

D 2500  
F 87  
no. 25

FEDERAL TRADE COMMISSION ACTIVITIES  
OF INTEREST TO THE TOBACCO INDUSTRY

Remarks of

HON. R. E. FREER, VICE CHAIRMAN  
FEDERAL TRADE COMMISSION

Before the

ASSOCIATED TOBACCO MANUFACTURERS

Washington, D. C.  
Shoreham Hotel, 10:00 A.M.  
November 6, 1947

FEDERAL TRADE COMMISSION ACTIVITIES  
OF INTEREST TO THE TOBACCO INDUSTRY

Remarks of

HON. R. E. FRER, VICE CHAIRMAN  
FEDERAL TRADE COMMISSION

Before the

ASSOCIATED TOBACCO MANUFACTURERS

Washington, D. C.  
Shoreham Hotel, 10:00 A.M.  
November 6, 1947

I. Introduction

Consumer acceptance of the weed we call tobacco shaped the course of early Colonial immigration. This may account for the public's deep interest in the tobacco manufacturing industry. Such interest is evidenced by the glamor which consumers associate with some of the legendary personalities, such as the wooden cigar store Indian, and to mention another, that English nobleman and court favorite with Queen Elizabeth I, tobacco's first tycoon, whom I won't identify further because long since his name has been appropriated for a pipe tobacco brand name. I have marked, too, the curiosity with which the public views your industry's institutions, present and past, the tobacco market and the 5 cent cigar, to cite an example of each. As a business barometer and as source of excise revenue, you have long been an engrossing subject to students of economics, inside and outside of government. The impact of your commercial decisions on that important segment of the agricultural community whose only customer you are is tremendous. Lastly, you are topics of prime interest to those who create advertising copy and disseminate it and the pattern of your advertising during the last two decades, in the opinion of some observers, has been sociologically significant.

Your industry returns this interest and is deeply preoccupied with appraising the factors which influence the trend of the world's economy. The first topic to which I want to direct my remarks today under my topic "Federal Trade Commission Activities of Interest to the Tobacco Industry" concerns the Commission's part in a financial reporting program.

II. Industrial Financial Reports

On October 31, 1947, the Federal Trade Commission and the Securities and Exchange Commission jointly released a report entitled "Quarterly Industrial Financial Report Series for All United States Manufacturing Corporations." This report covers the first quarter of 1947 and its nature is just that implied by the title.

This program is a resumption by the Federal Trade Commission, through its Bureau of Industrial Economics, of its pre-war reporting function and

The magazine Printer's Ink, an avowed supporter of those prewar reports, on one occasion commented as follows:

"For the marketing executive, the information contained in the F. T. C. reports is highly significant. Here for the first time is gathered information on the selling and advertising expenses in leading industries and the relationship of these expenses to total sales."

In commenting upon the proposed resumption of these reports, the National Industrial Conference Board made the following statement:

"Virtually every sector of American business is vitally concerned over the changes in the wage cost price structure, particularly since the end of the war. Your studies, when completed, should make it possible for American business to resurvey its price and cost structure in the light of essential facts which have not been available since this series was suspended."

From such quarterly and annual reports, enlightened determinations can be made as to the general financial situation, the trend of economic activity, and the nature and scope of deficiencies inherent in the economic positions of various manufacturing industries. From these determinations in turn, it is believed that the public, business and Government at any given time can chart the direction in which a dynamic U. S. Economy is moving.

### III. Guides to Advertisers

The Commission's work in protecting the scrupulous elements of business and the consuming public through the elimination of false and misleading advertising has an impact on and is an activity of interest to your industry. The lead sentence of the lead article recently published in a leading law journal reads as follows:

"Advertising copy generative of demand is a natural concomitant of the distributive process in a competitive economy, and therein lies an inducement to hyperbole that has had its effect on the life, health and pocketbook of the credulous consumer."

We see eye to eye on that and on the proposition, too, that false advertisements, that is, those containing outright falsity as to a material fact, are harmful both to consumers and to business.

Agreed as we are on the intellectual level of forthright condemnation of outright falsity, differences of opinion sometimes arise on the level of practical application to borderline situations. Words and sentences literally true, may be framed in a confusing setting capable of, - if not artfully designed to be, - misleading. It is just our hard luck -- the advertisers', the Commission's and the courts' -- that no magic formula can resolve the implications of such ambiguous advertising copy. No rule of thumb can be formulated as to whether calculated insertion of a restrictive weasel word here and a contradicting or subtractive phrase there will prove sufficient in a given case to remedy the deceptive ambiguity.

