

# FTC Consumer Protection at 100: 1970s Redux or Protecting Markets to Protect Consumers?

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## ABSTRACT

*Throughout most of the Federal Trade Commission’s (“FTC” or “Commission”) history, the agency has been condemned as ineffective. Indeed, the prestigious 1969 American Bar Association Report said that the FTC should either change or be abolished. The disastrous decade of the 1970s followed, in which the FTC tried to become the second most powerful legislature in Washington. The Commission then finally developed a bipartisan regulatory program, recognizing that the FTC was not the star player in the economy but had an important role in enforcing the rules that facilitate market interactions. Following the ABA report’s recommendation, the program’s consumer protection foundation was a systematic and aggressive attack on consumer fraud.*

*This Article discusses this modern FTC, providing details on programs involving fraud, conventional advertising, and privacy. We explain how, embracing a more limited role and recognizing its past mistakes, the FTC became one of the world’s most widely respected government agencies. Unfortunately, the agency has recently lost its way in regulating traditional advertising, threatening to restrict truthful information to consumers that is vital to the optimal performance of competitive markets. We also discuss the newest part of the FTC’s mission, protecting consumer privacy. The heart of the program has been to prevent harmful misuse of sensitive information, most notably the National Do Not Call Registry, one of the most popular government initiatives ever. In attempting to broaden the basis for protection of privacy, the agency currently threatens to impede rapidly evolving information technology markets.*

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## INTRODUCTION

In the last few decades, the Federal Trade Commission (“FTC” or “Commission”) has become a premier government agency, not just in the United States, but in the world.<sup>1</sup> This 100th anniversary is an opportune time for congratulations on this achievement, reunions with

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1 See, e.g., Andrew I. Gavil, *The FTC’s Study and Advocacy Authority in Its Second Century: A Look Ahead*, 83 GEO. WASH. L. REV. 1902 (2015); Woodrow Hartzog & Daniel J. Solove, *The Scope and Potential of FTC Data Protection*, 83 GEO. WASH. L. REV. 2230 (2015); David A. Hyman & William E. Kovacic, *Can’t Anyone Here Play This Game? Judging the FTC’s Critics*, 83 GEO. WASH. L. REV. 1948 (2015); Maureen K. Ohlhausen, *Weigh the Label, Not the Tractor: What Goes on the Scale in an FTC Unfairness Cost-Benefit Analysis?*, 83 GEO. WASH. L. REV. 1999 (2015); Joshua Wright & John Yun, *Stop Chug-a-lug-a-lugin 5 Miles an Hour on Your International Harvester: How Modern Economics Brings the FTC’s Unfairness Analysis Up to Speed with Digital Platforms*, 83 GEO. WASH. L. REV. 2130 (2015).

old friends, and discussion of the many issues the agency continues to face.

At 100, we should also recognize the tortuous road the FTC took to prominence, a road whose lessons reveal that continued success is hardly guaranteed.<sup>2</sup> For most of the FTC's history, the agency was regarded as a failure, often focusing on trivia, or worse, actually harming consumers. Critics, including those writing at earlier anniversaries, thought the agency was overly political, obsessed with the insignificant, and "woefully inefficient."<sup>3</sup> By 1969, the agency had hit bottom. After a scathing Nader report,<sup>4</sup> the American Bar Association, responding to the President's request to study the agency, concluded that:

[I]t should be the last of the long series of committees and groups which have earnestly insisted that drastic changes were essential to re-create the FTC in its intended image. The case for change is plain. What is required is that changes now be made, and in depth. Further temporizing is indefensible. Notwithstanding the great potential of the FTC in the field of antitrust and consumer protection, if change does not occur, there will be no substantial purpose to be served by its continued existence; the essential work to be done must then be carried on by other governmental institutions.<sup>5</sup>

The disastrous decade of the 1970s followed. In consumer protection, the agency attempted to become, in the words of the National Chamber of Commerce, "the second most powerful legislative body in the United States," surely an inappropriate task for unelected officials.<sup>6</sup> The enterprise of drafting industry-wide rules to reshape major sectors of the American economy collapsed due to flaws in both con-

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<sup>2</sup> See, e.g., Daniel A. Crane, *Debunking Humphrey's Executor*, 83 GEO. WASH. L. REV. 1835 (2015); Jeffrey A. Eisenach & Ilene Knable Gotts, *Looking Ahead: The FTC's Role in Information Technology Markets*, 83 GEO. WASH. L. REV. 1876 (2015); Jeffrey S. Lubbers, *It's Time to Remove the "Mossified" Procedures for FTC Rulemaking*, 83 GEO. WASH. L. REV. 1979 (2015); Richard J. Pierce, Jr. *The Rocky Relationship Between the Federal Trade Commission and Administrative Law*, 83 GEO. WASH. L. REV. 2026 (2015); D. Daniel Sokol, *Analyzing Robinson-Patman*, 83 GEO. WASH. L. REV. 2064 (2015).

<sup>3</sup> See, e.g., Timothy J. Muris & Kenneth W. Clarkson, *Introduction to THE FEDERAL TRADE COMMISSION SINCE 1970: ECONOMIC REGULATION AND BUREAUCRATIC BEHAVIOR* 1-3 (Kenneth W. Clarkson & Timothy J. Muris eds., 1981).

<sup>4</sup> See *id.* at 2-3.

<sup>5</sup> AM. BAR ASS'N, REPORT OF THE ABA COMMISSION TO STUDY THE FEDERAL TRADE COMMISSION 3 (1969), quoted in Muris & Clarkson, *supra* note 3, at 3.

<sup>6</sup> Jean Carper, *The Backlash at the FTC*, WASH. POST, Feb. 6, 1977, at C1.

ception and implementation.<sup>7</sup> In competition, the agency's main goal—restructuring major industries—also failed disastrously with the collapse of cases against the cereal and oil industry and the closing of an investigation launched in 1976 originally contemplated to be the first step to breaking up the domestic auto industry.<sup>8</sup>

By 1981, the FTC, under new leadership, began searching for a new and more stable mission, one better suited to a government regulatory agency. This Article explores the FTC's consumer protection mission, discussing the bipartisan agenda that developed, with its focus on fraud, deceptive advertising, and, especially in the twenty-first century, privacy. The FTC's role is important, but as a referee, not the star player, in our economy, enforcing basic rules to protect consumers and the market process.

Part I describes the institutions for protecting consumers in the American economy and how they coordinate. In our market economy, competition spurs producers to meet consumer expectations because the market disciplines most sellers who disappoint consumers by shifting sales to producers who better meet consumer needs. These same competitive pressures also encourage producers to provide truthful information about their offerings. Markets cannot always discipline deceptive sellers, however, as when product attributes are difficult to evaluate or sellers are unconcerned about repeat business.

When competition alone cannot punish or deter seller dishonesty, private legal rights can mitigate these problems by providing basic rules for interactions between producers and consumers. Government helps here through development of the common law of property, tort, and contract, including default rules, which apply when parties do not specify rules. By reducing the consequences to the buyer that arise from a problematic exchange, these rights and default rules alleviate some of the market's weaknesses. Notwithstanding the strengths of private legal rights, seller misbehavior may not be deterred effectively in some circumstances—such as when court enforcement is impractical or economically infeasible.

When market forces are insufficient and common law is ineffective, a public agency, such as the FTC, may supplement these other institutions to preserve competition and protect consumers. The

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<sup>7</sup> See generally Timothy J. Muris, *Rules Without Reason: The Case of the FTC*, REG., Sept./Oct. 1982, at 20, 20.

<sup>8</sup> See F.M. Scherer, *Sunlight and Sunset at the Federal Trade Commission*, 42 ADMIN. L. REV. 461, 482 (1990) (describing the cereal and automobile cases as “the foci of failed FTC actions”).

FTC's consumer protection and competition missions naturally complement each other by protecting consumers from harm without restricting their market choices or their ability to obtain truthful information about products or services. The bedrock principle of the FTC's agenda should be that robust competition in a strong market is the primary bulwark of consumer protection. Thus, the Commission acts on two fronts: promoting competition and the free exchange of accurate and nonmisleading information, and attacking conduct that undermines competition, impedes the exchange of accurate information, or otherwise poses the greatest threat to consumers.

With this explanation of the FTC's role, this Article turns to the specifics of the agency's consumer protection agenda. Part II discusses the Commission's fraud program. The agency's systematic attack on fraud, which began in 1981, has replaced the failed rulemakings of the 1970s as the core of FTC consumer protection. Relying on section 13(b) of the FTC Act, and working with other federal and state agencies, and more recently agencies in other countries, the Commission has brought hundreds of cases, stopping myriad frauds, returning large sums of money to consumers, and helping sister enforcers jail the worst offenders. The FTC has used, and in some cases pioneered, modern investigative techniques to catch fraudsters and also manages a Consumer Response Center that reviews and evaluates consumer complaints in real time, providing access to law enforcement partners in other agencies to help fight fraud.<sup>9</sup>

Part III discusses the FTC's cases against other deceptive advertising. The agency has long evaluated advertising by legitimate businesses, recognizing the central role of truthful information in a market economy and the FTC's limited, but still important, role in policing misleading marketing. In recent years, however, the agency has lost its way, increasingly returning to a 1970s style of regulation that restricts useful information, relies on the agency's alleged, but nonexistent, "expertise" in interpreting advertising claims, and imposes FDA-type requirements for high proof of efficacy. Outside of prescription drugs, for which the costs of allowing poorly tested products greatly exceed the costs for nondrug products, such an approach reduces the benefits that the marketplace of information provides to consumers.

Finally, Part IV discusses privacy. With the rise of the Internet, today's FTC has a leading role in protecting sensitive consumer information. The agency initially applied so-called Fair Information Prac-

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<sup>9</sup> See *infra* notes 102–04 and accompanying text.

tices (FIPs), which focus on giving consumers notice of information collection and choice about use of that information. Because of inherent weakness in FIPs as a tool for protecting consumers, in 2001 the FTC instead switched to basing its privacy program on the adverse consequences to consumers of information misuse. The result was a dramatic increase in FTC protection of privacy, including creation of the national Do-Not-Call Registry, one of the most popular government initiatives in history.<sup>10</sup> The Commission also began policing data breaches resulting from lax security that harmed consumers primarily through injuries such as identify theft.

Since 2009, the agency has, at times, attempted to substitute more subjective concerns, such as protecting “dignity” and stopping “creepy” information collection. To date, this effort has involved much rhetoric, with little impact on FTC enforcement. Nevertheless, there are disturbing trends in the information security program and other aspects of FTC privacy protection, including failing to provide adequate guidance regarding the agency’s enforcement criteria, moving toward strict liability for data breaches, and ignoring the statutory requirement of finding substantial consumer injury when bringing cases based on unfairness.

## I. GENERAL PRINCIPLES: THE ROLE OF THE FTC IN A MARKET ECONOMY

How do competition, consumer protection, and the FTC fit in the American economy? The answer involves two subsidiary issues. First, why have a government agency, instead of relying exclusively on markets and the common law? Second, why should this be a *federal* agency?

Rather than command-and-control regulation or public or collective ownership, the United States has largely chosen free enterprise and open markets as the organizing principle of our economy. Free enterprise, however, does not mean a system without rules. Market economies need a well-specified structure of property rights, contract law, and other rules of conduct.<sup>11</sup> One can envision the American system of consumer protection as a three-legged stool: a first leg of competition based on a market economy with the second leg the legal

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<sup>10</sup> See *infra* notes 277–80 and accompanying text.

<sup>11</sup> See William E. Kovacic, *Institutional Foundations for Economic Legal Reform in Transition Economies: The Case of Competition Policy and Antitrust Enforcement*, 77 CHI.-KENT L. REV. 265, 269–70 (2001) (describing views of commentators concerning necessary legal framework for a market economy).

structure of contract, property, and other private law that focuses on the relative rights of parties. Just as a two-legged stool is unstable, markets and private legal rights, while indispensable to the American economy, falter unless buttressed by a third leg.<sup>12</sup> Public agencies—entrusted to promote consumer welfare by preserving competition and protecting consumers—work as this third leg, reinforcing the other two. This Part briefly explains the strengths and limitations of the first two legs, competition and private law, and how agencies, including the FTC, complement these strengths and mitigate their limitations.<sup>13</sup>

### A. *Competition and Its Limits*

The competitive imperative to satisfy consumers presses producers to offer the most attractive price and quality options possible. Consumers can often determine whether a product will satisfy their needs by direct inspection before purchase or by past experience with the product.<sup>14</sup> In competitive markets, when consumers dislike the offerings of one seller, they turn to others. Besides imposing a rigorous discipline to satisfy consumer preferences, competition motivates sellers to provide truthful, useful information about their products<sup>15</sup> and drives them to fulfill promises about price, quality, and other terms of sale.<sup>16</sup> Consumers punish a seller's deceit or failure to fulfill a promise by voting with their feet—and their pocketbooks.<sup>17</sup> Punishment is usually swift for underperforming sellers.<sup>18</sup>

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<sup>12</sup> The analogy of the three-legged stool is drawn from Todd J. Zywicki, *Bankruptcy Law as Social Legislation*, 5 TEX. REV. L. & POL. 393, 400–01 (2001), which applies it in a different context.

<sup>13</sup> Of course, other government agencies exist to protect this third leg, including the Anti-trust Division of the Department of Justice; parts of the Food and Drug Administration; many state attorneys general; and local, state, and federal criminal enforcement agencies.

<sup>14</sup> See J. Howard Beales, Richard Craswell & Steven C. Salop, *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491, 501–02 (1981).

<sup>15</sup> See, e.g., Paul H. Rubin, *The Economics of Regulating Deception*, 10 CATO J. 667, 679 (1991) (“There is much support in the recent literature for the proposition that, as long as deception is not allowed, there are incentives for sellers to disclose even the negative attributes of their products. This is because consumers will rationally assume that any advertisement which omits a critical piece of information (say, the durability of a product) will imply that the value of that attribute for that product is at the lowest level.” (footnote omitted)); see also Beales, Craswell & Salop, *supra* note 14, at 502.

<sup>16</sup> See, e.g., L. G. Telser, *A Theory of Self-Enforcing Agreements*, 53 J. BUS. 27, 27–28 (1980) (noting that when benefits from repeated interaction are promised, acting opportunistically causes the benefits to be lost, leading self-interested businesses to forego the one-time gain of opportunism to preserve long-term benefits.)

<sup>17</sup> See *id.* at 28.

<sup>18</sup> See *id.*

For products purchased infrequently, for which an individual consumer cannot usually rely on personal experience to evaluate a seller's truthfulness, private institutions help provide information to augment or substitute for personal experience. Third-party evaluations such as Consumer Reports provide expert advice about cars and appliances, which an average consumer may buy only once every several years,<sup>19</sup> and numerous online services allow consumers to tap the experience of others. Moreover, sellers disclose information to consumers to gain an advantage over "inferior" rivals.<sup>20</sup> Consumers perceive that the average quality of a nondisclosing seller's product is inferior to that of the disclosing seller.<sup>21</sup> Rivals may also emphasize the gap between a competitor's promises and the product it delivers.<sup>22</sup> Reputation is important to sellers,<sup>23</sup> and company brands and logos implicitly convey quality and other important product information.<sup>24</sup>

Sometimes robust competition alone will not punish or deter seller dishonesty. For these "credence goods," consumers cannot readily use their own experiences to assess whether the seller's quality claims are true, even after they consume the product.<sup>25</sup> Whereas typical consumers know whether a food product "tastes great," they cannot judge whether consuming the same product reduces the risk of cancer or whether the cost of a car repair included expenses unnecessary to fix the vehicle. Private rating systems help, as do the creation of regional or national firms with established reputations that would be severely damaged through exposure of deceit or fraud.<sup>26</sup> Nevertheless, when information is costly to produce and to use or when the

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19 See, e.g., *Reviews*, CNET MAG., <http://www.cnet.com/reviews/> (last visited Nov. 22, 2015); CONSUMER REPORTS, <http://www.consumerreports.org/cro/index.htm> (last visited Nov. 22, 2015).

20 See Beales, Craswell & Salop, *supra* note 14, at 502.

21 See *id.*

22 See *id.* at 523.

23 See Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 527 (1981) (concluding that reputation is a crucial constraint on opportunistic behavior).

24 See Rubin, *supra* note 15, at 675 ("Investments in non-salvageable firm-specific capital (capital that would become worthless if the firm were to shut down) would serve to guarantee quality since the firm would lose the value of these investments if consumers dissatisfied with low-quality products forced it to shut down by withdrawing patronage. In addition to advertising, including endorsements by celebrities, such capital includes investments in establishing trademarks and brand names, and investments in physical assets such as signs and decor.").

25 See Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67, 68–69 (1973) ("Credence qualities are those which, although worthwhile, cannot be evaluated in normal use. Instead the assessment of their value requires additional costly information.").

26 See Beales, Craswell & Salop, *supra* note 14, at 515.



information provider cannot recoup costs of producing the information because of free-rider problems,<sup>27</sup> these market mechanisms will not correct all problems. Moreover, in certain circumstances, competing firms may lack strong incentives to identify their rivals' misrepresentations if the deficiency is common to all such products.<sup>28</sup>

For credence goods, therefore, the market may not identify and discipline deceptive sellers.<sup>29</sup> Moreover, a product market with special attributes, where consumers cannot determine quality before purchase, higher quality products cost more to produce than lower quality products, and firms cannot credibly guarantee quality, may become a "lemons market" in which only low-quality products are sold.<sup>30</sup> Under these circumstances, the markets may break down because, given information asymmetries, no seller can convince consumers that it offers a high-quality product.<sup>31</sup> Consumers would pay higher prices for better quality products if they could readily identify them, but because they cannot, producers cannot recoup the additional costs of manufacture. Fortunately, the empirical evidence does not show that the lemons effect destroys markets or that only low-quality products are sold.<sup>32</sup>

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<sup>27</sup> See, e.g., *id.* at 503–04.

<sup>28</sup> *Id.* at 506. In part for this reason, industries often acquiesce to private restraints on comparative advertising claims, particularly restraints on truthful claims that "disparage" competitors' products. See 16 C.F.R. § 14.15 (2015). This reluctance also justifies certain government actions requiring disclosures of health or safety risks that are common to a class of products; for example, requiring health warnings on tobacco products. See, e.g., Federal Cigarette Labeling and Advertising Act, 15 U.S.C. §§ 1331–1340 (2012).

<sup>29</sup> See Darby & Karni, *supra* note 25, at 67–69 ("Hence, the contention that competitive markets are sufficient to prevent fraud by, at least, established firms, because of the effect on future sales of the eventual discovery of fraud, does not hold in this case. The provision of joint diagnosis and repair implies that some fraud can be successful because of the high, if not prohibitive, costs of discovery of the fraud.").

<sup>30</sup> See generally George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488, 488–500 (1970).

<sup>31</sup> See *id.* at 495.

<sup>32</sup> Although market destruction is rare, if it occurs at all, some studies show that consumer inability to determine quality ex ante has detectable effects. For example, a recent study of the used car market found that trading for eight-year-old cars was delayed on average by about four months. Jonathan R. Peterson & Henry S. Schneider, *Adverse Selection in the Used-Car Market: Evidence from Purchase and Repair Patterns in the Consumer Expenditure Survey*, 45 RAND J. ECON. 140, 143 (2014). The effect for Hondas and Toyotas was smaller, around one month, than the effect for the American cars studied, the worst of which was about five months. See *id.* at 152 (Figure 3). Even in insurance markets, there is little systematic evidence of market destruction. See Peter Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat*, 113 YALE L.J. 1223, 1224 (2004); see also Timothy J. Muris, *California Dental Association v. FTC: The Revenge of Footnote 17*, 8 SUP. CT. ECON. REV. 265, 288–89 (2000) (discussing rarity of lemons markets).

Behavioral economics is a more recent, and in some ways more fundamental, challenge to the benefits of markets for protecting consumers. Even with perfect foresight, people make mistakes, and, as a result, sometimes will make decisions contrary to their self-interest.<sup>33</sup> If these were random decisionmaking errors, government intervention would be unwarranted.<sup>34</sup> Under behavioral economics theory, however, these errors are not treated as random,<sup>35</sup> but rather as consistently irrational decisions.<sup>36</sup>

For example, some behavioral economists argue that “consumers exhibit a present bias, or hyperbolic discounting, also referred to as “myopia or self-control problems.”<sup>37</sup> “Consumers will choose a small reward today over a larger reward later,” although “if both rewards are far in the future, then they will frequently choose the larger reward.”<sup>38</sup> Choosing immediate gains over long-term costs can result in short-term decisions that produce long-term distress.<sup>39</sup>

There are numerous problems with using behavioral economics to guide consumer protection policy. To begin with, even among enthusiasts behavioral economics does not yield consistent predictions about which biases may be relevant in particular situations.<sup>40</sup> The expected impact of potential government intervention on consumer action is therefore somewhat ad hoc.<sup>41</sup> A second problem is that behavioralists too often ignore market institutions and the nature of market equilibria that prevent consumer harm. For example, it is possible to achieve perfectly competitive outcomes without fully informed consumers.<sup>42</sup> As long as an informed minority large enough to be worth competing for exists, competition for the informed will drive all sellers to provide product characteristics that informed buyers

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<sup>33</sup> See Richard E. Hattwick, *Behavioral Economics: An Overview*, 4 J. BUS. & PSYCHOL. 141, 145 (1989).

<sup>34</sup> See J. Howard Beales III, *Consumer Protection and Behavioral Economics: To BE or Not to BE?*, 4 COMPETITION POL'Y INT'L 149, 156 (2008).

<sup>35</sup> See *id.* at 152–54, 156 (discussing systematic perceptual bias).

<sup>36</sup> See *id.* at 156.

<sup>37</sup> See *id.* at 157.

<sup>38</sup> *Id.*

<sup>39</sup> See *id.*

<sup>40</sup> See *id.* at 157–59.

<sup>41</sup> See *id.*

<sup>42</sup> *Id.* at 152; see also Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 635–37 (1979).

value.<sup>43</sup> Even in standard form contracts, the marginal informed consumer drives the contract terms that are offered to all consumers.<sup>44</sup>

In general, consumers make investments (such as in education) to learn how to make decisions for a particular type of choice, or they can learn from their experience with such choices over time.<sup>45</sup> A recent study of consumer choices of credit card contracts found that most consumers choose optimally, and that among those who made mistakes, those who made the largest mistakes were most likely to change to a more optimal credit card contract.<sup>46</sup> Thus, the mix of consumers, consumer learning, and firm responses to consumer choice patterns (or mistakes) will influence the market equilibrium that results, even if behavioral principles are relevant to some consumers.

In any real-world market, there may be consumers who regret their choices, and government regulators may be tempted to intervene. We argue here that intervention should reinforce, not supplant, the market as some behavioralists recommend. We have little, if any, reliable empirical evidence addressing the benefits and costs of possible interventions based on behavioral principles, and the adverse effects and unintended consequences of well-intentioned government regulation are well known.<sup>47</sup> Moreover, at an FTC conference on behavioral economics, “there was general agreement that more evidence based on market settings is required to justify” changes in consumer or competition policy.<sup>48</sup>

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<sup>43</sup> See Beales, *supra* note 34, at 152–53; Schwartz & Wilde, *supra* note 42, at 635.

<sup>44</sup> See Beales, *supra* note 34, at 152–53; For evidence addressing shopping for standardized franchise contracts, see J. Howard Beales III & Timothy J. Muris, *The Foundations of Franchise Regulation: Issues and Evidence*, 2 J. CORP. FIN. 157, 158–60 (1995). For evidence of shopping for personal loan terms, see James R. Barth et al., *Benefits and Costs of Legal Restrictions on Personal Loan Markets*, 29 J.L. & ECON. 357, 379 (1986).

<sup>45</sup> Becker and Stigler use the household production model to explore a number of situations in which human capital stocks are important. See George J. Stigler & Gary S. Becker, *De Gustibus Non Est Disputandum*, 67 AM. ECON. REV. 76, 89 (1977).

