THE GEORGE WASHINGTON UNIVERSITY

WASHINGTON, DC

Public Interest Comment[1] on FTC

# Trade Regulation on Unfair or Deceptive Fees

Docket ID No. FTC-2023-0064

JANUARY 8, 2024

Mary Sullivan, Visiting Scholar, Regulatory Studies Center[2]

## REGULATORY STUDIES CENTER

The George Washington University Regulatory Studies Center improves regulatory policy through research, education, and outreach. As part of its mission, the Center conducts careful and independent analyses to assess rulemaking proposals from the perspective of the public interest. This comment on the Federal Trade Commission Trade Rule on Unfair or Deceptive Fees does not represent the views of any particular affected party or special interest, but is designed to evaluate the effect of the agency's guidance on overall consumer welfare.

## Introduction

This proposed rule is concerned with deceptive and unfair fees. Many types of fees are unpopular, as evidenced by the large number of complaints submitted in comments on the Federal Trade

[1] This comment reflects the views of the author, and does not represent an official position of the GW Regulatory Studies Center or the George Washington University. The Center's policy on research integrity is available at https://regulatorystudies.columbian.gwu.edu/about#integrity.

[2] Prior to joining the GW Regulatory Studies Center, Mary Sullivan was an economist at the Federal Trade Commission. Previously, she was as an economist and Assistant Chief of the Competition Policy Section at the Antitrust Division, U.S. Department of Justice, Antitrust Division. In academia, she was on the faculties of the University of Chicago Booth School of Business and the George Washington School of Business. Her research focuses on regulation, antitrust, and the economics of brand names and trademarks.

Commission's advance notice of public rulemaking (ANPR), and research has shown that some of these fees are harmful to consumers. The Commission is right to be concerned about them.

Yet the proposed rule tries to do too much. The fees that the rule aims to prohibit include a wide variety of fees. While some of these fees are harmful, some are likely not. More research is needed to understand which ones warrant regulating.

The wide coverage is concerning because the Commission does not state the limits of the rule. While the proposed rule describes certain fees that would be prohibited, it does not delineate which fees would not be targeted.

The intended scope of the rule – the entire economy – is implausibly large. Many firms would be reluctant to comply, and fair enforcement of the rule would require coordinated compliance. Partial or uneven compliance would cause compliant firms to lose business to firms that ignored the rule. Implementing coordinated compliance for the entire economy would be difficult with the FTC's limited resources.

The Commission should terminate the present rulemaking and consider an alternative that targets limited, well-specified fee practices and a smaller scope. As written, the rule could do more harm than good.

## What Is Included in Bait-And-Switch Fees, and What Is Not?

The Commission relies heavily on the fee practices of hotels and live event ticketing businesses to describe the rule, explain the economic rationale, and develop the cost-benefit analysis. These practices are well understood. Hotels and ticketing firms charge mandatory fees that are not included in the advertised price, and the fees are mandatory and the same for all consumers. They are either a fixed amount like resort fees, or vary with the amount of the transaction, like some live event ticketing fees. I will refer to this fee practice as "across-the-board drip pricing" ("across-the-board" because the fees are mandatory and the same for all consumers, and "drip pricing" because the fees are not advertising upfront but are disclosed later as consumers go through the buying process).

Considerable research has shown that across-the-board drip pricing can be harmful to consumers. Studies include the FTC's economic analysis of hotel resort fees, empirical research on income tax, the Department of Transportation's Full Fare Advertising Rule, live event tickets, and experimental research.

However, the proposed prohibitions would go far beyond across-the-board drip pricing. The rule would also prohibit, as discussed below, at least some hidden fees that are mandatory for only some consumers, as well as some fees for add-ons that are completely optional. The proposed rule also considers the possibility of regulating prices themselves by prohibiting fees that they consider to be "excessive" or "worthless."

The inclusion of a broad range of fee types raises questions about how firms would comply and the relevance of the cost-benefit analysis that focuses only on resort and ticketing fees.

*Fees that are mandatory for only some consumers*

The proposed rule would prohibit at least two restaurant fees that only some consumers pay: the credit card surcharge and the large-party fee (NPRM, Section VII. Preliminary Analysis -- The Restaurant Industry).

Businesses sometimes charge a credit card surcharge because they must pay a fee to their merchant bank for credit card transactions. To comply with the ban, the proposed rule says: "…we assume restaurants would eliminate these fees and adjust menu prices in response to the proposed rule."

The rationale for the prohibition of credit card surcharges in restaurants is that consumers might not learn about the surcharge until the end of the meal, when it would be difficult to get cash. While this would happen to some consumers, other consumers would have cash, and consumers who had dined at the restaurant before would be aware of the surcharge and be able to get cash before dining.

