FTC Attempts to Abolish Vicarious Liability Defenses for Deceptive Sales Practices: Strict Liability for Manufacturers

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FTC ATTEMPTS TO ABOLISH VICARIOUS LIABILITY DEFENSES FOR DECEPTIVE SALES PRACTICES: STRICT LIABILITY FOR MANUFACTURERS?

The cornerstone for the federal government's policing of unfair and deceptive practices in the marketplace is Section 5 of the Federal Trade Commission Act. As originally enacted, the act proscribed only "unfair methods of competition in commerce" and was intended to enable the commission to supplement the Justice Department's prosecutions under the Sherman and Clayton Acts. Under the original act undesirable practices affecting consumers were immune from the Federal Trade Commission's [FTC] cease and desist orders. The Supreme Court in *FTC v. Raladam Co.*, had held a manufacturer of an "obesity cure" had not violated Section 5 because his false advertising practices were not shown by the commission to be harmful of competition. This decision provided the major impetus for congressional amendment of the act in 1938 adding "unfair or deceptive acts or practices in commerce" to the prohibition against unfair methods of competition.6

5. 283 U.S. 643 (1931).
6. Act of Mar. 21, 1938, ch. 49, § 3, 52 Stat. 111. "The necessity of this amendment is made apparent by the decision of the [sic] Supreme Court in a case involving deceptive advertising in which the Commission had issued its order to cease and desist. In that case the Court said:

"'If the necessity of protecting the public against dangerously misleading advertisements of a remedy sold in interstate commerce were all that is necessary to give the Commission jurisdiction, the order could not successfully be assailed.' 16E J. VON KALINOWSKI, BUSINESS ORGANIZATIONS § 38.06[2], at 38-92, n.12 (1971) [hereinafter cited as VON KALINOWSKI] citing S. REP. No. 221, 75th Cong., 1st Sess. 2 (1937).

"[The] Wheeler-Lea Amendment to the FTCA . . . was aimed primarily at broadening the FTC's jurisdiction by granting it power to regulate 'unfair or deceptive acts
Business has engaged in a wide variety of legal gyrations to blunt the effectiveness of the FTC in curbing deceptive sales practices. In order to insulate themselves from liability for such practices, business is likely to establish a legal barrier between a manufacturer and its sales organization by making that sales organization at least a nominally separate business entity. Unless the commission can hold a manufacturer liable for deceptive practices, a manufacturer can thwart attempts to halt deceptive practices merely by reorganizing its sales group. An extreme example of such manipulation came to the courts in 1970 in *P.F. Collier & Son Corp. v. FTC.*

In 1939 the FTC docketed a complaint against P. F. Collier & Son Corp. of New Jersey, a wholly-owned sales subsidiary of Crowell-Collier. Crowell-Collier organized a new P. F. Collier & Son Corp. in Delaware and merged the New Jersey corporation into the parent. The FTC complaint was dismissed. In 1952 the Delaware corporation was dissolved and merged into the parent after the United States had initiated criminal proceedings against it for violation of the Fair Labor Standards Act of 1938. For two years encyclopedias were sold through a division of Crowell-Collier, but in 1954 a new P. F. Collier & Son Corp. of Delaware appeared and resumed sales operations for the parent. In 1960, the FTC again complained against P. F. Collier & Son Corp. for deceptive sales practices in the sales of encyclopedias. That same year a new corporation, P. F. Collier, Inc. was formed to conduct sales operations and P. F. Collier & Son Corp. merged into its parent, Crowell-Collier. Directors and officers of the parent held similar positions in the various subsidiaries. Throughout this period, encyclopedias were sold to the public in the same manner later held to constitute a deceptive sales practice. The corporate purpose in the articles of incorporation P. F. Collier, Inc. contained wording identical to that of its predecessor. Yet in the ten years that the proceedings dragged on, Crowell-Collier maintained it should not be liable for the acts of its various subsidiaries and that the complaint should be dismissed because there was no defendant against whom to proceed. The FTC and the Sixth Circuit rejected this defense.

The courts have been liberal in interpreting the commission's function in regulating and controlling unfair methods of competition and unfair or deceptive business practices. The Supreme Court has in-

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8. Id.
terpreted the act as giving the commission broad powers to declare trade practices unfair and power to shape the remedy necessary, mandating to the courts that interference with the commission's decision is permissible only when there is no reasonable relation between the remedy and the violation. Congress left the wording of the statute broad so as to permit the commission "to eradicate evils with the least risk of interfering with legitimate business operations.' In thus divining that there is no limit to business ingenuity and legal gymnastics the Congress displayed much foresight."

This note will examine the conflicts between this broad mandate of power and the traditional concepts of the separateness of business entities which have arisen and continue to arise when the commission attempts to ignore the separateness of these entities in promulgating its cease and desist orders and in prosecuting violators. In attempting to eliminate unfair and deceptive practices, the commission has sought to direct at each respondent the broadest possible order so that the efficiency of the act is not avoided by a mere change in the legal form by which the respondent conducts its business. Focusing on the vicarious responsibility of the named respondent for the deceptive practices of the individuals or organizations selling its product or service, this note will examine three general types of sales-distribution arrangements and discuss the success of various respondents in avoiding vicarious liability for deceptive practices under each.

Since 1938, when the Wheeler-Lea Amendment expanded the FTC's jurisdiction to include the prevention of deceptive practices in commerce, the commission has steadfastly sought to avoid any common law separateness of business entities with which manufacturers attempted to insulate themselves from charges of deceptive practices. Always asserting the policy behind the act as justification, the earliest cases were successful in striking down the most transparent separate formation, the independent contractor.

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12. The commission has also been successful in imposing its orders on the individuals behind the corporate respondents, "piercing the corporate veil," but a discussion of these actions is beyond the scope of this note.

13. See, e.g., P.F. Collier & Son Corp. v. FTC, 427 F.2d 261 (6th Cir. 1970); Goodman v. FTC, 244 F.2d 584 (9th Cir. 1957); Steelco Stainless Steel, Inc. v. FTC, 187 F.2d 693 (7th Cir. 1951); International Art Co. v. FTC, 109 F.2d 393 (7th Cir.), cert. denied, 310 U.S. 632 (1940); Universe Chem., Inc., 77 F.T.C. 598 (1970).

