A BASIC OVERVIEW OF FRANCHISE AND CONSUMER ADVERTISING STANDARDS

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I. INTRODUCTION

All franchisors use some form of advertising—be it word of mouth, television spots, the Internet or other media communications—to recruit new franchisees and generate initial and repeat consumer business. This paper explores applicable procedures, requirements and prohibitions associated with franchise and consumer advertising, and identifies key principles with which all franchisors must comply. In particular, Section II of this paper addresses franchise sales advertising, including advertising trends, state filing requirements and content restrictions, unique advertising disclosure issues, and applicable exemptions and exclusions. Section III of this paper focuses on a plethora of consumer advertising issues, which all franchisors and franchisees must be aware of and address in their efforts to advance their products/services and brands through consumer advertising.

II. FRANCHISE SALES ADVERTISING

A franchisor's ability to attract qualified franchisees and maintain a solid franchisee base is central to the ongoing success of the franchise system. Consequently, every franchisor uses franchise sales advertising at some level. Moreover, given that franchising is highly regulated at both the federal and state level, it comes as no surprise that various states regulate franchise advertisements by imposing a filing requirement and dictating certain prohibitions related to the content of the advertisements. In addition, although the Federal Trade Commission (“FTC”) largely is silent with respect to franchise advertisements, the FTC's Disclosure Requirements and Prohibitions Concerning Franchising (the “Franchise Rule”)\(^1\) provide clear guidance with respect to one important area in the franchise sales advertising context—general media claims.

This section of the paper explores the different types of franchise sales advertising, including notable advertising trends, and summarizes the filing protocol and content restrictions imposed by various states. It also addresses the FTC’s stated prohibitions and requirements concerning general media claims. Finally, it offers a reference chart summarizing the state franchise sales advertising requirements, which franchisors can use to help ensure compliance with these laws.

A. Types of Advertising to Solicit Franchisees

Franchise sales advertisements start with some basics: The who, what and where regarding the franchise opportunity offered. Franchisors next select the medium for the advertisement based upon a variety of factors, including the intended audience, number of readers or listeners, visibility and past experience. The content of the franchise sales advertising may be tailored for the particular medium, if necessary. Moreover, given the fierce competition for leads, franchisors rarely rely on just one method of advertising to generate franchisee leads. Instead, most franchisors use a combination of the following media to attract the interest of potential franchisees in an effort to deliver the right message to the right audience at the right time.

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1. **Internet**

Over the past ten years, franchisors’ use of the Internet to generate leads has increased significantly. In fact, one study found that franchisor spending on Internet advertising more than tripled between 1999 and 2007. This same study reported that by 2007, the average franchisor devoted nearly half of its recruitment budget to Internet advertising. The increased use of the Internet by franchisors is attributed, in part, to the combined effect of technological advances and a commitment from franchisors to use that technology to grow their respective franchise systems. For example, even an abbreviated Internet search reveals an abundance of franchisee recruitment advertisements placed by franchisors with various industry-specific websites, such as FranchiseGator.com or Bison.com. In addition, franchisors continue to find ways to expand their e-presence through various methods, including the use of banner ads, which redirect the potential franchisee to the advertiser’s website when clicked by the prospect. The general search engine, Google, also remains a dominant force in Internet advertising.

Despite the increased use of the Internet for lead generation purposes and the Internet’s ranking as the number one franchise sales producer, typically the leads generated through this form of media—although large in number—lack quality on a per lead basis. Accordingly, franchise systems that historically have realized quality leads and have seen steady growth through the use of the Internet rarely rely on Internet leads alone. Instead, most franchisors use the Internet as a supplement to their current advertising practices by combining its use with a more traditional media mix that includes various forms of print advertisements (such as brochures or newspaper ads), television or radio spots, broker networks and referrals from existing franchisees.

2. **Referrals from Existing Franchisees**

Although the Internet remains the number one franchise sales producer, candidate referrals from existing franchisees are high on the list of valuable lead generation tools for many franchisors. Existing franchisees are invested in the franchise system: They know what it takes to operate the franchised business successfully, realize the power of numbers in terms of brand recognition/awareness, and are eager to share their excitement about the brand and

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3. *Id*. at 11.

4. By one author’s count, over 100 Internet portals are dedicated to franchising. See Mark Siebert, *The Frog Kissing Business: Getting the Most Out of Internet Frogs*, FRANCHISE TIMES, June-July 2008, at 70.

5. Franchise Update Media Group, *supra* note 2, at 8.

6. *Id*. at 7, 12.

7. See *id*. at 19, 28, 35, 40, 46, 53, 60, 67, 82, 96 and 104; see also Mark Siebert, *supra* note 4, at 70.


9. *Id*.

10. *Id*. at 7, 12.

11. *Id*. at 7.
system with others. Not surprisingly, since the existing franchisees know what it takes to succeed in the system, referrals from existing franchisees often are for well-qualified, quality candidates. Accordingly, candidate referrals often result in the highest lead-to-close ratio.\footnote{Id. at 19.}

Referrals from existing franchisees are generated in a variety of ways. Some franchisors sponsor formal lead generation or “bonus” programs for existing franchisees who refer new prospective franchisees to the franchisor. These programs incentivize existing franchisees to pass along information about potential new franchisee candidates. If the franchisor eventually closes a deal with the referred candidate, the existing franchisee receives a benefit from the franchisor, usually in the form of monetary compensation (although some franchisors reward referring franchisees with trips and other similar items of value). Franchisors with formal referral programs should place reasonable limits on the rewards offered to referring franchisees, however. Such limits would encourage these franchisees merely to pass along to the franchisor the name of interested, qualified candidates rather than engaging in activities or discussions that could be considered “offering” or “selling” the concept, such as by overstating earnings to increase the likelihood of a new franchise sale.

Absent a formal lead referral program, referrals from existing franchisees equate to cost-free advertising for the franchisor as these referrals entail no direct out-of-pocket recruitment expense to the franchisor. Additionally, the best quality referrals most often come from franchisees whose only incentive in passing along leads to the franchisor is to continue to grow the brand with quality franchisees. Equally as important, the absence of a formal lead referral program avoids the slippery slope that occurs when franchisees go beyond merely passing along information to the franchisor about prospective candidates and, instead, assume an informal sales role simply to enhance the likelihood of receiving a benefit.

3. **Broker Networks**

Franchisors increasingly rely on broker networks to generate franchise sales leads. In fact, franchisors identified broker networks as the third top franchise sales producer for 2007, behind only the Internet and referrals from existing franchisees.\footnote{Id. at 13.} Moreover, in a survey of 156 franchise companies, one study reported that 42 percent of franchisors relied on broker networks to locate potential franchisee candidates.\footnote{Id. at 8.} Of that 42 percent, a vast majority—82 percent—reported closing deals with the broker-referred candidates.\footnote{Id.}

Franchisors often use brokers as a supplement to existing internal franchise development activities, a trend that may be driven by a combination of franchisors wanting to control the franchise sales process and to keep recruitment costs under control. Other franchisors, such as new or emerging franchisors with little infrastructure, may rely on broker networks exclusively to locate potential franchisee candidates.\footnote{This trend is not unique to emerging franchisors. Mature franchisors also sometimes outsource their franchise development efforts to reallocate resources and better support the franchise system in other areas, including, for example, real estate and operational support. See Kurt Landwehr & Brian Schnell, *A Different Perspective on Outsourcing Franchise Sales*, FRANCHISE TIMES, August 2007, at 56.} When used correctly, broker

\footnote{Id. at 19.}

\footnote{Id. at 13.}

\footnote{Id. at 8.}

\footnote{Id.}

\footnote{This trend is not unique to emerging franchisors. Mature franchisors also sometimes outsource their franchise development efforts to reallocate resources and better support the franchise system in other areas, including, for example, real estate and operational support. See Kurt Landwehr & Brian Schnell, *A Different Perspective on Outsourcing Franchise Sales*, FRANCHISE TIMES, August 2007, at 56.}
networks are a valuable source of franchise sales advertising. To be most effective, however, the broker must be knowledgeable about the franchisor’s system, culture, product or service, and goals, and it must be aware of (and comply with) the patchwork of legal obligations dictated by federal and applicable state law.

4. **Print Advertisements**

Once the most popular form of franchise sales advertising, print advertisements have lost some appeal in recent years as the top franchisee recruitment tool. In 1999, franchisors invested four times more on print advertising than on Internet advertising. By 2003, however, franchisors’ use of the Internet as the primary franchise recruitment tool began to surpass print spending and the growth of the Internet as a franchise advertising tool has not slowed since. Nevertheless, recognizing the historical impact of print advertising on franchise sales, franchisors generally continue to devote at least some portion of their annual recruitment budgets to print advertisements.

The steady use of print advertisements over time also may be due to the many possible formats that print advertisements can take, the ability to target specific audiences and repetition of message. Common forms of print advertisements include, among others, information included in brochures, trade magazines, regional and national newspapers and direct mail fliers. While the message in each form of print advertisement may be substantially similar if not exactly the same, the manner in which the advertisement is delivered differs significantly.

Recognizing that one type of print advertisement does not speak to all audiences, franchisors that use print advertising often rely on multiple forms of advertisements to communicate the same message in an effort to target different candidate bases. A franchisor that places a franchise advertisement in the *Wall Street Journal* or *Nation’s Restaurant News*, for example, likely targets a more sophisticated (and likely more qualified) franchisee candidate than the franchisor that relies solely on the use of regional newspapers or publications. The combined use of these media, however, allows the franchisor to tap multiple lead generation avenues, ferret out serious inquiries from the mere exploratory, and explore its options with all qualified candidates irrespective of whether they originated from the financial section of a national newspaper or the classified section of a regional magazine.

5. **Television, Radio and Other Communications Media**

At least six franchise regulation states expressly define a franchise “advertisement” to include television, radio and other communications media used in connection with franchise sales advertising. Depending on the geographic area covered by the medium, a franchisor’s...
use of television, radio and other communications media can dramatically increase the potential base of potential franchisee candidates that have access to the advertisements. Despite the lack of detailed analysis or data supporting franchisors’ use of these media forms, franchisors that use television, radio and other similar communications media in connection with franchise sales efforts likely focus on key television and radio markets where they wish to expand. Further, it is very likely that franchisors who use this type of media do so as a supplement to other forms of franchise sales advertising.22

6. **Trade Shows**

Trade shows remain a popular franchise recruitment tool in that these venues foster personal contact with the franchisor’s representatives and the ability to target potential candidates in a particular region or area.23 Most franchisors view trade shows as a supplement to their other franchise sales efforts.24 In large part, the use of trade shows as a supplement to existing franchise sales efforts results from the fact that trade shows often bring a mixed bag of attendees (and franchise sales results)—some trade show attendees are ready to purchase a concept while others are just beginning the process of learning about franchise opportunities in general.

7. **Telemarketing**

Franchisors rarely, if ever, use cold-call telemarketing in connection with franchise sales. Some franchisors, however, may use telemarketing to follow up on leads generated through other forms of advertising especially if the franchisor lacks an internal franchise development team.25 Although follow up telemarketing calls may maintain a prospect’s interest in the system, franchisors must ensure that the telemarketer knows enough about the franchise system to make the personal contact worthwhile.

8. **General Media Claims as an Advertising Tool**

Prospective franchisees routinely ask franchisors one key question during the sales process: “How much money can I make?” Franchisors that include financial performance representations in Item 19 of their disclosure document often use this information in their franchise sales advertising to attract prospective franchisees.26 Financial performance representations used in this manner are called “general media claims” and are subject to the heightened disclosure requirements identified below.27 “General media” includes all forms of

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22 Franchise Update Media Group, supra note 2, at 11-12.

23 Joel Goldstein, *Expos: Producing Leads for Top Franchisors*, FRANCHISING WORLD, July 2008, at 27-28. The author notes that trade shows produce not only leads but general brand awareness due to the typically high number of attendees.

24 Telephone Interview with Dawn Lawin, supra, note 20.

25 Id.

26 A financial performance representation is “any representation, including any oral, written or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits.” 16 C.F.R. § 436.1(e) (2008) (emphasis added).

27 Ordinarily, statements made in publicly filed information submitted to the Securities and Exchange Commission as well as speeches, press releases and bona fide news stories are not considered “general media claims”—and,
advertising, such as television, radio, print (i.e., magazines, newspapers, journals), billboards, and web-based advertisements. Before using a general media claim in its franchise advertisements, however, franchisors must adhere to certain disclosure obligations unique to this form of advertising.

The Franchise Rule prohibits franchisors from making a general media claim absent three preconditions: (1) there is a reasonable basis for the information; (2) there is written substantiation for the representation at the time the representation is made; and (3) the representation, including the material bases and assumptions, appears in Item 19 of the franchisor’s most current disclosure document. In addition, the Franchise Rule requires franchisors to make specific disclosures applicable to general media claims. These disclosures include:

- the number and percentage of outlets from which supporting data for the representation were gathered that actually attained or surpassed the represented level of financial performance;
- the time period when the performance results were achieved; and
- a clear and conspicuous admonition that a new franchisee’s results may differ from the represented performance.

At the very least, franchisors that use general media claims in their franchise sales advertising “must furnish any prospective franchisees with the required Item 19 disclosures while the advertisement is running.” Even after the advertisement is pulled from circulation, the franchisor must continue to disclose the Item 19 information for at least six months. If the franchisor updates the financial information in its franchise advertisement, the updated information—including the material bases and assumptions for the new figures—must appear in Item 19 of the franchisor’s disclosure document. In short, franchisors must ensure the accuracy of all financial performance information provided to prospective franchisees in the general media. Franchisors also must ensure that all financial performance information provided in the general media is consistent with Item 19 of the franchisor’s most current disclosure document.

therefore, the heightened disclosure requirements applicable to such claims are inapplicable—unless the representations are specifically directed at members of the public interested in purchasing a franchise. See Fed. Trade Comm’n, Franchise Rule Compliance Guide 133 (2008).

29 Fed. Trade Comm’n, supra note 27, at 133.
30 Id. at 134.
31 Id.
B. Franchise Advertising Issues Under State Law

Eleven franchise regulation states govern the content of franchise sales advertising. Of those eleven states, seven require the franchisor to file one or more copies of franchise sales advertising that will appear in the state prior to using (or publishing) the advertising in the state. Advertising filed with these states generally is deemed approved unless the state objects within a specified period of time, however, examiners may—and often do—comment on the content of the advertisements. If the state issues comments, the advertisements cannot be used in that state until the comments are resolved. As noted further below, applicability of the content restrictions and filing requirements under state law rests on one key assumption: That the advertisement in question is used in connection with the offer or sale of a franchise.

1. Definition of Franchise “Advertising” and “Offer”

It goes without saying that franchisors must not offer or sell franchises without first complying with any state-imposed franchise registration requirements. In connection with the preparation and filing of each franchise registration application, the franchisor must determine whether applicable state statutes regulate the franchisor’s use of franchise sales advertising in that particular state. Accordingly, the proper analysis focuses on whether the franchisee recruitment materials are an “advertisement” and, if so, whether that advertisement constitutes an “offer” under state law. If the materials fall within these definitions, then the state regulations apply to the materials.

a. Definition of “Advertising”

The first prong of the analysis—the definition of franchise sales advertising—is an element that most franchise recruitment materials easily satisfy given that the term “advertisement” is broadly defined under applicable state laws. Although variances in statutory language exist, most states that regulate franchise sales advertising in some respect define an “advertisement” as:

[a]ny written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television, or other similar communications media, published in connection with the offer or sale of a franchise.


