M E M O R A N D U M

From:
John P. Feldman
Direct Phone: +1 202 414 9230
Email: jfeldman@reedsmith.com

Anthony E. DiResta
Direct Phone: +1 202 414 9488
Email: adiresta@reedsmith.com

Reed Smith LLP
1301 K Street, N.W.
Suite 1100 - East Tower
Washington, D.C. 20005-3373
+1 202 414 9200
Fax +1 202 414 9299
reedsmith.com

To: FRIENDS AND CLIENTS

Date: December 2, 2008

Subject: **Testimonials and Endorsements: Complying with the FTC Guides in Light of Proposed Changes**

One of the most frequent strategies employed by advertisers is to let the consumer hear about the advertised product or service from a third party, someone other than the advertiser itself. At its root, an endorsement or testimonial when used in advertising is the advertiser's way of saying, "Don't just take my word for how wonderful my product or service is, listen to this unbiased person whose opinion you should rely upon to make a purchasing decision." The Federal Trade Commission (FTC or Commission) originally published Guides Concerning the Use of Endorsement and Testimonials in Advertising (The Guides) in 1972. The Guides have not been updated since 1980. In January, 2007, the FTC sought comments on proposed modifications and updates to the Guides. In particular, the Commission sought comments on whether so-called "disclaimers of typicality," statements like "Results not typical" or "Your results may vary," should continue to be a valid way to communicate that a testimonial does not represent experiences consumers will generally achieve with the advertised product or service.

One of the driving forces behind the proposed revision of the Guides, especially with regard to "disclaimers of typicality," was a pair of studies that the FTC had commissioned to examine whether consumer endorsements communicate product efficacy and typicality and whether any of the several prominent disclosures qualify or limit the claims conveyed by the ads (the FTC Testimonial Studies). As briefly discussed below, the FTC Testimonial Studies purport to demonstrate that consumers believe that consumer testimonials convey the message that the endorser's experience with the advertised product or service is representative of what consumers can expect to achieve with the product or service, even when disclaimers of typicality are employed conspicuously.

The Commission received 22 comments last winter, including from the Association of National Advertisers and the Word of Mouth Marketing Association, both of which were written with the assistance of Reed Smith's Advertising Technology and Media Group. These comments were noted by the FTC in its Notice of Proposed Changes to the Guides, which were published on November 21, 2008. The proposed changes will likely become final next spring, subject to any additional comments the Commission receives on or before January 30, 2009.

The purpose of this memorandum is to provide you with an update concerning the Guides and the direction in which the Commission is proceeding as well as to point out the sorts of information the Commission is seeking as it finalizes its amended Guides.

I. WHAT IS A TESTIMONIAL OR ENDORSEMENT THAT IS SUBJECT TO THE GUIDES?

Under the proposed amended Guides, a "testimonial" and an "endorsement" are used interchangeably. There is no substantive difference between the two. An endorsement is "any advertising message . . . that consumers are likely to believe reflects the opinions, beliefs, findings, or experiences of a party other than the sponsoring advertiser. . . ." The revised examples provided with the Guides differ from the 1980 version to underscore that the only relevant criterion in determining whether a statement is an endorsement is whether consumers believe it reflects the endorser's views.

For example, a commercial with two unnamed women (other than in the context of the commercial) discussing the comparative benefits of laundry detergent would not be likely to be viewed by consumers to be an endorsement. It is a fictional dramatization of a real life situation. Thus, it would not be subject to the Guides. In contrast, an advertisement for golf balls showing a well-recognized professional golfer practicing numerous drives off the tee would be likely to communicate that the golfer endorses the golf balls, even if the golfer makes no verbal statement about the balls in the commercial. The test is whether consumers acting reasonably would be likely to understand the commercial to be expressing the opinions, beliefs, finding, or experiences of someone other than the sponsoring advertiser.

