FINANCIAL SERVICES AND PRODUCTS: THE ROLE OF THE FEDERAL TRADE COMMISSION IN PROTECTING CONSUMERS

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BEFORE THE

U.S. SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
SUBCOMMITTEE ON CONSUMER PROTECTION, PRODUCT SAFETY, AND INSURANCE

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Chairman Pryor, Ranking Member Wicker, and Members of the distinguished Subcommittee, my name is Tim Muris. I am Foundation Professor at the George Mason University School of Law, and Of Counsel at O'Melveny & Myers LLP. Most relevant for today's hearing, I have held four positions at the Federal Trade Commission (FTC), most recently as Chairman from 2001-2004. Also I am the only person ever to direct both of the FTC's enforcement arms — the Bureau of Consumer Protection and the Bureau of Competition. I believe strongly in the importance of the FTC as a consumer protection agency. Serving as Chairman was the greatest honor of my professional career, and I am especially proud of our accomplishments, such as our work in fostering competition in healthcare, developing and strengthening the anti-fraud program, and promoting and protecting the privacy of Americans, including creation of the National Do Not Call Registry.

Because most of the issues raised by the efforts to expand the FTC's authority are in the agency's consumer protection mission, most, but not all, of my testimony discusses that mission. I address seven points:

1. The FTC has an important, albeit limited, role in our economy. The Commission works best when it acts as a referee, not the star player.

2. Using its existing statutory authority, the Commission ranks as one of the world's preeminent competition and consumer protection agencies.

remedial regime, not because there is something different about the industry, but merely because of the historical accident of falling under FTC review, and not the DOJ.)

6. If this Committee does reauthorize the FTC Act, it should address another arbitrary and unfair distinction between the FTC and the DOJ, namely the different, and easier, enforcement standards that the FTC has recently obtained for itself in seeking to enjoin proposed mergers. Although both the FTC and the DOJ enforce the same merger statute, Section 7 of the Clayton Act, a merger's legality can turn, not on its underlying merits, but on which agency evaluates the transaction.

7. Finally, creation of a separate third-party liability section in the FTC Act is both unwise and unnecessary. The step is unwise because it creates a uniform standard in an area where uniformity is inappropriate. The new section is unnecessary because the FTC already has the ability to attack third parties in appropriate circumstances. Careful use of the Commission's "unfairness" jurisdiction provides the best vehicle to address third parties who facilitate violations by others. The standards for third-party liability should be developed, case-by-case, under the FTC's current authority.

I. THE FTC IS A REFEREE IN OUR ECONOMY, NOT A STAR PLAYER

As a nation, we use markets to organize and drive our economy. We derive vast economic benefits from these markets and the competition that helps markets function properly. These benefits should not be taken for granted; they are not immutable. The nation's consumer protection policy can profoundly enhance these benefits by strengthening the market. The policy also can reduce these benefits, however, by unduly intruding upon the market and hampering the competitive process. The Federal Trade

3. Under its existing statutory authority, the Commission has embraced some new, aggressive, and in some cases controversial, initiatives that would greatly expand its impact on the economy.

4. The so-called "Magnusson-Moss" rulemaking procedures are reasonable; their elimination would result in a major regression for the FTC. Coupled with almost certain Congressional requests for new rules, lowering the barriers to agency rulemaking will transform the FTC, threatening to place the Commission in the untenable posture of the 1970s, during which time it sought to be the second most powerful legislature in Washington, proposing dramatic, usually harmful, changes over wide-ranging sectors of the economy.

5. The FTC already can obtain civil penalties in many cases, notably those involving Commission order and rule violations. Further, the FTC currently can obtain all the monetary relief possible in fraud cases through its existing Section 13(b) authority. Civil penalties would add nothing to the FTC's arsenal in such cases. Nevertheless, a majority of the Commission seeks automatic civil penalty authority in *all* cases. Such authority would represent another fundamental change in FTC law, resulting in over-deterrence in some circumstances, and unnecessarily complicating efforts to expand FTC law to new areas. Moreover, because there is no sure way to limit this expansion of FTC authority to consumer protection cases, it would create an additional, arbitrary, and unfair distinction between the two federal antitrust agencies, the Department of Justice and the FTC. (Given that the FTC and the DOJ divide the economy between the two agencies in making enforcement decisions, those firms subject to FTC review would face a different

Commission has a special responsibility to protect and speak for the competitive process, to combat practices that harm the market, and to advocate against policies that reduce competition's benefits to consumers.

The FTC protects consumers in part through its responsibility to prevent "unfair or deceptive acts or practices."[1] The FTC, and other public institutions, operate against a backdrop of other consumer protection institutions, most notably the market and common law. In our economy, producers compete to offer the most appealing mix of price and quality. This competition spurs producers to meet consumer expectations because the market generally disciplines sellers who disappoint consumers, and thus those sellers lose sales to producers who better meet consumer needs. These same competitive pressures encourage producers to provide truthful information about their offerings. Market mechanisms do not always effectively discipline deceptive claims, however, especially when product attributes are difficult to evaluate or sellers are unconcerned about repeat business.

When competition alone cannot punish or deter seller dishonesty, another institution can mitigate these problems. Private legal rights provide basic rules for interactions between producers and consumers. Government also can serve a useful role by providing default rules, which apply when parties do not specify rules. These rights and default rules alleviate some of the weaknesses in the market system by reducing the consequences to the buyer from a problematic exchange. Although private legal rights provide powerful protections, in some circumstances – as when court enforcement is impractical or economically infeasible – they may not be an effective deterrent.

When consumers are vulnerable because market forces are insufficient and the common law is ineffective, a public agency, such as the Federal Trade Commission, can help preserve competition and protect consumers. The FTC's consumer protection and competition missions naturally complement each other by protecting consumers from fraud, deception, and harmful restraints on competition without restricting their market choices or their ability to obtain truthful information about products or services. The Commission attacks conduct that undermines competition, impedes the exchange of accurate information, or otherwise violates the common law rules of exchange.

Because of its antitrust responsibilities, the agency is well aware that robust competition is the best, single means to protect consumers. Rivalry among incumbent producers, and the threat or fact of entry from new suppliers, prompt firms to satisfy consumers. In competitive markets, businesses prosper by surpassing their rivals. In turn, this competitive market has important implications for the design of consumer protection policies to regulate advertising and marketing practices.

Without a continual reminder of the benefits of competition, consumer protection programs can impose controls that ultimately diminish the very competition that increases consumer choice. Some consumer protection measures – even those motivated by the best of intentions – can create barriers to entry that limit the freedom of sellers to provide what consumers demand. While I was Chairman, for example, the Commission participated in a court challenge to a state law that banned anyone other than licensed funeral directors from selling caskets to members of the public over the Internet. While recognizing the state's intent to protect its consumers, the Commission questioned

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[3] 15 U.S.C. § 45.

whether the law did more harm than good. In an amicus brief, the FTC noted that "[r]ather than protect[ing] consumers by exposing funeral directors to meaningful competition, the [law] protects funeral directors from facing any competition from third-party casket sellers."[2] The synergy between protecting consumers from fraud or deception without unduly restricting their choices in the market or their ability to obtain truthful information should undergird all of the Commission's consumer protection initiatives.

2. Under Its Existing Authority, The FTC Has Become One of the World's Preeminent Competition and Consumer Protection Agencies

With broad authority to protect consumers from fraudulent, deceptive, and unfair practices and to preserve competitive markets by prohibiting anticompetitive mergers and business conduct, the Federal Trade Commission's actions affect the lives of every American. As the only federal agency with both consumer protection and competition jurisdiction, the FTC has the unique ability to investigate the conduct of numerous players across our ever-changing economy and stop unlawful behavior that harms Americans. Particularly in difficult economic times, the agency protects financially distressed individuals who fall victim to fraud and deception and stops anticompetitive practices that deter the lower cost products and services that result from vigorous competition.

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[2] Memorandum of Law of *Amicus Curiae* Federal Trade Commission, *Powers v. Harris*, No. CIV-01-445-F (W.D. Okla. Sept. 5, 2002), *available at* http://www.ftc.gov/os/2002/09/okamicus.pdf.

During the past two years alone, the Commission has targeted problems in financial services as a primary area for helping consumers.[3] In particular, the agency has focused on deceptive practices in mortgage servicing, subprime credit, foreclosure rescue, fair lending, debt relief, credit repair, debt collection, advance fee loans, payday lending, and credit card marketing.[4] In addition, the FTC has targeted deceptive health, safety, and weight loss claims; telemarketing fraud; fraud against small business; and business opportunity schemes.[5]

The Commission has been very successful in addressing fraudulent, deceptive, and unfair practices. For example, from March 2008 through February 2009, the Commission filed 64 federal district court actions and secured 83 judgments and orders requiring defendants to pay more than $371 million in consumer redress or disgorgement of ill-gotten gains.[6] During this same time, the Department of Justice, on behalf of the FTC, obtained 15 civil penalty orders and $9.6 million in assessed civil penalties, of which nearly $8.3 million has been collected.[7]

Besides the high status accorded to fraud, deception, and unfairness cases, the FTC also places a very high priority on consumer privacy and the protection of personal information. The FTC enforces the FTC Act, the Safeguards Rule under the Gramm-

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[3] *See* Federal Trade Commission, *The FTC in 2009* 45 (Mar. 2009).

