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REFORMING THE FEDERAL TRADE COMMISSION THROUGH BETTER PROCESS

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INTRODUCTION

The Federal Trade Commission ("FTC" or "Commission") has been the chief consumer protection and competition agency in the United States for over 100 years.[1] During that time, this "uniquely compelling experiment in economic regulation"[2] has had mixed results. While the agency and the consumers it represents have enjoyed some tremendous victories along the way, there have also been some notable failures and missteps, which have resulted in numerous course corrections from the courts and Congress.

Such moments of conflict and transformation often followed periods of disruptive technological innovation, when business models, consumer habits and American lifestyles were undergoing tremendous change.[3] Arguably, we are in a similar period today, as advances in digital services, broadband connectivity and smartphone adoption continue to create new markets and disrupt existing ones—all of which dramatically changes the ways consumers behave and companies do business. In recent years, such changes have generated numerous conflicts and there are serious concerns that the FTC has not been handling them appropriately.[4] Moreover, in the near future, the FTC will once again be tasked with regulating the practices of broadband providers and policing any violations of Net Neutrality that threaten to harm consumers or competition.[5] Advances in artificial intelligence, automation and blockchain technologies will also surely present additional challenges for the FTC going forward.

Accordingly, it is imperative that the agency's processes are in good working order. While its missteps could be corrected by the courts, their limited scope of review may allow deficiencies to persist for longer than they should.[6] For this reason, a more direct path to reform is for Congress to amend the FTC Act and implement changes to the agency's processes directly. To this end, numerous reform bills have recently been proposed.[7] However, a full review of these is beyond the

1. See, e.g., Marc Winerman, "The Origins of the FTC: Concentration, Cooperation, Control, and Competition," *Antitrust Law Journal* 71:1 (2003), 1-97. https://goo.gl/GRZ6fh.

2. William E. Kovacic and Marc Winerman, "The Federal Trade Commission as an Independent Agency: Autonomy, Legitimacy, and Effectiveness," *Iowa Law Review* 100:5 (May 2015). https://goo.gl/VaXWtR.

3. See, e.g., J. Howard Beales, "The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection," Federal Trade Commission: The Marketing and Public Policy Conference, May 30, 2003. https://goo.gl/TZX9sJ.

4. See, e.g., Joshua D. Wright, "The FTC and Privacy Regulation: The Missing Role of Economics," George Mason University Law and Economics Center: Briefing on Nomi, Spokeo, and Privacy Harms, Nov. 12, 2005. https://goo.gl/AzMKH8.

5. See, e.g., In re Restoring Internet Freedom, Declaratory Ruling, *Report and Order, and Order*, WC Docket No. 17-108 (draft released Nov. 22, 2017). https://goo.gl/i3kmJE.

6. In addition to the Constitutional limit on judicial review to actual cases and controversies (U.S. Const. art. III, § 2), the judicial review of administrative agencies like the FTC is further constrained by the Administrative Procedure Act, Pub. L. No. 79-404, § 10, 60 Stat. 243 (codified at 5 U.S.C. § 706). See also *Chevron U.S.A. Inc. v. Nat. Res. Def. Council*, 467 U.S. 837, pp. 842–45 (1984).

7. See, e.g., U.S. House of Representatives, Energy & Commerce Committee, "Full Committee Advances Bills to Modernize the FTC and Put #InnovationFirst," Press Release, Jul. 14, 2016. https://goo.gl/kSR1Nj. For a detailed review of the legislative proposals, see, Berin Szóka and Geoffrey A. Manne, "The Federal Trade Commission: Restoring Congressional Oversight of the Second National Legislature—An Analysis of Proposed Legislation" FTC Technology and Reform Project, May 2016. https://goo.gl/36K7hM.

scope of this study,[8] which instead seeks to focus specifically on the FTC's abuse of consent decrees and the marked benefits that would be reaped if Congress were to circumscribe their use. Such an action would generate significant benefits for the regulatory environment as a whole because litigation of cases drives evolution and development of the law over time, and thus provides increased certainty for both industry and consumers about how the FTC's broad standards apply in different circumstances.[9]

