American Bar Association

Consumer Protection Update

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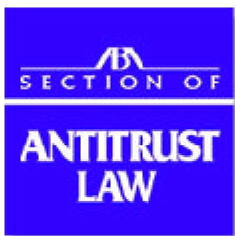

The C*onsumer Protection Update* returns. The Committee updated the entire Section by way of this summer's consumer protection-themed edition of Antitrust Magazine. Returning to our traditional format, we bring you again a wide range of articles covering the latest developments in consumer protection law and enforcement.

Attorneys who counsel their clients about the possible ramifications of signing a consent order with the Federal Trade Commission generally focus on details such as consumer redress or reporting requirements. But how often do they emphasize the criminal implications of a potential order violation? Perhaps not often enough, suggests Reilly Dolan, Assistant Director of the Division of Enforcement in the FTC's Bureau of Consumer Protection. In this edition of *Consumer Protection Update*, Dolan outlines Project Scofflaw, the Commission's crack-down on defendants who violate FTC-obtained federal court orders.

Also in this edition, Steven Malech discusses the voluntary payment doctrine, a long-standing but infrequently-invoked defense to restitution claims. Deborah Matties analyzes the FTC's use of the unfairness doctrine against spammers in *D Squared Solutions*. Those interested in private attorney general litigation will want to read the latest from Luanne Sacks and M. Todd Jenks on two cases pending before the California Supreme Court that could alter the catalyst theory is assessing attorneys' fees. Finally, Victor DeFrancis evaluates the Eighth Circuit's approach to the puffery defense in Lanham Act cases in its recent *American Italian Pasta* decision.

The Consumer Protection Committee is also pleased to announce the Janet D. Steiger Fellowship Program, a pilot project established by the Section of Antitrust Law in cooperation with the National Association of Attorneys General to fund summer clerkships in the offices of selected state attorneys general. Named in memory of the late Janet D. Steiger, Chairman of the FTC chair from 1989 to 1995, the Steiger Fellowship Program was the inspiration of Bob Langer, the Consumer Protection Committee's Council Liaison and former Chair of the Consumer Protection Committee. Congratulations to Bob, Kevin Grady, Rich Wallis and current Chair John Villafranco and all the others who made this happen for their leadership in establishing this ground-breaking project. Look for more details in the next *Consumer Protection Update*.

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The FTC's Project Scofflaw: "Go to Jail. Do Not Pass Go. Do Not Collect $200"

by J. Reilly Dolan*

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Remember Parker Brothers' Monopoly® board game with its orange or yellow cards that direct the player to "Go to Jail, Do Not Pass Go, Do Not Collect $200?" If you played by a common "cutthroat" modification to the rules of the game, those little orange or yellow cards had serious consequences. Not only were players incarcerated and did not collect $200 for passing "Go," but they also forfeited lucrative rental payments when competitors landed on properties with houses or hotels. Metaphorically speaking, the FTC created Project Scofflaw – its seven-year-old federal court order enforcement program – to hand "Go to Jail" cards to defendants who willfully violate FTC-obtained federal court orders prohibiting specific unfair or deceptive conduct.

Potential recidivists should take note of Project Scofflaw's results. Since the FTC unveiled Project Scofflaw in 1997,[1] 23 defendants have been sentenced to serve a total of about 77 years in prison or some other form of confinement, such as home detention or a half-way house. In addition, courts have awarded nearly $66 million in civil or criminal restitution – to extend the Monopoly® metaphor, an economic sanction akin to losing out on rent from a hotel-developed Boardwalk or Park Place.

Webster's New Collegiate Dictionary defines "scofflaw" as "a contemptuous law violator." Nothing better describes the targets of the FTC's comprehensive effort to stop these repeat offenders from violating the federal court orders against them. Project Scofflaw has three basic purposes: (1) to identify those who violate FTC-obtained federal court orders; (2) to stop the deceptive acts as quickly as possible through *civil contempt* actions; and (3) where appropriate, to refer egregious and knowing violators to the Department of Justice (DOJ) for *criminal contempt* prosecution.

This article first discusses Project Scofflaw's tools to monitor compliance and how the FTC assists DOJ in prosecuting criminal contempt matters. Second, it summarizes indictments and sentences announced in 2003 through September 2004 against defendants who violated an FTC-obtained federal court order. Finally, the article discusses recent events that directly affect sentence calculation for criminal contemnors and appropriate use of the proceeds of a fraud.

Monitoring Compliance and Assisting DOJ

Project Scofflaw's success is built on two cornerstones - order provisions that create tools for vigilant and effective compliance monitoring and a close working relationship between the FTC and DOJ. The model order provisions, which the FTC includes in settlements and seeks in litigation, utilize a multi-faceted framework. First, a defendant is required to maintain records of future activities and to submit information to the FTC staff, including an annual report listing his or her residence and employment addresses. In addition, the defendant is required to submit a report 90 or 180 days after entry of the order detailing how he or she is complying with all provisions of the order. Further, the reporting provision requires the defendant to provide other specified information upon FTC demand. Failure to submit a report increases the staff's attention to the defendant's whereabouts and conduct, and will be used in any subsequent criminal prosecution as evidence of intent to deceive. For example, Thomas Norton, who operated various investment schemes, refused to submit information detailing his post-order activities. As a result, the FTC staff delved deeper into his actions and gathered evidence that he was engaged in a scam very similar to the one that resulted in the initial order against him, and DOJ prosecuted him for criminal contempt and fraud.

Second, the model order language contains provisions to facilitate FTC investigation of a defendant's compliance with the order. For example, the order authorizes the FTC to use federal civil discovery rules, without seeking further leave of court, to monitor and investigate the defendant's conduct. In addition, the order preserves the FTC's authority to use common investigative techniques, such as staff members posing as consumers and taping sales pitches to observe the defendant's acts and practices as presented to the general public. Additional language clarifies that nothing in the order limits the Commission's lawful use of compulsory process pursuant to the FTC Act, so that various monitoring provisions contained in the order and federal court discovery are not construed as the exclusive means of investigating the defendant's post-judgment activities. Further, the model language alerts the defendant that, in appropriate cases, the Commission may apply for and the Court may issue an *ex parte* order granting the Commission immediate access to the business premises without prior notice.

The Scofflaw Project's second cornerstone is the close relationship the FTC staff has forged with DOJ and U.S. Attorneys' Offices throughout the country while assisting with criminal prosecutions. Close coordination from the early stages of investigation makes the order enforcement process more efficient, allowing the FTC to assess whether a case meets DOJ's case selection criteria before making a referral, and whether a parallel civil contempt action may be appropriate to halt conduct quickly and preserve assets for redress. In a number of cases, FTC staff has served as a member of the prosecution team, either an attorney cross-designated as a Special Assistant United States Attorney or an investigator functioning as the case agent. In other cases, FTC staff has testified at a trial or sentencing hearing as to the existence and nature of the FTC-obtained order. Such testimony may provide evidence of intent to engage in fraudulent practices, evidence of activity that violates the order, or evidence that justifies an adjustment to a defendant's sentence for engaging in conduct that violates a court order.[2]

Case Results

Since 1997, 23 defendants have been sentenced to serve a total of about 77 years in prison or some other form of confinement. In the last year alone, six defendants were sentenced to serve approximately 278 months confinement and to pay a total of $40 million in criminal restitution. In addition, nine individuals have been indicted in federal court and one in state court for conduct that violates an FTC-obtained federal court order. Two of those defendants have pled guilty and are awaiting sentencing, while the others are awaiting trial. Summarized below are the Scofflaw Project results for the past 18 months:

- *Kenneth Taves* was sentenced in May 2004 in the Central District of California to 135 months after he pled guilty to possessing credit card account numbers with the intent to defraud consumers and to obtaining money through unauthorized credit card charges. In 2001 Taves initially pled guilty to contempt for violating an order, issued in *FTC v. J.K. Publications*[3] which froze his assets and required full asset disclosure to the Commission. The indictment was subsequently superceded to include the underlying credit card fraud. The assets he concealed from the FTC, in contempt of the asset freeze, were proceeds of the fraud and thus included in the court's calculation of consumer injury pursuant to the fraud guideline. Although the criminal contempt count itself was voluntarily dismissed as part of the plea bargain, it had the effect of increasing his sentence. Taves was ordered to pay $37,566,577 in criminal restitution to be satisfied concurrently with his civil judgment in the same amount.

- *Ronald Pellar* (aka Ron Dante) was sentenced in April 2004 in the Central District of California to eight months for running a fraudulent diploma mill in the mid-to-late 1990s and ordered to pay $45,835.50 in restitution. This conduct violated the final order in *FTC v. Ronald Dante dba Perma-Derm Academy.*[4] Dante currently is serving a 67 month sentence for another violation of that order. In November 1997, Dante was convicted of criminal contempt for making false representations in connection with another permanent make-up academy and a paralegal training academy.