<sup>46</sup> Sumit Agarwal et al., *Do Consumers Choose the Right Credit Contracts?*, 4 REV. CORP. FIN. STUD. 239, 242 (2015).

<sup>47</sup> See, e.g., W. KIP VISCUSI ET AL, *ECONOMICS OF REGULATION AND ANTITRUST* 798–802 (4th ed. 2005).

<sup>48</sup> See JOSEPH P. MULHOLLAND, SUMMARY REPORT ON THE FTC BEHAVIORAL ECONOMICS CONFERENCE 19–20 (2007), <https://www.ftc.gov/sites/default/files/documents/reports/summary-report-ftc-behavioral-economics-conference/070914mulhollandrpt.pdf>. Furthermore, the Australian Productivity Commission concluded: “[c]rucially, most policy proposals (regardless of their supporting premises) require a case-by-case, empirical evaluation of their costs and benefits.” AUSTL. GOV’T PRODUCTIVITY COMM, 2 REVIEW OF AUSTRALIA’S CONSUMER POLICY FRAMEWORK: PRODUCTIVITY COMMISSION INQUIRY REPORT 388 (2008), <http://www.pc.gov.au/inquiries/completed/consumer-policy/report>. Even the Organisation for Economic Co-operation and Development (OECD), perhaps the most enthusiastic assessor of the potential impact of

Legitimate companies care about how consumers regard them. They count on repeat business and word-of-mouth endorsements to increase sales. By contrast, the commercial thief loses no sleep over its standing in the community and is unconcerned about repeat business. These fraudsters cheat consumers, grab the revenues, and disappear from sight, often to re-emerge in another guise to steal again.

When market forces cannot overcome these threats to consumer welfare, e.g., because some sellers are unconcerned about repeat business and reputation or because information asymmetries make deception difficult to detect, other ways exist to regulate exchanges. The second leg of the stool, private legal rights, not only complements the competitive market; it can also overcome, or at least mitigate, some of these market problems.

### *B. Private Legal Rights and Their Limits*

One of the crucial roles for government is to define and allocate legal rights. Courts and government agencies can both define and protect those rights. The triad of property, contract, and tort law provides basic legal rules permitting ownership, voluntary transference, and protection from harmful involuntary interactions. If parties could breach without legal consequence, the voluntary exchange of promises of future performance would not disappear, however.<sup>49</sup> Before the rise of formal contract law, voluntary exchanges existed, as parties used credit bureaus, bonding, reliance on experience from past dealings, and similar devices to ensure performance.<sup>50</sup> Nevertheless, compared to the contract law that developed, the alternative system was

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behavioral economics on policy, concluded: “[A]lthough there has been significant research in some areas (for example in certain financial markets), a more specific evidence base still needs to be identified before there is a more widespread policy approach.” ORG. ECON. CO-OPERATION & DEV., DIRECTORATE SCI., TECH. & INDUS., COMMITTEE ON CONSUMER POLICY, *ROUNDTABLE ON DEMAND-SIDE ECONOMICS FOR CONSUMER POLICY: SUMMARY REPORT 5* (2006), <http://www.oecd.org/internet/consumer/36581073.pdf>.

<sup>49</sup> See, e.g., Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615, 616 (1981) (examining the “repeat-purchase contract-enforcement mechanism” of private arrangements).

<sup>50</sup> See, e.g., Avner Greif, *Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders’ Coalition*, 83 AM. ECON. REV. 525, 530 (1993); Daniel B. Klein, *Promise Keeping in the Great Society: A Model of Credit Information Sharing*, in REPUTATION: STUDIES IN THE VOLUNTARY ELICITATION OF GOOD CONDUCT 267, 267–68 (Daniel B. Klein ed., 1997); Zywicki, *supra* note 12, at 401 n.36 (“For centuries commerce [based largely on promise keeping] existed outside of the jurisdiction of any political authority . . . . Modern commercial law was invented and enforced not by governments, but by merchants themselves.” (internal quotation marks omitted)).

inefficient because it was almost certainly more costly.<sup>51</sup> Credit bureaus and bonding, for example, increase the cost of contracting, at least because the parties need another contract to protect themselves from the consequences of breach.<sup>52</sup> In some cases—those that economists like to call “at the margin”—these costs would be so high that certain exchanges would not be made at all.<sup>53</sup>

One of the most useful roles for government is to provide default rules. Default rules are terms that apply when the parties do not explicitly specify otherwise.<sup>54</sup> The more efficient these rules, the greater the scope for exchange, and thus the greater the gain in consumer welfare.<sup>55</sup> When contracts are formed, even in the most complex transactions, parties do not find it useful to protect against every possible contingency.<sup>56</sup> Instead, courts, legislatures, and agencies have developed default rules that are like buying off-the-rack rather than specially tailored clothes.<sup>57</sup> Rather than writing your own contract, you get some terms “off-the-rack,” as they have come down in judicial and legislative pronouncements.<sup>58</sup> Many of these rules of exchange are so basic—for example, rules against fraud, breach of contract, and deceptive advertising—that we do not even think of them as rules at all. In this way, a vast and increasingly sophisticated common law has evolved to govern consumer and other commercial transactions.

Contractual terms, such as warranties and money-back guarantees, may alleviate some of the problems that would otherwise exist in a market economy, such as information asymmetries.<sup>59</sup> There are

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51 For certain industries, the system of contract rules can itself be inefficient. See, e.g., Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 135 (1992) (concluding that “extralegal contracts are more likely to become an industry norm in situations where traditional contract remedies are likely to lead to inefficiently high levels of breach of contract and the market is organized in a way that makes other methods of enforcing these agreements possible”).

52 See Klein, *supra* note 50, at 272–85.

53 See *id.*

54 See Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 732 (1992).

55 *Id.*

56 *Id.*

57 See *id.*; Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 261–62, 266 (1985).

58 Goetz & Scott, *supra* note 57, at 261–62, 266, 287–88 (1985).

59 See, e.g., Beales, Craswell & Salop, *supra* note 14, at 511–12 (noting that such contractual terms may partially indemnify the buyer against making a wrong decision based on a lack of information and may act as a signal of the product’s quality because warranties are cheaper to provide if the products seldom fail).

transaction costs involved in negotiating, forming, and enforcing contracts, however.<sup>60</sup> Moreover, using courts to enforce consumer transactions is often economically infeasible.<sup>61</sup> When disputes involve small losses to individual consumers, private lawsuits are often not useful because the costs of suing, including nonpecuniary costs, far outweigh any likely redress.<sup>62</sup> Class actions also suffer from structural problems such as inadequate consumer redress and excessive attorneys fees that limit its ability to protect consumer welfare adequately.<sup>63</sup> Further, small claims courts often do not reduce the costs of litigation sufficiently.<sup>64</sup>

Market factors, including a business's concerns about repeat business and reputation, augment the common law and overcome some of the incentives a seller otherwise might have to dishonor its agreements. In return, common law can complement the operation of the market. For example, judicial remedies reduce the risk of transacting with a new entrant, allowing the transaction to occur at lower cost.<sup>65</sup> These remedies encourage market participants to patronize new firms, with whom they have not previously transacted, who have no prior pattern of repeat dealings, and who have not yet established a reputation.<sup>66</sup>

In some cases, even market forces and common law together may not discipline bad actors. One can imagine sellers unconcerned about

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<sup>60</sup> See George M. Cohen, *The Fault Lines in Contract Damages*, 80 VA. L. REV. 1225, 1242–43 (1994).

<sup>61</sup> *Id.* at 1230, 1242–43.

<sup>62</sup> *Id.* at 1243–44.

<sup>63</sup> See Thomas B. Leary, Former FTC Comm'r, *The FTC and Class Actions: Remarks Before the Class Action Litigation Summit*, Washington, D.C. (June 26, 2003), <http://www.ftc.gov/public-statements/2003/06/ftc-and-class-actions> (identifying flaws in the class action system from the lack of an actual plaintiff, which increases the risk of collusive settlements between class counsel and defendant's counsel, inadequate consumer redress, excessive attorney's fees, and the prosecution of meritless cases that harm consumers indirectly).

<sup>64</sup> See, e.g., Arthur Best et al., *Peace, Wealth, Happiness, and Small Claims Courts: A Case Study*, 21 FORDHAM URB. L.J. 343, 367 (1994) (“The complexity of the existing apparatus for collection in Denver forces many small claims judgment creditors to go to an attorney for assistance in collecting a judgment. These additional costs can severely undercut the otherwise low cost of winning the judgment.”).

<sup>65</sup> See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 4.1, at 95 (9th ed. 2014); Todd J. Zywicki, *The Past, Present, and Future of Contract Governance: An Economic Theory of Contract Governance* 67 (July 1, 2009) (unpublished manuscript) (on file with author) (noting that reduced information about a potential trading partner makes parties less willing to contract: “at some point, the overall costs of relying on informal norms becomes sufficiently high that it becomes efficient to create institutions to enforce promises, despite the administrative costs of doing so”).

<sup>66</sup> See Zywicki, *supra* note 65, at 31–32, 67.

repeat customers or reputation, or who make product claims difficult to verify, and who know that few injured consumers will use costly lawsuits to vindicate their rights.

*C. Government Agencies—Including the Federal Trade Commission*

When the common law does not protect consumers' rights, as when injury claims are small individually but significant in the aggregate, and market forces are ineffective, another institution may overcome these weaknesses and thereby reinforce the effectiveness of competitive markets and common law.<sup>67</sup> Public agencies—entrusted to preserve competition and protect consumers—work as the third leg of the stool, reinforcing these other two legs in support of the market economy.<sup>68</sup>

A key part of the FTC's mission is to help preserve competitive markets, supporting the first leg.<sup>69</sup> Our nation's faith in markets "is firmly grounded in the principle that free enterprise and competition are the best guarantors of commercial freedom, economic efficiency, and consumer welfare."<sup>70</sup> The United States uses antitrust law to provide the governing rules for competition in most of the economy. Competition policy protects consumers, not competitors.<sup>71</sup> "Antitrust law helps maintain effective competition by prohibiting conduct that unreasonably restricts markets."<sup>72</sup> Antitrust law "is a form of regulation that competes with other regulatory structures"<sup>73</sup> and, in most instances, makes direct regulation unnecessary. Another option for addressing market problems is comprehensive sectoral regulation, which ordinarily entails strict controls on prices, entry, and conduct. For parts of our economy, state and federal governments have adopted this latter strategy, often at great costs.<sup>74</sup>

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<sup>67</sup> See generally Timothy J. Muris, *Looking Forward: The Federal Trade Commission and the Future Development of U.S. Competition Policy*, 2003 COLUM. BUS. L. REV. 359 (arguing that the FTC can serve as a mechanism to overcome these forces and protect consumers).

<sup>68</sup> Of course, government has its own limits, which must be considered when developing public policies. As the introduction to this Article notes, the FTC once imposed great costs on consumers and the economy.

<sup>69</sup> See Muris, *supra* note 67, at 363.

<sup>70</sup> *Id.* at 366.

<sup>71</sup> See, e.g., *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (noting that federal antitrust laws are designed "for the protection of *competition*, not *competitors*" (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962))).

<sup>72</sup> Muris, *supra* note 67, at 366.

<sup>73</sup> Timothy J. Muris, *Antitrust's Next Decade*, in BETTY BOCK ET AL., *IS ANTITRUST DEAD?* 55, 55 (1989).

<sup>74</sup> See VISCUSI ET AL., *supra* note 47, at 802. Moreover, there are many benefits from combining antitrust and consumer protection in one agency. An important form of osmosis runs

Consumer protection policy, the focus of this Article, has a vital role in supporting markets. It helps ensure that consumers can make well-informed decisions about their choices and that sellers will fulfill their promises rather than lying about their products to increase sales. Prevention of deception helps consumers, most obviously by deterring deceptive sellers, but also by making it easier for honest sellers to convey credible claims about their products.

Lost sales to an honest competitor are not the only harm the dishonest inflict on legitimate businesses. If many sellers lie about their products, a pernicious atmosphere of consumer distrust may develop, harming society in several ways. Deceit by one group of sellers may lead consumers to doubt the integrity of an entire industry or to distrust markets generally.<sup>75</sup> In such a world, truthful sellers must resort to extraordinary measures to persuade consumers of their honesty. Even if honest suppliers take precautions to show their trustworthiness, some consumers may avoid purchases that otherwise would improve their well-being. Not surprisingly, therefore, the FTC focuses heavily on preventing fraud and deceptive advertising. By striving to keep sellers honest, consumer protection policy does more than safeguard the interests of the individual victim—it serves the interest of consumers generally and facilitates competition.

Under the FTC Act, the Commission proscribes “unfair or deceptive acts or practices,”<sup>76</sup> thereby helping to reinforce the common law rules of exchange. Simply stated, the core of modern consumer protection policy is to protect consumer sovereignty by attacking practices that impede consumers’ ability to make informed choices, such as fraud, unilateral breach of contract, and unauthorized billing.<sup>77</sup> As

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from competition to consumer protection policy. Because of its antitrust responsibilities, the agency is well aware that robust competition is the single best means to protect consumers.

<sup>75</sup> Of course, consumer awareness of potential deception is an important part of consumer self-protection and is why the FTC has an active consumer education program. See *Division of Consumer & Business Education*, FED. TRADE COMM, <https://www.ftc.gov/about-ftc/bureaus-of-fices/bureau-consumer-protection/our-divisions/division-consumer-business> (last visited Nov. 22, 2015).

<sup>76</sup> See 15 U.S.C. § 45(a)(1) (2012).

<sup>77</sup> After a long struggle over the extent of its unfairness jurisdiction, the Commission adopted a cost-benefit analysis for unfairness, which was subsequently codified. See 15 U.S.C. § 45(n); J. Howard Beales III, *The Federal Trade Commission’s Use of Unfairness Authority: Its Rise, Fall, and Resurrection*, 22 J. PUB. POL’Y & MARKETING 192 (2003) (providing a history of the FTC’s unfairness jurisdiction). In 1980, the Commission itself recognized that unfairness as defined in section 5 of the FTC Act should be circumscribed. See FED TRADE COMM’N, COMMISSION STATEMENT OF POLICY ON THE SCOPE OF THE CONSUMER UNFAIRNESS JURISDICTION (1980), reprinted in Int’l Harvester Co., 104 F.T.C. 949, 1070 (1984) [hereinafter UNFAIRNESS STATEMENT]. In 1982, the Commission further clarified the reach of unfairness, eliminating the



discussed above, resort to courts for enforcement of consumer transactions often does not work well when many consumers suffer small injury. While private class actions can provide some relief for class members, the FTC can act in the interest of all consumers, free from the conflicting incentives in current class actions.

The Commission also can provide “rules of the game” that reduce consumer harm. The Commission can establish new default rules and procedures for transference of rights when it is otherwise difficult to do so. Nevertheless, when seeking to facilitate the exercise of consumer choice, the agency should be highly cognizant of shackling market forces unduly.<sup>78</sup> For example, this balance undergirds the FTC’s approach to unsolicited telemarketing calls, which lets consumers decide whether or not they wish to receive such calls and express their preferences through the Do-Not-Call registry.<sup>79</sup> Once these new rules of exchange are established, if transaction costs are low, parties can more easily transfer these rights.<sup>80</sup>

The FTC also uses its distinct institutional capabilities through its full range of tools—prosecuting cases, conducting studies, holding hearings and workshops, engaging in advocacy before other government bodies, and educating businesses and consumers—to address competition and consumer protection issues.<sup>81</sup> Beyond the immediate

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possibility that public policy could form an independent basis for a finding of unfairness. See James C. Miller III, *FTC’s Letter to Senate Subcommittees on Bill to Restrict Agency’s Jurisdiction over Professionals and Unfair Acts or Practices*, 42 Antitrust & Trade Reg. Rep. (BNA) 568, 570 (1982). Consumer sovereignty may be frustrated ex ante if, for example, important information is not provided. See *Labeling and Advertising of Home Insulation*, 16 C.F.R. pt. 460 (2015). It may be frustrated ex post if sellers do not honor their contracts with consumers. See *Orkin Exterminating Co., Inc.*, 108 F.T.C. 263 (1986), *aff’d sub nom.* *Orkin Exterminating Co., Inc. v. FTC*, 849 F.2d 1354 (11th Cir. 1988). The three-part unfairness test—that injury must be (1) substantial, (2) without offsetting benefits that outweigh the harm, and (3) one that consumers cannot reasonably avoid—is designed to provide a rational, empirical means to determine whether the challenged acts or practices interfere with consumers’ ability to make choices. See *id.* at 320 (citing UNFAIRNESS STATEMENT, *supra*, at 1072).

<sup>78</sup> See, e.g., Staff of the Bureau of Consumer Protection, the Bureau of Economics, and the Office of Policy Planning of the FTC, Comment on Food Labeling: Health Claims; Dietary Guidance, Food & Drug Administration Docket No. 2003-0496, at 5 (Jan. 26, 2004) [hereinafter FTC Comment on Food Labeling], [https://www.ftc.gov/sites/default/files/documents/advocacy\\_documents/ftc-staff-comment-food-and-drug-administration-concerning-labeling-health-claims-dietary-guidance/040126fdacommments.pdf](https://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-food-and-drug-administration-concerning-labeling-health-claims-dietary-guidance/040126fdacommments.pdf).

<sup>79</sup> See *infra* Part V.B.

<sup>80</sup> See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15–16 (1960) (“Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about.”).

<sup>81</sup> Muris, *supra* note 67, at 380–84.

goal of stopping a particular bad practice or promoting a beneficial one, the Commission's activities improve the institutions and processes by which policies are formulated and applied.

The agency's knowledge base involves an investment in policy research and development ("R&D").<sup>82</sup> The Commission is the public equivalent of a private firm whose success requires substantial R&D. Just as a high-technology company must perform research to develop new products, so too must the FTC expand its knowledge to design law enforcement and other policies to combat current and anticipated consumer protection problems.

## II. SUBSTANTIVE ISSUES: ATTACKING FRAUD IS THE HEART OF FTC CONSUMER PROTECTION

In the 1970s, the FTC sought to transform entire industries, proposing numerous rules, most of which lacked a clear legal theory and empirical evidence that a rule was necessary.<sup>83</sup> This effort failed because of these substantive flaws, the internal inadequacies of the Commission's procedures, and intense bipartisan opposition from members of Congress.<sup>84</sup>

The Commission needed a new vision of its consumer protection mission and turned to attacking fraud, as the prestigious American Bar Association Report had recommended in 1969.<sup>85</sup> Fraud is essentially theft, which both distorts market forces and limits the ability of consumers to make informed choices. Fraud reduces the value of legitimate advertising and thereby raises costs for legitimate competitors, who must offer more assurances of performance to overcome consumers' wariness.

Nevertheless, there was considerable justification for the FTC's decision in the 1970s to ignore fraud. Fraudsters are unlikely to obey legal rules unless forced to do so. The FTC lacked criminal authority, and while the FTC could issue cease-and-desist orders, it could not recover the money lost to fraud. To help remedy these problems, Congress in 1975 expanded the agency's ability to obtain monetary relief.<sup>86</sup> Recognizing that the FTC Act's proscription of "unfair and deceptive acts or practices" was "both broad and often ill defined,"

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<sup>82</sup> See e.g., *id.* at 403–06.

<sup>83</sup> See Muris, *supra* note 7, at 20–21; Teresa M. Schwartz, *Regulating Unfair Practices Under the FTC Act: The Need for a Legal Standard of Unfairness*, 11 AKRON L. REV. 1, 3 (1977).

<sup>84</sup> See Muris, *supra* note 7, at 20–21.

<sup>85</sup> AM. BAR ASS'N, *supra* note 5.

<sup>86</sup> See generally J. Howard Beales III & Timothy J. Muris, *Striking the Proper Balance: Redress Under Section 13(b) of the FTC Act*, 79 ANTITRUST L.J. 1, 2 (2013).

Congress declined to allow “open-ended” monetary relief in favor of two provisions that provided for monetary relief only under narrow conditions.<sup>87</sup> Section 19 permitted consumer redress in federal court only for practices that a reasonable person would have known were “dishonest or fraudulent” and only after an FTC administrative proceeding to determine whether a violation had occurred.<sup>88</sup> Under section 5(m)(1)(B), the Commission can obtain civil penalties for an act or practice that the Commission, in litigation, had previously determined was unfair or deceptive, but only if the company knew of that determination.<sup>89</sup> Neither provision would work against fraud because the investigative target could hide the money long before it would be ordered to pay redress.

Thus, to attack fraud successfully the FTC needed to freeze assets pending a final determination on the merits. The agency turned to the second proviso of section 13(b), added to the FTC Act in 1973, which provides that “in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction.”<sup>90</sup> Relying on this authority, the Commission could ask a federal district court not only to issue an ex parte order freezing assets and enjoining ongoing violations, but also to dispose of the case on its merits, ordering, if appropriate, that the frozen assets be returned to consumers and that a permanent injunction issue.<sup>91</sup> This use of section 13(b) became known as the “Section 13(b) Fraud Program.”<sup>92</sup>

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<sup>87</sup> *Id.*

<sup>88</sup> 15 U.S.C. § 57b (2012).

<sup>89</sup> *Id.* § 45(m)(1)(B). In addition, Congress enacted section 18, which also provided for monetary relief, *id.* § 57a, starting after the Commission first promulgated a rule. Additionally, section 19 authorizes civil penalties for rule violations. *Id.* § 57b.

<sup>90</sup> *Id.* § 53(b). The first part of section 13(b) provides, in pertinent part:

Whenever the Commission has reason to believe—

(1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and

(2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public—

the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that, weighing the equities and considering the Commission’s likelihood of ultimate success, such action would be in public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond . . . .

<sup>91</sup> *Id.*

<sup>92</sup> See generally David R. Spiegel, *Chasing the Chameleons: History and Development of the FTC’s 13(b) Fraud Program*, ANTITRUST, Summer 2004, at 43. The Commission had begun

Admittedly, the use of section 13(b) had its detractors, who argued that the 1975 amendments provided the exclusive road to financial relief.<sup>93</sup> The response was twofold. First, the asset freeze rested on the strong foundation of section 13(b) and the sense that the Commission should not be forced into three separate legal proceedings to resolve a single matter, as section 19 would have required.<sup>94</sup> Indeed, the legislative history of the 1975 amendments recognized that judges might be reluctant to issue preliminary relief unless they could ensure their ability to issue a final decision on the merits expeditiously.<sup>95</sup> Second, and equally important, because the Commission was attacking fraud, it was respecting the carefully crafted congressional limitations of the 1975 amendments that authorized monetary relief only against dishonest or fraudulent conduct.

In this early period, the Commission also brought three cases against sellers of gemstones and five cases involving oil and gas.<sup>96</sup> The fraud program was successful.<sup>97</sup> The first case involved defendants

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to explore possible uses of section 13(b) and section 19 before the fraud program launched in late 1981, but there was no systematic effort to attack fraudulent practices. After the fraud program was launched, two of those exploratory cases resulted in highly useful circuit court opinions in 1982. *See* *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1109 (9th Cir. 1982) (affirming district court grant of preliminary relief); *FTC v. Sw. Sunsites, Inc.*, 665 F.2d 711, 724 (5th Cir. 1982) (remanding for district court to reconsider denial of preliminary relief, and strongly suggesting that preliminary relief would be appropriate).

<sup>93</sup> *See* Beales & Muris, *supra* note 86, at 25–26.

<sup>94</sup> *See* David M. FitzGerald, *The Genesis of Consumer Protection Remedies Under Section 13(b) of the FTC Act* 11–12 (Sept. 23, 2004), [http://www.ftc.gov/sites/default/files/documents/public\\_events/FTC%2090th%20Anniversary%20Symposium/fitzgeraldremedies.pdf](http://www.ftc.gov/sites/default/files/documents/public_events/FTC%2090th%20Anniversary%20Symposium/fitzgeraldremedies.pdf) (“To obtain complete final relief, the Commission would need to litigate and win three separate actions: (1) a Section 13(b) preliminary injunction proceeding to obtain a preliminary asset freeze; (2) an administrative proceeding leading to a final cease and desist order; and (3) a district court action to obtain consumer redress under Section 19.”); *see also id.* at 19 (describing such a “three-part process” as “lengthy and cumbersome” and noting that “[t]he permanent injunction proviso of Section 13(b) . . . offered a much more effective and efficient weapon against fraud . . .”).

