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UNFAIR METHODS OF COMPETITION UNDER SECTION 5 OF THE FTC ACT: Does the U.S. Need Rules “Above and Beyond Antitrust”?

U.S. Chamber of Commerce

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I. INTRODUCTION

It is often asserted that the prohibition on “unfair methods of competition” contained in Section 5 of the Federal Trade Commission Act provides the FTC with flexibility to attack competitive conduct that is proper when examined under the federal antitrust laws. Although the FTC brought some early cases relying on this expansive view of Section 5, aggressive efforts to apply Section 5 during the late 1970’s and early 1980’s were consistently rejected by the courts. Although these courts acknowledged the FTC’s broad authority in concept, they faulted the FTC for failing to define the improper conduct according to acceptable criteria. Following these unsuccessful cases the FTC’s enthusiasm for extending Section 5 beyond established antitrust-law boundaries appeared to wane.

With recent changes in leadership taking hold at the FTC and throughout the federal government, there are renewed calls for efforts to extend Section 5 to additional forms of competitive conduct beyond the limits of established antitrust law. The FTC is being invited—from within and without—to use Section 5 to attack diverse categories of conduct otherwise outside the scope of antitrust law. These range from “invitations to collude,” to policing commitments made by members of standard-setting organizations, to conforming U.S. rules on single-firm conduct to European standards.

The character of many of these proposals, as well as their scope and diversity, highlights key disadvantages of extending Section 5 beyond the range of the existing antitrust laws. It is extremely difficult to identify conduct that seems both: a) deserving of condemnation based on sound, mainstream analysis and policy, and b) capable of being defined with sufficient consistency and objectivity that businesses will be able to understand the definition and rely upon it to develop practical standards for real-world conduct.

A policy of adding new restrictions on marketplace conduct enjoys little margin for error due to the fact that it can easily be counterproductive. The Chamber opposes any use of Section 5 beyond the current antitrust laws without clear standards that bound the use of Section 5 narrowly to types of conduct that are obviously not proper business behavior and could distort the competitive process.

We acknowledge that there are certain, limited forms of anticompetitive conduct that may not be covered by the antitrust laws, and thus may warrant scrutiny under Section 5. We

¹ This submission was compiled by the staff of the U.S. Chamber of Commerce, Chris Braddock, Senior Director.

believe “invitations to collude” are the most prominent and very well may be the only type of conduct that reaches this threshold. However, there is real danger if Section 5 is used to attack conduct that the FTC and others at any other point in time have viewed as fair. Section 5 should be informed by the same principles of “protecting competition not competitors” and “maximizing consumer welfare” that inform the antitrust laws. Additionally, the FTC must also provide significant notice and guidance to the business community (including hearings) before embarking on cases that are uniquely covered by Section 5.

II. “UNFAIR METHODS OF COMPETITION”—EARLY ENFORCEMENT AND INTERPRETATION

The basic legal restrictions on the competitive conduct of business firms in the United States arise from two federal antitrust statutes—the Sherman Act (1890)² and the Clayton Act (1914).³ The Sherman Act condemns unreasonably anticompetitive agreements (Section 1) and monopolization, including attempts and conspiracies to monopolize (Section 2). In its initial form, the Clayton Act condemned certain forms of anticompetitive price discrimination (Section 2), tie-ins and exclusive dealing (Section 3), as well as share acquisitions (Section 7) and interlocking directorates (Section 8). The price discrimination provisions were strengthened in 1936 by the Robinson-Patman Act, and in 1950 the Cellar-Kefauver Act amended Section 7 to reach anticompetitive asset acquisitions, assuring Section 7’s now-familiar role as the main antitrust provision governing mergers and acquisitions.

In 1914 Congress also passed the Federal Trade Commission Act⁴, creating the FTC and authorizing it under Section 5⁵ to attack “unfair methods of competition.” Although Congress seemed clear in its intent to allow the FTC to attack new forms of objectionable business conduct that might emerge as the dynamic U.S. marketplace grew and evolved,⁶ neither at the time of enactment nor at any time in the ninety-five years since has there been any consistent authoritative definition of what behavior is encompassed within the phrase “unfair methods of competition.”