34 See e.g., Md. Code Ann., Bus. Reg. § 14-228(a) (West 2008) (“Except as otherwise provided in this subtitle, a person may not offer to sell, through advertisement or otherwise, or sell a franchise in this state unless the offer of the franchise has been registered under this subtitle.”).

At least one state—Rhode Island—further expands the breadth of possible franchise sales advertising by defining the required “communication” in a simple, unqualified manner: “Advertisement means a communication published in connection with an offer or sale of a franchise.” As evidenced by these broad statutory provisions, franchisor communications that are circulated in these states and even arguably relate to the purchase or sale of franchises constitute “advertising” subject to state filing and content restrictions.

b. Definition of “Offer”

The second prong in the analysis—whether an offer of a franchise has occurred—is a fact-intensive inquiry. This inquiry begins with the basic definition of an offer under applicable state law. The majority of franchise regulation states broadly define an “offer” as any attempt to dispose of or sell a franchise, or interest in a franchise, for value. Notably, these same states overwhelmingly exclude renewals and extensions of existing agreements from the definition of an “offer” so long as there is no interruption in the operation of the franchised business. Minnesota, however, is one key exception to the nearly uniform treatment of renewals and extensions. The Minnesota franchise regulations specifically note that the term “offer” includes renewals and extensions of existing franchise agreements for value.

Once an offer is deemed to exist, the next inquiry for franchisors that wish to advertise in certain states is whether the offer falls within the jurisdiction of any state that regulates franchise advertising. Many franchise regulation states outline precisely the conduct that must occur for an offer to fall within the scope of the applicable statute. The California Franchise Investment Law (“CFIL”), for example, describes in great detail the various ways in which an offer or sale of a franchise is subject to the CFIL’s requirements and prohibitions. Specifically, the CFIL provides that:

i. an offer or sale of a franchise is made in this state when an offer to sell is made in this state, or an offer to buy is accepted in this state, or, if the franchisee is domiciled in this state, the franchised business is or will be operated in this state;

ii. an offer to sell is made in this state when the offer either originates from this state or is directed by the offeror to this state and received at the place to which it is directed. An offer to sell is accepted in this state when acceptance is communicated to the offeror in this state, and acceptance is communicated to the

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38 See id.
offeror in this state when the offeree directs it to this state reasonably believing the offeror to be in this state and it is received at the place to which it is directed.\(^{40}\)

Other states that regulate franchise advertising in some manner, including Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota and Washington, describe the manner by which offers fall within the scope of the respective state franchise statutes in a manner similar to the CFIL.\(^ {41}\) In addition, the Washington Franchise Investment Protection Act ("WFIPA") builds on the statutory language in the CFIL by noting that an offer to sell also is made in Washington when "the offer originates from [Washington] and violates the franchise or business opportunity law of the state or foreign jurisdiction to which [the offer] is directed."\(^ {42}\)

2. **Case Law Where Advertising Constituted an "Offer"**

Although courts rarely have addressed the issue of franchise sales advertising squarely, a 1986 decision from the Washington Supreme Court suggests that it is the act of publishing the advertisement in the state—rather than the franchisor’s conduct in procuring the advertisement for circulation in the state—that constitutes an unlawful franchise "offer" under Washington law. In *Morris v. Int'l Yogurt Co.*\(^ {43}\), former franchisees of the defendant franchisor, International Yogurt Co. ("IYC"), sued IYC for alleged violations of the WFIPA. The former franchisees, Vernon and Marilyn Morris (Morris), specifically alleged that IYC violated the registration requirements under the WFIPA by offering and selling franchises absent first obtaining an effective registration exemption.\(^ {44}\)

At issue was whether IYC properly availed itself of one of two possible exemptions. One exemption required the disclosure of certain information to the franchisee at least 48 hours before executing a franchise agreement ("Disclosure Exemption"), and the other exemption required the sale of less than 10 franchises and a total absence of franchise sales advertising in the state ("Sales Exemption"). After the court held that IYC unsuccessfully attempted to avail itself of the Disclosure Exemption due to a technicality,\(^ {45}\) the Morrises argued that IYC similarly did not satisfy the Sales Exemption requirements.\(^ {46}\) Specifically, the Morrises claimed that IYC’s conduct in placing franchise sales advertising in the Tacoma, Washington telephone book

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\(^{40}\) CAL. CORP. CODE § 31013(a)-(b) (West 2008).


\(^{42}\) WASH. REV. CODE § 19.100.020(2).

\(^{43}\) 729 P.2d 33 (Wash. 1986).

\(^{44}\) The Morrises also alleged that IYC committed fraud when it failed to disclose that the proprietary yogurt mix was sold to third parties other than IYC’s franchisees. *Morris v. Int'l Yogurt Co.*, 729 P.2d at 36-37.

\(^{45}\) The court found that the Morrises’ failure to submit a consent to service of process rendered their attempted notice of exemption ineffective. *Id.* at 36-36.

\(^{46}\) *Id.* at 36.
(“Tacoma Advertisement”) violated the WFIPA’s exemption requirements and, accordingly, resulted in an unlawful offer and sale of a franchise to the Morrises.⁴⁷

In rejecting this argument, the court noted that although IYC arranged for the advertisement in the Spring of 1977 and the Morrises executed a franchise agreement with IYC in June 1977, the Tacoma directory was not actually distributed to the public until August 1977.⁴⁸ Based on these facts, the court held that the Tacoma Advertisement did not constitute an “offer” in violation of the WFIPA because “at the time it sold the franchise to the Morrises . . . the telephone directory had not been distributed to the public.”⁴⁹ As a result, the court held that IYC complied with the Sales Exemption and, accordingly, did not violate the registration requirement under the WFIPA in connection with the franchise offer to the Morrises.⁵⁰

Similarly, in Baker v. Log Systems, Inc.,⁵¹ the court addressed whether the defendant franchisor, Log Systems, Inc. (“LSI”), violated California law related to the offer and sale of a franchise by advertising and selling a franchise to Baker, a California resident, absent an effective registration. Central to the court’s analysis was that Baker was “induced to travel to [LSI’s] office” after reading an advertisement in the San Francisco Chronicle (“Chronicle Advertisement”), through which LSI solicited persons to become franchise dealers of its log homes.⁵² Baker ultimately entered into a dealer agreement with LSI, and incurred start-up costs of $13,000.⁵³ Shortly thereafter, the California Department of Corporations issued a written order requiring LSI to cease and refrain from offering franchises in California absent compliance with the registration and disclosure provisions of California law.⁵⁴ After Baker learned that LSI was not authorized to sell franchises in California, he sued for rescission and damages.⁵⁵ Based in part upon Baker’s testimony that he was “induced” to travel to LSI’s office in North Carolina by the Chronicle Advertisement, the court held that LSI was not authorized to sell franchises in the state.⁵⁶

Finally, although not the central issue in dispute, one Minnesota decision cautions franchisors against issuing pre-registration franchise sales advertisements to Minnesota residents. In Martin Investors, Inc. v. Vander Bie,⁵⁷ the Minnesota Supreme Court affirmed the

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⁴⁷ Id. at 36-37.
⁴⁸ Id. at 34-35.
⁴⁹ Id. at 37.
⁵⁰ The court held that IYC did violate the WFIPA by failing to disclose that the proprietary yogurt mix was available to nonfranchisees. Id. at 40. Accordingly, the court remanded the case to determine whether IYC’s failure to disclose the availability of the proprietary yogurt mix to nonfranchisees resulted in damages to the Morrises. Id.
⁵² Id. at 633.
⁵³ Id.
⁵⁴ Id. at 634.
⁵⁵ Id.
⁵⁶ Id. at 634-35.
⁵⁷ 269 N.W.2d 868 (Minn. 1978).
rescission of a contract and restitution for Martin Investors, former franchisee consultants of Computer Capital Corporation (CCC). In response to advertisements placed in the *Wall Street Journal* and two Minnesota-published newspapers, Martin Investors traveled to CCC's headquarters in California to explore becoming franchisee consultants, participated in long-distance telephone calls and negotiated the parties' agreement through a series of written correspondence between California and Minnesota. Martin Investors ultimately executed a franchise agreement with CCC. After learning that CCC was under investigation for failing to register its franchise with the State of Minnesota, however, Martin Investors sued CCC for rescission and restitution. Despite CCC’s contention that it had not offered or sold franchises within Minnesota, the Minnesota Supreme Court held that CCC’s activities constituted an offer to sell within the state, and that the consulting arrangements that CCC advertised in various publications were indeed franchises. Accordingly, the court awarded Martin Investors rescission and restitution.

*Morris, Baker and Martin Investors* each reveal that, while courts appear hesitant to rest their holdings primarily on the timing of franchise sales advertising, franchise advertising is mentioned readily in support of the holdings where the advertising played a critical role in inducing the franchisee to act. More importantly, these cases reaffirm the long-standing rule that franchisors intending to recruit franchisees in any registration state must first secure an effective registration or exemption.

**C. State Requirements for Franchise Advertising**

If franchise recruitment materials constitute an “advertisement” used in connection with an “offer to sell” franchises in the state, the franchisor must comply with the procedural and substantive state regulations that govern franchise sales advertising. As described below, these regulations impose mandatory filing and waiting periods, unique disclaimers and processes to address specific issues (*e.g.*, public figure endorsement, submission of transcripts, etc.), and significant restrictions on the content of franchise sales advertising. Although the requirements vary by state, they exist for one uniform purpose: To prevent abuses in connection with franchise sales.

1. **General State Requirements**

   a. **Filing and Waiting Periods**

   Seven states—California, Maryland, Minnesota, New York, North Dakota, Rhode Island and Washington—require franchisors to file a copy of all franchise sales advertising prior to publication in the state. After filing the advertisement with the state, and before the franchisor may publish the advertisement in that state, the franchisor must adhere to the applicable waiting period and satisfactorily respond to state comments, if any. The applicable waiting periods range from three to seven days. As described further below, the filing and waiting periods are

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58 At the time of the dispute, section 80C.19, subdiv. 4 (1977) of the Minnesota Franchise Act exempted from the definition of an “offer” newspapers “not published in this state.” *Martin Investors, Inc.*, 269 N.W.2d at 873.

59 *Id.* at 870.

60 *Id.* at 871.

61 *Id.* at 873.
intended to provide state franchise examiners sufficient time to review the advertising for any violations of the state advertising requirements and prohibitions.

As noted more fully in Appendix A, California mandates the shortest waiting period by requiring franchise advertisements to be filed at least three business days prior to publication in the state, while franchisors filing their advertisements in Maryland must do so at least five calendar days prior to intended use. Other states, including North Dakota and Rhode Island, impose a waiting period equal to five business days after filing the advertisement with the appropriate state authorities. Minnesota requires franchisors to file their advertisements five business days prior to intended use in the state, however, Minnesota law also provides that the franchisor may publish the advertisement if the examiner does not issue a comment letter related to the advertisement within three business days after filing. The waiting periods in New York and Washington each are seven calendar days.

In states such as California, Maryland, Minnesota, North Dakota and Washington, the filing requirement and corresponding waiting period may be modified or waived by rule or order of the appropriate state authority. Although Michigan and South Dakota do not impose advertising filing requirements and waiting periods as a matter of course, both states reserve the right to do so by rule or order.

b. State Comments and Process to Address Them

As noted previously, the statutory waiting period for franchise sales advertising affords state authorities a period of time to review the advertisement for compliance with statutory requirements and prohibitions. In the authors’ collective experience, state comments on filed franchise advertisements run the gamut from preventing unlawful financial performance representations to requesting support for statements of fact (e.g., “We are the #1 residential cleaning business in America based on volume of homes cleaned”).

Before filing the advertisement with any state, the franchisor and its counsel should carefully review the advertisement, anticipate the potential issues that are likely to be raised by state examiners, and proactively address them. For example, if the advertisement states that “1 in 7 American households has used a professional housecleaning service in the past 5 years,”

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62 CAL. CORP. CODE § 31156 (West 2008).
63 See MD. CODE ANN., BUS. REG. § 14-225(1) (West 2008) (filing required seven business days before first publication of advertisement unless shortened by the commissioner by rule or order); MD. CODE REGS. 02.02.08.09(B) (2008) (shortening the time required for filing of advertisement to at least five days before intended use).
67 See CAL. CORP. CODE § 31156; MD. CODE ANN., BUS. REG. § 14-225(1); MINN. STAT. ANN. § 80C.09, subdiv. 1; N.D. CENT. CODE § 51-19-10(1); WASH. REV. CODE § 19.100.100.
68 MICH. COMP. LAWS § 445.1524, sec. 24(1) (2008) (“The department may by rule or order require the filing of any advertisement or other sales literature or advertising communication addressed or intended for distribution to prospective franchisees”); S.D. CODIFIED LAWS § 37-5B-23 (2008) (“Unless the director requests the filing of an advertisement, there is no requirement to file the advertising with the division”).
the source for this factual statement should be noted in the advertisement as a footnote. Information in the advertisement also must be consistent with the information in the current franchise disclosure document. Additionally, careful review of the advertisement for compliance with the unique state requirements described below will decrease the likelihood that the state examiner will comment on the advertisement due to franchisor alleged deficiencies.

Despite diligent pre-filing efforts, state examiners may issue written comments on the advertisement. As noted previously, these comments may relate to, among other things, alleged unlawful earnings claims, inconsistencies with the disclosure document, or requests for substantiation of certain factual statements. If the examiner comments on the advertisement, the franchisor must address and resolve those comments prior to publishing the advertisement in that state. Most often franchisors and their counsel can resolve comments through written correspondence or telephone conferences (or a combination of both) with the state examiner.

Unfortunately, the franchisor and examiner may reach an impasse concerning the content of the franchise advertisement despite the franchisor’s best attempts to resolve issues raised by the examiner during the comment and response process. If the impasse results from the examiner’s determination that the advertisement contains allegedly false or misleading content, a specific dispute resolution process is available by statute in Indiana, Minnesota, North Dakota and Washington. In particular, these states permit the franchisor to request a hearing to formally contest the examiner’s finding of false or misleading content. Upon receipt of the franchisor’s written request for a hearing, the state will hold an administrative hearing—typically within fifteen days of the franchisor’s request—to determine whether the state should affirm the prior finding of false and misleading content or rescind such finding and allow the advertisement to be published in the state. If the impasse relates to other issues that cannot easily be resolved between the examiner and franchisor, the franchisor may request to speak with the division head about potential resolutions or remove the offending content completely. Whatever avenue the franchisor pursues, the franchisor may not circulate the advertisement in the state until it addresses all of the issues raised by the examiner.

2. Unique State Requirements

In addition to the filing and waiting period requirements, some states impose other unique disclosure requirements on franchise sales advertising with which franchisors must comply. Four unique disclosure areas are: (a) specific disclaimers that must be included in the advertisement; (b) special rules concerning public figure endorsements; (c) inclusion of information that identifies the franchisor; and (d) necessity to provide written transcripts for audio or video requirements. The requirements applicable to these four disclosure areas are discussed below in greater detail.

