UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: Deborah Platt Majoras, Chairman
Orson Swindle
Thomas B. Leary
Pamela Jones Harbour
Jon Leibowitz

In the Matter of	)	
	)	
TELEBRANDS CORP.,	)	
a corporation,	)	
	)	
TV SAVINGS, LLC,	)	
a limited liability company, and	)	Docket No. 9313
	)	
AJIT KHUBANI,	)	
individually and as president of	)	
Telebrands Corp. and sole member	)	
of TV Savings, LLC.	)	
	)	

MOTION OF THE NATIONAL ASSOCIATION OF
CHAIN DRUG STORES FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The National Association of Chain Drug Stores ("NACDS") respectfully submits this Motion for Leave to File a Brief *Amicus Curiae* in the pending matter. A copy of the Brief *Amicus Curiae* that NACDS proposes to file is attached to this Motion.

NACDS is a non-profit trade association that represents more than 200 chain community pharmacy companies, which operate more than 35,000 retail pharmacies. The members of NACDS have a vital concern with the resolution of the legal issues presented in this appeal. Retail chain drug stores sell large numbers of generic, non-prescription, private label pharmaceutical products -- such as vitamins, pain relievers, cold medicine, and nutritional supplements – virtually all of whose brand-name

equivalents make health, efficacy and other claims about the products. In many cases, these generic or private label products are advertised and sold to consumers under so-called "compare and save" advertisements, in which the pharmacies emphasize that these products have the same physical properties as the name-brand product (such as pharmaceutical equivalence) but have substantial price benefits for the consumer.

Members of NACDS are concerned that under *Porter & Dietsch, Inc. v. FTC*, 605 F.2d 294 (7th Cir. 1979), the decision of the Administrative Law Judge might threaten them with liability if there were misleading statements in advertisements for products that were the basis of a "compare and save" marketing claim, even though the chain had no knowledge of the falsity. Accordingly NACDS wishes to submit the attached Brief *Amicus Curiae*, which requests that, in its decision in this matter, the Commission explicitly address two legal issues that are of great importance to its members: (1) when may the existence of an implied claim be determined based on so-called "facial analysis" of an advertisement?; and (2) may an advertiser that markets a product through a "compare and save" advertisement be held derivatively liable for misleading implied claims that may have been present in advertisements for products that were part of the target universe for the "compare and save" advertisement?

The proposed Brief *Amicus Curiae* would not support either party in this appeal. Rather, the Brief would request that the Commission resolve these two legal issues and sets forth legal principles and practical considerations that the NACDS believes should guide the Commission in establishing clear rules on these points. NACDS has learned only recently of the pendency of this appeal and the legal issues it presents. This Brief has been prepared and submitted as expeditiously as possible. Since the proposed Brief

is submitted approximately three weeks before the Brief of Complaint Counsel is due and well before the Reply Brief of Appellant Telebrands is due, the filing of this Brief *Amicus Curiae* will not prejudice either of the parties to this appeal.

For these reasons, the National Association of Chain Drug Stores respectfully requests that the Commission grant this Motion for Leave to File the attached Brief *Amicus Curiae* in this matter.

Respectfully submitted,

Don L. Bell, II
General Counsel
National Association of
Chain Drug Stores
413 N. Lee Street
Alexandria, Virginia 22314

November 10, 2004

CERTIFICATE OF SERVICE

I hereby certify that on November 10, 2004, pursuant to Federal Trade Commission Rules of Practice 4.2(c) and 4.4(b), I caused the foregoing Motion of the National Association of Chain Drug Stores for Leave to File Brief *Amicus Curiae* and Brief *Amicus Curiae* to be filed and served as follows:

(1) an original and twelve (12) paper copies filed by hand delivery and an electronic copy in Microsoft Word format filed by e-mail to:

Donald S. Clark, Secretary
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Rm. H-159
Washington, D.C. 20580
E-mail: secretary@ftc.gov

(2) one (1) paper copy served by hand delivery to:

The Honorable Stephen J. McGuire
Chief Administrative Law Judge
600 Pennsylvania Avenue, N.W.
Rm. H-112
Washington, D.C. 20580

(3) one (1) paper copy served by hand delivery and e-mail to:
(4)

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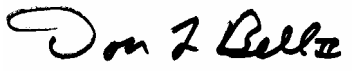
I further certify that the electronic copy sent to the Secretary of the Commission is a true and correct copy of the paper original, and that a paper copy with an original signature is being filed with the Secretary of the Commission on the same day by other means.



