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**BEFORE THE DEPARTMENT OF WATER RESOURCES**

**OF THE STATE OF IDAHO**

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| IN THE MATTER OF DISTRIBUTION OF WATER TO WATER RIGHTS NOS. 36-04013A, 36-04013B, AND 36-07148 (SNAKE RIVER FARM) | **Docket No. CM-MP-2009-04** |
| IN THE MATTER OF THE MITIGATION PLAN OFTHE NORTH SNAKE AND MAGIC VALLEY GROUND WATER DISTRICTS TO PROVIDE REPLACEMENT WATER FOR CLEAR SPRINGS SNAKE RIVER FARM<br><br>(Water District Nos. 130 and 140) | **CLEAR SPRINGS FOODS, INC.'S POST-HEARING MEMORANDUM**<br><br>**(Over-the-Rim Mitigation Plan)** |

COMES NOW, Clear Springs Foods, Inc. ("Clear Springs"), by and through its attorneys of record, Barker, Rosholt & Simpson, LLP, and herby submits this *Post-Hearing Memorandum* in support of its positions in protest to the Ground Water Districts' "Over-the-Rim" mitigation plan (OTR Plan). As described below, the Districts' plan fails to meet the requirements of IDWR's Conjunctive Management Rules (CM Rules) and therefore should be denied.

## PROCEDURAL BACKGROUND

The facts leading up to this hearing involve various mitigation plans filed by the North Snake and Magic Valley Ground Water Districts ("Districts"). First, the Districts filed an *Amended First Mitigation Plan* on September 5, 2008. The first plan relied upon a combination actions including CREP, conversions, a "pump-back" of Clear Springs' tail water, delivery of spring water under an IDFG water right, or drilling a well near Clear Springs' facility. At about the same time the Districts filed their first plan they had also filed applications for permit and transfer to implement the plan. These applications were protested by Clear Springs, Clear Lakes Trout Company, Clear Lakes Country Club, and the Clear Lakes Homeowners' Association, and the cases were then consolidated before the Director. The Districts later withdrew this first plan on February 17, 2009, a few weeks prior to the hearing scheduled on the plan and the other applications.

Next, the Districts filed their *Second Mitigation Plan* on December 18, 2008 and an amendment to the plan on February 23, 2009. This plan proposed to provide Clear Springs with "money" or "fish" in order to mitigate for the injury caused by their out-of-priority ground water diversions. Again, this plan was protested by other water users throughout the reaches of the Snake River. The Director denied this second plan on March 5, 2009 by final order. Judge Melanson recently affirmed the Director's decision in his *Order on Petitions for Judicial Review* issued on December 4, 2009 (Gooding County Dist. Ct., 5th Jud. Dist., Consolidated Cases 09-241, 09-270).

A week after a denial of their second plan the Districts filed their *Third Mitigation Plan* ("Over-the-Rim" or "OTR Plan") on March 12, 2009. As part of the plan the Districts proposed to convert approximately 1,060 ground water irrigated acres to a surface water supply and pump

and deliver ground water "over the rim" to Clear Springs. *See* OTR Plan at 6-9. The Districts stated their intent to "lease the water rights of the members converted to surface water and utilize their existing wells, pumps and motors to pump water" to "deliver pumped ground water directly from the wells to Snake River Farm." *Id.* at 7. The Districts further indicated that they "will file Transfer Applications with IDWR for each of the leased water rights as may be required by IDWR to change the place of use, period of use and nature of use for year-round mitigation and fish propagation at Snake River Farm." *Id.* at 8. Contrary to the procedure used with their first plan, the Districts have yet to actually file any applications for transfer with IDWR during the proceedings on this plan.

Testimony and expert reports related to the OTR Plan were filed by the Districts and Clear Springs in the fall, and hearing was held on December 7th and 8th before the Hearing Officer, Justice Gerald F. Schroeder. The parties agreed to a schedule to file simultaneous post-hearing briefing on December 18, 2009 and January 8, 2010.

## HEARING STAGING

At the August 26, 2009 Status and Scheduling Conference the parties decided upon a phased approach for hearing on the OTR Plan. The parties discussed the various issues raised by the plan and Clear Springs' protest. The Districts sought to have the "over-the-rim" proposal heard first and the Hearing Officer and the parties discussed the following at that status conference:

> **Hearing Officer**: Let me just interrupt first. Can we stage this, that is, as I understand, that you object to the concept of the Over the Rim plan, that in terms of reliability and in terms of reputation, several areas if, as a concept that is found to be either adequate or inadequate, then we would move forward with these other, I mean if it's found to be inadequate that's not an acceptable system, then the rest of this evidence would not seem to be relevant in this proceeding would it?

> **Mr. Simpson**: Well I think your Honor it is relevant in the overall administration of the rights, as between this junior and senior, as to what its ongoing obligation is using the best science.
>
> **Hearing Officer**: Well I understand that and I actually agree with you, but let's assume that there's a determination that Over the Rim is simply not an acceptable mitigation, then we have to back up and look at alternatives and then the evidence that you're talking about would seem to be highly relevant.
>
> * * *
>
> **Hearing Officer:** I think the threshold question that you need to get to pretty promptly is whether the Over the Rim simply is an acceptable approach in terms of reliability and quality of water. Then, there will, I assume that in the presentation you make, you would include the volume of water that you can actually engineer and then whether that ultimately is an adequate amount to take in the mind of contingencies because I think it would flux from year to year, flows that are natural and those that are unnatural. . . .

Unofficial transcription of audio recording of August 26, 2009 Status Conference, downloaded www.idwr.idaho.gov/News/WaterCalls/1000Springs%20Users%20Calls/thousand_audio.htm.

The Hearing Officer set forth the approach discussed at the August status conference in his Scheduling Order:

> Hearing on the mitigation plan and the objections will be staged, determining first whether the proposal for over the rim delivery is an acceptable method to mitigate the obligations of the junior ground water users. The remaining issues raised by the objections shall be addressed as and if they become relevant to a final determination.

*Scheduling Order* at 1.

The "acceptability" of the OTR Plan depends upon whether the injury to Clear Springs' senior water rights will be fully mitigated, the effects of the proposed use of a "ground water" supply to replace "spring water" diverted and used under Clear Springs' water rights, and whether the plan satisfies the criteria of the CM Rules. The injury to Clear Springs' water rights and its ability to put the water to beneficial use through its operations from the depletion of spring flows caused by junior ground water pumping must be remediated.

At the close of the 2-day hearing on the first stage, the Hearing Officer clarified the respective burdens on the parties and explained what the Districts had to prove to show an "acceptable" mitigation plan at this point:

> THE HEARING OFFICER: It strikes me that if a recommendation were to come out to approve an over-the-rim plan that there would be a multitude of conditions, because the engineering has not been completed, and we don't know, both from the pumping above the rim to the delivery at the – in the canyon, we don't know a lot of things. And so conditions would have to fill in some of those gaps, and if – I think that's going to fall a heavy burden on [the Districts] to propose conditions that would satisfy, that would make it the equivalent of a 100 percent known plan.
>
> * * *
>
> So – and that's one of the reasons I say that I think they have to prove a workable plan at the threshold. We can't just say "Well, it wouldn't be accepted anyway, so you don't have to go any farther. Your mitigation requirement is fulfilled." We have to have a plan.

Tr. Vol. II, p. 395 lns. 16-25, p. 396, lns. 1-2, p. 397, lns. 4-10.

Contrary to the Districts view of this stage of the hearing, whether the OTR Plan is "acceptable", "workable", and the "equivalent of a 100 percent known plan", is not satisfied by simply showing that water can be physically moved from Point A to Point B, i.e. from the wells sites to Clear Springs' property. Instead, the Districts carry the burden to prove an acceptable and workable mitigation plan when reviewed against the standards used by IDWR to evaluate a Rule 43 mitigation plan.

As explained below, the Districts have failed to carry their burden in this proceeding. Given the state of the testimony and evidence submitted for consideration, the Districts have not proven an acceptable and workable mitigation plan to prevent injury to Clear Springs' senior water rights. As a result, the Hearing Officer should deny the plan.[1]

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[1] Contrary to the Districts' claims, denying the OTR Plan does not preclude other forms of mitigation, including conversions and targeted voluntary curtailment to provide mitigation to the springs. *See* Tr. Vol. I, pp. 33-36.

## MITIGATION STANDARDS

Whether the OTR plan is an acceptable method to mitigate strikes at the heart of IDWR's policy requiring mitigation to be provided "in kind, in time, and in place". *See Testimony of Karl J. Dreher* (Spring Users' Delivery Call Hearing Tr. p. 1178, lns. 12-15) ("the mitigation contemplated in the order had to be in kind – in other words water of equal utility – in time, and in place as what would have resulted from curtailment").

A mitigation plan must identify "actions and measures to prevent, or compensate holders of senior-priority water rights for, material injury". CM Rule 10.15 (emphasis added). In basic terms, in order to be approved, "mitigation" must make the senior water right holder "whole" from the injury caused by out-of-priority ground water diversions.

The Districts must satisfy the requirements set forth in Rule 43 in order to present an "acceptable" and "workable" mitigation plan. Rule 43.01 identifies the information the Districts must submit, including a description of the plan, water supplies to be used for mitigation, and "such information as shall allow the Director to evaluate" the Rule 43 factors. The Director must review the plan and ask whether it "will prevent injury to the senior right"? Rule 43.03. The Rule 43 factors provide certain criteria the Districts must meet in this proceeding, and the list is not "exhaustive" of what can be considered. Rule 43.03 ("Factors that may be considered by the Director . . . include, but are not limited to . . .").

As explained below, the Districts' OTR Plan does not make Clear Springs "whole" from the injury caused by junior ground water pumping. Since the Districts propose to supply replacement water from a source that is not of "equal utility" to Clear Springs under its senior water rights, the plan is unacceptable pursuant to IDWR's mitigation standard and the CM Rules and therefore should be denied.

## REASONS TO DENY THE OTR PLAN

In general, the OTR Plan fails the criteria under the CM Rules and IDWR's mitigation policy requiring water to be provided "in kind, in time, and in place". The plan does not satisfy CM Rule 43 because it is incomplete, lacks a final well location and pumping operation, and provides no analysis or actions to completely mitigate Clear Springs' and other existing water rights. The plan does not provide water of "equal utility" to Clear Springs because it relies upon pumped ground water rather than natural spring water that Clear Springs has relied upon in the historical and current use of its senior water rights.

### I. The OTR Plan Does Not Meet the Requirements of the CM Rules.

The Districts have filed an incomplete and unsettled plan for review by the Hearing Officer. Whereas the proposal is admittedly only 50% complete in design, has changed from what was originally analyzed by the Districts' own experts in their opening reports and testimony, and provides no analysis as to the impact of the operation of the plan on existing water rights, the plan fails under the CM Rules.

The CM Rules do not allow an Applicant to file an "incomplete" mitigation plan for purposes of approval and authorizing ground water rights causing injury to divert out-of-priority. Specifically, the Rules require the following:

> 01. Submission of Mitigation Plans. ***A proposed mitigation plan*** shall be submitted to the Director in writing and ***shall contain the following information***:
>
> a. The name and mailing address of the person or persons submitting the plan.
>
> b. Identification of the water rights for which benefit the mitigation plan is proposed.
>
> c. ***A description of the plan setting forth the water supplies proposed to be used for mitigation and any circumstances or limitations on the availability of such supplies.***

d. ***Such information as shall allow the Director to evaluate the factors set forth in Rule Subsection 043.03.***

CM Rule 43.01 (emphasis added).