- *Jordan Drew* was sentenced in April 2004 in the Southern District of New York to 15 months for securities fraud. He also was ordered to pay $120,000 in criminal restitution. Drew is subject to a 1997 final order in *FTC v. Falcon Crest Communications*[5] entered in the Eastern District of New York which included a monetary judgment of $350,000 which banned him from telemarketing for five years and required him to report to the Commission for five years any changes of residence and employment. Drew never paid the consumer redress and never complied with the reporting requirements. In addition to the criminal restitution for securities fraud, the Court ordered Drew to pay 10% of his gross monthly salary to the FTC for the benefit of the Falcon Crest victims for three years after his release from prison.

- *Thomas Norton* was indicted in May 2003 in the Southern District of Florida in connection with the operation of various investment scams. He was charged with conspiracy, mail and wire fraud, money laundering and criminal contempt for violating the telemarketing restrictions imposed in the final order in *FTC v. Jordan Ashley*,[6] a case involving a business opportunity scam. In January 2004 Norton was sentenced to 60 months in prison followed by three years of supervised release. *Patricia M. Riley*, Norton's wife, received 24 months in prison and three years supervised release for assisting him in violating the FTC Order.[7] Each was ordered to pay $2,042,250 in restitution.

- *Philip Pestrichello* pled guilty to mail fraud in connection with an advance fee credit card scam, and in January 2004 he was sentenced to prison for 36 months, supervised release for a term of three years and payment of $133,765 in restitution. The length of Pestrichello's sentence was based in part on an upward adjustment due to his failure to abide by the final order in *FTC v. First Credit Alliance*.[8]

- *Richard Murkey* pled guilty in April 2004 to four counts of criminal contempt. He was indicted in the Central District of California in February 2004 in the first criminal contempt prosecution related to a deceptive credit repair scam. Murkey, a defendant in *FTC v. Keith Gill*,[9] deceptively offered credit repair services in violation of a final order in the FTC's case. The FTC previously brought a successful motion for civil contempt. Murkey awaits sentencing.

- *James Ronald Davis* was indicted in Atlanta in November 2003 for mail and wire fraud in connection with a vending machine business opportunity scam. In May 2004, Davis pled guilty to one count of transportation of stolen property and awaits sentencing. Davis is under an order issued in *FTC v. Nu-Idea Technologies, Inc.*,[10] which prohibits him from misrepresenting material facts in connection with the sale of business opportunities and from violating the FTC's Franchise Rule. At the sentencing phase the court likely will consider that the conduct for which he pled guilty also violates the FTC-obtained order.

- *Charles Hoffecker and Charles Edward Myers* were indicted in February 2003 in the District of New Jersey for allegedly fraudulently selling leveraged commodities. The indictment alleges that Hoffecker hid his involvement in the scheme because he was violating a previous FTC Order issued in *FTC v. Uni-Vest Financial Services*[11], which prohibited him from selling leveraged commodities. Myers also is under an order issued in *FTC v. Uni-met Credit Corp,*[12] prohibiting him from making any misrepresentations and requiring him to make certain disclosures in connection with any leveraged investment. Their first trial resulted in a mistrial, and the second trial currently is scheduled for March 2005.

- *Samuel Kingsfield* was indicted in February 2004 in the Western District of North Carolina for mail and wire fraud, among other crimes, in connection with the offering of commodities as investments. Kingsfield is prohibited pursuant to a final order issued in *FTC v. Western Trading Group, Ltd.*[13] from misrepresenting the investment potential, risk or other material feature of any investment offering. Trial is set for November 2004.

- *Jeffrey and Terri Salley* were indicted in the Southern District of Florida in July 2004 on 20 counts of criminal contempt for violating a December 2000 final order issued in *United States v. World Wide Coffee, Inc.*[14] The 2000 order prohibited the defendants from making false earnings claims in connection with business opportunities and from violating the FTC's Franchise Rule. According to the indictment the defendants continued to sell coffee franchises in a manner that violated the final order.

- *Christopher Love* was charged, the Southern District of Florida in September 2004 with criminal contempt for acting in concert and participation with John Doe 1 to violate a temporary restraining order issued in *FTC v. Federal Data Service, Inc.*[15] The TRO prohibited the defendants from misrepresenting the services they purportedly provide to help consumers obtain government jobs. In a related case, *Daniel Maldonado* was charged in the same month with fraud in connection with the offering of services to obtain a government job.

- *Nia Cano* was charged with racketeering, securities fraud and other lesser offenses in Utah state court in connection with a Ponzi scheme.

Cano is under an order issued in *FTC v. Credit Development Int'l*[16] which prohibits her from offering for sale the right to participate in a Ponzi scheme, or a pyramid scheme in which participants purchase the opportunity to derive income primarily from recruitment or payments by recruits, and prohibits her from misrepresenting material facts in connection with the sale of business opportunities. Her criminal case is ongoing, and her prior conduct likely will play some role in the trial and/or at sentencing.

Calculating Criminal Contemnors' Sentences and Other Recent Decisions

The teeth of Project Scofflaw, of course, are the likelihood of significant prison time. In the past, there has been disparity in the sentences handed down. A number of changes in the last 20 months, however, brought first clarity then disarray to the issue. The FTC staff is now in a "wait and see" mode.

In December 2002, as discussed in greater detail in the Staff's Second Annual Report to the Commission on Project Scofflaw,[17] the staff submitted a comment to the U.S. Sentencing Commission identifying, under the existing federal sentencing guidelines, a potential for disparate sentences for similar conduct by defendants convicted of criminal contempt. The comment noted that the sentencing guidelines direct courts to apply the guideline for the offense most analogous to the conduct that gave rise to the contempt. Courts, however, differed on what constituted the most analogous guideline for violations of an order involving fraudulent behavior; some used the fraud guideline, while others used the obstruction of justice guideline. Thus, the comment recommended implementing changes to lessen the disparity.

In July 2003, the Eighth Circuit addressed head-on which guideline to apply for contemptuous fraud. In *United States v. Robert Ferrara*,[18] the appellate panel reviewed and upheld defendant Ferrara's 125 month sentence for six counts of criminal contempt. Ferrara was subject to a 1983 federal court order prohibiting him from making false representations in connection with offering business opportunities and requiring him to comply with the FTC's Franchise Rule. On appeal, Ferrara contended that the district court erred by sentencing him pursuant to the fraud guideline rather than the guideline applicable to obstruction of justice, which would have resulted in a six to eight month sentence. The Eighth Circuit noted that Ferrara admitted he had made and caused others to make false representations to encourage the sale of the franchises involved in the six counts of the indictment and that the disclosure statements given to the six individuals had been inaccurate and contained material omissions. It then concluded "this is the type of conduct commonly sentenced under [the fraud guideline],"[19] and affirmed the district court's choice of that guideline.

Subsequently, in November 2003, the Sentencing Commission added to the contempt guideline an application note clarifying that the fraud guideline is the most analogous one in a case involving a violation of an order enjoining fraudulent behavior.[20] The application note further clarifies that using the fraud guideline for contemptuous fraud and including the fraud guideline's two-level upward adjustment for violating an order is not double counting. In addition, the Sentencing Commission amended the obstruction of justice guideline itself to ensure that defendants serve prison time, not just probation or home detention.

All of this is now in limbo. In its recent *Blakely v. Washington*[21] opinion, the Supreme Court declared unconstitutional state sentencing laws that allow an increase or enhancement in the sentence based on findings of fact made by a judge by a preponderance of the evidence rather than by a jury beyond a reasonable doubt. Although the Court expressly stated that "the Federal Guidelines are not before us, and we express no opinion on them,"[22] several appellate courts have applied the *Blakely* analysis to the federal guidelines and declared them unconstitutional either in whole or in part.[23] Others have ruled that *Blakely* does not render the federal guidelines unconstitutional,[24] and one decided to certify the question to the Supreme Court.[25] In light of this upheaval, the Supreme Court heard oral argument on the constitutionality of the federal sentencing framework in the first week in October, and likely will render its opinion shortly. Even if the Court were to overturn the sentencing guidelines, however, the last 20 months has done much to educate courts about the seriousness of contemptuous fraud.

On another note, the Seventh Circuit has issued a decision that makes it more difficult for a successful fraud perpetrator to use fraud proceeds to mount an expensive legal defense on the shoulders of the defrauded victims. In a decision penned by Judge Posner, the Seventh Circuit held that a defendant has no Sixth Amendment right to spend another person's money for a legal defense, even if those funds are the only way to retain the attorney of the defendant's choice.[26] The district court judge had granted summary judgment and ruled that all of the proceeds of the fraud were held by the defendant in constructive trust on behalf of the victims. Nonetheless, the court released from the constructive trust $25,000 for attorneys fees in a parallel criminal action. The appellate panel wrote that once the court found that all of the defendant's assets were proceeds of the fraud, the defendant had no right to use those assets, even to mount a defense to a criminal prosecution.

