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EDITOR'S NOTE:

Section 5, 1914, and the FTC at 100

BY JAMES J. O'CONNELL

THIS YEAR MARKS SOME VERY important centennials. The First World War began during the summer of 1914, of course, which is why so much of history can be arranged in terms of what came before 1914 and what came after.

But there were positive beginnings in 1914, too. The year saw the laying of the first stone of the Lincoln Memorial in Washington, DC, the establishment of Mothers' Day by the U.S. Congress, the first successful blood transfusion, and patent grants for W.H. Carrier's air conditioner and Robert Goddard's multi-stage and liquid-fuel rockets. George Bernard Shaw's *Pygmalion*, Charlie Chaplin's iconic Tramp character, and the Tarzan books by Edgar Rice Burroughs all had their debut in 1914. Merrill Lynch, Paramount Pictures, and the Panama Canal all opened for business.

The FTC at 100 and the Need for Section 5 Guidance

It was a significant year for the antitrust world, too. On September 26, 1914, the Federal Trade Commission was formed when President Woodrow Wilson signed the FTC Act into law. Twenty-four years later, the FTC moved into its Art Deco headquarters—the cornerstone of which was laid by President Franklin Roosevelt in 1937, using the same silver trowel that President George Washington used to lay the cornerstone of the U.S. Capitol in 1793. (See our cover photo.) With a pedigree like that, it should come as no surprise that today, a century after its founding, the FTC is one of the world's foremost competition and consumer protection law enforcement bodies. In this issue of ANTITRUST we mark this special centenary with a group of articles that look at various aspects of the FTC and its mission—past, present, and future.

Among those articles is the transcript of a fascinating roundtable discussion that ANTITRUST held in early October with Bureau of Competition Director Debbie Feinstein, former FTC Chairs Bill Kovacic and Debbie Majoras, and Mark Whitener, currently Senior Counsel for Competition Law & Policy for General Electric but once upon a time the Deputy Director of the Bureau of Competition. Our panelists covered a lot of ground during their discussion. I won't steal their thunder here, except to note that, in my view, one topic in particular warrants special attention as readers of this magazine contemplate what the next century has in store for the FTC.

During the course of the roundtable, our panelists discussed in some detail the FTC's authority to prohibit conduct that is not anticompetitive under the Sherman or Clayton Acts but which it determines is nevertheless an "unfair method of competition" under Section 5 of the FTC Act. The metes and bounds of what is commonly referred to as the FTC's "stand-alone" Section 5 authority are nearly as controversial as the Commission's reluctance to explain where those metes and bounds are. Having spent some years serving in the Antitrust Division of the Department of Justice, I understand that reluctance. Despite the occasional willingness of the U.S. agencies to recognize safe harbors and to issue reports expressing enforcement intentions with respect to certain types of conduct, enforcers don't often acknowledge publicly that their authority has limits, let alone articulate those limits themselves.

But while I may understand the rationale behind the reluctance, I don't agree with it. The primary mission of enforcement agencies like the FTC and the DOJ is to enforce the law, of course, but very closely related to that mandate is their responsibility to articulate what they think the law *is*—what it means, how it is to be enforced, and why. Reasonable people can disagree with the lines that an agency draws—something with which, as part of the team that drafted the Antitrust Division's erstwhile Section 2 Report, I have more than a little experience. But such statements, difficult and resource-consuming though they may be to prepare and controversial though they may be when released, are of critical importance. Companies need to be able to conduct their affairs in a manner that keeps them on the right side of the line between lawful and unlawful conduct. If that line is insufficiently clear to the enforcers, or if the enforcers would rather not draw lines at all for fear that acknowledging such limits could "tie their hands," how can those lines possibly be clear to companies and their counsel?

In response to calls for greater clarity and explanations of Section 5's limits, some express a preference for a "common law" evolution of an enforcement policy through the cases that the FTC chooses to bring over time. Neil Averitt articulated the potential problems with that approach last year in *The Antitrust Source*,[1] to which I would like to add a few points for consideration.

First, the use of the term "common law" is somewhat inaccurate in this context. While decisions issued by administrative bodies like the FTC form part of our common law, the FTC is developing the contours of its stand-alone "unfair methods of competition" authority not through decisions

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that follow from the presentation of facts and evidence in an adversarial process but rather through consent decrees. That parties under threat of stand-alone Section 5 enforcement might prefer to settle their disputes rather than litigate them is not, strictly speaking, the FTC's fault. But it does raise the question of whether the boundaries of the FTC's Section 5 authority will be properly drawn if they are done so only through some combination of the FTC's own restraint and the terms that settling parties are willing to accept in specific cases, spread across many years.