<sup>95</sup> *Id.* at 12.

<sup>96</sup> *The Economy and Fraud: Protecting Consumers During Downward Economic Times: Hearing Before the Subcomm. on Consumer Prot., Prod. Safety, & Ins. of the S. Comm. on Commerce, Sci., & Transp.*, 111th Cong. 42 (2009) (prepared statement of Timothy J. Muris, Professor, George Mason University School of Law and of Counsel, O'Melveny & Meyers LLP [hereinafter *Economy and Fraud Hearing*]). In these initial consumer protection section 13(b) cases, Commission staff began the practice, still followed today, of working closely with other government agencies, such as the Department of the Interior's Bureau of Land Management, and federal criminal enforcement authorities such as the United States Postal Inspection Service and the Secret Service in developing investigations and litigating cases. Parallel investigation and prosecution by both the FTC and criminal authorities are important aspects of the Commission's section 13(b) program.

<sup>97</sup> *See* FitzGerald, *supra* note 94, at 8–9.

that fraudulently sold diamonds for investment.<sup>98</sup> Subsequent actions were brought against boiler rooms that sold advisory services for the federal oil and gas lease lottery, as well as actions against the sellers of worthless oil and gas leases themselves.<sup>99</sup> Most recently, in 2013 the FTC filed forty-three actions in federal courts and obtained ninety-one orders for redress, disgorgement, and permanent injunctions, with total redress and disgorgement of \$297 million.<sup>100</sup> That year the Commission also approved twenty-nine administrative orders and fourteen civil penalty actions, resulting in orders assessing a total of \$20 million in civil penalties.<sup>101</sup>

To attack fraud effectively required new investigative techniques geared for speed and stealth. Initially, the new tool was taping of defendants' sales presentations, still a critical technique in many of the Commission's fraud cases.<sup>102</sup> At the same time, the agency developed a group of professional investigators trained to uncover fraudulent schemes, determine ownership and control of such schemes, trace assets, develop evidence, preserve evidence for trial, and testify in court.<sup>103</sup> More recently, Commission investigators have become experts in Internet investigative techniques and have provided training for hundreds of local, state, federal, and international criminal and civil law enforcement offices.<sup>104</sup>

The Commission's ability to protect consumers from these scams was aided immeasurably by the creation of the Consumer Response Center (CRC) in the 1990s—a central facility with trained call center staff and an automated call distribution system to record and respond to consumer complaints and inquiries. The existing telemarketing fraud complaint database, in operation since the early 1990s, was dramatically upgraded and revamped into Consumer Sentinel, a system

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<sup>98</sup> See *FTC v. Int'l Diamond Corp.*, No. C-82-0878 WAI (JSB), 1983 WL 1911 (N.D. Cal. Nov. 8, 1983). The Commission previously had pursued administrative cases against unconventional gemstone investments. *E.g., In re Thomas L. Baker, Inc.*, 100 F.T.C. 461 (1982) (complaint and consent order).

<sup>99</sup> See *Economy and Fraud Hearing*, *supra* note 94, at 42.

<sup>100</sup> *Annual Highlights 2013: Stats & Data 2013*, FED. TRADE COMM'N, <http://www.ftc.gov/reports/annual-highlights-2013/stats-data-2013>.

<sup>101</sup> *Id.*

<sup>102</sup> See FitzGerald, *supra* note 94, at 20.

<sup>103</sup> See *id.* at 19–20.

<sup>104</sup> See Press Release, Fed. Trade Comm'n, *FTC Testimony Portends Increase in Privacy Protection Efforts and Aggressive Antitrust Law Enforcement* (Mar. 19, 2002), <https://www.ftc.gov/news-events/press-releases/2002/03/ftc-testimony-portends-increase-privacy-protection-efforts-and>

linking law enforcers through a secure Internet site.<sup>105</sup> Consumer Sentinel enabled the CRC staff to enter data from consumer complaint calls in real time. Initially scores, and ultimately hundreds, of law enforcement agencies at the state, federal, and local levels joined the system, gaining access to the complaint database, as well as the opportunity to “cross-walk” their own complaint data into the Consumer Sentinel database.<sup>106</sup> Other entities, such as local Better Business Bureaus, also were invited to contribute complaint data to the Sentinel database.<sup>107</sup> Consumer Sentinel strengthened the fraud program by improving the staff’s ability to spot emerging trends, to identify bad actors more quickly, and to locate potential witnesses to support the Commission’s cases.

To ensure that the Commission uses its database effectively, in this century the agency began national surveys of fraud victims.<sup>108</sup> This information helps assess the significance of complaints the FTC receives and, more importantly, of complaints it does not receive. In addition, because the threat of criminal prosecution will deter some hardcore scam artists, the Commission has developed relationships with criminal law enforcement authorities to encourage the prosecution of the worst actors. This includes working with the Office of Criminal Litigation at the Department of Justice to determine the best cases for criminal prosecution, as well as developing relationships with Assistant United States Attorneys across the country to help them prosecute fraud in their districts.

The development of the Internet and the related increase in international commerce provide enormous benefits to consumers as well as multiplied opportunities for fraud. Today, satellite networks broadcast advertisements around the world, with operators waiting to take orders in the caller’s own language. Telemarketers routinely call U.S. consumers from Canada. Most significantly, in many markets the Internet is transcending national borders.

In developing new tools to fight fraud, the Commission has sought to multiply its effectiveness by working with consumer protec-

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105 See FED. TRADE COMM’N, THE FTC’S FIRST FIVE YEARS PROTECTING CONSUMERS ONLINE 4–5 (1999), <https://www.ftc.gov/sites/default/files/documents/reports/protecting-consumers-online/fiveyearreport.pdf>.

106 See Am. Bar Ass’n, *Interview with FTC Commissioner Julie Brill*, ANTITRUST SOURCE, Feb. 2012, at 9.

107 See *id.*

108 E.g., Press Release, Fed. Trade Comm’n, *FTC Releases Survey of Identity Theft in the U.S. Study Shows 8.3 Million Victims in 2005* (Nov. 27, 2007), <https://www.ftc.gov/news-events/press-releases/2007/11/ftc-releases-survey-identity-theft-usstudy-shows-83-million>.

tion agencies around the world to help these agencies fight practices that distort consumer choice and raise a serious threat to the proper functioning of markets. Such cooperation helps foster consistent, market-driven policies internationally.

Greater consistency among consumer protection rules will reduce compliance burdens for businesses selling internationally. In particular, the more commonality among different consumer protection regimes, the less burden merchants will face from different, and potentially conflicting, rules. To promote these goals, in 2002, the agency created an International Division in the Bureau of Consumer Protection.<sup>109</sup> As with consumer protection in general, the first priority of the international consumer protection program was combating fraud. Indeed, as the Commission's *domestic* efforts have become more effective, scam artists have recognized that the FTC and its foreign counterparts face significant obstacles in trying to fight *cross-border* fraud.<sup>110</sup> Increasingly, scam artists take advantage of these law enforcement difficulties by using facilities in one country to target consumers in others.<sup>111</sup> In 2013, eleven percent of consumer complaints filed with the FTC involved cross-border fraud.<sup>112</sup>

Cases involving international defendants have offshore evidence or assets. In recent years, for example, the FTC brought over fifty law enforcement actions involving cross-border components.<sup>113</sup> Examples include fraudulent money transfer systems abused by Canadian agents,<sup>114</sup> deceptively marketed directory listings to U.S. organizations

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<sup>109</sup> In 2007, international programs in the Bureau of Competition, Bureau of Consumer Protection, and the Office of the General Counsel were reorganized into a new Office of International Affairs. See Press Release, Fed. Trade Comm'n, FTC Chairman Announces New International Affairs Office (Feb. 5, 2007), <http://www.ftc.gov/news-events/press-releases/2007/02/ftc-chairman-announces-new-international-affairs-office>.

<sup>110</sup> *Cross-Border Fraud: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Governmental Affairs*, 107th Cong. 195–97 (2001) (prepared statement of the Federal Trade Commission).

<sup>111</sup> See *id.* at 192–93.

<sup>112</sup> *International Consumer Complaints: January–December 2013*, FED. TRADE COMM'N 5 (May 2014), [https://www.ftc.gov/system/files/documents/reports/international-consumer-complaints-cy-2013/cy-2013\\_international.pdf](https://www.ftc.gov/system/files/documents/reports/international-consumer-complaints-cy-2013/cy-2013_international.pdf).

<sup>113</sup> See *A Bill to Renew the Federal Trade Commission's Authority to Combat Cross-Border Spam, Spyware, and Fraud Through Reauthorization of the U.S. SAFE WEB Act of 2006: Hearing Before the H. Subcomm. on Commerce, Mfg., & Trade of the H. Comm. on Energy & Commerce*, 112th Cong. at 16 (2012) (prepared statement of the Federal Trade Commission) [hereinafter *FTC Prepared Statement on Reauthorization of U.S. SAFE WEB Act of 2006*].

<sup>114</sup> See Stipulated Order for Permanent Injunction & Final Judgment, *FTC v. MoneyGram Int'l Inc.*, No. 1:09-cv-6576 (N.D. Ill. Oct. 19, 2009); Press Release, Fed. Trade Comm'n, *MoneyGram to Pay \$18 Million to Settle FTC Charges That it Allowed Its Money Transfer System*

involving Canadian defendants,<sup>115</sup> and bogus employment scams by defendants in Australia.<sup>116</sup>

Fraud harms any economy, even a well-established one. In emerging markets, the damage from fraud may be even greater. Not only do consumers suffer out-of-pocket losses, but fraud can also undermine consumer confidence amid the uncertainty that often accompanies the abandonment of central planning. The inability of Albania, for example, to address effectively pyramid schemes that masqueraded as legitimate investments led to the fall of the government and retarded market reforms.<sup>117</sup> Unless a nation visibly and effectively suppresses seller deceit, consumers may perceive that in a market system commercial dishonesty is the norm, not the exception.

Moreover, consumers in countries that fail to develop effective antifraud strategies may become especially attractive targets for fraudsters. Countries that house the targets of cross-border fraud are not the only victims; countries that unwittingly host fraudsters suffer as well. Most countries do not want the dubious reputation as a haven for perpetrators of international fraud. Thus, Canada has been determined to resist attempts by fraudulent telemarketers to make Canada their safe haven. A consortium of Canadian agencies that includes the Competition Bureau, the Royal Canadian Mounted Police, and provincial and local authorities have worked with the FTC effectively to attack fraud.<sup>118</sup>

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*to Be Used for Fraud* (Oct. 20, 2009), <http://www.ftc.gov/news-events/press-releases/2009/10/moneygram-pay-18-million-settle-ftc-charges-it-allowed-its-money>.

<sup>115</sup> See *FTC v. 6654916 Canada Inc.*, No. 09C-3159, 2010 WL 2925520 (N.D. Ill. June 2, 2010); Preliminary Injunction Order With Asset Freeze & Other Equitable Relief, *FTC v. Integration Media Inc.*, No. 09-CV-3160 (N.D. Ill. June 23, 2009); Complaint for Permanent Injunction & Other Equitable Relief, *FTC v. 6253547 Canada, Inc.*, No. 1:09-cv-01211 (N.D. Ohio May 27, 2009) (consolidated with *FTC v. Integration Media, Inc.* after initial filing); Complaint for Permanent Injunction & Other Equitable Relief, *FTC v. 6555381 Canada, Inc.*, No. 1:09-cv-03158 (N.D. Ill. May 27, 2009).

<sup>116</sup> See Complaint for Injunctive & Other Equitable Relief, *FTC v. Mystery Shop Link, LLC*, No. CV07-01791(SJO)(SHx) (C.D. Cal. Mar. 16, 2007); FED. TRADE COMM'N, *THE U.S. SAFE WEB ACT: THE FIRST THREE YEARS* B-14 (2009), <http://www.ftc.gov/sites/default/files/attachments/international-consumer-protection/p035303safewebact2009.pdf>.

<sup>117</sup> See, e.g., Chris Jarvis, *The Rise and Fall of Pyramid Schemes in Albania*, 47 I.M.F. STAFF PAPERS 1 (2000), <http://www.imf.org/external/pubs/ft/staffp/2000/00-01/pdf/jarvis.pdf>; Lindsay Percival-Straunik, *Albania: Pyramid Schemes Common Across Eastern Europe*, RADIO FREE EUR./RADIO LIBERTY (Jan. 9, 1997), <http://www.rferl.org/content/article/1083065.html>.

<sup>118</sup> See, e.g., Press Release, Fed. Trade Comm'n, U.S., *Canadian Law Enforcers Target Cross-Border Telemarketers* (June 10, 2002), <http://www.ftc.gov/news-events/press-releases/2002/06/us-canadian-law-enforcers-target-cross-border-telemarketers>; see also *FTC Prepared Statement on Reauthorization of the U.S. SAFE WEB Act of 2006*, *supra* note 113, at 16–17, 19; FED. TRADE COMM'N, *supra* note 116, at A2–A4, B1–B15.



In response to an increasing number of cross-border fraud schemes, Congress passed the Undertaking Spam, Spyware, and Fraud Enforcement with Enforcers Beyond Borders Act of 2006 (“U.S. SAFE WEB Act”),<sup>119</sup> extending the Commission’s authority for cross-border enforcement in four areas: information sharing,<sup>120</sup> investigative assistance,<sup>121</sup> cross-border jurisdictional authority,<sup>122</sup> and enforcement relationships.<sup>123</sup> To implement the U.S. SAFE WEB Act, the FTC has an International Fellows Program and a SAFE WEB Interns Program,<sup>124</sup> and often cooperates with international counterparts to “bring successful cross-border enforcement actions.”<sup>125</sup> One of the Act’s most crucial benefits is that it affirmed the FTC’s cross-border jurisdictional authority, explicitly allowing the FTC to challenge frauds from abroad or fraud originating in the U.S. targeting foreign consumers.<sup>126</sup>

The U.S. SAFE WEB Act originally contained a seven-year sunset provision that would have ended its authority effective in 2013.<sup>127</sup> In both the required three-year report to Congress and testimony in

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119 U.S. SAFE WEB Act of 2006, Pub. L. No. 109-455, 120 Stat. 3372 (2006) (codified in scattered sections of 15 U.S.C. and 12 U.S.C. § 3412(e)).

120 *Id.* §§ 6, 10, 120 Stat. at 3376–77, 3381.

121 *Id.* § 4(b), 120 Stat. at 3373–75.

122 *Id.* §§ 3–5, 120 Stat. at 3372–76.

123 *Id.* §§ 4–6, 9, 120 Stat. at 3372–77.

124 FED. TRADE COMM’N, *supra* note 116, at 17 (explaining that the FTC invites “23 foreign colleagues from 14 countries to spend up to six months at the FTC. . . . [I]n the FTC’s 2008 telemarketing sweep, Operation Tele-PHONEY, a Canadian Fellow played a pivotal role in the sweep both as an investigator on the FTC’s enforcement team and by facilitating cooperation between the FTC and Canadian Competition Bureau, including sharing information pursuant to the Act.”); *see also* *International Fellows Program*, FED. TRADE COMM’N, <http://www.ftc.gov/internationalfellows> (last visited Nov. 22, 2015) (“Since 2007, the FTC has hosted 52 staff members from sister agencies around the world. . . . Through a separate SAFE WEB Interns program, the FTC hosts colleagues for shorter terms. Twenty SAFE WEB Interns have come to the FTC from Austria, Canada, Egypt, India, Israel, Mexico, and Turkey.”).

125 FED. TRADE COMM’N, *supra* note 116, at 12 (“Indeed, during the period FY2007–2009, the FTC received assistance from foreign agencies at least 26 times.”).

[W]ithout the authority provided by the Act, the FTC would not have been able to cooperate meaningfully with foreign authorities to shut down international spam networks or stop deceptive debt collection and advertising practices. In addition, without the Act, the FTC would have been unable to provide reciprocal investigative assistance to key foreign partners.

*Id.* at 19–20.

126 *See* 15 U.S.C. § 45(a)(4)(A) (2012); *FTC Prepared Statement on Reauthorization of the U.S. SAFE WEB Act of 2006*, *supra* note 113, at 20–22. “Since the passage of the Act, the FTC has used its new information sharing and investigative assistance authority to help bring down international spam gangs, Canadian fraud artists, and several other malefactors injuring both U.S. and foreign consumers.” FED. TRADE COMM’N, *supra* note 116, at 21.

127 U.S. SAFE WEB Act of 2006 § 13.

support of reauthorizing the Act, the Commission stressed the importance of the Act for international cooperation and the continued effectiveness of the FTC.<sup>128</sup> Thus, the Commission characterized the Act as “key to strengthening a culture of mutual assistance that enables law enforcers to achieve greater results working together than they ever could alone.”<sup>129</sup> The authority that the U.S. SAFE WEB Act provided to the FTC “is—and will be—vital to its ability to protect U.S. consumers in the global marketplace.”<sup>130</sup> On December 4, 2012, President Obama reauthorized the Act, signing a bipartisan bill suspending the SAFE WEB Act’s sunset provisions.<sup>131</sup>

Beyond international enforcement, the Commission has expanded its antifraud program to the Spanish-speaking community. In 1997, the FTC provided Spanish-language brochures covering several common fraud issues<sup>132</sup> and in 2002 made available a Spanish-language consumer complaint form on its website.<sup>133</sup> The Commission also employs Spanish-speaking operators for its complaint help line,<sup>134</sup> and the agency’s 2003 Spanish Language Media Monitoring Project reviewed Spanish-language ads, resulting in seven cases.<sup>135</sup> In 2004, the Commission announced its Hispanic Law Enforcement and Outreach Initiative to address deceptive advertising targeting the His-

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<sup>128</sup> *Id.* § 14. See generally *FTC Prepared Statement on Reauthorization of the U.S. SAFE WEB Act of 2006*, *supra* note 113, at 20–22; FED. TRADE COMM’N, *supra* note 116, at ii.

<sup>129</sup> *FTC Prepared Statement on Reauthorization of the U.S. SAFE WEB Act of 2006*, *supra* note 113, at 16.

<sup>130</sup> FED. TRADE COMM’N, *supra* note 116, at 21.

<sup>131</sup> *President Signs Bipartisan Bill to Extend Online Consumer Protections*, ENERGY & COMMERCE COMM. (Dec. 4, 2012), <http://energycommerce.house.gov/press-release/president-signs-bipartisan-bill-extend-online-consumer-protections>; see also Act of Dec. 4, 2012, Public L. No. 112-203, 126 Stat. 1484.

<sup>132</sup> Press Release, Fed. Trade Comm’n, *Mexican Authorities Join Federal/State Officials in Campaign to Halt Fraudulent Advertising Aimed at Spanish-Speaking Consumers* (June 26, 1997), <http://www.ftc.gov/news-events/press-releases/1997/06/mexican-authorities-join-federal-state-officials-campaign-halt>. “Since January 2002, the FTC has disseminated nearly 500,000 Spanish-language consumer publications and logged more than 600,000 accesses to the Spanish-language information on its Web site.” Press Release, Fed. Trade Comm’n, *FTC Announces Hispanic Law Enforcement and Outreach Initiative Designed to Stop Deceptive Advertising and Other Scams Aimed at Hispanic Consumers* (Apr. 27, 2004) [hereinafter *FTC Announces Hispanic Law Enforcement and Outreach Initiative*], <http://www.ftc.gov/news-events/press-releases/2004/04/ftc-announces-hispanic-law-enforcement-and-outreach-initiative>.

<sup>133</sup> Press Release, Fed. Trade Comm’n, *FTC Reaches out to Spanish-Speaking Consumers; Spanish Language Complaint Form Posted at www.FTC.gov* (Sept. 18, 2002), <http://www.ftc.gov/news-events/press-releases/2002/09/ftc-reaches-out-spanish-speaking-consumers-spanish-language>.

<sup>134</sup> *Id.*

<sup>135</sup> *FTC Announces Hispanic Law Enforcement and Outreach Initiative*, *supra* note 132.

panic community.<sup>136</sup> Most recently, as part of the agency's outreach and education efforts geared to the Latino community and scams targeting Spanish speakers, the FTC released a Spanish "fotonovela" that includes tips on how to identify an imposter posing as the government.<sup>137</sup> Examples of cases in which the fraud specifically targeted Spanish-speaking consumers include work-at-home-frauds,<sup>138</sup> mortgage assistance scams,<sup>139</sup> and most recently, a "truly abusive phone scam[ ]" in which the defendant allegedly "conned Spanish-speaking consumers out of \$2 million."<sup>140</sup>

### III. THE COMMISSION'S RECENT APPROACH TO ADVERTISING REGULATION HARMS CONSUMER WELFARE

For decades, a bipartisan consensus at the FTC recognized and promoted the central role of advertising in a market economy. The Commission challenged numerous restrictions on advertising adopted by professional associations under the name of consumer protection.<sup>141</sup> It forcefully decried FDA restrictions that limited consumers' ability to learn about the relationship between diet and health,<sup>142</sup> and agency enforcement activities recognized not only the costs of mistakenly allowing false claims to continue, but also the costs of mistakenly restricting the flow of truthful information.<sup>143</sup> The FTC recognized the difficulties of mass communication and the reality that some consumers will misunderstand even the most carefully crafted advertise-

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<sup>136</sup> *Id.*

<sup>137</sup> Press Release, Fed. Trade Comm'n, *FTC Releases its First Spanish-Language 'Fotonovela'* (July 17, 2014), <https://www.ftc.gov/news-events/press-releases/2014/07/ftc-releases-its-first-spanish-language-fotonovela>. The plot of the fotonovela is based on actual complaints that the Commission received in the past. *Id.*

<sup>138</sup> See, e.g., Press Release, Fed. Trade Comm'n, *Court Jails Promoter of Work-At-Home Scam; Envelop-Stuffing Scheme Deceived Spanish-Speaking Consumers* (Dec. 23, 2009), <http://www.ftc.gov/news-events/press-releases/2009/12/court-jails-promoter-work-home-scam-envelope-stuffing-scheme>.

<sup>139</sup> See, e.g., Press Release, Fed. Trade Comm'n, *Defendants in Dominican Mortgage Assistance Scam that Allegedly Defrauded Spanish-Speaking U.S. Homeowners Settle FTC Charges* (Jan. 8, 2013), <https://www.ftc.gov/news-events/press-releases/2013/01/defendants-dominican-mortgage-assistance-scam-allegedly-defrauded>.

<sup>140</sup> Alvaro Puig, *Spanish Speaking Consumers Conned out of \$2 Million*, FED. TRADE COMM'N CONSUMER INFO. BLOG (Oct. 23, 2014), <http://www.consumer.ftc.gov/blog/spanish-speaking-consumers-conned-out-2-million>.

<sup>141</sup> See, e.g., *In re Am. Med. Ass'n*, 94 F.T.C. 701, 993–96 (1979), *enforced as modified sub nom.* *Am. Med. Ass'n v. FTC*, 638 F. 2d 443 (2d Cir. 1980), *aff'd per curiam by an equally divided court*, 455 U.S. 676 (1982).

<sup>142</sup> See FTC Comment on Food Labeling: Health Claims, *supra* note 78, at 5–6; Irvin Molotsky, *Cereal Ad Praised by an FTC Aide*, N.Y. TIMES, Dec. 5, 1984, at C10.

<sup>143</sup> See e.g., FTC Comment on Food Labeling, *supra* note 78, at 5 n.10.

ment.<sup>144</sup> In the words of former Chairman Robert Pitofsky, the agency engaged in “a practical enterprise to ensure the existence of reliable data,” rather than “a broad, theoretical effort to achieve Truth . . . .”<sup>145</sup>

Unfortunately, as one of the Authors testified before Congress, “the Commission has lost its way in its approach to advertising regulation.”<sup>146</sup> Given the importance of advertising to competitive markets, discussed in section A, the FTC’s recent approach to advertising regulation creates three problems: (1) the current Commission’s harmful approach to interpreting advertising claims, discussed in Section B, (2) evidentiary requirements for advertising claims that are likely to do more harm than good, discussed in Section C, and (3) inappropriate efforts to obtain monetary relief in traditional advertising substantiation cases, discussed in Section D.

