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"Section 5 and 'Unfair Methods of Competition': Protecting Competition or Increasing Uncertainty?"

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The views expressed are personal and do not represent those of the Attorney General of New York or the Federal Trade Commission.

Introduction

Chairman Lee, Ranking Member Klobuchar, and members of the Subcommittee, thank you for inviting me to testify today. As I understand it, the question presented is whether the Federal Trade Commission's Section 5 enforcement is protecting competition, and if it does, whether it nonetheless creates too much uncertainty in the process. Based on a review of the last three decades of the Commission's Section 5 enforcement activity, I think Section 5 has grown to provide an important protection for competition distinct from that provided by the Sherman and Clayton Acts. I also think it does so without introducing a level of uncertainty that is exceptional for antitrust law or the American legal system in general.

If it was once wide-ranging, Section 5 practice has narrowed immensely over the last three decades, arguably making the law among the most limited in antitrust. Since the late 1980s, Section 5 has come to center on a certain kind of case, the so-called anticompetitive "scheme" featuring extraordinary and nefarious conduct -- like gaming a standards process, rigging industry tests, that sort of thing. Deception, fraud, bad-faith and oppressive action are typical. This kind of self-restraint has, to its credit, yielded a focus on cases where the conduct is extraordinary, an anticompetitive intent is obvious and the harm is substantial. At this point, the self-imposed limits on Section 5 enforcement are extensive enough that a critic could fairly accuse the agency of under-enforcing the law and deviating too far from Congress's original intent. There have, after all, only been a small handful of Section 5 complaints issued over the last decade. Hence, the notion that there is any kind of crisis of Section 5 over-enforcement is exaggerated at best.

Just as there are few cornerbacks who praise the NFL's pass interference rules, there will surely always be critics, especially those subject to the law's scrutiny, who would prefer that Section 5 be enforced less, or perhaps not at all. Others will fret and say that they can never be *completely* certain as to what Section 5 covers. Yet how "certain" is it, exactly, what antitrust laws like Section 2 of the Sherman Act make illegal? Section 2, after all, penalizes what might seem like ordinary business activities -- refusing to deal, tying two products, or signing an exclusivity contract. In contrast, firms subject to Section 5 scrutiny are those practicing deception, fraud, manipulation of process, or similar conduct and are surely on notice that they are are placing themselves at legal risk -- not merely of FTC action, but also of potential prosecution by a State Attorney General, or the local United States Attorney.

Finally, there are those who accept the importance of the antitrust law in a market economy, but nonetheless would argue that the Sherman Act is an adequate and inherently superior instrument for addressing any arising threat to competition or consumer welfare. I have enormous respect for the jurisprudence of the Sherman Act, and would agree that it can, with good lawyering and economic skill, deal with a broad range of challenges to competition. However, I do not think it wise to stretch the Sherman Act to reach cases better reached by Section 5. In particular, Section 2, the clearest substitute for Section 5, can sometimes be something of a blunt, destructive instrument, originally intended, as it was, for the busting of industry-wide trusts like Standard Oil or the American Tobacco Company. It also, unlike Section 5, can yield follow-on treble damage litigation by the private bar. There is reason, therefore, to view Section 5 as a faster, lighter-touch and better suited alternative to some of the most obviously opportunistic anticompetitive methods of business that arise in the contemporary economy.

Original Intent versus Current Practice

In Section 5 of the FTC Act, few can deny that Congress provided a very open-ended enforcement mandate, even by the standard of the antitrust laws. The statute declares "unlawful" all "unfair methods of competition"; the legislative history, moreover, suggests an intent to "leave it to the commission to determine what practices were unfair." S. Rep. No. 63-597, at 13 (1914); *see also* H.R. Rep. No. 63-1142, at 19 (1914) (Conf. Rep.). The law was seemingly meant, as the Supreme Court once explained, "to hit at every trade practice . . . which restrained competition or might lead to such restraint if not stopped . . . ." Fed. Trade Comm'n v. Cement Inst., 333 U.S. 683, 693 (1948). Earlier Commissions, following Congress's direction, sometimes adopted this very broad mandate. As the Commission itself said in 1919, "upon the creation of the Commission it was empowered to leave the shores defined by the common law and, taking the knowledge of those decisions with it, to embark on an uncharted sea, using common sense plus the common law for its compass." 1919 Fed. Trade Comm'n Ann. Rep. 45.