Second, the FTC does not operate in a vacuum but rather as part of an international enforcement community, the newer members of which study very closely the practices and policies of more experienced agencies. The FTC, the DOJ, and for that matter the private bar have spent a great deal of time and resources over the years working to help these newer agencies learn from U.S. experience. Among other things, the U.S. has encouraged other jurisdictions to avoid vague or subjective tests, to ensure that their enforcement decisions are supported by rigorous economic analyses of challenged conduct's competitive effects, and to clearly distinguish acceptable from anticompetitive conduct so that businesses know what is expected of them. Yet, despite the significant progress that has been made over the past 15–20 years to encourage consensus around these and other generally accepted enforcement principles, there are still challenges.

The Anti-monopoly Law of China, for example, prohibits the charging of prices that are "unfairly high" by firms that are deemed to be "dominant," and the extent to which China's enforcement agencies conduct economic analyses of actual or likely competitive effects before determining whether conduct violates the AML remains unclear. The FTC has been a strong and determined advocate for transparent, effects-based, consumer welfare-enhancing competition law enforcement for years, in China and elsewhere. But it risks undermining that critically important international mission through pursuit of a policy of stand-alone Section 5 enforcement against "unfair methods of competition" that is untethered from modern Sherman Act enforcement and unaccompanied by agency guidance or limiting principles. Put simply, how can we credibly advise the Chinese and others about the problems that can follow from a competition law enforcement system that includes subjective concepts like "unfairly high prices" when our own system includes a prohibition against "unfair methods of competition" that the FTC is reluctant to define, other than through the cases that it chooses to bring?

And while it's true that the FTC has used its stand-alone Section 5 authority very sparingly—a fact which itself calls into question how necessary it really is to preserve that authority unfettered—in the absence of clear limiting principles the FTC runs the risk of its enforcement being seen by newer agencies as following a kind of "We know it when we see it" approach, one which translates into other languages and cultures all too easily as a kind of implicit endorsement of arbitrary exercises of agency power.

It is at this stage of the conversation that those who disagree that Section 5 guidance is necessary often say something like, "In all my years of practice I've never heard of a company not doing something because they were concerned that the FTC would bring a stand-alone Section 5 case against them." FTC Commissioner Julie Brill said something very similar in an interview last year, saying

> she was doubtful of the premises on which arguments for the necessity of a [FTC guidance] rested, particularly [Commissioner Josh] Wright's claim that its absence was a drag on business innovation. "I've been a commissioner for over three years [and] I have never heard a business executive come in and talk to me about the problems they're having in their business because we don't have a section 5 statement. Never once," she said. "If we're going to be evidence based, I'd like to see the evidence that our lack of a statement has caused any kind of a problem in the economy. I am skeptical that's true based on my own subjective observations."[2]

But the question is not only whether the FTC's reluctance to offer clarity and certainty regarding Section 5 is preventing companies from engaging in certain types of conduct or "caus[ing] any kind of problem in the economy." It is also whether it is reasonable for the U.S. government, 100 years on, to expect companies to operate under an undefined cloud of regulatory risk that they will be the next N-Data, Intel, or Bosch.[3] In my view it is not, at least not unless we are going to tear the definition of "test case" out of the Standard Lexicon of Antitrust Counselors or start advising clients that everyone gets one free pass.

When it comes to conduct that is not clearly harmful or anticompetitive—and if we are talking about something that the FTC may someday decide to prohibit despite its not being unlawful under the Sherman Act, we are quite squarely within the grayest of gray areas[4]—surprise is simply not a legitimate enforcement tool. But when businesses are not given fair notice regarding the standards of conduct they should be following, when instead they and their counsel must peer into the minds of the commissioners to divine what any three of them might determine is an unfair method of competition, all with little or no—or, at best, an unclear––relation to the standards that have been developed over time for evaluating anticompetitive conduct under the Sherman Act, surprise—becoming the next test case—is what they risk. Some may call that flexibility, or even a feature rather than a bug. To borrow a metaphor used by Bill Kovacic during our roundtable, I call it failing the course.

Finally, I can't help but detect within the call for a "common law" development of stand-alone Section 5 authority the implication that enforcement policies must be given time to develop. But after a full century, how much more time is needed?

