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Bringing Antitrust's Economic and Institutional Limits to the FTC's Consumer Protection Authority

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I. INTRODUCTION

In 1914 Congress gave the U.S. Federal Trade Commission ("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 Commission approaches its 100th 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 multi-stakeholder 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 overconfidence and the

[1] Executive Director, International Center for Law & Economics. The paper is based largely on testimony given before the United States House of Representatives' Committee on Energy and Commerce hearing on *The FTC at 100: Views from the Academic Experts* (February 28, 2014), *available at* http://docs.house.gov/meetings/IF/IF17/20140228/101812/HHRG-113-IF17-Wstate-ManneG-20140228.pdf. A longer, more detailed version of this paper was submitted as an attachment to the written testimony and is available at http://docs.house.gov/meetings/IF/IF17/20140228/101812/HHRG-113-IF17-Wstate-ManneG-20140228-SD002.pdf.

erroneous condemnation of novel conduct that benefits consumers in ways that are difficult for regulators to understand.[2]

At the same time, business generally succeeds by trial-and-error more than theoretical insights or predictive power,[3] 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.[4]

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.[5]

B. Economics at the FTC

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 FTC decisions 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 offers a steadfast baseline of economic analysis against which to assess the Commission's recent work. For Wright:

> [E]conomics 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

[2] *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).

[3] *See* Armen Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950).

[4] 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).

[5] VIRGINIA POSTREL, THE FUTURE AND ITS ENEMIES 16 (1998).

> 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.[6]

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

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 Commission 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 a striking 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.[7]

[6] 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.

[7] Coase, *Industrial Organization*, *supra* note 2, at 67.

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, actually forebears. In this regard the Commission has set the bar fairly high. But several recent examples of regulatory overreach—of Agency action in the face of 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[8] from the FTC's 2 to 1 decision[9] 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.[10]

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.[11]

As Wright suggests, facts are essential—but they are not enough. Particularly when predicting future economic effects, proper, restrained application of economic analysis 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.

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[8] 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"].

[9] 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.

[10] Wright, *Nielsen* Dissent, *supra* note 8, at 5-6.

[11] *Id.* at 2, 3.

Compare in this regard Commissioner's Wrights 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.[12]

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 a 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 powerful dissent ably identifies where and how the Agency deviated from sensible restraint.

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."[13]

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

> T]he 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.[14]

[12] 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-mergeranalysis/140206mergeranalysis-dlf.pdf.

[13] 15 U.S.C. § 45 (2012), *available at* http://www.law.cornell.edu/uscode/text/15/45.

[14] 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 [hereinafter "Wright *Apple* Dissent"].

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 says in his dissent:

> 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.[15]

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 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.[16]

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 was a product in significant part of the influence of courts on the Agency (as well as 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 FTC and the courts alike—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.

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[15] *Id.* at 14.
[16] *Id.* at 16.

For the most part, and generally in competition issues, the FTC's model is an evolutionary, rather than regulatory, one.[17] The FTC learns from, and adapts to, the ever-changing technological and business environments. While the Commission'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.

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 ("UMC")

Among the FTC'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 nonexistent.

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.[18] But it's hard not to see in this 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."[19]

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….."[20]

Commissioner Wright's Proposed Statement on UMC enforcement attempts to remedy these defects, and, in the process, explains why the Commission's previous, broad applications of the statute are not, in fact, appropriate. His draft statement, along with the policy speech in

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[17] *See* Berin Szoka & Geoffrey Manne, *The Second Century of the Federal Trade Commission*, TECHDIRT (Sep. 26, 2013), *available at* http://www.techdirt.com/blog/innovation/articles/20130926/16542624670/second-century-federal-trade-commission.shtml

[18] *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.

[19] 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-definingfederal-trade-commissions-unfair-methods-competition-authority/130619section5recast.pdf.

[20] 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-commissionermaureen-ohlhausen/121126boschohlhausenstatement.pdf at 3-4.

which he introduced it,[21] 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….[22]

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 Unfair or Deceptive Acts or Practices ("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 FTC's data security complaints, consent orders, speeches, and Congressional testimony collectively provide sufficient guidance to business, the lack of more-formal guidelines is notable.[23] Moreover, this set of guiding materials is 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).[24]

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[21] *See* Wright, *Section 5 Recast*, *supra* note 19.

[22] 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-commissionerjoshua-d.wright/130619umcpolicystatement.pdf.

[23] 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 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.

[24] 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-storesinc./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

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 are 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.[25]

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. Examples of such policies include requiring "privacy by design" or "security by design" or, in the case of Apple, "industrial design by the FTC's design."

Letter Closing Letter (Jun. 5, 2007), *available at* http://www.ftc.gov/sites/default/files/documents/closing_letters/dollar-tree-storesinc./070605doltree.pdf.

[25] *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, 2013), *available at* http://docs.techfreedom.org/Wyndham_Amici_Brief.pdf [hereinafter "Wyndham Amicus Brief"].

The problem of the excessive use of consent decrees at the FTC is exacerbated by its administrative procedures, which create a fundamental imbalance between the Commission 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 are in the public interest.[26]

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.[27]

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."[28]

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.

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

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[26] Wright, *Nielsen* Dissent, *supra* note 8, at 6-7.

[27] *See* Wyndham Amicus Brief, *supra* note 25, at 6-7.

[28] 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/041613Q FRs-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/7-3013MunckTestimony.pdf.

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.[29]

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.[30]

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.[31] 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 apply everyday in our investigations."[32]

While perhaps this admission doesn't go far enough, now four of the FTC's five 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

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[29] *See* Wyndham Amicus Brief, *supra* note 25, at 6-12.

[30] Wright, *Nielsen* Dissent, *supra* note 8, at 6-7

[31] See *id.* at 10.

[32] 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 See also* Erica Teichert, *FTC Commissioners Spar Over Section 5 Guidance Boundaries*, LAW360 (Feb. 13, 2014), http://www.law360.com/articles/509894/ftccommissioners-spar-over-section-5-guidance-boundaries.

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 FTC (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 FTC 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.[33] 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 is 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 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.…[34]

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**.[35]

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."[36]

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

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[33] *See, e.g.*, Manne & Wright, *Innovation*, *supra* note 2.

[34] 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).

[35] 15 U.S.C. §45 (2012) (emphasis added).

[36] Wright, *Apple* Dissent, *supra* note 14.

1. The *McWane* Case

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 fail[ed] to support or justify an evidentiary inference of any unlawful agreement involving McWane."[37]

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.[38]

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, 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."[39]

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[37] 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.

[38] 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.

[39] 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-thelaw-and-economics-of-exclusive-dealing/.

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.[40] As seemingly innocuous as the amendment is, it is not without likely costs.[41] 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

Instead of asserting what companies should do, the FTC should offer more guidance on what it thinks its legal authority means.[42]

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 FTC'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 by 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 multi-stakeholder groups as well as novel, data-driven alternative

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[40] 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.

[41] Wright Concurrence in Notice of Public Comment for Proposed HSR Rules, http://www.ftc.gov/os/2013/02/130201hsrnprm-jwrightstmt.pdf.

[42] For more suggestions for FTC Reform, see FTC: TECHNOLOGY & REFORM PROJECT, CONSUMER PROTECTION & COMPETITION REGULATION IN A HIGH-TECH WORLD: DISCUSSING THE FUTURE OF THE FEDERAL TRADE COMMISSION (Dec. 2013), *available at* http://docs.techfreedom.org/FTC_Tech_Reform_Report.pdf.

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 urge 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."