[4] *See id.* at 46-48; *Financial Services and Products: The Role of the Federal Trade Commission in Protecting Consumers Before the Senate Comm. On Commerce, Science, & Transportation*, 110th Cong. 4-9 (2010) (Statement of the Federal Trade Commission).

[5] *See, e.g.*, Final Order, *F.T.C. v. Roex, Inc. et al.*, No. SACV09-0266 (C.D. Cal. May 20, 2009) (Marketers of dietary supplements and devices agree to pay $3 million to settle FTC charges of deceptive advertising); Final Order, *F.T.C. v. Advantage Credit Repair, et al.*, No. 08-CV-5994 (N.D. Ill. Oct. 27, 2009) (Credit repair scammers settle FTC charges).

[6] *See The FTC in 2009 supra* note 3 at 45-46.

[7] *Id.* at 46-48; Statement of the Federal Trade Commission *supra* note 4 at 4-9.

Leach-Bliley Act, and the Fair Credit Reporting Act to protect consumers from threats to the security of their personal information. Using these various statutes and the Safeguards Rule, as of March 2009, the FTC brought 25 enforcement actions that challenged inadequate security practices by firms that mishandled sensitive consumer information.[8]

On the competition side, the FTC scrutinizes industries that have a significant effect on consumers' daily lives, including health care, energy, technology, and consumer goods and services.[9] Challenging alleged anticompetitive mergers has been a key priority. The Commission reviews premerger notification filings and other information to determine if a transaction may substantially lessen competition. From March 2008 through February 2009, for example, the FTC filed six preliminary injunctions and administrative complaints challenging proposed and consummated mergers that it believed raised competitive concerns.[10] The agency also identified competitive concerns in an additional 16 proposed acquisitions during that time period that it resolved through consent agreements with the merging firms.[11] These consent orders permitted the transactions to proceed after changes were adopted in markets such as those involving generic and branded pharmaceuticals, specialty chemicals, medical devices, electronic public records services, and consumer goods and technology.[12]

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[8] *The FTC in 2009 supra* note 3 at 56.

[9] *Id.* at 15.

[10] *Id.* at 12.

[11] *Id.*

[12] *Id.*

The Commission continues to be vigilant in challenging possible anticompetitive conduct through filing actions in federal court. Examples of such challenges from March 2008 through February 2009 include actions to stop:

(a) The payments by branded drug makers to generic rivals to agree not to market a lower-priced generic drug;[13]

(b) The use of Multiple Listing Service rules to prevent discount real estate professionals from making their listings available on popular websites listing homes for sale;[14] and

(c) The use of joint fee negotiation by physician groups to keep reimbursement rates high without providing benefits to patients.[15]

The FTC uses a variety of tools to accomplish its objectives, including litigation, rulemaking, policy research and development, competition advocacy, consumer and business education, hearings, and the encouragement of self-regulatory initiatives.[16] The Commission also promotes sound policy initiatives by holding public workshops with industry leaders and consumers. Recent workshops have included, "Exploring Privacy: A Roundtable Series,"[17] held in March 2010; "Horizontal Merger Guidelines

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[13] *Id.* at 13.

[14] *Id.*

[15] *Id.*

[16] Former Chairman Robert Pitofsky and I discuss the remarkable range of FTC tools in Timothy J. Muris & Robert Pitofsky, *More Than Law Enforcement: The FTC's Many Tools – A Conversation With Tim Muris and Bob Pitofsky*, 72 Antitrust L.J. 773 (2005).

[17] "Exploring Privacy: A Roundtable Series" explored privacy issues posed by 21st century technology and business practices that collect and use consumer data, including social networking, cloud computing, online behavioral advertising, mobile marketing, and the collection and use of information by retailers, data brokers, third-party applications, and other diverse businesses.

Workshop,"[18] held in January 2010; and "Protecting Consumers in Debt Collection Litigation and Arbitration: A Roundtable Discussion,"[19] held in December 2009.

Given this impressive agenda and workload, in 2009 the Global Competition Review ("GCR") gave the FTC its highest rating, five out of five stars.[20] The GCR stated that "[f]ew agencies in the world balance their antitrust and consumer protection duties as well as the U.S. Federal Trade Commission. While many agencies struggle to be good at one or the other, the FTC has mastered both."[21] The agency does not need new authority to continue this stellar performance.

3. Under Its Existing Statutes, The FTC Already is Embarking on Major, Sometimes Controversial, Expansions of its Authority

As our economy evolves, so too should the FTC. Fraud, for example, takes new forms, and the Commission must adapt to the new threats. Moreover, the agency is currently considering using new remedies against fraudsters that appear worthwhile, such as banning them from certain activities in the future. Even without expanded statutory powers, the Commission has embarked on many other new initiatives. Whether or not one thinks these initiatives are wise, it is clear the FTC does not feel constrained by a lack of authority to pursue them. I discuss a few of the new activities in this section.

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[18] "Horizontal Merger Guidelines Workshop" explored possible updates to the Horizontal Merger Guidelines used by both the FTC and the Department of Justice to evaluate the potential competitive effects of mergers and acquisitions.

[19] "Protecting Consumers in Debt Collection Litigation and Arbitration: A Roundtable Discussion" examined consumer protection issues in debt collection proceedings.

[20] Global Competition Review, *Rating Enforcement 2009 – United States Federal Trade Commission* (2009).

[21] *Id.*

A. *The Proposed "Voluntary" Guides for Food Marketing.*

Today, most adults are either obese or overweight, and the rate of overweight children has increased rapidly. This alarming increase in obesity is a complex public health issue that demands effective response by parents, industry, physicians, consumer advocates, and government.

Responding to a Congressional request for a report and recommendations about guidelines for marketing food to children and teens, the Commission, together with the Food and Drug Administration (FDA), the Center for Disease Control, and the U.S. Department of Agriculture released proposed guides that would ban advertising of (among other products) many breakfast cereals, soups, and yogurts from thousands of TV shows and other media.[22] These foods, according to the standards, should not be advertised on television and other media when the audience has more than 20 percent teens or 30 percent children.

The FTC has been down this road before. Prodded by consumer activists in the late 1970s, the Commission sought to stop advertising to children because of concerns that they did not understand the nature of advertising, were eating too much of the wrong food, and were suffering tooth decay and other health risks as result.[23] After three years of work, 6,000 pages of transcript, 60,000 pages of comments, an editorial in *The Washington Post* scolding the Commission for acting like the National Nanny, and an increasingly exasperated Congress, the Commission abandoned the rulemaking.

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[22] Workshop, Federal Trade Commission, *Sizing Up Food Marketing and Childhood Obesity* (Dec. 15, 2009).

[23] *See* FTC Staff Report on Television Advertising to Children (Feb. 1978); Notice of Proposed Rulemaking on Television Advertising to Children, 43 Fed. Reg. 17,967 (April 27, 1978).

Today's proposal should fare no better. It is impractical, ineffective, and (were it to become law) illegal. It's impractical because, although kids see many food ads on children's programming, many ads they see air on programs that are not directed to them. Moreover, a ban would be ineffective because there is no reason to think that the ads kids see make them obese. Although American children see thousands of food ads each year, they have done so for decades — since long before the dramatic upswing in obesity. Today's kids actually watch less television than previous generations and have many more commercial-free choices. They see fewer food ads, but they weigh more. Even our dogs and cats are fat, and it is not because they are watching too much advertising.

Finally, a ban would be illegal. Food is not illegal to sell to those under 18. Our First Amendment requires government to demonstrate that restrictions on truthful, non-misleading commercial speech for legal products meaningfully advance a compelling interest. Because a children's advertising ban would be ineffective,[24] it would fall far short of that test. Moreover, many of the restricted foods actually meet existing government standards – such as those under WIC, the Special Supplemental Nutrition Program for Women, Infants, and Children.[25] Among the foods that the government is encouraging children to eat, but that the proposed standards would prevent advertisers from marketing to families, are milk, cheese, eggs, most breakfast cereal, and peanut butter. In any event, the government certainly cannot legally restrict truthful ads when the majority of the audience are adults.

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[24] The Institute of Medicine found insufficient evidence to conclude that advertising caused obesity in either kids or teens. *See* IOM, *Food Marketing to Children and Youth: Threat or Opportunity?* (2006).

[25] "[T]he WIC Program – serves to safeguard the health of low-income women, infants, & children up to age 5 who are at nutritional risk by providing nutritious foods to supplement diets, information on healthy eating, and referrals to health care." *See* http://www.fns.usda.gov/wic/aboutwic/.