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69 To illustrate this point, if the disclosure document states that there are 250 franchisees in the system but only 50 units are actually open for business, the franchise advertisement should not refer to a total franchisee count of 250 without mentioning the much smaller number of operating units. If the franchisor fails to reference the smaller number of operating units, this may suggest to the examiner that the franchisor has overstated its opportunity in an effort to attract potential buyers.

70 See IND. CODE § 23-2-2.5-26 (2008); MINN. STAT. ANN. § 80C.09, subdiv. 2; N.D. CENT. CODE § 51-19-10(2); WASH. REV. CODE § 19.100.110 (2008).

71 See id.
a. Specific Disclaimers and Statements Concerning State Approval/Endorsement

Franchisors should refrain from making statements in their franchise sales advertisements—either express or implied—that their franchise opportunity has been endorsed or recommended by any regulatory authority. As discussed below, three states specifically prohibit such statements from appearing in franchise advertising. These states also mandate the use of specific advertising disclaimers depending on the size and content of the advertisement. Each of these disclaimers is discussed below.

CALIFORNIA

Franchisors advertising in California must be mindful of added disclosure obligations if the franchise sales advertising refers to the status of a franchise registration under the CFIL. If the franchisor’s advertising states or implies that its franchise offering is registered pursuant to the CFIL, the following disclaimer must be included in the advertisement in at least 10-point type and in all capital letters:

THESE FRANCHISES HAVE BEEN REGISTERED UNDER THE FRANCHISE INVESTMENT LAW OF THE STATE OF CALIFORNIA. SUCH REGISTRATION DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION OR ENDORSEMENT BY THE COMMISSIONER OF CORPORATIONS NOR A FINDING BY THE COMMISSIONER THAT THE INFORMATION PROVIDED HEREIN IS TRUE, COMPLETE AND NOT MISLEADING.\(^\text{72}\)

Additionally, if the franchise sales advertising refers to an exemption from or reduction in taxation as a result of purchasing the franchise opportunity, such as through the use of retirement funds, the franchisor must base that statement on “an opinion of counsel, with the name of such counsel stated in the advertisement.”\(^\text{73}\)

ILLINOIS

Although Illinois does not impose an advertisement filing requirement, it does regulate the content of franchise sales advertising by prohibiting statements suggesting that the state endorses the franchise. In fact, the IFDA specifically notes as follows with respect to this issue:

Effect of Registration. The fact that a franchise has been registered by the Administrator is not a finding by the Administrator that the disclosure statement filed with the Administrator in connection with that registration is in any way true, accurate or complete in substance or on its face, or to be held to mean that the Administrator has in any way passed upon the merits or given approval to such franchise. It is unlawful to make, or cause to be made, to any prospective franchisee any express or implied representation contrary to the foregoing or to advertise or to represent that the Administrator approves or recommends any franchise.\(^\text{74}\)

\(^{72}\) CAL. CODE REGS. tit. 10, § 310.156.1(c) (2008).

\(^{73}\) Id. § 310.156.1(f).

\(^{74}\) 815 ILL. COMP. STAT. § 705/14 (2008).
NEW YORK

In New York, the following disclaimer must appear on all franchise sales literature, with one caveat described below:

This advertisement is not an offering. An offering can only be made by a prospectus filed first with the Department of Law of the State of New York. Such filing does not constitute approval by the Department of Law.

The foregoing disclaimer is not required, however, when the franchise sales advertising is less than five inches long by one column wide, or when the advertisement appears in a broadcast equal to thirty seconds or less in duration. In these instances, it is sufficient for the franchisor simply to state that “[t]his offering is made by prospectus only.”

b. Public Figure Endorsement

Although relatively rare, some franchisors use public figures to endorse their franchise offering. Recognizing that public figure endorsement may influence prospective franchisees by virtue of the public figure’s standing alone, certain states—notably California and Washington—impose specific requirements related to the use of public figures in franchise sales advertising.

75 Specifically, the disclaimer must appear “on the cover page of all circulars, flyers, cards, letters and other literature employed in connection with soliciting interests in the franchise offering.” N.Y. COMP. CODES R. & REGS. tit. 13, § 200.9(e) (2008).

76 Id. § 200.9(d).

77 Id. § 200.9(f).

78 Id.

79 A public figure “means a person whose name or physical appearance is generally known to the public in the geographic area where the franchise will be located.” 16 C.F.R. § 436.5(r)(4) (2008). Using a public figure, however, “to promote a system’s products or services sold to consumers does not bring a franchisor within the ambit of the Rule’s Item 18 requirements.” Fed. Trade Comm’n, supra note 21, at 84.

80 As noted in the Statement of Basis and Purpose, “a public figure pitchman’s endorsement of a franchise system may create the impression that the franchise system is sound or a low risk. How much weight a prospect may give a public figure endorser’s pitch may vary with the level of compensation received from the franchisor.” Federal Trade Commission, Statement of Basis and Purpose 16 C.F.R. Parts 436 and 437, at 209 (2008). Franchisors also must be aware of the prohibition in the Franchise Rule against the use of “shills” or fictitious references. See 16 C.F.R. § 436.9(b) (2008). As noted in the Statement of Basis and Purpose, “[a]ny actor or public figure who might run afoul of this provision . . . risks violating the FTC Act.” Fed. Trade Comm’n, supra, at 258 n.891.

81 In addition to any state-imposed public figure disclosures in franchise sales advertising materials, the Franchise Rule regulates the disclosure of public figure endorsements in the franchise disclosure document itself. Specifically, Item 18 of the franchise disclosure document must disclose:

(1) Any compensation or other benefit given or promised to a public figure arising from either the use of the public figure in the franchise name or symbol, or the public figure’s endorsement or recommendation of the franchise to prospective franchisees.
(2) The extent to which the public figure is involved in the management or control of the franchisor.
Specifically, California and Washington each regulate “express or implied” endorsements by public figures, such as by “inclusion of such person’s photograph or name in the advertisement” or a specific statement of endorsement.\textsuperscript{82} In the event of any such endorsement, the franchisor must disclose “any compensation or other benefit given or promised by the franchisor or any person associated with the franchisor” to be derived by the public figure as a result of the endorsement.\textsuperscript{83} If the public figure endorsement appears in a written advertisement, this disclosure must appear in that same document; if the endorsement occurs within a radio or television program, the disclosure must occur “as part of the same program, without an intermission or interruption.”\textsuperscript{84} In addition, special considerations exist concerning the use of public figures—particularly celebrities—in consumer advertising. Section III(F), infra, discusses these considerations.

c. Name and Primary Commercial Symbol

A franchisor’s name and primary commercial symbol define its business and system. Accordingly, the vast majority of all franchisors include both in all franchise sales advertising as a matter of course. Nonetheless, four states—California, Maryland, Minnesota and Washington—specifically mandate that the franchisor’s name and address appear in the advertisement.\textsuperscript{85} Minnesota goes one step further by requiring that each piece of franchise sales advertising also include the franchisor’s primary commercial symbol and “the registration number assigned to the offering by the commissioner.”\textsuperscript{86}

d. Written Transcripts

Under the Maryland Franchise Act (“MFA”), franchisors intending to publish franchise sales advertising in the state via videotape, audiotape or other electronic or recorded means must submit a written transcript as part of the required filing.\textsuperscript{87} Specifically, Maryland law mandates that:

\begin{quote}
[a]dvertising submitted under this regulation that is in the form of videotapes or audiotapes shall be accompanied by a written transcript and a description of the contents.\textsuperscript{88}
\end{quote}

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\textsuperscript{82} CAL. CODE REGS. tit. 10, § 310.156.1(e) (2008); WASH. ADMIN. CODE 460-80-500(d) (2008).
\textsuperscript{83} Id.
\textsuperscript{84} Id.
\textsuperscript{85} See CAL. CODE REGS. tit. 10, § 310.156.1(d); MD. CODE REGS. 02.02.08.09(A)(2) (2008); MINN. R. 2860.4100, subpart 2 (2008); WASH. ADMIN. CODE 460-80-500(c).
\textsuperscript{86} MINN. R. 2860.4100, subpart 2.
\textsuperscript{87} MD. CODE REGS. 02.02.08.09(C).
\textsuperscript{88} Id.
This statutory requirement is unique to Maryland, however, other examiners may request written transcripts for similar materials to assist in the advertising review process. Minnesota and Washington examiners, for example, each have requested in the past that franchisors submit written transcripts for audio and videotape franchise sales advertising.

3. **Prohibitions**

Statutes regulating franchise sales advertising are rife with prohibitions on the content of advertisements. As described below, the states overwhelmingly prohibit statements of “no risk,” assurances of earnings and false or misleading statements. These prohibitions are protectionist in that they guard the prospective franchisee/consumer against untoward franchise sales efforts. Similarly, these prohibitions ensure the continued integrity of the franchise sales process by helping to prevent past abuses that plagued the early years of franchising.

a. **Statements of “No Risk”**

State statutes overwhelmingly prohibit franchise sales advertising from making statements of “no risk” or statements inferring that the purchase of a franchise is a safe investment.\(^{89}\) Similarly, statements suggesting that loss or default of the franchise is unlikely are prohibited.\(^{90}\) Illinois specifically prohibits by statute use of words such as “success,” “profits” or “potential profit” unless they are “reasonably qualified” by the franchisor.\(^{91}\) Thus, in Illinois, a franchisor may not publish franchise marketing materials urging prospects to join its “successful system” without qualifying its use of the word “successful” (e.g., noting in a footnote that the metrics for “success” are measured with reference to the increase in new unit openings during a set period of time).

Conversely, California historically has taken issue with any use of words such as “success,” “profits” or “profitability” under the CFIL’s blanket prohibition against representations that the franchise is a safe investment, free from risk, or that earnings are assured.\(^{92}\) Therefore, California is not likely to permit franchise advertisements that promote the franchisor’s “successful system.”

The states’ differing treatment of certain words like “success,” “profits” and “profitability” illustrates a broader issue in franchise sales advertising: The perceived notion that to sell a franchise (or product or service), franchisors must speak in “absolutes.” Adherence to that belief can result in problematic issues for the franchisor. For example, a franchisor might say in its advertising materials that it “will help you find the best location for your business in your territory,” without regard for what each word means (i.e., the “best location”) and whether the franchisor can live up to the representation. The better choice is to state the facts—“We provide site selection assistance for your location in accordance with our site selection criteria.”

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\(^{89}\) See CAL. CODE REGS. tit. 10, § 310.156.1(a); ILL. ADMIN. CODE tit. 14, § 200.301 (2008); MD. CODE REGS. 02.02.08.09(A)(1)(a); MINN. R. 2860.4100, subpart 1(A); WASH. ADMIN. CODE 460-80-500(a).

\(^{90}\) See id.

\(^{91}\) ILL. ADMIN. CODE tit. 14, § 200.301.

\(^{92}\) CAL. CODE REGS. tit. 10, § 310.156.1(a).
latter example allows the franchisor to communicate more accurately its promised support to franchisee candidates. More importantly, stating the facts ensures that the franchisor can deliver on its promises without running afoul of any state-based franchise sales advertising prohibitions or consumer advertising issues.  

b. Guarantees and Assurances of Earnings  

California, Illinois, Maryland, Minnesota and Washington prohibit franchisors from making guarantees or assurances of earnings in franchise sales advertising. Although this prohibition is codified only in the statutes of these five states, the authors believe that all franchisors should adopt this approach for all franchise sales advertising. Simply put, franchisors should refrain from making guarantees or assurances of earnings in their franchise sales advertising no matter where it is circulated so as to decrease the potential for non-conforming financial performance representations. Moreover, this approach can help ensure that the often fine line between puffery and false or misleading statements is not blurred.  

c. False or Misleading Statements  

As noted in Section III below, all advertisers—including franchisors—must ensure the absence of false and misleading statements from their advertisements. In fact, nearly every franchise regulation state expressly prohibits the use of false and misleading statements in franchise sales advertising. Michigan, for example, broadly provides that:

[a] person shall not publish an advertisement concerning the offer or sale of a franchise in this state if the advertisement contains a statement that is false or misleading or omits to make any statement necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.  

Minnesota, while adopting much of the same language as the Michigan statute, prohibits the continued use of false or misleading statements, as determined by the commissioner:

No person shall publish or cause to be published in this state any advertisement concerning any franchise after the commissioner has found that the advertisement contains any statement that is false or misleading or omits to make any statement necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and has so notified the person by written order.  

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93 Section III(E)(5), infra, contains a detailed discussion of issues caused by the use of “absolutes” and other superlatives in the consumer advertising context.  

94 CAL. CODE REGS. tit. 10, § 310.156.1(a); ILL. ADMIN. CODE tit. 14, § 200.301; MD. CODE REGS. 02.02.08.09(A)(1)(a); MINN. R. 2860.4100, subpart 1(A); WASH. ADMIN. CODE 460-80-500(a).  

95 See discussion infra Sections III(E)(5) and III(I).  

96 See id.  


98 MINN. STAT. ANN. § 80C.09, subdiv. 2 (West 2008).
The statutory language of Indiana, North Dakota and Washington is identical to Minnesota on this issue.\textsuperscript{99} Other franchise regulation states have followed suit by adopting similar statutory language. For example, the CFIL notes that:

> [a]ny advertisement of a franchise should disclose fairly and accurately such relevant facts concerning the franchise, the terms and conditions thereof and the material rights and liabilities created thereunder as are necessary to make the advertisement not misleading.\textsuperscript{100}

Even in states like Rhode Island, whose statute does not reference specifically a prohibition against false or misleading franchise sales advertising, general prohibitions in the state franchise act operate to prevent such abuses. In fact, the Rhode Island statute specifically provides that, in connection with the offer or sale of a franchise, it is unlawful for a franchisor to:

> make an untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading . . . [or] omit to state a material fact or make or cause to be made an untrue statement of material fact in any application, notice or report filed with the director under this act.\textsuperscript{101}

Sections III(A)(2) and III(E)(5), \textit{infra}, further explore the implications of false and misleading consumer advertising, the principles of which apply equally to consumer advertising in the franchise context.

d. \textbf{Consistency with Disclosure Document}

As noted above, franchisors should ensure that franchise sales advertising is consistent with the most current disclosure document circulating in each state. In addition to this general requirement, New York requires franchisors to attest to this fact in writing. Specifically, under New York law:

> [n]o sales literature shall include any representation or statement inconsistent with the prospectus on file with the Department and the franchisor shall verify in a writing submitted with the sales literature that it is not inconsistent with the filed prospectus.\textsuperscript{102}

This verification requirement aims to bolster the general requirement that franchise advertising must be consistent with the disclosure document and further decreases the likelihood that stale or outdated franchise sales advertisements remain in circulation.


\textsuperscript{100} \textit{Cal. Code Regs.} \textsection\textbf{10, § 310.156.1} (2008).


