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Section 5 Recast: Defining the Federal Trade Commission's 1 1
Unfair Methods of Competition Authority 1

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Executive Committee Meeting of the 1
New York State Bar Association's Antitrust 1

I. 1 INTRODUCTION 1

Today I would like to talk about the Commission’s authority

authority to prosecute conduct under Section 5. Some commentators have argued that Section 5 should be no broader than the Sherman Act and the Clayton Act, effectively relegating the statute to serving the relatively perfunctory role of providing the vehicle by which the Commission challenges violations of the traditional federal antitrust laws.[4] Other commentators have articulated a multitude of theories as to why and how the Commission can and should use Section 5 to reach conduct outside the scope of the traditional federal antitrust laws. To name just a few, some have argued the Commission should use Section 5 to create convergence among international jurisdictions,[5] to shift the attention of competition policy from economic welfare to consumer choice,[6] or even to incorporate behavioral economics into modern antitrust.[7] Still others have claimed that the Commission should use Section 5 to free itself from some of the strict requirements established in Sherman Act jurisprudence because of a belief—a mistaken one in my view—that those requirements came only as a response to

[4] *See, e.g.*, Doug Melamed, Comments to Fed. Trade Comm'n Workshop Concerning Section 5 of the FTC Act (Oct. 14, 2008), *available at* http://ftc.gov/os/comments/section5workshop/537633-00004.pdf; Joe Sims, *A Report on Section 5*, GL <0231>Tj /TT5 1a0 Tc <0231>Tj /Tu23G0bi0 TD 0 Tc <0231>TjTT10 1 TfTj /a9c(. (Ji (of)Tj /TT1 1 TfTj /TT1 1

undesirable features that arise in private litigation and that should not constrain agency enforcement.[8] Members of Congress also have weighed in on the Section 5 debate, suggesting that the Commission's use of its unfair methods of competition authority is too expansive and potentially unauthorized.[9] The recent and historical Congressional interest in Section 5 raises the prospect that Congress could very well decide that its best response to the agency's failure to provide clear guidance is to revoke or to severely restrict the Commission's authority under Section 5.

For my part, I have made no secret of the fact that I think the Commission's record with respect to Section 5 is uninspiring if not bleak.[10] As I will discuss in more detail a bit later, I believe 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 Commission. I have echoed the comments of others, including former and current Commissioners, in calling for the Commission to

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articulate in a policy statement precisely what constitutes an unfair statement

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research and reporting functions to develop evidence-based competition policy. This promise has remained largely unfulfilled, in part because the Commission has failed to articulate a coherent framework for applying its unfair methods of competition authority. I will briefly discuss each of these concerns in turn.

a. Uncertainty in the Business Community

In the absence of any meaningful limiting principle distinguishing lawful conduct from unlawful conduct under Section 5, the breadth of the Commission's authority to prosecute unfair methods of competition creates significant uncertainty among members of the business community. Without a policy statement that clearly articulates how the Commission will apply its Section 5 authority, businesses must make difficult decisions about whether the conduct they wish to engage in will trigger a Commission investigation or worse. Such uncertainty inevitably results in the chilling of some legitimate business conduct that would otherwise have enhanced consumer welfare but for the firm's fear that the Commission might intervene and the attendant consequences of that intervention. Those fears would be of little consequence if the Commission's Section 5 authority was clearly defined and business firms could plan their affairs to steer clear of its boundaries.

In practice, however, 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. This lack of institutional commitment to a stable definition of an unfair method of competition leads

The uncertainty surrounding the scope of Section 5 is exacerbated by the administrative procedures available to the Commission for litigating unfair methods claims. This combination gives the Commission the ability to, in some cases, take advantage of the uncertainty surrounding Section 5 by challenging conduct as an unfair method of competition and eliciting a settlement even though the conduct in question very likely would not violate the traditional federal antitrust laws. This is because firms typically will prefer to settle a Section 5 claim rather than going through lengthy and costly administrative litigation in which they are both shooting at a moving target and have the chips stacked against them. Such settlements only perpetuate the uncertainty that exists as a result of ambiguity associated with the Commission's Section 5 authority by encouraging a process by which the contours of the Commission's unfair methods of competition authority are drawn without any meaningful adversarial proceeding or substantive analysis of the Commission's authority.

Critics have offered at least two rejoinders in response to claims that the uncertainty surrounding Section 5 may chill legitimate business conduct. The first is that the courts have provided sufficient guidance on the scope of Section 5 to alleviate concerns about its imprecise boundaries.[13] The second is that they claim the

[13] *See* Geoffrey Manne, *Time for Congress to Stop the FTC's Power Grab on Antitrust Enforcement*, BUSINESS IN THE BELTWAY, FORBES (Dec. 20, 2012), *available at* http://www.forbes.com/sites/beltway/2012/12/20/time-for-congress-to-stop-the-ftcs-power-grab-on-antitrust-enforcement/ (discussing a letter from members of the House Judiciary Committee that argues that "concerns about the use of Section 5 are unfounded").