14. See text accompanying notes 34-49 infra.
garding corporate subsidiaries. The final barrier which the commission is being asked to break down is that between a manufacturer and a dealer selling the product whose only relationship to the manufacturer is wholesaler-retailer. Under the present case law, it appears these independent dealers are beyond the scope of a manufacturer's responsibilities. While too stringent controls on allegedly independent dealers have led to FTC complaints against the manufacturer for antitrust violations, there are at least two untried theories under which the commission could impose liability for acts of even these independent dealers. This note will conclude with an examination of these theories and a prognosis for future FTC prosecutions.

The Commission's Approach to Vicarious Responsibility

Because consumers rely most heavily on information given them by salespersons, the unfair or deceptive practices in commerce proscribed by the act almost invariably occur at the consumer sales level. The commission's job of curbing deceptive practices is made more complex by the manufacturers' use of various sales distribution methods. While some manufacturers employ their own organic sales forces, many have developed distribution systems in which formally separate business entities do the direct selling. The manufacturers generally employ one or more of the following basic systems:

1. Single salesmen, called independent contractors, who are not actually employed by the manufacturers.
2. Owned or controlled subsidiary corporations who employ salesmen to distribute manufacturers' products.
3. Unrelated corporations or retail dealers who sell manufacturers' products, either exclusively or in conjunction with other lines.

The commission's attempts to impose vicarious liability upon manufacturers for deceptive sales practices occurs in both types of proceedings utilized by the commission to curb these practices. In order to

15. See text accompanying notes 53-80 infra.
17. See text accompanying note 97 infra.
18. See text accompanying notes 97-100, 114-119 infra.
19. Von Kalinowski lists eight practices which have been held violative of the act. They include: (1) misrepresentations concerning the origin or composition of the product; (2) use of similar trade names, packaging or design; (3) supplying inaccurate labels or tags; (4) half-truths; (5) come-on advertising; (6) misleading descriptive names; (7) deceptive collection practices; and (8) use of lotteries or other gambling devices in the distribution of merchandise. 16E VON KALINOWSKI, supra note 6, § 41.01. All of these practices are aimed at consumers. Where retailers or other manufacturers are involved, the practices become unfair methods of competition covered by the first clause of section 5 of the FTCA. Cf. 16E VON KALINOWSKI, supra note 6, § 41.01, at 41-5, 41-6.
justify the imposition of a cease and desist order the commission's complaint counsel will want to attribute the deceptive practices of a manufacturer's sales organization to the manufacturer. Secondly, once a cease and desist order has been entered against a manufacturer, the commission will try to prove a violation when a deceptive practice is committed by that manufacturer's allegedly separate sales force in a proceeding before a federal district court to collect civil penalties. Therefore, the orders issued by the Federal Trade Commission are phrased to run not only to the named respondents but to "successor[s], assign[s] and officers, agents, representatives, salesmen, and employees, directly or indirectly, through any corporate or other device . . . ." However, respondents in these proceedings typically assert that they should be responsible only for the acts of their direct agents or employees and not for the acts of independent sales organizations. Under the broadly phrased orders, the commission is now attempting to hold manufacturers liable for deceptive sales practices regardless of the method used to distribute the product. Theoretically, anyone who sells the product of another in whatever capacity could be called that other's "representative." To date, the commission has been successful in asserting the liability of manufacturers who distribute their product through thinly disguised independent contractors or subsidiary corporations. The commission is relying on the courts to continue the liberal trend of looking through the legal relationships established in product distribution to impose liability on manufacturers when anyone sells their products in a deceptive manner.

Independent Contractors

The Petitioner's Primary Contention is that the Salesmen . . . Were Independent Contractors, For Whose Actions He Was Not Responsible.

An independent contractor is one who contracts to do work according to his own methods, without being subject to the control of his employer, with the exception of the product or result of his work. The legal effect of such a relationship is that employers are not gen-

20. 3 TRADE REG. REP. ¶ 9701 (1971).
21. P.F. Collier & Son Corp. v. FTC, 427 F.2d 261, 265 n.6 (6th Cir. 1970); see, e.g., Complaint at 27, Grolier, Inc., No. 8879 (F.T.C. filed Mar. 9, 1972).
22. Representative has been defined as: "One who represents or stands in the place of another." BLACK'S LAW DICTIONARY 1466 (rev. 4th ed. 1968); cf. United States v. Ryan, 350 U.S. 299, 306 (1956) (anyone who deals with an employer on behalf of employees concerning employment matters is a representative).
23. Goodman v. FTC, 244 F.2d 584, 590 (9th Cir. 1957).
24. Donroy, Ltd. v. United States, 301 F.2d 200, 206 (9th Cir. 1962); Long v. Valley Steel Prod. Co., 207 F.2d 505, 507 (10th Cir. 1953); see Casement v. Brown, 148 U.S. 615 (1893).
erally liable for the torts their independent contractors committed during the performance of the contract work. Respondents in Federal Trade Commission adjudicative proceedings have frequently asserted this relationship between themselves and the persons selling their products, disclaiming liability or responsibility for deceptive practices of these persons. As will be shown the cases reflect the courts’ disfavor with this defense.

No single factor has been determinative of the question of whether or not a salesperson was an independent contractor. In the cases in which the commission or the courts refused to find independent contractor status for the purpose of Section 5 of the FTCA, one or more of the following indicia have been present:

1. Respondent gave express instructions on the sales representations to be made.26
2. The salespersons did not purchase their own sales material and advertising.27
3. Salespersons did not purchase their own stock and maintain it.28
4. The billing and shipping was done directly by respondent to the customer.29
5. Salespersons were given credentials introducing them as representatives of the manufacturer.30
6. The salespersons received a salary, often termed an advance on commissions.31