The Federal Trade Commission Act broadly prohibits unfair methods of competition and unfair and deceptive acts and practices in interstate commerce and directs the Commission to prevent their use. Congress refrained

continuance by the Securities and Exchange Commission of its current responsibility for collection of financial information for corporations with securities listed on a national stock exchange. The reports are designed to meet the general needs of Government and the public for current, reliable financial data on a quarterly and annual basis as to the operations of our manufacturing corporations.

This program of joint postwar financial reports was developed after extensive work with the assistance of an interagency committee representing nine Government agencies and functioning under the direction of the Division of Statistical Standards of the Bureau of the Budget. This special committee was formed in the early part of 1946 for the purpose of determining the needs of the Federal Government for financial statistics as well as the specific needs of the two Commissions. This committee developed a comprehensive program to provide the needed information at minimum cost, and with the complete elimination of any possibility of duplication. In the development of the program, advice and suggestions were obtained from advisory councils of industry and labor.

The key items of profit and loss and balance sheet will be shown by the reports on a quarterly basis, with much greater detail of costs and expenses on an annual basis. The quarterly reports will give the information by five size groups based on total assets, and for 21 industry groups covering all manufacturing operations. The annual reports will contain detailed product classification with extensive tabulation analysis.

Let us see what the first quarterly report has to say about tobacco manufacturers.

On page 4 we see that total assets of all tobacco manufacturers amounted to \$1,923.9 billions. Of this total amount, \$1,564.4 billion is in the form of inventories. As we all know, the large proportion of total assets being invested in inventory is peculiar to tobacco manufacturing because of the aging and blending processes. These processes, therefore, normally result in a slow turnover of inventory.

Now let us turn to page 6 and look at the profit ratio. Here we find that tobacco manufacturers realized next to the lowest industry quarterly rate of return on the stockholders' equity. The average rate of tobacco manufacturers' return after income taxes was 2.3 percent in the first quarter of this year. I looked a little deeper into the ratios of profits and found that the small manufacturer realized a quarterly rate of return of about three-fourths of one percent less than the larger corporations. When we come to the annual reports, we expect to give the ratios by size groups in the various industry classifications. (That is, of course, dependent upon favorable action by the Appropriations Committees of Congress.)

Reverting now to the reports covering the prewar years of 1939 and 1940, which were issued by the Federal Trade Commission on an annual basis, they demonstrated that there exists a great demand for this information not only from Government agencies, but also from private business concerns, including advertisers as well as advertising agencies.

from attempting to catalogue the practices it deemed unfair and deceptive, fearing that precise definition might result in evasion. The failure to enumerate and expressly define has been criticized by some on the ground that no guide is given to businessmen as to what conduct is rendered unlawful. This much is conceded, the statutory test of unfairness is an elastic one under which it is the Commission's duty to keep pace with new promotional inventions.

Court Decisions and Commission Opinions -- Decisions of the courts in unfair competition cases furnish some guidance as to distinguishing unlawful and lawful advertising. Many of the Commission's decisions as printed in some 39 volumes of Commission Reports deal directly with the distinction. The Commission in recent years is giving greater attention to reasoned opinions as a supplement to the general guidance afforded by its orders - particularly orders of dismissal.

The Statutory Language -- Despite the breadth of language, it is arguable with at least equal persuasiveness that section 5 of the Federal Trade Commission Act, as amended by the Wheeler-Lea Act, does furnish a concrete guide in outlawing "unfair or deceptive acts or practices." Furthermore, section 15 provides concrete standards for the advertising of foods, drugs, cosmetics and therapeutic devices, as follows:

"The term 'false advertisement' means an advertisement \* \* \* which is misleading in a material respect; and in determining whether any advertisement is misleading, there shall be taken into account (among other things) not only representations made or suggested by statement, word, design, device, sound, or any combination thereof, but also the extent to which the advertisement fails to reveal facts material in the 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."

I submit that this language is both definite and succinct and I feel the Commission's interpretation of it has been realistic.