### A. *Advertising Is Critical to Competitive Markets*

The competitive benefits of advertising are by now well known; to quote Nobel Laureate George Stigler, “[a]dvertising is . . . an immensely powerful instrument for the elimination of ignorance . . . .”<sup>147</sup> Informed consumers drive the competitive process, benefitting all as sellers compete for the informed minority.<sup>148</sup> Numerous economic studies have shown that restrictions on advertising increase prices to consumers, even when advertising does not mention price.<sup>149</sup>

Advertising also stimulates innovation. When sellers cannot advertise innovative products or cannot tell consumers why new product characteristics are important, there will be less incentive to make improvements in the first place.<sup>150</sup> One of the best-studied examples in-

<sup>144</sup> See e.g., *id.* at 9–10.

<sup>145</sup> Robert Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661, 671 (1977).

<sup>146</sup> *The FTC at 100: Views from the Academic Experts Before the H. Subcomm. on Commerce, Mfg., & Trade of the Comm. on Energy & Commerce*, 113th Cong. 2 (2014) (statement of J. Howard Beales III, Professor of Strategic Management and Public Policy, George Washington School of Business), <http://docs.house.gov/meetings/IF/IF17/20140228/101812/HHRG-113-IF17-Wstate-BealesH-20140228.pdf>.

<sup>147</sup> George J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213, 220 (1961).

<sup>148</sup> See, e.g., Schwartz & Wilde, *supra* note 42, at 631.

<sup>149</sup> The FTC itself has summarized the empirical evidence regarding the impact of advertising on prices. See *In re Polygram Holding, Inc.*, No. 9298, 2003 WL 21770765, at \*22 n.52 (F.T.C. July 24, 2003).

<sup>150</sup> Advertising is an intangible investment, whose value can only be recovered through repeat sales. Sellers invest in and maintain product quality to generate repeat business. See Phillip Nelson, *Advertising as Information*, 82 J. POL. ECON. 729, 734 (1974) (“[B]rands which provide the highest utility have the greatest incentive to advertise.”).

volves Kellogg's 1984 claims for All-Bran cereal, conveying the then-novel recommendation of the National Cancer Institute ("NCI") that diets high in fiber may reduce the risk of some cancers.<sup>151</sup> The science, which was based largely on epidemiology rather than human clinical trials, was uncertain.<sup>152</sup> Citing these uncertainties, the FDA threatened to seize All-Bran as an unapproved new drug.<sup>153</sup> When the FTC and the NCI defended Kellogg, the FDA backed down, launching a review of its policy.<sup>154</sup>

An FTC Staff Report documented the impact of the Kellogg campaign and its aftermath<sup>155</sup> as increased advertising about fiber content and its relationship to cancer risks led to significant changes in cereals.<sup>156</sup> Claims about the relationship between diet and disease increased elsewhere as well, with similar marketplace impacts. For example, claims about the relationship between saturated fat and heart disease rose from less than two percent of food advertising in 1984 to almost eight percent in 1989;<sup>157</sup> consumption of fat and saturated fat, the primary dietary risk factors for heart disease, fell far more sharply after 1985.<sup>158</sup> Again, advertising led to beneficial changes in diet.

Advertising is particularly important to economically disadvantaged groups. The FTC Staff Report documented that although fiber consumption increased for all groups it increased more among racial minorities and single parent households.<sup>159</sup> Similarly, in states that re-

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151 The Kellogg example is discussed in J. Howard Beales III, Timothy J. Muris & Robert Pitofsky, *In Defense of the Pfizer Factors*, in *THE REGULATORY REVOLUTION AT THE FTC: A THIRTY-YEAR PERSPECTIVE ON COMPETITION AND CONSUMER PROTECTION* 83, 84, 90–91 (James Campbell Cooper ed., 2013).

152 *Id.* at 84.

153 *Id.*

154 *Id.*

155 PAULINE M. IPPOLITO & ALAN D. MATHIOS, *FED. TRADE COMM'N, HEALTH CLAIMS IN ADVERTISING AND LABELING: A STUDY OF THE CEREAL MARKET* (1989).

156 *Id.* at 34, 45 (demonstrating that the fiber content of new cereals and the weighted average fiber content of cereals (reflecting both product changes and changes in consumer choices) increased at a significantly higher rate after health claim advertising began).

157 PAULINE M. IPPOLITO & JANICE K. PAPPALARDO, *FED. TRADE COMM'N, ADVERTISING NUTRITION & HEALTH: EVIDENCE FROM FOOD ADVERTISING 1977–1997* 40 (2002), <https://www.ftc.gov/sites/default/files/documents/reports/advertising-nutrition-health-evidence-food-advertising-1977-1997/advertisingfinal.pdf>.

158 PAULINE M. IPPOLITO & ALAN D. MATHIOS, *INFORMATION AND ADVERTISING POLICY: A STUDY OF FAT & CHOLESTEROL CONSUMPTION IN THE UNITED STATES 1977–1990* (1996), <https://www.ftc.gov/reports/information-advertising-policy-study-fat-cholesterol-consumption-united-states-1977-1990>.

159 IPPOLITO & MATHIOS, *supra* note 155, at 86–87.

stricted advertising for eyeglasses, the least educated consumers paid the highest increase in prices.<sup>160</sup>

*B. Advertising Interpretation Should Focus on the Ordinary Consumer*

Virtually any communication is subject to misinterpretation. If enough recipients hear or read the message, a minority will likely believe something other than what the speaker intended or what most consumers heard. Moreover, that minority understanding of the message may be completely wrong. This is an inherent problem of all communication and is particularly problematic for marketing messages, which are almost always brief and presented in times and places where consumers may not pay full attention. Although marketers frequently devote significant resources to ensure that their advertising conveys the intended message, however straightforward the message and however careful the execution, some consumers will likely misinterpret it. In academic studies of brief communications, twenty to thirty percent of the audience misunderstood some aspect of both advertising and editorial content.<sup>161</sup>

Meaningful protection for commercial speech requires, at the least, respect for the seventy to eighty percent of consumers who understand the message correctly. If regulators insist on communications that cannot be misunderstood, the result is likely to be communications that are also uninformative.

The Supreme Court has consistently held that the First Amendment does not protect deceptive speech.<sup>162</sup> That conclusion is straightforward when speech deceives most who hear it, but it is inherently more problematic when speech accurately informs most, but misleads a few. For example, for any performance claim, roughly half of purchasers will experience results that are worse than the average, but information about the average or expected result is likely extremely valuable to consumers. If the government maintains that providing

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<sup>160</sup> Lee Benham & Alexandra Benham, *Regulating Through the Professions: A Perspective on Information Control*, 18 J.L. & ECON. 421, 444 (1975).

<sup>161</sup> Regarding televised messages, see JACOB JACOBY ET AL., MISCOMPREHENSION OF TELEVISED COMMUNICATIONS 64 (1980). Regarding print communications, see generally JACOB JACOBY & WAYNE D. HOYER, THE COMPREHENSION AND MISCOMPREHENSION OF PRINT COMMUNICATIONS: AN INVESTIGATION OF MASS MEDIA MAGAZINES (1987). Both studies compare advertisements with excerpts of editorial content designed to be roughly equal in length, and find no significant differences in the extent of miscomprehension. Compare JACOBY ET AL., *supra*, with JACOBY & HOYER, *supra*.

<sup>162</sup> See *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y.*, 447 U.S. 557, 562-63 (1980).

the average is deceptive because “too many” consumers believe they will actually achieve that result, consumers would lose valuable information entirely.

When it adopted its Deception Policy Statement in 1983, the Commission stated that an act or practice is deceptive if it is likely to mislead consumers, acting reasonably in the circumstances, about a material issue.<sup>163</sup> The Policy Statement cites prior cases in which the Commission evaluated claims from the perspective of the “average listener,”<sup>164</sup> or the impression “on the general populace,”<sup>165</sup> or the “expectations and understandings of the typical buyer.”<sup>166</sup> In a footnote, the Policy Statement acknowledges that “[a]n interpretation *may* be reasonable even though it is not shared by a majority of consumers in the relevant class, or by particularly sophisticated consumers. A material practice that misleads a significant minority of reasonable consumers is deceptive.”<sup>167</sup>

In the Commission’s recent *POM* opinion,<sup>168</sup> the footnote swallows the standard. The case involves exaggerated claims about the health benefits of drinking pomegranate juice.<sup>169</sup> Some claims were broad, but others attempted to convey the limitations of the scientific evidence.<sup>170</sup> Nonetheless, the Commission found that essentially all of the advertisements it originally challenged were deceptive, based on its own reading of the ads.<sup>171</sup>

The *most* the Commission claims in its facial analysis of particular advertisements is that the advertisement conveys a challenged claim to “*at least* a significant minority of reasonable consumers.”<sup>172</sup> There is no discussion of the average listener, the typical buyer, or the general populace.<sup>173</sup> Nor is there any discussion or even acknowledgment of the problem of (random) background noise—that even in experimental conditions, twenty to thirty percent of consumers are likely to misunderstand the message.<sup>174</sup>

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163 FED. TRADE COMM’N, POLICY STATEMENT ON DECEPTION (1983), reprinted in *In re Cliffdale Assoc., Inc.*, 103 F.T.C. 110, 174, 175–76 (1984).

164 *Id.* at 178 & n.24 (citing *Warner-Lambert*, 86 F.T.C. 1398, 1415 n.4 (1975)).

165 *Id.* n.25 (citing *Grolier*, 91 F.T.C. 315, 430 (1978)).

166 *Id.* at 179 & n.28 (citing *Simeon Management*, 87 F.T.C. 1184, 1230 (1976)).

167 *Id.* at 177 n.20 (emphasis added).

168 *In re POM Wonderful LLC*, 155 F.T.C. 1 (2013).

169 *See id.* at 8–9.

170 *See id.* at 20–23.

171 *Id.* at 5, 40.

172 *Id.* at 12 (emphasis added).

173 *See id.*

174 *See id.*

The Commission's focus on a "significant minority" is particularly troubling because it decides which advertisements are deceptive based solely on a majority of its five members' own reading of the advertisement, without extrinsic evidence of how real consumers actually interpret the communication. As the Seventh Circuit and the Commission have noted, "implied claims fall on a continuum, ranging from the obvious to the barely discernible."<sup>175</sup> Requiring extrinsic evidence in all cases would be unnecessary and inappropriate. At the "obvious" end of the implied claim spectrum, there will likely be little disagreement about whether the claim was made, in part because most consumers are likely to infer the claim.<sup>176</sup> When the claim is "barely discernible," significantly more disagreement is likely, and probably fewer consumers actually identify and understand the claim.<sup>177</sup>

In *POM*, there was disagreement about the message conveyed in several of the advertisements. The three Commissioners who voted to issue the original complaint thought the advertisements were deceptive based on their own reading of the ads. Another Commissioner who was not a member of the Commission when the complaint issued, and the Administrative Law Judge who heard the Commission's case at trial, believed that extrinsic evidence was necessary to determine the meaning of these advertisements.<sup>178</sup> When reasonable people disagree about a fundamental proposition—what fraction of consumers are misled, and whether that fraction is significant—empirical evidence is a far more reliable way to resolve the disagreement than taking yet another vote among a different group of a few reasonable people (Commissioners or Judges).

In *POM*'s appeal, a unanimous panel of the District of Columbia Circuit upheld the Commission's finding of liability.<sup>179</sup> Although the court found that substantial evidence supported the Commission's conclusion, it narrowed its statement that it would reach the conclusion even under *de novo* review to the nineteen ads that the Administrative Law Judge found were misleading.<sup>180</sup> Even more importantly, it applied its conclusion that the First Amendment did not protect the ads only to those same ads by holding "insofar as the FTC imposed

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<sup>175</sup> *Kraft, Inc. v. FTC*, 970 F.2d 311, 319 (7th Cir. 1992) (citing *In re Thompson Medical*, 104 F.T.C. 648, 788–89 (1984)).

<sup>176</sup> *Id.* at 320.

<sup>177</sup> *Id.*

<sup>178</sup> See *In re POM Wonderful LLC*, 155 F.T.C. at 2, 26–27 (discussing, in its unanimous opinion, the Commission's difference of opinion with the ALJ on use of extrinsic evidence).

<sup>179</sup> *POM Wonderful, LLC v. FTC*, 777 F.3d 478, 484 (D.C. Cir. 2015).

<sup>180</sup> *Id.* at 500.



liability on petitioners for the nineteen ads found to be deceptive by the administrative law judge, the Commission sanctioned petitioners for misleading speech unprotected by the First Amendment.”<sup>181</sup>

Although some courts have deferred to the Commission’s “expertise” in interpreting advertising, that deference is unwarranted. As former Chairman Pitofsky wrote,

Why questions of meaning should be submitted to the virtually unreviewable discretion of five Commissioners of the FTC has never been articulated. Unlike other instances of deference to regulators as part of the administrative process, there is no reason to believe that commissioners of the FTC have unusual capacity or experience in coping with questions of meaning, nor any indication that successful regulation of advertising requires a balance of related regulatory considerations that commissioners are in a special position to handle.<sup>182</sup>

Indeed, even courts that have deferred to the Commission’s interpretations have expressed discomfort. As the Seventh Circuit stated in rejecting Kraft’s argument that the Commission must have extrinsic evidence: “Our holding does not diminish the force of Kraft’s argument as a policy matter, and, indeed, the extensive body of commentary on the subject makes a compelling argument that reliance on extrinsic evidence should be the rule rather than the exception.”<sup>183</sup>

The need for extrinsic evidence is acute when the issue is balancing the need to protect “at least a significant minority of reasonable consumers” against the interest of others who would like to learn about scientific evidence that, although not definite, is “promising,” “emerging,” or “hopeful.” In striking that balance, the Commission should have some sense of roughly how many consumers fall into each group. Even if the Commission can somehow determine that “at least a significant minority” is misled, the size of that minority matters, and can only be determined by empirical evidence. Moreover, it is essential to determine that the “significant minority” is greater than the twenty to thirty percent who are likely to miscomprehend *any* message. Good survey research can address precisely this question;<sup>184</sup> but

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<sup>181</sup> *Id.*

<sup>182</sup> Pitofsky, *supra* note 145, at 678.

<sup>183</sup> Kraft, Inc. v. FTC, 970 F.2d 311, 321 (7th Cir. 1992).

<sup>184</sup> See Shari Seidman Diamond, *Reference Guide on Survey Research*, in REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 359, 397 (3d ed. 2011). Advertising can be deceptive only when it causes a significant increase in the fraction of consumers who receive the misleading message compared to those who saw a nondeceptive advertisement. See *id.*

it is difficult to believe that Commissioners can do so effectively based exclusively on their reading of the advertisement in question.

Extrinsic evidence alone, however, is not the entire answer. What is needed is deeper appreciation of the fact that consumers who correctly interpret a message are harmed when the Commission prohibits claims that might be misunderstood by a “significant minority.” For example, in 2012 the Commission brought five cases<sup>185</sup> and issued fourteen warning letters<sup>186</sup> to window manufacturers who claimed that their products would save “up to” a specific amount of energy costs. Although it seems that most reasonable consumers understand that a claim of savings of “up to” a certain amount is different from a claim that you will save “at least” that amount, the warning letters assert that the two claims are *exactly* the same. The letter advises sellers that if they make “up to” claims, “your substantiation should prove that *all or almost all* consumers are likely to get that percentage in savings.”<sup>187</sup> An express claim about the *maximum* savings can only be substantiated by evidence that the claimed savings are in fact the *minimum* savings.

The FTC points to a copy test showing that if an advertisement mentions savings of 47%, 22–28% of consumers say that “all or almost all” consumers will save that much, whether the claim is “save 47%,” “save up to 47%,” or also discloses the average savings.<sup>188</sup> This is not a copy test to determine whether consumers actually see a fine print disclosure—“up to” is right next to the 47%, in the same size type, and with the same emphasis.<sup>189</sup> This is a test of how many consumers will play back the proper interpretation of a numerical claim after a

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<sup>185</sup> See Press Release, Fed. Trade Comm’n, *Window Marketers Settle FTC Charges That They Made Deceptive Energy Efficiency and Cost Savings Claims* (Feb. 22, 2012) <http://www.ftc.gov/news-events/press-releases/2012/02/window-marketers-settle-ftc-charges-they-made-deceptive-energy>.

<sup>186</sup> See Press Release, Fed. Trade Comm’n, *FTC Warns Replacement Window Marketers to Review Marketing Materials; Energy Savings Claims Must Be Backed by Scientific Evidence* (Aug. 29, 2012), <http://www.ftc.gov/news-events/press-releases/2012/08/ftc-warns-replacement-window-marketers-review-marketing-materials>.

<sup>187</sup> E.g., Letter from Frank Gorman, Assistant Dir., Div. of Enforcement, Fed. Trade Comm’n, to Acadia Windows & Doors Inc. 2 (Aug. 17, 2012), <http://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-warns-replacement-window-marketers-review-marketing-materials-energy-savings-claims-must-be/120829windowsacadialeter.pdf> (emphasis added).

<sup>188</sup> MANOJ HASTAK & DENNIS MURPHY, FED. TRADE COMM’N, EFFECTS OF A BRISTOL WINDOWS ADVERTISEMENT WITH AN “UP TO” SAVINGS CLAIM ON CONSUMER TAKE-AWAY AND BELIEFS 11 (2012), <https://www.ftc.gov/sites/default/files/documents/reports/effects-bristol-windows-advertisement-savings-claim-consumer-take-away-beliefs/120629bristolwindowsreport.pdf>.

<sup>189</sup> See *id.* app. A. at 1–3.

brief, artificial exposure.<sup>190</sup> Not surprisingly, many do not.<sup>191</sup> That, however, is not an argument for prohibiting numbers, or for allowing only numerical claims that cannot possibly mislead anyone. Consumers who seriously contemplate spending hundreds or thousands of dollars on new windows are likely to consider the investment more carefully than consumers who are paid five dollars to participate in a mall survey. Importantly, the survey did not find that there was a less misleading way to convey information about savings.<sup>192</sup> Instead, it found that some consumers misinterpreted all versions of the advertisement tested.<sup>193</sup>

The FTC has not yet addressed claims about average performance. Its testimonial guides allow claims about individual results (“I lost 50 pounds”) if the average result is disclosed (“most women . . . lose 15 pounds”).<sup>194</sup> Surely, many consumers mistakenly believe that everyone achieves at least the average result. No sensible, or constitutional, regulatory regime prohibits truthfully reporting, based on the average results of users, that “you can save x percent.” even if, by mathematical definition, roughly half routinely receive less than average. According to the FTC, however, if the claim is instead that “you can save *up to* x percent,” it must be true for virtually everyone—even if it is in fact the average result.

The Commission needs to return its focus to the average viewer. Extrinsic evidence can help to strike the appropriate balance when, as is often the case, a communication informs some consumers and misinforms others. Crucially, the evidence should be designed to assess whether there is an alternative way to communicate a truthful message that is less likely to be misleading. Prohibiting communications because some consumers will misunderstand is likely to leave the majority of consumers in relative ignorance, the opposite of what the Commission should be trying to accomplish.

### C. *The Current Commission Is Imposing Overly Burdensome Substantiation Requirements*

The Commission’s advertising substantiation doctrine requires that advertisers have a “reasonable basis” for claims before making

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<sup>190</sup> See *id.* at 3 (describing study methodology).

<sup>191</sup> *Id.* at 13.

<sup>192</sup> See *id.* at 17–18.

<sup>193</sup> See *id.* at 13, 18.

<sup>194</sup> 16 C.F.R. § 255.2(c) (2015) (example 4).

them.<sup>195</sup> Traditionally, the core principle of substantiation recognized the uncertainty surrounding many claims, and balanced the benefits of truthful claims against the costs of false ones.<sup>196</sup> In a series of settlements and in a litigated case in which the order was narrowed on appeal, the Commission has moved from balancing to a rigid rule that requires multiple clinical trials even if the benefits of the claim, if true, overwhelmingly exceed the costs of the claim, if false.<sup>197</sup> If continued, this approach would prohibit claims about the relationship between diet and disease that most scientists regard as prudent public health recommendations despite the absence of two well-controlled clinical trials.<sup>198</sup>

Used wisely, laws against deceptive advertising benefit consumers. The historical approach of the Commission allowed the government to balance two kinds of mistakes: allowing false claims to continue and prohibiting truthful claims.<sup>199</sup> To ensure that information flows are both free and clean,<sup>200</sup> the government must consider the cost of each possible mistake, and, *ex ante*, guard against the higher cost mistake. The FTC's traditional approach to advertising substantiation, first stated in the seminal *Pfizer* opinion,<sup>201</sup> reflects the central role of balancing the risks of these two types of mistakes.

Consider, for example, Kellogg's claim about the relationship between diets high in fiber and the risk of cancer, discussed above.<sup>202</sup> Although the FDA now approves the claim, uncertainty remains.<sup>203</sup> After all, no randomized clinical trials have measured the incidence of cancer at different levels of fiber intake.<sup>204</sup> If the claim were true, however, waiting for the results of such trials would impose substantial costs on consumers, who would lose important information about the likely relationship between fiber consumption and cancer risk.<sup>205</sup>

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<sup>195</sup> See generally *In re Pfizer, Inc.*, 81 F.T.C. 23, 64 (1972).

<sup>196</sup> See *id.*

<sup>197</sup> See, e.g., *POM Wonderful, LLC v. FTC*, 777 F.3d 478, 484 (D.C. Cir. 2015).

<sup>198</sup> For example, as Kellogg claimed, the National Cancer Institute recommended more fiber in American diets because fiber may reduce the risk of some forms of cancer, despite the absence of clinical trials establishing the relationship. See *supra* note 151 and accompanying text.

<sup>199</sup> *Pfizer*, 81 F.T.C. at 64.

<sup>200</sup> *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 772 (1976).

<sup>201</sup> *Pfizer*, 81 F.T.C. at 64.

<sup>202</sup> See *supra* Part IV.A.

<sup>203</sup> See *id.*

<sup>204</sup> See *id.*

<sup>205</sup> See *id.*

Before such claims were allowed, consumers ate less fiber, and as a result incurred a higher risk of cancer. On the other hand, if the claim is false, the consequences to consumers are relatively small. They may give up a better tasting cereal, or pay a little more for a higher-fiber product.<sup>206</sup> In this case, the far more serious error is mistakenly to prohibit truthful claims. Such a mistake is worth avoiding, even though it increases risk of the far less serious error of a false claim continuing.

Rather than relying on the traditional balancing test, the Commission's recent consent decrees and litigated decisions reflect a move to a more rigid standard, one more closely modeled on the FDA's drug approval process.<sup>207</sup> In place of the usual order provision requiring "competent and reliable scientific evidence," the Commission has instead required respondents to substantiate claims about the relationship between nutrients and disease with two randomized, placebo-controlled, double blind clinical trials ("RCTs").<sup>208</sup> This standard is excessive in most cases and is likely to deprive consumers of valuable, truthful information.

Basing substantiation requirements for claims about diet and disease on the drug approval process is itself inappropriate. The stakes are far higher in deciding whether to approve a new drug than when deciding whether to allow a claim about diet and health. The potentially large adverse public health impact of mistakenly allowing dangerous drugs on the market is the key reason for the rigorous FDA approval process. There is no corresponding risk in mistakenly allowing claims about the relationship between diet and disease, even when there is some uncertainty. On the other hand, the potential costs of mistakenly prohibiting claims are substantial: some may die or suffer severe illness because they did not learn of a simple approach to risk reduction. For both food and drugs, the crucial issue is the relative cost of the two types of mistakes, because reducing the risk of one mistake necessarily increases the risk of the other.