25. Mazer v. Lipschutz, 327 F.2d 42, 53 (3d Cir. 1963); Southern Natural Gas Co. v. Wilson, 304 F.2d 252 (5th Cir. 1962); Capitol Chevrolet Co. v. Lawrence Warehouse Co., 227 F.2d 169 (9th Cir. 1955).
27. Goodman v. FTC, 244 F.2d 584 (9th Cir. 1957); Steelco Stainless Steel, Inc. v. FTC, 187 F.2d 693 (7th Cir. 1951); All-State Indus. of N.C., Inc., 75 F.T.C. 465, 474 (1969); Wilmington Chem. Corp., 69 F.T.C. 828, 905-09 (1966); Graystone Portrait Agency, 55 F.T.C. 982, 985 (1959).
29. Globe Readers Serv., Inc. v. FTC, 285 F.2d 692 (7th Cir. 1961); Goodman v. FTC, 244 F.2d 584 (9th Cir. 1957); Atlas Aluminum Co., 71 F.T.C. 762, 785-87 (1967).
7. Control of credit arrangements involved in the sale was in the hands of the manufacturer.\textsuperscript{32}

On their face, these factors do not appear to be significantly different than those used to defeat an alleged independent contractor status at common law.\textsuperscript{33} However, the courts have repeatedly indicated that they will not be bound by common law principles in determining the scope of an employer's liability.\textsuperscript{34} Although never expressly stated, the result seems to be that the commission's complaint counsel are relieved from making a rigorous showing of a master-servant relationship once a deceptive practice has been demonstrated. Doubts or conflicts as to the nature of the relationship between respondent and the salespersons appear to be resolved in favor of a finding that respondent is liable for the deceptive practices.\textsuperscript{35}

The leading articulation of this philosophy appeared in \textit{Goodman v. FTC},\textsuperscript{36} where the court emphasized the policy of the FTCA as requiring the rejection of a flimsy independent contractor defense:

\begin{quote}
When interpreting a statute the aim of which is to regulate interstate commerce and to control and outroot some evil practices in it, the courts are not concerned with the refinements of com-
\end{quote}

\textsuperscript{32} Inter-State Builders, Inc., 72 F.T.C. 370, 401-04 (1967); Atlas Aluminum Co., 71 F.T.C. 762, 785-87 (1967).

\textsuperscript{33} The factors for determining whether a person is an independent contractor at common law have been stated alternatively by various courts. Buchanan v. United States, 305 F.2d 738 (8th Cir. 1962); Beatty v. Halpin, 267 F.2d 561 (8th Cir. 1959); King v. Southwestern Greyhound Lines, Inc., 169 F.2d 497 (10th Cir.), \textit{cert. denied}, 335 U.S. 891 (1948). The \textit{RESTATEMENT (SECOND) OF AGENCY} § 220(2) (1957) also makes a complete compilation: "In determining whether one acting for another is a servant or an independent contractor, the following matters of fact, among others, are considered: (a) the extent of control which, by agreement, the master can exercise over the details of the work; (b) whether or not the one employed is engaged in a distinct occupation or business; . . . (e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work; . . . (g) the method of payment, whether by the time or by the job; (h) whether or not the work is part of the regular business of the employer; (i) whether or not the parties believe they are creating the relation of master and servant . . . ."


\textsuperscript{35} Examination of the way the commission and courts have brushed aside this independent contractor defense suggests this conclusion. \textit{See, e.g.}, Libby-Owens-Ford Glass Co. v. FTC, 352 F.2d 415 (6th Cir. 1965); Carlton Fredericks, 71 F.T.C. 193, 226 (1967); National Trade Publications Serv., Inc., 58 F.T.C. 706, 710 (1961), \textit{aff'd}, 300 F.2d 790 (8th Cir. 1962); Basic Books, Inc., 56 F.T.C. 69, 73 (1959); Tri-State Printers, Inc., 53 F.T.C. 1019, 1027 (1957); \textit{cf.} Universal Interchange, Inc., 63 F.T.C. 350, 371 (1963).

\textsuperscript{36} 244 F.2d 584 (9th Cir. 1957).
mon-law definitions, when they endeavor to ascertain the power of any agency to which the Congress has entrusted the regulation of the business activity or the enforcement of standards it has established.  

The court arrived at this conclusion through an analogy to a Supreme Court interpretation of the Labor Management Relations Act in *NLRB v. Hearst Publications.* There, the Court was trying to determine whether newsboys were employees rather than independent contractors such that the newspapers would be required to bargain with the union representing them. After noting that there was a lack of uniformity in the common law relationships of independent contractors, the Court concluded that Congress could not have intended to incorporate those standards into a statute requiring national uniformity. The objective of the statute was the prime consideration in giving meaning to the word employee. The Court would not let the policy of this regulatory legislation be frustrated by the niceties of common law definitions.

In *Goodman,* petitioner published a course in weaving. By virtue of contracts made with the salespersons who peddled the course, Goodman claimed they were independent contractors for whose acts it was not liable. However, the court noted that Goodman provided the sales kit, trained the salespersons, supplied them with credentials, contracted directly with customers and shipped the orders without any intermediation by a salesperson. The court had little difficulty in finding the salespersons to be Goodman's agents and in justifying the imposition of liability on Goodman for their misrepresentations. The court said it only needed "to determine whether misrepresentations were made within the apparent scope of the authority of the salespersons."

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37. *Id.* at 590.
40. "It will no do, for deciding this question as one of uniform national application, to import wholesale the traditional common-law conceptions or some distilled essence of their local variations as exclusively controlling limitations upon the scope of the statute's effectiveness. To do this would be merely to select some of the local, hairline variations for nation-wide application and thus to reject others for coverage under the Act. That result hardly would be consistent with the statute's broad terms and purposes." *Id.* at 125, cited in *Goodman v. FTC,* 244 F.2d 584, 590-91 (9th Cir. 1957).
41. *Goodman v. FTC,* 244 F.2d 584, 591 (9th Cir. 1957). The court in *Goodman* relied heavily upon *International Art Co. v. FTC,* 109 F.2d 393 (7th Cir. 1940): "[E]ach salesman was issued a certificate designating him as the representative of the Art Company; the order was taken in its name; the picture was shipped in its name, and the customer was notified in its name of the time of delivery. All blanks used by the salesmen were furnished by the Art Company and bore its name. The customer had a right to believe—in fact, could not have believed otherwise, than that the sales-
In the fifteen years following the *Goodman* decision, the commission has relied heavily upon it to sweep away respondents' disclaimers of responsibility for acts of their independent sales agents. For example, registration under state law of the salespersons as independent contractors has not been deemed controlling.\(^2\) In another case, the only information presented customers bore the manufacturer's name. This was the main basis for a finding that the salespersons were the manufacturer's agents.\(^4\) One manufacturer had the sales force certified as its representatives and supplied them with order forms upon which its name was printed. When the facts also indicated that the manufacturer knew of the unauthorized and deceptive business practices, liability was imposed.\(^4\) Similarly, where respondent furnished contracts and credit applications with its name imprinted, allowed the sales persons to use its office and phones, and provided customers through its paid advertising system, liability was imposed.\(^4\)

