



Federal Trade Commission

DECEPTIVE AND UNFAIR ACTS AND PRACTICES PRINCIPLES: EVOLUTION AND CONVERGENCE

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Introduction

As most of you know, this is my second stint at the FTC. From 1973 to 1975, I served as Director of the agency's Bureau of Consumer Protection. "BCP" (as it has always been called) was a different world back then. The principal statute we enforced – Section 5 of the FTC Act – was the same as the one that is enforced today. And the words of the statute were the same. Then, as now, it prohibited "unfair or deceptive acts or practices." But what was meant by the terms "deceptive" and "unfair" in 1973 or 1975 was very different from what these words mean now. And today they cover acts and practices that we couldn't then imagine might occur.

From 1975 until the beginning of 2006, when I returned to the FTC, I was back in California – where I practiced in San Francisco. Although my practice was predominantly

¹ The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I would like to express my gratitude to Beth Delaney and Serena Viswanathan, my attorney advisors, for their contributions to this speech.

antitrust litigation, I also dabbled in consumer protection litigation, and specifically in litigation under B&P Code § 17200. With minor exceptions, like Section 5 of the FTC Act, the language of Section 17200 did not change between 1977 and the beginning of 2006.² Notwithstanding those exceptions, then, as now, it prohibited “unlawful, unfair or fraudulent” business practices and “unfair, deceptive, untrue or misleading advertising and any act prohibited by the [Section 17500 – the so-called false advertising statute].”³ But, like the FTC Act, what was meant by “deceptive” and “unfair” in § 17200 was very different in 1977 than it is today.

What I’d like to do today is to trace the evolution of the way the two statutes have been interpreted and applied, to explain possible reasons for the changes, and finally to do a little crystal-ball gazing about what may happen in the future.

The FTC Act Standard for Deception

Let me begin with the FTC Act standard for deception. When I left in 1975, it was taken as gospel that proof of actual deception was not necessary. It was enough that the act or practice had the tendency or capacity to deceive.⁴ It also seemed settled that the act or practice didn’t need to have the tendency or capacity to deceive *all* or even *most* people to be “deceptive.” It

² In 1992, the legislature added the words “act or” before “practice” in response to the California Supreme Court’s holding in *California v. Texaco, Inc.*, 46 Cal. 3d 1147 (1988), that, without that word, the state statute did not cover corporate mergers. In addition, the word “any” added after the word “include.”

³ Cal. Bus. & Prof. Code § 17200 (Deering 2007).

⁴ *Aronberg v. F.T.C.*, 132 F.2d 165, 167 (7th Cir. 1942); *Charles of the Ritz Distrib. Corp. v. F.T.C.*, 143 F.2d 676, 679 (2d Cir. 1944).

was enough that it have the tendency or capacity to deceive “an appreciable or measurable segment of the public.”⁵ And the “public” for this purpose included “the ignorant, the unthinking and the credulous.”⁶ Indeed, a 1979 Practising Law Institute handbook on *Advertising, Rulemaking and New Consumer Protection* described these as the basic principles underlying advertising law enforcement at the FTC.⁷ Yours truly authored one of the chapters that said that.

In 1983, however, the agency issued a Policy Statement on Deception, which was appended to its decision in *Cliffdale Associates*.⁸ In that Policy Statement, the Commission defined the three elements of deception as follows:

First, there must be a representation, omission or practice that is likely to mislead the consumer.

Second, we examine the practice from the perspective of a consumer acting reasonably in the circumstances.

⁵ *Feil v. F.T.C.*, 285 F.2d 879, 892 n.19 (9th Cir. 1960).

⁶ *Aronberg v. F.T.C.*, 132 F.2d 165, 167 (7th Cir. 1942); *Florence Mfg. Co. v. J.C. Dowd & Co.*, 178 F. 73, 75 (2d Cir. 1910); *see also F.T.C. v. Standard Educ. Society*, 302 U.S. 112, 115 (1937)(“The fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced. . . . Law are made to protect the trusting as well as the suspicious.”)