Congress, in the process of drafting § 5, gave up efforts to define specifically which methods of competition and practices are competitively harmful and abandoned a proposed laundry list of prohibited practices for the reason that there were too many practices to define and many more unforeseeable ones were yet to be created by ingenious business minds. The specific practices that might be barred were left to be defined by the Commission, applying its expertise, subject to judicial review. Congress did not, however, authorize the Commission under § 5 to bar any business practice found to have an adverse effect on competition. Instead, the Commission could proscribe only “unfair” practices or methods of competition. Review by the courts was essential to assure that the Commission would not act arbitrarily or without explication but according to

² 15 U.S.C. §§ 1-7.

³ 15 U.S.C. §§ 12-27.

⁴ 15 USC §§ 41-58.

⁵ 15 USC § 45.

⁶ *F.T.C. v. R.F. Keppel & Bros., Inc.*, 291 U.S. 304 (1934).

definable standards that would be properly applied. (*DuPont vs. FTC*, citations omitted).⁷

Several Supreme Court cases affirm that in principle the FTC may use Section 5 to attack practices not strictly within the letter or the “spirit” of the antitrust laws. Indeed, the Supreme Court has suggested that Section 5 authorizes the FTC to attack conduct for “other reasons of public policy,” including reasons having nothing to do with antitrust law.⁸ Section 5 remains outside the specific definition of “antitrust laws” provided in 15 USC §12.⁹

III. THE 1970’S RESURGENCE OF ENFORCEMENT AGAINST UNFAIR METHODS OF COMPETITION

During the 1970’s the FTC attacked a variety of new competitive practices as unfair methods of competition under Section 5. The most prominent examples include *Boise Cascade Corp.*¹⁰ involving a system for quoting freight rates used by plywood lumber suppliers, *Official Airline Guides*¹¹ involving claims that the leading airline schedule publisher unfairly disadvantaged commuter airlines by failing to list certain flight connections, and *Ethyl*,¹² involving a variety of marketing practices¹³ adopted by the suppliers of an important gasoline additive. Although the cases involved a variety of competitive practices, each occurring within a unique competitive setting, the juridical decisions rejecting the FTC’s positions had some common themes: (1) the absence of clear criteria for distinguishing between proper and improper conduct; (2) the inability of businesses to conform their conduct to the standards asserted by the FTC; and (3) the need to provide some limits—however marginal—to the discretion of the FTC to condemn competitive practices as illegal.

⁷ E.I. DuPont de Nemours & Co. v. Federal Trade Commission, 729 F.2d 128, 136 (citations omitted).

⁸ F.T.C. v. Indiana Federation of Dentists, 476 U.S. 447, 454 (1986).

⁹ This has the important consequence that private claims may not be asserted with regard to violations of Section 5 under the treble-damage provisions of federal antitrust law. 15 USC §15.

¹⁰ Boise Cascade Corp. v. FTC¹⁰, 637 F.2d 573 (9th Cir. 1980)

¹¹ Official Airline Guides v. FTC, 630 F.2d 920 (2d Cir. 1980) “[W]e think enforcement of the FTC’s order here would give the FTC too much power to substitute its own business judgment for that of the monopolist in any decision that arguably affects competition in another industry. Such a decision would permit the FTC to delve into...‘social, political, or personal reasons’ for a monopolist’s refusal to deal.” at 927 (citation omitted).

¹² E.I. duPont de Nemours & Co. (“Ethyl”) v. FTC, 729 F.2d 128 (2d Cir. 1984), “When a business practice is challenged by the Commission, even though, as here, it does not violate the antitrust or other laws and is not collusive, coercive, predatory or exclusionary in character, standards for determining whether it is “unfair” within the meaning of § 5 must be formulated to discriminate between normally acceptable business behavior and conduct that is unreasonable or unacceptable. Otherwise the door would be open to arbitrary or capricious administration of § 5; the FTC could, whenever it believed that an industry was not achieving its maximum competitive potential, ban certain practices in the hope that its action would increase competition. . . .”

“[T]he Commission owes a duty to define the conditions under which conduct claimed to facilitate price uniformity would be unfair so that business will have an inkling as to what they can lawfully do rather than be left in a state of complete unpredictability.” 138-39.