Banning credit card surcharges would benefit consumers who pay with a credit card and harm those who pay with cash. Consumers paying with cash would have to pay higher menu prices to offset the credit card fees generated by consumers paying with a credit card. It would be especially harmful to lower-income consumers who do not have access to credit. It would also hurt low-margin mom and pop restaurants that would lose business if they raised prices. They do not want the fee; they just want to be paid in cash. Are the benefits to some consumers from banning the surcharge worth the costs imposed on others? It is not obvious. Yet the proposed rule does not discuss these costs or take them into account in the cost-benefit analysis. A less costly approach would simply require that restaurants disclose the surcharge on the menu or in some other prominent location, so consumers are aware of the charge before they order.

The proposed rule also fails to discuss whether the ban on credit card surcharges would be imposed on businesses other than restaurants. If the rule gave the Commission the authority to prohibit credit card surcharges in restaurants, it would also permit them to prohibit them elsewhere. The proposed rule does not state any limits to the prohibition.

The proposed rule would also prohibit another restaurant fee that is paid only by some consumers: the fee for large parties. To comply, the proposed rule states "…we assume restaurants currently imposing these fees would respond to the proposed rule by printing separate small party and large party menus, the latter of which would incorporate the large party fees into menu prices." This method of compliance sounds simple on paper, but anyone who has worked at a busy restaurant on a Saturday night knows otherwise. The separate-menu solution would create operational problems that could result in consumers receiving the wrong menu. When a restaurant is very busy, the working environment is fast-passed and unpredictable. The different menus could easily be mixed up. Consumers could end up paying the wrong price, which could hurt consumers and be costly for the restaurant as well.

Moreover, it is not clear that consumers are unaware of large-party fees. It is likely that most consumers have experienced these fees and expect and understand them. To the extent that consumers are unaware of such fees, a simpler solution would be to disclose the fee on the menu or have servers inform large parties of the fee when they are seated or when they make the reservation.

Requiring dual menu prices may also harm servers. Large party fees are intended to compensate servers for the greater difficulty of handling large parties. The fee is usually seen as a minimum tip. Dual menu prices may make it more difficult to pass the service fee on to servers, as it would be embedded in the menu prices. It may also require restaurants to modify their transactions and accounting software to handle menu prices that include server tips in the price, rather than only revenue to the restaurant.

The two restaurant fees that would be targeted by the proposed rule are examples of fees that are mandatory for only some consumers. The Commission could also target fees in this category used by other businesses, although it does not state which would be targeted and which would not, leaving uncertainty about the limits of the rule.

*Fees for add-ons that are completely optional*

Another practice described as a bait-and-switch pricing tactic is "sales that omit material terms such as requiring an additional purchase to make full use of the good or service" (NPRM, Section III). The proposed rule does not describe this practice in any detail, but comments from the ANPR in footnote 10 provide an idea of what the Commission has in mind (NPRM, footnote 10). One comment contains a complaint about subscription services for automobiles: "We need to ban having subscription services attached to vehicle features, requiring you to pay monthly fees for items already installed in the vehicle." Other comments mention a video subscription service, recurring fees for rental apartments, add-ons for a gym membership, and a security camera that requires extra purchases to use.

The proposed rule says nothing about what would be required for businesses to comply with this part of the rule. If consumers were misled into believing that the services in question were included in the product price, this would indeed be deceptive. In this case, adequate disclosures would resolve the problem. But the proposed rule classifies this as a "bait-and-switch" tactic, suggesting that the practice would be prohibited.

If adequately disclosed, subscription services are not harmful and even have benefits for consumers. Consider subscription services for optional features that are installed in automobiles, like satellite radio, active driving assistance, and voice recognition. The hardware and software for these features are installed in cars and a consumer pays a subscription fee to use the features. Most automobile subscription services, with the exception of satellite radio, are only being used in luxury automobiles and are not for basic features like opening the door or starting the car. Moreover, subscription fees for satellite radio are not paid to the automobile manufacturer but to a third-party satellite radio service. The automobile company merely installs the radio in the vehicle so that consumers can easily obtain the service if they choose to do so (Consumer Reports).

These subscription services are not mandatory – they are purely optional. A consumer who does not want to pay the fee is under no obligation to do so. Unless advertising falsely states or implies that these features are included in the price, the fees are not deceptive or unfair.