\textsuperscript{102} \textit{N.Y. Comp. Codes R. & Regs.} \textsection\textbf{13, § 200.9(c)} (2008).
4. Exemptions and Exclusions

Despite the broad reach of franchise sales advertising requirements, certain exemptions and exclusions from the advertising filing requirement apply. Notably, exemptions from state-ordered content restrictions do not exist. Accordingly, franchisors must ensure that all advertisements adhere to special disclosures and prohibitions mandated by each state that regulates franchise sales advertising. Franchisors also must ensure that their franchise advertisements do not violate the state and federal statutory prohibitions against false and misleading statements. In all cases, franchisors should carefully review the exemptions and exclusions before relying on them.

a. Internet Exemption

Given technological advances and the increased use of technology in franchise sales advertising, the most significant exemption relates to Internet advertising. As described below, the vast majority of state laws expressly exempt Internet advertisements from the scope of the state filing requirements by statute or order.

Nine states—California, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island and Washington—each exempt Internet-based franchise sales advertising from the scope of the state franchise advertising filing requirements. As noted below, Indiana, Maryland, Minnesota, North Dakota and Washington address this issue through substantially identical statutory language on this point. These five states provide that Internet-based franchise sales advertising is exempt from the statutory filing requirements so long as (1) the advertisement indicates that the offer is not directed to residents of the applicable state, (2) the advertisement is not in fact directed to any person or resident of the state, and (3) no franchises are sold in the state until the franchisor obtains a state registration, the disclosure document is declared effective, and proper disclosure is made to the prospect.

Rhode Island closely follows suit by adopting the above three exemption requirements, but includes an additional factor with which franchisors must comply to avail themselves of the Internet exemption. Specifically, franchisors advertising via the Internet in Rhode Island must implement procedures to control the timing of subsequent communications with prospective franchisees. This additional factor specifically requires that each Internet advertisement:

103 See discussion on false statements in the consumer advertising context infra Section III(E)(5).
105 See Exemption for Internet Sales, Bus. Franchise Guide (CCH) ¶ 5140.011; MD. CODE REGS. 02.02.08.18(A); Offers of Franchises Made on the Internet, Bus. Franchise Guide (CCH) ¶ 5230.81; Order Regarding Exemption of Certain Offers of Franchises Made on the Internet, Bus. Franchise Guide (CCH) ¶ 5340.02; Washington Franchise Policy Statement 6, Bus. Franchise Guide (CCH) ¶ 5470.90.
contain a mechanism, including and without limitation, technical “firewalls” or other implemented policies and procedures, designed reasonably to ensure that prior to any subsequent, direct communication with prospective customers or clients in this state, said franchisor is first registered in Rhode Island or qualifies for an exemption or exclusion from such requirement. Nothing in this paragraph shall be construed to relieve a state-registered franchisor from any applicable franchise registration requirement in Rhode Island.\(^{107}\)

California, Illinois and New York each contain unique statutory language related to franchise sales advertising Internet exemptions. In addition to a prohibition against franchisors directing any Internet franchise sales advertising to residents of the state, California law requires that franchisors make certain written representations and additional disclosures prior to availing themselves of the Internet exemption. Specifically, the CFIL requires that:

(1) The franchisor files with the Commissioner a notice, executed by an officer or general partner of the franchisor having direct responsibility for the conduct of the franchisor’s activities, and verified pursuant to Section 2015.5 of the Code of Civil Procedure, that includes:

(A) The Uniform Resource Locator (“URL”) address or similar address or device identifying the location of any internet advertisement;

(B) A statement that the franchisor, or anyone acting with the franchisor’s knowledge, agrees to comply with the California Franchise Investment Law, and Rules thereunder, when posting any Internet advertisement on a website; and

(C) The franchisor’s name, address, telephone number and contact person.

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(2) A preface, exhibit or appendix of the franchisor’s [franchise disclosure document] includes the URL address of the franchisor’s website, and the following statement, in clear readable type of not less than 12-point size:

OUR WEBSITE HAS NOT BEEN REVIEWED OR APPROVED BY THE CALIFORNIA DEPARTMENT OF CORPORATIONS, ANY COMPLAINTS CONCERNING THE CONTENT OF THIS WEBSITE MAY BE DIRECTED TO THE CALIFORNIA DEPARTMENT OF CORPORATIONS AT www.corp.ca.gov.\(^{108}\)

Conversely, although Illinois law does not impose a franchise sales advertising filing requirement, it does regulate franchisor conduct with respect to Internet-based franchise advertising. Under Illinois law:

\(^{107}\) Id.

\(^{108}\) CAL. CODE REGS. tit. 10, § 310.156.3(a).
[a]ny communication made through the Internet, the World Wide Web, or any other similar proprietary or common carrier electronic delivery system, of an offer to sell a franchise ("Internet Offer") is exempt from the registration provisions of the Illinois Franchise Disclosure Act if the franchisor limits contact with prospective Illinois franchises to keeping a prospect list and notifying such prospects that until the franchisor registers the franchise in Illinois, no further discussion about the franchise opportunity can take place.\textsuperscript{109}

In New York, franchisors need not file copies of their Internet-based franchise sales advertising so long as (1) the franchisor’s web site address is stated on the cover page of (a) the disclosure document filed with the Department of Law with an application for registration or exemption and (b) on any other notice filed with the Department, and (2) the Internet advertising is not directed to any person in New York.\textsuperscript{110}

All franchisors should exercise caution with respect to Internet-based franchise sales advertising in light of the variations that exist in applicable state law. Specifically, franchisors should include a disclaimer on all web-based advertisements, including on the franchisor’s development web site, if applicable. The disclaimer should advise consumers very clearly that the Internet advertisement does not constitute an offer to sell a franchise. One example of the disclaimer is as follows:

This website and the franchise sales information on this site do not constitute an offer to sell a franchise. The offer of a franchise can only be made through the deliver of a Franchise Disclosure Document (FDD). Certain states require that we register the FDD in those states. The communications on this web site are not directed by us to residents of any of those states. Moreover, we will not offer or sell franchises in those states until we have registered the franchise (or obtained an applicable exemption from registration) and delivered the FDD to the prospective franchisee in compliance with applicable law.

Other disclaimer language may be used so long as the disclaimer clearly communicates that (1) the advertisement does not constitute an offer to sell franchises to residents of certain states, (2) the advertisement is not otherwise directed to residents of those states, and (3) no franchises will be sold to residents of those states absent compliance with the registration and disclosure laws of each state.

b. Minimum Circulation Levels

Most states that regulate franchise sales advertising recognize that even when advertising is not directed to residents of that state, it nevertheless may make its way into the state by way of major publications or other media outlets. Due to this reality, many franchise regulation states specifically exclude from the scope of their regulatory schemes any franchise sales advertisements appearing in “bona fide newspaper[s] or other publication[s] of general,\textsuperscript{109} ILL. ADMIN. CODE tit. 14, § 200.306.
\textsuperscript{110} N.Y. COMP. CODES R. & REGS. tit. 13, § 200.12(a).
For this reason, franchise advertisements in publications such as The Wall Street Journal, USA Today and Newsweek are excluded from the definition of a franchise “offer” in the majority of states that regulate franchise advertising. Accordingly, advertisements in these publications typically are not subject to state-imposed advertising filing requirements.

Also excluded from the definition of a franchise “offer” (and, therefore, the related filing requirements in California, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island and Washington) is any radio or television program that originates outside of the state but nevertheless is received by residents in the state. Despite the exclusions for minimum circulation levels and media originating outside of the state, franchisors must comply with all franchise sales advertising content restrictions set forth in the applicable state law.

Importantly, franchisor compliance with state-level filing requirements and content restrictions applicable to franchise sales advertising is just one part of the story. Not surprisingly, consumer advertising issues also greatly impact franchisors given the heavy reliance on various forms of consumer advertising to generate public interest in their products and services. Accordingly, franchisors and franchisees must control the content of and delivery methods for consumer advertising consistent with the requirements and prohibitions set forth in Section III, below.

III. ADVERTISING DIRECTED TO CONSUMERS

Consumer advertisements, with their ability to capture the attention of purchasers around the country and the world, are an essential part of a franchise business’s marketing strategy. With the potential to drive new business, however, consumer advertising may entail substantial risk for franchisors and franchisees. False or misleading advertising may harm consumers or competitors, create unintended promises and unmet expectations, and in specific fields such as the food and drug context, danger to consumer health. Thus, consumer advertising is subject to a heavy overlay of requirements by both federal and state law, with significant overlap in the coverage of such laws. Businesses must evaluate a host of legal issues each time they consider a new advertising campaign.

This section provides a general overview of the laws and regulation of consumer advertising in the United States. We discuss the use of certain terms in advertisements, the intersection between advertising law and other relevant laws, and false advertising claims under the federal Lanham Act. Appendix B provides a checklist of considerations when reviewing an advertisement that may lessen an advertiser’s risk of liability.

Given the number of laws, regulations and industry standards, franchisors and franchisees are strongly encouraged to consult legal counsel prior to beginning any significant advertising campaign.


112 See id.
A. Federal, State, and Industry Regulation of Advertising

The most prominent regulator of advertising at the federal level is the FTC. Other federal regulatory bodies include the Food and Drug Administration (“FDA”), the United States Postal Service, the Federal Communications Commission (“FCC”), and the Bureau of Alcohol, Tobacco, and Firearms. Certain industries such as securities and insurance face specific regulatory oversight. In addition, the federal Lanham Act, as discussed in detail below, provides a private cause of action against false advertising, enabling enforcement by competitors. States also have enacted consumer protection statutes. Finally, the advertising community and various industries have created self-regulation schemes. We examine the federal, state, and industry regulatory structures in turn.

1. Federal Regulatory Authority

a. The FTC

Section 5 of the FTC Act proscribes “[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce,” and grants the FTC the authority to regulate and prevent such behavior.\(^\text{113}\) Section 12 of the FTC Act specifically proscribes false advertising and clarifies that false advertising falls within the ambit of Section 5.\(^\text{114}\)

The FTC has promulgated numerous Policy Statements and Guides explaining its positions on various advertising practices. For example, in determining whether a practice is “unfair,” the FTC states that it considers whether the practice: (1) injures consumers, (2) violates established public policy, and (3) is unethical or unscrupulous.\(^\text{115}\) The first of these factors is the most important, and may support a finding of unfairness even in the absence of factors (2) and (3).\(^\text{116}\) With regard to the first factor, however, the FTC requires that to be indicative of the unfairness of a practice, the injury caused by the practice must: (a) be substantial, (b) not be outweighed by any consumer or competitive benefits arising from the practice, and (c) not have been one that consumers could reasonably have avoided.\(^\text{117}\) In the advertising context, the FTC has specifically stated that it will not pursue advertisements that are merely offensive to some viewers.\(^\text{118}\)

In addition, the FTC states that a practice is “deceptive” if it is likely to: (1) mislead consumers and (2) affect consumers’ behavior or decisions about a product or service.\(^\text{119}\) The FTC takes express claims, implied claims, and omissions into consideration.\(^\text{120}\) In the context of

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\(^{114}\) Id. § 52 (LexisNexis 2008).


\(^{116}\) Id.

\(^{117}\) Id.

\(^{118}\) Id.


\(^{120}\) Id.
advertisements, the FTC has noted that certain claims may be “unreasonably misunderstood” by consumers, such as an advertisement for “Danish pastry” that is in fact made in the United States. Such claims are not actionable and an advertiser is not required to guard against “every conceivable misconception.” Rather, the FTC examines advertising practices for deception from the vantage point of a reasonable consumer.

b. The FDA

The FDA and FTC have entered into a liaison agreement that provides for the allocation of their regulatory efforts. In general, the FDA regulates the labeling of foods, over-the-counter drugs, dietary supplements, medical devices, and cosmetics, while the FTC regulates the advertising of these products. The FDA regulates most consumer advertising of prescription drugs by enforcing the federal Food, Drug, and Cosmetic Act. That Act requires that advertisements for prescription drugs include the established name of the drug, any brand name of the drug, the quantity of each ingredient, and a brief summary including a true statement of side effects, contraindications, and effectiveness. These requirements are relaxed for so-called “reminder advertisements,” which call attention to the name of the drug but do not include indications for use of the drug or dosage recommendations. Reminder advertisements are required to list only the name, and not the quantity, of each active ingredient.

c. The United States Postal Service

The United States Postal Service (“USPS”), through the United States Postal Inspection Service, regulates use of the mail for the distribution of certain advertising content, including sexually oriented advertisements. The USPS also regulates use of the mail to distribute content pertaining to lotteries and sweepstakes promotions, which we address in further detail below.

d. Other Federal Regulatory Bodies

Several other regulatory bodies, including the FCC and the Bureau of Alcohol, Tobacco, and Firearms, have responsibility for certain types of advertising. The FCC, for example, allows consumers to complain about obscene, indecent, or profane broadcast advertising, and also regulates telemarketing practices as discussed below. The Bureau of Alcohol, Tobacco, and Firearms has regulatory authority over the advertising of alcohol. The Bureau only regulates

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121 Id. (quoting In re Heinz W. Kirchner, 63 F.T.C. 1282, 1290 (1963)).
125 See id.
tobacco advertising to the extent that such advertising promotes a lottery or includes indecent or immoral content; the FTC has responsibility for the general regulation of tobacco products.  

2. **State Regulation and “Little FTC” Acts**

All fifty states and the District of Columbia have enacted their own consumer protection statutes. More than half of these statutes are based on states' versions of the Uniform Deceptive Trade Practices Acts or Consumer Sales Practices Acts. Slightly more than one-third of the states have enacted statutes based on the FTC Act. Regardless of their basis, the majority of these statutes, unlike the FTC Act, authorize private causes of action. The state statutes also may be enforced by the state Attorney General.

The main differences among the state consumer protection statutes. These differences include the degree to which showings of causation and harm, consumer reliance, and intent are required. For example, some states, such as Oregon and Pennsylvania, condition the availability of damages on whether the plaintiff can prove that he or she was injured by the practice at issue and that such injury resulted from a violation of the statute. Some states, such as Indiana and Colorado, require proof of reliance on the allegedly deceptive practice, while others, such as Connecticut, require no such proof. Still other states, such as Michigan, require no proof of actual reliance but instead proof that a reasonable person would have relied on the allegedly deceptive practice. Further, some states, such as Oregon, require proof of a willful violation of the statute to bring a private action for damages, while others, such as Alaska, do not require willfulness.

The availability of damages also varies among the states. For example, in Illinois, a plaintiff can only obtain injunctive relief, while in Maryland, a plaintiff may recover actual damages. A minority of states, such as Florida, also allow recovery for punitive damages.

3. **Non-Governmental Regulation of Advertising**

The Council of Better Business Bureaus, Inc. ("BBB"), the American Association of Advertising Agencies, the American Advertising Federation, and the Association of National Advertisers created the National Advertising Division ("NAD") in 1971 as an alternative dispute

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130 *Id.* at 266.
131 *Id.* at 269.
132 *Id.* at 271 & n.76.
133 *Id.* at 272 & nn.82 & 84.. 
134 *Id.* at 272 & n.83.
135 *Id.* at 275 nn.104-05.
136 *Id.* at 277-78.
137 *Id.* at 279.
resolution mechanism for national advertising cases. NAD may initiate a proceeding against an advertiser on its own or in response to a complaint filed by an adverse party. NAD is staffed by attorneys with extensive knowledge of advertising law and provides a quick, private alternative to litigation. A written decision is provided within sixty business days after a case is heard, and all documents submitted during a case remain confidential, but the decisions are published. Decisions of the NAD may be appealed to the National Advertising Review Board (“NARB”).

