

**THE FTC AT 100: VIEWS FROM THE ACADEMIC  
EXPERTS**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON COMMERCE, MANUFACTURING,  
AND TRADE  
OF THE  
COMMITTEE ON ENERGY AND  
COMMERCE  
HOUSE OF REPRESENTATIVES  
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## CONTENTS

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	Page
Hon. Lee Terry, a Representative in Congress from the State of Nebraska, opening statement .....	1
Prepared statement .....	2
Hon. Marsha Blackburn, a Representative in Congress from the State of Tennessee, opening statement .....	3
Hon. Janice D. Schakowsky, a Representative in Congress from the State of Illinois, prepared statement .....	3
Hon. Henry A. Waxman, a Representative in Congress from the State of California, prepared statement .....	112
WITNESSES	
Howard Beales, Professor, The George Washington University School of Busi- ness .....	5
Prepared statement .....	8
Answers to submitted questions .....	113
Daniel Crane, Associate Dean for Faculty and Research and the Frederick Paul Furth, Sr. Professor of Law, University of Michigan School of Law .....	27
Prepared statement .....	29
Answers to submitted questions .....	122
Geoffrey Manne, Founder and Executive Director, International Center for Law and Economics .....	43
Prepared statement <sup>1</sup> .....	45
Answers to submitted questions .....	128
Christopher Yoo, John H. Chestnut Professor of Law, Communication, and Computer and Information Science, and Director, Center for Technology, Innovation and Competition, University of Pennsylvania Law School .....	65
Prepared statement .....	67
Answers to submitted questions <sup>2</sup> .....	142
Robert Lande, Venable Professor of Law, University of Baltimore School of Law .....	71
Prepared statement .....	73
Answers to submitted questions .....	143
Paul Ohm, Associate Professor, University of Colorado Law School .....	89
Prepared statement .....	91
Answers to submitted questions <sup>3</sup> .....	147

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<sup>1</sup> The attachment to Mr. Manne's statement is available at:  
[http://docs.house.gov/meetings/if/if17/20140228/101812/hhrg-113-if17-  
wstate-manneg-20140228-sd002.pdf](http://docs.house.gov/meetings/if/if17/20140228/101812/hhrg-113-if17-<br/>wstate-manneg-20140228-sd002.pdf).

<sup>2</sup> Mr. Yoo did not answer submitted questions for the record by the time  
of printing.

<sup>3</sup> Mr. Ohm did not answer submitted questions for the record by the time  
of printing.



## **THE FTC AT 100: VIEWS FROM THE ACADEMIC EXPERTS**

**FRIDAY, FEBRUARY 28, 2014**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COMMERCE, MANUFACTURING, AND  
TRADE,  
COMMITTEE ON ENERGY AND COMMERCE,  
*Washington, DC.*

The subcommittee met, pursuant to call, at 9:34 a.m., in room 2123 of the Rayburn House Office Building, Hon. Lee Terry (chairman of the subcommittee) presiding.

Members present: Representatives Terry, Lance, Blackburn, Harper, Guthrie, Kinzinger, Bilirakis, Johnson, Long, Schakowsky, McNerney, Barrow, and Waxman (ex officio).

Staff present: Charlotte Baker, Press Secretary; Kirby Howard, Legislative Clerk; Nick Magallanes, Policy Coordinator, CMT; Brian McCullough, Senior Professional Staff Member, CMT; Gib Mullan, Chief Counsel, CMT; Shannon Weinberg Taylor, Counsel, CMT; Michelle Ash, Democratic Chief Counsel; and William Wallace, Democratic Professional Staff Member.

### **OPENING STATEMENT OF HON. LEE TERRY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA**

Mr. TERRY. Good morning, everybody, and thank you for being here to our second installment on our review of the FTC at 100. Today's theme is basically outsiders looking in as opposed to the insiders looking out, which was our first hearing. But before we get into the details, I want to thank Gib Mullan for his years of service on our subcommittee. He is going back to his roots, going back to the Consumer Protection Council or Consumer Protection Safety Commission and he will be counsel over there. So Gib, I just really appreciate the great work you have done for this subcommittee in the last 3 years, two different chairmen with two different personalities, and you've managed both well, so thank you for your service. Yes, this is his last day, then he goes and gets a real job. And starting the clock. Well, so good morning, and the FTC at 100 years. This was an agency that was built, established in 1914 when there was a great deal of consternation in our country about some of the larger businesses that seemed to have—well, not seemed, were monopolies, and abuses to consumers ensued when there was total control over a certain market by one business; whether it was Standard Oil or American Tobacco. And that was the reason for the FTC's commission. And today we are looking at whether those missions of 1914 are still relevant today, and I think most consumers,

citizens, and people on this committee say, yes, those are relevant, but is the FTC doing what they need to do. And it is a different society in 2014, and today we are an economy not of big manufacturers that become the monopolies, but a country of innovators in technology, and data, and privacy, and so many other issues that frankly weren't part of the culture or infrastructure on which the FTC was built.

So are their standards appropriate? Are the tests to determine if there is consumer harm appropriate? Are they even at a hearing from your opinions to those long-standing tests of harm? How do they quantify this today? And frankly I think there is another outside competing and adding to the layer of complexity in how they do their job with the Consumer Finance Committee that's been put in, and the reality is that those two committees now share jurisdiction, but you have the CFPB that virtually has no tests and no standards, and in reality it looked like the FTC is trying to compete to make sure that they have equal status in the sense that they don't have any standards or tests. I want to see if that is your collective interpretation of how the FTC is working in the modern world.

[The prepared statement of Mr. Terry follows:]

#### PREPARED STATEMENT OF HON. LEE TERRY

Welcome to our second hearing examining the Federal Trade Commission in its one-hundredth year. I want to thank all of the witnesses for coming today to share the academic perspective on how we can modernize the FTC.

When the FTC was established in 1914, American voters expected policymakers to "bust the trusts." Stung by the recent abuses of Standard Oil and American Tobacco, Americans wanted a new cop on the beat to take on the behemoths of business. The FTC was therefore established to fill this role.

Like many other federal agencies, the FTC finds itself in an era that doesn't necessarily fit its original design. Standard Oil and American Tobacco have been replaced by Apple and Google. Increasingly, the economy the FTC oversees crosses international borders—and is defined by a constant and ubiquitous interconnection over the Internet. And it's not just people, but their devices that are connected. Five years ago, the number of "things" connected to the Internet surpassed the number of people. Some predictions say that by 2015, there will be 25 billion devices connected to the Internet—ranging from sensors in the soil that track growing conditions for farmers to chips in pills that notify a doctor when a patient has taken her medicine. This is the "Internet of Things," and it presents countless economic advantages, but also unique privacy concerns. Innovations like this underscore the difficulty the FTC faces in trying to apply its original principles.

The spirit of consumer protection was the fundamental driver in the creation of the FTC 100 years ago and that continues to be the case even though the activities it oversees have changed. The FTC certainly has a role to play in preventing business practices that harm consumers. But something that the subcommittee could explore today is whether the FTC's design already allows for greater flexibility to better protect consumers than other agencies within the federal government.

The FTC's Section 5 authority, for example, prohibits "unfair and deceptive acts" as well as "unfair methods of competition." These broadly defined standards allow for a fairly nimble agency to account for business practices as they evolve.

Nonetheless, there are dangers in this flexible approach. For example, there is little definition as to what constitutes "unfair methods of competition." The Supreme Court affirmed that the provision applies to activity that is not yet deemed illegal under antitrust law. As a result, businesses have a hard time figuring out exactly what an "unfair method of competition" really is.

The temptation for "mission creep" is difficult to resist for any federal agency, and I believe the FTC is no exception. I believe this could be remedied by having the commission focus its efforts on protecting consumers. Otherwise, the commission is an arbiter of business models—where it can pick one business model over another and I believe that government shouldn't be picking winners and losers.

As we start thinking about how to modernize the FTC, I believe there are a few important principles to keep in mind. First, we should aim to sharpen the commission's guidance to provide clearer signals as to what is a prohibited business practice. Second, we should maintain the commission's flexibility to update this guidance—which means maintaining broad overarching authority. Third, I believe the commission should re-commit itself to basing its decisions on consumer welfare effects—and those decisions should be supported by empirical evidence.

As we continue this series of hearings, I look forward to fleshing these out.

Mr. TERRY. So at this point, Marsha, do you have an opening statement?

Mrs. BLACKBURN. Yes, I do.

Mr. TERRY. And I yield to the gentlelady from Tennessee.

**OPENING STATEMENT OF HON. MARSHA BLACKBURN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE**

Mrs. BLACKBURN. And first, I want to thank Gib Mullan for all of his service to our committee. The past two Congresses Gib has really worked tirelessly with us on a host of issues for consumer product safety and working with me on everything from the Reform Act to buckyballs to a host of manufacturing issues. And so, Gib, we are really going to miss you. We appreciate the leadership that you have brought to the committee and the due diligence that you have done on behalf of the committee and of our constituents, so we thank you for that.

The FTC is turning 100 in less than a year, and we are pleased to have all of you with us and to look at their role and to see how they are enforcing their core mission. A few of the questions that I am going to touch on today, how can Congress and the FTC work better to maximize consumer welfare? Are there regulatory jurisdictions that overlap between the FTC and other agencies? And how do we address these duplications and redundancies? How can we best harmonize regulations so that the industry does not have duplicative costs? And what should the balance be between regulation and enforcement?

So, Mr. Chairman, I thank you for the hearing, and I yield the balance of my time.

Mr. TERRY. Well, I thank you, and now recognize the Ranking Member of the committee from the great state of Illinois.

**OPENING STATEMENT OF HON. JANICE D. SCHAKOWSKY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS**

Ms. SCHAKOWSKY. Thank you, Mr. Chairman. You know, in thanking and congratulating Gib Mullan, I want to say that I think too often we don't thank the staff for the incredible work that they do. Most people around here do understand the absolutely critical role, the essential role of our staff—and Gib has really shown his professionalism and I think has contributed to what has been remarkably bipartisan nature of this committee. So, Gib, I really want to wish you well as you go to the Consumer Product Safety Commission, and hope to see you in that capacity as well. Thank you.

So to the hearing, this is our second in our series on the Federal Trade Commission's first 100 years and the future of the agency.

So I am very eager to hear from our witnesses about your perspective on the FTC at 100 and where the commission ought to be going.

The FTC is an important cop on the beat, protecting both public and business against unfair, deceptive, fraudulent, or anti-competitive practices through its consumer protection and anti-trust authorities.

I began my career in public service as a consumer advocate fighting successfully to get expiration dates posted on food packaging. And I view the FTC through the lens of how effective it is in making sure consumers are respected, well-informed, and fairly treated.

The FTC has been effective in many areas of consumer protection. For example, last year, it successfully strengthened the Children's Online Privacy Protection Act to reflect the rapidly changing nature of what is considered personal information. And it also defended consumers from companies that failed to reasonably protect consumer data such as the Web-connected camera company TransNet, whose poor security allowed hackers to spy on consumers and their kids in their homes.

As commerce continues to change, as the Chairman so clearly talked about, and expand, the FTC has had to adapt to a new economy. As our social network shopping, banking, and other forms of communication and business move to the Internet, the FTC has changed, bringing more technology experts on board.

At the same time, its resources are as tight as ever. In our December hearing with the commissioners, they pointed to "resource constraints" and the need to leverage those resources through "careful case selection." I am concerned that we are asking one of the country's most important consumer agencies to choose which criminals it will pursue or on which crimes it will enforce the law. I hope we will work together to ensure that the FTC has the resources it needs to maintain consumer protection and a fair marketplace.

From a regulatory standpoint, I believe it is time to look at ways to reduce barriers to FTC consumer protection rule makings. The FTC's ability to move forward with important rule making is much more limited than those at other agencies. I also believe the FTC should have greater authority to pursue civil penalties in the event of a failure to reasonably protect consumers.

In the rapidly changing climate of commerce today, rule making must be efficient, and penalty enforcement must be meaningful. The growth of the Internet has presented us with new questions about privacy rights and expectations. That is why Chairman Terry and I decided to form the Privacy Working Group, which is co-chaired by Congresswoman Blackburn and Congressman Welch. The group is tasked with exploring the current privacy landscape and considering possible solutions to the challenges that we find.

As I said at the last FTC hearing, I am particularly interested in the issue of privacy agreements. The FTC has the power to hold companies to the privacy agreements they offer their customers, visitors, and users, and it does hold bad actors accountable. But there is no law requiring that baseline privacy protections are promised to consumers. And the FTC can't enforce what is not promised.

I look forward to hearing from our witnesses as to whether a minimum online privacy standard would be beneficial. Again I look forward to hearing from our witnesses about what we can do to enable the FTC to continue its progress and increase its effectiveness in the future. I yield back.

Mr. TERRY. Does anyone else on our side, the Republican side, have a statement? Well, Billy said no, and the others are ignoring us. So I am going to say no. Do you have—Mr. McNerney? All right, so we are going to go right to our witnesses. This is a distinguished panel of academics who have great experience with the FTC and can provide us that view, the expert view now from the outside looking into the FTC. And we appreciate all. I am going to introduce all of you now, and then we will just go from my left to your right along the panel. Many of you have testified before before us, so you know how it works.

So our first witness, Mr. Howard Beales, Professor of the George Washington University School of Business. Daniel Crane, Associate Dean for Faculty and Research at the Frederick Paul Furth, Senior Professor of Law, University of Michigan School of Law. Thank you for being here. Geoffrey Manne, Founder and Executive Director, International Center for Law and Economics. Christopher Yoo, John H. Chestnut Professor of Law, Communication and Computer and Information Science, Director, Center for Technology, Innovation and Competition, University of Pennsylvania Law School. I certainly like the Big 10 theme occurring here. Robert Lande, venerable Professor of Law, University of Baltimore School of Law. Thank you. Paul Ohm, Associate Professor of University of Colorado Law School, and I will make no comments, sarcastic comments about the University of Colorado.

We do appreciate you being here, and we will start with Mr. Beales. As you know, you have 5 minutes. If you go over 5 minutes, I will start lightly tapping just to remind you to jump to the conclusion. If you get to 6 minutes, I will start pounding really hard. So with that, Mr. Beales, you are recognized for your 5 minutes. And once again to all of you, thank you for being here.

**STATEMENTS OF HOWARD BEALES, PROFESSOR, THE GEORGE WASHINGTON UNIVERSITY SCHOOL OF BUSINESS; DANIEL CRANE, ASSOCIATE DEAN FOR FACULTY AND RESEARCH AND THE FREDERICK PAUL FURTH, SR. PROFESSOR OF LAW, UNIVERSITY OF MICHIGAN SCHOOL OF LAW; GEOFFREY MANNE, FOUNDER AND EXECUTIVE DIRECTOR, INTERNATIONAL CENTER FOR LAW AND ECONOMICS; CHRISTOPHER YOO, JOHN H. CHESTNUT PROFESSOR OF LAW, COMMUNICATION, AND COMPUTER AND INFORMATION SCIENCE, AND DIRECTOR, CENTER FOR TECHNOLOGY, INNOVATION AND COMPETITION, UNIVERSITY OF PENNSYLVANIA LAW SCHOOL; ROBERT LANDE, VENABLE PROFESSOR OF LAW, UNIVERSITY OF BALTIMORE SCHOOL OF LAW; AND PAUL OHM, ASSOCIATE PROFESSOR, UNIVERSITY OF COLORADO LAW SCHOOL**

**STATEMENT OF HOWARD BEALES**

Mr. BEALES. Chairman Terry, Ranking Member Schakowsky, and members of the committee, thank you for the opportunity to

testify today. I am Howard Beales, Professor of Strategic Management and Public Policy at the George Washington School of Business. In addition to publishing a number of academic articles on the FTC, I have held a variety of positions at the agency, most recently as Director of the Bureau of Consumer Protection from 2001 to 2004.

In my testimony today, I will focus on the FTC's consumer protection mission, recognizing that it is closely related to the commission's role in protecting competitive markets because markets organize and drive our economy.

Consumer protection policy can profoundly enhance the economic benefits of competition by strengthening the market or it can reduce these benefits by unduly hampering the competitive process. By and large, the FTC has done an excellent job in its consumer protection mission. Recognizing that generally strong performance, I want to highlight today some areas where it is harming consumer welfare.

First and most importantly, the commission has lost its way in its approach to advertising regulation. Virtually any communication is subject to misinterpretation, and advertising is no exception. However straightforward the message and however careful the execution, some consumers are likely to misinterpret it. In fact, academic studies of communications find 20 to 30 percent of the audience misunderstand some aspect of whether it is advertising or editorial content.

To address this problem, the 1983 Deception Policy Statement focused on the meaning of an advertisement to the average listener or the general populous or the typical buyer. A footnote acknowledged that an interpretation may be reasonable if it is only shared by a significant minority of consumers. The commission's recent POM opinion, the footnote swallows the standard. The most commission claims is the advertisement convey challenges claims to at least a significant minority of reasonable consumers.

The commission relied entirely on its own reading of the advertising. When balancing the protection of a minority of consumers against the interests of others who would like to learn about emerging science, however, the need for extrinsic evidence is acute. There is no reasonable way to strike the balance without some sense of roughly how many consumers fall into each group.

Moreover, it is essential to determine whether that significant minority is greater than the 20 or 30 percent who are likely to misunderstand any message. Good survey evidence can address precisely that question. What is needed is a deeper appreciation of the fact that consumers who correctly interpret a message are harmed when the commission prohibits claims that some misunderstand.

The commission's approach to "up to" claims is a case in point. Although most reasonable consumers surely understand that saving up to a certain amount is different from saving at least that amount. The FTC issued warning letters asserting that the two claims are exactly the same. An "up to" claim is only allowed if all or almost all consumers experience that result. That is a standard that suppresses valuable information.

Second, the commission is requiring excessive amounts of evidence to substantiate advertising claims. The core principle of sub-

stantiation has always recognized the uncertainty surrounding many claims and balanced the benefits of truthful claims against the cost of false ones. Consider, for example, the Kellogg's claim about the relationship between diets high in fiber and the risk of cancer. If the claim is true, waiting for the results of clinical trials would impose substantial costs on consumers who would lose important information about the likely relationship between fiber consumption and cancer risk.

On the other hand, if the claim is false, the consequence of consumers are only giving up a better tasting cereal or paying a little bit more for a higher fiber product. The far more serious mistake is to prohibit truthful claims.

The commission's recent cases reflect a move toward a more rigid standard modeled on the drug approval process, requiring two randomized clinical trials for claims about the relationship between nutrients and disease. This standard is excessive in most cases and likely to deprive consumers of valuable, truthful information.

There are ways of learning about the world other than clinical trials. There are, for example, no randomized trials of parachutes, but few would jump out of an airplane without one. Nor are there randomized trials about the adverse effects of tobacco consumption.

Indeed, much of what we know about the relationship between diet and disease is based on epidemiology, not randomized trials.

The commission says nothing has changed because the requirement for two clinicals is just fencing in really. However, the reason the commission offers for this second test is universally true. The second test might yield a different result. As former Chairman Potofsky has written, advertising regulations should seek reliable data, not abstract truth. Knowing that precisely one clinical trial supports an important health-related claim is valuable to consumers. The commission should return to its traditional balancing test.

Second, the commission should restrict its privacy enforcement actions to practices that cause real harm. There may be subjective preferences that some consumers have to stop practices that they think of as creepy. And those preferences should be protected when they are expressed in the marketplace. I think it is analogous to kosher where some people have a preference that is very real and should be protected. But the people who have that preference are the people who need to make the choice. It shouldn't be the commission making the choice for them or requiring all sellers to cater to the preferences of a few consumers when others don't share that preference.

Anchoring privacy enforcement and harm is a way to do that, and I think it is something the commission should retain.

Thank you very much, and I look forward to your questions.

[The prepared statement of Mr. Beales follows:]

8

Testimony of

J. Howard Beales III

Professor of Strategic Management and Public Policy

George Washington School of Business

Before the

Subcommittee on Commerce, Manufacturing, and Trade

Committee on Energy and Commerce

House of Representatives

On

The FTC at 100: Views from the Academic Experts

February 28, 2014

Chairman Terry, Ranking member Schakowsky, and members of the Committee, thank you for the opportunity to testify today on the Federal Trade Commission. I am Howard Beales, a professor of Strategic Management and Public Policy in the George Washington School of Business. I have both published numerous academic articles on the FTC, and held a variety of different positions at the agency. Most recently, I was the Director of the Bureau of Consumer Protection from 2001 to 2004.

In my testimony today, I will focus on the FTC's consumer protection mission. That mission is closely related to the Commission's role in protecting competitive markets, because markets organize and drive our economy. Consumer protection policy can profoundly enhance the vast economic benefits of competition by strengthening the market. The policy also can reduce these benefits, however, by unduly intruding upon the market and hampering the competitive process. The Federal Trade Commission has a special responsibility to protect and speak for the competitive process, to combat practices that harm the market, and to advocate against policies that reduce competition's benefits to consumers.

The FTC's consumer protection mission derives from its responsibility to prevent "unfair or deceptive acts or practices."<sup>1</sup> The FTC, and other public institutions, operate against a backdrop of other consumer protection institutions, most notably the market and common law. In our economy, producers compete to offer the most appealing mix of price and quality. This competition spurs producers to meet consumer expectations because the market generally disciplines sellers who disappoint consumers, and thus those sellers lose sales to producers who better meet consumer needs. These same competitive pressures encourage producers to provide truthful information about their offerings. Market mechanisms do not always effectively discipline deceptive claims, however, especially when product attributes are difficult to evaluate or sellers are unconcerned about repeat business.

When competition alone cannot punish or deter seller dishonesty, private legal rights provide basic rules for interactions between producers and consumers. Government also can serve a useful role by providing default rules, which apply when parties do not specify rules. These rights and default rules alleviate some of the problems in the market system by reducing the consequences to the buyer from seller misconduct. Although private legal rights provide powerful protections, in some circumstances – as when court enforcement is impractical or economically infeasible – they may not be an effective deterrent.

When insufficient market forces and ineffective common law remedies leave consumers vulnerable, the Federal Trade Commission can help preserve competition and protect consumers. Without a continual reminder of the benefits of competition, however, consumer protection programs can ultimately diminish the very competition that increases consumer choice. Some consumer protection measures – even those motivated by the best of intentions – can create barriers to entry that limit the freedom of sellers to provide what consumers demand.

By and large, the Commission has done an excellent job in its consumer protection mission. It has pursued fraudulent practices aggressively, and generally adapted well to address newly emerging fraudulent practices that threaten consumer welfare. As the agency approaches its 100<sup>th</sup> anniversary, however, there are key areas in which it is harming consumer welfare. Recognizing the Commission's generally strong performance, I want to highlight today some areas where improvements are needed.

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<sup>1</sup> 15 U.S.C. § 45.

### I. The Commission's Recent Approach to Advertising Regulation Harms Consumer Welfare

First, and most importantly, the Commission has lost its way in its approach to advertising regulation. For decades, the FTC recognized and promoted the central role of advertising in a market economy. It challenged numerous private restrictions on advertising adopted by professional associations under the name of consumer protection. It spoke out forcefully against FDA restrictions that limited consumers' ability to learn about the relationship between diet and health. In its own enforcement activities, it recognized not only the costs of mistakenly allowing false claims to continue, but also the costs of mistakenly restricting the flow of truthful information. It recognized the difficulties of mass communication, and the reality that even most carefully crafted advertisement is likely to be misunderstood by some consumers. In the words of former Chairman Robert Pitofsky, it engaged in "a practical enterprise to ensure the existence of reliable data," rather than "a broad theoretical effort to achieve Truth."<sup>2</sup>

I first discuss the significance of advertising to competitive markets. I then turn to three problems in the FTC's recent approach to advertising regulation. Section B discusses the Commission's recent approach to the interpretation of advertising claims. Section C considers recent orders imposing evidentiary requirements for advertising claims that are likely to do more harm than good. Section D considers the Commission's recent efforts to obtain monetary relief in traditional advertising substantiation cases.

#### A. Advertising Is Critical to Competitive Markets

The competitive benefits of advertising are by now well known. In the words of Nobel Laureate George Stigler, "advertising is an immensely powerful instrument for the elimination of ignorance."<sup>3</sup> Informed consumers drive the competitive process, benefitting all consumers as sellers compete for the informed minority.<sup>4</sup> Numerous economic studies have shown that restrictions on advertising increase prices to consumers, even when advertising does not mention price.<sup>5</sup>

Advertising also stimulates innovation. If sellers cannot advertise innovative products, or if they cannot tell consumers why new product characteristics are important, there is less incentive to make improvements in the first place.<sup>6</sup> One of the best studied examples involves Kellogg's 1984 claims for All Bran cereal, conveying the then novel recommendation of the National Cancer Institute ("NCI") that diets high in fiber may reduce the risk of some cancers.<sup>7</sup> The science, which was based largely on epidemiology rather than human clinical trials, was uncertain. Citing these uncertainties, the FDA

<sup>2</sup> Robert Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 *Harv. L. Rev.* 661, 681-83 (1977).

<sup>3</sup> George J. Stigler, *The Economics of Information*, 64 *J. Pol. Econ.* 213, 220 (1961).

<sup>4</sup> See, e.g., Alan Schwartz and Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 *U. Pa. L. Rev.* 630 (1978-1979).

<sup>5</sup> The FTC itself has summarized the empirical evidence regarding the impact of advertising on prices. See *In re Polygram*, 2003 WL 21770765 (FTC), Docket No. 9298 (July 24, 2003), at note 52.

<sup>6</sup> Advertising is an intangible investment, whose value can only be recovered through repeat sales. Sellers invest in and maintain product quality to generate repeat business. See Phillip Nelson, *Advertising as Information*, 82 *J. Pol. Econ.* 729 (1974).

<sup>7</sup> The Kellogg incident is discussed in J. Howard Beales, Timothy J. Muris, and Robert Pitofsky, "In Defense of the Pfizer Factors," in James C. Cooper, Ed., *The Regulatory Revolution at the FTC: A Thirty-Year Perspective on Competition and Consumer Protection* (Oxford University Press, 2013), pp. 83-108.

threatened to seize All Bran as an unapproved new drug. When the FTC and the NCI defended Kellogg, the FDA changed course, launching a review of its policy.

An FTC Staff Report documented the impact of the Kellogg campaign and its aftermath.<sup>8</sup> Increased advertising about fiber content and its relationship to cancer risks led to significant changes in cereals.<sup>9</sup> Claims about the relationship between diet and disease increased elsewhere as well, with similar marketplace impacts. For example, claims about the relationship between diet and heart disease rose from less than 2 percent of food advertising in 1984 to more than 8 percent in 1989;<sup>10</sup> consumption of fat and saturated fat, the primary dietary risk factors for heart disease, fell far more sharply after 1985.<sup>11</sup> Again, advertising led to beneficial changes in diet.

Advertising is particularly important to less advantaged groups. The FTC Staff Report documented that although fiber consumption increased for all groups, it increased more among racial minorities and single parent households.<sup>12</sup> Another study has shown that the least educated paid the highest increase in prices when eyeglass advertising was restricted.<sup>13</sup>

#### B. Advertising Interpretation Should Focus on the Ordinary Viewer.

Virtually any communication is subject to misinterpretation. If enough recipients hear or read the message, a minority will likely believe something other than what the speaker intended or what most consumers heard. Moreover, that minority understanding of the message may be completely wrong. This is an inherent problem of all communication and is particularly problematic for marketing messages, which are almost always brief and presented in times and places where consumers may not pay full attention. Marketers frequently devote significant resources to ensure that their advertising conveys the intended message, but however straightforward the message and however careful the execution, some consumers are likely to misinterpret it. In academic studies of brief communications, 20 to 30 percent of the audience misunderstood some aspect of both advertising and editorial content.<sup>14</sup>

<sup>8</sup> Pauline Ippolito & Alan Mathios, Health Claims in Advertising and Labeling: A Study of the Cereal Market, FTC Staff Report (1989), available at <http://www.ftc.gov/be/econrpt/232187.pdf>.

<sup>9</sup> For example, the fiber content of new cereals increased 52 percent, and the weighted average content of cereals (reflecting both product changes and changes in consumer choices) increased at a significantly higher rate than before health claim advertising began. Ippolito and Mathios, *supra* note 8.

<sup>10</sup> Pauline Ippolito & Janice Pappalardo, Advertising Nutrition & Health: Evidence from Food Advertising, 1977–1997, FTC Staff Report (2002), available at <http://www.ftc.gov/opa/2002/10/advertisingfinal.pdf>.

<sup>11</sup> Pauline Ippolito & Alan Mathios, Information and Advertising Policy: A Study of Fat and Cholesterol Consumption in the United States, 1977–1990, FTC Staff Report (1996), available at [http://www.ftc.gov/be/consumerbehavior/docs/reports/ippolitoMathios96\\_fat\\_long.pdf](http://www.ftc.gov/be/consumerbehavior/docs/reports/ippolitoMathios96_fat_long.pdf).

<sup>12</sup> Ippolito and Mathios, *supra* note 8.

<sup>13</sup> Lee Benham & Alexandra Benham, Regulating through the Professions: A Perspective on Information Control, 18 J.L. & Econ. 421 (1975).

<sup>14</sup> Regarding televised messages, see Jacob Jacoby et al., *Miscomprehension of Televised Communications* 64 (1980). Regarding print communications, see Jacob Jacoby and Wayne D. Hoyer, *The Comprehension and Miscomprehension of Print Communications* (1987). Both studies compare advertisements with excerpts of editorial content designed to be roughly equal in length, and find no significant differences in the extent of miscomprehension.

Meaningful protection for commercial speech requires, at the least, respect for the 70 to 80 percent of consumers who understand the message correctly. If regulators insist on communications that cannot be misunderstood, the result is likely to be communications that are also uninformative.

The Supreme Court has consistently held that the First Amendment does not protect deceptive speech.<sup>15</sup> That conclusion is straightforward when speech deceives most of those who hear it, but it is inherently more problematic when speech accurately informs most, but misleads a few. For example, for any performance claim, roughly half of purchasers will experience results that are worse than the average, but information about the average or expected result is likely extremely valuable to consumers. If the government maintains that providing the average is deceptive because “too many” consumers believe they will actually achieve that result, consumers would lose valuable information entirely.

When it adopted its Deception Policy Statement in 1983, the Commission stated that an act or practice is deceptive if it is likely to mislead consumers, acting reasonably in the circumstances, about a material issue.<sup>16</sup> The Policy Statement cites prior cases in which the Commission evaluated claims from the perspective of the “average listener,”<sup>17</sup> or the impression “on the general populace,”<sup>18</sup> or the “expectations and understandings of the typical buyer.”<sup>19</sup> In a footnote, the Policy Statement acknowledges that “[a]n interpretation *may* be reasonable even though it is not shared by a majority of consumers in the relevant class, or by particularly sophisticated consumers. A material practice that misleads a significant minority of reasonable consumers is deceptive.”<sup>20</sup>

In the Commission’s recent POM opinion,<sup>21</sup> the footnote swallows the standard. The case involves exaggerated claims about the health benefits of drinking pomegranate juice. Some claims are broad, both others attempt to convey the limitations of the scientific evidence. Nonetheless, the Commission found essentially all of the advertisements it originally challenged were deceptive, based on its own reading of the ads.

The *most* the Commission claims in its facial analysis of particular advertisements is that the advertisement conveys a challenged claim to “*at least* a significant minority of reasonable consumers.” There is no discussion of the average listener, the typical buyer, or the general populace. Nor is there is discussion or acknowledgement of the problem of (random) background noise – that even in experimental conditions, 20 to 30 percent of consumers are likely to misunderstand the message.

The Commission’s focus on a “significant minority” is particularly troubling because it decides which advertisements are deceptive based solely on a majority of its five member’s own reading of the advertisement, without extrinsic evidence of how real consumers actually interpret the communication. As the Seventh Circuit and the Commission have noted, “implied claims fall on a continuum, ranging

<sup>15</sup> Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n, 447 U.S. 557 (1980).

<sup>16</sup> F.T.C. Policy Statement on Deception (1983), appended to *Cliffdale Assoc.*, 103 F.T.C. 110, 174 (1984), available at <http://www.ftc.gov/bcp/policystmt/ad-decept.htm> (“Deception Policy Statement”).

<sup>17</sup> *Id.* at n. 24, citing *Warner-Lambert*, 86 F.T.C. 1398, 1415 n.4 (1975).

<sup>18</sup> *Id.* at n. 25, citing *Grolier*, 91 F.T.C. 315, 430 (1978).

<sup>19</sup> *Id.* at n. 28, citing *Simeon Management*, 87 F.T.C. 1184, 1230 (1976).

<sup>20</sup> *Id.*, note 20 (emphasis added).

<sup>21</sup> In the Matter of POM Wonderful LLC et al., January 16, 2013, Docket Number 1344, available at <http://www.ftc.gov/enforcement/cases-proceedings/082-3122/pom-wonderful-llc-roll-global-llc-successor-interest-roll>.

from the obvious to the barely discernible. *Thompson Medical*, 104 F.T.C. at 788-89.<sup>22</sup> Requiring extrinsic evidence in all cases would be unnecessary and inappropriate. At the “obvious” end of the implied claim spectrum, there will likely be little disagreement about whether the claim was made, in part because most consumers are likely to make the inference. When the claim is “barely discernible,” significantly more disagreement is likely, and likely fewer consumers actually identify and understand the claim.

In POM, the three Commissioners who voted to issue the original complaint believe that a number of advertisements made deceptive claims that another Commissioner (not a member of the Commission when the complaint issued) and the Administrative Law Judge (who heard the Commission’s case at trial) do not believe are apparent on the face of the advertisements. When reasonable people disagree about a fundamentally empirical proposition – what fraction of consumers are misled, and whether that fraction is significant – empirical evidence is a far more reliable way to resolve the disagreement than taking yet another vote among a different group of a small number of reasonable people (Commissioners or Judges).

Although some courts have deferred to the Commission’s “expertise” in interpreting advertising, that deference is unwarranted. As former Chairman Robert Pitofsky wrote,

Why questions of meaning should be submitted to the virtually unreviewable discretion of five Commissioners of the FTC has never been articulated. Unlike other instances of deference to regulators as part of the administrative process, there is no reason to believe that commissioners of the FTC have unusual capacity or experience in coping with questions of meaning, nor any indication that successful regulation of advertising requires a balance of related regulatory considerations that commissioners are in a special position to handle.<sup>23</sup>

Indeed, even courts that have deferred to the Commission’s interpretations have expressed discomfort. As the Seventh Circuit stated in rejecting Kraft’s argument that the Commission must have extrinsic evidence:

Our holding does not diminish the force of Kraft’s argument as a policy matter, and, indeed, the extensive body of commentary on the subject makes a compelling argument that reliance on extrinsic evidence should be the rule rather than the exception.<sup>24</sup>

The need for extrinsic evidence is acute when the issue is balancing the need to protect “at least a significant minority of reasonable consumers” against the interest of others who would like to learn about scientific evidence that is “promising,” “emerging,” or “hopeful.” In striking that balance, the Commission should have some sense of roughly how many consumers fall into each group. Even if the Commission can somehow determine that “at least a significant minority” is misled, the size of that minority matters, and can only be determined by empirical evidence. (Moreover, it is essential to determine that the “significant minority” is greater than the 20 to 30 percent who are likely to miscomprehend *any* message.) Good survey research can address precisely this question;<sup>25</sup> it is difficult

<sup>22</sup> *Kraft, Inc. v. FTC*, 970 F.2d 311 (1992).

<sup>23</sup> Pitofsky, *supra* note 2, at 678.

<sup>24</sup> *Kraft, Inc. v. FTC*, 970 F.2d 311 (1992).

<sup>25</sup> See Shari S. Diamond, Reference Guide on Survey Research, available at [https://bulk.resource.org/courts.gov/fic/sciam.8.sur\\_res.pdf](https://bulk.resource.org/courts.gov/fic/sciam.8.sur_res.pdf). See especially Section IV F, If the Survey Was

to believe that Commissioners can do so based entirely on their own reading of the advertisement in question.

Extrinsic evidence alone, however, is not the entire answer. What is needed is deeper appreciation of the fact that consumers who correctly interpret a message are harmed when the Commission prohibits claims that might be misunderstood by a “significant minority.” For example, in 2012 the Commission brought five cases<sup>26</sup> and issued 14 warning letters<sup>27</sup> to window manufacturers who claimed that their products would save “up to” a specific amount of energy costs. Although most reasonable consumers surely understand that a claim of savings of “up to” a certain amount is different from a claim that you will save “at least” that amount, the warning letters assert that the two claims are exactly the same. The letter advises sellers that if they make “up to” claims, “your substantiation should prove that *all or almost all* consumers are likely to get that percentage in savings.”<sup>28</sup> An express claim about the *maximum* savings can only be substantiated by evidence that the claimed savings are in fact the *minimum* savings.

The FTC points to a copy test showing that if an ad mentions savings of 47%, 22 to 28 percent of consumers say that “all or almost all” consumers will save that much, whether the claim is “save 47%,” “save up to 47%,” or also discloses the average savings. This isn’t a copy test to determine whether consumers actually see a fine print disclosure – “up to” is right next to the 47%, in the same size type, and with the same emphasis. This is a test of how many consumers will play back the proper interpretation of numerical claims after a brief, artificial exposure. Not surprisingly, many do not. That, however, is not an argument for prohibiting numbers, or for reducing numerical claims to those that cannot possibly mislead anyone. Consumers who seriously contemplate spending hundreds or thousands of dollars on new windows are likely to consider the investment more carefully than consumers who are paid \$5 to participate in a mall survey. Importantly, the survey did not find that there was a less misleading way to convey information about savings. Indeed, it found that some consumers misinterpreted all versions of the advertisement that were tested.

The FTC has not yet addressed claims about average performance. Its testimonial guides allow claims about individual results (“I lost 30 pounds”) if the average result is disclosed (“the average user lost 13.6 pounds”). Surely, however, “many consumers” – the standard in the FTC’s warning letters – labor under the misconception that everyone achieves at least the average result. No sensible, or constitutional, regulatory regime prohibits truthfully reporting, based on the average results of users, that “you can save x percent.” According to the FTC, however, if the claim is instead that “you can save up to x percent,” it must be true for virtually everyone – even though it is in fact the average result.

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Designed to Test a Causal Proposition, Did the Survey Include an Appropriate Control Group or Question? at 256. Advertising can be deceptive only when it causes a significantly increase in the fraction of consumers who receive the misleading message compared to those who saw a nondeceptive advertisement.

