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Section 5 of the FTC Act: principles of navigation

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Section 5 of the Federal Trade Commission (FTC) Act prohibits 'unfair methods of competition' (UMC), including conduct that violates either the antitrust laws or

violations both conduct that violates the Sherman Act and other federal antitrust laws, as well as conduct that would not necessarily violate the antitrust laws but that represents a so-called standalone Section 5 violation.

II. A sea of uncertainty

Accordingly, the Commission has from time to time set out with the idea that because the chart is theoretically very expansive, it does not even need a chart

wish to travel. This then prompts the question, 'If the destination is already on the Sherman train line, why not take that route?'

Others believe that, because there are places worth visiting that the Sherman railroad will not reach, it is important to be able to use the UMC route under Section 5. They may be right in some cases, but, before the FTC sets off into uncharted waters, this author wants to know where the agency is going and, equally if not more important, where it will not venture.

Although it has been amusing to engage in this extended nautical metaphor, the goal of this article is serious: to offer a framework for defining the parameters of the FTC's UMC authority. It calls upon drafting tools that have been carefully developed and widely deployed in government for almost two decades. It also is essentially a forward-looking inquiry that asks what this author believes is the most crucial question here: Why will consumers and competition be better off in the future by the FTC using its UMC authority more expansively?

A significant focus in evaluating the proper scope of UMC has been the legislative history of the FTC Act and the agency's cases from 50, 60, and more years ago. As rigorous and interesting as that focus has been—and the extensive work that former Chairman Kovacic and others have done in this area is admirable—the FTC should look forward to the next 100 years of its existence and ask

economic regulation of business conduct, not a social regulation, which is to say that it should focus only on economic efficiency goals, not social goals, such as increased employment or better working conditions, or industrial policy goals, such as favouring domestic competitors.[27]

Once UMC is defined as an economic regulation, it is logical when drafting a chart of its appropriate scope to look for guidance in existing regulatory philosophy and principles for regulation in general to aid the analysis by FTC

regulation for use by federal agencies in deciding whether and how to regulate.[30] President Clinton issued EO 12866 in 1993, and although it has been supplemented and amended since then, the philosophy and guiding principles remain in effect and relevant today.

At its core, EO 12866 seeks to ensure that a regulation does more good than harm for the public by requiring a federal agency to identify a significant market failure or systemic problem, to evaluate alternative approaches to regulation, to choose the regulatory action that maximizes net benefits, to base the proposal on strong economic evidence, and to understand the expected effects of the regulation on those who bear the costs of the regulation and those who enjoy its benefits. Other scholars of regulation have also endorsed this basic approach. For example, now-Justice Stephen Breyer in his 1982 book, *Regulation and Its Reform*, framed the proper inquiry as follows: 'The framework is built upon a simple axiom for creating and implementing any program: determine the objectives, examine the alternative methods of obtaining these objectives, and choose the best method for doing so.'[31]

Before continuing, a couple clarifications are in order. First, looking to EO 12866 and its underlying ir a6tervelop

Commission achieve transparency, predictability, and fairness in its enforcement efforts.[33]

IV. Drawing the UMC boundaries

The various principles underlying EO 12866 suggest that the FTC consider several important factors to discern when consumers and competition would

raising prices, or lowering quality. The Commission must tie its UMC enforcement back to its core mission of promoting and protecting consumer welfare. The FTC's UMC authority therefore should be used solely to address harm to competition or the competitive process, and thus to consumers. The FTC should not use its UMC authority to address harm merely to competitors. As the ABA Section of Antitrust Law argued in its most recent Presidential Transition Report, 'Section 5 should not be used to sacrifice efficient behaviour for insignificant or illusory increases in consumer welfare or to shield competitors from the rigors of efficient competition.'[36]

Furthermore, any harm to competition pursued under the FTC's UMC authority ought to be substantial. This substantiality requirement would mirror the one in the FTC's Unfairness Statement on the consumer protection side, which states that the consumer injury must be substantial for the agency to pursue an unfair act or practice claim under Section 5.[37] As the Unfairness Statement notes, 'The Commission is not concerned with trivial or merely speculative harms.'[38] Enforcement efforts on the competition side of Section 5 should likewise focus solely on substantial harms to ensure both that the agency is properly allocating its scarce resources[39] and that it is not pursuing matters with high legal and political risks for little consumer benefit.[40]

Identif ing currents and shoals (anal sing benefits, costs, and the impact on incentives)