II. WHAT SUBSTANTIATION DOES THE ADVERTISER NEED TO POSSESS AND RELY UPON IF IT USES A TESTIMONIAL/ENDORSEMENT?

The rule of thumb for substantiation of a testimonial is two-fold: (1) the testimonial must reflect the honest opinions, findings, beliefs, or experience of the endorser; and (2) the testimonial must not convey any express or implied representation that the advertiser could not have made directly. It follows that the advertiser must possess and rely upon substantiation for the claims made through endorsements. Failure to have substantiation for representations made in the context of testimonials would subject the advertiser to liability under Section 5 of the FTC act just like failure to have substantiation for the advertiser's own statements.

The issue of whether the endorser actually is speaking from experience comes into focus acutely in the blogosphere. Consider the example of a skin care products advertiser who decides to use blog marketing service as a strategy for reaching its target audience. The service matches up advertisers with bloggers who will promote the advertiser's products on their personal blogs. The advertiser requests that a blogger try a new body lotion and write a review of the product on his blog. The blogger writes on his blog that the lotion cures eczema and recommends the product to his blog readers who suffer from this condition. The advertiser did not give the blogger any specific information about the lotion's ability to cure skin conditions and the blogger did not ask the advertiser if there was any substantiation for such claim. In this case, the advertiser would be subject to liability for false or unsubstantiated statements made through the blogger's endorsement.

Liability may extend to the endorser as well as to the advertiser. In the example above, the blogger was disseminating claims without any substantiation, indeed, without even asking whether such substantiation existed. In that case, the blogger would be liable for false advertising as well.

So what should an advertiser do in the case of blogs? The Commission offers suggestions in the Guides on this point. To limit potential liability in this context, the advertiser should ensure that the advertising service provides guidance and training to its bloggers concerning the need to ensure that statements they make are truthful and substantiated. The advertiser should monitor bloggers who are being paid to promote its products and should take steps necessary to halt the continued publication of deceptive representations when they are discovered.

A. Substantiation of Consumer Endorsements

Under the 1980 Guides, an advertisement employing an endorsement reflecting the experience of an individual or group of consumers on a central or key attribute of the product or service is always interpreted as representing that the endorser's experience is representative of what consumers will generally achieve with the advertised product in actual, albeit variable, conditions of use. If in fact the experience presented did not reflect that which consumers would generally be able to achieve, then the advertiser could either (1) clearly and conspicuously disclose what the generally expected performance would be in the depicted circumstances, or (2) disclose the limited applicability of the endorser's experience to what consumers may generally expect to achieve. It was under this second branch of the existing Guide that advertisers used with confidence disclaimers such as "results not typical," "results may vary," or similar statements that sought to inform consumers how rare or extreme the featured results were.

The Commission is proposing to do away with the "safe harbor" for "disclaimers of typicality" as well as the definitive statement that every consumer endorsement is interpreted as representing that the endorser's experience is representative of what consumers will generally achieve with the advertised product or service.

1. Not all consumer endorsements represent typical experiences – but most do.

The latter change simply amends the Guide on consumer endorsements to state that an advertisement employing an endorsement reflecting the experience of an individual or group of consumers on a central or key attribute of the product or service *will likely be* interpreted as representing that the endorser's experience is representative of what consumers will generally achieve with the advertised product in actual, albeit variable, conditions of use. This change emphasizes that the Commission in any case that it brings alleging a false or misleading endorsement must prove that the endorsement communicates that the consumer's experiences are representative of what consumers can generally achieve with the advertised product. One should not find too much comfort in the apparent restraint shown by the Commission. The FTC always had the burden of proving falsity or deceptiveness and it is likely to find that consumers will take away a representation of typicality in all but the most extreme instances. (The Commission's Notice of Proposed Changes to the Guides suggests an example in which an advertisement for a casino depicts a person who won $100,000 on a slot machine. In that context, according to the FTC, consumers are not likely to take away a message that the person's experience is typical of visitors to the casino. Similar examples may be hard to find.)