Although the Districts' plan contains information relative to subparts (a) and (b) of Rule 43.01, it does not satisfy the requirements of subparts (c) and (d). Without a "reliable water supply" and "such information" to allow the Director to evaluate the factors in Rule 43.03, the Districts' plan is incomplete. Even after submission of all their testimony and evidence at hearing, the Districts still have not provided sufficient information to demonstrate compliance with the Department's CM Rules. The Rules place the burden on the applicant, not the injured party. The Districts' attempt to shift the Rule 43 requirements onto Clear Springs fails to recognize this obligation. Consequently, the OTR Plan should be denied.

**A. The OTR Plan Design is Only 50% Complete.**

At the close of the hearing, the Hearing Officer recognized the burden on the Districts, as the applicant seeking approval of a mitigation plan. *See* Tr. Vol. II, pp. 396-97 ("I think you still have to establish a mitigation plan that will be workable. . . . I think they have to prove a workable plan at the threshold."). The Districts have failed to demonstrate an approvable mitigation plan where the design for construction and operation of the proposed pipeline is only 50% complete at this time. Although the Districts' witnesses opine that they can move water from Point A to Point B, the analysis is incomplete and does not meet the burden to prove a workable mitigation plan at this time.

For example, both Mr. Hardgrove and Mr. Scanlan testified that their engineering design and analysis is only 50% complete. *See* Exhibit 2000, at p. 5; Tr. Vol. I, p. 122 ("A. [Mr. Hardgrove]: The plans that you see in here are approximately 50 percent complete. And these weren't the plans we were planning off building on. We were still working on them."); Vol. II,

p. 252-53 ("Q. Would you agree with Mr. Hardgrove's testimony that the drawings and design work are only about 50 percent complete at this time? A. [Mr. Scanlan]: Yes."). Mr. Hardgrove testified that this approach did not conform to the traditional method used by engineers which typically requires a design to be 90% or better. *See* Tr. Vol I, p. 122, lns. 5-11.

In addition to an incomplete design, Mr. Hardgrove and Mr. Scanlan both acknowledged that additional governmental permissions and permits regarding the location and road crossings for the pipeline have not been obtained by the Districts. For instance, Mr. Hardgrove testified that the highway district has not granted any permission to cross the county roads. *See* Tr. Vol. I, p. 123, lns. 4-10. Mr. Scanlan confirmed this requirement was not yet satisfied. *See* Tr. Vol. II, pp. 255, lns. 9-20. Finally, the Districts' witnesses admitted they did not obtain any permission to place the pipeline within the new route proposed in Mr. Eldridge's Rebuttal Testimony, the county road right-of-way north of the old Clear Lakes Road.

> Q. [BY MR. THOMPSON]: And looking at this alignment within the county road, do the districts have that permission to place that pipeline in that area?
>
> A. [BY MR. ELDRIDGE]: Not to my knowledge.

Tr. Vol. I, p. 137, lns. 15-18.

> Q. [BY MR. THOMPSON]: And if this new alignment is pursued within the road right-of-way, would you agree that county permission would need to be sought for that?
>
> A. [BY MR. SCANLAN]: Yes.
>
> Q. And isn't it true at this time that none of those permits or permissions have been acquired?
>
> A. That's true.

Tr. Vol. II, p, 255, lns. 12-20.

More importantly, none of the Districts' witnesses analyzed or conducted any studies related to moving the route of the pipeline north of the Clear Lakes Road in an area closer to the springs source. *See* Tr. Vol. I, p. 135-36; Vol. II, p. 254-55. Accordingly, although the Districts have proposed to move the pipeline to a new location within the county road right-of-way, apart from "walking the alignment", they have not conducted any studies or investigations related to the new route.

In addition to an incomplete design, lack of permissions for the pipeline route, and no studies or investigations related to the new route, the Districts have not conducted any well pump tests and have not presented any long-term water quality data. *See Brockway Report* at 15, 19; *Macmillan Report* at 26 ("Unfortunately, there is only limited temporal water quality data (Sept. 2009) for the wells so it is not possible to characterize how the ground water quality in these wells varies over time."); *see also*, Tr. Vol. II p. 259, lns. 9-12 ("Q. Isn't it true that you have not conducted any well pump tests on any of these wells under consideration in this plan? A. [By Mr. Scanlan]: That's true.").

In summary, the Districts' design for the pipeline, including the new route proposed north of the old Clear Lakes Road, is only 50% complete at this time. The lack of a complete design and accompanying analyses, as well as the failure to obtain the necessary county and highway district permissions shows the Districts have not met their burden to prove an approvable mitigation plan. *See* Rule 40.01.d.

**A. No Analysis Relative to a Final Well Location and Pumping Operation.**

Apart from an incomplete pipeline design, the Districts have also failed to present a complete analysis regarding a final well location and pumping operation. The lack of a definite well location and pumping operation is fatal to the plan as the Districts cannot meet their burden

to demonstrate an approvable and workable mitigation plan. Identifying a specific well location and pumping regime is necessary to fully understand the effects of the OTR Plan on the springs, both for Snake River Farms, and other existing water rights in the area as explained by Mr. Scanlan at hearing:

> Q. [BY MR. THOMPSON]: Would you agree, based upon your design concepts, whether it's pumping in one location like we discussed under Alternative B or pumping in several locations that knowing the exact configuration and the actual pumping operation is necessary to fully evaluate the impacts on the area springs and area water rights?
>
> A. [BY MR. SCANLAN]: ***Yes. To determine whatever mitigation requirement you'll need, you'll need to know the pumping location and the pumping pattern.***
>
> Q. And this is something we don't have presently in this case; is that correct?
>
> A. Not that I'm aware of. But again, I haven't – that hasn't been part of my evaluation.

Tr. Vol. II, p. 256, lns. 2-15 (emphasis added).

Despite the need to have a final well location and pumping operation to fully evaluate the plan, it's obvious the Districts did not meet this threshold requirement either prior to or at the hearing.

Instead, Mr. Scanlan offered two alternatives in his Direct Testimony and Report filed on September 11, 2009. *See* Exhibit 2000, pp. 6-7, 12-15. Both alternatives incorporated the use of Well #4, which has since been removed from consideration.[2] *See Eldridge Rebuttal Testimony* at 2, *Brendecke Rebuttal Testimony* at 3. Despite this change in the plan, Mr. Scanlan admitted at hearing that he has not revised his prior analysis to determine a well location and pumping operation without the use of Wells #2 and #4 as presented in his Direct Testimony and Report.

[2] Specifically, Mr. Eldridge testified that he recommended and the Districts agreed to remove Wells 2 and 4 from the OTR Plan. *See* Tr. Vol. I, p. 130, lns. 24-25; p. 131, lns. 1-4.

*See* Tr. Vol. II, pp. 256-58. Accordingly, although the general "concepts" expressed in Mr. Scanlan's Alternatives A and B may still be available (i.e. using multiple wells or one well location), the Districts have not presented a final well location and pumping regime to be implemented under the plan. As such, the Districts have failed to meet their burden to present an approvable and workable mitigation plan since it lacks a final plan and pump design analysis.

Different than the pumping regime and schedule offered in Mr. Scanlan's report, Dr. Brendecke offered yet a third alternative in his Rebuttal Testimony, the use of five wells with "uniform pumping" at each site. *See Brendecke Rebuttal* at 3. Although Dr. Brendecke stated his assumptions were "meant to be representative of a likely operating regime of the Over the Rim Plan", Mr. Scanlan couldn't confirm that opinion and admitted his analysis would have to change compared to what was presented in his report:

> Q. [BY MR. THOMPSON]: So would you agree that if wells 2 and 4 were ultimately eliminated, that this Alternative A would change?
>
> A. [BY MR. SCANLAN]: To – yes, to have two less wells.
>
> * * *
>
> Q. So the scheduling of pumping location, volume, timing, that would change from what you identified in this report; correct?
>
> A. That's correct.
>
> * * *
>
> Q. And what, in your opinion, is the most likely configuration of the wells to be used, the actual pumping regime, timing that will be implemented?
>
> A. You know, I don't know what it's going to turn out to be. . . .

Tr. Vol. II, p. 256-257, p. 268, lns. 13-18.

Accordingly, although the "concept" was proposed in rebuttal testimony, no formal analysis or engineering of the "5 well, uniform pumping" alternative was presented by the Districts. As admitted by Mr. Scanlan, he was unaware of the "likely operating regime" to be used for the OTR Plan and he had performed no analysis on the option listed by Dr. Brendecke.

Finally, Mr. Eldridge offered an opinion that a fourth alternative would include "pumping from one location near existing Well 7" and he claimed that both Mr. Scanlan and Dr. Brendecke supported this through "hydrogeologic analyses and numerical simulations". *See Eldridge Rebuttal* at 2. However, contrary to Mr. Eldridge's claim, neither Dr. Brendecke nor Mr. Scanlan presented any analysis as to the alternative to pump all the water at Well 7 only. At most, Mr. Scanlan testified that pumping at one location near Well 7 "might be a candidate". *See* Tr. Vol. II, p. 258, ln. 20.

In summary, the exact well location and pumping configuration for the OTR Plan is unknown and has not been completely analyzed by any of the Districts' witnesses. Although two alternatives were studied by Mr. Scanlan, the removal of Wells #2 and #4 from that design has not been accounted for in any revised studies or design. Although Dr. Brendecke offered a third alternative, no studies or analysis was provided to evaluate that option.

Since pumping from different wells and under a variable schedule necessarily affects the springs differently, the Districts' final proposal to implement the OTR Plan was not presented. Consequently, Clear Springs did not have the opportunity to present a review and rebuttal of that mystery well location and pumping configuration. *See* Tr. Vol. II, p. 315, lns. 21-24. Critical for a review under the CM Rules, it is obvious the Districts have not met their burden to demonstrate an approvable and workable mitigation plan at this point. In addition, the lack of a final well location and operation plan does not provide the Director with sufficient information to evaluate the OTR Plan in the context of the Rule 43 factors. This undefined approach to mitigation was rejected by the Gooding County District Court and does not comply with the law.

In the context of the SWC Delivery Call appeal, Moreover, Judge Melanson recently ruled that it is insufficient for a junior water user to claim that water may or should be available

to provide for mitigation for out-of-priority ground water diversions. Instead, Judge Melanson ruled that juniors have an obligation to "assure" protection of the injured senior water right:

> However, the provision goes on to provide: "***The mitigation plan must include contingency provisions to assure protection of the senior priority right in the event the mitigation water sources becomes unavailable***." *Id.* (emphasis added). This language is unambiguous. . . . In this regard, although the Director adopted a "wait and see" approach, the Director did not require any protection to assure senior water right holders that junior ground water users could secure replacement water.

*Order on Petition for Judicial Review* at 18-19 (emphasis in original) (Gooding County Dist. Ct., 5th Jud. Dist., Case No.08-551; July 24, 2009).

Although the Court was addressing the "reasonable carryover" decision in that case, the holding with regards to a Rule 43 mitigation plan applies with equal force here. The plan must be complete or include contingency provisions to "assure" protection of the senior water right. In this case the Districts have claimed that there is some undefined "well location and pump operation" that could work to provide mitigation water. However, this "theoretical" plan is insufficient on its face and provides no contingency provisions to protect Clear Springs' senior water rights. Since the OTR Plan is incomplete, and contains no contingency provisions to assure protection of Clear Springs' senior water rights, the plan fails. The Hearing Officer should deny the plan accordingly.

