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**UNSUBSTANTIATED REPRESENTATIONS
UNDER THE FAIR TRADING ACT: AN ANALYSIS**

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Abstract

Section 12A of the Fair Trading Act 1986 was recently inserted following the passage of the Consumer Law Reform Bill in 2013, and came into force on 17 June 2014. The provision introduces a general prohibition on unsubstantiated representations being made by anyone promoting goods and services in trade. As the provision is only a year old, the Commerce Commission have not yet brought any cases on the provision before the courts. A body of case law examining the effects arising from this amendment has therefore not yet been developed. This paper seeks to analyse the effects which have been brought about by established substantiation policies in other jurisdictions, in order to provide a number of possible outcomes which may arise in New Zealand following the introduction of s 12A. It also considers whether there is a need to specifically regulate unsubstantiated representations in New Zealand and if so whether a general prohibition is the best approach. In conclusion, both queries are answered in the affirmative as the overall benefits of implementing a general prohibition against unsubstantiated claims will likely contribute beneficially to New Zealand's economy.

Key Words

Fair Trading Act, section 12A, unsubstantiated representations, consumer law.

Table of Contents

ABSTRACT	1
TABLE OF CONTENTS	2
I INTRODUCTION.....	3
II LEGISLATIVE BACKGROUND	3
A Fair Trading Act 1986	3
B 2006 Review	5
C Consumer Law Reform	6
III THE REQUIREMENT FOR SUBSTANTIATION	8
A Section 12A – How it works	9
B The Australian approach to substantiation	11
C The United States advertising substantiation programme.....	13
IV POSSIBLE EFFECTS – THE COSTS AND BENEFITS	14
A Increased Protection for Consumers.....	14
B Increased Honesty by Businesses.....	16
C Costs	17
D Section 12A too wide	20
E Uncertainty	21
F Effect on claims.....	22
V RECOMMENDATIONS	24
A Should New Zealand have a substantiation requirement at all?.....	24
B Was a general prohibition the right approach?.....	25
VI CONCLUSION	26
BIBLIOGRAPHY	28

I Introduction

On 17 June 2014, s 12A of the Fair Trading Act 1986 (FTA) came into force, prohibiting unsubstantiated claims from being made by traders in the market. Unsubstantiated claims are claims that cannot be verified or backed up with evidence or documentation. The introduction of this provision is a major amendment – anyone from the manufacturer to the retailer to the advertiser now has to think carefully about any claims that they are making, and make sure that they do not breach the requirements of s 12A. As with any major legislative change, there is a need to analyse the costs and benefits of the change. This paper carries out such an analysis, then considers whether Parliament was right to add a substantiation requirement into the FTA, and if so whether a general prohibition was the correct approach.

Part II of the paper outlines the legislative background of fair trading laws in New Zealand, from the original FTA to the amendments brought about by the Consumer Law Reform (CLR) Bill in 2011. Part III explains how s 12A operates as a substantiation requirement, providing comparisons to Australian and United States law. Part IV considers the positive and negative effects that may arise with s 12A in practice. Part V weighs up all the costs and benefits, and concludes that a general prohibition was the right approach to implementing a substantiation requirement in the FTA.

II Legislative Background

A Fair Trading Act 1986

Consumer law in NZ is largely governed by statute, one of which is the FTA. The purpose of the Act is set out in s 1A.¹

1A Purpose

- (1) The purpose of this Act is to contribute to a trading environment in which—
- (a) the interests of consumers are protected; and
 - (b) businesses compete effectively; and
 - (c) consumers and businesses participate confidently.
- (2) To this end, the Act—

¹ Fair Trading Act 1986, s 1A. The purpose section was added into the FTA following the CLR, replacing the previous long title.

- (a) prohibits certain unfair conduct and practices in relation to trade; and
- (b) promotes fair conduct and practices in relation to trade; and
- (c) provides for the disclosure of consumer information relating to the supply of goods and services; and
- (d) promotes safety in respect of goods and services.

One of the consumer rights provided for by the FTA is the access to adequate and accurate information. This is to ensure consumers are effectively able to make choices in the market based on their “true” preferences.² As there are many incentives for traders to provide false or misleading representations regarding their goods or services, the FTA contains provisions which aim to prohibit such behaviour, namely ss 9 and 13 as set out below:³

9 Misleading and deceptive conduct generally

No person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

13 False or misleading representations

No person shall, in trade, in connection with the supply or possible supply of goods or services or with the promotion by any means of the supply or use of goods or services,—

- (a) make a false or misleading representation...

Section 9 has a broad application, including to conduct covered by other specific provisions. In any case where s 13 is breached, an action is available in s 9 as well, because any false representation is also likely to mislead or deceive the public.⁴ Both sections are designed to be broadly applicable to any conduct “in trade”, so as to focus primarily on consumer protection considerations.⁵ These claims can be brought by the Commerce Commission (CC) or rival traders, who bear the burden of proving the contravention.

² This idea is discussed in Howard Beales, Richard Cresswell and Steven Salop “The Efficient Regulation of Consumer Information” (1981) 24 J L & Econ 491 at 492.

³ Fair Trading Act, above n 1, ss 9 and 13. Sections 13(a)–(j) list the various types of misrepresentations, for example in respect of the standard and quality of goods, price and place of origin among others.

⁴ Debra Wilson “Consumer Information” in Kate Tokeley (ed) *Consumer Law in New Zealand* (2nd ed, LexisNexis, Wellington, 2014) 125 at 143.

⁵ *Body Corporate 202254 v Taylor* [2008] NZCA 317, [2009] 2 NZLR 17 at [78]. Consumer protection under the Act is not limited to the contractual relationship between the purchaser and supplier. Claims can also be made against manufacturers or anyone acting “in trade”.