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BRIEF OF THE NATIONAL ASSOCIATION OF
CHAIN DRUG STORES AS AMICUS CURIAE

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BRIEF OF THE NATIONAL ASSOCIATION OF CHAIN DRUG STORES AS AMICUS CURIAE

The National Association of Chain Drug Stores submits this Brief Amicus Curiae to request that, in its decision in this matter, the Federal Trade Commission establish express standards to resolve important legal issues of recurring significance for chain drug stores.

Interest of Amicus Curiae the National Association of Chain Drug Stores

The National Association of Chain Drug Stores ("NACDS") is a non-profit trade association that was founded in 1933. NACDS membership consists of more than 200 chain community pharmacy companies, which operate more than 35,000 retail pharmacies with sales of prescription drugs totaling approximately $124 billion and

combined sales of over-the-counter medication and health and beauty aids totaling approximately $73 billion. NACDS membership also includes more that 1,000 suppliers of goods and services to community pharmacies.

The chief purpose of NACDS is to represent the views and policy positions of its member chain drug companies. NACDS accomplishes this purpose through a number of programs and services, including ensuring that the perspective of the community retail pharmacy companies with respect to public policy issues is communicated to and understood by policy-makers.

Retail pharmacies run by NACDS members sell many "generic" products in competition with those marketed by other companies, such as private label health and beauty aids that are produced by manufacturers but are marketed and sold under the name of the chain pharmacy. In particular, retail chain drug stores sell large numbers of generic, non-prescription, private label pharmaceutical products -- such as vitamins, pain relievers, cold medicine, and nutritional supplements – virtually all of whose brand-name equivalents make health, efficacy and other claims about the products. In many cases, these generic or private label products are advertised and sold to consumers under so-called "compare and save" advertisements, in which the pharmacies emphasize that these products have the same physical properties as the name-brand product (such as pharmaceutical equivalence) but have substantial price benefits for the consumer.

Members of NACDS are concerned with the potential for liability created by the decision below. In *Porter & Dietsch, Inc. v. FTC*, 605 F.2d 294 (7th Cir. 1979), the Commission held a retail drug store chain liable, on a strict liability basis, for misleading representations in an advertisement for non-prescription weight reducing tablets, even

though the chain simply participated in co-operative advertisements created by a manufacturer through which it received advertising materials and instructions for their publication, and even though nothing in the record indicated that the chain had any knowledge that representations in the advertisements were false and misleading. *Id*. at 308-309. Under the *Porter & Dietsch* precedent, the decision by the ALJ might threaten the members of NACDS with liability if there were misleading statements in advertisements for products that were the basis of a "compare and save" marketing claim, even though the chain had no knowledge of falsity.

Accordingly, the members of NACDS have a vital concern with the resolution of the legal issues presented in this appeal.

INTRODUCTION AND SUMMARY OF ARGUMENT

This appeal presents two important questions of law that have not been, but should be, explicitly addressed by the Commission.

> (1) When may the existence of an implied claim be ascertained based on so-called "facial analysis" of an advertisement, without resort to extrinsic evidence of actual consumer understanding of what claims were made, and when must the Commission base its decision on such extrinsic evidence?
>
> (2) May an advertiser who markets a product through a "compare and save" advertisement be found derivatively liable, on an incorporation by reference theory or other basis, for misleading claims that were present in advertisements for products that were part of the target universe for the "compare and save" advertisement?

NACDS submits that the Commission should adopt clear standards to control its decisions and to provide appellate courts with meaningful standards against which to review the Commission's decisions. Such explicit rules also would serve the important function of providing guidance to chain drug stores and other retailers that advertise their

products about the principles that will be applied to future advertisements and so that these retailers may conform their conduct to the law.

In this case, the Administrative Law Judge ("ALJ") found that advertisements for the Ab Force Ab Belt violated Sections 5 and 12 of the Federal Trade Commission Act. The ALJ found that express claims made by the advertisements constituted "compare and save" claims, by which the manufacturer claimed that the Ab Force product contained the same technology as, but was cheaper than, competing products manufactured by other companies.[1] The explicit claims were not found to mislead consumers.

The ALJ found, however, that the advertisements made certain implied claims for the Ab Force product and that these claims were misleading. Initially, the ALJ held that Complaint Counsel had not met its burden of proving its claim that references to other ab belt infomercials had an effect on the implied claims that consumers would take away from the Ab Force advertisements. But the ALJ then applied a process known as "facial analysis" and found that four implied claims were made by the advertisements:

> [I]t is clear from the other evidence of the surrounding circumstances, including . . . the development of the Ab Force campaign, when combined with the product name, visual images, and statements, that the ads make the claims that use of the Ab Force causes loss of inches, weight, and fat; causes well-defined abs; and is an effective alternative to regular exercise.