Lessons for Practitioners

The FTC's message is clear: Just like the Monopoly® player drawing the "Go to Jail" card, the consequences for a scofflaw are serious. Practitioners should advise their clients who are under a federal court order in an FTC action that the FTC will use its compliance monitoring techniques to identify scofflaws, and when a scofflaw has been identified, prosecute the scofflaw through civil contempt and, where appropriate, criminal contempt actions. Practitioners further should advise their clients about the risks of violating an order, including significant time in prison and the forfeiture of the proceeds of the contemptuous conduct. In other words, non-compliance will cost more than a lost turn and $200 for not passing "Go."

The Voluntary Payment Doctrine: A Potential Bar to Restitution Claims

by Steven B. Malech*

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It is common practice for businesses, ranging from credit card issuers to cable television providers, to impose late fees on consumers who fail to pay for goods and services in a timely fashion. Over the past several years, however, consumers have attacked such fees under various consumer protection laws, particularly those imposed on cable television subscribers,

claiming that the fees are illegal because they are not reasonably related to the actual costs incurred as a result of the late payment.[1] In response to purported class action lawsuits initiated by consumers seeking the return of a portion of such fees, cable television operators and other businesses have successfully invoked a decades, if not centuries, old defense called the Voluntary Payment Doctrine ("VPD"),[2] which provides that "money paid with knowledge of all the facts, and without fraud or duress, cannot be recovered merely on account of ignorance or mistake of the law."[3] By contrast, however, a small minority of courts has held that the VPD does not bar claims for monetary relief brought by consumers challenging allegedly illegal late fees or other alleged violations of public policy.[4]

This article considers justifications for applying the VPD to bar claims for restitution in consumer litigation, reasons for rejecting the use of the VPD in consumer litigation and the potential impact that the successful invocation of the VPD may have on the resolution of actions brought by the FTC and state enforcement agencies seeking restitution remedies, actions that conceptually (if not intuitively) may be affected by the VPD.

Applying the VPD: Putnam v. Time Warner

In *Putnam*, the plaintiffs alleged that a $5.00 late payment fee assessed by Time Warner to customers who failed to pay their monthly cable bill by the time specified in their contract constituted an unlawful liquidated damages provision because the amount of the fee was not reasonably related to the actual costs incurred by the company as a result of the late payments. The plaintiffs alleged that they paid the late fee without knowing that Time Warner's actual costs from a late payment were less than 50 cents and that the company concealed material information regarding those costs. The plaintiffs sought restitution with respect to fees that had already been paid, and declaratory and injunctive relief to prevent the assessment of such fees in the future. Time Warner moved to dismiss the claims on the basis of the VPD, among other grounds. The trial court granted the motion and the plaintiff's appealed.

The Wisconsin Supreme Court affirmed the dismissal of the claims for monetary relief.[5] The Court noted that the "voluntariness in the doctrine goes to the willingness of a person to pay a bill without protest as to its correctness or legality."[6] The Court also explained that "[t]here are two primary reasons why courts have adopted the voluntary payment doctrine. First, the doctrine allows entities that receive payment for services to rely upon these funds and to use them unfettered in future activities . . . . Second, the doctrine operates as a means to settle disputes without litigation by requiring the party contesting the payment to notify the payee of its concerns. After such notification, a payee who has acted wrongfully can react to rectify the situation."[7] Based on these principles, the Court held that the VPD barred a claim for monetary relief on behalf of a person who paid a late-payment fee without protest and who thereafter alleged that the fee was based on unlawful liquidated damages.[8]

Importantly, the Court also held that its decision was supported by "the principles of public policy and equity that gave birth to the doctrine."[9] In particular, the Court explained that "[p]rivate businesses such as Time Warner should be able to incorporate into their revenue stream payments made by their customers without dispute."[10] The Court further explained that the doctrine "provided stability and certainty once funds have been transferred without notice of dispute, thereby decreasing the transaction costs that would accrue if payments received long ago could be demanded back."[11] Noting that a customer could avoid the application of the VPD by making some form of protest prior to or contemporaneous with the payment, the Court held that "[a]bandoning the voluntary payment doctrine here would open the door for a wide array of challenges to past payments in the name of protecting persons who were tardy in inquiring into and contesting demands for payment. The equities of cable customers who fail to make timely protests against allegedly unlawful late-payment fees must be weighed against the fiscal interests of cable providers in the certainty of payments received without dispute. We find this balancing favors the latter interest and the preservation of the voluntary payment doctrine in this context."[12]

Rejecting the VPD: Time Warner Entertainment v. Whiteman

In a case with strikingly similar facts but an opposite result, the plaintiffs in Whiteman alleged that the late fees (either $4.40 or $4.60) assessed by the company on their monthly cable television bills were unlawful because they exceeded the cost of collection. The plaintiffs sought to recover the fees paid in excess of Time Warner's actual damages and sought declaratory and injunctive relief preventing further assessment of the allegedly inflated fee. Time Warner moved to dismiss the claims for monetary relief on the grounds that they were barred by the VPD. The trial court ultimately rejected Time Warner's argument and allowed the case to proceed on the merits. The Indiana Court of Appeals affirmed the trial court's ruling with respect to the claims for declaratory and injunctive relief, but reversed with respect to the claims for monetary relief.

The Indiana Supreme Court, however, held that the VPD did not bar the plaintiffs' claims for monetary relief. The Court based its decision on several factors. First, the Court determined that the payment of the late fees was not "voluntary" under Indiana law because the plaintiffs were "put in the position by Time Warner of having to pay in order to receive cable service" and that "[t]he plaintiffs against whom the voluntary payment doctrine was enforced faced no immediate deprivation of good or services if they did not pay."[13]

Second, the Court interpreted "the current tentative draft of a new Restatement of Restitution & Unjust Enrichment" as limiting the application of the VPD "to situations where a party has voluntarily paid a disputed amount . . . in the face of a recognized uncertainty as to the existence or extent of an obligation" to do so.[14] The Court found that there was a genuine issue of material fact in that regard that precluded the dismissal of the action.

Third, while acknowledging that the majority of cases from other jurisdictions favored Time Warner's position, the Court noted that the authority was not unanimous. Rather, it cited the dissent in Putnam for the proposition that a customer had no reason to protest the payment of a fee if he or she had no reason at the time of payment to believe that the fee was unreasonable or unconscionable.[15]

Fourth, the Court expressly rejected the public policy arguments that the Wisconsin Supreme Court found persuasive in Putnam. The Whiteman Court noted that it did not "believe that it is appropriate to favor a private enterprise over private individuals."[16] Rather, the Court concluded that, if the fee is unlawful, Time Warner should not be able to benefit from its own wrongdoing.[17]

Pratt v. Smart Corporation

In a decision similar in effect to Whiteman, plaintiff Pratt alleged that Smart Corporation charged her attorneys $28.50 to provide a copy of a four-page medical record pertaining to treatment that she received in a hospital for injuries resulting from a car accident. Pratt claimed that the charge was excessive and, therefore, violated a statute requiring hospitals to furnish such records without unreasonable delay and the requesting parties to pay reasonable costs of copying.[18] The trial court granted Smart's motion for summary judgment on the grounds that there was no "factual dispute about anything happening in this case" and "that the statute in question . . . does not allow for recovery."[19]

On appeal to the Tennessee Court of Appeals, Smart Corporation's primary argument was that Pratt's claim was barred by the VPD. The Court, however, held that "the State has an interest in transactions that involve violations of statutorily-defined public policy, and, generally speaking, in such situations, the voluntary payment rule will not be applicable."[20] Accordingly, the Court held that "the voluntary payment rule presents no impediment to Pratt's cause of action, and thus does not provide an adequate basis for sustaining the trial court's grant of summary judgment in favor of Smart."[21]

The Implications of the VPD to Government Enforcement

The FTC and state enforcement agencies often investigate the circumstances under which consumers were charged certain fees, including late fees and early termination fees. Where the agencies believe that a business or individual has illegally, deceptively or unfairly imposed and obtained payment for such fees, they often seek to obtain restitution on behalf of the consumers who paid the challenged fees. In doing so, the agencies effectively step into the shoes of the consumers themselves.

While an old doctrine, the VPD doctrine seldom has been offered as a defense to either a federal or state enforcement action in which restitution was sought. Clearly, an argument can be made that the agencies should not be allowed to obtain monetary relief for consumers who would be barred from such a recovery if they pursued a lawsuit on their own. In jurisdictions in which businesses have successfully invoked the VPD to obtain dismissal of restitution claims brought by consumers, it appears that the agencies might likewise be barred from recovering a portion of the fees voluntarily paid by those consumers. Businesses facing this scenario would be well served to at least pursue the defense.

