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FTC Addresses Earnings Claims in Internet Advertising

By Lee J. Plave

As franchisors find new ways to reach out to prospective franchisees, there are inevitably questions about how franchise laws — written long before electronic media such as the Internet and e-mail were contemplated — might apply. Recently, the Federal Trade Commission's (FTC) staff provided some guidance to help franchisors understand how the FTC Franchise Rule applies with respect to earnings claims made in the context of Internet advertising.

In January 2004, the FTC's franchise rule staff issued an advisory opinion (FTC Staff Advisory Opinion No. 04-2, available at Bus. Franchise Guide (CCH) ¶ 6522; it can be found online at *www.ftc.gov/bcp/franchise/advops/advis04-2.htm.*) The staff's advisory opinion makes for interesting reading and helps franchisors with questions about how to comply with the FTC's Franchise Rule when advertising on the Internet. While staff advisory opinions are not binding on the FTC, they are nonetheless useful in that they reflect the current views of the staff lawyers responsible for administration and enforcement of the Franchise Rule. In the author's view, the Commission will be reluctant to proceed against a private company that reasonably relied upon the guidance given by staff in an informal advisory opinion that was not revoked.

The principal points addressed in the staff advisory opinion are:

An earnings claim made in an Internet advertisement falls under the coverage of Section 436.1(e) of FTC Franchise Rule, 16 C.F.R. §436.1(e), which is the part of the FTC Rule that addresses earnings claims made for "general dissemination" in the media, as well as in speeches and press releases. This provision of the FTC Rule imposes certain standards (*eg*, the franchisor must have a reasonable basis for the claim and must have substantiating material) and requires certain disclosures to be made with an earnings claim (*eg*, the number and percentage of outlets that achieved similar results as those represented in the claim, and the inclusion of the franchisor's earnings claim information in Item 19 of its UFOC). The portions of the Rule that apply to "media claims" (Section 436.1(e)) are slightly less restrictive than the provisions of the Rule relating to earnings claims directed to a particular prospective franchisee (*see* Sections 436.1(a) and (b)). Staff Opinion 04-2 concluded that the media claims standard will apply to advertising, no matter whether the ad is placed in "traditional media [defined as] print, radio, and television" or whether the ad is transmitted electronically through the franchisor's own Web site or through a third-party Web site.

Staff concluded that there was no reason to distinguish among the different kinds of electronic ads, such as e-mails, banner ads, pop-up ads, or static ads on a Web site.

Ads sent by e-mail might fall into one of two categories. The first category includes communication to a person who started or was (at the time of the e-mail) already involved in a dialogue with a particular franchisor. The second category includes communications in general to other persons — for example, a mass e-mail campaign to reach a list of parties who may be interested in buying a franchise.

Unsolicited commercial e-mail (UCE or spam) sent to persons who expressed interest in a *specific franchisor* (or who otherwise initiated or were already having a dialogue with a particular franchisor) are covered as "point-of-sale" communications and do not fall under the media claim category noted above; rather, these come within the stricter general standard for earnings claims in general found in Sections 436.1(b) and 436.1(c) of the FTC Franchise Rule. 16 C.F.R. §§436.1(b) or (c). Of course, e-mail sent to a prospective franchisee in reply to his or her expression of interest would also fall under Sections 436.1(b) or 436.1(c). E-mail also has to be considered in the context of the CAN-SPAM Act of 2003, which took effect on Jan. 1, 2004, as well as the FTC's ongoing rule making to determine how to implement the new law.

Staff concluded that an initial UCE sent to a person on a mailing list because he or she expressed a general interest in franchising, rather than interest in a specific franchisor, would be covered by the "media claims" standard under Sections 436.1(e). If after receipt of that message, the recipient contacts the franchisor, *then* any follow-up e-mail, in staff's view, would be a "point-of-sale" communication falling under Sections 436.1(b) or 436.1(c)).

The staff concluded that North American Securities Administrators Association's (NASAA) policy on Internet advertisements does not apply to the FTC Rule because the NASAA policy addresses filing requirements, and there are no filing requirements under the FTC Rule. As a result, the Commission would not exclude Internet ads from coverage under FTC Rule Section 436.1(e).

A reference in an e-advertisement to the fact that the franchisor's UFOC contains an earnings claim would not itself be deemed an earnings claim, but staff noted that it might reach a different conclusion if the e-advertisement contained a hot link to the UFOC or a link to other earnings claim information.

The FTC is understood to be in the final phases of its rule making to amend the Franchise Rule. Among other things, the FTC has announced that it is considering a change to the Rule that would add a new section that would specifically permit franchisors to provide "e-Disclosure." This new provision — proposed Section 436.7 — would remove any ambiguity that might still exist notwithstanding the passage in 2000 of the federal E-Sign Act, which largely empowered parties to transact most private and public business using electronic documents instead of paper-and-ink documents. Until the FTC completes that rule making and announces its final position, the states are not likely to get out ahead. Consequently, much action remains to be had in the coming months and years as we await action in Washington and the state capitals.

Once the FTC adopts the final revisions to the Rule, states are more likely to take a serious look at adopting the NASAA Internet policy regarding franchise advertising on the Internet as well as NASAA's proposed policy on e-disclosure. Combined with the application of the CAN-SPAM Act of 2003, the late 2003 provisions of the FACT Act concerning safeguarding of consumers' data (online and offline), and developments in the domain name and cybergriping (online defamation) arenas, this area remains one to watch.

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