CURRENT FTC PROCESS ISSUES

The common law approach of case-by-case adjudication is far better at providing certainty than industry-wide rulemakings in areas that are undergoing rapid innovation and disruption to existing technologies and business models. This is because rules quickly become outdated and either ineffective or counterproductive as a result. However, the FTC's shift away from rulemaking and formal adjudication and toward consent decrees and informal guidance has all but nullified the benefits of this approach. Most notably, it has substantially reduced the level of judicial oversight over the FTC's actions.[10] It has also greatly reduced the level of guidance provided to both industry and consumers on how the agency's broad standards in Section Five of the FTC Act would apply in a given situation.[11]

While consent decrees may be in the best interest of the FTC and the party under investigation, they ultimately reduce guidance and stunt the development of appropriate and evolving legal standards. This harms consumer welfare and economic growth. Accordingly, the following sections describe the benefits of using case-by-case adjudication and common law over industry-wide rulemaking, and then explain how the FTC has recently deviated from that approach in a critical way through its abuse of consent decrees.

Rulemaking vs. case-by-case adjudication

The FTC has authority to pursue its mission to protect consumers and competition through the use of either industry-wide rulemaking[12] or case-by-case adjudication.[13] It also has discretion to choose how to exercise that authority in any given circumstance.[14] However, there are situations in which case-by-case adjudication is clearly preferable to rulemaking, as explained by Justice Frank Murphy in the *SEC v. Chenery Corp.* (1947) opinion:

> Problems may arise in a case which the administrative agency could not reasonably foresee, problems which must be solved despite the absence of a relevant general rule. Or the agency may not have had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule. Or the problem may be so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule. In those situations, the agency must retain power to deal with the problems on a case-to-case basis if the administrative process is to be effective. There is thus a very definite place for the case-by-case evolution of statutory standards.[15]

Such a discussion illustrates that industry-wide rulemaking is at times imprudent—when the agency lacks "sufficient experience with a particular problem"—and at other times infeasible—when a problem is "so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule."

The FTC has confronted both of these situations in the past. For example, it encountered the first in the 1970s when, under pressure from parents concerned about the health and wellbeing of their children, the Commission hastily proposed industry-wide rules that prohibited all children's advertising on television, which Congress later deemed to be an inappropriate use of the Commission's authority.[16] This fiasco resulted in a temporary shutdown of the Commission and legislative checks that terminated the rulemaking on children's advertising, eliminated the FTC's rulemaking authority in that area and imposed new procedural checks on its rulemaking authority across the board.[17]

This marked a major change in FTC process, as Congress forced it to rely more heavily upon case-by-case adjudication. Since then, the Commission has issued rules in specific areas that Congress has identified as requiring spe-

8. For excellent holistic takes on FTC reform, see, e.g., William E. Kovacic, *The Federal Trade Commission at 100: Into Our 2nd Century—The Continuing Pursuit of Better Practices*, U.S. Federal Trade Commission, January 2009. https://goo.gl/z6YjGV; and Berin Szóka & Graham Owens, "FTC Stakeholder Perspectives: Reform Proposals to Improve Fairness, Innovation, and Consumer Welfare," Testimony of TechFreedom at a Hearing Before the Subcommittee on Consumer Protection, Product Safety, Insurance, and Data Security of the U.S. Senate Committee on Commerce, Science, & Transportation, Sept. 26, 2017. https://goo.gl/tN9xKR.

9. See, e.g., Justin (Gus) Hurwitz, "Data Security and the FTC's UnCommon Law," *Iowa Law Review* 101:3 (2016), 980–88. https://goo.gl/pP6tAf.

10. See, e.g., Hurwitz, 980–88.

11. Federal Trade Commission Act, Pub. L. No. 63-203, § 5, 38 Stat. 719 (1914) (codified at 15. U.S.C. § 45). Section Five of the FTC Act declares unlawful and empowers the FTC to police all "unfair methods of competition" and "unfair or deceptive acts or practices."

