CPI Antitrust Chronicle
November 2013 (2)

Recalibrating Section 5: A Response to the CPI Symposium

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I. INTRODUCTION

I want to thank the participants in Competition Policy InternationalÕs Symposium on the Federal Trade CommissionÕs (ÒFTCÓ or the ÒCommissionÓ) unfair methods of competition (ÒUMCÓ) authority under Section 5 of the FTC Act and, in particular, my Proposed Policy Statement[2] suggesting one approach to defining what constitutes an UMC.[3] The Symposium elicited many thoughtful contributions and identified some misunderstandings about the rationale for my proposal. I will take this opportunity to share my view of the current state of play with respect to FTC guidance for Section 5, suggest the intellectual distance between the various UMC definitions offered for public scrutiny is relatively small, address a few criticisms of my Proposed Policy Statement, and demonstrate why I believe there is significant reason to be optimistic that this Commission can finally produce much needed guidance in this important area.

As the FTC enters its second century, it is an especially appropriate time to reflect upon whether the agencyÕs various enforcement and policy tools are being put to the best possible use to help the agency fulfill its competition mission. Now is the time to sharpen tools that have long been deployed effectively and to evaluate whether tools that have not lived up to the task should be salvaged or scrapped. One of these tools—theCommissionÕs UMC authority under Section 5 of the FTC Act—is a particularly suitable candidate for evaluation.

I have made no secret of the fact that I think the CommissionÕs record with respect to Section 5 is bleak. The historical record reveals a remarkable and unfortunate gap between the theoretical promise of Section 5 as articulated by Congress and its application in practice by the

In the absence of guidelines, the CommissionÕs UMC authority cannot possibly contribute effectively to the agencyÕs competition mission. At best, without UMC guidelines, the gap will remain. At worst, the absence of UMC guidelines can be counterproductive to the FTCÕs competition mission, raising issues of fundamental fairness and potentially deterring consumer welfareenhancing conduct.

II. IDENTIFYING THE PROBLEMS: SECTION 5 PROCESS AND SUBSTANCE

The fundamental problem with the CommissionÕs UMC enforcement is one that combines administrative process and substance. The agencyÕs competition mission and its beneficiariesÑ consumersÑ are put at risk by the obvious and problematic interaction between the agencyÕs administrative process advantages and the vague and ambiguous nature of the FTCÕ UMC authority. These two issues combine to pose a unique barrier to the application of Section 5 in a manner that consistently benefits rather than harms consumers.

The vague nature of Section 5 is well known, and it is not necessary to recount the systematic sources of its volatility here.[4] Proposed UMC definitions and approaches to UMC enforcement have varied substantially over time. Beliefs that the modern FTC has somehow moved beyond this product of its institutional design are no more than wishful thinking. Indeed, there are still a few voices among the commentariat who lament the vague and broad UMC authority as too limiting upon FTC enforcement. These commentators today hold out hope for an unbridled Section 5 the Commission can use expansively to capture all manner of conduct that a majority of the Commission happens to perceive as bad for consumers.[5]

For instance, one former commissioner has recently called upon the Commission to challenge Patent Assertion Entities (ÒPAEsÓ) often referred to as Òpatent trollsÓ because Òwe

[4] The sources of the significant variation and instability of the UMC definition include, but are not limited to: (1) the lack of any requirement that the agency interpret Section 5 consistently while membership of the Commission remains constant and (2) ongoing membership of the Commission over time. Joshua D. Wright, Commissioner, Fed. Trade CommÕn, Section 5 Recast: Defining the Federal Trade CommissionÕs Unfair Methods of Competition Authority (June 19, 2013), at 12, Remarks at the Antitrust Section of the New York State Bar AssociationÕs Executive Committee Meeting, available at http://ftc.gov/speeches/wright/130619section5recast.pdf.

