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NON-DECEPTIVE BREACH OF CONTRACT CONSTITUTES UNFAIR BUSINESS PRACTICE UNDER SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT

In *Orkin Exterminating Co. v. Federal Trade Commission*, 849 F.2d 1354 (11th Cir. 1988), *cert. denied*, __ U.S. __, 109 S. Ct. 865 (1989), the United States Court of Appeals for the Eleventh Circuit enforced a Federal Trade Commission ("FTC") order which found that Orkin Exterminating Company ("Orkin") committed an unfair practice within the meaning of § 5 of the Federal Trade Commission Act ("the Act"), 15 U.S.C. § 45(a) (1982 & Supp. IV 1986). In so holding, the court stated that Congress charged the FTC with adopting its own standards regarding unfair or deceptive practices. Accordingly, the court applied the FTC's unfairness standard and held that Orkin's unilateral increase of fixed annual renewal fees, although non-deceptive, was an unfair act or practice within the scope of the Act.

Background

Orkin is the world's largest termite and pest control company. Between January 1966 and February 1975, Orkin offered its customers a continuous protection guarantee in which the buyer could renew coverage by paying the fixed annual fee as stated in the contract. These "lifetime" guarantee contracts ("pre-1975 contracts") were to remain in effect for the life of the treated structure. There was only one provision in the contract which indicated that these fees were subject to increases. If an Orkin-treated building were structurally altered, the fee could be adjusted. In 1968, Orkin launched a six month advertising campaign—referred to as the "Orkin Twelve Point Plan"—which featured a special provision promoting the "lifetime" service contracts. Point Six of this plan plainly stated that annual renewal fees for "lifetime" guarantees would *never* increase. Orkin contracts made during this six month period did not differ materially from other pre-1975 contracts.

In 1978, Orkin investigated the feasibility and legality of increasing the renewal fees in the pre-1975 contracts. In this regard, Orkin's president prepared a memorandum in which he showed that a rise in renewal fees would produce revenues of almost $2.3 million. He also indicated that if renewal rates were increased, there would probably be a corresponding increase in complaints, administrative inquiries and customer lawsuits. He suggested that Orkin had the following options: maintaining the current renewal fees or raising the fees and handling the resulting problems on a case-by-case basis.

In August 1980, Orkin sent notices to approximately 207,000 customers with pre-1975 contracts informing them of an increase in their renewal fees of either twenty-five dollars or forty percent, whichever was greater. In response to customer complaints and official inquiries, Orkin adopted an "accommodation program." Orkin sent form letters to complaining customers explaining that Orkin had suffered losses due to inflation and that the increase was "both consistent with law and reasonable business standards," given the amount of losses Orkin had suffered. 849 F.2d at 1350.

As part of the accommodation program, Orkin sent a directive to its branch managers. They were informed that if a complaining customer had entered into a contract during the six-month period covered by the Orkin Twelve Point Plan, then the branch managers could roll back their fees only if the customer produced a pamphlet stating that the renewal fee would never increase. Orkin directed its branch managers to have the customers read this statement aloud in order to verify that it was identical to Point Six of the Twelve Point Plan. Customers who passed this "test," were informed that their increase was due to a computer error. Customers who did not have sales literature or who had sales literature without the verbatim wording of Point Six were told that their guarantee provided the fees would remain unchanged only for a "reasonable period."

Subsequent to its directive, Orkin expanded its accommodation program twice. In December, 1980, Orkin decided to allow roll backs for customers with pre-1975 contracts if they had relied on either sales presentations or on their own interpretation of the terms of the contract. By August 1984, Orkin had rolled back fees for approximately 21,500 customers. Over 42,000 customers had cancelled their contracts outright.