12. See 15 U.S.C. § 57a(a).

13. See 15 U.S.C. § 45(b).

14. See *SEC v. Chenery Corp.*, 332 U.S. 194, p. 203 (1947).

15. Ibid., pp. 202–03.

16. See, e.g., Beales; and Mary L. Azcuenaga, "FTC Rulemaking: Harnessing Fire," Federal Trade Commissioner's Remarks Before the Society of Consumer Affairs Professionals in Business SOCAP Meeting, Sept. 12, 1985. https://goo.gl/pwM2xm.

17. See FTC Improvements Act of 1980, Pub. L. No. 96-252, §§ 7–11, 94 Stat. 374, 376 (1980) (codified at 15 U.S.C. § 57a).

cial attention,[18] but it has otherwise refrained from issuing industry-wide rules. Instead, it has used case-by-case adjudication, especially in innovative and dynamic areas like privacy and data security, which are practically "impossible of capture within the boundaries of a general rule."[19] Thus, it seems as though the FTC has learned the lesson of its previous overreach and has refrained from rulemaking in areas that are either unsuited to rules or where it lacks adequate understanding to promulgate effective ones. However, there are still significant issues with the FTC's current process of case-by-case adjudication.

(Un)common law at the FTC

While commendable, particularly in dynamic industries with rapid innovation cycles, the FTC's shift toward greater reliance on case-by-case adjudication has significantly deviated from the true common law approach that Congress intended it to use in one critical way.[20] Specifically, rather than to litigate individual cases and produce binding precedent that industries can rely on prospectively for the purposes of compliance or business planning, the Commission has instead settled almost all of its cases via consent decrees. However, these produce no formal guidance, as they are never reviewed by an independent judge. By one account, over the past two decades the FTC has settled nearly three-quarters of its enforcement actions (1,524 out of 2,092) in this manner—without any adjudication or judicial oversight whatsoever.[21]

Such a practice lacks the key features that make true common law such an effective steward of liberty and driver of economic growth[22] and for this reason, commenters have derisively referred to it as "un-common law"[23] or the "common law of consent decrees."[24] Since 2002, the FTC has brought over 60 data security cases,[25] but it is still entirely unclear what level of data security constitutes an "unfair" practice under Section Five, as almost all of those cases ended in unadjudicated consent decrees. Only three companies have even been willing to challenge the FTC in a data security case, and no court has yet considered the question of whether the agency's complete reliance on informal guidance has given industry enough ability to comport with constitutional due process.[26] This is particularly concerning given the increasing importance of data security practices to economic security and growth.

It is certainly true that if the Commission were to litigate more and settle less, it would encounter more judicial setbacks—when attempts to extend precedent and prove a violation are rebuffed—especially in developing areas like privacy, data security and broadband regulation. However, such losses are actually quite beneficial for the health of the legal system as a whole. After all, the Commission's defeats in court can clarify the scope and boundaries of existing law, giving certainty to industry about how to conform their business practices. Formal adjudications and the judicial opinions they necessitate can also lay the groundwork for a future court to extend legal precedent to cover a new area or overturn existing precedent that no longer makes sense. In this way, the common law approach to case-by-case adjudication produces gradual evolution of legal standards over time, providing stability and predictability in the law's operation.[27]

Moreover, the current system merely allows the FTC to maximize its own discretion and its ability to extract pro-consumer and pro-competitive concessions from parties under investigation. If particular commissioners were dedicated to reforming internal agency process, individuals at the FTC could end this precedent on their own. However, a reliance upon personality politics is inevitably uncertain and impermanent. After all, future FTC staff with different inclinations could simply undo whatever interpretations or internal rulemakings their predecessors had done. Similarly, if it loses one of its currently pending cases and more parties are emboldened to challenge the FTC's enforcements, such reforms might inevitably be forced upon the Commission by the courts. Such an outcome, however, is uncertain and may take years or even decades to materialize. What is truly necessary, then, is congressional action to reform the FTC's use of consent decrees, as the incentives within the current legal framework all favor the status quo.