### B. The Districts Provided No Analysis Regarding Injury to Existing Water Rights Caused by Pumping Under the OTR Plan.

Likely due to the failure to present a final well location and operation plan, the Districts were unable to provide any definitive analysis regarding the injury to existing water rights caused by implementation of the plan. Although Dr. Brendecke used the Department's "transfer tool" relative to a uniform pumping schedule for 5 wells for purposes of his *Rebuttal Testimony*, he did not evaluate the injury to existing water rights resulting from that plan.

Initially, it should be recognized that Dr Brendecke did not advocate the use of the model when evaluating the proposed mitigation plan, including the accompanying transfers. *See Brendecke Direct* at 8 *("*The model simply cannot represent the precise flow pathways that feed specific spring outlets*");* at 13 ("I concluded that the tool is not designed to readily accommodate the simultaneous analysis necessary for the present situation,"); at 14("It is possible, perhaps even likely, that aquifer behavior in this area is non-linear, in which case the transfer tool cannot be used…").

The CM Rules contain certain factors for the Director's consideration in reviewing a mitigation plan, including the following:

> i. Whether the mitigation plan proposes enlargement of the rate of diversion, seasonal quantity or time of diversion under any water right being proposed for use in the mitigation plan.
>
> j. Whether the mitigation plan is consistent with the conservation of water resources, the public interest or injures other water rights, or would result in the diversion and use of ground water at a rate beyond the reasonably anticipated average rate of future natural recharge.

CM Rule 43.03.

The Districts' OTR Plan proposes to enlarge the "seasonal quantity" and "time of diversion" of the existing ground water rights. The irrigation ground water rights under the plan are not authorized for year-round use for aquaculture purposes. *See* Ex. 2401. Consequently, the Districts have proposed to file transfer applications with IDWR to change the purpose, season, and place of use for the water rights.[3] *See* Exs. 2402, 2403, 2408.

Although an analysis to change the water rights is required for a transfer proceeding, it is also listed as an independent factor in reviewing a mitigation plan under Rule 43. Stated another

[3] Exhibits 2402 and 2403 are "draft" transfer applications and Exhibit 2408 is a revised application that includes the use of Wells #2 and #4, which have since been eliminated by the Districts. Therefore, these exhibits are inaccurate representations of the proposal presented by the Districts.

way, the Hearing Officer and the Director must consider this factor in determining whether or not to approve the Districts' OTR Plan, regardless of a separate transfer proceeding. As demonstrated by the evidence and testimony in this case, the Districts failed to justify the proposed "enlargement" of the irrigation ground water rights and have completely failed to address the injury to existing water rights resulting from implementation of the OTR Plan.

First, Mr. Scanlan, the Districts' witness that provided testimony regarding the pipeline design and well location and pumping operation, did not look at injury to other water rights resulting from the plan:

> Q. [BY MR. THOMPSON]: And you didn't perform any analysis as to injury to other water rights based upon the effects of the plan?
>
> A. [BY MR. SCANLAN]: None.

Tr. Vol. II, p. 264, lns. 11-14.

Similarly, Dr. Brendecke acknowledged that he was not offering any opinions as to injury of water rights:

> Q. [BY MR. SIMPSON]: So in either your direct or rebuttal report, you're not offering any opinions as to the injury of existing water rights?
>
> A. [BY DR. BRENDECKE]: No. The plan is meant to respond to an order by the Department for a replacement supply.

Tr. Vol. II, p. 246, lns. 21-25, p. 247, ln. 1.

Next, Dr. Brendecke testified the changing the irrigation ground water rights to a "year-round" use for aquaculture purposes at Snake River Farms would change the historic pumping pattern and effects on the area springs.

> Q. [BY MR. SIMPSON]: And as it provides more water in the summer to the Snake River Farms complex, wouldn't it be true that it would be taking water away from another spring complex or another part of the spring reach in the Buhl to Thousand Springs reach or another subreach as well?

A. [BY DR. BRENDECKE]: There conceivably could be impacts elsewhere from the effects of the plan. But they would be purely due to the change in the season of use –

* * *

A. Because there's pumping in the winter now under the year-round plan, there will be some pumping stress on the aquifer that wasn't there before in the winter, and so there will be some decrease in discharges in those winter periods.

* * *

Q. And when they reduce flows, spring flows in the wintertime, that's a reduction not only at Snake River Farms but on other springs within the connected reaches, as you've described it.

A. Yeah.

Tr. Vol. I, p. 99, lns. 19-25, p. 100, lns. 1-3, p.101, lns. 21-25, p. 103, lns. 11-16.

Dr. Brendecke clearly recognized that enlarging the "season of use" and pumping the wells year-round results in new stresses on the aquifer, reducing wintertime spring flows. This testimony about new wintertime impacts on area springs is supported by Dr. Brockway's Rebuttal Report:

> The transfer will decrease wintertime SRF spring flow below the historic wintertime flows. . . . Simulation of the changes in seasonal timing and location of pumping based on the over-the-rim plan, shows that there will be additional wintertime impact to all reaches of the Snake River from Milner downstream. There will be decreased wintertime reach gains in the Buhl to Thousand Springs reach and decreases in SRF spring flows compared to historical. The provision of 3 cfs of replacement water proposed in the over-the-rim plan does not totally eliminate decreases in SRF spring flow in the wintertime.

*Brockway Rebuttal Report* at 17.

Despite the new injury to existing water rights, the OTR Plan does not mitigate the effects on the spring supplying Snake River Farms as well as other springs or senior water rights on those sources. Dr. Brendecke admitted that the plan does not address the new seasonal depletions on area spring flows:

Q. [BY MR. SIMPSON]: Is there any provision in the plan to mitigate for that change, the change in the historical depletive pattern?

* * *

Q. So is the answer to my question no, there's not anything in the plan that --

A. [BY DR. BRENDECKE]: There's nothing in the plan right now to explicitly mitigate the changes associated that would come about in the process of doing the transfer to year-round pumping.

Tr. Vol. I, p. 110, lns. 4-6, 10-15.

In summary, the OTR Plan fails the criteria under CM Rule 43.03.i and j. The Districts' proposed change to year-round pumping results in new wintertime depletions different than historical use of the water rights. This change is predicted to occur both at the springs supplying Snake River Farms and other area springs in all reaches of the river downstream from Milner Dam. Even supplying some "replacement water" to Clear Springs does not completely eliminate the new wintertime depletion. *See Brockway Rebuttal Report* at 17, 19. Since the resulting injury to existing water rights is not addressed by the OTR Plan, it should be denied.

**C. No Reliable Water Supply.**

The Districts do not have an authorized or reliable water supply to use for mitigation to implement the OTR Plan. *See Clear Springs' Motion to Dismiss*; *Reply in Support of Motion to Dismiss*. Without an approved transfer, the Districts have no water to supply for the pipeline. The Districts' witnesses admitted this fact at hearing. *See* Tr. Vol. I, pp. 78-79 ("[Dr. Brendecke]: The over-the-rim plan can't deliver water only pumping in the irrigation season. . . These things will require that a transfer be approved."); Vol. II, p. 269 ("Q. And would you agree that until that transfer is approved, the districts do not have an authorized water supply to provide under this plan? A. [Mr. Scanlan]: Yes.").

Since the Districts do not have an authorized water supply to implement the plan, this failure constitutes a "circumstance or limitation" on the availability of the water to be used for mitigation. *See* CM Rule 43.01.c. Absent an approved transfer, the plan cannot be implemented.

In addition, the Districts have failed to include any "contingency provisions" to assure protection of Clear Springs' injured senior water rights in the event the "mitigation source becomes unavailable". *See* Rule 43.03.c. For example, even assuming the Plan is approved and the Districts have a reliable water supply, the leases with the ground water right holders provide for termination in the event surface water for the conversion acres are not supplied. *See* Exhibit 2502 at 4, ¶ 3.2. It doesn't matter that the termination for failure to deliver surface water can only occur during the non-irrigation season, the fact remains that there is no contingency in place to protect Clear Springs' water rights in the event any of those leases are terminated.

## II. The OTR Plan Does Not Provide Water "In Kind, In Time, and In Place".

The Districts' proposal to provide pumped well water to Clear Springs does not provide water "in kind, in time, and in place". Based upon the evidence and testimony submitted by Clear Springs, pumped ground water is not of "equal utility" to replace the spring water appropriated and used under Clear Springs' senior water rights.

Similar to the "money" or "fish" mitigation recently rejected by the Director, and Judge Melanson, the OTR Plan does not "mitigate" Clear Springs' injury to its senior water rights. By proposing to deliver pumped ground water, the Districts are seeking to provide water from a "source" that is not of equal utility to Clear Springs in the way it has historically used its senior water rights.

In affirming the Director's denial of the Districts' *Second Amended Mitigation Plan*, Judge Melanson held:

> Any interpretation authorizing the Director to compel the acceptance of monetary compensation or other compensation in lieu of water, except for purposes of providing access to water, replacement water or by agreement, would not only result in the Director exceeding his authority but would also result in an unconstitutional application of the CMR.
>
> * * *
>
> Interpreting the phrase "***or other appropriate compensation***" as granting the Director authority to compel the acceptance of monetary or other compensation in lieu of water is entirely inconsistent with Article XV, § 3.

*Order on Petitions for Judicial Review* at 16-17 (Gooding County Dist. Ct., 5th Jud. Dist, Consolidated Case Nos. 09-241 and 09-270) (emphasis in original).

Similarly in this case, the Director should not be authorized to compel the acceptance of replacement water from another source that does not mitigate the senior water rights from depletions of spring flows. Just as providing "money" or "fish" associated with lost production of 2 cfs was not acceptable, providing 2 cfs of water that is not of "equal utility" as the spring source Clear Springs has historically relied upon under its senior rights is not acceptable either.

Although the Districts propose to mitigate the "quantity" element of Clear Springs' water rights, the "source" element is not mitigated with pumped ground water. Stated another way, the "source" of Clear Springs' water rights is a critical aspect of the use of its senior water rights. Injury to the source, by providing pumped ground water instead of spring water, is not mitigated by replacing the quantity only. In that regard Clear Springs is not made "whole" and the injuries from junior ground water pumping will continue contrary to the CM Rules and IDWR's mitigation requirements.

### A. The OTR Plan Does Not Provide Water "In Place".

At the outset it is important to place the effect of the OTR Plan in perspective. The plan does not replace or "create" additional water for Clear Springs or provide it in the springs.[4] Instead, the proposal to pump ground water and deliver it through an "over-the-rim" pipeline only changes the timing as to when Clear Springs would otherwise receive "spring water" under its senior water rights. In essence, the proposal takes water away from the natural springs and sends it through a series of wells, pumps, a pipeline and degassing structure in order to deliver it to Clear Springs.

The Districts' engineer Terry Scanlan testified that if the Districts did not pump the water, the "majority" of the water would flow to and discharge as springs supplying Snake River Farms:

> Q. [BY MR. THOMPSON]: And you would agree that the water pumped at these wells affects the discharges at the springs in this Clear Lakes vicinity?
>
> A. [BY MR. SCANLAN]: Yes.
>
> Q. And I believe you've testified that it's your opinion that pumping by wells close to the rim is likely to intercept water that is headed for the springs?
>
> A. Yes.
>
> * * *
>
> Q. Would you agree that it's your opinion that if water is not pumped out under the over-the-rim plan that the majority of the water, if not all of it under these wells, is headed to the discharge at the springs that supplies Snake River Farms?
>
> A. The springs that supply Snake River Farms and other – the other springs within the Clear Lake complex, I believe the majority of the water is flowing towards those springs.

