UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

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

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

RESPONDENTS' BRIEF IN REPLY TO COMPLAINT COUNSEL'S OPPOSITION TO RESPONDENTS' CROSS-APPEAL, AND IN OPPOSITION TO COMPLAINT COUNSEL'S APPEAL

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I. PRELIMINARY STATEMENT

Respondents Telebrands Corp., TV Savings, LLC and Ajit Khubani submit the following Brief in reply to Complaint Counsel's Brief in Opposition to Respondents' Appeal and in Opposition to Complaint Counsel's Cross-Appeal.

II. THERE IS NO RELIABLE EXTRINSIC EVIDENCE IN THE RECORD TO SUPPORT A FINDING THAT THE CHALLENGED ADS MADE THE ASSERTED CLAIMS.

Respondents' Opening Brief began by discussing the ALJ's rejection of the central theory for liability advanced by Complaint Counsel because it was unsupported by reliable extrinsic evidence. As Respondents argued, the Complaint

was based primarily on the theory that the Ab Force ads were deceptive because they had triggered consumers' preexisting "category beliefs" formed by having seen ads for the AbTronic, Ab Energizer and Fast Abs products. Under this theory, consumers would associate the Ab Force ads with their preexisting beliefs, causing consumers to view the Ab Force ads as making the same weight loss and fitness claims found in those other ads. Respondents have consistently referred to this theory as an "importation theory," because it essentially argues that consumers "imported" claims from the three other ads into the Ab Force ads.[1] The ALJ rejected this novel theory as unsupported by reliable extrinsic evidence, and, in doing so, necessarily rejected part of Dr. Mazis' facial analysis. (Opening Brief, p. 43)

Respondents also argued that the remaining extrinsic "evidence" offered by Complaint Counsel should similarly have been rejected. First, the rest of Dr. Mazis' facial analysis should have been rejected because it lacks the reliability required by *Daubert* and its progeny, and is, at best, the mere say-so opinion of Dr. Mazis. (Opening Brief, p. 44). Second, given Complaint Counsel's argument that preexisting category beliefs had an impact on consumers' perceptions, the decision not to control for preexisting beliefs in the copy test was a fatal flaw that rendered the copy test results wholly unreliable (Opening Brief, p. 51).

Complaint Counsel's response completely ignores these arguments. First, rather than explain how its importation theory was supported with reliable evidence,

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[1] Dr. Mazis did not refer to this as an "importation theory," but characterized these categorization beliefs and their impact on consumers viewing the Ab Force ads as "indirect effects." (Tr. 60 – 61).

Complaint Counsel argues that the importation theory is supported by "common sense" and that it is "reasonable to conclude" that the importation theory is correct without the need for extrinsic evidence. (Complaint Counsel's Appeal Brief ("CC Brief"), p. 32). As discussed in Section I(A) below, this argument is nothing more than an effort to circumvent evidentiary requirements with an unsupported insistence that the theory is true.

Second, Complaint Counsel responds to Respondents' challenge to the reliability of the remaining part Dr. Mazis' facial analysis by citing his qualifications as an expert. (CC Brief, p.47). As discussed in Section I(B) below, this argument ignores the two-part analysis established by *Daubert* permitting the introduction of expert opinion only if (1) the witness is qualified as an expert by virtue of training or experience, and (2), if the expert's opinions are reliable. Complaint Counsel responds to Respondents' challenge that the second requirement was not met by arguing that Dr. Mazis was qualified as an expert (CC Brief, p. 47). As discussed in Section I(B)(1) below, this argument begs the question. Moreover, Complaint Counsel argues that in any event *Daubert* need not be followed by the Commission, despite the fact that FTC counsel has previously urged the rejection of expert testimony for failure to meet the *Daubert* standards.

Third, Complaint Counsel responds to Respondents' challenge to the reliability of the copy test by claiming that the Dr. Mazis did not need to control for the possibility of preexisting beliefs, even though the existence of preexisting beliefs was the lynchpin of the central case against Respondents and despite Dr. Mazis'

admission that the skewed control group result was likely caused by preexisting beliefs on the part of copy test participants (CC Brief, p. 61).

Complaint Counsel also argues a lack of definitive proof of preexisting beliefs excuses the failure to control for pre-existing beliefs. (CC Brief, p. 63). As discussed in Section I(B)(2) below, Complaint Counsel simply misreads both *Kraft* and *Stouffer*, and ignores the fact that evidence of preexisting beliefs found in the record is the same type of evidence found in *Kraft* that compelled the Commission to conclude that a control for preexisting beliefs should have been included in the copy test in *Kraft*.

Finally, as an argument of last resort, Complaint Counsel claims that even if there was some evidence of preexisting beliefs, that evidence should be enough to impose liability. (CC Brief, p. 65). As discussed in Section I(C) below, that rejected argument fundamentally confuses the quantum of evidence necessary to draw the reliability of a copy test into doubt with the quantum of evidence necessary to impose liability. In no event do any of these arguments rebut Respondents' arguments that the copy test is unreliable because it failed to control for the preexisting beliefs of copy test participants.

Lacking either competent expert testimony or a reliable consumer perception study that measures up to settled evidentiary standards, it is clear that the extrinsic evidence offered by Complaint Counsel is fundamentally unreliable.

A. The ALJ Was Correct to Reject Complaint Counsel's Central "Importation Theory" of Liability, Because There is no Reliable Evidence in the Record to Support That Theory.

In its brief, Complaint Counsel argues that the ALJ erred in failing to accept that Respondents were liable because the Ab Force ads intentionally referred to ads for AbTronic, Ab Energizer and Fast Abs. (CC Brief, p. 31). Indeed, from the outset of this case, Complaint Counsel has argued that the challenged ads impliedly made the asserted claims because they caused consumers to make an association between the Ab Force ads and claims made in ads for three other products, AbTronic, Ab Energizer, and Fast Abs. But there is no evidence in the record that consumers do.

1. Complaint Counsel's importation theory relies on several interdependent assumptions, none of which were proven with any reliable evidence.

Complaint Counsel's theory assumes the following: (1) the ads for AbTronic, Ab Energizer and Fast Abs made weight loss and fitness claims; (2) consumers likely saw the ads for AbTronic, Ab Energizer, and Fast Abs; (3) as a result of seeing those ads, consumers formed certain category beliefs about ab belts; (4) those same consumers also saw ads for Ab Force; (5) seeing the Ab Force ads triggered consumers' preexisting categorization beliefs; and (6) as a result of this association, consumers perceived the ads as making the same claims made in ads for the three other products.

Respondents have consistently maintained that this novel theory could only be proven with reliable evidence that supports each assumption. At the hearing,

Complaint Counsel provided no evidence that this importation theory was true. Indeed, all Complaint Counsel had to offer was a series of unproven assumptions. The ALJ correctly agreed.

To prevail on the importation theory, the ALJ wrote that Complaint Counsel would have to prove a number of things:

> when, what channels, and how often advertisements for other ab belts or EMS devices aired; whether the consumers had seen advertisements for other ab belts or EMS devices; whether the consumers remembered the claims from the other advertising; how similar the products were in appearance; and how similar the advertisements were in terms of claims, visual images, and statements.

(ID, p. 51). But the ALJ found numerous evidentiary holes that precluded imposing liability on the basis of the importation theory:

> [T]here is no empirical evidence to determine what beliefs consumers would include in an ab belt category. Indeed, there is no reliable, demonstrated showing regarding whether consumers have ab belt category beliefs and, if so, what products would fall into that category.

(ID, p. 51). The Judge went on to conclude that the validity of the importation theory "cannot be determined without more evidence than was provided by Complaint Counsel in this case" and that the "analysis fails as a matter of proof." (ID, p. 51).

2. Instead of reliable evidence, Complaint Counsel invites the Commission to accept the importation theory as a matter of "common sense," an invitation that the Commission should decline.

On appeal, Complaint Counsel offers no reason why this finding should be rejected. Although Complaint Counsel's brief asserts that the ads for the three other products and for Ab Force were top-ranked in the Jordan-Whitney reports and that

the Ab Force ads compared the Ab Force to other ab belts, (CC Brief, pp. 14 – 26), there is no reliable evidence in the record to support the assertion that consumers who saw those ads formed category beliefs.[2] Or that consumers who saw the ads for AbTronic, Ab Energizer and Fast Abs ever saw the ads for the Ab Force product.[3] Or that those who did see the three other ads associated their category beliefs with the Ab Force. (ID, p. 51).

Rather than identify extrinsic evidence proving the validity of the importation theory, Complaint Counsel almost urges the Commission to accept this novel and intricate through judicial notice. Lacking reliable evidence, Complaint Counsel offers the astounding assertion that "[t]he Commission does not need extrinsic evidence to conclude consumers had seen the other ab belt infomercials" because "[c]ommon-sense alone dictates that at least some group of reasonable consumers who purchased the Ab Force saw one or more of the infomercials for other ab belts first." (CC Brief, p. 32). As the ALJ seemed to acknowledge, common sense dictates nothing of the sort.

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[2] The parties and the experts do not dispute "categorization theory," as described in the Mita Sujan article introduced into evidence. (Tr. 49, 344-45; CX-57). However, Dr. Jacoby testified that one could not just assume—as Dr. Mazis did—that people formed certain category beliefs after seeing ads for AbTronic, Ab Energizer and Fast Abs. (Tr. 344-45). Instead, he testified that one would have to test to determine if category beliefs were formed, just as Dr. Sujan did in the study described in the article.

[3] Apart from citing the Jordan Whitney rankings, Complaint Counsel never offered any extrinsic evidence that consumers who saw ads for the Ab Force had ever seen ads for AbTronic, Ab Energizer or Fast Abs.

Complaint Counsel then argues that even if common sense is not a sufficient evidentiary basis to accept the importation theory, evidence of its validity may be found in the Ab Force ads' statement, "I'm sure you've seen those fantastic electronic ab belt infomercials on TV." (CC Brief, p. 32). Complaint Counsel would have the Commission improperly conclude that this statement is a damning admission that consumers had, in fact, seen the ads for AbTronic, Ab Energizer and Fast Abs. Setting aside the fact that the statement was included to create a sense of excitement and urgency as part of a "bandwagon effect," (Tr. 491-92), it is impossible to determine how this statement constitutes evidence that consumers formed category beliefs on the basis of seeing ads for AbTronic, Ab Energizer or Fast Abs, or how this statement is evidence that consumers applied those category beliefs to the Ab Force.

Complaint Counsel simply states that "it is reasonable to conclude that many consumers viewing the Ab Force ads recalled the ads for AbTronic, Ab Energizer and/or Fast Abs and at least some of the core efficacy claims for those products and attributed them to Ab Force." (CC Brief, p. 37). That conclusion includes a number of assumptions, none of which, as the ALJ wrote, were supported with reliable evidence.

The Commission should reject Complaint Counsel's grand leaps of logic absent sufficient evidentiary support in the record. Because there is none in this case, the Commission should reject any finding that the importation theory has been proven.

B. There is Also No Reliable Extrinsic Evidence that Consumers Who Saw the Ab Force Ads Would Perceive the Asserted Claims Solely Based Upon the Content of the Ads.

Just as there was no reliable evidence to support Complaint Counsel's "importation theory," there is no reliable evidence to support the conclusion that the Ab Force ads made the asserted weight loss and fitness claims. First, the part of Dr. Mazis' facial analysis reliant upon "indirect effects" was properly excluded, and the rest of his analysis should also be rejected as unreliable. Second, the copy test designed was fatally flawed because it failed to control for the preexisting beliefs that Dr. Mazis believed impacted the results, and the existence of which is evidenced in the record.

1. Dr. Mazis' "indirect effects" opinion was properly rejected, and his "direct effects" opinion is unreliable as a matter of law.

a. Dr. Mazis attributed two claims to "direct effects" and two claims to "indirect effects," and his "indirect effects" opinion was rejected as unreliable.

Dr. Mazis opined that after seeing the ads, he concluded that they contained visual and other elements that had a "direct effect" on consumers' perceptions, and that there were elements that had an "indirect effect" on consumers' perceptions.[4] (Tr. 60 – 61). Moreover, he testified that the "direct effects" would cause consumers to perceive the Ab Force rollout TV ads as making "well-defined abs" and "loss of inches" claims. However, he testified that the asserted claims of "weight loss" and

[4] Dr. Mazis' opinions were limited exclusively to the 60-second and 120-second rollout ads for the Ab Force. He never reviewed any other Ab Force ads, and his opinions cannot support the ALJ's facial analysis with regard to any of those ads.

"replacement for exercise" were secondary claims, and were attributable only to the "indirect effects" of associating the Ab Force with the category beliefs formed by ads for AbTronic, Ab Energizer and Fast Abs. (Tr. 60 – 61). Complaint Counsel ignores the fact that Dr. Mazis' facial analysis segregated between "direct effects" and "indirect effects," and maintains that his facial analysis supports the view that all of the ads[5] made all of the claims. This is not correct.