Analysing the relative benefits and costs of a regulation underlies several of the guiding principles in EO 12866. For example, the Order calls for agencies to consider both the costs and the benefits of proposed regulations,[41] as well as

[36] ABA Section of Antitrust Law, 'Presidential Transition Report: The State of Antitrust Enforcement 2012' (2013) 20; see also Herbert Hovenkamp, 'The Federal Trade Commission and the Sherman Act' (2010) 62 Fla L Rev 871, 878–79 ('[T]he practices that [the FTC] 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. . . . [A]nd most importantly, consumers—and not competitors—must be the ultimate protected class.'). A focus on harm to competition is fully consistent with the sentiment expressed by former Chairman Leibowitz to Congress in 2010 that the FTC ought to focus its standalone s 5 efforts on 'cases where there is clear harm to the competitive process and to consumers.' Prepared Statement of the Federal Trade Commission, presented by Jon D Leibowitz, Chairman, before the US House Committee on the Judiciary (27 July 2010) 13 <http://www.ftc.gov/os/testimony/100727antitrustoversight.pdf> accessed 25 September 2013.

[37] FTC Unfairness Statement (n 5) 1073.

[38] ibid; see also ABA Transition Report (n 36) 20 ('Standalone Section 5 enforcement should be used, if at all, only when the conduct involves substantial competitive harm.').

[39] In all agency activities, the FTC must keep the concept of opportunity costs firmly in mind. Given the many instances of competitive harm that are reachable under the Sherman and Clayton Acts occurring today, the FTC should not focus significant enforcement efforts on standalone s 5 matters that do not present substantial harm.

[40] There may be circumstances in which all of these proposed UMC criteria are met, except that the substantial harm has not yet taken place. In such cases, the Commission ought to intervene only if there is a high likelihood of the harm taking place. This author contemplates a standard of likelihood that is comparable to the 'dangerous probability of success' element in claims of attempted monopolization.

[41] See Executive Order 12866 s 1(b)(6).

incentives for innovation, among other factors.[42] The Order further requires agencies to design regulations in the most cost-effective manner to achieve the regulatory objective and to tailor regulations to impose the least burden on

The disproportionate harm test would focus any UMC enforcement on conduct that is most likely to harm competition. It also avoids attempts to balance precisely procompetitive and anticompetitive effects that are based on after-the-fact evaluations of conduct whose effects on consumers and competitors, as well as the firm itself, may have been unclear when undertaken. The FTC previously has advocated for the disproportionality test in the Section 2 context,[49] and it is part of Professor Hovenkamp's preferred general definition of anticompetitive exclusion under Section 2.[50]

Although the disproportionality test potentially allows for an increased reach of Section 5 relative to one that allows Section 5 enforcement only where no procompetitive justifications are offered, this disproportionality test is a demanding one, reflecting significant concerns about an expanded Section 5 chilling procompetitive conduct. The more demanding this test, the more confidence the FTC will have that it is challenging conduct that is something other than competition on the merits.[51]

Furthermore, to avoid chilling procompetitive conduct, the FTC should seek only prospective, non-punitive remediethisa3(,)6(5(p.4(irelat)(ca8.2(6g)-3I4.1(7Hov)17.-

Preventing collisions at sea (avoiding inconsistent or duplicative efforts and institutional conflict)

EO 12866 also counsels an agency to avoid regulations that are inconsistent with, or duplicative of, those that it or other federal agencies already have.[55] This is a vital issue for UMC, as much of the debate has centred around its use either to shore up Sherman Act cases that lack a required element or to duplicate Sherman Act or Clayton Act enforcement under some circumstances.[56]

First, the FTC should not use UMC to rehabilitate a deficient Sherman or Clayton Act claim.[57] Recent history suggests that the temptation to use Section 5 as a path to avoid the requirement of clearly specifying theories and harms is a powerful one, as highlighted by the strong dissents by Chairman Majoras and Commissioner Kovacic in the *N-Data* matter.[58]

Second, if there is a viable Sherman or Clayton Act claim that the FTC can pursue for a particular type of conduct, then it should not use UMC in such a case. Those acts, as currently interpreted by the courts, likely cover almost all the anticompetitive conduct that the agency should want to reach.[59] Moreover, the FTC must be sensitive to the fact that it shares antitrust enforcement authority with DOJ. Using UMC to supplant unnecessarily the Sherman or Clayton Act

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follow-on litigation against FTC respondents. See eg *Liu v Amerco* 677 F 3d 489, 491, 495 (1st Cir 2012) (holding that customer stated a claim against U-Haul and its parent company under Massachusetts unfair trade practices statute for inviting its competitors to collude; 'Liu's complaint alleged peculiar facts not uncovered by Liu but recounted in documents stemming from an investigation by the Federal Trade Commission . . . .').