Misaligned incentives and negative externalities

In the context of case-by-case adjudication, both the FTC and the company under investigation have strong incentives to settle an enforcement action and sign a consent decree. In so doing, a company generally agrees to undertake or refrain

18. See, e.g., Children's Online Privacy Protection Act of 1998, Pub. L. No. 105-227, 112 Stat. 2681-1 (codified at 15 U.S.C. §§ 6501 et seq.).

19. *Chenery Corp.* 332 U.S., p. 203; see also Bureau of Consumer Protection, "Privacy & Data Security Update: 2016," U.S. Federal Trade Commission, January 2017. https://goo.gl/8CaUgE.

20. See, e.g., Daniel A. Crane, "Debunking Humphrey's Executor," *George Washington University Law Review* 83:6 (November 2015), 1867. https://goo.gl/9UT3HP.

21. Ibid.

22. See, e.g., Paul G. Mahoney, "The Common Law and Economic Growth: Hayek Might Be Right," *The Journal of Legal Studies* 3:2 (June 2001), 503-25. https://goo.gl/3KNkuS.

23. See, e.g., Hurwitz. https://goo.gl/pP6tAf.

24. See, e.g., Berin Szóka and Geoffrey A. Manne, "The Second Century of the Federal Trade Commission," *Techdirt*, Sept. 26, 2013. https://goo.gl/SLkhM2.

25. See, U.S. Federal Trade Commission, "Privacy & Data Security Update: FTC 2016 Privacy and Security Report," January 2017. https://goo.gl/8CaUgE.

26. See *FTC v. Wyndham Worldwide Corp.*, 799 F.3d 236 (3d Cir. 2015); *LabMD v. FTC*, No. 16-16270 (11th Cir. argued June 21, 2017); *FTC v. D-Link Corp.*, No. 3:17-cv-00039-JD (N.D. Cal. filed Jan. 05, 2017).

27. Hurwitz, 980. https://goo.gl/pP6tAf.

from certain practices—and without having to admit guilt or wrongdoing—in exchange for the FTC's termination of the enforcement action. From the company's perspective, this option is often desirable—even if a successful legal challenge could potentially exonerate the company from all liability—because of the substantial costs and uncertainty associated with litigation.[28] This incentive is even stronger because any challenge to the FTC's Civil Investigative Demands ("CIDs")—the equivalent of discovery requests—immediately publicizes the dispute, likely harming the company's reputation.[29] To comply with the CIDs and settle disputes via consent decree allows a company not only to avoid the admission of liability, but also to plan the release of the decree to correspond with announcements for various other pro-consumer or pro-competitive benefits, like individual refunds or the launch of new programs.[30] This type of strategic news bundling has been found to offset significantly the expected losses to stock market value that would otherwise be expected.[31] For these reasons, it is entirely reasonable for a company to utilize such a strategy in the context of FTC enforcements even when a legal challenge might be successful.

Likewise, from the FTC's perspective, to settle an enforcement action via consent decree is also an attractive option. Not only does it allow the Commission to avoid any potential embarrassment from pursuing a case that is ultimately unsuccessful,[32] it also enables it to enforce bigger penalties and extract greater concessions from the party under investigation than it could otherwise do under the law. The Commission's enforcement tools are strictly limited in adjudications,[33] but consent decrees allow for fines, injunctions, decades-long monitoring programs and essentially any other remedy to which the party under investigation is willing to agree.[34]

In view of the foregoing, it is easy to see why both the FTC and companies under its investigation would prefer to resolve disputes in this manner. However, as has been demonstrated, such a method provides no formal guidance to industry on whether or how certain practices violate the law, which is the true hallmark of the common law's evolutionary approach.[35] Further, since the benefit thereof has been described as a positive externality,[36] to work around it in favor of consent decrees should be viewed as a negative one. Accordingly, Congress should use its legislative capacity to internalize this negative externality by forcing the FTC to settle less and litigate more in order to ensure that consumers and competition reap the benefits associated with the true common law approach.