Complaint Counsel also ignores the fact that the ALJ rejected the whole notion of "indirect effects" as having been unproven in this case through any "reasonably reliable" evidence. (F., pp. 163-192; ID, p. 51). In doing so, the ALJ necessarily rejected Dr. Mazis' facial analysis conclusion that the ads made "weight loss" or "regular exercise" claims only by reference to the ads for AbTronic, Ab Energizer and Fast Abs. This point, raised by Respondents in the Opening Brief at p. 43, is unchallenged by Complaint Counsel.

b. The Commission should reject Dr. Mazis' "direct effects" opinion as unreliable.

Equally unreliable is Dr. Mazis' opinion that as a result of "direct effects," consumers would perceive the Ab Force rollout TV ads as making claims of "well-defined abs" and "loss of inches" claims. Specifically, he testified that those claims could be inferred "because there's certain implied claims in the ads, because of seeing the models and seeing the pulsating effect of the vibrations of the—of the ab belt,

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[5] Complaint Counsel incorrectly argues that the Commission can view all of the ads together as a single "campaign," and that the Commission need not separate the ads based on content or meaning so long as the "overall impression" of the ads taken together is false and misleading. As discussed below, this is not a correct reading of *Novartis Corp.*, 127 F.T.C. 580 (1999), *aff'd* 223 F3d 783 (D.C. Cir. 2000).

and these people look very fit, very trim, and it has the name Ab Force." (Tr. 66). Respondents challenged the finding that Dr. Mazis' "direct effects" opinion was acceptable because Dr. Mazis had not sufficiently identified a nexus between his expertise in the general area of "consumer behavior" and this case. (Opening Brief, p. 44).

Rather than attempt to explain if and how there is a nexus between Dr. Mazis' expertise in the general field of "consumer behavior" and his opinions in this case, Complaint Counsel merely cited Dr. Mazis' qualifications as an expert in the area of consumer behavior, and his experience conducting consumer surveys. (CC Brief, p. 47). Complaint Counsel confuses the issue of qualification as an expert with the requirement that an expert's opinion be both relevant and reliable. Federal court cases following *Daubert v. Merrell Dow Pharmaceuticals Inc.*, 43 F.3d 1311, 1319 (9th Cir. 1995)(on remand), firmly establish that two broad—but fundamental—criteria must be met before an expert's opinion may be accepted by a tribunal:

(1) the witness must be qualified as an expert by knowledge, skill experience, training or education; and

(2) the expert's opinions regarding scientific, technical, or other specialized knowledge must be both relevant and reliable.

Kumho Tire Co. v. Carmichael, 526 U.S. 137, 141 – 142 (1999) (citing *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993)).

It is not enough that Complaint Counsel cites Dr. Mazis' expertise as evidence of the reliability of his opinions. The qualification to render an opinion does not

alone provide that the opinions rendered are reliable. If that were true, then any qualified expert would generally be free to render an opinion and claim that opinion is based on his or her expertise. The expert would not be required to show how that expertise relates to—and shows the reliability of—his or her opinions. The law demands more.

A mere assertion of an expert's qualifications, conclusions and an assurance of reliability is not enough to allow a court to consider an expert's proffered opinion to be reliable. *See Daubert*, 43 F.3d at 1319. Although an expert witness may rely on his or her experience as the basis for testimony, the law is clear that if the expert is resting solely or primarily on experience, "then he must explain how that experience leads to the conclusion reached, why that experience is a sufficient basis for the opinion and how that experience is reasonably applied to the facts." *See Daubert*, 43 F.3d at 1319; *Nemir v. Mitsubishi Motors Corp.*, 200 F. Supp. 2d 770, 774 (E.D. Mich. 2002).

Dr. Mazis made no effort at the hearing to explain how his experience in the general field of consumer behavior informed his opinions about the specific ads and claims in this case, or why his general consumer behavior expertise is applied to the facts. There is no evidence that Dr. Mazis has testified regarding consumer perceptions concerning ab belts or other EMS devices, so he has no particular expertise about the products advertised. Indeed, Dr. Mazis saw only the rollout television ads for Ab Force and the three other ab belts within the context of this litigation. (Tr. 124). Respondents do not question that Dr. Mazis is qualified in the

general field of consumer behavior. However, this qualification alone is not sufficient to render his opinions reliable.[6] Complaint Counsel made no effort to explain how his expertise informed his opinions as they apply to the facts. Absent that showing, Dr. Mazis' opinions cannot be considered more reliable than the opinions offered by any lay witness.

c. Dr. Mazis should be held to the rigorous standards set forth in *Daubert* and its progeny.

In addition to answering the question of the reliability of Dr. Mazis' opinions by pointing to his qualifications, Complaint Counsel argues that *Daubert* and cases that followed should not apply to the type of "soft science" engaged in by Dr. Mazis. Complaint Counsel further argues, without citing any authority, that this type of "soft science" is subject to a lower standard than expert opinions concerning "hard science." (CC Brief, p. 48). Specifically, Complaint Counsel rejects Respondents' position that Dr. Mazis' expert testimony must meet the reliability standards articulated in *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993), by claiming that "the Commission has never expressly adopted *Daubert* in its jurisprudence" and that *Daubert* "is limited to the hard science context." (CC Brief, p. 48). These arguments are not only flatly wrong, but contrary to arguments made by FTC counsel

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[6] Indeed, as Janis Pappalardo has observed: "academic studies suggest that experts are often unable to predict consumer opinions." *The Role of Consumer Research in Evaluating Deception: An Economist's Perspective*, 65 ANTITRUST L.J. 793 (1997) (citing J. Scott Armstrong, *Prediction of Consumer Behavior by Experts and Novices*, 18 J. CONSUMER RES. 251 (1991); Stephen J. Hoch, *Who Do We Know: Predicting the Interests and Opinions of the American Consumer*, 15 J. CONSUMER RES., 315 (1988)). Armstrong reports that experts fared no better than chance in predicting consumer behavior. Hoch found that experts were no more accurate than everyday consumers in predicting consumer opinions. Pappalardo, *supra*, 65 ANTITRUST L.J. 793, n. 1.

in other recent cases, as demonstrated by multiple filings made by the Commission in federal court as well as in Commission administrative litigation, in which the Commission (or its staff) has expressly adopted and relied upon *Daubert* to exclude expert testimony.

In a recent Section 13(b) proceeding, FTC counsel moved to disqualify respondent's expert, arguing under *Daubert* that "[e]xpert opinion that is unreliable should not be relied upon." FTC's Proposed Findings of Fact, at 168 (Sept. 18, 2000), filed in *FTC v. Swedish Match North America, Inc., et al.*, Civ. No. 00-1501 (D.D.C. 2000)("[t]he *Daubert* rule applies to all expert testimony, not only 'scientific' testimony.' "). Indeed, that is the plain teaching of *Kumho Tire Co. v. Carmichael*, 526 U.S. at 141 (1999)(the *Daubert* requirements of reliability apply to any technical or specialized knowledge, not just "scientific" knowledge).

Filings made by FTC counsel are replete with other instances in which counsel embraced *Daubert* for its own benefit when it wishes to exclude expert testimony. Indeed, less than a month ago, FTC counsel moved to exclude respondents' expert testimony in a Part III proceeding Evanston Northwestern Healthcare Corp., analyzing and applying the *Daubert* standards to respondents' expert testimony, and noting for the ALJ that the *Daubert* factors apply not only in jury trials but in bench trials as well. *See* Complaint Counsel's Motion *In Limine* to Exclude Certain Testimony of Dr. Mark Chassin, at 1, 4-7 (Dec. 21, 2004), filed in *In the Matter of*

Evanston Northwestern Healthcare Corp, et al., Dkt. No. 9315. FTC counsel has taken the same positions in several other Part III proceedings.[7]

The Commission Staff has used the *Daubert* standards as a sword for years in an effort to exclude expert testimony.[8] The Commission should reject Complaint Counsel's now-convenient position and hold Dr. Mazis' testimony to the same standards by which the FTC Staff has long insisted that opposing experts be judged.

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[7] *See also* Complaint Counsel's Memorandum in Support of Motion *In Limine* to Preclude Certain Opinion Testimony of Robert S. Maness, at 3-4 (March 31, 2004) ("The court's task 'is to analyze not what the experts *say*, but what *basis* they have for saying it'" [citing *Daubert*]), filed in *In the Matter of North Texas Specialty Physicians*, Dkt. No. 9312; Complaint Counsel's Memorandum in Support of Motion *In Limine* to Preclude Report and Testimony of Gail R. Wilensky, at 1 (March 31, 2004) ("Dr. Wilensky's opinions have no factual basis, are inherently unreliable, and will not assist this Court's review of the evidence. Thus, Dr. Wilensky's opinion does not meet the standard set forth in *Daubert v. Merrell Dow Pharmaceuticals* [citation omitted] and *Kumho Tire Co. v. Carmichael* [citation omitted])", filed in *In the Matter of North Texas Specialty Physicians*, Dkt. No. 9312; Complaint Counsel's Memorandum in Support of Motion *In Limine* to Preclude Report and Testimony of Michael Geilhufe, at 14 (March 26, 2003) (citing *Daubert* for the principle that expert evidence must be reliable and relevant), filed in *In the Matter of Rambus Inc.*, Dkt. No. 9302; Complaint Counsel's Memorandum in Support of Motion *In Limine* to Preclude Report and Testimony of William L. Keefauver, at 1 (March 26, 2003) ("Mr. Keefauver's opinions are inherently unreliable and do not meet the standard the set forth in the Supreme Court's decisions in *Daubert v. Merrell* [citation omitted] and *Kumho Tire Co. v. Carmichael* [citation omitted]") (March 26, 2003), filed in *In the Matter of Rambus Inc.*, Dkt. No. 9302.

[8] Recently, the Director of the FTC's Bureau of Economics advocated that the *Daubert* reliability screen even be extended to merger simulation, whereby structural game-theory models are used to predict the price effects of mergers. *See* Gregory J. Werden, Luke M. Froeb & David Scheffman, *A Daubert Discipline for Merger Simulation* (draft of February 16, 2004), *available at* www.ftc.gov (lasst visited on Jan. 7, 2005).

2. The copy test is fatally flawed because it did not contain any controls to filter out preexisting beliefs.

Complaint Counsel's central argument in this case is that consumers perceived the asserted claims as a result of "indirect effects" of category beliefs about ab belts which were created by having seen ads for other ab belt ads. But Complaint Counsel now asserts that Dr. Mazis did not need to control for the very preexisting beliefs upon which Complaint Counsel relies, in part, to impose liability.

Respondents do not argue, as Complaint Counsel has suggested (CC Brief, p. 35), that the Commission must overturn or reject its previous decisions in *Kraft* and *Stouffer* regarding the need to control for preexisting conditions. Indeed, the pronouncements set forth in those decisions are entirely applicable here. Where, as here, there is sufficient evidence that preexisting beliefs may have impacted the results of a copy test, *Kraft* and *Stouffer* require that the copy test at issue must control for preexisting beliefs in order to be deemed reliable.

The fundamental purpose of controls in a copy test of this type is to ensure that the results accurately reflect consumers' take-away, and are not effected by "background noise." Where that "background noise" may consist of consumers' preexisting beliefs about that which is being tested, the Commission has consistently stated that such preexisting beliefs must be controlled.

Complaint Counsel takes the position that no such controls were necessary in this case, even though their case is predicated on the idea that preexisting beliefs shaped consumers' perceptions of the Ab Force ads (CC Brief, p. 61). Complaint Counsel tries to minimize Dr. Mazis' flaw by arguing that preexisting beliefs need not

be controlled unless there is concrete evidence in the record that preexisting beliefs actually existed in the minds of consumers at the time of the copy test. This argument mischaracterizes the Commission's previous decisions.

The Commission has never held that there must be evidence that the tested consumers *actually* held preexisting beliefs, as Complaint Counsel now urges. As discussed below, in *Kraft* and *Stouffer* the Commission determined that preexisting beliefs must be controlled if there is *some* evidence that the existence of pre-beliefs *may* have affected the results of a copy test. An examination of the record shows that this case presents the same type of evidence deemed sufficient by the Commission in *Kraft* to suggest that preexisting beliefs may have existed in consumers' minds, and must be controlled if a copy test is to be deemed reliable.

First, this case is not at all analogous to *Stouffer*, where the record was utterly devoid of any evidence of preexisting beliefs. In *Stouffer*, respondents incorrectly argued that *Kraft* stood for the proposition that copy tests must generally employ controls for preexisting beliefs, and that the copy test at issue in that case was flawed because it did not control for the possibility that survey participants may have held preexisting beliefs. *Stouffer* at 806. The only evidence Stouffer cited to support its argument was the opinion of its own experts that such controls are generally necessary, an opinion that the Commission noted was "without apparent basis." *Id.* at 809. The Commission went on to note that the case was distinguishable from *Kraft* because in *Kraft* there was some evidence that preexisting beliefs may have affected the copy test results, whereas in *Stouffer*, respondents' objections on this point were

"wholly theoretical." *Stouffer* at 811. Unlike *Stouffer*, there is evidence in this case to raise a sufficient concern that preexisting beliefs may have affected the results of the copy test.