On the other hand, the agencies seek to enforce laws designed to promote clear and conspicuous disclosure of the material terms governing a consumer relationship. Like the consumers in *Whiteman*, the agencies faced with a VPD challenge are likely to assert that businesses should not be allowed to profit from illegal fees that a consumer might not have had any reason to believe was being improperly charged. The agencies are also likely to assert that, like the interests recognized in *Whiteman and Pratt*, the strong public policy underlying unfair and deceptive trade practices laws should trump any such policy benefit by which businesses can unlawfully impose and collect certain fees because of mistake or insufficient consumer awareness.

As the number of enforcement actions brought by the FTC and the various state enforcement agencies continues to grow, there is a significant possibility that more defendants will assert the VPD whenever the agencies seek restitution as a remedy. It seems self-evident that the agencies will vigorously oppose such efforts to use the doctrine. How the courts (and possibly Congress and state legislatures) resolve this issue in the coming years undoubtedly will have a major impact on the ability of the agencies to recover money for consumers and, thus, alter the manner in which the agencies and business approach such issues.

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FTC v. D Squared Solutions: An On-Line Application of The FTC's Unfairness Doctrine

by Deborah Matties*

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In a common 1950s scam, unscrupulous door-to-door salesmen represented themselves as "heating engineers" and offered homeowners free furnace "inspections." While "inspecting" a furnace, they dismantled and refused to reassemble it until the homeowner submitted to extortionate demands for "repair" fees. The FTC successfully challenged that scam as an unfair trade practice in *Holland Furnace*.[1]

In its recent case against software marketer D Squared Solutions, the FTC alleged that the defendants engaged in a 21st Century variation on this classic scheme. On July 28th, a federal judge in Baltimore entered a stipulated permanent injunction against D Squared Solutions and its two principals, settling FTC charges that they had interfered with the operation of consumers' computers by barraging them with repeated Windows Messenger Service "pop up" spam that advertised software that would stop the pop up spam at a cost of $25 to $30.[2]

According to the FTC, the defendants assaulted consumers with an estimated 135,000 pop up ads ***per hour***, with many consumers receiving them at a rate of one every ten minutes. Consumers from across the country testified that they lost data and work productivity. Others reported that their computers crashed or froze as a result of the pop ups. The defendants' purpose in sending so many ads so frequently was apparent: by maximizing the disruption to consumers' computers, they hoped that consumers would ultimately buy their pop up-blocking software.

According to the FTC complaint, the defendants also operated a synergistic side business whereby they licensed the pop up-sending software to other electronic marketers so that they could send the same kind of pop ups to the same consumers. In addition to profiting directly from these licensing arrangements, the defendants increased demand for their pop up-blocking software by encouraging others to engage in the same disruptive practice. Thus, the FTC's complaint also alleged that by selling pop up-*sending*

software, in addition to pop up-*blocking* software, the defendants provided third parties with the means and instrumentalities to engage in unfair acts or practices.

The FTC received an extraordinary number of complaints about the defendants' pop ups. An estimated 80,000 consumers finally gave in and bought the software, which was advertised as a solution to the pop up problem the defendants themselves had created. Ultimately, after six months of discovery, the case settled, and the defendants agreed to the entry of a permanent injunction banning them from advertising through the pop ups described in the complaint, among other provisions discussed below.

Procedural History

In late October of 2003, the FTC filed under seal a two-count complaint against three defendants: D Squared Solutions, LLC, a California company, and its principals Anish Dhingra and Jeffrey Davis. The FTC sought preliminary and permanent injunctive relief, as well as other equitable remedies, including restitution and disgorgement, pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b). With its complaint, the FTC filed a motion for a temporary restraining order seeking to halt defendants' unfair practices, to require defendants to preserve records and assets, to submit financial statements, and to show cause why a preliminary injunction should not issue during the pendency of the lawsuit. The FTC contended that an *ex parte* hearing was necessary because, among other reasons, the individual defendants had made attempts to hide their identities. Emergency Duty Judge William D. Quarles in the Baltimore Division of the United States District Court for the District of Maryland issued the TRO *ex parte* on October 30, 2003.

The FTC served the TRO on the defendants in the first week of November. The case was transferred to the docket of Judge Andre M. Davis, who, on the request of the defendants, scheduled a hearing on December 15, 2003, for defendants to show cause why a preliminary injunction should not issue. At the outset of the case, the defendants stated through their attorney that they had stopped sending pop ups. The individual defendants also stated through their attorneys that they would not complete the financial statement for the corporate defendant, D Squared Solutions, because they were asserting their Fifth Amendment privilege against self-incrimination.

At the preliminary injunction hearing, the defendants argued that their pop up advertisements were in the public interest because they warned consumers about a potential security flaw in the Microsoft Windows Operating System, citing a security bulletin issued by Microsoft two weeks prior to the filing of the case. Although the FTC submitted sworn declarations from consumers who stated that they were receiving pop ups from defendants every ten minutes, the defendants asserted that they were sending only one pop up per day to individual consumers. After oral argument, Judge Davis decided that he did not have sufficient evidence to issue a preliminary injunction at that time, so he set the case down for a preliminary injunction hearing in March 2004, to be combined with a trial on the merits of the case. He ordered expedited discovery to begin immediately.

After settlement negotiations during discovery, the parties agreed to the entry of a stipulated permanent injunction. As discussed below, the permanent injunction prohibits the defendants from sending these kinds of pop up advertisements and has various fencing-in provisions and monitoring requirements to allow the FTC to ensure the defendants' compliance with the injunction.

The FTC's Allegations that Defendants' Practices Were Unfair

In *Holland Furnace*, the Commission held that the purported inspectors' interference with homeowners' ability to use a home appliance – in that case, the furnace – was an unfair trade practice under the FTC Act.[3] The Commission cited the case favorably in its 1980 Policy Statement, noting that it would be an unfair practice for "sellers [to] coerce consumers into purchasing unwanted goods or services."[4] Such tactics, the Commission said, "unjustifiably hinder such free market decisions."[5] In 1994, Congress amended the FTC Act to statutorily adopt the Commission's three-part test for determining when an act or practice is unfair.[6] Thus, to prevail in an unfairness case, the FTC must demonstrate: 1) a likelihood of substantial consumer harm; 2) that cannot reasonably be avoided by consumers; and 3) that is not outweighed by countervailing benefits to consumers or to competition. Had the action against D Squared Solutions proceeded to trial, the FTC would have presented evidence establishing all three indicia of unfairness.

1. Likelihood of Substantial Consumer Harm

To establish the first prong of the unfairness test – the likelihood of substantial consumer injury – the FTC alleged that the defendants, through their relentless pop up ads, caused two significant types of harm, which were charged as separate counts in the complaint: 1) interference with consumers' use of their computers; and 2) attempted coercion of purchases of software. As in *Holland Furnace*, the FTC argued that the defendants' marketing blitz interfered with consumers' ability to operate a modern-day home appliance – in this case, a computer. The pop-ups came while consumers were connected to the Internet, but not only when they were using the Internet to access web pages or download content. The incessant interruption of pop up ads caused several kinds of injury. Many consumers lost hours of productivity when screen freezes interrupted their work and application crashes caused loss of data. For example, a distance learning student reported that the pop-ups caused her to lose the answers to an on-line test she was taking. Additionally, consumers who play community on-line games found that their game sessions would end or that their computer controls would become unresponsive each time they received a pop up.

The FTC claimed that consumers were also injured when they spent hours trying to get the pop ups to stop. Desperate for a solution to the problem pop ups, consumers rebooted their computers, researched pop ups on the Internet, downloaded blocking software that proved ineffective against the defendants' pop ups, and even tried to contact the defendants directly in an unsuccessful effort to get them to call off the onslaught of spam. Some consumers became so frustrated with the repeated interruptions, freezes, and lost data that they simply stopped using their computers. Others finally gave in and spent between $20 and $30 on the defendants' software.

The FTC also argued that the defendants' coercive tactics interfered with a consumer's ability to exercise free choice in the marketplace. Like the sellers in *Holland Furnace*, D Squared used tactics akin to commercial blackmail by offering to fix for a fee the very problem that it created. The FTC argued that this "unjustifiably hinder[ed]" a consumers' free market decisions about purchasing firewalls or other types of protection.[7] Just as the frustrated homeowners in *Holland Furnace* had no meaningful choice other than to accede to the company's demands, a victim of D Squared's

spam attack could not exercise unfettered choice about whether to purchase the defendants' pop up-blocking software or another vendor's product.