One difference between the current proposal and the old rulemaking – called Kid Vid – is that this time the agencies are suggesting that the standards be adopted "voluntarily" by industry. Yet, can standards suggested by a government claiming the power to regulate truly be "voluntary"? Moreover, at the same workshop that the standards were announced, a representative of one of the same activist organizations that inspired the 1970s efforts speculated that a failure to comply with the new proposal would provoke calls for rules or legislation.[26] And, it would be a risky proposition for advertisers all to adopt the Commission's standards voluntarily, as joint restraints on advertising are well known to impair competition,[27] and these restraints would hardly pass antitrust muster.[28]

Attacking food advertising may offer the illusion of progress in the fight against childhood obesity. But in the end, Americans must eat less and exercise more. That said, advertising can play a role in fighting obesity. One FTC study showed that when the government changed its position and permitted cereal advertisers to make truthful claims about the relationship between fiber intake and reduced cancer risk, consumers and

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[26] *See* Jared Favole, *Federal Group Proposes Curbs on Marketing Food to Kids*, WSJ.com, Dec. 16, 2009, *available at* http://online.wsj.com/article/SB126092800862493091.html ("The foods and beverages that could be affected if the proposed marketing restrictions became law include most sodas, candies, cookies, cereals and some types of yogurt, said Margo Wootan, Director of Nutrition Policy at the Center for Science in the Public Interest.").

[27] Numerous studies have demonstrated the role of advertising in competitive markets. Some are collected in William MacLeod, et al., *Three Rules and a Constitution: Consumer Protection Finds Its Limits in Competition Policy*," 3 Antitrust L. J. (2005). For an example in the food industry, *see* C. Robert Clark, *Advertising Restrictions and Competition in the Children's Breakfast Cereal Industry*, 50 J. L. & Econ. (Nov. 2007), which found that cereal prices and shares of leading brands were higher in Quebec Canada, which banned advertising to children under 13, than in other Canadian provinces where the advertising is allowed.

[28] *See Food Marketing to Children and Youth: Threat or Opportunity? supra* note 24.

sellers responded.[29] Consumers increased their consumption of high-fiber cereals, the market share for high-fiber cereals increased, and more high-fiber cereals found a place on grocers' shelves.

We need to harness that same power to help fight obesity. Year after year, manufacturers have shown great ingenuity in pitching foods to kids as tasty and fun; their challenge now is to develop and promote healthy foods, too. Major marketers (representing over three quarters of all ads kids see) have already undertaken initiatives to market nutritious foods and healthy lifestyles. Under the auspices of the Council of Better Business Bureaus, the companies also made individual commitments to do so, and we have seen big shifts in advertising to kids, and major reformulations of the foods advertised to them.

B. ***Changes in Advertising Substantiation.***

Changing the advertising substantiation doctrine is another significant new initiative. The Commission has long required that advertisers possess a "reasonable basis" to substantiate their advertising claims. Since its inception, the substantiation doctrine has employed a flexible approach for determining the amount of evidence an advertiser needs to substantiate a particular claim.[30] Recognizing the importance of the free flow of information to help markets best serve consumers' needs, the Commission has developed a balancing test to assure that information flows both freely and truthfully,

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[29] Pauline Ippolito & Alan Mathios, *Health Claims in Advertising and Labeling: A Study of the Cereal Market* (1989) (FTC Bureau of Economics Staff Report) ("Study of the Cereal Market").

[30] *Pfizer, Inc.*, 81 F.T.C. 23 (1972).

without unnecessarily chilling advertisers' ability to provide consumers with important information.[31]

Thus, to support health-related claims for foods, the Commission has traditionally required that companies have "competent and reliable scientific evidence."[32] That standard requires tests or other studies using "procedures generally accepted in the profession to yield accurate and reliable results."[33] Clinical testing is sometimes required because there is no other method that professionals believe yields accurate and reliable results. In other cases, however, other forms of evidence are generally accepted as reliable. There are, for example, no clinical trials of parachutes – and no serious doubt about whether they actually work to reduce risk.

In recent investigations, however, the staff has been seeking to replace that flexible standard with the same kinds of evidence that the Food and Drug Administration has traditionally required to approve new drugs. These proposed standards would require two well-controlled clinical trials to substantiate certain claims even if experts generally accept other methods as reliable. Moreover, they would apparently prohibit more limited claims that accurately disclose the limitations of the available evidence. An advertiser could not report, for example, that a single well-conducted clinical trial supports a claim

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[31] FTC Policy Statement Regarding Advertising Substantiation, *appended to Thompson Med. Co.*, 104 F.T.C. 648, 839 (1984), *aff'd*, 791 F.2d 189 (D.C. Cir. 1986).

[32] Bureau of Consumer Protection, FTC, *Dietary Supplements: An Advertising Guide for Industry* 9 (1998).

[33] *Id.*

until a second study came to the same conclusion. Courts have consistently rejected such blanket prohibitions on truthful speech as violations of the First Amendment.[34]

Abandoning the flexible substantiation standard is a bad idea. The current approach lets the Commission strike the appropriate balance between the risks of mistakenly allowing false claims and the risks of mistakenly prohibiting truthful ones. When the consequences of false claims are high, as they are when an unsafe new drug is allowed on the market even though effective alternatives are available, a high substantiation standard is appropriate. But the risks of mistaken claims about foods are vastly lower. Consumers may pay a few pennies more or give up a better tasting product, costs that are purely economic.

In contrast, mistakenly prohibiting truthful claims about the relationship between diet and disease creates risks to public health. Consumers who do not know about the relationship between saturated fat consumption and heart disease, or about the relationship between fiber and cancer, or the relationship between folic acid and neural tube birth defects may suffer serious health consequences. When experts in the field believe that reliable studies indicate the likely truth of these relationships, there is good reason to allow such claims, even if the evidence does not meet the standard that would be required for a new drug.

The empirical evidence is clear that excessive restrictions on truthful advertising harm consumers.[35] They lead to higher product prices and less incentive for sellers to

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[34] *See Pearson v. Shalala*, 164 F.3d 650 (D.C. Cir. 1999); *Whitaker v. Thompson*, 248 F. Supp. 2d 1 (D.D.C. 2002).

[35] *See* J. Howard Beales & Timothy J. Muris, *State and Federal Regulation of National Advertising* (1993), especially Chapter 2.

improve their products. Moreover, excessive restrictions have a disproportionate effect on those who are not as good at finding information from other sources. The well-educated, two-parent household may find their information elsewhere, but too often the less-educated, single-parent household will not. Much of the evidence for these conclusions is developed in a series of reports by the FTC's Bureau of Economics, beginning with a ground-breaking study of the impact of health claims on the market for cereals.[36] Applying FDA-like standards in cases in which experts regard other methods as reliable is simply bad policy.

Finally, repudiation of the Commission's flexible standard is not necessary to facilitate enforcement of FTC orders. Although the Commission does not win every case, it wins the overwhelming majority of those it brings. That fact alone makes clear that a more specific standard is not necessary to simplify enforcement. "Fencing in" order provisions that cover more products or more claims from a company that has violated the law are entirely appropriate, and widely used. There is no reason, however, to require past violators to meet a higher burden to substantiate the likely truth of their claims. A more specific requirement would not "fence in" proven violators; rather, it would "wall off" truthful claims that would be quite valuable to consumers.

C. *Behavioral Advertising.*

Increasingly, advertising supports the provision of free Internet content. The amount of money available to fund that content, and hence the quality of information available online, will depend on the advertising rates. The higher the rates, the more (and better) content consumers will receive. Behavioral advertising, which uses information

[36] Ippolito and Mathios, *Study of the Cereal Market*, *supra* note 29.

about an anonymous consumer's browsing behavior to infer which ads are most likely to appeal to that consumer, promises to raise the rates that advertisers are willing to pay. Inappropriate restrictions on such ads could significantly impair the advertising-based model for financing Internet content.

The FTC is evaluating its approach to privacy, and is considering preventing behavioral advertising unless consumers affirmatively agree (i.e., opt in) to accept such ads.[37] The analytical framework that the FTC currently employs was the result of a similar review undertaken when I became Chairman in 2001. That review led the Commission to shift its focus to the adverse consequences of the use and misuse of sensitive consumer information. Consequently, the Commission launched the National Do Not Call Registry and filed several cases involving failure to protect sensitive personal information.

The consequences model remains a powerful basis for guiding FTC privacy policy. Under that model, the Commission can protect consumers' subjective preferences for anonymity, just as it protects subjective preferences for products that are "Made in America." (Advertising misrepresenting that a product is made in America would violate the FTC Act. Moreover, customs and tariff rules may require disclosure of origin information for reasons unrelated to consumer misrepresentation.) For the Commission to protect consumer preferences, however, they must be preferences that are actually reflected in marketplace behavior. Subjective preferences only can be known from consumer behavior in the marketplace. They cannot be inferred from survey results if consumers can ignore the consequences of their own answers. Precisely because they are

subjective, we cannot infer that because some consumers care about a particular attribute that such an attribute is worth the costs to others.

The question is one of approach. Of course, the Commission should protect known subjective consumer preferences, whether for products made in America or for privacy. Such preferences are important drivers of a market economy. It is another thing altogether, however, to argue that because *some* consumers have a preference, the Commission should require *all* sellers to satisfy that preference. That argument is simply wrong. Assuring the accuracy of claims that a product is made in America enhances consumer sovereignty – it lets consumers choose what matters to them and what does not. Requiring all sellers to offer American-made products – or even to disclose that their products are not made in America – is another matter altogether. It imposes the costs of admittedly real preferences of some on many who do not share them. The fact that a particular product characteristic, whether related to privacy or product attributes, is important *to me* is a very good reason for protecting affirmative claims about that characteristic. It is a very bad reason for imposing that preference on everyone else.