RESTORING A TRUE COMMON LAW APPROACH

There are those who defend the FTC's use of consent decrees,[37] and some who believe it is functionally equivalent to a common law,[38] but a growing body of scholarly research recognizes the problems it causes.[39] In view of this, there have been several legislative changes proposed to address these problems, and these proposals have substantial merit. For example, to limit the maximum term of consent decrees[40] and/or to require them to be justified by an economic analysis that demonstrates that the public-interest benefits outweigh the costs would both make marginal differences.[41] From the FTC's perspective, such changes would make consent decrees less attractive because their scope would be more limited and the agency would be required to provide more detailed explanations for the consent decrees it does issue. This would encourage the Commission to settle less and litigate more. However, such measures still would not ensure that the FTC litigates more and generates more formal guidance going forward. Thus, while these proposed reforms would significantly curb the abuse of consent decrees at the FTC, they would arguably not go far enough.

To restore the true common law approach to FTC process and deliver the substantial benefits to consumer welfare and economic growth that come with it, Congress should simply prohibit the Commission from using consent decrees to settle enforcement actions unless the party admits liability. Since neither the Commission nor Congress can force

28. See, e.g., Hurwitz, 986.

29. See, e.g., "A Brief Overview of the Federal Trade Commission's Investigative and Law Enforcement Authority," U.S. Federal Trade Commission, July 2008. https://goo.gl/g85hAQ.

30. See, e.g., U.S. Federal Trade Commission, "Uber Settles FTC Allegations that it Made Deceptive Privacy and Data Security Claims," Press Release, Aug. 15, 2017. https://goo.gl/JixKH7.

31. See, e.g., Sebastien Gay, "Strategic News Bundling and Privacy Breach Disclosures," Aug. 21, 2015. https://goo.gl/GC2p6E.

32. Some might consider the time and effort spent pursuing a case that is ultimately unsuccessful to be wasteful, but the development of the law is itself a public good. For this reason, even bringing cases that are unsuccessful from the FTC's perspective may actually be a very good use of agency resources.

33. For example, the maximum civil penalty the FTC can seek for violations of Section Five is $40,654 per day for continuing violations. See U.S. Federal Trade Commission, "FTC Raises Civil Penalty Maximum to Account for Inflation," Press Release, June 29, 2016. https://goo.gl/yjtioJ.

34. See, e.g., Geoffrey A. Manne, "Federal Intrusion: Too Many Apps for That," *The Wall Street Journal*, Sept. 16, 2014. https://goo.gl/uU3FZW.

35. Hurwitz, 980. https://goo.gl/pP6tAf.

36. See, e.g., Ibid., 983.

37. See, e.g., Deborah L. Feinstein, "The Significance of Consent Decrees in the Federal Trade Commission's Competition Enforcement Efforts," Remarks of the Director of the Bureau of Competition of the U.S. Federal Trade Commission, Sept. 17, 2013. https://goo.gl/gCHjUZ.

38. See, e.g., Daniel J. Solove & Woodrow Hartzog, "The FTC and the New Common Law of Privacy," *Columbia Law Review* 114 (2014), 583. https://goo.gl/96DM9L.

39. See, e.g., Douglas H. Ginsburg and Joshua D. Wright, "Antitrust Settlements: The Culture of Consent," *Bill Kovacic Liber Amicorum*, Feb. 28, 2013. https://goo.gl/ieCFuJ; and Hurwitz. https://goo.gl/pP6tAf.

