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The Past, Present, & Future of Stand- Alone Section 5 Competition Enforcement at the FTC: Is *N-Data* a New Direction or a Mere Diversion?

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Section 5 of the Federal Trade Commission Act empowers the Federal Trade Commission (“FTC” or “Commission”) to prohibit “unfair methods of competition.”¹ Congress left these terms largely undefined in order to provide the new agency with broad and flexible authority to address threats to competition. Not surprisingly, the Commission has grappled with how to apply its mandate throughout its history. On the one hand, the Supreme Court has suggested that the FTC has great discretion to condemn behavior it deems “unfair.” The Court in *Sperry & Hutchinson* held that Section 5 empowered the FTC to “define and proscribe an unfair competitive practice, even though the practice does not infringe either the letter or the spirit of the antitrust laws” and to “proscribe practices as unfair or deceptive in their effect on competition.”² It has acknowledged the breadth of Section 5 elsewhere, finding that the unfairness standard encompasses “not only practices that violate the Sherman Act and other antitrust laws, but also practices that the Commission determines are against public policy for other reasons.”³ On the other hand, the FTC has struggled in the modern era to apply its authority beyond the four corners of the antitrust laws.

¹15 U.S.C. § 45.

²FTC v. *Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).

³FTC v. *Indiana Federation of Dentists*, 476 U.S. 447, 454 (1986).

The Commission's action in N-Data has revived the debate over the Commission's authority under Section 5.⁴ In this recent case, the Commission condemned a breach of a licensing commitment made to a standard-setting organization and subsequently relied upon by the market as both an unfair method of competition *and* an unfair act or practice. This article begins with a look back at the last time the FTC sought to interpret Section 5 expansively. After reviewing some of the cases from the late 1970s and early 1980s, the article then highlights some current developments at the Commission and closes with some thoughts on where the Commission might head in the future.

I. THE PAST: *BOISE CASCADE, OFFICIAL AIRLINE GUIDES, AND ETHYL.*

For the last quarter century, the FTC has generally interpreted its Section 5 authority to be coextensive with that of the Sherman and Clayton Acts.⁵ The reasons for that narrow interpretation can be traced to the rise of the conservative movement under President Reagan and several high profile litigation setbacks in the Commission's efforts to apply Section 5 in the late 1970s and early 1980s. The courts turned back the Commission in three straight cases in which the Commission sought to apply Section 5 after explicitly eschewing reliance on the Sherman Act. Twenty-five years, later as the

⁴In re Negotiated Data Solutions, LLC, Dkt. No. 051-0094 (2008) *available at* <http://www.ftc.gov/os/caselist/0510094/index.shtm>.

⁵The exceptions are arguably the "invitation to collude" cases. *See, e.g.,* in re Valassis Communications, Inc., 2006 FTC LEXIS 25 (2006); Stone Container Corp., 125 F.T.C. 853 (1998); Precision Moulding Co., 122 F.T.C. 104 (1996); YKK (USA) Inc., 116 F.T.C. 628 (1993); A.E. Clevite, Inc., 116 F.T.C. 389 (1993); Quality Trailer Products Corp., 15 F.T.C. 944 (1992); *but see* United States v. American Airlines, 743 F.2d 1114 (5th Cir. 1984).

FTC debates the scope of its authority under Section 5, one important question is what lessons, if any, it can draw from those appellate decisions.

The first of these cases is *Boise Cascade*.⁶ In 1978, the Commission addressed the legality of a pricing practice used by Southern plywood mills. The mills all relied on the cost of West Coast freight to calculate the delivered price of plywood sold in the South. The Commission found that the practice began innocently. And it did not find that there was any agreement, express or tacit, to maintain the practice and thus it could not rely on Section 1 of the Sherman Act. Nevertheless, the Commission condemned the maintenance of the practice as an unfair method of competition under Section 5 in part because of the “extreme artificiality” of the practice.⁷ It found that the practice stabilized southern plywood prices at levels they would not otherwise have achieved; or, in other words, prices would have been lower “but for” the practice.

The Ninth Circuit reversed the Commission’s opinion. The Ninth Circuit observed that the “law of delivered pricing” was not a blank slate. It found that the case law and the Commission’s historical approach to delivered pricing established the rule that the Commission must find either an express agreement to maintain the pricing practice or, in the alternative, that the practice actually had the effect of fixing or stabilizing prices.⁸ It held the Commission had done neither. The discussion suggested that the Commission’s decision in *Boise Cascade* was akin to changing the rules of the

⁶In the Matter of Boise Cascade Corp. et. al., 91 F.T.C. 1 (1978) rev’d Boise Cascade Corp. v. Federal Trade Com., 637 F.2d 573 (9th Cir. 1980).

