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FALSE ADVERTISING LITIGATION

Managing Investor Risk In Food and Beverage Industry

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What do Uncle Ben's rice, Don Francisco Coffee, and Utz potato chips all have in common? In May 2016, the manufacturers of each of these products became the target of class action lawsuits alleging false advertising in courts all over the country. Over the last six years, consumer products companies, and particularly manufacturers in the food and beverage industry, have been hit with a wave of similar litigation. Hundreds of companies have been swept in, from the largest multi-nationals to the rawest startups. Contrary to popular belief, these cases crop up in courts all over the country, and are not confined to California. Business interests, especially those new to the sector, need to appreciate this trend in false advertising litigation as the "new normal," and recognize it for what it is: one more business risk to be managed.

The complaints typically hinge on labeling statements or images on the packaged good, often in combination with allegations targeting the company's social media or other advertising. The theories of deception vary widely. For example:

- Plaintiffs claim a labeling error under the Federal Food, Drug & Cosmetics Act (FDCA), asserting that the product is "misbranded" and deceptive.
- Both regulated words, such as "healthy" or "fresh" and unregulated words, such as "handmade," are routinely targeted. "Natural" is a frequent target. Several brand-name breakfast cereal manufacturers are currently facing class actions built on the theory that the oats and wheat are supposedly tainted with trace amounts of the herbicide glyphosate, and therefore the cereals cannot be labeled "natural." Hundreds of other "natural" cases have been filed on a host of other allegations, too numerous to detail in this article.
- Almost any aspect of a product label can become a target, even tiny print on the back that, in the real world, consumers never consider in their purchasing decisions.
- Even everyday terms can become a target. Chobani, for example, is currently fending off a lawsuit that labeling its yogurt tubs "Greek Yogurt" is deceptive if the yogurt is not made in Greece or by real Greeks, see *Stoltz v. Chobani*, No. 1:14-CV-03827 (E.D.N.Y)).

Businesspeople typically perceive this type of litigation to be frivolous and sometimes struggle to reconcile the fact that these cases may require substantial resources to defend even when the allegations seem absurd. There may be hurdles to defeating claims at the outset of a case (and before expensive discovery commences) on a motion to dismiss: Refuting the allegations may require the introduction of facts, some judges may be reluctant to dismiss a claim of subjective deception as a matter of law, and some facts and arguments may hit different judges in different ways.

Beyond the direct litigation costs, these lawsuits also could entail reputational risk, not to mention potential costs of rebranding. As a consequence, companies have been willing to pay out millions of dollars in settlements and legal fees, unfortunately funding the arsenals of their adversaries.

Managing Investor Risk

Meanwhile, the food and beverage industry has never been hotter for the investors, remaining a traditional safe haven in unsettled economic times. Against this backdrop, the deal community has a new mandate to consider consumer advertising claims in the diligence and documentation process. This analysis can affect the deal in a host of ways, from valuation to deal structure (including perhaps a separate indemnity for pre-transaction labeling claims) to capital planning for label and marketing changes.

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Where deals are conducted in an auction context or where financial interests are scrutinizing food and beverage concerns from the outside, the following steps may help in assessing litigation risk.

• First, collect copies of current product labels and analyze them for litigation magnets. Look for terms like "natural" and its close cousin "no artificial ingredients," as well as "local," "handcrafted," "small batch;" "antioxidants;" "Made in USA;" "sustainable" and any kind of health claim. Of course, these marketing terms (and others like them) may well be core to the brand, fully legitimate to use, and entirely appropriate to maintain on the product after the transaction. But it is critical to appreciate that these terms may also draw litigation attention—a risk that may only grow if the goal is to scale up distribution.

• Second, evaluate the current state of litigation over these terms with an eye to what the product is and what it contains. For example, ascorbic acid and canola oil are both ingredients contained in "natural" products that have been challenged as non-natural.

• Third, research false advertising claims against the target's direct competitors; docket searches can often be conducted with a product class in mind. Several premium juice manufacturers, for example, have been sued for using the word "raw" without adequately disclosing their use of high pressure pasteurization, and entrants to the category must be mindful of that risk.

• Finally, if the target has a marquis product, take a hard, skeptical look at it, and consider whether the product could be characterized as junk food dressed up as health food, a line of attack often employed by the consumer advocacy groups.

Requests for Information

In the deal context, parties who can submit an initial or follow-up information request to the target should ask for all the usual litigation documents, including complaints in pending or threatened matters; active litigation files, including letters asserting claims or complaints; litigation settlement documents; all letters from enforcement agencies, courts or other tribunals. And parties should also request the same class of litigation documents submitted to insurers for advertising insurance coverage.

For this assessment, however, you should go further.

For example, ask for product labels used over the last one to two years, including the approximate time frame when these labels were in distribution, and the timing of significant label changes. (Six years is even better, since that is the statute of limitations for many consumer protection statutes that are commonly used, though some states are shorter, in the three-to-four-year range.) These labels should be examined for the same hot litigation terms as the current labels, because to the extent the products (or online images of the products) are still in circulation, they can continue to pose risk.

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Ask for the substantiation for major labeling terms, especially the "magnet" terms to get a sense of why the target is using those words. What is "handmade" about a cider that has boomed in distribution in the last 18 months? What makes that popular protein snack "natural"? Are there warrants from suppliers? What do they say? What type of reliable scientific data back up health claims? This information can help identify which claims are not only litigation magnets, but those that stand on the shakiest ground.

It is also worth inquiring after the extent of the target's current existing advertising injury insurance, which might be an asset to help defray certain post-transaction litigation costs.

Investors and acquirers would be wise to ask about the process the target uses to clear its product labels, and in particular whether it utilizes a regulatory specialist. The absence of someone experienced in FDCA or (where relevant) USDA labeling rules may be a red flag that there may be other regulatory errors that could be fodder for regulatory, consumer, or competitor action.

Finally, a note of caution. It is impossible to screen a target's product line for all litigation risks. A term on a product label can be in use for decades by an entire industry without a hint of trouble, when seemingly overnight it is the subject of a false advertising claim. Just ask major retailers about "100% grated parmesan cheese." This long-used labeling term lies at the heart of dozens of lawsuits filed earlier this year on the heels of a Bloomberg article highlighting the industry-wide use of an FDA-approved anti-caking ingredient. "Claims of Wood Pulp in Parmesan Cheese Spur 45 Class Actions," National Law Journal, April 26, 2016. But the prudent investor can take steps to assess—and plan for—the risk of investing not only in the hottest new brand, but the latest new trend in food and beverage litigation.