¹³ These included individual decisions to sell only at delivered prices, use of “most-favored-nation” clauses in sales contracts, and requirements that customers be given thirty days’ advanced notice of price increases, 729 F.2d at 133.

After these repeated judicial roadblocks, the FTC lodged few if any additional attacks on unfair methods of competition for some time. But judicial rejection was not the only reason for the subsequent lull in FTC enforcement activity. The resolution of these cases coincided with a broader evolution in federal antitrust enforcement approaches that tended to disfavor expanding the scope of Section 5. Both the agencies and the federal courts were coming to rely more explicitly upon rigorous, empirically-supported economic analysis in their assessment of marketplace conduct and in their case selection practices.¹⁴ Accordingly, the decline in novel FTC enforcement approaches under Section 5, as under the antitrust laws themselves, was supported by multiple interrelated causes and can be seen as a natural product of the evolution in antitrust doctrine of the time.

The FTC did not entirely withdraw from the field, however. In *Dell Computer Corp.*¹⁵, the FTC challenged under Section 5 alleged deceptive conduct intended to obtain monopoly control of a technology important to the operation of personal computers.¹⁶ The matter ultimately was settled by entry of a consent order, thus avoiding any judicial test of the FTC underlying legal approach. Section 5 also continued to be applied by the FTC in a number of cases involving allegations of “invitations to collude”¹⁷ — a practice that may escape the precise requirements of the antitrust laws.¹⁸

IV. RECENT SUGGESTIONS FOR NEW SECTION 5 INITIATIVES

More recently, suggestions for extension of Section 5 and a more aggressive FTC enforcement program against unfair methods of competition have become increasingly common, both inside and outside the FTC. In the FTC’s most recent case alleging an invitation to collude, it invoked only Section 5, and signaled that it might adopt a more expansive approach in Section 5 cases involving other forms of conduct.¹⁹ In speeches and in statements made in connection with cases involving standard-setting, several Commissioners have suggested that Section 5 should be relied upon to challenge unilateral conduct that lies beyond the reach of the main antitrust statute applicable to single-firm conduct, Section 2 of the Sherman Act.²⁰

¹⁴ See, e.g., *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

¹⁵ 121 F.T.C. 616 (May 20, 1996).

¹⁶ One Commissioner dissented based on her view that the impugned conduct did not fit into any properly defined category of anticompetitive conduct, under the antitrust laws or under Section 5.

¹⁷ An “invitation to collude” involves an offer by one competitor to one or more other competitors to enter into an agreement to restrict competition unlawfully as, for example, by fixing minimum selling prices or rigging bids.

¹⁸ See cases cited in “Analysis of Agreement Containing Consent Order to Aid Public Comment” at 3 n.5, In the Matter of Valassis Communications, Inc., File No. 051 0008, available at <http://www.ftc.gov/os/caselist/0510008/060314ana0510008.pdf>.

¹⁹ *Id.*

²⁰ In re Negotiated Data Solutions, LLC, Dkt. No. 051-0094 (2007), available at: <http://www.ftc.gov/os/caselist/0510094/index.shtm>. See also, Welcoming Remarks, Commissioner J. Thomas Rosch, FTC Section 5 Workshop, Washington, D.C. (October 17, 2008).

At a recent FTC Workshop,²¹ invited speakers from the private bar also offered a wide variety of proposals for expansion of Section 5 enforcement by the FTC. One speaker, for example, asserted “Section 5 can be used to attack facilitating practices in oligopolistic industries, which cannot be challenged under the Sherman Act.”²² This speaker also suggested that Section 5 be used to attack commercial bribery, “kickbacks,” and other practices alleged to be characteristic of certain segments of the health care industry.

