Plaintiff Victories (cont.)**

- VistaPrint USA, Inc. (CA) (2005)
 - Defendant offering consumers 250 free business cards but charging \$8 for shipping and handling
 - Suit alleged that S&H charges were excessive and in violation of California's unfair competition law
 - Settlement
 - Class of persons who ordered and received free business cards each will receive a coupon allowing the member to purchase additional business cards at a reduced rate
 - Defendant to change its website to replace "shipping and handling" with "shipping and processing" to make clear that the fee charged includes processing fees
 - Plaintiffs counsel awarded attorneys fees of \$115,800

- J&B Importers (IL) (2001)
 - Defendant sold bicycles and bicycle parts
 - Suit alleged that defendant imposed a "freight" charge that included a \$1.50 to \$3.00 surcharge over and above the defendant's actual costs
 - Judgment entered against defendant based on settlement including payment of \$225,000 in attorneys fees



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

- **Plaintiff Victories (cont.)**

- Onsale, Inc. (CA) (1999)

- Suit brought by Santa Clara District Attorney under California Deceptive Practices Statute
 - Challenge to “at cost” promotion - offer to sell items at wholesale cost, including cost of shipping
 - Allegation that Onsale received discounts on shipping not passed on to customers
 - Onsale agreed to pay fine of \$160,000

- Buy.com (FL) (2003)

- Florida deceptive and unfair trade practices statute
 - Suit alleged that Buy.com’s flat “shipping fees” of \$1.95 for DVDs, CDs and cassettes, \$3.95 for videos, games and books were inflated and exceeded actual costs
 - Judgment entered for plaintiff class pursuant to settlement agreement
 - Each class member received a 10% discount and free shipping on their next order of entertainment products (books, CDs, videos, etc.) up to \$100
 - Plaintiffs’ counsel awarded attorneys’ fees of \$100,000



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

■ Plaintiff Victories (cont.)

□ Oriental Trading Co. (NE, CA) (2003)

- Suit alleged that defendant's shipping and handling charges exceeded its actual costs and that a \$1.65 "replacement fee" imposed by the company was improper
- Settlement
 - Each class member to receive \$3.30 Coupon
 - Attorneys' fee awarded
 - \$87,000 paid out to date

■ Plaintiffs' Class Certified, But Case Not Yet Resolved

□ Turner Greenberg (FL) [discussed above]

- Suit against furniture retailer
- Court of Appeals upheld certification and expressly endorsed plaintiffs' "pass through" theory of liability

□ Hanover Direct (OK)

- Suit challenging imposition of \$0.50 "insurance" charge
- Trial court certified class; defendant's appeal is pending



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS TARGETING S&H PRACTICES

■ Other Examples of Class Action Litigation

- California cases
 - Several similar suits were filed in late 2002 and early 2003 targeting, among others, major computer direct marketers, such as Compaq and Winbook.
 - Alleged “profit schemes” using deceptive shipping charges that exceed actual costs of shipping
 - Each suit has been dismissed as a result of a recent change in California law (Proposition 64) requiring named plaintiffs to prove actual damages to pursue action under state consumer protection law (and in one case due to defendants’ bankruptcy)
 - California remains a favorite venue for class action litigation (e.g., VistaPrint)
- Oklahoma state court litigation
 - Series of cases challenging a variety of delivery-related charges, including use of the term “insurance” where direct marketer did not actually purchase insurance for each shipment
- Spiegel (IL) (filed in 1998)
 - Allegation that Spiegel overcharged for shipping
 - Alleged violation of the Illinois Consumer Fraud Statute
- There appears to be an appetite among the class action plaintiffs’ bar to bring suits challenging delivery charges and other types of surcharges. Plaintiffs’ lawyers include some of the most prominent class action counsel in the United States. The West Publishing and Turner Greenberg decisions are likely to encourage more lawsuits.