[5] Take for instance the position offered by one commissioner who several years ago stated that conduct can constitute an

have a gut feelingÓ that the conduct violates Section 5.[6] Such statements illustrate precisely the type of enforcement regime we should be concerned about when the Commission has failed to commit itself to a set of principles captured in a formal policy statement articulating how the agency intends to apply its UMC authority under Section 5.

However, the key to understanding the threat of Section 5 is the interaction between its lack of boundaries and the FTCÕs administrative process advantages. What do I mean by administrative process advantages? Consider the following empirical observation that demonstrates at the very least that the institutional framework that has evolved around the application of Section 5 cases in administrative adjudication is quite different than that faced by Article III judges in federal court in the United States. The FTC has voted out a number of complaints in administrative adjudication that have been tried by administrative law judges (ÒALJsÓ) in the past nearly twenty years. In each of those cases, after the administrative decision was appealed to the Commission, the Commission ruled in favor of FTC staff. In other words, in 100 percent of cases where the ALJ ruled in favor of the FTC, the Commission affirmed; and in 100 percent of the cases in which the ALJ ruled against the FTC, the Commission reversed.[7] By way of contrast, when the antitrust decisions of federal district court judges are appealed to the federal courts of appeal, plaintiffs do not come anywhere close to a 100 percent success rate. Indeed, the win rate is much closer to 50 percent.

There are a number of hypotheses one might suggest to explain this disparity, but the leading two possibilities are (1) Commission expertise over private plaintiffs in picking winning cases and/or (2) institutional and procedural advantages for the Commission in administrative adjudication that are fundamentally different than what private plaintiffs face in federal court. The relatively harsh treatment Commission decisions have endured in federal courts of appeal over the same time period relative to the treatment federal district courts have received gives at least some pause to the expertise hypothesis.[8] At a very minimum, however, these figures suggest that how we conceive of the appropriate time and place to use the CommissionÕs UMC authority to further its competition mission ought to take into account these institutional features.

Further, these figures should call into question the idea that concepts like the rule of reason and other substantive doctrine that evolved in the federal courts, a different institutional setting with a different balancing of the costs and benefits of error and administration, are

III. STATE OF PLAY IN THE SECTION 5 DEBATE

In an effort to start a discussion about the appropriate contours of the CommissionÕs UMC authority, and ultimately to remedy the problems outlined above that have prevented Section 5 from being a productive member of the antitrust community, earlier this year I offered a concrete Proposed Policy Statement explaining my views of how the agency should apply its signature competition statute. My Proposed Policy Statement provides that an unfair method of competition should be defined as an act or practice that (1) harms or is likely to harm competition significantly and that (2) lacks cognizable efficiencies.[10]

There are several benefits to this definition of an UMC. First, the definition allows the Commission to reach beyond the scope of the Sherman and Clayton Acts, as Congress intended. Second, it does so while explicitly tethering the agencyÕs enforcement actions to the modern economic concept of harm to competition. Third, this definition allows the Commission to leverage its expertise and administrative process advantages to target conduct that is most likely to harm consumers. Fourth, this definition reduces the risk of potentially deterring welfare-enhancing conduct and provides the business community with clear guidance as to what conduct will be considered unlawful under Section 5.

My proposed definition in no way immunizes, as some have suggested, conduct that has efficiency benefits from the antitrust laws. Any conduct falling outside my proposed UMC definition because it generates cognizable efficiencies still can be prosecuted under the traditional antitrust laws. The FTC is more than capable of challenging conduct where the anticompetitive effects outweigh any procompetitive benefits. The agency does so successfully today, and should continue to do so where appropriate.

Nor will just any efficiency justification save a party from scrutiny under Section 5 under my proposed definition. As practitioners who appear regularly before the agency on merger matters know all too well, the Commission does not credit efficiency benefits easily and requires significant evidence before deeming an efficiency to be cognizable.

