Concurrences
Revue des droits de la concurrence
Competition Law Journal

Revisiting antitrust institutions: The case for guidelines to recalibrate the Federal Trade Commission's section 5 unfair methods of competition authority

Foreword | Concurrences N° 4-2013
www.concurrences.com

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Foreword

Revisiting antitrust institutions: The case for guidelines to recalibrate the Federal Trade Commission's section 5 unfair methods of competition authority

Abstract

The absence of guidelines identifying the boundaries of the Federal Trade Commission's authority to prosecute unfair methods of competition under Section 5 has rendered this enforcement tool ineffective in helping the agency fulfill its competition mission. As the Commission approaches its centennial, it should strive to achieve the long overdue goal of articulating a coherent policy for the application of its signature competition statute that ensures it is targeting anticompetitive conduct and not deterring welfare-enhancing behavior.

L'absence de lignes directrices relatives à la Section 5 du Sherman Act a conduit à l'inefficacité de l'action de la Federal Trade Commission en matière de pratiques déloyales. A l'approche de son centième anniversaire, la FTC devrait s'efforcer de poursuivre son objectif de mise en oeuvre d'une politique de concurrence cohérente en poursuivant les comportements anticoncurrentiels sans dissuader les comportements favorisant le bien-être des consommateurs.

As the Federal Trade Commission (FTC) enters its second century, it is an especially appropriate time to reflect upon whether the agency's 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 proven up to the task should be salvaged or scrapped. One of these tools—the Commission's Unfair Methods of Competition (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 Commission's 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 Commission. This gap has grown in large part due to the absence of any guidance articulating what constitutes an UMC. Both the existence and cause of the Section 5 performance gap are fairly well understood. Indeed, for at least the past twenty years, Commissioners from both parties have acknowledged that a principled standard for application of Section 5 would be a welcome improvement. In my view, the Commission must bear the ultimate responsibility for articulating a position on the appropriate application of the agency's signature competition statute.

Members of Congress also have weighed in on the Section 5 debate, suggesting that the Commission's use of its UMC authority is too expansive and potentially unauthorized. The recent and historical Congressional interest in Section 5 raises the prospect that Congress could 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. If the Commission does not address the ambiguity surrounding its application of Section 5 on its own, the Commission may ultimately have its UMC authority defined for it by the courts, or worse, have that authority completely revoked by Congress.

If we are to avert this result, and preserve a sustainable and positive role for Section 5 enforcement consistent with the agency's competition mission, the Commission must offer an analytically coherent policy for the application of its UMC authority. To this end, and with hopes of starting a fruitful discussion of the topic, earlier this year I distributed publicly a draft Policy Statement proposing one way the Commission might articulate the standards for and limits of its authority to prosecute UMC under Section 5.

I . The benefits of Section 5 UMC guidelines

UMC guidelines would solve, or at a minimum lessen, at least two serious impediments that currently stand in the way of Section 5 contributing effectively to the Commission's competition mission.

The first and most serious impediment arises from the combination of the vague and ambiguous nature of the Commission's UMC authority, and, quite importantly, the agency's considerable administrative process advantages. In the absence of UMC guidelines, the Commission can extract easy settlements whenever it desires by simply asserting that conduct is unfair. This threat extends to conduct that is potentially welfare-increasing. These two issues—vague authority and administrative process advantages—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. The lack of institutional commitment to a stable definition of an UMC leads to at least two sources of problematic variation in Section 5 interpretation by the agency. One is that the agency's interpretation of the statute in different cases need not be consistent even when the individual Commissioners remain constant. Another is that as the members of the Commission change over time, so does the agency's Section 5 enforcement policy, leading to wide variation in how the Commission prosecutes UMCs. Take for instance the position offered by one Commissioner who several years ago stated that conduct can constitute an UMC when it includes "actions that are collusive, coercive, predatory, restrictive, or deceitful, or other-wise oppressive, and does so without a justification that is grounded in legitimate, independent self-interest." I do not know any antitrust practitioners who would have felt comfortable providing guidance to clients on how to avoid the "otherwise-oppressive" prong of an UMC claim.

