

ADVERTISING & MARKETING BULLETIN

December 2007

REFER WITH CARE – LEGAL CONSIDERATIONS FOR REFERRAL MARKETING PROGRAMS

Referral marketing is a category of word of mouth marketing used primarily by companies that generate sales from signing up customers to service contracts. For example, the popular Canadian exercise club, *Goodlife Fitness*, recently ended a program whereby members were entered into a draw for a free holiday to Las Vegas simply by referring a friend to the club for a free workout. Another example is *Nutri-lawn* which offered a \$40 credit to customers if they referred a family member or friend who signed up with the company for lawn care service. The practice of referral marketing has increased in recent years due to the ease of distribution of electronic messages over the Internet and in recent times, the popularity of social networking websites which allow companies to effectively focus referral marketing campaigns on target markets.

For many years, both the federal *Competition Act* and the *Ontario Consumer Protection Act* prohibited certain referral marketing practices. However, the relevant provision in the *Competition Act* was abolished in 1999, and in 2005 the *Ontario Consumer Protection Act, 2002* repealed the previous provincial prohibition on referral marketing. In discarding the provisions, both levels of government showed their acceptance of referral marketing as a relatively harmless practice. In addition, prohibitions against multi-level marketing and pyramid selling in the *Competition Act* addressed many of the “evils” thought to be associated with the practice of referral marketing.

For the most part, legislation in Ontario continues to be free from express prohibitions of referral marketing practices. There are, however, some exceptions in specific sectors, such as insurance and social services. Despite the absence of express prohibitions on referral marketing in Ontario’s consumer protection legislation, referral marketing is not a free pass for companies to exploit their customers. A company must ensure that it does not make a “representation that misrepresents or exaggerates the benefits that are likely to flow to a consumer if the consumer helps a person obtain new or potential customers.”

The legal framework applicable to referral marketing programs is in contrast to “stealth marketing”, another form of word of mouth marketing. Stealth marketing involves a marketer engaging with customers without disclosing that they are in fact paid by the business for which they are marketing a product or service. Businesses that use stealth marketing techniques are potentially at risk for violating the false and misleading representation and testimonial/endorsement provisions of the *Competition Act*.¹ The risks of an enforcement proceeding based on non-compliance with competition law in Canada was heightened when the US Federal Trade Commission published an opinion that stealth marketers must disclose their relationship with the business supporting the promotion.

Referral marketing programs that give existing customers fixed or potential financial incentives to sign up friends whether or not the customers disclose to their friends the potential reward, are different in nature from campaigns where actors are paid to covertly promote a product to random strangers. The latter tactic has an added element of deception. However, the line between acceptable referral marketing and potentially non-compliant stealth marketing is blurred with certain online promotions. For example, certain trendy influencers who have websites, blogs or social networking profiles may be compensated by companies for including the companies under their “favourite links” and for completed transactions resulting from the “referrals”. Companies involved in such practices should err on the side of caution and cause their affiliates to disclose that they will be compensated for making referrals.

¹ For more information about some legal issues connected with word of mouth marketing, please see the August 2006 Advertising and Marketing Bulletin “*Stealth Marketing: To Disclose or Not to Disclose*” by Bill Hearn, available online at: http://www.mcmbm.com/Upload/Publication/StealthMarketing_0806.pdf

Several other provinces have referral selling prohibitions in their consumer protection legislation. Many of these provisions have been part of the legislation for years, but for the most part have never been judicially considered. The language in the provisions is often vague and the scope of the application is not very clear. However, these provisions are still on the books and marketers should review their referral marketing programs with their legal advisers to ensure the programs are onside.

By Les Chaiet and Jeffrey Levine

Don't miss the presentations of our Advertising and Marketing Group's Co-Chairs, **Bill Hearn** and **Sharon Groom**, at the *Canadian Institute's 14th Annual Conference on Advertising and Marketing Law* on January 24h – 25, 2008 at the St. Andrew's Club & Conference Centre, (Toronto, Ontario).

Sharon and Bill will be presenting on the topics "*IP and Advertising: Protecting your Organization from Litigation*" and "*Mine's Better than Yours: Managing Legal Considerations in Comparative Advertising Campaigns*" respectively.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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ABOUT OUR ADVERTISING & MARKETING GROUP

The landscape of laws, regulations and codes governing advertising and marketing is complex and multi-jurisdictional. Our Advertising and Marketing Group has the knowledge and experience to help businesses comply with these legal requirements, without weakening the marketing effectiveness and creative brilliance of our clients' ideas. Our advertising and marketing clients operate in a wide range of business sectors, including automotive, food and beverages, consumer credit and other financial services, cosmetics, consumer goods, drugs, education, gaming, media and entertainment, electronics, publishing, medical devices, retail, textiles and telecommunications.

ABOUT McMILLAN BINCH MENDELSON LLP

McMillan Binch Mendelsohn LLP, one of Canada's leading business law firms, is committed to advancing our clients' interests through exemplary client service combined with thoughtful and pragmatic advice. The firm is a values-driven organization that takes a dynamic and sophisticated approach to providing practical and creative solutions to its clients. Its client first, team-based approach draws effectively upon our diverse expertise. The firm has a national, cross-border and international practice and has grown to be one of the top 20 largest firms in Canada. The firm is agile and flexible, committed to always striving for excellence. For additional information visit www.mcmbm.com.

For further information please contact your McMillan Binch Mendelsohn LLP lawyer or one of the Practice Leaders of our Advertising & Marketing Group listed below:

PRACTICE LEADERS

Sharon Groom	416.865.7152	sharon.groom@mcmbm.com
Bill Hearn	416.865.7240	bill.hearn@mcmbm.com

McMILLAN BINCH MENDELSON

TORONTO | TEL: 416.865.7000 | FAX: 416.865.7048

MONTRÉAL | TEL: 514.987.5000 | FAX: 514.987.1213

www.mcmbm.com