Over the past nearly six months, through symposiums such as this one, conferences, roundtables, and other forums, there has been considerable debate and commentary from the antitrust bar, consumer groups, the business community, my colleagues on the Commission, and even members of Congress[11] about the need for Section 5 guidelines and what those guidelines should ultimately say about the CommissionÕs UMC authority. These discussions lead me to be very optimistic that this Commission can reach agreement on a policy statement that benefits consumers and the business community by strengthening the agencyÕs ability to target anticompetitive conduct and providing clear guidance about the boundaries of the CommissionÕs

[10] Wright, supra note 2, at 2-3.

[11] Members of the Senate and House Judiciary Committees have engaged in the debate about the need for Section 5 guidance by sending a letter to Chairwoman Ramirez urging the Commission to issue a UMC policy statement. See Letter from Chairman Bob

agenda as VonÕs Groceryis for predicting which mergers the agency will challenge Õ which is to say not at all.[18]

The CommissionÕs consents also do not provide meaningful guidance about how the Commission will apply its Section 5 authority. Although the consents clearly suggest that a practitioner today would be wise to advise a client that holds a standard essential patent (ÒSEPÓ) that the agency might use Section 5 to challenge how the client has enforced its SEP, what guidance did the first SEP holder that became subject to a Section 5 challenge have? Put another way, how do businesses know which conduct that has not yet been subject to a Section 5 claim will become subject to Section 5 scrutiny in the future?[19] For instance, as mentioned above, some are calling on the FTC to use Section 5 to prosecute PAEs. Are PAEs sufficiently on notice that their conduct could violate Section 5? What consent can PAEs look to for guidance about whether their conduct violates Section 5?

With respect to the notion that the Commission uses its Section 5 authority judiciously and only in limited instances, the data simply does not support the assertion that Section 5 represents an insignificant part of the agencyÕs enforcement agenda. For instance, in the past year alone the Commission has brought four non-merger enforcement actions, of which precisely one-half were Section 5 UMC cases.[20] More dramatically, the agency claimed credit for consumer savings of roughly $1 billion in fiscal year 2012 from merger and non-merger enforcement victories, of which over 33 percent is attributable to standalone Section 5 UMC enforcement actions.[21] When viewed as a portion of consumer savings solely from the CommissionÕs non-merger enforcement agenda, the percentage attributable to Section 5 standalone claims balloons to over 75 percent.

Both in terms of the number of standalone Section 5 cases as a percentage of the CommissionÕs non-merger enforcement agenda and as a percentage of consumersÕ purported overall return on investment, the CommissionÕs use of Section 5 appears to be anything but minimal and certainly these data are more than sufficient to rebut the claims of those who would argue that Section 5 guidelines are a solution in search of a problem. Given the significant role Section 5 plays in the agencyÕs enforcement agenda, the Commission would do well to provide transparency and guidance for how it applies its Section 5 UMC authority as it has done in other areas of enforcement.

Second, there is broad consensus that one of the requirements of the FTCÕs signature competition statute should be a showing of Òharm (or likely harm) to competitionÓ as the phrase

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[18] United States v. VonÕs Grocery Co., 385 U.S. 270 (1966).

[19] See Sims, supra note 17, at 2 (ÒThe one thing we know for certain is that there will always be something new that catches attention but looks hard to attack under the Sherman Act.Ó).

[20] A complete list of non-merger competition enforcement actions for fiscal year 2013 is available at http://ftc.gov/bc/caselist/nonmerger/consents/2013.pdf.