Tr. Vol. II, p. 261 lns. 12-20, p. 262, lns. 1-10.

[4] Although pumping under the junior rights depletes the ESPA and affects spring discharges, the out-of-priority pumping under the ground water rights offered in the Plan is causing injury to Clear Springs' senior water rights

If the Districts did not pump the wells, including the junior priority irrigation rights, water would otherwise flow to the springs for use under Clear Springs' senior water rights.[5] Of the 28 water rights listed in the Districts' OTR Plan (*see* Exhibit 2401), 16 of those rights are junior in priority to Clear Springs' 1964 water right (36-0413B). Of those same 28 rights, 23 of those are junior in priority to Clear Springs' 1955 water right (36-0413A). Accordingly, but for that interference caused by junior pumping under those rights, Clear Springs would receive more water discharging through springs for use under its senior water rights. Changing the pumping regime to year-round schedule, even at a lower rate, does not change the fact that the water is still pumped out-of-priority, to the injury of Clear Springs' senior rights.

Since the OTR Plan relies upon man-made facilities to pump and deliver "ground water", spring water is not provided "in place".

### B. The OTR Plan Does Not Provide Water "In Kind" and the Districts Propose to Replace Injury to Quantity with Injury to the Source.

The Rule 43 factors are not "exhaustive" and in order to meet IDWR's standard to provide mitigation "in kind, in time, and in place", the Districts must make Clear Springs' "whole". Providing water from a source that is not of "equal utility" to Clear Springs is unacceptable since it replaces injury to the quantity with injury to the source of Clear Springs' water rights.

Although the Districts acknowledge the importance of "water quality" for purposes of their mitigation plan, since they removed Wells #2 and #4 from the OTR Plan proposal, they fail to mitigate the injury to the spring source by proposing to provide pumped ground water instead of natural spring water. Pumped ground water is not "spring water" that Clear Springs has relied upon in the appropriation and use of its senior water rights. As demonstrated by the testimony

[5] As explained in Part I.B, *supra*, pumping also affects other area springs and the OTR Plan does not mitigate for any of those effects on other senior water rights on those sources.

and evidence submitted by Clear Springs' witnesses, the source of Clear Springs' water rights is the very foundation of its operations at Snake River Farm and is the cornerstone of the Company's "brand image" and reputation it has developed to market and sell its Idaho grown rainbow trout.

Contrary to the Districts' claims at hearing, Clear Springs has consistently raised objections to the delivery of water which impairs the reputation, image or value of the Company.[6] Exhibit 2 to *Expert Report of John R. MacMillan.* In addition, Mr. Cope and Dr. MacMillan each described the importance of the source of water to Clear Springs in their pre-filed testimony filed on October 30, 2009. In that testimony Mr. Cope explained the Clear Springs' brand and the image created by the company over time:

> 1. From inception through heavy investment and time the Company has built its brand name CLEAR SPRINGS, and image around our claim of only growing our Idaho Rainbow Trout in spring water. . . . Nearly weekly the company receives visits from customers and potential customers who are astounded by the fresh pristine water that flows from the Snake River Canyon into the Clear Springs production farms. The CLEAR SPRINGS brand was built around this unique resource, not available any other place in the world.
>
> 2. The water resource, both quality and quantity, is the primary foundation of value for Clear Springs Foods, Inc. and the Idaho aquaculture industry as well as other surface water users located below the rim in western Magic Valley.
>
> * * *
>
> 1. . . . The water being delivered to the Snake River Farm site would not be natural spring water, thereby diminishing the image of the CLEAR SPRINGS brand and products and reducing the value of the CLEAR SPRINGS brand and the company. The pillar of the brand strength is the identity of the water where the Rainbow Trout are being produced in. The Company could no longer represent that our Idaho grown Rainbow Trout are only grown in pure pristine spring water.

*Larry W. Cope Testimony* at 3-4, 5.

[6] *See also*, Hearing Officer's comment at 8/26/09 conference: "that is, as I understand, that you object to the concept of the Over the Rim plan, that in terms of reliability and in ***terms of reputation***" (emphasis added).

Dr. MacMillan described the company's image and its marketing approach that has centered upon the natural spring source and the differentiation with other forms of aquaculture:

> **1. Clear Springs Foods historic marketing has focused on the fact that it's Idaho produced rainbow trout (its core business) are grown in pure "spring" water flowing its farms. The general marketing approach has been holistic-addressing environmental stewardship, food safety, efficient production and that consumer value originates with Clear Springs Foods large supply of pure spring water (JRM Expert Report Exhibits 3, 4a, 4b, 5, 6, and 7).** The spring water is globally unique and the aquifer supplying the springs is world class (Smith 2004). . . . While the gravity fed spring water is crucial for efficient low-cost flow-through rainbow trout production, but it establishes a critical point of differentiation with other forms of aquaculture, and wild capture fisheries because the water itself is so unique. **The OTR Plan proposes to strip Clear Springs Foods of this crucial point of differentiation and diminish its marketing success.**
>
> * * *
>
> The spring water entering Clear Springs Foods facilities, flowing naturally from the canyon walls over-looking the Snake River, is globally unique. . . . **The water is delivered by gravity flow eliminating consumer concerns about energy consumption. Natural, gravity fed, pure spring water creates a dramatic point of product differentiation that Clear Springs Foods has capitalized on.**
>
> * * *
>
> **4. Clear Springs Foods historic marketing has emphasized its Idaho trout are all "natural".** Clear Springs Foods marketing definition of natural is that water is delivered free of energy costs, free of contaminants that can taint the fish, and fed food containing all natural ingredients. **Natural begins with the spring water and is another point of distinction for Clear Springs Foods.**
>
> * * *
>
> **But contrary to most agriculture products raised in Idaho, issues of water purity, water delivery mechanisms, environmental impacts both locally and globally, energy inputs and public/consumer perceptions are key factors impacting the marketability of farmed seafood. Clear Springs Foods, a domestic aquaculture based food company recognized that challenge in 1966. Its marketing program includes environmental stewardship, and the use of gravity flow, pure spring water. Consequently, mitigation plans that if implemented would jeopardize the marketability of Clear Springs Foods core business project, such as the OTR project would do, must be rejected.**

*Expert Report of John R. MacMillan* (October 30, 2009) at 10-11, 13-15 (emphasis in original).

The source of the water for Clear Springs' fresh commercial rainbow trout products, grown in Idaho, for example its "Clear Cuts® natural fillet", has historically and consistently been the "spring" discharges:

**"All Natural"**

**"Grown in Pure Spring Water"**

*See* Exhibit 4 at 2 (emphasis added).

As described by Mr. Cope and Dr. MacMillan, the source of water has been the foundation for the Company's marketing and advertising since inception. Site visits by potential customers include tours of the source of the water, pristine spring water, discharging from the canyon wall and cascading down through natural vegetation until collected. Visitors observe the entire natural, gravity operations at Clear Springs where pumping is not utilized in the direct delivery of water through the raceways. The sustainability observed by this system is not lost upon customers who visit. *See Cope Testimony* at 3-4.

Apart from Clear Springs' actual operations, the Company's trademark reflects the blue, clear water against the *natural* green backdrop mirroring the natural occurrence at the facility which has continued without interruption. Clear Springs has been able to differentiate its operations and product from others throughout the United States and the world because of the uniqueness both in terms quantity and quality of the source. Without the spring water, Clear Springs would not have originally been a viable venture and its continued viability based upon reputation, image and market is premised upon the natural spring water source. *See Cope Testimony* at 7, *MacMillan Expert Report* at 13-15; *Cope and MacMillan Supplemental Testimony* at 2-3.

At hearing, Mr. Cope explained the substantial investment Clear Springs has made in its brand and the image it has portrayed in developing its fresh Idaho-grown rainbow trout product:

> A. [BY MR. COPE]: As I testified I think earlier today that over the nearly – approximately 40-some years, our company has invested literally millions of dollars in developing our brand identification. And the foundation for that branding has always been with our Idaho-produced trout that our products are produced in natural, pristine spring water. And it's true today.
>
> It's in our materials. It's in our sales presentations, our sales points. It's covered in visitations of our – many people coming in on a weekly basis visiting us, visiting our facilities, what we're doing.
>
> So we have a very, very heavy investment in our brand that's taken years to achieve the recognition that we have today in the fish and seafood business.

Tr. Vol. II, p. 372, lns. 1-17.

Importantly, the natural environment, from the source of the water, delivery, the use of feed, waste management, water quality and quantity management have been an integral part of the Monterey Bay Aquarium's recognition of rainbow trout as a seafood best choice, a recognition highly sought after in the market place. *See Cope Testimony* at 3.

Accordingly, the "source" of the water used by Clear Springs under its senior water rights is an integral part of its operations and is the foundation for its brand and image. The source of Clear Springs' water rights, the springs, is analogous to Idaho land to a farmer that grows potatoes and relies upon that image for his operations. Although that farmer could theoretically replace his Idaho farm and grow potatoes of the same yield and quality in land located in Washington the end product would not be an "Idaho potato". Similarly, Clear Springs cannot grow its fresh Idaho grown rainbow trout in pumped ground water and represent that it was grown in spring water. The spring source is critical for Clear Springs' continued operations and represents an image that has been built upon from years of historical use of the Company's senior water rights and has allowed the Company to gain a reputation in the market.

Even the Ground Water Districts' witness recognized this fact at hearing. Despite Mr. Schuur's lack of any experience in the commercial trout industry, he still recognized Clear Springs' relationship with spring flows and dependence upon market differentiation. *See* Tr. Vol. I. p. 185, lns. 20-23 ("But in a general hierarchy of the quality of water in aquaculture facilities, ***a spring such as you have at Clear Springs is the best you can get, no question***.") (emphasis added); *see also* pp. 214-16.

What Clear Springs' witnesses Mr. Cope and Dr. MacMillan, as well as the Districts' witness Mr. Schuur all point out directly is that marketing is all about perception. Clear Springs has expended years and resources developing the intimate relationship between the source of its water rights, naturally occurring spring water, and the quality of its Idaho grown fresh rainbow trout. It is this very nexus between the Company, quality of the product and quality of the resources utilized to raise the product from egg to fillet, that is referenced in documentation supplied by Mr. Schuur. *See* Exhibit 35 at p. 33.

Although Clear Springs' witnesses and the Districts' witnesses agree on the importance of branding, quality, and market perception, they part ways with their respective perspectives on the ethical standards which govern fair Marketing practices. Mr. Schuur would find no ethical or legal impediments to continuing to market Clear Springs' fresh, rainbow trout fillets as grown in natural spring water even though the Districts would supply pumped ground water through the OTR Plan. *See Schuur Rebuttal Testimony* at 10; Tr. Vol. I, p. 203. Mr. Schuur's ignorance of the commercial trout industry standards, might stand as the basis for the lack of appreciation of the ethical dilemma taking such a stance would impose upon Clear Springs and its business. However, given his asserted experience in other seafood operations, his disregard for federal requirements prohibiting deceptive advertising cannot go un-noticed. *See* Tr. Vol. I, p. 204-205.