The NAD process has several limitations. Compliance with its decisions is voluntary and these decisions are not binding upon the courts. Nonetheless, failure of an advertiser to follow a ruling may lead to a referral to the FTC, where more substantial penalties may result. Additionally, the NAD reviews only national advertisements, although private review of local advertising may be undertaken by a local BBB office.

Other non-governmental bodies are present in many industries, including the distilling, insurance, securities, and banking industries, to name a few. For example, the Financial Industry Regulatory Authority (“FINRA”) regulates advertising by member securities firms and requires these firms to file certain advertising literature with its Advertising Regulation Department.

B. Common Types of Advertising

Some common types of advertising directed to consumers include image advertising, comparative advertising, guerilla advertising, sweepstakes and promotional advertising, and advertising directed to children. Unique issues apply to each of these areas.

1. Image Advertising

Image advertising is characterized by the use of visual depictions that evoke positive feelings about a company or its products or services. Vibrant, fanciful imagery bringing to

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140 Id.
143 Lesley Anne Fair, Regulation of Marketing Claims by the Federal Trade Commission and States, in COSMETIC REGULATION IN A COMPETITIVE ENVIRONMENT 151, 179 (Norman F. Estrin & James M. Akerson eds., 2000).
mind youth, strength, and good health is particularly common. Large, well-known companies are especially likely to find image advertising beneficial because they have less need to educate the public about the details of their offerings than do smaller, lesser-known companies. Large companies can devote more effort to the maintenance of goodwill, and image advertising can help them make their products more memorable. 

2. Comparative Advertising

Comparative advertising, as its name suggests, compares the attributes and benefits of one’s product or service to those of a competing product or service. While the merits of comparative advertising itself have been hotly debated, the FTC has recognized that comparative advertising can provide consumers with valuable information, encourage competitors to improve their offerings, and drive prices down. Indeed, the FTC has stated it will “scrutinize carefully” any restraints on the use of comparative advertising.

Advertisers must ensure they follow FTC requirements that comparative advertising be truthful and not deceptive. Advertisers should also avoid using any more of a competitor’s trademark or identity than necessary to make the desired comparison, lest the comparative advertisement imply endorsement or sponsorship by the competitor. The American Association of Advertising Agencies, a national trade association, also has noted several points that advertisers should consider when engaging in comparative advertising. For example, a comparison of one product to another should be an “apples to apples” comparison of similar features of the products, and the features being compared should be significantly related to the value or usefulness of the product. Additionally, when advertising references test results, it is preferable that such results come from a test conducted by an independent entity. 

For example, in Kraft, Inc. v. Fed. Trade Comm’n, Kraft misstated the amount of calcium contained in Kraft Singles cheese products as compared to the amount of calcium in imitation cheese slices. The FTC filed a complaint and the administrative law judge issued a cease and desist order against Kraft, which the FTC later affirmed with modifications. On appeal to the Seventh Circuit, Kraft argued that the advertisement was not deceptive because its claims

\[147\] See id.


[150] Id.

[151] Id.

[152] See Playboy Enters., Inc. v. Welles, 279 F.3d 796 (9th Cir. 2002).


[155] Id.

were not material to consumers' purchasing decision. The court disagreed, noting that calcium is a significant health concern to consumers. Accordingly, the comparative advertising at issue was deceptive and the cease and desist order was affirmed.

Comparative advertising also is inherently risky precisely because it asserts a claim regarding a competitor’s product or service, creating an obvious plaintiff under the Lanham Act’s false advertising section. Thus, the requirement that advertisers must be able to back up, or “substantiate,” all advertising claims is particularly important when engaging in comparative advertising. Clinical tests are advisable for the substantiation of claims made in comparative advertisements. An advertiser should ensure, however, that such tests support the exact claim that is being made; failure to do so is a common mistake. Claim substantiation is discussed below.

In addition to false or misleading comparisons, an advertiser engaging in comparative advertising must be careful that mention of the competitor does not create the impression that the competitor endorses or authorizes the advertiser’s product or advertising. For example, in *Eli Lilly & Co. v. Natural Answers, Inc.*, Natural Answers marketed a herbal blend under the name Herbrozac, calling the blend “a powerful and effective all-natural and herbal formula alternative to [the] prescription drug Prozac.” Natural Answers’ founder stated that the company chose the name to suggest an association with the functions or benefits of Prozac and not with Prozac itself. The court rejected that distinction, finding that any suggestion of the functions or benefits of Prozac would arise only because consumers were so familiar with Prozac itself. Rather, the court found that Natural Answers intended to create confusion between its product and Prozac and went on to grant a preliminary injunction based on Eli Lilly’s Lanham Act claims. By incorporating its competitor’s product name into its own product name in a manner that suggested endorsement or sponsorship by Eli Lilly, Natural Answers stepped across the boundaries of permissible comparative advertising. Determining whether an advertisement suggests endorsement or sponsorship by a competitor can be a complex, multi-factor inquiry.

Franchisors also should note that statements that do not expressly name another’s brand, product or service nonetheless may be considered comparative advertising. See discussion of superlatives “best”, “favorite” and “only” below.

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157 See id. at 324.


159 Id.

160 See Pebble Beach Co. v. Tour 18 I Ltd., 155 F.3d 526, 545-46 (5th Cir. 1998) (explaining that comparative advertising is permissible but not when it creates confusion as to source, sponsorship, affiliation, or approval).


162 Id. at 838.

163 Id.

164 Id. at 845.

165 Id. at 854.
3. **Guerrilla Advertising**

“Guerrilla advertising” is an umbrella term for nontraditional forms of advertising that seeks to capture the attention of consumers in unexpected ways, including through the use of unexpected media. The term stems from Jay Conrad Levinson’s concept of “guerrilla marketing,” which he used to refer to nontraditional, low-cost marketing strategies often characteristic of small companies. Recently, even large companies are taking note and beginning to use unconventional advertising techniques.

Guerrilla advertising can include “buzz marketing,” in which advertisers employ tactics that do not appear at first glance to be marketing activities. For example, in 2002, Sony Ericsson hired actors who asked consumers in major U.S. cities to take their pictures using one of the company’s new phones. As an actor handed a phone to a consumer, the actor talked about how “cool” the phone was. Additionally, the Macy’s department store chain paid a Northwestern University student to wear clothing sold by the chain and plan Macy’s events on campus. Upon receiving compliments on her outfits, she reported disclosing her affiliation with Macy’s approximately 85 to 90 percent of the time. In the Internet context, companies may create seemingly unaffiliated websites or use “bloggers” who do not disclose their affiliation to post information on websites touting the products or services of that company. The line between speech and advertising is becoming increasingly blurred.

Opponents of “buzz marketing” assert that this form of advertising is deceptive under the FTC Act if done in “stealth;” that is, if the individual who is wearing, using, or otherwise touting the advertiser’s product does not disclose his or her relationship to the advertiser. Indeed, one trade association, the Word of Mouth Marketing Association (“WOMMA”), agrees and has stated in its ethics code that individuals paid to engage in buzz marketing should disclose their relationship to the advertiser, should speak only their personal opinions, and should not obscure their identities. The FTC, however, has declined to publish guidelines specifically addressing buzz marketing, opting instead to evaluate on a case-by-case basis any conduct that violates the FTC Act, such as conduct that is inconsistent with the FTC’s Guides Concerning Use of Endorsements and Testimonials in Advertising. For example, the Guides state that if a

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167 Id.
169 Id.
170 Nara Schoenberg, Meet Alex. She's a B.M.O.C.; Make that 'Big Marketeer On Campus,' Part of a Growing Cadre Hired to Spread Commercial Messages to Peers, CHI. TRIB., May 13, 2008, at C1.
171 Id.
connection exists between the endorser and advertiser that would materially affect the weight or credibility of the endorsement because a reasonable consumer would not expect such a connection, that fact must be disclosed.\footnote{176}{FTC Guides Concerning Use of Endorsements and Testimonials in Advertising, 16 C.F.R. § 255.5 (2008).}

Guerrilla advertising also includes “viral marketing,” which is characterized by an advertiser’s efforts to deliver a message to people who are then likely to pass that message along to others.\footnote{177}{See Theresa Howard, ‘Viral’ Advertising Spreads Through Marketing Plans, USA TODAY, June 23, 2005.} Viral marketing is particularly popular online and its success depends on the creation of messages that recipients want to share with others.\footnote{178}{Id.} For example, Long John Silver’s created the web site http://www.shrimpbuddy.com/ to promote its popcorn shrimp products.\footnote{179}{See Welcome to ShrimpBuddy.com, http://www.shrimpbuddy.com/ (last visited June 23, 2008).} The web site features a video of a road trip of a man and his friend, who is a shrimp. The video depicts the travels of the man and the shrimp and closes with a shot of the man seated at a Long John Silver’s restaurant eating the shrimp. As the restaurant chain’s Director of Marketing indicated, the intent behind the web site was to appeal to “younger, hipper” consumers who would enjoy the video and, presumably, pass it on to others.\footnote{180}{Theresa Howard, ‘Viral’ Advertising Spreads Through Marketing Plans, USA TODAY, June 23, 2005 (quoting Don Gates, Long John Silver’s Director of Marketing).}

The guerrilla marketing umbrella includes a host of other unconventional advertising practices. For example, Microsoft placed 16,000 butterfly stickers around Manhattan in 2002 to promote its release of MSN 8.\footnote{181}{Margaret Kane, Microsoft Decals Don’t Stick in NYC, CNET NEWS.COM, Oct. 25, 2002, available at http://news.cnet.com/Microsoft-decals-dont-stick-in-NYC/2100-1023_3-963330.html.} In 2007, small electronic devices placed around Boston to promote an Aqua Teen movie were misinterpreted as a bomb scare.\footnote{182}{Two plead not guilty to Boston hoax charges, cnn.com, Feb. 2, 2007, available at http://www.cnn.com/2007/US/02/01/boston.bombscare/.} The possibilities for unconventional marketing are seemingly limitless, but franchisors and franchisees must ensure that their new tactics do not exceed the boundaries of any applicable laws.

4. **Sweepstakes Promotions**

Franchise businesses that intend to conduct sweepstakes promotions must ensure that their activities do in fact amount to sweepstakes promotions and are not illegal lotteries. A purported sweepstakes promotion becomes an illegal lottery if: (1) a prize is offered, (2) any chance is involved in the selection of prize winners, and (3) consideration (monetary or otherwise) is required to be eligible to win a prize.\footnote{183}{See U.S. Postal Serv. v. Amada, 200 F.3d 647, 651 (9th Cir. 2000).}

State laws require sweepstakes promoters to make certain disclosures in the official rules, which govern key attributes of the promotion, and require distribution of the rules and other key information in advertising. New York and
Florida require a sweepstakes promoter to obtain a license or post a bond if the total prize value exceeds $5,000.\textsuperscript{184}

The USPS also has jurisdiction over sweepstakes promotions sent by mail. The Deceptive Mail Prevention and Enforcement Act prohibits the mailing of any false representation that an individual has won a prize, must place an order to enter a sweepstakes promotion, must make a purchase to continue receiving sweepstakes mailings, or must send in an entry form with payment for a previous purchase.\textsuperscript{185} The Act also requires that all terms and conditions of a sweepstakes promotion, including odds of winning, be disclosed.\textsuperscript{186} Further, a sweepstakes promoter must maintain a notification system allowing individuals to request not to receive further sweepstakes mailings from that promoter.\textsuperscript{187}

5. Advertising Directed to Children

The BBB, the American Association of Advertising Agencies, the American Advertising Federation, and the Association of National Advertisers established the Children’s Advertising Review Unit (“CARU”) in 1974 as a means of self-regulation of advertising directed to children.\textsuperscript{188} CARU monitors and reviews national advertisements directed to children under twelve years of age for advertisements that are deceptive, unfair or inappropriate in light of the vulnerability of these children.\textsuperscript{189} Like the NAD, CARU relies on advertisers’ voluntary cooperation with its decisions.\textsuperscript{190}

CARU’s Self-Regulatory Program for Children’s Advertising is concerned with preventing children’s unrealistic expectations about product or performance characteristics, preventing children from being misled into thinking advertisements are actually program content, ensuring parental permission for orders placed online, insulating children from sales pressure, and promoting the safe use of products.\textsuperscript{191}

The Children’s Food and Beverage Advertising Initiative, established by the BBB, is a self-regulation program designed to encourage children to adopt healthier diets.\textsuperscript{192} Participating companies, which include Burger King Corp., The Coca-Cola Company, and McDonald’s

\begin{itemize}
\item \textsuperscript{185} Id.
\item \textsuperscript{186} Id. §§ 3001(k)(3)(A)(ii)(III), (V)(aa) (LexisNexis 2008).
\item \textsuperscript{187} Id. § 3017(c)(2).
\item \textsuperscript{188} Children’s Advertising Review Unit, \textit{Self-Regulatory Program for Children's Advertising} 1 (2006).
\item \textsuperscript{189} Id. at 1-2.
\item \textsuperscript{190} About the Children’s Advertising Review Unit (CARU), http://www.caru.org/about/index.asp (last visited June 16, 2008).
\item \textsuperscript{191} See id. at 6-7, 9-10.
\item \textsuperscript{192} About the Initiative, http://us.bbb.org/WWWRoot/SitePage.aspx?site=113&id=b712b7a7-fcd5-479c-af49-8649107a4b02 (last visited June 16, 2008).
\end{itemize}
USA, commit to focusing at least half of their advertising directed at children under twelve on healthier food and beverage choices and healthy lifestyles.

Online privacy requirements also are important considerations for those who advertise to children. In 1996, CARU amended its Self-Regulatory Program to include a section on online privacy protection for children under the age of thirteen. These amendments were the basis for the federal Children’s Online Privacy Protection Act of 1998 ("COPPA").

C. Advertising in Certain Media

Franchise businesses are increasingly turning to new media to advertise their products and services. As these new media continue to evolve, regulators develop new and updated regulations to address deceptive and disruptive practices in the areas of e-mail, telemarketing and text messaging.

1. Commercial E-Mail

In 2003, Congress passed the Controlling the Assault of Non-Solicited Pornography and Marketing ("CAN-SPAM") Act to address the problem of unsolicited e-mail, or "spam." The CAN-SPAM Act’s prohibitions are primarily directed to commercial e-mail messages, defined as having a primary purpose to advertise or promote a commercial product or service. Commercial e-mail messages are distinguished from “transactional or relationship messages,” which are messages pertaining to a previously-agreed-upon commercial transaction between the sender and recipient or to an existing commercial or employment relationship.

The CAN-SPAM Act sets forth four main requirements for commercial e-mail messages, only the first of which also pertains to transactional or relationship messages. Any commercial e-mail message must include accurate header information. Header information includes the “From” and “To” lines and routing information; namely, the originating e-mail address and domain name. The subject line of a commercial e-mail message must accurately reflect the

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195 About the Children’s Advertising Review Unit (CARU), http://www.caru.org/about/index.asp (last visited June 16, 2008).

196 15 U.S.C. § 6501 et seq. (privacy notices and parental consent before collecting, using or disclosing a child’s personal information).