In fact the evidence that preexisting beliefs may have affected the results in this case is the same type of evidence cited by the Commission in *Kraft* to point to the possible impact of preexisting beliefs. The copy test at issue in *Kraft* was designed to measure consumer perceptions about a Kraft's "Class Picture/5 ounce" ads. The copy test measured consumer responses to the "Class Picture/5 ounce" ads (the test ads) and control ads unrelated to the claims at issue. *Kraft* at 63. The copy test, however, did not contain any controls to measure or compensate for consumers' preexisting beliefs about dairy slices and imitation slices of cheese. *Id.* Nor did it apparently make any effort to determine if any of the survey participants actually had preexisting beliefs. *Id.* In response to questioning, a large number of respondents perceived the control ads as making the challenged claim—an "imitation superiority claim." *Id.*, at 131, n.19.

The Commission determined that preexisting beliefs about dairy and imitation slices should have been controlled because the results from the control group showed a high response rate for the asserted claim. *Id.* As the Commission stated:

> The apparent 45 percent response rate suggesting that an imitation superiority message was taken by survey participants may well be attributable to consumers' prior exposure to the "Skimp" ads, which did contain an explicit comparison to imitation slices, and which were disseminated extensively prior to the "Class Picture/5 ounce" ads.

Id.

The Commission rejected the copy test as unreliable even though there was no concrete evidence establishing that consumers actually held preexisting beliefs about imitation cheese slices, or that such beliefs actually influenced the results. In the view of the Commission, the unusually high response rate for the asserted claim by those who saw the control ads—coupled with the existence of an earlier similar advertising campaign—was sufficient to raise concerns about the existence and impact of preexisting beliefs formed by the earlier advertising campaign. *Id.*[9]

This case is strikingly similar to *Kraft* in this regard. As in *Kraft*, there was an unusually high number of 'false positive' responses to the control ad in this case. Dr. Mazis admitted that the 'false positive' response rate for the control group was a "relatively high number for a control ad." (Tr. 108). Moreover, when asked to what this relatively high number of false positives was attributable, Dr. Mazis testified that he thought it was attributable to preexisting beliefs about ab belts created by earlier advertising. *Id.*

Also as in *Kraft*, there is evidence of an earlier, similar advertising campaign that may have formed preexisting beliefs that may have influenced test participants' perceptions. Mr. Khubani testified that ads for other EMS ab belts aired before the

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[9] The Commission in *Kraft* did not require—as Complaint Counsel now urges—that respondents actually show that consumers who saw the "Skimp" ads also saw the "Class Photo/5 ounces" ad, nor did it require that respondents show that copy test participants actually formed preexisting beliefs on the basis of the "Skimp" ads. The mere possibility that consumers had formed preexisting beliefs about imitation cheese slices was enough to require that the copy test contain measures to control for preexisting beliefs. Consequently, the Commission properly found that failure of the copy test to control for those potential preexisting beliefs rendered the copy test not "reasonably reliable." *Kraft*, at 131.

ads for the Ab Force aired, and before the survey was conducted. (Tr. 261-62; 462-72). Mr. Khubani testified that he recalled a number of ads for EMS ab products that made a variety of claims. (Tr. 261-62; 462-72). Indeed, Dr. Mazis believed, and Complaint Counsel argues, that prior ads were widely disseminated and were likely seen by at least some of the copy test participants in this case. (Tr. 108).

Therefore—as in *Kraft*—there is evidence to suggest that the unusually high response rate of copy test participants to the control ad may very well have been the result of preexisting beliefs that were not controlled for. This is the very same type of evidence that persuaded the Commission to determine that the copy test was not reasonably reliable. The Commission should do so again in this case.

Complaint Counsel is not correct that the ALJ found that the 'false positive' responses were conclusively the result of the failure of Dr. Mazis to completely filter out certain visual images and the product name "Ab Force" from the control ad. After acknowledging that Dr. Mazis admitted that preexisting beliefs likely accounted for the 'false positive' responses to the control ad, the ALJ went on to write that "[t]he higher numbers, however, could also result from the direct effects which remained in the control ad." (ID, p. 54). This finding does not rule out the existence of preexisting beliefs as a factor leading to relatively high 'false positive' responses, but merely suggests that other factors could also have impacted the results. It does not diminish in any way the significant evidence in the record that survey participants responding to the control ad may have held preexisting beliefs about ab belts, nor does it diminish the need to control for any such preexisting beliefs.

There can be no doubt that Dr. Mazis failed to make any meaningful effort to control for preexisting beliefs on the part of copy test participants. The Commission should not accept Complaint Counsel's baseless assertion that "Dr. Mazis did attempt to control for preexisting beliefs." (CC Brief, p. 62, n. 38). The record is clear that Dr. Mazis' efforts to filter out preexisting beliefs was limited solely to identifying and removing from the copy test results copy test participants who had seen a news story about ab belts in the 30 days prior to the copy test. (Tr. 152-55). Moreover, this additional screening criterion was added only after Dr. Mazis learned from Complaint Counsel that there had been a press report about ab belts shortly prior to the copy test being conducted. (Tr. 152-55).

But Dr. Mazis did not identify or attempt to control for copy test participants who, for example, may have held preexisting beliefs on the basis of seeing one of the ads for another ab belt product. He also did not identify or attempt to control for participants who may have seen or heard stories about ab belt products more than 30 days prior to the copy test. In fact, Complaint Counsel has never attempted to address the probability that some or many (or all) copy test participants may have seen the Commission's press release about the "fraud" case against Ab Force, which was widely disseminated by United Press International and the Associated Press wire service six weeks before the copy test was conducted. (Tr. 158-63; CX-83 to CX-85).

Dr. Mazis dismissed the need to include any such controls on the baseless theory that "random assignment" would evenly divide those with preexisting conditions between the test and control groups. (Tr. 153-54). However, as Dr.

Jacoby explained in unchallenged testimony, there is no way that "random assignment" of participants would have insured that there were equal numbers of participants in each group who had preexisting beliefs if those with preexisting beliefs were never identified. (Tr. 377-81). If Dr. Mazis was correct that "random assignment" would automatically order participants evenly between groups, then the control and test groups should have been even in size. (Tr. 379-80). They were not. Moreover, if, as Dr. Mazis asserted, it was not necessary to screen out those with preexisting beliefs due to "random assignment," then it is puzzling why Dr. Mazis would nevertheless choose to screen out certain people who had previously seen or heard a story about ab belts.

"Random assignment" alone would not have insured that each group had the same number of people who may have held preexisting beliefs. Therefore, the Commission cannot reliably exclude the possibility that the copy test results were the product of disproportionate assignment of participants with preexisting beliefs between the test and control groups. Without having controlled for preexisting beliefs, it is impossible to know whether the test results are sound or the result of unfiltered "background noise" impacting consumers' perceptions. Accordingly, the standards of reliability set forth in the line of *Daubert* cases discussed above have not been met. For this reason alone, the copy test must be deemed too unreliable to be of any probative value.

3. The evidence of preexisting beliefs does not support Complaint Counsel's new argument that liability should be imposed for an alternative reason.

In discussing the issue of preexisting beliefs, Complaint Counsel advances an alternative theory of liability that if the Commission agrees that there was some evidence of preexisting beliefs, it must impose liability on Respondents for capitalizing on those preexisting beliefs. This argument should be rejected for three reasons.

First, as admitted in its brief, Complaint Counsel did not appeal Judge McGuire's alleged failure to base his decision, in part, on an alternative theory of liability that Respondents' allegedly exploited deceptive preexisting beliefs. (CC Brief, p. 6, n. 4).[10] As such, this new ground for imposing liability was not timely raised. Anticipating Respondents' objection, Complaint Counsel argues that Rule 3.54 permits the Commission to consider any argument, no matter when raised. (CC Brief, p. 6). That Rule, however, provides that the Commission reviews cases on a *de novo* basis, not that the Commission may consider parts of a decision or order not appealed. Rule 3.54(a) ("The Commission reviews the decision of the ALJ under a *de novo* standard."). The applicable Rule is Rule 3.52, which requires appellants to "designate the initial decision and order or part thereof appealed from." *Id.*

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[10] Complaint Counsel's Notice of Appeal stated that "it will appeal the following parts of the Order...and any related findings of fact: [1] As against Respondent Khubani, the failure to include a provision requiring Respondent Khubani to obtain a performance bond in the principal sum of $1,000,000 prior to engaging in or assisting others in engaging in any manufacturing, labeling, advertising, promotion, offering for sale, sale or distribution of any device...; and [2] [a]s against all Respondents, the failure to apply the provisions of Part IV of the Order to all claims for all products..." Complaint Counsel's Notice of Appeal.

Complaint Counsel did not comply with that Rule, and its alternative theory of liability must be rejected as untimely.

Second, even if the Commission permits Complaint Counsel to raise that ground for appeal now, it should still reject the theory as having no adequate basis in law. The ALJ considered Complaint Counsel's alternative theory of liability and properly rejected it. As the ALJ noted, Complaint Counsel's argument rests upon a single footnote from *Stouffer* that "respondents may be held liable for dissemination of ads that capitalize on preexisting consumer beliefs." *Stouffer*, at 810, n. 31 (citing *Simeon Mgmt. Corp. v. FTC*, 579 F.2d 1137, 1146 (9th Cir. 1978)). (ID, p. 55). The ALJ examined *Simeon* and a prior case, *Brite Mfg. Co. v.* FTC, 347 F.2d 477 (D.C. Cir. 1965), and reasoned that neither case supported the assertion in *Stouffer* that respondents may be held liable for dissemination of ads that capitalize on preexisting consumer beliefs:

> In *Simeon*, the Ninth Circuit stated "[t]hat the belief [that injections have been determined by a proper government agency to be safe and effective] is attributable in part to factors other than the advertisement itself does not preclude the advertisement from being deceptive." *Simeon*, 579 F.2d at 1146 (citing *Brite Mfg. Co. v.* FTC, 347 F.2d 477 (D.C. Cir. 1965)). In *Brite*, the D.C. Circuit held that the Commission properly took official notice of specific consumer preferences where the respondents made no attempt to rebut those perceptions during the hearing, stating that the FTC was "entitled to rely on established general facts within the area of its expertise, subject, of course, to [respondent's] right to rebut." *Brite*, 347 F.2d at 478.

(ID. pp. 55–56). As the ALJ correctly noted, neither *Simeon* nor *Brite* provide any support for the conclusion that respondents may be held liable for advertising that

capitalizes on preexisting consumer perceptions. Here, of course, we do not know what those beliefs included.

Third, even if the footnote in *Stouffer* somehow established that advertising could be challenged to the extent it incorporates or otherwise takes advantage of consumer perceptions, there is no evidence that the Ab Force ads did so in this case. The record is bereft of any evidence supporting Complaint Counsel's theory that consumers who saw the Ab Force ads were likely to recall beliefs formed on the basis of claims made in ads for AbTronic, Ab Energizer and Fast Abs. (See *supra*, Section I (A)(1)). Complaint Counsel's position rests on the notion that a lack of any evidence that consumers were actually perceiving the asserted claims on the basis of preexisting beliefs must necessarily mean that there is a lack of evidence that consumers' perceptions may have been affected by preexisting beliefs.

Complaint Counsel fails to recognize the distinction that evidence which is sufficient to raise the concern that preexisting beliefs may have impacted the results of a copy test may not be sufficient evidence to establish that advertisements actually capitalized on consumers' preexisting beliefs and that liability should therefore be imposed. Complaint Counsel's belief that both inquiries are subject to the same evidentiary standard is utterly without support.

III. THE ALJ'S FACIAL ANALYSIS SHOULD BE SET ASIDE

Respondents argued in their Opening Brief that this case falls so far on the end of the spectrum away from cases such as *Kraft* and *Stouffer* that the ALJ simply could not have concluded "with confidence" that the ads made the asserted claims

based solely on a facial analysis. As Respondents argued in their Opening Brief, the ALJ made several errors that colored his facial analysis of the ads.

First, Respondents argued that none of the ads contained all of the elements identified and discussed by the ALJ, and that the ALJ erred in failing to consider the ads separately. Complaint Counsel argues that the ALJ could analyze the ads a single "campaign," and not separately. However, there is not authority that Complaint Counsel's approach is acceptable. More importantly, Complaint Counsel's argument does not address the fact that each of the ads did not contain all of the elements discussed by the ALJ and Dr. Mazis.

Second, Respondents argued that they intended to make two claims only as part of a compare and save advertising strategy: same technology, lower price. Complaint Counsel argues that lacking a stated purpose for the product, this "compare and save" strategy was designed to make consumers associate the Ab Force with claims found in ads for the AbTronic, Ab Energizer and Fast Abs products. On the contrary, the record shows that Respondents intended to generate sales using an everyone-wants-one "bandwagon effect," a fact that was never challenged by Dr. Mazis or otherwise.

Third, Respondents argued that the supposed development of the Ab Force in the wake of an unsuccessful Ab Pulse campaign was a key fact in the ALJ's analysis. The ALJ clearly believed that the failure of the Ab Pulse campaign led Respondents to develop ads for the Ab Force with the asserted claims in an effort to prevent a failure like the Ab Pulse. However, even Complaint Counsel acknowledges that this

wrong, and that the Ab Pulse campaign was created after the Ab Force ads. (CC Brief, p. 3, n.2). Complaint Counsel argues that this error is harmless, but given the weight and emphasis placed on this fact by the ALJ, it is impossible to reconcile how this error should be considered irrelevant to findings regarding Respondents' intent.

