

# UNINTENDED LIABILITY

## Under the FTC Guides

By Jeffrey Richardson



In 2009, the Federal Trade Commission (FTC) revised the “Guides Concerning the Use of Endorsements and Testimonials in Advertising” (Guides).<sup>1</sup> The Guides provide a disclosure framework for marketing tactics in the blogosphere and beyond. Under the Guides and recent decisions, businesses must be proactive in monitoring intended and unintended advertising in the digital marketplace. Also, businesses must be aware of the ramifications when choosing to be dilatory in their review of items ranging from employee Facebook postings to disclosures required from third-party product commentators.

### The 2009 FTC Guides

The Guides, promulgated under Section 5 of the Federal Trade Commission Act and codified at 15 USC 45(a), empower the FTC to prevent acts involving “[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce....”<sup>2</sup> The 2009 Guides modified existing

practice significantly in three fundamental ways: (1) digital media and its “word of mouth” advertising were explicitly brought under the FTC regulations; (2) the scope of material connections between advertisers and endorsers, which must be disclosed, was altered; and (3) the safe harbor provided by the “results not typical” disclaimer has been eliminated, requiring a distinction between exceptional and typical results.

### Kasky and Commercial Speech

To be sure, the updated Guides are in line with jurisprudence regarding commercial speech. In *Kasky v Nike, Inc.*,<sup>3</sup> the California Supreme Court discussed the lack of constitutional value in false statements: “Neither the intentional lie nor the careless error materially advances society’s interest in ‘uninhibited, robust, and wide-open’ debate on public issues.”<sup>4</sup> As such, “[u]ntruthful speech, commercial or otherwise, has never been protected for its own sake.”<sup>5</sup>

## FAST FACTS:

Businesses must effectively monitor endorsements by employees and third-party advertisers, ensuring that material connections are disclosed.

Digital media and its “word of mouth” advertising are explicitly governed by Federal Trade Commission regulations.

The “results not typical” disclaimer has been eliminated, requiring a distinction between exceptional and typical results.

Specifically, the Court noted the differential treatment between commercial and noncommercial speakers:

A noncommercial speaker’s statements criticizing a product are generally noncommercial speech, for which damages may be awarded only upon proof of both falsehood and actual malice. A commercial speaker’s statements in praise or support of the same product, by comparison, are commercial speech that may be prohibited entirely to the extent the statements are either false or actually or inherently misleading.<sup>6</sup>

Inherently misleading commercial speech is simply incongruent with the goals of the First Amendment.

## Endorsements

In determining disclosure requirements, the threshold issue is whether the speaker’s statement is an endorsement, which may now include consumer-generated media:

However, if the statement does qualify as an “endorsement” under the construct set forth [ ] for determining when statements in consumer-generated media will be deemed “sponsored” . . . disclosure of the connection between the speaker and the advertiser will likely be warranted regardless of the monetary value of the free product provided by the advertiser.<sup>7</sup>

The FTC has revised the scope of endorsement to mean any advertising message “that consumers are likely to believe reflects the opinions, beliefs, findings, or experiences of a party other than the sponsoring advertiser, even if the views expressed by that party are identical to those of the sponsoring advertiser.”<sup>8</sup> An advertising message includes verbal statements, demonstrations, or depictions of the name, signature, likeness, or personal characteristics of an individual or an organization.<sup>9</sup> This broad definition of endorsement expands the material that comprises a message, shifting the focus to that communication which consumers are “likely to believe” is not organically arising solely from the sponsoring advertiser.

The Guides define an “endorser” to be an individual, group, or institution “whose opinions, beliefs, findings, or experience the message appears to reflect . . .”<sup>10</sup> Endorsements provided by consumers, experts, celebrities, and organizations are all regulated, requiring disclosure of material connections “[w]hen there exists a connection between the endorser and the seller of the advertised product that might materially affect the weight or credibility of the endorsement (i.e., the connection is not reasonably expected

by the audience). . . .”<sup>11</sup> Examples within the Guides requiring disclosure range from a college student who receives a free copy of a video game system, which results in the student’s blogging, to an employee of an MP3 player company who posts comments on a message board about the excellence of his employer’s device, to a “street team” member who receives free prizes for talking to his friends about a specific product.<sup>12</sup> Liability clearly lies with both the endorser and the advertiser:

The Commission recognizes that because the advertiser does not disseminate the endorsements made using these new consumer-generated media, it does not have complete control over the contents of those statements. Nonetheless, if the advertiser initiated the process that led to these endorsements being made—e.g., by providing products to well-known bloggers or to endorsers enrolled in word of mouth marketing programs—it potentially is liable for misleading statements made by those consumers.<sup>13</sup>

Advertisers must now be wary about how they engage with their partners to deter potentially misleading statements from reaching consumers.