[55] See Executive Order 12866 s 1(b)(10).

[56] See eg Section 5 Workshop (n 11) 98–9 (William Page) (advocating use of s 5 in certain cases 'in which the plaintiff cannot satisfy *Twombly*'s pleading standards'); ibid 158 (Bert Foer) (advocating use of s 5 in unilateral conduct cases in which the respondent's market share 'is less than the 70 per cent or so that often characterizes Sherman Act decisions'); ibid 169 (Thomas Krattenmaker) (advocating use of s 5 in 'gap-filling cases' that are 'missing some legal hook that's required under the Sherman Act').

[57] See eg Jon Leibowitz, Commissioner, US Federal Trade Commission, '"Tales from the Crypt": Episodes '08 and '09: The Return of Section 5' (17 October 2008) 5 ('Nor would we be wise to use the broader [Section 5] authority whenever we think we can't win an antitrust case, as a sort of "fallback."') <http://www.ftc.gov/bc/workshops/section5/docs/jleibowitz.pdf> accessed 25 September 2013; Section 5 Workshop (n 11) 127 (Robert Pitofsky) ('I really do not like that idea that Section 5 is there to diminish the burden on the Commission on how it proves its cases. . . . I can't believe that Congress in 1914 said, let's make it easier for the Commission to prove its cases, let's put unfairness in there.'); Matter of General Foods Corp 103 FTC 204, 365 (1984) ('While Section 5 may empower the Commission to pursue those activities which offend the "basic policies" of the antitrust laws, we do not believe that power should be used to reshape those policies when they have been clearly expressed and circumscribed.').

[58] See Majoras *N-Data* Dissent (n 11) 4–6; Kovacic *N-Data* Dissent (n 11) 2–3.

[59] See eg Phillip E Areeda and Herbert Hovenkamp, *Antitrust Law*

FTC Act, including in particular the notion that the agency would research and evaluate potentially problematic business conduct.[64]

Choosing the most direct route (evaluating e isting alternatives)

In keeping with the principles underlying EO 12866, the FTC also should

identify the institutional advantages of the FTC as an agency and those of Section 5 as a statute that justify the application of Section 5 to the particular conduct. Second, the agency should explain why the antitrust laws could not reach the conduct at issue.[75] Providing such explanations goes to the institutional comparative advantage rationale underlying the creation of the FTC and enactment of Section 5.

Furthermore, in the interest of providing clear guidance and avoiding doctrinal confusion, the Commission generally should not pursue particular conduct as both an unfair method of competition and an unfair or deceptive act or practice, without clearly spelling out how particular alleged conduct meets each of the elements of a UMC and a consumer protection claim.[76]

V. Charting the UMC course

Having identified several guiding and limiting principles for consideration in developing a UMC policy statement, the logical next question is: What conduct meets these principles? That is, in what types of cases would a standalone Section 5 claim be justified? Ultimately, as suggested by the UMC criteria proposed above, this author believes that UMC ought to extend only a very limited amount beyond the antitrust laws.

There are many reasons why this should be the case, several of which were mentioned above. First, it is crucial to avoid false positives and the chilling of efficient conduct in any UMC enforcement the agency pursues. Second, the FTC needs to provide clarity and predictability to those subject to its UMC jurisdiction. Those goals become much less attainable, the farther the agency goes beyond the antitrust laws. Third, although Section 5 was designed to go beyond a cramped reading of the Sherman Act as of 1914, and the scope of the Sherman Act has been narrowed over the past 30 years or so, today it is still more expansive—and arguably much more so—than it was in 1914. Thus, reading Section 5 as largely coextensive with the Sherman Act today does not undercut the initial expansion that Section 5 may have served. Fourth, the lack of any meaningful, enduring role for Section 5 in shaping US competition policy over nearly a century counsels against any significant expansion beyond the antitrust laws.[77] Fifth, given the development of the antitrust laws in the courts over the

[75] See eg ABA Transition Report (n 36) 20 ('If it intends to pursue any standalone Section 5 theory, the FTC should specify the distinct contribution of the standalone theory to the prosecution of the claim and explain why the Sherman Act and the Clayton Act are not sufficient to address the competition concerns raised by the conduct in question.'); Phillip E Areeda and Herbert Hovenkamp, *Antitrust Law*, vol 2 (3rd edn, Aspen Publishers 2007) para 302h, at 35 ('[T]o say that §5 is not limited by the other statutes is no excuse for sloppy thinking or a failure to show whether, how, and the degree to which any peculiarities of §5 proceedings call for a divergence from Sherman Act analysis of antitrust policies and their application to the particular case.').