<sup>26</sup> See FTC Press Release, Window Marketers Settle FTC Charges That They Made Deceptive Energy Efficiency and Cost Savings Claims, Feb. 22, 2012, available at <http://www.ftc.gov/news-events/press-releases/2012/02/window-marketers-settle-ftc-charges-they-made-deceptive-energy>.

<sup>27</sup> See FTC Press Release, FTC Warns Replacement Window Marketers to Review Marketing Materials; Energy Savings Claims Must Be Backed by Scientific Evidence, August 29, 2012, available at <http://www.ftc.gov/news-events/press-releases/2012/08/ftc-warns-replacement-window-marketers-review-marketing-materials>.

<sup>28</sup> See, for example, Letter from Frank Gorman to Acadia Windows & Doors Inc., August 17, 2012, available at <http://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-warns-replacement-window-marketers-review-marketing-materials-energy-savings-claims-must-be/120829windowsacadialetter.pdf>.

The Commission needs to return its focus to the average viewer. Extrinsic evidence can help to strike the appropriate balance when, as is often the case, a communication informs some consumers and misinforms others. Crucially, the evidence should be designed to assess whether there is an alternative way to communicate a truthful message that is less likely to be misleading. Prohibiting communications because some consumers will misunderstand is likely to leave the majority of consumers in relative ignorance. That is the opposite of what the Commission should be trying to accomplish.

C. The Commission Is Imposing Overly Burdensome Substantiation Requirements.

The Commission's advertising substantiation doctrine requires that advertisers have a "reasonable basis" for claims before they are made. Traditionally, the core principle of substantiation recognized the uncertainty surrounding many claims, and balanced the benefits of truthful claims against the costs of false ones. In a series of recent settlements and in a litigated case that is currently on appeal, the Commission has moved from balancing toward a rigid rule that requires multiple clinical trials even if the benefits of the claim, if true, overwhelmingly exceed the costs of the claim, if false. If continued, this approach would prohibit claims about the relationship between diet and disease that most scientists regard as prudent public health recommendations despite the absence of two well controlled clinical trials.

Used wisely, laws against deceptive advertising benefit consumers. The historical approach of the Commission allowed the government to balance against two kinds of mistakes: allowing false claims to continue or prohibiting truthful claims. To ensure that information flows are both free and clean,<sup>29</sup> the government must consider the cost of each possible mistake, and, ex ante, guard against the higher cost mistake. The FTC's traditional approach to advertising substantiation, first stated in the seminal Pfizer opinion,<sup>30</sup> reflects the central role of balancing the risks of these two types of mistakes.

Consider, for example, Kellogg's claim about the relationship between diets high in fiber and the risk of cancer. Although the FDA now approves the claim, uncertainty remains. After all, no randomized clinical trials have measured the incidence of cancer at different levels of fiber intake. If the claim is true, however, waiting for the results of such trials would impose substantial costs on consumers, who would lose important information about the likely relationship between fiber consumption and cancer risk. Before such claims were allowed, consumers ate less fiber, and as a result incurred a higher risk of cancer.

On the other hand, if the claim is false, the consequences to consumers are relatively small. They may give up a better tasting cereal, or pay a little more for a higher-fiber product.<sup>31</sup> In this case, the far more serious error is mistakenly to prohibit truthful claims. Such a mistake is worth avoiding, even though it increases risk of the far less serious error of a false claim continuing.

Rather than relying on the traditional balancing test, the Commission's recent consents and litigated decision reflect a move to a more rigid standard, one more closely modeled on the FDA's drug approval process. In place of the usual order provision requiring "competent and reliable scientific evidence," the

<sup>29</sup> Va. State Bd. Of Pharmacy v. Va. Citizens Consumer Council, Inc., 425 U.S. 748, 772 (1976).

<sup>30</sup> Pfizer, Inc., 81 F.T.C. 23, 64 (1972).

<sup>31</sup> Preventing economic injuries such as these is at the core of the Commission's consumer protection mission. Historically, however, the Commission has been unwilling to risk public health consequences to avoid economic injuries.

Commission has instead required respondents to substantiate claims about the relationship between nutrients and disease with two randomized, placebo controlled, double blind clinical trials (RCTs). This standard is excessive in most cases, and is likely to deprive consumers of valuable, truthful information.

Modelling substantiation requirements for claims about diet and disease on the drug approval process is itself inappropriate. Typically, more is at stake in approving new drugs than in whether to allow diet and health claims. The critical issue in both cases is the relative risk of the two potential mistakes, because reducing the risk of one mistake necessarily increases the risk of the other. It is not that foods offer greater benefits than new prescription drugs; rather, unlike prescription drugs, the potential benefits of allowing claims about diet and health, even in the face of uncertainty, are vastly greater than the potential costs of allowing mistaken claims. The potentially large public health impact of mistakenly allowing dangerous drugs on the market is the key reason for the rigorous FDA approval process.

Simply put, the potential consequences of mistaken decisions about what to eat, or whether to take a safe dietary supplement, are not remotely comparable to the potential consequences of mistaken decisions about prescription drugs. Because the costs of mistaken choices about foods and dietary supplements are substantially lower than the costs of mistakes choosing drugs, the value of added testing to determine the likely truth of the claim is lower. To be sure, more information always reduces uncertainty, but with less at stake, there is less reason for the elaborate precautions of the drug approval process.

Congress made that judgment about dietary supplements when it enacted the Dietary Supplements and Health Education Act. That statute removed dietary supplements from the rigorous requirements of the new drug approval process, and allowed claims about the relationship between nutrients and the structure or function of the human body as long as they are supported by a "reasonable basis." It made a similar decision in the Nutrition Labeling and Education Act regarding foods, when it allowed health claims for foods that FDA found were supported by "significant scientific agreement." The FTC's recent orders threaten to reverse these Congressional decisions, restoring the rigors of the drug approval process in everything but name.

The randomized, double blind, placebo-controlled clinical trial is the gold standard of medical research. For some specific questions, it is the only methodology that experts accept as yielding accurate and reliable results. Despite the value of clinical trials, sometimes they are simply not necessary. A systematic review of randomized trials of parachutes, unsurprisingly, could not locate any such trials. Notwithstanding this deficiency, few would recommend jumping from an airplane without one because of the failure to conduct one or more random controlled clinical trials. The authors concluded:

As with many interventions intended to prevent ill health, the effectiveness of parachutes has not been subjected to rigorous evaluation by using randomised controlled trials. Advocates of evidence based medicine have criticised the adoption of interventions evaluated by using only observational data. We think that everyone might benefit if the most radical protagonists of evidence based medicine organised and

participated in a double blind, randomised, placebo controlled, crossover trial of the parachute.<sup>32</sup>

Moreover, any trial takes time. As another group of authors noted, “waiting for the results of randomized trials of public health interventions can cost hundreds of lives, especially in poor countries with great need and potential to benefit. If the science is good, we should act before the trials are done.”<sup>33</sup> “Good science” they suggest “is taking the research to the problem rather than conducting the research in the tallest ivory tower the investigator can find.”<sup>34</sup>

There are also instances in which clinical trials would be unethical or impractical. Thus, there are no randomized clinical trials establishing the adverse effects of tobacco consumption on humans, nor are there such trials of any number of workplace chemicals regulated as hazardous. In other circumstances, clinical trials might be possible conceptually, but are wildly impractical. For example, a randomized clinical trial of whether increasing calcium intake in young adults actually reduces the risk of osteoporosis would have to follow participants for decades.

We learn about the real world in ways beyond clinical trials. Thus, much of what we know about the relationship between diet and disease is based on epidemiology,<sup>35</sup> not randomized trials. Trials are frequently a useful supplement, as, for example, with studies that document the short-term effect of diets with different fat compositions on serum cholesterol, but the crucial knowledge about the relationship between cholesterol and heart attacks is epidemiological. Reliance on epidemiology is also common where clinical trials are difficult or impossible. The “best evidence” of workplace hazards is often derived from epidemiologic studies of workers exposed to different levels of suspect chemicals. Moreover, the Commission’s *Dietary Supplements: An Advertising Guide for Industry* explicitly recognizes that epidemiology alone may substantiate efficacy claims for dietary supplements.<sup>36</sup>

Even the FDA has approved health claims relying on basic science and epidemiology. For example, in 1996 it approved a claim regarding dietary noncariogenic carbohydrate sweeteners and dental caries. The FDA reasoned that it would be virtually impossible to isolate a control group that consumed no foods containing sugars or sugar alcohols. Instead, the FDA relied on evidence from human epidemiological, animal, and in vitro studies related to the association between an individual’s consumption of sugar alcohols in chewing gum and the incidence of caries.<sup>37</sup>

Similarly, the FDA relied on only one clinical trial in approving a health claim regarding folate and neural tube defects. Even though the study was difficult to generalize to the population because it only

<sup>32</sup> Gordon C.S. Smith & Jill P. Pell, Parachute Use to Prevent Death and Major Trauma Related to Gravitational Challenge: Systematic Review of Randomized Controlled Trials, 327 B.M.J. 1459 (2003).

<sup>33</sup> Malcolm Potts et al., Parachute Approach to Evidence Based Medicine, 333 B.M.J. 701 (2006).

<sup>34</sup> *Id.* at 702.

<sup>35</sup> Epidemiology uses sophisticated statistical techniques to analyze a relationship of interest while holding constant other factors that may influence the result. Epidemiological studies controlling for other possible risk factors, for example, establish that smoking causes cancer in humans.

<sup>36</sup> BUREAU OF CONSUMER PROTECTION, DIETARY SUPPLEMENTS: AN ADVERTISING GUIDE FOR INDUSTRY [HEREINAFTER GUIDE] 8 (1998). <http://business.ftc.gov/documents/bus09-dietary-supplements-advertising-guide-industry> at 11, example 14.

<sup>37</sup> Dietary Noncariogenic Carbohydrate Sweeteners and Dental Caries, 60 Fed. Reg. 37,507 (July 20, 1995) (codified at 21 C.F.R. § 101.80 (2009)).

included women with a history of neural tube defects in pregnancy, it was sufficient for the FDA to conclude that there was a significant risk reduction when women supplemented their diets with high levels of folic acid. Most of the evidence the FDA considered consisted of nonclinical human studies, including four intervention trials with women at a high risk of a pregnancy with a neural tube defect because they had a personal history of such a pregnancy.<sup>38</sup>

The Commission contends that nothing has changed. It defends the requirement for two clinical trials as traditional “fencing in” relief that imposes special requirements on proven violators that do not apply to other companies. Initially, there is no sound reason to require anyone to meet this higher burden to substantiate the likely truth of their claims. Rather than “fencing in” potential violations, the requirement “walls off” truthful claims that would likely prove valuable to many consumers. Although the scope of the potential harm from such a requirement is formally limited to the covered claims and a particular respondent, incorporating these more rigid standards signals to others in the industry (and, eventually, the Courts) what the Commission expects as adequate substantiation. This is especially true where the reason the Commission offers for this requirement for POM – that a second test might yield a different result – is universally true. Like the clinical trials requirement itself, this is a general rule, rather than a requirement that is unique to a particular respondent.

Moreover, the two clinical test requirement will more likely suppress truthful claims than prevent deceptive ones. If a statistical test that finds a significant difference between two products at the conventional 95 percent confidence level, there is a 5 percent chance that the result is due solely to the peculiarities of the particular sample. Repeating the test would reduce that risk to less than one percent,<sup>39</sup> but most likely, it will simply achieve the same result.

A peculiar sample may also fail to detect a relationship that actually exists. Although larger samples could increase the chance of detecting a real difference, they are more costly and the tests frequently take longer. As a practical compromise between these competing objectives, statistical tests and sample sizes are frequently chosen to have an 80 percent chance of detecting a difference (of a specified size) if it really exists.<sup>40</sup> Thus, 20 percent of the time a test will fail to detect a real difference that in fact exists. Repeating the test will raise the probability that at least one of the two tests will fail to find a difference from 20 percent to 36 percent.<sup>41</sup> *Requiring the second test is therefore much more likely to reject truthful claims than to detect a result that only arose in the first place because of chance.*<sup>42</sup> Thus the

<sup>38</sup> Folate and Neural Tube Defects, 61 Fed. Reg. 8, 752 (Mar. 5, 1996) (codified at 21 C.F.R. § 101.79 (2009)).

<sup>39</sup> The likelihood that both tests find a significant difference when in fact there is no difference is .05 times .05, or .0025. That is, only in one quarter of 1 percent of cases will both tests find a statistically significant difference that does not in fact exist.

<sup>40</sup> The probability of detecting a difference that actually exists is known as the power of the test. “The ideal power for any study is considered to be 80%.” K.P. Suresh and S. Chandrashekar, “Sample Size Estimation and Power Analysis for Clinical Research Studies,” 5 J. Hum. Reprod. Sci. 7 (2012), available at <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3409926/>.

<sup>41</sup> When there is a real difference, the chance of finding the difference statistically significant is .8. The chance of finding it significant in both tests is .8 times .8, or .64.

<sup>42</sup> A second test is more likely to reject truthful claims even if the chances of failing to detect a difference are the same as the chances of mistakenly finding one. If the chance of either mistake (significance when there is no difference or failure to find significance when one exists) is 5 percent, the chance that both tests will find the difference is 90.25 percent (i.e., .95 times .95). Thus, there is almost a 10 percent chance of mistakenly rejecting a truthful claim. With only one test, there was only a 5 percent chance of mistakenly allowing a false one.

requirement of two RCT's, rather than one, increases the likelihood that truthful claims will be suppressed.

When the Commission rejected a petition to establish more explicit substantiation standards for dietary supplements, it did so in part because of the likelihood of setting a standard that is "higher than necessary to ensure adequate scientific support."<sup>43</sup> This risk is no different when the Commission imposes a more rigid standard as an order provision. Indeed, the "competent and reliable scientific evidence" standard itself emerged from a series of orders incorporating that provision. Responsible companies will have little choice but to follow the two RCT requirement incorporated into recent orders, creating exactly the problems the Commission sought to avoid when it rejected the petition in 2000.

Not only is such a requirement harmful, it is unnecessary. When the District of Columbia Circuit rejected the FDA's ban on health claims that were not supported by "significant scientific agreement" on First Amendment grounds,<sup>44</sup> it did so because it believed that carefully qualified claims could avoid the risk of deception even without significant scientific agreement. The FTC's own empirical studies of qualified health claims support that conclusion.<sup>45</sup> As the FTC staff commented to the FDA with respect to health claims, "On average, consumers were able to discern clear differences in the level of certainty communicated by these [tested] claims."<sup>46</sup>

Where the policy goal is to maximize consumer welfare by allowing the commercial discussion of emerging scientific evidence, there is no conceptual difference between "two clinical trials" and "significant scientific agreement" as requirements that must be met before certain claims are permissible. Like "significant scientific agreement," the "two clinical trials" standard will likely prohibit carefully qualified claims that are not likely to mislead reasonable consumers.<sup>47</sup>

Moreover, in practical day-to-day decision making, knowing that *precisely one* clinical trial supports an important health-related claim is highly valuable to consumers. The requirement for a second clinical trial appears unnecessary to insure truthful, useful claims. The Commission should return to its traditional balancing test to determine the appropriate level of substantiation for particular claims.

#### D. The FTC Should Not Seek Monetary Relief in Traditional Substantiation Cases.

Since 1981, the FTC has attacked fraud systematically, successfully using the authority under Section 13(b) of the FTC Act to obtain a permanent injunction "in proper cases" to freeze assets *ex parte* and to

<sup>43</sup> Letter Denying Petition for Rulemaking from Donald S. Clark to Jonathan W. Emord (Nov. 30, 2000), available at <http://www.ftc.gov/os/2000/12/dietletter.htm>.

<sup>44</sup> See *Pearson v. Shalala*, 164 F.3d 650 (D.C. Cir. 1999).

<sup>45</sup> Dennis Murphy et al., A Generic Copy Test of Food Health Claims in Advertising, FTC (1998); Dennis Murphy, Consumer Perceptions of Qualified Health Claims in Advertising, FTC, Working Paper No. 277 (2005).

<sup>46</sup> FTC Staff Comments on Assessing Consumer Perceptions of Health Claims (Jan. 17, 2006), at 12, available at <http://www.ftc.gov/be/V060005.pdf>.

<sup>47</sup> By its nature, "competent and reliable scientific evidence" requires different amounts of evidence depending on the specifics of the covered claim, because the kinds of evidence necessary to support a qualified claim will frequently differ from what is needed to substantiate unqualified claims. Thus, the standard permits claims that appropriately describe the available evidence even when that evidence would not support an unqualified claim. With a clinical testing requirement, however, any covered claim must be supported by clinical testing, regardless of how it might be qualified and regardless of whether it is misleading.

force disgorgement of ill-gotten gains.<sup>48</sup> More recently, the Commission has asserted the authority to expand the use of the Section 13(b) program beyond fraud cases, suggesting that it may use Section 13(b) to seek consumer redress even against legitimate companies when there are simply questions about the substantiation for claims made as part of national advertising campaigns.<sup>49</sup> This use of the Section 13(b) remedial authority is wrong as a matter of law, troubling as a matter of policy, and threatens to undermine the operation of the fraud program, which has proven critical to the FTC's consumer protection mission.

The legislative history surrounding the enactment of Sections 13(b), 19, and 5(m)(1)(B)<sup>50</sup> has received vanishingly little attention in the cases that have addressed the legality of the Section 13(b) fraud program, even though it sheds considerable light on the proper scope of that provision. There is no hint in the legislative history that Congress intended to grant the FTC broad authority to seek monetary relief when it enacted Section 13(b). In particular, Section 19 limits monetary relief to conduct a reasonable person would know is dishonest or fraudulent. Both injunction and redress authority were included as separate provisions in a bill that passed the Senate in 1971. Although an amended Section 13 was enacted in 1973, and Section 19 was enacted two years later, the inescapable inference from their common origin and the entire legislative history is that Congress did *not* intend to give the Commission blanket authority to obtain redress.

The use of 13(b) against fraud respects the carefully constructed congressional grant of authority to the Commission in part because fraud meets the knowledge test of Section 19. Moreover, using Section 19 alone would require three separate actions to attack a fraud successfully -- a preliminary injunction to freeze assets, an administrative action to determine liability, and then another, independent district court action to seek redress. As Congress itself recognized, district courts may be reluctant to grant preliminary relief when they cannot assure an expeditious resolution of the matter. Thus, fraud cases are "proper" under Section 13(b), but routine use of Section 13(b) to seek redress would read "proper" out of the statute.

One type of case that is not "proper" is the traditional substantiation case. Typically, such cases involves a reputable national advertiser making claims about the features or benefits of its product or services.

<sup>48</sup> 15 U.S.C. § 53(b).

<sup>49</sup> Consent Order, Oreck Corp., FTC File No. 102-3033 (Apr. 7, 2011) (\$750,000); Consent Order, Beiersdorf, Inc., FTC File No. 092-3194 (June 29, 2011) (\$900,000); Consent Order, NBTY, INC., FTC Docket No. C-4318, File No. 102-3080 (Dec. 13, 2010) (\$2.1 million). In some cases, the the redress is paid in conjunction with a settlement with other plaintiffs. See *FTC v. Reebok Int'l Ltd.*, No. 1:11CV2046 (N. Dist. Ohio Sept. 29, 2011) (\$25 million); Order Preliminary Certifying a Class for Settlement Purposes, *In re Reebok Easytone Litig.*, No. 4:10-CV-11977-FDS (D. Mass. Oct. 6, 2011); *FTC v. Skechers U.S.A., Inc.*, No. 1:12-cv-01214 (N. Dist. Ohio May 16, 2012) (\$40 million); *Grabowski v. Skechers U.S.A., Inc.*, No. 3:12-cv-00204 (W.D. Ky.). See *also* Stipulation and Order, *Gemelas v. The Dannon Co.*, No. 1:08cv236 (N.D. Ohio July 19, 2011).

<sup>50</sup> The second proviso of Section 13(b) states, "Provided further, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." 45 U.S.C. § 53. Section 19 authorizes "such relief as the court finds necessary to redress injury" (45 U.S.C. § 57(b) against any party subject to a final cease and desist order "[i]f the Commission satisfies the court that the act or practice to which the cease and desist order relates is one which a reasonable man would have known under the circumstances was dishonest or fraudulent ..." 45 U.S.C. § 57(b)(2). Section 5(m)(1)(B) authorizes civil penalties against any party engaged in a practice that the Commission has found unfair or deceptive in a litigated proceeding "with actual knowledge that such act or practice is unfair or deceptive and is unlawful ..." U.S.C. § 45(m)(1)(B)(2).

Although such claims may highlight something new, the product will often have been on the market for many years based on other claims. For example, the Commission's cases against Kellogg involved claims of increased attention in class for children who eat Frosted Mini Wheats for breakfast,<sup>51</sup> and claims that Rice Krispies will help "support your child's immunity."<sup>52</sup> Even if the claims about the effects of these cereals on enhanced attention or immunity are completely unsupported, such claims generally are not the sole (or even primary) reason that most consumers purchase the products.<sup>53</sup> Moreover, such cases often involve disputes over scientific details about the proffered substantiation and the required level of evidence, with well-regarded experts on both sides of the question.

The knowledge that the FTC might seek consumer redress could chill companies from providing consumers with information that they would want to have about the products they are using. The risk is particularly acute when, as discussed above, the traditional standard for substantiation appears to be changing. Even with the "right" substantiation standard, however, uncertainty will exist about how it will be applied in a particular case. With monetary penalties, the increased risk, in combination with the uncertainty, will encourage greater caution about making truthful claims.

Finally, the expanded use of Section 13(b) poses risks to the fraud program itself. Beyond the risk that the current widespread judicial deference to the program might be revisited, a greater risk concerns the judicial determination of the appropriate amount of redress. Although courts have been imprecise about whether equitable awards should be analyzed as "restitution" (which would be based on what consumers paid for the product) or "disgorgement" (which would be based on amounts received by the defendant),<sup>54</sup> the baseline for redress awards has generally been either consumer loss or the defendant's unjust gain. Because these measures usually coincide, under either measure the defendant can be required to pay amounts well in excess of profits.<sup>55</sup> Indeed, even if the defendant's gain is the

<sup>51</sup> Complaint, Kellogg Co., FTC File No. 082 3145 (July 31, 2009).

<sup>52</sup> Press Release, Order Modifying Order, Kellogg Co. (FTC June 3, 2010) (modifying order to cover additional claims), available at <http://www.ftc.gov/opa/2010/06/kellogg.shtm>.

<sup>53</sup> Thus, Frosted Mini Wheats have been successfully marketed nationally since 1970, apparently without the need to mention any effects on attentiveness. See Kellogg in the 1970s, <http://www.kellogghistory.com/timeline.html> (last visited Dec. 5, 2011). Rice Krispies have been on the market much longer, first appearing in 1928. See Kellogg in the 1920s, <http://www.kellogghistory.com/timeline.html> (last visited Dec. 5, 2011).

<sup>54</sup> See, e.g., FTC v. Wolf, No. 94-8119-CIV-FERGUSON, 1996 WL 812940, at \*9 (S.D. Fla. Jan. 31, 1996) (restitution); FTC v. SlimAmerica, Inc., 77 F. Supp. 2d 1263 (S.D. Fla. 1999) (providing "consumer redress"); FTC v. Verity Int'l, Ltd., 443 F.3d 48 (restitution); FTC v. Stefanchik, 559 F.3d 924 (9th Cir. 2009) ("equitable monetary relief"); FTC v. Bronson Partners, 674 F. Supp. 2d 373 (D. Conn. 2009) (restitution); FTC v. Direct Mktg. Concepts, Inc., 648 F. Supp. 2d 202 (D. Mass. 2009) (disgorgement).

<sup>55</sup> See, e.g., FTC v. Nat'l Urological Group, Inc., 645 F. Supp. 2d 1167, 1213 (N.D. Ga. 2008) (noting that "[r]estitution is intended to return the injured party to the status quo and is measured by the amount of loss suffered by the victim" and awarding total product sales over the relevant period); see also FTC v. Febre, 128 F.3d 530, 536 (7th Cir. 1997) ("A major purpose of the Federal Trade Commission Act is to protect consumers from economic injuries. Courts have regularly awarded, as equitable ancillary relief, the full amount lost by consumers.").

measure, permissible offsets are generally limited.<sup>56</sup> That is a reasonable approach for a “Chinese Diet Tea”<sup>57</sup> promoted as a weight loss product, when few, if any, consumers likely purchased the product because of its inherent value as a beverage. It is not a workable approach for a product like Rice Krispies; an unsubstantiated claim may increase sales somewhat, but is not responsible for the vast majority of the sales that occur. Thus, courts may change their measure of calculating damages, and those changes could complicate the determination of redress in fraud cases, as well.

The FTC’s consumer protection mission is to prevent unfair or deceptive acts or practices. In giving the FTC the tools to accomplish that mission, Congress struck a delicate balance. It recognized that the FTC must prevent harm to the public and ensure that those who cause the harm are punished; at the same time, it recognized that the FTC could go too far. Imposing monetary penalties on those who did not know their conduct was unlawful could chill the provision of beneficial information and thus hurt members of the public more than it helps them. If companies are afraid that they will be subjected to monetary liability for claims about their products that the FTC ultimately concludes cannot be substantiated, they may not make the claims at all. As a result, consumers could be deprived of valuable information.

## II. The Commission Should Restrict Its Privacy Enforcement Actions to Practices that Cause Real Consumer Harms.

In 2001, the Federal Trade Commission adopted a new approach to privacy, based on the consequences of information use and misuse. Most notably, that approach led to the National Do Not Call Registry and a series of cases holding companies liable for their failure to take reasonable and appropriate steps to protect the security of sensitive commercial information. Based initially on deception, when companies breached security promises in their privacy policies and elsewhere, subsequent cases alleged that security failures could also be challenged as unfair practices.

Although the Commission has not abandoned the consequences-based approach to privacy entirely, and cannot, given the statutory constraints under which it operates, it has adopted a new “privacy

<sup>56</sup> Redress is generally not reduced by the amount of actual operating costs, such as those for manufacturing the product, advertising, processing costs, or taxes. *Bronson Partners*, 674 F. Supp. 2d at 382 (restitution); *SlimAmerica*, 77 F. Supp. 2d at 1276 (“Costs incurred by the defendants in the creation and perpetration of the fraudulent scheme will not be passed on to the victims.”); see generally *Verity Int’l*, 443 F.3d at 68 (noting that in most cases there is no difference between measuring redress according to consumer loss and the defendant’s unjust gain). By contrast, in the cases reflecting the Commission’s new expansion of Section 13(b), see *supra* note 15, the Commission has sought and obtained redress far less than the total sales of the product. For example, in *Skechers*, the Commission obtained \$40 million, which was considerably less than 10 percent of *Skechers’* sales in the peak year of the toning shoe fad alone. First Research, *Footwear Manufacturing Industry Profile* (June 25, 2012), available at <http://search.proquest.com>; Christopher C. Williams, *After a Tough Stretch Adidas’ Run Resumes*, 33 BARRON’S 17 (2010), available at <http://search.proquest.com> (sales of toning shoes hit \$1 billion in 2010 and Skechers held 67% market share). Although the Commission’s complaint included a falsity claim regarding alleged serious problems with one study, it apparently rejected other studies supporting similar fitness benefits of rocker bottom shoes. Scott C. Landry, Benno M. Nigg & Karella E. Tecante, *Standing in an Unstable Shoe Increases Postural Sway and Muscle Activity of Selected Smaller Extrinsic Foot Muscles, GAIT & POSTURE*, June 2010, at 215 (reporting findings that even when standing, muscle activation is higher in rocker bottom footwear than conventional shoes). Moreover, unlike Section 19, both falsity and lack of substantiation are strict liability offenses; the defendant’s knowledge is irrelevant.

<sup>57</sup> Chinese Diet Tea was the product at issue in *FTC v. Bronson Partners, LLC*, 654 F. 3d 359 (2d Cir. 2011).

framework,” based on what the Commission views as “best practices.” The framework urges “privacy by design,” “simplified choice,” and “greater transparency.” The Commission Report recognizes that some of the practices it urges go “beyond existing legal requirements,” but provides little guidance on the contours of the practices it believes are subject to challenge under the FTC Act.

The FTC’s primary tool to address privacy issues is Section 5 of the FTC Act, which prohibits “unfair or deceptive acts or practices.” Whether the theory is unfairness or deception, injury to consumers is a necessary element of a law violation. As the Commission stated in its Unfairness Policy Statement, “unjustified consumer injury is the primary focus of the FTC Act.”<sup>58</sup> The injury requirement is explicit in unfairness, and implicit in the materiality element that is necessary to find a practice deceptive.

Some breaches of privacy involve real and concrete harms. Location information in the wrong hands can lead to stalking of a consumer and actual physical injury. Privacy violations may also lead to economic injury. Compromised information may be used for identity theft, for example, acquiring new loans or other accounts in someone else’s name. Simple annoyance can also constitute a privacy harm, as was the case with telemarketing calls before the advent of the Do Not Call registry. The harm to each individual is small, but the aggregate harm is substantial.

Harms are also actionable even if they are difficult to monetize directly. Damage to a reputation or intrusion into private places are not concrete harms in the same sense as the risk of physical or economic injury, but they are real harms nonetheless, widely recognized in tort law.<sup>59</sup> From the beginning, the harm-based approach to privacy addressed such harms. Indeed, the Commission’s first information security case was against Eli Lilly for inadvertent disclosure of sensitive information: the email addresses of a group of Prozac users.<sup>60</sup> Such information is sensitive because of the risk of damage to reputations. Similarly, an early case challenged the practice of email “spoofing” – falsifying the return address in spam email – as unfair. The bulk emails used deceptive subject lines to induce consumers to open sexually explicit solicitations to visit adult web sites. As part of the injury to consumers, the complaint cited the reputational harm from being associated with spamming to parties whose addresses were spoofed.<sup>61</sup>

Many potential “harms” to consumers involve secondary characteristics of a product or service that do not affect its functionality. Often, such preferences concern how a product or service is produced, rather than the characteristics of the final product. Many consumers, for example, have preferences for products that are kosher. Others may prefer products that are “made in USA” or union made, or free range chickens, or locally grown produce. Although we can determine objectively whether such a claim is accurate, its importance, and hence the magnitude of any injury, depends entirely on the preferences of the consumer. I term these types of preferences subjective, because not all consumers agree that the attribute is important, and because there is no way for an outside observer to measure the magnitude of the injury if they are violated.

<sup>58</sup> Unfairness Policy Statement, appended to *Int’l Harvester Co.*, 104 F.T.C. 949, 1070 (1984).

<sup>59</sup> Restatement (Second) of Torts §559 Defamatory Conduct Defined, §652B Intrusion Upon Seclusion, and §652D Publicity Given to Private Life.

<sup>60</sup> See Complaint at 3, *Eli Lilly and Company*, No. 123214 (Jan. 18, 2004), available at <http://www.ftc.gov/os/2002/01/lillycmp.pdf>.

<sup>61</sup> *FTC v. Brian D. Westby et al.*, No. 03 C 2540 (E. D. N. Ill. Apr. 17, 2003).

Privacy is one area where such subjective preferences are important. As the FTC's preliminary report noted in 2010, "for some consumers, the actual range of privacy-related harms is much wider and includes ... the fear of being monitored or simply having private information 'out there.'"<sup>62</sup> Consumers may also feel harmed when information is used "in a manner that is contrary to their expectations," and may have "discomfort with the tracking of the online searches and browsing."<sup>63</sup> Some have summarized these kinds of harms as "creepiness."<sup>64</sup>

No doubt, there are consumers with such preferences. As with other subjective preferences, the Commission should protect them when they are manifested in marketplace choices. If a company promises "no information sharing," or no tracking, or kosher, it had better deliver. That was the lesson of Gateway Learning, where the Commission challenged a retroactive, unilateral change in the company's privacy policy. The policy had provided that "we do not sell, rent or loan any personally identifiable information regarding our consumers unless we receive a customer's explicit consent." The company later began renting such information, without seeking consent, and then revised its privacy policy to allow its new practice. The Commission challenged the retroactive application of the new privacy policy as unfair, but it did so without any specific allegations about the consequences of sharing. It was the unilateral modification of the contract that was unfair, rather than the specific modification adopted.<sup>65</sup> Consumers had been promised one product characteristic, about which they might reasonably care, and were now being offered another.<sup>66</sup> Because consumers made a choice based on the promises made, the company cannot unilaterally change the deal.

Critical to protecting subjective preferences, however, is the notion that consumers have made a choice based on the promise that a provider will deliver. It does not follow that because *some* consumers have a preference, the Commission should require *all* sellers to satisfy that preference. That argument is simply wrong. Assuring the accuracy of claims that a product is kosher enhances consumer sovereignty – it lets consumers choose what matters to them and what does not. Consumers who believe keeping kosher is important can do so, but they must face the cost of paying attention and finding a seller who promises to provide kosher products. Consumers who think kosher is irrelevant are not burdened in any way.

Requiring all sellers to offer kosher products is another matter altogether. Such a policy imposes the costs of the admittedly real preferences of some on many who do not share them. The FTC Act, however, is about preserving consumer sovereignty, not about substituting the preferences of the Commissioners for those of consumers, or imposing the preferences of one group of consumers on another. The fact that a particular product characteristic, whether related to privacy or religious preference, is important to *me* is a very good reason for protecting affirmative claims about that characteristic. It is a very bad reason for imposing that preference on everyone else.

<sup>62</sup> Federal Trade Commission, Protecting Consumer Privacy in an Era of Rapid Change, 20, available at <http://www.ftc.gov/os/2010/12/101201privacyreport.pdf>.

<sup>63</sup> *Id.*

<sup>64</sup> Adam Thierer, *The Pursuit of Privacy in a World Where Information Control is Failing*, 36 *Harvard Journal of Law & Public Policy* 409 (2013).

<sup>65</sup> See Complaint at 2-6, 13, Gateway Learning Corp., No. 0423047 (Jun. 7, 2004), available at <http://www.ftc.gov/os/caselist/0423047/040707cmp0423047.pdf>.

<sup>66</sup> The seminal case applying the Commission's unfairness authority to unilateral contract modifications is *Orkin Exterminating Co., Inc.*, 108 F.T.C. 263 (1986).

For the Commission to protect such subjective preferences, they must be preferences that are actually reflected in marketplace behavior, because that is the only reliable indication that these preferences are real. They cannot be sensibly inferred from survey results where consumers can express a preference without confronting the costs of satisfying it.

The nature of subjective preferences means that an unfairness analysis is particularly inappropriate. Unless there is some reason that a uniform choice is necessary, the essence of the problem is one of matching each consumer to the product or service that best satisfies his or her preferences, a task to which markets are particularly well suited. Determining that a practice is unfair because of some alleged violation of subjective preferences would amount to imposing the preferences of some on others who do not share them, violating the very consumer sovereignty that Section 5 is supposed to protect. The Commission's Unfairness Policy Statement was therefore wise in ruling out use of unfairness to address subjective harms,<sup>67</sup> and it is difficult to imagine a more subjective harm than "creepiness."

Anchoring the Commission's enforcement efforts to practices that cause harm is important, because the modern information economy is built on data collection and analysis. The commercial use of information contributes to reducing the incidence of credit card fraud, democratizing the availability of consumer credit, and creating fraud detection tools to reduce the risk of identity theft.<sup>68</sup> It is essential not only for the basic functioning of the Internet, but also in creating value for consumers by supporting advertising, which underwrites the cost of content and services. Data collection and analysis allow tailoring both commercial and non-commercial offerings to meet consumers' specific preferences, and facilitates innovation by new and existing suppliers. Consumer data and feedback also enable the increased customization and personalization of online experiences and offerings for consumers, which is helping to fuel growth in broadband usage and e-commerce.

With data-dependent products and services, it is risky to let artificial distinctions get in the way of efficient market organization. If a use of information by a "first party" is a useful practice that benefits consumers, it does not become any less useful, or any more of a risk to privacy, because the most efficient way to produce those benefits is to share the information with a "third party" who actually does the analysis. A focus on information sharing, rather than information uses, risks creating entirely artificial barriers to innovation that will ill serve consumers in a market environment as dynamic as the internet.

The principle of avoiding the most serious mistake that should be central to advertising substantiation is equally applicable to privacy regulation. Regulation or enforcement that is too stringent may reduce the risk of the particular privacy harms to which it is addressed, but it increases the risk of precluding innovations that would make everyone's life better. Too little enforcement may facilitate innovation, but it also increases the risk of real and concrete privacy harms. The question is one of balance, and should be asked about every potential privacy enforcement action. Is the more serious error failing to regulate, or is overly burdensome regulation the greater risk?

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<sup>67</sup> Unfairness Policy Statement, appended to *Int'l Harvester Co.*, 104 F.T.C. 949, 1070 (1984). ("Emotional impact and other more subjective types of harm ... will not ordinarily make a practice unfair.")

<sup>68</sup> For an extended discussion, see e.g., J. Howard Beales, III & Timothy J. Muris, *Choice or Consequences: Protecting Privacy in Commercial Information*, 75 *University of Chicago Law Review* 109, 115-117 (2009).

The Commission can reduce the risks of overregulation by focusing on real and identifiable harms. That is a proper role for consumer protection in general, and privacy regulation is no different. Regulation to prevent hypothetical problems, however, poses far greater risks that the next big innovation will be precluded, not because it would have caused a problem, but simply because no one had previously considered the possibility.

Thus, a focus on harm is particularly vital as the Commission examines new issues, such as the “internet of things,” from a privacy perspective. It will be easy to speculate about the potential privacy problems that might result from interconnected devices that talk to each other. Regulation based on speculative problems, however, is far more likely to chill useful innovations than it is to prevent real harms.

For example, when Congress and the Commission first began considering online privacy issues in the late 1990s, few would have imagined that literally billions of consumers would want to post many of the details of their personal lives online for all to see. Facebook and other social media have created tremendous value for consumers by enabling exactly that practice. Regulation based on what some might still consider “creepy” could easily have prohibited a valuable innovation.

Thank you again for the opportunity to testify today. I look forward to your questions.

Mr. TERRY. Thank you very much. Mr. Crane, now you are recognized for your 5 minutes.

#### STATEMENT OF DANIEL CRANE

Mr. CRANE. Chairman Terry, Ranking Member Schakowsky, and members of the subcommittee, thank you for this opportunity to appear before you today. I am Daniel Crane of the University of Michigan. My comments will concern the FTC's continuing and original mandate to guard against unfair methods of competition.