(Slip. op. at 47). The ALJ also found that "[a]lthough an examination of the extrinsic evidence is not necessary for disposition of this case, that evidence likewise supports the Court's conclusions." *Id*.

The process followed by the Administrative Law Judge in determining the existence of implied claims threatens to create substantial problems for NACDS members

[1] The only express claim that was not a "compare and save" claim involved the words "Relaxing Massage", which appeared on screen in block letters over the stomach of the user of the product.

and other retailers that market products that are sold in their stores in competition with national brands under comparative advertisements, including products sold under private labels. The ALJ's application of the "facial analysis" doctrine goes well beyond the Commission's decisions in *Kraft* and *Stouffer*, the two principal cases in which the Commission has applied that doctrine.[2] In those cases, the implied claims that the Commission judged to be misleading were more clearly evident on the face of the advertisements, and they directly reinforced, and were reinforced by, the explicit claims that were made. In this case, however, the express claims addressed a completely different aspect of the product – price and technology comparisons with other products already in the market – rather than the health and appearance claims that the ALJ found to have been implied. The ALJ nonetheless found that the implied claims were misleading, based on his determination that he could "conclude with confidence" that the claims were reasonably evident on the face of the advertisements.

The ALJ thus based his determination of the existence of implied claims on an "I know it when I see it" analysis, without consideration of extrinsic evidence of the actual understanding of consumers. That approach threatens to expand substantially the potential liability of marketers under Sections 5 and 12 of the Federal Trade Commission Act, without (1) providing an objective rule that would govern in future Commission cases, thus assuring that similar cases are decided in the same way; and (2) providing a rule that would permit meaningful appellate review of the Commission's actions. Further, the absence of an explicit rule, and the reliance on the impressionistic and standardless judgment of the ALJ, deprives retail stores that market products on a

[2] *In re Kraft, Inc.*, 114 F.T.C. 40, 121 (1991), *aff'd* 970 F.2d 311 (7th Cir. 1992), *cert. denied*, 509 U.S. 909 (1993); *In re Stouffer Foods Corp.*, 118 F.T.C. 746 (1994).

"compare and save" basis of objective, functional criteria that they can use in the due diligence process for future advertisements.

If adopted generally in false advertising cases, the ALJ's broad application of the "facial analysis" doctrine could undermine the statutory scheme created by Section 5 of the Federal Trade Commission Act, by permitting imposition of liability on an intuitive "it seems to me" basis ungrounded in objective facts of record. The ALJ's reliance on the "conclude with confidence" rationale does not solve this problem, because reviewing courts must base their determinations on the facts of record, not the beliefs or intent of the agency decisionmakers. *United States v. Morgan*, 313 U.S. 409, 422 (1941). Indeed, as applied under these circumstances, the "facial analysis" approach utilized by the ALJ threatens to create substantial First Amendment problems, by purporting to regulate protected commercial speech on an "it seems to me" basis in violation of the Commission's obligations established by the Supreme Court in such cases as *Edenfield v. Fane*, 507 U.S. 761 (1993), and *In re R.M.J.*, 455 U.S. 191 (1982).

In resolving this appeal, the Commission should follow the recommendation of the Seventh Circuit in *In re Kraft*, 970 F.2d 311 (7th Cir. 1992), *cert. denied*, 509 U.S. 909 (1993), and establish a clear principle governing when the existence of implied claims may be based on application of "facial analysis" and when their existence must be based on objective factual evidence in the record.

The Commission also should use this case as a vehicle to establish an explicit standard concerning whether the sponsor of a "compare and save" advertisement may be deemed derivatively liable for claims that it never made but that were later found to be

misleading as set forth in an advertisement for a product that was the target of a bona fide "compare and save" advertisement.

ARGUMENT

I. THE COMMISSION SHOULD ESTABLISH A CLEAR STANDARD AS TO WHEN EXTRINSIC EVIDENCE IS REQUIRED TO ESTABLISH THAT AN IMPLIED CLAIM HAS BEEN MADE.