Previous versions of the FTA do not specifically prohibit making unsubstantiated claims. Claims of this nature had to be brought under ss 9 or 13. Both section 13 and section 9 impose civil liability.⁶ In civil proceedings the contravention must be proved on the “balance of probabilities”. Breach of section 13 is also a criminal offence.⁷ In criminal proceedings the contravention must be proved “beyond reasonable doubt”. It has often been difficult and expensive for the Commission to prove contraventions of s 9 and 13, particularly when the claim is of a technical or scientific nature.⁸ As a result only a relatively low incidence of such claims have historically been prosecuted under the Act. This excludes claims that were misleading in fact but could not be proven to the appropriate standard, and claims that were generally unsubstantiated.⁹

Concern over unsubstantiated claims have arisen as it is common practice in some markets to make claims without first ensuring that they are capable of being supported by evidence. These include claims of comparative pricing, product safety and effectiveness, and are particularly troubling in relation to credence claims.¹⁰ An example of a credence claim is where a company claims their detergent is environmentally friendly. Purchasers are not able to verify this on their own as the effects cannot be easily and immediately detected by the average consumer without conducting tests. They are therefore more likely to rely heavily on the information provided by the trader in making a decision to purchase the product. If it does not work as claimed, the purchaser then suffers a financial loss for the price of the product. Goods with particular advertised characteristics such as “eco-friendly”, “organic” or “healthy” tend to be sold at a higher price, making it crucial for the claim to be substantiated so as to avoid loss on the part of the consumer.¹¹

B 2006 Review

The Ministry of Consumer Affairs (MCA) first addressed the issue of unsubstantiated claims in the 2006 Review of the Redress and Enforcement Provisions of Consumer

⁶ Fair Trading Act, above n 1, ss 41–46.

⁷ Section 40(1).

⁸ Ministry of Consumer Affairs *Review of the Redress and Enforcement Provisions of Consumer Protection Law: International Comparison Discussion Paper* (May 2006) at 33.

⁹ Ministry of Consumer Affairs *Consumer Law Reform: A Discussion Paper* (June 2010) at 35.

¹⁰ At 35. A credence claim is one which is heavily relied upon by consumers as it is too difficult for them to investigate on their own.

¹¹ Ministry of Consumer Affairs *Consumer Law Reform Additional Paper: Substantiation* (November 2010) at 3.

Law. The review involved a comparison of redress and enforcement methods between New Zealand and other common law jurisdictions¹² to determine which of these methods were more effective. The comparison showed that most overseas jurisdictions had statutory provisions regulating unsubstantiated representations in some form or another, leading to the recommendation that the Australian approach to substantiation be adopted in New Zealand. Under this approach the Commission would have the power to issue substantiation notices to suppliers requiring them to provide evidence relevant to backing up their claims.¹³ This would reduce the need for the Commission to gather such evidence themselves. If a supplier fails to provide adequate information, the Commission could subsequently choose to bring proceedings for misleading representations.¹⁴

Submissions for this proposal were mainly supportive, affirming the view that the substantiation requirement (SR) would promote reassurance among consumers that claims disseminated in the market were made on valid grounds. The Commerce Commission considered that the introduction of substantiation notices would assist greatly in prosecuting false and misleading claims.¹⁵ It would be a welcome development after the High Court had placed limits on the Commission's powers to require information or documents during investigations under the FTA.¹⁶ However, while the review recommended that substantiation notices be implemented, no formal steps were taken after the discussion to legislate accordingly.

C Consumer Law Reform

The possible implementation of an SR was once again explored by the Ministry in their plans for consumer law reform, initiated in 2010. The CLR was to revise and update New Zealand consumer law, which had not been amended in 20 years.¹⁷ The reform

¹² Common law jurisdictions which were compared to New Zealand in the survey included Australia, Canada, the United Kingdom and the United States.

¹³ See Part III(B) for a detailed explanation of the Australian substantiation notices approach.

¹⁴ Ministry of Consumer Affairs *International Comparison Discussion Paper*, above n 8, at 36.

¹⁵ Ministry of Consumer Affairs *CLR Discussion Paper*, above n 9, at 37.

¹⁶ *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1991] NZAR 155.

¹⁷ Lindsay Trotman and Debra Wilson *Fair Trading: Misleading or Deceptive Conduct* (2nd ed, LexisNexis, Wellington, 2013) at 6.

process also aimed to harmonise New Zealand and Australian commercial law, creating a Single-Market Economy (SEM) between the two countries.¹⁸

The Ministry, in its CLR discussion paper, proposed a general prohibition on unsubstantiated representations in lieu of substantiation notices. They recommended that the FTA be amended to include a provision prohibiting unsubstantiated representations. The shift in favour of a general prohibition was due to several factors:

- i) The defences in s 44 of the FTA would not apply to businesses served with a substantiation notice, as it would not be an offence under the Act to make an unsubstantiated claim.
- ii) Section 47G already provides the CC with investigative powers which operate similarly to substantiation notices. The difference is that s 47G is limited to where there is suspicion by the CC of an FTA breach, whereas substantiation notices can be used whenever a promoting claim has been made.
- iii) The broad scope in the issuance of substantiation notices, and in the information which may be requested, might allow the Commission to carry out “fishing expeditions” on businesses, hoping to “catch them in the act”.
- iv) There is a danger of misconstruing substantiation notices as reversing the onus of proof onto the trader.¹⁹ It seemed like businesses would be compelled to provide evidence in order to “prove their innocence” when served with a substantiation notice. However, the MCA has explained how both the general prohibition and substantiation notice approaches do not in fact constitute a reverse onus.²⁰

The MCA also considered adopting both a general prohibition and substantiation notices, but rejected this option as the CC would already have enough powers under s 47G. A general prohibition was thus favoured as it would not face the issues which arise with substantiation notices as above. It was predicted that the provision would likely be

¹⁸ Ministry of Consumer Affairs *CLR Substantiation Additional Paper*, above n 11, at 11.

¹⁹ Section 25(a) of the New Zealand Bill of Rights Act 1990 provides that everyone charged with an offence is to be presumed innocent until proven guilty.

²⁰ See Ministry of Consumer Affairs, above n 11, at 12–13.

used as a “wake-up call” to businesses that they should only make supported and justified claims.²¹

The majority of submissions on the Discussion Paper supported the general prohibition on unsubstantiated claims as it would promote honesty amongst suppliers.²² Some positive effects raised include increased consumer confidence and protection, easier enforcement by the Commission, and the creation of a more even foundation for businesses to compete in. Most submissions agreed that only the Commerce Commission should have the power to bring proceedings under the new provision, for concern that allowing traders such powers could lead to abuse of the provision for anti-competitive purposes.²³

In the following month, the Ministry recommended to Cabinet that a general prohibition on unsubstantiated claims be added to the Fair Trading Act. Other suggested amendments included a prohibition on unfair terms in standard form consumer contracts and the insertion of a purpose section amongst others. These were packaged into an omnibus Consumer Law Reform Bill, introduced to Parliament in February 2012. After going through the legislative process, the Bill was passed and given royal assent on 17 December 2013. The Bill was then split into amendments coming into force over the next two years.²⁴

III The Requirement for Substantiation

A substantiation requirement calls for the verification, corroboration or proof that any claim made by a trader is backed up by evidence.²⁵ The approaches taken in New Zealand, Australia and the United States, while implemented and enforced differently, are based on the same fundamental purpose: to promote credibility and honesty among businesses and confidence in consumers. It would be unfair to consumers if traders were

²¹ Ministry of Consumer Affairs *CLR Discussion Paper*, above n 9, at 37.