2. Advertisers may no longer rely on "disclaimers of typicality."

It is the former change – the removal of the "safe harbor" for "disclaimers of typicality" – that will likely create new challenges for advertisers. Under the proposed amended Guides, if an advertiser does not have substantiation that the endorser's experience is representative of what consumers will generally achieve, then the advertisement should clearly and conspicuously disclose the generally expected performance in the depicted circumstances, and the advertiser must possess and rely on adequate substantiation for that representation. The FTC expressly states that it is not prepared to say that a disclaimer is a *per se* violation of Section 5 of the FTC Act; however, based on the FTC Testimonial Studies, the Commission believes that disclaimers such as "results not typical" and the like will not be effective most of the time. An advertiser hoping to rely on such "disclaimers of typicality" will need to possess reliable empirical testing demonstrating that the net impression of the advertisement with such disclaimer is non-deceptive in order to avert initiation of an enforcement action.

Assuming that most disclaimers of typicality will no longer be effective, an advertiser seeking to present a consumer endorsement for which the advertiser does not possess substantiation of typicality must disclose the generally expected performance in the depicted circumstances. What will that mean for advertisers and what is "typical"?

Generally, this means that most advertisements containing consumer endorsements would have to present experiences that are representative of what consumers can generally expect to achieve using the advertised product or service or must include an indication of what consumers would typically experience when using the product.

For example, assume that an advertiser disseminates an advertisement for heat pumps. In the ad, the sponsor presents endorsements from three individuals who state that after installing the company's heat pump their monthly utility bills went down by $100, $125, and $150, respectively. The Commission would likely find that these statements purport to be representative of what consumers who buy the sponsor's heat pumps can generally expect. In fact, the sponsor's data shows that less than 20% of purchasers will save $100 or more. If the sponsor were to add a disclaimer reading "Results not typical" or "These testimonials are based on the experiences of a few people and you are not likely to have similar results," the Commission would likely find the disclaimer to be ineffective and the advertisement to be deceptive and unsubstantiated. If, on the other hand, the advertiser instead disclosed "The average homeowner saves $35 per month," "the typical family saves $50 per month during cold months and $20 per month in warm months," or "most families save 10% on their utility bills," then the Commission would be less likely to find the endorsement to be misleading.

From this example, and from the Notice of Proposed Change to the Guides, it is evident that if the endorsement reflects an experience that is likely to occur 20% of the time or less, then an endorsement that conveys a message of typicality will likely be found by the FTC to be false or misleading. If a 20% incidence level is atypical, then what is typical? The Commission suggests in its Notice of Proposed Change to the Guides that it believes that some percentage at or about 50% will suffice for a showing of typicality. The FTC's Deception Policy Statement states that "a material practice that misleads a *significant minority* of reasonable consumers is deceptive." Thus, if it can be shown that about half of the targeted consumers are not misled into believing that the presented endorsement reflects typical results then the advertisement should not be deceptive. In the FTC Testimonial Studies, the researchers

found that even with disclaimers of typicality, large percentages of respondents viewing a consumer endorsement believed that the consumer endorsement tested communicated a message that "at least half" of the people who try the product will achieve the advertised results. The Commission states in the Notice of Proposed Change to the Guides that "in lay terms, 'about half' is consistent with the concept of generally expected results. . . ." The Commission does not present any definitive numerical standard for what is "generally representative" but clearly puts weight on the finding of the FTC Testimonial Studies that showed that consumers interpret testimonials to convey that about half of new consumers could expect the claimed results.

3. Requiring disclosure of typical results could pose challenges.

This could place advertisers in a difficult position. Unless an advertiser can determine what the expected results of about half of its customers would be, it may not be able to use a testimonial at all. When commenters raised concern about the cost of tracking consumers' experiences with their products, the Commission responded that it believed that "in the vast majority of cases – particularly those for legitimate products and programs whose efficacy has already been demonstrated by competent and reliable scientific evidence – that information is likely to be present." The Commission went on to suggest that advertisers might limit the testimonial statement to a subset of users for which it can determine the typical results. For example, the Commission suggests that an advertisement depicting the atypical results of women who used a weight-loss program for a year could clearly and conspicuously disclose the average results of women who remained in the program for a year. Finally, the Commission suggested that an advertiser who is unable to figure out what is typical could describe the endorser's experience with such detail as to communicate that her experience is actually unique. For example, in an advertisement for a weight-loss product featuring a formerly obese woman, the ad might state, "Every day, I drank 2 WeightAway shakes, only ate raw vegetables, and exercised vigorously for six hours at the gym. By the end of six months I had gone from 250 pounds to 140 pounds." Assuming that this accurately describes the woman's experience and that such a result is within the range that would be generally experienced by an extremely overweight individual who consumed WeightAway shakes, only ate raw vegetables, and exercised as the endorser did, then the ad would not convey that consumers who weigh substantially less or use WeightAway under less extreme circumstances should generally expect to lose something in the vicinity of 110 pounds in six months. In other words, the FTC suggests that if the endorsement itself contains the details that explain the unusual and atypical circumstances of the endorser's experience, there would be no need to disclose what the typical experience would be.