⁷*Boise Cascade*, 91 F.T.C.at 102 (“Section Five, with its proscription of ‘unfair methods of competition,’ permits a more direct approach to the problem of harmful commercial behaviour.”).

⁸*Boise Cascade*, 637 F.2d at 577.

game in the second half. The Ninth Circuit was unwilling to endorse the Commission's decision given the evidence in the record.

Official Airline Guides was the next Commission decision to condemn a practice as an unfair method of competition.⁹ Commissioner Robert Pitofsky, writing for the Commission majority, addressed the legality of refusals to deal under Section 5. Donnelly, the sole publisher of flight schedules in the United States, refused to list connecting flight information for noncertificated air carriers and to group the listings of all carriers together in its official airline guide. Donnelly's listing policies put noncertificated air carriers such as Southwest Airlines at a significant competitive disadvantage to certificated air carriers such as American Airlines and United Airlines. Section 2 of the Sherman Act did not apply because Donnelly was not a participant in the airline market in which competition was allegedly affected.¹⁰ Nor did Section 1 of the Sherman Act apply because there were no allegations that Donnelly imposed or maintained the policies pursuant to an agreement with the certificated air carriers. Nevertheless, the Commission held that Donnelly had a duty under Section 5 not to "arbitrarily" discriminate in dealing with firms that compete with one another in the adjacent air carrier market.¹¹

The Commission decision was reversed on appeal.¹² The Second Circuit recognized that the Commission's interpretation of practices as "unfair methods of

⁹In the Matter of The Reuben H. Donnelley Corp. 95 F.T.C. 1 (1980), rev'd *Official Airline Guides, Inc. v. Federal Trade Commission* ("OAG"), 630 F.2d 920 (2d Cir. 1980).

¹⁰*Donnelley*, 95 F.T.C. at 76. ("[t]he question we are presented with is outside the mainstream of law concerning monopolies and monopolization").

¹¹*Id.* at 172.

¹²*Official Airline Guides, Inc. v. Federal Trade Commission* ("OAG"), 630 F.2d 920 (2d Cir. 1980).

competition” was generally entitled to great deference. It also credited the Commission’s findings that Donnelly’s refusal was arbitrary and that it had an adverse effect on airline competition. However, the court was uncomfortable with the Commission’s decision in light of the principle articulated by the Supreme Court in *Colgate*: “[i]n the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.”¹³ It concluded that the Commission’s analysis did not warrant an exception to this principle. The court voiced concern that the breadth of the Commission’s analysis “would give the Commission too much power to substitute its own business judgment for that of the monopolist in any decision that arguably affects competition in another industry.”¹⁴

Two years later, in *Ethyl*, a divided Commission once again addressed the scope of its authority under Section 5.¹⁵ Commissioner Michael Pertschuk, writing for the three member majority, condemned certain practices in a gasoline additive market despite finding that the practices were not the product of either an express or tacit agreement. The majority found that the practices violated Section 5 because they facilitated price coordination and lessened price competition in the market. In reaching their conclusion, the majority articulated a rule of reason test whereby unilateral business practices could violate Section 5 if the structure of the industry rendered it susceptible to anticompetitive price coordination, if there was substantial evidence of actual noncompetitive

¹³*Id.* at 927-928.

¹⁴*Id.* at 927.

¹⁵In the Matter of Ethyl Corp., et.al. 101 F.T.C. 425 (1983), rev’d E.I. DuPont de Nemours & Co. v. FTC (“Ethyl”), 729 F.2d 128 (2d Cir. 1984).

performance, and if there was no “pro-competitive” justification offsetting the harmful effect of the practices. The majority interpreted *Boise Cascade* to leave the door open to condemn a pricing system in similar circumstances if it could prove parallel behavior and competitive effects. They suggested that *Ethyl* was “easily distinguishable . . . on the basis of a stronger factual record.”¹⁶ Chairman James Miller issued a stinging dissent but he did not challenge the majority’s interpretation of the Commission’s authority under Section 5.