²² Ministry of Consumer Affairs *CLR Substantiation Additional Paper*, above n 11, at 3.

²³ Ministry of Consumer Affairs *Brief Summary of Submissions to the Consumer Law Reform Discussion Paper* (September 2010) at 3.

²⁴ Kate Tokeley “Introduction” in Kate Tokeley (ed) *Consumer Law in New Zealand* (2nd ed, LexisNexis, Wellington, 2014) 1 at 12.

²⁵ Ministry of Consumer Affairs, above n 11, at 1.

allowed to make unsubstantiated claims, further widening the information imbalance between the two classes.²⁶

In most jurisdictions, the level of substantiation required for each claim depends on the nature of the claim itself.²⁷ For example, scientific or medical claims would require a high level of substantiation, such as data and results from independent studies that are consistent with the contents of the claims. Conversely, a claim of goods being sold at a discounted price would require a lower level of substantiation, such as pricing and sales data showing the accurate level of price cuts.²⁸

It is also likely that the level of substantiation needed will increase with the specificity of the claim made. A distinction is made between the reasonable grounds for express claims and implied claims. Express claims are those which are literally stated, such as “tests show...”, while implied claims are those made indirectly, such as “factory prices” which implies that prices are much lower than retail price.²⁹ An express claim needs to be proven to the standard which it boasts, while an implied claim needs to be substantiated to the level likely perceived by consumers.

The reasonable grounds requirement also works similarly amongst the jurisdictions compared. All claims are decided on a case-by-case basis. Factors similar to those listed under s 12B of the FTA (set out below) can be taken into account in the process of doing so.

A Section 12A – How it works

In New Zealand, the prohibition of unsubstantiated representations is contained in ss 12A – 12D, under Part 1 of the FTA.

Section 12A reads:³⁰

12A Unsubstantiated representations

- (1) A person must not, in trade, make an unsubstantiated representation.

²⁶ Ministry of Consumer Affairs *CLR Substantiation Additional Paper*, above n 11, at 3.

²⁷ At 1.

²⁸ Commerce Commission *Fact Sheet, Unsubstantiated representations* (December 2013) at 1.

²⁹ At 1.

³⁰ Fair Trading Act, above n 1, s 12A.

- (2) A representation is **unsubstantiated** if the person making the representation does not, when the representation is made, have reasonable grounds for the representation, irrespective of whether the representation is false or misleading.
- (3) This section does not apply to a representation that a reasonable person would not expect to be substantiated.
- (4) In this section and sections 12B to 12D, **representation** means a representation that is made—
 - (a) in respect of goods, services, or an interest in land; and
 - (b) in connection with—
 - (i) the supply or possible supply of the goods or services; or
 - (ii) the sale or grant or possible sale or grant of the interest in land; or
 - (iii) the promotion by any means of the supply or use of the goods or services or the sale or grant of the interest in land.

There is no precise test to determine what constitutes reasonable grounds. Section 12B sets out a list of factors that have to be considered by the court in identifying these grounds.³¹

- a) The nature of the goods or services;
- b) The nature of the claim;
- c) Any research or steps taken before the claim was made;
- d) The nature or source of any information relied on to make the claim;
- e) The extent to which any standards, codes or practices relating to the claim were complied with;
- f) The actual or potential effects of the claim on any person.

Section 12C limits enforcement under s 12A to the Commerce Commission.³² Furthermore, where other enactments have set out specific grounds for claims to be made, businesses do not have to comply with s 12A if they have already complied with the other enactment.³³

Section 12A operates in a similar way to s 13. The CC can bring civil or criminal proceedings, and in doing so they have to show to the appropriate standard of proof that

³¹ Fair Trading Act, above n 1, s 12B(1).

³² Section 12C.

³³ Section 12D. This section does not apply to voluntary codes not governed by law or regulations.

the defendant trader did not have reasonable grounds when making the claim. As s 12A is a strict liability offence, there is no need to show intention to make an unsubstantiated claim – rather, the act itself deems the defendant liable.

Civil penalties include injunctions and orders, while criminal sanctions available to the court are individual fines up to \$200,000 and body corporate fines up to \$600,000.³⁴ With the possibility of high fines, the defences to criminal prosecution under s 44 of the FTA are applicable to s 12A. These include the defences of reasonable mistake and reasonable reliance. A breach out of the defendant's control or attributable to a third party is also exempted if the defendant has taken reasonable precautions to avoid contravention.³⁵

B The Australian approach to substantiation

Australia has also recently undergone a sweeping reform of consumer law in 2010, resulting in the passage of the Australian Consumer Law (ACL): a single, national law concerning consumer protection and fair trading. The ACL applies in the same way nationally and in each state and territory, ensuring that businesses have to adhere to the same standards nationwide. At the same time, consumers are able to enjoy uniform expectations and protection regarding their rights in the marketplace.³⁶ The passage of the ACL was one of the main factors which prompted New Zealand's CLR, as two countries have a commitment to achieving a SEM, as mentioned earlier.

The ACL introduced an SR contained in s 219 of the Competition & Consumer Act 2010, schedule 2.³⁷ This provision allows the Australian Competition and Consumer Commission (ACCC)³⁸ to issue substantiation notices to businesses where the accuracy of the claim is not readily discernible. Under this approach, making an unsubstantiated claim is not an offence on its own. A substantiation notice is merely a preliminary enforcement tool which the ACCC can use to gather evidence from businesses to verify their claims. A failure to reach the adequate standard of substantiation, or a refusal to

³⁴ Ministry of Consumer Affairs *CLR Substantiation Additional Paper*, above n 11, at 13.

³⁵ Fair Trading Act, above n 1, s 44(1).