The most comprehensive analysis of the relevant factors appeared in *Wilmington Chemical Corp.*\(^4\) There, the commission noted that even if the arrangement between respondent and its sales-persons "conformed factually and legally to the separateness attributed to it, that would not be dispositive of the issue."\(^4\) After reviewing the relevant case law, the commission went on to formulate an extensive list of considerations.\(^4\)

The summary of this analysis is that manufacturers will have difficulty in avoiding liability for any deceptive practices established to have been committed by persons selling their products on a purported independent contractor basis. Manufacturers must take affirmative preventive action; they will be unable to avoid liability by merely ordering their salespersons to refrain from making a certain repre-

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\(^4\) Steelco Stainless Steel, Inc. v. FTC, 187 F.2d 693 (7th Cir. 1951), also greatly influenced the *Goodman* court: "[The] salesmen, in most instances, devote their full time to respondents and do not sell other merchandise. These salesmen do not purchase respondents' products for resale to the consumer but sell them on behalf of respondents. Such salesmen are agents or employees of respondents and are not independent contractors or independent dealers. Respondents are fully responsible for such salesmen's acts and statements made in connection with the sale or offering for sale of their products and germane thereto." *Id.* at 697.

\(^4\) Inter-State Builders, Inc., 72 F.T.C. 370, 403 (1967).

\(^4\) *Id.* at 905.
sentations. The subterfuge is too simple and the public policy too strong for the courts to reach any other result.

Related Corporations

[A]bsent Highly Unusual Circumstances, the Corporate Entity Will Not Be Disregarded.60

A second type of relationship between seller and manufacturer exists where the salespersons have been employees of separate, but wholly-owned subsidiary corporations distinct, at least in form, from the manufacturer. Generally, mere ownership by one corporation of a controlling interest of the stock of another corporation does not destroy the identity of the latter as a distinct legal entity.61 This rule holds even though the same individuals may be officers or directors of the two corporations.62 As a result, respondent manufacturers in commission proceedings have generally sought to insulate themselves from potential liability for deceptive practices of their owned or controlled subsidiaries by asserting the legal separateness of the two corporations.

The law has recognized an exception to this general rule when there is very close identity between corporations and recognition of the separate identities would work an injustice or inequity.63 Separate corporate existence can be disregarded when

[s]tock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner, but for the purpose . . . of controlling a subsidiary company so that it may be used as a mere agency or instrumental-ity of the owning company or companies.64

49. Standard Distribs., Inc. v. FTC, 211 F.2d 7 (2d Cir. 1954); Parke, Austin & Lipscomb, Inc. v. FTC, 142 F.2d 437, 440 (2d Cir.), cert. denied, 323 U.S. 753 (1944); Perma-Maid Co., Inc. v. FTC, 121 F.2d 282 (6th Cir. 1941).
50. P.F. Collier & Son Corp. v. FTC, 427 F.2d 261, 266 (6th Cir. 1970).
54. Chicago, M. & St. P. Ry. v. Minneapolis Civic & Commerce Ass'n, 247 U.S. 490, 501 (1918). Compare the famous language of Justice Cardozo in Berkey v. Third Ave. Ry. Co., 244 N.Y. 84, 95, 155 N.E. 58, 61 (1926): "Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice."
The federal courts do not appear to be as eager to disregard the corporate entity as they have disregarded the assertion of independent contractor status in imposing liability on manufacturers for the deceptive practices committed by these sales organizations.\textsuperscript{55} As early as 1923, the Second Circuit acknowledged that they would not let the policy of a regulatory statute be frustrated by resorting to the fiction that the corporation is separate from the stockholders.\textsuperscript{56} Despite this early recognition of the policy considerations, the traditional common law test for determining when the corporate entity will be disregarded was not abandoned until recently.\textsuperscript{57} The common law test was based on two considerations. To justify the disregard of the corporate entity, the commission (or other administrative agency) had to show that the parent possessed actual legal control over its subsidiary and used such control to so dominate the subsidiary that the subsidiary corporation was the alter ego of the parent.\textsuperscript{58}

Actual legal control was primarily a question of fact based on the presence of the following factors: (1) Ownership of all or part of the stock of the subsidiary; (2) Interlocking directorates or officers who held positions in both firms.\textsuperscript{59} In the cases where vicarious liability has been imposed under the common law test both factors have been present although the mere ownership of a controlling interest of the subsidiary's stock would appear sufficient.\textsuperscript{60}

The exercise of such control to the point where the court or commission is compelled to reach "the conclusion that the corporate identity of the subsidiary is a mere fiction"\textsuperscript{61} has been a question of fact in applying the policy of the act. The courts have not steadfastly relied on certain factors to reach their conclusion to disregard the corporate

\textsuperscript{55} See, e.g., Eagle Star Ins. Co. v. Deal, 474 F.2d 1216 (8th Cir. 1973); Stark v. Flemming, 283 F.2d 410 (9th Cir. 1960); National Lead Co. v. FTC, 227 F.2d 825 (7th Cir. 1955); cf. Schenley Distillers Corp. v. United States, 326 U.S. 432, 437 (1946).

\textsuperscript{56} Mennen Co. v. FTC, 288 F. 774, 782 (2d Cir.), cert. denied, 262 U.S. 759 (1923). The same court reasserted this proposition thirty years later. Corn Prods. Ref. Co. v. Benson, 232 F.2d 554, 565 (2d Cir. 1956).

\textsuperscript{57} P.F. Collier & Son Corp. v. FTC, 427 F.2d 261 (6th Cir. 1970).