199 Id. § 7702(17) (LexisNexis 2008).

200 Id. § 7704(a)(1) (LexisNexis 2008).

Any commercial e-mail message must provide an “opt-out” method to allow the recipient to request not to receive further commercial e-mail messages from the sender. The “opt-out” method may include a functioning return e-mail address or other Internet-based mechanism and must be clearly and conspicuously displayed. After receiving an “opt-out” request, the sender has ten days to stop sending commercial e-mail messages that fall within the scope of the request. Finally, the Act requires that a commercial e-mail message be identified as an advertisement, provide notice of the “opt-out” method, and include a valid physical postal address for the sender.

Advertisers should carefully heed these provisions when engaging in any e-mail campaign, as each violation may subject a commercial e-mail sender to fines of up to $11,000. Additionally, although the CAN-SPAM Act preempts state anti-spam laws, states still may enforce provisions of the Act that apply to other types of “spam.”

On May 12, 2008, the FTC clarified the requirements for commercial e-mail messages. To opt out of receiving further messages, a recipient may not be required to pay a fee, to provide anything more than his or her e-mail address and details of opt-out preferences, or do more than send a single e-mail or visit a single web site to complete the opt out process.

2. Telemarketing

Telemarketing is a popular practice among advertisers but not so among consumers; the vast majority of Americans dislike such “cold calls.” In response to this concern, Congress passed the Telephone Consumer Protection Act of 1991 (“TCPA”), which prohibits certain telemarketing practices.

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203 Id. § 7704(a)(3)(A) (LexisNexis 2008).
204 Id. § 7704(a)(4)(A)(i) (LexisNexis 2008).
205 Id. § 7704(a)(5) (LexisNexis 2008).
209 Id. The FTC also clarified the definition of “sender” where multiple parties advertise in one e-mail message. Further, the sender’s valid physical postal address can be an accurately-registered Post Office box or private mailbox.
211 47 U.S.C.S. § 227 (LexisNexis 2008). Artificial or prerecorded voices may not be used to make telephone calls to residential lines except in cases of emergency or with prior consent of the called party. Unsolicited commercial faxes over regular telephone lines and the use of an automatic dialing system to simultaneously call two or more
The TCPA also authorized the FCC to create a national list of the telephone numbers of residential subscribers who do not wish to receive telephone sales calls. Any personal telephone phone number, including cell numbers, may be registered, and with the passage of the federal Do-Not-Call Improvement Act of 2007, which was signed into law on February 15, 2008, registration is now permanent. Telemarketers covered by the Registry must stop all calls within 31 days of registration, and violations could result in fines of up to $11,000 per call. The Registry does not, however, prevent calls from political organizations, charities, telephone surveyors, or sellers from whom an individual has consented to receive calls or with whom an individual has an existing business relationship.

Under the Telemarketing and Consumer Fraud and Abuse Prevention Act, the FTC issued the Telemarketing Sales Rule ("TSR"), which outlines deceptive and abusive practices in telemarketing. The TSR requires that if a purchase is made, the total cost and quantity of the goods or services must be disclosed, along with any restrictions. If the seller does not make refunds, this fact also must be disclosed. Conversely, if the telemarketer makes a representation about refunds, the refund policy must be disclosed. The TSR requires a telemarketer to disclose, at the beginning of a call: (1) the name of the seller, (2) that the call is being made to sell goods or services, and (3) the nature of the goods or services. If a sweepstakes promotion is offered, the telemarketer must also disclose the odds of winning and that no purchase is necessary to enter the promotion. Among other things, the TSR also prohibits sales calls other than between 8:00 a.m. and 9:00 p.m. in the called person’s time zone, repetitive sales calls intended to annoy the called person, and other abusive practices, including threats and profane language.

Several self-regulatory efforts also concern the telemarketing industry. For example, the Direct Marketing Association ("DMA") provides general guidelines for all types of direct marketing, including telemarketing. More information on the DMA may be found at http://www.the-dma.org/.

telephone lines of a business as proscribed. The Act gives standing to sue to private individuals and businesses, with minimum damages set at $500 and $1500 for knowing or willful violation of the Act.


213 See id.

214 Id.


217 Id. at 4670.

218 Id. at 4673.

219 Id. at 4670, 4673.

220 Id. at 4671-73.

3. **Text Messaging**

Text messages may be sent strictly between mobile telephones, or via internet e-mail addresses to mobile telephones. As discussed above, the CAN-SPAM Act allows non-wireless “spam,” but subjects it to the four primary requirements of the Act. The FCC, however, has promulgated rules under the Act which prohibit the initiation of “mobile service commercial message[s]” in the absence of “express prior authorization” from the recipient.\(^{222}\) The rules define a “mobile service commercial message” as a commercial electronic mail message—as that term is defined in the CAN-SPAM Act—that is transmitted directly to a wireless device that is being used in connection with a commercial mobile service.\(^{223}\) Thus, the rules apply only to messages that reach a mobile phone from an Internet address and not to messages sent from one mobile phone to another. A commercial message is presumed to be a mobile service commercial message if it is sent to a domain name that has been listed on the FCC’s wireless domain names list for at least thirty days.\(^{224}\) Even if a domain name has not been on the FCC’s list for at least thirty days, one who knowingly sends a message that meets the definition of a mobile service commercial message cannot escape liability.\(^{225}\)

When requesting express prior authorization, an advertiser should disclose its identity, that the consumer’s authorization would constitute an agreement to receive text messages from the advertiser, that a charge may accompany the receipt of such text messages, and that the consumer may revoke the authorization at any time. Advertisers should also ensure that, in granting express prior authorization, a consumer specifies the wireless number to which text messages will be sent.

For messages sent from one mobile phone to another, the TCPA applies. As discussed above, the TCPA proscribes the use of automatic dialing systems or artificial or prerecorded voices to make telephone calls to cellular phones without prior consent of the called party.\(^{226}\) The FCC issued an order in 2003 stating that the term “telephone call” in this prohibition encompasses both voice calls and text calls such as short message service (“SMS”) calls.\(^{227}\) This extension of the prohibition against automatic dialing systems is a significant limitation on the use of text message advertising because it effectively prevents advertisers from sending messages to cellular phones in bulk.\(^{228}\) Additionally, FCC rules prohibit the sending of any

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\(^{222}\) 47 C.F.R. § 64.3100(a)(1) (2008).

\(^{223}\) Id. §§ 64.3100(c)(2), (c)(7).

\(^{224}\) Id. § 64.3100(c)(7).

\(^{225}\) Id. § 64.3100(a)(4).


unwanted text messages to any wireless device with a telephone number registered on the national Do-Not-Call list.229

D. Claim Substantiation

The FTC requires that advertisers have a “reasonable basis” to make the claims that appear in advertisements and objective evidence to support such claims.230 In other words, advertising claims that are capable of being understood as factual must be based on actual facts. When a claim is less specific, the type of evidence needed to support the claim varies by subject matter. For instance, health and safety claims must have “competent and reliable scientific evidence,” whereas the level of expertise to substantiate non-specific claims in less technical fields may be less strict.

Claim substantiation is evaluated from the viewpoint of an ordinary, reasonable consumer. If an advertisement makes a claim that the ordinary consumer would rely on or believe, then claim substantiation may be necessary. Franchisees should evaluate the headlines, text, symbols and images of their advertisements, both literally and implicitly, to assess what message or claim the advertisement conveys to the consumer. The reasonable perception of the consumer must be based on true and substantiated facts.

Factual allegations can produce a “slippery slope” for claim substantiation. Some factual claims may be literally untrue. Other factual claims may be interpreted as “literally false by implication,” when interpreted in the context of the entire advertisement. When H&R Block, as part of a “Rapid Refund” campaign, claimed it was providing “refunds” to consumers who were actually taking out interest-bearing loans for the anticipated amount of their refund, the advertisements were found to be unsubstantiated, false and misleading.232

Visual and pictorial claims may cause substantiation issues. Consumers expect to achieve the same results that they see in an advertisement. This may create an implicit claim that something is “easy-to-use,” because it seems simple to use in the advertisement, or “easy-to-assemble,” because the flier made it look like it would quickly snap together. The implicit claims that are extrapolated from advertisements also must be supported, and franchisors must be aware of the underlying message that they are portraying and the claims they may inadvertently make.

When conducting studies or surveys, franchisors should be aware that claim substantiation research may not be protected against disclosure as attorney work product. In the recent case of Procter & Gamble Co. v. Ultreo, Inc.,233 the Southern District of New York found unpersuasive a statement by defendant Ultreo’s attorney that the product performance research was conducted at his direction and thus in anticipation of litigation, noting that Ultreo


231 Id.


had “long sought to obtain clinical proof of the effectiveness of the ultrasound component of its
toothbrush” and had even promised to do so in a letter to its shareholders.\textsuperscript{234}

\textbf{E. Specific Advertising Content}

Some terms and phrases commonly used in advertising are actually the subject of very
specific rules and regulations for their use. Below are some examples of such terms and claims
that should be reviewed in detail before use in advertising.

\textbf{1. Use of the Term “Free”}

Offering a “free” product or service is a tried-and-true way to attract consumer attention,
and for that reason such offers have great potential to mislead and deceive consumers and
must be made with “extreme care.”\textsuperscript{235} Under the FTC Guide Concerning Use of the Word
“Free” and Similar Representations, a seller may use the term “free” or a related term such as
“gift” or “given without charge” only if products or services that must be bought to take
advantage of the “free” offer are sold at their “regular” price.\textsuperscript{236} Those products or services may
not be sold at a higher price that compensates for the cost to the seller of giving away the “free”
item. Nor may other products or services of an inferior quality be substituted for those of the
quality that is customarily sold at the “regular” price. Moreover, the other products or services
must have been sold at the “regular” price for a reasonable period of time, which the FTC Guide
specifies as thirty days.\textsuperscript{237} And a “free” offer must not occur too frequently or go on for too long,
lest the cost of the “free” item turn out to be absorbed into the cost of the other items a
consumer must purchase first. The FTC Guide provides that a “free” product or service should
not be advertised as such for more than six months in any twelve month period, that any repeat
“free” offer in the same trade area must be separated from the first “free” offer by at least thirty
days, and that no more than two repeat offers should occur in the same trade area in the twelve
month period.\textsuperscript{238} The Guide also provides that during the twelve month period, sales of the
“free” product in a given trade area should not exceed fifty percent of the total sales volume of
that product in the trade area when not accompanied by a “free” offer.

Further, the seller is required to conspicuously disclose, in close proximity to the
advertisement for the “free” item, any conditions a buyer must first meet to take advantage of
the offer.\textsuperscript{239} Additionally, if the seller promoting the “free” item is a supplier who knows that
resellers are not in fact offering the item “free” as described above, the supplier must not
continue to promote the item as “free.”\textsuperscript{240} The supplier also must identify any geographical
limitations on the availability of the “free” item through resellers.\textsuperscript{241}

\begin{itemize}
\item \textsuperscript{234} \textit{Id.} at *3.
\item \textsuperscript{236} \textit{Id.} § 251.1(b)(1).
\item \textsuperscript{237} \textit{Id.} § 251.1(b)(2).
\item \textsuperscript{238} \textit{Id.} § 251.1(h).
\item \textsuperscript{239} \textit{Id.} § 251.1(c).
\item \textsuperscript{240} \textit{Id.} § 251.1(d).
\item \textsuperscript{241} \textit{Id.} § 251.1(e).
\end{itemize}
2. **Use of the Term “New”**

The FTC has delineated several requirements for use of “new” and related terms such as “brand new.” First, to be advertised as “new,” a product must have a new aspect that relates to its performance, and not just an aesthetic change. Second, the product and its component materials must not have been previously used.

For those products that may be advertised as “new,” the term may be used for only six months from the time the product is first offered for sale. One exception to this rule applies when the product is test marketed to consumers comprising not more than fifteen percent of the United States population; such test marketing itself may go on for up to six months before the standard six-month period begins. Thus, advertisers may describe a product as “new” for up to one year if they meet the test marketing conditions.

Certain situations provide additional limitations on the use of the term “new.” For example, the BBB notes that seasonal goods should only be advertised as “new” if they were created for the current or an upcoming season, regardless of whether the six-month period has been exceeded.

3. **Use of the Term “Certified”**

The FTC prohibits the use of the term “certified,” either in conjunction with the offering of products or services or as part of the name of a product or service, unless a recognized and impartial agency has stated in writing that the quality of the product is as represented. If a legally established or governmental certifying agency exists for the particular product or service, that agency should be the one to have attested to the quality of the product. If the certification comes from an agency affiliated with the advertiser, the advertiser should disclose that fact “in immediate conjunction” with the certification statement.

4. **Use of Environmental or “Green” Claims**

The FTC last revised its Guides for the Use of Environmental Marketing Claims in 1998 and is currently considering further revisions. As currently constituted, the Guides require that any advertiser making an express or implied claim about the environmental benefits of a product, its package, or a service must have a reasonable basis for substantiation of the claim, such as appropriate scientific evidence. The advertiser also must indicate whether a claim applies to one or more of a product, its package, a service, or a component thereof.

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242 F.T.C. 1729 (1967).
244 Id.
246 Id. § 19-957.
247 Fed. Trade Comm’n, Guides for the Use of Environmental Marketing Claims: Request for Public Comment; Announcement of Public Meetings (2007). The Guides remain under review as of the writing of this paper.
The Guides note that advertisers should exercise particular caution when making unqualified general environmental claims, such as “environmentally safe.” Such claims are usually unclear and can have a variety of different meanings. Thus, appropriate qualification is typically required. Advertisers also must not make claims which, although literally true, ignore the realities of how a particular material is handled. For example, if a first part of a product or package is recyclable but a second part of the product or package makes it significantly difficult to recycle the first part, a claim of recyclability of the first part would be deceptive. And on another cautionary note, the Guides state that any comparative claim should reference the basis for the comparison. One example in the Guides concerns the use of a claim such as “20% more recycled content.” Standing alone, this comparative claim could be deceptive because it does not indicate whether the “20% more” is in relation to a previous version of the same product or in relation to a competitor’s product. The Guides also address the applicability of the above principles to specific claims, such as claims of biodegradability, compostability, recyclability, recycled content, source reduction, refillability, and ozone friendliness.

5. **Superlative Claims**

The Lanham Act specifically prohibits false or misleading statements of fact. Alternatively, statements of opinion are not actionable. If the accuracy of a superlative claim can be measured against some benchmark, the claim must be substantiated to avoid being deceptive, false or misleading. In contrast, statements of opinion include “(1) exaggerated statements that bluster or boast upon which no reasonable consumer would rely; and (2) vague or highly subjective claims of product superiority, including bald assertions of superiority.” These statements are commonly referred to as “puffery.” Because such statements are not allegations of truth, they lack the deceptive element of a false advertising claim and the harmful effect on the consumer is negated.

Courts will make the determination of public perception in weighing whether a statement is understood by consumers as a factual allegation or a mere statement of opinion. A statement of fact is usually perceived as a “measurable claim” that is reasonably interpreted as being factual and therefore capable of verification, whereas non-specific, non-measurable statements

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249 Id. § 260.7(a).
250 Id. § 260.7(d).
251 Id. § 260.6(d).
252 Id.
253 Id.
254 Id. § 260.7(b)-(h).
256 Am. Italian Pasta Co. v. New World Pasta Co., 371 F.3d 387, 390 (8th Cir. 2004).
258 Am. Italian Pasta Co. v. New World Pasta Co., 371 F.3d 387, 390 (8th Cir. 2004).
259 Id.
not capable of reasonable interpretation as facts are considered opinion. Thus, while opinions are not actionable as part of a false advertisement claim, franchisors and franchisees should be cautious when making statements intended as puffery, but which may be interpreted as factual allegations that are deceptive and therefore actionable.