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

■ Notable Defense Victories

□ Brawn of California (CA) (2005)

- Suit challenging imposition of \$1.48 “insurance” charge on grounds that charge was fraudulent because the defendant bears risk of loss as a matter of law
- Trial court agreed and order defendant to make restitution to all class members
- Defendant appealed, and the Court of Appeal reversed and ordered judgment to enter for the defendant, rejecting the argument that the defendant bears the risk of loss under California law

□ American Master Products, Inc. (NY) (2003)

- Suit alleged that a \$0.50 “insurance” charge was deceptive because defendant did not actually purchase insurance for each shipment from an outside insurance agent
- The court rejected the plaintiffs argument, finding that the term “insurance” was intended to refer to the defendant’s guarantee to replace lost or damaged goods

□ BMG Direct Marketing (NY) (2001)

- Allegation that S&H charge exceeded actual cost
- NY trial and appellate court concluded however, that disclosure of amount of S&H charge was sufficient



THE BIGGEST THREAT TO DIRECT MARKETERS: CLASS ACTION LAWSUITS (cont.)

■ **Lessons Learned From Defending Suits**

- Don't Be the Low-hanging Fruit
 - S&H as “profit center” is a smoking gun
 - Do not use the term “shipping” alone if costs other than common carrier charges and packaging materials are included
 - Even the addition of the term “handling” is likely not adequate if cost justification is weak
 - Some settlements have required adoption of “shipping and processing” and/or additional disclosures (Columbia House, Vistaprint, BMG)
 - Inclusion of references to “insurance” or “replacement fee” invites suit (although some defendants have prevailed)

- Two Elements Are Crucial to Defending Class Action Lawsuits:
 - Ability to defend S&H charges as reasonably related to actual costs
 - Accurate and available description and disclosure of charge to consumers



THE BIG PICTURE, PART II: WHAT A DIRECT MARKETER CAN DO TO IMPROVE ITS DELIVERY CHARGE PRACTICES IN THE CURRENT LEGAL ENVIRONMENT

- ***Review and Follow DMA Guidance***

- ***Take Preventative Measures To Reduce Risk and Prepare A Defense – Cost Justification and Good Disclosures Go Hand-in-Hand***
 - ***Establish and Document A Solid Cost Justification for Shipping & Handling Charges***
 - ***Define and Manage Consumer Expectations Through a Clear Description of and Adequate Disclosures Concerning Shipping and Handling Charges***

- ***Be Aware of Regulatory Standards***



THE DMA'S GUIDANCE REGARDING SHIPPING & HANDLING CHARGES: GENERAL RULES FOR BEST PRACTICES

- DMA Responding to Current Business, Ethical and Legal Climate:
 - Prepared in 2003 in response to increased consumer concern and confusion regarding shipping and handling charges, especially difficulty in determining the amount of such charges in on-line transactions
 - Developed at a time when there have been several high visibility class action lawsuits alleging deceptive and excessive S&H charges.
- DMA Guidance on Best Practices for S&H Charges is Intended for Benefit of Direct Marketers and Consumers Alike
 - The new Guidance is an expansion of existing Article 11 of The DMA Guidelines for Ethical Business Practice which provides:
 - “Postage, shipping or handling charges, if any, should bear a reasonable relationship to actual costs incurred.”
 - The thrust of the new DMA guidance is two-fold:
 - Provide assistance in identifying those fulfillment costs that are reasonable to recover when setting shipping and handling charges
 - Emphasize the importance of properly describing and disclosing the surcharge to customers



THE DMA'S GUIDANCE REGARDING S&H BEST PRACTICES (cont.)

- DMA recommendations:
 - Direct marketers should review their delivery related costs in a thorough in-house audit or by relying on the assistance of an outside consultant to perform a cost study and analysis of delivery charges practices
 - Direct marketers should have a goal of recovering from customers , in the aggregate, clearly defined actual delivery-related costs
 - The less directly a cost is associated with delivery of products to customers, the more difficult it is to justify its recovery. In such cases disclosures are even more important.
 - There is no single “right” answer to charging for shipping and handling, but direct marketers must ensure that such charges are clear, fair, reasonable and justified.