Clear Springs' ethical standards would bar them from the continued advertising of gravity fed, spring water utilized in the production of Idaho rainbow trout, if in truth pumped water from off-site sources was being conveyed mechanically through pumps, a pipeline and a de-gassing facility to artificially enhance the water supply. *See Cope and MacMillan Supplemental Testimony* at 5, lns. 12-21; Tr. Vol. II, pp. 355-56. Mr. Cope testified as to the Company's ethical standard it abides by:

> Q. [BY MR. BUDGE]: And that's simply a business decision that Clear Springs may choose to make?
>
> A. [BY MR. COPE]: Well, it's not necessarily a business decision. It's a decision of value. Do you tell the truth or don't you tell the truth?

Tr. Vol. II, p. 355, lns. 16-20.

Forcing Clear Springs to accept pumped ground water would dictate ethically that Clear Springs modify or cancel its historical marketing focus on the source of water for Idaho products as "pristine spring water." The image created by Clear Springs' diversion and use of this water and the quality image and value associated with its product would be jeopardized.

When questioned about balancing the effects of having more water for production versus the toll on Clear Springs' image, Mr. Cope responded:

> A. [BY MR. COPE]: . . . But if the State imposes this mitigation on Clear Springs, is what really occurs is the State then substituting the injury of not receiving water for another injury, which, in my view, is substantially more to where we at that time, as we have discussed in this testimony, would no longer be able to represent our products as being raised in natural, pristine spring water in Idaho. We would discontinue that. We would need to discontinue that.

Tr. Vol. II, p. 373, lns. 8-17.

Moreover, imposing on Clear Springs the decision to either risk violating federal law, or take well water, can't be viewed under any circumstances as viable mitigation.

It was this same balancing of business operations concerning adequate spring flows and the

Company's historical image and marketing that led Clear Springs to the conclusion that chasing declining spring flows back into the subsurface through horizontal wells was not neither prudent; nor practical. *MacMillan Supplemental Testimony at* 3. Likewise, in a similar conclusion former Director Dreher determined that the senior was not required to "chase" the water through the drilling of horizontal wells. The use of wells was not the historic means of appropriating water and such actions should not be imposed upon Clear Springs.

Moreover, imposing on Clear Springs the decision to either risk violating federal law, or take ground or well water, cannot be viewed under any circumstances as "acceptable" or "workable" mitigation. Arguably, if Clear Springs Foods received pumped water and continued its claim to use only "pure, gravity fed spring water," Clear Springs would be subject to claims of Federal Trade Commission Act violations. *See* **Exhibit A** *FTC Policy Statement on Deception* (appended to *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 174 (1984)); *see also*, 15 U.S.C. § 41 et seq. (particularly 15 U.S.C. §§ 52-55).

It is clear that there would exist the opportunity for someone, including competitors, to assert wrongdoing on the part of Clear Springs, irrespective of the result. Since "marketing is all about perception", as recognized even by the Districts' witness Mr. Schuur, exposing Clear Springs to such a claim, regardless of its ultimate outcome, creates risk to Clear Springs' operations, image and reputation that was not present prior to the injury caused by junior ground water pumping. Since Clear Springs has invested considerable time and resources to gain its reputation, brand image, and place in the market, the Districts' proposal to provide replacement water that is not "in kind" or of "equal utility" to the natural spring water Clear Springs relies upon is not adequate mitigation.

## CONCLUSION

In summary, the Districts' OTR Plan does not meet the criteria for an acceptable mitigation plan under the CM Rules and IDWR's mitigation standards. The Districts' plan is incomplete, does not identify a final well location and pumping operation, and fails to completely mitigate the injury to Clear Springs' and other existing water rights. In addition, the water proposed for replacement does not provide mitigation "in kind, in time, and in place" to mitigate Clear Springs' senior water rights to the springs.

Since the Districts have failed to meet their burden to prove an acceptable mitigation plan, the Hearing Officer should deny the OTR Plan.

DATED this 18th day of December, 2009.

**BARKER ROSHOLT & SIMPSON LLP**

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**CERTIFICATE OF MAILING**

I hereby certify that on December 18, 2009, the above and foregoing, was sent to the following by U.S. Mail proper postage prepaid and by email:

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Travis L. Thompson

# Exhibit
# A

# FTC POLICY STATEMENT ON DECEPTION

Appended to Cliffdale Associates, Inc., 103 F.T.C. 110, 174 (1984).

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

October 14, 1983

The Honorable John D. Dingell
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This letter responds to the Committee's inquiry regarding the Commission's enforcement policy against deceptive acts or practices.[1] We also hope this letter will provide guidance to the public.

Section 5 of the FTC Act declares unfair or deceptive acts or practices unlawful. Section 12 specifically prohibits false ads likely to induce the purchase of food, drugs, devices or cosmetics. Section 15 defines a false ad for purposes of Section 12 as one which is "misleading in a material respect."[2] Numerous Commission and judicial decisions have defined and elaborated on the phrase "deceptive acts or practices" under both Sections 5 and 12. Nowhere, however, is there a single definitive statement of the Commission's view of its authority. The Commission believes that such a statement would be useful to the public, as well as the Committee in its continuing review of our jurisdiction.

We have therefore reviewed the decided cases to synthesize the most important principles of general applicability. We have attempted to provide a concrete indication of the manner in which the Commission will enforce its deception mandate. In so doing, we intend to address the concerns that have been raised about the meaning of deception, and thereby attempt to provide a greater sense of certainty as to how the concept will be applied.[3]

## I. SUMMARY

Certain elements undergird all deception cases. First, there must be a representation, omission or practice that is likely to mislead the consumer.[4] Practices that have been found misleading or deceptive in specific cases include false oral or written representations, misleading price claims, sales of hazardous or systematically defective products or services without adequate disclosures, failure to disclose information regarding pyramid sales, use of bait and switch techniques, failure to perform promised services, and failure to meet warranty obligations.[5]

*Second*, we examine the practice from the perspective of a consumer acting reasonably in the circumstances. If the representation or practice affects or is directed primarily to a particular group, the Commission examines reasonableness from the perspective of that group.

*Third*, the representation, omission, or practice must be a "material" one. The basic question is whether the act or practice is likely to affect the consumer's conduct or decision with regard to a product or service. If so, the practice is material, and consumer injury is likely, because consumers are likely to have chosen differently but for the deception. In many instances, materiality, and hence injury, can be presumed from the nature of the practice. In other instances, evidence of materiality may be necessary.

Thus, the Commission will find deception if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer's detriment. We discuss each of these elements below.

## II. THERE MUST BE A REPRESENTATION, OMISSION, OR PRACTICE THAT IS LIKELY TO MISLEAD THE CONSUMER.

Most deception involves written or oral misrepresentations, or omissions of material information. Deception may also occur in other forms of conduct associated with a sales transaction. The entire advertisement, transaction or course of dealing will be considered. The issue is whether the act or practice is likely to mislead, rather than whether it causes actual deceptions.

Of course, the Commission must find that a representation, omission, or practice occurred in cases of express claims, the representation itself establishes the meaning. In cases of implied claims, the Commission will often be able to determine meaning through an examination of the representation itself, including an evaluation of such factors as the entire document, the juxtaposition of various phrases in the document, the nature of the claim, and the nature of the transactions.[7] In other situations, the Commission will require extrinsic evidence that reasonable consumers reach the implied claims.[8] In all instances, the Commission will carefully consider any extrinsic evidence that is introduced.

Some cases involve omission of material information, the disclosure of which is necessary to prevent the claim, practice, or sale from being misleading.[9] Information may be omitted from written[10] or oral[11] representations or from the commercial transaction.12

In some circumstances, the Commission can presume that consumers are likely to reach false beliefs about the product or service because of an omission. At other times, however, the Commission may require evidence on consumers' expectations.[13]

Marketing and point-of-sales practices that are likely to mislead consumers are also deceptive. For instance, in bait and switch cases, a violation occurs when the offer to sell the product is not a bona fide offer.[14] The Commission has also found deception where a sales representative misrepresented the purpose of the initial contact with customers.[15]

When a product is sold, there is an implied representation that the product is fit for the purposes for which it is sold. When it is not, deception occurs.[16] There may be a concern about the way a product or service is marketed, such as where inaccurate or incomplete information is provided.[17] A failure to perform services promised under a warranty or by contract can also be deceptive.[18]

## III. THE ACT OR PRACTICE MUST BE CONSIDERED FROM THE PERSPECTIVE OF THE REASONABLE CONSUMER

The Commission believes that to be deceptive the representation, omission or practice must be likely to mislead reasonable consumers under the circumstances.[19] The test is whether the consumer's interpretation or reaction is reasonable.[20] When representations or sales practices are targeted to a specific audience, the Commission determines the effect of the practice on a reasonable member of that group. In evaluating a particular practice, the Commission considers the totality of the practice in determining how reasonable consumers are likely to respond.

A company is not liable for every interpretation or action by a consumer. In an advertising context, this principle has been well-stated:

An advertiser cannot be charged with liability with respect to every conceivable misconception, however outlandish, to which his representations might be subject among the foolish or feeble-minded. Some people, because of ignorance or incomprehension, may be misled by even a scrupulously honest claim. Perhaps a few misguided souls believe, for example, that all "Danish pastry" is made in Denmark. Is it therefore an actionable deception to advertise "Danish pastry" when it is made in this country.? Of course not, A representation does not become "false and deceptive" merely because it will be unreasonably misunderstood by an insignificant and unrepresentative segment of the class of persons to whom the representation is addressed. Heinz W. Kirchner, 63 F.T.C. 1282, 1290 (1963).

To be considered reasonable, the interpretation or reaction does not have to be the only one.[21] When a seller's representation conveys more than one meaning to reasonable consumers, one of which is false, the seller is liable for the misleading interpretation.[22] An interpretation will be presumed reasonable if it is the one the respondent intended to convey.

The Commission has used this standard in its past decisions. The test applied by the Commission is whether the interpretation is reasonable in light of the claim."[23] In the Listerine case, the Commission evaluated the claim from the perspective of the "average listener."[24] In a case involving the sale of encyclopedias, the Commission observed "[i]n determining the meaning of an advertisement, a piece of promotional material or a sales presentation, the important criterion is the net impression that it is likely to make on the general populace."[25] The decisions in American Home Products, Bristol Myers, and Sterling Drug are replete with references to reasonable consumer interpretations.[26] In a land sales case, the Commission evaluated the oral statements and written representations

"in light of the sophistication and understanding of the persons to whom they were directed."[27] Omission cases are no different: the Commission examines the failure to disclose in light of expectations and understandings of the typical buyer[28] regarding the claims made.

When representations or sales practices are targeted to a specific audience, such as children, the elderly, or the terminally ill, the Commission determines the effect of the practice on a reasonable member of that group.[29] For instance, if a company markets a cure to the terminally ill, the practice will be evaluated from the perspective of how it affects the ordinary member of that group. Thus, terminally ill consumers might be particularly susceptible to exaggerated cure claims. By the same token, a practice or representation directed to a well-educated group, such as a prescription drug advertisement to doctors, would be judged in light of the knowledge and sophistication of that group.[30]

As it has in the past, the Commission will evaluate the entire advertisement, transaction, or course of dealing in determining how reasonable consumers are likely to respond. Thus, in advertising the Commission will examine "the entire mosaic, rather than each tile separately."[31] As explained by a court of appeals in a recent case:

The Commission's right to scrutinize the visual and aural imagery of advertisements follows from the principle that the Commission looks to the impression made by the advertisements as a whole. Without this mode of examination, the Commission would have limited recourse against crafty advertisers whose deceptive messages were conveyed by means other than, or in addition to, spoken words. American Home Products, 695 F.2d 681, 688 (3d Cir. Dec. 3, 1982).[32]

In a case involving a weight loss product, the Commission observed:

It is obvious that dieting is the conventional method of losing weight. But it is equally obvious that many people who need or want to lose weight regard dieting as bitter medicine. To these corpulent consumers the promises of weight loss without dieting are the Siren's call, and advertising that heralds unrestrained consumption while muting the inevitable need for temperance, if not abstinence, simply does not pass muster. Porter & Dietsch, 90 F.T.C. 770, 864-865 (1977), 605 F.2d 294 (7th Cir. 1979), cert. denied, 445 U.S. 950 (1980).