[76] See eg Ohlhausen *Google/MMI* Dissent (n 10) 1–3; Kovacic *N-Data* Dissent (n 11) 2–3; Hovenkamp (n 36) 878–9 ('Expansive readings of the FTC Act should not unreasonably blur the line between competition concerns and consumer protection concerns....').

[77] See eg Kovacic and Winerman (n 11) 933–4.

past 30 years, there is ample reason to think that the FTC will fare even worse today than it did back in the late 1970s and early 1980s in its last significant foray into Section 5 territory.[78] Sixth, there is a significant potential for political backlash for any Section 5 overreach.[79] Finally, the FTC needs to minimize any substantive divergence between itself and DOJ. The farther the FTC goes beyond the antitrust laws, the larger that divergence will be.[80]

As discussed below, all of these concerns should counsel the agency not to seek an expansive definition of UMC, but rather to focus its efforts and many available tools on improving the antitrust laws. In other words, there are too many risks and too little reward to pursue an expanded UMC role; the more prudent course is to focus on the antitrust laws.

As to which types of conduct UMC should capture, the short and admittedly less than totally satisfactory answer is that, if and when the FTC promulgates a policy statement, this still must be evaluated on a case-by-case basis to determine whether the particular conduct at issue passes the various screens that the Commission ultimately adopts in that guidance. Similarly, there is limited utility in discussing categories of potential UMC enforcement, such as gap-filling and

deception on an SSO.[90] Assuming it was properly treated as a Section 5 violation over 15 years ago, when the FTC settled its case against Dell, this is now a viable Section 2 claim.[91] Thus, it should no longer be pursued as a standalone Section 5 claim.

VI. Staying the antitrust course

Although Section 5 (properly interpreted) should not play a significant role in the FTC's competition enforcement efforts, many of the unique features of the FTC can and should be used to further develop and improve the antitrust laws. Using the EO 12866 approach also shows why the FTC is uniquely well suited to address competition law issues. The factors considered in the Order match up with the FTC strengths as an agency, including its capabilities in enforcement, policymaking, and research.[92]

As a threshold matter, one might ask: Why, despite the fact that the agency has not used its UMC authority very successfully, has the FTC in the last few decades not just thrived but become one of the most respected competition agencies in the world? The answer lies in the other unique, foundational aspects of the agency, including primarily its administrative litigation function and the extensive use of its competition policy tools to develop the antitrust laws, particularly in the cases of novel or factually complex conduct. More specifically, conducting competition policy R&D (by holding workshops and issuing reports) to assess the economic impact of a particular business practice and then, if warranted, using an administrative trial and potentially a Commission opinion to pursue such practice as a violation of the antitrust laws is an extremely valuable means for developing those laws.[93] Additionally, the bipartisan, multimember composition of the agency allows it to build consensus on questions of antitrust

[90] See eg Commission Opinion, Matter of Rambus Inc 142 FTC — (2006) (finding deception that undermined the standard-setting process) <http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf> accessed 25 September 2013, *rev'd*, *Rambus Inc v FTC* 522 F 3d 456 (DC Cir 2008); Commission Opinion, Matter of Union Oil Co of Cal 138 FTC 1 (2003) (*Unocal*) (same); Consent Order, Dell Computer Corp 121 FTC 616 (1996) (alleging same).

[91] See eg *Broadcom Corp v Qualcomm Inc* 501 F 3d 297, 314 (3d Cir 2007) (holding that intentional misrepresentation to an SSO regarding a royalty commitment may constitute monopolization under certain circumstances).

[92] Before continuing with the recommendation to stay the antitrust course (rather than go adrift on the sea of s 5), a fairly significant foundational issue must be addressed. Some have argued that if s 5 does not go beyond the antitrust laws, it calls into question the need for the FTC to exist. See eg Kovacic and Winerman (n 11) 944. This author respectfully comes to a different conclusion. Moreover, even the most ardent supporters of the FTC as an agency and s 5 as a competition statute acknowledge that s 5 has not played a meaningful or enduring role in shaping US competition policy over the past century. See ibid 933–4, 941–2. Other than in the *Sperr & Hutchinson* case from the early 1970s, the last FTC victory in the courts of appeals in a standalone s 5 case came in the 1960s. See ibid 941.