⁷ Christopher Smith & Christian S. White, *FTC Trade Regulation: Advertising, Rulemaking and New Consumer Protection*, P.L.I. Corporate Law and Practice Course Handbook Number 303 at 12, 25-26 (1979).

⁸ 103 F.T.C. 110, 174 (1984).

Third, the representation, omission, or practice must be a “material” one. The basic question is whether the act or practice is likely to affect the consumer’s conduct or decision with regard to a product or service.

Two dissenting Commissioners argued that this description of the elements presented a sharp departure from the “tendency or capacity” standard and the “credulous consumer” standard. And it surely did. The former standard was replaced by a standard requiring “likely” misleading. The latter standard was then enhanced by a second standard linking the likelihood of misleading to “a consumer acting reasonably in the circumstances.”

Additionally, in 1984, the Commission issued a Statement on Advertising Substantiation.⁹ That statement adopted prior cases in which the Commission had held that the failure to have a reasonable basis for a claim at the time a claim is made may render the claim deceptive.¹⁰ But the Statement went beyond the prior case law by making it clear that the substantiation requirement applied to implied as well as express claims and that the prior substantiation required would have to be sufficient to satisfy the relevant scientific community about the claim’s proof.¹¹ This meant, for example, that claims that impliedly promised a level of scientific substantiation would have to be supported by well-controlled, double-blind clinical

⁹ Appended to *Thompson Medical Co.*, 104 F.T.C. 648, 839 (1984), *aff’d*, 791 F.2d 189 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1086 (1987).

¹⁰ *Firestone Tire & Rubber Co. v. F.T.C.*, 481 F.2d 246, 251 (6th Cir. 1973).

¹¹ *Removatron International Corp.*, 111 F.T.C. 206, 306-07 (1988), *aff’d*, 884 F.2d 1489 (1st Cir. 1989).

testing.¹²

Why these changes in the FTC's principles of deception? First, the Policy Statement on Deception was issued during President Reagan's first term. It undoubtedly reflected the view of a more conservative majority of Commissioners that the application of the old principles could result in unwarranted federal government challenges to advertising. Second, truth be told, the old principles were an anachronism. When I was at BCP in the early 1970s, we never challenged advertising that merely had a tendency or capacity to deceive the credulous consumer. Our challenges were to advertising that was likely to deceive a reasonable consumer.

The reasons for the Statement on Advertising Substantiation were essentially the same. Even in the early 1970s, we were anxious to shift from the federal government to private entities as much as policing as possible, and one way to do that was to require advertisers to substantiate their claims before the claims were made. In 1984, the Reagan FTC doubtless felt that was also philosophically sound.

B&P C Section 17200 (and 17500) Standards for Deception

The evolution of the deception standard under § 17200 somewhat mirrors the evolution at the FTC. Back in the late 1970s, when I returned to California, deception under § 17200 was

¹² *Id.* at 311.

often construed to include any act or practice that had a tendency or capacity to deceive.¹³

By the time I returned to Washington in 2006, however, California courts had firmly adopted the position that a plaintiff proceeding under § 17200 is obliged to prove that the act or practice is “likely to mislead or deceive the consumer.”¹⁴ Additionally, California courts (and federal courts applying § 17200) were also consistently applying a “reasonable consumer” standard in determining whether a practice was likely to deceive.¹⁵

What are the reasons for this evolution? First, § 17200 was regarded as a “baby FTC Act” and FTC “analog;” accordingly, it was held that “FTC interpretation of the federal Act has always been viewed as more than ordinarily persuasive” in construing “the breadth of protection afforded under [§ 17200].”¹⁶ Thus, it is not surprising that the FTC’s 1983 Policy Statement on

¹³ *Leoni v. State Bar*, 39 Cal. 3d 609, 626 (1985)(noting that Sections 17200 and 17500 are “interpreted broadly to embrace not only advertising which is false, but also advertising which although true, is either actually misleading or which has a capacity, likelihood or tendency to deceive or confuse the public”); *Payne v. United California Bank*, 23 Cal. App. 3d 850, 856 (1972)(“The statute affords protection against the probability or likelihood as well as the actuality of deception or confusion”); see also *People ex re. Mosk v. National Research Co. of Cal.*, 201 Cal. App. 2d 765 (1962)(affirming lower court decision finding practices directed at consumer debtors had ‘tendency and capacity’ to mislead).