I wish to make three broad points. First, over the course of its first 100 years, the FTC has not followed the original congressional design, which contemplated that the commission would be an expert, politically independent agency exercising quasi-legislative and quasi-judicial functions.

Second, the FTC has nonetheless emerged as a successful law enforcement agency. Third, the FTC's 100 birthday is an opportune moment to consider options for modernizing the agency in light of its actual functioning.

The FTC was a product of progressive era belief in regulation by technocratic experts. In 1935, in upholding the FTC's independence and the president's removal power, the Supreme Court articulated the statutory features that justified the commission's independence. The FTC was to be nonpartisan and politically independent from other branches of government. Its responsibilities were not executive but rather quasi-judicial and quasi-legislative. The FTC was to be a uniquely expert body. The original statutory design also contemplated that the commission would collaborate with the Justice Department in enforcing the anti-trust laws, for example, by sitting as a chancellor in equity.

As a historical matter, almost none of this has worked out. Though the commission may be politically independent from the executive branch, social science research shows that it is highly inclined to the will of Congress. This may create a desirable separation of powers, but it does not create the kind of pure political neutrality envisioned during the progressive era. As competition capacity, the commission has not been a rule-making authority almost at all. Indeed a 1989 study by the American Bar Association suggested that it would be inappropriate for the commission to have such a role.

The commission may in theory exercise an adjudicatory function, but that too is largely illusory. First, the commission more frequently brings anti-trust actions in court than through internal adjudication. Second, when it does adjudicate internally, it is questionable whether there is an impartial adversarial contest.

Between 1983 and 2008, for example, the FTC staff won all 16 cases adjudicated by the commission, leaving the real contest to happen in the court of appeals.

What about expertise? Yes, the FTC has considerable expertise on economics and particular industries, but not greater expertise in the justice department. The FTC is thus expert but not uniquely expert compared to other governmental bodies.

Finally the statutory provisions designed to encourage collaboration between the FTC and Justice Department have been almost entirely neglected. Instead of collaborating on enforcements, the

two agencies essentially allocate cases depending on their experience with particular industries or political factors.

In sum, the FTC's action behavior as an institution bears little resemblance to the design that ostensibly justifies its independence as an agency. This does not mean, however, that the FTC is a failed institution. To the contrary, the FTC today is largely an effective law enforcement agency, an agency that enforces the anti-trust laws on essentially equal terms with the anti-trust division. Although there would be considerable sense in consolidating anti-trust enforcement in a single agency, the political will for such a move is probably lacking.

It is therefore appropriate to focus on more modest reforms that could improve the functioning of the agency in light of what it actually is and does. Let me briefly propose four such reforms.

First, as several commissioners have recently proposed, the FTC should adopt guidelines to limit its powers to prosecute unfair methods of competition that would not be already covered by the Sherman or Clayton Acts. This is important to prevent the FTC from having excessive discretion to make up competition rules on the fly while serving an essentially prosecutorial function.

Second, under existing case law, the FTC can obtain a preliminary injunction against mergers in order to pursue administrative action on a lower standard of proof than a substantial likelihood of success on a merits criterion applicable to the Justice Department. Given that both agencies exercise essentially the same law enforcement function, there is no reason for the FTC to enjoy an advantage that the Justice Department does not.

Third, the two agencies should be encouraged to enter into a formal public agreement allocating anti-trust enforcement authority, which would enhance clarity and transparency in case allocation. The agencies entered into such an agreement in 2002 but then rescinded it under pressure from Congress.

Fourth and finally, under the unique appellate review statute in place since 1914, a large corporate defendant may appeal a commission order to essentially any of the 12 appellate circuits that it chooses. This creates a serious disadvantage for the FTC insofar as defendants routinely pick the court of appeals with the most favorable law on the relevant issue which the Supreme Court rarely reviews. The statute could be amended to reduce this appellate forum shopping. Thank you very much. I look forward to your questions.

[The prepared statement of Mr. Crane follows:]

29

**Prepared Statement of Professor Daniel A. Crane**

**Associate Dean for Faculty and Research and Frederick Paul Furth, Sr., Professor of Law**

**University of Michigan**

**On**

*The FTC at 100: Views from the Academic Experts*

**Before the**

**United States House of Representatives**

**Committee on Energy and Commerce,  
Subcommittee on Commerce, Manufacturing, and Trade**

**Washington, D.C.**

February 28, 2014

## I. Introduction

Chairman Terry, Ranking Member Schakowsky, and Members of the Subcommittee, I am Daniel Crane, Associate Dean for Faculty and Research and Frederick Paul Furth, Sr., Professor of Law at the University of Michigan. I appreciate this opportunity to appear before you today and provide some reflections on the FTC's history in its first century and its potential for modernization.

These are broad topics, and I will not be able to do them justice given constraints of time and space.<sup>1</sup> I hope, however, that reflection on the unrealized Congressional vision for the FTC and its historic performance as a law enforcement agency will set the stage for consideration of reforms that it may be appropriate to consider on the Commission's 100<sup>th</sup> birthday.

Let me say, finally by way of introduction, that my expertise as a scholar and practitioner primarily concerns the FTC's competition and antitrust portfolio, not its consumer protection portfolio. Hence, my testimony is primarily about the FTC's original and continuing mandate to promote competition.

## II. Congress's Unrealized Vision for the FTC

### A. History and Congressional Vision

Like all agencies, the FTC was a product of its times, in this case the Progressive Era. The backdrop to the passage of the FTC and Clayton Acts in 1914 can be summarized briefly as follows. During the Gilded Age of the late nineteenth century, a series of events including the second industrial revolution, the liberalization of state corporate law, and the growth in scale of business organizations led to popular demand for federal legislation to control

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<sup>1</sup> My perspectives are more fully set out in my book *The Institutional Structure of Antitrust Enforcement* (Oxford University Press 2011).

the power of the “trusts.” Congress responded in 1890 with the Sherman Act, which remains to this day our foundational antitrust law. However, during its first two decades, the Sherman Act was not used as effectively as Progressives of the early twentieth century would have liked. The law was turned more often against labor combinations than capital and was perceived as being too weak. Also, the Progressives were frustrated with a model of antitrust enforcement that depended on the Justice Department bringing lawsuits before federal judges. The Progressive believed that a specialized commission with broad investigatory and remedial powers would be preferable to the litigation model of antitrust enforcement.

The debates over the appropriate model of antitrust enforcement crystallized in the 1912 Presidential election between Theodore Roosevelt, William Howard Taft, and Woodrow Wilson. Roosevelt argued vigorously for the creation of a new federal agency with broad supervisory power over corporations. Roosevelt wanted to replace the prosecutorial and judicial model of antitrust with an expert commission model. Taft, by contrast, pointed to recent prosecutorial successes by his administration against U.S. Steel, American Sugar, General Electric, the meat packers, and the transcontinental railways in arguing in favor of a continuation of the prosecutorial and judicial model. Wilson came in somewhere between Taft and Roosevelt, arguing in favor of the creation of a new commission, but one would still be accountable to the courts.

Following Wilson’s victory, Congress turned first to banking reform, passing the Federal Reserve Act of 1913, and then to antitrust reform, passing the FTC and Clayton Acts of 1914. The design of the FTC reflected the Progressive Era belief in regulation by technocratic experts insulated from direct political pressures. In its 1935 decision in *Humphrey’s Executor*,<sup>2</sup> a

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<sup>2</sup> *Humphrey’s Ex’r v. U.S.*, 295 U.S. 602 (1935).

decision that legitimized the constitutionality of independent regulatory agencies, the Supreme Court described the technocratic features that made the FTC a distinctive type of governmental organization. According to the Court, the FTC is “a body which shall be independent of executive authority, except in its selection, and free to exercise its judgment without leave or hindrance of any other official or any department of the government.”<sup>3</sup> “The commission is to be nonpartisan; and it must, from the very nature of its duties, act with entire impartiality.”<sup>4</sup> “It is charged with the enforcement of no policy except the policy of the law.”<sup>5</sup> “Its duties are neither political nor executive, but predominantly quasi judicial and quasi legislative.”<sup>6</sup> “Like the Interstate Commerce Commission, its members are called upon to exercise the trained judgment of a body of experts ‘appointed by law and informed by experience.’”<sup>7</sup>

This independent agency, technocratic conception of the FTC contrasted with the prevailing common law model of antitrust enforcement by prosecutors before judges. The question thus arose of what should be the relationship between the FTC and the Justice Department, to which the Sherman Act had delegated the primary responsibility for enforcing the antitrust laws. Here, the FTC Act’s legislative history evidences a Congressional intent that “[f]ar from being regarded as a rival of the Justice Department . . . the [FTC] was envisioned as an aid to them.”<sup>8</sup> The FTC Act contains several mechanisms for collaborative antitrust enforcement between the two agencies, in particular on questions of remedy. Section 6(c) of the act calls for the Commission to monitor compliance with antitrust decrees obtained by the Justice Department.<sup>9</sup> Section 6(e) allows the attorney general to request that the FTC “make

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<sup>3</sup> *Id.* at 625–26.

<sup>4</sup> *Id.* at 624.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* (citation omitted).

<sup>8</sup> *FTC v. Cement Inst.*, 333 U.S. 683, 692–93 (1948).

<sup>9</sup> 15 U.S.C. § 46(c).

recommendations for the readjustment of the business of any corporation alleged to be violating the Antitrust Acts in order that the corporation may thereafter maintain its organization, management, and conduct of business in accordance with law.”<sup>10</sup> Section 7 of the act allows district courts to refer Department of Justice antitrust cases to the FTC to sit as a “master of chancery” and determine the appropriate form of relief.<sup>11</sup>

To summarize, the original Congressional design contemplated that the FTC would have the following characteristics: (1) non-partisanship and independence from the political branches of government; (2) superior expertise; (3) primarily legislative and adjudicatory responsibilities; and (4) a cooperative partnership with the Justice Department. For better or for worse, almost none of this vision has been realized.

## B. Failure of the Congressional Vision

### I. Political Independence

Congress designed the FTC to be independent from the political branches of government. The *Humphrey’s Executor* case sealed this independence by preventing the President from removing Commissioners from office for political reasons. The Commission thus enjoys a high degree of independence from the executive branch of government. However, this does not mean the Commission is politically independent as a general matter. To the contrary, empirical evidence suggests that the Commission yields to the will of Congress, and, particularly, of the oversight committees with funding responsibility.<sup>12</sup> For example, a study by Roger Faith, Donald Leavens, and Robert Tollison found that case dismissals at the FTC were non-randomly concentrated on defendants headquartered in the home districts of congressmen on

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<sup>10</sup> 15 U.S.C. § 46(e).

<sup>11</sup> 15 U.S.C. § 47.

<sup>12</sup> See PUBLIC CHOICE AND REGULATION: A VIEW FROM INSIDE THE FEDERAL TRADE COMMISSION (Robert J. Mackay, James C. Miller III and Bruce Yandle eds., 1987).

committees and subcommittees with budgetary and oversight jurisdiction over the FTC.<sup>13</sup> Bill Kovacic, who later went on to become the FTC's chair, found that the FTC has consistently chosen policy programs that follow the expressed will of the FTC's oversight committees in Congress.<sup>14</sup>

To say that the FTC responds to the will of Congress is not necessarily to criticize the FTC for being a "political" institution. In a democracy, having a politically accountable agency may be desirable. However, it is important to acknowledge that the Progressive Era vision for technocratic independence and a non-political character is largely illusory.

## 2. Superior Expertise

The Progressive Era agency model was largely based on the assumption that regulatory commissions would be run by people with superior expertise to that of ordinary law enforcement officials, in this case, that the FTC would have superior expertise on competition issues to the Justice Department. In the early years, the FTC may have had an expertise advantage over the Justice Department. In 1914, the FTC inherited the Economic Department (later transformed into the Economic Division and then the Bureau of Economics) of its predecessor—the Bureau of Corporations.<sup>15</sup> The Justice Department's Antitrust Division did not hire its first economist or create an economics unit until 1936.<sup>16</sup> Until the early 1970s, economists played a relatively small role in the division—mostly in data gathering and statistical litigation support.<sup>17</sup> The FTC's economics unit, by contrast, enjoyed earlier influence within the

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<sup>13</sup> Roger L. Faith, Donald R. Leavens & Robert D. Tollison, *Antitrust Pork Barrel*, in Mackay et al., *supra* n. 12 at 15–29.

<sup>14</sup> William E. Kovacic, *The Federal Trade Commission and Congressional Oversight of Antitrust Enforcement: A Historical Perspective*, in MACKAY, et al, *supra* n. 12 at 63.

<sup>15</sup> Lawrence J. White, *Economics, Economists, and Antitrust: A Tale of Growing Influence*, NYU Law and Economics Research Paper No. 08-07, available at [http://www.aeaweb.org/annual\\_mtg\\_papers/2008/2008\\_180.pdf](http://www.aeaweb.org/annual_mtg_papers/2008/2008_180.pdf).

<sup>16</sup> R. Hewitt Pate, *Robert H. Jackson at the Antitrust Division*, 68 ALB. L. REV. 787, 791 n. 12 (2005).

<sup>17</sup> White, *supra* n. 41 at 11.

agency.<sup>18</sup> Today, however, there is little distinction between the agencies on this score. At the Antitrust Division, a deputy assistant attorney general for economics—usually a prominent academic economist—heads a staff of approximately 60 Ph.D.-level economists.<sup>19</sup> At the FTC, the Bureau of Economics features about 70 Ph.D.-level economists (although they spend about a quarter of their time on consumer protection issues).<sup>20</sup> The bureau director is also usually a prominent academic economist, and it is typical to have an economist among the commissioners. Although there have been exceptions, including on the present commission, the commissioners historically have not been leading experts in their fields when appointed and have not stayed at the Commission long enough to acquire expertise.<sup>21</sup> In terms of overall expertise, there is no substantial difference between the FTC and Antitrust Division.

### 3. Legislative and Adjudicatory Character

As noted earlier, the key features that justified the independence of the FTC from the executive branch were supposedly that it was not merely another law enforcement agency, but that it instead had a legislative and adjudicatory character. However, this vision has been largely unrealized.

First, the FTC has never been an antitrust rule maker. Although the Commission has promulgated influential rules on the consumer protection side—the Cigarette Rule and the Do Not Call Registry, for example—it has published almost no antitrust rules.<sup>22</sup> Indeed, it has been discouraged from doing so. A 1989 ABA report on the FTC concluded that “we are not

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<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 13.

<sup>20</sup> *Id.*

<sup>21</sup> See Richard A. Posner, *The Federal Trade Commission: A Retrospective*, 72 ANTITRUST L. J. 761, 768 (2005).

<sup>22</sup> A 1989 ABA report found only one instance of the FTC promulgating an antitrust rule. *Report of the American Bar Association Section of Antitrust Law Special Committee to Study the Role of the Federal Trade Commission*, 58 ANTITRUST L. J. 43, 91 n.103 (1989).

optimistic about the chances that the FTC could codify antitrust-oriented prohibitions on specific types of business conduct.<sup>23</sup>

Second, although the Commission may adjudicate matters internally, it more often chooses to litigate in court instead. During the 1990s, for example, the FTC brought slightly more injunctive actions in district court than it did administrative actions.<sup>24</sup> Thus, while the FTC enjoys the flexibility of choice, it often chooses the conventional law enforcer route—in which capacity it is essentially identical to the Antitrust Division.

Further, it is unclear how much real adjudication is happening in administrative proceedings at the FTC—if we assume that adjudication means a true contest over evidence before an impartial tribunal. The FTC’s enforcement staff enjoy tremendous success in adjudication at the Commission level. One study found that between 1983 and 2008 the staff won all 16 cases adjudicated by the Commission.<sup>25</sup> This does not necessarily translate into ultimate victory for the Commission, since the courts of appeal have not been shy about reversing Commission decisions. The Commission faces better prospects on appeal if it has won in a district court proceeding than if it has found liability through an administrative proceeding, which explains the Commission’s preference to litigate cases in court.

#### 4. Cooperative Partnership with Justice Department

Finally, despite Congress’s intention that the two agencies collaborate in antitrust enforcement, the statutory provisions encouraging such collaborations have been seldom used. In a 1962 letter to the chairman of the FTC, referring a decree matter to the FTC under Section 6(c),

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<sup>23</sup> *Id.*

<sup>24</sup> According to a tally from the FTC’s annual reports, during the 1990–1998 period, the FTC brought thirty-one administrative complaints and thirty-three district court actions.

<sup>25</sup> A. Douglas Melamed, *The Wisdom of Using the “Unfair Methods of Competition” Prong of Section 5*, COMPETITION POLICY INTERNATIONAL (Nov. 2008). The study Melamed cites found that the respondents won 4 of the 16 cases before the Administrative Law Judge, but then lost those cases before the Commission.

the Attorney General stated the section had been “virtually unused since its enactment in 1914,”<sup>26</sup> and the neglect of 6(c) has continued since that time. The antitrust agencies collaborate to the extent of figuring out how to divide responsibility and issuing joint guidelines on certain topics, but they do jointly enforce the antitrust laws on the same matters, as contemplated by Congress.

### III. The FTC as a Law Enforcement Agency

Despite the original Congressional design, on competition matters the FTC is not a legislative body, is not primarily an adjudicatory body, is not uniquely expert on antitrust matters, and does not play the collaborative role with Justice Department that Congress wrote into the FTC Act. Rather, the FTC is primarily a law enforcement agency that enforces antitrust norms created by the courts on equal terms with the Justice Department, state attorneys general, and private plaintiffs. The question thus arises as to why maintain the FTC’s antitrust enforcement role. More specifically, why should the federal government continue to fund two separate antitrust agencies that perform essentially the same executive law enforcement function? In recent years, the trend in other countries (like Brazil, France, and Portugal, for example) has been toward consolidating antitrust enforcement in a single agency, and thus eliminating the duplication costs, jurisdictional battles, and uncertainty for the business community that can arise from multiple agencies.

In 2007, the bipartisan, congressionally appointed Antitrust Modernization Commission released an evaluative report on the entire gambit of modern antitrust law. Among other things, the twelve members of the Commission considered whether dual federal enforcement should continue. Three of the twelve—including two former heads of the Antitrust Division—voted to recommend abolishing the FTC’s antitrust enforcement authority and vesting

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<sup>26</sup> *U.S. v. Int’l Nickel Co. of Can.*, 203 F.Supp. 739 (S.D.N.Y. 1962)

responsibility for all antitrust enforcement with the Justice Department.<sup>27</sup> But the majority recommended retaining the dual-enforcement structure.

The reasons for retaining dual enforcement are largely conservative and prudential. Although the FTC may not be functioning as the agency that Congress designed it to be, it is by and large an effective law enforcement agency today. One cannot be sure what would happen if antitrust enforcement were consolidated in a single agency, and since there is no pressing problem with federal antitrust enforcement, its basic structure should be retained. To put it colloquially, if it ain't broke, don't fix it.

The one hundredth anniversary of the FTC is an opportune time for reflecting on whether this conservative and prudential wisdom is sound, or whether it is simply the path of least resistance. However, since there appears to be little political appetite for a wholesale reexamination of the institutional structure of antitrust enforcement, I will close by suggesting four relatively modest measures that could be implemented to better integrate the modern functioning of the FTC and Antitrust Division in light of the FTC's law enforcement role. The first could be accomplished without Congressional intervention. The next three would likely require new legislation.

#### IV. Four Modest Recommendations for Modernization

##### A. Promulgating Guidelines for Section 5 Enforcement

In recent years, the scope of the FTC's power to enjoin "unfair methods of competition" under Section 5 of the FTC Act has been one of the most frequently discussed and controversial topics with respect to the FTC's competition mission. The Supreme Court has held that Section 5 reaches all conduct prohibited by the Sherman Act and goes even further to allow the FTC to reach conduct not yet illegal under the Sherman Act but nonetheless posing a threat

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<sup>27</sup> Antitrust Modernization Commission, Report and Recommendations II.A at 129 (footnote).

to competition.<sup>28</sup> Despite this recognition of the FTC's prophylactic authority under Section 5, there are few, if any, litigated cases in the last several decades in which the FTC has successfully invoked Section 5 as to conduct not covered by the Sherman Act.

Several Commissioners and many antitrust practitioners have recently raised the need for the Commission to issue guidelines concerning the scope of Section 5. In my view, the Commission should issue such guidelines, although not necessarily for the reasons suggested by others. Some commentators have suggested that the Commission should issue guidelines in order to provide greater notice and predictability for the business community. Although such guidance might be provided on particular types of competitive practices (such as patent settlements or participation in standard-setting organizations), I am skeptical that the kinds of broad guidelines under consideration would help businesses better to plan their activities. Rather, the value of such guidelines would obtain primarily from enhancing judicial review of Commission decisions. Although guidelines issued by the Commission may not be legally binding, they can provide a set of principles that can be invoked initially before the Commission and ultimately in court to limit the Commission's discretion.<sup>29</sup> Given that the FTC acts principally as a law enforcement agency rather than as a legislative or judicial body, it is important that it be constrained by principles announced in advance that can be fairly contested in litigation and ultimately resolved by the courts.

#### B. Aligning the Preliminary Injunction Standard in Merger Cases

Under Section 13(b) of the FTC Act, the FTC receives greater deference than the Justice Department when seeking to block a merger in district court in order thereafter to initiate

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<sup>28</sup> *FTC v. Brown Shoe Co.*, 348 U.S. 316, 322 (1966).

<sup>29</sup> For example, courts frequently rely on the Horizontal Merger Guidelines in assessing FTC and Justice Department merger challenges. See Hillary Greene, *Guideline Institutionalization: The Role of Merger Guidelines in Antitrust Discourse*, 48 Wm. & Mary L. Rev. 771 (2006).

administrative proceedings. Courts have interpreted Section 13(b) as creating a presumption that the Commission will be accorded a preliminary injunction so long as it raises “serious, substantial, difficult, and doubtful” issues about the merger.<sup>30</sup> By contrast, in order to secure a preliminary injunction against an anticompetitive merger, the Justice Department must meet the traditional preliminary injunction standard, including proving a substantial likelihood of success on the merits and irreparable harm.

Solicitude to the FTC’s position as an independent agency with “quasi-adjudicatory” powers might make sense if the FTC had a fundamentally different role than the Justice Department in merger cases, but it does not. Both agencies act functionally as law enforcement agencies executing legal rules created by Congress and the courts. Whether a merger case ends up before the Justice Department or FTC has nothing to do with the complexity of the case or whether it has features making it particularly suitable for administrative or executive handling. It turns on whether the Justice Department or FTC happens to be the usual custodian of the relevant industry. For example, if the relevant industry is computer software the Justice Department takes charge but if it is computer hardware the FTC takes charge. There is no logical reason that the FTC should have an easier time getting a preliminary injunction in a hardware case than the Justice Department does in a software case. Given that preliminary injunctions are often dispositive in merger challenges, this difference in the preliminary injunction standard means that the FTC has an arbitrary advantage in blocking mergers in the industries over which it holds sway. Congress could remedy this anomaly by passing legislation establishing a single preliminary injunction standard for both the FTC and Justice Department.

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<sup>30</sup> *FTC v. Whole Foods, Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008) (citation omitted).

### C. Allowing Formal Division of Authority

As noted earlier, the idea that the agencies will play a cooperative role in investigating and prosecuting antitrust cases has not materialized. Instead, the agencies informally allocate enforcement based on their experience with particular industries. It is often not obvious in advance which agency will end up taking a particular case. Particularly in the merger context, where the Hart-Scott-Rodino Act's premerger notification clock is running, delay in identifying which agency will be responsible for reviewing a merger can be costly.

In 2002, the FTC and Justice Department entered into a formal Memorandum of Agreement allocating merger enforcement by industrial segment.<sup>31</sup> Thus, for example, the FTC was to investigate computer hardware, energy, health care, retail stores, pharmaceuticals, and professional services, and the Antitrust Division was to investigate agriculture, computer software, financial services, media and entertainment, telecommunications, and travel. Unfortunately, the agencies ultimately had to withdraw their agreement under pressure from Congress.<sup>32</sup> An opportunity for greater clarity and transparency in the allocation of authority between the two agencies was lost.

Although the agencies do not require statutory authority to allocate their workload informally, given that Congressional pressure was responsible for the collapse of their 2002 agreement, some Congressional involvement in encouraging the agencies to undertake such an effort again is desirable.

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<sup>31</sup> See Memorandum of Agreement Between the Federal Trade Commission and the Antitrust Division of the United States Department of Justice Concerning Clearance Procedures for Investigations (March 5, 2002), available at <http://www.ftc.gov/opa/2002/02/clearance/ftcdojagree.pdf>.

<sup>32</sup> Lauren Kearney Peay, Note, *The Cautionary Tale of the Failed 2002 FTC/DOJ Merger Clearance Accord*, 60 Vand. L. Rev. 1307, 1333-38 (2007).

#### D. Preventing Appellate Forum Shopping by Defendants

Under the current appellate review statute, which dates back to the Commission's founding in 1914, a losing defendant may appeal the Commission's order "within any circuit where the method of competition or act or practice in question was used or where such person, partnership, or corporation resides or carries on business."<sup>33</sup> What this unique appellate review statute means, in effect, is that a large corporate defendant doing business throughout the United States can choose any of the twelve federal courts of appeal (not including the specialized Court of Appeals for the Federal Circuit) in which to lodge its appeal. This means that large corporate defendants always have the advantage of litigating in the shadow of the most sympathetic appellate court in the nation and can shape their defenses accordingly.

The appellate forum shopping that this creates is particularly problematic in light of the fact that the Supreme Court has been relatively uninterested in antitrust cases, in general, and FTC cases, in particular, in the last four decades. During the 1960s, the FTC sought certiorari on substantive antitrust issues fifteen times, and the Supreme Court granted certiorari in eleven of those cases. Since the 1960s, the FTC has filed thirteen certiorari petitions in antitrust cases and has been granted Supreme Court review only six times. Given current odds, the FTC knows that it is likely that the appellate court selected by the defendant will have the final say in the case. This problem could be addressed by a statutory reform requiring the defendant to lodge its appeal in a particular court—for example the U.S. Court of Appeals for the D.C. Circuit or in jurisdiction of the defendant's principal place of business.

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<sup>33</sup> 15 U.S.C. § 45(c).

Mr. TERRY. Well timed. Mr. Manne, you are now recognized for your 5 minutes.

**STATEMENT OF GEOFFREY MANNE**

Mr. MANNE. Thank you, Chairman Terry, Ranking Member Schakowsky, and members of the committee. Thanks for the opportunity to testify today. The FTC does much very well. Compared to other regulatory agencies, it is frankly a paragon of restraint and economic analysis. And this has long been true especially of its anti-trust enforcement disciplined by the courts and internal practice.

Not so much so for the commission's ambiguous and somewhat cavalier use of Section 5. The FTC's essential dilemma is clear. Very often, the challenged practice could either harm or help consumers or both. Everyone agrees that wrongly deterring the helpful can be just as bad as failing to deter the harmful. Indeed, sometimes it may be much worse.

So, principled restraint is key to ensuring the FTC actually protects consumers. Restraint requires two things; objective economic analysis and transparent decisions reviewable by the courts. Both are increasingly lacking at the FTC. Consider the recent Nielsen-Arbitron merger. The FTC imposed structural conditions claiming the merger would lessen competition in the market for national syndicated cross-platform audience measurement services. You will be forgiven for not knowing that market existed because it doesn't exist. The majority presumed to predict the future business models and technologies of these companies. They assumed the merger would also reduce competition in this hypothetical future market. That is an economic question.

As Commissioner Wright noted in his dissent, without rigorous economics, non-economic considerations, intuition, and policy preferences may guide enforcement. That will hardly benefit consumers. Economics' fundamental lesson is humility, how little we know about the future, indeed how little we understand about markets at the present. Economics is a powerful tool for understanding that, but it isn't perfect.

But increasingly, major policy decisions increasingly rest on theoretical ideas or non-economic evidence about what companies intended to do, not actual effects, or the economics is missing entirely.

Perhaps Nielsen is in outlier. In its Sherman and Clayton Act cases, the FTC and the staff usually do apply economic reasoning and are appropriately humble. Interestingly, of course, those cases often come or almost always come before courts. Not so in pure Section 5 cases.

The term "unfair methods of competition" is, as Commissioner Wright has put it, as broad or as narrow as the majority of the commissioners believes it is. The commission has issued no limiting principles unlike its two policy statements on consumer protection. There is broad agreement that such guidelines would be helpful, an overwhelming agreement that the UMC, the Unfair Methods Competition, should be limited at minimum to cases where there is consumer harm.

The chairman even seems to agree, and yet with two proposals from sitting commissioners, the chairman continues to resist. Her argument boils down to maximizing the FTC's discretion. Excess discretion is the problem at the FTC. The FTC has pushed the boundaries of the law through consent agreements with essentially no judicial oversight. And the problem is most acute in consumer protection.

First let me say that in consumer protection cases, the large majority of them are uncontroversial and require no methodological overhaul. Deception cases like fraud or placing unauthorized charges are usually straightforward, but the FTC is increasingly dealing with more difficult cases and increasingly it is using its unfairness authority and stretching its deception authority in exercises of unchecked and opaque discretion to determine when ambiguous conduct harms consumers.

The recent Apple case highlights the problem. The FTC concluded that Apple's design of its billing interface insufficiently disclosed to iTunes users when their kids, not Apple, might make charges. Apple left parents' accounts open to make more purchases for a brief window to balance convenience for all users with unauthorized charges by children.

The economic framework to decide the case correctly was built right into the statute, but still it didn't make it into the majority's decision. Section 5N says nothing is unfair under the act if the harm it causes is outweighed by countervailing benefits to consumers or to competition. So you would expect an unfairness case against Apple to balance harms and benefits. Instead the majority treats Apple's design decisions like cramming and assumes there is no redeeming benefit through its design.

But as any user of Apple products can attest, design is everything. Apple faces real tradeoffs here about exactly how and when to notify customers that they may be charging themselves. The FTC simply dismissed the countervailing benefits that the statute clearly requires it to weigh.

The same is true of the agency's privacy and data security cases. It is not clear what is really best for consumers. Of course, stolen data can harm consumers but so can spending too much protecting against it or limiting otherwise desirable product features.

The outcome of the Apple case was possible only because it never went before a judge. It was just a settlement. The only balancing the commission had to do was to convince Apple to settle instead of litigate. That does not fulfill the commission's statutory balancing obligation. The majority pushed the law as far as it could without Apple baulking. Apple just wanted the case to go away. Beyond a certain point, it didn't care anymore how or whether the FTC justified its decision. It is refreshing that Commissioner Wright dissented in this case. It forced the majority to at least mount a defense that was not embarrassing. But this is a much lower bar than what the court would require.

Is there was any question at all that if more of these cases were coming before a court, dissents like Commissioner Wright's could become the blueprint for a court to potentially overrule the majority. We would have better cases, better dissents, and better argued majority opinions. I would stop there. Thank you very much.

[The prepared statement of Mr. Manne follows:]



**Humility, Institutional Constraints and Economic Rigor:  
Limiting the FTC's Discretion**

Prepared Testimony of

**Geoffrey A. Manne**

Executive Director,  
International Center for Law & Economics

On

*The FTC at 100: Views from the Academic Experts*

Before the

United States House of Representatives  
Committee on Energy and Commerce,  
Subcommittee on Commerce, Manufacturing, and Trade

Washington, D.C.

February 28, 2014

## Humility, Institutional Constraints and Economic Rigor: Limiting the FTC's Discretion

*Geoffrey A. Manne, International Center for Law & Economics*

### I. Introduction

*This Testimony is drawn from ICLE White Paper 2014-01, "Humility, Institutional Constraints and Economic Rigor: Limiting the FTC's Discretion." The full report is attached as an Exhibit to this Testimony.*

In 1914, Congress gave the FTC sweeping jurisdiction and broad powers to enforce flexible rules to ensure that it would have the ability to serve as the regulator of trade and business that Congress intended it be. Much, perhaps even the great majority, of what the FTC does is uncontroversial and is widely supported, even by critics of the regulatory state. However, both Congress and the courts have expressed concern about how the FTC has used its considerable discretion in some areas.

Now, as the agency approaches its 100<sup>th</sup> anniversary, the FTC, courts, and Congress face a series of decisions about how to apply or constrain that discretion. These questions will become especially pressing as the FTC uses its authority in new ways, expands its authority into new areas, or gains new authority from Congress.

The FTC oversees nearly every company in America. It polices competition by enforcing the antitrust laws. It tries to protect consumers by punishing deception and practices it deems "unfair." It's the general enforcer of corporate promises made in privacy policies and codes of conduct generated by industry and multistakeholder processes. It's the *de facto* regulator of the media, from traditional advertising to Internet search and social networks. It handles novel problems of privacy, data security, online child protection, and patents, among others. Even Net neutrality may soon wind up in the FTC's jurisdiction.

#### A. The Federal *Technology* Commission

But perhaps most importantly, the Federal Trade Commission has become, for better or worse, the Federal *Technology* Commission, and technology creates a special problem for regulators.

Inherent limitations on anyone's knowledge about the future nature of technology, business and social norms caution skepticism as regulators attempt to predict whether any

given business conduct will, on net, improve or harm consumer welfare. In fact, a host of factors suggests that even the best-intentioned regulators may tend toward over-confidence and the erroneous condemnation of novel conduct that benefits consumers in ways that are difficult for regulators to understand.<sup>1</sup>

At the same time, business generally succeeds by trial-and-error more than theoretical insights or predictive power,<sup>2</sup> and over-regulation thus risks impairing experimentation, an essential driver of economic progress. As a consequence, doing nothing may sometimes be the best policy for regulators, and limits on regulatory discretion to act can be of enormous importance.<sup>3</sup>

One thing is certain – a top-down, administrative regulatory model of regulation is ill-suited for technology, and this technocratic model of regulation is inconsistent with the regulatory humility required in the face of fast-changing, unexpected – and immeasurably valuable – technological advance:

Technocrats are “for the future,” but only if someone is in charge of making it turn out according to plan. They greet every new idea with a “yes, but,” followed by legislation, regulation, and litigation.... By design, technocrats pick winners, establish standards, and impose a single set of values on the future.<sup>4</sup>

## B. Economics at the FTC

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<sup>1</sup> See, e.g., Ronald H. Coase, *Industrial Organization: A Proposal for Research*, in ECONOMIC RESEARCH: RETROSPECT AND PROSPECT VOL. 3: POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION (Victor R. Fuchs, ed. 1972), available at <http://www.nber.org/chapters/c7618.pdf>; Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984); Geoffrey A. Manne & Joshua D. Wright, *Innovation and the Limits of Antitrust*, 6 J. COMPETITION L. & ECON. 153 (2010).

<sup>2</sup> See Armen Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950).

<sup>3</sup> As Nobel Laureate economist Ronald Coase put it, “direct governmental regulation will not necessarily give better results than leaving the problem to be solved by the market or the firm. But equally there is no reason why, on occasion, such governmental administrative regulation should not lead to an improvement in economic efficiency.... There is, of course, a further alternative which is to do nothing about the problem at all.” Ronald H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1, 18 (1960).

<sup>4</sup> VIRGINIA POSTREL, *THE FUTURE AND ITS ENEMIES* (1998).

The most important, most welfare-enhancing reform the FTC could undertake is to better incorporate sound economic- and evidence-based analysis in both its substantive decisions as well as in its process.

While the FTC has a strong tradition of incorporating economic analysis in its antitrust decision-making, its record in using economics in other areas is mixed. Meanwhile, a review of some recent decisions at the agency suggests that the Commission is perhaps becoming even less consistent in its application of economic principles.

Joshua Wright, the first JD/Econ PhD appointed to the FTC, has produced in his first year at the agency a set of speeches, statements and dissents that offer a steadfast baseline of economic analysis against which to assess the Commission's recent work. For Wright,

economics provides a framework to organize the way I think about issues beyond analyzing the competitive effects in a particular case, including, for example, rulemaking, the various policy issues facing the Commission, and how I weigh evidence relative to the burdens of proof and production. Almost all the decisions I make as a Commissioner are made through the lens of economics and marginal analysis because that is the way I have been taught to think.<sup>5</sup>

In what follows I discuss Commissioner Wright's work at the FTC and its relentless economic approach extensively. Congress should work to ensure that the rest of the agency follows his lead.

## II. Themes

In assessing the FTC, three themes emerge as being crucial to the agency's continued success: humility, institutional structure, and economic rigor. Together these three elements serve the essential function of restraining this powerful agency's discretion.

### A. Humility

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<sup>5</sup> Interview with Joshua Wright, FTC Commissioner, ABA Antitrust Section, Economic Committee Newsletter, Winter 2014, vol. 13, p. 6, *available at* [http://www.americanbar.org/content/dam/aba/publications/antitrust\\_law/at308000\\_newsletter\\_2014winter.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/antitrust_law/at308000_newsletter_2014winter.authcheckdam.pdf).

It's hard enough to predict what the future will look like as a descriptive matter. It is another matter entirely to assess what the net competitive effects will be of the unpredictable interplay of innumerable (and often unknowable) forces in a complex economy. Regulators should be reluctant to intervene in markets – and well-designed regulatory systems will constrain their discretion to do so. When they do intervene they should do so only where clear economic evidence indicates actual competitive harm or its substantial likelihood.

In competition cases, the FTC generally follows this prescription and the interplay between the agency and the courts (among other things) serves to restrain regulators' sometimes irresistible urge to "just do something." But there are exceptions. The FTC's consent agreement in the recent *Nielsen/Arbitron* merger is an acute example. And among consumer protection cases, the FTC's recent *Apple* case stands out for its hubris in substituting the FTC's judgment for that of a private firm's design decisions.

Regulatory restraint and economic rigor are closely linked: In many instances appropriate economic analysis will demonstrate the counter-productivity of intervention – and in others the absence of clear economic justification for intervention will preclude it. Respect for the power of the economic tools used in the FTC's daily practice leads inexorably to respect for the limits of the regulator's knowledge.

Of course restraint is not the regulator's natural condition. Rather, the regulator's inclination – in fact, his very job – is to regulate. This inclination on the regulator's part is compounded by the fact that, as the Nobel laureate economist, Ronald Coase, explained:

If an economist finds something – a business practice of one sort or another – that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be very large, and the reliance on a monopoly explanation, frequent.<sup>6</sup>

In this way economics is not without limits, of course, which is why humility – restraint – is so important.