Section 5's prohibition of unfair methods of competition was born at the height of the Progressive Era, championed by a president who, as a candidate, needed to distinguish his views from those of his better-known opponents and who

was advised by a group of progressive thinkers for some of whom consumer welfare—today's competition law enforcement touchstone—was not exactly the priority. As Bill Kolasky has explained over several past issues of ANTITRUST in his terrific "Trustbusters" series, due in part to the Supreme Court's decision to break up Standard Oil in 1912, antitrust policy was one of the dominant issues in the 1912 presidential campaign.[5] William Howard Taft, the Republican incumbent whose administration had carried on its predecessor's prosecutions of Standard Oil and the American Tobacco Company and gone after the "sugar trust" and U.S. Steel, believed in prosecuting "bad" trusts as a law enforcement matter under the Sherman Act—a statute which, as Bill Kovacic noted in our panel discussion, was interpreted and applied more narrowly then than it is today. Progressive Party candidate Teddy Roosevelt, Taft's predecessor and former political godfather before their falling-out, had despite his "trust-buster" reputation come to view large corporations as efficient and indispensable to a continent-sized nation, and so favored government regulation of monopolies.[6]

Wilson, seeking to seize the "progressive" mantle from Roosevelt and needing to stake out his own position in order to distinguish himself from his better-known rivals—one the incumbent president and the other his still-popular predecessor—favored regulating competition rather than monopolies. "Trusts"—bad or otherwise—were a problem, Wilson argued, but "big business" was not. What was the difference?

> A trust is an arrangement to get rid of competition and a big business is a business that has survived competition by conquering in the field of intelligence and economy. I am for big business and I am against the trusts. Any man that can survive by his brains, any man that can put the others out of business by making the thing cheaper to the consumer at the same time that he is increasing its intrinsic value and quality, I take off my hat to and I say, "You are the man who can build up the United States and I wish there were more of you."
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> But the third party says that trusts have come and they are inevitable; that is the only way of efficiency. I would say parenthetically that they don't know what they are talking about because the trusts are not efficient. If I had time for another speech I could prove that to you. They have passed the point of efficiency. Their object is not efficiency, though when they sell you their stock they say it is. Their object is monopoly, is the control of the market, is the shutting out by means fair or foul of competition in order that they may control the product.[7]

To Wilson, then, big wasn't necessarily bad, especially if a company got big by being more efficient than its rivals. But his antitrust enforcement philosophy was otherwise rather short on details. For that, he relied on advisors like Louis D. Brandeis, who—before Wilson appointed him to the Supreme Court in 1916—devoted much of his considerable energies and talents to combating trusts. Unlike Wilson, though, Brandeis most definitely thought that "big was bad." In 1911, the then-progressive Republican had helped craft a

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Senate bill that, among other things, would have imposed on companies with 30 percent market shares the burden of proving the reasonableness of their conduct.[8] As Franklin Foer notes in a recent article in *The New Republic*, Brandeis was largely focused on protecting small producers and sellers, even if consumers had to pay higher prices as a result.[9]

In 1912, Brandeis urged Wilson and the Democratic Party to distinguish themselves from Roosevelt and his Progressives by insisting that the only acceptable monopolies were public ones and that outside that (limited, he hoped) context the correct policy was "to regulate competition" to prevent monopolies from forming, rather than to regulate their conduct after they'd been formed.[10] Wilson's advisors later also included George Rublee, a progressive Republican like his friend Brandeis who, unlike Brandeis, had supported Roosevelt in 1912 (and who would later help establish my firm). Rublee, who was instrumental in both the creation and passage of Section 5, argued that the Sherman Act alone was insufficient because, unlike his vision for an express (if undefined) prohibition of "unfair competition," it could do nothing to protect competitors before a monopoly had been achieved or was dangerously close to being achieved.[11]

Thus was born the FTC, and with it, the FTC's authority to prohibit unfair methods of competition. Although the subject of considerable debate, by design the statute in its

final form did not enumerate or describe specific types of conduct that were forbidden, a determination that was left instead to the newly established commission and, ultimately, the courts.[12] Over time, and not always smoothly or without significant course changes along the way, competition law enforcement would evolve in the U.S. into a kind of amalgam: Wilsonian policing of conduct through Taftian enforcement of the Sherman Act against dominant or very-near-dominant firms. Over that same period, economic efficiency and consumer welfare, rather than the protection of competitors from nascent monopolies, came to be accepted as the priorities. By contrast, Brandeis's Jeffersonian suspicion of large enterprises and his related desire to protect smaller competitors fell out of favor, although they still have their advocates.[13]

What did this evolution mean for Section 5's prohibition against "unfair methods of competition"? The question of whether conduct that was not unlawful under the Sherman Act could nevertheless be prohibited under Section 5 was answered in the affirmative several times by the Supreme Court.[14] But regardless of whether the FTC *could* use its Section 5 authority to prohibit unfair methods of competition that are not unlawful under the Sherman Act, the question of whether it *should* do so—whether it needed to do so—became easier to answer in the negative as, over time, the Sherman Act proved to be a stronger and more flexible enforcement tool than it may have been in 1914.[15] Thus, until a few years ago and with only a few exceptions the enforcement boundaries of Section 5 and those of other antitrust statutes like the Sherman and Clayton Acts were, as a practical matter, coterminous.