For consumers who independently value anonymity, an opt-out regime protects them because for these consumers, the benefits of opting out exceed the minimal costs.[38] Consumers who are willing to opt out reveal that they, in fact, have a preference for anonymity.

An opt-in regime, however, does not reveal consumer preferences in the same way. Because most consumers apparently think that little is at stake in deciding whether

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[37] Stephanie Clifford, *F.T.C.: Has Internet Gone Beyond Privacy Policies?*, N.Y. Times, Jan. 11, 2010.

[38] Of course, the ability to opt out should be prominently disclosed and easy to use.

to allow information sharing, they are not willing to incur even small costs to exercise choice. Therefore, an opt-in regime will protect "privacy" on which they place little value, while denying them the benefits of information sharing – including, perhaps, some of the Internet content they desire.

Opt-out is clearly superior to opt-in in this context. It protects those who care about preserving anonymity in commercial transactions, while allowing the benefits of information sharing and advertiser-supported content for those who do not care. An FTC decision to require opt-in for behavioral advertising would adversely affect consumers and their use of the Internet.

D. ***Endorsements and Testimonials.***

Many advertisers use testimonials from satisfied customers to tout the product's benefits. The available evidence indicates that consumers discount the performance claimed in testimonials. Most consumers believe that their results will differ from those claimed and that a variety of factors influence the results they will achieve.[39]

In 1972, the Commission published Guidelines for endorsements and testimonials that have provided valuable guidance to advertisers using such techniques.[40] Nevertheless, there were some problems that were apparent in certain testimonial advertising. For example, testimonials were frequently used for essentially fraudulent products with a ritualistic disclaimer that the results were not typical. Such a disclaimer should not protect fraud. A second problem occurs when the testimonials, even for non-

[39] *See* Comments Of Kelley Drye & Warren On The Commission's Guides Concerning The Use Of Endorsements And Testimonials In Advertising, *In re Guides Concerning the Use of Endorsements and Testimonials in Advertising*, Commission File No. P034520 (Mar. 2, 2009), *available at* http://www.ftc.gov/os/comments/endorsementguides2/539124-00016.pdf.

fraudulent products, portray results that are so extreme that almost no one will realize them.

Rather than narrowly addressing these problems, the revised Guidelines the Commission recently issued are overbroad.[41] The changes have created confusion among advertisers, endorsers, celebrities, bloggers, and the media regarding what conduct complies with Section 5 of the FTC Act. Accompanying this confusion is the fear that the Commission may soon have the power to impose civil penalties the first time it decides an advertiser failed to follow its guidance.

Contrary to consumer expectations, the tendency at the Commission now is to treat a testimonial as a representation of the average or typical performance that consumers can expect.[42] If advertisers meant to communicate that the results in a testimonial were those that most people receive, they could say so directly, and thereby avoid the discounting that consumers apply to claims made in testimonials.

An additional problem with the new Guidelines involves "endorsers," especially those in the new media, such as bloggers. The Commission warned advertisers that they would be responsible for media over which they had no control:

> An advertiser's lack of control over the specific statement made via these new forms of consumer-generated media would not automatically disqualify that statement from

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[40] FTC Guides Concerning the Use of Endorsements and Testimonials in Advertising, 16 C.F.R. § 255 (1980).

[41] Guides Concerning the Use of Endorsements and Testimonials in Advertising, 16 C.F.R. pt. 255 (Dec. 1, 2009).

[42] David C. Vladeck, Director, Bureau of Consumer Protection, Federal Trade Commission, *A Look Forward With the FTC: Advertising and Marketing Enforcement Challenges* (Feb. 3, 2010).

being deemed an "endorsement" within the meaning of the Guides.[43]

After severe criticism in the blogosphere, the Commission has sought to temper the implications of this statement. Although company sponsorship and support of blogs raise different issues, merely providing free samples of a product to a blogger should not render the manufacturer liable for the blogger's conclusions. There is no reason to think that product reviews online are any different from a book or movie review for which the reviewer did not pay for the product.

4. MAGNUSON-MOSS PROCEDURES SHOULD BE RETAINED[44]

Proposals to expand the Commission's rulemaking authority should be considered in the historic context of the Commission's purpose and mission.

A. *The Role of FTC Rulemaking*

As I discussed above, the Commission has relied on the development of common law principles, supplemented with occasional rules and guides. The cornerstone of the FTC's consumer protection mission is the fraud program, discussed in more detail below, through which the Commission has returned hundreds of millions of dollars to defrauded consumers.

Although many do not think of them as such, these common law principles *are* rules, providing a crucial part of the institutional framework that helps our market

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[43] Guides Concerning the Use of Endorsements and Testimonials in Advertising, Overview of the Commission's Review of the Guides (Dec. 1, 2009), *available at* http://www.ftc.gov/os/2009/10/091005endorsementguidesfnnotice.pdf.

[44] Although within the Commission these procedures are uniformly referred to as "Magnuson Moss," in fact, the procedures are contained within Title II of the Magnuson Moss Warranty – Federal Trade Commission Improvement Act of 1975. Only Title I involved the Magnuson Moss Warranty Act, but I use here the conventional designation of Magnuson-Moss procedures.

economy to function. In most circumstances, these common law rules provide both clear guidance to the business community and an adequate basis for FTC enforcement actions.

The common law process is well suited to develop new policy. For example, the Commission has used this process to formulate general rules to protect the security of sensitive consumer information. Using both its deception and unfairness authority, the Commission has brought cases addressing information security, as the growth of the Internet and new technologies have created new vulnerabilities. Attempting to write a rule defining the scope of liability in advance could have stymied the natural development of this common law process, leading to uncertain results.[45]

Rules seeking to address fraudulent or other practices often are very difficult to write. Unlike the Federal Communications Commission, the Securities and Exchange Commission, or other regulatory bodies, the FTC is not a sector-specific regulator. Thus, the agency generally lacks industry-specific knowledge, expertise, and routine contacts with regulated entities and congressional committees with jurisdiction over those industries.[46] Instead, in its law enforcement experience, the Commission deals with pathology. It is familiar with bad actors, who have demonstrated their unwillingness to comply with basic legal principles.

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[45] Although the FTC promulgated the Safeguards Rule at the same time as it was initiating information security cases, the rule was primarily useful in establishing a structure for remedies. Adopted under GLB, the rule set out a flexible, process-oriented approach to providing information security. Because Congress had specified liability for financial institutions that failed to protect sensitive information, the rule did not require a theory of who was liable under Section 5 and under what circumstances. Those theories were developed through the common law process in individual cases, and most of the Commission cases have involved industries not covered by GLB.

[46] Of course, the agency and its staff have become quite knowledgeable about certain sectors of the American economy, including, for example, the downstream parts of the oil industry, certain aspects of health care, and credit reporting agencies. For credit reporting agencies, the FTC is *the* regulator, and pursuant to the FACT Act, has promulgated numerous rules in the last few years. These rules, and many others, were promulgated pursuant to congressional direction.

By their nature, however, rules also must apply to legitimate actors, who actually deliver the goods and services they promise. Remedies and approaches that are entirely appropriate for bad actors can be extremely burdensome when applied to legitimate businesses, and there is usually no easy or straightforward way to limit a rule to fraud. Rather than enhancing consumer welfare, overly burdensome rules can harm the very market processes that serve consumers' interests. For example, the Commission's initial proposal for the Telemarketing Sales Rule was extremely broad and burdensome, and one of the first acts of the Pitofsky Commission was to narrow the rule.[47] More recently, the Commission found it necessary to re-propose its Business Opportunity Rule, because the initial proposal would have adversely affected millions of self-employed workers.[48]

Of course, rulemaking can be appropriate. For example, the Commission sometimes can provide "rules of the game" that reduce consumer harm in the future. The Commission can establish new default rules and procedures for transferring rights when it is otherwise difficult to do so. Thus, the Commission's Mail Order Rule provides that, unless the parties agree otherwise, the merchandise must be delivered within 30 days. While seeking to facilitate the exercise of consumer choice, the agency also is highly cognizant of the need to avoid unduly shackling market forces.[49] For example, this balance undergirds the FTC's approach to unsolicited telemarketing calls, through which consumers decide whether or not they wish to receive such calls and express their preferences effectively through the Do Not Call Registry. Once these new rules of

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[47] Telemarketing Sales Rule, 60 Fed. Reg. 8313 (Feb. 14, 1995) (codified at 16 C.F.R. pt. 310 (1995)).

[48] Business Opportunity Rule, 73 Fed. Reg. 16110 (Mar. 26, 2008).