And, to be sure, the FTC could no doubt undertake a plethora of ill-advised, unrestrained actions from which it, instead, forebears. In this regard the agency has set the bar fairly high. But several recent examples of regulatory overreach – of agency action in the face of

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<sup>6</sup> Coase, *Industrial Organization*, *supra* note 1.

clear economic evidence counseling against it, or in the absence of economic justification in its favor – may signify a surfeit of hubris and may portend a less-restrained Commission.

1. The Nielsen/Arbitron Merger Review

In *Nielsen* Commissioner Wright wrote a powerful and important dissent<sup>7</sup> from the FTC's 2-1 decision<sup>8</sup> to impose conditions on the acquisition. Essential to Wright's dissent was the absence of any actual, existing relevant market supporting the Commission's challenge:

The Commission thus challenges the proposed transaction based upon what must be acknowledged as a novel theory—that is, that the merger will substantially lessen competition in a market that does not today exist.

[W]e...do not know how the market will evolve, what other potential competitors might exist, and whether and to what extent these competitors might impose competitive constraints upon the parties.<sup>9</sup>

Commissioner Wright's straightforward statement of the basis for restraint stands in marked contrast to the majority's decision to impose antitrust-based limits on economic activity *that hasn't even yet been contemplated*. Such conduct is directly at odds with a sensible, evidence-based approach to enforcement, and the economic problems with it are considerable, as Commissioner Wright notes:

[I]t is an exceedingly difficult task to predict the competitive effects of a transaction where there is insufficient evidence to reliably answer the[] basic questions upon which proper merger analysis is based.

When the Commission's antitrust analysis comes unmoored from such fact-based inquiry, tethered tightly to robust economic theory, there is a more significant risk that non-economic considerations, intuition, and policy preferences influence the outcome of cases.<sup>10</sup>

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<sup>7</sup> In the Matter of Nielson Holdings N.V. and Arbitron, Inc. (Sep. 20, 2013), <http://www.ftc.gov/os/caselist/1310058/130920nielsenarbitron-jdwstmt.pdf> (Commissioner Wright, dissenting) [hereinafter "*Nielsen* Dissent"].

<sup>8</sup> Complaint & Consent, In the Matter of Nielson Holdings N.V. and Arbitron, Inc. (Jan. 24, 2014), <http://www.ftc.gov/os/caselist/1310058/index.shtm>.

<sup>9</sup> Wright, *Nielsen* Dissent, *supra* note 8, at 5-6.

<sup>10</sup> Wright, *Nielsen* Dissent, *supra* note 8, at 2, 3.

As Wright notes, facts are essential – but they are not enough. Particularly when predicting future economic effects, proper, restrained application of *economic rigor* to the facts is also essential. And, as noted above, this entails a recognition of the limits of the regulator's ability not only to *describe* the future, but also to understand its competitive significance.

Compare in this regard Commissioner's Wright's words about *Nielsen* with those of Deborah Feinstein, the FTC's current Director of the Bureau of Competition:

The Commission based its decision not on crystal-ball gazing about what might happen, but on evidence from the merging firms about what they were doing and from customers about their expectations of those development plans. From this fact-based analysis, the Commission concluded that each company could be considered a likely future entrant, and that the elimination of the future offering of one would likely result in a lessening of competition.<sup>11</sup>

Instead of requiring rigorous economic analysis of the facts, for Feinstein the FTC fulfilled its obligation in *Nielsen* by considering the "facts" alone (not *economic evidence*, mind you, but customer statements and expressions of intent by the parties) and then, at best, casually applying to them the simplistic, outdated structural presumption – the conclusion that increased concentration would lead inexorably to anticompetitive harm.

This mode of analysis underestimates the fragility of factual predictions about the future and elevates the resulting, faux descriptive clarity when it should be emphatically questioning it with more, not less, rigorous economic analysis.

## 2. The *Apple* Case

The FTC's recent complaint and consent agreement with Apple highlights these issues, and, again, Commissioner Wright's scathing dissent ably identifies where and how the agency deviated from sensible restraint.

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<sup>11</sup> Deborah L. Feinstein, *The Forward-Looking Nature of Merger Analysis*, Speech given at Advanced Antitrust U.S. (2014), available at [http://www.ftc.gov/system/files/documents/public\\_statements/forward-looking-nature-merger-analysis/140206mergeranalysis-dlf.pdf](http://www.ftc.gov/system/files/documents/public_statements/forward-looking-nature-merger-analysis/140206mergeranalysis-dlf.pdf).

The application of Section 5's "unfair acts and practices" prong (the statute at issue in *Apple*) is circumscribed by Section 45(n) of the FTC Act, which, among other things, proscribes enforcement where injury is "not outweighed by countervailing benefits to consumers or to competition."<sup>12</sup>

The majority in the *Apple* decision, although tasked with applying 45(n)'s "countervailing benefits" balancing test, failed to do so, instead assuming without proving that the benefits of *Apple's* challenged conduct was \$0:

The Commission effectively rejects an analysis of tradeoffs between the benefits of additional guidance and potential harm to some consumers or to competition from mandating guidance.... I respectfully disagree. These assumptions adopt too cramped a view of consumer benefits under the Unfairness Statement and, without more rigorous analysis to justify their application, are insufficient to establish the Commission's burden.<sup>13</sup>

That such a balancing was absent from the majority's decision in *Apple* reflects not only a dereliction of a legal obligation by the Commission, but also the subversion of sensible economic analysis. As Commissioner Wright notes:

The Commission... substitutes its own judgment for a private firm's decisions as to how to design its product to satisfy as many users as possible, and requires a company to revamp an otherwise indisputably legitimate business practice. Given the apparent benefits to some consumers and to competition from *Apple's* allegedly unfair practices, I believe the Commission should have conducted a much more robust analysis to determine whether the injury to this small group of consumers justifies the finding of unfairness and the imposition of a remedy.<sup>14</sup>

What's particularly notable about the *Apple* case - and presumably will be in future technology enforcement actions predicated on unfairness - is the unique relevance of the attributes of the conduct at issue to its product. Unlike past, allegedly similar, cases, *Apple's* conduct was not aimed at deceiving consumers, nor was it incidental to its product offering. But by challenging the practice, particularly without the balancing of harms required by Section 5, the FTC majority failed to act with restraint and substituted its own

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<sup>12</sup> 15 U.S.C. §45, <http://www.law.cornell.edu/uscode/text/15/45>.

<sup>13</sup> Wright *Apple* Dissent, *supra* note 14 at 11-12, 13.

<sup>14</sup> *Id.* at 14

judgment, not about some manifestly despicable conduct, but about the very design of Apple's products. This is the sort of area where regulatory humility is more – not less – important.

In failing to observe common sense limits in *Apple*, the FTC set a dangerous precedent that, given the agency's enormous regulatory scope and the nature of technologically advanced products, could cause significant harm to consumers:

Establishing that it is “unfair” unless a firm anticipates and fixes such problems in advance – precisely what the Commission's complaint and consent order establishes today – is likely to impose significant costs in the context of complicated products with countless product attributes. These costs will be passed on to consumers and threaten consumer harm that is likely to dwarf the magnitude of consumer injury contemplated by the complaint.<sup>15</sup>

#### **B. Institutional Structure and the Role of the Courts**

The FTC's tradition of applying sound economics didn't come solely from within the agency. Rather, its emergence as the touchstone of antitrust enforcement and adjudication is a product in significant part of the influence of courts on the agency (as well as of the influence of a few exceptional former FTC Chairmen). As judges became increasingly sophisticated about economics, they began to demand such sophistication of the parties that appeared before them, including the FTC. This interplay between the courts and the agency is essential to imparting valuable information to both the agency and the courts – and, perhaps more significantly, to the business community. And thus the oft-repeated claims that the FTC's data security or privacy consent orders, for example, amount to a “common law” miss the mark in several crucial respects.

For the most part, and generally in competition issues, the FTC's model is an evolutionary, rather than regulatory, one. The agency learns from, and adapts to, the ever-changing technological and business environments. While the FTC's own information gathering and analytical resources and talents are prodigious, the ongoing give and take with the courts is central to this dynamic and to ensuring that the agency furthers this evolution rather than impedes it.

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<sup>15</sup> *Id.* at 16.

At the same time the FTC's internal constraints – from guidelines to interpersonal relationships to reputational concerns – can impose important limits on the agency's broad discretion.

1. Guidelines: Unfair Methods of Competition

Among the agency's activities, the issuing of guidelines, policy statements, advisory letters and the like regarding its own authority is unique in that these tend to *restrain* the scope of the agency's discretion rather than expand it. Other than increased judicial oversight (or legislated jurisdictional limitations), such guidance may be the most effective procedural tool for cabining agency discretion.

But Section 5 enforcement standards in the unfairness context are essentially non-existent.

Former Chairman Leibowitz and former Commissioner Rosch, in particular, have, in several places, argued for an expanded use of Section 5, both as a way around judicial limits on the scope of Sherman Act enforcement, as well as an affirmative tool to enforce the FTC's mandate.<sup>16</sup> But it's hard not to see in the argument an effort to expand the scope of the agency's discretion. "In practice..., the scope of the Commission's Section 5 authority today is as broad or as narrow as a majority of the commissioners believes that it is."<sup>17</sup>

Similarly, as Commissioner Ohlhausen put it in her dissent in *In re Bosch*, "I simply do not see any meaningful limiting principles in the enforcement policy laid out in these cases...the Commission should fully articulate its views.... Otherwise, the Commission runs a serious risk of failure in the courts and a possible hostile legislative reaction...."<sup>18</sup>

Commissioner Wright's Proposed Statement on UMC enforcement attempts to remedy these defects, and, in the process, explains why the Commission's previous, broad

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<sup>16</sup> See, e.g., In the Matter of Negotiated Data Solutions LLC., Statement of the Commission at 3, available at <http://www.ftc.gov/os/caselist/0510094/080122statement.pdf>.

<sup>17</sup> Joshua Wright, *Section 5 Recast: Defining the Federal Trade Commission's Unfair Methods of Competition Authority* (Jun. 19, 2013), available at [http://www.ftc.gov/sites/default/files/documents/public\\_statements/section-5-recast-defining-federal-trade-commissions-unfair-methods-competition-authority/130619section5recast.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/section-5-recast-defining-federal-trade-commissions-unfair-methods-competition-authority/130619section5recast.pdf).

<sup>18</sup> In the Matter of Robert Bosch GmbH, FTC File No. 121-0081 (Commissioner Ohlhausen, dissenting), available at [http://www.ftc.gov/sites/default/files/documents/public\\_statements/statement-commissioner-maureen-ohlhausen/121126boschohlhausenstatement.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-maureen-ohlhausen/121126boschohlhausenstatement.pdf) at 3-4.

applications of the statute are not, in fact, appropriate. His draft statement, along with the policy speech in which he introduced it,<sup>19</sup> present a compelling and comprehensive vision for Section 5 UMC reform at the Commission.

In much of its consumer protection practice, the Commission hasn't developed a predictable set of legal doctrines because that's what courts do – and the FTC has managed to convince dozens of companies to settle out of court, even when the challenged conduct was novel and/or the agency's case thin. Instead,

[t]he Commission must formulate a standard that distinguishes between acceptable business practices and business practices that constitute an unfair method of competition in order to provide firms with adequate guidance as to what conduct may be unlawful. Articulating a clear and predictable standard for what constitutes an unfair method of competition is important because the Commission's authority to condemn unfair methods of competition allows it to break new ground....<sup>20</sup>

What some at the FTC call its "common law of consent decrees" is really just a series of unadjudicated assertions. That approach is just as top-down and technocratic as the FCC's regulatory model, but with little due process and none of the constraints of detailed authorizing legislation or formal rulemakings.

## 2. Data Security Cases

Through a string of more than 50 UDAP enforcement actions over the last decade, the FTC has policed how American companies protect user data. And while the courts have been adjudicating similar (and sometimes the same) cases in parallel, the two have rarely had occasion to meet.

Although some have argued that the agency's data security complaints, consent orders, speeches and Congressional testimony collectively provide sufficient guidance to business, the lack of more-formal guidelines is notable.<sup>21</sup> Moreover, this set of guiding materials is

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<sup>19</sup> See Wright, *Section 5 Recast*, *supra* note 17.

<sup>20</sup> Joshua Wright, *Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act*, at 9 (Jun. 19, 2013), available at [http://www.ftc.gov/sites/default/files/documents/public\\_statements/statement-commissioner-joshua-d.wright/130619umcpolicystatement.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-joshua-d.wright/130619umcpolicystatement.pdf).

<sup>21</sup> Some have further argued, in fact, that that the threat of action through speeches, reports and the like is preferable to more concrete statements or guidelines because they are even more

notably lacking any direct discussion of the reasons data security investigations are closed (and none are likely to appear in the near future given a relatively new, informal policy strongly disfavoring such explanations).<sup>22</sup>

To the extent that the FTC's approach has, in fact, become a "strict liability" rule, presuming that any loss of data is *per se* proof that a company's data security practices were unreasonable, there is no evidence that the inherent trade-offs this entails between increased administrability and economic rigor, or between preventing consumer injury and imposing costs on businesses that are ultimately born by consumers, is actually desirable. *How* the FTC weighs those trade-offs may be as important as the substantive conclusion of that process.

In practice, the FTC brings data security cases (under both Deception and Unfairness) based on the alleged "unreasonableness" of a respondent's security practices. But it does so without addressing the actual Section 5 elements (materiality, substantial injury, etc.) and even without connecting them to the unreasonableness standard that the FTC employs in lieu of the statutory language.

There are further problems. In cases where the agency does act, the FTC's complaints describe numerous potential problems but offer few insights into which ones were particularly important to the FTC's decision to bring an enforcement action. Such lack of guidance could even violate judicial requirements that agencies must, to satisfy constitutional standards of due process, provide "fair notice" of their policies.<sup>23</sup>

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flexible. *See, e.g.*, Tim Wu, *Agency Threats*, 60 DUKE L.J. 1841 (2011), available at <http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1506&context=dlj>.

<sup>22</sup> The FTC has issued very few closing letters on data security issues. None of them is particularly helpful. *See* FTC FOIA Request Response <on file with author>. Some of the letters are completely devoid of useful information. *See, e.g.*, Michaels Closing Letter (Jul. 26, 2012), available at [http://www.ftc.gov/sites/default/files/documents/closing\\_letters/michaels-stores-inc./120706michaelsstorescltr.pdf](http://www.ftc.gov/sites/default/files/documents/closing_letters/michaels-stores-inc./120706michaelsstorescltr.pdf). To the best of my knowledge, this was only "closing letter" regarding data security since 2009. That letter provides no details on the nature of the investigation or the reasons why it was closed. At the same time, some of the letters do, if briefly, lay out the FTC's basic reasoning, providing somewhat more helpful guidance. *See, e.g.*, Dollar Tree Letter Closing Letter (Jun. 5, 2007), available at [http://www.ftc.gov/sites/default/files/documents/closing\\_letters/dollar-tree-stores-inc./070605doltree.pdf](http://www.ftc.gov/sites/default/files/documents/closing_letters/dollar-tree-stores-inc./070605doltree.pdf).

<sup>23</sup> *See* Amici Curiae Brief of TechFreedom, International Center for Law and Economics & Consumer Protection Scholars at 6-12, *FTC v. Wyndham Worldwide Corp.*, No. 2:13-cv-01887 (D.N.J. Jun. 17,

Thus unmoored from the traditional oversight of our legal system, the FTC's data security cases and the enforcement rationales behind them represent the agency acting with little restraint. To the Commission's credit, no doubt its conduct could be much worse. But odds are we've yet to see the full extent of the FTC's exercise of its discretion in this area.

### 3. Consent Decrees

The Commission is able to ignore the statutory language, and can render decisions in data security cases with essentially no analysis, because its decisions are, as a practical matter, un-reviewed and un-reviewable by the courts.

In some areas of law, most notably privacy, data security and high-tech product design, the FTC operates almost entirely by settling enforcement actions in consent decrees. Consent decrees (with remarkably consistent 20-year terms that are seemingly unjustified by the equally *inconsistent* characteristics of the companies they govern), are also increasingly becoming a tool for informal policymaking, allowing the Commission to require individual companies to agree to things that are not required by law. This is particularly true in the high-tech sector and on evolving issues like privacy.

It is unclear what institutional limits exist on the FTC's discretion in setting the terms of its settlements and thus on its ability to make policy via consent decree, such as by requiring "privacy by design" or "security by design" or, in the case of Apple, "industrial design by the FTC's design."

The problem of the excessive use of consent decrees at the agency is exacerbated by its administrative procedures, which create a fundamental imbalance between the agency and the businesses it regulates, leading to heightened incentives for parties to settle. As Commissioner Wright highlighted in his *Nielsen* dissent:

Whether parties to a transaction are willing to enter into a consent agreement will often have little to do with whether the agreed upon remedy actually promotes consumer welfare....

Because there is no judicial approval of Commission settlements, it is especially important that the Commission take care to ensure its consents

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2013), available at [http://docs.techfreedom.org/Wyndham\\_Amici\\_Brief.pdf](http://docs.techfreedom.org/Wyndham_Amici_Brief.pdf) [hereinafter "Wyndham Amicus Brief"].

are in the public interest.<sup>24</sup>

The pseudo-common law of un-adjudicated settlements, lacking any doctrinal analysis developed under the FTC's unfairness authority, simply doesn't provide sufficient grounds to separate the fair from the unfair.<sup>25</sup>

Perhaps most significantly in this regard, the FTC's so-called "common law" decisions identify, at best, only what conduct in specific instances *violates* the law; they do not identify what conduct does *not* violate the law. Real common law, by contrast, provides insights into both – offering guidance to firms regarding not only specifically proscribed conduct but also the scope of conduct in which they may operate without fear of liability. Consent decrees tell us, for example, that "invitations to collude" and "deception in standard setting" are violations of Section 5. And thus they are potentially useful guidance for that conduct. But they tell us nothing to very little about the *next* type of conduct that will be prosecuted under Section 5.

Chairwoman Ramirez has claimed that:

Section 5 of the FTC Act has been developed over time, case-by-case, in the manner of common law. These precedents provide the Commission and the business community with important guidance regarding the appropriate scope and use of the FTC's Section 5 authority.<sup>26</sup>

But settlements (and testimony summarizing them) do not in any way constrain the FTC's subsequent enforcement decisions. They cannot alone be the basis by which the FTC provides guidance on its consumer protection authority because, unlike published guidelines, they do not purport to lay out general enforcement principles and are not recognized as doing so by courts and the business community.

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<sup>24</sup> Wright, *Nielsen* Dissent, *supra* note 8, at 6-7.

<sup>25</sup> See Wyndham Amicus Brief, *supra* note 23, at 6-7.

<sup>26</sup> Ramirez Questions for the Record, *Hearing before the S. Comm. on the Jud. Subcomm. on Antitrust, Competition Pol'y and Consumer Rights: "Oversight of the Enforcement of the Antitrust Laws"* (Apr. 16, 2013), available at <http://www.judiciary.senate.gov/resources/documents/113thCongressDocuments/upload/041613QFRs-Ramirez.pdf>. See also *Hearing before S. Comm. on the Jud. Subcomm. on Antitrust, Competition Pol'y and Consumer Rights: Standard Essential Patent Disputes and Antitrust Law* (statement of Federal Trade Commission, Jul. 30, 2013), available at <http://www.judiciary.senate.gov/pdf/7-30-13MunckTestimony.pdf>.

Moreover, because, as written, they are largely devoid of analysis, and because there is no third-party assessing the appropriateness of the FTC's process or substance, there is often no way to tell from this alleged "common law" whether the agency is even acting within the bounds of its authority. The *Apple* decision raises serious concerns in this regard, and it is apparent that the requisite economic analysis was simply absent in the majority's holding in that case.

Without Article III court decisions developing binding legal principles, and with no other meaningful form of guidance from the FTC, the law will remain vague – perhaps even unconstitutionally so.<sup>27</sup>

In the end,

[w]here the Commission has endorsed by way of consent a willingness to challenge transactions where it might not be able to meet its burden of proving harm to competition, and which therefore at best are competitively innocuous, the Commission's actions may alter private parties' behavior in a manner that does not enhance consumer welfare.<sup>28</sup>

In important ways the real work in Wright's Proposed Statement is done by the further limitation on UMC enforcement in cases where the complained-of practice produces cognizable efficiencies. In his framing it is not a balancing test or a rule of reason. It is a safe harbor for cases where conduct is efficient, regardless of its effect on competition otherwise.<sup>29</sup> In this way it represents an impressive (proposed) codification of error cost analysis, appropriately foreclosing entirely the riskiest and most costly mistakes of over-enforcement without foreclosing the availability of enforcement where it's more likely beneficial.

With Chairman Ramirez' recent speech at the George Mason Law Review Symposium on Antitrust Law, even she has essentially endorsed a "rule of reason" approach to Section 5 that requires a showing of harm to competition and a balancing of harms against benefits:

Our most recent Section 5 cases show that the Commission will condemn conduct only where, as with invitations to collude, the likely competitive harm outweighs the cognizable efficiencies. This is the same standard we

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<sup>27</sup> See Wyndham Amicus Brief, *supra* note 23, at 6-12.

<sup>28</sup> Wright, *Nielsen* Dissent, *supra* note 8, at 6-7

<sup>29</sup> See *Id.* at 10.

apply everyday in our investigations.<sup>30</sup>

While perhaps this admission doesn't go far enough, now all four currently sitting Commissioners have at least partially endorsed the idea of enumerated standards for Section 5 built on a fundamentally "rule of reason" approach. There is hope.

### C. The Constraints of Economic Rigor

One of the important lessons of economics in antitrust is that economic tools are uniquely capable (although still imperfectly so) of distinguishing competitive from anticompetitive conduct – the perennial challenge of (non-cartel) antitrust enforcement and adjudication. Non-economic evidence (so-called "hot docs," for example) can be counter-productive and can obscure rather than illuminate the competitive significance of challenged conduct. A rigorous adherence to economic principles and economic reasoning is essential if the FTC is to ensure that its interventions actually benefit consumers.

And, once again, the agency (at least in competition enforcement) has generally followed these principles. But not always. The Commission's recent *McWane* case, as well as a good deal of its conduct in data security and other cases arising out of its UDAP authority, are essentially unmoored from sensible economic principles.

The basic approach to analyzing competition concerns at the agency is the "error cost" framework. Such a framework seeks to balance the potential harms of false positives (erroneous intervention) and negatives (erroneous restraint) – Type I and Type II errors – against the potential benefits of correct judgments.<sup>31</sup> The error cost approach has come to dominate antitrust over the past 40 years. There is, however, constant pressure for antitrust law to take a more aggressive stance towards potentially harmful conduct. Where greater aggression is applied to potentially bad conduct, it is in the resolution of the conduct's *potentiality* that the relaxing of economic constraints on enforcement are felt.

While the FTC's antitrust cases and Guidelines have generally embraced sensible economic reasoning, the agency has also frequently based its competition enforcement decisions not

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<sup>30</sup> Edith Ramirez, Keynote, 17th Annual George Mason Law Review Symposium on Antitrust Law: "The FTC: 100 Years of Antitrust and Competition Policy" (2014), available at <http://vimeo.com/86788312>. See also Erica Teichert, *FTC Commissioners Spar Over Section 5 Guidance Boundaries*, LAW360 (Feb. 13, 2014), <http://www.law360.com/articles/509894/ftc-commissioners-spar-over-section-5-guidance-boundaries>.

<sup>31</sup> See, e.g., Manne & Wright, *Innovation*, *supra* note 1.

on economic evidence pointing to harmful outcomes, but on "hot docs" that purport to evince nefarious motives for challenged conduct – but that do not necessarily shed any light on actual competitive effects.

This approach has a “the light’s better over here” feel to it. It is undoubtedly easier to “discover” anticompetitive behavior and relevant markets by inferences from business language than it is to deduce it from rigorous economic analysis. [But] it is not clear that this type of business rhetoric bears much relationship to economic reality....<sup>32</sup>

Section 5 itself actually incorporates sensible economic limiting principles:

The Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair **unless the act or practice causes or is likely to cause substantial injury to consumers** which is **not reasonably avoidable by consumers themselves** and **not outweighed by countervailing benefits to consumers or to competition**.<sup>33</sup> [Emphasis added].

The core requirements (that injury be substantial, that it not be reasonably avoidable by consumers and that it not be outweighed by countervailing benefits) serve to impose an error cost approach on unfairness questions, limiting both the likelihood and harm of erroneous over-enforcement. “To justify a finding of unfairness, the Commission must demonstrate the allegedly unlawful conduct results in net consumer injury.”<sup>34</sup>

As I will discuss, however, the absence of significant institutional constraints from the courts has diluted the effect of these provisions in certain cases.

1. The *McWane* Case

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<sup>32</sup> Geoffrey A. Manne & E. Marcellus Williamson, *Hot Docs vs. Cold Economics: The Use and Misuse of Business Documents in Antitrust Enforcement and Adjudication*, 47 ARIZ. L. REV. 609 (2005).

<sup>33</sup> 15 U.S.C. §45, <http://www.law.cornell.edu/uscode/text/15/45>.

<sup>34</sup> Dissenting Statement of Commissioner Joshua D. Wright, In the Matter of Apple, Inc., FTC File No. 1123108, at 14 (Jan. 15, 2014), available at [http://www.ftc.gov/sites/default/files/documents/cases/140115applestatementwright\\_0.pdf](http://www.ftc.gov/sites/default/files/documents/cases/140115applestatementwright_0.pdf) [hereinafter “Wright *Apple* Dissent”].

As noted, the FTC doesn't always meet its analytical burden in its decisions. In particular, where the agency eschews economic evidence in favor of other, less probative evidence or indirect measures of harm, it risks damaging outcomes.

The FTC's recent administrative collusion and exclusion case against McWane, a manufacturer of iron pipe fittings, is remarkable for the complete absence – even in the testimony of the Commission's economic expert – of economic evidence pointing to the actual anticompetitive outcomes necessary to make a valid case.

Fortunately, the ALJ threw out a significant portion of the case on the grounds that the Commission's evidence was "weak," "unsupported speculation" and that its "daisy chain of assumptions fails to support or justify an evidentiary inference of any unlawful agreement involving McWane."<sup>35</sup>

On the other hand, a majority of the Commissioners (with Commissioner Wright again dissenting) missed the full significance of the evidence that was lacking at trial and held in favor of the Complaint Counsel on the exclusion count.

As Commissioner Wright noted in his dissent from this portion of the holding, this lapse had significant effect, essentially rewriting the well-accepted standards required to prove a violation of Section 2 of the Sherman Act:

By concluding that Complaint Counsel need only demonstrate that [McWane's competitor] was foreclosed from some unspecified amount of distributors as a result of the [McWane's exclusive dealing program], without linking that foreclosure to the preservation of McWane's monopoly power, the Commission in effect holds that harm to a competitor without more is sufficient to establish a violation of Section 2.<sup>36</sup>

If there were evidence of actual harm it would have been readily available to the Commission because the conduct challenged in the case had already occurred. Instead,

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<sup>35</sup> In the Matter of McWane, Inc., Docket No. 9351, Initial ALJ Decision, at 286, 300, 306-07 (May 8, 2013), *available at* <http://www.ftc.gov/sites/default/files/documents/cases/2013/05/130509mcwanechappelldecision.pdf>.

<sup>36</sup> In the Matter of McWane Inc., Docket No. 9351, Dissenting Statement of Commissioner Joshua D. Wright at 37 (Feb. 6, 2014), *available at* <http://www.ftc.gov/system/files/documents/cases/140206mcwanestatement.pdf>.

Complaint Counsel (which was authorized by the Commission to pursue the case) made an affirmative choice to forego adducing this economic evidence and to rely instead on “hot” docs rather than “cold” economics.

In accepting this evidence a majority of the Commission produced an outcome unsupported by the evidence and in violation of one of the first, cardinal rules of antitrust: “Because antitrust exists to protect competition, not competitors, an antitrust complainant cannot base a claim of monopolization on the mere fact that its business was injured by the defendant’s conduct.”<sup>37</sup>

## 2. HSR Premerger Notification Amendments

Economic analysis at the FTC should not be confined only to competition policy nor only to substantive decision-making. Instead, it can and should govern the full range of the Commission’s decisions. Consumers may be harmed just as much by faulty process as by bad substantive decision-making.

Last year, over Commissioner Wright’s dissent, the FTC approved amendments to its HSR Premerger Notification rules to establish procedures for the automatic withdrawal of an application upon announcement of the termination of a transaction.<sup>38</sup> As seemingly innocuous as the amendment is, it is not without likely costs.<sup>39</sup> Here, as in substantive decision-making, cost-benefit analysis can restrain undesirable conduct.

It must be counted a straightforward abdication of sensible principles of economic analysis and good governance that these amendments were adopted without any evidence to support them.

## III. Suggestions for Reform

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<sup>37</sup> Thom Lambert, *Commissioner Wright’s McWane Dissent Illuminates the Law and Economics of Exclusive Dealing*, TRUTH ON THE MARKET (Feb. 17, 2014), <http://truthonthemarket.com/2014/02/17/commissioner-wrights-mcwane-dissent-illuminates-the-law-and-economics-of-exclusive-dealing/>.

<sup>38</sup> Premerger Notification; Reporting and Waiting Period Requirements, 78 Fed. Reg. 41293 (Jul. 10, 2013), available at <http://ftc.gov/os/fedreg/2013/06/130628hsrfinalrulefrn.pdf>.

<sup>39</sup> Wright Concurrence in Notice of Public Comment for Proposed HSR Rules, <http://www.ftc.gov/os/2013/02/130201hsrnprm-jwrightstmt.pdf>.

Instead of asserting what companies should do, the FTC should offer more guidance on what it thinks its legal authority means.

And the Commission can't just ignore or revoke those limiting principles when they become inconvenient.

Meanwhile, a more significant and better-defined role for economics, and thus the agency's Bureau of Economics, could provide some degree of internal constraint. That's a second-best to the external constraint the courts are supposed to provide. But it could at least raise the cost of undertaking enforcement actions simply because three Commissioners – or a few staff lawyers – think they're helping consumers by crucifying a particular company.

One easy place to start would be holding a comprehensive workshop on data security and then issuing guidelines. The FTC has settled more than 50 data security cases but has provided scant guidance, even though data breaches and the identity thefts they cause are far and away the top subject of consumer complaints. The goal wouldn't be to prescribe what, specifically, companies should do but how they should understand their evolving legal duty. For example, at what point does an industry practice become sufficiently widespread to constitute "reasonable" data security?

More ambitiously, the FTC could use its unique power to enforce voluntary commitments to kick start new paradigms of regulation. That could include codes of conduct developed by industry or multistakeholder groups as well as novel, data-driven alternative models of self-regulation. For example, Uber, Lyft and other app-based personal transportation services could create a self-regulatory program based on actual, real-time data about safety and customer satisfaction. The FTC could enforce such a model – if Congress finally makes common carriers subject to the FTC Act. The same could work for online education, Airbnb and countless other disruptive alternatives to traditional industries and the regulators they've captured.

Finally, the FTC could do more of what it does best: competition advocacy – like trying to remove anticompetitive local government obstacles to broadband deployment. The FTC has earned praise for defending Uber from regulatory barriers taxicab commissions want to protect incumbents. That's the kind of thing a Federal Technology Commission ought to do: stand up for new technology, instead of trying to make "it turn out according to plan."

[The attachment to Mr. Manne's testimony has been retained in committee files and can be found at <http://docs.house.gov/meetings/if/if17/20140228/101812/hrg-113-if17-wstate-manneg-20140228-sd002.pdf>.]

Mr. TERRY. Thank you very much. Mr. Yoo, you are recognized for your 5 minutes.

#### STATEMENT OF CHRISTOPHER YOO

Mr. YOO. I am grateful for the opportunity to testify at this hearing, exploring the new challenges confronting the Federal Trade Commission as it enters its second century. The FTC now operates in a context that bears little resemblance to the world that existed when it was first created. I would like to focus my remarks on two of the most significant changes: globalization and the growing importance of technology.

Focusing first on globalization, when Congress created the FTC in 1914, the vast majority of the economy consisted of local markets. Goods traveled only a short distance and rarely crossed state lines. Since that time, commerce has become increasingly national and international in focus. U.S. companies routinely operate in a wide range of countries, and business practices that once affected only domestic economies now have ramifications that are felt around the globe.

The increasing globalization of the economy places new demands on agencies charged with enforcing anti-trust laws and consumer protection. Not only must they investigate conduct that spans multiple jurisdictions, the fact that multiple regulatory authorities have jurisdiction over the same matter can force companies to incur duplicative compliance costs. To the extent that substantive standards differ, companies faced with inconsistent mandates may be forced to reduce their practices to the least common denominator or forsake doing business in a country altogether. As a result, regulatory and harmonization has now emerged as a key element of trade policy.

Toward these ends, the FTC has developed increasingly close relationships with other competition authorities both through bilateral cooperation and through a global organization of competition policy authorities known as the International Competition Network. Such efforts help coordinate and standardize the work in competition authorities and will continue to grow in importance in the future.

The other big change is the increasingly central role that technology plays in the modern economy. Innovation has emerged as a key driver of economic growth. Products and services have become increasingly sophisticated in their own right and have become part of a larger and more tightly integrated economic system. Technological change can also be very disruptive, altering old patterns of doing business and creating new business models and market-leading companies in the process. Companies who find themselves disadvantaged by technological change may be tempted to look to the government for relief.

The growing importance of technology will require the FTC to expand its institutional capabilities. One key step in that direction has been the creation of the office of Chief Technologist. This posi-

tion is only 4 years old, and the agency is still exploring how it can best contribute to the FTC's mission. In addition, the FTC's usual practice is to require that every major decision be accompanied by an analysis by the Bureau of Economics. The agency has not always adhered to this practice in recent years and would be well advised to make sure to follow this important procedural guideline in the future in every major case.

The FTC will also have to determine what substantive legal principles it will apply to high tech industries. The problem is that our current understanding of innovation remains nascent and largely unsettled. This creates the risk that enforcement authorities will apply anti-trust law without a clear goal or with a multitude of goals in mind. And the past has taught us that unless anti-trust laws are applied with a clear focus on consumer welfare, they may be abused to protect specific competitors instead of consumers.

Under these circumstances, the FTC must adhere to the principles that have emerged to guide its conduct since its founding in 1914. These principles require that all decisions be based on a solid empirical foundation, not speculation, and must protect consumers, not competitors. In particular, the agency should make sure that it does not embroil itself in routine disagreements over price that are everyday occurrences in any market-based economy. Indeed, both the Supreme Court and enforcement authorities have long recognized that anti-trust agencies are institutionally ill-suited to overseeing prices to make sure they remain reasonable.

Consider, for example the FTC's growing interest in standard essential patents. The debate presumes that patents are being asserted in ways that harm consumers without a clear understanding of how government intervention could also harm consumers by discouraging innovation. Moreover the typical remedy mandates uniform rates despite the fact that economic theory shows that innovation is best promoted when innovators are allowed flexibility in the business models they pursue. Instead of directly overseeing the outcomes of negotiations, the FTC already has ample authority to preserve the integrity of standard-setting processes that are being abused in ways that harm consumers.

Finally, some are calling for the FTC to exercise the authority granted by Section 5 of the FTC Act to police unfair methods of competition in ways that go beyond consumer welfare. The past has taught us that attempting to use the anti-trust laws to promote goals other than consumer welfare opens the door to a wide range of intrusive government intervention that often harm consumers.

In short, the lesson of the past 100 years is that the FTC would be well served to continue to look to consumer welfare as its guide. Any other approach opens the door to governmental overreach and to allowing the law to be abused to benefit individual competitors instead of consumers.

[The prepared statement Mr. Yoo follows:]



Center for Technology, Innovation and Competition



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**TESTIMONY OF CHRISTOPHER S. YOO**

**John H. Chestnut Professor of Law, Communication, and Computer & Information Science and  
Founding Director, Center for Technology, Innovation and Competition,  
University of Pennsylvania**

**Hearing on “The FTC at 100: Views from the Academic Experts”**

**Before the Subcommittee on Commerce, Manufacturing, and Trade,  
Committee on Energy and Commerce,  
United States House of Representatives**

**February 28, 2014**

I am grateful for the opportunity to testify at this hearing exploring the new challenges confronting the Federal Trade Commission as it enters its second century. The FTC now operates in a context that bears little resemblance to the world that existed when it was first created. I would like to focus my remarks on two of the most significant changes: globalization and the growing importance of technology.

Focusing first on globalization, when Congress created the FTC in 1914, the vast majority of the economy consisted of local markets. Goods typically traveled only a short distance and rarely crossed state lines. Since that time, commerce became increasingly national and international in focus. U.S. companies routinely operate in a wide range of countries. Business practices that once affected only domestic economies now have ramifications that are felt around the globe.

The increasing globalization of the economy places new demands on agencies charged with enforcing the antitrust laws. Not only must they investigate conduct that spans multiple

jurisdictions; the fact that multiple regulatory authorities have jurisdiction over the same matter can force companies to incur duplicative compliance costs. To the extent that substantive standards differ, companies faced with inconsistent mandates may be forced to reduce their practices to the least common denominator or forsake doing business in a country altogether. As a result, regulatory harmonization has also emerged as a key element of trade policy.

Towards these ends, the FTC has developed increasingly close relationships with other competition authorities both through bilateral cooperation and through a global organization of competition policy authorities known as the International Competition Network. Such efforts help coordinate and standardize the work of competition authorities and will continue to grow in importance in future years.

The other big change is the increasingly central role that technology plays in the modern economy. Innovation has emerged as a key driver of economic growth. Products and services have become increasingly sophisticated both in their own right and in the extent to which they have become part of a larger and more tightly integrated economic system. Technological change can also be very disruptive, altering old patterns of doing business and creating new business models and market-leading companies in the process. Companies who find themselves disadvantaged by technological change may be tempted to look to the government for relief.

The growing importance of technology will require the FTC to expand its institutional capabilities. One key step in that direction has been the creation of the office of Chief Technologist. This position is only four years old, and the agency is still exploring how it can best contribute to the FTC's mission. In addition, the FTC's usual practice is to require that every major decision be accompanied by an analysis by the Bureau of Economics. The agency

has not always adhered to this practice in recent years and would be well advised to make sure to follow this important procedural guideline in the future in every major case.

The FTC will also have to determine what substantive legal principles it will apply to high-tech industries. The problem is that our current understanding of innovation remains nascent and largely unsettled. This creates the risk that enforcement authorities will apply antitrust law without a clear goal or with a multitude of goals in mind. And the past has taught us that unless the antitrust laws are applied with a clear focus on consumer welfare, they may be abused to protect specific competitors instead of consumers.