Commission has used Section 5 very judiciously and only in appropriate circumstances.[14] Neither argument is particularly compelling. On the first point, although the Supreme Court has decided a handful of cases in which it examined the scope of the Commission's authority under Section 5, no court has set out the elements

rather than the updated economic thinking provided by the Horizontal Merger Guidelines.[20] Similarly, court decisions from the early 1970s are not a serious argument against providing agency guidance on Section 5; rather, they are evidence demonstrating the need for it.

With respect to the second point, the naked assertion by the Commission that

framework, what the Commission's Section 5 enforcement looks like can vary dramatically from commissioner to commissioner, and commission to commission. No amount of pointing to recent cases as examples of the Commission's "judicious" and "responsible" use of Section 5 and no number of commissioner speeches—including this one—can be counted upon to supply businesses with the information they require to ensure that they do not violate the statute.

b. Leveraging Institutional Advantages to Steer Competition Policy

The second reason for issuing a policy statement with respect to the Commission's unfair methods of competition authority is that Congress intended Section 5 to play a key role in the Commission's competition mission.[22] Specifically, Congress intended for the Commission to use Section 5 to reach business conduct outside the scope of the traditional federal antitrust laws. A key rationale for creating a competition statute that reaches behavior not otherwise unlawful under the Sherman Act and Clayton Act is that the Commission, as an expert administrative tribunal, could interpret its operative statute in a manner that is flexible to changes in the marketplace and capable of expanding beyond current judicial interpretations. In order to expand beyond current judicial interpretations, Congress authorized the Commission not only to bring enforcement actions, but also to conduct studies of business practices in order

[22] *See* Kovacic & Winerman, *supra* note 11, at 930-31 ("Through repeated exposure to competition policy problems, the FTC would use distinctive research and data collection powers to develop, apply, and assess doctrine.").

to understand their competitive implications.[23] These institutional design features were intentional and were undertaken with the hope that, as former Chairman Bill Kovacic and Marc

Commission has failed to articulate a coherent framework for the application of Section 5.

Having outlined the reasons why issuing an unfair methods of competition policy statement is important, I will now turn to the key features of my specific proposal.

III. SECTION 5 UNFAIR METHODS OF COMPETITION DEFINED

To establish a framework for the application of Section 5 that sufficiently distinguishes between lawful and unlawful conduct and that promotes the Commission's mission of protecting competition and promoting consumer welfare, the Commission must begin by defining what precisely constitutes an unfair method of competition. In undertaking this task, I think it is important to recall why the Commission's use of Section 5 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, called into serious question whether it has any limits whatsoever. In order to save Section 5, and to fulfill the vision Congress had for this important statute, the Commission must recast its unfair methods of competition authority with an eye toward regulatory humility in order to effectively target plainly anticompetitive conduct.

With this in mind, and in light of the case law, legislative history, and the Commission's institutional capabilities, I believe 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. There are several benefits to this definition of an unfair method of competition. First, this definition allows the Commission to

unfair method of competition.[27] This is a simple commitment but eliminates one source of variation in Section 5 enforcement while making the agency's own interpretation of its authority consistent with well-developed federal jurisprudence and the legislative history of the FTC Act.[28]

Focusing Section 5 only upon conduct that harms competition in the economic sense allows the Commission to prosecute conduct that is anticompetitive, but that does not necessarily constitute a violation of the Sherman Act or Clayton Act. At the same time, I have proposed in my Policy Statement that the Commission would not challenge conduct as an unfair method of competition where there is well-forged case law under the traditional federal antitrust laws. This limitation is important because the Commission does not necessarily hold an institutional advantage over the courts in discerning competitive effects where the courts have analyzed the business conduct at issue and constructed an analytical framework to determine liability. Moreover, prosecuting conduct under disparate standards depending upon whether the claim is

[27] *See id.* at 8 ("The FTC should expand its reach to bring in some conduct that does not fall within the coverage of the Sherman and Clayton Acts as currently interpreted . . . . [But] the practices it condemns must really be 'anticompetitive' in a meaningful sense. That is, *there must be a basis for thinking that the practice either does or will lead to reduced output and higher consumer prices or lower quality in the affected market*." (emphasis added)).