Thus, the Commission's amended Guide will force advertisers to make some tough choices when contemplating the use of testimonials reflecting particularly favorable results. Either an advertiser must be able to determine and disclose what consumers would typically experience or it must revise its testimonial statement to describe the unique conditions under which the favorable results were achieved.

One might assume that this burden would be particularly heavy on those advertisers who are presenting the results for a new product that does not have a track record. The FTC contemplates that this proposed change to the Guides could impede "newly established companies" or those introducing new products; however, it states "such an outcome would not necessarily be inappropriate." Just because the company is new or the product has no track record does not mean that the advertiser has the right to tout atypical results in a manner that suggest that such results are typical.

As a final point, the Commission highlights that even if the advertiser is fastidious about keeping records and carefully discloses the typical range of efficacy or experiences that consumers are likely to achieve with the advertiser's product or service, the testimonial would still be deceptive if the advertiser had no basis for believing that the results or experiences expressed by the endorser had actually occurred or could occur. For example, if an ad for a cholesterol-lowering product features an individual who claims to have reduced her serum cholesterol level by 120 points without any lifestyle changes, then the advertiser needs to have support that the product *is capable of causing the specific results* claimed by the endorser, even if the advertiser discloses that generally people experience a 15% drop in serum cholesterol with the product. Thus, if the advertiser knows or should know that the experience claimed by the endorser is impossible or highly unlikely, then it should not use the testimonial at all.

It is entirely possible that there are categories of products or services for which the requirement to substantiate and disclose that which is typical in order to express that which is atypical will impose an unacceptable burden to the degree that testimonials will no longer be possible at all. The time to put these examples on the record is now. The comment period for these proposed changes ends on January 30, 2009.

B. Substantiation of Expert Endorsements

The general requirements apply to expert endorsements: (1) the testimonial must reflect the honest opinions, findings, beliefs, or experience of the endorser; and (2) the testimonial must not convey any express or implied representation that the advertiser could not have made directly. As with all testimonials, the advertiser must possess and rely upon substantiation for the claims made through endorsements. How is this applied to circumstances in which the endorser is an expert? What special considerations must be taken into account?

1. The endorsement must reflect the expert's "expert" findings and experience.

Whenever an advertisement represents that the endorser is an expert with respect to the endorsement message, the endorser's qualifications must in fact give the endorser the expertise that he or she is represented as possessing with respect to the endorsement. Moreover, the expert endorser must exercise his expertise in evaluating the product's features or characteristics that are relevant to the ordinary consumer.

For example, an endorser of a hearing aid who is referred to simply as "Doctor" during the course of the commercial would likely be understood by consumers to be a medical doctor with substantial experience with audiology. If that is not the case, then the advertisement would be deceptive. Although a non-medical doctor could endorse a hearing aid product, the advertiser would have to disclose the nature and limits of the endorser's expertise.

Similarly, a medical doctor who in an advertisement states that a particular drug will safely allow consumers to lower their cholesterol by 50 points, but has based his opinion on letters from satisfied consumers or the result of an animal study, would not have exercised his expertise appropriately or in a manner that would support the endorsement. In that case, the endorsement would likely be deceptive

assuming that those materials are not what others with the same degree of expertise would consider adequate to support this conclusion about the drug's safety and efficacy.