Under these circumstances, the FTC must adhere to the principles that have emerged to guide its conduct since its founding in 1914. These principles require that all decisions must be based on a solid empirical foundation, not speculation, and must protect consumers, not competitors. In particular, the agency should make sure that it does not embroil itself in routine disagreements over price that are everyday occurrences in any market-based economy. Indeed, both the Supreme Court and enforcement authorities have long recognized that antitrust courts are institutionally ill-suited to overseeing prices to make sure they remain reasonable.

Consider, for example, the FTC's growing interest in standard essential patents. The debate presumes that patents are being asserted in ways that harm consumers by increasing prices without a clear understanding of how government intervention could also harm consumers by discouraging innovation. Moreover, the typical remedy mandates uniform rates despite the fact that economic theory shows that innovation is best promoted when innovators are allowed flexibility in the business models they pursue. Instead of directly overseeing the outcomes of negotiations, the FTC already has ample authority to preserve the integrity of standard setting processes that are abused in ways that harm consumers.

Finally, some are calling for the FTC to exercise the authority granted by Section 5 of the FTC Act to police unfair methods of competition in ways that go beyond consumer welfare. The past has taught us that attempting to use the antitrust laws to promote goals other than consumer welfare opens the door to a wide range of intrusive government intervention that often harms consumers.

In short, the lesson of the past one hundred years is that the FTC would be well served to continue to look to consumer welfare as its guide. Any other approach opens the door to governmental overreach and to allowing the law to be abused so as to benefit individual competitors instead of consumers.

Mr. TERRY. Thank you very much. Mr. Lande, you are now recognized for 5 minutes.

**STATEMENT OF ROBERT LANDE**

Mr. LANDE. Chairman Terry, Ranking Member Schakowsky, and members of the subcommittee—

Mr. TERRY. Is your microphone on?

Mr. LANDE. No.

Mr. TERRY. And why don't you pull it a little closer too? Yes, perfect.

Mr. LANDE. Sorry about that. Chairman Terry, Ranking Member Schakowsky, and members of the subcommittee, I am truly honored to appear here today. The subject of my remarks will be the overall scope of Section 5 of the FTC Act. I will discuss how Congress intended this law to be interpreted in a broad and flexible way. I will also discuss why any Section 5 anti-trust guidelines should center around the goal of protecting consumer choice rather than increasing economic efficiency.

As all the commissioners agree, Congress intended the FTC Act to include more than just Sherman Act violations. The legislative history makes it clear Section 5 was also intended to prohibit incipient violations of the Sherman Act and conduct violating the policies behind the Sherman Act. The Supreme Court has accepted this interpretation.

There are a number of specific ways the commission could carry out this congressional mandate that would be in the public interest. I will briefly discuss one example, and there are others in my written testimony.

Tying exclusive dealing violations that violate the Sherman Act require a minimum amount of market power. I believe the market power requirements should be relaxed whenever the case involves a defendant with a significantly larger market share than that of its victims. In these incipient tying or exclusive dealing situations, incumbents may be able to significantly disadvantage smaller competitors and potential entrants because of their relatively larger market power.

Suppose, for example, a company wants to introduce a new brand of super premium ice cream. Suppose an existing seller of super premium ice cream has 30 percent of this market and also 30 percent of the other types of ice cream markets. Suppose the incumbent firm tells stores that they have to choose between the established firm's products and the newcomer's products. Suppose the store agrees to exclude the newcomer's products. These facts would be very unlikely to constitute a Sherman Act violation. However if the incumbent's exclusionary strategy succeeds, consumer choice in terms of varieties of ice cream on the market could decrease substantially, and consumer prices could increase substantially. If so, this conduct should violate Section 5 as an incipient exclusive dealing or tying arrangement.

Now, last year Commissioner Wright proposed that the commission adopt Section 5 anti-trust guidelines. Unfortunately this proposal contains a fatal flaw. It directly contradicts congressional intent. This is because Section 5 prohibits unfair methods of competition, a prohibition that, as I noted earlier, Congress intended to be

quite broad. The proposed guidelines, however, would effectively eliminate the term "unfair method of competition" and substitute for it a very different narrow term "inefficient methods of competition."

Contrary to what Congress intended, these guidelines would reach less anti-competitive conduct than the Sherman Act. Its proposed test of illegality is whether a practice "generates harm to competition as understood by the traditional anti-trust laws and generates no cognizable efficiencies." Now, this test is contrary to current law and narrower than current law.

The prevailing test balances of practices efficiency and market power effects under a rule of reason. The current law does not immunize conduct at least to a significant amount of monopoly power simple because it results in cognizable efficiency. Thus the proposed guideline would not apply to conduct that currently violates the Sherman Act, the opposite of the expansive law that Congress intended.

Now, Commissioner Wright certainly is correct that it would be desirable if the FTC issues Section 5 anti-trust guidelines. However bad guidelines would be worse than no guidelines. By analogy, years ago, the United States wanted to negotiate arms control agreements with the Soviet Union. A good arms control agreement would have had many benefits. However, an agreement that would have forced us unilaterally to disarm would have been much worse than no agreement at all.

Similarly the suggested guidelines effectively would disarm the Federal Trade Commission. Now, the commission instead should formulate sound Section 5 guidelines that properly reflect congressional intent. Now, I believe this can be accomplished if the guidelines were written to protect consumer choice, not economic efficiency. My written testimony explains how anti-trust guidelines built in terms of the consumer choice framework would be both faithful to congressional intent and would enhance predictability for business. I welcome your questions.

[The prepared statement of Mr. Lande follows:]

**Testimony of Robert H. Lande**  
**Venable Professor of Law at the**  
**University of Baltimore School of Law**

**Before the**

**United States House of Representatives**  
**House Energy and Commerce Committee**  
**Subcommittee on Commerce, Manufacturing,**  
**and Trade**

**at a Hearing entitled**

**“The FTC at 100: Views From the Academic Experts.”**

**Rayburn House Office Building, Washington, D.C.**

**February 28, 2014**

Chairman Terry, Ranking Member Schakowsky, and Members of the Subcommittee, I am honored and delighted to have the opportunity to appear before you today. The specific subject of my remarks will be the overall nature of Section 5 of the FTC Act. I will discuss how this law should be interpreted in a broad and flexible manner, as Congress intended. I also will discuss why any Section 5 Guidelines should center around the goal of protecting consumer choice, rather than Commissioner Wright's proposed economic efficiency orientation. Finally, I will list some areas that should become higher priorities as part of an affirmative agenda for the Commission in its second century.

There is no doubt that when Congress enacted the FTC Act it intended this law to be more expansive and more vigorous than the Sherman Act.<sup>1</sup> Even though the Sherman Act had already been enacted, Congress affirmatively decided that additional, enhanced legislation was needed. The FTC Act's legislative history makes it clear that Section 5 was intended to prohibit not only every violation of the other antitrust laws, but also incipient violations of these laws, conduct violating the spirit of the other antitrust laws, conduct violating recognized standards of business behavior, and conduct violating competition policy as framed by the Commission.<sup>2</sup> The Supreme Court has explicitly adopted this interpretation of the nature of the FTC Act.<sup>3</sup>

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<sup>1</sup> See Neil W. Averitt, *The Meaning of 'Unfair Methods of Competition' in Section 5 of the Federal Trade Commission Act*, 21 B.C. L. REV. 227, passim (1980).

<sup>2</sup> *Id.* at 299-300.

<sup>3</sup> See, e.g., *F.T.C. v. Sperry & Hutchinson Co.*, 405 U.S. 233, 239-240 (1972).

## **I. Types of Cases That Should be Brought Under The FTC Act**

There are a number of ways the FTC could carry out this Congressional intent that would be in the public interest. I will briefly discuss three specific categories of appropriate cases. Each is discussed in more detail in the attached article.<sup>4</sup>

### **1. Invitations to Collude**

Invitations to collude can violate Section 2 of the Sherman Act. However, for enforcers to prove a Sherman Act violation they must undertake a large number of formidable tasks, including proving a relevant market, a complex and time-consuming undertaking. Then the enforcers must prove that the challenged conduct was anticompetitive (as that term has been defined) and that it would result in either the respondents achieving or maintaining monopoly power or the “dangerous probability” of achieving monopoly power. Lastly, claimed efficiencies associated with the practices would have to be litigated. Like every successful Section 2 action, these cases would be complex, lengthy, and costly.

By contrast, naked collusion cases are much less complicated. The enforcers do not have to define markets, prove difficulty of entry into the market or any form of market power, litigate efficiencies, or establish actual anticompetitive effects. Invitation to collude cases should be as easy to prove as collusion cases. The same jurisprudential reasons that permit the enforcers to dispense with the complex, costly and lengthy market definition and market power issues in collusion cases also apply to invitations to collude cases. As the Commission has concluded, they should violate Section 5 of the FTC Act.

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<sup>4</sup> See generally Robert H. Lande, *Revitalizing Section 5 of the FTC Act Using 'Consumer Choice' Analysis*, 8 ANTITRUST SOURCE, no. 3, Feb. 2009, at 1, available at <http://ssrn.com/abstract=1287218>.

## 2. Incipient Exclusive Dealing and Tying Cases

There currently is substantial uncertainty over the minimum market shares required to establish a tying violation and the amount of foreclosure necessary for an exclusive dealing violation. Regardless of how high these requirements are under the Sherman Act, they should be relaxed whenever the case involves a defendant with a significantly larger market share than those of the victims. In these “incipient” tying or exclusive dealing situations, incumbents often will be able to significantly disadvantage smaller competitors and potential market entrants because of their relatively larger market shares. This is true even in cases where the incumbents do not hold large enough market share to trigger a traditional Sherman Act violation.<sup>5</sup>

Suppose, for example, a company introduces a new brand of super-premium ice cream. Suppose also that an existing seller of super-premium ice cream has 30 percent of this market as well as another 30 percent of the premium and non-premium ice cream markets. Then suppose the incumbent firm tells supermarkets they have to choose between the established firm’s products and the newcomer’s products. No efficiencies would arise if the established firm’s demands were met. Suppose also that the supermarkets agree to the incumbent firm’s demands.

These facts, including in particular the incumbent’s 30% market share, would be unlikely to be found to constitute either an unlawful tying agreement or an unlawful exclusive dealing agreement under the Sherman Act. However, if the incumbent’s exclusionary strategy succeeded consumer choice in terms of varieties of ice cream on

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<sup>5</sup> See Lande, *supra* note 4, at 6.

the market would be diminished, and prices would be likely to increase. This conduct should violate Section 5 as an incipient exclusive dealing or tying arrangement.

### **3. Cases Similar to N-Data.**

The FTC's action in the *Negotiated Data Solutions (N-Data)* case should be applauded, and the Commission commended for condemning the opportunistic behavior at issue and affirming that this conduct can be an antitrust violation of the FTC Act even if it does not violate the Sherman Act.<sup>6</sup>

The facts of this case are exceptionally complicated, and it is not completely clear that the conduct at issue would have violated the Sherman Act. One could argue that the conduct only constituted the exploitation of intellectual property rights, in which case it might not have violated the Sherman Act. It could also be argued that the case does not clearly involve an act of monopolization in violation of Section 2 of the Sherman Act because the original patent holder adhered to its agreement and the successor holder was just exploiting its newly acquired patent rights rather than taking improper steps to acquire or maintain monopoly power. In light of this uncertainty, it is fortunate the Commission was able to use Section 5 of the FTC Act to challenge the anticompetitive conduct at issue.

## **II. Commissioner Wright's Section 5 Guidelines Proposal**

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<sup>6</sup> See *Negotiated Data Solutions, LLC.*, FTC File No. 051 0094, 2008 WL 4407246 (Sept. 22, 2008) (complaint and consent order), available at <http://www.ftc.gov/os/caselist/0510094/080122statement.pdf>.

Last year FTC Commissioner Joshua Wright proposed that the Commission adopt Section 5 Guidelines.<sup>7</sup> Unfortunately this proposal contain a fatal flaw. It directly contradicts Congressional intent. This is because Section 5 of the FTC Act prohibits "unfair methods of competition", a prohibition that, as noted above, Congress intended to be quite broad. His proposal would effectively eliminate this term and substitute for it a very narrow prohibition, one against "inefficient methods of competition".

Contrary to what Congress intended, this proposal reaches less anticompetitive conduct than the other antitrust laws. For example, the proposed central test of illegality is whether a practice "generates harm to competition as understood by the traditional antitrust laws and generates no cognizable efficiencies."<sup>8</sup> This test is contrary to current law and much narrower. The prevailing test of legality under the Sherman Act balances a practice's efficiency and market power effects under a rule of reason.<sup>9</sup> The existing law most certainly does not follow the proposal's suggestion to immunize conduct that leads to a significant amount of monopoly power simply because it results in a cognizable

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<sup>7</sup> See, e.g., Joshua D. Wright, *Revisiting Antitrust Institutions: The Case for Guidelines to Recalibrate the Federal Trade Commission's Section 5 Unfair Methods of Competition Authority*, 2013 CONCURRENTS: COMPETITION L.J. no. 4, at 1.

<sup>8</sup> Id. at 3.

<sup>9</sup> For a discussion of the rule of reason in various contexts see John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency*, 84 NOTRE DAME L. REV. 191, 211-33 & 240-43 (2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1113927](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1113927); See also Robert H. Lande & Howard P. Marvel, *The Three Types of Collusion: Fixing Prices, Rivals, and Rules*, 2000 WIS. L. REV. 941, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1134820&download=yes](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1134820&download=yes)

efficiency. Almost every corporate action leads to some efficiencies.<sup>10</sup> The crucial legal question is - and should be - whether these efficiencies are outweighed by the harm caused by these practices. Thus, this proposed interpretation of the FTC Act would not apply to a considerable amount of conduct that currently violates the Sherman Act - the opposite of the broad prohibition that Congress intended. The proposal should be rejected.

Commissioner Wright certainly is correct that it could be desirable if the FTC issues comprehensive Section 5 antitrust Guidelines. As he points out, this could help increase business certainty and enhance the predictability of government enforcement actions. However, bad Guidelines would be worse than no Guidelines at all.

By analogy, years ago the United States wanted to negotiate arms control agreements with the Soviet Union. A good arms control agreement would have had many benefits. However, an agreement that would have forced the United States to unilaterally disarm would have been far worse than no agreement at all.

The suggested proposal effectively would disarm the FTC by restricting Section 5 to an enforcement program narrower than that of the Sherman Act or Clayton Act. For this reason, the proposal should not be taken seriously by anyone who wants to carry out Congress's desire that the FTC Act be enforced vigorously. The proposal does not even contain token concessions towards Congress's preferred position. Rather, it is a step backwards. Returning to the arms control analogy, suppose the Soviet Union's opening position on an issue was 50 and the position of the United States was 100. Suppose the

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<sup>10</sup> For examples of rule of reason cases involving anticompetitive conduct that would be immunized from Section 5 scrutiny by this proposal, *see* the cases discussed in the sources cited in note 9 *supra*.

parties might have had a chance of compromising at somewhere between 70 and 80. Then, suppose the Soviet Union offered proposed Guidelines that called for only a 30. The United States would have been justified in concluding that the Soviet Union was not negotiating seriously. This is exactly what Commissioner Wright has done. The FTC Act was written to proscribe "unfair methods of competition", not "inefficient methods of competition".

### **III. An Alternative Framework For Section 5 Guidelines: Consumer Choice**

The Commission instead could formulate sound Section 5 antitrust Guidelines that properly reflect Congressional intent. I believe this only could be accomplished if these Guidelines were written in terms of the fundamental concept that the FTC Act should enhance "consumer choice".<sup>11</sup> The attached article explains how antitrust Guidelines that utilize the consumer choice framework would be both faithful to Congressional intent and likely to enhance certainty and predictability for business.<sup>12</sup>

### **IV. Areas for Increased FTC Scrutiny**

If Section 5 of the FTC Act were interpreted in terms of the consumer choice framework this would have a number of advantages in addition to providing a sound,

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<sup>11</sup> For a general explanation of the consumer choice approach to antitrust law, see Neil W. Averitt & Robert H. Lande, *Using the "Consumer Choice" Approach to Antitrust Law*, 74 ANTITRUST L. J. 175 (2007), available at <http://ssrn.com/abstract=1121459>.

<sup>12</sup> For additional situations that might be especially appropriate for the application of the consumer choice framework see Neil W. Averitt, *Consumer Choice on the Menu at FTC*, 2013 FTC:WATCH, no. 837, Oct. 17, 2013, at 1 (on file with the author), available at <http://www.ftcwatch.com/neil-averitt-commentary-consumer-choice-on-the-menu-at-ftc/>.

clear, and predictable basis for Section 5 antitrust Guidelines. There are a number of areas that would be affected:

- Media consolidations and joint ventures should receive increased scrutiny to determine whether they affect consumer choice. This analysis should be in addition to the traditional antitrust concerns over the effects of media transactions on prices. A media sector transaction that significantly reduces the choices available to consumers should be challenged even if it does not result in price increases.
- Health Care consolidations and joint ventures should also receive enhanced scrutiny to determine whether they affect consumer choice. Price effects should of course continue to be crucial considerations, and it is certainly possible that the arrival of Obamacare will lead to an increased number of anticompetitive consolidations and joint ventures in this sector, especially in cases involving hospital mergers and hospitals purchasing physician practices. All of these transactions should be analyzed carefully for both price and choice effects on consumers.
- Food and agricultural industry consolidations, collusion, joint ventures, and exclusionary conduct should merit similarly higher levels of FTC attention.<sup>13</sup> These are areas where the practices in question might not rise to the level where they constitute monopsony or monopoly, or give rise to a traditional Sherman Act violations. For the reasons given above as to why Section 5 should enable the Commission to more beneficially scrutinize exclusive dealing and tying situations, Section 5 also might be used appropriately to guard against a variety of incipient anticompetitive practices in the food and agricultural sectors.

I welcome your questions about any of these topics

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<sup>13</sup> For example, see *Letter from the American Antitrust Institute to the FTC concerning the proposed merger of Sysco and U.S. Foods* (Am. Antitrust Inst., Washington, D.C.), Feb. 25, 2014, available at [http://www.antitrustinstitute.org/sites/default/files/AAISyscoUSFoodsMergerLetter\\_0.pdf](http://www.antitrustinstitute.org/sites/default/files/AAISyscoUSFoodsMergerLetter_0.pdf)

Theantitrustsource : www.antitrustsource.com | February 2009 |  
Electronic copy available at: <http://ssrn.com/abstract=1287218>

## Revitalizing Section 5 of the FTC Act Using “Consumer Choice” Analysis

Robert H. Lande

The ongoing debate over the breadth and nature of Section 5 of the FTC Act has intensified due to the outcome of the recent Presidential election. Some call for or predict a much broader and more aggressive approach to Section 5. Others caution that reviewing courts will not permit an overly expansive interpretation of Section 5 unless it is clearly bounded by a structure that will prevent it from becoming untethered and standardless.

In this article, I propose that the use of the consumer choice framework would be the best and perhaps the only way to revitalize Section 5 in a manner that is definite, predictable, principled, and clearly bounded. This approach would focus attention on the factors that are important for a market to function competitively, including variety and quality, as well as price. It also would provide a relatively clear way for businesses and courts to distinguish anticompetitive conduct from procompetitive or benign conduct. If the Commission were to adopt the consumer choice limitations, the Act would be given the broad interpretation Congress intended, and this reinvigorated interpretation would be likely to be sustained by reviewing courts.

### Section 5 of the FTC Act Is Significantly Broader than the Other Antitrust Laws

There is no doubt that when Congress enacted Section 5 of the FTC Act, it intended the law to be more aggressive than the Sherman and Clayton Acts.<sup>1</sup> The legislative history and Supreme Court decisions<sup>2</sup> demonstrate that Section 5 was intended to cover incipient violations of the other antitrust laws, conduct violating the spirit of the other antitrust laws, conduct violating recognized standards of business behavior, and conduct violating competition policy as framed by the Commission.<sup>3</sup> Even though reasonable people may differ as to whether the FTC Act should be more expansive than the other antitrust laws, congressional intent concerning this point is clear.<sup>4</sup> Some might question the propriety of subjecting conduct to a different, tougher legal standard when it is challenged under Section 5 of the FTC Act. For example, one might ask why an exclusive dealing arrangement should be evaluated under an incipency standard when it is challenged under the FTC Act, but not when challenged under the Sherman Act?<sup>5</sup> One answer is that Sherman Act violations lead to automatic treble damages and award of attorneys' fees to victorious plaintiffs.<sup>6</sup> By contrast, there is no private right of action under the FTC Act, and FTC Act vio-

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<sup>1</sup> See Neil W. Averitt, *The Meaning of "Unfair Methods of Competition" in Section 5 of the Federal Trade Commission Act*, 21 B.C. L. REV. 227, 233, 251, 271 (1979-1980).

<sup>2</sup> See, e.g., *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 239-44 (1972).

<sup>3</sup> See Averitt, *supra* note 1, at 228-29, 242, 251, 271, 275.

<sup>4</sup> See *id.* at 229-38.

<sup>5</sup> For the current legal treatment of exclusive dealing arrangements under the Sherman Act, see the sources cited *infra* note 31.

<sup>6</sup> See 15 U.S.C. §15(a).

iations are not precedents that lead to private litigation unless an FTC decision specifically finds a Sherman Act or Clayton Act violation; a "pure" FTC Act violation would not do this.<sup>7</sup> Moreover, mergers already are judged under two different laws that employ two different standards. Mergers can potentially violate Section 2 of the Sherman Act,<sup>8</sup> but only if they violate a monopolization standard.

Mergers also can violate Section 7 of the Clayton Act, where they are scrutinized under a much stricter incipency standard.<sup>9</sup> In other words, despite the existence of the 1890 Sherman Act, Congress wanted mergers challenged more aggressively, so in 1914 it enacted the Clayton Act. Similarly, Congress believed that the Sherman Act was not aggressive, flexible, or broad enough,<sup>10</sup> so in 1914 it enacted the FTC Act.

However, the Supreme Court case law addressing Congress' intent in enacting Section 5 is relatively old.<sup>11</sup> There is no guarantee today's more conservative<sup>12</sup> Court would interpret Section 5 expansively today. If the Commission were to attempt to promulgate an approach to the FTC Act that was vague, insufficiently bounded, or that gave it undue discretion, more conservative reviewing courts today might well restrict the scope of Section 5 and make it coterminous with the other antitrust laws, no matter how clear the congressional intent and no matter what the older case law holds. A narrower interpretation of Section 5 would be especially likely if the Commission were to articulate the scope of Section 5 in non-economic terms, such as by forbidding conduct that is "unjust," "oppressive," or "immoral." Fortunately, the Commission does have a way to minimize the risk of reversal on appeal.

#### Section 5 Can Be Expansive If, But Only If, It Is Constrained by the Choice Framework

Section 5 prohibits conduct that constitutes "unfair methods of competition" (which, in this article, I call Section 5 antitrust violations) as well as conduct that constitutes "unfair or deceptive acts or practices" (which, in this article, I call Section 5 consumer protection violations).<sup>13</sup> The choice framework would impose a threshold requirement that every Section 5 antitrust violation significantly impairs the choices that free competition brings to the marketplace.<sup>14</sup> The choice framework also would impose the requirement that every Section 5 consumer protection violation significantly impairs consumers' ability meaningfully to choose from among the options the market provides. Construed this way, the two halves of Section 5, operating together, ensure that consumers have

<sup>7</sup> See Averitt, *supra* note 1, at 251 n.112; see also *id.* at 253 n.116, 299 n.303.

<sup>8</sup> Section 2 of the Sherman Act provides: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire . . . to monopolize any part of the trade or commerce . . . shall be deemed guilty of a felony . . ." 15 U.S.C. § 2. Illegal conduct can include corporate mergers. See LOUIS ALTMAN & MALLA POLLACK, CALLMANN ON UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 4:41 (4th ed. 2003).

<sup>9</sup> See Robert H. Lande, *Resurrecting Incipency: From Von's Grocery to Consumer Choice*, 68 ANTITRUST L. J. 875, 876 (2001).

<sup>10</sup> See Averitt, *supra* note 1, at 228–29, 233, 242, 251, 271, 275.

<sup>11</sup> The Supreme Court's most recent expansive interpretation of Section 5 occurred more than twenty years ago in *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 454 (1986), where the Court characterized Section 5 to include traditional antitrust violations and also "practices that the Commission determines are against public policy for other reasons."

<sup>12</sup> See William M. Landes & Richard A. Posner, *Rational Judicial Behavior: A Statistical Study* 6, tbl.3 (U. Chi. Law & Economics, Olin Working Paper No. 404, May 23, 2008), available at <http://ssrn.com/abstract=1126403> (documenting that a large proportion of the most conservative Supreme Court justices of recent decades are serving on the Court today).

<sup>13</sup> See 15 U.S.C. § 45.

<sup>14</sup> See Neil W. Averitt & Robert H. Lande, *Using The "Consumer Choice" Approach to Antitrust Law*, 74 ANTITRUST L.J. 175, 182 (2007) [hereinafter *Using the "Consumer Choice" Approach*]; see also Neil W. Averitt & Robert H. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust And Consumer Protection Law*, 65 ANTITRUST L.J. 713, 718–20 (1997) [hereinafter *Consumer Sovereignty*].

the two ingredients needed to exercise effective sovereignty—a competitive array of options and the ability to choose meaningfully from among these options.<sup>15</sup> Antitrust law prevents restraints that would restrict the competitive array of options in the marketplace, ensuring these competitive options are undiminished by artificial restrictions, such as price fixing or anticompetitive mergers. Consumer protection law then ensures that consumers are able to make a reasonably free and rational selection from among those options, unimpeded by artificial constraints, such as deception or the withholding of material information. In this way, the two halves of Section 5 together protect a free market economy.

By contrast, conduct not causing either type of problem should not violate Section 5 of the FTC Act. Conduct not unduly restricting the options available in the marketplace should not be an antitrust violation, and conduct not unduly restricting consumers' ability to choose from among these options should not constitute a consumer protection violation.

The choice approach to antitrust, instead of a price or efficiency approach,<sup>16</sup> has the advantage of explaining accurately, simply and intuitively, in a way that is easy to understand, why antitrust is good for consumer welfare.<sup>17</sup> Under a consumer choice standard, factors like innovation, perspectives,<sup>18</sup> quality and safety would in effect be moved up from the footnotes, where they are all too-often forgotten, into the text, where they would play a more prominent role in the antitrust evaluation. When antitrust law is construed and applied within the consumer choice framework, it will change some antitrust analysis because it will give greater emphasis to such short term issues as quality and variety competition, and to such long term issues as competitive innovation, ideas, and perspectives. It would make a difference in several broad categories of cases where a price or efficiency approach to antitrust often would lead to the wrong result.<sup>19</sup> The consumer choice framework could also lead to more aggressive enforcement,<sup>20</sup> but would do so in a predictable, principled manner.

<sup>15</sup> The converse, however, is not correct. It is not true that everything that reduces consumer choice is an antitrust violation, or that everything that reduces consumers' ability to choose from among the options the market provides is a consumer protection violation. What is true is that every antitrust violation reduces or distorts the choices that are on the market. It also is true that every consumer protection violation reduces or distorts consumers' ability to choose from among the options the market provides. Averitt & Lande, *Consumer Sovereignty*, *supra* note 14, at 715–22.

<sup>16</sup> For specific differences between the consumer choice, price and efficiency approaches, see Averitt & Lande, *Using the "Consumer Choice" Approach*, *supra* note 14, at 185–89.

<sup>17</sup> The choice framework should also be applied to Sherman Act and Clayton Act cases. Fortunately, there is reason to believe that all antitrust jurisprudence is slowly evolving in this direction. *Id.* at 263–64.

<sup>18</sup> Competition in terms of perspectives arises most meaningfully in the media contest. *See id.* at 206–12.

<sup>19</sup> There are several categories of cases where courts have reached the wrong results, and would be likely to reach the right results if they had used the choice approach. The first category involves conduct in markets with little or no price competition, as may occur with certain types of regulation. In these situations, no avenues exist for properly assessing consumer welfare without focusing explicitly on non-price issues. For these markets a price standard would be inadequate because our main concern is artificially diminished consumer choice. *See id.* at 196–99.

A second category of cases for which the consumer choice approach would work better involves conduct that increases consumers' search costs or otherwise impairs their decision-making ability. Such conduct tends to cause consumers to obtain products or services less suited to their needs, as well as to produce adverse effects on price. There are a large number of examples, including the advertising restriction cases and similar cases that involve collusion to raise consumer search costs. *Id.* at 199–201.

Finally, there are cases involving markets in which firms compete primarily through independent product development and creativity, rather than through price. These markets may involve high-tech innovation or editorial independence in the news media. *Id.* at 201–22.

<sup>20</sup> *Id.* at 196–222.

### Three Examples: Cases Similar to *N-Data*, Invitations to Collude, and Incipient Exclusive Dealing and Tying Violations

In this section I provide three examples of ways that Section 5 usefully could be construed and applied more expansively than the other antitrust laws. I will also briefly show how the choice framework would beneficially assist in the analysis of each example, and raise the probability of a reviewing court sustaining a decision by the Commission.

#### 1. Cases Similar to *N-Data*.

The FTC's action in the *Negotiated Data Solutions (N-Data)* case should be applauded,<sup>21</sup> and the Commission commended for condemning the opportunistic behavior at issue and affirming that conduct can be an antitrust violation of the FTC Act even if it does not violate the Sherman Act.<sup>22</sup>

The issues in *N-Data* never reached a reviewing court, but the next time the Commission decides a similar case the issues could be appealed. The FTC's approach to such cases would be more likely to be sustained if it were supplemented by "consumer choice" limitations that make it clearer and more predictable why the conduct at issue was challenged.

It is not completely clear that the conduct at issue in *N-Data* would have violated the Sherman Act. It could be argued that the conduct only constituted the exploitation of intellectual property rights, in which case it might not have violated the Sherman Act. It could also be argued that the case does not clearly involve an act of monopolization in violation of Section 2 of the Sherman Act because the original patent holder adhered to its agreement, and the successor holder was just exploiting its newly acquired parent rights, rather than taking improper steps to acquire or maintain monopoly power.<sup>23</sup> In light of this uncertainty, it is fortunate the Commission was able to use Section 5 of the FTC Act to challenge the anticompetitive conduct at issue.

Even though the Commission's *N-Data* decision came to the right result, the majority opinion's overall articulation of its "unfairness" standard risks attack for being unduly indefinite. The Commission correctly noted: "The legislative history from the debate regarding the creation of the Commission is replete with references to the types of conduct that Congress intended the Commission to challenge" including conduct that is "unjust, inequitable or . . . contrary to good morals."<sup>24</sup> Despite the clear legislative intent to give the Commission the power to define, challenge, and condemn such conduct, doing so arguably would give the Commission too much discretion.

Any Commission assertion that conduct violates Section 5 because it is "unjust, inequitable or . . . contrary to good morals" also could be criticized as not providing sufficient notice to businesses as to what specific conduct is illegal.

<sup>21</sup> See *Negotiated Data Solutions LLC*, FTC File No. 051 0094, 2008 WL 4407246 (Sept. 22, 2008) (complaint and consent order), available at <http://www.ftc.gov/os/caselist/0510094/080122statement.pdf>.

<sup>22</sup> *Id.*

<sup>23</sup> There was free and fair competition at the time presentations were made in the early 1990s by owners of different technologies to the Institute of Electrical and Electronics Engineers (IEEE), a standard-setting organization, in connection with the selection of a standard to facilitate interoperability between Ethernet technologies. In that connection the IEEE accepted the offer of National Semiconductor in 1994 to license its technology (which accomplished the desired objective) for a one-time fee of \$1000 (a price far below the monopoly level). After roughly eight years, following transfer of the pertinent patents to a new owner, the new owner increased its royalty demand. Rather than honor the price that had been established through the competitive standard-setting process, due to lock-in effects consumers purchasing from licensees were forced to pay higher prices to cover the increased licensing fees. This was a significant change to the (price) choice that competition had brought to the marketplace roughly eight years earlier. The conduct therefore quite properly was found to violate Section 5 of the FTC Act. See *N-Data*, 2008 WL 4407246.

<sup>24</sup> See Statement of Commission at 1–2, *N-Data*, available at <http://www.ftc.gov/os/caselist/0510094/080122statement.pdf> (citations omitted).

However, *N-Data's* conduct did artificially remove important consumer choices that would have arisen if competition had been set by the free market.<sup>25</sup> For this reason, it would have been condemned if the Commission had utilized the choice approach. Moreover, because the choice framework carefully relies upon an extensive body of earlier Commission "unfairness" policy statements and opinions, as well as court decisions, it would have helped inoculate the Commission's opinion against the charge that it provided inadequate notice that the conduct in question was illegal. Additionally, the consumer choice limitation would help reassure the antitrust and business communities that the Commission is not evaluating conduct on an ad hoc, unprincipled basis. When a case like *N-Data* is appealed, the reviewing courts would be more likely to give deference to the FTC's interpretation of Section 5 if "unfairness" were limited to practices that significantly interfere with consumer choice, rather than if the Commission uses "fuzzier" concepts such as "unjust," "inequitable," or "contrary to good morals." The consumer choice limitation also would provide bounds that would demonstrate that the Commission was not seeking open ended powers. This should help convince reviewing courts to give the Commission the considerable deference it deserves when it goes beyond traditional Sherman Act violations.

## 2. *Invitations to Collude.*

Invitations to collude can violate Section 2 of the Sherman Act.<sup>26</sup> However, for enforcers to prove a Sherman Act violation they must undertake several formidable tasks.<sup>27</sup> First, they must prove a relevant market, a complex and time-consuming undertaking. Then the enforcers must prove that the challenged conduct was anticompetitive (as that term has been defined) and that it would result in either the respondent's achieving or maintaining monopoly power or the "dangerous probability" of its achieving monopoly power. This analysis would have to show harm to competition, including a careful analysis of barriers to entry. Lastly, claimed efficiencies associated with the practices would have to be litigated.<sup>28</sup> Like every successful Section 2 action, these cases would be complex, lengthy, and costly.

By contrast, naked collusion cases are much less complicated. In these cases the enforcers do not have to define markets, prove difficulty of entry or any form of market power, litigate efficiencies, or establish actual anticompetitive effects.<sup>29</sup>

Invitation to collude cases should be as easy to prove as collusion cases. The same jurisprudential reasons that permit the enforcers to dispense with the complex, costly and lengthy market definition and market power issues in collusion cases also apply to invitations to collude cases. Moreover, invitations to collude can comfortably be characterized as conduct that significantly risks impairing the price or other choices that the marketplace otherwise would provide to consumers, and thus fit comfortably within the consumer choice framework. They should, as the Commission has concluded,<sup>30</sup> violate Section 5 of the FTC Act without requiring the Commission

<sup>25</sup> If the Commission adopted the self-limiting principle that every antitrust violation must significantly impair the choices that free competition would have brought to the marketplace, in the *N-Data* case the choice option of concern would have been the price of the products in question. At the time of the original presentations to the IEEE, the presentations should have been forced to fully compete with each other in terms of price options (as well as quality options). The IEEE should have been free to select as its preferred technological option the one with the lowest long term cost.

<sup>26</sup> *United States v. American Airlines*, 743 F.2d 1114, 1121 (5th Cir. 1984) ("attempted monopolization may be established by proof of a solicitation along with the requisite intent").

<sup>27</sup> See LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* ch. 3 (2006).

<sup>28</sup> *Id.* at 73–74.

<sup>29</sup> *Id.* at 228–29. This is not to suggest that collusion cases are simple. Collusion cases are, however, far less complex than Section 2 cases.

<sup>30</sup> Valassis Commc'ns, Inc., FTC File No. 051 0008 (Mar. 14, 2006) (Analysis to Aid Public Comment), available at <http://www.ftc.gov/os/caselist/0510008/060314ana0510008.pdf>.

to undertake the Herculean tasks of proving the traditional Sherman Act requirements. This would save money for the taxpayer and also lead to faster and more reliable results.

### 3. Incipient Exclusive Dealing and Tying Violations.

There is substantial uncertainty over the market share required to establish a tying violation, and the amount of foreclosure necessary for an exclusive dealing violation.<sup>31</sup> Similar uncertainty exists over how much pressure or inducement, in the form of a discount or other conduct, must exist before an arrangement will be termed a "tying" or "exclusive dealing" arrangement.<sup>32</sup>

The traditional market share requirements and degree of certainty over whether an effective tie or exclusive dealing arrangement should be found to exist should be relaxed when the case involves a defendant with a significantly larger market share than that of the plaintiff. In these "incipient" tying or exclusive dealing situations, incumbents often will be able to disadvantage significantly smaller competitors or would-be entrants because their market share is larger, even if it is not large enough for a traditional Sherman Act violation. Suppose, for example, a company introduces a new brand of super-premium ice cream. Suppose also that an existing seller of super-premium ice cream has 30 percent of this market, and also another 30 percent of the premium and non-premium ice cream markets. Then suppose the incumbent firm tells supermarkets that they have to choose between the established firm's products and the newcomer's products. No efficiencies would arise if the established firm's demands were met.

These facts, including defendant's low market share, would be unlikely to constitute either a tying or exclusive dealing case.<sup>33</sup> Moreover, market definition and market power or foreclosure issues would be extremely difficult, lengthy, and costly to litigate. However, if the incumbent's exclusionary strategy succeeded, consumer choice in this market, in terms of varieties of ice cream on the market, would be diminished for the short term. Moreover, successful exclusion would risk diminishing incentives to innovate and enter by non-incumbents in the long term. This conduct should violate Section 5 as an incipient exclusive dealing or tying arrangement.<sup>34</sup> The consumer choice framework helps explain why incipient tying and exclusive dealing arrangements should violate Section 5. Its focus on actual or potential choice in the marketplace should also increase predictability for the business community and make it more likely that reviewing courts would uphold the Commission's determinations. Moreover, treating incipient exclusive

<sup>31</sup> See Sullivan & Grimes, *supra* note 27, §§ 7.2, 7.3; HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE ch. 10 (3d ed. 2005). The market shares and market power required can be similar to those required for Section 2 violations as some commentators suggest: "courts require a significantly lower foreclosure share in Sherman Act § 2 cases than in Sherman Act § 1 cases." See EINER ELHAUGE & DAMIEN GERADIN, GLOBAL ANTITRUST LAW AND ECONOMICS 530 (2007).