The subscription model is efficient. It reduces the number of different versions of a car that must be produced to offer optional features. Without a subscription service, the carmaker would have to predict the percentage of car buyers who would want a particular feature, such as voice recognition, and produce its output accordingly. Unless the automaker predicted demand for the feature perfectly, there would be too many of one version of the car and not enough of the other. This would increase the inventory that the automaker and dealer would have to hold, thus increasing their costs. It would also cause some consumers to wait or pay higher prices for their desired car.

At least one auto manufacturer, Porche, offers consumers a choice of buying these features outright or obtaining them through a subscription. The subscription permits consumers to try luxury features without paying the higher price required to buy them. They can drop the subscription for features that they feel are not worth the money. If they had bought the features outright, they would not be able to return them and receive a refund (Consumer Reports).

The proposed rule does not discuss what compliance would be required of automakers and dealers that offer the targeted subscription services. Would adequate disclosure be sufficient, or does the Commission intend to ban this practice? Nor does it explain what other types of subscription services would be implicated by the rule. The lack of specificity in this part of the rule creates confusion for businesses trying to understand whether it applies to them and what would be required to comply.

*Regulating the amount of fees*

The proposed rule considers the possibility of banning fees that are "excessive" or "worthless." (NPRM, Section VII and Section X, question 24). The Commission should drop this from consideration. Banning "excessive" or "worthless" fees would go well beyond the stated purpose of the proposed rule, which is to prohibit "misrepresenting the total costs of goods and services by omitting mandatory fees from advertised prices." It would be out-and-out price regulation.

To its credit, the proposed rule does identify one disadvantage of prohibiting excessive and worthless fees: it would be costly to for businesses "to determine whether a fee qualified as worthless or excessive under the rule." It would also require FTC resources to define "excessive" and "worthless," and this would be a tall order.

The Commission correctly points out that if a mandatory fee is included in the advertised price, it should not be necessary to evaluate the value of a fee. By including a fee in the advertised price, a business would have little or no need to justify it, and the consumer could simply judge whether the product was worth the price. Thus, requiring mandatory fees to be included in the advertised price would eliminate any perceived need to ban "excessive" or "worthless" mandatory fees.

But the Commission is considering including *add-on fees* in the prohibition of "excessive" or "worthless" fees (Section X, question 24). Regulating add-on fees would restrict a firm's freedom to design its own products. Price caps generally do not have the intended effect because they give firms the incentive to produce less and reduce quality. If the FTC regulates the price of add-ons, a price that is too low would induce a firm to lower the quality of the add-on or quit offering it entirely. Another possibility is that firms would make add-ons mandatory and include them in the price of the product. This would increase the price for consumers who did not want the add-on. Any of these possibilities would reduce consumer choice and welfare.

What add-ons fees would the Commission consider regulating? The proposed rule does not discuss this. Would it cover add-ons like airline fees for checking bags and seat selection (NPRM, footnote 69)? These add-ons are purely optional. What about bank fees for late payment, overdrafts, and insufficient funds (NPRM, footnote 105)? These are fees that are triggered by actions of consumers that impose costs on banks and are intended to discourage such actions. Eliminating or lowering them would increase consumer actions that impose costs on businesses and these costs would be passed on to other consumers through higher prices or a worsening of other terms.

Importantly, the proposed rule states no limits on the Commission's authority to prohibit or regulate fees and fee practices. Would all businesses be prohibited from using credit card surcharges? Would other fees that are mandatory for only some consumers be targeted? Which subscription services would be prohibited or otherwise regulated? Are there other types of fees that the rule would prohibit that are not discussed? The failure to include limits to the rule creates tremendous uncertainty for the business community.

## The Scope of the Proposed Rule

After considering various alternatives, the Commission concludes that the rule should have economy-wide coverage. This would provide the most protection for consumers, they argue, and limiting the proposed rules to certain sectors would permit unfair or deceptive practices in other parts of the economy. Moreover, applying the rule to all sectors in the economy would protect businesses from competitors that were not covered by the rule.

One issue that needs to be addressed in the discussion of scope is the relevance of the cost-benefit analysis, which focuses only on two sectors, short-term lodging and live event ticketing. The proposed rule does not consider how the cost-benefit analysis would change with economy-wide coverage.

Another more fundamental issue is that, while the Commission's rationale for economy-wide coverage is well-intentioned, it is naïve. The Commission underestimates the difficulty of enforcing the rule throughout the entire economy. In giving the rule such a large scope, the Commission would be taking on a seemingly impossible task. The resulting confusion and incomplete compliance arising from uncertainty over how the Commission intends to apply the rule would hurt both consumers and businesses.

The Commission's assumption that compliance would occur immediately is unrealistic: "The Commission anticipates that most companies that are subject to any eventual rule would comply with it right away, especially as their competitors would also be bound by it" (NPRM, Section VII.B).