[49] *See, e.g.*, Comment of the Staff of the FTC before the Department of Health and Human Services Food and Drug Administration, *In re Food Labeling: Health Claims; Dietary Guidance, Docket No. 2003-0496* (Jan. 26, 2004), *available at* http://www.ftc.gov/os/2004/040126fdacomments.pdf.

exchange are established, if transaction costs are low, parties can more easily transfer these rights when a different allocation is important to them.[50]

It would be a major mistake for rulemaking to be a substantial component of FTC consumer protection. The FTC went down this road once before, with disastrous consequences. In the 1970s, using its unfairness authority under Section 5 without meaningful standards, the Commission embarked on a vast enterprise to transform entire industries. Over a 15-month period, the Commission issued a rule a month, usually without a clear theory of why there was a law violation, with only a tenuous connection between the perceived problem and the recommended remedy, and, at best, a shaky empirical foundation.[51] This enterprise foundered because of the internal inadequacies of the Commission's procedures and because of intense opposition from both parties in Congress.

As it did before, the FTC will fail in its mission to protect consumers if it seeks to become the second most powerful legislature in Washington. This is surely an unsuitable task for five unelected representatives, not closely supervised by the White House or a Cabinet department.

Regardless of the procedures, rulemaking is a resource-intensive activity that inevitably draws resources away from enforcement. While I was Chairman, the agency

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[50] *See* Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & Econ. 1, 15-16 (1960) ("Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about.").

[51] For similar criticisms of the FTC's rulemaking binge, see the extensive, contemporaneous studies by Barry Boyer, Report to the Administrative Conference of the US, *Trade Regulation Rulemaking Procedures of the Federal Trade Commission* (1979); and Teresa Schwartz, *Regulating Unfair Practices Under the FTC Act: The Need for a Legal Standard*, 11 Akron L. Rev. 1 (1977). *See also* Timothy J. Muris, *Rules Without Reason – The Case of the FTC*, 6 Regulation 20 (Sept./Oct. 1982).

was pursuing subprime lending cases involving failure to disclose adequately key terms of the transaction. In 2005, however, as more and more dubious loans were made, the agency diverted substantial resources to rulemakings to implement the FACT Act. The FTC asked for rulemaking authority in one narrow area (risk-based pricing); it ended up with statutory mandates for more than a dozen separate rules and studies. Whatever their value, those rules and studies consumed resources the Commission could have productively employed on cases.

B. *Magnuson-Moss Procedures Are Appropriately Tough, But Usable.*

Rulemaking is an exercise in generalization. The FTC should determine whether a problem occurs often enough to justify a rule, whether the problem has a common cause in a sufficient number of cases to justify the remedy, and whether that remedy can correct the problem without imposing excessive costs. Because the FTC cannot generalize simply from its own experiences or from the horror stories of others, it should rely on projectable evidence such as surveys of consumers and econometric studies of industry behavior.

The Magnuson-Moss procedures force the Commission to be clear about its theories and focus its evidence on the key questions. Otherwise, the procedures can make the rulemaking almost interminable, as Chairman Leibowitz recently testified.[52] The ability of rulemaking participants to propose disputed factual issues and cross-examine witnesses on those issues the presiding officer designates as disputed is very useful in

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[52] *Financial Services and Products: The Role of the Federal Trade Commission in Protecting Consumers Before the Senate Comm. On Commerce, Science, & Transportation*, 110th Cong. (2010) (Statement of the Federal Trade Commission).

testing the Commission's theories. Properly focused, Magnuson-Moss procedures are workable.

The Commission's recent experience in the Business Opportunity Rulemaking is a reminder of the useful aspects of the Magnuson-Moss procedures. The Commission proposed a wide-ranging rule, apparently aimed at fraud, but that instead would have adversely affected millions of self-employed workers and the consumers they serve. Based on the public comments and the need to proceed under Magnuson Moss, the Commission has now sensibly proposed a much more targeted rule that addresses fraud without regulating legitimate businesses.[53] Although the Commission may have retreated without the threat of hearings and cross examination, those threats undoubtedly helped to influence the Commission's deliberations.

The FTC has successfully used Magnuson Moss Rulemaking in the past. Several of the rules proposed in the 1970s were eventually promulgated. Some rules, like the two involving eyeglasses, were well conceived initially and concluded expeditiously. More recently, the Commission has used these procedures to amend the Franchise Rule.

The Commission's most prominent rulemaking endeavor, the creation of the National Do Not Call Registry, could have proceeded in a timely fashion under Magnuson-Moss procedures. It took two years from the time the rule was first publicly discussed until it was implemented. Although it would have been necessary to structure the proceedings differently, there would have been little, if any, additional delay from using Magnuson-Moss procedures.

[53] Business Opportunity Rule *supra* note 48.

C. *Magnuson-Moss Procedures Should Be Retained.*[54]

The problems that resulted from FTC rulemaking in the 1970s are not just that the agency needed "better" regulators. Instead, the problem is one of incentives and constraints. We are entering a period of unusual consumer activism. Numerous groups are pressing the Commission for immediate action, whether or not the proposal is well considered. In the short run, Congress may push hard for action as well. Without the constraints of the Magnuson-Moss procedures, the potential for mischief and long run harm to the Commission and to consumers is enormous. Although Congress and the courts may eventually restrain the Commission, it would be far better to avoid these costs from the beginning.

It is true that part of the problem from the 1970s has been addressed with the Commission's adoption of the Deception Policy Statement and the codification of the definition of unfairness. Nonetheless, the Commission's authority remains extremely broad. The procedural safeguards of Magnuson Moss create a strong need for the Commission to develop clear theories and strong incentives to develop a firm evidentiary base early in the rulemaking proceeding. When these requirements are met, Magnuson Moss rulemaking is workable.

In some areas, the FTC has engaged in rulemaking, pursuant to congressional direction, using APA procedures. Congressional directives avoid a significant part of the

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[54] The Administration's proposal would do more than just change the procedures used in rulemaking. It also would eliminate the requirement that unfair or deceptive practices must be prevalent, and eliminate the requirement for the Commission's Statement of Basis and Purpose to address the economic effect of the rule. It also changes the standard for judicial review, eliminating the court's ability to strike down rules that are not supported by substantial evidence in the rulemaking record taken as a whole. The current statutory restrictions on Commissioners' meeting with outside parties and the prohibition on *ex parte* communications with Commissioners also are eliminated. These sensible and important protections should be retained.

problems that bedeviled the FTC in the 1970s, as they provide explicit political "cover" for the specific rulemaking at issue. That cover may subside, however, as the political tides shift or as the specific parameters of the proposal prompt fierce industry resistance. Moreover, congressional directives often remove the question of what constitutes a violation, which proved to be one of the most contentious issues of many 1970s rulemakings. Even with congressional authorization, I would retain Magnuson-Moss procedures when a rulemaking is major and when Congress has not specifically defined the violation.

5. Broad Expansion of FTC Civil Penalty Authority Is Unwise

A. *Automatic Civil Penalties Are Both Unnecessary and Harmful.*

In most of its consumer protection matters for which monetary relief is appropriate, the FTC already has authority to obtain money. Using the extraordinary equitable powers of federal district courts, the Commission routinely obtains *ex parte* asset freezes, injunctions, and redress for consumers. The Commission also can obtain disgorgement of ill-gotten gains, and in its fraud program, discussed in detail below, the Commission has used these powers extensively, and successfully.

The Commission also has used these equitable remedies to recover substantial sums from legitimate companies that engaged in significant violations of the law. Moreover, the money recovered usually is paid as redress *to consumers* injured by the illegal conduct, rather than to the Treasury. For example, the agency obtained significant financial recoveries in many of its subprime lending cases, including $215 million from

Citigroup[55] and $60 million from Fameo.[56] It obtained substantial monetary relief in the form of restoring inadequately disclosed fees in its gift card cases.[57] And just last week it obtained $12 million in refunds for consumers to settle allegations of deceptive advertising of identity theft protection services.[58]

The Commission should not, however, have the authority to obtain civil penalties in all cases. Faced with the threat of substantial civil penalties, firms may become too cautious to avoid any possibility of a law violation. The statutory cap on penalties at $16,000 per violation may not sound huge, but the way the FTC counts violations magnifies the impact. In one case, for example, the court regarded each instance of a direct mail advertisement sent to consumers as a separate violation.[59] It is easy to argue that a separate violation occurs each time an advertisement containing a deceptive claim is aired (ordinarily hundreds or thousands of times in a campaign); it is plausible to argue that each consumer who sees the message constitutes a separate violation. Thus, a direct-mail advertising campaign sent to 10 million consumers is potentially subject to a civil penalty of up to $160 *billion*. In practice, FTC civil penalties are obviously far smaller, but the potential for substantial liability may lead cautious firms to avoid conduct that would actually benefit consumers.

Consider, for example, advertising cases. As discussed above, the economic evidence is clear that advertising offers important benefits for consumers. When

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[55] Order, *F.T.C. v. Citigroup Inc.*, No. 01 CV-0606 (N.D. Ga. Sept. 19, 2002).

[56] Order, *F.T.C. v. First Alliance Mortgage Co.*, No. SACV 00-964 (C.D. Cal. Mar. 21, 2002).

[57] *E.g.*, FTC Order, *In re Kmart Corp.*, No. 062 3088 (Mar. 12, 2007); FTC Order, *In the Matter of Darden Restaurants, Inc., et al.*, No. 062 3112 (Apr. 3 2007).