REDUCING YOUR RISK AND PREPARING YOUR DEFENSE: HAVING A SOLID COST JUSTIFICATION FOR S&H CHARGES IS KEY

- **S&H Charges Should Be Based on Actual Costs**
 - Two methods of setting S&H charges are consistent with this goal
 - Setting S&H charges to recover specifically identified costs of doing business
 - Recouping Actual Delivery Cost on a Per Item Basis

- **Value of Fulfillment Cost Study as a Good Business Practice and Anticipatory Defensive Evidence**
 - Central issues in any legal action (class action or regulatory investigation) are likely to be:
 - Whether S&H charges exceed reasonable S&H costs
 - The adequacy of S&H disclosures

 - S&H cost study provides “Exhibit A” for the Direct Marketer to refute allegation of overcharging

 - Without a cost study, a retailer is subject to the inference that S&H charges were based on some consideration other than actual cost - i.e., additional profit



REDUCING YOUR RISK AND PREPARING YOUR DEFENSE: SOLID COST JUSTIFICATION FOR S&H CHARGES (cont.)

■ How to Conduct a Cost Study

- Why to Perform A Cost Study Before Becoming The Target of a Shipping and Handling Class Action
 - Provides The Best Defense: Increases the value of a study when defending a lawsuit or responding to a government inquiry
 - No Fire Drill: Will decrease defense burdens at time of challenge
 - Rain On Their Parade: In the class action context, will dampen the enthusiasm of the attorney driving the litigation
 - A cost study undertaken after a lawsuit is filed (or a regulatory investigation is commenced), will look like post-hoc justification of S&H charges - but is still better than no justification at all

- The Value That An Outside Consultant Can Add
 - Credibility: A company's own internal cost study may be fine, but an independent third-party review can add credibility, especially if the study is performed before the direct marketer has been sued.
 - Experience and Broad Industry Knowledge: A consultant specializing in the fulfillment function and related costs knows what questions to ask and how to subsequently present cost information to the direct marketer's advantage.
 - Offers A Strong Spokesperson: Based on his/her experience, the consultant will likely be an accomplished spokesperson/witness, able to defend conclusions reached in the study. There is no guarantee that an internal company employee would be similarly persuasive.



REDUCING YOUR RISK AND PREPARING YOUR DEFENSE: SOLID COST JUSTIFICATION FOR S&H CHARGES (cont.)

■ How to Conduct a Cost Study (cont.)

□ How To Select an Outside Consultant

- Independence is Important: A potential problem with the company's regular accounting firm, especially after recent accounting scandals, is the issue of independence.
- Bigger Isn't Necessarily Better: Large national accounting firm
 - Pros: Routinely perform various kinds of cost studies; offer experienced litigation support
 - Cons: Typically expensive; may face credibility problems in current environment
- Consider A Fulfillment Consultant or Industry Analyst
 - Pros: Typically more affordable; may face fewer credibility problems in current environment
 - Cons: Depending on person selected, may not have the resources and litigation support experience.

REDUCING YOUR RISK AND PREPARING YOUR DEFENSE: SOLID COST JUSTIFICATION FOR S&H CHARGES (cont.)

- **How To Conduct A Cost Study (cont.)**
 - Deciding What Costs Are Included
 - Should only common carrier, direct labor, and packaging materials costs (variable costs) be included, or should allocated fixed overhead costs be included as well?
 - Should the study only include outbound fulfillment costs, or should other warehousing and inbound delivery costs be included?
 - Risk spectrum

RISK CONTINUUM

LOW

HIGH



Common carrier, packaging materials (“shipping”) and direct labor (“handling”) costs

Direct costs and conservatively allocated overhead costs

Direct costs and allocation of all indirect costs (inbound shipping, G&A expenses, inventory carrying costs, aggressive fixed overhead allocation)



REDUCING YOUR RISK AND PREPARING YOUR DEFENSE: SOLID COST JUSTIFICATION FOR S&H CHARGES (cont.)