[93] Other beneficial features of the FTC (in its own right and as part of a dual enforcement system with the DOJ) include: (i) better outcomes from diversification in enforcement mechanisms through dual DOJ and FTC enforcement of the antitrust laws; (ii) the benefits of having an 'independent' agency enforce the antitrust laws; and (iii) the benefits that result from housing competition and consumer protection enforcement in a single institution.

nature of competition in the health care sector. That project ultimately deserves credit for not only the *Phoebe Putne* decision, but also several other recent favourable decisions in hospital merger challenges, including court victories in *Rockford*[99] and *ProMedica*[100] and abandoned mergers in other matters.[101]

Other valuable contributions to the development of the antitrust laws include the Commission's *Unocal*[102] opinion in the *Noerr-Pennington* area, the Commission's *hree ens*[103] and *Realcomp*[104] opinions in the joint conduct area, and the Commission's *Rambus*[105] opinion in the monopolization area. There are, of course, many others.

In sum, the FTC has contributed significantly to developing the antitrust laws via its unique characteristics of policy and research tools as well as its administrative litigation capability. Going forward the agency should measure its success by looking at how it may continue to make valuable contributions to the antitrust laws, not in how it can pursue expansive UMC cases under Section 5.

VII. Conclusion

To conclude, although standalone Section 5 cases should not play a significant role in the FTC's competition enforcement efforts, the agency should use its many unique institutional features—including its administrative litigation, policymaking, and research capabilities—to further develop and improve the federal antitrust laws. The Commission's success stories in the competition space over the past several decades have come in its antitrust cases, not its pure Section 5 cases.

To the extent that the FTC does pursue standalone Section 5 enforcement, there are six important criteria that it should satisfy in so doing. First, the FTC should use its UMC authority only in cases of substantial harm to competition. Second, the FTC should pursue a UMC violation only where there is no procompetitive justification for the challenged conduct or where such conduct results in harm to competition that is disproportionate to its benefits. Third, in

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[99] *F G v OSF Healthcare S s* 852 F Supp 2d 1069 (ND Ill 2012) (granting FTC's motion for preliminary injunction).

[100] *F G v ProMedica Health S s Inc* 2011 WL 1219281 (ND Ohio 29 March 2011) (granting FTC's motion for preliminary injunction). The Commission's opinion in this matter is currently on appeal at the Sixth Circuit.

[101] See eg Press Release, Federal Trade Commission, 'Statement of FTC Competition Director Richard Feinstein on Today's Announcement by Capella Healthcare that It Will Abandon its Plan to Acquire Mercy Hot Springs' (27 June 2013) <http://www.ftc.gov/opa/2013/06/capella.shtm> accessed 25 September 2013; Press Release, Federal Trade Commission, 'FTC Approves Order Dismissing Administrative Complaint Against Inova Health System Foundation and Prince William Health System, Inc.' (17 June 2008) <http://www.ftc.gov/opa/2008/06/inovafyi.shtm> accessed 25 September 2013.

[102] *Unocal* (n 90).

[103] Commission Opinion, Matter of PolyGram Holding Inc 136 FTC 310 (2003), *appeal dismissed*, *Pol Gram Holding Inc v F G* 416 F 3d 29 (DC Cir 2005).

[104] Commission Opinion, Matter of Realcomp II Ltd 148 FTC — (2009) <http://www.ftc.gov/os/adjpro/d9320/091102realcompopinion.pdf>

using its UMC authority, the FTC should avoid or minimize conflict with other institutions, including most notably the Department of Justice. Fourth, UMC enforcement must be grounded in robust economic evidence regarding the anticompetitive effects of the challenged conduct. Fifth, prior to pursuing a UMC violation, the agency should consider using its many non-enforcement tools to address the perceived competitive problem. Sixth, the agency should provide clear guidance and minimize uncertainty in the UMC area.

Having circumnavigated the topic of UMC and the best way to deploy the FTC's capabilities, this author will continue to consider where the boundaries of Section 5 should be and looks forward to engaging her fellow Commissioners and others within the agency, as well as interested parties outside the agency, on these important but complex issues. If the Commission wishes to pursue expanded UMC theories, the Commissioners ought to be able to work together