This hearing, however, is not an examination of the enforcement policies of the 1919 Commission. Over the last few decades -- beginning in the late 1980s -- reacting both to a changing zeitgeist and feedback from the Courts of Appeals, the Commission has taken a far more restrained and limited approach. Indeed, at this point a critic might easily charge the Commission of erring on the side of excessive caution, given what appears to be its deviation from the original, far more aggressive intent of Congress. However, there are advantages to judicial or prosecutorial self-restraint, and a main advantage of the FTC's approach is that, over the last three decades, it has created a more concrete and defined scope for Section 5 investigation and enforcement. It is one that involves far less of the broad policing of business methods that Congress intended, but instead a Section 5 practice sharply limited to cases where the conduct is very problematic and the harm to the competitive process is very clear. That process has culminated in the issuance of last year's Policy Statement, which can be taken as a codification of the practice of the last several decades. *See* Fed. Trade Comm'n, Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act (2015).

What does the practice consist of? When you look carefully at the complaints and investigations considered or brought under Section 5, coupled with the Commission's recent Policy Statement, several patterns emerge.

First, in recent decades, Section 5 has really become focused on extraordinary or nefarious conduct -- arguably more so than any other antitrust statute. Section 5 might be called a "scheme-busting" statute -- it seems to come to mind most often when faced with what might best be described as an unscrupulous scheme with anticompetitive aims and consequences. Stated in legal terms, the Commission's investigations under Section 5 tend to be sparked by conduct that is deceptive, coercive, or somehow otherwise oppressive. Second, in conjunction with the first limit, the Commission has limited itself to cases where it seems easy to provide evidence of substantial harm to competition and consumers. Combined, these two limits have sharply narrowed the range of possible cases that, in practice, the Commission will even begin to think about investigating under Section 5.

Second, the Commission has become much more aware of the counterintuitive utility of Section 5's milder remedies, as compared with the Sherman Act. Section 5 does not provide for damages; but more importantly, as a practical matter, it does not create a rule of law for private plaintiffs. 15 U.S.C. § 16(a). As Republican Commissioner Tom Rosch pointed out, "only the Commission has the power to enforce Section 5." Concurring and Dissenting Statement of Commissioner J. Thomas Rosch, In the Matter of Intel Corporation, Docket No. 9341, at 4 (Dec. 16, 2009). Hence, the Commission has felt it can use the law in cases where it is concerned that follow-on litigation might be too destructive. Section 5's more limited remedies can sometimes be used to discourage what amount to antitrust misdemeanors, as opposed to the traditional heavier remedies implied by the Sherman Act, such as wholescale industry breakups.

This focus on conduct and harm have by now yielded a fairly distinctive and defined corpus of Section 5 investigation and enforcement -- that is to say, situations in which the agency will begin thinking about employing Section 5 at all. Consider two categories. The first includes those forms of harmful anticompetitive conduct that violate the spirit of the Sherman Act, but do not fit neatly, if at all, into the Sherman Act's legal paradigm. Typically, what lies in this category are cases of particularly nefarious or anticompetitive conduct accompanied with enough market power to make a difference, yet where the case is a particularly poor fit for Sherman Act enforcement. This isn't to say that one could not try and squeeze such a case into a Sherman Act action, but it would be a stretch.

This situation is typified by, for example, the Commission's well-established actions taken against "invitations to collude" on prices, wherein, say, Waste Hauling Company A sends a text to Company B with an offer to set the prices per ton of trash. Under Section 1 of the Sherman Act, such a case may be hard to prosecute, for want of an agreement -- there was no perfected conspiracy, or meeting of the minds, and so Section 5 serves as a backstop. Another kind of case in this category is where the offending firm is dominant, but is not technically a monopolist, and therefore not easily subject to Section 2 enforcement. The *AMERCO* case, 109 F.T.C. 135 (1987), if not particularly well-known, is a good example of this practice. A company named Jatran, a competitor to the moving company U-Haul, had entered bankruptcy proceedings. To keep it stuck there, U-Haul filed multiple frivolous claims in the proceedings, so as to delay or prevent the reemergence of its competitor. U-Haul was not a monopolist, nor did it realistically have a chance of making itself one with its actions, making a Section 2 case challenging. Nonetheless, U-Haul clearly had enough market power to do significant competitive harm, which seemed to justify the Commission's Section 5 action.

Another example of a Section 5-inspired investigation transpired during the Google investigation. The FTC became concerned when it noticed that Google was stripping reviews from sites like TripAdvisor and Yelp -- that is, millions of short reviews of hotels, restaurants and other establishments. Google was then using those reviews to create Google's own clones of those sites, which were favored in Google's searches. It even made it appear that the reviews were collected by Google, not Yelp or TripAdvisor. While Google may have had monopoly power in some markets, making Sherman Act action plausible, the conduct was particularly unscrupulous, leading the agency to begin thinking about Section 5 action. Under pressure, Google abandoned the practice.