Another speaker suggested that the FTC take the lead in seeking convergence between U.S. antitrust policy and that of the European Commission toward unilateral conduct, using Section 5 to overcome statutory limitations on U.S. antitrust liability, including: (1) the U.S. antitrust principle that unilateral conduct may be prohibited only when engaged in by firms with monopoly power or a dangerous probability of acquiring monopoly power;²³ and (2) the requirement under U.S. law that a firm have a very substantial share of a properly defined relevant market (in the minimum range of 70 percent) to be regarded as a monopolist. This would be in contrast to European practice, which tends to regard as “dominant” firms that account for a substantially smaller market share (40-50 percent).²⁴ This same speaker suggested that Section 5 could reach, *inter alia*, “[s]trategic unilateral withholding by a non-monopolist,”²⁵ the exercise of buyer power by purchasers accounting for as little as 10-20 percent of the relevant market,²⁶ and clarifying how “price discrimination can, under identifiable circumstances, be used anticompetitively by a firm with less market power than a monopolist.”²⁷

Other papers presented at this FTC Workshop explored the possibilities of subjecting these and other forms of behavior—“facilitating practices” similar to those challenged in *DuPont, supra*, and “patent-fishing,” for example—to condemnation under Section 5.²⁸ Although these proposals by no means exhaust the list of recent suggestions for FTC use of Section 5 to attack competitive conduct otherwise beyond the reach of the antitrust statutes, they are representative of the range of proposals that exists.

V. THE SECTION 5 REVIVAL MOVEMENT

The federal antitrust laws, enacted 119 years ago, have been applied to an enormous variety of marketplace conduct. Scholars, enforcement officials, policy experts, economists, and

²¹ Section 5 of the FTC Act as a Competition Statute. Agenda, transcript, and recorded webcast available at <http://www.ftc.gov/bc/workshops/section5/index.shtml>

²² David A. Balto, “Reviving Competition in Healthcare Markets: The Use of Section 5 of the FTC Act” at 2 (Oct. 17, 2008). A challenge to such “facilitating practices” was at the heart of the FTC’s unsuccessful case against *DuPont, E.I. duPont de Nemours & Co. (“Ethyl”) v. FTC*, 729 F.2d 128 (2d Cir. 1984).

²³ *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993)

²⁴ Albert A. Foer, “Section 5 as a Bridge Toward Convergence” at 3 (Oct. 17, 2008).

²⁵ *Id.* at 5-7.

²⁶ *Id.* at 8,

²⁷ *Id.* at 9-10.

²⁸ Thomas B. Leary, “The Search for Consensus on the Revival of Section 5” (Oct. 17, 2008); Commissioner (now FTC Chairman) Leibowitz, “Tales from the Crypt” (Oct. 17, 2008).

legal practitioners have pored over literally thousands of government investigations and decisions in private and public cases over this period, arguing the pros and cons of including specific types of conduct within the ambit of the statutory prohibitions of the Sherman and Clayton Acts. Antitrust constitutes one of the oldest, most elaborate, and sophisticated systems of law in the United States and, indeed, anywhere in the world. It has been applied to low prices and to price differences, to exclusive dealing and to every conceivable type of license, franchise or other vertical agreement, to joint ventures, standard-setting organizations, cooperatives, and to thousands of other specific types of transactions, agreements and instances of unilateral behavior. This is the natural result of U.S. recognition of antitrust law as “a comprehensive charter of economic liberty.”²⁹

Moreover, the original antitrust statutes have been supplemented and amended numerous times, and the available remedies and procedures for the application of federal antitrust law by both federal and state government agencies, as well as private parties, have been strengthened enormously over the years. Two federal agencies, fifty state attorneys general, and literally “anyone who shall be injured in his business or property”³⁰ can bring an antitrust claim. The Clayton Act itself swept in a number of practices just to ensure they were not missed by the Sherman Act.

Moreover, during the 1960’s and early 1970’s, antitrust prohibitions were vastly extended by the use of *per se* rules, encouraged by the federal enforcement agencies. By the mid-1970’s all vertical restraints were *per se* unlawful, as were a wide array of intellectual property licensing restrictions, horizontal mergers, and a wide variety of joint ventures. These outer extensions of U.S. antitrust law are now regarded by the broad mainstream of antitrust scholars and practitioners to have been a costly error. Although largely modified to conform to sound economic analysis over the last thirty years, antitrust remains a massive, weighty, and ever-present system of law, extending to a broad range of conduct.

