



ABC's of The FTC and False Advertising

By: Jim Astrachan

Competitors can sue an advertiser and its agency under the Lanham Act for false advertising. But, advertisers often overlook the ability of the Federal Trade Commission to bring an action for violation of the Federal Trade Commission Act, which give the FTC the power to stop false advertising.

The FTC can pursue the advertiser, its agency, and their employees. It can fine, and enjoin, them. If the advertiser or agency is a subsidiary of another company, the FTC can go after the parent. The FTC can even impose liability for false advertising on a merged successor.

When the FTC examines an ad to determine whether it is false, it will look at express and implied representations. Where information is necessary to prevent a claim from misleading consumer, but it is not provided, the FTC will likely conclude that the ad is deceptive.

An ad need not actually mislead consumers. It is still false if, in the subjective determination of the FTC staff, the ad is likely to mislead those consumers that the FTC believes to be reasonable. This means that the impact of the ad on foolish or feeble minded consumers should be ignored. However, if the ad is targeted at a

particular group of consumers, such as mentally impaired persons or children, the impact of the ad on that class of consumers will be considered even if the ad's claim would be ignored as silly by other consumers.

The most important factor in judging whether the ad is deceptive, or false, is the materiality of the claim. The FTC has published advice that information is material if it would be considered important by consumers as they consider their purchase decisions. The FTC automatically considers express claims to be material. When judging materiality, the FTC attempts to create for itself the mind of reasonable consumers and asks whether these consumers would consider the claim to be important to their decision to act. Claims considered material by the FTC are purpose, safety, efficiency, cost, durability, warranty and quality.

Prior Substantiation.

When an advertiser makes an objective claim, the FTC requires that the claim be substantiated by the advertiser before the ad runs. Consumers, the FTC reason, rely on the advertiser's claim and believe that the claim would not be made by the advertiser if not already substantiated. The FTC's logic follows, then, that if consumers rely on prior substantiation, and that advertisers are aware of this reliance, failure to have prior substantiation is an unfair and deceptive practice. To be actionable the FTC need not show that the claim is false, although if the advertiser can demonstrate the truth of its claims it is not likely to be prosecuted for lack of prior substantiation. The nature of the claim should determine the required substantiation.

“Four out of five mechanics recommend...” must be substantiated with a relevant survey.

Individual Liability.

The FTC Act allows civil prosecution of individuals if they participate in the advertising, or had the right to stop the activity, and had knowledge that the claims were false. The FTC can establish that individuals had knowledge if there was actual knowledge of material misrepresentations, reckless indifference to the truth or an awareness of a high probability of fraud together with intentional avoidance of the truth. The FTC is likely to hold individuals liable when an advertiser or agency is small and the charged individuals actually created the ads or schemes.

Agency Liability.

An agency can be liable for false advertising by creation or distribution of the misleading ads. The FTC believes that an ad agency has a duty to question claims made by its clients and to require prior substantiation where appropriate. While an agency that acts merely as a media buying service may not have liability for false ads, an agency that creates and distributes the ads likely will. In one case the FTC ruled that an agency has an affirmative duty to assure that advertising under its supervision did not have the capacity to deceive consumers. An agency with responsibility to develop a marketing plan can be held strictly accountable for the truthfulness of its ads.

This was the case when a famous New York agency was taken to the wood shed for its role in reforming the roof structure of Volvos to make them appear safer in a TV ad than they really were. The FTC ordered the embarrassed agency to pay a six figure fine.

Successor Liability.

Entities that acquire advertisers and their agencies in merger transactions can also be liable for the acts of the acquired company under the FTC Act. Often this occurs where the successor is controlled by the principals of the merged entity, but almost all FTC orders, and requests for injunction, seek to bind successors and assigns. The FTC will generally be successful in binding successors to its orders when the successor has acquired substantial assets of its predecessor and continued unchanged and without interruption substantially the business of the predecessor.

Under the FTC Act a parent can be held liable for the acts of its subsidiary. Generally, this liability is imposed when the parent is the alter ego of the subsidiary, as determined by commingling employees and assets, thin capitalization and failure of the parent and subsidiary to recognize the corporate formalities that allow two entities to maintain their independent legal existence.

How does an advertiser know the FTC is watching? It does not. While the FTC can respond to a competitor's or consumer's complaint and it also conducts its own monitoring of all the media. An advertiser running false advertising must assume that someone unfriendly is watching.

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