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MEMORANDUM

John P. Feldman, Reed Smith LLP: Thoughts on the Revised FTC Guides on Use of Testimonials and Endorsements in Advertising upon Their Effective Date, December 1, 2009

What does this mean for advertisers? In general, the modification of the FTC Guides on Testimonials signals a definite shift in enforcement attitude toward certain types of testimonial advertising. The Guides are neither laws nor regulations. They do not carry penalties nor can they be enforced on their own. They are guidelines that reflect where the FTC staff's thinking is in relation to this type of advertising. They are used by the National Advertising Division (NAD) extensively and can be a touch point for state attorneys general. Actions pursuant to section 5 of the FTC Act or a state unfair and deceptive practices act may use the Guides as a reference when determining whether a particular advertising practice is deceptive. Thus, the Guides are very important for anyone who engages in this sort of advertising, and they have received an increased level of attention because of their application to new media channels, which permit a greater degree of opinion dissemination and a much lesser degree of sponsor control.

What is the most dramatic shift in enforcement policy? There are a few dramatic shifts. What is most "dramatic" will depend on what sort of advertiser you are. Probably the shift that is universally viewed as a true shift in enforcement policy is the departure from "disclaimers of typicality," that is, those disclaimers attached to virtually all consumer testimonials that state that the results depicted are not typical or that results vary. At its root, this shift is a restatement of the basic tenet of advertising law that every claim in advertising, both express and implied, must be substantiated. Applied to consumer testimonials, in which a consumer states his opinion, experience, or findings regarding an advertised product or service, and the sponsoring advertiser presents that consumer statement as evidence of the product's or service's efficacy, the sponsoring advertiser must substantiate not only the express claim that the consumer actually held that opinion, had that experience, or made those findings, but also that *the implied claim* that experience or findings of the endorser are typical of that which consumers generally will experience with the product or service. The FTC acknowledges that there has been a shift in policy but only to place those implied claims on the same footing with all other implied claims. That is, to the extent the results depicted are not typical, the advertiser must do more than simply disclaim typicality; he must "clearly and conspicuously disclose the generally expected performance in the depicted circumstances, and … possess and rely on adequate substantiation for that representation." But, to marketers, particularly those who advertiser dietary supplements, weight loss products, or other self-improvement products, this raises a slew of new considerations and potential costs.

1. Can the claim be presented in a manner that does not imply typicality? What additional facts about the circumstances under which the consumer used the product need to be disclosed? How can an advertiser best capture those special circumstances at the testimonial affidavit stage so that the creative team can appropriately build those circumstances into the overall communication? There may be ways to use visual or voice-over cues that will communicate, for example, that a person ate healthy meals and exercised extensively in addition to using the advertised product to achieve the depicted results. If the advertiser is able to do this, the advertiser may achieve the best solution because there should be no need to substantiate the "typical" experience.

2. If the claim states or implies typicality, what type of substantiation is required to support the "generally expected performance" of the advertised product or service? The FTC has stated that this does not mean that the advertiser needs to determine an exact mathematical average of users of the product. But, the advertiser will need some sort of well-controlled clinical study of subjects matching the profile of the persons depicted in the advertisement. It may be that generally accepted scientific principles could form the basis of that support.

3. Assuming the advertiser has the right type of support, what outcome incidence will constitute "typicality"? The FTC has implied that a 20% incidence is not likely to be viewed as "typical." What about 33⅓%? Forty-nine percent? Fifty-one percent? And, what sort of data and statistical analysis is appropriate? Should advertisers establish a "50-95" rule, that is, should they ensure that they achieve the depicted results 50% of the time at the 95% confidence level? What statistical models should be viewed as most reliable and defensible?

What will this mean for advertisers that use celebrity endorsers? The FTC has sought to "codify" a position that it has fought for in court – and lost (or at least has not won). The Commission has stated that the revised Guides do not create new liability for celebrities but only restate a principle that the Commission has already asserted through consent agreements, namely that endorsers may be subject to liability for their statements. The FTC tried to defend this "principle" in federal court and was unsuccessful. *FTC v. Garvey*, 383 F.3d 891 (9th Cir. 2004). But, the Commission maintains that the court's decision never reached the principle itself and only held that the FTC could not obtain restitution damages from the defendant. The court, according to the FTC, left open the possibility that the FTC could seek injunctive relief against the celebrity. With that window possibly left open, the FTC may continue to reach through the advertiser and name the celebrity in an enforcement action. (One can anticipate that when this happens there will be an interesting lawsuit that will finally decide whether the Commission has the right to do this absent a showing that the celebrity was at least a partial owner of the company sponsoring the advertisement.) This leaves advertisers and celebrities with some interesting practical concerns.

1. What needs to go into the celebrity talent agreements? What additional burden does this place on talent? What about long-term talent agreements? Must they be renegotiated?