³⁶ SG Corones *Australian Consumer Law* (2nd ed, Lawbook Co., Sydney, 2013) at [1.05].

³⁷ Competition and Consumer Act 2010 (Cth), sch 2, s 219.

³⁸ The Australian equivalent of the Commerce Commission, with similar powers and functions.

provide documentation under a substantiation notice is an offence in itself.³⁹ Alternatively, it enables the ACCC to bring separate claims of deceptive conduct or false/misleading representations.⁴⁰

In its submission to the Productivity Commission's Review of Australia's Consumer Policy Framework, the ACCC contended that substantiation notices can achieve two objectives. Firstly, it will greatly assist the relevant enforcement agency in determining whether there has been false or misleading conduct. Instead of having to gather evidence that the representation is false or misleading, the Commission can now require the business to do so, effectively saving costs, time and effort. The information supplied for substantiation would also make it much easier for the Commission to sift through innocent traders and those who have committed a breach of fair trading laws. Secondly, the SR will raise the standard of behaviour that businesses are expected to adhere to, as a failure to comply with the substantiation notices may attract a criminal penalty in itself.⁴¹

To comply with a substantiation notice, the supplier does not have to prove that a claim is true or not misleading. The supplier needs only to give information and/or produce documents that are specified in the notice. The notice will usually require documents or information that could be capable of substantiating or supporting the supplier's claim or representation.⁴² However if the claim is not based on reasonable grounds the claim will be treated as unsubstantiated, and the ACCC is likely to take enforcement action.⁴³ The Commission can either treat the claim as false/misleading if there is enough evidence, or impose a criminal penalty under s 205 of the ACL for failing to comply with the notice.⁴⁴ Section 206 also sets out criminal sanctions for traders who provide false or misleading information in response to a notice. These two offences are of strict liability, but subject to the Australian equivalent of s 44 defences.⁴⁵

³⁹ Failure of compliance with a substantiation notice is an offence under ss 205 and 206, see below for a more detailed explanation.

⁴⁰ Trade Practices Amendment (ACL) Act (No 2) 2010 (Cth) (explanatory memorandum) at 14.13.

⁴¹ Competition and Consumer Act, sch 2, above n 37, s 205.

⁴² Section 219(2).

⁴³ Corones, above n 36, at [13.300].

⁴⁴ Competition and Consumer Act, sch 2, above n 37, s 205.

⁴⁵ Section 206.

Under Australia's approach to requiring substantiation, the fines imposed on businesses for failing to comply with a substantiation notice⁴⁶ are much lower than that for a misleading representation.⁴⁷ In the New Zealand context, making an unsubstantiated representation is prohibited under the FTA, so any contravention will subject the trader to fines under s 40, which means that a breach of s 12A will impose the same fine as a breach of s 13.⁴⁸ Effectively, traders who make unsubstantiated claims in New Zealand have a chance of paying a much higher fine than those in Australia.

C The United States advertising substantiation programme

The idea of advertising substantiation began in the USA in the early 1970s with the aim of assisting consumers in making rational choices.⁴⁹ The Federal Trade Commission (FTC)⁵⁰ had designed a procedure requiring advertisers to submit data that can substantiate advertised claims. The programme, which continues to this day, treats unsubstantiated claims as “unfair and deceptive acts and practices” under s 5 of the FTC Act.⁵¹

The FTC case *In re Pfizer Inc.* was instrumental in defining the concepts of the advertising substantiation programme (ASP), and is still cited as the basis for most of the Commission's complaints. In it, the FTC emphasised that the obligation to substantiate advertising claims existed even before the claim was made.⁵² Indeed that was the time where substantiation is most necessary, as not doing so would be fundamentally unfair to the consumer, exposing them to the economic risk that the product/service would not perform as claimed. The risk is very much amplified when not even the manufacturer, let alone the consumer has a reasonable basis for belief in

⁴⁶ The fine for breaching s 205 is \$3,300 for individuals and \$16,500 for body corporates, while the fine for breaching s 206 is \$5,500 for individuals and \$27,500 for body corporates.

⁴⁷ Competition and Consumer Act, sch 2, above n 37, s 151. The fine for making a misleading representation is \$220,000 for individuals and \$1.1 million for body corporates.

⁴⁸ Fair Trading Act, above n 1, s 40. The fine for breaching any provision in Part 1 of the Act is up to \$200,000 for an individual and \$600,000 for a body corporate.

⁴⁹ Dorothy Cohen “The FTC's Advertising Substantiation Program” (1980) 44(1) *Journal of Marketing* 26 at 26.

⁵⁰ The FTC is a bipartisan federal agency with similar functions as the CC – to protect consumers and promote competition. However, the FTC has a wider range of powers compared to the CC and the ACCC.

⁵¹ Federal Trade Commission Act 1914 (US), s 5.

⁵² *In re Pfizer Inc.* (1972) 81 F.T.C.23 at 98.

the claim. It generally does not matter that the claim is subsequently found to be true, as the injustice to the consumer has already occurred at the time the claim was made.⁵³

Another point clarified by the FTC in the *Pfizer* case was that the reasonable grounds required for each claim were to be decided on a case-by-case basis.⁵⁴ They also stated that the “adequacy of substantiation cannot be considered in the abstract”.⁵⁵ Hence some considerations of the kind of product for which the claim is made, and whether the claims is express or implied, have to be taken into account. The FTC is cautious to only challenge reasonable interpretations of advertising claims.⁵⁶

Those in violation are subject to a cease-and-desist order, which can lead to monetary penalties if not obeyed. Besides that, the FTC also has other enforcement methods available to them, such as corrective advertising and counter-advertising orders.⁵⁷ The CC and ACCC in Australia and New Zealand do not have such a wide range of powers, meaning that any comparison done to the United States advertising substantiation programme must be done with caution.

IV Possible effects – the costs and benefits

This section analyses the possible effects of s 12A when put into practice. As s 12A only came into force on 10 June 2014, there has not been any litigation concerning unsubstantiated claims. Hence the analysis will be done based on submissions on the CLR Discussion Paper and the CLR Bill. Some cases brought under ss 9 and 13 will also be used to demonstrate likely outcomes under s 12A. A number of articles regarding the economic effects of the United States ASP will also be discussed where relevant.