A superlative claim is one which makes a claim of absolute superiority of a product’s or service’s attributes, whether or not expressly in comparison to those of competing products or services. Examples include claims that a product or service is the “best,” “biggest,” “only,” offered at the “lowest price,” of the “highest quality,” and so on. Whether such a claim must be substantiated by facts or studies generally depends upon whether it is perceived as a statement of fact, or “obviously exaggerated” and thus not likely to be taken seriously and not likely to be deceptive. Claims that are laudatory, but not superlative, such as “great,” “fantastic” or “luxurious,” generally are not considered statements of fact and are unlikely to be considered misleading.

The meaning of a claim must be taken in the context in which the claim is made. For example, in a Lanham Act case, the Eighth Circuit held that use of the phrase “America’s Favorite Pasta” on the packaging of dried pasta was not a statement of fact because of the absence of any suggestion of a benchmark against which the claim could be evaluated.

On the other hand, a claim that a product is, for example, of the “best” quality when quality measurement standards exist for that product is a statement of fact which, if untrue in light of the quality measurement standards, would invite legal action. For example, in Country Tweeds, Inc. v. FTC, Country Tweeds, Inc. claimed in advertising that its new cashmere was “the best money could buy.” The FTC found, and the Second Circuit agreed, that such advertising was a misrepresentation of test results and violated section 5 of the FTC Act. Country Tweeds illustrates that advertisers cannot hide behind superlative terms that may in the abstract appear to be mere exaggeration if such terms are, in a particular situation, another way of making a verifiable, non-exaggerated factual assertion.

6. Use of Satisfaction Guarantees and Warranties

The FTC has promulgated Guides for the Advertising of Warranties and Guarantees. These Guides require that any advertisement that refers to a warranty or guarantee for a product or service also must state that a consumer may view the warranty or guarantee at the place where the product or service is sold. In television advertisements, any printed message to this effect must remain on the screen for at least five seconds. In the case of catalogs, such
advertisements must indicate that a consumer can request a copy of the warranty or guarantee in writing.\textsuperscript{266}

With specific reference to satisfaction or money-back guarantees and free trial offers, the Guides provide that such guarantees may be made only if the seller’s practice is to refund the full purchase price of the product or service to the consumer upon request.\textsuperscript{267} Any limitations on such a guarantee or offer, including a requirement that a product be returned in its original packaging, also must be disclosed.

If a "lifetime" warranty or guarantee is made, the advertisement must specify how the "life" is measured.\textsuperscript{268} For example, an advertisement for a new computer part with a lifetime guarantee may comply with this requirement by specifying that the part is under warranty as long as the consumer owns his or her computer.

\section{F. Use of Endorsements and Testimonials}

Given Americans’ obsession with celebrities, their endorsement of a product or service can be an extremely valuable marketing tool. Advertisers recognize as much and pay great sums to celebrities for their favorable statements. Additionally, testimonials of ordinary satisfied consumers are often used with great success. These testimonials may even prove more effective than celebrity endorsements because consumers know celebrities are well paid for delivering their glowing reports.\textsuperscript{269} Some ordinary consumer testimonials are so successful that they transform the consumer into something of a celebrity, as was the case with Jared Fogle and his testimonials based on his well-known “Subway Diet.”

Because endorsements and testimonials are such potent means of influencing consumers, the FTC has paid particular attention to them. The FTC promulgated Guides Concerning Use of Endorsements and Testimonials in Advertising, which treat celebrity endorsements and ordinary consumer testimonials largely the same.\textsuperscript{270} The principal requirement of such endorsements and testimonials is that while they are not required to be in the endorser’s words, they must reflect the honest opinions of the endorser and must be statements that could be substantiated if they were made by the advertiser. In the case of organizational endorsements, the endorsement must be the product of the “collective judgment of the organization.”\textsuperscript{271} Moreover, an endorsement or testimonial may be used only so long as the advertiser has good reason to believe that the endorser continues to hold the opinion expressed in the advertisement. If a connection exists between the endorser and advertiser.

\begin{footnotes}
\item \textsuperscript{266} Id. § 239.2(b).
\item \textsuperscript{267} Id. § 239.3(a).
\item \textsuperscript{268} Id. § 239.4.
\item \textsuperscript{270} Id. § 255.0(a).
\item \textsuperscript{271} Id. § 255.4.
\end{footnotes}
that would materially affect the weight or credibility of the endorsement, that connection must be disclosed.\textsuperscript{272} 

If an endorsement or testimonial describes a consumer’s experience, it is assumed absent further disclosure that that experience is typical and to be expected by consumers in general. If that assumption is inaccurate, the Guides require that the advertisement make a conspicuous disclosure stating either what the generally expected results are or that the results achieved by the endorser are not a typical experience.\textsuperscript{273}

The Guides also address the specific use of expert endorsements. Anyone purporting to be an expert on the subject matter of the advertisement must in fact have sufficient qualifications to merit that title.\textsuperscript{274} The expert also must have examined the product with sufficient care to support any conclusions asserted in the advertisement. In the case of comparative advertising, the expert must have sufficiently examined competitors’ products and found the endorsed product superior to such products as a result of the examination.\textsuperscript{275}

G. Disclosures

Advertising disclosures and disclaimers may be used to provide explanations, substantiation, disaffiliation statements, and otherwise help avoid allegations of false advertising. The use of terms such as “simulation” or “dramatization” attempts to disconnect visual representations from the expectation of the consumer. Similar messages are conveyed with a disclosure that the person using a product is an actor, or that “actual results may vary.”

The logical first question concerns whether disclosures must be used. The FTC has indicated that disclosures must be used as necessary to prevent an advertisement from being misleading, to provide material information to consumers, and to advance public policy goals.\textsuperscript{276} Importantly, disclosures cannot be used to undo the effects of a false statement of fact.\textsuperscript{277}

The FTC enforces regulations for the placement, visibility, and content of disclosures used in advertising, including the 900 Number Rule\textsuperscript{278} as well as the Truth in Lending Act and the Consumer Leasing Act.\textsuperscript{279} The FTC also has provided guidance to advertisers regarding

\textsuperscript{272} Id. § 255.5.
\textsuperscript{273} Id. In 2007 the FTC requested public comments on the Guides in conjunction with its release of two studies suggesting that such disclosures do little to reel in consumer expectations of product performance based on endorsements. See FTC Requests Public Comments on Endorsement Guides, http://www.ftc.gov/opa/2007/01/fyi0707.shtm (last visited June 6, 2008). The FTC has not amended the Guides as of this writing.
\textsuperscript{274} FTC Guides Concerning Use of Endorsements and Testimonials in Advertising, 16 C.F.R. § 255.3(a) (2008).
\textsuperscript{275} Id.
\textsuperscript{276} Fed. Trade Comm’n, Dot Com Disclosures (2000).
\textsuperscript{278} http://www.ftc.gov/bcp/conline/pubs/buspubs/900number.shtm (outlining the FTC’s regulation of pay-per-call services).
these aspects of disclosures.\textsuperscript{280} For example, the FTC has stated that while it has no precise requirement as to the required font size of a disclosure or the length of time that one must appear on a screen, any disclosure must be clear, conspicuously presented, visible to consumers, and easily understood.\textsuperscript{281} A disclosure that appears in fine print at the bottom of an advertisement, as a brief video superscript, as a difficult-to-understand spoken message, or which is otherwise easily missed, is not likely to suffice. Additionally, advertisers should bear in mind that reasonable consumers encountering advertisements do not read or listen to every word in the media they encounter.\textsuperscript{282} In order to draw the attention of a reasonable consumer to a disclosure, it is necessary to avoid introducing the disclosure at a time when it is likely to be overwhelmed by other parts of the advertisement, and it may even be necessary to repeat the disclosure within an especially long advertisement.\textsuperscript{283}

Specific issues arise when making disclosures in conjunction with online advertising. Advertisers should draw attention to disclosures with text or visual cues—and not just the presence of a scroll bar—directing consumers to scroll when necessary.\textsuperscript{284} Moreover, in the context of scrolling, advertisers should consider how different web browsers present the same information. If an advertiser hyperlinks to a disclosure, the advertiser should make clear that the hyperlink is a hyperlink, and that it leads to important content. The hyperlink should be noticeable and near the claim it qualifies. Additionally, the hyperlink should be in the same style as other hyperlinks on the advertiser’s web site, and it is preferable that the hyperlink include part of the disclosure. Essentially, the FTC’s statements on online disclosures boil down to the proposition that the same laws that regulate advertising in other media also apply to the Internet. It is how the laws are complied with, and not what the laws are, that changes with each medium.

H. False Advertising and the Lanham Act

Franchisors should be aware that the federal Lanham Act provides a private remedy for false advertising. In a false advertising claim under Section 43(a) of the Lanham Act, the plaintiff must demonstrate that the defendant (1) uses in commerce; (2) a materially false or misleading representation of fact; (3) in commercial advertising or promotion of its product; (4) that is likely to cause confusion or mistake as to the nature, characteristics, qualities or origin of his or another person’s goods, services, or commercial activities; and (5) causes injury to the plaintiff.\textsuperscript{285} Various considerations in a false advertising claim are outlined below.


\textsuperscript{281} See id.


\textsuperscript{283} Id.

\textsuperscript{284} Id.

\textsuperscript{285} 15 U.S.C. § 1125(a) (West 2006); see also Abbott Labs. v. Mead Johnson & Co., 971 F.2d 6, 13 (7th Cir. 1992).
1. **Proper Plaintiff**

The typical plaintiff in a false advertising violation is a competitor. While Section 43(a) protects consumers, the consumer does not have standing to sue under the Act.\(^{286}\)

2. **Commercial and Commerce**

A statement must be made "in commercial advertising or promotion" to be actionable under the Lanham Act\(^ {287}\). Some courts interpret this element as requiring (1) a misrepresentation constituting commercial speech, (2) a defendant in commercial competition with the plaintiff, (3) a statement purposely made to influence consumers to purchase the defendant’s goods or services, and (4) sufficient dissemination of the advertisement to the public.\(^ {288}\) Different courts may vary in their application of some or all of these considerations, so advertisers should be prepared to demonstrate or defend against all factors. Additionally, the "use in commerce" requirement of Section 43(a) requires that the false or misleading description or representation be made regarding products and services that have entered interstate commerce.\(^ {289}\)

In a recent case interpreting the "commercial advertising or promotion" requirement, Paul Sherrill, an architect at the firm of Solis-Betancourt, wrote to the magazine *Architectural Digest* ("AD") and described work that the firm had purportedly done on a home. AD published an article restating Sherrill’s claims. Later, the architectural firm Garcia & Landrau claimed that it was responsible for the house’s architecture and sued Solis-Betancourt in what the court ultimately construed as a false advertising claim under the Lanham Act.\(^ {290}\)

The court made short shrift of the false advertising claim because the AD article was not “commercial advertising or promotion” as required under the Lanham Act.\(^ {291}\) In order to be commercial advertising or promotion, the article had to be, among other things, commercial speech. The court found that the article was not commercial speech because it proposed no commercial transaction and was the product of the efforts of a freelance writer and freelance photographer, and because neither Solis-Betancourt nor the owner of the featured home paid AD to write the article. The fact that Sherrill may have had the economic motivation of drawing attention to Solis-Betancourt could not alone transform the article into commercial speech. Accordingly, Landrau had no actionable false advertising claim under the Lanham Act.

\(^{286}\) *Barrus v. Sylvania*, 55 F.3d 468 (9th Cir. 1995); see also *Made in the USA Found. v. Phillips Foods, Inc.*, 365 F.3d 278 (4th Cir. 2004).


\(^{291}\) *Id.* at *6.*
3. **Literally False or Misleading**

Factual allegations are actionable in false advertising claims when they are either literally false claims, or literally true or ambiguous claims that “implicitly convey a false impression, are misleading in context, or [are] likely to deceive consumers.”

When an advertisement is literally false, a false advertising claim is actionable without proof of consumer confusion, although the plaintiff still must demonstrate injury. The literally false statement “misrepresent[s] the nature, characteristics, qualities, or geographic origin of his or her or another person’s goods, services or commercial activities.” Therefore, to be “literally false,” the statement must be relative to the competitor’s or another’s product, and not just an untrue statement in the abstract. Courts may be more likely to grant a preliminary injunction with a literally false statement in order to prevent consumer confusion.

The recent case of *Healthport Corp. v. Tanita Corp. of America* provides an example of literal falsity. After Healthport sued Tanita for infringement of patents covering Healthport’s body composition monitor, Tanita counterclaimed for false advertising under the Lanham Act. Healthport’s advertising claimed that its ELG product was “the only metabolic analyzer patented in the United States and abroad for unequaled accuracy and validity in the prediction of human body composition” and that the “patented accuracy of the ELG [was] backed by the largest study on body composition analyzers ever conducted, including more than 750 subjects from a wide demographic population.” In truth, of two studies that were conducted, neither compared the ELG head-to-head with a competing product, and neither found the ELG’s accuracy “unequaled;” rather, both studies simply found the ELG “accurate.” The court found that however the two statements about the ELG were construed, they were literally false. For example, the statements could have been construed to mean that the ELG was unequaled in accuracy and validity. Because such a meaning would amount to a claim based on test or study results, and because ELG could not substantiate that claim given the limitations of the two studies, the claim was treated as literally false in accordance with established precedent.

As an alternative to being literally false, the doctrine of “literally false by necessary implication” extends the impact of a misleading statement that, when taken in context, has the effect of being literally false. Such statements, subject to the interpretation of the court,
cannot have multiple interpretations, but instead must unambiguously communicate a false message to be actionable without proof of consumer confusion. For example, when Pennzoil advertised that viscosity breakdown leads to engine failure, and also claimed that Pennzoil outperforms other leading motor oils against viscosity breakdown, the necessary implication and unambiguous conclusion was that Pennzoil oil protected against engine failure better than its competitors.\textsuperscript{302} In fact, the implied claim of superiority in protecting against engine failure was false, as other brands of oil would produce the same engine wear and therefore actionable as false advertising.

Misleading statements also are actionable under Section 43(a), which prohibits “false or misleading description[s] of fact, or false or misleading representation[s] of fact.”\textsuperscript{303} When an advertisement is misleading, as opposed to being literally false, the plaintiff must prove consumer confusion.\textsuperscript{304}

4. \textbf{Causation and Materiality}

The causation element of Section 43(a) requires a link between the confusion caused and the resulting harm.\textsuperscript{305} A misleading advertisement also must be “material” in that it is “likely to influence [a] purchasing decision.”\textsuperscript{306} Therefore, an advertiser’s claims are not actionable unless they have a direct impact on consumers.

Because Section 43(a) refers to “commercial advertising or promotion,” both statements made about an advertiser’s own product and statements made about a competitor’s product qualify as potentially false or misleading claims that are material to purchasing decisions.