In the end, Complaint Counsel offers little more than an appeal to the Commission that the facial analysis is sufficient to conclude "with confidence" that the implied claims were made, without answering Respondents' argument that the record is bereft of the kind of evidence that led the Commission to impose liability in *Kraft* and *Stouffer*.[11] In this case, there are too many variables and uncertainties to permit a conclusion "with confidence" that the asserted advertising claims were made based only on a facial analysis.

Because the asserted claims cannot be found on the face of the ads alone with reasonable certainty, they are not, as Complaint Counsel argues, in the same league as *Zauderer*, or even *Kraft* or *Stouffer*. Consequently, this case raises significant First Amendment implications that cannot be brushed aside. Constitutional principles, considerations of the applications of the burden of proof, and the Commission's own Section 5 cases show that in light of the evidence in the record—and not in the record—the ALJ's facial analysis violates settled First Amendment standards.

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[11] Complaint Counsel also suggests that Respondents seek a reversal of *Kraft* or *Stouffer*, or both. To the contrary, the principles outlined by the Commission in *Kraft* and *Stouffer* guide Respondents' arguments. As discussed below, (see, infra, p. 44), *Kraft* and *Stouffer* presented cases where the claims were sufficiently clear to permit a facial analysis without resort to reliable extrinsic evidence. This case does not.

A. The ALJ Could Not Conclude With Confidence That the Asserted Implied Claims Were Made Based on the Evidence in the Record.

In their Opening Brief, Respondents argued that the ALJ could not have concluded with confidence that the advertisements made four implied claims on their face, and that any such conclusion needed to be supported with reliable extrinsic evidence. Specifically, Respondents cited portions of the record demonstrating that the primary challenged visuals and statements were not in each of the ads and that, even where they were, their impact – if any – was so difficult to assess that even the ALJ and Complaint Counsel's own expert disagreed as to their meaning. Moreover, Respondents pointed out that the ALJ had gotten wrong the timing of the Ab Pulse campaign, and had mischaracterized Mr. Khubani as testifying that he meant to convey the asserted claims in each ad. In its response, Complaint Counsel ignores or attempts to marginalize these arguments, first claiming that the ALJ carefully considered each ad and then arguing that the ALJ correctly ascertained Mr. Khubani's intent. Neither is the case.

Nothing in the ALJ's findings permits the certainty of conclusion urged by Complaint Counsel. Complaint Counsel asserts that even though the ALJ focused primarily on elements in the television ads, some of the elements were the same in other ads and, even if they were not, Mr. Khubani testified that he meant to convey the same message in each ad. (CC Brief, p. 3). A review of the Initial Decision, however, reveals that the ALJ incorrectly considered all of the ads as if they all

contained the same elements, and thus made the asserted claims. (CC Brief, p.3; Opening Brief, p. 17).

Additionally, Complaint Counsel fails to point out that this facial analysis was rejected by Complaint Counsel's own expert and is flatly contradicted by unchallenged testimony in the record. Moreover, Complaint Counsel glosses over a critical error it admits the ALJ made with regard to the timing of the Ab Pulse advertising campaign, a campaign the ALJ incorrectly cited as providing Respondents "with valuable experience in the ab belt market and [which] affected the development of its subsequent [Ab Force] advertising." (ID, p. 44). A careful review of the ads, coupled with a correct understanding of Respondents' intent, demonstrates that this case is not as clear and convincing as Complaint Counsel argues, and not an appropriate case for fixing liability absent reliable extrinsic evidence (of which there is none).

1. Complaint Counsel is wrong that the ads each contain the visual and other elements cited by the ALJ

Complaint Counsel readily admits that the ALJ's facial analysis "focused primarily on the television ads" (CC Brief at p. 31), but argues that the ads contained "one or more" of the elements the ALJ discussed, and that the advertising may be viewed in the context of the campaign as a whole, rather than individually. This is incorrect for three reasons.

First, not all of the ads contained the elements discussed by the ALJ, notwithstanding Complaint Counsel's assertions to the contrary. In the initial

decision, the ALJ identified the product name, visual images and certain statements as contributing to the overall net impression of the advertising. (ID, pp. 41-43).

- Name – The ALJ found that the name "Ab Force" implied "that the device works on the abdominal muscles . . ." (ID, p. 41). This conclusion is unremarkable, particularly when considered in tandem with the ALJ's conclusion that "the name 'Ab Force' alone would not be sufficient to imply a claim," but may contribute to such an implication "in combination with the visual images and words used "in the ads." (Tr. 41). Thus, the critical elements, in the ALJ's opinion, are the visual images and statements made in the ads.
- Visual elements -- The ALJ identified the use of models wearing exercise equipment and using the product,[12] and two fleeting images of models with well-defined ads who were not wearing an Ab Force.[13] But the images of the models without Ab Force products were only in the 120-second television ads, one of which was a test ad that had a

[12] There was a practical consideration for using models: showing the product causing muscle contractions was the only way to show the product actually working. Even Dr. Mazis conceded this was true. (Tr. 149-50).

[13] These shots, which were added merely as stock footage background by the commercial's producer, (Tr. 541-42, 553-54) were on-screen for approximately one second each out of a 120-second commercial (JX2 to JX-5).

one-week limited run. None of these visual elements identified by the ALJ were in the radio ads, the internet ads, or the print ads.[14]

- Statements – The oft-cited statement that ads for other ab belts "promis[e] to get our abs into great shape fact – without exercise" appeared in one radio ad that ran for less than two weeks in a handful of markets. (CX-1H). It is in no other ads. Likewise, the statements "latest fitness craze" and "just as powerful and effective" appeared in the test television ads only. (F., p. 91). They did not appear in the later rollout versions of those test ads, nor did they appear in the print ad. (F., p. 91). The later ads eliminated this language in favor of "latest craze" and "same powerful technology." (F., p. 89)

In its brief, Complaint Counsel argued that the revisions to the ads were irrelevant because Respondents meant to convey the "same message" (*i.e.*, weight loss and fitness messages) throughout all the ads. This argument misconstrues Mr. Khubani's testimony. He did not testify that he meant to convey weight loss and fitness claims throughout the ads, as the ALJ implied. Rather, as the full testimony shows, the "same message" in each was that the Ab Force uses the same technology as other products, at a lower price.[15] The "message" Mr. Khubani intended to make

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[14] Complaint Counsel, for the first time on appeal, asserts that the print ads contained "visual images" consisting of a small picture of a man's torso with the Ab Force attached. This visual element was never discussed by the ALJ or Dr. Mazis.

[15] **Q:** ...[T]he TV ad was changed in that context to what the print ad was saying.

from one message to the next was about price and technology, not weight loss and exercise. For this testimony to be misconstrued as it has is flatly wrong.

Finally, Complaint Counsel argues in a footnote to its brief that the ALJ was not required to view the ads separately, but could view the ads as a campaign as a whole, and glean the claims from the overall campaign, citing *Novartis*. But the Commission in *Novartis* did not, as Complaint Counsel suggests, determine the message of the campaign as a whole and then attribute that message to each ad; it looked at the claims of each ad first, and then, because the claims were the same in each ad, attributed the message of those ads to a campaign. *Novartis Corp.*, 127 FTC 380 (1999), *aff'd*, 223 F3d 783 (D.C. 2000). Here, as the evolution of the ads shows,

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A: Not exactly. It didn't say exactly – it wasn't worded exactly the same. You know, in – in media there's a time limitation or a word limitation. You have got to phrase things differently than you would in a print ad.

* * *

Q: Was there an inconsistency between the TV ads that you – that were rewritten and the other drafting that you had done prior to that time?

A: There were some minor changes made in the wording. In my opinion, the message was – was still the same, compare and save.

* * *

Q: [W]as there a change in your intent on what the meaning was to be between the first and the second?

A.: My intention in this commercial the whole time had been to convey that it's – it uses the same EMS technology – EMS technology at a much lower price, and in both those sentences, the way it was phrased the first time and the way it was phrased after we made the changes, my intention was to convey that we're using similar technology.

Q: Okay. The last thing that was brought up by Complaint Counsel is there's a reference in the radio ad to no exercise, and the subsequent radio ad did not have that reference. Do you recall that change?

A: Yes.

Q: Okay. Did you intend to change the meaning from one ad to the next?

A: No, I didn't.

(Tr. 491-92).

Mr. Khubani honed his message to more clearly convey compare and save claims on price and technology. As discussed below, to argue otherwise is to misread the evidence of Respondents' intent.

2. Critical evidence showing that Respondents never intended to make the asserted claims was misconstrued or ignored.

In their Opening Brief, Respondents argued that the ALJ made a fundamental error regarding the timing of the Ab Pulse campaign. The Ab Pulse campaign was critical to the ALJ's conclusion that Respondents' intended to make the claims, having learned from their "earlier" Ab Pulse campaign. In addition, Respondents argued that the ALJ did not understand that Respondents intended only to have ads for the Ab Force that made two and only two claims: same technology, lower price.

Complaint Counsel dismisses the Ab Pulse error as being an irrelevant mistake. Nothing could be further from the truth. The ALJ spent a significant portion of his analysis of the surrounding circumstances discussing the critical role the Ab Pulse campaign played in Respondents' decisions regarding the Ab Force campaign. (ID, pp. 44-45). According to the ALJ, the unsuccessful Ab Pulse campaign helped Respondents develop the Ab Force ads, indicating that having learned from mistakes of the Ab Pulse campaign, Respondents wrote the Ab Force ads with the intent of increasing the appeal of the product through the inclusion of the implied claims. (ID, pp. 44-45). But because the ALJ based a significant portion of his intent analysis on a mistake, the facial analysis of the ALJ's decision—which

looked at the surrounding circumstances for the context for the ads themselves—cannot be deemed reliable.

B. The ALJ's Application of Facial Analysis is Inconsistent With the First Amendment.

Complaint Counsel mischaracterizes Respondents' position as challenging the Commission's ability, under any circumstances, to interpret an advertisement on its face and find that an express or implied claim has been made when the claim is "reasonably apparent from the face of the ad." FTC Br. at 35-36. This is a strawman argument that ignores the serious First Amendment concerns presented by the manner in which the ALJ applied the facial analysis doctrine.

At issue is how far the Commission may go in applying its intuitive feeling that a claim is "reasonably apparent" from the face of an advertisement. The First Amendment imposes significant limits on how far the Commission may go in asserting that a claim is "reasonably apparent" without objective evidence of actual consumer understanding. The ALJ's conclusion that four implied claims can be found on the face of the Ab Force advertisements goes far beyond any prior case in which the Supreme Court has held that commercial speech may be limited based solely on analysis of the face of an advertisement and without consideration of extrinsic evidence.

Complaint Counsel attempts to defend this unprecedented expansion of the facial analysis doctrine by asserting that the implied claims the ALJ found to exist "are no less apparent than the implied claim" in *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626 (1985). (CC Brief, 35, 39). However, the claim at issue in *Zauderer*

involved the advertiser's deliberate confusion of two legal terms of art. The Supreme Court took judicial notice of the fact that, while clear to lawyers, the differences in these terms of art would not be understood by members of the public and that the possibility of deception of the target audience was "self-evident." 471 U.S. at 652-653.

In this case, by contrast, the ALJ did not find that the existence of the four implied claims was "self-evident" or so clear that he could take judicial notice. Rather, the ALJ reached his conclusion only after a tortuous analysis of statements in multiple advertisements that ran in various media, the timing of the creation of various advertisements; the circumstances surrounding the ads; evidence of Respondents' intent in preparing the ads; and the content and impact of advertisements for three other ab belt products. The analysis followed here is not remotely analogous to the Supreme Court's taking notice of the "self-evident" risk of misrepresentation involved in the confounding of two legal terms of art in *Zauderer.*

The Supreme Court has held repeatedly that a government agency must prove that there is a justification for prohibiting a certain type of commercial speech and may not simply rely on conjecture or its own say-so, however well intentioned. Under the First Amendment, "facial analysis" may provide the requisite proof to punish commercial speech only in a limited range of exceptional cases in which the potential for deception is extremely high. In the vast majority of cases, the requisite proof must be provided through extrinsic evidence of actual consumer understanding. Approval of the ALJ's decision here would expand the scope of the

"reasonably apparent" test well beyond the constitutional limit. It would convert the facial analysis doctrine into a mechanism by which the Commission would have unfettered discretion in a vast range of cases to "discover" that an implied claim of its own creation had been made and thereby to punish commercial speech without proof that any consumers actually were misled.

1. The standards governing First Amendment analysis.

a. Constitutional Principles.