The uncertainty surrounding the scope of Section 5 is exacerbated by the administrative procedures available to the Commission for litigating UMC claims. 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 in the past nearly twenty year. In each of those cases, after the administrative decision is appealed to the Commission, the Commission has ruled in favor of FTC staff. In other words, in 100 percent of cases where the administrative law judge ruled in favor of the FTC staff, the Commission affirmed; and in 100 percent of the cases in which the administrative law judge ruled against the FTC staff, the Commission reversed. 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 (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 received in federal courts of appeal over the same time period relative to the treatment federal district court decisions have received gives at least some pause to the expertise hypothesis. At a minimum, however, the figures above suggest that how we conceive of the appropriate time and place to use the Commission's UMC authority to further its competition mission ought to take into account 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 appropriate for wholesale incorporation into Section 5 adjudication.

The combination of institutional and procedural advantages with the vague nature of the Commission's Section 5 authority gives the agency the ability, in some cases, to elicit a settlement even though the conduct in question very likely may not be anticompetitive. This is because firms typically will prefer to settle a Section 5 claim rather than to go through lengthy and costly administrative litigation in which they are both shooting at a moving target and have the chips stacked against them. Significantly, such settlements also perpetuate the uncertainty that exists as a result of the ambiguity associated with the Commission's UMC authority by encouraging a process by which the contours of Section 5 are drawn without any meaningful adversarial proceeding or substantive analysis of the Commission's authority.

The second impediment to Section 5 contributing effectively to the Commission's competition mission is the absence of even a minimal level of certainty for businesses. UMC guidelines would provide businesses with important guidance about what conduct is lawful and what conduct is unlawful under Section 5. The benefit of added business certainty is less important than ensuring Section 5 enforcement actions—including consents—actually reach and deter anticompetitive conduct rather than chill procompetitive conduct. However, guidance to the business community surely is important. Indeed, the FTC has issued nearly 50 sets of guidelines on a variety of topics, many of them much less important than Section 5, to help businesses understand how the Commission applies the law and to allow practitioners to better advise their clients on

how to comply with their legal obligations. Without guidelines that clearly articulate how the Commission will apply Section 5, 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 businesses could plan their affairs to steer clear of its boundaries. In practice, however, the scope of Section 5 today is as broad or as narrow as a majority of the Commissioners believes that it is.

II. Recalibrating the FTC's UMC Authority

The Commission's UMC authority can be recalibrated to address these impediments so that Section 5 can contribute meaningfully to the Commission's competition enforcement agenda. Significantly, there already is broad agreement about how to move forward. Indeed, there is a growing consensus that guidelines would be helpful, if not required, if the Commission desires to use Section 5 to reach beyond the scope of the traditional antitrust laws. Further, there is broad consensus that one of the requirements for finding a violation of the Commission's signature competition statute should be showing "harm (or likely harm) to competition" as the phrase has been developed under the traditional antitrust laws. This phrase has a specific meaning that is known to the antitrust bar and that is tethered to modern economics. Section 5 jurisprudence—what there is of it—developed in the "pre-economic" era of antitrust analysis in the United States. The Commission should be a leader in updating its authority—as it has done with the Merger Guidelines—to be more reflective of modern economic thinking. Finally, there also is broad, albeit incomplete, agreement that Section 5 extends beyond the traditional federal antitrust laws.

What remains is to identify the definition of an UMC claim that will maximize the rate of return the Commission's Section 5 UMC enforcement efforts earn for consumers. There is no shortage of potential definitions that would bring Section 5 UMC jurisprudence and agency practice within the confines of "harm to competition" as understood in modern antitrust practice and improve the incorporation of economic analysis in standalone Section 5 cases. The major possibilities consistent with a modern economic approach to antitrust appear to be:

→ A standalone UMC violation requires evidence of a violation of the traditional federal antitrust laws; in other words, Section 5 UMC authority is co-extensive with the Sherman Act and Clayton Act.