The Commission’s decision was once again reversed on appeal. The Second Circuit, as it did in *OAG*, acknowledged at the outset that the Commission enjoyed broad and flexible authority under Section 5 to address threats to competition.¹⁷ However, as in *OAG*, the court voiced concern that the breadth of the standard articulated by the Commission vested it with too much power. The Second Circuit drew a distinction between the conduct in *Ethyl* and conduct that was “either a violation of the antitrust laws or collusive, coercive, predatory, restrictive or deceitful.”¹⁸ It held that the Commission was in the strongest legal position when it challenged the latter conduct. It did not rule out a challenge to other conduct but it held that the Commission had to articulate clear standards to discriminate between normally acceptable business behavior and conduct that is unreasonable or unacceptable. For example, the court suggested that if the Commission sought to challenge “facilitating practices” in oligopolistic markets as an unfair method of competition it should find “at least some indicia of oppressiveness must

¹⁶*Ethyl*, 101 F.T.C. at 596.

¹⁷*Ethyl*, 729 F.2d at 137.

¹⁸*Id.*

exist such as (1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of a legitimate business reason for its conduct.”¹⁹

Ethyl marked the end of an era at the Commission. The 1980s saw a retrenchment of antitrust policy across the board and there has been very little interest in testing the limits of Section 5 since *Ethyl*. That may be changing.

II. THE PRESENT: A RENEWED DEBATE

The scope of the Commission’s Section 5 authority is once again a subject of debate after years of silence. The *Valassis* settlement, *Rambus*, *N-Data*, public remarks by Commissioners Leibowitz and Rosch, and a public workshop on the issue have signaled a renewed interest by some at the Commission in the application of Section 5 beyond the four corners of the Sherman Act. The Commission’s settlement with N-Data likely is likely the most significant of these developments.

N-Data involved proprietary technology that was included in the IEEE’s Ethernet standard. In 1994, the IEEE standard-setting body voted to include National Semiconductor’s NWay technology in the Ethernet standard. An important factor in the standard-setting decision was National’s commitment to license its technology for a one-time paid-up royalty of \$1000 per licensee to manufacturers and sellers of products that use the IEEE standard. Several years later, National transferred the patents to a third party for use in applications that did not implicate the IEEE Ethernet standard. The third party was fully aware of the licensing commitment and made no effort to enforce the patents against firms practicing the IEEE standard or change the terms of the licensing

¹⁹*Id.* at 139.

commitment. N-Data acquired the relevant patents in 2001. By that time, virtually every computer in the United States read on the IEEE Ethernet standard and the patents conferred potentially significant monopoly power. Soon after its acquisition of the patents, N-Data sought to renegotiate the terms of the licensing commitment with IEEE and impose new terms on dozens of firms practicing the standard. The Commission's action brought a halt to N-Data's efforts.

The Commission's decision in N-Data to eschew reliance on the Sherman Act and instead rely on its authority under Section 5 has reignited the debate over Section 5. Indeed, N-Data was issued by a divided Commission with Chairman Deborah Majoras and then-Commissioner William Kovacic dissenting from the decision. If the Commission's recent workshop is any indication, the only point of consensus appears to be that Section 5, as a matter of law, could theoretically apply to practices beyond the reach of the Clayton and Sherman Act. However, everything else appears to be open to debate and a number of different theoretical and practical questions have been raised by those inside and outside of the Commission.

One question that is inevitably raised is the impact of *Boise Cascade*, *OAG*, and *Ethyl* on the future of Section 5 enforcement. On the one hand, all three appellate courts acknowledged the breadth of the Commission's authority under Section 5. Indeed, a narrow interpretation of Section 5 would appear to fly in the face of the legislative history of Section 5 and Supreme Court precedent. The context of the three cases is also noteworthy. The Commission's decisions in *Boise Cascade* and *Ethyl* departed from

well-established law on facilitating practices—law developed by the Commission itself. As for *OAG*, the Commission’s decision arguably gutted a fundamental principle articulated by the Supreme Court. There appears to be an acknowledgment by those at the Commission that there are lessons to be drawn from these cases. For example, Commissioner Rosch has suggested that Section 5 should be used only when the conduct is “oppressive” and the Commission has demonstrated that the practice resulted in anticompetitive effects.²⁰ On the other hand, there are also those who suggest that this is all a fool’s errand. The courts may acknowledge the potential breadth of Section 5 in theory, but they are unlikely to find a violation in practice unless it is grounded in the other antitrust laws.