A Increased Protection for Consumers

The primary purpose of making it an offence to disseminate unsubstantiated claims is to protect consumers. The guiding principle of the CLR is that consumers should have the

⁵³ At 99.

⁵⁴ Cohen, above n 49, at 27.

⁵⁵ At 28.

⁵⁶ Federal Trade Commission (US) *FTC Policy Statement Regarding Advertising Substantiation* (March 1983).

⁵⁷ “The Pfizer Reasonable Basis Test – Fast Relief for Consumers but a Headache for Advertisers” (1973) *Duke LJ* 563 at 587–592.

right to be confident when purchasing goods and services. The purpose section added into the FTA as a result reflects this.⁵⁸ Consumers' reasonable expectations toward the quality of the goods/services should be met. Hence it is problematic if traders make claims about their goods and services that consumers cannot verify on their own. The capability of verifying claims is only available to the traders, and so they owe the consumers a duty to do so before disseminating the claim.⁵⁹

In this sense, the prohibition of unsubstantiated claims by s 12A of the FTA relates back to one of the overarching rationales of consumer law: the imbalance of power between consumers and traders.⁶⁰ Traditionally, classical contract theory and neoclassical economic theory both support a minimal level of legal intervention to protect consumers.⁶¹ Neoclassical economic theory assumes that in a free market, consumers are able to make rational choices that are both in line with their preferences and have the best chance in improving consumer welfare. Similarly, classical contract theory advocates total freedom to each individual to enter into any bargain which suits them, and they should therefore be responsible for their own shopping decisions.⁶²

However, the free market is not always the most suited for consumer interests. In reality, there is often a position of unequal bargaining power between traders and consumers, which has been exacerbated in today's marketplace by technological change, large multi-national corporations and increasingly complex products. The ability of traders to disseminate inadequate and inaccurate information in the marketplace further contributes to this imbalance.⁶³ In this sense, a general prohibition on unsubstantiated claims would provide a large practical benefit towards the underlying purpose of consumer protection laws.

Most submissions made on the CLR Discussion Paper and the CLR Bill which favoured a prohibition of unsubstantiated claims did so for the purpose of consumer protection.⁶⁴ However some analysts from the United States have doubted the actual benefits which the ASP can offer to the consumer. This is because increased accuracy in claims will

⁵⁸ Fair Trading Act, above n 1, s 1A.

⁵⁹ Ministry of Consumer Affairs *CLR Substantiation Additional Paper*, above n 11, at 5.

⁶⁰ At 3.

⁶¹ See Richard Posner *Economic Analysis of Law* (7th ed, Aspen Publishers, Austin, Texas, 2007) for more discussion on neoclassical economic theory and classical contract theory.

⁶² *Printing and Numerical Registering Co v Sampson* (1875) LR 19 Eq 462 at 465.

⁶³ Tokeley, above n 24, at 21.

⁶⁴ Ministry of Consumer Affairs *Brief Summary of Submissions*, above n 23, at 3.

result in higher supply costs in products, due to the supplier having to spend costs on making sure that the claims are substantiated to the acceptable standard.⁶⁵ The educational purpose of the United States ASP – to increase consumer’s understanding of the product by allowing them access to the evidence behind the claims – has also been ineffective. In the early stages of implementation of the programme, the FTC found that most of the time the information and data provided to substantiate claims were too technical or questionable for the average consumer to understand.⁶⁶

It has also been argued that the credibility of advertisers has always been so low that consumers will only view the overall effects of the SR as an across-the-board price rise.⁶⁷ They may prefer to make an occasional “wrong” product choice and incur this economic loss, than to pay the added cost of prior substantiation for all products.⁶⁸ However, Higgins and McChesney argue that consumers, by taking an economic risk that a product will not perform as advertised, have always been paying the equivalent of the increased cost. The increased cost due to substantiation is negligible. Furthermore, the ASP spreads that cost amongst all consumers, and not just on those who are more susceptible to deceptive advertising.⁶⁹

Overall, the protection offered to consumers by s 12A will likely produce a positive effect on consumers’ confidence in the market, thus fulfilling the purpose envisioned by the MCA during the drafting process.⁷⁰ This also achieves the purpose of the FTA as a whole.⁷¹

B Increased Honesty by Businesses

An SR also provides an advantage to businesses who have been honest and have made supported claims even before s 12A was enacted. As it is now a requirement for all businesses to do so, unethical competitors will no longer be able to gain an advantage by making excessive or untrue claims about their marketed products/services. Without an SR, these unethical businesses would be able to gain a profit above others as they

⁶⁵ Richard Higgins and Fred McChesney “Truth and Consequences: the Federal Trade Commission’s Ad Substantiation Program” (1986) 6 Intl Rev of Law and Economics 151.

⁶⁶ “Advertisers Headache”, above n 57, at 584.

⁶⁷ At 596.

⁶⁸ At 595.

⁶⁹ At 596.

⁷⁰ Ministry of Consumer Affairs *CLR Discussion Paper*, above n 9, at 38.

⁷¹ Fair Trading Act, above n 1.

would not have to incur the additional cost of substantiation. They are able to price their products at a lower price, thus attracting more customers. Some customers, believing the excessive claims to be true, may also choose to purchase these products, further disadvantaging businesses whose products feature substantiated claims.

The CC's prediction that s 12A would be used as a "wake-up call" means businesses will be more careful to consider beforehand the evidence behind claims they are about to make, for fear of being penalised.⁷² The increased possibility of liability compared to ss 9 and 13 might encourage them to be more vigilant. In the long run, businesses will hopefully show a widespread change in behaviour, reducing the chances of misrepresentation and misleading or deceptive conduct. This in turn will contribute to the increased credibility of the entire business sector and will reduce the risk of injury to competition caused by unsubstantiated claims.⁷³ Substantiating claims might even shift to become a standard business practice, which would lead to a safer and more stable market for both businesses and consumers alike.

C Costs

Compared to ss 9 and 13, proving a breach of the FTA in terms of unsubstantiated claims to the trader will save a large amount of investigative costs for the Commerce Commission. As mentioned earlier, under ss 9 and 13 the CC needs to show that "on the balance of probabilities" or "beyond a reasonable doubt" there has been a misleading representation or deceptive conduct. In comparison, under s 12A the CC need only to show to the same standards that the claim was not backed up with reasonable grounds.