Commercial speech is entitled to protection under the First Amendment. *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976); *Bigelow v. Virginia*, 421 U.S. 809 (1975). However, the First Amendment does not protect commercial speech that is false and misleading, and the government may properly limit it. *Zauderer*, 471 U.S. at 652-653. The constitutionality of governmental efforts to regulate commercial speech is determined under so-called "intermediate tier" scrutiny. *Board of Trustees of the State University of New York v. Fox*, 492 U.S. 469 (1989). The government bears the burden of proving that a specific type of commercial speech is subject to prohibition or punishment. *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996); *Rubin v. Coors Brewing Co.*, 514 U.S. 476 (1995); *Edenfield v. Fane*, 507 U.S. 761, 770 (1993); *In re R.M.J.*, 455 U.S. 191 (1982). To carry its burden of proof, the government must either (1) demonstrate that the allegedly deceptive speech "is inherently likely to deceive" or (2) show by record evidence "that a particular form or method of advertising has in fact been deceptive." *In re R.M.J.*, 455 U.S. at 202. *Accord*, Section 3.43(a) of the Commission's rules, 16 C.F.R. §

3.43(a), which provides that Complaint Counsel "shall have the burden of proof" in an adjudication to determine if an advertisement is misleading.

b. Applications of Burden of proof principles.

The Supreme Court has repeatedly overturned attempted prohibitions of commercial speech where the government has failed to provide sufficient proof as to the actions consumers allegedly would take in response to a challenged advertisement. For example, in *44 Liquormart*, the Court overturned a statutory ban on price advertising for alcoholic beverages because the State failed to carry its burden of showing that the advertising ban would significant reduce alcohol consumption. Absent such proof, the Court refused to "engage in the sort of 'speculation or conjecture' that is an unacceptable means of demonstrating that a restriction on commercial speech directly advances the State's asserted interest." 517 U.S. at 507 (quoting *Edenfield*, 507 U.S. at 770).

Similarly, in *Coors Brewing*, the Supreme Court invalidated a regulation that prohibited label disclosure of the alcohol content of beer. The Court found that the Secretary of the Treasury "did not offer any convincing evidence" that the labeling ban would carry out its purported purpose, inhibiting "strength wars" between rival brewers; it also rejected the government's reliance on "anecdotal evidence and educated guesses" in an attempt to satisfy its burden of proof under the First Amendment. 514 U.S. at 1593.

In *Edenfield*, the Supreme Court declared unconstitutional an administrative rule that banned in-person solicitation of business clients by certified public

accountants. The court held that the government's burden of justifying a restriction on commercial speech:

> is not satisfied by mere speculation or conjecture; rather, a governmental body seeking to sustain a restriction on commercial speech must demonstrate that the harms it recites are real and that its restriction will in fact alleviate them to a material degree.

507 U.S. at 770. The Court overturned the rule based on its finding that the government had presented no studies or other evidence to support its asserted justification for its action.

c. The Supreme Court's discussion of Section 5 of the FTC Act.

Since its decision in the mid-1970s that commercial speech is protected by the First Amendment, the Supreme Court has not ruled directly on the validity of the standards applied by the Commission for determining the existence of advertising claims under Section 5.[16] However, in *Zauderer*, in the course of rejecting Ohio's argument that a rule prohibiting advertising by attorneys should be found to survive intermediate-level scrutiny, the Court did discuss the Commission's experience in enforcing Section 5:

> Nor is it true that distinguishing deceptive from non-deceptive claims in advertising involving products other than legal services is a comparatively

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[16] *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374 (1965), was decided a decade before *Bigelow v. Virginia* and *Virginia State Board of Pharmacy*. Accordingly, while it stands for the proposition that the Commission may, in some cases, determine that an advertisement has a tendency to mislead without conducting a survey of the public's actual reactions, *Colgate-Palmolive* does not address the question presented in this case, concerning where to draw the dividing line beyond which the Commission must rely on extrinsic evidence in order to satisfy its constitutional burden of proving that a particular advertisement is misleading.

> simple and straightforward process. A brief survey of the body of [Section 5] case law that has developed ... reveals that distinguishing deceptive from non-deceptive advertising in virtually any field of commerce may require resolution of exceedingly complex and technical factual issues and the consideration of nice questions of semantics. . . .

471 U.S. at 645 (emphasis added).

The Court then articulated the rationale underlying its commercial speech cases in terms of the burden of proof imposed upon a governmental entity seeking to distinguish lawful advertising from false or deceptive advertising:

> The First Amendment protections afforded commercial speech would mean little indeed if such arguments [that the costs to the agency in differentiating truthful from misleading speech justify a blanket rule against some forms of advertising] if such arguments were allowed to prevail. Our recent decisions involving commercial speech have been grounded in the faith that the free flow of commercial information is valuable enough to justify imposing on would-be regulators the costs of distinguishing the truthful from the false, the helpful from the misleading, and the harmless from the harmful.

471 U.S. at 646 (emphasis added).

Based on the close relationship of its description of the difficulties inherent in the Commission's inquiries under Section 5 and its justification for imposing on the government the costs and burdens of distinguishing truthful speech from misleading speech, the logical inference to be drawn from *Zauderer* is that the Supreme Court would sustain a finding that an advertisement was deceptive on its face, without extrinsic proof of consumer understanding, only in a narrow range of cases in which there was compelling evidence of a substantial possibility of deception.

2. The ALJ's application of facial analysis to the challenged advertisements violates First Amendment standards as set forth in *Zauderer*.

Complaint Counsel's defense of the ALJ's application of facial analysis rests on the proposition that "[t]he implied claims here are no less apparent than the implied claim the Supreme Court found 'self-evident' in *Zauderer*." FTC Br. at 39. This assertion is demonstrably erroneous and with it collapses the justification for the ALJ's decision. In essence, the ALJ relied upon, and Complaint Counsel advocates that the Commission follow, an "I know it when I see it" approach to facial analysis for determining whether an advertisement made an implied claim. This approach would commit the determination whether a misleading claim had been made to the unfettered, unreviewable discretion of the Commission and is contrary to the FTC Act and the First Amendment.

a. *Zauderer* does not support the decision.

In *Zauderer*, the Supreme Court considered whether Ohio had properly disciplined a lawyer for failure to include in an advertisement a disclosure that clients might be liable for significant litigation costs if their lawsuits were unsuccessful. The Court rejected the lawyer's First Amendment challenge to a regulation that required attorneys advertising their availability on a contingent-fee basis to disclose that clients would have to pay such costs if their lawsuits failed. The Court stated:

> Appellant's advertisement informed the public that "if there is no recovery, no legal fees are owed by our clients." The advertisement makes no mention of the distinction between "legal fees" and "costs," and to a layman not aware of the meaning of these terms of art, the advertisement would suggest that employing appellant would be a no-lose proposition in that his representation in a losing cause would come entirely free of charge. The assumption that

> substantial numbers of potential clients would be so misled is hardly a speculative one: it is a commonplace that members of the public are often unaware of the technical meanings of such terms as "fees" and "costs" – terms that, in ordinary usage, might well be virtually interchangeable. When the possibility of deception is so self-evident as it is in this case, we need no require the State to "conduct a survey of the . . . public before it [may] determine that the [advertisement] had a tendency to mislead." *FTC v. Colgate-Palmolive Co.*, 380 U.S., at 391-293. The State's position that it is deceptive to employ advertising that refers to contingent-fee arrangements without mentioning the client's liability for costs is reasonable enough to support a requirement that information regarding the client's liability for costs be disclosed.

471 U.S. at 652-653 (emphasis added).

There are several reasons why this decision does not support Complaint Counsel's position that "[t]he implied claims here are no less apparent than the implied claim the Supreme Court found 'self-evident' in *Zauderer*."

First, Complaint Counsel errs in suggesting that the Supreme Court conducted an "implied claim" analysis, as that term is understood in FTC practice. What the Court actually did is take judicial notice ("self-evident") of the fact that a small group (lawyers) know that there is a significant difference between the professional terms of art "legal fees" and "costs"; but that many lay persons, who use these words interchangeably in the vernacular sense, would not be aware of this material distinction between these words when employed as terms of art. On that basis, the Court found that the advertisement was misleading because it failed to disclose to clients their potential liability for payment of "costs" if their lawsuits were unsuccessful.

By contrast, in an "implied claim" analysis under Section 5 of the FTC Act, the Commission determines whether a consumer would take away from an

advertisement a claim that is nowhere found explicitly within its four corners. This procedure is fundamentally different from the approach that the Supreme Court took in *Zauderer*. Accordingly, Complaint Counsel's argument breaks down at the outset.[17]

Second, *Zauderer* itself provides substantial indications that the situations in which a government agency may find consumer deception on the face of an advertisement are limited to exceptional cases in which there is a clear-cut potential for misleading the public.

As noted, the Court in *Zauderer* took judicial notice of the potential for deception when an advertiser confounded two legal terms of art that most consumers use interchangeably and of whose differences they are not aware. The standard for taking judicial notice of facts is high. The Supreme Court has long held that tribunals may take judicial notice only of that which "is generally known within the limits of their jurisdiction" or "matters of common knowledge." *See Brown v. Piper*, 91 U.S. 37 (1875), *Ohio Bell Tel. Co. v. Public Utilities Commission of Ohio*, 301 U.S. 292, 300 (1937). The critical element that permits judicial notice is "indisputability." *See Green v. Warden, U.S. Penitentiary*, 699 F.2d 364, 369 (7th Cir. 1983) ("It is recognized, however,

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[17] Complaint Counsel's argument is defective for another reason. The rule at issue in *Zauderer* was not an outright prohibition on speech, but a requirement that a lawyer running a contingent-fee advertisement must affirmatively disclose whether the client would be liable for litigation costs. In holding that the State's interest in compelling disclosure justified this limited imposition on the attorney's right of free speech, the Supreme Court noted that disclosure requirements "trench much more narrowly on an advertiser's interests than do flat prohibitions on speech . . . ." and thus are more easily justified under intermediate scrutiny. 471 U.S. at 651. Thus, *Zauderer* itself does not provide direct support for the proposition for which Complaint Counsel cites it -- that commercial speech may be punished without consideration of extrinsic evidence of actual consumer understanding.

that an appellate court may take judicial notice of matters which are so commonly known within the community as to be indisputable among reasonable men, or which are capable of certain verification through recourse to reliable authority."); *United States v. Jones*, 29 F.3d 1549, 1553 (11th Cir. 1994) (noting "indisputability is a prerequisite" to the taking of judicial notice).

In Federal courts, very few facts can be established through judicial notice. Rather, in virtually all instances, the parties are required to submit evidence to the fact-finder. Complaint Counsel cannot credibly argue that, if this matter were being tried in Federal court, the trial judge could possibly take judicial notice from the face of the advertisements that consumers took away four implied claims. Accordingly, there is no logical basis upon which Complaint Counsel can assert that the implied claims at issue here "are no less apparent" than the claim in *Zauderer*.

In performing his purported "facial analysis," the ALJ considered many different statements and visual elements in several advertisements, which ran in three types of media (print, radio and television). He also reviewed the timing of the creation of various advertisements; the circumstances surrounding the ads; the express claims made in the ads concerning price and technology; purported evidence of Respondents' intent in preparing the ads; and the content and impact of advertisements for three different ab belt products. The breadth and intensity of his consideration of these factors belies any notion that the risk of deception is "self-evident" in the sense of *Zauderer*.

b. Neither *Kraft* nor *Stouffer* support the decision.

Not only does this case present facts that are wholly different in scope and kind as those considered in *Zauderer*, but it presents facts that are also significantly different from those in *Kraft* and *Stouffer*. Respondents do not seek departure from *Kraft* or its subsequent decision in *Stouffer*. Instead, the Commission is urged to recognize that the breadth and intensity of the factors described above show that this case is at the other end of the spectrum from *Kraft* and *Stouffer*.

In *Kraft*, respondent was accused of running ads suggesting that Kraft Singles contained more calcium than imitation cheese slices. 114 F.T.C. at 41. In fact, they did not. *Id.* At issue was whether consumers would believe that various Kraft Singles ads contained more calcium than imitation cheese slices based on statements similar to, "Kraft Singles are made from five ounces per slice. So his bones get calcium they need to grow...," or because they showed milk filling a five-ounce glass. *Id.* at 42 – 43. The Commission held that these ads "contain implied claims that are close to express" because

> when the Kraft "Skimp" ads proclaimed that a slice of Kraft Singles has or is made from five ounces of milk "so her little bones get calcium" (emphasis added), the causal link of the phrases naturally implied that a Kraft Single has the same amount of calcium as five ounces of milk.

Id. at 125. The Commission did not examine beyond these elements in conducting the facial analysis, and concluded that these claims were "virtually express" in nature.

Similarly, *Stouffer* presented advertisements with virtually express claims. The ads there stated that Stouffer's Lean Cuisine meals were low in sodium. Among other things, the Stouffer ads claimed that Lean Cusine meals contained "always less

than 1 gram of sodium per entrée," accompanied by an asterisk that the product actually contained 1000mg (or 1 gram) of sodium. 104 F.T.C. at 754–755. The Commission determined that the claims indicated a sodium level well above that for FDA and public health groups' guidelines for "low sodium." *Id.* at 770. The Commission, considering the print ads presented, made the following facial analysis:

> A footnote states "All Lean Cuisine entrees have been reformulated to contain less than 1 gram (1000 mg.) of sodium." If the footnote is overlooked by a consumer, the ad explicitly describes the sodium content of Lean Cuisine as "1" gram, a low number. The sodium is described as "less than" 1 gram, diminishing the quantity.