Finally, the FTC argued that while the injury suffered by a given consumer might vary, "injury to consumers [is] substantial in the aggregate," given the widespread and uniquely pernicious nature of the defendants' extortionate marketing scheme.[8] In analyzing the "substantial injury" prong, it is well-settled that "[i]njury may be sufficiently substantial if it causes a small harm to a large class of people."[9] In addition, the "substantial injury prong can be satisfied if the FTC establishes that consumers were injured by a practice for which they did not bargain."[10]

Although providing substantial benefits to consumers, the Internet has also proven to be a receptive forum for unscrupulous marketers to recycle old scams in high-tech packaging. The injury alleged in *D Squared* was similar to that recently alleged in *FTC v. Zuccarini*.[11] In *Zuccarini*, the court entered a default judgment against defendants for the unfair practice of diverting consumers to their website and preventing them from exiting, a practice known as "mousetrapping."[12] The Commission similarly alleged in *FTC v. Pereira*[13] that it was an unfair practice for marketers to launch multiple browser windows that displayed defendants' web pages and mimicked other web pages, a practice known as "page-jacking." In *Zuccarini, Pereira*, and *D Squared*, the Commission alleged that it was an unfair trade practice for the defendants to deny consumers' the use of their computers by interfering with its normal functioning. However, unlike the practices alleged to be unfair in *Zuccarini* and *Pereira*, which interfered only with internet browser applications, the *D Squared* defendants added a new twist on the scam by interfering with computer use no matter what application the consumer was using.

2. Whether the Harms Were Reasonably Avoidable

To establish the second prong of the unfairness test – that the injury was not reasonably avoidable by consumers – the FTC alleged that consumers were unable to find a way to stop the defendants' pop ups on their own. The defendants' pop ups did not appear in a browser window; rather, they appeared as a grey system dialog box that was impervious to the usual solutions consumers implement to block pop-ups. Unlike browser pop ups that appear when visiting certain websites, consumers could not avoid the defendants' pop ups by simply not visiting certain websites. Additionally, widely available pop up blockers, such as those offered by google.com and many Internet Service Providers, were ineffective against the defendants' pop ups. Although the defendants claimed to offer an opt-out mechanism on their website, consumers reported that it did not work and that their e-mail requests that the defendants stop the pop up onslaught went unanswered.

As it turned out, although it was technically possible to stop the pop ups by changing the default settings of the Microsoft Windows Operating System, it was a solution beyond the knowledge of even tech-savvy consumers. The defendants generated the pop up boxes by using an operating system "service," the settings for which are all but impossible for consumers to find on their own, assuming that they can even determine what service the defendants were using to cause the problem. To confuse things further, the service that was involved – the Windows Messenger Service – is completely different from an application more familiar to many consumers and that has a similar name, Microsoft Windows Instant Messenger. Many consumers unsuccessfully tried to solve the problem by turning off their instant messenger. Without a sophisticated technology background (and in some cases, in spite of it), consumers were unable to reconfigure the service settings of the operating system to stop the defendants' pop ups from appearing simply because they could not diagnose the problem. Thus, the injury caused by the defendants' pop ups was not avoidable by reasonable consumers – and was often not avoidable even by consumers more technically expert than the typical user.

3. Countervailing Benefits to Consumers or Competition

To establish the third prong of the unfairness test – that the injury caused by the challenged practice is not outweighed by countervailing benefits to consumers or to competition – the FTC argued that the pop ups offered no countervailing benefits to the consumers whose computers had been held hostage by the defendants' cyber-assault. The defendants' main argument on this point was that the software they were promoting – not the pop ups themselves – provided valuable security protections. They further argued that the pop ups served to warn consumers of a security vulnerability related to Windows Messenger Service. The FTC argued that whatever benefits their software may have provided were confined to the software itself, and not to the method by which the defendants chose to market it. The FTC also argued that even if consumers received a benefit from receiving a warning through a pop up, hundreds of additional warnings were of diminishing benefit.

It is important to note two things that the FTC did not charge as unfair or fraudulent in its complaint: 1) the features of the defendants' software itself, and 2) the advertisement of the defendants' software by means that did not interfere with consumers' computer use, such as the defendants' advertising on their dozens of websites. The FTC's case concerned the method of marketing, not the product being marketed. The FTC argued that if advertisers could always use the most effective marketing method available, marketers would have free rein to call and visit consumers' homes at any time of day or night to pitch their wares to a captive audience. The FTC contended that because only the defendants benefitted from the substantial harm suffered by consumers, their activity met the third prong of the unfairness test – that the harm did not offer countervailing benefits to consumers or competition.

Resolution of the Case

The parties reached a settlement in which the corporate and individual defendants each agreed to the entry of a permanent injunction by the court. The permanent injunction imposes conduct prohibitions on the defendants: a lifetime ban on sending Windows Messenger Service pop-up advertisements, as well as a lifetime ban on selling Windows Messenger Service pop-up-blocking or Windows Messenger Service pop-up-sending goods or services.

Other parts of the order contain fencing-in provisions, which are designed to prevent the defendants from translating their business model into other forms of internet communication and commerce. The order prevents the defendants from marketing any product or service using Instant Messaging pop ups. The order also permanently enjoins the defendants from sending any other type of unsolicited advertisement without providing an opt-out mechanism if one is technologically feasible. If an opt-out mechanism is not technologically feasible, the defendants may not make false

representations that an opt-out is available. Finally, the order permanently enjoins the defendants from "spoofing" Internet Protocol addresses, e-mail addresses, or other information that identifies the sender of a message.

In addition to the conduct prohibitions, the final order also contains standard monitoring provisions, including access to defendants' business premises with limited notice, reporting provisions, record keeping provisions. Each defendant is also required to distribute the order to his principals and managers if his job responsibilities include "conduct related to the subject matter of this Order."

Conclusion

As in the recent Zuccarini case, the D Squared defendants were alleged essentially to have taken control of consumers' computers. The FTC has brought these cases because such practices are likely to undermine consumer confidence in the Internet and cause consumers to reduce their use of this developing medium. In addition to vigorously prosecuting these unfair trade practices, the Commission has also undertaken an educational campaign – ***Ready to Pop Your Top Over "Pop up Spam?"*** – to alert consumers on how to protect themselves should copycat scam artists not heed the lesson of *FTC v. D Squared Solutions*.[14]

Revisiting Attorneys' Fees: A Catalyst for Change to the California Private Attorney General Statute

by Luanne Sacks and M. Todd Jenks*

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IRegardless of where one stands on the desirability of mass private enforcement of public consumer protection laws, it is safe to say that California is the epicenter for the phenomenon. Efforts to change that reality through legislation aimed at curbing perceived abuses of California's unfair competition laws, including private attorney general actions, has stalled in the California legislature. Trial lawyers, on the one hand, and businesses being targeted by these laws, on the other, are pointing the finger at each other for this stalemate. But now their, and our, eyes are trained on the California Supreme Court which soon will rule on two cases that threaten to abolish or alter current practice that allows a successful party in a private attorney general action to seek attorneys' fees if the suit acts as a ***catalyst*** in producing voluntary changes in the absence of a court ordered change on the part of the defendant that provides a substantial benefit to the public.

The California cases arise in the context of a clear federal rule against recognizing such fee awards. In *Buckhannon Board & Care, Inc. v. West Virginia Dept. of Health and Human Resources*, 532 U.S. 598 (2001) ("*Buckhannon*"), the United States Supreme Court pronounced the catalyst theory dead, at least on the federal level, in a 5-4 decision holding that it is not a permissible basis for the award of attorney's fees under the Americans with Disability Act (ADA) or the Fair Housing Amendments Act (FHAA) because the plaintiff had to be awarded some relief from the court, evidencing a judicial imprimatur, to qualify as a "prevailing party" under the operative fee statutes. 532 U.S. 598, 600. The Court noted that a judgment on the merits or a court-ordered consent degree would provide the "judicial imprimatur" necessary to justify the award of attorneys' fees. Id. at 604-605.

At issue now is whether the California Supreme Court will adopt a similar approach regarding catalyst theory fee demands in state consumer law actions. California Code of Civil Procedure section 1021.5 (the private attorney general statute) authorizes attorneys' fees to be awarded to a:

> successful party . . . in any action which has resulted in the enforcement of an important right affecting the public interest if (a) a significant benefit, whether pecuniary or nonpecuniary, has been conferred on the general public or a large class of persons, (b) the necessity and financial burden of private enforcement . . . are such as to make the award appropriate, and (c) such fees should not in the interest of justice be paid out of the recovery, if any.

California cases preceding *Buckhannon* contain dicta suggesting that a party may be deemed "successful" under section 1021.5 where the private attorney general lawsuit serves as a catalyst for remedial action that is not required by court order but that achieves the result sought by the lawsuit. These cases, however, arise in circumstances where there was a judicially enforceable change in the legal relationship between the parties. *See Maria P. v. Riles*, 43 Cal. 3d 1281, 1291-1292 (1987) (preliminary injunction); *In re Head*, 42 Cal. 3d 223, 225 (1986) (petitioners prevailed on habeas corpus claims); *Folsom v. Butte County Ass'n of Gov'ts*, 32 Cal. 3d 668, 675-76 (1982) (partial summary judgment and injunction); *Northington v. Davis*, 23 Cal. 3d 955, 960 (1979) (summary judgment). In fact, even after *Buckhannon* a California Court of Appeal, in dicta, endorsed the catalyst theory under the private attorney general statute. See *Jordan v. California Dep't of Motor Vehicles*, 100 Cal. App. 4th 431, 438. Since *Buckhannon*, however, no California court in a published decision has squarely addressed the issue of catalyst fees.