[58] Order, *FTC v. Lifelock, Inc.*, (D. Ariz., Mar. 9, 2010).

[59] *U.S. v. Reader's Digest Ass'n*, 662 F.2d 955, 960 (3d Cir. 1981).

advertising is restricted, prices rise because markets are less competitive. There is less incentive for product improvements, because producers find it more difficult to tell consumers about the change and to explain the benefits of the product change. Differences between demographic groups are larger, because advertising makes information widely available to everyone in a form that is remarkably easy to use.

If the risk of substantial civil penalties makes advertisers too careful about providing information, these benefits of advertising may be reduced. There are, of course, advertising violations that are crystal clear, and as noted above, the Commission has obtained monetary relief in such cases. Many cases, however, are judgment calls about whether admittedly imperfect evidence is sufficient to substantiate a particular claim. Such cases may turn on disagreements between qualified experts, with different views about the state of the science or the appropriate methods for testing a particular claim. Civil penalty liability may make advertisers considerably less willing to make such claims, because the consequences of agreeing with the wrong expert could be large. Consumers, however, will benefit from hearing different points of view from different products, or from products in different categories, enabling them to make their own choices about which expert to believe. The risk of large civil penalty liability may discourage that marketplace debate.

Obviously, we do not want companies to stretch the truth when doing so would be profitable. But it should be equally obvious that we also do not want companies to suppress the truth to avoid the risk that the FTC will second guess their judgment and impose civil penalties. If the claims are egregious, the Commission already has ample authority to seek financial sanctions against violators, and has done so successfully.

A second difficulty of across-the-board civil penalty authority stems from the Commission's role in developing and extending common law principles. The case-by-case process is well suited to developing new policy, and the Commission has used it effectively to develop common law principles of consumer protection in new areas. For example, the Commission recently formulated general rules to protect the security of sensitive consumer information. Using both its deception and unfairness authority, the Commission has brought numerous cases in this century addressing information security.[60]

Before the Commission began pursuing information security cases, companies were not on notice that failure to maintain reasonable and appropriate security precautions to protect sensitive information would subject them to liability, let alone to civil penalty liability. The fact that the Commission lacks the authority to impose civil penalties in such cases makes it easier to establish new legal principles, because it encourages both the Commission and the respondent to focus on reasonable standards for future conduct.[61] Indeed, the vast majority of the Commission's efforts to expand consumer protection to new areas occur through consent agreements. For example, virtually none of its information security cases have been litigated. Civil penalty liability would increase a company's incentive to defend the choices it had made, even when it is

[60] *See, e.g.* FTC Order, *Eli Lilly & Co.*, No. C-4047 (May 8, 2002) (deception); FTC Order, *Microsoft Corp.*, No.C-4010 (May 15, 2001) (deception); FTC Order, *BJ's Wholesale Club, Inc.*, No. C-4148 (Sept. 20, 2005) (unfairness); FTC Order, *Cardsystems Solutions, Inc.*, No. C-4168 (Sept. 5, 2006) (unfairness).

[61] Of course, the Commission could decide not to seek civil penalties, but doing so when such penalties are available would subject the agency to serious second-guessing by Congress, the press, and consumer groups.

perfectly willing to agree to new standards of conduct.[62] This result would retard, rather than advance, the Commission's important mission of developing appropriate standards of consumer protection in areas it has not previously addressed. It would waste resources in litigation about past conduct that would be better spent on establishing appropriate standards for future behavior.

Given that the FTC's information security standards are now well known (although there are of course disputes at the margin), there may be a case for civil penalty authority in such cases, because establishing either harm (and therefore the basis for consumer redress) or ill-gotten gain is difficult. In fact, the Commission has only rarely obtained financial relief in its information security cases.[63] If there is a case for civil penalties, however, it is a narrow one, based on the nature of the particular violation, and not at all generalizable to most Section 5 violations.

It is crucial to recognize that the Commission's ability to impose sanctions is not the only consequence for companies subject to FTC orders. Even before the FTC obtained financial relief in advertising cases, academic studies found that an FTC complaint about deceptive advertising led to a significant reduction in the stock market's valuation of the company. Peltzman, for example, found a one to two percent reduction in the stock market valuation of a company in the month before an FTC deceptive advertising complaint, and an additional two percent loss in the month after a

[62] As the General Counsel of the respondent in one information security case expressed it, the company was willing to be a martyr for privacy, but did not want to be Joan of Arc.

[63] *See U.S. v. ChoicePoint Inc.*, No. 1:06-cv-0198-JTC (N.D. Ga. Oct. 14, 2009).

complaint.[64] FTC economists found an even larger effect.[65] These losses are themselves a substantial deterrent to violating the FTC Act. As Peltzman noted, "the overall message of the results is that the salary of the copywriter or lawyer who avoids entanglement with the FTC in the first place is a bargain."[66]

Since these studies, other players able to impose significant financial penalties have also entered the scene. Class actions under state deceptive practices laws, virtually nonexistent when the academic studies were done, have increased substantially, and continue to grow. State attorneys general often also weigh in, and frequently seek monetary relief.

There is simply no reason to suspect that widespread violations by legitimate companies subject to the Commission's jurisdiction are occurring or will occur because of inadequate financial sanctions. The Commission has not offered any persuasive examples of why it needs automatic civil penalty authority.

B. *Civil Penalties Are Not Needed For Fraud Cases.*

Preventing fraud is a crucial part of the Commission's support of the market system and the common law. More than half of the Commission's budget and staff is devoted to consumer protection, with a significant focus on fraud. Fraud is essentially theft. Fraud distorts market forces, limiting the ability of consumers to make informed choices. Fraud leads to inefficiency, causing consumers to allocate their resources

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[64] Sam Peltzman, *The Effects of FTC Advertising Regulation*, 24 J.L. & Econ. 403 (1981) ("The story the stock market appears to be telling is that an FTC complaint implies essentially a wiping out of the brand's advertising capital.").

[65] Alan Mathios & Mark Plummer, *The Regulation of Advertising by the FTC: Capital Market Effects*, 12 Res. L. & Econ. 77 (1989).

[66] Peltzman note 63 at 419.

unproductively. Fraud also reduces consumer confidence and reduces the efficacy of legitimate advertising, diluting the amount of useful information to guide consumers' choices. This effect also raises costs for legitimate competitors, who must offer more assurances of performance to overcome consumers' wariness.

The costs of fraud to consumers are enormous. Fraud takes many forms from fraudulent credit repair services, to unauthorized billing, to deceptive weight loss products. A 2007 FTC survey showed that an estimated 13.5 percent of U.S. adults, approximately 30.2 million consumers, were victims of one or more of the frauds covered in the survey, and that an estimated 48.7 million incidents of these frauds had occurred during the previous year.[67]

The victims of fraud are as varied as the form of the fraud. For example, the AARP has shown that investment fraud victims are more likely to be male, 55-61, more financially literate, college-educated, higher income, and more optimistic.[68] Lottery fraud victims are more likely to be female, over 70 years old, less financially literate, less educated, and have lower incomes.[69]

Because fraud is often national in scope, and scarce federal criminal law enforcement resources are used primarily against drug trafficking, terrorism, and other crimes, fraud will go largely unchecked without the active leadership of the nation's consumer protection agency. We created the FTC's modern anti-fraud program in 1981

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[67] FTC Staff Report, *Consumer Fraud in the United States: The Second FTC Survey* s-1 (Oct. 2007) *available at* http://www.ftc.gov/opa/2007/10/fraud.pdf.

[68] FTC Fraud Forum, Presentation, Day One: Panel 1 (Doug Shadel, State Director, AARP Washington, *Advances in Fraud Prevention Research*), at slide 31 (Feb. 25, 2009), *available at* http://www.ftc.gov/bcp/workshops/fraudforum/index.shtm#presentations.

[69] *Id.* at slide 32.

when I was Director of the Bureau of Consumer Protection. The development of a vibrant anti-fraud program at the FTC is a major success story. Fortunately, the legal tools for such a program already existed; in 1973, Congress had amended the FTC Act in Section 13(b) to allow the Commission to sue in federal district court and obtain strong preliminary and permanent injunctive relief, including redress for defrauded consumers.[70]

Before the shift to federal court, the Commission's consumer protection work relied on its administrative process. Most investigations relied upon voluntary production of requested documents and information from the investigated targets, who had every incentive to delay. This process had obvious drawbacks for addressing fraud. Federal district court cases proved much more effective, enabling the Commission to bring fraudulent schemes to an immediate halt, to take the targets by surprise so that money might be available for redress, and to prevent destruction of records showing the extent of the fraud and identifying injured parties.