Id. at 777 – 778. The Commission also looked at extrinsic evidence to determine that consumers were not aware of FDA guidelines and did not know the daily recommended intake of sodium. *Id.* at 784 – 85.

Stouffer and *Kraft* were fundamentally different cases from this one. Those cases lay at the end of the spectrum where the claims are "express" or "virtually express." The facial analysis conducted by the Commission did not require a sifting of various factors such as surrounding circumstances and intent, such as that conducted by the ALJ here. Here, not even Complaint Counsel believed that to be the case. If they were express or virtually express claims, there would have been no reason to resort to lengthy quotations in the Complaint regarding the statements made in the ads for AbTronic, Ab Energizer and Fast Abs, and those products would not have been central to Complaint Counsel's case at the hearing. Moreover, if the asserted claims were as clear as the claims in *Kraft* and *Stouffer*, then it seems unlikely

that the ALJ and Dr. Mazis would have reached different conclusions as to what claims were being made in the television ads.

3. The "conclude with confidence" standard is improper as a matter of law and in any event cannot correct for the plain error in the ALJ's application of facial analysis.

Complaint Counsel argues that the Commission may impose liability against the Respondents if it can "conclude with confidence" that the ALJ's facial analysis was correct. However, Complaint Counsel's defense of the "conclude with confidence" test contains a fatal internal contradiction, which graphically demonstrates why this test cannot, as a matter of law, justify the ALJ's misapplication of facial analysis.

Complaint Counsel failed to challenge the showing in Respondents' opening brief that the "conclude with confidence" test relates not to an enhanced quantum of proof that must be satisfied in order to impose liability upon an advertiser (Opening Brief, p. 62), but to the subjective degree of assurance that the members of the Commission have in their intuitive judgment as to what claims a reasonable consumer would take away from an advertisement. Respondents further argued that the "conclude with confidence" standard that the ALJ applied is defective as a matter of law, because it based the decision – and would require a reviewing court to inquire into – the heart and mind of the decisionmaker.

In response, Complaint Counsel has argued that the "conclude with confidence" test is not improper because:

> in fact the reviewing court can examine the advertising for itself, as the Seventh Circuit did in *Kraft*, and determine whether the claims are "reasonably

> clear from the face of the advertisement." In reaching this determination, the Seventh Circuit did not inquire into the "hearts and minds" of the Commissioners.

(CC Brief, p. 38). Complaint Counsel thus argues that a "conclude with confidence" decision is capable of judicial review because the court may conduct a de novo review of the face of the advertisements and determine for itself whether the implied claims found by the Commissioners are "reasonably clear." However, Complaint Counsel's argument is flatly contradicted by Section 5(c) of the FTC Act, 15 U.S.C. § 45(c), which provides, in pertinent part, that upon judicial review of an FTC order:

> The findings of the Commission as to the facts, if supported by evidence, shall be conclusive.

This statute establishes a standard of review that is binding on reviewing courts. Thus, an appellate court may conduct only a limited review to determine if the Commission's findings are supported by evidence and may not perform its own, de novo review of the facts. Complaint Counsel simply ignores the governing law.

Further, Complaint Counsel's brief contradicts its own argument. Two pages after asserting that an appellate court could engage in de novo review, Complaint Counsel quotes the Seventh Circuit's decision in *Kraft v.* FTC, 970 F.2d 311, 317 (7th Cir. 1992), *cert. denied*, 507 U.S. 909 (1993), for the proposition that a Commission finding of fact is "to be given great weight by reviewing courts because it 'rests so heavily on inference and pragmatic judgment' and in light of the frequency with which the Commission handles these cases." (CC Brief, p. 40).

In other words, having argued for de novo review to solve the problem of looking into the hearts and minds of the decisionmakers, Complaint Counsel then

turns around and relies on *Kraft* for the proposition that a reviewing court must defer to the Commission's findings of fact. Assuming this is the case, the only other factor that would be presented for appellate review under the "conclude with confidence" test would be the subjective intensity of the Commissioners' confidence in their decision. A standard that would require the reviewing court to base its judgment upon a review of the mental processes of the Commissioners would violate both Section 5(c) and the basic principle of administrative law established by *United States v. Morgan*, 313 U.S. 409, 422 (1941).[18]

In sum, in its effort to justify the ALJ's use of facial analysis, Complaint Counsel has advocated that the Commission follow an "I know it when I see it" approach for determining what representations a reasonable consumer would take away from an advertisement, without having to incur the costs of obtaining actual extrinsic evidence, through surveys or other methods, of what consumers actually understood. Complaint Counsel's proposed approach would be tied to no objective standard of proof. It would confide the decision of what claims impliedly were made (and thus for which the advertiser must have substantiation) to the unfettered discretion of the five Commissioners.

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[18] The Commission has in the past objected to arguments by respondents that would require the courts to look into the mental states of the Commissioners. For example, as the Supreme Court noted in *FTC v. Standard Oil Co. of California*, 449 U.S. 232 (1980), the Commission rejected the company's effort to challenge the finding that it had "reason to believe" that a violation of Section 5 of the FTC Act had occurred on the ground that such matters "go to the mental processes of the Commissioners and will not be reviewed by the courts." *Id.* at 235 n.5 quoting *In re Exxon Corp.*, 83 F.T.C. 1759, 1760 (1974)).

However, Complaint Counsel's proposal that the Commission proceed on its own say-so in cases where, as here, the possibility of deception must be teased out of multiple factors in many advertisements would violate the requirement of Section 5(c), that the Commission's decisions must be based on "evidence." It also would ignore the burden of proof the agency must carry under the First Amendment before it may limit commercial speech.

The subjective standard that Complaint Counsel advocates is inherently arbitrary, because no two persons can hope to apply such a test in the same manner, and it is impossible to treat like cases in a similar manner when the test is not anchored in any objective decisionmaking criteria. Neither *Zauderer* nor any of the decisions of the courts of appeals cited by the Complaint Counsel justify a determination whether an implied claim has been made based on the Commission's standardless say-so.

Finally, Complaint Counsel argues that "commercial speech is far too hardy to be chilled" by the broad use of the "facial analysis" approach it advocates. (CC Brief, p. 26, 44). However, the Supreme Court already has relied on this factor in determining that government restrictions on commercial speech need satisfy only "intermediate tier" scrutiny, rather than a higher standard. Accordingly, in order to avoid improperly chilling commercial speech, it is vital that the Commission adhere to the constitutional requirements that the Court has imposed, including the requirement that it prove that commercial speech is either "inherently likely to

deceive" or that it "has in fact been deceptive" before prohibiting it. *In re R.M.J.*, 455 U.S. at 202.[19]

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[19] Complaint Counsel objects to a request by Amicus National Association of Chain Drug Stores that the Commission clearly articulate a standard that would apply to advertisers who run "compare and save" advertisements. In particular, Complaint Counsel argues that it is "difficult to understand why NACDS members should have a safe harbor to sell pharmaceutical products by comparing them to brand-name products that 'make health, efficacy, and other claims' and making the same claims, albeit implicitly, without having substantiation for those claims." (CC Brief, p. 43) (emphasis added). However, the reason for seeking guidance is easy to understand. Complaint Counsel's approach would place an impossible compliance burden on "compare and save" advertisers and would thereby chill an important kind of commercial speech.

Under Complaint Counsel's approach, a "compare and save" advertiser would be deemed to make all explicit and implicit claims that had been made by all advertisers in the target universe for its price comparison. Before it could safely run a "compare and save" ad, the advertiser and would have to have its own evidence to substantiate all the claims of those other entities, even though the necessary information would be out of its control and in the control of those other entities.

As the Court observed in *Bates v. State Bar of Arizona*, 433 U.S. 350, 380-381 (1977), "the advertiser seeks to disseminate information about a product or service that he provides, and presumably he can determine more readily than others whether his speech is truthful and protected," so there is little risk that government regulation of misleading advertising will chill accurate commercial speech. This "presumption" is not necessarily valid for "compare and save" advertisers. While such advertisers may have knowledge of some factors relating to their products (such as whether a generic version of a drug is the pharmaceutical equivalent of a brand name drug), they typically will not have access to information concerning all claims that were made by each individual brand name manufacturer or concerning all implied claims that the Commission might conclude, after the fact, that a brand name manufacturer was deemed to have made. It would be prohibitively expensive (or impossible) for "compare and save" advertisers to obtain such information on products offered by their competitors before advertising their own products.

If "compare and save" advertisers were deemed to have made "albeit implicitly" all express and implied claims made by all advertisers within the target universe for their products, they would have to assume a commercially untenable burden and potentially would be severally liable for any misleading statement that any advertiser had made, regardless of whether any actual consumer ever relied on that

In sum, the Commission should reject Complaint Counsel's proposal that it extend the facial analysis doctrine beyond matters in which the facts are as "self-evident" as they were in the *Zauderer* judicial notice situation. Consistently with the requirements of Section 45(c) and its obligations under the First Amendment, the Commission should hold that the challenged advertisements may be deemed misleading only if the existence of the four alleged implied claims can be demonstrated by extrinsic evidence of actual consumer understanding. The record does not contain such evidence, and the ALJ's decision should be overturned.

IV. THIS CASE DOES NOT PRESENT EVIDENCE THAT WOULD JUSTIFY THE IMPOSITION OF A PERFORMANCE BOND OR AN "ALL PRODUCTS, ALL CLAIMS" ORDER.

The Supreme Court has repeatedly upheld the ability of the Commission to include "fencing in" language in its orders. *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 394 (1965); *FTC v. Ruberoid Co.*, 434 U.S. 470, 473 (1952). However, such language must be justified by the remedial purposes for which the FTC Act was enacted. *Chrysler Corp. v. FTC*, 561 F.2d 357, 364 (D.C. Cir. 1977); *Marco Sales Co. v. FTC*, 453 F.2d 1 (2d Cir. 1971). Where an order has been found vague, overbroad or unsupported by the record, courts of appeal have modified or vacated the order. *See, e.g., Standard Oil Co. v. FTC*, 577 F.2d 653, 660-93 (9th Cir. 1978); *ITT Continental Baking co. v. FTC*, 532 F.2d 207, 220-21 (2d Cir. 1976). The propriety of a broad

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misstatement in purchasing a product from the "compare and save" advertiser. Thus, Complaint Counsel's approach would chill this valuable type of commercial speech.

order depends on the specific circumstances of the case, which must be fully considered by the Commission. *FTC v. Colgate-Palmolive Co., supra.*

The proposed order recommended by the ALJ at the end of the trial in this case reflects a careful analysis of the various factors mandated by the case law to be considered in the shaping of appropriate "fencing in" language. Although based on a false premise – that Respondents in fact made the claims at issue here – the proposed order faithfully follows the findings of violation made by the ALJ and provides language which addresses appropriately the problems which he defined. Paragraph II of the Order covers advertising for the Ab Force device or "any substantially similar device." Paragraph III of the Order covers various specific claims made in connection with the marketing "of any EMS device." Most broadly, paragraph IV of the Order prohibits in connection with the marketing "of Ab Force, or any other EMS device, or any device, product, service, or program promoting the efficacy of or pertaining to health, weight loss, fitness, or exercise benefits" of such a product, the making of various specified claims without adequate substantiation, including any claims regarding the "health benefits, safety, or efficacy of any such product, service, or program." This is an exceptionally broad order and reaches not only abdominal belts but any product that promotes the efficacy of or pertains to products claiming health, weight loss, fitness, or exercise benefits.

Complaint Counsel is, however, dissatisfied with the Order in two respects: first, as argued in Part V of its brief, Complaint Counsel contend that an "all products" order is required to protect the public interest. And, in Part VI of their

Brief, they argue that Respondent Khubani should be required to secure a $1 million performance bond before engaging in the manufacturing, labeling, advertising, promotion, offering for sale, sale or distribution of any "device" as that term is defined in Section 15(d) of the FTC Act, 15 U.S.C. §52. Both arguments are unsupportable, the first because, as the ALJ found, there is a lack of support in the record for requiring an all products order, and the second because not only does the record lack support for such an unprecedented provision, but the imposition of such a requirement is outside the scope of remedies available under Section 5 of the FTC Act, 15 U.S.C. §45.

The arguments advanced by Complaint Counsel fall into two main categories: first, there are arguments which merely recite the general considerations required to be considered by the Commission in fashioning the scope of an appropriate order – seriousness and deliberateness, ease of transfer of unlawful conduct, *etc.* – coupled with the assertion that there are circumstances present here that match each standard. As discussed below, these assertions are demonstrably unsupportable. Complaint Counsel's real "weapon of choice," however, is its effort to use some prior consent agreements entered into by one of the Respondents against all of the Respondents as evidence of guilt.

Indeed, Complaint Counsel bases both its reasonable relation analysis, as well as its justification for a performance bond, primarily on Respondents' "past history" with the Commission. Complaint Counsel reasons that Telebrands' past history indicates a proclivity toward violating the Act or as Complaint Counsel puts it, a

likelihood "to fail to conform to the requirements of the law." (CCBrief at 77). But courts have held repeatedly that past consent agreements cannot be used to fashion a broad order because they are not evidence of guilt or liability. Complaint Counsel in turn argues that these agreements are not being used to establish guilt, but only to determine the appropriate scope of relief under the order, which is appropriate under the holdings of several cases. But it is clear that Complaint Counsel is pointing to the agreements as evidence of guilt to argue that the proper scope of relief is a broad order and this has repeatedly been held to be impermissible. Finally, and as pointed out by the ALJ, Complaint Counsel failed to properly enter these agreements into evidence and this failure should not be ignored by the Commission. Quite simply, the prior Telebrands consent orders should not be relied upon by the Commission in fashioning the order.