It is settled that the primary evidence of what claims an advertisement conveys to reasonable consumers is the advertisement itself. *In re Kraft, Inc.,* 114 F.T.C. 40, 121 (1991), *aff'd* 970 F.2d 311 (7th Cir. 1992), *cert. denied*, 509 U.S. 909 (1993). A claim may be either express or implied. This appeal presents a broad and important question about the process that the Commission will follow in defining what implied claims are made to consumers.

Current Commission precedents hold that implied claims may be found only where the FTC can "conclude with confidence", after examining all of the constituent elements of the advertisement, that the challenged implied claims are conspicuous, self-evident, or reasonably clear on its face. *In re Stouffer Foods Corp.,* 118 F.T.C. 746, 777 (1994)(citing *Kraft*, 970 F.2d at 318); *Thompson Medical*, 104 F.T.C. 648, 788-789 (1984), *aff'd* 791 F.2d 189 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1086 (1987). Further, *Stouffer* holds that the determination of claims should not be based on a few parsed elements taken out of context. Instead, the Commission must consider the overall net impression of the advertisement, taken as a whole. *Stouffer*, 118 F.T.C. at 777 (citing *Thompson Medical*, 104 F.T.C. at 793). Indeed, *Stouffer* teaches that individual words,

phrases or visual images contained in an advertisement can effectively counter other words, phrases or visual images that are contained in the same advertisement.

The Commission has never adopted a general standard defining when an advertisement may be deemed to contain misleading implied claims based on a "facial analysis" of its contents. The Supreme Court has rejected imposition of a requirement that the Commission must, in every case, conduct a consumer survey as a prerequisite for determining that an implied claim has been made in an advertisement and that it has a tendency to mislead. *See FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 391-392 (1965); *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 645-646 (1985). However, rejection of this polar position does nothing to answer the more important question about the circumstances in which, in the broad run of cases, record evidence of actual consumer understanding must be introduced before the Commission may lawfully conclude that an implied claim was made.

As the Seventh Circuit recognized in *Kraft*, implied claims fall on a continuum, ranging from the obvious to the barely discernable. 970 F.2d at 319, citing *In re Thompson Medical*, 104 F.T.C. 648, 788-789 (1984), *aff'd*, 791 F.2d 180 (D.C. Cir. 1986). The FTC Act does not authorize the Commission to impose liability on an advertiser, based on its own say-so, for barely imaginable implied claims falling at the end of the spectrum. *See Kraft*, 970 F.2d at 319-320. The Commission must be able to point to objective factual evidence in the record to support its conclusions that an implied claim was made and is misleading. The Commission cannot simply rely on a "I know it when I see it" approach and dispense with the requirement for record evidence. At some point on the continuum, the Commission must base its decision on objective evidence of

the actual understanding of consumers as to what claims were made, evidence such as that produced by a properly designed and conducted consumer survey.

In *Kraft*, the Seventh Circuit found that from the face of the challenged advertisements, it was reasonably clear that the alleged implied claims had been made and that the Commission could find the company liable without the further evidence that would have been supplied by consumer surveys. 970 F.2d at 321, citing *Colgate-Palmolive*, 380 U.S. at 391-392, and *Zauderer*, 471 U.S. at 652-653. However, the Seventh Circuit explicitly cautioned the Commission that this decision did not give it carte blanche to dispense with actual evidence of consumer understanding in all cases. The court also advised the Commission that, as a matter of policy, it would be in the agency's own long-term interest to adopt objective standards to define when extrinsic evidence of consumer reactions would be required, both for the benefit of the Commission and reviewing courts and to provide clear notice to advertisers, in conducting their due diligence, about the requirements of the law.

In particular, the panel majority warned the Commission:

> Our holding does not diminish the force of Kraft's argument as a policy matter, and, indeed, the extensive body of commentary on the subject makes a compelling argument that reliance on extrinsic evidence should be the rule rather than the exception. Along those lines, the Commission would be well-advised to adopt a consistent position on consumer survey methodology – advertisers and the FTC, it appears, go round and round on this issue -- so that any uncertainty is reduced to an absolute minimum.

Id. at 321 (emphasis added). The concurring judge was even more emphatic.

> [T]he FTC's current procedure threatens to chill nonmisleading, protected speech. . . . [T]he FTC would be well-advised to take this court's suggestion – apply its expertise and develop a consumer survey methodology that advertisers can use to ascertain whether their ads contain implied, deceptive messages.

Id. at 328.

The formula currently followed by the Commission for dispensing with extrinsic evidence of consumer understanding does not state an objective rule and does not provide adequate guidance to retailers that market products on a "compare and save" basis. The Commission will not dispense with such evidence unless it can "conclude with confidence" that an advertisement can reasonably be read to contain a particular implied message. In reality, however, this formulation is no different from a test of "I know it when I see it."