Until now. There currently are two major catalyst fee cases before the California Supreme Court, one a state case under review, and the other a federal case in which the federal appellate court certified questions for determination the state Supreme Court. In *Graham v. DaimlerChrysler Corp.*, 2002 WL 31732556 (2002) ("*DaimlerChrysler*"), California's Second District Court of Appeal voiced that, despite *Buckhannon*, "[t]he catalyst theory is well-recognized under California law as justifying an award under section 1021.5." Id. at *6. The Court rejected the plaintiff's claim that *Buckhannon* compelled it to reject the fee request under section 1021.5—a "separate California statute"—"at least until the California Supreme Court so orders." *Id*. Consequently, the Court affirmed the trial court's award of $760,000 in fees based on the trial court's finding that the defendant had not responded to complaints about the towing capacity of its Dakota R/T truck until three owners filed a class action. *Id*. The California Supreme Court granted review.

In *Tipton-Whittingham v. City of Los Angeles*, 316 F.3d 1058 (9th Cir. 2003) ("*Tipton-Whittingham*"), the City of Los Angeles appealed the award of $1,703,383 in attorneys' fees, predicated on the city's voluntary institution of several reforms in response to allegations of sex and race discrimination prior to plaintiff's voluntary dismissal of its claims for injunctive relief. *Id*.

at 1061. Uncertain as to whether California would follow the United States rejection of the catalyst theory in *Buckhannon*, the Ninth Circuit certified the following unresolved questions to the California Supreme Court:

A. Under California law, may attorneys' fees as provided for in California Code of Civil Procedure § 1021.5 and the California Fair Employment and Housing Act ("FEHA") § 12965(b) [citation] be awarded where the plaintiff has been the "catalyst" in bringing about the relief sought by the litigation?

B. If the catalyst theory is viable under California law, will that theory support an award of attorneys' fees where the plaintiff "activates" the defendant to modify his behavior? Or does California law require a *judicially recognized* change in the legal relationship between the parties, such as a judgment on the merits, a consent decree, or a judicially ordered settlement?

Id. at 1060 (citations omitted). The California Supreme Court granted the request, not surprisingly since *DaimlerChrysler* already was on its docket.

On September 8, 2004, the California Supreme Court heard oral argument in the closely watched cases of *DaimlerChrysler* and *Tipton-Whittingham*. Based on the barrage of questions in these two cases, it is obvious that there is disagreement among the justices regarding the central issue before the Court, namely:

> Should California reconsider the propriety of awarding attorneys' fees under the California private attorney general statute (Code of Civil Procedure Section 1021.5) to a party who did not receive a favorable judgment but whose lawsuit was the "catalyst" inducing the other party to modify its behavior, in light of the United States Supreme Court's recent disapproval of that theory in interpreting certain federal attorneys' fees statutes in *Buckhannon Board & Care, Inc. v. West Virginia Dept. of Health and Human Resources* (2001) 532 U.S. 598?

At the hearing, advocates for the plaintiffs stressed that abolishing the catalyst theory likely would result in fewer private attorney general suits because lawyers would fear substantial litigation without any compensation. The defense replied that the continued recognition of the theory posed the threat of extensive satellite litigation over fees, and that such awards act as a barrier to early, reasonable settlements. Interestingly, both of these positions were discussed in the *Buckhannon* decision, and ultimately the Court resolved the question in favor of the defense.

Justice Ming Chin seemed the most likely to follow *Buckhannon*, repeatedly pointing out that the plaintiffs in the two cases did not receive a favorable judicial ruling. Justice Marvin Baxter's comments suggested that he sided with Justice Chin. Justice Janice Rogers Brown, who made no comments during the hearing, is known to typically join Justices Chin and Baxter on issues involving corporate or governmental issues.

Justice Joyce Kennard appeared to embrace the middle ground. She observed that the catalyst theory ensures that lawyers get rewarded for taking cases that benefit the public interest. But she also noted that certain lawyers abuse the intended purpose of catalyst fees by prosecuting claims that lack any merit, fueled by economic spoils. She posed questions about whether the Court should restrict fees to suits in which the trial court finds that the case had merit, that it caused change that benefited the public interest, and that it was filed as a last resort, after the plaintiffs attempt to resolve the issue informally. It is notable that Justice Kennard's suggestions were remarkably similar to the changes recommended by Attorney General Bill Lockyer in *amicus* briefs filed on behalf of the plaintiffs in both cases. *See also Baxter v. Salutary Sportsclubs, Inc.* 04 C.D.O.S. 8865 (embracing a similar position).

At the other extreme of Justice Chin, Chief Justice Ronald George and Justice Carlos Moreno questioned whether the Court should defer to the trial judge's discretion. Skeptically, Chief Justice George vigorously questioned counsel for the City of Los Angeles, in *Tipton-Whittingham*, as to whether she sincerely believed that the positive change (i.e., the consent decree) would have occurred without the filing of the suit.

While it is impossible to predict how the decision will come down, it seems fair to say that, while some brand of the catalyst theory likely will continue to be recognized in California, the theory will be applied more stringently so as to curb extreme abuses of California's private attorney general statute. In other words, of course the Legislature will need to speak to and ultimately resolve the issue.

Remembrance of Things Pasta: the Eighth Circuit Addresses Puffery

by Victor F. DeFrancis*

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The Federal Trade Commission has long recognized the defense of puffery. Nearly fifty years ago, it defined puffery as a "term frequently used to denote the exaggerations reasonably to be expected of a seller as to the degree of quality of his product, the truth or falsity of which cannot be precisely determined."[1] The FTC has also generally held that puffery does not warrant enforcement action by the Commission. In its FTC Policy Statement on Deception ("FTC Deception Statement"),[2] the Commission stated:

> The Commission generally will not pursue cases involving obviously exaggerated or puffing representations, i.e., those that the ordinary consumers do not take seriously.

The statement reveals a central assumption underlying the defense of puffery: In short, consumers "get it." Certainly, the reasoning goes, ordinary consumers will not believe that a widget marketed as the "Best Widget in the World" *really* is the best widget on the planet. Rather, we assume that ordinary consumers can be expected to distinguish between those advertising claims of fact and those of (obviously exaggerated) fiction. And once an advertising claim is deemed to fall into the latter category, it is unassailable because (so the reasoning goes) consumers do not believe it. Recently, the

United States Court of Appeals for the Eighth Circuit weighed in with a vigorous affirmation of the puffery defense in *American Italian Pasta Co. v. New World Pasta Co.*[3] The Court's rather dismissive treatment of the challenged claim issue raises a nagging question: When it comes to puffery, do we assume too much?

In the *American Italian Pasta* case, American Italian Pasta Company ("American") filed a declaratory judgment action against New World Pasta Company ("New World") after the latter sent a letter to American demanding that it cease using the phrase "America's Favorite Pasta" in connection with the marketing of American's Mueller brand of pasta. New World claimed that the advertisement constituted false and misleading advertising under section 43(a) of the Lanham Act[4] and many states' unfair competition laws. The lower court granted summary judgment in favor of American, ruling that "America's Favorite Pasta" constituted non-actionable puffery. The Eighth Circuit affirmed. The Court began with a recitation of the standard for establishing a false or deceptively misleading advertising claim under section 43(a) of the Lanham Act:

> (1) a false statement of fact by [American on its packaging] about its own or another's product; (2) the statement actually deceived or has the tendency to deceive a substantial segment of the audience; (3) the deception is material, in that it is likely to influence the purchasing decision; (4) the defendant caused its false statement to enter interstate commerce; and (5) the plaintiff has been or is likely to be injured as a result of the false statement.[5]

The Court further observed that, with respect to the first factor, there are two categories of actionable statements – (1) those factual claims that are literally false; and (2) those factual claims that are literally true or ambiguous which implicitly convey a false impression, are misleading in context, or are likely to deceive consumers.[6] In the dispute at issue, however, the Court found that it need not consider into which category of actionable statements "America's Favorite Pasta" fell because the statement was not, in fact, actionable at all. Instead, it fell into the category of "(1) exaggerated statements of bluster or boast upon which no reasonable consumer would rely; and (2) vague or highly subjective claims of product superiority, including bald assertions of superiority."[7] "America's Favorite Pasta," concluded the Court, was mere puffery.