The second major category of FTC Section 5 practice consists of cases where the FTC has taken action to police abuse of the institutions meant to facilitate the competitive process. That is, the FTC targets firms who subvert or manipulate essential processes, like standard setting, the patent system, industry benchmarking or others. What is notable in these cases is the patent lack of "pro-competitive" efficiencies. What one sees, instead, is conduct intended to game a system that is meant to aid competition.

Of these efforts, some of the best known are the FTC's policing of the standard-setting process. Many of the FTC's Section 5 enforcement efforts over the last two decades have been in this category. The facts of the Dell "VL-bus" case, Dell Computer Corp., 121 F.T.C. 616 (1996), provide the classicexample of an anticompetitive scheme in the standard-setting process.

In the early 1990s, Dell, a company of rising power and influence in the computer industry, decided to join an organization that was working on a new standard for computing hardware meant to deal with the challenge of graphical data. Dell, as a participant, helped steer the process toward what became known as the "VL-bus" standard, while certifying that the "proposal does not infringe on any trademarks, copyrights, or patents" that Dell possessed. Dell, 121 F.T.C. at 617. Unbeknownst to anyone in the group, however, Dell had quietly obtained a patent covering the proposed standard. Once millions of computers were using it, Dell suddenly announced that it possessed the exclusive rights over the technology.

Dell's standard manipulation scheme conduct forms a core example of contemporary Section 5 practice. The conduct was unscrupulous; it targeted a process important to competition and innovation (standard setting) and yet probably would have either fallen between the cracks of the Sherman Act and Clayton Act, or required stretching the law to reach it. Moreover, the remedy in the case was both forward-looking and did not create problems of excessive private follow-on litigation. The Dell case has served as a model for other cases, like the N-Data investigation, which involved not deception, but a scheme involving opportunistic breach of a licensing arrangement made during the standards process, with both similar consequences for the standards process and a similar policing rationale.

It is cases of this nature that, I think, make it clear why Section 5 is important for the protection of competition. Indeed, the kind of schemes that Section 5 targets are the kind that most of the public would assume are illegal, for the damage to the competitive process is not hard to see. That said, it is certainly possible similar claims can be brought under Section 2 (and indeed, other standard-setting cases, *Unocal* and *Rambus*, have been brought under that heading). But I think it is worth questioning the fit between the subtle business of policing standard setting and the comparative heaviness of Section 2. That law was originally designed and used for decades to police massive, industry-spanning monopolies or trusts like Standard Oil, the Tobacco trust, or Microsoft. Section 2's traditional remedy was the breakup of the firm, and nowadays the successful suit invariably leaves the losing defendant with private treble-damage claims from the private bar. The lighter-touch approach implied by Section 5 has been, and will be, often a better tool.

Too Much Uncertainty?

The question raised by this panel is not merely whether Section 5 is useful for targeting uncompetitive conduct. It is also whether, in the course of doing so, it creates an unacceptable level of uncertainty for those subject to its jurisdiction. I think the answer is no. The Commission's narrowed focus on extraordinary conduct and competitive harm has tended to capture conduct that any reasonable counsel could see as legally risky. The limit to extraordinary and nefarious conduct has made Section 5 arguably narrower than other parts of the antitrust law, which sometimes punishes conduct understood, in other contexts, as ordinary business practice.

Section 5's *de facto* conduct requirement is what, in my view, puts potential defendants on notice. A company engaged in nakedly oppressive, deceptive or fraudulent conduct is always courting legal risk, and not just from the Federal Trade Commission. It is putting itself in danger of potential enforcement actions undertaken by the Justice Department, a State Attorney General, private lawsuits or even district attorneys and United States Attorneys. Fraud, abuse of process and deception -- a centerpiece of the Commission's actions -- were not invented by the FTC and no firm practicing such methods of business can consider itself safe from the law. More precisely, when engaged in conduct amounting to a common law business tort, it is hard for the defendant to claim that he lacked notice that such conduct might yield liability. The point was well stated by former Chairman Jon Leibowitz, when he said that "firms are almost always aware of, and intend, the anticompetitive implications of the types of conduct that would be sufficient for a Section 5 violation." Concurring Opinion of Commissioner Jon Leibowitz, In the Matter of Rambus, Inc., Docket No. 9302, at 15 (Aug. 2, 2006).