→ A standalone UMC violation requires evidence of harm to competition and no cognizable efficiencies; that is, a standard that acknowledges Section 5 is broader than the traditional antitrust laws but targets violations at nakedly anticompetitive conduct.

→ A standalone UMC violation requires evidence of harm to competition and that the harms are disproportionate to any benefits arising from the conduct in question.

→ A standalone UMC violation requires evidence of harm to competition and that the harms outweigh the benefits; in other words, what is often described as a traditional rule of reason analysis or consumer-welfare test.

I will not address the various costs and benefits of each of these proposals here, but I will note that all would require evidence of harm to competition. It is only the treatment of efficiencies within the analysis that would differ.

I have advocated the second of these positions in my draft Policy Statement—that is, that a standalone UMC violation requires a showing that the conduct in question generates harm to competition as understood by the traditional antitrust laws and generates no cognizable efficiencies. In choosing among the four standards outlined above, 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, has called into serious question whether it has any meaningful limits whatsoever. Further, this failure, and the absence of meaningful limits, is compounded by the procedural and administrative advantages conferred to the Commission in enforcing Section 5. As a result, the intuitive appeal of a rule of reason analysis that might make sense in federal court is undermined in the context of Section 5 by the institutional differences between the Commission and the federal courts—a difference starkly highlighted by the Commission's "perfect" record on appeal in the last nearly twenty years. 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 so that it can effectively target plainly anticompetitive conduct. My proposed Policy Statement does so in a simple manner: targeting Section 5 enforcement efforts to the most anticompetitive conduct—that without redeeming efficiency virtues—and allows the Commission to pursue all other cases in federal court where it can and does litigate with success.

There are several benefits to this definition of an UMC. First, this definition allows the Commission to reach beyond the scope of the Sherman Act and Clayton Act, as Congress intended. Second, it does so while explicitly tethering the agency's enforcement actions to the modern economic concept of harm to competition. Third, this definition also allows the Commission to leverage its expertise 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 guidance as to what conduct will be considered unlawful under Section 5.

There are some skeptics of the benefits of UMC guidelines. I have heard three chief arguments against UMC guidelines. The first is the claim that "the cases provide sufficient guidance." But which cases? The case law we have is from before the incorporation of economics that has occurred in the modern era, and our consent agreements provide no more guidance than to say "don't do what was done in this case." This objection is also contrary to the view of most Commissioners and Chairmen over the past twenty years.

The second argument is that the "business community is not banging on the Commission's door demanding guidelines." To the extent this is true, I find it unsurprising that businesses are not jumping at the opportunity to tell an agency that serves as judge, jury, and executioner that its system is rigged. Nevertheless, I do think businesses care about the scope of Section 5. For instance, the U.S. Chamber of Commerce has been very clear that if Section 5 is used to reach conduct beyond the traditional federal antitrust laws, guidance is critical. Moreover, businesses and their counsel expressed significant concern about UMC uncertainty during the FTC's 2008 workshop on Section 5.

The third argument is a more practical concern: "why should the FTC expend scarce resources on an exercise that is unlikely to result in guidance?" First, as discussed, I think there is a vast area of agreement on Section 5 that could result in a meaningful set of guidelines and I am optimistic that this Commission can issue a coherent policy position on its application of Section 5. Second, in my view, this exercise does not require significant resources. In fact, the Commission already has invested considerably in this issue by holding an extensive workshop on Section 5 in 2008, and would be able to rely heavily on the information and learning gathered during that important exercise.

Congress intended Section 5 to play a key role in the Commission's 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, the agency must first provide a framework for how it intends to use its authority to prosecute Section 5 UMC cases. I have proposed 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. In doing so, I believe the Policy Statement would strengthen the Commission's ability to target anticompetitive conduct and provides clear guidance about the contours of its Section 5 authority. ■

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* *The views expressed herein are my own and do not reflect those of the Commission or any of its Commissioners. I thank my attorney advisor, Jan Rybnicek, for his thoughtful contributions on this topic.*

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