A. Seriousness, Deliberateness and Transferability of Conduct

Concerning seriousness and transferability, Complaint Counsel states that Respondents' ads were widely disseminated and cost $4 million; 747,000 Ab Force units were sold and that Respondents took in $19 million; and Respondents have the financial means to spend millions on advertising and have promoted and sold thousands of products. (CCBrief at 69-70, 72). The relevance of these facts to Complaint Counsel's reasonable relation analysis is unclear.[20] Of course, Respondent

[20] Complaint Counsel also argues that Respondents' purported claims are "inherently serious" because "claims about health are important to consumers", noting the current "obesity epidemic." (CCBrief at 70). Complaint Counsel then seems to implicitly analogize this case to the recent case against Kentucky Fried Chicken, where the company made a number of deceptive, express health claims about its fried

is a large company that promotes and sells lots of products and can afford to advertise them. Certainly, courts have considered these types of factors in a reasonable relation analysis. *See, e.g., Kraft, Inc. v. Federal Trade Commission*, *supra* at 326. But that does not end the reasonable relation analysis – otherwise every large company would automatically be subject to an "all products" order. And they are not – *see, e.g. In the Matter of KFC Corporation*, Docket No. C-4118 (Sept. 9, 2004).

Moreover, as to deliberateness, Complaint Counsel noted just three facts: that Mr. Khubani desired to enter "one of the hottest categories to ever hit the industry;" Respondents used stock footage of models in skimpy clothing to visually and deliberately convey the claims at issue; and Mr. Khubani edited a script to avoid making claims for which he did not have substantiation. (CC Brief at 71- 72). But, surely, the fact that Mr. Khubani made a concerted and deliberate effort to avoid making claims for which he had no substantiation, and that he wanted the ads to focus on a compare and save strategy stressing on price and technology cuts the <u>other</u> way. Consider the following facts regarding to the rollout of the television advertising alone:

- Mr. Khubani instructed Ms. Liantonio that the script for the television commercial should not contain any claims other than claims concerning price. (JX-6, Liantonio Dep. 56 – 57; Tr. 490 - 491).

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chicken. *See In the Matter of KFC Corporation*, Dkt. No. C-4118 (Sept. 9, 2004). Interestingly, however, despite the egregious conduct to which Complaint Counsel points, *KFC* was <u>not</u> an all products order but was limited to foods "in which chicken is a component" and covered only certain limited claims. The order in *KFC* is, in fact, narrower than the proposed order issued by Judge McGuire.

- Mr. Khubani expressly rejected a draft script provided to him that contained several exercise and weight-related claims. Specifically, Ms. Liantonio—who had not seen the Ab Force product, and who had not seen any ads for other EMS ab products (JX-6, Liantonio Dep. 30 -33)—presented Mr. Khubani with a draft script the morning of the shoot that contained the following introduction:

> "Do you wish you could get into shape fast without exercise? Wouldn't you love to have a flatter tummy without painful sit-ups? There are millions of Americans just like you who have discovered the power of those amazing Electronic Ab Belts advertised on television."

(JX-6, Liantonio Dep. 35 – 36; RX-34).

- When Ms. Liantonio showed Mr. Khubani the script, Mr. Khubani saw that Ms. Liantonio had made "all the claims I didn't want to make—you know, flatter tummy, without painful sit-ups and so on..." (Tr. 490). Mr. Khubani testified that when he saw the script he "knew I had to rewrite the script." (Tr. 490). He testified that he did not want to make those or similar claims because "we didn't possess substantiation to make those claims." (Tr. 490).

- Mr. Khubani discarded Ms. Liantonio's draft and rewrote the scripts while Ms. Liantonio finished setting up for the shoot. (Tr. 484 – 486; 490 – 491; JX-6, Liantonio Dep. 56-57). The new script completely eliminated Ms. Liantonio's opening and instead opened with point-of-reference

statements similar to those found in the print advertisements. (Tr. 486 – 489; JX-2; CX-1B; JX-4).

Also undercutting Compliance Counsel's deliberateness argument is the fact that, before the nationwide advertising campaign began, Respondents engaged in a detailed legal review of the Ab Force product and advertising to ensure compliance with all applicable laws and regulations. (Tr. 495). As a result of this review, minor changes were made to both the radio and television advertisements to avoid making the types of claims that are now at issue here. (Tr. 495).

Nor is there any support in the record under the other prongs of the tests: seriousness and transferability.

Complaint Counsel makes much in its brief of the seriousness of Respondents' purported actions because the alleged claims relate to weight loss as well as loss of inches. Complaint Counsel's Brief (CC Brief, p. 70) observes that claims related to loss of weight are especially serious and that the ads were disseminated nationwide.

Complaint Counsel proceeds as if the ALJ had decided to issue no order at all, instead of the Order which was issued – relating directly to any claims for any device, product, service or program regarding health, weight loss, fitness, or exercise benefits. In short, the proposed Order covers not only the products at issue – abdominal belts and EMS devices which are covered in Paragraphs II and III of the Order – but to any other product that relates to the subject matter discussed in that section of Complaint Counsel's brief. The seriousness of the obesity epidemic is not at issue

and any claims related to the subject matter are fully covered in the ALJ's proposed order.

The intent of Mr. Khubani (CC Brief, p. 71) is also an issue of marginal relevance. As Respondents have discussed at length above, Khubani's intent was clear: to make a "compare and save" claim. Given the nature of the visual clues on which Complaint Counsel rests its case – thin models with well-defined abs "in skimpy clothing" (CC Brief, p. 71) – the assertion that these purported violations "are readily transferable to any product and any claim" seems to be little more than an *ipse dixit*. Transferable how? Complaint Counsel never explains, merely asserts. Similarly, as mentioned above, the fact that Telebrands has not insubstantial financial means and has promoted and sold hundreds of products proves absolutely nothing. The same is true with many large companies that come before the Commission but even a casual review of Commission Orders reveals the legion of such companies that are not subject to "all products" orders.

B. Respondents' Past Consent Agreements Are Irrelevant

Complaint Counsel has argued in this case that a broad, multi-product order that also includes a performance bond is appropriate because the FTC has taken "four previous actions" against one of the Respondents and suggests that "Respondents' past history with the Commission indicates that they may be likely to fail to conform to the requirements of the law." (CC Brief, p. 73). However, courts have held that the "Commission may not rely on such orders as evidence of additional illegal conduct when formulating cease-and-desist orders in other

proceedings." *See ITT Continental Baking Co., Inc. v. Federal Trade Commission*, 532 F.2d at 223 n. 23 (citing *N.L.R.B. v. Local 926, International Union of Operating Engineers*, 267 F.2d 418 (5th Cir. 1959); Teamsters' Local 327 (Greer Stop Nut Co.), 160 N.L.R.B. 1919 (1966); Local 92, Int'l Ass'n of Bridge, etc. Workers (R.N. Hughes Constr. Co.), 138 N.L.R.B. 428, 429 n. 2 (1962)).

In *ITT Continental Baking*, the court upheld the FTC's imposition of a multi-product cease-and-desist order on respondents, the maker of Wonder Bread and its advertising agency. *Id.* at 207. However, the court rejected the Commission's contention that multi-product order was further justified as to the advertising agency because it was subject to six orders, five of which were consent agreements. *See id.* at 223. The court pointed out that these past consent agreements provided that they did not constitute an admission that the law had been violated, and therefore could not be relied upon in formulating the order. *Id.* Other courts have stated that the entering of a consent decree "is not a decision on the merits and therefore does not adjudicate the legality of any action by a party thereto. Nor is a consent decree controlling precedent for later Commission action." *See Beatrice Foods Company v. Federal Trade Commission*, 540 F.2d 303, 312 (1976).

The ALJ concluded that the Respondents' past consent agreements could not be cited with any authority, citing *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 331 n.12 (1961). In that case, the Supreme Court noted that the circumstances surrounding negotiated agreements are "so different that they cannot be persuasively cited in a litigation context." *See United States v. E.I. du Pont de Nemours & Co.*, 366 U.S.

at 331. And in other recent cases, ALJs have rejected Complaint Counsel's attempt to cite consent agreements for the same reason, citing *du Pont*. *See Chicago Bridge & Iron Company N.V., Chicago Bridge & Iron Company, and Pitt-Des Moines, Inc.*, Dkt. No. 9300, at 123 (June 18, 2003) *available at* http://www.ftc.gov/os/2003/06/cbiid.pdf (affirmed on other grounds (Jan. 6, 2005)); *In the Matter of North Texas Specialty Physicians*, Dkt. No. 9312, at 89 (Nov. 15, 2004) *available at* www.ftc.gov/os/adjpro/d9312/041116initialdecision.pdf.

1. Complaint Counsel's use of consent agreements is improper here

Complaint Counsel points to a number of cases (CC Brief, p. 75) where the Commission and courts have considered consent agreements in determining the appropriate scope of relief. In *Sterling Drug, Inc.*, 102 F.T.C. 395, 793 n. 54 (1983), *aff'd*, 741 F.2d. 1146 (9th Cir. 1984), *cert. denied*, 105 U.S. 1843 (1985), the Commission held that consent orders are relevant "for determining the appropriate scope of relief."[21] However, the Commission also stated that the consent orders could not be taken as evidence of prior guilt. *Id.* But prior guilt is precisely the basis of Complaint Counsel's argument to determine the "appropriate scope of relief." Complaint Counsel also misinterprets the holding in *J. Walter Thompson USA, Inc.*, 120 F.T.C. 829 (1995) (cited CC Brief, p. 75), where the Commission stated that "whether consent orders may be used as evidence of past violations is at best unsettled", citing the holding in *ITT Continental Baking* as well as *Thompson Medical Co.*, 104 F.T.C. 648, 833

[21] The Commission cited the past multi-product cease-and-desist orders to note that it would be appropriate to impose a multi-product cease-and-desist order in the case before it. *Id.*

n. 78 (1984), *aff'd* 791 F.2d 189 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1086 (1987). With respect to the consent agreements in that case, the Commission stated only that they showed respondent was aware of the Commission's concern about the types of claims at issue in that case. Complaint Counsel also cites *Jay Norris Corp. v. FTC*, 91 F.T.C. 751, 856 n. 33 (1978) (CC Brief, p. 75) where the Commission noted the Respondents' past history of prior proceedings in fashioning a broad cease-and-desist order.[22] The order was subsequently upheld by the Second Circuit in *Jay Norris, Inc. v. Federal Trade Commission*, 598 F.2d 1244, 1250 (2d Cir. 1979), which – contrary to Complaint Counsel's assertion – did not pass on whether it was appropriate for the Commission to have relied on the past proceedings in fashioning the order.[23]

In short, Complaint Counsel's reliance on these cases is misplaced. The question here is whether Respondents' past consent agreements with the Commission can be considered in fashioning a cease-and-desist order in this proceeding.[24] While the issue, as noted by the Commission in *J. Walter Thompson*, is

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[22] The past proceedings consisted of one consent agreement with the Commission, one order entered by the Commission after litigation, one assurance of discontinuance entered by the New York Attorney General and one proceeding with the U.S. Postal Service. *Id.*

[23] The Second Circuit stated only that "the Commission may take into account petitioner's past history of noncompliance" which assumes a finding of noncompliance or an admission of liability. *Id.* Of course, there is no such admission contained within consent agreements.

[24] Complaint Counsel also cites as persuasive authority on this issue *federal Trade Commission v. SlimAmerica*, 77 F. Supp. 2d 1263 (S.D. Fla. 1999) and *United States v. Union Circulation*, 1983 U.S. Dist. LEXIS 18794 (N.D. Ga. 1983)(CCBrief at 75). These cases are completely irrelevant to the question here. *SlimAmerica* was a Section 13(b) case where broad injunctive relief was imposed based in part on one consent

unsettled, the weight of authority argues against considering consent agreements in fashioning orders.[25]

2. Complaint Counsel failed to enter these consent agreements into evidence and they cannot now be considered by the Commission

Additionally, these consent orders cannot be considered by the Commission because Complaint Counsel failed to enter them into evidence. (ID, p. 63). It was squarely Complaint Counsel's burden and responsibility to do so – not that of Respondents and not the ALJ's. (CC Brief, p. 74 n. 49.) Complaint Counsel admits that they could have requested that the ALJ do so and note that such requests have

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agreement and five default judgments. *Union Circulation* was a civil penalties action under 15 U.S.C. § 45(l)(C) in which prior conduct is statutorily required to be considered in determining whether penalties should be assessed. *See United States v. Union Circulation*, 1983 U.S. Dist. LEXIS at *5.