Simply put, the potential consequences of mistaken decisions about prescription drugs, which can include significant health risks, are vastly greater than the potential consequences of mistaken decisions about what to eat or whether to take a safe dietary supplement.

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<sup>206</sup> Preventing economic injuries such as these is at the core of the Commission's consumer protection mission. Historically, however, the Commission has been unwilling to risk public health consequences to avoid economic injuries.

<sup>207</sup> See *POM Wonderful, LLC v. FTC*, 777 F.3d 478, 504–05 (D.C. Cir. 2015).

<sup>208</sup> See *id.*

Because the costs of mistaken choices about food and dietary supplements are substantially lower than the costs of mistakes in choosing drugs, added testing to improve the reliability of a food or diet claim is less valuable. Although more information always reduces uncertainty, there is less reason for the Commission to implement the elaborate precautions of the drug approval process because less is at stake.

Congress made that judgment about dietary supplements when it enacted the Dietary Supplement Health and Education Act.<sup>209</sup> That statute removed dietary supplements from the rigorous requirements of the new drug approval process, and allowed a claim about the relationship between nutrients and the structure or function of the human body as long as the manufacturer “has substantiation that such statement is truthful and not misleading.”<sup>210</sup> It made a similar decision in the Nutrition Labeling and Education Act<sup>211</sup> regarding foods, when it allowed health claims for foods that the FDA found were supported by “significant scientific agreement.”<sup>212</sup> The FTC’s recent orders threaten to reverse these congressional decisions, restoring the rigors of the drug approval process in everything but name.

The randomized, double blind, placebo-controlled clinical trial is the gold standard of medical research. For some specific questions, it is the only methodology that experts accept as yielding accurate and reliable results. Despite the value of clinical trials, sometimes they are simply not necessary. A tongue-and-cheek review of randomized trials of parachutes, unsurprisingly, could not locate any such trials actually taking place,<sup>213</sup> because few are willing to jump from an airplane without one. The review concluded:

As with many interventions intended to prevent ill health, the effectiveness of parachutes has not been subjected to rigorous evaluation by using randomised controlled trials. Advocates of evidence based medicine have criticised the adoption of interventions evaluated by using only observational data. We think that everyone might benefit if the most radical protagonists of evidence based medicine organised

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<sup>209</sup> Dietary Supplement Health and Education Act of 1994 (“DSHEA”), Pub. L. No. 103-417, 108 Stat. 4325 (codified in scattered sections of 21 U.S.C.).

<sup>210</sup> *Id.* § 6 (codified at 21 U.S.C. § 343(r)(6)(B) (2012)).

<sup>211</sup> Nutrition Labeling and Education Act of 1990, Pub. L. No. 101-535, 104 Stat. 2353 (codified in scattered sections of 21 U.S.C.).

<sup>212</sup> *Id.* § 3(a)(3)(B)(i) (codified at 21 U.S.C. § 343(r)(3)(B)(i)).

<sup>213</sup> See Gordon C.S. Smith & Jill P. Pell, *Parachute Use to Prevent Death and Major Trauma Related to Gravitational Challenge: Systematic Review of Randomised Controlled Trials*, 327 *BMJ* 1459, 1459 (2003).

and participated in a double blind, randomised, placebo controlled, crossover trial of the parachute.<sup>214</sup>

A key component of the cost of clinical trials is the time it takes to conduct one. As a result, “[w]aiting for the results of randomised trials of public health interventions can cost hundreds of lives, especially in poor countries with great need and potential to benefit. If the science is good, we should act before the trials are done.”<sup>215</sup> The authors conclude that “Good science . . . is taking the research to the problem rather than conducting the research in the tallest ivory tower the investigator can find.”<sup>216</sup>

As the Commission’s Dietary Supplements Guide explicitly recognizes, clinical trials are not the only way to learn.<sup>217</sup> Epidemiology,<sup>218</sup> rather than randomized clinical trials, is the basis for much of our knowledge about relationships between diet and disease. The key fact that high levels of serum cholesterol are correlated with the risk of heart attacks is epidemiological. Supplementary short-term studies that demonstrate the effects of particular fats on serum cholesterol are useful, but there are obvious ethical problems in randomly assigning some people to a diet likely to produce high serum cholesterol levels to see whether they actually have more heart attacks.

The FDA itself has relied on evidence other than clinical trials to approve certain health claims.<sup>219</sup> It approved a claim about noncariogenic sweeteners and cavities because isolating a control group that consumed no foods with sugar or sugar alcohols would be virtually impossible.<sup>220</sup> The claim was based on animal and in vitro studies, as well as human epidemiological studies of the relationship between

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<sup>214</sup> *Id.*

<sup>215</sup> Malcolm Potts et al., *Parachute Approach to Evidence Based Medicine*, 333 *BMJ* 701, 701 (2006).

<sup>216</sup> *Id.* at 702.

<sup>217</sup> FED. TRADE COMM’N, BUREAU OF CONSUMER PROT., *DIETARY SUPPLEMENTS: AN ADVERTISING GUIDE FOR INDUSTRY* 10 (2001), <https://www.ftc.gov/system/files/documents/plain-language/bus09-dietary-supplements-advertising-guide-industry.pdf> (“[E]pidemiologic evidence may be an acceptable substitute for clinical data, especially when supported by other evidence, such as research explaining the biological mechanism underlying the claimed effect.”).

<sup>218</sup> Epidemiology uses multivariate statistical techniques to control for other factors that may be important to assess whether a variable of interest is significantly related to a health outcome. See *Principles of Epidemiology in Public Health Practice*, CTRS FOR DISEASE CONTROL & PREVENTION, <http://www.cdc.gov/ophss/csels/dsepd/ss1978/lesson1/section1.html> (last updated May 18, 2012).

<sup>219</sup> *E.g.*, Health Claims: Dietary Noncariogenic Carbohydrate Sweeteners and Dental Caries, 21 C.F.R. § 101.80 (2015) (relying on epidemiological evidence).

<sup>220</sup> *Id.*

sugar alcohols in chewing gum and cavities.<sup>221</sup> It approved a claim about folate and neural tube defects based primarily on nonclinical studies in humans.<sup>222</sup> There was one clinical trial, but it was difficult to generalize because it included only women with a history of neural tube defects in pregnancy.<sup>223</sup> The agency concluded that folic acid supplementation resulted in a significant risk reduction.<sup>224</sup>

Nevertheless, the FTC contends that nothing has changed, defending the requirement for two clinical trials as traditional “fencing-in” relief that imposes special requirements on proven violators that do not apply to other companies.<sup>225</sup> Yet, there is no sound reason to require anyone to meet this higher burden to substantiate the likely truth of their claims. Rather than “fencing in” potential violations, the requirement “walls off” truthful claims that would likely prove valuable to many consumers. Although the scope of the potential harm from such a requirement is formally limited to the covered claims and a particular respondent, incorporating these more rigid standards signals to others in the industry (and, eventually, the courts) what the Commission expects as adequate substantiation. This is especially true because the reason the Commission offered in *POM*—that a second test might yield a different result—is universally true. Like the clinical trials requirement itself, this is a general rule, rather than a requirement unique to a particular respondent.

Moreover, mathematically, the two clinical requirements will more likely suppress truthful claims than prevent deceptive ones. In a statistical test that finds a significant difference between two products at the conventional ninety-five percent confidence level, there is a five percent chance that the result is due solely to the peculiarities of the particular sample. Repeating the test would reduce that risk to less than one percent,<sup>226</sup> but most likely it will simply achieve the same result.

Similarly, a particular sample may fail to detect a relationship that actually exists. Although larger samples could increase the chance of detecting a real difference, they are more costly and the tests frequently take longer. As a practical compromise between

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221 *Id.*; see also Beales, Muris & Pitofsky, *supra* note 151, at 99.

222 Health Claims: Folate and Neural Tube Defects, 21 C.F.R. § 101.79 (2015).

223 *See id.*

224 *Id.*

225 *In re POM Wonderful*, 155 F.T.C. 1, 3–6 (2013).

226 The likelihood that both tests find a significant difference when in fact there is no difference is 0.05 times 0.05, or 0.0025. That is, only in one quarter of one percent of cases will both tests find a statistically significant difference that does not in fact exist.



these competing objectives, statistical tests and sample sizes are frequently chosen to have an eighty percent chance of detecting a difference (of a specified size) if it really exists.<sup>227</sup> Thus, twenty percent of the time a test will fail to detect a real difference that in fact exists. Repeating the test will raise the probability that at least one of the two tests will fail to find a difference from twenty percent to thirty-six percent.<sup>228</sup> Requiring the second test is therefore much more likely to reject truthful claims than to detect a result that only arose in the first place because of chance.<sup>229</sup> Thus the requirement of two RCTs, rather than one, increases the likelihood that truthful claims will be suppressed.

When the Commission rejected a petition to establish more explicit substantiation standards for dietary supplements in 2000, it did so in part because of the likelihood of setting a standard that is “higher than necessary to ensure adequate scientific support.”<sup>230</sup> This risk is no different when the Commission imposes a more rigid standard as an order provision. Indeed, the “competent and reliable scientific evidence” standard itself emerged from a series of orders incorporating that provision.<sup>231</sup> Responsible companies will have little choice but to follow the two-RCT requirement incorporated into recent orders, creating exactly the problems the Commission sought to avoid when it rejected the petition in 2000.<sup>232</sup>

Not only is such a requirement harmful, it is unnecessary. When the District of Columbia Circuit rejected, on First Amendment grounds, the FDA’s ban on health claims not supported by “significant

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<sup>227</sup> The probability of detecting a difference that actually exists is known as the power of the test. “The ideal power for any study is considered to be 80%.” K.P. Suresh & S. Chandrashekhara, *Sample Size Estimation and Power Analysis for Clinical Research Studies*, 5 J. HUM. REPROD. SCI. 7, 9 (2012).

<sup>228</sup> When there is a real difference, the chance of finding the difference statistically significant is 0.8. The chance of finding it significant in both tests is 0.8 times 0.8, or 0.64.

<sup>229</sup> A second test is more likely to reject truthful claims even if the chances of failing to detect a difference are the same as the chances of mistakenly finding one. If the chance of either mistake (finding significance when there is no difference or failure to find significance when a difference exists) is 5%, the chance that both tests will find the difference is 90.25% (i.e., 0.95 times 0.95). Thus, there is almost a 10% chance of mistakenly rejecting a truthful claim. With only one test, there was only a 5% chance of mistakenly allowing a false one.

<sup>230</sup> Letter from Donald S. Clark, Sec’y, Fed. Trade Comm’n, to Jonathan W. Emord, at 5 (Nov. 30, 2000), <https://www.ftc.gov/sites/default/files/attachments/press-releases/announced-actions-december-5-2000/001205dietletter.pdf> (denying petition for rulemaking).

<sup>231</sup> *Id.* at 3–4.

<sup>232</sup> *See id.* at 6 (indicating “other forms of evidence, like animal and *in vitro* studies” are “acceptable substitutes for human research”).

scientific agreement,”<sup>233</sup> it did so because it believed that carefully qualified claims could avoid the risk of deception even without significant scientific agreement.<sup>234</sup> The FTC’s own empirical studies of qualified health claims support that conclusion.<sup>235</sup> As the FTC staff commented to the FDA with respect to health claims: “On average, consumers were able to discern clear differences in the level of certainty communicated by these [tested] claims.”<sup>236</sup>

When the policy goal is to maximize consumer welfare by allowing the commercial discussion of emerging scientific evidence, there is no conceptual difference between “two clinical trials” and “significant scientific agreement” as requirements that must be met before certain claims are permissible. Like “significant scientific agreement,” the “two clinical trials” standard will likely prohibit carefully qualified claims that are not likely to mislead reasonable consumers.<sup>237</sup> Moreover, in practical day-to-day decisionmaking, knowing that *precisely one* clinical trial supports an important health-related claim is highly valuable to consumers.

That was the conclusion that the D.C. Circuit reached in the *POM* appeal.<sup>238</sup> In narrowing the Commission’s order to require only one clinical trial, the court noted:

If there is a categorical bar against claims about the disease-related benefits of a food product or dietary supplement in the absence of two RCTs, consumers may be denied useful, truthful information about products with a demonstrated capacity to treat or prevent serious disease. That would sub-

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<sup>233</sup> Pearson v. Shalala, 164 F.3d 650, 651–52 (D.C. Cir. 1999).

<sup>234</sup> *Id.* at 65960.

<sup>235</sup> See DENNIS MURPHY ET AL., FED. TRADE COMM’N, A Generic Copy Test of Food Health Claims in Advertising (1998), <https://www.ftc.gov/reports/generic-copy-test-food-health-claims-advertising>; R. Dennis Murphy, *Consumer Perceptions of Qualified Health Claims in Advertising* 17–20 (Fed. Trade Comm’n, Working Paper No. 277, 2005), [https://www.ftc.gov/sites/default/files/documents/reports/consumer-perceptions-qualified-health-claims-advertising/wp277\\_0.pdf](https://www.ftc.gov/sites/default/files/documents/reports/consumer-perceptions-qualified-health-claims-advertising/wp277_0.pdf).

<sup>236</sup> Staff of the Bureau of Economics, the Bureau of Consumer Protection, & the Office of Policy Planning of the Federal Trade Commission, Assessing Consumer Perceptions of Health Claims, Food & Drug Administration Docket No. 2005N-0413, at 12 (2006), <http://www.ftc.gov/be/V060005.pdf>.

<sup>237</sup> By its nature, “competent and reliable scientific evidence” requires different amounts of evidence depending on the specifics of the covered claim, because the kinds of evidence necessary to support a qualified claim will frequently differ from what is needed to substantiate unqualified claims. Thus, the standard permits claims that appropriately describe the available evidence even when that evidence would not support an unqualified claim. With a clinical testing requirement, however, any covered claim must be supported by clinical testing, regardless of how it might be qualified and regardless of whether it is misleading.

<sup>238</sup> *POM Wonderful, LLC v. FTC*, 777 F.3d 478, 484 (D.C. Cir. 2015).

vert rather than promote the objectives of the commercial speech doctrine.<sup>239</sup>

The court also noted that the prior history of two-clinical-test requirements “suggests that the Commission has imposed two-RCT requirements only in narrow circumstances based on particularized concerns.”<sup>240</sup> Thus, the court held, on First Amendment grounds, “that the Commission’s order is valid to the extent it requires disease claims to be substantiated by at least one RCT. But it fails *Central Hudson* scrutiny insofar as it categorically requires two RCTs for all disease-related claims.”<sup>241</sup>

Although appellate courts have frequently narrowed Commission orders, it is highly unusual to do so on First Amendment grounds. Indeed, we know of only one prior case, *Beneficial Corp.*,<sup>242</sup> where the court used the First Amendment to prevent the Commission from prohibiting the phrase “Instant Tax Refund.”<sup>243</sup> As the Commission has become more aggressive, arguments over the First Amendment, as in *POM*, will become more frequent. For example, in a recent consent agreement, the Commission split three to two over whether the speech of a guest on the Dr. Oz show enjoys the full First Amendment protection that Dr. Oz himself receives.<sup>244</sup> Although Dr. Oz chose the topic, wrote the script, and prevented the guest from discussing any specific product, the majority said that the guest’s commercial interest was enough to make his responses to Dr. Oz’s questions commercial speech, subject to the Commission’s oversight under the expanded definition of deception discussed above.<sup>245</sup> In so act-

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<sup>239</sup> *Id.* at 502.

<sup>240</sup> *Id.* at 504.

<sup>241</sup> *Id.* at 505.

<sup>242</sup> *Beneficial Corp. v. FTC*, 542 F.2d 611 (3rd Cir. 1976).

<sup>243</sup> *Id.* at 621.

<sup>244</sup> See Stipulated Final Judgment and Order for Permanent Injunction and Other Equitable Relief, *FTC v. Genesis Today, Inc.*, No. 1:15-cv-62 (W.D. Tex. Jan. 27, 2015), <http://www.ftc.gov/system/files/documents/cases/150126linddunorder.pdf>; STATEMENT OF CHAIRWOMAN EDITH RAMIREZ, COMM’R JULIE BRILL, & COMM’R TERRELL MCSWEENEY, FEDERAL TRADE COMMISSION V. GENESIS TODAY, INC., PURE HEALTH LLC, AND LINDSEY DUNCAN 2–3 (Jan. 26, 2015) [hereinafter GENESIS TODAY STATEMENT], [http://www.ftc.gov/system/files/documents/public\\_statements/620651/150126linddunstmtter-jb-tm.pdf](http://www.ftc.gov/system/files/documents/public_statements/620651/150126linddunstmtter-jb-tm.pdf). The Authors advised Genesis Today, Inc. during the FTC investigation.

<sup>245</sup> See generally GENESIS TODAY Statement, *supra* note 244, at 3; DISSENTING STATEMENT OF COMM OLHAUSEN & COMM WRIGHT, FEDERAL TRADE COMMISSION V. GENESIS TODAY, INC., PURE HEALTH LLC, AND LINDSEY DUNCAN 1–2 (Jan. 26, 2015), [https://www.ftc.gov/system/files/documents/public\\_statements/620661/150126linddunstmtmko-jdw.pdf](https://www.ftc.gov/system/files/documents/public_statements/620661/150126linddunstmtmko-jdw.pdf).

ing, the Commission ignored contrary First Amendment jurisprudence.<sup>246</sup>

First Amendment protection for commercial speech supports and protects the importance of truthful advertising in competitive markets. The Commission should return to its former bipartisan consensus that the flow of truthful information to the typical consumer is important, even if not everyone interprets the message correctly.

*D. The FTC Should Not Seek Monetary Relief in Traditional Substantiation Cases*

As discussed above, since 1981, the FTC has attacked fraud systematically, successfully using its authority under section 13(b) of the FTC Act to obtain a permanent injunction “in proper cases” to freeze assets *ex parte* and to force disgorgement of ill-gotten gains.<sup>247</sup> More recently, the Commission has asserted the authority to expand the use of section 13(b) beyond fraud cases, suggesting that it may seek consumer redress even against legitimate companies when they allegedly lack substantiation for claims made as part of national advertising campaigns.<sup>248</sup> This use of the section 13(b) remedial authority is wrong as a matter of law, troubling as a matter of policy, and threatens to undermine the operation of the fraud program, which has proven critical to the FTC’s consumer protection mission.

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<sup>246</sup> See, e.g., *Boule v. Hutton*, 328 F.3d 84, 90–92 (2d Cir. 2003); *TYR Sport, Inc., v. Warnaco Swimwear, Inc.*, 709 F. Supp. 2d 821, 828–29 (C.D. Cal. 2010).

<sup>247</sup> 15 U.S.C. § 53(b) (2012).

<sup>248</sup> See Agreement Containing Consent Order at 4–5, *In re Beiersdorf, Inc.*, No. 092-3194 (F.T.C. June 29, 2011), 2011 WL 2632096, at \*4–5 (requiring Beiersdorf, Inc. to pay \$900,000 to the FTC and substantiate any future advertising claims); Agreement Containing Consent Order at 4–5, *In re Oreck Corp.*, No. 102-3033, at \*4–5 (F.T.C. Apr. 7, 2011), 2011 WL 1429878, at \*11–12 (requiring Oreck Corp. to pay \$750,000 to the FTC and substantiate any future advertising claims); Agreement Containing Consent Order at 4, *NBTY, Inc.*, No. 102-3080 (F.T.C. Dec. 13, 2010), 2010 WL 5132518, at \*5–6 (requiring joint respondents including NBTY, Inc. to pay \$2.1 million to the FTC and substantiate any future advertising claims). In some cases, the redress is paid in conjunction with a settlement with other plaintiffs. See *In re Skechers Toning Shoes Prods. Liab. Litig.*, No. 3:12-cv-00204, 2013 WL 2010702, at \*2–3 (W.D. Ky. May 13, 2013), (requiring that remaining balance of settlement fund be distributed to FTC and noting that FTC played role in negotiating settlement); *FTC v. Skechers U.S.A., Inc.*, No. 1:12-cv-01214, at \*8 (N.D. Ohio July 12, 2012) (\$40 million settlement) (the Authors advised Skechers during the FTC investigation); *In re Reebok Easytone Litig.*, No. 4:10-CV-11977-FDS, at \*1 (D. Mass. Oct. 6, 2011) (preliminary order certifying a class for settlement purposes); *FTC v. Reebok Int’l Ltd.*, No. 1:11-CV-02046, at \*7 (N.D. Ohio Sept. 29, 2011) (\$25 million); see also *Gemelas v. Dannon Co.*, No. 1:08-cv-236, 2010 WL 3703811, at \*1 (N.D. Ohio Aug. 31, 2010) (granting motion for attorneys fees on appeal and granting expedited class discovery).

The legislative history surrounding the enactment of sections 13(b), 19, and 5(m)(1)(B)<sup>249</sup> has received vanishingly little attention in the cases that have addressed the legality of the section 13(b) fraud program, even though it sheds considerable light on the proper scope of that provision. As we discuss earlier, that legislative history shows no hint that Congress intended to grant the FTC broad authority to seek monetary relief when it enacted section 13(b).<sup>250</sup> Indeed, two years *after* it enacted section 13(b), Congress granted the FTC authority in section 19 to seek monetary relief only in carefully circumscribed cases.<sup>251</sup> This authority would have been wholly unnecessary under the current Commission's new reading of section 13(b), raising fatal questions about the validity of this interpretation. We argue elsewhere that the FTC and the courts should give meaning to the text of section 13(b) by limiting it to "obviously 'bad actors.'"<sup>252</sup> We suggest that the "touchstone for defining a 'proper case' is found in the language of section 19, limiting monetary relief to cases involving practices that a reasonable person would have known were dishonest or fraudulent."<sup>253</sup>

The use of 13(b) against fraud respects the carefully constructed congressional grant of authority to the Commission in part because fraud meets the knowledge test of section 19. Fraud cases are "proper" under section 13(b), but routine use of section 13(b) to seek redress would read "proper" out of the statute.

One type of case that is not "proper" is the traditional substantiation case. Typically, such cases involve a reputable national advertiser making claims about the features or benefits of its product or services. Although such claims may highlight something new, the product will often have been on the market for many years during which other claims about the product were made. For example, the Commission's

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<sup>249</sup> See Beales & Muris, *supra* note 86, at 5. The text of the second proviso of section 13(b) states, "Provided further, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." 15 U.S.C. § 53(b) (2012). Section 19 authorizes "such relief as the court finds necessary to redress injury" against any party subject to a final cease and desist order "[i]f the Commission satisfies the court that the act or practice to which the cease and desist order relates is one which a reasonable man would have known under the circumstances was dishonest or fraudulent . . . ." *Id.* § 57b(a)(2)–(b). Section 5(m)(1)(B) authorizes civil penalties against any party engaged in a practice that the Commission has found unfair or deceptive in a litigated proceeding "with actual knowledge that such act or practice is unfair or deceptive and is unlawful . . . ." *Id.* § 45(m)(1)(B)(2).

<sup>250</sup> See *supra* Part III.

<sup>251</sup> See 15 U.S.C. §§ 53, 57b; see also *supra* Part III.

<sup>252</sup> Beales & Muris, *supra* note 86, at 5.

<sup>253</sup> *Id.* at 6.

cases against Kellogg involved claims of increased attention in the classroom for children who eat Frosted Mini-Wheats for breakfast,<sup>254</sup> and claims that Rice Krispies would help “support your child’s immunity.”<sup>255</sup> Even if the claims about the effects of these cereals on enhanced attention or immunity are unsupported, such claims generally are not the sole (or even primary) reason that most consumers purchase the products.<sup>256</sup> Moreover, such cases often involve disputes over scientific details about the proffered substantiation and the required level of evidence, with well-regarded experts on both sides.

The knowledge that the FTC might seek consumer redress could dissuade companies from providing consumers with information that they would want to have about the products they are using. This risk is particularly acute when, as discussed above, the traditional standard for substantiation appears to be changing. Even with the “right” substantiation standard, however, uncertainty will exist about how it will be applied in a particular case. With monetary penalties, the increased financial risk, in combination with the uncertain enforcement standard, will encourage greater caution about making truthful claims.