■ How To Conduct a Cost Study (cont.)

□ Updating the study

- At least every 3 years, more frequently is better
- Whenever there is a significant change (especially a reduction) in incurred costs
- Whenever there is a significant increase in the amount of, or change in the manner of, imposing S&H charges

□ Documenting the study

- Must have a “deliverable”: strong report from person performing the study as to information reviewed and conclusions reached
- Weigh the level of detail: pros and cons of detailed workpapers
- Pro: lends credibility to conclusions
- Con: many targets to shoot at



REDUCING YOUR RISK AND PREPARING YOUR DEFENSE: REDEFINING CONSUMER EXPECTATIONS THROUGH S&H DISCLOSURES

- Disclosures Are Fundamentally Important To Defending Your S&H Charges
 - The nature of the disclosures can be a key issue in lawsuits and regulatory inquiries.
 - Weak cost justification may in some cases be overcome by adequacy of disclosures.

- Terminology Describing S&H Charges
 - If not limited to common carrier costs (and perhaps packaging materials), include “handling” or better still “processing.”
 - Do not use “insurance” unless insurance was actually purchased to cover each order.
 - Specific choice of terminology is less important than achieving clarity and accuracy as to the amount being charged and the nature of the charge.
 - Consider a more comprehensive explanation, especially in the FAQ section of your website.
 - If product is offered in a continuity, negative option, or subscription program, provide consumers a range of shipping costs that may apply to each shipment before they subscribe or otherwise inform customers how they can readily determine applicable shipping and handling charges.



REDUCING YOUR RISK AND PREPARING YOUR DEFENSE: S&H DISCLOSURES (cont.)

- When, Where and How Much
 - Early and Often: Even the most basic disclosure of shipping and handling charges should be clear and conspicuous and made as early as possible during the order process.
 - Internet – S&H charges should be accessible up front on the website and in the order path
 - Telephone – The current common practice is acceptable (inform caller when giving order total, except for extraordinary costs)
 - Catalogs – S&H charges should be prominently displayed on the order form
 - Supplemental disclosures/explanations can greatly improve upon a short-hand description of S&H charge
 - A direct marketer can readily create an internal page on its website, linked to the S&H reference in the order path and referenced on the catalog order form.
 - Consider including similar, additional discussion of charge on the catalog order form itself, to avoid a complaint by catalog customers that cannot or do not access the website.
 - Develop a script for the call center for telephone orders and inquiries.
 - Examples:
 - Columbia House: “The shipping and processing charge is designed to compensate Columbia House for the services we provide that enable our members to enjoy the convenience of home selection and delivery of our products as well as overhead costs associated with these services.”
 - Consider: “Our shipping and processing charge is intended to compensate our company for the cost of processing your order, handling and packaging the products you have purchased, and delivering them to you and/or to the recipients you designate.”



BE AWARE OF CONSUMER PROTECTION STANDARDS

■ **Federal Trade Commission**

- FTC has a broad mandate under federal law to protect consumers from any unfair or deceptive act or practice which is likely to cause substantial injury to consumers and which “is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition” (15 U.S.C. Sec. 45(n)).
- The primary focus of the FTC is whether the offer was adequately disclosed to the consumer – direct marketers should avoid not only outright deception but also customer confusion.
- No recent enforcement actions have targeted allegedly unfair and deceptive delivery charges, but the FTC has pursued the issue in the past – e.g., Bill Crouch Foreign Auto, Inc. (1980).