\textsuperscript{58} Fish v. East, 114 F.2d 177, 191 (10th Cir. 1940); National Bond Fin. Co. v. General Motors, 238 F. Supp. 248 (W.D. Mo. 1964), aff'd, 341 F.2d 1022 (8th Cir. 1965).

\textsuperscript{59} Steven v. Roscoe Turner Aero. Corp., 324 F.2d 157, 161 (7th Cir. 1963); National Lead Co. v. FTC, 227 F.2d 825, 829 (7th Cir. 1955); Press Co. v. NLRB, 118 F.2d 937, 947 (D.C. Cir. 1940), cert. denied, 313 U.S. 595 (1941).

\textsuperscript{60} A parent has the power to exercise control whenever it has a controlling interest in the subsidiary's stock. Interlocking directorates facilitate the exercise of that control but do not increase the amount or degree of control possessed. Cf. Steven v. Roscoe Turner Aero. Corp., 324 F.2d 157 (7th Cir. 1963); J. Powell, Parent & Subsidiary Corporations 4-12 (1931).

\textsuperscript{61} National Lead Co. v. FTC, 227 F.2d 825, 829 (7th Cir. 1955).
form but the following indicia have emerged: (1) Use of common offices; (2) Undercapitalization of the subsidiary; (3) Directing financial policy; (4) Providing advice and handling of subsidiary business at the parent level; and (5) Direct dealing with the customers and advertising designed to create an image of corporate unity.62

The Second Circuit was the first court to indicate that the policy inherent in the administrative controls imposed upon business by Congress would mandate a lesser showing to pierce the corporate veil than ordinarily is required. In Bowater Steamship Co. v. Patterson63 the plaintiff argued that it and defendant were separate, independent industries for purposes of the Norris-LaGuardia Act.64 The court spurned this contention and stated that while there may have been sufficient independence to be regarded as separate in contract or tort litigation, such was not necessarily so for application of this statute.65

This analysis was foreshadowed by Mr. Justice Rutledge's dissenting opinion in Press Co. v. NLRB.66 Then, sitting on the Court of Appeals for the District of Columbia Circuit, he indicated that potential frustration of public policy would be a paramount consideration in determining whether the corporate separateness should be disregarded.

The Sixth Circuit made the most severe departure from the common law principles in its landmark decision in P. F. Collier & Son Corp. v. FTC.67 Manifestly, where the public interest is involved, as it is in the enforcement of Section 5 of the Federal Trade Commission Act, a strict adherence to common law principles is not required in the determination of whether a parent should be held for the acts of its subsidiary, where strict adherence would enable the corporate device to be used to circumvent the policy of the statute.68

Judge Celebrezze, writing for the majority, first reviewed the general rule that "absent highly unusual circumstances, the corporate entity

63. 303 F.2d 369 (2d Cir. 1962).
65. "As the Supreme Court has repeatedly taught, the policy behind the Norris-LaGuardia Act was a strong one; we cannot think Congress would have meant this to be defeated by the fragmentation of an integrated business into a congeries of corporate entities, however much these might properly be respected for other purposes." Bowater S.S. Co. v. Patterson, 303 F.2d 369, 373 (2d Cir.), cert. denied, 371 U.S. 860 (1962).
66. 118 F.2d 937, 947 (D.C. Cir. 1940).
68. Id. at 267.
will not be disregarded."

After rejecting the common law test for determining the existence of these "highly unusual circumstances," he described the evidence upon which the commission's finding of a single Collier enterprise for the purposes of the act was based.

[The parent not only wholly-owned its Collier subsidiaries, but also . . . it: interchanged personnel with its subsidiaries and maintained common or overlapping officers and directors; operated through its subsidiaries, which were often created and dissolved for purposes unrelated to the business carried on by the corporate complex; approved the use by its subsidiaries of the parent's name and goodwill in order to develop favorable public associations between the parent and its subsidiaries; and possessed and exercised ultimate control over Collier & Son.]

Although the factors present clearly seemed to fit the common law test, the court felt constrained to emphasize the paramount position of policy considerations in enforcing the act (or any other public interest statute) and promulgated a new test for piercing the corporate veil.

In the alternative, however, the law is clear that where a parent possesses latent power, through interlocking directorates, for example, to direct the policy of its subsidiary, where it knows of and tacitly approves the use by its subsidiary of deceptive practices in commerce, and where it fails to exercise its influence to curb the illegal trade practices, active participation by it in the affairs of the subsidiary need not be proved to hold the parent vicariously responsible.

The court cited no direct authority for this new test even though it stated that "the law is clear." The court did, however, cite Goodman v. FTC, the landmark case disposing of common law considerations in imposing vicarious responsibility in the independent contractor distribution method. In so doing, the court in Collier emphasized its adoption of a similar approach to related corporations. The court could have justified the creation of this new test by liberally interpreting earlier cases in which parent and subsidiary were treated as one. The early cases had verablized the role of policy in interpreting these statutes, but none had clearly abandoned the common law test even though the same national uniformity was required as in the independent contractor situation.

Aside from the reference to interlocking directorates, Judge Cele-
brezze did not indicate just what would constitute "latent power to control." The court could have merely intended to restate the traditional test in a new manner, softened perhaps by policy considerations. Given the language that "active participation . . . need not be proved," the court more likely intended to indicate its willingness in future cases to impose vicarious responsibility where something less than actual legal control actively exercised is present.

In addition to the "latent power to control," the court indicated the parent would have to possess knowledge of the deceptive practices and would have to fail to curb such practices. The evidence in the case indicated that the Collier parent actually knew of the deceptive practices at the salesperson-customer level. Where interlocking directorates exist, the parent cannot be heard to say it did not know what its subsidiaries were doing. Where "latent power" amounts to something less than full interlocking directorates, the question arises whether actual knowledge must be shown. If such is the requirement, this new test adds little to the common law test. The vigorous rejection of the common law principles in the opinion compels a contrary conclusion. If the commission can show the power to control and a means of knowledge on the part of the parent, the courts will not allow blatant deceptive practices to continue unabated.

In future prosecutions for deceptive practices, the Federal Trade Commission probably will enjoy success in imposing liability upon parent corporations for the deceptive practices of their subsidiaries. The commission will be required to make some showing of knowledge and control due to the strong policy favoring the separateness of corporate entities, but it is difficult to conceive of a situation in which the commission will be unable to make such a showing.