<sup>32</sup> See ELHAUGE & GERADIN, *supra* note 31, at 623–33.

<sup>33</sup> For the necessary requirements, see *id.* at 352–87, 404–05, 435–39.

<sup>34</sup> A similar exclusive dealing case where a diminution of consumer choice occurred was in *J.B.D.L. Corp. v. Wyeth-Ayerst Labs., Inc.*, 485 F.3d 880 (6th Cir. 2007). Although the *Wyeth* case was vastly more complicated than the ice cream hypothetical, the conduct at issue was bundled discounts, in the form of rebates, that were tantamount to an exclusive dealing arrangement. *Id.* at 884–85. The conduct offered no significant efficiencies and resulted in the serious possibility of diminished consumer choice in the conjugated estrogen market. See *id.* at 886 (One of Wyeth's clients, Express Scripts, wanted to renegotiate its contract with Wyeth because a small group of Scripts' customers insisted on having the other product, Cenestin, available but defendant refused and reminded Script that 40 million dollars in rebates per year would be at risk if it made the other product available). The defendant's exclusionary strategy could have significantly diminished an important aspect of consumer choice in the short term, regardless whether prices were affected by its conduct. Moreover, successful exclusion would risk diminishing incentives to innovate and enter by non-incumbents in the long term. Unfortunately, the court focused on price, rather than consumer choice, and did not condemn the conduct in question. *Id.* at 886–91. Regardless whether the conduct should have been found to constitute a Section 2 violation, it should be a violation of Section 5 of the FTC Act.

dealing or tying arrangements as a violation of Section 5 would advance international harmonization in an increasingly globalized economy by beneficially moving U.S. antitrust law in the direction of European Union competition law.

**Conclusion**

In conclusion, Section 5 of the FTC Act should be interpreted to be significantly broader than the other antitrust laws. But this expansive mandate only should be used within the consumer choice framework.

Mr. TERRY. Thank you, and, Mr. Ohm, you are now recognized for your 5 minutes.

#### STATEMENT OF PAUL OHM

Mr. OHM. Thank you, Chairman Terry, Ranking Member Schakowsky, and members of the subcommittee. I am here to talk today about consumer protection and in particular online privacy and data security. My comments reflect not only my scholarship but also the 10 months I spent as senior policy advisor in the office of policy planning at the Federal Trade Commission from 2012 to 2013.

I have three broad points I would like to make in my short amount of time. Number one, we should understand that there is a tendency within debates about the FTC to focus on a hypothetical FTC, one that does not reflect the FTC as it actually exists and operates. The FTC that really exists is one that is informed, and recent scholarship really exposes this, through a theory known as privacy on the ground as opposed to privacy on the books.

The idea is privacy is a very complex, nuanced, textured, contextual thing. We shouldn't want an agency that once and for all declares the rules of the game. Instead we should want something that is more tenable to technological innovation and dynamism. And that is exactly what we have through this structure set up by Congress and the way it has been executed by the FTC.

An important component of this is documented in the scholarship as a large cadre of privacy professionals, lawyers here in D.C. and around the country, who read the FTC's pronouncements as a kind of common law of privacy law. This belies the notion that this is this opaque, progressive, envelope-pushing agency that never reveals the rules of the road for privacy. Quite the contrary, the privacy rules are something that are studied, understood, and companies are made to order their activities accordingly.

Number two, and I am sorry to use a very technical, legal scholarship term, if it ain't broke, don't fix it. The Federal Trade Commission, I left my year very, very impressed by the efficiency and the way that this agency executes its privacy mission. And I would urge Congress to help the commission maintain the status quo, the tools and the resources it needs to do the job well. By I can't resist giving you a few recommendations for small fixes that you could make to Section 5 and other parts of the FTC authorization to help them do their job better.

Number one, as I am sure you are all aware, there is ongoing litigation against Windom in data security, and as I say in my written testimony, there isn't a defender of Windom out there that tries to defend the reasonableness of the data security practices in that case. Quite the contrary, there are some very, very creative jurisdictional arguments, to my mind, far too creative jurisdictional arguments, that I certainly hope the federal courts will decline.

But in the meantime, all of this activity and all of this aggressive defense, which of course is the defendant's right, has cast something of a cloud over the FTC's ongoing ability to bring data security cases under Section 5. And I don't think I need to tell the members of the subcommittee, this is a very bad time to be taking away one of the few tools we have to incentivize good data security.

I think every American citizen was impacted by some of the data breaches that occurred over the holidays.

Companies are not living up to the standards and expectations we have of them in securing our personal and sensitive data. And they are not living up to these expectations even though the FTC is on the beat. How much worse will it be if the FTC's jurisdiction over data security is called into question? And I would ask Congress to clarify what is already in the statute, that data security falls within Section 5.

And last but not least, number three, I would argue that the definition of harm as it is currently defined in the word unfairness in Section 5, could use a refresh. It was last defined by the FTC in 1980. Congress memorialized this understanding in the statute in 1994. And at that time, two statements were made about harm that I think do not reflect the way the Internet has changed the nature of privacy harm.

Number one, the statement says—and it is laudable that the statement is still so relevant 23 years later. It says harm is almost always monetary, and yet we have case after case demonstrating nonmonetary yet significant harms from privacy violations on the Internet. I would be happy to elaborate during questions. And two, the statement says that harm under unfairness in Section 5 is rarely merely emotional, injurious primarily to emotional standards.

Again we have seen in many cases, for example, the FTC's case in Designerware that harms to emotion may be quite concrete, quite substantial, and the kind of thing that an effective law enforcement agency like the FTC should have the jurisdiction to bring cases against. Thank you very much for having me.

[The prepared statement of Mr. Ohm follows:]

Statement of Professor Paul Ohm  
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Before the  
Subcommittee on Commerce, Manufacturing, and Trade  
Committee on Energy and Commerce  
U.S. House of Representatives  
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Chairman Terry, Ranking Member Schakowsky, and Members of the Subcommittee, I appreciate the opportunity to be here with you today to discuss the Federal Trade Commission ("FTC") at 100, reflecting on the past, present, and future of this important government agency.

I am an Associate Professor of Law at the University of Colorado Law School and a Faculty Director of the Silicon Flatirons Center for Law, Technology, and Entrepreneurship. I have written and lectured extensively on information privacy, computer crime, and technology and the law. From 2012 to 2013, I served for ten months as Senior Policy Advisor in the Office of Policy Planning of the FTC. These comments are made in my personal, academic capacity and do not necessarily reflect the views of any organization with which I am now affiliated or have been affiliated with in the past. Although some of what I discuss below involve matters that were pending during my year at the FTC, I rely upon only facts in the public record. My comments do not necessarily reflect the views of the FTC, its staff, or individual Commissioners.

I will focus my remarks on the FTC's work on data security and consumer privacy, and especially the privacy of information collected from consumers via the Internet. I will not focus on the FTC's important work in other aspects of consumer protection and competition.

Although vital work on privacy protection takes place throughout federal, state, and local governments, were it not for the activities of the FTC, no agency would play the

critical roles of leader, central clearinghouse, and backstop. The FTC is the only agency with the authority and expertise to oversee the many industries that are not regulated specifically by statute. It has been recognized as a peer by the community of data protection authorities from other countries for its central role in American privacy policy. The FTC has become the centerpiece of privacy policy in this country, and I encourage Congress to continue to grant it the tools and authorities it needs to continue to do its job well.

At the outset, consider a simple, important fact: The United States boasts the most innovative, dynamic technology industry in the world. The bubbling fount of activity and competition and vibrancy in this industry belies any argument that the FTC has sapped the innovative spirit. Indeed, the FTC has demonstrated that consumer protection and technological dynamism can prosperously coexist.

#### **1 THE FTC'S EXERCISE OF ITS ENFORCEMENT DISCRETION**

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Many employees of the FTC see the agency first and foremost as a civil law enforcement agency. Of course the agency also promulgates regulations and guidance and engages in research and consumer education, but these roles are second in priority for many at the FTC. The beating heart of the FTC reverberates in its investigations, judicial filings, adjudications, settlements and consent decrees.

In its privacy enforcement activity, the FTC has exercised wise and measured discretion. I will elaborate this point to urge the Subcommittee to focus not on a hypothetical FTC or imaginary FTC, one which wields its power like a sword and presses the envelope of statutory text. It should focus on the actual FTC, one which chooses cases with care.

The simplest reason why the FTC exercises great discretion in selecting cases is

structural: The FTC is a very small agency. It employs only 1,100 civil servants, many of whom are engaged in something other than its consumer protection mission. With such a small workforce, the agency can investigate only a tiny fraction of the many complaints it receives each year.<sup>1</sup>

Political accountability exerts another structural check on the agency's enforcement decisions. The statutorily mandated bipartisan composition of the Commission ensures that more than one political party will influence and cast votes on enforcement actions.<sup>2</sup> In addition, FTC Commissioners and staff meet regularly with members of Congress and Congressional staff and know that they will be held to account for overly aggressive action.

The FTC's wise use of its enforcement discretion is apparent in the cases it brings. Most of the cases the FTC brings each year are clear cut. It almost always brings cases in which the proof of deceptive or unfair conduct is undeniable, cases in which the defendant's conduct falls well below standards of reasonableness.<sup>3</sup> This is not to say that these cases are easy; on the contrary, many are quite complex. But the FTC tends to focus on cases with a significant impact on consumer protection, avoiding marginal cases that push the envelope unnecessarily.

Another measure of the strength of these cases is the rate at which they are settled. In the history of the FTC's work on online privacy, the number of cases that have not led to swift settlement can be counted on one hand.<sup>4</sup> And many of the cases that have settled have

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<sup>1</sup> For example, the FTC received more than two million complaints to its Consumer Sentinel database in 2012 alone. FED. TRADE COMM'N, CONSUMER SENTINEL NETWORK DATA BOOK: FOR JANUARY – DECEMBER 2012 at 3.

<sup>2</sup> 15 U.S.C. § 41.

<sup>3</sup> Daniel J. Solove & Woodrow Hartzog, *The FTC and the New Common Law of Privacy*, 114 COLUM. L. REV. (forthcoming 2014) (manuscript at 19), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2312913](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2312913) (“[T]he Commission also tends to target cases with a high likelihood of success and where companies have no viable defense.”).

<sup>4</sup> *Id.* at 18 (finding only two out of more than 150 privacy-related cases that did not lead to settlement).

been brought against companies that have litigated privacy lawsuits brought by other plaintiffs tenaciously and relentlessly.<sup>5</sup>

Consider the data security case brought against Wyndham, which is one of the rare cases that did not settle but instead is actively being litigated in federal court.<sup>6</sup> Wyndham has attracted the support of some academics and trade associations who have filed friend of the court briefs advancing aggressive and novel (and to my mind, far too creative) challenges to FTC jurisdiction.<sup>7</sup> Almost none of Wyndham's champions have tried to defend the reasonableness of Wyndham's security practices, which appears to have been far below industry standards.<sup>8</sup> I speak not only from my experience as a legal scholar, former FTC official, and former U.S. Department of Justice computer crimes prosecutor but also from my experience as an IT professional who helped defend several large computer networks. Once you move past the jurisdictional side show, the Wyndham case supports the point I am making: the FTC sued Wyndham because the case was clear cut and because the harm to consumers was so plain.

## 2 THE FTC AND EVOLVING STANDARDS

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If the only measure of effective agency action were the promulgation of crystal clear,

<sup>5</sup> Compare Press Release, Fed. Trade Comm'n, Google Will Pay \$22.5 Million to Settle FTC Charges It Misrepresented Privacy Assurances to Users of Apple's Safari Internet Browser (August 9, 2012), available at <http://www.ftc.gov/news-events/press-releases/2012/08/google-will-pay-225-million-settle-ftc-charges-it-misrepresented-with-Venkat-Balasubramami>, *Google Wins Cookie Privacy Lawsuit*, TECH. & MARKETING LAW BLOG (Oct. 31, 2013) <http://blog.ericgoldman.org/archives/2013/10/google-wins-cookie-privacy-lawsuit.htm>.

<sup>6</sup> *FTC v. Wyndham Worldwide Corp.*, No. 2:13-cv-01887 (D.N.J. filed June 26, 2012).

<sup>7</sup> Brief for International Franchise Association as Amicus Curiae Supporting Defendants, *Wyndham Worldwide Corp.*, No. 2:13-cv-01887 (D.N.J. filed May 3, 2013); Brief for Chamber of Commerce of the United States et al. as Amici Curiae Supporting Defendants, *Wyndham Worldwide Corp.*, No. 2:13-cv-01887 (D.N.J. filed May 3, 2013); Brief for TechFreedom et al. as Amici Curiae Supporting Defendants *Wyndham Worldwide Corp.*, No. 2:13-cv-01887 (D.N.J. filed May 3, 2013).

<sup>8</sup> Amended Complaint, *FTC v. Wyndham Worldwide Corp.*, No. 2:13-cv-01887, at 10-12 (D. Ariz. Filed Aug 17, 2012) (alleging "Defendant's Inadequate Data Security Practices").

detailed, and highly prescriptive rules, we might worry about the FTC's emphasis on enforcement over rulemaking. This worry seems unfounded, however, because the FTC undertakes its enforcement activities in a way that leads gradually to evolving standards of appropriate conduct, standards most affected companies seem to have little trouble understanding. Two recent law review articles illuminate this point.

First, Daniel Solove and Woodrow Hartzog argue that the FTC's enforcement activities operate as a sort of common law of FTC Section 5 privacy law.<sup>9</sup> With every settlement, the FTC approves and publishes a complaint, a consent order, and a press release, which lay out in some detail the theory of the FTC case. The consent order is the product of active negotiation between the FTC and the defendant, which helps ensure that at least one company's point of view is reflected.

What makes this common law analogy work, according to the authors, is the work of a large and growing cadre of privacy professionals in companies and law firms who give these FTC documents the level of scrutiny that litigators give to appellate decisions in other areas of the law.<sup>10</sup> These professionals seem quite capable of determining the FTC's evolving standards without difficulty, and they give their clients the clear advice needed to avoid FTC scrutiny and enforcement.<sup>11</sup>

Second, Deirdre Mulligan and Kenneth Bamberger have elaborated a theory of "Privacy on the Ground," meaning privacy policy as it emerges from the practices of these same privacy professionals.<sup>12</sup> According to them, we make a mistake if we look only to "privacy on the books," as codified in statute and regulation, because the practices of

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<sup>9</sup> Solove & Hartzog, *supra* note 3, 15-28.

<sup>10</sup> *Id.* at 24-27.

<sup>11</sup> *Id.*

<sup>12</sup> Kenneth A. Bamberger & Deirdre K. Mulligan, *Privacy on the Books and on the Ground*, 63 STAN. L. REV. 247 (2011).

professionals help build a richer body of privacy protection.<sup>13</sup> They have documented through careful qualitative empirical research how Chief Privacy Officers and other privacy professionals look in particular to pronouncements from the FTC to help them develop and understand privacy on the ground.<sup>14</sup>

We should prefer the FTC's development of evolving standards of privacy law to prescriptive rulemaking. Privacy is complex and contextual. What people expect and worry about can tend to shift with every technological advance. It is very unlikely that this contextual complexity can ever be fixed in a rigid set of promulgated rules. Instead, what is needed is a flexible standard, administered by an expert and independent agency (perhaps one constrained by limited resources and political accountability) which is dedicated to making public the reasoning underlying its enforcement actions. In other words, what is needed is precisely what Congress and the FTC have developed.

### 3 THE ROLE OF "SOFT LAW" AT THE FTC

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The FTC influences debates over privacy policy through activities that are far less formal than enforcement actions or regulation. Solove and Hartzog refer to these as the "soft law" of the FTC, which take "the form of guidelines, press releases, workshops, and white papers."<sup>15</sup> These activities leverage the expertise, competence, and convening power of the FTC to produce high quality reflections on the state of privacy today.

The high watermark of this activity is perhaps the 2012 report on *Protecting Consumer Privacy in an Era of Rapid Change*.<sup>16</sup> The FTC staff worked on this report for more than a

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<sup>13</sup> *Id.* at 251.

<sup>14</sup> *Id.* at 273-75.

<sup>15</sup> Solove & Hartzog, *supra* note 3, 27.

<sup>16</sup> FED. TRADE COMM'N, PROTECTING CONSUMER PRIVACY IN AN ERA OF RAPID CHANGE (2012), available at <http://www.ftc.gov/sites/default/files/documents/reports/federal-trade->

year, holding several well-received workshops featuring many different interested stakeholders, issuing a draft report and receiving public comment, and incorporating that feedback and working with Commissioners to issue the official report.<sup>17</sup>

The report explains that it is “intended to articulate best practices” but not necessarily announce how the agency interprets its authorities or intends to use its discretion.<sup>18</sup> And indeed, the Report does give examples of privacy best practices that go beyond what might be considered deceptive or unfair under Section 5.<sup>19</sup> But some critics seem to forget or distrust this statement of purpose and instead assume that the framework announced in the report reveals the new enforcement agenda of the agency.<sup>20</sup> These critics argue that some of the privacy best practices discussed are in fact outside the agency’s authority or at least represent rules the agency would be unwise to enforce.<sup>21</sup> Once again, these critics seem to be focusing on a hypothetical FTC rather than the real FTC.

We should celebrate not castigate the FTC for taking on this difficult project. The privacy report engages seriously with competing arguments and reflects soberly and wisely on these conflicts. Modern debates about privacy and technology count among some of the thorniest, most complex debates in which we as a society are engaged, and there is always

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commission-report-protecting-consumer-privacy-era-rapid-change-recommendations/120326privacyreport.pdf.

<sup>17</sup> *Id.* at 2-3.

<sup>18</sup> *Id.* At iii (“These best practices can be useful to companies as they develop and maintain processes and systems to operationalize privacy and data security practices within their businesses. The final privacy framework contained in this Report is also intended to assist Congress as it considers privacy legislation. To the extent the framework goes beyond existing legal requirements, the framework is not intended to serve as a template for law enforcement actions or regulations under laws currently enforced by the FTC.”).

<sup>19</sup> For example, the report concludes that “affirmative express consent is appropriate when a company uses sensitive data for any marketing,” which seems to state advice about best practices rather than a blanket requirement for triggering Section 5 liability. *Id.* at 47.

<sup>20</sup> *E.g.* Thomas M. Lenard and Paul H. Rubin, *The FTC and Privacy: We Don’t Need No Stinking Data*, THE ANTITRUST SOURCE (OCT. 2012).

<sup>21</sup> *Id.* at 3 (“It is inappropriate for the FTC to call for a massive new regulatory scheme when the only available systematic surveys of the industry are both out of date and suggest significant improvement over time.”).

room for rigorous thought leadership of the kind the FTC has provided. The final product has already had great influence on privacy debates, here and abroad, and it promises to enjoy a long, useful shelf life. We should encourage the FTC to conduct more work along these lines.

#### **4 EMPOWERING AN FTC FOR THE NEXT 100 YEARS**

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Overall, this statement paints an optimistic picture of privacy enforcement at the FTC. I urge Congress not to upset the status quo in any significant ways. Still, I offer four smaller proposals for reforms and clarifications Congress could enact that would help the FTC with its privacy mission: clarifying the FTC's Section 5 authority to police data security; amending the definition of "unfair" in Section 5 to keep pace with changing privacy harms; bolstering the FTC's authority to lodge civil penalties; and granting the FTC additional resources, particularly with respect to hiring in-house technologists.

##### **4.1 CLARIFYING DATA SECURITY AUTHORITY.**

I have already given my thoughts about the FTC's ongoing lawsuit against Wyndham. Wyndham presents an easy case for liability for patently unreasonable data security practices. The jurisdictional arguments, while creative, should not carry the day in federal court. Yet the force with which the case has been defended, and the cacophony of supporters who have filed briefs on behalf of Wyndham have cast a small cloud over the FTC's ability to police data security. Congress might consider making explicit what is already clearly within the broad strictures of Section 5: the FTC has the authority to find violations for unreasonable security practices, meaning practices that unreasonably fail to live up to industry standards. This recommendation would take on greater urgency were any federal court to rule in favor of Wyndham's creative arguments.

I know every member of Congress is well aware that this would be an awful time to weaken the few tools we have to encourage good data security. Every American citizen, it seems, has personally or at least knows someone who has been affected by the attacks that hit American retailers around the holidays. Threats on the Internet to sensitive data seem to be increasing in frequency and sophistication.

Although most American companies seem genuinely interested in trying to secure the personal and sensitive information of their customers, too many fall short. Perhaps they are overwhelmed by the significant technical challenges, or maybe they have calculated that their focus and resources are better spent elsewhere. They make these disastrous calculations despite the fact that the FTC has been a cop on the beat. How much worse might things become if the only government agency with a comprehensive, multi-industry responsibility for policing data security is forced to scale back its efforts?

#### 4.2 AMENDING THE DEFINITION OF “UNFAIR” ACTS OF PRACTICES

In 1980, the FTC issued a policy statement detailing how it interpreted the word “unfair” in Section 5.<sup>22</sup> At the heart of the policy statement was a harms versus benefits balancing test, which Congress largely incorporated into the statute by amendment in 1994.<sup>23</sup>

In my opinion, this definition is unduly narrow and constrained, and Congress should consider amending it to keep up better with the seismic changes that have been wrought by the modern Internet, and even more so the changes yet to come. For example, in the 1980 statement, the FTC explained that

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<sup>22</sup> Fed. Trade Comm'n, FTC Policy Statement on Unfairness (Dec. 17, 1980), *available at* <http://www.ftc.gov/ftc-policy-statement-on-unfairness>.

<sup>23</sup> 15 U.S.C. § 45(n) (defining unfair acts or practices as those that “cause[] or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition”).

The Commission is not concerned with trivial or merely speculative harms. In most cases a substantial injury involves monetary harm, as when sellers coerce consumers into purchasing unwanted goods or services or when consumers buy defective goods or services on credit but are unable to assert against the creditor claims or defenses arising from the transaction. Unwarranted health and safety risks may also support a finding of unfairness. Emotional impact and other more subjective types of harm, on the other hand, will not ordinarily make a practice unfair. Thus, for example, the Commission will not seek to ban an advertisement merely because it offends the tastes or social beliefs of some viewers, as has been suggested in some of the comments.<sup>24</sup>

While the Commission should be praised for having the foresight to draft a policy statement that still serves a purpose more than two decades on, several aspects of this passage seem no longer to describe new forms of privacy harm that the Internet has wrought. Although it still may be true that privacy injuries “involve[] monetary harm” in “most” cases,<sup>25</sup> it is also true that nonmonetary harm abounds online, and the FTC should be empowered to bring cases to redress those harms. As only one example, every person who has spent hours dealing with a stolen credit card number understands the concretely harmful impact of data breach, even if this injury might be difficult to measure in dollars.

Another part of the passage that has not aged well is the way it associates “emotional impact” only with mere offense to “tastes or social beliefs.”<sup>26</sup> Many privacy law scholars have documented how privacy harms often affect emotions first and foremost. The FTC itself seems to understand this, because it charged an unfairness count in *Designerware*, a case involving the use by furniture rental stores of hidden software installed on rental laptops that surreptitiously videotaped consumers in their homes.<sup>27</sup> The FTC found consumer harm from the fact that some of the companies used the software to record “images of visitors, children, family interactions, partially undressed individuals,

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<sup>24</sup> FTC Policy Statement on Unfairness, *supra* note 22.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Designerware, LLC*, 2013 WL 1684153 (F.T.C. 2013) (complaint, decision and order).

and couples engaged in intimate activities.”<sup>28</sup> This was unfair, in part, because “[s]haring these images with third parties can cause consumers financial and physical injury and impair their peaceful enjoyment of their homes.”<sup>29</sup> This may have been largely nonmonetary harm, and it seems to have involved primarily harm to emotions, yet the FTC was nevertheless correct to plead this as an unfairness case.

None of this is to argue that Congress or the FTC should redefine unfairness to extend to vague, “trivial or merely speculative harms.”<sup>30</sup> On the contrary, as I have suggested in some of my writing, modern privacy harms are often concrete and deeply felt, even if nonmonetary and difficult to quantify. This is especially so if unfairness encompasses, as the Policy Statement says it does, not merely completed harm but also the “significant risk of concrete harm.”<sup>31</sup>

The victims of data misuse suffer fear and apprehension. Data gleaned from large databases have been used by stalkers.<sup>32</sup> Modern databases, filled by the ever proliferating array of sensors that dot our landscape, track our every movement<sup>33</sup> and communication, including the kind of evanescent water-cooler chatter that was once saved nowhere. Newer sensors are detecting our paces, heartbeats and even brain waves.<sup>34</sup> Miniature cameras contain enough storage to snap a photo every moment.<sup>35</sup> And Big Data techniques give companies the power to make inferences from this rich database about our predilections,

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<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> FTC Policy Statement on Unfairness, *supra* note 22.

<sup>31</sup> *Id.* n. 12.

<sup>32</sup> *E.g.* *Remsburg v. Docusearch*, 149 N.H. 148 (2003).

<sup>33</sup> Noam Cohen, *It's Tracking Your Every Move and You May Not Even Know*, N.Y. TIMES, March 26, 2011 at A1.

<sup>34</sup> Quentin Hardy, *Big Data in Your Blood*, N.Y. TIMES BITS BLOG, Sept. 7, 2012, <http://bits.blogs.nytimes.com/2012/09/07/big-data-in-your-blood/>.

<sup>35</sup> Duncan Geere, *Logging Life with a Lapel Camera*, MIT TECH. REV., May 10, 2013, <http://www.technologyreview.com/news/514361/logging-life-with-a-lapel-camera/>.

habits, and desires.<sup>36</sup> Four years ago, I described this confluence of technologies and business models as creating a “database of ruin,” one which holds a secret about every person in America that he or she would not want his or her worst enemy to know.<sup>37</sup> This description seems truer today than then. The database of ruin, when misused, can lead to significant harm, the kind of harm that should support a finding of unfair conduct.

I could direct this appeal at the FTC, which retains the power to revisit the 1980 unfairness statement. But it is also properly directed at Congress, which could amend Section 5 to make it more responsive to redressing privacy harm in the Internet age.<sup>38</sup> I urge Congress to amend the definition of “unfair” to allow it to apply to any harm, monetary or not, including harm with emotional impact, provided the harm is significant and concrete.

#### 4.3 ENHANCING THE FTC’S POWER TO SEEK CIVIL PENALTIES

For the most part, the FTC has made the most of the remedial powers granted to it. Under its power to seek preliminary and permanent injunctions, it has crafted broad and aggressive consent decrees. Under the same authority, it has sought equitable monetary relief, to try to recover funds to make victims whole or disgorge ill-gotten gains.

But all too often, and particularly in data security cases, we see companies adopt lax, substandard practices that fall well below reasonable industry standards. It may be that these outliers do not feel deterred by the threat of FTC action. To try to alter that behavior of companies like these, Congress should increase the deterrent effect, by giving the FTC an

<sup>36</sup> VIKTOR MAYER-SCHÖNBERGER & KENNETH CUKIER, *BIG DATA: A REVOLUTION THAT WILL TRANSFORM HOW WE LIVE, WORK, AND THINK* (2013).

<sup>37</sup> Paul Ohm, *Broken Promises of Privacy: Responding to the Surprising Failure of Anonymization*, 57 *UCLA L. REV.* 1701, 1748 (2010).

<sup>38</sup> If Congress is reluctant to amend Section 5, it could exhort the FTC to consider redrafting the 1980 policy statement, which after all was written in response to a letter from the Consumer Subcommittee of the House Committee on Commerce, Science, and Transportation. FTC Policy Statement on Unfairness, *supra* note 22.

enhanced authority to seek meaningful civil penalties from courts.

#### 4.4 GRANT ADDITIONAL RESOURCES TO THE FTC

It is impressive that the FTC has accomplished as much as it has, despite the relatively small size of its staff and its relatively low operating budget. The agency has done much with little, so imagine what it might do with a little more.

I would emphasize in particular the need to give the FTC more resources devoted to keeping up with rapidly changing technology. The FTC already employs several very talented technologists in its staff, and some of its lawyers are recovering technologists too. But given the decidedly technological turn that the FTC docket has taken in recent years, it needs many more. And these technologists need access to cutting edge technologies for training, investigation, and forensic analysis, technologies that at the agency are currently in short supply.

Mr. TERRY. Thank you. All well done. Thank you very much. Very informative. Now it is our opportunity on this panel to ask you questions, and I think one of the areas of great discussion among those of us here who have never been on the inside of the FTC but we look at the unfairness issue and whether it appears so nebulous to us that it can morph into anything you want it to be, and that seems to be what is occurring now.

So I want to ask each and every one of you what is your view and I know this is an unfair question in the sense that you get about a minute to answer it. But what is your view? Is the FTC expanding the use of the term unfairness? Are they changing it? Do you have any specific recommendations to us on a way to make it more consistent? Mr. Beales, we will start with you.

Mr. BEALES. I think that the definition that Congress wrote into the law is a good one. It focuses on essentially a cost/benefit test. And the issue is how good a job does the commission do in conducting that kind of cost/benefit analysis that is what the statute requires. But that is a conduct issue. That is how do you go about using the standard as opposed to what is the standard.

I think there is no question that the FTC has expanded its use of unfairness. There was a long period, shortly after the unfairness policy statement, where the commission was extremely reluctant to use unfairness for anything, but I think it is a useful legal theory. It is one that in many cases focuses much more clearly on the right questions, and I think probably data security is one of those where the issue is really what are the costs, what are the benefits.

Mr. CRANE. So, Chairman Terry, you are quite right that the word unfair is quite nebulous and open-ended, and the question is unfair as to whom. And I would suggest that the right answer to that question is unfair as to consumers. And as Professor Yoo suggested, one of the problems is that unfairness could be turned into a protection for less efficient competitors who simply cannot keep up because they are not as efficient. So I would suggest that any guidelines that the commission would issue on the meaning of Section 5 would make clear that a minimum requirement for enforcement of Section 5 would be unfairness to the welfare of consumers.

Mr. TERRY. Thank you. Mr. Manne.

Mr. MANNE. I think the statutory language is good, as I suggested. And I think the balancing test that it contemplates is appropriate. The problem, as I think Howard suggested, is in its application. And there is at least two problems here. One is we don't actually know for sure what the FTC is doing because the vast majority if not the entirety with two minor exceptions frankly of the cases where they have interpreted Section 5, in particular in privacy and data security cases, arise in dissent decrees with very little analysis by the commission.

To call this common law is a little bit crazy. There is no way you could discern clear principles, and let alone clear principles that might have evolved over time from what the commission gives us in its dissent decrees. So if they are actually applying the statute correctly, we don't know.

But I think there is evidence, as the Apple case suggests, that they are not applying it correctly anyway. They seem to have somewhat abandoned or at least truncated collapsed into a reasonable-

ness test the entirety of the language in the statute. And that may indeed in the background be analogous to what the statute requires, but I am skeptical.

There is very little clear application of the specific facts of any specific case to, sorry, the language of the statute to the specific facts of each specific case. The dissent decrees look the same. The remedies are the same, and that can't be right. It can't be that every company that is addressed by the FTC, no how big they are or what the problems are, deserves exactly the same remedy and exactly the same 20-year dissent decree.

Mr. TERRY. Right, Mr. Yoo.

Mr. YOO. We actually have a lot of studies of other agencies who have applied similarly nebulous mandates, and what they find is that even an attempt to distill common law principles from them have revealed that the agency behaves in an extremely unpredictable way, particularly under mandates such as public interest mandates and unfairness mandates. Attempts to distill from them a consistent point of view has failed.

And what is interesting is when you have multi-factor balancing tests where you are doing multiple things, the agency can justify almost any decision it wants to make. Now, the FTC actually historically solved this by focusing on consumer welfare. By disciplining itself under the influence of the courts to actually focus in a clear sort of way.

The problem is we don't always know what exactly benefits consumers. I will give you a couple easy examples. We are often suspicious of privacy and Internet companies who take personal information. There is research by Catherine Tarkenton at MIT that suggests that the ability to target ads allows Internet companies to generate 65 percent more revenue. So the reality is you are giving up a certain amount of privacy, but because the companies get more revenue, they are able to provide services that actually may be creating benefits that have to be taken into account at any balance.

And what you will discover is you will see fights right now in different spaces about patents about who should be paying how much. The result is there is we are seeing that in fact consumers benefit tremendously by devices versus services, and that in fact there is an allocation that is very ambiguous about how those go.

The last point I would like to make is to reinforce a point that Geoff Manne made about use and consent decrees. Technically those aren't law, and even worse they are often done by the FTC in merger contexts where the issue is not the particular privacy or competitive practices at hand, but do you want the merger and are you willing to give up other things for it. And the agency can use its authority, the fact that they have the merging parties over a barrel to make them address issues that aren't actually germane to the merger.

Mr. TERRY. That is a concern. Mr. Lande?

Mr. LANDE. I agree with Professor Crane that the unfairness jurisdiction should not be used to protect competitors. I certainly agree it should protect consumer welfare. The problem is that is an ambiguous term. People define that differently. Many people define that to me as nothing more than economic efficiency, whereas I

think consumer welfare should mean consumer choice, that is, worrying about the significant choices on the market.

That would actually have three components. In addition to an efficiency component, it would have a concern with any wealth transferred from consumers to firms with market power or transferred from purchasers to a fraudulent firm, and it would also have a tremendous concern with non-price competition as Professor Ohm talked about earlier.

Mr. OHM. So the answer is yes, I think the FTC is using its unfairness capabilities and authorizations in slightly different ways. But I think that is not because the FTC is pushing the boundaries on what it does. I think it is a testament to the changing nature of harm on the Internet. And so with all of the wonderful innovations that the Internet brings, it gives those innovations to people who would do harmful things. You know, the news headlines are replete with examples of this. As you all know, a few months ago, a father received in the mail a flier addressed to daughter killed in car crash, right.

These are things that were not possible before the rise of the data collection, the big data techniques that are now present, and we should expect that as harm begins to proliferate, expand, and change the nature, that authorization such as unfairness which after all reside on theories of harm would expand as well.

Mr. TERRY. All right, thank you very much. Mr. McNerney, you are recognized for—Ms. Schakowsky is recognized for 5 minutes.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman. I wanted to ask Professor Ohm a couple of questions first. Currently the FTC brings legal actions against companies that fail to employ reasonable data security under Section 5, Unfair and Deceptive Practice Authority. However, there is no comprehensive federal law governing the collection or protection of consumer information. So in your testimony, you recommended that Congress consider making explicit the FTC's data security enforcement authority which you state is "already clearly within the broad strictures of Section 5." So could you explain that recommendation about clarifying—

Mr. OHM. Again this a commentary on the cloud that has been cast by litigation like Windham and Labbe MD where the FTC has to devote some of its scarce resources to defending theories that frankly I find a little too creative. And the federal courts, as is their right, is taking a very, very careful look at this. Congress could help us have a clearer data security mandate by just clarifying—

Ms. SCHAKOWSKY. So maybe we could talk to you more clearly about what language might be—

Mr. OHM. Yes, I would appreciate it.

Ms. SCHAKOWSKY. OK, in order to implement the Children's Online Privacy Protection Act, Congress explicitly granted the FTC authority to promulgate regulations using the Administrative Procedures Act. Outside of such authority specifically granted by statute in this case, the FTC's authority to promulgate rules regarding privacy and data security is severely limited by what I believe to be the unduly burdensome Magnus and Moss rule-making procedure.

So, Professor Ohm, are there tools that the FTC currently does not have that would improve its data security enforcement or deterrent capabilities such as APA rule making authority, enhanceable penalties authority, or jurisdiction over nonprofit entities like universities and hospital?

Mr. OHM. Absolutely. I want to be clear. I think that in data security in particular, we are better off with an evolving standard like we have right now. I don't think any of us should want the FTC to spend a lot of time promulgating data security rules that will no longer be accurate the day that they are enacted. It is such a rapidly moving target.

But on the other hand, enhanced APA authorities absolutely would be greatly appreciated and bring a lot more certainly to all as well as a higher ability to bring civil penalties. Clearly the deterrent effect message is not getting across to some companies. Providing the FTC with a larger stick in some of these cases would be a good idea.

Ms. SCHAKOWSKY. And it seems to me and then having to do it case-by-case like congressional authority, I think, is really cumbersome.

Mr. OHM. Absolutely yes. A broader set of authorities would be very useful for the mission of the FTC.

Ms. SCHAKOWSKY. And finally would a federal breach notification law that gives FTC explicit authority to bring actions against companies for failing to timely notify consumers and law enforcement officials of a breach improve the FTC's ability to protect consumers? And what do you believe would be the utility of such a measure alone compared to a comprehensive bill that also included baseline data security standards?

Mr. OHM. I think we need both. We should celebrate the laboratory of federalism that created the breach notification in the beginning. But now with 48 conflicting standards, it is probably time to federalize and pre-empt those laws and have one uniform standard with the FTC playing a role. Baseline data privacy legislation is an excellent idea, and I think the White House's White Paper that laid out some of the principles, I might go into that, is a great place to start.

Ms. SCHAKOWSKY. Thank you. And I missed the answers to all the questions. I think I left. Mr. Lande, the question about the anti-competitive conduct and Section 5, I wonder if you could maybe repeat or expand on what you said while I wasn't here.

Mr. LANDE. Sure. The question was what is unfairness authority, what I think unfairness authority is. And I started by agreeing with Professor Crane that it is not to protect competitors. We are all in favor of consumer welfare. The problem is we often disagree about what consumer welfare is, and many people when they say they want to help consumer welfare, all they mean is they want to enhance economic efficiency, which often has very little to do with the welfare of real consumers, at least in the short run.

For me, I believe that unfairness really translates to the consumer choice framework. That is ensuring that the choices that consumers want are, in fact, on the marketplace, and nothing artificial is done to remove those choices from the marketplace. And if you unbundle that, it really has three components. First, a concern

with economic efficiency, second, a concern with wealth that might be transferred from consumers to firms with market power or from consumers to firms engaging in fraud, a concern with that transfer or distributive effect, and then finally a heightened concern with non-price competition which Professor Ohm had talked about earlier.

Ms. SCHAKOWSKY. And I yield back.

Mr. TERRY. Thank you. You may have heard the bells go off or buzzer and we have time, I think, to get through everybody. But if we don't, don't worry. We are going to adjourn, not recess. So, Mrs. Blackburn, you are recognized for 5 minutes.