2. Because there are contexts and media today in which the celebrities are not under direct control by the advertiser (e.g., unscripted interviews, blogs and other social media), what responsibility will an advertiser have for a celebrity's failure to make clear that material connections exist between the advertiser and the celebrity? Should there be additional guidelines and contract terms inserted into talent agreements? What sort of new monitoring programs must be put into place to ensure that the celebrity does not create liability for the sponsoring company?

How much control should sponsoring advertisers exercise over endorsers in new media channels? The FTC has sought to "update" its enforcement policy with regard to disclosure of "material connections" in connection with new media and non-traditional media. A "material connection" is a connection between the endorser and the sponsoring advertiser that, if known to the audience of the advertisement, would affect the weight given to the endorsement. In this context, the Commission is probably confounding the well-established principle of unlawful deception with the less easily defined concept of "materiality." There is no doubt that the sort of deception occurring with "astroturfing," as seen in the New York Attorney General actions against Lifestyle Lift, is actionable. When an advertiser essentially makes up endorsements and testimonials, the advertiser is liable. In that case, the advertiser and the "endorser" were essentially one and the same. In the context of a blogger, on the other hand, who is well-known for his review of computer games and who receives free games from a game company and reviews them on his blog, the blogger is not the same entity as the advertiser. There is no deception as to whether the blogger is separate from the sponsoring advertiser. The Commission's concern is that the free software provided to the blogger might imply to the audience some sort of *quid pro quo* relationship that would lessen the reliability of the review. Thus, this concern over a material connection between the advertiser and the blogger touches on something far less clear than deception. It relies on certain assumptions about how people view blog sites and reviews by bloggers. *The FTC has presented no evidence that consumers are being deceived by bloggers who review products and services on the Internet.* Yet, the rationale for applying its Guides in a context in which an established blogger receives samples from manufacturers (in the absence of an express agreement to make positive comments) is to prevent deception. Although the Guides are not laws or regulations, as discussed above, they are used as benchmarks for determining what is or may be deceptive. Thus, by incorporating the new examples for "new media" and non-traditional media, the FTC has infused confusion into the marketplace and will undoubtedly encourage disclosure of "material terms" that are probably more likely to confuse consumers than help them. At the very least, this will force marketers to include speech that is not warranted by any demonstrated harm, thus raising Constitutional questions. Moreover, because its approach is so confused, the FTC is forced into illogical distinctions in order to protect so-called "traditional" media channels at the expense of "non-traditional" media channels.

Ultimately, the FTC must prove that an advertiser's payment or other material connection with the endorser is deceptive. But, short of a lawsuit against the FTC, a marketer is faced with the prospect of getting roiled in the Commission's "enforcement activities" – meaning an investigation and possibly a compliant leading to a consent order – or taking prophylactic steps. Thus, in the meantime, marketers should consider:

1. Does the marketer have guidelines in place internally so that it knows when it is engaging in "sponsorship" of advertising on blogs, on message boards, in social media generally, and in non-traditional media?

2. Does the marketer have guidelines in place that are externally facing to notify the potential "sponsored" endorsers of their responsibilities to disclose the nature of the "sponsorship"?

3. Does it have a mechanism in place to retain records of these sponsorship relationships with confirmation that guidelines have been disseminated and to monitor compliance with the guidelines?

Only through the use of such guidelines will an advertiser be able to demonstrate to the FTC that it has taken appropriate steps to avoid deception and that an investigation is unwarranted.

What impact will the FTC's new approach to clinical trials have on the OTC, cosmetic, and pharmaceutical industry? The Commission reversed course on whether an advertiser's payment of expenses to a named outside entity that conducted a study must be disclosed if the advertiser uses the results of the study in advertising. Under the old enforcement position, the Commission was confident with the application of general testimonial principles that would negate the need to disclose the payment as a "material connection." The underlying assumption was that an independent third party laboratory would not risk its reputation by "selling out" to the advertiser and producing shoddy, unreliable data to support an advertising claim. Moreover, the entity would be treated as an expert organization. Under the Guides (even as revised), for example, a snoring expert, could endorse a snoring product even if he were "reasonably compensated" without disclosing that he had been paid. According to the FTC, it would be assumed by the consumer that the expert would be compensated for his time. However, somehow (completely unexplained by the Commission) the manufacturer of the anti-snoring product would have to disclose that an expert organization that conducted a study (using completely independent protocols) had received payment if the results of the study were used to substantiate the claim. This ill-conceived, contradictory position will undoubtedly haunt the Commission, but in the meantime, it will have a significant impact on those who advertise products using claims that are typically substantiated through clinical trials. To avoid an investigation by the FTC, those advertisers will need to consider:

1. Does the FTC mean to apply the "material connection" disclosure requirement only when the name of the third-party organization is mentioned in the claim? Could the Guides

apply if the advertiser merely states that the results were proven by tests conducted by an "independent lab"? Arguably, without a mention of an expert or an organization there is no "endorsement." The claim may be deceptive because the lab is not "independent," but it would not necessarily be deceptive merely because the advertiser did not disclose that it had paid an outside lab's expenses in conducting the study. Hopefully, with some targeted clarification from the Commission, those in the OTC/pharmaceutical and cosmetic industries (and others) will be able to confirm that the Guides only kick in when an advertiser expressly calls out that the results described in the advertisement emanate from "findings" of a specifically named organization. That would limit the application of the Guides substantially in this context and would carve out all other establishment claims that do not name the independent lab. Of course, such establishment claims would be actionable if they were otherwise deceptive.