76. P.F. Collier & Son Corp. v. FTC, 427 F.2d 261, 270 (6th Cir. 1970).
77. Id. at 270. Curbing the practice means more than a mere direction not to engage in deceptive practices. Steelco Stainless Steel, Inc. v. FTC, 187 F.2d 693, 696 (7th Cir. 1951). Also see the cases cited in note 44 supra.
78. The knowledge of a corporate director and officer is imputed to the corporation. Federal Sav. & Loan Ins. Corp. v. Fielding, 343 F. Supp. 537, 544 (D. Nev. 1972); see Phoenix Sav. & Loan, Inc. v. Aetna Cas. & Sur. Co., 427 F.2d 862, 869 (4th Cir. 1970). Thus when an individual is a director of two corporations, knowledge of the activities of one can be properly imputed to the other.
79. If a parent possesses a means of knowledge of its subsidiary's activities, it can be properly charged with knowledge of those activities. Cf. Higgins v. Shenango Pottery Co., 279 F.2d 46 (3d Cir.), cert. denied, 364 U.S. 899 (1960); RESTATEMENT (SECOND) OF AGENCY § 9, comment d (1957). Corporations are acknowledged to have a duty to stockholders (in this case the parent corporation) to keep them informed as to corporate affairs. Reynolds v. Texas Gulf Sulphur Co., 309 F. Supp. 548, 558 (D. Utah 1970), aff'd in part, rev'd in part sub nom., Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90 (10th Cir.), cert. denied, 404 U.S. 1004 (1971). Therefore, a sole shareholder (which could be a corporation) could reasonably be charged with knowledge of the corporation's activities.
80. In the cases where the courts have refused to hold the parent liable for the
Unrelated Retailers

There are a number of . . . entities to whom Respondents sell . . . at wholesale, and who are in all other respects independent of Respondents.81

The final distribution method used by manufacturers is where the entity selling to the consumer is a retail dealer who is wholly without corporate ties to the manufacturer and who generally handles the merchandise line of more than one manufacturer. In a case now pending82 the commission's complaint counsel are seeking to impose liability upon a corporate manufacturer for deceptive sales practices conducted by such a retailer.

The respondent in Grolier, Inc.83 publishes encyclopedias which are sold door-to-door. One of the basic factual issues of the case concerns the oral presentation made when these encyclopedias are sold. The complaint alleges fourteen different misrepresentations or deceptive practices including misrepresenting the purpose of the visit, misrepresenting that the offeree has been specifically selected for contact, misrepresenting that the products are sold without cost in return for the offeree's endorsement and payment of a service fee and misrepresenting that the publications have been endorsed by such groups as the Better Business Bureau.84 Grolier denies that such representations are made and further denies that if made, the representations constitute a deceptive practice in commerce.85

Between Grolier and the consumer are various subsidiary corporations and independent distributors some of whom purchase products from Grolier at wholesale and sell other lines of merchandise. The commission's complaint counsel are seeking to hold Grolier responsible for any deceptive practices that may be proven to have been committed by these distributors and to impose upon Grolier the duty to police otherwise independent retailers. The complaint counsel are not posing the issue as one of abrogating the standards for the imposition of vicarious responsibility. Rather, by framing the question in terms of the commission's power to order affirmative acts, they urge the commission to draw upon a wealth of expansive statements by the Supreme Court emphasizing the commission's broad discretion to fashion a rem-

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83. Id.
84. Id., Complaint at 10-12.
85. Id., Respondent's Trial Brief at 16.
edy which will be disturbed only "where the remedy selected has no reasonable relation to the unlawful practices found to exist." 86

Complaint counsel acknowledge that in Grolier "[t]he proposed order . . . seeks extensive and novel affirmative relief." 87 They feel, however, that the commission clearly possesses the power to impose upon respondent the duty to insure that various persons not named in the complaint who sell respondent's products abide by the terms of the proposed order. The commission's power is asserted to be essentially equitable and broad enough to require "affirmative acts to cure the effects of illegal conduct and insure the public freedom from its continuance." 88

Characterizing the order as affirmative relief should not relieve the commission from justifying the complete disregard for the principles of vicarious responsibility. The relief requested appears too novel to be justified solely on the ground it may bear a close relation to the evil sought to be eradicated.

The courts which pioneered the move away from the common law considerations acknowledged that acts of true independent and unrelated retailers would not be visited upon the product manufacturers. With regard to the independent contractor relationship, the court in International Art Co. v. FTC 89 contrasted the nominally independent contractors therein found to be agents of the respondent from true independent retailers, such as department stores which handle many lines of merchandise or auto dealers over whom the manufacturer possesses no legal control. 90 In FTC v. National Lead Co. 91 the Supreme


87. Complaint Counsel Trial Brief at 63, Grolier, Inc., No. 8879 (F.T.C. filed Mar. 9, 1972). The proposed order reads in part: "(c) Respondents advise each such present and future salesman, agent, solicitor, independent contractor or any person engaged in the promotion, sale or distribution of any of the publications, merchandise or services included in this Order that respondents will not engage or will terminate the engagement or services of any said person, unless each person agrees to and does file a notice with the respondents that he will be bound by the provisions contained in this Order . . . ." Id., Complaint at 42 (emphasis added).

88. Id., Complaint Counsel Trial Brief at 64.

89. 109 F.2d 393 (7th Cir. 1940).

90. "[T]he argument and authorities are largely concerned with the relation between a manufacturer and a retail merchant. For example, [respondent] cites Marshall Field and Company, a store which sells the products of the American Woolen Company, and argues that the latter is not liable for representations made by the former as to the products sold. We assume, however, that Marshall Field and Company acts entirely in an independent capacity, and not as a representative of the Woolen Company. . . . These illustrations have no analogy to the present situation [where the alleged independent contractors were really agents]." Id. at 396.

91. 352 U.S. 419 (1957).
Court emphasized the commission's broad discretion and the reasonable relation test while affirming the court of appeals' finding that the parent corporation would not be liable for its subsidiary's conduct. Even the cases which best articulated the abrogation of common law principles in imposing liability for the acts of independent contractors and related corporations presented fact situations which could have resulted in vicarious liability under a common law test. The order urged in *Grolier, Inc.* comes very close to the imposition of a rule of strict vicarious liability for deceptive sales practices.