Children have also been the specific target of ads or practices. In *Ideal Toy*, the Commission adopted the Hearing Examiner's conclusion that:

False, misleading and deceptive advertising claims beamed at children tend to exploit unfairly a consumer group unqualified by age or experience to anticipate or appreciate the possibility that representations may he exaggerated or untrue. *Ideal Toy*, 64 F.T.C. 297, 310 (1964).

See also, *Avalon Industries Inc.*, 83 F.T.C. 1728, 1750 (1974).

In a subsequent case, the Commission explained that "[i]n evaluating advertising representations, we are required to look at the complete advertisement and formulate our opinions on them on the basis of the net general impression conveyed by them and not on isolated excerpts." *Standard Oil of Calif*, 84 F.T.C. 1401, 1471 (1974), *aff'd as modified*, 577 F.2d 653 (9th Cir. 1978), *reissued*, 96 F.T.C. 380 (1980).

The Third Circuit stated succinctly the Commission's standard. "The tendency of the advertising to deceive must be judged by viewing it as a whole, without emphasizing isolated words or phrases apart from their context." *Beneficial Corp. v. FTC*, 542 F.2d 611, 617 (3d Cir. 1976), *cert denied*, 430 U.S. 983 (1977).

Commission cases reveal specific guidelines. Depending on the circumstances, accurate information in the text may not remedy a false headline because reasonable consumers may glance only at the headline.[33] Written disclosures or fine print may be insufficient to correct a misleading representations.[34] Other practices of the company may direct consumers' attention away from the qualifying disclosures.[35] Oral statements, label disclosures or point-of-sale material will not necessarily correct a deceptive representation or omission.[36] Thus, when the first contact between a seller and a buyer occurs through a deceptive practice, the law may be violated even if the truth is subsequently made known to the purchaser.[37] Pro forma statements or disclaimers may not cure otherwise deceptive messages or practices.[38]

Qualifying disclosures must be legible and understandable. In evaluating such disclosures, the Commission recognizes that in many circumstances, reasonable consumers do not read the entirety of an ad or are directed away from the importance of the qualifying phrase by the acts or statements of the seller. Disclosures that conform to the Commission's Statement of Enforcement Policy regarding clear and conspicuous disclosures, which applies to television advertising, are generally adequate, CCH Trade Regulation Reporter, ¶ 7569.09 (Oct. 21, 1970). Less elaborate disclosures may also suffice.[39]

Certain practices, however, are unlikely to deceive consumers acting reasonably. Thus, the Commission generally will not bring advertising cases based on subjective claims (taste, feel, appearance, smell) or on correctly stated opinion claims if consumers understand the source and limitations of the opinion.[40] Claims phrased as opinions are actionable, however, if they are not honestly held, if they misrepresent the qualifications of the holder or the basis of his opinion or if the recipient reasonably interprets them as implied statements of fact.[41]

The Commission generally will not pursue cases involving obviously exaggerated or puffing representations, *i.e.*, those that the ordinary consumers do not take seriously.42 Some exaggerated claims, however, may be taken seriously by consumers and are actionable. For instance, in rejecting a respondent's argument that use of the words "electronic miracle" to describe a television antenna was puffery, the Commission stated:

Although not insensitive to respondent's concern that the term miracle is commonly used in situations short of changing water into wine, we must conclude that the use of "electronic miracle" in the context of respondent's grossly exaggerated claims would lead consumers to give added credence to the overall suggestion that this device is superior to other types of antennae. *Jay Norris*, 91 F.T.C. 751, 847 n.20 (1978), *aff'd*, 598 F.2d 1244 (2d Cir.), *cert. denied*, 444 U.S. 980 (1979).

Finally, as a matter of policy, when consumers can easily evaluate the product or service, it is inexpensive, and it is frequently purchased, the Commission will examine the practice closely before issuing a complaint based on deception. There is little incentive for sellers to misrepresent (either by an explicit false statement or a deliberate false implied statement) in these circumstances since they normally would seek to encourage repeat purchases. Where, as here, market incentives place strong constraints on the likelihood of deception, the Commission will examine a practice closely before proceeding.

In sum, the Commission will consider many factors in determining the reaction of the ordinary consumer to a claim or practice. As would any trier of fact, the Commission will evaluate the totality of the ad or the practice and ask questions such as: how clear is the representation? how conspicuous is any qualifying information? how important is the omitted information? do other sources for the omitted information exist? how familiar is the public with the product or service?[43]

## IV. THE REPRESENTATION, OMISSION OR PRACTICE MUST BE MATERIAL

The third element of deception is materiality. That is, a representation, omission or practice must be a material one for deception to occur.[44] A "material" misrepresentation or practice is one which is likely to affect a consumer's choice of or conduct regarding a product.[45] In other words, it is information that is important to consumers. If inaccurate or omitted information is material, injury is likely.[46]

The Commission considers certain categories of information presumptively material.[47] First, the Commission presumes that express claims are material.[48] As the Supreme Court stated recently, "[i]n the absence of factors that would distort the decision to advertise, we may assume that the willingness of a business to promote its products reflects a belief that consumers are interested in the advertising."[49] Where the seller knew, or should have known, that an ordinary consumer would need omitted information to evaluate the product or service, or that the claim was false, materiality will be presumed because the manufacturer intended the information or omission to have an effect.[50] Similarly, when evidence exists that a seller intended to make an implied claim, the Commission will infer materiality.[51]

The Commission also considers claims or omissions material if they significantly involve health, safety, or other areas with which the reasonable consumer would be concerned. Depending on the facts, information pertaining to the central characteristics of the product or service will be presumed material. Information has been found material where

it concerns the purpose,[52] safety,[53] efficacy,[54] or cost,[55] of the product or service. Information is also likely to be material if it concerns durability, performance, warranties or quality. Information pertaining to a finding by another agency regarding the product may also be material.[56]

Where the Commission cannot find materiality based on the above analysis, the Commission may require evidence that the claim or omission is likely to be considered important by consumers. This evidence can be the fact that the product or service with the feature represented costs more than an otherwise comparable product without the feature, a reliable survey of consumers, or credible testimony.[57]

A finding of materiality is also a finding that injury is likely to exist because of the representation, omission, sales practice, or marketing technique. Injury to consumers can take many forms.[58] Injury exists if consumers would have chosen differently but for the deception. If different choices are likely, the claim is material, and injury is likely as well. Thus, injury and materiality are different names for the same concept.

## V. CONCLUSION

The Commission will find an act or practice deceptive if there is a misrepresentation, omission, or other practice, that misleads the consumer acting reasonably in the circumstances, to the consumer's detriment. The Commission will not generally require extrinsic evidence concerning the representations understood by reasonable consumers or the materiality of a challenged claim, but in some instances extrinsic evidence will be necessary.

The Commission intends to enforce the FTC Act vigorously. We will investigate, and prosecute where appropriate, acts or practices that are deceptive. We hope this letter will help provide you and the public with a greater sense of certainty concerning how the Commission will exercise its jurisdiction over deception. Please do not hesitate to call if we can be of any further assistance.

By direction of the Commission, Commissioners Pertschuk and Bailey dissenting, with separate statements attached and with separate response to the Committee's request for a legal analysis to follow.

/s/James C. Miller III
Chairman

cc: Honorable James T. Broyhill
Honorable James J. Florio
Honorable Norman F. Lent

**Endnotes:**

[1]S. Rep. No. 97-451, 97th Cong., 2d Sess. 16; H.R. Rep. No. 98-156, Part I, 98th Cong., 1st Sess. 6 (1983). The Commission's enforcement policy against unfair acts or practices is set forth in a letter to Senators Ford and Danforth, dated December 17, 1980.

[2]In determining whether an ad is misleading, Section 15 requires that the Commission take into account "representations made or suggested" as well as "the extent to which the advertisement fails to reveal facts material in light of such representations or material with respect to consequences which may result from the use of the commodity to which the advertisement relates under the conditions prescribed in said advertisement, or under such conditions as are customary or usual." 15 U.S.C. 55. If an act or practice violates Section 12, it also violates Section 5. *Simeon Management Corp.*, 87 F.T.C. 1184, 1219 (1976), *aff'd*, 579 F.2d 1137 (9th Cir. 1978); *Porter & Dietsch*, 90 F.T.C. 770, 873-74 (1977), *aff'd*, 605 P.2d 294 (7th Cir. 1979), *cert. denied*, 445 U.S. 950 (1980).

[3]Chairman Miller has proposed that Section 5 be amended to define deceptive acts. Hearing Before the Subcommittee for Consumers of the Committee on Commerce, Science, and Transportation, United States Senate, 97th Cong., 2d Sess. *FTCs Authority Over Deceptive Advertising*, July 22,1982, Serial No. 97-134, p. 9. Three Commissioners believe a legislative definition is unnecessary. *Id.* at 45 (Commissioner Clanton), at 51 (Commissioner Bailey) and at 76 (Commissioner Pertschuk). Commissioner Douglas supports a statutory definition of deception. Prepared statement by Commissioner George W. Douglas, Hearing Before the Subcommittee for Consumers of the Committee on Commerce, Science and Transportation, United States Senate, 98th Cong. lst Sess. (March 16, 1983) p. 2.

[4]A misrepresentation is an express or implied statement contrary to fact. A misleading omission occurs when qualifying information necessary to prevent a practice, claim, representation, or reasonable expectation or belief from being misleading is not disclosed. Not all omissions are deceptive, even if providing the information would benefit consumers. As the Commission noted in rejecting a proposed requirement for nutrition disclosures, "In the final analysis, the question whether an advertisement requires affirmative disclosure would depend on the nature and extent of the nutritional claim made in the advertisement.". ITT Continental Baking Co. Inc., 83 F.T.C. 865, 965 (1976). In determining whether an omission is deceptive, the Commission will examine the overall impression created by a practice, claim, or representation. For example, the practice of offering a product for sale creates an implied representation that it is fit for the purposes for which it is sold. Failure to disclose that the product is not fit constitutes a deceptive omission. [See discussion below at 5-6) Omissions may also be deceptive where the representations made are not literally misleading, if those representations create a reasonable expectation or belief among consumers which is misleading, absent the omitted disclosure.

Non-deceptive emissions may still violate Section 5 if they are unfair. For instance, the R-Value Rule, 16 C.F.R. 460.5 (1983), establishes a specific method for testing insulation ability, and requires disclosure of the figure in advertising. The Statement of Basis and Purpose, 44 FR 50,242 (1979), refers to a deception theory to support disclosure requirements when certain misleading claims are made, but the rule's general disclosure requirement is based on an unfairness theory. Consumers could not reasonably avoid injury in selecting insulation because no standard method of measurement existed.