Finally, the expanded use of section 13(b) poses risks to the FTC’s fraud program itself. Beyond the risk that the current widespread judicial deference to the program might be revisited, a greater risk concerns the judicial determination of the appropriate amount of redress. Although courts have been imprecise about whether equitable awards should be analyzed as “restitution” (which would be based on what consumers paid for the product) or “disgorgement” (which would be based on amounts received by the defendant),<sup>257</sup> the base-

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<sup>254</sup> Complaint at 5, *In re Kellogg Co.*, No. C-4262 (F.T.C. July 27, 2009).

<sup>255</sup> See Press Release, Fed. Trade Comm’n, *FTC Investigation of Ad Claims that Rice Krispies Benefits Children’s Immunity Leads to Stronger Order Against Kellogg* (June 3, 2010), <http://www.ftc.gov/opa/2010/06/kellogg.shtm> (discussing modification of original order to cover additional claims).

<sup>256</sup> Frosted Mini-Wheats have been successfully marketed nationally since 1970, apparently without the need to mention any effects on attentiveness. See *Timeline: Kellogg in the 1970s*, KELLOGGHISTORY.COM, <http://www.kellogghistory.com/timeline.html> (last visited Nov. 22, 2015). Rice Krispies have been on the market much longer, first appearing in 1928. See *Timeline: Kellogg in the 1920s*, KELLOGGHISTORY.COM, <http://www.kellogghistory.com/timeline.html> (last visited Nov. 22, 2015). See generally *A Historical Overview*, KELLOGGHISTORY.COM, <http://www.kellogghistory.com/history.html> (last visited Nov. 22, 2015).

<sup>257</sup> See, e.g., *FTC v. Bronson Partners, LLC*, 654 F.3d 359, 372 (2d Cir. 2011) (disgorgement); *FTC v. Stefanchik*, 559 F.3d 924, 931–32 (9th Cir. 2009) (“equitable monetary relief”); *FTC v. Direct Mktg. Concepts, Inc. et al.*, 648 F. Supp. 2d 202, 217–18 (D. Mass. 2009) (disgorgement); *FTC v. SlimAmerica, Inc.*, 77 F. Supp. 2d 1263, 1275–77 (S.D. Fla. 1999) (providing “consumer redress”); *FTC v. Wolf*, No. 94-8119-CIV-FERGUSON, 1996 WL 812940, at \*9 (S.D. Fla. Jan. 31, 1996) (restitution).

line for redress awards has generally been either consumer loss or the defendant's unjust gain.<sup>258</sup> These measures usually coincide; under either the defendant can be required to pay amounts well in excess of profits.<sup>259</sup> Indeed, even if the defendant's gain is the measure, permissible offsets are generally limited.<sup>260</sup> That is a reasonable approach for a "Chinese Diet Tea"<sup>261</sup> promoted as a weight loss product when few, if any, consumers likely purchased the product because of its inherent value as a beverage. It is not a workable approach for a product like Rice Krispies, where an unsubstantiated claim may increase sales somewhat, but is not responsible for the vast majority of the sales that occur. Thus, courts may change their measure of calculating damages, and those changes could complicate the determination of redress in fraud cases as well.

The FTC's consumer protection mission is to prevent unfair or deceptive acts or practices. In giving the FTC the tools to accomplish

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<sup>258</sup> Compare, e.g., *Stefanchik*, 559 F.3d at 931–32 (consumer loss) with *Direct Mktg. Concepts, Inc.*, 648 F. Supp. 2d at 218 (defendant's unjust gain).

<sup>259</sup> See, e.g., *FTC v. Febre*, 128 F.3d 530, 536 (7th Cir. 1997) ("A major purpose of the Federal Trade Commission Act is to protect consumers from economic injuries. Courts have regularly awarded, as equitable ancillary relief, the full amount lost by consumers."); *FTC v. Nat'l Urological Grp., Inc.*, 645 F. Supp. 2d 1167, 1212–13 (N.D. Ga. 2008) (noting that "[r]estitution is intended to return the injured party to the status quo and is measured by the amount of loss suffered by the victim" and awarding total product sales over the relevant period).

<sup>260</sup> Redress is generally not reduced by the amount of actual operating costs, such as those for manufacturing the product, advertising, processing costs, or taxes. See, e.g., *FTC v. Bronson Partners, LLC*, 674 F. Supp. 2d 373, 382–86 (D. Conn. 2009) (restitution); *SlimAmerica, Inc.*, 77 F. Supp. 2d at 1276 ("Costs incurred by the defendants in the creation and perpetration of the fraudulent scheme will not be passed on to the victims."). See generally *FTC v. Verity Int'l, Ltd.*, 443 F.3d 48, 68 (2d Cir. 2006) (noting that in many cases there is no difference between measuring redress according to consumer loss and the defendant's unjust gain). By contrast, in the cases reflecting the Commission's new expansion of section 13(b), the Commission has sought and obtained redress far less than the total sales of the product. For example, in *Skechers*, the Commission obtained forty million dollars, which was considerably less than ten percent of Skechers' sales in the peak year of the toning shoe fad alone. FIRST RESEARCH, PROQUEST, FOOTWEAR MANUFACTURING: INDUSTRY PROFILE (2012); Christopher C. Williams, *After a Tough Stretch, Adidas' Run Resumes*, BARRON'S, Aug. 16, 2010, at 17 (sales of toning shoes were expected to hit \$1.5 billion in 2010 and Skechers held sixty-seven percent market share). Although the Commission's complaint included a falsity claim regarding alleged serious problems with one study, see Complaint for Permanent Injunction & Other Equitable Relief at 14, *FTC v. Skechers U.S.A., Inc.*, No. 1:12-cv-01214 (N.D. Ohio May 16, 2012), it apparently rejected other studies supporting similar fitness benefits of rocker bottom shoes. See, e.g., Scott C. Landry et al, *Standing in an Unstable Shoe Increases Postural Sway and Muscle Activity of Selected Smaller Extrinsic Foot Muscles*, 32 GAIT & POSTURE 215, 215 (2010) (reporting findings that even when standing, muscle activation is higher in rocker bottom footwear than conventional shoes).

<sup>261</sup> Chinese Diet Tea was the product at issue in *F.T.C. v. Bronson Partners, LLC*, 654 F.3d 359 (2d Cir. 2011).

that mission, Congress struck a delicate balance. It recognized that the FTC must prevent harm to the public and ensure that those who cause harm are punished; at the same time, it recognized that the FTC could overreach. Imposing monetary penalties on those who did not know their conduct was unlawful could chill the provision of beneficial information and thus hurt the public more than it helps. If companies are afraid that they will be subjected to monetary liability for claims about their products that the FTC ultimately concludes are not substantiated, they may not make the claims at all, depriving consumers of valuable information.

#### IV. PRIVACY ENFORCEMENT SHOULD FOCUS ON HARMS TO CONSUMERS

Since the emergence of the Internet in the 1990s, privacy has become an increasingly important part of the Commission's consumer protection mission. We first consider the increasing irrelevance of the Commission's initial efforts to use the Fair Information Practices ("FIPs") to address privacy issues in the commercial marketplace. We then explain the advantages of approaching privacy by considering the consequences of information use and misuse, an approach that led to the National Do-Not-Call Registry and a series of increasingly controversial information security cases. Next, we argue that the Commission should restrict its enforcement actions to cases that involve real, objective harms. Finally, we argue that transparency about information collection and use is at most a means to an end that has not been clearly identified; it is not an end in itself.

##### A. *FIPs are Irrelevant for Most Commercial Privacy Issues*

The touchstone for many privacy discussions has long been the FIPs. Originally developed to address privacy concerns about different government agencies merging their data,<sup>262</sup> the core of FIPs is notice and choice—consumers should be told what information is being collected and how it will be used, and they should have a choice about those uses, particularly any secondary uses.<sup>263</sup> If consumers understand the collection and use of information and agree to it, there is

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262 SEC'YS ADVISORY COMM. ON AUTOMATED PERS. DATA SYST., U.S. DEP'T OF HEALTH, EDUC., & WELFARE, RECORDS, COMPUTERS AND THE RIGHTS OF CITIZENS xix-xx (1973).

263 See *id.* at 57–63. Other FIPs include the notion that a person should be able to find out what information is in a record and have a way to correct it. Organizations maintaining records must take precautions to prevent misuses of the data. See *The Code of Fair Information Practices*, ELEC. PRIVACY INFO. CTR., [https://epic.org/privacy/consumer/code\\_fair\\_info.html](https://epic.org/privacy/consumer/code_fair_info.html) (last visited Oct. 15, 2015).



certainly no privacy problem. The mere fact that consumers are unaware of an information use, however, does not imply that a privacy problem exists. It seems likely that most consumers are blissfully unaware of the various parties with whom information is shared to settle a payment via a check or a credit card; they are certainly unaware of the identities of the intermediaries who process the transaction. Yet few would see this information sharing as a privacy problem. Information sharing without knowledge or consent will only grow with the expansion of the “Internet of things,”<sup>264</sup> with interconnected devices that facilitate numerous consumer benefits.<sup>265</sup>

Although theoretically tempting, notice and choice pose serious practical problems. In particular, they ignore the costs of obtaining information and using it to make a decision. One study of online privacy policies estimated that the national opportunity cost of actually reading website privacy policies would be \$781 billion!<sup>266</sup> Not surprisingly, most consumers choose not to do so most of the time.<sup>267</sup> With the total online advertising market at more than \$49 billion in 2014,<sup>268</sup> the costs of reading policies are grossly disproportionate to any potential benefit. To be sure, regulators could command companies to invest in making privacy policies “more transparent,” and thereby reduce the costs. Even if simplified disclosures reduced costs to a tenth of current costs—a wildly optimistic estimate of what is possible—the costs of acquiring information would remain grossly disproportionate to the potential benefits.<sup>269</sup> Moreover, simpler notices

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264 FED. TRADE COMM’N, INTERNET OF THINGS: PRIVACY AND SECURITY IN A CONNECTED WORLD 5–7 (2015) [hereinafter INTERNET OF THINGS], <https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-staff-report-november-2013-workshop-entitled-internet-things-privacy/150127iotrpt.pdf> (defining the internet of things).

265 Financial privacy notices at best only tell the reader that information sharing to process a transaction “may” occur. This genuflection to notice does nothing to correct any privacy problem that might exist. Similarly, a utility’s privacy policy for an internet-connected light bulb that reports its energy consumption is not a realistic solution to any privacy problem that information may pose. See, e.g., *id.* at 21–22, 39–46 (describing the challenges of implementing notice provisions for products in the internet of things); Cristina Miranda, *Is That Gadget Internet-Connected?*, FED. TRADE COMM’N CONSUMER INFO. BLOG (Jan. 27, 2015), <http://www.consumer.ftc.gov/blog/gadget-internet-connected>.

266 Aleecia M. McDonald & Lorrie Faith Cranor, *The Cost of Reading Privacy Policies*, 4 I/S: J.L. & POL’Y 543, 544 (2008).

267 See Daniel J. Solove, *Introduction: Privacy Self-Management and the Consent Dilemma*, 126 HARV. L. REV. 1880, 1884 (2013).

268 PRICEWATERHOUSECOOPERS & INTERACTIVE ADVERT. BUREAU, IAB INTERNET ADVERTISING REVENUE REPORT: 2014 FULL YEAR RESULTS 4 (2015), [http://www.iab.net/media/file/IAB\\_Internet\\_Advertising\\_Revenue\\_FY\\_2014.pdf](http://www.iab.net/media/file/IAB_Internet_Advertising_Revenue_FY_2014.pdf).

269 For most consumers, privacy policies would remain, in the words of The Rolling Stones, someone “tellin’ me more and more, about some useless information, supposed to fire my imagi-

would necessarily provide less detail about the information sharing practices that are at the heart of the information economy.

Choice is also problematic, because some economically important uses of information depend on the fact that consumers have no choice about whether to participate.<sup>270</sup> Credit reporting, for example, enables lenders to separate good risks from bad, offering credit on terms that reflect differences in risk. If consumers could block reporting of their payment history, those with poor payment histories would presumably be more likely to opt out of credit reporting, and creditors would be less able to identify high-risk borrowers.<sup>271</sup> Similarly, the property recordation system protects purchasers of real property and allows potential purchasers or lenders to identify prior claims against the property.<sup>272</sup> If consumers could either restrict access to this information or choose to not have liens recorded, the system would lose much of its utility.

If FIPs and the principle of choice are to be the basis of privacy law, we could presumably make exceptions to allow credit reporting and property recordation. The FIPs offer no principled basis for doing so, however. A privacy regime based on the notion that consumers should have a choice in some circumstances but not others has no foundation at all.

The premise of FIPs is that information is property; it “belongs” to the consumer that it concerns, who is therefore entitled to control its use. Commercial information, however, is generally a joint product of the buyer and seller. Both need to know the terms and conditions of the transaction for a variety of purposes and may find other uses for that information beneficial. There is no way to assign “ownership” to only one of the parties, particularly if that ownership includes the right to prevent the other party from making legitimate use of the information. Correctly in our view, but unlike FIPs, U.S. law does not treat information as consumer property.<sup>273</sup>

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nation.” The result is inevitable: “I can’t get no satisfaction.” THE ROLLING STONES, (I CAN’T GET NO) SATISFACTION (RCA Studios 1965).

<sup>270</sup> For a fuller discussion of the role of choice in credit reporting, see J. Howard Beales, III & Timothy J. Muris, *Choice or Consequences: Protecting Privacy in Commercial Information*, 75 U. CHI. L. REV. 109 (2008). On the benefits of credit reporting, see THOMAS A. DURKIN ET AL., CONSUMER CREDIT AND THE AMERICAN ECONOMY (2014).

<sup>271</sup> See Beales & Muris, *supra* note 270, at 116.

<sup>272</sup> 14 RICHARD R. POWELL, POWELL ON REAL PROPERTY § 82.01[3] (Michael Allen Wolf, ed., 2007).

<sup>273</sup> See, e.g., *Dwyer v. Am. Express Co.*, 652 N.E.2d 1351, 1354–55 (Ill. App. Ct. 1995) (dismissing plaintiff consumers’ challenge to American Express’s practice of renting lists); Shib-

In a world of zero transaction costs, the allocation of the property right would not matter, because buyers and sellers would bargain to achieve efficient use of the jointly produced information. As in selecting other product characteristics, buyers and sellers of products and services that could impact privacy are in contact with each other, which would suggest that the transactions costs of bargaining are low. On the other hand, the risk of potential privacy problems like data security breaches is relatively remote, which suggests that consumers may have little reason to consider them carefully. The problem is similar to products liability, in which consumers are unlikely to invest in information about the benefits and costs of a relatively remote risk of a serious product failure.<sup>274</sup>

With privacy preferences, the most important cost may well be the cost of considering the issue at all. As discussed above, costs of obtaining the necessary information are significant, and for most consumers, the stakes in considering commercial privacy issues are small, and not worth the time and attention that would be required to make careful decisions about the optimal choice. Consumers may decide that a decision is not worth the cognitive costs of thinking about an issue at all, particularly when the stakes are small.

The default rule is therefore likely to dominate consumer choices.<sup>275</sup> If the default is no sharing, most consumers will end up not sharing.<sup>276</sup> If the default is sharing, however, most consumers will

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ley v Time, Inc., 341 N.E.2d 337, 339–40 (Ohio Ct. App. 1975) (upholding the practice of selling subscription lists).

<sup>274</sup> See POSNER, *supra* note 65, § 6.6.

<sup>275</sup> E.g., Eric J. Johnson & Daniel Goldstein, *Do Defaults Save Lives?*, 302 SCI. 1338 (2003) (stating that countries with opt-in default rules for organ donation have substantially lower donation rates than countries with opt-out rules). As Richard Posner notes in explaining this result, “When the consequences of making a ‘correct’ decision are slight, ignorance is rational, and therefore one expects default rules to have their greatest effect on behavior . . . .” Richard Posner, *Organ Sales—Posner’s Comment*, BECKER-POSNER BLOG (Jan. 1, 2006, 5:38 PM), <http://www.becker-posner-blog.com/2006/01/page/2/>.

<sup>276</sup> Default rules should be designed to impose the costs of transactions on consumers who think these costs are worth paying. An “opt-out” default rule means that consumers who do not think that decisionmaking costs are worthwhile do not need to bear those costs. Consumers who care more intensely, however, will face the costs of making a decision. In contrast, an “opt-in” default rule enables those who care the most about the issue to avoid the decision costs because the default will match their preferences. For example, experiments have found that among consumers who are more concerned about privacy, there is no difference in participation whether the default rule is opt-in or opt-out. See Yee-Lin Lai & Kai-Lung Hui, *Internet Opt-In and Opt-Out: Investigating the Roles of Frames, Defaults and Privacy Concerns*, in PROCEEDINGS OF THE 2006 ACM SIGMIS CPR CONFERENCE ON COMPUTER PERSONNEL RESEARCH 253, 253, 259–61 (2006). On the other hand, among consumers who were less concerned about privacy, the de-

share. Numerous experiments find essentially this result.<sup>277</sup> Thus, bargaining over privacy-related terms is unlikely, and where there are real and concrete potential costs that most consumers would recognize as harms, a tort approach to controlling risk is sensible. That is the essence of the consequences-based approach to privacy regulation.

*B. Privacy Regulation Based on Consequences Has Been Highly Productive*

As the example of information sharing to settle a credit card transaction demonstrates, there is little reason for concern about information sharing per se. The real issue is that some recipient of information about a consumer may use that information to harm the consumer. The consequences-based approach to regulation starts by asking about the impact of a particular use of information on consumers. There is no reason for regulatory policy to restrict information uses that benefit the consumer by facilitating a transaction or reducing the risk of fraud, for example. When information uses create adverse consequences for consumers, however, there is a basis for regulatory intervention.

One of the first applications of the consequences-based approach was the National Do-Not-Call Registry. For many consumers, unwanted calls were an annoyance and an intrusion on their right to be let alone.<sup>278</sup> The privacy problem is the intrusion itself and not any sharing of information that led to the call. Moreover, attempting to control the problem by controlling access to information is doomed to fail because most consumers have chosen to make their telephone number public and random digit dialing can easily reach those who have not.<sup>279</sup>

The Do-Not-Call Registry addressed the consequences directly, creating an enforceable right for consumers to avoid most telemarket-

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fault rule mattered. *Id.* Thus, opt-out is a preferable default rule, because it avoids imposing costs on consumers who do not think the issue is worth the costs of making a decision.

<sup>277</sup> E.g., Eric J. Johnson et al., *Defaults, Framing and Privacy: Why Opting In-Opting Out*, 13 MARKETING LETTERS 5, 10, 13–14 (2002).

<sup>278</sup> See Press Release, Fed. Trade Comm'n, *Do Not Call Registry Tops 30 Million Phone Numbers* (Aug. 6 2003), <https://www.ftc.gov/news-events/press-releases/2003/08/do-not-call-registry-tops-30-million-phone-numbers> (noting that over 30 million consumers signed up for the registry in the first five weeks of the program).

<sup>279</sup> In 2011, 74.5% of landline telephone households were listed in the telephone directory. See JESSICA SMITH, SURVEY SAMPLING INT'L, THE DECLINING WORKING PHONE RATE AND ITS IMPACT ON RDD EFFICIENCY: THE POND HAS GROWN BUT THE NUMBER OF FISH REMAINS THE SAME 9 (2011).

ing calls if they choose to do so.<sup>280</sup> More than 223 million telephone numbers are currently included in the Registry;<sup>281</sup> the minimal burden to sign up has plainly not been a barrier to widespread participation. Because the consequences-based approach directed attention to the harm—the intrusion itself—it led to a superior solution to the problem of annoying telemarketing calls.

Another area where information use can create serious adverse consequences for consumers is related to information security. When information is compromised, consumers can become the victims of identity theft. The risk of significant consequences is particularly high if social security numbers are compromised because they enable thieves potentially to open new credit accounts in the consumer's name.

Although precise statistics are unavailable, data breaches are not rare. A public database maintained by the Open Security Foundation includes 1274 incidents in 2014, including several that compromised more than 100 million records.<sup>282</sup> Estimates from the ID Theft Resource Center are lower, with 761 breaches involving about 83 million records.<sup>283</sup> Under either estimate, the number of breaches is substantial.

In turn, compromised information can increase the risk of identity theft, although the magnitude of the increased risk is unclear. An early study by ID Analytics found that only 0.098 percent of the social security numbers involved in a large, intentional breach were used in applications covered by its fraud prevention network.<sup>284</sup> Survey based

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<sup>280</sup> See *Mainstream Mktg. Servs, Inc. v. FTC*, 358 F.3d 1228 (10th Cir. 2004) (upholding the constitutionality of the national Do-Not-Call Registry). The court explained that “[o]ne important aspect of residential privacy is protection of the unwilling listener . . . [A] special benefit of the privacy all citizens enjoy within their own walls, which the State may legislate to protect, is an ability to avoid intrusions. Thus, we have repeatedly held that individuals are not required to welcome unwanted speech into their own homes and that the government may protect this freedom. *Id.* at 1237–38 (quoting *Frisby v. Schultz*, 487 U.S. 474, 484–85 (1988)).

<sup>281</sup> FED. TRADE COMM’N, DO-NOT-CALL REGISTRY FEE EXTENSION ACT OF 2007, FTC BIENNIAL REPORT TO CONGRESS ON FISCAL YEARS 2012–2013 1 (2013), <http://www.ftc.gov/sites/default/files/documents/reports/national-do-not-call-registry-biennial-report-congress-fiscal-years-2012-2013-pursuant-do-not-call/131223biennialdnrcpt.pdf>.

<sup>282</sup> See *Data Loss Statistics*, DATALOSSDB, <http://datalossdb.org/statistics> (last visited Oct. 15, 2015). The peak in the number of reported incidents was 1664 incidents in 2012. *Id.* For a running record of the largest data break incidents, see DATALOSSDB.ORG.

<sup>283</sup> 2014 *Data Breach Category Summary*, IDENTITY THEFT RES. CTR. (Dec. 23, 2014), <http://www.idtheftcenter.org/images/breach/ITRCBreachStatsReportSummary2014.pdf>.

<sup>284</sup> ID ANALYTICS, NATIONAL DATA BREACH ANALYSIS 4 (2006) (report on file with *The George Washington Law Review*). Because the methodology only detects misuse that occurs among ID Analytics’ subscribers, this figure is undoubtedly an understatement. At roughly the

approaches suggest a higher risk. Javelin Strategy and Research reports that sixty-eight percent of fraud victims received a data breach notification, compared to thirty-two percent of all consumers.<sup>285</sup>

Data are more reliable on the incidence and consequences of identity theft. The Bureau of Justice Statistics reported that there were 16.6 million victims of identity theft in 2012.<sup>286</sup> The vast majority, 15.3 million victims, involved compromises of existing accounts, but 1.1 million victims had new accounts opened in their name and over 0.8 million had their information used for other fraudulent purposes, such as getting a job or providing false information to law enforcement.<sup>287</sup> Aggregate losses were estimated at \$24.7 billion, almost twice the losses from all other property crimes measured in the National Crime Victimization Survey.<sup>288</sup> Consumers, however, do not bear most losses. When an existing credit card account is compromised, only 6.5% of consumers experience out-of-pocket losses, with a median loss of forty dollars.<sup>289</sup> Some, however, experience far larger out-of-pocket costs; the mean loss is \$1,991.<sup>290</sup> Most such cases are resolved in a day or less, but forty percent take longer to resolve.<sup>291</sup> Costs to consumers are far higher when personal information is used for other fraudulent purposes, with twenty-three percent experiencing out of pocket costs (median \$700, mean \$34,352).<sup>292</sup> Such instances also take longer to resolve, with fifty-seven percent taking more than a day.<sup>293</sup>

Most of the Commission's information security cases have been based on section 5's prohibition on "unfair or deceptive acts or prac-

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time of the study, the company was evaluating almost forty million transactions per month, and its risk scores were offered to card issuing banks through VISA USA. *See* ID ANALYTICS, STRENGTH IN NUMBERS 2 (2006) (report on file with *The George Washington Law Review*).