[28] 51 CONG. REC. 12220 (1914) (Senator Newlands stating "the legal significance is the same as the economic significance").

brought under Section 5 or, for example, Section 2 of the Sherman Act, may unfairly blur the line between lawful and unlawful behavior.[29]

Harm to competition is a concept that is readily understandable and that has been deeply

challenged conduct has a harmful impact on price or output.[33] More broadly, there are numerous methods and techniques to examine the economic evidence and determine the effect of the conduct in question on competition. For instance, conduct that results in harm to competition, and in turn,

harm. This approach ensures that even in cases of likely harm to competition, the Commission's analysis is tethered to sound economic reasoning.

Under my definition of unfair methods of competition, there are two broad categories of conduct that the Commission can pursue even though the conduct has not yet caused harm to competition. The first category is those cases in which a firm seeks to form an illegal restraint of trade but its efforts are thwarted before an agreement can be reached. These so-called invitation to collude cases satisfy the harm to competition element of an unfair method of competition claim, that

market power as a result of its deceptive conduct, the Commission could challenge Firm A's conduct as an unfair method of competition under Section 5.

b. Unfair Methods of Competition Must Lack Cognizable Efficiencies

The second element of an unfair methods of competition claim as I have defined it here is that the act or practice in question must not generate cognizable efficiencies. Under my proposed Policy Statement, the Commission therefore would not challenge conduct as an unfair method of competition if cognizable efficiencies exist. The efficiencies screen is important for at least three reasons. First, it helps establish a test

be unlawful. Articulating a clear and predictable standard for what constitutes an unfair method

Moreover, because the Commission is an administrative body with changing membership, there is a significant risk that different Commissions may apply Section 5 differently. The efficiency screen significantly reduces this problem by linking the definition of an unfair method of competition to the Commission's analytical framework for mergers as articulated in the Horizontal Merger Guidelines. The Commission has developed significant expertise and articulated clear standards in the merger merger

business activity. Given the size of the national economy and the range of business practices employed by firms within it, the Commission must identify those patterns of conduct that are most likely to harm consumers so that it can target enforcement efforts to maximize consumer welfare. Anticompetitive conduct that lacks cognizable efficiencies is the most likely to harm consumers because it is without any redeeming consumer benefits.[37]

The efficiency screen also works to ensure that welfare-enhancing conduct is not inadvertently deterred. Firms engage in a variety of business practice that create efficiencies and thus enhance the firm's ability and incentive to compete. These efficiencies can result in lower prices, improved quality, better services, new products, and other benefits that enhance consumer welfare. Some of these practices also may harm competition and consumers under certain specific circumstances. Where conduct plausibly produces both costs and benefits for consumers it is fundamentally difficult to identify the net competitive consequences associated with the conduct.[38] This is particularly true if business conduct is novel or is being applied to an emerging or rapidly changing industry, and thus where there is little empirical evidence about the

[37] Such conduct also may be relatively inexpensive to implement, making it a low-cost, and thus

conduct's potential competitive effects.[39] The Supreme Court has long recognized that erroneous condemnation of procompetitive conduct significantly reduces consumer welfare by deterring investment in efficiency enhancing business practices.[40] To avoid deterring consumer welfare enhancing conduct, my proposed Policy Statement limits the use of Section 5 to conduct that lacks cognizable efficiencies.

One obvious question raised by my Policy Statement is why should the Commission employ a bright line efficiencies screen rather than engage in a rule of reason styled balancing of a conduct's procompetitive efficiencies against its anticompetitive harm? Why should the Commission not

conduct that has very significant anticompetitive effects but only small efficiencies? I have already given a number of reasons for why the efficiencies screen is important, but the overarching rationale that unites each of these is a desire to articulate a framework that recasts the Commission's unfair methods of competition authority in a way that has modest but clear objectives and that is calibrated to best enhance consumer welfare.

To save Section 5, and fulfill its promise, the Commission must confine its unfair methods of competition authority to those areas where the agency can leverage its unique institutional capabilities to target the conduct most harmful to consumers. This recasting of the Commission's Section 5 unfair methods authority in no way requires the Commission to let anticompetitive conduct run rampant. The Commission can still challenge such conduct where appropriate by bringing a claim under the traditional federal antitrust laws. The current formulation of the Commission's unfair methods of competition enforcement has proven unworkable in large part because it lacks boundaries and is ambiguous. It is no answer in the face of Section 5's track record to claim the agency will continue to balance harms and benefits as it sees it. Where the agencies seek to challenge conduct that has both competitive harms and benefits it is fully capable of making its case to federal courts. The efficiencies screen plays an important role in remedying this problem by clearly distinguishing between lawful and unlawful conduct. The Commission can harness the significant expertise and

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the appropriate application of the agency's signature competition statute. I look forward to working with my fellow commissioners to achieve this long overdue goal.

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Thank you again for having me here today. I am happy to take a few questions.