40. See, e.g., Szóka and Manne, 75–78. https://goo.gl/SLkhM2.

41. Ibid., 48–53.

companies to challenge legal actions against their will and because settlements are quicker and often less costly than litigation, to settle individual cases should still be permissible. However, this should only be allowed if the resulting settlements include an admission of liability for at least one of the charges, and an explanation of how the underlying conduct violated the law. Thus, for example, if the Commission alleged multiple violations of Section Five under different legal theories—say, by claiming both that a company's privacy practices were "unfair" and that its privacy policy describing such practices was "deceptive"[42]—it would be permissible for the Commission to drop the unfairness charge if the company admits liability for the deception. Effectively, this would make the FTC's consent decrees operate much like plea bargains in the criminal justice system. The resulting decrees may not be immediately subject to judicial review, but as formal FTC orders they would still establish binding precedent that could not be arbitrarily overturned by the Commission going forward.[43] Thus, to require consent decrees to contain both (1) an admission of liability on the part of the company under investigation, and (2) the FTC's explanation of how the underlying conduct violates the law, would produce even more binding precedent that can further drive development of the law and reduce industry uncertainty.

Additionally, limitations on the FTC's use of consent decrees could be combined with stronger authority, additional remedies and reforms to its judicial operations. For example, the statutory maximum for civil penalties could be changed from an absolute figure (i.e., a dollar amount) to a relative figure (e.g., some percentage of business revenues or profits).[44] This would give the Commission even greater incentive and ability to pursue formal adjudication and establish binding precedent to drive evolution of the law.[45] It would also ensure the Commission has adequate punishments available to penalize bad actors, regardless of how big or powerful they may be.

Congress could also consider hiring more administrative law judges (ALJs) to staff the FTC and hear cases within the agency.[46] Many scholars have criticized the FTC's use of administrative litigation,[47] but it can often provide quicker and cheaper resolution of legal disputes than the traditional court. Further, parties always have the right to appeal their claim in the traditional manner if they are unsatisfied with the determination of the administrative law judge. If there are lingering concerns over agency bias, Congress could also provide companies with the right to remove cases from the administrative litigation process during the initial trial phase, rather than having to wait for appeal—perhaps based on some showing of need or convenience.

FTC staff would likely resist these changes, preferring instead to maintain their vast discretion to resolve enforcement actions however they wish. From an institutional perspective, however, it is perfectly reasonable to restrict the FTC's use of consent decrees and force it to rely more upon formal adjudication. The benefits of the common law approach are well established, and Congress has already made clear that the FTC should use its broad authority to police unfair competition and protect consumers on a case-by-case basis. However, the FTC's overuse of consent decrees is harmful to both consumers, industry and the proper functioning of the law.

CONCLUSION

During its more than a century-long existence, the FTC has been reformed many times and it will continue to change and evolve. Many of the changes to the FTC in recent years have been positive, but some have also been decidedly negative. In particular, the reliance on informal adjudication and abuse of consent decrees has led to a dearth of legal precedent and formal guidance, and this has generated substantial regulatory uncertainty.

These problems are unlikely to resolve themselves, as they are the result of the current incentive structures within the agency itself. Thus, Congress should enact a handful of simple reforms to the FTC's process that will substantially improve regulatory and enforcement outcomes for both consumers and competition. With these process reforms in place, the agency will finally be ready to tackle the vital competition and consumer protection issues of the 21st century.

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42. 15 U.S.C. § 45.

43. See, e.g., *FCC v. Fox Television Stations*, 132 S.Ct. 2307 (2012).

44. "FTC Raises Civil Penalty Maximum to Account for Inflation." https://goo.gl/yjtioJ.

45. See Maureen K. Ohlhausen, "Administrative Litigation at the FTC: Effective Tool for Developing the Law or Rubber Stamp?", *Journal of Competition Law & Economics* 12 (2016), 623. https://goo.gl/yWfQ6Z.

46. The FTC currently has only one ALJ, Chief Administrative Law Judge D. Michael Chappell. See Office of Administrative Law Judges, "D. Michael Chappell, Chief Administrative Law Judge, U.S. Federal Trade Commission, 2017. https://goo.gl/fqVDi6.

47. See, e.g., Joshua D. Wright, "Judging Antitrust," Remarks of the Commissioner of the Federal Trade Commission: Global Antitrust Institute Invitational Moot Court Competition, Feb. 21, 2015. https://goo.gl/9HPBvX.