The "conclude with confidence" approach is inherently subjective. The phrase does not define the quantum of proof that Complaint Counsel must present, but rather looks to the degree of assurance that the Commission has in its own judgment. Further, an appellate court cannot meaningfully review a Commission decision rendered on this standard. It is black letter law that reviewing courts may not be asked to seek within the minds and hearts of government officials for the justifications for agency action. *See United States v. Morgan*, 313 U.S. 409, 422 (1941). Finally, this formulation provides no guidance to retailers/advertisers about the standard governing a particular advertisement, because it is impossible for anyone to predict whether a majority of the Commission would "conclude with confidence" that an implied claim is conveyed on the face of the advertisement.

The statutory scheme created by Section 5 of the Federal Trade Commission Act also requires that the conclusion reached by the Commission with regard to the existence of implied claims be firmly based on evidence in the record. Section 5(c) of the Act, 15 U.S.C. § 45(c) provides that the "findings of the Commission as to the facts, if supported by evidence, shall be conclusive." Obviously, a "facial analysis" that is ungrounded in

objective facts of record – that rests, in short, on nothing more than a “it seems to me” sort of analysis – would short circuit this mechanism. On appeal, the Commission would be entitled to claim conclusive effect for a finding that was not based on extrinsic evidence of consumer understanding, but rather its "confidence" in reaching an entirely subjective decision. Thus, the logic of the ALJ's decision, if not confined to exceptional cases but if applied to the broad run of implied claim cases, would threaten to undermine the entire statutory scheme.

II. THE COMMISSION SHOULD ESTABLISH A CLEAR RULE THAT SPONSORS OF "COMPARE AND SAVE" ADVERTISEMENTS ARE NOT DERIVATIVELY LIABLE FOR MISLEADING CLAIMS IN ADS FOR PRODUCTS TO WHICH THEIR PRODUCT IS COMPARED.

The ALJ's findings on the implied claims also are troublesome because of the "compare and save" nature of the challenged advertisements. His decision underlines the importance that the Commission establish a clear legal standard in this case concerning the responsibilities of retailers/advertisers when comparisons are made.

The express claims made in the challenged advertisements were "compare and save" claims. As the Commission has long recognized, "compare and save" advertisements are of great importance to the industry and to consumers.[3] As noted above, the ALJ's decision was based on implied claims he found to have been made, and not on the express claims. The four implied claims he found to have been made bear a striking resemblance to claims that the Commission found were set forth in infomercials for other ab products that were among the products covered by the explicit "compare and save" claims.

[3] *See, e.g.*, Federal Trade Commission, Statement of Policy Regarding Comparative Advertising (1979).

NACDS is concerned that the ALJ's action might cast a substantial chill on future "compare and save" advertisements, on which its members rely extensively. In concluding that four implied claims were made in the challenged advertisements, the ALJ appears to have been influenced substantially by representations that were not made directly in those advertisements but that were made in advertisements for other products that were the subject of appellants' "compare and save" claim. NACDS is concerned that the ALJ's decision threatens to impose a form of guilt by association -- a species of derivative liability for claims that are contained in advertisements for a product that is the target of the "compare and save" claim and that are later found by the Commission to have been misleading.

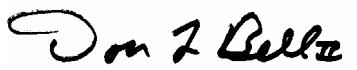
A retailer/advertiser should not be held derivatively liable for misleading advertising based on the theory that through a "compare and save" advertisement, it will be deemed to have incorporated by reference in its advertisement any false statements in ads for the products that were the focus of the "compare and save" claim. The risk that an advertiser could be held liable on an "implied claim" basis for a misleading statement made by a manufacturer of a competing product, even if the retailer/advertiser itself did not directly make the claim, would have a chilling effect on "compare and save" advertising.

To prevent this adverse effect on a valuable form of commercial speech, the Commission should clearly articulate the standard that will apply to retailers/advertisers that choose to compete through "compare and save" advertisements.

CONCLUSION

For the reasons set forth above, NACDS submits that in resolving this appeal the Commission should establish explicit rules governing when reliance on extrinsic evidence of consumer understanding is necessary to conclude that an implied claim has been made and whether the sponsor of a "compare and save" advertisement may ever be found liable based on claims that the retailer/advertiser did not itself make but were made in advertisements for a product that was a target of its "compare and save" claim.

Respectfully submitted,



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