¹⁴ *Day v. AT&T Corp.*, 63 Cal. App. 4th 325, 332-333 (1998).

¹⁵ *Lavie v. Procter & Gamble*, 105 Cal. App. 2d 496, 504-07 (2003); *Haskell v. Time*, 857 F. Supp. 1392, 1399 (E.D. Ca. 1994); *Freeman v. Time, Inc.*, 68 F.3d 285, 289 (9th Cir. 1995).

¹⁶ *Lavie, supra*, 105 Cal. App. 4th at 507 (citations omitted). The Attorney General argued in *Lavie* that a “least sophisticated consumer” standard should apply. The court rejected the contention “absent evidence that the ad targeted particularly vulnerable customers.” *Id.* at 504.

Deception was incorporated into the § 17200 case law.

Second, in a couple of respects, California law has been more demanding than the FTC case law in terms of proving deception. For one thing, California’s False Advertising Act, Section 17500, not only mimics § 17200, but requires proof that the alleged actionable statement “is known, or which by the exercise of reasonable care should be known, to be untrue or misleading”¹⁷ It makes little sense to require proof of this state of mind on the part of the defendant making an allegedly deceptive statement, on the one hand, and then on the other hand, to require proof only of a tendency or capacity to deceive a credulous consumer, when it comes to proof of the statement’s effect.

For another thing, California (and federal) case law have been very demanding in terms of the kind of evidence needed to prove the likelihood of deception.¹⁸ Thus, in *Haskell v. Time*, the court found that declarations from a “few” consumers and a professor of rhetoric to be insufficient.¹⁹ In *William H. Morris Co. v. Group W, Inc.*, the Ninth Circuit concluded that the plaintiff had not carried its burden where the evidence consisted of testimony from two out of 300 recipients.²⁰ It would be hard to square these proof requirements with a substantive rule requiring only proof of a “tendency or capacity” to deceive a credulous consumer.

¹⁷ Cal. Bus. & Prof. Code § 17500 (Deering 2007).

¹⁸ See *S. Bay Chevrolet v. GM Acceptance Corp.*, 72 Cal. App. 4th 861, 896 (1999)(requiring “substantial evidentiary support”).

¹⁹ 965 F. Supp. 1398, 1407-08 (E.D. Cal. 1997).

²⁰ 66 F.3d 255, 258 (9th Cir. 1995).

The FTC Act Standard for Unfairness

The “unfairness” prong of Section 5 of the FTC Act has likewise undergone a metamorphosis. Shortly before I got to the FTC in 1973, the Supreme Court held in *Sperry & Hutchinson*²¹ that the Commission could act “like a court of equity” in determining whether unfairness existed.²² Accordingly, the Commission applied standards that best can be described as “bloppy.” In its Trade Regulation Rule for Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking,²³ for example, the Commission said that in determining whether an act or practice was unfair it would consider (1) whether the practice affects public policy . . . ; (2) whether it is immoral, unethical, oppressive or unscrupulous; and (3) whether it causes substantial injury to consumers.”²⁴

In the Bureau of Consumer Protection we created a whole new “Special Projects” Division whose mission was to explore the outer boundaries of “unfairness,” using these “bloppy” standards as the lodestar. That division did some fine work – for example, it developed the Funeral Rule²⁵ and the Holder in Due Course Rule,²⁶ which I would argue have conferred enormous benefits on consumers. However, in other matters the “outer boundaries” that were

²¹ *F.T.C. v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).

²² *Id.* at 244.

²³ 29 Fed. Reg. 8324 (July 2, 1964).

²⁴ *Id.* at 8355.

²⁵ Funeral Industry Practices, 16 C.F.R. § 453 (2007).