■ **State Regulators**

- State enforcement officials, in particular Attorneys General, are very active in pursuing consumer protection issues, both acting alone and in concert to bring class actions on behalf of their states’ consumers
- Onsale, Inc. – Not California AG, but Santa Clara District Attorney sued Onsale in 1999 for deceiving customers by not passing through discount on shipping fees
- Taylor Gifts – In 2004, Pennsylvania Attorney General filed suit against Taylor Gifts alleging that Taylor engaged in a variety of deceptive practices, including violation of FTC mail order rule and imposition of a \$0.99 insurance charge. Taylor paid \$25,000 and agreed to adjust to ensure compliance with the mail order rule. Today, there is no mention of an “insurance” charge on Taylor’s website.



CONSUMER PROTECTION STANDARDS (cont.)

■ Offers of “Free” Shipping

□ FTC Guide Concerning Use of the Word “Free” and Similar Representations

- “All such offers must be made with extreme care so as to avoid any possibility that consumers will be misled or deceived.”
- In connection with an offer of “free” merchandise or services, a “purchaser has a right to believe that the merchant will not directly and immediately recover, in whole or in part, the cost of the free merchandise or service by marking up the price of the article which must be purchased, by the substitution of inferior merchandise or service, or otherwise.”
- All terms and conditions of “free” service must be set forth clearly and conspicuously.
- Violations cannot be corrected by merely substituting language that also conveys the impression that the merchandise or service is “free.”

□ Offers of “Free Shipping” by Direct Marketers

- Offering “free shipping” is perfectly acceptable, so long as FTC rules are carefully followed.
- Disclaimers should be clear and conspicuous.
- Marketers should not eliminate their delivery charge, concurrently increase the retail prices of their products, and still advertise “free” delivery. If the retail prices of products are raised in connection with a “free” shipping promotion, a term such as “shipping included” should be used instead of the term “free.”



A FINAL NOTE: SALES/USE TAX TREATMENT OF SHIPPING AND HANDLING CHARGES

■ **Delivery Charges Excluded From / Included In Use Tax Base**

- Transportation/Delivery Costs Excluded From The Use Tax Base
 - Historically, many states exclude transportation/delivery charges from the use tax base if separately stated.
 - In most such states, the charge must represent only actual shipping costs (i.e., including “handling” or “processing” may destroy the exclusion)
 - A few states exclude a separately stated delivery charge regardless of how it is described (e.g., a “shipping and handling” charge is excluded)

- Transportation/Delivery Charges Included In The Use Tax Base
 - Most other states include transportation/delivery charges in the tax base, regardless of how they are described. Some states exclude such charges from the tax base if title passes at the point of origin.

- Streamlined Sales and Use Tax Agreement
 - The SSTA creates a presumption that ALL costs for “preparation and delivery” will be included in the tax base, including “transportation, shipping, postage, handling, crating, and packing.”
 - Participating states (there are 13 current members, and other states that have passed legislation attempting to conform to the SSTA), however, may elect exclude delivery costs from the tax base.
 - The choice offered is all-or-nothing (include all delivery costs or none) so SSTA states that previously taxed only a portion of such costs have incentives to expand tax base to include all costs.



A FINAL NOTE: SALES/USE TAX TREATMENT OF S&H (cont.)

- **Qualifying for Exclusion in States Which Exclude Separately Stated Delivery Charges From Use Tax Base**
 - The Mechanics of the Requirement That the Transportation/Delivery Charge Be Separately Stated Vary From State to State
 - For example, California does not require retailer to collect use tax on a separately stated delivery charge, but the charge must be separately stated on a per item basis to qualify for the exclusion
 - Under Massachusetts law, the separately-stated delivery charge may be described as including “handling” or “processing,” but the exemption applies only if the charge, however described, “reasonably reflects” the cost to ship the product(s)
 - Possible Conundrum
 - Including “handling” or the like is advisable for defending against class action lawsuits alleging that the charge exceeds costs, but may destroy eligibility for exclusion from sales/use tax base