92. 227 F.2d 825 (7th Cir. 1955).
93. Goodman v. FTC, 244 F.2d 584 (9th Cir. 1957).
94. P.F. Collier & Son Corp. v. FTC, 427 F.2d 261 (6th Cir. 1970).
95. The Goodman facts are discussed in the text accompanying notes 40-41 supra. The facts of Collier appear in the text at note 70 supra.
96. The duty to police an otherwise independent seller which would flow from the commission or the courts upholding the order sought in *Grolier* evinces a strong parallel to that duty incumbent upon finance companies and other purchasers of consumer commercial paper to police their assignors' fraudulent sales practices under the close connection doctrine. Under the doctrine when a close connection exists between an original seller of consumer goods and the financier, that connection warrants the establishment of a fictional agency relationship between the financier and the seller such that the financier is denied any holder in due course status on the consumer conditional sales contracts. The doctrine has developed because "the more the holder knows about the underlying transaction . . . the more he controls or participates in it, the less he fits the role of the good faith purchaser for value; and the less justification there is for according him the protected status of the holder in due course . . . ." *Jones v. Approved Bancredit Corp.*, 256 A.2d 739, 742 (Del. 1969). The holder in due course status developed to further the free transferability of commercial paper but this rationale is generally not applicable in a retail installment sale since neither the seller nor the financier intends any further negotiation of the sales contract.


At least one obvious difficulty exists with analogizing from the close connection doctrine to the strict vicarious liability suggested here. The order contemplated in *Grolier* would require no connection between manufacturer and seller except that of wholesaler-retailer to give rise to the duty to police while the term "close connection" itself
In order to impose liability upon a manufacturer, the commission would only need to show that a deceptive practice occurred in the sale of that product. Legal separateness by corporation or proprietorship would be meaningless in this context. While the strong public policy of the act justifies a weakening of the tests used in ignoring legal separateness,97 no theory has yet been advanced, much less approved by a court, which would support the complete disregard of the separate entities.

Therefore, under the present law, the commission can find ample authority to impose vicarious liability on manufacturers for deceptive sales practices of independent contractors acting under apparent authority or for the practices of related corporations. However, absent new theories which could justify the imposition liability on this basis, it is unlikely that the courts will approve the commission's creation of a duty for manufacturers to police the selling practices of truly independent, unrelated retailers over whom the manufacturers have no legal latent power to control.


At least two theories not yet examined by the courts or the commission suggest themselves as possible justification for the commission to adopt a rule of strict vicarious liability for deceptive practices. Applying the new test for disregarding the separateness of corporate subsidiaries promulgated in the Collier case to the unrelated retailer situation poses no real hurdles given a commission of sufficiently liberal inclination. By analogy, the commission would have to establish only that respondent possessed the latent power to control the retailer and knowledge of the deceptive practices. Latent power to control would not have to mean legal power to control. Each manufacturer holds the ultimate power of terminating its relationship with a retailer engaged in deceptive practices. With the increased emphasis on the strong public policy behind the act, the commission could find that this power to refuse to permit a deceptive retailer to continue handling the line of merchandise amounted to the latent power to control. If only the means of obtaining knowledge of the deceptive practice were required rather than actual knowledge,98 the test would effectively create strict vicarious liability.

Alternatively, analogizing from the doctrine of strict products liability presents another possible justification upon which the commiss-

97. See text accompanying notes 37-41, 63-71 supra.
98. See text accompanying note 79 supra.
sion could impose strict vicarious liability for deceptive practices. The policy behind this doctrine bears an apparent similarity to the policy which led to the abrogation of the common law principles of vicarious responsibility in the enforcement of the Federal Trade Commission Act. The theory and policy of strict products liability in tort have been stated in various ways, but the classic exposition remains Chief Justice Traynor's opinion in *Greenman v. Yuba Power Products, Inc.* The purpose of imposing such strict liability was said in the *Greenman* decision to be "to insure that the costs of injuries resulting from defective products are borne by the manufacturers . . . that put such products on the market rather than by the injured persons who are powerless to protect themselves." The rationale behind strict products liability was the same as the one behind the deceptive practices proscription in the Federal Trade Commission Act—protection of the consumer. The development of both theories paralleled the retreat of *caveat emptor*. Consumers "no longer approach products warily but accept them on faith, relying on the reputation of the manufacturer." They should be entitled to expect an honest sales presentation as well as a product free of defects.

Under strict products liability the risk of an injury resulting from a defective product is placed upon the one who can best insure against such a risk, the manufacturer. Placing the duty upon the manufacturer to insure that a product is fairly represented when sold seems

99. See text accompanying notes 37-41, 63-71 *supra*.


101. 59 Cal. 2d at 63, 377 P.2d at 901, 27 Cal. Rptr. at 701.


104. The justifications listed in *Restatement (Second) of Torts* § 402A, comment c (1965) seem equally applicable to deceptive sales practices. "[T]he seller, by marketing his product for use and consumption, has undertaken and assumed a special responsibility toward any member of the consuming public who may be injured by it; that the public has the right to and does expect, in the case of products which it needs and for which it is forced to rely upon the seller, that reputable sellers will stand behind their goods; that public policy demands that the burden of accidental injuries caused by products intended for consumption be placed upon those who market them, and be treated as a cost of production . . .; and that the consumer of such products is entitled to the maximum of protection at the hands of someone, and the proper persons to afford it are those who market the products." *LaGorga v. Kroger Co.*, 275 F. Supp. 373, 376 (W.D. Pa. 1967).
equally reasonable and in conformity with the policy behind the statute. As in the products liability situation, the manufacturer is in the best position to control the methods employed in the sale of his products and to correct any abuses. Under this rationale, distinctions in the imposition of liability based upon the legal formality employed in distributing the product are difficult to justify. To be sure, in the independent contractor or related corporation distribution situations the manufacturer has a ready means of control. However, the ultimate economic power of every producer or wholesaler to terminate the retail agency should be sufficient to enable the manufacturer to police that retailer. Policing the retailer will impose an additional cost on the manufacturer but he can bear that cost as part of the responsibility incurred when he places a product on the market. Using the analogy of strict products liability in imposing vicarious liability for deceptive sales practices could provide the commission with the legal rationale to justify a policy of strict vicarious liability to the courts.105