²⁶ Preservation of Consumers’ Claims and Defenses, 16 C.F.R. § 433 (2007).

explored had few limiting principles. Chief among these was the so-called “Kid Vid” initiative, which tried to define unfair practices in marketing products to children and which was buried under a heap of scorn – the Washington Post accused us of trying to be the “National Nanny.”²⁷

So, in 1980, the Commission issued a policy statement that defined an unfair act or practice as one that “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers and to competition.”²⁸ The agency fleshed this standard out in its policy statement and subsequently in *International Harvester*,²⁹ explaining that “substantial injury to consumers” would exist if the practice “does a small harm to a large number of people or it raises a significant risk of concrete harm.”³⁰ The Commission added, however, that “substantial injury” did not ordinarily include emotional injury or distress.³¹ Additionally, the Commission explained that “[w]hether some consequence is ‘reasonably avoidable’ depends, not just on whether people know the physical steps to take in order to prevent it, but also whether they understand the necessity of actually taking those steps.”³²

²⁷ Editorial, “*The FTC as National Nanny*,” Wash. Post., Mar. 1, 1978 at A14.

²⁸ Reprinted in H.R. Rep. No. 98-156 at 33 (1983) and 4 Trade Reg. Rep. (CCH) ¶ 13,203.

²⁹ *In the Matter of International Harvester Company*, 104 F.T.C. 949 (1984).

³⁰ *Id.* at 1064 and 1073 n.12.

³¹ *Id.* at 1073; *see also* H.R. Rep. No. 98-156 at 33 (1983).

³² 104 F.T.C. at 1066.

In the FTC Act Amendments of 1994, Congress codified the basic definition in the 1980 policy statement without the explanatory language.³³ Section 5(n) probably does fence the Commission off from some of the consumer protection experimentation that it did in the immediate wake of the *S&H* case. However, the requirements of the statutory definition of unfairness are certainly met in the data security, pretexting, and spyware cases we have brought based on unfairness. And, because the policy statement's position respecting emotional injury or distress was not enacted into law, I believe that the door has been left open for the Commission to use unfairness in cases where the injury is substantial, yet does not result in the typical, quantifiable injury.³⁴

There is no mystery as to why the Commission issued its 1980 policy statement or why the Congress codified the basic definition of unfairness in the statute in 1994. Both were a reaction to a pretty much untethered notion of unfairness in the consumer protection area. Both the policy statement and the statutory amendment provided limiting principles, and, as I say, I doubt either has crippled our consumer protection mission.

The Section 17200 Standard for Unfairness

That brings me to the Section 17200 standard of unfairness. Unlike what has happened

³³ 15 U.S.C. § 45(n).

³⁴ An example of such a case might include a situation where a business has failed to adequately secure the sensitive, but not financial, information of consumers; while such a breach of privacy may not result in financial harm, it could embarrass or have a significant emotional impact on consumers.

under (and to) the FTC Act, the law of unfairness in California is, quite simply, a mess. One need look only as far as the decision in *Bardin v. Daimler Chrysler Corp.*,³⁵ to reach that conclusion. There the court wrestled for at length with what “unfairness” meant in consumer cases brought under § 17200, only ultimately to throw up its hands and “respectfully suggest that our Legislature and Supreme Court clarify the definition of “unfairness” in consumer actions under [§ 17200].”³⁶

The court correctly stated that there are “two lines of appellate opinion” on point. One line, led by *Smith v. State Farm Mutual Automobile Ins. Co.*,³⁷ and *Pastoria v. Nationwide Ins.*³⁸ defines as “unfair” any conduct that is “immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers and requires the court to weigh the utility of the defendant’s conduct against the gravity of the harm to the alleged victim.”³⁹ This is essentially the standard that we were administering at the FTC from 1973 to 1975 and that the Commission and Congress later abandoned.⁴⁰

³⁵ 136 Cal. App. 4th 1255 (2006).

³⁶ *Id.* at 1274.

³⁷ 93 Cal. App. 4th 700, 718-19 (2001).

³⁸ 112 Cal. App. 4th 1490, 1498 (2003).