[5]Advertising that lacks a reasonable basis is also deceptive. *Firestone*, 81 F.T.C. 398, 451-52 (1972), *aff'd*, 481 F.2d 246 (6th Cir.), *cert. denied*, 414 U.S. 1112 (1973). *National Dynamics*, 82 F.T.C. 488, 549-50 (1973); *aff'd and remanded on other grounds*, 492 F.2d 1333 (2d Cir.), *cert. denied*, 419 U.S. 993 (1974), *reissued*, 85 F.T.C. 391 (1976). *National Comm'n on Egg Nutrition*, 88 F.T.C. 89, 191 (1976), *aff'd*, 570 P.2d 157 (7th Cir.), *cert. denied*, 439 U.S. 821, *reissued*, 92 F.T.C. 848 (1978). The deception theory is based on the fact that most ads making objective claims imply, and many expressly state, that an advertiser has certain specific grounds for the claims. If the advertiser does not, the consumer is acting under a false impression. The consumer might have perceived the advertising differently had he or she known the advertiser had no basis for the claim. This letter does not address the nuances of the reasonable basis doctrine, which the Commission is currently reviewing. 48 FR 10,471 (March 11, 1983)

[6]In *Beneficial Corp. v. FTC*, 542 F.2d 611, 617 (3d Cir. 1976), the court noted "the likelihood or propensity of deception is the criterion by which advertising is measured."

[7]On evaluation of the entire document:

The Commission finds that many of the challenged Anacin advertisements, when viewed in their entirety, did convey the message that the superiority of this product has been proven [footnote omitted]. It is immaterial that the word "established", which was used in the complaint, generally did not appear in the ads; the important consideration is the net impression conveyed to the public. *American Home Products*, 98 F.T.C. 136, 374 (1981), *aff'd*, 695 F.2d (3d Cir. 1982).

On the juxtaposition of phrases:

On this label, the statement "Kills Germs By Millions On Contact" immediately precedes the assertion "For General Oral Hygiene Bad Breath, Colds and Resultant Sore Throats" [footnote omitted]. By placing these two statements in close proximity, respondent has conveyed the message that since Listerine can kill millions of germs, it can cure, prevent and ameliorate colds and sore throats [footnote omitted]. *Warner Lambert*, 86F.T.C. 1398, 1489-90 (1975), *aff'd*, 562 F.2d 749 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 950 (1978) (emphasis in original).

On the nature of the claim, *Firestone* is relevant. There the Commission noted that the alleged misrepresentation concerned the safety of respondent's product, "an issue of great significance to consumers. On this issue, the Commission has required scrupulous accuracy in advertising claims, for obvious reasons." 81 F.T.C. 398,456 (1972), *aff'd*, 481 F.2d 246 (6th Cir.), *cert. denied*, 414 U.S. IU2 (1973).

In each of these cases, other factors, including in some instances surveys, were in evidence on the meaning of the ad.

[8]The evidence can consist of expert opinion, consumer testimony (particularly in cases involving oral representations), copy tests, surveys, or any other reliable evidence of consumer interpretation.

[9]As the Commission noted in the Cigarette rule, "The nature, appearance, or intended use of a product may create the impression on the mind of the consumer . . . and if the impression is false, and if the seller does not take adequate steps to correct it, he is responsible for an unlawful deception." Cigarette Rule Statement of Basis and Purpose, 29 FR 8324, 8352 (July 2, 1964).

[10]*Porter & Dietsch*, 90 F.T.C. 770, 873-74 (1977), *aff'd.* 605 F.2d 294 (7th Cir. 1979), *cert. denied*, 445 U.S. 950 (1980); *Simeon Management Corp.*, 87 F.T.C. 1184, 1230 (1976), *aff'd*, 579 F.2d 1137 (9th Cir. 1978).

[11]*See, e.g., Grolier*, 91 F.T.C. 315,480 (1978), *remanded on other grounds*, 615 F.2d 1215 (9th Cir. 1980), *modified on other grounds*, 98 FM 882 (1981), *reissued*, 99 F.T.C. 379 (1982).

[12]In *Peacock Buick*, 86 F.T.C. 1532 (1975), *aff'd*, 553 F.2d 97 (4th Cir. 1977), the Commission held that absent a clear and early disclosure of the prior use of a late model car, deception can result from the setting in which a sale is made and the expectations of the buyer ... *Id* at 1555.

Even in the absence of affirmative misrepresentations, it is misleading for the seller of late model used cars to fail to reveal the particularized uses to which they have been put... When a later model used car is sold at close to list price ... the assumption likely to be made by some purchasers is that, absent disclosure to the

contrary, such car has not previously been used in a way that might substantially impair its value. In such circumstances, failure to disclose a disfavored prior use may tend to mislead. *Id* at 1557-58.

[13]In *Leonard Porter*, the Commission dismissed a complaint alleging that respondents' sale of unmarked products in Alaska led consumers to believe erroneously that they were handmade in Alaska by natives. Complaint counsel had failed to show that consumers of Alaskan craft assumed respondents' products were handmade by Alaskans in Alaska. The Commission was unwilling, absent evidence, to infer from a viewing of the items that the products would tend to mislead consumers.

By requiring such evidence, we do not imply that elaborate proof of consumer beliefs or behavior is necessary, even in a case such as this, to establish the requisite capacity to deceive. However, where visual inspection is inadequate, some extrinsic testimony evidence must be added. 88 F.T.C. 546, 626, n.5 (1976).

[14]*Bait and Switch Policy Protocol*, December 10, 1975; Guides Against Bait Advertising, 16 C.F.R. 238.0 (1967). 32 PR 15,540.

[15]*Encyclopedia Britannica* 87 F.T.C. 421, 497 (1976), *aff'd*, 605 F.2d 964 (7th Cir. 1979), *cert. denied*, 445 U.S. 934 (1980), *modified*, 100 F.T.C. 500 (1982).

[16]See the complaints in *BayleySuit*, C-3117 (consent agreement) (September 30,1983) [102 F.T.C. 1285]; *Figgie International, Inc.*, D. 9166 (May 17, 1983).

[17]The Commission's complaints in *Chrysler Corporation*, 99 F.T.C. 347 (1982), and *Volkswagen of America*, 99 F.T.C. 446 (1982), alleged the failure to disclose accurate use and care instructions for replacing oil filters was deceptive. The complaint in *Ford Motor Co.*, D. 9154, 96 F.T.C. 362 (1980), charged Ford with failing to disclose a "piston scuffing" defect to purchasers and owners which was allegedly widespread and costly to repair. *See also General Motors*, D. 9145 (provisionally accepted consent agreement, April 26, 1983). [102 F.T.C. 1741]

[18]*See Jay Norris Corp.*, 91 F.T.C. 751 (1978), *aff'd with modified language in order*, 598 P.2d 1244 (2d Cir. 1979), *cert. denied*, 444 U.S. 980 (1979) (failure to consistently meet guarantee claims of"immediate and prompt" delivery as well as money back guarantees); *Southern States Distributing Co.*, 83 F.T.C. 1126 (1973) (failure to honor oral and written product maintenance guarantees, as represented); *Skylark Originals, Inc.*, 80 F.T.C. 337 (1972), *aff'd*, 475 F.2d 1396 (3d Cir. 1973) (failure to promptly honor moneyback guarantee as represented in advertisements and catalogs); *Capitol Manufacturing Corp.*, 73 F.T.C. 872 (1968) (failure to fully, satisfactorily and promptly meet all obligations and requirements under terms of service guarantee certificate).

[19]The evidence necessary to determine how reasonable consumers understand a representation is discussed in Section II of this letter.

[20]An interpretation may be reasonable even though it is not shared by a majority of consumers in the relevant class, or by particularly sophisticated consumers. A material practice that misleads a significant minority of reasonable consumers is deceptive. *See Heinz W. Kirchner*, 63 F.T.C. 1282 (1963).

[21]A secondary message understood by reasonable consumers is actionable if deceptive even though the primary message is accurate. *Sears, Roebuck & Co.*, 95 F.T.C. 406, 511 (1980), *aff'd* 676 F.2d 385, (9th Cir. 1982); *Chrysler*, 87 F.T.C. 749 (1976), *aff'd*, 561 F.2d 357 (D.C. Cir.), *reissued* 90 F.T.C. 606 (1977); *Rhodes Pharmacal Co.*, 208 F.2d 382, 387 (7th Cir. 1953), *aff'd*, 348 U.S. 940 (1955).

[22]*National Comm'n on Egg Nutrition*, 88 F.T.C. 89, 185 (1976), *enforced in part*, 570 F.2d 157 (7th Cir. 1977); *Jay Norris Corp.*, 91 F.T.C. 751, 836 (1978), *aff'd*, 598 F.2d 1244 (2d Cir. 1979).

[23]*National Dynamics*, 82 F.T.C. 488, 524, 548 (1973), *aff'd*, 492 P.2d 1333 (2d Cir.), *cert. denied*, 419 U.S. 993 (1974), *reissued* 85 F.T.C. 39-1 (1976).

[24]*Warner-Lambert*, 86 F.T.C. 1398, 1415 n.4 (1975), *aff'd*, 562 F.2d 749 (D.C. Cir. 1977), *cert denied*, 435 U.S. 950 (1978).

[25]*Grolier*, 91 F.T.C. 315, 430 (1978), *remanded on other grounds*, 615 F.2d 1215 (9th Cir. 1980), *modified on other grounds*, 98 F.T.C. 882 (1981), *reissued*, 99 F.T.C. 379 (1982).

[26]*American Home Products*, 98 F.T.C. 136 (1981), *aff'd* 695 F.2d 681 (3d Cir. 1982). consumers may be led to expect, quite reasonably..." (at 386); "... consumers may reasonably believe..." (*Id.* n.52); "... would reasonably have been understood by consumers...." (at 371); "the record shows that consumers could reasonably have understood this language . . ." (at 372). See also, pp. 373, 374, 375. *Bristol-Myers*, D. 8917 (July 5, 1983), appeal docketed, No. 83-4167 (2nd Cir. Sept. 12,1983)..... ads must be judged by the impression they make on reasonable members of the public . . . " (Slip Op. at 4); ". . . consumers could reasonably have understood . . ." (Slip Op. at 7); ". . . consumers could reasonably infer . . ." (Slip Op. at 11) [ 102 F.T.C. 21 (1983)]. *Sterling Drug, Inc.*, D. 8919 (July 5,1983), appeal docketed, No. 83-7700 (9th Cir. Sept. 14,1983)..... consumers could reasonably assume . . ." (Slip Op. at 9); ". . . consumers could reasonably interpret the ads . . ." (Slip Op. at 33). [102 F.T.C. 395 (1983)]

[27]*Horizon Corp.*, 97 F.T.C. 464, 810 n.13 (1981).

[28]*Simeon Management*, 87 F.T.C. 1184, 1230 (1976).

[29]The listed categories are merely examples. Whether children, terminally ill patients, or any other subgroup of the population will be considered a special audience depends on the specific factual context of the claim or the practice.

The Supreme Court has affirmed this approach. "The determination whether an advertisement is misleading requires consideration of the legal sophistication of its audience." *Bates v. Arizona*, 433 U.S. 350, 383 n.37 (1977).

[30]In one case, the Commission's complaint focused on seriously ill persons. The ALJ summarized: According to the complaint, the frustrations and hopes of the seriously ill and their families were exploited, and the representation had the tendency and capacity to induce the seriously ill to forego conventional medical treatment worsening their condition and in some cases hastening death, or to cause them to spend large amounts of money and to undergo the inconvenience of traveling for a non-existent "operation." *Travel King*, 86 F.T.C. 715, 719 (1975).

[31]*FTC v. Sterling Drug*, 317 F.2d 669, 674 (2d Cir. 1963).