It is difficult, costly and time-consuming for the Commission to gather evidence to prove a breach of ss 9 or 13. It has to conduct surveys, hire experts or run tests amongst other methods in order to prove that consumers are misled or likely to be misled by the representation. Even when they have done so, there is a risk that the evidence will not be admissible in Court. As a result, there might be a disproportionately low number of dishonest traders who are penalised for breaching the two sections.

⁷² Ministry of Consumer Affairs *CLR Discussion Paper*, above n 9, at 38.

⁷³ Ministry of Consumer Affairs, above n 9, at 39.

A helpful example based on the facts of *CC v Martini Ltd* was included in the 2006 Review by the MCA.⁷⁴ The case was brought by the CC under s 13 – that the slimming product Celluslim was marketed under false and misleading claims of its performance. The claim was that Celluslim tablets would melt away fat and cellulite but in fact, they could not. The promotional material also stated that these products had been tried and tested by experts in Europe and America, however, these ‘experts’ were found to not even exist. The defendants admitted that they had only copied the promotional material given to them by the suppliers of the product. They were not able to substantiate the claim, and had taken no steps to do so by conducting tests.⁷⁵

The Commission had to spend nearly \$40,000 to bring in an expert who could testify about the efficacy of the tablets for a successful court claim. These costs would have been higher had the defendants pleaded not guilty. There was also a considerable time delay in sentencing, with judgment and compensation to the purchasers of the product only passed down in November 2005, 3 years after the distribution of Celluslim had ceased.⁷⁶ Had s 12A been in place at that time, the process would have been considerably simpler – the CC could have brought a claim against the defendants for not substantiating the claim before disseminating it. There would have been no need for expert opinion because once trader failed to show that the experts exist, and that the products work, they can be successfully prosecuted under s 12A. As such, the trial would have been significantly shorter.

Other cases which would have been successful under s 12A and saved costs, time and effort on behalf of the CC include *CC v GlaxoSmithKline (NZ) Ltd*, where the drink Ribena was found to not contain the level of Vitamin C as labelled.⁷⁷ That case is also significant in that the falsity was exposed by two students who had tested the product in a high school project. Had s 12A been in place at the time, these results would have been enough for the CC to commence proceedings under s 12A as they would have been suspicious that the claim is unsubstantiated. The process to obtain the relevant evidence would be much simpler. On the other hand, if they were to prosecute under s 13, results from a high school lab test is unlikely to be acceptable in court as evidence

⁷⁴ Ministry of Consumer Affairs *International Comparison Discussion Paper*, above n 8, at 33.

⁷⁵ *Commerce Commission v Martini Ltd*, DC North Shore, 8 November 2005 at [4].

⁷⁶ Ministry of Consumer Affairs, above n 8, at 34.

⁷⁷ *Commerce Commission v GlaxoSmithKline (NZ) Ltd* DC Auckland CRI 2006-004-503913, 27 March 2007.

that Ribena does not contain the represented levels of Vitamin C. The CC would still have to run independent tests for this purpose.

The decreased costs to the Commission is balanced out by the increased costs for businesses to comply with s 12A. These costs will vary with the nature of the claims being made. A higher level of substantiation needed for more specific claims will naturally mean that the costs involved will be higher.⁷⁸ A number of businesses who opposed a SR, such as Telecom, submitted that the increase of costs by businesses will be disproportionate to the benefits gained by consumers.⁷⁹ The increase in cost price will be reflected in retail price, and consumers have no increased level of protection as that already offered by ss 9 and 13. Another submitter, Business NZ also noted that the increase in compliance costs for substantiating claims seemed “frivolous” compared to those involving significant health and safety concerns.⁸⁰

A study by Sauer and Leffler on the United States ASP, however, has shown otherwise. They sought to determine the truth in the theory that SRs would result in significant costs but negligible improvement in credibility. Were this to be true, a decrease in verifiable claims was to be expected, with a greater difficulty for new entrants to enter the market due to high substantiation costs. Conversely, if credibility effects win out, entrants to the market will enjoy more profitable sales.⁸¹ The results showed that new entry to the market with the implementation of a SR was not hindered by significant costs. From that it can be deduced that the ASP increased the credibility of advertising.⁸²

While this study was carried out in the 1990s, it can be applied to New Zealand’s recent introduction of s 12A. It may be that with every jurisdiction, the effects of a SR provision can only accurately be determined after years of practice. Businesses in New Zealand, while showing the same scepticism as those who opposed the ASP when it was first introduced, may be appeased if s 12A goes as planned and its results can be determined empirically in the future.

⁷⁸ Ministry of Consumer Affairs *CLR Discussion Paper*, above n 9, at 39.

⁷⁹ Telecom NZ “Submission to the Ministry of Consumer Affairs on the Consumer Law Reform Additional Paper – Substantiation” (23 December 2010) at [30].

⁸⁰ Business NZ “Submission to the Ministry of Consumer Affairs on the Consumer Law Reform Discussion Paper” (30 July 2010) at 6.4.

⁸¹ Keith Leffler and Raymond Sauer “Did the Federal Trade Commission’s Advertising Substantiation Program Promote More Credible Advertising?” (1990) 80 *American Economic Rev* 191 at 197.

⁸² Leffler and Sauer, above n 81, at 198.

D Section 12A too wide

It could be argued that s 12A is unnecessary when ss 9 and 13 are already in place to prevent harm to consumers from false or misleading representations. There is no overwhelming evidence of false claim cases which would justify the introduction of such a wide provision to the FTA.⁸³ In fact in most cases successful prosecution of a claim under s 12A would go hand in hand with ss 9 and 13.

Sections 9 and 13 Section 12A	Liability found	No Liability
Liability found	Trader makes an unsubstantiated claim which turns out to be false/misleading.	Trader makes an unsubstantiated claim which turns out to be true.
No Liability	Trader makes a claim which is substantiated by evidence that turns out to be false. Defences under s 44 of FTA can be utilised.	Claim is substantiated and true.