Administrative Proceedings

In May 1984, the FTC issued an administrative complaint alleging that Orkin's unilateral increase was an unfair act or practice within the meaning of § 5 of the Act because Orkin's pre-1975 contracts provided for a fixed annual renewal rate. Both parties moved for a summary decision pursuant to rule. The administrative law judge ("ALJ") held that Orkin's pre-1975 contracts did provide for a fixed renewal fee and that Orkin had breached these contracts; that the breach of contract could constitute a violation of § 5; that there was substantial consumer injury; that consumers could not reasonably have avoided this injury; and that there were no countervailing benefits to consumers or to Orkin's competition. The ALJ ordered Orkin to roll back all fees to the original level specified in the pre-1975 contracts. Orkin appealed to the FTC. The FTC upheld all aspects of the ALJ's decision and ordered Orkin to cease and desist from its unlawful conduct.

Judicial Proceedings

Orkin appealed to the United States Court of Appeals for the Eleventh Circuit challenging the FTC's order on three grounds. First, Orkin challenged that part of the FTC's order which concluded that the pre-1975 contracts unambiguously provided for fixed annual renewal fees. Orkin contended that because the pre-1975 contracts failed to expressly address the possibility of fee increases, the contracts were ambiguous. The court disagreed, holding that the plain language of the contracts precluded any finding of ambiguity concerning the annual renewal fees. The contracts unequivocally stated that customers were getting a lifetime service contract for a lifetime fixed annual renewal fee. In addition, because the language in the contracts was clear, the court held that the FTC had properly refused to allow Orkin to introduce extrinsic parol evidence tending to show ambiguity. Orkin also contended that the pre-1975 contracts were silent as to duration. The court concluded that the contracts made clear that the lifetime guarantees would last for as long as the stated renewal payment was made. Moreover, the court noted, the contracts contained a provision which allowed for adjustment of the renewal fee if the treated premises were structurally altered. If Orkin had wished to retain the option of raising renewal fees, it could have included another provision to that effect.

Second, Orkin argued that the FTC exceeded its authority under § 5. Section 5 states that "unfair or deceptive acts or practices in or affecting commerce" are unlawful, 15 U.S.C. § 45(a)(1) (1982), and empowers the FTC to prevent certain entities from engaging in such behavior. 15 U.S.C. § 45(a)(2) (1982). Orkin contended that the conduct in question was outside the scope of § 5 because this conduct did not involve deceptive or fraudulent behavior. The court explained that Orkin's argument was inconsistent with the ways in which the FTC's authority had developed, noting that the Supreme Court had approved the FTC's consumer unfairness doctrine.

In interpreting § 5, the FTC developed a consumer unfairness doctrine which is not restricted by traditional theories of anti-competitiveness or deception. In 1980, the FTC issued a policy statement setting forth a three-prong test for the unfairness doctrine. To justify a finding of unfairness, the injury to consumers must be substantial, must not be outweighed by any countervailing benefits to consumers or competition, and must be an injury that consumers could not reasonably have avoided. In the instant case, although the increased renewal rate did not substantially injure each individual consumer, the increase generated over seven million dollars in revenue to Orkin. The court concluded that the overall injury was substantial because it caused harm to a large number of people, and that the demonstrated increase in renewal fees did not enhance product quality or customer service, or provide other countervailing benefits. The court also concluded that consumers could not have reasonably avoided the injury because there was no evidence the customers could have obtained a similar contract with any of Orkin's competitors. The court ultimately determined that because the consumer injury test was not inconsistent with Congressional policy or prior FTC precedent, it would defer to the FTC's judgment.

Finally, Orkin argued that the FTC erred in failing to consider Orkin's evidence that it had relied on the advice of counsel. The court determined that the FTC had not based any part of its decision on a finding that Orkin had acted on the advice of counsel. More importantly, the court noted, Orkin's assumed reliance upon counsel was irrelevant to a § 5 action. Because § 5 focuses on consumer injury, the mental state of the entity accused of violating § 5 is immaterial. Therefore, a practice may be found to be unfair to consumers without a showing that the offending party intended to cause consumer injury. The court held that Orkin's supposed reliance upon counsel was simply not germane to the question whether Orkin's conduct was unfair under § 5.

The court affirmed the FTC's cease and desist order. The court enjoined Orkin from violating the terms of the FTC's order, and prohibited Orkin from collecting increased annual renewal fees from any pre-1975 contracts.

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