Any proposal to extend Section 5 of the FTC Act to further widen the range of behavior subject to legal condemnation by the FTC accordingly bears a heavy burden of justification. Even considering that Section 5 violations are not automatically subject to private treble damage claims and certain other remedies, increasing legal jeopardy for additional categories of business conduct poses obvious and substantial policy questions. Is there any category of business conduct that is generally recognized as harmful but that has not been recognized or addressed previously under the existing antitrust statutes? What are the key characteristics of that conduct, and can they be defined in a way that places business firms on effective notice to avoid such practices, so that business firms are not unfairly surprised or penalized by new enforcement efforts? The broad range of proposals exhibited at the FTC Workshop, suggesting the extension of U.S. legal prohibitions on businesses undertaking conduct that is clearly permissible under existing U.S. antitrust standards, strongly indicates the dangers of opening new fronts through Section 5 enforcement.

²⁹ Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1958).

³⁰ 15 U.S.C. §15.

Although several Commissioners have acknowledged that it would be critically important to articulate sensible guidelines and limitations on the scope of Section 5 before venturing beyond conduct already recognized to violate the antitrust laws,³¹ none have satisfactorily identified any such limitations. In particular, one such criterion that has been advanced is “oppressiveness,” which is not a useful concept for this purpose.³² The FTC has had some experience with attempting to assert broad, subjective, and vague liability standards and that experience was not happy or productive for either the FTC or any entities within its jurisdiction. “Oppressiveness” was, in fact, one of the factors the FTC proposed to use to determine “unfairness” in consumer protection cases and rulemakings in the 1960’s and 1970’s (including the ill-fated children’s television advertising proceeding), which led to significant backlash against the agency and a substantial re-trenching of the definition of “unfairness” under Section 5.³³

It is also important to consider whether other remedies exist to address particular issues before expanding Section 5 jurisprudence. In the N-Data matter, for example, very serious issues were presented whether the conduct at issue was better addressed under state contract or tort law, once it was acknowledged that the conduct did not fit well within the Sherman Act. The FTC has itself been careful to consider whether particular concerns could be better addressed by modifications in other, more relevant legal regimes, such as the patent system.³⁴ In the final analysis, if a practice under scrutiny does not merit sanction under the antitrust laws, and no other legal regime would apply to such conduct, the FTC might well pause to consider whether, in fact, there is any legitimate basis for attempting to second-guess and attack that practice.

Whatever the superficial appeal of a residual legal provision that can be applied to novel forms of anticompetitive conduct, proponents of a Section 5 revival have not made the case for any significant departure from the recent past practices on the limited use of Section 5. Excluding cases regarding “invitations to collude,” Section 5 advocates have not justified the existence of a clearly definable class of conduct that is both anticompetitive and therefore harmful, yet beyond the reach of current U.S. antitrust doctrine. The proponents of such a revival have not explained how the high degree of discretion inherent in a “catch-all” provision can be effectively controlled, so that the mistakes and overreaching that led to the judicial rejections of FTC efforts referred to above are not repeated at great cost to the economy. Until there are satisfactory answers to these fundamental questions, the danger of further extending the reach of antitrust doctrine cannot be undertaken with confidence that it will do more good than harm. Any additional movement toward the use of Section 5 should be preceded by

³¹ See Remarks of Commissioner Leibowitz, FTC Section 5 Workshop at 5 (Oct. 17, 2009), www.ftc.gov/bc/workshops/section5/docs/jleibowitz.pdf.

³² Cf. Welcoming Remarks, Commissioner J. Thomas Rosch, FTC Section 5 Workshop at 3 (Wash. D.C. Oct. 17, 2008), <http://www.ftc.gov/speeches/rosch/081017section5wksp.pdf>.

³³ See, e.g. T.M. Schwartz & A.S. Hardy, FTC Rulemaking: Three Bold Initiatives and Their Legal Impact at 8, 18-19 (FTC 90th Anniversary Symposium, Sept. 22, 2004), <http://www.ftc.gov/ftc/history/docs/040922schwartzhrdy.pdf>.

³⁴ See To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy (FTC, Oct. 2003), <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>.



hearings and substantial time for debate among the antitrust community to ensure appropriate notice and guidance is provided to the business community and other interested constituents.