Courts may vary in their interpretations of what misrepresentations are material, taking into consideration such resources as consumer surveys and expert testimony. However, courts have rejected the use of surveys evaluating reactions to generic or common words that would not qualify for trademark protection.\textsuperscript{307} Advertisers should be aware of the impact of statements made regarding superior performance or premier pricing, as the reliance on such allegations may lead to a false advertising claim.

\textsuperscript{302} \textit{Castrol, Inc. v. Pennzoil Co.}, 987 F.2d 939, 946-48 (3rd Cir. 1993).
\textsuperscript{303} 15 U.S.C. § 1125(a) (West 2006).
\textsuperscript{304} See \textit{Time Warner Cable, Inc. v. DirecTV, Inc.}, 497 F.3d 144, 153 (2d Cir. 2007) (explaining consumer deception is assumed with a literally false statement, whereas with a misleading statement, courts must rely on extrinsic evidence to prove consumer deception or confusion).
\textsuperscript{305} See \textit{Phoenix of Broward, Inc. v. McDonald’s Corp.}, 489 F.3d 1156, 1169 (11th Cir. 2007) (exploring the prudential standing requirements under § 43(a) for the “directness or indirectness of the asserted injury” and finding that McDonald’s misleading advertisements for promotional game prizes did not directly cause Burger King’s sales decrease).
\textsuperscript{306} See \textit{United Indus. Corp. v. Clorox Co.}, 140 F.3d 1775, 1180 (8th Cir. 1998) (explaining the materiality requirement that a plaintiff must prove when claiming a Lanham Act violation).
\textsuperscript{307} See \textit{America Online, Inc. v. AT&T Corp.}, 243 F.3d 812 (4th Cir. 2001) (explaining the lack of relevance of survey evidence of consumer reaction to commonly used words).
5. **Harm**

False advertising claims distinguish between “injury” and “damage.” While proving injury is required, there is no direct requirement for proof of damages. When an injunction to stop further false advertising is the desired remedy, it is sometimes available with only a showing of injury to the plaintiff.\(^{308}\)

6. **Relief**

The remedies for false advertising claims under Section 43(a) are defined in 15 U.S.C. § 1116-1118. The relief sought in a false advertising claim includes preliminary or permanent injunction preventing continued use of a false advertisement; damages and lost profits, which may be increased; and attorneys fees and costs. Punitive damages are not permitted under the Lanham Act, but may be available under state law.

When an advertisement is literally false, the plaintiff need not prove actual deception in order to obtain a preliminary injunction, yet when an advertisement is misleading and not literally false, the plaintiff must demonstrate consumer confusion. When seeking damages, most courts require proof of actual deception of the public or reliance by purchasers on the false advertisement.\(^{309}\)

The recent case of *North American Medical Corp. v. Axiom Worldwide*\(^{310}\) addressed the current issue of “irreparable harm” prerequisite to injunctive relief. Axiom manufactured a spinal device used to treat lower back pain. North American Medical (“NAM”), a competitor, sued Axiom for false advertising over representations by Axiom that: (1) an affiliation existed between Axiom and NASA, and (2) the spinal device was FDA “approved.” On a motion for preliminary injunction, the trial court found that no affiliation existed with NASA and that the device had only received FDA “clearance.”\(^{311}\) Accordingly, the two representations at issue were literally false. The trial court presumed that NAM would suffer irreparable harm from the representations simply because they were literally false, and proceeded to grant a preliminary injunction.\(^{312}\)

The Eleventh Circuit affirmed the trial court’s findings of literal falsity but vacated the grant of the preliminary injunction.\(^{313}\) The Eleventh Circuit stated that proof of literal falsity had previously been found sufficient to justify a presumption of irreparable harm only for comparative advertising. Because the representations at issue were not comparative advertising, the Eleventh Circuit instructed the trial court to reconsider the question of irreparable harm.

\(^{308}\) See *Novartis Consumer Health, Inc. v. Johnson & Johnson-Merck Consumer Pharm. Co.*, 290 F.3d 578 (3rd Cir. 2002)


\(^{310}\) 22 F.3d 1211 (11th Cir. 2008).

\(^{311}\) *Id.* at 1225.

\(^{312}\) *Id.* at 1217, 1226-27.

\(^{313}\) *Id.* at 1225-26.
In so holding, the Eleventh Circuit expressly declined to consider whether the Supreme Court’s 2006 decision in *eBay Inc. v. Mercexchange, L.L.C.*[^314]—which held that the traditional four-factor test for permanent injunctive relief applies to cases under the Patent Act—also required that irreparable harm not be presumed in a false advertising claim. Notably, however, in vacating the grant of a preliminary injunction on a trademark claim in the same case, the Eleventh Circuit stated that *eBay* was applicable to that claim.[^315]

Plaintiffs also may seek corrective advertising costs for responding to false advertising, which is available without proof of the effect on consumers because the plaintiff can easily produce proof of such damages.[^316] In awarding such “damage control costs,” courts may consider (1) the likelihood of consumer confusion or damage to the plaintiff’s sales, profits, or goodwill, (2) whether the damage control expenses are attributable to the violation, and (3) that the damage control efforts were reasonable under the circumstances and proportionate to the potential damage.[^317]

**IV. CONCLUSION**

Advertising is significant to all franchisors and their franchise systems. Accordingly, franchisors must implement procedures to help ensure compliance with the overlap of state and federal laws applicable to franchise sales advertising and consumer advertising. In the franchise sales context, these laws largely arise at the state level and impose certain filing requirements and content restrictions related to the advertisements. At the federal level, franchisors must make added disclosures under the Franchise Rule if they use financial performance representations as an advertising tool to recruit new franchisees. Franchisor compliance with laws applicable in the consumer advertising context is equally important. Among other considerations, franchisors must be mindful of the vast array of federal and state laws and rules that regulate the content of the consumer advertisements and methods of delivery. While navigating the patchwork of laws applicable to franchise sales advertising and consumer advertising is not easy, successful franchisors will always consult with their counsel—however briefly—to determine the applicability of such laws to each advertisement prior to circulation.

[^315]: 522 F.3d at 1227 n.16.
[^316]: *Big O Tire Dealers, Inc. v. Goodyear Tire & Rubber Co.*, 561 F.2d 1365 (10th Cir. 1977) (providing corrective advertising damages to reverse confusion from trademark infringement).
APPENDIX A

Franchise Advertising: State Filing Requirements

<table>
<thead>
<tr>
<th>State</th>
<th>File # Days Prior to Use</th>
<th>Filing Fee</th>
<th>Number of Copies to Submit</th>
<th>Submit To</th>
<th>Special Requirements</th>
</tr>
</thead>
</table>
| CA    | 3 business days          | None       | 1                           | Franchise Division Department of Corporations 1515 K Street Sacramento, CA 95814 (916) 445-7205 | • Name and address of the franchisor must appear in advertising and promotional materials.  
  • If ad states that the franchise offering is registered pursuant to the CFIL, then include in the ad (in 10-point font & capital letters): THESE FRANCHISES HAVE BEEN REGISTERED UNDER THE FRANCHISE INVESTMENT LAW OF THE STATE OF CALIFORNIA. SUCH REGISTRATION DOES NOT CONSTITUTE APPROVAL, RECOMMENDATION OR ENDORSEMENT BY THE COMMISSIONER OF CORPORATIONS NOR A FINDING BY THE COMMISSIONER THAT THE INFORMATION PROVIDED HEREIN IS TRUE, COMPLETE AND NOT MISLEADING.  
  • If public figure endorses the franchise opportunity (express or implied), disclose in the ad any compensation or other benefit given or promised to such person by franchisor or persons associated with franchisor. |
| MD    | 5 calendar days          | None       | 1                           | Franchise Office Division of Securities 200 St. Paul Place Baltimore, MD 21202 (410) 576-6360 | • Name and address of the franchisor must appear in advertising and promotional materials.  
  • If ad is a videotape, audiotape or other form of communications media (i.e., CD-Rom), must submit a written transcript and a description of the contents of the media. |
<p>| MN    | 5 business days          | None       | 1                           | Franchise Division Department of Commerce 133 East Seventh St. St. Paul, MN 55101 (651) 296-6328 | • Name, address and franchisor’s registration number must appear in advertising and promotional materials. |</p>
<table>
<thead>
<tr>
<th>State</th>
<th>File # Days Prior to Use</th>
<th>Filing Fee</th>
<th>Number of Copies to Submit</th>
<th>Submit To</th>
<th>Special Requirements</th>
</tr>
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</table>
| NY ► | 7 calendar days          | None       | 1                           | Franchise & Securities Division State Department of Law 120 Broadway 23rd Floor New York NY 10271 (212) 416-8211 | • Submit a signed verification that the advertisement is consistent with the FDD on file.  
• In cover letter, state: “We verify that the enclosed advertisement is consistent with the filed Franchise Disclosure Document.” (This is in addition to the separate verification.)  
• Special statement required on all advertisements and promotional materials in easily readable print:  
  “This advertisement is not an offering. An offering can only be made by a prospectus filed first with the Department of Law of the State of New York. Such filing does not constitute approval by the Department of Law.”  
For advertisements no more than 5’ LONG/1 COLUMN WIDE and broadcasts of 30 SECONDS OR LESS, use the following disclaimer in lieu of the longer version noted above: “This offering is made by prospectus only.” |
| ND ► | 5 business days          | None       | 1                           | Franchise Division Office of Securities Commission 600 East Boulevard - 5th Floor Bismarck, ND 58505 (701) 328-2910 | None. |
| RI ► | 5 business days          | $10 per advertisement | 1                           | Franchise Office Division of Securities 233 Richmond St. - Suite 232 Providence, RI 02903 (401) 222-3048 | • Make check payable to: General Treasurer of Rhode Island |
| WA ► | 7 calendar days          | None       | 1                           | The Department of Financial Institutions Securities Division P.O. Box 9033 Olympia, WA 98507-9033 Voice: (360) 902-8760 Fax: (360) 586-5068 | • Name and address of the franchisor must appear in advertising and promotional materials.  
• If public figure endorses the franchise opportunity (express or implied), disclose in the ad any compensation or other benefit given or promised to such person by franchisor or persons associated with franchisor. |
APPENDIX B

Checklist for Review of Consumer Advertising

Below is a summary of sample items to consider in reviewing advertising before publication. The list is not comprehensive, as additional or different issues may be raised in specific situations.

1. **Copyrights**
   a. Releases or assignments from creators of original works of authorship made specifically for the advertisement
      1. Photographs, film or video clips, artwork, illustrations, sound recordings, choreography, written script, etc.
      2. Employee work-made-for-hire
      3. Permissions/Release from contractors and vendors
   b. Releases or licenses from owners of works not created specifically for the advertisement
      1. Photographs, film or video clips, artwork, clip art, illustrations, music, sound recordings, choreography, written script, etc.
      2. Reprint and reuse rights
   c. Musical recordings clearance
      1. Copyrighted Work: Permission to use musical work
      2. Copyrighted Recording: Permission to use sound recording
      3. Synchronization Right: Permission to synchronize song with specific advertisement
      4. Performance rights and potential compulsory licenses
   d. Web links, deep linking or framing may raise copyright or other issues

2. **Trademarks**
   a. Conduct trademark clearance search for proposed trademarks, slogans, logos
1. File trademark applications where appropriate
2. Follow usage guidelines for trademarks

b. Identify any third party-owned trademarks, slogans, logos
   1. Evaluate whether use is proper as comparative advertising, fair use, etc.
   2. Obtain permission for use of other’s trademarks where endorsement may be implied
   3. Consider whether mark is necessary to ad, prominence in ad, accurate, confusing

3. **People and Places**
   a. Releases for model, talent, customer, performer, person-on-street, etc. who are recognizable or identifiable in the advertisement
      1. Consider name, likeness, voice, statements
      2. Person may be identifiable by clothing, tattoo
      3. Avoid use of private, personal information
   b. Location releases for properties where advertisement filmed, photographed, created
      1. Location may be identifiable by architecture, design, artwork, etc.
   c. Check releases to confirm they cover all possible use and users, and adequate contract consideration
   d. Endorsements and testimonials by celebrities or consumers - check separate rules
   e. Deceased celebrities - check separate rules

4. **Claims and Comparisons**
   a. Is there support (substantiation) for all explicit claims?
      1. Statements on product performance, price, quality, etc.
      2. Statements that "tests show" or "consumers prefer"
      3. Statements about market share, "top seller" or "best"
4. Statements comparing advertiser’s product or service to one or more competitors, whether or not named
5. Statistical data and study results; is the testing current, standard, accurate and reproduceable?

   b. Is there support for all implicit claims?
      1. Implied performance claim based on how product or service is shown or used in advertisement
      2. Implied comparison with competitor through visual cues, superlatives

   c. No false claims; no claims that are false by implication when taken in context of entire advertisement; no misleading claims

   d. No material omissions of key facts or information

   e. Do statements appear to be based in fact rather than opinion?

   f. Disclaimers for explanations, potentially misleading aspects or implied endorsement and implied performance
      1. Check placement and type size of disclaimers, footnotes, explanations
      2. No use of disclaimer to contradict claim

   g. Evaluate use of specific terminology such as "free", "new"

   h. Evaluate all substantiation

   i. Consider perspective of typical consumer in target market

5. **Special Issues and Regulations**

   a. Follow specific advertising formats, standards and claims issues of the advertiser

   b. Avoid any dangerous, offensive, inappropriate or socially irresponsible activity or presentation

   c. Be careful with satire and parody; do not assume satire or parody will prevent liability
d. Avoid disclosure of confidences, trade secrets

e. Consider advertising medium
   1. For example, direct mail, telemarketing, email advertising and text message advertising have special rules

e. Consider type of product or service advertised
   1. For example, see special rules about food and drug advertising

f. Consider audience for the advertising
   1. For example, see special rules for children under 13

g. Sweepstakes, contests, coupons and rebates - check separate rules

j. Environmental claims - check separate rules

k. Health claims - check separate rules

l. Warranties and guarantees - check separate rules

m. Country of origin - check separate rules
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CAROL ANNE BEEN

Carol Anne Been is Chair of the national Intellectual Property & Technology practice at Sonnenschein Nath & Rosenthal LLP. Ms. Been has extensive experience in trademark, copyright, trade secret, advertising, computer, internet, media, entertainment and publishing law. She is involved in intellectual property counseling, transactions, clearance, prosecution and litigation. She is a panelist for the World Intellectual Property Organization deciding domain name dispute proceedings under the Uniform Domain-Name Dispute-Resolution Policy. In the advertising area, Carol Anne advises clients on sweepstakes and contests, advertising copy clearance, false and misleading advertising, copyright and right of publicity, privacy, Internet advertising and marketing campaigns, web-development and hosting agreements, affiliate agreements, and blogging and social networking sites. Carol Anne is on the Governing Committee of the Forum on Franchising, and was a co-author of “Brand Misappropriation in the Digital Age,” ABA 28th Annual Forum on Franchising (2005). She serves on the Seventh Circuit Jury Instruction Committee, developing jury instructions for trademark and copyright trials. She is a member of the Richard Linn American Inn of Court for intellectual property attorneys in Chicago. She has been ranked as a leading lawyer by Chambers USA, the Leading Lawyers Network, and the Legal 500 US.