As our highest court expressed it, the public is entitled to get what it chooses even though such choice "be dictated by caprice or by fashion or perhaps by ignorance." Of further relevancy on the question of whether the statutory proscriptions are obscure is the hard economic truth that when a seller publishes statements respecting a product's composition, origin, efficacy, principle of operation, method of manufacture or terms and conditions of his offer, he is deep in the realm of material fact. The same holds true when he makes statements of like tenor to agents in soliciting their services or to retailers in persuading them to put the product on their shelves. Obviously, these claims pertain to matters peculiarly within the seller's knowledge. The practicalities of the public interest require that he who purports to be informed respecting product efficacy and attributes must answer for the veracity of the claims he has asserted.

Mr. Justice Holmes once wrote:

"It is not enough for the knight of romance that his lady is a very nice girl. If you do not admit that she is the best that God ever made, or will make, you must fight."

Unquestionably, there is a legal privilege attaching under ordinary conditions to use of honest expressions of opinion when so characterized even though ultimately they prove erroneous. Some call this puffing. However, if the circumstances are such that they may mislead consumers or unfairly injure a competitor, they fail of justification. Admittedly, the Commission must give very careful study and close consideration to each of the relatively few cases falling in this realm when rendering decision.

As I view it, the mandate of the statute as it applies to false advertising is plain and direct. It lacks, of course, a blueprint showing how to use deceptive, ambiguous or misleading statements without apprehension that such use may lead to a request from the Commission for their discontinuance and the execution of an agreement to forego them in the future.

Trade Practice Conference Rules -- Numerous useful guides to advertisers are found in the trade practice rules promulgated under the Commission's trade practice conference procedure. This procedure was adopted twenty years ago to enable all members of an industry voluntarily to catalog and abandon unfair trade practices simultaneously.

The conferences have proved particularly useful in preventing unfair representations by developing an understanding of the meaning of trade terms and of the circumstances under which a seller has a duty to avoid deception by disclosing the facts concerning his product.

Rules were promulgated for the wholesale tobacco trade in 1935 and others are in effect for more than 150 industries, including among the more recent, wood cased pencils, razor and razor blades, water heaters, hearing aids, musical instruments, household fabric dyes, masonry water-proofing, vertical turbine pumps, watches, piston rings and dolls and stuffed toys.

In leaving the topic of guides to advertisers, I call attention to the further fact that trade practice conferences are becoming increasingly useful instruments by which the public and businessmen may jointly reach an understanding as to the quantity and quality of useful information needed in the market place. And I digress briefly to touch upon the matter of good and bad taste in advertising.

#### IV. Lack of Good Taste Not Good Business

The regulation of good taste in advertising is not a government function, yet lack of good taste is a criticism which has been leveled by consumers at some advertising copy, whose preoccupation with various body functions, religious beliefs, loyalties or prejudices is bound to offend a substantial part of the public. When utilizing radio, for instance, as a medium of dissemination, the advertiser may walk in the twilight zone of good taste through the program itself, even though the commercials are above reproach. No doubt advertisers themselves, with the elaborate aids now available to test the reactions of the public to particular copy, will be able to determine, largely, what copy transgresses on the side of bad taste or indelicacy. There is general agreement that every program or piece of copy which offends even a few people harms the whole category of products to which the advertising relates.

#### V. Survey of Advertising

The Commission feels keenly its statutory responsibility to eliminate false and deceptive advertising. Not all of the questionable advertising considered by it comes to its attention through complaints registered by a competitor or a dissatisfied consumer. The Commission's Division of Radio and Periodical Advertising maintains a continuous survey of advertisements appearing in magazines, newspapers, radio broadcasts and mail order catalogs. This results in earlier investigation of advertisements questionable on their face, whether or not the commodity or claims had been previously the subject of Commission action, as well as in answering the question whether advertisers as to whose representations corrective action has been taken are living up to Commission orders to cease and desist therefrom or to their own voluntary stipulations or agreements to discontinue or modify them.

During the fiscal year ended June 30, last, there were procured for examination 1733 editions of representative newspapers of general circulation and 1309 editions of magazines and farm and trade journals. Included in the last were 236 issues of farm journals, 179 issues of trade and specialty publications and 10 issues of domestic foreign-language publications. Eighteen thousand two hundred and fifty-six advertisements were noted as containing representations that appeared to warrant inquiry as to their factual basis. The catalogs or circulars of 102 mail order concerns were examined and 238 advertisements marked for further consideration as possibly misleading. Marked for further study were 9573 of the 641,402 radio broadcast continuities examined.