Second, there is an important baseline question: just what is Section 5 more unpredictable than? Section 5 will never achieve the clarity, say, of an airline regulation specifying the language of the "No Smoking" sign to be placed in the lavatory.[1] Nonetheless, its prudential safeguards have yielded, at minimum, a mandate that is clearly more limited than the other major antitrust statutes, most clearly Section 2 of the Sherman Act. Unless we are to condemn Section 2 as well -- which I understand some might prefer -- there is little basis

[1] "No person may operate an airplane unless there is installed in each lavatory a sign or placard that reads: 'Federal law provides for a penalty of up to $2,000 for tampering with the smoke detector installed in this lavatory.'" 14 C.F.R. § 121.317.

for condemning Section 5 as too unpredictable.

Indeed, Section 2 of the Sherman Act in many cases requires far less of defendants than Section 5. It punishes "monopolization," defined by the Supreme Court as "willful acquisition or maintenance" of monopoly power. United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966). But of course what constitutes monopoly power, if not quite residing in the eye of the beholder, does usually depends on the imperfect process of market definition. And the conduct potentially condemned by Section 2 is far broader than Section 5, at least if the last several decades are any indication. Unlike a Section 5 enforcement action, much that is ordinary conduct in other circumstances can get a monopolist in trouble. Refusals to deal are common in business, but can sometimes be risky for the monopolist. An exclusive agreement might be condemned, even though exclusive contracts are a very common business practice. The bottom line is that because Section 2 condemns both normal as well as extraordinary business conduct, it arguably yields greater uncertainty than Section 5 of the FTC Act.

Future Needs for Section Five Enforcement

Over the next decade, intelligent and targeted enforcement of Section 5 is likely to be of continuing importance. For one thing, the ability to target anticompetitive conduct without follow-on consequences of a Sherman Act action can be very important. For another, perhaps because of changes in the structure of the economy, there seem to be more examples of opportunistic anticompetitive conduct with clear harm for the economy and consumers that the Sherman Act does not appear well suited to handle.

Consider a few concrete examples. While the FTC has broadly tasked itself with policing the standards process, its efforts to do so using the Sherman Act have sometimes shown the inadequacy of that law for this complex area. In the well-known *Rambus* case, as in the *Unocal* and *Dell* cases, the FTC faced a defendant who deceived a standards organization and then asserted patents over a standard it helped create. In *Rambus* the Commission decided to try and police the standard-setting process by relying on Section 2 of the Sherman Act, but then lost the case in the D.C. Circuit based on the Court's inability to find enough of a link between the deception and the acquisition of monopoly power. Whether the Court's Section 2 holding was correct might be debated; but it seems, in retrospect, that the case was better fit for Section 5 enforcement.

A second example concerns opportunistic practices in the pharmaceutical drug industry. The Commission and other law enforcement offices, like the New York State Attorney General, have had some success using the Sherman Act to fight various forms of opportunistic conduct, like reverse payments schemes and product-hopping. Nonetheless there may be other anticompetitive methods of protecting drugs from competition that might be a better fit for Section 5 enforcement. For example, consider the range of drug firms, of which Turing Pharmaceuticals is perhaps the most publicly well-known, that have relied on the manipulation of drug distribution schemes to make possible outrageous price-hikes. Turing's case is typical of a growing practice: it bought the rights to a medicine named Daraprim relied upon by HIV-positive patients, and jacked up the price 5,000 percent, from $13.50 to $750 a pill, and relied, on part, on distribution limits to sustain the increase. Other firms have taken advantage of a legitimate FDA program named "risk evaluation and mitigation strategies"

(REMS) to insulate their drugs from effective competition, once again by controlling the distribution of the drug.

No one thinks such manipulations or price hikes serves either the public interest or the competitive process. Yet combatting such conduct using the Sherman Act or Clayton Act poses some challenges – the laws were not meant for this kind of thing. The area, therefore, is a good example where Section 5 may not just be a helpful tool, but a necessary tool for fighting the manipulation of REMS or other drug distribution systems. The harm to competition is evident, and it hurts both consumers and taxpayers, and the conduct is difficult to defend on the merits, making it ripe for FTC investigation.

The bottom line is that unscrupulous anticompetitive schemes are not likely to go away soon, and are not straightforwardly the concern of the Sherman Act. That is why I think the public and the economy will continue to be benefited by enforcers who have Section 5 powers and who are thinking about how they may combat clear dangers to the competitive process.