Expert endorsers can be organizations, too. Consider a manufacturer of automobile parts who advertises that its products are approved by the "American Institute of Science." From the name of the organization, consumers can reasonably assume that the American Institute of Science is a bona fide testing organization with expertise in judging automobile parts. If that is not the case, then the advertisement would be deceptive. Even if it were a bona fide expert testing facility, the endorsement could be deceptive if the organization simply licensed its name to the advertiser and did not conduct scientific tests that support the endorsement message. This example is instructive for another reason: if the American Institute of Science was a bona fide expert in evaluating automobile parts and conducted scientific tests that supported the endorsement message, then the endorsement itself would have been all the substantiation needed for the claim. The amended Guides make clear that "a valid endorsement by an expert endorser may constitute all or part of an advertiser's substantiation, depending on the claim."

Experts can make determinations for a number of reasons. If there is a particular reason for the endorsement omission of which could mislead consumers, then the advertisement would be deceptive. For example, a manufacturer of a non-prescription drug product advertises that its product was selected over other competing products by a large metropolitan hospital. The hospital selected the advertiser's product because it has unique individual packaging for each dose. This packaging form was available to hospitals and other health providers but not to consumers generally. A claim that the hospital chose the advertiser's drug over its competitors' products would be deceptive because the basis for the hospital's choice – the convenience of the packaging – is neither relevant nor available to consumers, and it is not disclosed to consumers.

2. An endorser may be subject to liability for his statements.

As was noted in the example mentioned above concerning bloggers, those who make endorsements can be liable along with the advertiser on whose behalf the endorsement is given. The FTC has brought law enforcement actions against expert as well as celebrity endorsers. Consider an advertisement for an acne treatment featuring a dermatologist who claims that the product is "clinically proven" to work. Before giving the endorsement, she received a write-up of the clinical study in question, which indicated that the there were flaws in the design and conduct of the study so serious that they preclude any conclusions about the efficacy of the product. Not only would the advertiser be liable but the dermatologist would also face liability.

III. When Can an Advertiser Pay an Endorser?

Another core principle in the 1980 Guides, which remains in full force, is that advertisers are subject to liability for failing to disclose material connections between themselves and their endorsers if such connections might materially affect the weight or credibility of the endorsement. That means that an advertiser does not need to disclose a payment to an endorser if the consumer ordinarily would expect the endorser to have been compensated for his endorsement. For example, consumers ordinarily will expect that endorsers who are well-known personalities (i.e., celebrities) or experts will be compensated for their endorsements. Therefore, unless the advertiser represents that a celebrity or expert endorser has

given an endorsement without compensation, the advertiser need not disclose the payment of compensation to that endorser. Currently, under the 1980 Guides, celebrities and experts are treated the same in that the Guides make no distinction between an endorser who receives a flat fee for the endorsement and one who earns a royalty for each product sold after the ad containing the endorsement is disseminated.

A. Expert Compensation

The proposed amendments to the Guides change this by treating celebrities and experts differently with regard to how they are compensated. With regard to celebrities, consumers always assume they are being paid, and it generally is not relevant to consumers how or how much they are paid for their services in the context of conventional advertising. Thus, even if a royalty is paid to the celebrity for each product sold, that need not be disclosed. In contrast, the nature or amount of an expert's compensation might be relevant to consumers, according to the Commission. Specifically, the FTC is proposing and is seeking comment on a recommendation that if consumers know that an expert has a significant financial interest in the sales of the advertised product (such as an ownership interest in the company or compensation based on product sales), this information may likely affect their assessment of the expert's credibility and would require disclosure. Thus, under the proposed revisions to the Guides, an expert can be paid for his endorsement, but if his compensation is other than a flat fee or is somehow related to the success of the advertiser or the sale of the advertised product, then the Commission would be likely to require disclosure of that compensation relationship because it could affect the weight or credibility that consumers would give to the endorsement.

The Commission received comments from a coalition of Attorneys General stating that the current Guides unwisely (and somewhat inconsistently) permit an advertiser to help defray the costs of a research project conducted by a third party research organization without disclosure of the payment of expenses. The FTC has not proposed a change to this approach in the current Notice of Proposed Change to the Guides; however, it is asking for comments on this comment from the Attorneys General. Unless it receives some reasons why advertisers should not have to disclose the payment to an outside research group that tests their products and ultimately is named as the source of research that supports the advertiser's claims, it is possible that the Commission will revisit this point and may in its final preparation of the revised Guides determine that disclosure is required to avoid deception.