Based on this formulation, the only set of circumstances in which s 12A will work independently is where there is no real threat of harm – where the claim is unsubstantiated but true. This means that the implementation of s 12A may run counter to its purpose, and to the purpose of the FTA as a whole. If the purpose of the provision was to protect consumers, the question arises: what have these cases protected the consumer from? There was no harm to begin with, and no harm would have arisen from the trader’s unsubstantiated claim as it was in fact true. An unsubstantiated claim which is not false or misleading must be one that is accurate and fairly represented.⁸⁴

One counter-argument to this would be that s 12A was meant to be a deterrent to dishonest businesses who do not take the initiative to substantiate claims in the first place. While it is unnecessary for traders to share all their information with consumers, they need to know themselves that the claims can be substantiated.⁸⁵ The possibility of prosecution if the offence is made out will only serve to strengthen the deterrent effect of s 12A. This is noted in the submission by the Banking Ombudsman to the MCA. A general prohibition, while making it unlawful for a business to make an unsubstantiated

⁸³ Business NZ, above n 80, at 6.7.

⁸⁴ Telecom NZ, above n 79, at [16].

⁸⁵ Ministry of Consumer Affairs *CLR Substantiation Additional Paper*, above n 11, at 3.

claim in the first place, will not work alone. Rather, for the effects of the prohibition to be efficiently seen, there has to be penalties available to address any contravention.⁸⁶

Furthermore, there has been research carried out on whether the policy of mandatory prior substantiation is redundant to a false-claims ban, based on Canadian competition policy which also contains the equivalent of ss 12A and 13. The study, done in 2013, is the first explicit theoretical inquiry into the effects of mandatory substantiation policies.⁸⁷ The results suggested that having a ban on false claims alone would produce significant shortcomings in deterring optimistic firms which are more likely to discount the risk of being caught. A prior-substantiation policy is more powerful in the deterrent aspect, and provides more flexibility. In short, having the two policies work together will allow the regulator to devise a penalty which is applicable across a wide range of possible cases where suspicious claims are made. A socially optimal policy employs penalties for both false and unsubstantiated claims.⁸⁸

E Uncertainty

The “reasonable basis” approach has suffered criticism concerning its uncertain nature ever since it was implemented in the ASP by the FTC in the 1970s.⁸⁹ The same has occurred in Australia and New Zealand as both countries have incorporated it into their SR provisions. The main criticism was that it is difficult for traders to know for certain what documentation to provide in order to substantiate their claims.⁹⁰ There was another issue that the “reasonable” standard was set entirely by the Commission in determining whether the claim has been adequately substantiated. It seemed like the Commission could do so entirely as they wish, and there would not be consistent standard of adequate substantiation made available to the public for clarity’s sake.

An article published in the United States shortly after the introduction of the ASP describes the problem this poses to traders. They first have to examine their claim in terms of the factors set out in *Pfizer* (in New Zealand law, s 12B). This involves

⁸⁶ Banking Ombudsman “Submission to the Ministry of Consumer Affairs on the Consumer Law Reform” (3 August 2010) at [10].

⁸⁷ Kenneth Corts “Prohibitions on False and Unsubstantiated Claims: Inducing the Acquisition and Revelation of Information through Competition Policy” (2013) 56(2) *Journal of Law and Economics* 453 at 455.

⁸⁸ Corts, above n 87, at 483.

⁸⁹ “Advertisers Headache”, above n 57.

⁹⁰ Telecom NZ, above n 79, at [25].

weighing the substantiation data against specific values they have assigned to each factor and against the relative importance of each factor generally. After this long and laborious process, the Commission can still decide that the level of documentation provided to back up the claim is not “reasonable” if they place a different amount of weight on each factor.⁹¹ Indeed as the article was aptly named, this situation would cause a “headache” to traders who would have a considerable problem trying to predict the level of substantiation which would satisfy the Commission. This problem could be just unique to the FTC and might not arise in the case of the CC, but it remains to be seen.

In the New Zealand context, there have been concerns that this problem would arise. As the implementation of s 12A is recent, there may be a significant amount of uncertainty amongst businesses and advertising practices until there are established guidelines in case law.⁹²

F Effect on claims

By outlawing unsubstantiated claims, the desired outcome would be that the credibility of claims made in the marketplace would increase. A number of studies have analysed this hypothesis based on the ASP in the United States. These results could be helpful reference in predicting the outcome on claims resulted by the introduction of a SR to New Zealand.

A study was conducted by Healey and Kassajian in 1983, around a decade after the ASP was introduced.⁹³ Firstly, they hypothesised that claims would be handled in two extreme ways: by providing inherently verifiable evidence or by making non-verifiable and vague claims. Inherently verifiable claims were those whose selling point was an obvious feature of the product itself, which did not require documentation to back up. On the other end of the spectrum were puffery claims which were so exaggerated to the point where no verification could be demanded.⁹⁴ The results confirmed this hypothesis

⁹¹ “Advertisers Headache”, above n 57, at 574.

⁹² Telecom NZ, above n 79, at [5].

⁹³ John Healey and Harold Kassajian “Advertising Substantiation and Advertiser Response: A Content Analysis of Magazine Advertisements” (1983) 47 *Journal of Marketing* 107.

⁹⁴ At 108.

– by 1976, advertising for products subject to the ASP had shifted to largely utilise either of these two tactics.⁹⁵

Secondly, the researchers predicted that the level of informativeness in advertisements would increase. They found that the advertisements contained less information compared to pre-ASP 1970, but the information that was given was of a better quality. It was thus concluded that the ASP did contribute towards the credibility of advertisements, and this may well be the case in New Zealand with s 12A in practice. However these are only short-term results, and do not represent long-run implications in the court room or in promotional material distributed by traders.⁹⁶

Leffler and Sauer’s study, mentioned above, also produced results supporting increased credibility in claims. The aim of the study was to examine whether the goal of the ASP had been achieved – whether advertising was more credible in the post-ASP period. If consumer scepticism of claims in general is positively related to the frequency of false claims, and the ASP is able to reduce this frequency, then consumer scepticism will decrease and the return to making verifiable claims will rise. It can then be deduced that credibility of claims has increased. This hypothesis was confirmed by the results which showed an increase in the level of informativeness and a general increase in claims made relating to products which were regulated by the ASP.⁹⁷

While the results of these two studies suggest that the credibility of claims will likely increase with a substantiation policy in place, the shift in types of claims to the “extreme” ends as evident from Healey and Kassarian’s results could be troublesome. This is reflective of the concerns by some that a SR could stifle creativity when promoting goods and services. Many businesses could choose to “play it safe” for fear of being investigated by the CC under s 12A, negatively impacting the level of information being transmitted to the consumer. Other industries, such as media and advertising, would also have their ability to forecast their advertising commitments affected.⁹⁸

⁹⁵ Healey and Kassarian, above n 93, at 114.