Puffery, the Court continued, is different from a factual claim: "A factual claim is a statement that '(1) admits of being adjudged true or false in a way that (2) admits of empirical verification.'"[8] Puffery and fact are "mutually exclusive."[9] Before turning to its factual analysis, the Court set forth the rationale which would ultimately lead to its conclusion: "Defining puffery broadly provides advertisers and manufacturers considerable leeway to craft their statements, allowing the free market to hold advertisers and manufacturers accountable for their statements, ensuring vigorous competition, and protecting legitimate commercial speech."[10]

Turning to the factual analysis, the Court deemed the "key" term in the phrase "America's Favorite Pasta" to be "favorite."[11] "Favorite," the Court reasoned, is an ambiguous concept. In interpreting the term, the Court consulted Webster's Third International Dictionary, which defines it as "markedly popular especially over an extended period of time."[12] In turn, Webster's defines "popular" as "well liked or admired by a particular group or circle."[13] The Court then concluded that the combination of the terms "favorite" with "America's" in "America's Favorite Pasta" merely conveyed that Mueller's pasta has been well liked or admired over time by America, "a non-definitive person."[14] Deeming "well liked" and "admired" to be "entirely subjective and vague," the Court determined that the advertising claim did not and could not convey a "quantifiable threshold in sheer number, percentage, or place in a series."[15]

After determining that "America's Favorite Pasta," standing alone, was mere puffery, the Court then analyzed whether the context in which American used the phrase transformed it into a statement of fact. The Court noted that the phrase was used in a paragraph extolling the virtues of Mueller's pasta, and also appeared in various places on the product packaging, along with "Since 1867" and "Made from 100% Semolina" or "Made with Semolina."[16] None of these uses, the Court found, illuminated why Mueller's is America's favorite. Rather, they merely (truthfully) identified characteristics of the pasta. As a result, the Court concluded that the context did not "define a methodology by which to ascertain the veracity of American's claim" and, thus, transform "America's Favorite Pasta" from a puff into a fact.[17]

Finally, the Court also refused to consider New World's survey evidence, which indicated that 33% of those surveyed believed that "America's Favorite Pasta" conveyed that Mueller's was the number one brand, while 50% of those surveyed perceived the phrase to mean that Mueller's was a national brand.[18] (The parties agreed that Mueller's was a regional brand and that Barilla brand pasta is the number one seller in the United States). The Court, relying on the Seventh Circuit's opinion in *Mead Johnson & Co. v. Abbott Laboratories*,[19] found that "to allow a consumer survey to determine a claim's benchmark would subject any advertisement or promotional statement to numerous variables, often unpredictable, and would introduce even more uncertainty into the marketplace."[20]

The Court's somewhat brisk treatment of New World's challenge to "America's Favorite Pasta" gives one pause. In its zeal to "define puffery broadly," the Court missed an opportunity to examine how the claim at issue in the *American Italian Pasta* case is different in degree from the claims at issue in other puffery cases on which the Court relied. At first blush, "America's Favorite Pasta" suggests something objectifiable, whereas "Better Ingredients. Better Pizza."[21] – the phrase at issue in the Fifth Circuits decision in *Pizza Hut v. Papa John's* – for example, does not. One could readily fashion a survey of a statistically significant sample of United States consumers that could determine which brand of pasta could be termed "America's Favorite," while it is difficult to imagine how "Better Ingredients. Better Pizza" – standing alone – could be quantified or analyzed in any manner whatsoever.

Indeed, in a footnote, the Court hinted that, in fact, "America's Favorite Pasta" may not be entirely subjective. The Court noted that:

> We note that the outcome of this case might be different if American claimed Mueller's pasta was the favorite pasta of a specific person or an identifiable group. For example, the claim that Mueller's is Judge Michael Melloy's favorite pasta would not be puffery. Such a statement is a factual statement that could be verified by simply asking Judge Melloy which pasta brand is his favorite.[22]

If the import of the term "favorite" in the examples above were clear, then the term that transforms "America's Favorite Pasta" from factual claim into puffery is not "favorite," as the Court suggests, but "America's." It may have been more logical, then, for the Court to conclude that the outcome of the case hinged on the ambiguity of the term "America's," an arguably "non- identifiable" group. That, too, would not have been entirely satisfactory, because it would have raised the question of precisely how identifiable any particular group need be for purposes of factual verification. What if American advertised that Mueller's was "Ohio's Favorite Pasta?" Would that be puffery or a fact capable of verification?

It also is somewhat inconsistent to hold that an advertising claim is puffery, *i.e.*, "obviously exaggerated bluster and boast," on the one hand, and be compelled to dissect it with the assistance of Webster's, on the other. To put it another way, an obvious exaggeration should not require legal analysis akin to that of statutory construction. Take, for example, the advertising claim at issue in the *Mead Johnson* case. In that case, the Court reviewed the advertising claim "1st Choice of Doctors," as applied to Similac, an infant formula.[23] The claim was deemed to be verifiable – its "ordinary usage" suggested that doctors preferred Similac over other formulas. Arguably, substituting the term "Favorite" for "1st," as in "Favorite Choice of Doctors" does not alter the meaning substantially, for it still states, or at least implies, that, among all brands, doctors select or prefer Similac the most. Under the *America Italian Pasta* analysis, however, the claim would be mere puffery, especially given the ambiguity of the term "doctors." (Pediatricians? Ph.D.'s? Doctors within the continental United States?)

Perhaps much of the problem in the case stems from the use of superlative terms such as "favorite" in advertising. By engaging in its dictionary definition sleight of hand, the American Italian Pasta Court concluded that the term "favorite" is tantamount to "well liked" or "admired." It is not. One seriously doubts that New World would have objected had American used the tagline "America's Admired Pasta" with Mueller's. More importantly, it is also doubtful that, had American used this tagline, nearly 1/3 of consumers in a survey would have concluded that it meant that Mueller's was the number one brand. Superlative terms in advertising are rife with significance – *implying* first in sheer number, percentage, or place in a series. Most superlative terms are not as ambiguous as terms such as "easy," "amazing," "prime," "wonderful," "excellent" – all of which courts have explicitly recognized as obvious puffery.[24]

If the puffery defense rests on the assumption that certain advertising claims are so obviously exaggerated that ordinary consumers do not take them seriously, then a properly designed survey should bear that out. When confronted with New World's proffered survey evidence, the Court dismissed it, contending that to accept it would inject more "uncertainty" into the marketplace. The Court's thinly veiled skepticism towards such evidence is arguably inconsistent with the spirit of FTC practice. For example, the Commission has not hesitated to turn to extrinsic evidence if it is unable to determine with confidence what claims are conveyed on their face. The FTC Deception Statement noted that, in reviewing potential representations, omissions or practices with respect to both express and implied claims, "the Commission will carefully consider any extrinsic evidence that is introduced."[25]

Where an advertising claim walks an ambiguous line between fact and puffery, and is open to interpretation, it makes sense for a court to consider proffered survey evidence to gauge consumer understanding of the claim at issue. In dismissing New World's survey evidence, the Court was able to avoid addressing the following question its analysis raises: By "defining puffery broadly" to provide clarity to advertisers and manufacturers, do we create uncertainty for consumers? If the survey evidence in *American Italian Pasta* is any indication, our assumptions about what ordinary consumers believe when confronted with a particular advertising claim may be misplaced.

There can be little doubt that the Eighth Circuit's decision in the *American Italian Pasta* case has reaffirmed the continuing vitality of the puffery defense for advertisers and marketers. The facts of the *American Italian Pasta* case also suggest that – at least with respect to certain advertising claims – puffery may not be as obvious to consumers as the current law deems it to be.

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ENDNOTES

The FTC's Project Scofflaw: "Go to Jail. Do Not Pass Go. Do Not Collect $200"