[25] Complaint Counsel also cites two Securities and Exchange Commission ("SEC") cases that are, again, irrelevant to the matter here. One case concerned whether a consent agreements could be used, not to prove guilt or to fashion a cease-and-desist order, but to show that a defendant knew about the SEC's reporting requirements. *See* United States v. Gilbert, 668 F.2d 94 (2d Cir. 1981). The consent agreements were entered under Federal Rules of Evidence 408, and the court stated in that case that consent agreements may not "be used to prove underlying facts of liability." *Id.* (citing *Lipsky v. Commonwealth United Corp.*, 551 F.2d 887 (2d Cir. 1976)). The other case concerned the Ivan Boesky-Michael Milliken-Drexel Burnham scandal of the 1980s. In *Securities and Exchange Commission v. Drexel Burnham Lambert, Inc.*, 837 F. Supp. 587 (S.D. N.Y. 1993), the SEC sought an injunction that would permanently bar two individuals involved in the scandal from ever participating as officers or directors in public companies with the SEC. *Id.* The relief was sought pursuant to the Remedies Act, which amended Section 20(b) of the Securities Act and Section 21(d) of the Exchange Act. *Id.* These provisions provided *express statutory authority* to "bar or suspend individuals addicted to predatory or unprincipled conduct in respect of their management and control of public enterprises." *Id.* Such a showing under the statute is naturally predicated on showing the defendant's history of such conduct.

been done in later stages of these sorts of proceedings, but still fails at this late stage to formally request that the Commission take official notice of the consent agreements. *Id.* Moreover, "failure to follow the formalities" is not harmless error, particularly since Complaint Counsel is attempting to use Respondents' past consent agreement to fashion a broad order that would include $1 million performance bond.[26] *Id.* Complaint Counsel attempts to avoid their evidentiary burden by citing several irrelevant cases for the proposition that consent agreements have been cited by courts even though they have not been admitted into evidence.[27] The ALJ properly held that the orders were not in the record.

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[26] Complaint Counsel cites *Skylark* where respondents requested that the Commission take official notice of its own guidelines on deceptive advertising of guarantees. This is certainly distinguishable, particularly since the Commission's own guidelines were not a "contested material fact" as are the entry into evidence and use of the Respondents' past consent agreements here. *See id.* (citing *In the Matter of Skylark Originals, Inc.*, et al., 80 F.T.C. 337, 350 (1972)). Note that even in *Skylark*, official notice was requested by the proponents of the evidence.

[27] The three cases in question are *County of Oakland v. City of Detroit*, 784 F. Supp. 1275, 1281 (E.D. Mich. 1992), *Bowman v. Hale*, 302 F. Supp. 1306, 1307 (S.D. Ala. 1969) and *Lancaster v. Lord*, 1991 U.S. Dist. LEXIS 8328 (S.D.N.Y. June 19, 1991). Absolutely none of these cases deal with the evidentiary question now before the Commission. For example, *County of Oakland* concerned the question of whether a lawsuit under the Local Government Antitrust Act ("LGAA") could properly be brought against the City of Detroit. *See City of Oakland v. Detroit*, 784 F. Supp. at 1280. Six factors are to be considered in making such a determination, including whether the alleged violations were predicated on state or federal law or policy. *Id.* As to this factor, the court noted that the city's actions, which were the subject of the suit, were predicated on a consent agreement it entered with the Environmental Protection Agency ("EPA"). *Id.* at 1281. Similarly immaterial, *Bowman v. Hale* concerned a civil action brought by a state prisoner on a number of grounds. *Id.* at 1307. The petition was denied by the court, which noted as an aside that a number of the prisoner's grounds were similar to those that were the subject of a previous consent agreement between prison authorities and inmates. *See id.* The third extraneous case concerned plaintiff's failure to plead with specificity in a § 1983 case the link between plaintiff's

V. IMPOSITION OF A PERFORMANCE BOND IS OUTSIDE THE SCOPE OF THE COMMISSION'S REMEDIAL POWER UNDER SECTION FIVE

The Commission does not have statutory authority under Section 5(b) to impose equitable remedies such as the performance bond contemplated here. The performance bond is related to a requirement of restitution, and courts have specifically held that the Commission does not have statutory authority under Section 5(b) to order restitution. Although courts have held that requiring a performance bond is an "appropriate" ancillary equitable remedy in Section 13(b) cases, no court has ever endorsed the type of ancillary equitable remedy sought here in a litigated Part III matter. In fact, the Commission is really attempting to impose a penalty on the Respondents for alleged past bad acts, which is also impermissible under Section 5(b).

In many cases, particularly in the 1990s, the FTC required a performance bond as part of consent agreements reached in Section 13(b) cases in exchange for allowing the respondent to continue business operations. Such consent agreements, those cited as having been "accepted" by the Commission in Part III matters, are irrelevant in determining whether the Commission has the power to order such relief in a litigated matter. As the ALJ found, Complaint Counsel's attempt to impose a performance bond on Respondents in this case is unsupported by law, overly broad and must fail.

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allegations and a prior consent agreement entered into by defendants. *Lancaster v. Lord*, 1991 U.S. Dist. LEXIS 8328 at *7.

A. The Commission Does Not Have Statutory Authority Under Section 5(b) to Require A Bond

The FTC has wide discretion in its choice of remedies against alleged violators of the laws its enforces and is thus authorized to enter an order that is sufficiently broad to ensure that respondents will refrain from engaging in similar conduct or conduct that likely would have the same or similar effects. *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952); *Jacob Siegel Co. v. FTC*, 327 U.S. 608, 611-13 (1946). Nevertheless, the remedies available to the Commission are specific under the FTC Act: Injunctive relief under Section 13(b); restitution, rescission, refunds and damages under Section 19; and, additional relief under Section 5(l) in those cases that involve violations of final orders. 15 U.S.C. §§ 53(b), 57(b), 45(1). In this cease-and-desist proceeding brought under Section 5(b) of the FTC Act, Complaint Counsel is seeking to require the Respondents to post a $1 million performance bond before marketing or promoting any weight-loss product in the future. This goes too far.

To impose such extraordinary relief in this type of proceeding is plainly outside the Commission's statutory authority. *See Heater v. FTC*, 503 F.2d 321, 327 (9th Cir. 1974). The Ninth Circuit in *Heater* "delineated the 'scope of the powers given to the Commission' to order remedies under its statute-born cease-and-desist authority", striking down the FTC's attempt to require a defendant, as part of a Section 5(b) cease-and-desist order, to pay restitution. *See Heater v. FTC*, 503 F.2d at 323; *Federal Trade Commission v. Evans Products Co.*, 775 F.2d 1084, 1087 (9th Cir. 1985). The Court in *Heater* held that Congress did not grant the Commission statutory authority under Section 5(b) of the Act to include a restitution provision in the cease-

and-desist order.[28] Specifically, the Court noted that ordering such a remedy "... impermissibly expands the Commission's remedial power beyond that contemplated by Congress or written into the [FTC] Act" and that "[t]he Commission's endeavors must be limited to the exercise of powers granted by Congress." *Id.* at 327.

Subsequently, of course, Congress added Sections 13(b) and 19 to the Act which, implicitly and explicitly, provided the Commission the authority to seek restitution and other equitable remedies. However, Congress did not so expand the Commission's cease-and-desist authority under Section 5(b). Thus, the holding in *Heater* is still relevant today – and particularly so in this case. Here, as in *Heater*, Complaint Counsel is attempting to impose an equitable remedy in a cease-and-desist proceeding that is outside the scope of Section 5.

Nor can Complaint Counsel establish that there is a need for a bond in this case. Indeed, Complaint Counsel makes little effort to support the notion that the bond is needed to insure "that funds will be available if Khubani fails to comply with the FTC Act in marketing devices." (CC Brief, p. 79). The real affect of the bond provision is to require that Telebrands pay a substantial amount of money "up front" before it can market any "device" as that term is defined in Section 15(d) of the FTC Act. There is no evidence that money is needed to insure the availability of funds for redress or civil penalties in the hypothetical event that Respondents violate the cease-

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[28] Other cases acknowledge *Heater* as standing for the proposition that the Commission does not have the statutory authority under Section 5(b) to order restitution as an equitable remedy. *See, e.g., Baum v. Great Western Cities, Inc.*, 703 F.2d 1197, 1208 (10th Cir. 1983); *FTC v. Virginia Homes Manufacturing Corp.*, 509 F. Supp 51, 55 n. 2 (D. Md. 1981).

and-desist order. Indeed, Complaint Counsel has gone out of its way to describe the financial resources of Telebrands (CC Brief, p. 72). In short, there is no reasonable explanation for the seeking of a bond other than, as we discuss below, an effort to punish Respondents.

B. The Real Purpose of the Bond Is to Punish Respondents, Which Is Impermissible Under the Act

In addition, the broad equitable relief the Commission is apparently seeking in this Section 5(b) proceeding is really a penalty or punishment for alleged past bad or illegal acts. The Commission points to the past consent agreements it has entered into with the Respondents in justifying the imposition of the bond and noting that it will serve as a "powerful deterrent" to ensure that deceptive campaigns of the sort alleged here do not occur again. *See In the Matter of Telebrands Corp., T.V. Savings L.L.C. and Ajit Khubani*, File No. 022 3279, Dkt. No. 9313, at 41 (Apr. 26, 2004) (Complaint Counsel's Pretrial Brief). Just as the Commission does not have the authority to impose a performance bond under Section 5(b), neither does it have the authority to seek the bond under this provision of the Act as a penalty or punishment. In fact, cease-and-desist orders issued under Section 5(b) are not meant to punish or penalize respondents. *See, e.g., Heater v. FTC*, 503 F.2d at 326. The FTC "is not is not empowered to issue a cease and desist order as punishment for past offenses. It has power only to put a stop to present unlawful practices and to prevent their recurrence in the future." *See Coro, Inc. v. FTC*, 338 F.2d 149, 153 (1st Cir. 1964) *cert denied*, 380 U.S. 954 (1965).

Courts have upheld the FTC's ability to seek equitable remedies such as performance bonds that were arguably punitive in nature under Section 13(b). *See, e.g., Federal Trade Commission v. Febre*, 128 F.3d 530, 537 (1997); *Federal Trade Commission v. Silueta Distributors, Inc.*, 1995 WL 215313 at *6 (N.D. Cal. Feb. 24, 1995). In fact, courts have pointed out that there is no limitation on the awarding of exemplary or punitive damages under Section 13(b). *See id.* (citing *FTC v. Figgie Intern., Inc.*, 994 F.2d 595, 607-608 (9th Cir. 1993)). This is not a Section 13(b) case, and nowhere in Section 5(b) does it contemplate a penalty or punishment of the sort the Complaint Counsel proposes here.

There is no Section 5(b) case where such a broad ancillary equitable remedy was imposed. In fact, and as pointed out by Judge McGuire, even Complaint Counsel could cite no case where a performance bond was imposed in a Part III litigated matter. *See* ID, p. 63.

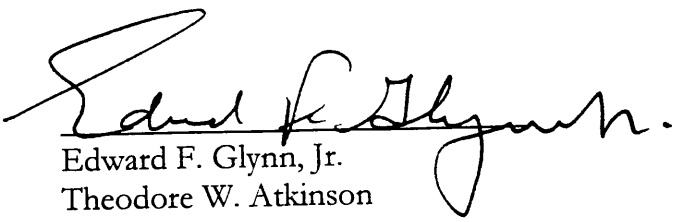
Indeed, until the statutory scheme embodied in the Federal Trade Commission Act is shown not to work, there is no rationale behind Complaint Counsel's assertion of the need for the bond they describe. Complaint Counsel's assertion that the Commission "has the authority to impose a bond as fencing-in relief if presented with facts showing that such relief is necessary to prevent future violations" (CC Brief, p. 78) ignores the obvious: the proper means of enforcing a Commission Cease and Desist Order is a Civil Penalty proceeding under Section 5(l) of the FTC Act, 15 U.S.C. §45(l). Complaint Counsel has not explained why this is an insufficient remedy in this case. Apparently, since this is not a civil penalty action,

Mr. Khubani and Telebrands have complied with the earlier Consent Orders to which they are parties. In short: (1) Complaint Counsel have no basis for the assertion that Respondent Khubani has violated the Federal Trade Commission Act and the signing of Consent Orders that expressly reject any such factual finding cannot be used as support for this assertion; (2) there is no demonstrated need for the issuance of a bond requirement in order to ensure future compliance with the Act: indeed, the evidence based on the conduct by Respondents is to the contrary.

CONCLUSION

For the foregoing reasons, the Initial Decision should be reversed and the Complaint dismissed.

Respectfully submitted,



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Dated: January 18, 2005

CERTIFICATE OF SERVICE

I hereby certify that on January 18, 2005, pursuant to Federal Trade Commission Rules of Practice 4.2(c) and 4.4(b), I caused the foregoing RESPONDENTS' BRIEF IN REPLY TO COMPLAINT COUNSEL'S OPPOSITION TO RESPONDENTS' CROSS-APPEAL, AND IN OPPOSITION TO COMPLAINT COUNSEL'S APPEAL to be filed and served as follows:

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

Donald S. Clark, Secretary
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(2) one (1) paper copy served by hand delivery and e-mail to:

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

Edward F. Glynn, Jr.