⁹⁶ At 116.

⁹⁷ Leffler and Sauer, above n 81, at 192.

⁹⁸ Telecom NZ, above n 79, at [31].

Furthermore, it has been suggested that substantiation policies will only really produce positive results in claims made by big firms.⁹⁹ This is because they are able to cover the extra cost of substantiation or are more able to avoid the cost through the use of substitute inputs.¹⁰⁰ They also have established reputations for providing top utility per dollar to consumers, so that merely reminding purchasers of their brand name can still attract high sales. Small firms, on the other hand, are more reliant on factual advertising to market their products or services, and so will be subject to regulation under the substantiation requirement.¹⁰¹ If this situation arises in New Zealand due to s 12A, it would pose a problem most local businesses do not have large market shares. Small businesses which form the majority of the marketplace will be adversely affected while the minority of big businesses with large market shares win out as they are more adaptable.

V Recommendations

A Should New Zealand have a substantiation requirement at all?

Given the situation in other jurisdictions and the benefits brought about by requiring substantiation, it is reasonable to contend that the FTA should contain some form of regulation in respect of unsubstantiated claims. In particular, the argument by Courts that a false claims ban works the best alongside an unsubstantiated claims ban is especially convincing. There are clear differences between the two prohibitions, and it would be an oversight to say that s 13 catches claims “most of the time”. The two are different – not only do they serve different functions, but taking a claim under s 12A is also much easier to prove than s 13, and therefore less costly and time-consuming. The CC will be able to make sure that all dishonest businesses can be caught for not backing up a claim, even if they are unable to prove that the claim is false/misleading. This alone is a very strong factor going towards support of a substantiation requirement in New Zealand.

Furthermore, having a SR will bring New Zealand’s fair trading rules more in line with that of Australia, which is conducive given their commitment to forming a SEM. Though the approach taken is different, the presence of a SR alone will take New Zealand a step closer to fulfilling this commitment. This combined with the fact that

⁹⁹ Higgins and McChesney, above n 65.

¹⁰⁰ At 155.

¹⁰¹ At 156.

consumers will have more confidence in claims made by businesses will lead to a more efficient market.

While a SR will impose additional costs on businesses, these technically should have been incurred anyway in the process of making the claim. Even before s 12A was implemented, the costs for making sure that every claim made is backed up by evidence should have always been included in the marketing of the product. As mentioned earlier, this is to ensure that the consumer gets the full truth about the product, and that even the businesses have the full confidence that the claims they are making is wholly accurate. It would be unethical, and unjust to both consumers and other honest businesses if traders were allowed to choose whether or not to substantiate their claims. If this situation were to continue, it would lead to inefficiency in the market as competition between businesses would be harmed.

Therefore, the decision to include an SR in the FTA was appropriate. While there are still quite a number of problems that may present themselves, these will have to be clarified by the use of guidelines and case law as they arise in the future.

B Was a general prohibition the right approach?

As it was partly the ACL which spurred New Zealand's CLR, it is surprising that the Ministry did not follow the Australian approach when submitting recommendations for the CLR Bill to Cabinet. There has been argument that a general prohibition was the wrong approach to take, if a SR were to be implemented. If the CLR aimed for closer adherence to Australian law for the purposes of the SEM, then why not just adopt substantiation notices into New Zealand law?

As mentioned earlier, the CC already has wide investigative powers under s 47G of the FTA, and allowing them to issue substantiation notices would extend those powers too far. The Commission had argued that their powers had been limited by *Telecom NZ Ltd v CC*, which held that the CC only had the power to seek information relevant to an investigation as authorised by the FTA.¹⁰² The ruling, however, does not operate as a restriction on their investigative powers, rather as a clarification on the limits to which their powers extend.¹⁰³ With these limits, the Commission is unable to go on “fishing

¹⁰² *Telecom v Commerce Commission*, above n 16.

¹⁰³ *Telecom NZ*, above n 79, at [22].

expeditions” where they issue notices to any business in hopes of catching them in breach.¹⁰⁴ This dispels the concern that the CC, if given the power to issue substantiation notices, will use them to go on “fishing expeditions”.

If substantiation notices were adopted in New Zealand, businesses when responding to a substantiation notice cannot rely on s 44 defences. The defences can only be used to negate liability for the relevant offence, which is failing to comply with the substantiation notice. They would not be able to help businesses if they have in fact made an unsubstantiated representation. They can only rely on their privilege against self-incrimination if served with a notice, however s 44 will be available if further proceedings for misleading representations are brought.¹⁰⁵ In this sense, a general prohibition is able to “skip a step”, making the process much simpler, faster and cheaper for all parties.

A general prohibition also serves the deterrent function of a SR better as all unsubstantiated claims are now banned. It conveys clearly that New Zealand fair trading laws will not tolerate dishonest businesses who do not bother to substantiate their claims before disseminating them amongst the public. Having a blanket ban also allows consumers the full knowledge that businesses will be breaking the law if they make an unsubstantiated claim, and that the Commission will have the power to take action against such cases as they arise. Hefty fines at a similar level to s 13 further strengthens the deterrent effect.

The general prohibition in the form of s 12A was an appropriate way to implement a SR into the FTA. However, as before, further guidelines by the Commission and the Courts by way of case law would provide more assistance as to how the prohibition is to be put into practice. Such areas of concern could be the effect of s 12A on small firms, guidelines on appropriate substantiation levels, and the avoidance of significant costs being imposed on businesses when complying with s 12A.

VI Conclusion

The implementation of s 12A as a general prohibition on unsubstantiated claims is the right approach to be taken in New Zealand. It increases consumer confidence,

¹⁰⁴ Ministry of Consumer Affairs *CLR Substantiation Additional Paper*, above n 11, at 6.

¹⁰⁵ At 7.

encourages ethical practices by businesses, and overall leads to a more efficient and competitive market, which is in line with the purpose of the Fair Trading Act. It will also lighten the Commerce Commission's workload considerably when investigating claims, and will enable their resources to be allocated where necessary. While s 12A may give rise to some problems when put into practice, these can be worked out with guidelines and case law in the future. Concrete conclusions on any actual effects can only be drawn after years of observation with s 12A in practice. Until then, long-term implications remain to be seen.

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