Almost from the inception of the § 13(b) program, the Commission has not only halted fraudulent schemes, but also pursued consumer redress and other potent equitable remedies to benefit consumers. Very early in the § 13(b) consumer protection cases, the Commission obtained, as ancillary to issuance of permanent injunctions, provisional remedies such as a freeze of assets, expedited discovery, an accounting, and the

[70] The Commission uses the "second proviso" of § 13(b), "in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." Trans-Alaska Pipeline Authorization Act, Pub. L. No. 93-153, § 408(f), 87 Stat. 576 (1973). *See, e.g.*, John Villafranco, *Looking Back on the Muris Years in Consumer Protection: An Interview With Timothy J. Muris*, Antitrust 80, 82-83 (Summer 2004).

appointment of a receiver on the ground that these remedies would insure the effectiveness of any final injunction ordered.[71]

To use this approach effectively, the agency employed modern investigative techniques geared for speed and stealth. The agency also developed professional investigators trained to uncover fraudulent schemes, determine ownership and control of such schemes, trace assets, develop evidence, preserve evidence for trial, and testify in court. More recently, Commission investigators have become experts in Internet investigative techniques and have provided training for thousands of local, state, federal, and international criminal and civil law enforcement offices.

Once launched, the fraud program grew in importance and success. Each succeeding FTC Chairman has expanded its scope and improved its operation. By 2004, when my tenure as Chairman ended, there had been a total of 78 sweeps, resulting in 2,200 law enforcement actions.[72] Not surprisingly, as the number of filings increased, so has the amount of consumer redress ordered. In fiscal year 2003, for example, nearly $873 million in consumer redress was ordered in 98 judgments.[73]

Because of the ability to obtain consumer redress, and because virtually all of the money paid to the fraudsters is obtained illegally and thus eligible for redress, the FTC already has the authority to obtain all of the monetary relief available in these cases. The effective limit on the FTC's ability to recover money in cases of fraud is the money

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[71] *FTC v. H.N. Singer, Inc.*, 668 F.2d 1108 (9th Cir. 1982) is a seminal case establishing the Commission's authority to seek, and the district courts' power to grant, all the traditional equitable remedies inherent in the authority granted by § 13(b) to obtain permanent injunctions. *Singer* was the first § 13(b) case to attack a business opportunity scam.

[72] David R. Spiegel, *Chasing the Chameleons: History and Development of the FTC's 13(b) Fraud Program*, 18 Antitrust 43 (Summer 2004).

[73] FTC, *Federal Trade Commission Performance Report – Fiscal Year 2003* (Mar. 2004).

available, not any lack of authority to recover the funds. Expanded civil penalty authority is simply unnecessary in fraud cases.[74]

C. *Automatic Civil Penalties Are Unnecessary in Antitrust Cases.*

Although largely unnoticed, this Committee's reauthorization bill in the last Congress and the House-passed version last year also would allow for automatic civil penalties in antitrust cases. The Senate Commerce Committee did so by its express terms.[75] At first glance, the House bill does not appear to do so, because it provides for civil penalties only in cases involving "unfair or deceptive acts or practices." Within the FTC, antitrust cases are traditionally thought of as involving "unfair methods of competition." Yet, there is no prohibition, legal or otherwise, that prevents the agency from designating antitrust cases as involving "unfair or deceptive acts or practices," and, in fact, the Commission has recently done so in its actions against Negotiated Data

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[74] Many fraudsters should be jailed, and the Commission also has taken important steps to improve its cooperation with criminal law enforcement agencies. While Chairman, we established a Criminal Liaison Unit to coordinate with criminal law enforcement agencies across the country to encourage criminal prosecution of consumer fraud. The unit identifies criminal law enforcement agencies that may bring specific types of consumer fraud cases, educates criminal law enforcers in areas of FTC expertise, coordinates training with criminal authorities to help the FTC prepare cases for referral and parallel prosecutions, and provides Special Assistant United States Attorneys to help prosecute the worst FTC Act violators. Between October 1, 2002, and July 31, 2007, 214 individuals were indicted in telemarketing fraud cases resulting from referrals from the Criminal Liaison Unit. (Prepared Statement of The Federal Trade Commission Before the Senate Committee on Commerce, Science and Transportation, United States Senate, July 31, 2007, *available at* http://www.ftc.gov/os/testimony/P034412telemarket.pdf.)

Another important expansion of the FTC's consumer protection efforts involves Spanish language media. The agency uses its full powers to prosecute fraud and deception occurring in the media, and has brought numerous cases against fraud and other illegal marketing practices that targeted the Hispanic community. That effort continues.

[75] FTC Reauthorization Act of 2008, S. 2831, 110th Cong. (2008) ("The Commission may commence a civil action to recover a civil penalty in a district court of the United States against any person, partnership, or corporation which violates this Act . . . .")

Solutions and Intel.[76] Moreover, the FTC has proposed unfair acts or practices rules involving practices most practitioners would regard as antitrust issues, including restraints on advertising and restrictions on the form of operations businesses could take.[77]

Automatic civil penalties in antitrust cases are both unnecessary and unwarranted. Indeed, a unanimous FTC explicitly stated in 2003 that monetary relief (in the form of disgorgement) was inappropriate for most of its antitrust cases.[78] The FTC said that it would "continue to rely primarily on more familiar, prospective remedies,"[79] and would not seek monetary relief when it would result in injured persons receiving duplicative recoveries or cause defendants to make multiple payments for the same injury. As the agency stated: "although a particular illegal practice may give rise both to monetary equitable remedies and to damages under the antitrust laws, when an injured person obtains damages sufficient to erase an injury, [the FTC does] not believe that equity warrants restitution to that person."[80] Because private, treble actions follow most FTC antitrust cases, monetary relief is simply unnecessary as a routine part of the FTC's antitrust arsenal.

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[76] FTC Order, *Negotiated Data Solutions*, No. C-4234 (Sept. 22, 2008); FTC Order, *Intel Corp.*, No. 9341 (Jan. 19, 2010).

[77] Advertising of Ophthalmic Goods and Services, 43 Fed. Reg. 23992 (June 2, 1978); ("Eyeglasses I"); Ophthalmic Practice Rules, 54 Fed. Reg. 10285 (Mar. 13, 1989) ("Eyeglasses II") (the rule regarding advertising restrictions was mooted when the Supreme Court protected such advertising under the First Amendment of the U.S. Constitution. The D.C. Circuit struck down the commercial practices rule for reasons unrelated to the antitrust / consumer protection distinction) (*see Am. Optometric Ass'n v. F.T.C.*, 626 F.2d 896 (D.C. Cir. 1980)).

[78] Federal Trade Commission, *Policy Statement on Monetary Equitable Remedies in Competition Cases*, 68 Fed. Reg. 45,820 (Aug. 4, 2003).

[79] *Id.*

[80] *Id.*

6. CONGRESS SHOULD RESTORE EQUALITY BETWEEN FTC AND DOJ MERGER STANDARDS

Both the FTC and the DOJ enforce Section 7 of the Clayton Act,[81] which determines the legality of mergers. Mergers or acquisitions of a certain size[82] (and not subject to an exemption) must be notified to the FTC and the DOJ, and the parties must observe a waiting period, prior to consummation of the transaction. Either the FTC or the Antitrust Division of the Department of Justice (but not both) can investigate a merger and seek to enjoin it in federal district court. Unfortunately, a few recent court decisions provide the FTC with a lower preliminary injunction standard than the standard for the DOJ. Because of this lower standard, it is now possible for the FTC to obtain a preliminary injunction to block a merger with evidence that would be insufficient for the DOJ to obtain the injunction. Because most preliminarily enjoined deals cannot, as a practical matter, survive the months (much less years) of delay attendant upon an FTC administrative proceeding, the FTC's relative ease in obtaining a preliminary injunction means that it can permanently foreclose more mergers than its counterpart.

This result is fundamentally unfair. Because the FTC and DOJ divide merger review between them pursuant to an *ad hoc* agreement, the legality of some mergers today depends not on their underlying merits, but instead on which agency reviews them. In other words, the flip of a coin (to resolve a dispute between the two agencies over which agency should review the merger) could determine whether a merger survives antitrust scrutiny.

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[81] 15 U.S.C. § 18.

[82] 15 U.S.C. § 18(a).

Moreover, the FTC's advantage results from a judicial misreading of Congressional intent. Under the public interest test the courts apply, the DOJ must prove a likelihood of success to obtain a preliminary injunction:

> The proper test for determining whether preliminary relief should be granted in a Government-initiated antitrust suit *is whether the Government has shown a reasonable likelihood of success on the merits and whether the balance of equities tips in its favor* . . . once the Government demonstrates a reasonable probability that § 7 has been violated, irreparable harm to the public should be presumed. To warrant that presumption, the Government must do far more than merely raise sufficiently serious questions with respect to the merits to make them a fair ground for litigation.[83]

In some circumstances, the DOJ does not need to meet this standard. If the DOJ wants to use a lesser likelihood-of-success standard, however, it must – like private litigants – *prove* that the equities are strongly in its favor.[84]

Once the FTC acquired the right through section 13(b) of the FTC Act to seek an injunction against mergers, it was initially held to a quite similar standard. Under section 13(b), the FTC is entitled to a preliminary injunction "[u]pon a showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest."[85] As one court commented: "The case law Congress codified [in section 13(b) of the FTC Act] . . . permits the judge to presume from a

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[83] *U.S. v. Siemens Corp.*, 621 F.2d 499, 506 (2d Cir. 1980) (emphasis added).