## The Guide’s Requirements on Advertising Activities

The Guides have eliminated the safe harbor previously provided by using a “disclaimer of typicality” requiring that an “endorser’s experience is representative of what consumers will generally achieve with the advertised product or service in actual, albeit variable, conditions of use.”<sup>14</sup> The FTC now requires substantiation or a strong disclosure statement:

If the advertiser does not have substantiation that the endorser’s experience is representative of what consumers will generally achieve, the advertisement should clearly and conspicuously disclose the generally expected performance in the depicted circumstances, and the advertiser must possess and rely on adequate substantiation for that representation.<sup>15</sup>

Without proper substantiation, the advertiser should simply reconsider the appropriateness of the marketing strategy.

Along with the substantiation principles, the Guides require experts to possess sufficient qualifications surrounding the message content to provide “the endorser the expertise that he or she is represented as possessing with respect to the endorsement.”<sup>16</sup> Moreover, as applied to an organization, the spirit of substantiation requires a “collective experience [which] exceeds that of any individual member, and whose judgments are generally free of the sort of subjective factors that vary from individual to individual.”<sup>17</sup> This collective judgment should be reached through a process sufficiently broad to represent the organization as a whole.

Finally, celebrities are no longer permitted to simply read a script, but are now required to make reasonable efforts to ensure that statements are accurate. For a hypothetical scripted infomercial, the Guides require the following accountability:

[a] significant percentage of consumers are likely to believe the celebrity’s statements represent his own views even though he is

reading from a script. The celebrity is subject to liability for his statement about the product. The advertiser is also liable for misrepresentations made through the endorsement.<sup>18</sup>

Thus, it is clear that liability can lie with the advertiser and the endorser: self-blinding is not permitted.

### Ann Taylor Stores

The first test under the Guides involved Ann Taylor Stores, which provided “gifts to bloggers who the company expected to post blog content about the company’s LOFT division.”<sup>19</sup> Specifically, the inquiry focused on bloggers who attended previews of the summer 2010 collection and “failed to disclose that they received gifts for posting blog content about the event.”<sup>20</sup> There was concern that this violated the FTC Act, which requires the disclosure of a material connection between an advertiser and an endorser when the relationship is not otherwise apparent from the context of the communication that contains the endorsement.<sup>21</sup>

But the FTC declined to proceed with an enforcement action against Ann Taylor for three reasons. First, Ann Taylor held only one preview providing gifts. Second, a minimal number of bloggers posted content from the preview, with several disclosing the free gifts (Ann Taylor had posted a sign at the preview advising bloggers to disclose the gifts). Third, Ann Taylor had adopted a written policy soon after the preview, stating “it would not issue any gift to any blogger without first telling the blogger that the blogger must disclose the gift in his or her blog.”<sup>22</sup>

### *In the Matter of Reverb Communications, Inc*

Next, the FTC sought to enforce the Guides against Reverb Communications, which provides sales and marketing for gaming clients targeting consumers through iTunes. In the case, *In*

*the Matter of Reverb Communications, Inc*,<sup>23</sup> Reverb employees posted public reviews about client gaming applications in the iTunes store, giving readers of these reviews the impression they had been submitted by disinterested consumers.<sup>24</sup> These comments were overwhelmingly positive or clearly promoted the applications.

As the FTC found, these postings “were not independent reviews reflecting the views of ordinary consumers,” but rather the reviews were created by employees of Reverb, “a company hired to promote the gaming applications and often paid a percentage of the applications’ sales.”<sup>25</sup> The FTC alleged that failure to disclose this connection was a “deceptive practice.”<sup>26</sup>

After comments were received on the proposed consent order, the FTC issued a decision and order in which “material connection” was defined to “mean any relationship that materially affects the weight or credibility of any endorsement and that would not be reasonably expected by consumers.”<sup>27</sup> Having found that Reverb failed to disclose an existing material connection, the FTC issued an order preventing any further misrepresentation.<sup>28</sup> However, Reverb was not assessed monetary sanctions and the order self-terminates after 20 years, provided there are no additional violations.

### *In the Matter of Legacy Learning Systems, Inc*

Finally, in 2011, the FTC brought a complaint against Legacy Learning Systems, a company that manufactures and markets instructional DVDs. Legacy uses commissioned sales affiliates to sell its programs, with representatives earning 20–45 percent of each instructional course sold. The affiliates “promote Legacy’s instructional courses through positive endorsements in articles, blog posts, or other online editorial copy that contain hyperlinks to Legacy’s website in close proximity to the endorsements.”<sup>29</sup>



The FTC has revised the scope of endorsement to mean any advertising message “that consumers are likely to believe reflects the opinions, beliefs, findings, or experiences of a party other than the sponsoring advertiser...”

The postings gave the impression that they were submitted by ordinary citizens. For example, Legacy's advertisements stated:

Features: \*\*\*\*\* (5 stars out of 5 stars)

The undisputed No. 1 training product for someone wanting to learn how to play the guitar.

Learn and Master Guitar. 4.9/5 Stars

The best home study DVD course for guitar I have ever seen.