by J. Reilly Dolan

1 **http://www.ftc.gov/opa/1997/04/scofflaw.htm.**
2 The U.S. Sentencing Commission's fraud guidelines provide that if the offense involved "a violation of any prior, specific judicial or administrative order, injunction, decree, or process not addressed elsewhere in the guidelines" the court must increase the sentence calculation by two levels. Such an adjustment can increase a defendant's sentence for fraud by at least three months, if not more. U.S.S.G. § 2B1.1(b)(7) (Nov. 1, 2001).
3 *FTC v. J.K. Publications, Inc.*, No. CV-99-44 (C.D. Cal.).
4 *FTC v. Ronald Dante dba Perma-Derm Academy*, No. 90-CV-945 (C.D. Cal.).
5 *FTC v. Falcon Crest Communications, Inc.*, No. CV 95-4881 (E.D. N.Y.).
6 *FTC v. Jordan Ashley*, No. 93-2257-civ-Nesbitt (S.D. Fla.).
7 Five other individuals also were charged for engaging in the fraud scheme but were not charged with assisting Norton violate the terms of his order.
8 *FTC v. First Credit Alliance, Inc.*, CV: 3:00CV1049 (CFD) (D. Conn.).
9 *FTC v. Keith Gill*, Civ. No. 98-436 (C.D. Cal.).
10 *FTC v. Nu-Idea Technologies, Inc.*, No. 95-CV-1753 (N.D. Ga.).
11 *FTC v. Uni-Vest Financial Services*, No. 89-6382-civ-Gonzalez (S.D. Fla.).
12 *FTC v. Uni-met Credit Corp.*, Civ. No. 92-5759-RSWL (C.D. Cal.).
13 *FTC v. Western Trading Group, ltd.*, Civ. No. 92-4194 (C.D. Cal.)
14 *United States v. Worldwide Coffee, Inc.*, 00-8137-civ-Graham (S.D. Fla.).
15 *FTC v. Federal Data Service, Inc.*, 00-6462-civ-Ferguson (S.D. Fla.).
16 *FTC v. Credit Development International*, Civ. No. 97-7947 (C.D. Cal).
17 *See* Second Annual Report, Section III. A., pp. 6-8.
18 *United States v. Robert Ferrara*, 334 F.3d 774 (8th Cir. 2003), cert. denied, 124 S. Ct. 1127 (2004).
19 *United States v. Ferrara*, 334 F.3d at 777.
20 United States Sentencing Commission Guidelines Manual, Appendix C, Amendment 653 (Nov. 1, 2003).
21 __ U.S. __, 124 S. Ct. 2531, 159 L. Ed. 2d 403 (2004).
22 124 S. Ct. at 2538 n.9, 159 L. Ed. at 415 n.9.
23 *United States v. Booker*, 2004 U.S. App. LEXIS 14223 (7th Cir. July 9, 2004); *United States v. Pirani*, 2004 U.S. App. LEXIS 16117 (8th Cir. Aug. 5, 2004); *United States v. Ameline*, 2004 U.S. App. LEXIS 15031 (9th Cir. July 21, 2004).
24 *United States v. Hammoud*, 2004 U.S. App. LEXIS 15898 (4th Cir. Aug. 2, 2004) (*en banc*); *United States v. Pineiro*, U.S. App. LEXIS 14259 (5th Cir. July 12, 2004).
25 *United States v. Penaranda*, 2004 U.S. App. LEXIS 14268 (2d Cir. July 12, 2004) (*en banc*).
26 *FTC v. Think Achievement Corp.*, 312 F.3d 259 (7th Cir. 2002).

The Voluntary Payment Doctrine: A Potential Bar to Restitution Claims

by Stephen B. Malech

1 *See, e.g., Time Warner Entertainment Company, L.P. v. Whiteman*, 802 N.E.2d 886 (Ind. 2004) and *Putnam v. Time Warner Cable of Southeastern Wisconsin*, 649 N.W.2d 626 (Wis. 2002).
2 *See, e.g., Time Warner Entertainment Company*, L.P., 802 N.E.2d at 886; *Putnam*, 649 N.W.2d at 626; *Dillon v. U-A Columbia Cablevision of Westchester*, 740 N.Y.S.2d 396 (N.Y. App. Div. 2002); *Telescripps Cable Company v. Welsh*, 542 S.E.2d 640 (Ga. App. 2000); *Hill v. Galaxy Telecom, L.P.* , 2000 WL 264325 (N.D. Miss. 2000); *Horne v. Time Warner Operations, Inc.*, 119 F.Supp.2d 624 (S.D. Miss. 1999); *McWethy v. Telecommunications, Inc.*, 988 P.2d 356 (Ok. Civ. App. 1999); *Sanchez v. Time Warner, Inc.*, 1998 WL 834345 (M.D. Fla. 1998); and *Smith v. Prime Cable of Chicago*, 658 N.E.2d 1325 (Ill. App. 1995).
3 *Putnam*, 649 N.W.2d at 632.
4 *See, e.g., Time Warner Entertainment Company, L.P. v. Whiteman*, 802 N.E.2d 886 (Ind. 2004); *Pratt v. Smart Corporation*, 968 S.W.2d 868 (Tenn. App. 1998).
5 The trial court also dismissed the claims for declaratory and injunctive relief on the grounds that the claim "was not ripe for resolution because the amended complaint failed to allege that any customer had presently refused to pay a late fee." *Putnam*, 649 N.W.2d at 632. The Wisconsin Supreme Court ultimately reversed this aspect of the trial court's ruling. *Id.* at 642.
6 *Id.* at 633.
7 *Id.*
8 *Id.*
9 *Id.* at 634.
10 *Id.* at 636.
11 *Id.* at 637.
12 *Id.*
13 *Time Warner Entertainment Company, L.P.* , 802 N.E.2d at 891.
14 *Id.* at 891-92.
15 *Id.* at 892.
16 *Id.*
17 *Id.* at 893 (citations omitted).
18 *Pratt v. Smart Corporation*, 968 S.W.2d 868, 870 (Tenn. App. 1998).
19 *Id.*
20 *Id.* at 872.
21 *Id.* By contrast, Georgia has a statute that provides, "Payments of claims made through ignorance of the law or where all the facts are known and there is no misplaced confidence and no artifice, deception or fraudulent practice used by the other party are deemed voluntary and cannot be recovered unless made under an urgent and immediate necessity therefore or to release person or property from detention or to

prevent an immediate seizure of person or property. Filing a protest at the time of payment does not change the rule prescribed in this Code section." OCGA § 13-1-13. Applying this statute, Georgia's courts have held that the VPD bars claims like those brought by Pratt. *See, e.g., Cotton v. Med-Cor Health Information Solutions, Inc.*, 472 S.E.2d 92 (Ga. App. 1996).

FTC v. D Squared Solutions: An On-Line Application of the FTC's Unfairness Doctrine

by Deborah Matties

1 55 F.T.C. 55 (1958).
2 *FTC v. D Squared Solutions, LLC, Anish Dhingra, and Jeffrey Davis*, No. 03-CV-3108 (D. Md. 2004).
3 *In the Matter of Holland Furnace*, 55 F.T.C. 55 (1958); *see also In the Matter of the Hearst Corp., et al.*, 82 F.T.C. 1792, 1997 (1973); *In the Matter of Neighborhood Periodical Club, Inc.*, 81 F.T.C. 93, 101 (1972).
4 Appended to *International Harvester Co.*, 104 F.T.C. 949, 1073 (1984).
5 *Id.* at 1074.
6 15 U.S.C. § 45(n).
7 Unfairness Policy Statement, 104 F.T.C. at 1074.
8 *FTC v. Crescent Publ'g Group, Inc.*, 129 F. Supp. 2d 311, 322 (S.D.N.Y. 1991) (finding that "injury to consumers was substantial in the aggregate").
9 *FTC v. J.K. Pubs. Inc.*, 99 F. Supp. 2d 1176, 1201 (C.D. Cal. 2000); *see also FTC v. Pantron Corp.*, 33 F.3d 1088, 1102 (9th Cir. 1994) ("[C]onsumer injury is substantial when it is the aggregate of many small individual injuries.").
10 *J.K. Pubs.*, 99 F. Supp. 2d at 1201.
11 No. 01-CV-4854, 2002 WL 1378421 (E.D. Pa. Apr. 9, 2002).
12 John Zuccarini is also known as one of the Internet's most notorious cybersquatters. *See, e.g., Shields v. Zuccarini*, 254 F.3d 476, 480 (3rd Cir. 2001). Mr. Zuccarini is currently serving a thirty-month prison sentence on charges that he created and used misleading domain names on the Internet to deceive minors into logging on to pornographic web sites.
13 No. 99-1367-A (E.D. Va. 1999).
14 FTC Consumer Alert, **http://www.ftc.gov/bcp/conline/pubs/alerts/popalrt.htm.**

Rememberance of Things Pasta: The Eighth Circuit Addresses Puffery

by Victor F.DeFrancis

1 *Better Living, Inc. et al.*, 54 F.T.C. 648 (1957), aff'd, 259 F.2d 271 (3rd Cir. 1958).
2 *Federal Trade Commission Policy Statement on Deception*, 103 F.T.C. 174 (1984), appended to *Cliffdale Assoc. Inc.*, 103 F.T.C. 110 (1984).
3 371 F.3d 387 (8th Cir. 2004)
4 15 U.S.C. § 1125(a)(1)(B).
5 371 F.3d at 390.
6 Id.
7 *Id.*, citing *Pizza Hut, Inc. v. Papa John's Int'l, Inc.*, 227 F.3d 489, 496-97 (5th Cir. 2000).
8 *Id.* at 391.
9 *Id.*
10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*
14 *Id.*
15 *Id.*
16 *Id.* at 392.
17 *Id.*
18 *Id.* at 393.
19 201 F.3d 883 (7th Circuit), opinion amended on denial of reh'g, 209 F.3d 1032 (7th Cir. 2000)
20 *Id.* at 393.
21 *See Pizza Hut*, *supra* note 7.
22 371 F.3d at 391, n. 5.
23 *Mead Johnson*, 201 F.3d at 884.
24 *See Carlay Co. v. Federal Trade Commission*, 153 F.2d 493, 496 (7th Cir. 1946).
25 *FTC Deception Statement*, *supra* note 2, at 175.