285 JAVELIN STRATEGY & RESEARCH, 2014 DATA BREACH FRAUD IMPACT REPORT: CONSUMERS SHOOT THE MESSENGER AND FINANCIAL INSTITUTIONS TAKE THE BULLET 8 (2014), [https://www.javelinstrategy.com/uploads/web\\_brochure/1413.R\\_2014DataBreachFraudImpactBROCHURE.pdf](https://www.javelinstrategy.com/uploads/web_brochure/1413.R_2014DataBreachFraudImpactBROCHURE.pdf). If, as seems likely, fraud victims are more likely to remember and/or report a prior breach notification, survey approaches are likely to overstate the disparity between fraud victims and other consumers.

286 ERIKA HARRELL & LYNN LANGTON, U.S. DEP'T OF JUSTICE, BUREAU OF JUSTICE STATISTICS, VICTIMS OF IDENTITY THEFT, 2012 1 (2013), <http://www.bjs.gov/content/pub/pdf/vit12.pdf>.

287 *Id.* at 2.

288 *Id.* at 1.

289 *Id.* at 19.

290 *Id.*

291 *Id.* at 10.

292 *Id.* at 19.

293 *Id.* at 22.

tices.”<sup>294</sup> The early cases were based on deception—a company had promised to keep sensitive information secure and failed to honor that promise.<sup>295</sup> Recognizing that perfect security is impossible, the Commission’s complaints construe a promise to protect sensitive information as one to take steps that are “reasonable and appropriate” under the circumstances.<sup>296</sup> In turn, what is reasonable and appropriate depends on the sensitivity of the information. Subsequent cases alleged that the failure to take security precautions that were reasonable and appropriate under the circumstances also constituted an unfair practice.<sup>297</sup>

The Commission’s first information security case in 2002 was settled,<sup>298</sup> as were all subsequent cases, roughly fifty, until the Commission sued Wyndham Hotels and Resorts in federal district court in June 2012.<sup>299</sup> Wyndham’s motion to dismiss argued that the Commission lacked authority to challenge data security practices as unfair and that an unfairness claim that had not been through the rulemaking process violated fair notice principles.<sup>300</sup> The district court rejected these arguments and the Third Circuit affirmed.<sup>301</sup> In August 2013, the Commission filed an administrative complaint against LabMD.<sup>302</sup> Like Wyndham, the company is challenging the Commission’s authority to use unfairness to address security practices.<sup>303</sup>

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<sup>294</sup> 15 U.S.C. § 45(a)(1) (2012); see Michael D. Scott, *The FTC, The Unfairness Doctrine, and Data Security Breach Litigation: Has the Commission Gone Too Far?*, 60 ADMIN L. REV. 127, 129 (2008).

<sup>295</sup> See Scott, *supra* note 294, at 143. A practice is deceptive if it is likely to mislead a consumer, acting reasonably in the circumstances, about a material fact. Thompson Med. Co., Inc., v. FTC, 791 F.2d 189, 193 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1086 (1987); POLICY STATEMENT ON DECEPTION, *supra* note 163, at 175–76.

<sup>296</sup> *In re* Guess?, Inc., 136 F.T.C. 507, 512 (2003) (complaint); *In re* Microsoft Corp., 134 F.T.C. 709, 711–12 (2002) (complaint).

<sup>297</sup> The first case alleging unfairness was against BJ’s Wholesale Club. *In re* BJ’s Wholesale Club, Inc., 140 F.T.C. 465, 468 (2005) (complaint). Subsequent cases alleging unfairness include other retailers who suffered breaches, e.g., *In re* DSW, Inc., 141 F.T.C. 117, 119–20 (2006) (complaint); against other sellers of information, e.g., Complaint at 4, *United States v. ChoicePoint, Inc.*, No. 1:06-cv-0198-GET (N.D. Ga. Jan. 30, 2006); and credit card processors, e.g., Complaint at 2, *In re* CardSystems Solutions, Inc., No. C-4168, (F.T.C. Sept. 5, 2006), 2006 WL 2709787, at \*1.

<sup>298</sup> See *In re* Eli Lilly & Co., 133 F.T.C. 763 (2002) (complaint and consent order).

<sup>299</sup> See Complaint for Injunctive and Other Equitable Relief, FTC v. Wyndham Worldwide Corp., No. 2:12-cv-01365-SPL (D. Ariz. June 26, 2012).

<sup>300</sup> See Motion to Dismiss by Defendant Wyndham Hotels & Resorts LLC at 2–4, FTC v. Wyndham Worldwide Corp., No. 2:12-cv-01365-PGR (D. Ariz. Aug. 27, 2012).

<sup>301</sup> See FTC v. Wyndham Worldwide Corp., 799 F.3d 236 (3d Cir. 2015).

<sup>302</sup> See Complaint, *In re* LabMD, Inc., No. 9357 (F.T.C. Aug. 28, 2013).

<sup>303</sup> See Respondent’s Answer & Defenses to Administrative Complaint at 6–7, *In re* LabMD, Inc., No. 9357, F.T.C. (Sept. 17, 2013).

At its inception, the “reasonable and appropriate” standard was viewed as a common law reasonableness standard, balancing the benefits of reduced security risks against the costs of providing greater protection.<sup>304</sup> Many cases challenge the failure to take exceedingly cheap security precautions that would significantly reduce risk, such as using “a commonly known default user id and password”<sup>305</sup> or the failure to use “readily available security measures to limit wireless access.”<sup>306</sup> There is, however, no checklist of required security measures, nor would it be reasonable to establish such a list, which in the fast-moving world of Internet threats would probably be out of date almost immediately. Instead, implicit in the cases is a sliding scale, with more sensitive information requiring more elaborate security precautions to protect it.

Apart from the consent orders, the only formal statement of the Commission’s view of information security requirements is the Safeguards Rule, promulgated in 2002.<sup>307</sup> The rule covers a broad range of “financial institutions” subject to FTC jurisdiction—essentially any business offering products or services that banks were permitted to offer prior to the Gramm-Leach-Bliley Act.<sup>308</sup> The rule requires businesses to develop a written “comprehensive information security program” with safeguards “appropriate to your size and complexity, the nature and scope of your activities, and the sensitivity of any customer information at issue.”<sup>309</sup> The program must designate a responsible employee, identify reasonably foreseeable security risks, implement and regularly test safeguards to control those risks, and evaluate and adjust the program based on test results or changes in circumstances.<sup>310</sup> The Commission’s orders in information security settlements typically impose these requirements, along with requiring periodic audits of security practices.<sup>311</sup>

Although the process-based method is a reasonable way to approach data security issues, there are multiple, serious questions regarding the current Commission’s approach. First, the agency has not

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<sup>304</sup> See Complaint, *Wyndham Worldwide Corp.*, *supra* note 299, at 19.

<sup>305</sup> *In re* BJ’s Wholesale Club, Inc., 140 F.T.C. 465, 467 (2002).

<sup>306</sup> Complaint at 2, *In re* The TJX Cos., Inc., No. C-4227 (F.T.C. July 29, 2008), 2008 WL 3150421, at \*2.

<sup>307</sup> 16 C.F.R. pt. 314 (2015); Beales & Muris, *supra* note 270, at 127.

<sup>308</sup> 16 C.F.R. § 314.1.

<sup>309</sup> *Id.* § 314.3.

<sup>310</sup> *Id.* § 314.4.

<sup>311</sup> See, e.g., Order at 3–6, *In re* Fandango, LLC, No. C-4481 (F.T.C. Aug. 13, 2014), 2014 WL 4252396, at \*6–7.



provided sufficient guidance to regulated companies about what is required. The consent agreements provide information about the practices that, at least in combination, will lead to finding a violation, but they give little sense of how the Commission evaluates either the reduction in risk that more precautions would produce or the costs of implementing those precautions. Most important, they give no guidance about the cases that the Commission ultimately chooses not to bring. Although a breach may be publicly known, the lack of a subsequent consent agreement may mean either that the Commission thought the security precautions were reasonable, that the matter was not investigated, that it was too small to be of concern, or that it was resolved informally. Moreover, when the matter was investigated, there is often no indication of why the staff determined not to move forward.

For a time, the Bureau of Consumer Protection put closing letters from data security investigations on the public record, offering some insight into the staff's thinking about what security measures were appropriate.<sup>312</sup> This practice was apparently suspended, because there appear to be no closing letters providing meaningful information regarding data security after 2009.<sup>313</sup> It may have resumed last year, however, when the Bureau placed a closing letter in an investigation of Verizon on the public record.<sup>314</sup> Hopefully, the useful practice of placing informative closing letters on the public record will continue.

The relative lack of guidance about how the staff will apply the inherently discretionary "reasonable and appropriate security" standard stands in stark contrast to the information available about the FTC's thinking regarding merger enforcement. Like data security, there are few bright-line standards in merger enforcement;<sup>315</sup> instead,

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<sup>312</sup> See, e.g., Letter from Joel Winston, Assoc. Dir., Div. of Privacy & Identity Prot., Fed. Trade Comm'n, to Michael E. Burke, Counsel, Dollar Tree Stores, Inc. (June 5, 2007), [http://www.ftc.gov/sites/default/files/documents/closing\\_letters/dollar-tree-stores-inc./070605doltree.pdf](http://www.ftc.gov/sites/default/files/documents/closing_letters/dollar-tree-stores-inc./070605doltree.pdf).

<sup>313</sup> Geoffrey A. Manne, *Humility, Institutional Constraints, & Economic Rigor: Limiting the FTC's Consumer Protection Discretion* 34 n.102, (ICLE Antitrust & Consumer Prot. Program Working Paper, 2014-1).

<sup>314</sup> See Letter from Maneesha Mithal, Assoc. Dir., Div. of Privacy & Identity Prot., Fed. Trade Comm'n, to Dana Rosenfeld, Counsel, Verizon Commc'ns, Inc. (Nov. 12, 2014), [https://www.ftc.gov/system/files/documents/closing\\_letters/verizon-communications-inc./141112verizon-closingletter.pdf](https://www.ftc.gov/system/files/documents/closing_letters/verizon-communications-inc./141112verizon-closingletter.pdf).

<sup>315</sup> See, e.g., DEP'T OF JUSTICE & FED. TRADE COMM'N, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES (2006), <http://www.justice.gov/sites/default/files/atr/legacy/2006/04/27/215247.pdf> (detailing the analytical framework and standards the FTC applies in assessing horizontal mergers).

decisions depend on a balance of competing considerations.<sup>316</sup> Like data security, the merger standard is discretionary, but there is much more transparency about how the staff weighs the issues in determining whether to recommend enforcement.<sup>317</sup> The Commission should bring comparable levels of transparency to its data security program. Failure to do so is a serious black mark on the current Commission's record.

The second problem with the current FTC's security cases involves misapplication of the "reasonable and appropriate" standard. Clever thieves can defeat virtually any security system on at least some occasions. Data security cases should not be a backward-looking failure analysis when breaches occur; rather, they should assess the *ex ante* choices that companies made when they adopted some security precautions and failed to adopt others. The issue is whether those choices were reasonable, given the information available when the choice was made. Recognizing this principle, Commission statements about information security have repeatedly said that not all breaches are actionable.<sup>318</sup> Thus, the Commission has sought to avoid a standard of strict liability for any breach. Instead, the issue is whether the company was employing reasonable and appropriate security measures.

In some recent cases, however, the Commission's allegations seem far closer to strict liability than to an assessment of the *ex ante* reasonableness of a company's choices. In *Accretive Health*,<sup>319</sup> for example, the allegations amounted to the fact that a single unencrypted but password-protected laptop computer was stolen from the locked

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<sup>316</sup> See *id.* at 20–21.

<sup>317</sup> In the last decade alone, the FTC released a commentary on what the 1992 merger guidelines meant; a detailed data release explaining the importance in enforcement decisions—including decisions not to sue—of factors such as concentration, entry barriers, customer complaints, and the number of significant competitors; separate statements on important cases in which the FTC did not act; and issued new guidelines in 2010 to replace those of 1992. See *id.*; DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (2010), <https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf>.

<sup>318</sup> See, e.g., *Data Breach on the Rise: Protecting Personal Information from Harm: Hearing Before S. Comm. on Homeland Sec. & Governmental Affairs* 4 (2014) (prepared statement of the FTC) ("[T]he Commission does not require perfect security; and that the mere fact that a breach occurred does not mean that a company has violated the law."); *Identity Theft: Recent Developments Involving the Security of Sensitive Consumer Information: Hearing Before S. Comm. on Banking, Hous., & Urban Affairs* 41 n.42 (2005) (prepared statement of the FTC) ("It is important to note, however, that there is no such thing as perfect security, and breaches can happen even when a company has taken every reasonable precaution.").

<sup>319</sup> Complaint, *In re Accretive Health, Inc.*, No. C-4432 (F.T.C. Feb. 5, 2014), 2014 WL 726603.

passenger compartment of an employee's car in 2011.<sup>320</sup> In accordance with Accretive's policy, most computers were encrypted, but an oversight by a subsequently fired IT employee resulted in 30 of 1,400 computers lacking effective encryption software.<sup>321</sup> Moreover, the company continued to monitor the laptop and maintained that "[i]f the laptop is used to access the Internet, Accretive Health will be notified . . . ." <sup>322</sup> There is no allegation in the Commission's complaint that there was any such notification, nor any allegation that the information was actually compromised in any way.

To be sure, companies should take care to avoid the loss of laptop computers and to protect the information stored on them. There is nothing in the complaint, however, other than the theft itself, to suggest why the Commission thought the decision to rely on a single employee to enforce the encryption policy was unreasonable *ex ante*.<sup>323</sup> Moreover, the adoption of a redundant system after the incident would seem to be exactly the kind of experience-based adjustment of security precautions that the Safeguards Rule contemplates. At best, the Accretive complaint is an example of the need for more guidance about how the Commission assesses reasonableness; at worst, it is an inappropriate application of a strict liability rule that the Commission has consistently disavowed.<sup>324</sup>

### C. *The Commission Should Restrict Its Privacy Enforcement Actions to Practices that Cause Real Consumer Harm*

Although the Commission has not abandoned the consequences-based approach to privacy entirely, and cannot given the statutory constraints under which it operates, it has adopted a new "privacy framework," based on what the Commission views as "best practices."<sup>325</sup> The framework urges "privacy by design," "simplified con-

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<sup>320</sup> *Id.* at \*2; Defendants Memorandum of Law in Support of its Motion to Dismiss at 7 n.3, *Minnesota v. Accretive Health, Inc.*, No. 12-cv-00145 (RHK-JJK) (D. Minn. Apr. 30, 2012), 2012 WL 1578341. The Authors advised Accretive during the FTC investigation.

<sup>321</sup> Defendant's Memorandum of Law in Support of its Motion to Dismiss, *supra* note 321, at 7 n.3.

<sup>322</sup> *Id.* at 7.

<sup>323</sup> *See id.*

<sup>324</sup> Complaint, *In re Accretive Health, Inc.*, *supra* note 319.

<sup>325</sup> FED. TRADE COMM'N, PROTECTING CONSUMER PRIVACY IN AN ERA OF RAPID CHANGE: RECOMMENDATIONS FOR BUSINESSES AND POLICYMAKERS Part IV (2012) [hereinafter PROTECTING CONSUMER PRIVACY], <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-report-protecting-consumer-privacy-era-rapid-change-recommendations/120326privacyreport.pdf>.

sumer choice,” and greater “transparency.”<sup>326</sup> The Commission Report recognizes that some of the practices it urges go “beyond existing legal requirements,” but provides little guidance on the contours of the practices it believes are subject to challenge under the FTC Act, particularly those labeled “unfair.”<sup>327</sup>

As discussed above, some breaches of privacy involve real and concrete harms such as the annoyance of an unwanted telemarketing call or identity theft.<sup>328</sup> Harm can also be actionable even if difficult to monetize directly.<sup>329</sup> Damage to a reputation or intrusion into private places are not as concrete as the risk of physical or economic injury, but they cause real harm nonetheless, widely recognized in tort law.<sup>330</sup> From the beginning, the harm-based approach to privacy addressed such harm. Indeed, the Commission’s first information security case was against Eli Lilly for inadvertent disclosure of sensitive information—the email addresses of many Prozac users.<sup>331</sup> Such information is sensitive because of the risk of damage to reputations. Similarly, an early case challenged the practice of email “spoofing”—falsifying the return address in spam email—as unfair.<sup>332</sup> The bulk emails used deceptive subject lines to induce consumers to open sexually explicit solicitations to visit adult web sites.<sup>333</sup> As part of the injury to consumers, the complaint cited the reputational harm from being associated with spamming to parties whose addresses were spoofed.<sup>334</sup>

Some potential “harm” to consumers involves secondary characteristics of a product or service that do not affect its functionality. Often, such preferences concern how a product or service is produced, rather than the characteristics of the final product.<sup>335</sup> Many consumers, for example, prefer products that are kosher.<sup>336</sup> Others may pre-

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<sup>326</sup> *Id.* at Part IV(B)–(D).

<sup>327</sup> *Id.* at iii–vi.

<sup>328</sup> *Id.* at Part IV(B).

<sup>329</sup> See, e.g., RESTATEMENT (SECOND) OF TORTS §§ 559 (“Defamatory Communication Defined”), 652A (“Invasion of Privacy: General Principle”).

<sup>330</sup> See *id.* §§ 559 (“Defamatory Communication Defined”), 652B (“Intrusion Upon Seclusion”), 652D (“Publicity Given to Private Life”).

<sup>331</sup> See *In re Eli Lilly & Co.*, 133 F.T.C. 763, 766–67 (2002).

<sup>332</sup> See *FTC v. Westby*, No. 03 C 2540, 2004 WL 1175047, at \*2–3 (N.D. Ill. Mar. 4, 2004).

<sup>333</sup> See Amended Complaint at 3–4, *FTC v. Westby*, No 03 C 2540, 2003 WL 23525272 (N.D. Ill. Sept. 16, 2003).

<sup>334</sup> See *id.* at 5.

<sup>335</sup> See Donna M. Byrne, *Cloned Meat, Voluntary Food Labeling & Organic Oreos*, 8 PIERCE L. REV. 31, 41 (2009).

<sup>336</sup> See Shayna M. Sigman, *Kosher Without Law: The Role of Nonlegal Sanctions in Overcoming Fraud Within the Kosher Food Industry*, 31 FLA. ST. U. L. REV. 509, 536–45 (2004).

fer products that are “made in USA,” or union made, or free-range chickens, or locally grown produce.<sup>337</sup> Although we can determine objectively whether such a claim is accurate, its importance, and hence the magnitude of any injury, depends entirely on the preferences of the consumer.<sup>338</sup> We term these types of preferences subjective, because not all consumers agree that the attribute is important and because there is no way for an outside observer to measure the magnitude of the injury if they are violated.<sup>339</sup>

Such subjective preferences can be important for privacy. As the FTC’s preliminary report noted in 2010, “for some consumers, the actual range of privacy-related harms is much wider and includes . . . the fear of being monitored or simply having private information ‘out there.’”<sup>340</sup> Consumers may also feel harmed when information is used “in a manner that is contrary to their expectations,” and may have “discomfort with the tracking of their online searches and browsing.”<sup>341</sup> Some have summarized these kinds of harms as “creepiness.”<sup>342</sup>

No doubt, there are consumers with such preferences. As with other subjective preferences, the Commission should protect them when they are manifested in marketplace choices. If a company promises “no information sharing,” or no tracking, or kosher, it must deliver. Thus, in *Gateway Learning*,<sup>343</sup> the Commission challenged a retroactive, unilateral change in the company’s privacy policy.<sup>344</sup> The policy originally provided that “[w]e do not sell, rent or loan any personally identifiable information regarding our consumers with any third party unless we receive a customer’s explicit consent,”<sup>345</sup> but the company later began renting such information without seeking consent, and then revised its privacy policy to allow its new practice.<sup>346</sup> The Commission challenged the retroactive application of the new

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<sup>337</sup> See generally, e.g. Brad Rose, *Locally Grown Food: Examining the Ambiguity of the Term “Local” in Food Marketing*, 9 J. FOOD L. & POL’Y 135 (2013) (discussing consumers’ growing emphasis on locally grown products).

<sup>338</sup> See Timothy J. Muris, *The Costs of Freely Granting Specific Performance*, 1982 DUKE L.J. 1053, 1053–54.

<sup>339</sup> See *id.*

<sup>340</sup> PROTECTING CONSUMER PRIVACY, *supra* note 325, at 20.

<sup>341</sup> *Id.*

<sup>342</sup> See Adam Thierer, *The Pursuit of Privacy in a World Where Information Control is Failing*, 36 HARV. J. L. & PUB. POL’Y 409, 417–18 (2013).

<sup>343</sup> *In re Gateway Learning Corp.*, 138 F.T.C. 443 (2004) (complaint).

<sup>344</sup> See *id.* at 449.

<sup>345</sup> *Id.* at 445.

<sup>346</sup> *Id.* at 446.

privacy policy as unfair, but it did so without any specific allegations about the consequences of sharing.<sup>347</sup> It was the unilateral modification of the contract that was unfair, rather than the specific modification adopted.<sup>348</sup> Consumers had been promised one product characteristic, about which they might reasonably care, and were now being given another.<sup>349</sup>

Critical to protecting subjective preferences, however, is that consumers have made a choice based on the promise, and they expect the provider to deliver. It does not follow that because *some* consumers have a preference, the Commission should require *all* sellers to satisfy that preference. Assuring the accuracy of claims that a product is kosher enhances consumer sovereignty—it lets consumers choose what matters to them and what does not. Consumers who believe keeping kosher is important can do so, but they must face the cost of paying attention and finding a seller who promises to provide kosher products. Consumers who think kosher is irrelevant are not burdened in any way.

Requiring all sellers to offer kosher products is another matter altogether. Such a policy imposes the costs of the admittedly real preferences of some on many who do not share them. The FTC Act, however, is about preserving consumer sovereignty, not about substituting the preferences of the Commissioners for those of certain consumers, or imposing the preferences of one group of consumers on another. The fact that a particular product characteristic, whether related to privacy or religious preference, is important *to me* is a very good reason for protecting affirmative claims about that characteristic. It is a very bad reason for imposing that preference on others.

Marketplace behavior is the only reliable indication that subjective preferences are real. They cannot be sensibly inferred from survey results in which consumers can express a preference without confronting the costs of satisfying it. There are numerous examples of the differences between expressed consumer preferences and actual choices. Nearly half of consumers express a willingness to pay more for locally grown produce, but locally sourced produce accounts for less than a quarter of sales at the leading retailers of local produce; at Wal-Mart the figure is about ten percent (with “local” defined as from

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<sup>347</sup> See *id.* at 449–59.

<sup>348</sup> See *id.*

<sup>349</sup> The seminal case applying the Commission’s unfairness authority to unilateral contract modifications is *In re Orkin Exterminating Co., Inc.*, 108 F.T.C. 263 (1986), *aff’d*, 849 F. 2d 1354 (11th Cir. 1988).

the same state).<sup>350</sup> Two-thirds of consumers say that proximity to a branch bank is very important, but 58% would rather have the branch close than pay higher fees.<sup>351</sup> A study of Danish consumers' interest in "organic" products found far more claimed willingness to pay more for organic than was revealed in actual behavior.<sup>352</sup> For "minced beef," 41% of consumers expressed a willingness to pay more for organic products; only 6% actually did.<sup>353</sup> For rye bread, 51% said they were willing to pay, but only 35% did.<sup>354</sup> For potatoes, 48% said they were willing, but only 14% actually purchased organic potatoes. Only for milk were the claimed and actual percentages close (59% and 55%, respectively).<sup>355</sup>

The nature of subjective preferences means that an unfairness analysis is particularly inappropriate.<sup>356</sup> Unless there is some reason that a uniform choice is necessary, markets are better suited than governments to match each consumer to the product or service that best satisfies his or her preferences. Determining that a practice is unfair because of some alleged violation of subjective preferences would impose the preferences of some on others who do not share them, violating the very consumer sovereignty that section 5 is supposed to protect. The Commission's Unfairness Policy Statement was therefore wise in ruling out use of unfairness to address subjective harms,<sup>357</sup> and it is difficult to imagine a more subjective harm than "creepiness."