Learn and Master Guitar is by far the most comprehensive guide out there to help you learn to play the guitar... This truly is the most you can get for your money as far as a guitar course where you are able to learn at your own pace.<sup>30</sup>

Each of these ad affiliate comments was proximate to a hyperlink designed to facilitate a sale. Legacy was able to successfully use the ad affiliates to garner at least \$5 million in sales of its instructional courses.<sup>31</sup>

The FTC stated that Legacy took the steps to require that its affiliates comply with FTC guidelines on disclosures. However, Legacy "failed to implement a reasonable monitoring program to ensure that their Review Ad affiliates clearly and prominently disclose their relationship to Legacy."<sup>32</sup> Legacy represented "directly or indirectly, expressly or by implication, that the reviews of their instructional videos were independent reviews reflecting the opinions of ordinary consumers."<sup>33</sup> In sum, the FTC alleged that Legacy "failed to disclose, or disclose adequately, that the endorser receives financial compensation from the sale of Legacy's products."<sup>34</sup> The FTC labeled this fact material and the practice deceptive.

The FTC's decision and order issued on June 1, 2011, contains requirements similar to *Reverb*: Legacy cannot misrepresent the status of any user or endorser of a product or service and must require affiliates to "disclose, clearly and prominently, a material connection, when one exists...."<sup>35</sup> The *Legacy* decision expands the requirement to construct a disclosure monitoring system by requiring that Legacy maintain a system to review representations and disclosures to ensure compliance. Specifically, for its top 50 revenue-generating affiliates, Legacy was required to "monitor and review each of their web sites on at least a monthly basis at times not disclosed in advance to their Affiliates and in a manner reasonably calculated not to disclose the source of the monitoring activity at the time it is being conducted."<sup>36</sup> Regarding the remainder of its affiliates, Legacy was required to complete a review of a random sample at least monthly. If, during its review, Legacy determines that any affiliate misrepresented its status or failed to disclose its connection with Legacy, then Legacy must "cease payment" and "immediately terminate any Affiliate found to be in violation."<sup>37</sup> In the end, Legacy was required to pay the FTC \$250,000.<sup>38</sup>

## Conclusion

The 2009 FTC Guides provide an expanded framework for enforcement requiring increased awareness and monitoring to properly examine assertions, monitor ongoing third-party advertising,

and disclose endorsement connections. As shown in *Legacy*, the FTC has far-reaching power to require an entity to monitor affiliated third parties. Ignoring the Guides can result in the imposition of significant monetary penalties and supervisory requirements. ■



*Jeffrey Richardson is general counsel for Wall Street Productions, Ltd. in Southfield. His practice focuses on entertainment, licensing, and general business.*

## FOOTNOTES

1. 16 CFR § 255.0 *et seq.*
2. 15 USC 45(a)(1).
3. *Kasky v Nike, Inc.*, 27 Cal 4th 939; 119 Cal Rptr 2d 296 (2002).
4. *Id.* at 953.
5. *Id.*
6. *Id.*
7. 74 Fed Reg 53,134.
8. 16 CFR § 255.0(b).
9. *Id.*
10. *Id.*
11. 16 CFR § 255.5.
12. 16 CFR § 255.5, Example 7 through Example 9.
13. 74 Fed Reg 53,127.
14. 16 CFR § 255.2(b).
15. *Id.*
16. 16 CFR § 255.3(a).
17. 16 CFR § 255.4.
18. 16 CFR § 255.1, Example 4.
19. See Closing Letter Issued to Ann Taylor Stores Corp, FTC File No. 102-3147, April 20, 2010, available at <<http://ftc.gov/os/closings/100420anntaylorclosingletter.pdf>>. All websites cited in this article were accessed September 11, 2012.
20. *Id.*
21. 16 CFR § 255.5.
22. Closing Letter, n 19 *supra*.
23. See *In the Matter of Reverb Communications, Inc.*, unpublished decision and order of the FTC, issued November 22, 2010 (Docket No. C-4310), available at <<http://www.ftc.gov/os/caselist/0923199/101126reverbdo.pdf>>.
24. See *In the Matter of Reverb Communications, Inc.*, unpublished complaint of the FTC, issued November 22, 2010 (Docket No. C-4310), available at <<http://www.ftc.gov/os/caselist/0923199/101126reverbcmpt.pdf>>.
25. *Id.*
26. *Id.*
27. *Reverb*, n 23 *supra*.
28. *Id.*
29. See *In the Matter of Legacy Learning Systems, Inc.*, unpublished complaint of the FTC, issued March 15, 2011 (Docket No. C-4323), available at <<http://www.ftc.gov/os/caselist/1023055/110610legacylearningcmpt.pdf>>.
30. *Id.* at ¶ 7.
31. *Id.* at ¶ 8.
32. *Id.* at ¶ 9.
33. *Id.* at ¶ 10.
34. *Id.* at ¶ 12.
35. See *In the Matter of Legacy Learning Systems, Inc.*, unpublished decision and order of the FTC, issued June 1, 2011 (Docket No. C-4323), available at <<http://www.ftc.gov/os/caselist/1023055/110610legacylearningdo.pdf>>.
36. *Id.* at 4.
37. *Id.*
38. *Id.* at 5.