Another important question facing the Commission is the relationship between Section 5 and the other antitrust laws. For example, Commissioner Rosch has suggested in the past that Section 5 should not be applied to conduct that could be addressed under either the Sherman or Clayton Acts.²¹ However, the question of what is, and what is not, a violation of the Sherman Act is often unclear; a fact recognized by Judge Lombard in his separate opinion in *Ethyl*. He emphasized that the FTC’s power to address collusive behavior was “already broad and ill-defined” given that Section 1 of the Sherman Act reached tacit agreements.²² The question is particularly difficult, however, when it comes

²⁰See, Commissioner J. Thomas Rosch, Federal Trade Commission, Welcoming Remarks at FTC Section 5 Workshop (October 17, 2008) *available at* <http://www.ftc.gov/speeches/rosch/081017section5wksp.pdf>.

²¹See, Commissioner J. Thomas Rosch, Federal Trade Commission, Perspectives on Three Recent Votes (July 6, 2006) <http://www.ftc.gov/speeches/rosch/Rosch-NERA-Speech-July6-2006.pdf>.

²²*Id.* at 143 (Judge Lombard suggested that the potential of the Sherman Act to reach tacit agreements “created a hole in the agreement requirement large enough at times to swallow it entirely.”).

to Section 2. The metes and bounds of Section 2 are hotly debated in the courts, academia, and even between the federal antitrust agencies.

As both Chairman Kovacic and Commissioner Leibowitz have observed, the courts have adopted a narrower interpretation of Section 2 of the Sherman Act today than was the case twenty-five years ago when *Ethyl* was decided by the Second Circuit. That has led some commentators to suggest that perhaps Section 5 would be most appropriate to address “novel” or “frontier” Sherman Act claims.²³ They emphasize that courts might find Section 5 more attractive in light of the forward-looking nature of the Commission’s remedies and the limited ability of private plaintiffs to use Commission decisions in their own litigation. Of course, it has led others, including Chairman Kovacic, to speculate as to whether a renewed effort to apply Section 5 more expansively would find a receptive audience in the courts.

III. THE FUTURE OF SECTION 5 ENFORCEMENT

It remains to be seen what the future holds for Section 5: was *N-Data* simply an interesting diversion or a new direction for the Commission? To some extent the question is impossible to answer at this point given that the Commission is entering a period of uncertainty with the change of Administration and the likely appointment of at least two new Commissioners in 2009. At the same time, Commissioners Leibowitz and Rosch have several years left on their respective terms and they have both publicly expressed support for a broader interpretation of Section 5.

²³See Thomas B. Leary, A Suggestion for the Revival of Section 5, presented at the Workshop on Section 5 of the FTC Act (Oct. 17, 2008) available at <http://www.ftc.gov/bc/workshops/section5/docs/tleary.pdf>; Susan A. Creighton & Thomas G. Krattenmaker, *Some Thoughts About the Scope of Section 5*, presented at the Workshop on Section 5 of the FTC Act (Oct. 17, 2008) available at <http://www.ftc.gov/bc/workshops/section5/docs/screighton.pdf>.

If the Commission decides to apply Section 5 more broadly, it will have to decide how it wants to proceed. It could simply continue to apply Section 5 on a case-by-case basis. Or it could endeavor to articulate upfront standards for practices in certain industries as it is currently doing in its ongoing gas manipulation rulemaking.²⁴ For example, the breadth and flexibility of Section 5 could arguably allow the Commission to weigh in on issues caught up in the Net Neutrality debate. Healthcare is another industry in which the Commission could potentially use Section 5 as a tool to address competitive problems.

Of course the courts will eventually have the final say on Section 5 and it is by no means certain that they will be receptive of a broader interpretation. At one time, the courts showed great deference to the FTC's view of the extent of its powers under Section 5 to attack anticompetitive conduct.²⁵ However, as Chairman William Kovacic noted at the recent Section 5 workshop, times have changed. Not only have the courts grown more conservative on antitrust but they have also shown less deference to the Commission than in the past. One should look no further than the decisions in *Schering*²⁶ and *Rambus*²⁷ for evidence of that.

²⁴One could argue whether the Commission needed the additional authority under the Energy Independence and Security Act in light of the potential breadth of its Section 5 authority.

²⁵*See, e.g.,* FTC v. Brown Shoe Co., 384 U.S. 316 (1966); FTC v. Motion Picture Advertising Serv. Co., 344 U.S. 392, 394-395 (1953); FTC v. Cement Institute, 333 U.S. 683, 689-93 (1948).

²⁶ *Schering-Plough Corp. v. FTC*, 402 F.3d 1056 (11th Cir. 2005).

²⁷ *Rambus Inc. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008).