[32]Numerous cases exemplify this point. For instance, in *Pfizer*, the Commission ruled that "the net impression of the advertisement, evaluated from the perspective of the audience to whom the advertisement is directed, is controlling." 81 F.T.C. 23, 58 (1972).

[33]In *Litton Industries*, the Commission held that fine print disclosures that the surveys included only "Litton authorized" agencies were inadequate to remedy the deceptive characterization of the survey population in the headline. 97 F.T.C. 1, 71, n.6 (1981), *aff'd as modified*, 676 F.2d 364 (9th Cir. 1982).

Compare the Commission's note in the same case that the fine print disclosure "Litton and one other brand" was reasonable to quote the claim that independent service technicians had been surveyed, "[F]ine print was a reasonable medium for disclosing a qualification of only limited relevance." 97 F.T.C. 1, 70, n.5 (1981).

In another case, the Commission held that the body of the ad corrected the possibly misleading headline because in order to enter the contest, the consumer had to read the text, and the text would eliminate any false impression stemming from the headline. *D.L. Blair*, 82 F.T.C. 234, 255,256 (1973).

In one case respondent's expert witness testified that the headline (and accompanying picture) of an ad would be the focal point of the first glance. He also told the administrative law judge that a consumer would spend [t]ypically a few seconds at most" on the ads at issue. *Crown Central*, 84 F.T.C. 1493, 1543 nn. 14-15 (1974),

[34]In *Giant Food*, the Commission agreed with the examiner that the fine-print disclaimer was inadequate to correct a deceptive impression. The Commission quoted from the examiner's finding that "very few if any of the persons who would read Giant's advertisements would take the trouble to, or did, read the fine print disclaimer." 61 F.T.C. 326, 348 (1962).

*Cf. Beneficial Corp. v. FTC*, 542 P.2d 611, 618 (3d Cir. 1976), where the court reversed the Commission's opinion that no qualifying language could eliminate the deception stemming from use of the slogan "Instant Tax Refund."

[35]"Respondents argue that the contracts which consumers signed indicated that credit life insurance was not required for financing, and that this disclosure obviated the possibility of deception. We disagree. It Is clear from consumer testimony that oral deception was employed in some instances to cause consumers to ignore the warning in their sales agreement. . ." *Peacock Buick*, 86 F.T.C. 1532, 1558-59 (1974).

[36]*Exposition Press*, 295 F.2d $69, 873 (2d Cir. 1961); *Gimbel Bros.*, 61 F.T.C. 1051, 1066 (1962); *Carter Products*, 186 F.2d 821, 824 (1951).

By the same token, money-back guarantees do not eliminate deception. In *Sears*, the Commission observed:

A money-back guarantee is no defense to a charge of deceptive advertising.... A money-back guarantee does not compensate the consumer for the often considerable time and expense incident to returning a major-ticket item and obtaining a replacement.

*Sears, Roebuck and Co.*, 95 F.T.C. 406, 518 (1980), *aff'd*, 676 F.2d 385 (9th Cir. 1982). However, the existence of a guarantee, if honored, has a bearing on whether the Commission should exercise its discretion to prosecute. *See* Deceptive and Unsubstantiated Claims Policy Protocol, 1975.

[37]*See American Home Products*, 98 F.T.C. 136, 370 (1981), *aff'd*, 695 F.2d 681, 688 (3d Cir. Dec. 3, 1982), Whether a disclosure on the label cures deception in advertising depends on the circumstances:

... it is well settled that dishonest advertising is not cured or excused by honest labeling [footnote emitted). Whether the ill-effects of deceptive nondisclosure can be cured by a disclosure requirement limited to labeling, or whether a further requirement of disclosure in advertising should be imposed, is essentially a question of remedy. As such it is a matter within the sound discretion of the Commission [footnote omitted]. The question of whether in a particular case to require disclosure in advertising cannot be answered by application of any hard-and-fast principle. The test is simple and pragmatic: Is it likely that, unless such disclosure is made, a substantial body of consumers will be misled to their detriment?

*Statement of Basis and Purpose for the Cigarette Advertising and Labeling Trade Regulation Rule*, 1965, pp. 89-90. 29 FR 8325 (1964).

Misleading "door openers" have also been found deceptive (Encyclopedia Britannica, 87 F.T.C. 421 (1976), *aff'd*, 605 P.2d 964 (7th Cir. 1979), *cert. denied*, 445 U.S. 934 (1980), *as modified*, 100 F.T.C. 500 (1982)), as have offers to sell that are not bona fide offers (*Seekonk Freezer Meats, Inc.*, 82 F.T.C. 1025 (1973)). In each of these instances, the truth is made known prior to purchase.

[38]In the Listerine case, the Commission held that pro forma statements of no absolute prevention followed by promises of fewer colds did not cure or correct the false message that Listerine will prevent colds. *Warner Lambert* 86 F.T.C. 1398, 1414 (1975), *aff'd*, 562 F.2d 749 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 950 (1978).

[39]*Chicago Metropolitan Pontiac Dealers' Ass'n*, C. 3110 (June 9,1983). [101 F.T.C. 854 (1983)]

[40]An opinion is a representation that expresses only the behalf of the maker, without certainty, as to the existence of a fact, or his judgement as to quality, value, authenticity, or other matters of judgement. American Law Institute, Restatement on Torts, Second ¶ 538 A.

[41]*Id.* ¶ 539. At common law, a consumer can generally rely on an expert opinion. *Id.*, ¶ 542(a). For this reason, representations of expert opinion will generally be regarded as representations of fact.

[42]"[T]here is a category of advertising themes, in the nature of puffing or other hyperbole, which do not amount to the type of affirmative product claims for which either the Commission or the consumer would expect documentation." *Pfizer, Inc*, 81 F.T.C. 23, 64 (1972).

The term "Puffing" refers generally to an expression of opinion not made as a representation of fact. A seller has some latitude in puffing his goods, but he is not authorized to misrepresent them or to assign to them benefits they do not possess [cite omitted]. Statements made for the purpose of deceiving prospective purchasers cannot properly be characterized as mere puffing. *Wilmington Chemical*, 69 F.T.C. 828, 865 (1966).

[43]In *Avalon Industries*, the ALJ observed that the "'ordinary person with a common degree of familiarity with industrial civilization' would expect a reasonable relationship between the size of package and the size of quantity of the contents. He would have no reason to anticipate slack filling." 83 F.T.C. 1728, 1750 (1974) (I.D.).

[44]"A misleading claim or omission in advertising will violate Section 5 or Section 12, however, only if the omitted information would be a material factor in the consumer's decision to purchase the product." *American Home Products Corp.*, 98 F.T.C. 136,368 (1981), *aff'd*, 695 F.2d 681 (3d Cir. 1982). A claim is material if it is likely to affect consumer behavior. "Is it likely to affect the average consumer in deciding whether to purchase the advertised product-is there a material deception, in other words?" Statement of Basis and Purpose, *Cigarette Advertising and Labeling Rule*, 1965, pp. 86-87. 29 FR 8325 (1964).

[45]Material information may affect conduct other than the decision to purchase a product. The Commission's complaint in *Volkswagen of America*, 99 F.T.C. 446 (1982), for example, was based on provision of inaccurate instructions for oil filter installation. In its *Restatement on Torts, Second*, the American Law Institute defines a material misrepresentation or omission as one which the reasonable person would regard as important in deciding how to act, or one which the maker knows that the recipient, because of his or her own peculiarities, is likely to consider important. Section 538(2). The Restatement explains that a material fact does not necessarily have to affect the finances of a transaction. "There are many more-or-less sentimental considerations that the ordinary man regards as important." Comment on Clause 2(a)(d).

[46]In evaluating materiality, the Commission takes consumer preferences as given. Thus, if consumers prefer one product to another, the Commission need not determine whether that preference is objectively justified. *See Algoma Lumber*, 291 U.S. 54, 78 (1933). Similarly, objective differences among products are not material if the difference is not likely to affect consumer choices.

[47]The Commission will always consider relevant and competent evidence offered to rebut presumptions of materiality.

[48]Because this presumption is absent for some implied claims, the Commission will take special caution to ensure materiality exists in such cases.

[49]*Central Hudson Gas & Electric Co. v. PSC*, 447 U.S. 557, 567 (1980).

[50]*Cf. Restatement on Contracts, Second* ¶ 162(l).

[51]In *American Home Products*, the evidence was that the company intended to differentiate its products from aspirin. The very fact that AHP sought to distinguish its products from aspirin strongly implies that knowledge of the true ingredients of those products would be material to purchasers." *American Home Products*, 98 F.T.C. 136, 368 (1981), *aff'd*, 695 F.2d 681 (3d. Cir. 1982).

[52]In *Fedders*, the ads represented that only Fedders gave the assurance of cooling on extra hot, humid days. "Such a representation is the raison d'etre for an air conditioning unit-it is an extremely material representation." 85 F.T.C. 38, 61 (1975) (I.D.), *petition dismissed*, 529 F.2d 1398 (2d Cir.), *cert. denied*, 429 U.S. 818 (1976).

[53]"We note at the outset that both alleged misrepresentations go to the issue of the safety of respondent's product, an issue of great significance to consumers." *Firestone*, 81 F.T.C. 398, 456 (1972), *aff'd*, 481 P.2d 246 (6th Cir.), *cert. denied*, 414 U.S. 1112 (1973).

[54]The Commission found that information that a product was effective in only the small minority of cases where tiredness symptoms are due to an iron deficiency, and that it was of no benefit in all other cases, was material. *J.B. Williams Co.*, 68 F.T.C. 481, 546 (1965), *aff'd*, 381 F.2d 884 (6th Cir. 1967).

[55]As the Commission noted in *MacMillan, Inc.*:

In marketing their courses, respondents failed to adequately disclose the number of lesson assignments to be submitted in a course. These were material facts necessary for the student to calculate his tuition obligation, which was based on the number of lesson assignments he submitted for grading. The nondisclosure of these material facts combined with the confusion arising from LaSalle's inconsistent use of terminology had the capacity to mislead students about the nature and extent of their tuition obligation. *MacMillan, Inc.*, 96 F.T.C. 208, 303-304 (1980).

*See also, Peacock Buick*, 86 F.T.C. 1532, 1562 (1975), *aff'd*, 553 F.2d 97 (4th Cir. 1977).

[56]*Simeon Management Corp.*, 87 F.T.C. 1184 (1976), *aff'd*, 579 P.2d 1137, 1168, n.10 (9th Cir. 1978).

[57]In *American Home Products*, the Commission approved the ALJ's finding of materiality from an economic perspective:

If the record contained evidence of a significant disparity between the prices of Anacin and plain aspirin, it would form a further basis for a finding of materiality. That is, there is a reason to believe consumers are willing to pay a premium for a product believed to contain a special analgesic ingredient but not for a product whose analgesic is ordinary aspirin. *American Home Products*, 98 F.T.C. 136, 369 (1981), *aff'd*, 695 F.2d 681 (3d Cir. 1982).

[58]The prohibitions of Section 5 are intended to prevent injury to competitors as well as to consumers. The Commission regards injury to competitors as identical to injury to consumers. Advertising and legitimate marketing techniques are intended to "lure" competitors by directing business to the advertiser. In fact, vigorous competitive advertising can actually benefit consumers by lowering prices, encouraging product innovation, and increasing the specificity and amount of information available to consumers. Deceptive practices injure both competitors and consumers because consumers who preferred the competitor's product are wrongly diverted.

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