Mrs. BLACKBURN. Thank you, Mr. Chairman, and what I am going to do is submit most of my questions to you. But I am going to condense this a little bit. As you have heard from the Chairman and from Ms. Schakowsky, we are all involved and concerned about privacy and data security. And we have had the working group. We have put a good bit of attention into this. As we look at privacy legislation and data security legislation, Mr. Beales, I am going to start with you and go down the line. Number one, these are the questions I want you all to answer for me. Is it appropriate that the FTC retain privacy jurisdiction? Because we have the what takes place in the physical world and the online world. Number two, are they effective in their approach? Number three, should more of their attention be placed on enforcement and education and less on regulation? And the fourth piece I want to come from you all is what would you like to see in a light-touch data security and privacy bill? Mr. Beales.

Mr. BEALES. Well, to try to address your specific questions, I think it is appropriate that the FTC retains privacy jurisdiction. I think they have been mostly effective in that area. They have been more effective when they have been focused on things that really are harms. It was the consequences-based approach that led, for example, to the do-not-call list that I think was a very successful answer, intervention to address something that really was a privacy problem and not an isolate example or a speculative case.

I think it should be enforcement-based, not rule-based. That is a more sensible way to respond to the wide variety and rapidly changing circumstances that we see in the privacy environment. I am not sure beyond data security, and I think the notion of civil penalties for data security breaches or inadequate security procedures is one that has merit. Beyond that, I am not convinced that a privacy law would make things better, and there would be considerable risk of chilling really useful, innovative ideas that nobody has even thought of yet.

I think 15 years ago when Congress started talking about this, no one would have imagined that billions of people want to post the details of their personal life for everybody to see. But that is what Facebook is.

Mrs. BLACKBURN. OK.

Mr. BEALES. And it has created huge value. If we tried to regulate at the beginning, we may well have precluded it by mistake.

Mrs. BLACKBURN. Thank you. Mr. Crane?

Mr. CRANE. So my expertise is on the competition side, so I think I should defer to other members of the panel.

Mrs. BLACKBURN. Sounds good. Mr. Manne?

Mr. MANNE. I will use his time. So I think the core problem here is, as I have been suggesting, when it comes to things like privacy, when it comes to data security, contrary to what Paul said, you know, maximum privacy or maximum data security are not optimal for anyone. These are things, unlike say low prices, that have both costs and benefits. And what is really crucial is getting the appropriate balance, is understanding how not to deter valuable things while yet still deterring harmful abuses of information.

And I don't think that the FTC is doing a very good of this yet, or if they are, they are not telling us how they are getting there. And it is essential that we know so companies can know how to respond, how to anticipate what may or may not be a problem and so that Congress and the courts can ensure that the FTC is doing its job.

I am wary of more enforcement particularly in the privacy realm where honestly no one has really demonstrated that there is a significant problem. You know, data security is something else, right. Breaches where information is stolen, I get it. Recently while the FTC was holding a hearing on privacy issues and the Internet of things doesn't even exist yet, right. It is not even really a problem. \$27 million of bitcoin is being stolen because of a data breach.

Mrs. BLACKBURN. My time has expired.

Mr. TERRY. So we will just assume that will be a question submitted to the three left. Mr. McNerney, you are recognized for your 5 minutes. Mr. Bilirakis, do you have questions? You will be after Mr. McNerney.

Mr. MCNERNEY. Thank you, Mr. Chairman. Mr. Ohm, I would like to know if you think it is possible to develop security, data security standards either in the FTC or through the private standards development process that would be applicable to sectors of the industry or uniformly throughout the industry.

Mr. OHM. I am skeptical that you can have any meaningfully detailed data security standard that applies to all industries. However, if you tackle this on a sector-by-sector basis, I think you absolutely could. I think the key is that you need to focus on true compliance. You need to focus on things like industry standards and reasonableness as opposed to a kind of check-the-box mentality. But I have also witnessed how efforts of Congress to bring about cyber-security legislation have not gone so well. I absolutely think that trying to find some sort of forcing mechanism to bring companies together to talk about data security standards is a wonderful idea.

Mr. MCNERNEY. Thank you. Mr. Yoo, you stressed that the FTC should ensure it focuses on protecting consumers at all times. Do you think the agency has the safeguards in place to ensure that consumer protection comes first?

Mr. YOO. They have the safeguards in place should they choose to use them, and the things that the agency has developed over the last century, a lot of internal processes and substantive guidelines, makes sure that they place consumers at the forefront.

But there are, I would put a couple cautionary notes. So there is a tendency, for example, in data security. People are talking about comprehensive legislation. That tends to lead to inflexible

rules, and so you see there is a tension in what people are saying or the flexibility that people need at the same time, but the need for umbrella legislation—

Mr. MCNERNEY. So the flexibility should be with the commission?

Mr. YOO. Well, to an extent, but the problem that they should have is what I would say is two things. One is if you end up with that world, you have what we have in Europe which is inflexible rules and no enforcement action whatsoever, which is sort of the worst of all possible worlds.

The model that I would think is what the FTC did with privacy policies is they brought people together and instead of issuing rules, they allowed industries to get into a discussion and actually formulate new policies, which I think were much more beneficial.

Another problem with it, if you just go about it through enforcement, there is a hindsight problem, which if there is always more you can do. But after a problem has happened, you will say well of course you didn't do enough. And in fact, companies have to make the decisions before hand, not afterwards. And so I think by bringing companies together to talk about best practices, creating a forum, will be a much more effective than even through enforcement action.

Mr. MCNERNEY. Thank you. I have other questions, but I think I am going to yield so that Mr. Bilirakis can—

Mr. TERRY. All right, thank you since there are two minutes left in the vote. Mr. Bilirakis.

Mr. BILIRAKIS. Thank you so very much. I appreciate it, and I will go as quick as I possibly can. And I will submit the other questions as well, but I have a couple here. The FTC—and this is for the panel. The FTC has a responsibility to help provide consumer protections by ensuring that up-to-date information regarding scams and complaints are available to consumers.

However the GAO has identified a number of instances in which states felt frustrated with a lack of support from federal officials in helping to combat fraud against the senior populations. And the question is do you believe the FTC currently has the ability to help facilitate this effort? Can you discuss what impediments prevent greater support from federal officials to increase cooperation with state authorities in order to protect seniors from scams and abuses? And how can the FTC help better protect seniors within its current budget? And for the panel, whoever would like to start.

Mr. OHM. I am happy to chime in. I don't know the details, I apologize, of the GAO report specifically, but I do know from my time at the FTC that focus on both state cooperation and vulnerable populations including senior populations are at the highest levels of priority per the current chairwoman, her predecessor, the chairman. I have no doubt that they will work within their resources to do exactly what you are talking about and to enhance exactly what you are talking about. More resources, of course, would probably be appreciated in this vein as well.

Mr. YOO. The problem is related to the globalization problem I talked about before. State authorities have trouble reaching conduct that spans multiple states. They face enterprises that have much broader horizons, and that in fact they are in a very difficult

position. The FTC is absolutely, just as they are cooperating with other authorities, can bring people together in ways I think are extremely constructive.

The interesting thing, there is an ambivalence about federal involvement personified by the do not call initiative. That was initiated by state PUCs. It was the best headline states PUCs had seen in decades, and then they federalized it. And they were in fact, state, it is a very delicate relationship you have that state authorities want help in an era of declining state revenue. That is very, very important.

On the other hand, they want to make sure that the federal doesn't actually displace the enforcement authority of the states. Otherwise, the political benefit doesn't go to them. And so there is a very strange dance organizations like the FTC have to play.

Mr. BEALES. I think the FTC has, I mean certainly in the time that I was there, there was a very structured attempt to share complaint information in particular with state enforcement authorities. There is—the commission's complaint database is accessible to other law enforcement agencies who can join and get the same access that the commission staff has to those complaints essentially. And I am also not familiar with the GAO report as to, you know, as to what the particular issue, but whether they are complaints about problems for the elderly or anybody else, I mean there is or was a complaint sharing mechanism that worked quite well and led to a great deal of cooperation.

Mr. YOO. I would just say quickly as I was starting to answer Mrs. Blackburn's question, resource allocation is important and something that I think, you know, Congress and everyone else should be looking at, ensuring that indeed the FTC is putting its resources where the low-hanging fruit is, where there are obvious problems.

I don't know for sure. Again, I am not familiar with the GAO report, I don't know that this is one of them. But if it is, then I would like to see more resources there instead of things like, as I was suggesting, you know, an Internet of things, workshop to discuss potential possible privacy harms that haven't really materialized and may not ever. You are talking about very concrete sort of harms, and that is where they should be directing their attention.

Mr. BILIRAKIS. Thank you very much, Mr. Chairman, and I would like to follow up with you specifically on the GAO report and give you some specific examples. Appreciate it very much. I yield back, Mr. Chairman.

Mr. TERRY. Thank you, and I want to thank all of our witnesses for participating today. We anticipated at least a good, solid two hours, but sometimes on Fridays, things speed up for some reason. I just don't get it, and today was one of those days. But I think we did a good job of getting your insights on the record, and it is really appreciated. As mentioned, we have the opportunity to submit questions, written questions to you. We usually leave that open for a couple of weeks for our staff to be able to help us with that and submit those. And we give you a couple of weeks to reply. Would really appreciate it. Again thank you for your time and your testimony, and we are adjourned.

[Whereupon, at 10:47 a.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

THE PREPARED STATEMENT OF HON. HENRY A. WAXMAN

Today's hearing continues this Subcommittee's discussion on the important work of the Federal Trade Commission.

The FTC is required to prevent business practices that are anticompetitive and those that are deceptive or unfair to consumers. The responsibilities given to the FTC are broad and rightly so, because our country needs an agency that can address, with flexibility, a wide variety of commercial conduct in order to safeguard consumers in the marketplace.

For the last 100 years, the FTC has been utilizing the FTC Act and other federal antitrust and consumer protection laws to conduct investigations, administrative proceedings, and judicial enforcement of commercial behavior that may violate the law.

The Bureau of Competition promotes vigorous competition and ample consumer choice by preventing anticompetitive mergers and other anticompetitive business practices in the marketplace. I am particularly glad to see the FTC closely scrutinizing potentially anticompetitive conduct in health care markets - involving hospitals, pharmacies, medical device and pharmaceutical manufacturers, and others.

The Bureau of Consumer Protection promotes fair and transparent business practices by preventing scams, frauds, and other unfair or deceptive practices. While such practices can occur in any industry, the FTC is perhaps best known for its work with Do Not Call, which our constituents benefit from every day.

Today I would like to highlight the FTC's work on privacy and data security. No comprehensive federal law governs the collection, use, dissemination, or security of consumer data. This makes the FTC the principal ally of consumers in ensuring that companies employ reasonable data security measures for personal information and uphold their privacy promises.

In looking forward to the Federal Trade Commission's next chapter, our message should be more than: "Keep up the good work." As it enters its second century, the Commission must not be reluctant to adapt to changing markets, technologies, and consumer threats. It must apply its existing authorities in new ways and assume new roles, if necessary to preserve competitive markets, consumer choice, and fair and transparent business practices.

Congress must be an active partner with the FTC. We can start by encouraging the Commission to assert its Section 5 authority to challenge anticompetitive conduct, in whatever form it may take, and allow the FTC oversight over insurance, or, at a minimum, the ability to study insurance.

In addition, we should enact comprehensive privacy and data security laws that establish baseline standards of protection for consumer data and strengthen the FTC's enforcement authority. Furthermore, we should provide the agency with the tools it needs to operate in the 21st century, in the form of additional resources, general APA rulemaking authority, greater authority to assess civil penalties, and enhanced jurisdiction over non-profits and common carriers.

I am pleased to welcome the distinguished panel of professors testifying before us today. I encourage my colleagues to support those recommendations that will enhance, not diminish, the ability of the FTC to protect consumers from anticompetitive, unfair, or deceptive conduct.

Thank you.

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FRED UPTON, MICHIGAN  
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA  
RANKING MEMBER

ONE HUNDRED THIRTEENTH CONGRESS  
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October 2, 2014

Mr. J. Howard Beales  
Professor  
Strategic Management and Public Policy  
George Washington School of Business  
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Washington, D.C. 20052

Dear Mr. Beales,

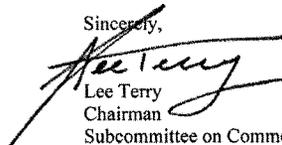
Thank you for appearing before the Subcommittee on Commerce, Manufacturing, and Trade on Friday, February 28, 2014 to testify at the hearing entitled "The FTC at 100: Views from the Academic Experts?"

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for ten business days to permit Members to submit additional questions for the record, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and (3) your answer to that question in plain text.

To facilitate the printing of the hearing record, please respond to these questions by the close of business on Thursday, October 16, 2014. Your responses should be e-mailed to the Legislative Clerk in Word format at [Kirby.Howard@mail.house.gov](mailto:Kirby.Howard@mail.house.gov) and mailed to Kirby Howard, Legislative Clerk, Committee on Energy and Commerce, 2125 Rayburn House Office Building, Washington, D.C. 20515.

Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,



Lee Terry  
Chairman  
Subcommittee on Commerce,  
Manufacturing, and Trade

cc: Jan Schakowsky, Ranking Member, Subcommittee on Commerce, Manufacturing, and Trade  
Attachment

## Responses to Additional Questions For the Record

J. Howard Beales III  
 Professor, Strategic Management and Public Policy  
 George Washington School of Business

Additional Questions for the Record**The Honorable Lee Terry**

1. In 1975 and 1980, this Committee placed safeguards on the FTC's authority following a number of large and significant rules the agency issued in the 1970's, including a very controversial rule to regulate children's advertising. These rules have been in place for about 35 years in order to ensure the Commission can promulgate the best rules possible for all businesses and consumers. Congress acted in part because the FTC (unlike some other agencies that have narrower jurisdiction) has vast authority to identify and sanction unfair and deceptive acts or practices across nearly every sector of the economy, and it doesn't focus on specific industry technology or practices. In fact, former FTC Chairman Kovacic has said that "no regulatory agency in the United States matches the breadth and economic reach of the Commission's mandates."

- a. Do you think the FTC has been effective in protecting consumers during the 35-plus years since the FTC Act was amended and changed the procedures for their rule writing authority?

Since 1980, the Commission has developed a sound, effective, and largely bipartisan program for protecting consumers. Its considerable efforts to pursue fraudulent practices have returned substantial sums to injured consumers. Its efforts to work with the criminal authorities to put fraudsters in jail can help increase deterrence of fraud beyond what civil remedies alone can provide.

- b. Do you agree that, as current law requires, the FTC should ensure that its rules are narrowly tailored, based on sufficient information, and able to withstand appropriate judicial review?

Case by case law enforcement provides more flexibility than rigid rules, and can more easily adapt to changing circumstances, changing business practices, and changing priorities. Because rules apply across the board, they should be narrowly tailored to address common problems in the most cost effective manner possible. Doing so requires systematic evidence of the nature and frequency of the problems the rule seeks to prevent, and careful analysis of the costs of the remedy.

2. Here are some of the differences between the FTC Act and the "notice-and-comment" rulemaking that is undertaken by some other agencies.

- **Prevalence:** The FTC must identify a pattern of activity – a prevalence, as opposed to one instance – before engaging in a rulemaking. There is no similar requirement in notice-and-comment rulemaking.
- **Disputed issues.** If the FTC concludes that there is a disputed issue of material fact in a rulemaking, the agency must permit cross-examination of witnesses in a pre-rulemaking hearing and afford the right to offer rebuttal comment. That gives all parties the opportunity to participate. Those requirements don't apply notice-and-comment rulemaking.
- **Economic effect.** When the FTC issues a rule, it is required to provide "a statement as to the economic effect of the rule, taking into account the effect on small business and consumers." That seems eminently reasonable to me, yet it is not required by notice-and-comment rulemaking.

Do you agree that these are good protections both for consumers and businesses?

Since 1981, notice and comment rulemaking at executive branch agencies has been subject to Executive Orders requiring that the benefits of the rule are sufficient to justify the costs. Because the FTC is an independent agency, it is not subject to this requirement. Nevertheless, it should only regulate if the benefits are sufficient to outweigh the costs. The statutory requirement for prevalence helps to assure that problems are sufficiently common that regulation could produce significant benefits. The requirement to address the economic effects of the rule requires the Commission to consider the costs of its actions. Precisely because the FTC is not subject to the cost-benefit requirements that govern executive branch agencies, these provisions are particularly important.

When key facts are in dispute, cross-examination is a widely recognized and widely used method of getting at the truth. Rebuttal comments serve a similar purpose, allowing all participants in the rulemaking the opportunity to address the logical and factual flaws in the arguments offered by other parties. Although wide-ranging cross examination can be time consuming, the Commission can avoid this problem with carefully crafted rulemaking proposals. If proposed rules are narrowly drawn, with clear theories of why a practice is unfair or deceptive, the inquiry can be limited to the key factual matters that the Commission must resolve to determine whether the rule is appropriate.

Thus, all three protections – prevalence, disputed issues, and economic effects – are important, particularly for an agency with the breadth of authority and jurisdiction as great as that of the FTC.

3. It appears to me that those who argue for the FTC to have general notice-and-comment rulemaking authority under the APA must believe that the FTC does not possess sufficient authority today to identify, penalize and prevent bad actors from taking actions detrimental to consumers. Yet we've heard testimony today and in the past repeatedly about how effective the FTC is, so that doesn't seem consistent. What are your thoughts here?

The Commission has the tools it needs to address bad actors. In particular, the ability to obtain restitution for consumers usually offers far greater monetary relief than civil penalties for rule violations would provide. Rules can be useful to set bright-line standards to make clear that a violation has occurred, thereby simplifying prosecution in some cases. In most cases, however, establishing that the challenged conduct is unfair or deceptive is not particularly onerous.

4. In some specific areas, the Congress has given the FTC targeted authority to use notice-and-comment rulemaking. Some of these instances include the Telemarketing and Consumer Fraud and Abuse Prevention Act (1994), the Children's On-Line Privacy rulemaking required in 1998, and the Gramm-Leach-Bliley Act (1999) regarding financial institutions and consumer privacy. This "case-by-case" approach to notice-and-comment rulemaking ensures that, where it is needed, the FTC can address a specific issue in the manner that Congress has determined.

- a. Do you agree that these specific directions from Congress have been working well?

Notice and comment rulemaking has generally worked well when used to implement a specific statutory scheme that Congress has devised. In many such instances, the issue is not whether to regulate, because Congress has required rulemaking. Rather, the question is how best to implement the statute. Such rules are generally narrower in scope than rules defining, and attempting to prevent, unfair or deceptive practices that may cut across numerous industries.

- b. Would you agree with former FTC Chairman Kovacic when he stated that this is the best approach to FTC rulemaking, given the broad subject matter authority and economic effects that FTC decisions can have across the economy?

When Congress desires that the Commission address specific questions regarding the implementation of a statute, notice and comment rulemaking is an appropriate means of regulating. When the issues are broader, the extra protections of the prevalence requirement, designated issues, and the requirement to address economic effects are appropriate.

5. You have articulated that restricting advertising because some consumers will misunderstand will leave the majority of consumers in relative ignorance. You state the Commission needs to return its focus to the average viewer. How would this help consumers? How do we get the FTC to change its focus?

An advertisement that provides accurate information to the average person who sees the ad effectively increases the number of informed consumers in the marketplace. When the average consumer understands the advertisement correctly, the average consumer can make better choices. If the Commission prohibits that advertisement because a minority of

consumers might misunderstand the message in a way that is misleading, it is likely reducing the number of informed consumers in the marketplace. That is clearly harmful to the consumers who lose information that they correctly understood. It is harmful to other consumers as well, because competition for informed consumers assures that all sellers must offer consumers the best possible combination of price and quality.

Of course, in some instances, it may be possible to reduce the number of people who take away a misleading message without compromising the information that the majority of the audience receives, but that is not always the case. In all probability, some people will always discount or ignore qualifications that are included in an advertisement or on a label. In such cases, it is necessary to balance the interests of the majority in knowing about promising or emerging evidence against the potential costs to those who ignore the qualifications.

The Commission's position on claims that energy-efficient windows can save "up to" a certain amount of energy are a good example of the problem. Because it was concerned that a minority might be misled by such claims, it warned manufacturers that they could not make such claims unless almost all consumers would experience the result. Even the average savings would not satisfy this standard, since in general about half of consumers would experience below average results. Nor is this a case where the misimpression can easily be corrected. The Commission's copy test found significant misunderstanding of *all* versions of the advertisement that it tested.

Congress should ask the Commission to explain how ignoring the information needs of the majority of consumers helps protect either consumers or the market.

6. The FTC's recent path on advertising substantiation for dietary supplements has required two randomized, placebo controlled, double blind clinical trials to satisfy the substantiation requirements.
  - a. What effect will that requirement have on the ability of supplement manufacturers to advertise?

Virtually no claims for dietary supplements are supported by two clinical trials that meet the standards the Commission has been insisting on in recent cases. If the Commission continues to insist on this standard, supplement manufacturers will be able to tell consumers what their product is, but they will not be able to say why anyone might be interested in using it. That information will have to come from elsewhere.

- b. Does the new requirement effectively displace the Commission's guide: "Dietary Supplements: An Advertising Guide for Industry"?

The Dietary Supplements Guide follows the Commission's traditional approach to advertising substantiation, which balances the risks of mistakenly allowing false claims against the risks of mistakenly prohibiting truthful claims. Using this approach, the

Guides require that claims be supported by “competent and reliable scientific evidence.” The two clinical test requirement essentially abandons that approach. Although the Commission maintains that only “bad actors” are subject to the new standard, no responsible manufacturer can ignore the fact that recent orders uniformly require two clinical trials.

- c. Are consumers harmed by restricted advertising? How?

A wide variety of empirical studies, including those conducted by the FTC itself, establish that restrictions on advertising tend to increase product prices, discourage product improvements, and widen the gaps between different demographic groups. The FTC’s study of the introduction of health claims for high fiber cereals in 1984 found that the claims led to the largest increases in fiber consumption for non-whites and single parent households. Earlier studies of the effects of restrictions on eyeglass advertising found that prices were higher for everyone, with the least educated consumers paying the highest prices.

- d. What would the effect on consumer welfare be if the same standard were applied to advertising claims for “healthy” food?

Applying a requirement for two clinical trials to claims about the relationship between diet and disease would deprive consumers of valuable health information. Many FDA-approved health claims are based largely on epidemiological evidence, as is much of our knowledge of the relationship between diet and disease. Clinical trials to determine whether increased calcium consumption in young adults reduces the risk of osteoporosis, for example, would require following young women for 50 to 60 years. Such trials are simply not feasible. Similarly, many recommendations in the government’s Dietary Guidelines for Americans 2010 are not supported by clinical trials. The recommendation to eat more fruits and vegetables, for example, cites an association between higher levels of consumption and reduced risk of chronic diseases, but no clinical trials. Applied to foods, the two clinical trial requirement would deprive consumers of this important information.

- e. Have the FTC’s new substantiation requirements effectively reversed Congressional intent established in the Dietary Supplement and Health Education Act? If yes, what should Congress do to fix this?

The two clinical testing requirement effectively reverses DSHEA. Congress sought to remove dietary supplements from the new drug approval process, but the FTC has adopted essentially the same evidentiary requirements. Congress could clarify that “competent and reliable scientific evidence” constitutes a reasonable basis for claims about dietary supplements.

7. You stated the recent expansion of the 13(b) authority the FTC may use to freeze assets or force disgorgement of ill-gotten gains --historically used in fraud cases -- is being used for consumer redress in cases involving questions about substantiation in national advertising campaigns. Your testimony mentioned this threatens to undermine the FTC's consumer protection mission. Could you please explain why? Why do you say it is wrong as a matter of law?

The Supreme Court has said that if a court can issue an injunction, it can also exercise any of its equitable powers, including redress and disgorgement, unless Congress clearly intended otherwise. The Commission first received the authority to obtain injunctions in a "proper" case, and two years later received the authority to obtain redress if the conduct was dishonest or fraudulent. Both provisions, however, were initially part of the same bill. Clearly Congress did not think that the injunction authority included redress authority, or the separate redress provision would have been wholly unnecessary. We therefore believe the Commission's reading of the statute as allowing redress in any case it brings is incorrect.

The danger to the Commission's consumer protection mission is twofold. First, the statutory foundation of the fraud program is uncertain, given a careful reading of the legislative history. Attempting to obtain redress in cases that do not involve fraudulent or dishonest conduct runs the risk that courts will reexamine the extent of the Commission's authority in fraud cases as well, and find it lacking. Second, in fraud cases, the Commission and the courts have generally treated the respondent's total revenue from sales of the product as the measure of damages that must be returned to the consumer. That measure, however, is unreasonable when applied to traditional substantiation cases for well-established products. Courts will need to develop more sophisticated measure of damages, which may in turn reduce the amount of money the Commission can obtain in fraud cases.

8. When the Commission pursues substantiation cases for products whose majority of sales are not related to the claim, what is the opportunity cost? Is the Commission neglecting actual fraud cases?

Any case has an opportunity cost, and there are always more fraud cases than the Commission can bring. Nonetheless, preventing deceptive claims even when there are other, legitimate reasons that many consumers purchase the product is useful. That is particularly the case when competing products actually have the feature or attribute, because, but for the deception, consumers could have actually obtained what they wanted.

The problem is not pursuing the substantiation case in such instances; rather, it is pursuing money. Total sales are not a reasonable measure of damages, because many consumers purchase the product for reasons that are completely unrelated to the misleading claim, and therefore are not injured by the claim. Redress should only reflect the sales attributable to the deceptive claim, rather than all sales.

9. You referenced the Commission's Deception Policy Statement adopted in 1983. What prompted the development and adoption of this policy statement? What was the effect of issuing the policy statement?

Early Commission cases were based on the notion that the Commission should seek to protect the ignorant, the unthinking, and the credulous from every possible misinterpretation of an advertisement, a standard that was known as the "fools test." The result was many cases that challenged bizarre interpretations of advertisements that consumers were highly unlikely to share in any significant number. This approach often made it difficult for advertisers to tell consumers about important product features, because there is always some risk of consumer misinterpretation. As noted in my testimony, academic studies of brief communications find that whether the message is an advertisement or editorial content, 20 to 30 percent of consumers misunderstand the message.

As the Commission came to recognize the important role of advertising in providing information to facilitate competitive markets, it shifted its focus away from the fools test. Indeed, it essentially abandoned the fools test in a 1963 case. Instead, later cases focused on the meaning of the advertisement to the ordinary viewer, or the average listener, or the reasonable consumer. The Deception Policy Statement sought to synthesize these cases into a coherent summary of the law of deception, making clear that the Commission was no longer using the fools test.

When the Deception Policy Statement was adopted in litigated cases and endorsed by the courts of appeal, it became the standard for finding a claim deceptive. It has worked well for many years, and generally has kept the Commission's efforts focused on claims that are likely to mislead the typical recipient of the claim.

In its most recent cases, however, the Commission has let the exception swallow the rule. Without even discussing how ordinary consumers are likely to interpret a message, and without any attempt to distinguish between real deception and the background noise that attends any communication, the Commission has simply asserted that at least a "significant minority" of consumers shares the interpretation of the advertisement that it is challenging. This represents a significant move back towards the fools test that the Commission abandoned in 1963.

10. What is the practical effect of issuing guidelines? For instance, you referenced the "privacy framework" the Commission recently adopted. Should we be concerned that such guidelines or frameworks become a de facto standard or rule – one that is born outside of the rulemaking process?

The Commission has issued a number of Guides that indicate how it will use its enforcement discretion in deciding which practices to challenge. For example, the Guides for the Use of Environmental Marketing Claims explain how the Commission approaches environmental

claims, and identifies the kinds of qualifications of claims that may be necessary to avoid deception. “Dietary Supplements: An Advertising Guide for Industry,” is a similar guide. These and other Guides do not have the force of law; in any case brought challenging a practice identified as deceptive in a guide, the Commission must establish that the practice is either unfair or deceptive. Guides such as these identify practices that the Commission believes are law violations, and are generally adopted through a notice and comment rulemaking process.

Other “guides,” such as the privacy report, are Commission documents adopted after, for example, a workshop addressing the issues. The Privacy Report recognizes that some of its recommendations are beyond what the Commission has the authority to require, but it is often unclear about the difference between what the law requires and what the Commission considers “best practices.” Business education materials based on the report simply address the recommendations, without acknowledging that some are beyond what the law would require. There are grounds for concern that the Commission is attempting to set a standard without rulemaking, and, as it acknowledges, beyond its authority.

11. You point out that while too stringent regulation or enforcement can stifle innovation in the technology space, too little regulation or enforcement increases the risk of consumer harm in terms of privacy, so it is a question of balance. How do you believe the FTC is doing in performing this balancing act?

Some recent cases give cause for concern. The Commission’s HTC America consent is a relatively heavy handed intervention in the competition between open mobile operating systems such as Android and proprietary systems such as Apple. One of the inherent advantages of proprietary systems is that the provider can update them quickly and easily, because it has no need to customize the software for different wireless carriers or networks. In contrast, updates on open systems may require coordination of several parties. Such systems also allow more freedom for innovation, however, because other service providers can add their own unique features. The Commission’s consent seeks to make open systems behave more like closed ones, which will likely reduce the innovation advantages of open systems. That, however, is a choice that should be made in the marketplace.

12. You suggest that one way to reduce the risk of overregulation or enforcement is “by focusing on real and identifiable harms.” How would you define this? Is this something Congress needs to do or is the FTC equipped to do this?

Tort law has a long history of insisting on harm as a necessary element of a tort, and has reasonably clear concepts of what constitutes an actionable harm and what does not. The Commission should focus on the kinds of harms that are necessary for recovery at common law, not more subjective standards of what kinds of practices are “creepy.”

FRED UPTON, MICHIGAN  
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA  
RANKING MEMBER

ONE HUNDRED THIRTEENTH CONGRESS  
**Congress of the United States**  
**House of Representatives**  
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October 2, 2014

Mr. Daniel A. Crane  
Associate Dean  
Faculty and Research  
Senior Professor of Law  
University of Michigan  
625 South State Street  
Ann Arbor, MI 48104

Dear Mr. Crane,

Thank you for appearing before the Subcommittee on Commerce, Manufacturing, and Trade on Friday, February 28, 2014 to testify at the hearing entitled "The FTC at 100: Views from the Academic Experts?"

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for ten business days to permit Members to submit additional questions for the record, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and (3) your answer to that question in plain text.

To facilitate the printing of the hearing record, please respond to these questions by the close of business on Thursday, October 16, 2014. Your responses should be e-mailed to the Legislative Clerk in Word format at [Kirby.Howard@mail.house.gov](mailto:Kirby.Howard@mail.house.gov) and mailed to Kirby Howard, Legislative Clerk, Committee on Energy and Commerce, 2125 Rayburn House Office Building, Washington, D.C. 20515.

Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,



Lee Terry  
Chairman  
Subcommittee on Commerce,  
Manufacturing, and Trade

cc: Jan Schakowsky, Ranking Member, Subcommittee on Commerce, Manufacturing, and Trade  
Attachment

Subcommittee on Commerce, Manufacturing, and Trade

Hearings on the Federal Trade Commission at 100, February 28, 2014

Written answers to additional questions.

Daniel A. Crane, Associate Dean for Faculty & Research and Frederick Paul, Furth, Sr. Professor of Law, University of Michigan

**The Honorable Lee Terry**

1. In 1975 and 1980, this Committee placed safeguards on the FTC's authority following a number of large and significant rules the agency issued in the 1970's, including a very controversial rule to regulate children's advertising. These rules have been in place for about 35 years in order to ensure the Commission can promulgate the best rules possible for all businesses and consumers. Congress acted in part because the FTC (unlike some other agencies that have narrower jurisdiction) has vast authority to identify and sanction unfair and deceptive acts or practices across nearly every sector of the economy, and it doesn't focus on specific industry technology or practices. In fact, former FTC Chairman Kovacic has said that "no regulatory agency in the United States matches the breadth and economic reach of the Commission's mandates."
  - a. Do you think the FTC has been effective in protecting consumers during the 35-plus years since the FTC Act was amended and changed the procedures for their rule writing authority?
  - b. Do you agree that, as current law requires, the FTC should ensure that its rules are narrowly tailored, based on sufficient information, and able to withstand appropriate judicial review?

CRANE RESPONSE: Respectfully, I am not going to attempt to answer the first four questions since they involve the FTC's Consumer Protection mission, in which I do not claim the same expertise as with respect to the Commission's Competition mission.

2. Here are some of the differences between the FTC Act and the "notice-and-comment" rulemaking that is undertaken by some other agencies.
  - **Prevalence:** The FTC must identify a pattern of activity – a prevalence, as opposed to one instance – before engaging in a rulemaking. There is no similar requirement in notice-and-comment rulemaking.

- *Disputed issues.* If the FTC concludes that there is a disputed issue of material fact in a rulemaking, the agency must permit cross-examination of witnesses in a pre-rulemaking hearing and afford the right to offer rebuttal comment. That gives all parties the opportunity to participate. Those requirements don't apply notice-and-comment rulemaking.
- *Economic effect.* When the FTC issues a rule, it is required to provide "a statement as to the economic effect of the rule, taking into account the effect on small business and consumers." That seems eminently reasonable to me, yet it is not required by notice-and-comment rulemaking.

Do you agree that these are good protections both for consumers and businesses?

3. It appears to me that those who argue for the FTC to have general notice-and-comment rulemaking authority under the APA must believe that the FTC does not possess sufficient authority today to identify, penalize and prevent bad actors from taking actions detrimental to consumers. Yet we've heard testimony today and in the past repeatedly about how effective the FTC is, so that doesn't seem consistent. What are your thoughts here?
4. In some specific areas, the Congress has given the FTC targeted authority to use notice-and-comment rulemaking. Some of these instances include the Telemarketing and Consumer Fraud and Abuse Prevention Act (1994), the Children's On-Line Privacy rulemaking required in 1998, and the Gramm-Leach-Bliley Act (1999) regarding financial institutions and consumer privacy. This "case-by-case" approach to notice-and-comment rulemaking ensures that, where it is needed, the FTC can address a specific issue in the manner that Congress has determined.
  - a. Do you agree that these specific directions from Congress have been working well?
  - b. Would you agree with former FTC Chairman Kovacic when he stated that this is the best approach to FTC rulemaking, given the broad subject matter authority and economic effects that FTC decisions can have across the economy?
5. Some have raised concerns that because the FTC faces a lesser burden in obtaining a preliminary injunction from a federal judge than does the Department of Justice's Antitrust Division, merging parties can reasonably anticipate the possibility of different substantive outcomes depending on which agency has jurisdiction to review the matter. To avoid the potential for these different outcomes, should Congress require the FTC to litigate merger challenges in federal court just as the DOJ is required to?

CRANE RESPONSE: It is my view that there should be no difference in the preliminary injunction standard in FTC and Justice Department cases. I would not necessarily require the FTC to litigate in federal court, but if the FTC seeks a preliminary injunction in federal court, it should have the same obligations of proof and persuasion as the Justice Department does.

6. You testified that “there is little distinction between the agencies in terms of antitrust expertise and economics expertise. Are you arguing that these two functions – the FTC antitrust function and the DOJ’s antitrust function – are redundant? Are you arguing to dismantle the Bureau of Competition?”

CRANE RESPONSE: The agencies’ antitrust functions are largely redundant, with some exceptions, particularly the DOJ’s criminal enforcement jurisdiction. If Congress were designing the agencies from scratch, there would be no sense in creating this overlapping and redundant jurisdiction. However, there would be some costs to trying to consolidate them now. I have not spent much time on this option since there does not seem to have been much political will for it. However, as discussed in my book *The Institutional Structure of Antitrust Enforcement*, should Congress be interested in re-examining the agencies’ respective functions, there are two possibilities that should be considered: (1) making the FTC a pure consumer protection agency and transferring all antitrust responsibility to the DOJ; (2) maintaining only criminal antitrust enforcement at DOJ, and delegating all civil antitrust enforcement to FTC.

7. An overwhelming majority of the FTC’s merger investigations are closed without any enforcement action. Unlike when the FTC files a complaint to challenge a merger, when the FTC closes an investigation, the public typically learns very little about how the agency analyzed the potential effects of the transaction. Such information can be incredibly important to businesses attempting to determine what types of transactions are permissible under federal law. Should the FTC do more to issue so-called “closing letters” to explain its analysis even when it closes a merger investigation?

CRANE RESPONSE: Yes, closing letters are very important and should be issued more often. If a business has been under the cloud of an FTC investigation and then the Commission decides to close the file because it has found no violation of law, it is only fair to disclose that fact. Such letters can also be helpful to explain the Commission’s views if there is ongoing private litigation that may be stirred up by the Commission’s investigation in the first place.

8. Because the Department of Justice and Federal Trade Commission share jurisdiction to enforce our antitrust laws, there is a complex “clearance” process in place to determine which agency will review a proposed merger. As some have pointed out, the two agencies don’t always agree on which should review a particular deal. A prolonged clearance fight could significantly delay the closing of major merger. What can Congress do to prevent these “clearance” battles? Would a random assignment of cases between the two agencies be better?

CRANE RESPONSE: I don’t think that a random assignment of cases would be better. One of the arguments for maintaining two agencies is that each agency has acquired experience with certain industries over the years. For example, the FTC has expertise in pharmaceuticals and the DOJ has expertise in transportation. If random assignment became the rule, it would be really difficult to see the justification for continuing to have two agencies at all.

9. You stated there is no substantial difference in overall expertise between the FTC and the DOJ Antitrust Division. So what is gained by maintaining two separate entities?

CRANE RESPONSE: There is no *overall* expertise advantage in either agency, although, as stated in my last response, sometimes one agency or the other has more expertise in a particular industry. Some antitrust experts worry that such expertise would be lost if the agencies were consolidated. I'm not sure why that would have to be the case. If, for example, the FTC's antitrust jurisdiction were transferred to the DOJ, the DOJ could hire the FTC group that works on pharma matters.

10. You testified that the FTC was designed to be politically independent, but you seem to criticize the agency for responding to the concerns of its authorizing committee. Surely you don't want the FTC to operate with unchecked power? The judicial system surely isn't enough with their limited resources.