[84] *See, e.g., United States v. Gillette*, 828 F. Supp. 78, 96 (D.D.C. 1993) ("given the strength of plaintiff's irreparable injury argument, plaintiff need only make a lesser showing on likelihood of success" but "[a]s plaintiff has failed to demonstrate any likelihood of success, the court may not enter a preliminary injunction on this balance"); *United States v. UPM-Kymmene, Oyj*, No. 03-2528, 2003 WL 21781902 (N.D. Ill. July 25, 2003) (describing a sliding scale analysis that balances the harm to the parties against the Government's likelihood of success).

[85] 15 U.S.C. § 53(b).

likelihood of success showing that the public interest will be served by interim relief."[86]

Like the DOJ, a lesser showing on likelihood of success was held to be appropriate only with a "requisite showing on the equities".[87]

> [I]f [the FTC] shows that the newly-minted "equities" weigh in its favor, a preliminary injunction should issue if the FTC has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.[88]

Recent court decisions, however, have reduced the FTC's burdens. Under *Whole Foods*, the FTC can now use the "serious question" standard *without* making an equitable showing in its favor. It can enjoin a merger simply by demonstrating that there are "questions going to the merits so serious, substantial, difficult, and doubtful as to make them fair grounds for thorough investigation."[89] According to Judge Brown, this means that the FTC is entitled to a preliminary injunction unless it "entirely failed to show a likelihood of success." This conclusion departs from the statutory standard and its legislative history, which requires the FTC, in the first instance, to show likelihood of success. Further, the equitable burden has somehow shifted to the merging parties, who now must demonstrate a "balance [of equities] against the FTC" in order to hold the FTC

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[86] *FTC v. Weyerhauser Co.*, 665 F.2d 1072, 1082 (D.C. Cir. 1981) (*quoting* H.R. Rep. No. 624, at 31 (1973), *reprinted in* U.S.C.C.A.N. at 2533).

[87] *FTC v. Beatrice Foods Co.*, 587 F.2d 1225, 1229 (D.C. Cir. 1978) (*citing FTC v. Lancaster Colony Corp.*, 434 F. Supp. 1088 (S.D.N.Y. 1977)).

[88] *FTC v. Lancaster Colony Corp.*, 434 F. Supp. 1088 (S.D.N.Y. 1977) (*citing Hamilton Watch Co. v. Benrus Watch Co.*, 206 F.2d 738, 740 (2d Cir. 1953)).

[89] *See FTC v. Whole Foods Mkt., Inc.*, 548 F.3d 1028 (D.C. Cir. 2008); followed shortly thereafter by *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26 (D.D.C. 2009).

to a "greater likelihood of success."[90]

These changes had a notable and predictable impact on the outcome in *FTC v. CCC Holdings Inc.* After finding that both the government and defendants had adduced evidence in their respective favors—a "tie" so to speak—the Court still granted the preliminary injunction, commenting that:

> Whether the Defendants' argument that the unique combination of factors in these markets negates the probability that the merger may tend to lessen competition substantially, or whether the FTC is correct that the market dynamics confirm the presumptions that follow its *prima facie* case, is ultimately not for the Court to decide. … The Defendants' arguments may ultimately win the day when a more robust collection of economic data is lain before the FTC. On this preliminary record, however, the Court must conclude that the FTC has raised questions that are so 'serious, substantial, difficult and doubtful' that they are 'fair ground for thorough investigation, study, deliberation and determination by the FTC."[91]

This lower standard is much more like that imposed for summary judgment – whether there are issues of fact that require a trial – than the standard for a preliminary injunction.[92] The court further found that the defendants had not met their equitable burden—even though it accepted that the evidence supported the combined company's ability to offer an integrated product that incorporated the best features of each company's portfolio, that the merging parties envisioned spending more on research and development than they could spend individually, and that the consumers would benefit

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[90] *Whole Foods*, 548 F.3d at 1035, 1041.

[91] *CCC Holdings*, 605 F. Supp. 2d at 67-68. O'Melveny & Myers, of which I am Of Counsel, represented one of the merging parties.

[92] *Id.* at 36, n. 11 ("precedents irrefutably teach that in this context 'likelihood of success on the merits' has a less substantial meaning than in other preliminary injunction cases").

from more innovative products.[93]

With these rulings, the DOJ and FTC no longer operate under the same, or even similar, standards. The DOJ must still prove that it is likely to succeed in blocking a merger to obtain a preliminary injunction. Alternatively, if the DOJ shows that the equities are in its favor, above and beyond the normal public interest presumption, it may obtain a preliminary injunction by showing that it has raised a "serious question" meriting further investigation. In contrast, the FTC can now invoke *Whole Foods* and *CCC Holdings* to access the "serious question" standard *without* making a concomitant equitable showing. Indeed, to avoid a preliminary injunction the merging parties in an FTC case (but not a DOJ one) must demonstrate that the equities are decidedly in their favor.

Thus, merging companies under FTC review have a more onerous burden than those before the DOJ in preliminary injunction proceedings: they must show that there is no serious question on the merits or, if there is a serious question, that the preliminary injunction would irreparably harm the public. Because there is no policy justification for imposing a higher standard of proof on some industries and not on others, and because this result is fundamentally unfair, this difference in standards should be rectified. Congress should restore its original intent and return the FTC standard to that of the DOJ.[94]

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[93] *Id.* at 76.

[94] This Committee may also wish to consider the recommendations of the Antitrust Modernization Commission in 2007, which address the issue discussed above, as well as the FTC's ability to challenge mergers administratively while the DOJ can proceed only in federal court. *See Antitrust Modernization Commission – Report and Recommendations* 129-132 (2007).

7. Creation of a Separate Third-Party Liability Section In The FTC Act is Both Unwise And Unnecessary

The step is unwise because it creates a uniform standard where uniformity is inappropriate. For example, consider advertising agencies, which the Commission has long held liable for deceptive and unsubstantiated claims if they "knew or should have known" that the claim was deceptive or unsubstantiated.[95] The rationale for liability is that the ad agency has considerable expertise in how consumers are likely to interpret the communication, and can easily check with the client to determine whether there is a reasonable basis for the claim. Agencies are not, however, held responsible for evaluating all of the scientific details that may stand behind the claim. If the substantiation on its face supports the claim, the agency can rely on the client for the details, but it is responsible if there are obvious flaws in the substantiation.

Publishers are every bit as essential to the completed deceptive advertisement as the advertising agency. If they are liable at all, given the First Amendment concerns that such an action would raise, it should be under a different and much more stringent standard than the standard for ad agency liability. The publisher has no particular expertise in determining the messages the advertisement is likely to convey to consumers, and it has no expertise in evaluating the substantiating evidence.

This conclusion does not mean that publishers cannot play a role in policing fraud. During my tenure as Chairman, we launched a program to address deceptive weight loss claims that were widespread in the popular press. After a workshop to explore the scientific issues, we developed a list of seven weight loss claims that were

false on their face. These claims, identified and explained in a pamphlet distributed to publishers called Red Flag Bogus Weight Loss Claims,[96] formed the basis for a campaign to get publishers to reject advertisements containing bogus claims.[97] The campaign reduced the incidence of obviously false claims from 50 percent of weight loss ads in 2001 to 15 percent in 2004.[98]

A new section establishing third-party liability is unnecessary because the FTC already has the ability to attack third parties in appropriate circumstances. Careful use of the Commission's "unfairness" jurisdiction, which Congress codified in 1994,[99] provides the best vehicle to address third parties. If a third party can prevent a violation that injures consumers at low net cost, it is straightforward to argue that the failure to do so is an unfair practice. Unfair practices derive from substantial injury to consumers, that consumers cannot reasonably avoid, the third party can prevent the violation at low cost, and the injury is not outweighed by countervailing benefits. The extent to which the third party knows of the violation will of course be relevant in determining the costs of avoiding injury, but it is not necessarily the only factor. The unfairness analysis focuses the inquiry on the benefits and costs of liability for a particular practice, which is precisely where the focus should be.

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[95] *See e.g.*, FTC Consent Order, *Bozell Worldwide, Inc.*, (Jan. 13, 1999); FTC Consent Order, *Jordan, McGrath, Case & Taylor*, No. 96-3053 (June 26, 1996).

[96] *Available at* http://www.ftc.gov/bcp/edu/pubs/business/adv/bus60.pdf.

[97] Timothy J. Muris, Chairman, F.T.C., *Remarks at the Cable Television Advertising Bureau: Do the Right Thing* (Feb. 11, 2003).

[98] 2004 Weight-Loss Advertising Survey: A Report From the Staff of the Federal Trade Commission (April 2005), *available at* http://www.ftc.gov/os/2005/04/050411weightlosssurvey04.pdf.

[99] 15 U.S.C. § 45(n).

In a recently proposed rule aimed at fraud in certain mortgage practices, the FTC would impose third-party liability, using its existing authority.[100] As in this proceeding, the standards for third-party liability should be developed under current law.

CONCLUSION

Once again, thank you for the opportunity to testify today. I would be glad to answer any questions.

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[100] Mortgage Assistance Relief Services, 74 Fed. Reg. 26,130 (June 1, 2009).