In attempting to apply the Collier doctrine or the strict products liability in tort doctrine to a theory of strict vicarious liability for deceptive practices, the commission will encounter several difficulties. The analogy suggested to strict products liability pales when one considers that strict products liability in tort was developed to redress physical injuries and not pecuniary losses. As the doctrine expanded following Greenman, damage to property was redressable106 and the class of plaintiffs who could avail themselves of the remedy included non-purchasing users107 and third party bystanders.108 However, Chief Justice Traynor in Seely v. White Motor Co.,109 held that the rationale behind the Greenman decision did not support the recovery of purely economic or pecuniary losses on a strict liability theory.110 The courts feel much less outrage over a pecuniary loss than they do over a personal injury and while this position has been criticized,111 only a minor-

105. The federal courts have not been hostile to strict liability in tort. The Eighth Circuit has recently held the doctrine applicable in a case arising solely out of federal law. Lindsay v. McDonnell Douglas Aircraft Corp., 460 F.2d 631, 635 (8th Cir. 1972) (Death on the High Seas Act).
109. 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).
110. "That rationale in no way justifies requiring the consuming public to pay more for their products so that a manufacturer can insure against the possibility that some of his products will not meet the business needs of some of his customers." Id. at 19, 403 P.2d at 151, 45 Cal. Rptr. at 23.
111. Id. at 21, 403 P.2d at 153, 45 Cal. Rptr. at 25 (Peters, J., concurring & dissenting).
ity of jurisdictions have provided redress for pecuniary loss on a strict liability theory.\textsuperscript{112}

Similarly, the extension of the \textit{Collier} test to create strict vicarious liability for deceptive practices is tenuous when the setting in which the decision was rendered is closely examined. The interpretation is totally inconsistent with the factual situation which confronted the Sixth Circuit when it delivered the \textit{Collier} opinion.\textsuperscript{113} Collier's operation justified the imposition of vicarious liability under \textit{any} test and in this regard the new test could even be regarded as dictum.

Recent language in an antitrust decision indicates that the Supreme Court continues to distinguish the amount of control a manufacturer has over related corporations or thinly disguised independent contractors from the degree of control possessed over an unrelated retailer. In \textit{United States v. Arnold, Schwinn & Co.},\textsuperscript{114} Schwinn was \textit{per se} in restraint of trade when it attempted to control the sales territory and customers of its independent dealers who had purchased their merchandise from Schwinn and upon whom the risk of loss rested.\textsuperscript{115} "If the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale."\textsuperscript{116} Schwinn could impose such controls only upon franchised sales agencies who received their bikes from Schwinn on a consignment basis.\textsuperscript{117}

When a manufacturer exercises his power to control a retailer by terminating him for deceptive sales practices, he subjects himself to antitrust claims under the rationale of \textit{Schwinn}.\textsuperscript{118} While the manu-

\textsuperscript{112} R. Hursh, \textit{American Law of Products Liability} § 5A.17 (Supp. 1973).
\textsuperscript{113} The facts of \textit{Collier} are discussed in the text at note 70 \textit{supra}.
\textsuperscript{115} In \textit{Schwinn} the Court reaffirmed its formulation of the indicia of an independent businessman. The independent is one who sets his own price and upon whom the risk of loss rests. Simpson v. Union Oil Co., 377 U.S. 13, 20 (1964).
\textsuperscript{117} \textit{Cf.} United States v. Topco Associates, Inc., 405 U.S. 596 (1972) (trade association which wholesaled goods to its independent members could not control distribution without being in restraint of trade).
\textsuperscript{118} \textit{But cf.} Corn Prods. Ref. Co. v. Benson, 232 F.2d 554, 565 (2d Cir. 1956). "Merely because the corporate entities are disregarded for one specific purpose does not require that they be disregarded for other or all purposes . . . ."
manufacturer who so terminates pursuant to a FTC order of the type sought in Grolin can defend on that ground, this defense does not spare the manufacturer the harassment or expense that comes with resisting such a suit. A conscientious manufacturer who policed his retailers prior to the entry of an FTC order would not have even this defense available.

While the strong policy of the act coupled with these new theories could persuade the commission or a court to adopt strict liability for deceptive practices, the foregoing arguments militate against a court established rule of strict vicarious liability for deceptive practices. If manufacturers are to be charged with the duty of controlling the manner in which their products are sold regardless of who does the selling, it is more likely that Congress will have to create this duty. Congress indicated its willingness to protect the consumer by establishing the commission and has continually taken steps to keep the act current by amending it ten times during its sixty year history. The imposition of such a duty would greatly increase the commission's efficiency and eliminate a distinction that appears to have no sound basis given the strong policy behind curbing deceptive sales practices. Nor would the imposition of this duty force the commission's two divisions (anti-trust and deceptive practices) into inconsistent positions. While the Supreme Court has noted that manufacturer's controls over an independent retailer may be destructive of competition, the duty to control the sales methods would not carry with it the power to destroy competition by imposing price controls or other restraints.

Conclusion

The Federal Trade Commission, in its efforts to curb deceptive business practices, continually faces the problem of establishing liability as it issues cease and desist orders and prosecutes violations of those orders. While Congress may have recognized the ingenuity of businessmen when leaving the commission latitude in determining what constitutes a deceptive practice, the courts have insisted on some recognition of the legal forms under which those deceptive practices are perpetrated on the public.

The individual salespersons operating as independent contractors and the owned subsidiaries distributing the product will almost invariably be found to be agents of the manufacturer and he will be properly charged with their deceptive practices. However, there will still be a class of independent retailers for whose acts the manufacturers

119. See note 87 supra.
will have no responsibility. Notwithstanding the strong policy argu-
ments favoring the elimination of this distinction, the courts will not
likely make this radical departure from existing law, especially where
the change would establish a potential conflict with the antitrust
laws. Rather it will be left to Congress to seize the initiative and
impose further vicarious liability for deceptive practices.

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