CRANE RESPONSE: I'm not criticizing the FTC for being politically responsive. What I'm saying is that the standard Progressive-technocratic narrative for why we have independent agencies—that they're detached from political pressures—is false. In my forthcoming article *Debunking Humphrey's Executor*, I explain how the Supreme Court's account of the FTC in the landmark *Humphrey's Executor* decision is historically off base. Rather than being a uniquely expert, politically detached, and quasi-legislative/quasi-judicial body, the FTC has been politically motivated, no more expert than DOJ, and primarily a law enforcement agency rather than a rule-making or adjudicatory body.

#### **The Honorable Jerry McNerney**

1. In written testimony for the Subcommittee hearing on February 28, 2014, you discussed the relationship between the Department of Justice and the Federal Trade Commission with respect to Congressional intent in the FTC Act of 1914 and the Supreme Court's decision in *Humphrey's Executor*, and a more recent observation about how the agencies may have strayed from Congress' vision of political independence, superior expertise of one agency over another in certain areas, legislative and adjudicatory character, and cooperative partnership. As we move forward, can you expand upon how we can ensure that the Department of Justice and the FTC do not have duplicative roles and capabilities?

CRANE RESPONSE: With the exception of criminal enforcement against cartels, which is solely the province of the Justice Department, the DOJ and FTC do have largely duplicative roles and capabilities. Although the agencies do have some different expertise in particular industries, they have similar overall capabilities and do largely the same work in antitrust law. Major policy decisions, such as the 2010 revisions to the Horizontal Merger Guidelines, are undertaken by the two agencies jointly.

As set forth in my responses to Congressman Terry, I think there's a good case to be made for consolidating antitrust enforcement in a single agency. Although there would be some costs to

doing that, there would be considerable benefits to streamlining antitrust enforcement and eliminating the friction that sometimes arises from having two competing agencies doing the same job.

FRED UPTON, MICHIGAN  
CHAIRMAN

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RANKING MEMBER

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October 2, 2014

Mr. Geoffrey A. Manne  
Executive Director  
International Center for Law & Economics  
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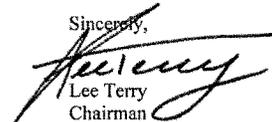
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Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,  
  
Lee Terry  
Chairman  
Subcommittee on Commerce,  
Manufacturing, and Trade

cc: Jan Schakowsky, Ranking Member, Subcommittee on Commerce, Manufacturing, and Trade  
Attachment

Question for the Record  
Response of  
Geoffrey Manne  
Executive Director  
International Center for Law & Economics

Additional Questions for the Record

The Honorable Lee Terry

1. **In 1975 and 1980, this Committee placed safeguards on the FTC’s authority following a number of large and significant rules the agency issued in the 1970’s, including a very controversial rule to regulate children’s advertising. These rules have been in place for about 35 years in order to ensure the Commission can promulgate the best rules possible for all businesses and consumers. Congress acted in part because the FTC (unlike some other agencies that have narrower jurisdiction) has vast authority to identify and sanction unfair and deceptive acts or practices across nearly every sector of the economy, and it doesn’t focus on specific industry technology or practices. In fact, former FTC Chairman Kovacic has said that “no regulatory agency in the United States matches the breadth and economic reach of the Commission’s mandates.”**
  - a. **Do you think the FTC has been effective in protecting consumers during the 35-plus years since the FTC Act was amended and changed the procedures for their rule writing authority?**

The FTC has simply sidestepped the procedural safeguards Congress imposed on its rulemaking powers through Magnuson-Moss. Instead, the FTC engages in *de facto rulemaking* through a combination of case-by-case enforcement through consent decrees (and therefore effectively outside the judicial system) and informal guidance, particularly reports issued after workshops, that have the effect of law — with none of the safeguards of formal rulemaking. This has allowed the FTC to create informal law on a wide variety of issues grounded, often tenuously, in its unfair or deceptive acts or practices (“UDAP”) authority and, to a lesser degree, its unfair methods of competition (“UMC”) power — while offering regulated companies little guidance on how to comply with the law. This raises significant due process concerns and the more fundamental question: are the substantive constraints volunteered by the FTC in its 1980 Unfairness Policy Statement and 1983 Deception Policy Statement still meaningful constraints upon the FTC’s discretion? Or, by slipping the bonds of the FTC’s procedural authority, has the FTC essentially also escaped these substantive limitations?

- b. **Do you agree that, as current law requires, the FTC should ensure that its rules are narrowly tailored, based on sufficient information, and able to withstand appropriate judicial review?**

Certainly — for both formal and *de facto* rules. The FTC's Magnuson-Moss rulemaking procedures are designed to ensure that formal rules issued under Section 5 are narrowly tailored to clear problems in ways that satisfy the cost-benefit analysis inherent in Section 5(n)'s unfairness standard and the analysis of materiality (a proxy for harm and, thus, cost-benefit) inherent in Section 5's deception standard. The FTC has essentially leveraged its costly investigative process, its cumbersome Part III adjudication process and its enormous bully pulpit (capable of inflicting serious public relations harm) to coerce companies to agree to settlements and consent decrees — rather than litigate in court.

The FTC should use its formal Magnuson-Moss rulemaking powers more often, but where it does not do so, it should change its approach to case-by-case enforcement to achieve the same essential goal of Magnuson-Moss: rigorously applying the requirements of Section 5. On the one hand, the FTC should evaluate and revise its own procedures in order to make these disputes more likely to be litigated in federal courts, so as to ensure appropriate judicial review and build a proper record for regulated parties to rely upon going forward. On the other hand, where litigation does not occur, the FTC should do more to explain its analysis of the requirements of Section 5 in each case it settles, and in a systematic way through doctrinal guidelines similar to those the FTC and Department of Justice issue to summarize the development of antitrust law. As with the Merger Guidelines, Section 5 guidelines should be grounded as much as possible in law and economics.

**2. Here are some of the differences between the FTC Act and the “notice-and-comment” rulemaking that is undertaken by some other agencies.**

- ***Prevalence.* The FTC must identify a pattern of activity — a prevalence, as opposed to one instance — before engaging in a rulemaking. There is no similar requirement in notice-and-comment rulemaking.**
- ***Disputed issues.* If the FTC concludes that there is a disputed issue of material fact in a rulemaking, the agency must permit cross-examination of witnesses in a pre-rulemaking hearing and afford the right to offer rebuttal comment. That gives all parties the opportunity to participate. Those requirements don't apply to notice-and-comment rulemaking.**
- ***Economic effect.* When the FTC issues a rule, it is required to provide "a statement as to the economic effect of the rule, taking into account the effect on small business and consumers." That seems eminently reasonable to me, yet it is not required by notice-and-comment rulemaking.**

**Do you agree that these are good protections both for consumers and businesses?**

The particular restraints on FTC rulemaking are certainly good protections both for consumers and businesses. While the FTC and its advocates argue that these protections hamstring the agency and make it impossible for it to promulgate rules, there are good

reasons for these procedural safeguards. The FTC's rulemaking spree had reached such a height that, by 1978, the Washington Post dubbed the FTC the "National Nanny" — over its attempts to ban advertisements of high-sugar food products to children.<sup>1</sup> This, and a variety of other regulatory pushes, led a heavily Democratic Congress to enact Magnuson-Moss — and demand that the FTC constrain its substantive authority through its 1980 Unfairness Policy Statement. Despite these procedural safeguards, the FTC is again stretching the bounds of its authority today in a way that largely avoids them, which is troubling.

- 3. It appears to me that those who argue for the FTC to have general notice-and-comment rulemaking authority under the APA must believe that the FTC does not possess sufficient authority today to identify, penalize and prevent bad actors from taking actions detrimental to consumers. Yet we've heard testimony today and in the past repeatedly about how effective the FTC is, so that doesn't seem consistent. What are your thoughts here?**

The FTC can be an effective regulator by using its case-by-case enforcement authority under Section 5. But, unfortunately, it has repeatedly abused that process. Often the successes it points to in enforcements could also be seen as examples of bad process. For example, the unbroken streak of settlements in Section 5 data security cases until *FTC v. Wyndham* could be because the FTC was on sound legal ground in every single case — but it could testify to the defects in what some FTC Commissioners have taken to calling a "common law of consent decrees," notably that a lack of predictability may make companies reluctant to litigate even when the FTC is *not* carefully grounding its legal claims in Section 5.

Before Congress considers any revision to Magnuson-Moss, or any new major new grants of standard APA rulemaking authority over specific issues (e.g., cyber-security), Congress should insist that the FTC: (1) make a good faith effort to actually conduct a Magnuson-Moss rulemaking and (2) change its approach to policymaking through enforcement by issuing more guidance, pursuing more litigation in federal courts, examining the institutional structure that makes litigation so unlikely, and being more explicit about its economic analyses in *all* its actions.

- 4. In some specific areas, the Congress has given the FTC targeted authority to use notice-and-comment rulemaking. Some of these instances include the Telemarketing and Consumer Fraud and Abuse Prevention Act (1994), the Children's On-Line Privacy rulemaking required in 1998, and the Gramm-Leach-Bliley Act (1999) regarding financial institutions and consumer privacy. This "case-by-case" approach to notice-and-comment rulemaking ensures that, where it is needed, the FTC can address a specific issue in the manner that Congress has determined.**

- a. Do you agree that these specific directions from Congress have been working well?**

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<sup>1</sup> <http://techfreedom.org/post/92723075484/thanks-ftc-but-we-dont-need-a-national-nanny>

Yes, generally speaking the specific directions Congress has given to the FTC regarding financial institutions and consumer privacy seem to have been working well. Those specific directions resulted in expedited rulemakings that produced targeted regulatory frameworks that typically adequately addressed the underlying problems. Some might say that the FTC needs greater free reign to address those problems as they arise, without having to wait for specific direction from Congress, but history shows both that (1) the FTC has at times abused such general discretion, and (2) Congress is able to react timely to address serious harms as they arise — such as with threats to the online privacy protection of children — so this current system of delegating specific authority to the FTC when appropriate seems to be working well.

**b. Would you agree with former FTC Chairman Kovacic when he stated that this is the best approach to FTC rulemaking, given the broad subject matter authority and economic effects that FTC decisions can have across the economy?**

When Congress wants the FTC to have an expedited notice-and-comment rulemaking, it can craft a narrow grant of APA rulemaking authority that gives FTC discretion but limited, appropriately, to the targeted harm at issue. As Chairman Kovacic argued at this hearing, there giving the FTC standard rulemaking authority across the board would be unwise: given the breadth of the FTC's jurisdiction and vagueness of its authority, the FTC could regulate just about every aspect of economic activity in the U.S. This is not a theoretical risk; it is precisely what the FTC began trying to do in the 1970s — from pollution to labor practices and beyond.<sup>2</sup> Such actions might well extend into tenuous and sensitive areas where Congress never intended it to regulate, and might also have wide-reaching and deleterious effects upon the national economy. For those reasons, former FTC Chairman Kovacic is correct in his assessment that giving the FTC specific grants of APA rulemaking authority over specific issues to address real problems is the best approach to FTC rulemaking.

**5. Today the Federal Trade Commission has jurisdiction over a wide-range of high-tech markets, including computer hardware and software, online search engines, and audience measurement services. What are some of the challenges the agency faces in applying its competition and consumer protection authority to such rapidly changing markets?**

Inherent limitations on anyone's knowledge about the future nature of technology, business and social norms caution skepticism about regulators' ability to predict whether any given business conduct will, on net, improve or harm consumer welfare. In fact, a host of factors suggests that even the best-intentioned regulators may tend toward overconfidence and the erroneous condemnation of novel conduct that benefits consumers in ways that are difficult for regulators to perceive or understand.

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<sup>2</sup> <http://www.ftc.gov/public-statements/2003/05/ftcs-use-unfairness-authority-its-rise-fall-and-resurrection> - N\_15

Nobel Prize winning economist Ronald Coase lamented that industrial organization is still not well understood — and this remains true.<sup>3</sup> Transaction costs help explain why companies choose to internalize operations within the firm, rather buying them on the market. Sometimes it is cheaper for a firm to go buy what it needs on the market. Other times, it is easier for a firm to vertically integrate and build the components of production. Firms exhibit a lot of variation answering the “make or buy” question. Regulators often misunderstand why businesses make the choices they do, though, and attribute anti-competitive or anti-consumer intent to what Coase called “ununderstandable” business practices.<sup>4</sup>

Business generally succeeds by trial-and-error more than by theoretical insights or predictive power, and over-regulation thus risks impairing experimentation, which is an essential driver of economic progress. As a consequence, doing nothing may sometimes be the best policy for regulators, and constraints upon regulatory discretion to act can greatly benefit consumers by reducing the likelihood that regulators will proscribe ununderstandable conduct that turns out to be pro-consumer.

One thing is certain: a top down, administrative model of regulation is ill-suited for rapidly changing technologies. The technocratic mindset, which presumes that regulation is simply a kind of social engineering, is inconsistent with the regulatory humility required in the face of fast-changing, unexpected — and immeasurably valuable — technological advance. As Virginia Postrel put it:

Technocrats are “for the future,” but only if someone is in charge of making it turn out according to plan. They greet every new idea with a “yes, but,” followed by legislation, regulation, and litigation.... By design, technocrats pick winners, establish standards, and impose a single set of values on the future.<sup>5</sup>

- 6. In response to calls from members of Congress and her fellow Commissioners for formal guidelines on what constitutes an “unfair method of competition” under Section 5 of the FTC Act, Chairwoman Ramirez has said that guidelines are unnecessary because sufficient guidance already exists in the form of the Commission’s settlement agreements. Do you believe the FTC’s settlement agreements provide sufficient guidance about what conduct the agency will prosecute under its Section 5 authority?**

No. The FTC’s complaints and settlement agreements fail to provide enforceable precedents or adequate guidance — either as a policy matter or a constitutional matter. For instance, the FTC brings data security cases (under both UDAP and UMC) based on the alleged “unreasonableness” of a respondent’s security practices. But it does so without addressing

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<sup>3</sup> R.H. Coase, *Industrial Organization: A Proposal for Research*, in ECONOMIC RESEARCH: RETROSPECT AND PROSPECT, 59 (Victor R. Fuchs, ed. 1972), available at [www.nber.org/chapters/c7618.pdf](http://www.nber.org/chapters/c7618.pdf) (“Very little work is done on the subject of industrial organization at the present time, as I see the subject[.]”).

<sup>4</sup> *Id.* at 67.

<sup>5</sup> THE FUTURE AND ITS ENEMIES: THE GROWING CONFLICT OVER CREATIVITY, ENTERPRISE, AND PROGRESS, 48 (1998).

the actual Section 5 elements (materiality, substantial injury, etc.) and even without connecting them to the unreasonableness standard that the FTC claims to employ in lieu of the statutory language. Most of these complaints are so conclusory and threadbare that they would likely fail to withstand a 12(b)(6) motion to dismiss for failure to state a claim under *Twombly*.

Despite the hopes of the FTC's defenders, the FTC's complaints and consent decrees do not amount to a "common law" at all. A recent study by Geoffrey Manne and Ben Sperry, presented at a George Mason Law and Economics Center symposium, suggests that the FTC's complaints on data security, for instance, are pro forma and cursory, exhibiting none of the detailed factual analysis and doctrinal evolution that is the great virtue of the common law.<sup>6</sup> The typical FTC complaint is only three pages long and cites no precedent (mainly because there *is* no precedent). Indeed, few FTC complaints even allege or quantify actual harm to consumers, instead relying on vague assertions of loss (which are often borne entirely, or almost entirely, by credit card companies — not consumers — anyway). At the same time, the consent decrees impose almost identical remedies irrespective of the cases' widely varying facts, with 20-year oversight and imposition of a set of data-security policies derived nearly verbatim from financial services regulations, regardless of the industry involved in the breach. This regulation-by-complaint system — uniformly offered with the barest of legal analysis— has left companies with almost no guidance on what data-security practices the FTC Act supposedly prohibits or requires. Instead, the FTC has adopted an essentially standardless, ad hoc approach to data security. Such a lack of guidance could even violate judicial requirements that agencies must, to satisfy constitutional standards of due process, provide "fair notice" of their policies.

7. **(For Geoffrey Manne and/or Daniel Crane) Commissioner Wright has called on the FTC to issue a policy statement explaining the boundaries of the agency's authority to prosecute "unfair methods of competition." In his view, federal antitrust enforcement should not be a "game of gotcha," and businesses need to be able to distinguish between conduct that is lawful and conduct that is unlawful under Section 5. Do you agree that formal UMC guidance is important, and if so, why? Are there any reasons why the Commission should not issue such guidance?**

Commissioner Wright is right in saying that formal UMC guidance is important, and that the FTC should use its institutional expertise to develop and issue such guidance. As he put it, "In order for enforcement of its unfair methods of competition authority to promote consistently the Commission's mission of protecting competition, the Commission must articulate a clear framework for its application."<sup>7</sup> A regulatory "game of gotcha" is indeed an

<sup>6</sup> See Manne, et al., *Gap-Filler or Over-Regulator?: An Empirical Analysis of the FTC's "Common Law" of Data Security* (working paper delivered at the LEC Public Policy Conference on "The Future of Privacy and Data Security Regulation") (2014).

<sup>7</sup> Statement of Commissioner Joshua D. Wright, *Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act* (June 19, 2013),

apt description of how the FTC has proceeded in recent years under its UMC authority, and Commissioner Wright's proposed policy statement is an admirable step towards developing a clear outline for the FTC's UMC authority. However, further collaboration and deliberation are needed for any potential framework to strike the right balance going forward.

In drafting Section 5, Congress intentionally left it in general terms, because more specific terms would likely become soon obsolete or subject to simple workarounds by regulated parties. To some extent, the same concerns are present in developing any formal guidance under the FTC's UMC authority (or its UDAP authority), in that formal guidelines appropriate and comprehensive today might soon prove to be useless (because parties find easy ways to work around them) or even harmful (if they hamstring the agency's ability to address novel conduct that is in fact detrimental to consumer welfare) in the future. However, revising and updating standards as needed is easier for the FTC to do than for Congress, so those concerns are not as acute in the administrative context, and they should not keep the FTC from trying to develop such guidance. More importantly, if "guidelines" prove fragile, it is probably because they are overly detailed and prescriptive. The more closely guidelines amount to *de facto* regulations, the more likely they will be to become obsolete quickly (in addition to raising serious administrative law problems about circumvention of procedural safeguards for rulemaking, whether under the APA or Magnuson-Moss). The form of "guidance" most needed from the FTC is more *doctrinal*: how does the FTC apply the various prongs of unfairness and deception?

8. **You testified that “[t]he most important, most welfare-enhancing reform the FTC could undertake is to better incorporate sound economic- and evidence-based analysis.” In what arenas does the FTC fail to do this? Why is it so important in your view? Conversely, what is the harm by not incorporating economic- or evidence-based analysis?**

Consumer protection is one particular arena where the FTC repeatedly fails to sufficiently incorporate sound economics into its analysis and develop an adequate evidentiary base. This failure is critically important because, in many cases, new and innovative business practices that appear on their face to harm consumer welfare — and thus require the FTC to step in under the guise of consumer protection — actually, on net, are either neutral or beneficial to consumer welfare, particularly when considered in the aggregate and over the long run. By failing to rigorously examine the economic and other evidentiary bases in its consumer protection analyses, the FTC risks not only wrongfully condemning consumer welfare-enhancing behavior, but also chilling innovations and new business practices that firms might otherwise experiment with in the future, thereby depriving consumers of whatever consumer welfare gains that might flow therefrom.

9. **You quoted Commissioner Wright in saying that he “weigh[s] evidence relative to the burdens of proof and production.” Can you explain why this is important? How can we formalize this?**

The Bureau of Consumer Protection should act more like the Bureau of Competition when weighing evidence of consumer harm. On the competition side, antitrust law and economics have long recognized that there is value to many business arrangements previously thought to be anticompetitive. Efficiencies from things like tying arrangements, vertical integration, group boycotts, etc. can often be passed on to consumers and be beneficial on net. The Antitrust Guidelines issued by the FTC and DOJ clearly reflect the agencies’ ongoing dialogue with the economics profession, both indirectly, through litigation (where economists play a key role as expert witnesses) and directly, through, among other things, FTC workshops featuring economists and the FTC’s own Bureau of Economics.

Unfortunately, the FTC’s Bureau of Consumer Protection has failed to integrate economic analysis into its work, with scant exceptions, such as calculating damages in certain areas. At least from the outside, it does not appear that the Bureau of Consumer Protection is taking advantage of the Bureau of Economics’ expertise, or of economics more generally, to guide its enforcement actions — and ensure that it prioritizes its limited resources on actions that will do the most good for consumers.

In fact, the “countervailing benefits” prong of the Unfairness Policy Statement that was enshrined in statute (15 U.S.C. § 45(n)) mandates a cost-benefit analysis. In other words, cost-benefit analysis is already supposedly formalized, but the FTC rarely follows through in sharing this analysis in its complaints.

10. **I realize I’m asking an economist this question, but can you imagine a scenario where it would ever be appropriate to not consider economic analysis?**

There may be certain occasions where economic analysis can be more abbreviated, such as when public policy has long dealt with a practice and has determined it is nearly always harmful. The Unfairness Policy Statement allows the FTC to consider long-established public policy when evaluating “substantial injury.” In 1994 Congress added Section 5(n) to the FTC Act, providing that the FTC “may consider established public policies as evidence to be considered with all other evidence” but adding a limitation: “Such public policy considerations may not serve as a primary basis for such determination.” This essentially means that, the FTC can abbreviate its Section 5 analysis *somewhat* for conduct that contravenes clearly established public policy. For instance, conduct that would amount to a tort, like intrusion upon seclusion, could also be a cognizable harm under Section 5 Unfairness, with less need for the FTC to do an extended economic analysis before condemning it. But such cases would likely be relatively rare. The Bureau of Competition has developed a deep (if not perfect or consistent) institutional appreciation of the error cost framework. The Bureau of Consumer Protection must do so as well.

**11. You highlight that Section 5’s “unfair acts or practices” prong is balanced by consideration of whether an injury is “outweighed by countervailing benefits to consumers or competition.” How would you grade the Commission on its consideration of that limitation in enforcement actions in recent years?**

This requirement, which amounts to cost-benefit analysis, was essential to the *quid pro quo* by which Congress allowed the FTC to retain its unfairness authority — and yet the FTC just isn’t taking it seriously.

Everyone remembers that in math class growing up, even getting the right answer without showing our work would not result in full points on a test. In its enforcement actions, the Commission has consistently failed to consider the countervailing benefits prong in any meaningful way (*see, e.g., Apple, Amazon*), so they would have to be graded quite poorly in that respect. If the FTC wants businesses to have sufficient notice from Section 5 complaints, much more needs to be said in the complaints than the threadbare conclusions of law that are currently common. More effective use of no-action letters and more formal legal guidance (rather than the vague business brochures currently in vogue) would help, but ultimately, the only way to get the FTC to develop its unfairness doctrines in anything like the rigorous way it has developed its antitrust doctrines is to reform the FTC’s structure and approaches to encourage at least *some* litigation over substantive questions.

**12. Is it appropriate for the FTC to issue 20 year consent agreements in every case, or to apply the same conditions in very different cases? Or should the FTC craft remedies that are commensurate to the conduct at issue? Would anyone else like to comment?**

No, it is inappropriate for the FTC to issue 20 year consent decrees in every case, particularly in high-tech areas like data security and online consumer protection. These areas are evolving so rapidly that far-reaching consent decrees — while appropriate in the near-to-medium term — may prove to be unreasonably burdensome and ineffectual in the long term, either putting the consenting parties at a competitive disadvantage or forcing them to have to go back to the FTC to seek modification of a consent decree before it has run its course. Thus, while 20 year consent decrees may be appropriate in *some* cases, they certainly are not appropriate in *every* case, and applying the same sort of conditions in very different cases may result in very disproportionate and inequitable outcomes for regulated parties. Ideally, the FTC should craft remedies in each case that are commensurate to the conduct at issue and the nature of the particular industry at hand.

At a minimum, the FTC should issue guidelines on consumer protection consent decrees explaining its approach in a systematic way. But the fact that the FTC had such guidelines on disgorgement remedies in competition cases and then summarily revoked them, without any

further process or public discussion,<sup>8</sup> suggests that that the FTC — or at least, this Chairman — is deeply resistant to constraints upon its/her discretion, whatever the value of those constraints. Accordingly, Congress may need to legislate in this area — or at least begin by requiring the FTC either to issue such guidelines or to explain, in a meaningful way, why they are not necessary.

**13. The FTC’s draft strategic plan, released last summer, says nothing about the role of economics or the Bureau of Economics. What should it have said?**

The plan should have said much more about the role of economics, in general, and the Bureau of Economics, in particular. The Bureau of Economics is one of the most important tools for the FTC to ensure its rules and enforcement actions promote consumer welfare — and that it prioritizes its limited enforcement resources on the greatest harm to consumers. The FTC should use cost-benefit analysis and empirical scholarship rather than relying on anecdotes and speculation about consumer harm from ambiguous conduct.

For instance, in *Amazon*, the FTC seemingly failed to compare the benefits from one-click buying, even for in-app purchases, to the harms. The Bureau of Consumer Protection chose to cherry-pick anecdotes instead of engage in the type of economic analysis the Bureau of Economics is well-positioned to make. It is quite possible that the benefits from this feature (more specifically, from the particular way it was designed) for the vast majority of consumers greatly outweigh the harms to a few users. A serious analysis of transaction costs would likely suggest that the “least cost avoider” (an essential concept in any economic analysis of regulation) in such a case is the parents who could have reasonably avoided the costs by better monitoring of their devices, rather than Amazon.

**14. Congress and the FTC spent a lot of time working out the standards for deception and unfairness. What are the limitations on an agency’s authority if it can push the law in new directions without a court ever weighing in to make sure they’re appropriately applying their legal mandate?**

Since the FTC’s 1980 showdown with Congress, the FTC has effectively evaded judicial review of its Section 5 enforcement actions —until the recent challenges by Wyndham and LabMD. This appears to reflect the tremendous pressure the FTC can put on defendants to settle. The FTC’s Part III administrative litigation process gives Bureau staff free rein to drag investigation targets through a very expensive discovery process, in which targets have few procedural rights, before ever getting the full Commission to agree to filing an administrative complaint. Once the Commission decides to pursue a case, unless it chooses to file suit directly in Federal court, the target faces a long and costly internal process: trial before an

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<sup>8</sup> FTC, *FTC Withdraws Agency’s Policy Statement on Monetary Remedies in Competition Cases; Will Rely on Existing Law* (July 31, 2012), available at <http://www.ftc.gov/news-events/press-releases/2012/07/ftc-withdraws-agencys-policy-statement-monetary-remedies>.

ALJ and then appeal to the FTC, where they will almost always lose (since the FTC brought the complaint in the first place). Each loss could impose significant damage on the company's public image, which may be its most valuable asset. Under these circumstances, it is hardly surprising that rational defendants will agree to settle, even in cases of ambiguous conduct or uncertain law.

The problem with this scenario is that it allows the FTC to assert novel legal theories of unfairness and deception without judicial review — and that this pattern can, apparently, persist indefinitely. The *Wyndham* and *LabMD* cases have already highlighted the process failures behind the FTC's current enforcement regime, but Congress should not wait for the FTC to address these process failures. Congress should begin drafting FTC process reform legislation aimed at ensuring that the FTC does not violate the spirit of the 1980 and 1983 Policy Statements and the 1994 amendments to the FTC Act through the loophole of adjudicated consent decrees.

**15. Do you believe the FTC is using its workshops properly? Are they really helping to inform the agency and prioritize its limited enforcement resources? Or are they being used as informal rulemakings to circumvent the Magnuson-Moss process by producing recommendations like “privacy by design” that, while technically non-binding, the FTC then treats as legal requirements or imposes in consent decrees?**

Unfortunately, the FTC has repeatedly failed to use its workshops properly, as they often adduce little information about how the agency will prioritize its limited enforcement resources. Paramount among those considerations ought to be how the FTC will use its statutory authority to achieve optimal regulatory outcomes, but, as was the case with the FTC's Internet of Things workshop, for example, the FTC simply failed to ask such basic questions when it solicited public comment ahead of the workshop.<sup>9</sup> Instead, the FTC is using its workshops as a *de facto* rulemaking process for unfairness and deception in many areas. Where once workshops reports were simply descriptive accounts of what was discussed, they often now take the form of prescriptive quasi-rules that regulated parties must abide by or risk having enforcement actions brought against them. Not only is this a poor use of agency resources, it also fails to provide for fair notice and effectively evades Congressionally-designed requirements for FTC rulemaking.

For instance, in *LabMD*, the FTC claims that it was an unfair trade practice for LabMD not to have done more than it did to keep peer-to-peer file sharing software off its computers — and rests its case, in significant part, on a 2004 staff report on the subject of peer-to-peer file sharing.<sup>10</sup> That report summarizes an FTC workshop at which one technologist mentioned

<sup>9</sup> See FTC, *FTC Seeks Input on Privacy and Security Implications of Internet of Things* (Apr. 17, 2013), available at <http://www.ftc.gov/news-events/press-releases/2013/04/ftc-seeks-input-privacy-and-security-implications-internet-things>.

<sup>10</sup> See FTC, *In re LabMD, Inc.*, Docket No. 9357, COMPLAINT (Aug. 28, 2013), available at <http://www.ftc.gov/sites/default/files/documents/cases/2013/08/130829labmdpart3.pdf>.

the potential risk that such software could cause. The FTC seems to believe this report, issued without notice and comment (let alone the other requirements of Magnuson-Moss) created a legal duty.<sup>11</sup>

In *Wyndham*, the FTC similarly pointed to brochures produced by workshops as part of fair notice to businesses — despite the fact that these brochures are not binding law. Relatedly, the FTC has pointed to previous complaints and consent decrees as further notice to businesses. Legally, consent decrees are simply contracts, binding only upon the parties involved. Even more importantly, neither the workshops, brochures, complaints, nor the consent decrees actually explain how Section 5's factors apply to real world facts in a way that would allow a business to understand the subtle evolution of doctrine — and use that understanding of doctrine to predict the law in advance, and to adjust their conduct accordingly. At most, a business could discern what specific things the FTC found to constitute violations of Section 5 in the past; but it could not know with any certainty what is within the law prospectively.

Congress created Magnuson-Moss for a reason: the FTC of the 1970s had effectively untethered itself from Section 5. If the courts allow the FTC to continue down this road, then the agency will again become essentially a second national legislature.

**16. In unfairness cases like the one previously pursued against Apple regarding in-app purchases, the FTC seems to aggregate diffuse harms on one side of the equation but does not consider the diffuse costs of their requirements, like time spent dealing with extra disclosures. Is the FTC stacking the deck? Could this be considered arbitrary and capricious if it ever wound up before a court?**

Indeed, particularly when it comes to unfairness cases like those regarding in-app purchases by Apple and Amazon, the FTC is stacking the deck in its favor. Not only does it aggregate diffuse costs while ignoring the costs that enforcement action would impose on regulated parties, but it ignores the aggregate benefits to many users who likely enjoyed the great ease of in-app purchases. The idea that parents were not able to monitor their children's device use, but will be able to navigate the legalistic disclosures required for express consent seems contradictory, yet this is just another example of the FTC failing to consider the countervailing benefits and reasonable avoidance prongs of Section 5 unfairness.

On the legal prospects, it is certainly possible that the FTC's current approach could face a legal challenge and have one of their enforcement actions found arbitrary and capricious in court as a violation of the Administrative Procedure Act.<sup>12</sup> Indeed, a court may even find the

<sup>11</sup> See FTC, *FTC Issues Report on Peer-to-Peer File Sharing* (June 23, 2005), available at <http://www.ftc.gov/news-events/press-releases/2005/06/ftc-issues-report-peer-peer-file-sharing>.

<sup>12</sup> 5 U.S.C. § 706(2)(A) (2012) (“[A] reviewing court shall—hold unlawful and set aside agency action, findings, and conclusions found to be—arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law[.]”).

FTC has failed to produce sufficient evidence to satisfy the elements of Section 5 in the *Wyndham* or *LabMD* cases.<sup>13</sup> Thus, rather than leave it to the often unpredictable judiciary, the FTC should take the time to reform its processes now before a court forces it to.

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<sup>13</sup> See *FTC v. Wyndham Worldwide Corp.*, D.N.J., No. 2:13-cv-01887; *LabMD, Inc. v. FTC*, U.S. Dist. Ct. N.D. Georgia, Atlanta Div., No. 1:14-cv-00810-WSD.

FRED UPTON, MICHIGAN  
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA  
RANKING MEMBER

ONE HUNDRED THIRTEENTH CONGRESS  
**Congress of the United States**  
**House of Representatives**  
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October 2, 2014

Mr. Christopher S. Yoo  
John H. Chestnut Professor of Law  
Communication, Computer and Information Science  
University of Pennsylvania Law School  
3501 Sansom Street  
Philadelphia, PA 19104-6204

Dear Mr. Yoo,

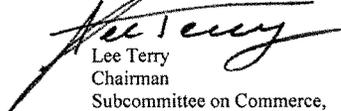
Thank you for appearing before the Subcommittee on Commerce, Manufacturing, and Trade on Friday, February 28, 2014 to testify at the hearing entitled "The FTC at 100: Views from the Academic Experts?"

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for ten business days to permit Members to submit additional questions for the record, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and (3) your answer to that question in plain text.

To facilitate the printing of the hearing record, please respond to these questions by the close of business on Thursday, October 16, 2014. Your responses should be e-mailed to the Legislative Clerk in Word format at [Kirby.Howard@mail.house.gov](mailto:Kirby.Howard@mail.house.gov) and mailed to Kirby Howard, Legislative Clerk, Committee on Energy and Commerce, 2125 Rayburn House Office Building, Washington, D.C. 20515.

Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,



Lee Terry  
Chairman  
Subcommittee on Commerce,  
Manufacturing, and Trade

cc: Jan Schakowsky, Ranking Member, Subcommittee on Commerce, Manufacturing, and Trade  
Attachment

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HENRY A. WAXMAN, CALIFORNIA  
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October 2, 2014

Mr. Robert H. Lande  
Venable Professor of Law  
University of Baltimore School of Law  
Angelos Law 1106  
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Baltimore, MD 21201

Dear Mr. Lande,

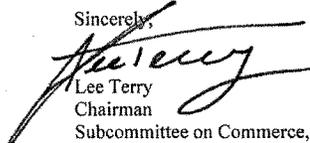
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Attachment



## Responses to Additional Questions for the Record

Robert Lande  
Venable Professor of Law  
University of Baltimore School of Law

## Questions Posed By The Honorable Henry A. Waxman

3(a). Vertical mergers – in which a company acquires a key supplier or service provider – can create cost savings due to improved coordination, but can also make it hard for other companies to compete in the same market. Are the current FTC guidelines concerning vertical mergers sufficient to address this concern?

Answer: No. The FTC currently does not have vertical merger guidelines. I believe that it would be beneficial if the FTC developed and issued vertical merger guidelines

3(b). Are antitrust statutes important solely for reasons of economic efficiency, or do you believe they have a broader political or social significance? Please explain.

Answer: The antitrust statutes also have as their goal protecting consumers from paying higher prices due to unfairly acquired market power. When cartels raise prices, for example, these higher prices constitute a form of theft from consumers that Congress meant to prevent when it enacted the antitrust laws. For the relevant legislative history and case law see John B. Kirkwood & Robert H. Lande, “The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency,” 84 Notre Dame L. Rev. 191 (2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1113927](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1113927) and Robert H. Lande, “Wealth Transfers As the Original And Primary Concern of Antitrust: The Efficiency Interpretation Challenged,” 34 Hastings L. J. 65 (1982), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2065413](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2065413)

3(C). Do you see the non-economic benefits of antitrust laws (e.g., decentralization of power, freedom of choice, and increased trust in the free market system) as essential to how these laws and the enforcement of these laws are ultimately analyzed and judged?

Answer: The antitrust laws also have as their goal enabling consumers to receive the array of choices that the unrestrained operation of the free market would have provided to them. Practices such as cartels that unreasonably restrict the choices the free market otherwise would have delivered to consumers are antitrust violations. See Neil W. Averitt & Robert H. Lande, “Using The Consumer

Choice Approach To Antitrust Law,” 74 Antitrust L. J. 175 (2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1121459](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1121459)

Questions Posed By The Honorable Jan Schakowsky

2(a). Is the FTC exceeding its authority to enforce antitrust laws? Do you believe there is convincing evidence to support the position that the Commission is acting in an unrestrained manner?

Answer. No, the FTC is not exceeding its authority to enforce the antitrust laws, and the agency is not acting in an unrestrained manner. I do disagree as to the optimal with the wording of certain FTC decisions from time to time, but this is only natural, and does not mean they are acting in any way improperly.

(b). To your knowledge, has there been a significant “chilling effect” on business as a result of the FTC’s recent enforcement of the antitrust laws?

Answer: No. I have never seen neutral evidence of a significant “chilling effect” on business as a result of recent FTC enforcement of the antitrust laws.

(c). In your testimony, you suggested a number of areas in which the FTC possesses the authority to act against anticompetitive conduct but has not done so. Given the extent of consolidation in certain industries in recent decades, do you think there are circumstances or types of cases in which the FTC has been reluctant to act?

Answer: Yes. I believe the FTC sometimes has been reluctant to act in the public interest because some FTC Commissioners have given too much weight to low probabilities that enforcement actions could possibly harm big businesses, but that these same Commissioners have not given enough weight to the possibility that agency inaction is highly likely to harm consumers.

(d). Do you believe the FTC has an adequate understanding of how its competition policy decisions ultimately turn out, over the long term? Do you believe the FTC (or outside entities that could advise the FTC) adequately test or evaluate previous competition policy, and do you think long-term lessons play a large enough role in influencing future policy decisions?

Answer: I believe the FTC should engage in more impact evaluation studies of their enforcement efforts, and also of their decisions not to enforce the antitrust laws. I also believe that outside entities should undertake more of the same types of studies. I believe these studies would be likely to help improve long term FTC enforcement and policy decisions.

146

Please let me know if I can supply you with additional information about any of these issues. I would be delighted to do this either in writing or orally, at your convenience.

Sincerely yours,

Robert H. Lande  
Venable Professor of Law  
University of Baltimore School of Law

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October 2, 2014

Mr. Paul Ohm  
Associate Professor  
University of Colorado Law School  
433 Wolf Law Building  
2450 Kittredge Loop Road  
Boulder, CO 80309

Dear Mr. Ohm,

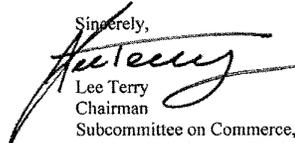
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