³⁹ *Bardin*, 136 Cal. App. 4th at 1260 (citing *Smith*, 93 Cal. App. 4th at 718-19 and *Pastoria*, 112 Cal. App. 4th at 1498).

⁴⁰ *See F.T.C. v. Sperry & Hutchinson Co.*, 405 U.S. at 244-45 n.5.

The other line of cases, led by *Scripps Clinic v. Superior Court*⁴¹ and *Gregory v. Albertson's Inc.*,⁴² hold that the public policy which is the basis for an unfair competition action under the “unfair” prong must be “tethered to specific constitutional, statutory, or regulatory provisions.”⁴³ This formulation essentially embraces the judgment made by the Commission in 1980 and the Congress in 1994.

The reason for this schizophrenic state of the law is easy to discern. It is rooted in the California Supreme Court’s decision in *Cel-Tech Communications Inc. v. Los Angeles Cellular Telephone Co.*⁴⁴ As the court in *Bardin* states correctly, on the one hand, the *Cel-Tech* decision severely criticized the untethered definition of unfairness in several cases brought by consumers.⁴⁵ On the other hand, however, after severely criticizing an untethered definition of unfairness in the case before it – which was brought by a competitor – the court declared that “nothing we say relates to actions by consumers.”⁴⁶

To date, neither the California Supreme Court nor the Legislature has provided the clarification requested in *Bardin* but I will hazard speculation that ultimately the FTC view of

⁴¹ 108 Cal. App. 4th 917 (2003).

⁴² 104 Cal. App. 4th 845 (2002).

⁴³ *Bardin*, 136 Cal. App. 4th at 1261 (citing *Scripps*, 108 Cal. App. 4th 917 and *Gregory*, 104 Cal. App. 4th 845).

⁴⁴ 20 Cal. 4th 163 (1999).

⁴⁵ *Bardin*, 136 Cal. App. 4th at 1266.

⁴⁶ *Id.* at 1267.

unfairness will prevail. Why? First, as I've previously said, § 17200 is regarded as a "baby FTC Act," and the way that the agency and the Congress have interpreted the Act will probably be followed in the case of unfairness as it has been in the case of deception. Indeed, the recent *Camacho* decision by the appellate court supports this prediction.⁴⁷ After an extensive discussion of the two lines of authority considered in *Bardin*, the court adopted the modern FTC Section 5 definition of unfairness, noting that this definition "is on its face geared to consumers" and "is suitably broad and is therefore in keeping with the 'sweeping' nature of section 17200."⁴⁸ The court specifically rejected the Attorney General's suggestion to follow the *S&H* test, finding that it "suffers from too many of the ills in the old definitions of unfair."⁴⁹

Second, limiting principles make sense. *Cel-Tech* so held when it came to interpreting the meaning of "unfair methods of competition" in competitor cases brought under § 17200, and there is no principled reason for ruling otherwise in cases brought by consumers under § 17200.

Finally, and perhaps most important, from a policy standpoint, it is imperative to any firm doing business in California and interstate commerce where the FTC roams, that the limiting principles be uniform.

⁴⁷ *Camacho v. Automobile Club of California*, 142 Cal. App. 4th 1394 (2006).

⁴⁸ *Id.* at 1403. The court, in fact, declined to adopt the limiting principle found in the last two sentences of Section 5(n): In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination. *Id.* at 1405.

⁴⁹ *Id.* at 1404.

Other Unanswered Questions

Several other questions remain unanswered. One is whether the failure to have a reasonable basis for a claim is “unfair or deceptive” under § 17200. The answer to that question seems clear. If § 17200 is really a “baby FTC Act,” the Commission’s 1984 statement on that score will almost certainly be endorsed. The second question is whether, and to what extent, § 17200 will be held to cover the plethora of practices that do not involve advertising or marketing that are front and center in consumer protection enforcement; today they are data security practices, pretexting, and the invasion of spyware and other malware, but tomorrow they may be different. Again, I would suggest that, as a “baby FTC Act,” the courts will follow the FTC’s lead in challenging these practices – and challenge them we will.