A recent series of cases reflects the Commission's confusion about the nature of consumer injury, as well as appropriate remedies. The cases alleged section 5 violations by software provider DesignerWare, as well as a number of rent-to-own stores that use the

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<sup>350</sup> See Tom Burfield, *Retailers Define Local Produce*, PRODUCE RETAILER (Apr. 2, 2013, 10:16 AM), <http://www.produceretailer.com/produce-retailer-issues/Retailers-work-to-define-local-produce-201050821.html>.

<sup>351</sup> See *The Financial Brand: The Branch Paradox: Consumers Say One Thing, Do Another*, CHADWICK MARTIN BAILEY (Sept. 10, 2012, 10:41 AM), <http://blog.cmbinfo.com/in-the-news-content/-/bid/82089/The-Financial-Brand-The-Branch-Paradox-Consumers-Say-One-Thing-Do-Another>.

<sup>352</sup> See MILLOCK KATRIN & LARS GARN HANSEN, MUNICH PERS. RePEc ARCHIVE, WILLINGNESS TO PAY FOR ORGANIC FOODS: A COMPARISON BETWEEN SURVEY DATA AND PANEL DATA FROM DENMARK 14–15 (2002), [https://mpra.ub.uni-muenchen.de/47588/1/MPRA\\_paper\\_47588.pdf](https://mpra.ub.uni-muenchen.de/47588/1/MPRA_paper_47588.pdf).

<sup>353</sup> *Id.* at 13, 16 (Tables 3 & 5).

<sup>354</sup> *Id.*

<sup>355</sup> *Id.*

<sup>356</sup> See POLICY STATEMENT ON UNFAIRNESS, *supra* note 77, at 1073 ("Emotional impact and other more subjective types of harm . . . will not ordinarily make a practice unfair.").

<sup>357</sup> *Id.*

software on rental computers.<sup>358</sup> As described in the DesignerWare Complaint, the software can disable the computer remotely, logs any WiFi hotspots that the computer sees, and reports this information to DesignerWare's servers every two hours.<sup>359</sup> Most controversial, the software includes a "Detective Mode" that, when activated at the request of the licensee, captures keystrokes and screenshots, and can take photographs through the webcam in the computer.<sup>360</sup>

Licensees also have the option of causing the computer to display a fake software registration window seeking the user's name, address, and phone number; consumers cannot close the window until they fill in the required fields.<sup>361</sup> The Complaint charges that, because the popup windows appear to be "notices from trusted software providers," this practice is deceptive.<sup>362</sup> There is little reason, however, to think the "trusted software provider" claim is material to anyone. There may be an attempt to "trick" the consumer into providing the information, but if the user cannot continue using the computer until the boxes are filled in, it hardly matters what software is allegedly being registered. A "registration window" for DesignerWare's software would presumably work as well.

The Complaint alleges that installing Detective Mode is an unfair practice and the consent order prohibits monitoring software entirely.<sup>363</sup> There is no question that the intrusion inherent in the Detective Mode, particularly the use of the computer's camera, is an actionable injury. The complaint's analysis is far too cavalier, however, regarding the allegedly unfair geophysical tracking software and the allegedly deceptive popup registration windows.<sup>364</sup> The consumer who is behind in payments for a rented computer that has suddenly become a paperweight because software is used to prevent the computer's continued use may or may not return it to the store. Additional efforts to collect and to recover the computer are likely necessary in many such cases. Both geophysical location and popup registration seek precisely the information that can enable the owner

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<sup>358</sup> *In re DesignerWare, LLC*, 155 F.T.C. 421, 428–30 (2013) (complaint); *see also* Press Release, Fed. Trade Comm'n, *FTC Halts Computer Spying* (Sept. 25, 2012), <http://www.ftc.gov/opa/2012/09/designware.shtm>.

<sup>359</sup> *In re DesignerWare, LLC*, 155 F.T.C. at 422–23, 426.

<sup>360</sup> *Id.* at 423.

<sup>361</sup> *Id.* at 427.

<sup>362</sup> *Id.* at 430.

<sup>363</sup> *Id.* at 435.

<sup>364</sup> *Id.* at 426–28.



to recover the merchandise.<sup>365</sup> In an industry where one in five transactions ends with the consumer skipping with the goods or in collection,<sup>366</sup> these benefits are not trivial and likely reduce the costs of rental computers to consumers who honor their agreement.<sup>367</sup> The DesignerWare complaint, however, offers no reason to think the privacy costs of these practices outweigh the benefits.<sup>368</sup>

The harm the Commission apparently sees from tracking without notice to users is totally unclear from the complaint, which articulates no harm of any kind that flows from this lack of knowledge (or from the tracking itself). It is odd to worry about location tracking from software that only reports locations in two-hour intervals and when connected to the Internet,<sup>369</sup> especially when most people carry phones that constantly report their locations.<sup>370</sup>

The consent order is also somewhat schizophrenic about location tracking software.<sup>371</sup> It requires “affirmative express consent” before installation, but it allows the company to refuse to rent to anyone who declines installation.<sup>372</sup> This is the illusion of choice, but not actual choice. It also requires notice to the user “prior to each use” of the tracking technology.<sup>373</sup> The most straightforward way to comply with the notice requirement is to provide notice at startup and run the tracking software continuously.<sup>374</sup> To avoid the unspecified “harm” of having location reported every two hours, the computer’s location will be tracked continuously.<sup>375</sup> If there is a problem in the first place, the order would appear to make it worse, not better.

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<sup>365</sup> See *id.*

<sup>366</sup> The consumer skips with the merchandise in eight percent of rent-to-own transactions; in twelve percent, the merchandise is returned because of collection problems. See J. HOWARD BEALES III ET AL., CONSUMER WELFARE IMPLICATIONS OF REGULATING RENT-TO-OWN TRANSACTIONS 18, 21 (2012), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2060984](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2060984).

<sup>367</sup> See *id.* at 37–38.

<sup>368</sup> See *In re DesignerWare, LLC*, 155 F.T.C 421 (2013).

<sup>369</sup> *Id.* at 423.

<sup>370</sup> An interesting question, which the complaint does not address, is what happens to the software if and when the consumer acquires ownership of the computer. See *id.* Rent-to-own contracts are typically twelve to twenty-four months, with twelve months seeming more likely for a computer, and are frequently terminated early. See BEALES ET AL., *supra* note 366, at 1–2. The longer the duration of location tracking, the greater the likelihood that it raises privacy concerns. If the software is not deactivated, tracking without the knowledge of the consumer when there is no relationship with the tracker would certainly raise concerns.

<sup>371</sup> See *In re DesignerWare, LLC*, 155 F.T.C. at 435–38.

<sup>372</sup> *Id.* at 436.

<sup>373</sup> *Id.* at 435–36.

<sup>374</sup> See *id.*

<sup>375</sup> See *id.*

Anchoring the Commission's enforcement efforts to practices that cause harm is important because the modern information economy is built on data collection and analysis.<sup>376</sup> The commercial use of information contributes to reducing the incidence of credit card fraud, democratizing the availability of consumer credit, and creating fraud detection tools to reduce the risk of identity theft.<sup>377</sup> It is essential not only for the basic functioning of the Internet, but also in creating value for consumers by supporting advertising, which underwrites the cost of content and services. Data collection and analysis allow tailoring both commercial and noncommercial offerings to meet consumers' specific preferences and facilitate innovation by new and existing suppliers. Consumer data and feedback also enable the increased customization and personalization of online experiences and offerings for consumers, which are helping to fuel growth in broadband usage and e-commerce.

With data-dependent products and services, it is risky to let artificial distinctions get in the way of efficient market organization. If a use of information by a "first party" is a useful practice that benefits consumers, it does not become any less useful, or any more of a risk to privacy, because the most efficient way to produce those benefits is to share the information with a "third party" who actually does the analysis. A focus on information sharing, rather than information uses, risks creating entirely artificial barriers to innovation that will ill serve consumers in a market environment as dynamic as the Internet.<sup>378</sup>

The principle of avoiding the most serious mistake that should be central to advertising substantiation is equally applicable to privacy regulation. Regulation or enforcement that is too stringent may reduce the risk of the particular privacy harms addressed, but it increases the risk of precluding innovations that would make everyone's life better. Too little enforcement may facilitate innovation, but it also

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<sup>376</sup> See Adam Thierer, *Relax and Learn to Love Big Data*, U.S. NEWS & WORLD REP. ECON. INTELLIGENCE BLOG (Sept. 16, 2013, 12:10 PM), <http://www.usnews.com/opinion/blogs/economic-intelligence/2013/09/16/big-data-collection-has-many-benefits-for-internet-users>.

<sup>377</sup> See generally Beales & Muris, *supra* note 270, at 115–17.

<sup>378</sup> Because it focuses on information sharing, rather than information use, the Commission often distinguishes between "first party" information uses and uses by a third party that occur after sharing. See generally, e.g., FED. TRADE COMM'N, FTC STAFF REPORT: SELF-REGULATORY PRINCIPLES FOR ONLINE BEHAVIORAL ADVERTISING 26 (2009), <http://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-staff-report-self-regulatory-principles-online-behavioral-advertising/p085400behavadreport.pdf>. For example, the "Self Regulatory Principles for Online Behavioral Advertising" are limited to "third party" behavioral advertising, not to "first party" behavioral advertising. See *id.* at iii. The result is an artificial advantage for large content providers, who know more about a consumer's usage patterns.

increases the risk of real and concrete privacy harms. The question is one of balance, and should be asked about every potential privacy enforcement action. Is the more serious error failing to regulate or is overly burdensome regulation the greater risk?

The Commission can reduce the risks of overregulation by focusing on real and identifiable harms. That is a proper role for consumer protection in general and privacy regulation is no different. Regulation to prevent hypothetical problems, however, poses far greater risks that the next big innovation will be precluded, not because it would have caused a problem, but simply because no one had previously considered the possibility. In considering, for example, the privacy implications of the “Internet of things,” it is easy to speculate about the potential problems that might result from interconnected devices that talk to each other.<sup>379</sup> Regulation based on speculative problems, however, is far more likely to chill useful innovations than it is to prevent real harms.

For example, when Congress and the Commission first began considering online privacy issues in the late 1990s, few would have imagined that literally billions of consumers would want to post many of the details of their personal lives online for all to see.<sup>380</sup> Facebook and other social media have created tremendous value for consumers by enabling exactly that practice. Regulation based on what some might still consider “creepy” could easily have prohibited a valuable innovation.

Finally, some of the Commission’s recent privacy and security cases allege that a practice is unfair, but employ what is at best a rather loose concept of harm. The Commission can only find a practice “unfair” if it “causes or is likely to cause substantial injury to consumers.”<sup>381</sup> In the early cases, there was real injury. In *BJ’s Wholesale Club*, for example, the complaint alleges that banks discovered fraudulent charges on counterfeit credit and debit cards made using the

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<sup>379</sup> The FTC’s January 2015 Staff Report on the Internet of Things, issued with one Commissioner dissenting and another declining to endorse two of its recommendations, recommends “best practices” for privacy and data security for connected devices. INTERNET OF THINGS, *supra* note 264, at i n.1, 27. Tech Freedom characterized the report as “stealth regulation.” See Evan Swarztrauber et al., *FTC Issues Stealth Regulations Over Internet of Things*, TECHFREEDOM (Jan. 27, 2015), <http://techfreedom.org/post/109300953614/ftc-issues-stealth-regulations-over-internet-of>.

<sup>380</sup> See, e.g., *Privacy in Electronic Communications: Hearing Before the H. Subcomm. on Courts & Intellectual Prop. of the H. Comm. on the Judiciary*, 105th Cong. (1998) (prepared statement of the FTC).

<sup>381</sup> 15 USC § 45(n) (2012).

compromised information;<sup>382</sup> the *ChoicePoint*<sup>383</sup> complaint alleges at least 800 cases of identity theft arising from compromised information.<sup>384</sup> More recent cases appear to have a greatly softened concept of consumer injury. In the *HTC America*<sup>385</sup> complaint, for example, the Commission alleges numerous flaws, but when it comes to injury, the complaint alleges only that there was “potential exposure” and that consumers are “at risk”—a standard that is met by crossing the street.<sup>386</sup> The complaint enumerates various events that “could” happen and that malware developers have targeted similar information and vulnerabilities.<sup>387</sup> Other than the charging paragraph that recites the statutory standard, the only place that “likely” appears is in the allegation that “an adequate security program . . . likely would have prevented . . . many of the serious security vulnerabilities.”<sup>388</sup> Similarly, the complaint against *Compete, Inc.*<sup>389</sup> is based on unfairness as well as deception, but it alleges only that security failures created “unnecessary risk.”<sup>390</sup> “Likely” only appears in the charging paragraph.<sup>391</sup> Whether a practice “causes or is likely to cause substantial consumer injury” is a factual question, and it is reasonable to expect that the Commission’s complaints allege facts that would lead to the conclusion that the standard has been violated. Instead, as with the *Accretive* complaint discussed above, the recent cases suggest a movement towards strict liability, without regard to whether injury has occurred or is likely to occur.

#### D. *The Value of Transparency*

“Greater transparency” is one of the three fundamental principles articulated in the FTC’s 2012 privacy report.<sup>392</sup> This principle includes “clearer, shorter, and more standardized privacy notices,” consumer access to information that companies maintain about the

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382 See *In re BJ’s Wholesale Club, Inc.*, 140 F.T.C 465, 467 (2005).

383 *United States v. ChoicePoint, Inc.*, No. 1:06-cv-0198-JTC (N.D. Ga. Sept. 2, 2010) (granting second supplemental stipulated order for permanent injunction).

384 Complaint at 4, *United States v. ChoicePoint, Inc.*, No. 1:06-cv-0198 (N.D. Ga. Jan. 30, 2006).

385 *In re HTC Am., Inc.*, 155 F.T.C. 1617 (2013) (complaint).

386 *Id.* at 1624–25.

387 *Id.* at 1620.

388 *Id.* at 1625. The complaint also challenges many of the alleged vulnerabilities under a deception theory. *Id.* at 1627–28.

389 Complaint, *In re Compete, Inc.*, 155 F.T.C. 264 (2013).

390 *Id.* at 269.

391 *Id.* at 271.

392 PROTECTING CONSUMER PRIVACY, *supra* note 325, at ix.

consumer, and “educat[ing] consumers about commercial data privacy practices.”<sup>393</sup>

The regulators, including the FTC, invested considerable effort in developing a simplified form for financial privacy notices required under the Gramm-Leach-Bliley Act.<sup>394</sup> Launched with Federal Register notices in 2003,<sup>395</sup> the effort finally resulted in the adoption of new model forms in 2009.<sup>396</sup> Although many banks, likely with some encouragement from their regulators, have adopted the simplified notices,<sup>397</sup> no evidence exists that they have influenced either the likelihood that consumers read the notice or the choices consumers make in the marketplace. Some attempt to assess the benefits of that effort would be useful before pressing for broader implementation of simplified and standardized notices,<sup>398</sup> but the Commission has pressed ahead nonetheless. A comparative study of online privacy notices in different formats is not encouraging—it found that “[a]ll formats and policies were similarly disliked.”<sup>399</sup>

Undoubtedly, there are many consumers who do not understand the collection and use of information in the modern economy. It is not clear, however, why most consumers need even a rough, let alone a sophisticated, understanding of information uses and information tools. For most consumers, there is a similar lack of transparency about nearly any complex product. A few consumers understand the product in detail, many more have a limited understanding of the key technologies, and for still others the product is essentially magic. In these other contexts, there is little concern about this lack of information, and it is not clear why privacy is different.

Consider, for example, the modern computer. A new computer includes gigabytes of data and programming, in literally hundreds of separate programs, and thousands, if not tens of thousands, of files. Consumers need to understand some of those programs to use them

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<sup>393</sup> *Id.* at 70–78.

<sup>394</sup> Press Release, Fed. Trade Comm’n, *Federal Regulators Issue Final Model Privacy Notice Form* (Nov. 17, 2009), <http://www.ftc.gov/opa/2009/11/glb.shtm>.

<sup>395</sup> Regulation S–P—Privacy of Consumer Financial Information, 68 Fed. Reg. 27,601–02 (May 20, 2003).

<sup>396</sup> Press Release, *supra* note 394.

<sup>397</sup> See LORRIE FAITH CRANOR ET AL., A LARGE-SCALE EVALUATION OF U.S. FINANCIAL INSTITUTIONS’ STANDARDIZED PRIVACY NOTICES 1 (2014) [https://www.cylab.cmu.edu/news\\_events/events/fopnac/pdfs/leon.pdf](https://www.cylab.cmu.edu/news_events/events/fopnac/pdfs/leon.pdf).

<sup>398</sup> Aleecia M. McDonald et al., *A Comparative Study of Online Privacy Policies and Formats*, in *PRIVACY ENHANCING TECHNOLOGIES* 37, 51 (Ian Goldberg & Mikhail J. Atallah, eds., 2009).

<sup>399</sup> *Id.* at 37.

appropriately, but most are undoubtedly thankful that they do not need to understand the functions of these programs or the technologies behind them. It was not always so; the text-based operating system (MS-DOS) of the early IBM-compatible personal computers required users to understand the technology in considerably more detail in order to make it work. Computers today are much easier to use, but they are also much less transparent to the user.

Automobiles are no different. There was a time when many, and perhaps most, drivers could perform important repairs on their car. Today, with the integration of electronics into nearly every automotive system, few drivers can even diagnose a problem, let alone fix it. The car, however, is safer, operates more efficiently in every respect, and is easier and more comfortable to use.

Thankfully, in our recent purchasing experience we have not received “computer policies” or “automobile policies” that seek to explain how the product works. Cars still come with owner’s manuals to provide operating and maintenance information, but most computers no longer even come with a manual.<sup>400</sup>

Transparency is a means to an end, not an end in itself.<sup>401</sup> When government is the user of information, transparency is the mechanism to assure political accountability for government decisions, and a reasonably comprehensive disclosure of the practices at issue is essential.<sup>402</sup> Under the Privacy Act, the notices to accomplish this purpose are published in the Federal Register and provide considerable detail about the information that is collected and how it will be used.<sup>403</sup> The goal is to allow those outsiders with considerable expertise to evaluate the program. It is not intended to inform ordinary consumers, and there is little reason for concern that few actually read the Federal Register.

If the goal of privacy policies in the commercial context is to provide the same kind of transparency, then notices should be more elaborate and more complex, rather than simplified and standardized. They should provide the information about privacy practices that ex-

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<sup>400</sup> Although some computers have an online manual, consumers have to know enough to set up the computer and obtain Internet access before they can use it.

<sup>401</sup> Heather Franzese, *What Does Transparency Mean to You?*, HUFFINGTON POST IMPACT BLOG, [http://www.huffingtonpost.com/heather-franzese/what-does-transparency-me\\_b\\_6102302.html](http://www.huffingtonpost.com/heather-franzese/what-does-transparency-me_b_6102302.html) (last updated Nov. 6, 2014, 11:59 AM).

<sup>402</sup> This is exactly the context in which the FIPs were originally developed, as the government considered merging its various systems of personal data collection and use. See RECORDS, COMPUTERS AND THE RIGHTS OF CITIZENS, *supra* note 262, at 1, 42.

<sup>403</sup> See 5 U.S.C. § 552(e)(4) (2012).

perts and competitors need to raise red flags about problematic practices, which will provoke a market response if consumers agree. If the goal of commercial privacy policies is something different, however, we cannot hope to achieve it without a clear specification of the objective. To date, neither privacy advocates nor the FTC has identified any clear goal. If disclosures seek to prevent particular harms, we need to identify those harms, both as the necessary predicate of determining the appropriate disclosure, and as the means of evaluating whether it worked.

Access and correction, the second component of the FTC's transparency approach, are also problematic, particularly in the context of fraud detection tools. Information tools allow users to look for inconsistencies between the information provided in a particular transaction and information that the real person has provided on other occasions.<sup>404</sup> Those inconsistencies are a trigger to look further, to be sure that the individual seeking to enter the transaction is really who they say they are. Typically, that is all that happens, as a real person provides further information to resolve the inconsistency. The thief walks away when confronted with this challenge to search for an easier target.

Indeed, some of the most sophisticated fraud detection tools are built on the premise that there may be no real person (other than a thief) associated with the information at all. They are organized around "identity elements," rather than an individual identity, and would be difficult to reorganize without surrendering the very premise that makes them effective.<sup>405</sup>

Access and correction are vital tools for consumers in the context of credit reports, which are used to make important decisions about individuals.<sup>406</sup> And they help to improve the accuracy of the data for all users. But when the goal of the information tool is only to establish that a consumer is who he or she claims to be, an inadvertent result is that thieves are given the opportunity to "correct" their infor-

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<sup>404</sup> See, e.g., EXPERIAN, *PRECISE ID: AN INTEGRATED APPROACH TO THE WORLD OF IDENTITY RISK MANAGEMENT* 1, 5 (2006), [https://www.experian.com/whitepapers/precise\\_id\\_whitepaper.pdf](https://www.experian.com/whitepapers/precise_id_whitepaper.pdf).

<sup>405</sup> See, e.g., *ID Analytics Secures Patent for Identity Manipulation Detection System*, ID ANALYTICS (Jan. 13, 2015), <http://www.idanalytics.com/blog/press-releases/id-analytics-secures-patent-identity-manipulation-detection-system-2/>; *ID Network Attributes for Fraud*, ID ANALYTICS (Feb. 17, 2015), <http://www.idanalytics.com/solutions/fraud-risk-management/id-network-attributes-for-fraud/>.

<sup>406</sup> See, e.g., Beales & Muris, *supra* note 270, at 112 n.13, 131.

mation, which risks undermining some of the most effective tools we have in the fight against identity theft.

### CONCLUSION

Following the rulemaking debacle of the 1970s, the FTC abandoned attempts to be the second most powerful legislature in Washington. The bipartisan consensus that followed focused on the FTC as a referee in our market economy, an important job to be sure, but not the starring role. The fraud program anchored the agency's consumer protection program, and the Commission also scrutinized the marketing practices of otherwise legitimate businesses to police deception and other practices with clear consumer harm. With the rise of the Internet, the FTC became an important protector of privacy, leading to the National Do-Not-Call Registry and numerous cases proscribing lax security measures for sensitive consumer information.

The lessons of the 1970s no doubt continued to influence the agency. Key staffers in the Bureau of Consumer Protection started at the FTC in the 1970s and stayed into the first decade of the new century. The FTC Chairmen from 1995–2004, Robert Pitofsky and Timothy Muris, both had worked at the agency in the 1970s; both shared the market-oriented vision of the FTC reflected in the 1989 ABA Antitrust Section Report on the Federal Trade Commission,<sup>407</sup> which they helped write as members of the task force that produced it.

By 2009, with a new Chairman and senior leadership team, and the retirement of important career staffers who began in the 1970s, for the first time no one in the senior management positions at the FTC had firsthand experience of the 1970s. Given this fact, and the enormous prestige that the FTC enjoyed, it was likely, and perhaps inevitable, that the agency would seek to expand its power, and indeed overreach. Change followed, some of it for the better, such as improvements to the fraud program, but much of it, in particular the abandonment of the bipartisan consensus regarding advertising enforcement, was decidedly for the worse. Moreover, although the departure in the agency's approach to privacy has not been as sharp as its departure in advertising regulation, warning signals are flashing.

Once again, the FTC stands at an important crossroads in its history. Some of the goodwill built up over decades has already been

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<sup>407</sup> Am. Bar Ass'n, *Report of the American Bar Association Section of Antitrust Law Special Committee to Study the Role of the Federal Trade Commission*, 58 ANTITRUST L.J. 43 (1989).



spent. The more the agency deviates from the carefully crafted, bipartisan path it followed, particularly in the 1990s and most of the decade that followed, the greater will be the agency's peril.