This understanding started to shift only during the last ten or so years, around the time that worries about the excesses of private litigation and concerns over error costs started to play a more prominent role in the antitrust decisions of the Supreme Court. One could therefore reasonably suggest that the push for "reinvigorated" stand-alone Section 5 enforcement may be at least in part a response by those who believe that the Sherman Act pendulum has swung too far towards an enforcement philosophy that trusts markets more than experts and that strives to minimize false positives rather than denying their existence. Indeed, I suspect that there are at least some in the antitrust community who may feel that they have lost the argument over the Sherman Act—those, for example, who recoil in horror at the dicta of Justice Scalia's *Trinko* opinion—and who may therefore see a "reinvigorated" Section 5 that is disconnected from contemporary Sherman Act jurisprudence as an opportunity for a kind of do-over, at least as far as federal enforcement is concerned (and, arguably, for private enforcement under the various state "baby FTC Acts"[16]). Against this backdrop, the FTC's reluctance to issue any sort of guidance or statement explaining where the boundaries to its stand-alone Section 5 authority may be drawn—or even an acknowledgement that there are or should be any boundaries—is particularly troubling.

Conclusion

I write this as the Kansas City Royals and the San Francisco Giants are preparing to face off against each other in the 2014 World Series. A century ago, 19 year-old "Babe" Ruth made his major league debut pitching a winning game for the Boston Red Sox around the same time that Chicago's Wrigley Field (then Weeghman Park) opened. In Pittsburgh—in a game that lasted even more innings than a more recent Giants game on which this Washington Nationals fan will not elaborate further—the then-New York Giants fought through 21 innings to defeat the Pirates, with Giants outfielder Red Murray catching the final out at Forbes Field moments before he was knocked unconscious by a bolt of lightning. The "Miracle" Boston Braves, in last place by 15 games on July 4, came roaring back to win the National League pennant by 10.5 games and went on to beat the Philadelphia Athletics in a first-ever World Series sweep. And in Martinez, California, Italian immigrant and fisherman Giuseppe DiMaggio and his wife Rosalia welcomed the birth of their son Giuseppe, whom the rest of the world would later know better as "Joe."

"America's pastime" is so rich with tradition that it can almost seem timeless and unchanging. But the rules of the game have actually changed a lot since 1914. For example, "doctored" balls or "freak deliveries," sometimes generically referred to as "spitballs," were phased out of the game starting in 1920, the same year in which runners were officially prohibited from running the bases in reverse order "for the purpose of confusing the fielders or making a travesty of the game." In reaction to the dominance of pitching over hitting, which was driving down scores (and boring fans), Major League Baseball decided in 1969 to shrink the size of the strike zone and lower the height of the pitcher's mound by five inches. And the less said about the designated hitter rule, which was adopted by the American League in 1973, the better.

The competition law enforcement game has changed since 1914, too. For a long time—albeit not consistently—the game was played according to the understanding that while Section 5's prohibition of unfair methods of competition may have been intended by Congress to exceed the reach of the Sherman Act, it generally did not do so in practice, and the need for it to do so had declined significantly since 1914. To the extent that the umpires of the FTC no longer share that view, they need to explain the rules of the game to the players on the field. ■

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[1] Neil W. Averitt, *The Elements of a Policy Statement on Section 5*, ANTITRUST SOURCE 3–4 (Oct. 2013), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/oct13_averitt_10_29f.authcheckdam.pdf.

[2] Pallavi Guniganti, *Brill Questions Need for and Feasibility of Section 5 Statement*, GLOBAL COMPETITION REV. (Aug. 21, 2013), http://globalcompetitionreview.com/news/article/34038/brill-questions-need-feasibility-section-5-statement/.