#### VI. The Clayton Act

The Commission is charged with administration of the Clayton Act as amended in 1936 by the Robinson-Patman Anti-Discrimination Act. I have elected to make brief reference to this legislation in my remarks because the question of its consistency and accord with the legislative principle enunciated in the Sherman and the Federal Trade Commission Acts has been challenged in some quarters. The purpose of the Sherman Act is to proscribe combinations to fix prices and otherwise unlawfully restrain competition. The goal of section 2 of the Clayton Act as amended by the Robinson-Patman Act is to eliminate discriminations as to prices, allowances and facilities

which Congress believed injurious to our economy. These are in the nature of and have been characterized as excesses of competition but are regarded essentially harmful to the competitive system in the same manner as restraints on freedom of competition, since such proscribed discriminations aid the large buyer to grow even larger as a result of his cheaper purchases being translated into lower sales prices in competitive markets.

In the 19th century, it was apparent that the discriminations existing in the field of transportation rates were adversely affecting American economy. In the century's 7th and 8th decades our rail network was expanding, traffic geographically belonging to one line was being sought by others, often at rates so low as to be destructive, and there followed inevitable retaliation. Of such struggles the key cities and important shippers took full advantage. Even when the rivalry was less intense, open or secret rebates or special facilities were exacted by large or exclusive shippers and special arrangements extended from person to person. The need for secrecy was enhanced and it has been said that the memorandum book reposing in the general agent's pocket sometimes was the only record of the road's rates made to its different shippers.

There was favoritism between persons, places and things plus an almost universal acquiescence in the proposition that there must be a privileged rate class. The roll call of discrimination's methods and forms included "commissions for securing traffic," "handling allowances," "false classification of product," "rebates" and "secret rates." A whim here, a caprice there and one town or business could boom; others wither.

In 1887 Congress enacted legislation designed to curb railroad rate discrimination; but despite the Interstate Commerce Act, discrimination continued and was reported to have reached a new high during 1898. Additional legislation and administrative action proved necessary to alleviate this evil in the present century.

After hearings and considerations of analyses of special discounts and allowances which were available, Congress arrived at the conclusion that certain patterns of discrimination existing in business generally were conducive to economic concentration and monopoly. It enacted the Clayton Act of 1914 and in 1936 the Robinson-Patman Amendment thereto.

It is interesting to take a flashback on the tobacco industry of 1930. Out of a total of 691 manufacturer-customer accounts carrying allowances in that year, a total of 418 or just over 60 percent showed a rate of allowance on sales of less than 5 percent. Slightly over 1/5 of the accounts showed rates ranging from 5 percent to 10 percent, and over 1/8 showed rates ranging from 10 percent to 15 percent. Only 6½ percent of the total allowances were in excess of 15 percent. The independent wholesalers exceeded the chains in the number and proportion of allowances under 5 percent, while the chains exceeded the independent wholesalers in all of the other and higher rates of allowance groups. No allowances of 20 percent or more were given to independent wholesalers, and only one allowance of 15 percent or more. Between 6 percent and 7 percent of the total chain allowances, on the other hand, carried rates of 20 percent or more on sales, and over 11 percent showed allowances of 15 percent or more.



VII. The Commission Policies And Procedures

The Commission recently reexamined its own procedures and the methods of handling its work, resulting in an expanded use of industry-wide investigations coupled with increased emphasis upon correction by cooperative procedures as well as in a revision of the rules of practice in formal cases. One criticism of the traditional case-by-case procedure, viz., investigation, complaint, hearing and order, was that competitors of the party so proceeded against were left free to follow the identical illegal practice until such time as the Commission issued orders to cease and desist against each separate offender in turn. Where appropriate, simultaneous uniform corrective measures on an industry-wide basis are now proposed rather than directing action solely against the concern to which the complaining finger first pointed. I say where appropriate, because, application of such simultaneous uniform corrective action must appear not only to be warranted in the public interest, but also to be practicable of execution.

Not only is the Commission expanding its work in establishing trade practice conference rules but also it is giving greater emphasis to the elimination of false and misleading advertising and other unfair trade practices through voluntary stipulations to cease and desist.

The time and money saved by use of the cooperative methods of handling false advertising and other matters involving excesses of competition, will be used to implement a broader program of formal proceedings to prevent restraints on competition itself and those tending to monopoly. I hope the results will inspire further confidence on the part of the public in the Commission's effectiveness in both fields.

--oOo--