To understand how implausible this is, consider the ban on across-the-board drip pricing, the easiest part of the rule to understand. Requiring businesses to use all-in pricing for fees that are mandatory for all consumers would appear to be simple and straightforward, because all businesses would need to do is add the fee to the advertised price. Yet no firm would want to be the first in its market to comply. The harm to businesses of using all-in pricing when its competitors do not is illustrated by StubHub's switch to all-in pricing in 2014 in response to consumer complaints about hidden fees. After losing significant market share, the company resumed the practice of adding fees at the end of the transaction (see, StubHub sings the blues after shifting fees, Why StubHub is tacking on fees again). Firms would not voluntarily comply if they feared ending up in this situation. And this example is one in which both the violation and compliance are completely straightforward to understand. Anticipating the Commission's application of the rule throughout the economy would be much more difficult. Therefore, the FTC itself would have to take on the responsibility to guarantee coordinated compliance for all sectors in the economy.

Perhaps the Commission is basing its assumption of immediate compliance on the experience of the Department of Transportation (DOT) with the 2012 Full Fare Advertising Rule, which required that all airlines and travel agents include taxes and fees in advertised air fares. This rule achieved quick success and has been shown to have benefited consumers. Compliance with the Full Fare Rule was likely immediate because the rule applied to a single industry, one that the DOT had long regulated and knew well. The regulation was clear and specific to that industry, and what was required was unambiguous. DOT could easily determine whether all the firms were in compliance.

Despite the FTC's vast experience with deceptive and unfair fees, it has never enforced an all-in pricing requirement for an entire market, let alone the entire economy, so the challenges involved are not fully known to the agency. The FTC sent warning letters to hotels about their use of drip pricing, but it did not follow up with enforcement when the hotels failed to drop the practice. The ANPR for this rulemaking identified the DOT's Full Fare Advertising Rule as a "useful regulatory precedent for requiring clear indication of 'the entire price to be paid.'" (ANPR, Section II.C.), but as noted, the DOT rule addressed a specific practice in a specific industry.

To understand the enormity of implementing economy-wide compliance of the rule, consider the number of firms in the sectors discussed in NPRM, II. B., which is a fraction of the number of firms in the economy.

- Hotel and short-term lodging: 166,272 hotels and motels in the US ;.over 2 million Airbnb listings
- Live event ticketing: at least 18 live event ticketing businesses
- Restaurants and apps for prepared foods and grocery delivery: 749,000 restaurants ; 10 popular food delivery apps
- Transportation—Airlines, car rental, car sales: 10 major airlines; 68,236 new and used auto dealerships
- Telecommunication: 133,231 telecommunication businesses, including nearly 3,000 internet providers , at least 14 pay-TV providers ;
- Rental housing: 19.3 million rental properties, which contain 45.9 million rental units Rental properties
- Education: 39,947 colleges and universities
- Financial service: 104,037 depository institutions and 66,504 nondepository credit institutions
- Correctional services: 96,370 private prisons

Note: Links accessed January 7, 2024

Given the large number of firms that would be covered by the rule, it is unrealistic to believe that the FTC could oversee compliance in a way that would be timely and fair to the covered businesses.

## Recommendation

In defending the rule, the Commission emphasizes the importance of strengthening "the set of tools available in support of the Commission's enforcement program against unfair or deceptive practices relating to fees…" (NPRM, Section VII.B).

Yet some of the fees that would be prohibited by the rule are not unambiguously harmful or harmful at all. More research is needed to understand how these fees affect consumer welfare and what the costs of complying with their prohibition would be to businesses and consumers.

The Commission claims that the broad scope of the rule is necessary, for to narrow it would "leave the door open to widespread unfair or deceptive practices in other sectors" and "give some businesses an unfair competitive advantage" (NPRM, Section VII.B. par 8).

But giving the rule such a broad scope would create its own problems. Coordinating the compliance of firms in all sectors of the economy in a timely and fair manner would be impossible, given the limited resources of the FTC.

My recommendation is to limit the rule to short-term lodging and live event ticketing. This approach has several advantages. First, research has been conducted on these sectors and has found their use of across-the-board drip pricing to be harmful. Second, keeping the scope focused would increase the chance of success. The FTC is most knowledgeable about the fee practices in these sectors from its study on the economics of resort fees, warning letters to hotels, and Online Event Tickets Workshop. By focusing on sectors that the FTC understands well, the agency would be more likely to avoid partial compliance that would hurt businesses. Third, the rule would not cover fee practices with ambiguous welfare consequences or that are beneficial to consumers. Fourth, the rule would have well-defined limits. Firms would know whether they were in violation of the rule or not.