[3] *See* FTC Press Release, FTC Challenges Patent Holders Refusal to Meet Commitment to License Patents Covering "Ethernet" Standard Used in

Virtually All Personal Computers in U.S. (Jan. 23, 2008) (explaining the Commission's consent decree with *N-Data*), *available at* http://www.ftc.gov/news-events/press-releases/2008/01/ftc-challenges-patent-holders-refusal-meet-commitment-license; FTC Press Release, FTC Challenges Intel's Dominance of Worldwide Microprocessor Markets (Dec. 16, 2009), http://www.ftc.gov/news-events/press-releases/2009/12/ftc-challenges-intels-dominance-worldwide-microprocessor-markets; FTC Press Release, FTC Order Restores Competition in U.S. Market for Equipment Used to Recharge Vehicle Air Conditioning Systems (Nov. 26, 2012) (explaining the Commission's consent decree with Bosch), http://www.ftc.gov/news-events/press-releases/2012/11/ftc-order-restores-competition-us-market-equipment-used-recharge; see also Guniganti, supra note 2 (quoting FTC Commissioner Brill's observation that "[t]he FTC was meant to be 'an agency that wouldn't have penalty authority necessarily when using section 5, but would have the ability to kind of do the innovative stuff and be very forward thinking and stop practices that maybe couldn't be stopped in court.'").

[4] *See* Maureen Ohlhausen, Commissioner, Fed. Trade Comm'n, *Section 5 of the FTC Act: Principles of Navigation*, 1 J. ANTITRUST ENFORCEMENT, Vol. 2, at 3 (Oct. 2013) ("As a Commissioner, when asked to set out on the open waters of unfair methods of competition under Section 5 in a five-person boat, this author has repeatedly asked, 'Where is the chart?'"), *available at* http://www.ftc.gov/system/files/documents/public_statements/section-5-ftc-act-principles-navigation/131018section5.pdf.

[5] *See* William Kolasky, *The Election of 1912: A Pivotal Moment in Antitrust History,* ANTITRUST, Summer 2011, at 82.

[6] *See id.* at 84–85 (discussing Roosevelt's belief that "'if we are to compete with other nations in the markets of the world . . . we must utilize those forms of industrial organization that are indispensable to the highest industrial productivity and efficiency'" and his support for a "'national industrial commission' that could tell businesses in advance what they could legally do if they voluntarily came under its jurisdiction.").

[7] Woodrow Wilson, Campaign Address Delivered at the Interstate Fair, Sioux City, IA (Sept. 17, 1912).

[8] *See* Kolasky, *supra* note 5, at 85.

[9] *See* Franklin Foer, *Amazon Must Be Stopped: It's Too Big. It's Cannibalizing the Economy. It's Time for a Radical Plan*, NEW REPUBLIC (Oct. 9, 2014), *available at* http://www.newrepublic.com/article/119769/amazons-monopoly-must-be-broken-radical-plan-tech-giant (noting that Brandeis believed that manufacturers "should legally control the retail value of their wares, rather than hand the power of pricing over to large chains and department stores, whose size gave them the unstoppable advantage of offering deep discounts. If this campaign forced consumers to pay slightly higher prices, Brandeis didn't mind one bit.").

[10] *See* Kolasky, *supra* note 5, at 86.

[11] *See* William Kolasky, *George Rublee and the Origins of the Federal Trade Commission*, ANTITRUST, Fall 2011, at 109.

[12] *See* Averitt, *supra* note 1, at 5.

[13] *See* Foer, *supra* note 9.

[14] *See* Averitt, *supra* note 1, at 6 (citing FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 454 (1986) (dictum); FTC v. Sperry & Hutchinson, 405 U.S. 233, 239 (1972)).

[15] *See, e.g.*, Ohlhausen, *supra* note 4, at 5–6 ("[T]he Sherman [Act] train lines were rather limited in 1914. Ninety-nine years later, however, the courts recognize the Sherman Act's expanded reach, with extensive precedent developed through actions by the antitrust enforcement authorities, including the FTC, and private parties. Although the courts have trimmed back a few spur lines since the 1960s and 1970s, the Sherman Act route still goes almost everywhere a competition agency should wish to travel. This then prompts the question, 'If the destination is already on the Sherman train line, why not take that route?'); Joshua D. Wright, Commissioner, Fed. Trade Comm'n, What's Your Agenda?, Remarks at the ABA Spring Meeting (Apr. 11, 2013) (arguing that "it is the Sherman Act and not Section 5 that has proven the more flexible instrument of antitrust law in terms of adjusting to economic learning and changes in market conditions"), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/whats-your-agenda/130411abaspringmtg.pdf.

[16] *See* Dissenting Statement of Commissioner William E. Kovacic, In the Matter of Negotiated Data Solutions, LLC, FTC File No. 051-0094 at 1–2 (Jan. 23, 2008) (explaining the risk of "spillover effects" of the FTC's enforcement action on private rights of action via state statutes that are modeled on the FTC Act), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2008/01/080122kovacic.pdf.