Is there a role for self-regulation and what do you make of the proposed "best practices" recently announced by the Word of Mouth Marketing Association (WOMMA)? Self-regulation is almost always preferable to government intervention. When Reed Smith drafted comments on behalf of the Association of National Advertisers (ANA) and WOMMA in response to the FTC's proposed revisions to the Guides, we urged the Commission to stick to its basic principles and not try to force those principles into "new media" examples which were heavily nuanced and highly variable depending on the form of the media and the context. Section 255.0 of the Guides created a subset of expression that communicated the opinions or beliefs about a product or service of someone other than the manufacturer or marketer of the product or service. In this subset, the expression is meant to communicate preferences among friends, colleagues, and those with similar interests. There is another subset of expression that consists of sponsored statements. When those two subsets intersect – i.e., when you have expressions of opinion that are sponsored by an advertiser – the Guides apply. Thus, the regulation of endorsements and testimonials pursuant to the Guides only applies when the communication by a person other than the advertiser about a product or service is "sponsored" by the advertiser. The FTC adopted this view in its final statement of basis and purpose.

However, when it came to dealing with disclosure of "material connections," ANA and WOMMA pointed out several aspects of section 255.5 and its accompanying examples that were far too vague to be of use to marketers. The Commission did not heed these admonitions and the result has been uproar in the blogosphere and attempts by the FTC to mollify bloggers, traditional reviewers, marketers and others who, based on the language in the revised Guides, are understandably perplexed and nervous.

Self-regulation can be a leading force that works with industry and the Commission to drill down on section 255.5 and its examples and to help flesh out how and where the testimonial principles apply and where they do not. Self-regulation, to be valuable, needs to be a counterforce against ambiguity; it needs to promote dialog and examination of various situations; and it needs to document its research and its dialog. One needs to look no further

than the National Advertising Division to see an example of how self-regulation can work. The NAD publicly examines the principles underlying section 5 of the FTC Act and painstakingly addresses views from both sides of an advertising dispute over those principles. Moreover, it publishes those results in detail. Most national advertising disputes are handled before the NAD, saving resources both for the Commission and for the participants in the process. Another example is the Children's Advertising Review Unit. CARU has helped to shape children's privacy particularly over the last 18 years and was a leading force in helping the Commission fashion workable rules under the Children's Online Privacy Protection Act. Over the last 12 years, CARU has handled scores of kid privacy cases and has helped to create a body of self-regulatory guidelines that are reflected in the FTC's own COPPA FAQ web area. Self-regulation saves time, energy, and resources, and is flexible enough to deal with new contexts and media as they arise or are developed.

Self-regulation in the context of word-of- mouth marketing can be equally valuable. WOMMA's current articulation does not yet appear to have been given the sort of rigorous analysis necessary to be ready for prime time. WOMMA's proposed "best practices" do not appear to take into account the "sponsorship" analysis it forcefully submitted to the FTC and which the industry supports, and WOMMA's "best practices" only relate to disclosure conventions. They do not offer guidance that would enable manufacturers to avoid a "sponsorship" relationship under the current FTC Guides. For example, in its "Review Blog" section, WOMMA suggests that a reviewer should "Disclose any product, service or compensation provided by a marketer." However, even the FTC expressly notes in its own statement accompanying the revised Guides that a reviewer, employed by a traditional or electronic periodical with independent editorial responsibility, need not disclose "freebies" if they are funneled to him through his employer in the context of his employment for the purpose of writing reviews. While the WOMMA materials provide "best practices" as to how best to disclose a "material connection," they do not tackle the fundamental question that keeps many manufacturers and advertisers awake at night, namely, what connections are "material" and when and under what circumstances can one refrain from – or be forced to – disclose that connection, especially in the social media context.

Thus, yes, self-regulation has a role to play, especially in the context of social media marketing. We are hopeful that the marketing industry leaders will explore new examples and contexts that will illustrate how the FTC's Guides should be properly applied. It is premature to determine with any finality how far the Guides will go. It is also critical to remember that the Guides do not, in and of themselves, have the force or effect of law. So it is important to be careful when suggesting revisions to current practices when there is not necessarily a legal requirement to do so.

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