B. Celebrity Compensation

With regards to celebrities, as stated above, in traditional advertising, it is always assumed that they are being paid and consumers do not care how or how much they are paid. But what about situations in which celebrities go on talk shows or other television programs and are compensated for touting the performance of brand-name products? Under the revised Guides, a celebrity's financial connection to the advertiser must be disclosed in the context of a routine interview if he or she makes an endorsement. For example, consider a television talk show during which the host introduces a well-known professional tennis player. During the course of the interview, the tennis player mentions her corrective vision surgery at a named clinic, and she attributes her recent success to that service. She describes the service in detail, noting her speedy recovery and how she can now engage in a variety of activities even at night. In this situation, the Commission states that the failure to disclose that she has a contract with the eye vision clinic, which pays her to speak publicly about the service, would likely be deceptive.

If, on the other hand, the tennis player was wearing clothing bearing the trademark of an athletic gear company with whom she has an endorsement contract that requires her to wear clothing bearing the insignia in public appearances when possible, that would not require any disclosure because she is making no representation about the gear in this context.

This new disclosure requirement for celebrities could pose some challenges not only for the celebrities and advertisers, but also for the television shows that may want to control how and when such disclosures are made. The Commission is requesting comments on this new approach in the Guides.

C. Consumer Compensation

What about consumers? Can an advertiser pay them for appearing on camera and endorsing the advertiser's product or service without running afoul of the Guides? The general rule is that an advertiser cannot pay or otherwise compensate a person to give an endorsement without disclosing the material connection. That said, if the advertiser is filming using a "hidden camera" or otherwise gets an unsolicited testimonial without any promise of payment or other consideration, and then asks the person to use the endorsement statement in advertising in exchange for payment, that payment does not need to be disclosed because the endorsement had been expressed without any promise of compensation.

The world of consumer endorsements has changed in the last 15 years and the FTC has proposed additional examples that address compensated blogs, message boards, and "street team" word-of-mouth marketing strategies.

1. Free samples for testing constitute a material connection.

Consider a college student who has earned a reputation as a video game expert and who maintains a blog on which he posts entries about his gaming experiences. Readers of his blog frequently seek his opinions about video game hardware and software. A video game manufacturer sends the student a free copy of the game system and asks him to write about it on his blog. He tests the gaming system and writes a favorable review. The Commission states that the blogger should have to disclose that he received the gaming system free of charge. The fact that he had been given the value of the video game system would "likely materially affect the credibility" of his endorsement.

2. Postings on message board must disclose connection with advertiser.

Similarly, consider an online message board for discussion of new music download technology that is frequented by MP3 player enthusiasts. They exchange information about new products, utilities, and the functionality of various playback devices. Without disclosure to the community, an employee of a leading MP3 manufacturer begins to post messages on the board promoting the manufacturer's product. Because knowledge that the poster was employed by the MP3 manufacturer would likely affect the weight or credibility of his endorsement on the message board, failure to disclose his relationship to the manufacturer would likely be deceptive.

3. "Street teams" members must disclose their incentive structure.

Finally, an individual signs up to be part of a "street team" program in which he gains points every time he talks to his friends about a particular advertiser's products. Team members can exchange their points for prizes such as concert tickets or electronics. These incentives would materially affect the weight or credibility of the team member's endorsement. Accordingly, the incentives should be disclosed and the advertiser who is sponsoring the street team should take steps to ensure that such disclosures are made.

Each of these three new examples set forth in the Guides are consistent with self-regulatory principles championed by the Word of Mouth Marketing Association (WOMMA), which expressly discourages concealed relationships between endorsers and advertisers and promotes transparency in these new forms of one-to-one marketing.

* * *

If you have questions about the FTC's proposed revisions to the Guides, please do not hesitate to us or one of our other advertising lawyers. We will be happy to walk through a specific scenario with you. Furthermore, if you have comments you wish to place on the record, please let us know as soon as possible. Again, the deadline for filing comments on these proposed revisions to the Guides is January 30, 2009.

JPF

AED