[21] Fed. Trade CommÕn, Performance & Accountability Report Fiscal Year 2012, available at www.ftc.gov/opp/gpra/2012parreport.pdf. The fiscal year 2012 consumer savings are calculated using the average consumer savings of fiscal year 2012 and the previous four fiscal years. See Performance & Accountability Report

has been developed under the traditional antitrust laws.[22] This phrase has a specific meaning that is known to the antitrust bar and that is tethered to modern economics. Indeed, a majority of the Commission has publicly stated that the Commission should only invoke Section 5 on a standalone basis where there is harm to competition as understood under the traditional laws.[23] Most significantly, in a letter to Chairman Bob Goodlatte of the House Judiciary Committee, Chairwoman Ramirez expressed her view that the Commission should only use Section 5 where there is likely harm to competition and only after taking into account any efficiency justifications.[24]

Third, there is a growing (albeit incomplete with the notable exception of Joe Sims and others who contend Section 5 ought to be interpreted to extend only to the boundaries of the Sherman and Clayton Acts and no further) consensus that Section 5 is broader than the traditional antitrust laws and is a unique institutional tool in the FTCÕs toolkit. For instance, I have explained in my Proposed Policy Statement that Section 5 should be able to reach practices that have not yet resulted in harm to competition but are likely to result in anticompetitive effects if allowed to continue.[25]

These three areas of consensus cover much of the Section 5 debate, while leaving room on the margins with respect to how we deal with efficiencies to best allow the FTC to use its UMC auth.1215686 ractices

efficiencies equally in a balancing test. Chairwoman Ramirez also appears to endorse and approach to Section 5 that balances anticompetitive harms and efficiencies benefits.[30]

I will not fully address the various costs and benefits of each of these proposals, but I will note that all would require evidence of harm to competition and calls upon efficiencies. It is only the treatment of efficiencies within the analysis that would differ. Each treats a UMC as an antitrust violationÑ focusing upon and applying differing weights to harms and efficiencies.

But how should we select amongst these options?

To choose among the standards outlined above, I think it is important to recall why the CommissionÕs use of its Section 5 UMC authority has failed to date. In my view, this failure is principally because the Commission has sought to do too much with Section 5, and in so doing, has called into serious question whether it has any limits whatsoever. This failure also is primarily a function of the combination of the absence of these limits and the procedural and administrative advantages conferred to the Commission in enforcing Section 5.

Consider once again those advantages and their impact on Section 5 UMC outcomes. Over the last twenty years the Commission has affirmed 100 percent of ALJ decisions in favor of FTC staff while reversing 100 percent of the ALJ decisions ruling against FTC staff. Those statistics alone ought to give significant pause to those like Professor Salop and others who favor an approach that contemplates the sort of balancing that occurs in antitrust claims in federal court.

One response would be to rely upon Commission expertise to explain the disparity of these outcomes with the reversal rate of federal district court judges. However, federal courts of appeals reverse federal district court judges four times less often than the Commission.[31] Another approach is to ignore the statistics, which amounts to ignoring critical institutional differences between the Commission and courts by merely hoping that the Commission will do better in its UMC enforcement efforts if we try harder in the future. That is an entirely unsatisfactory explanation when we have a track record of 100 years to go on that gives little reason for such optimism. Ignoring institutional detail and its impact on substantive outcomes and agency performance is a recipe for repeating old mistakes and discovering new ones.

Thus, in order to save Section 5, and to fulfill the vision Congress had for this important statute, the Commission must recalibrate its UMC authority with an eye toward regulatory humility in order to effectively target plainly anticompetitive conduct. My proposal does so in a simple manner: targeting the

anticompetitive conduct Ñ those without redeeming efficiency virtues Ñ and allowing the Commission to pursue all other cases in federal court where it can and does litigate with success.

V. CONCLUSION

Congress intended Section 5 to play a key role in the CommissionÕs competition mission by allowing the agency to leverage its institutional advantages to develop evidence-based competition policy. In order for the Commission to fulfill that promise, it must first provide a framework for how it intends to use its authority to prosecute Section 5 UMC cases. My Proposed Policy Statement offers a framework that is tethered to modern economics and antitrust jurisprudence and that avoids deterring consumer welfare-enhancing competition while targeting conduct most harmful to consumers. I believe the framework would strengthen the CommissionÕs ability to target anticompetitive conduct and provide clear guidance about the contours of its Section 5 authority.