Hughes Hubbard & Reed

Federal Trade Commission Issues New Policy Statement Regarding the Scope of "Unfair Methods of Competition" Under Section 5 of the FTC Act

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

November 29, 2022 - On November 10, 2022, the U.S. Federal Trade Commission ("FTC") issued its long-awaited "Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act" ("New Policy Statement"). The FTC says that by releasing this statement it is seeking to "restore the agency's policy of rigorously enforcing the federal ban on unfair methods of competition." The New Policy Statement takes an expansive view of the FTC's authority to prevent unfair methods of competition under Section 5. While it enunciates general principles of enforcement that are broadly consistent with past Commission practice, it articulates new criteria for determining whether a business practice is an unfair method of competition, thereby creating greater uncertainty as to what conduct the FTC may find to violate Section 5.

The New Policy Statement is part of an ongoing effort by the Biden administration to reinvigorate antitrust enforcement after what President Biden and his senior antitrust advisors view as four decades of under-enforcement that began in the late 1970s with the adoption of the consumer welfare standard by the Supreme Court and its greater reliance on the rule of reason to decide antitrust cases. They blame weaker antitrust enforcement for having contributed to higher concentration in many industries, depressed wages for American workers, and higher prices for American consumers. (*See* Statement of the Commission on the Withdrawal of the Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act).

FTC Chair Lina Khan, who President Biden nominated to chair the FTC shortly after he became president, had for several years been one of the most prominent advocates for more aggressive antitrust enforcement and one of the most outspoken critics of both the consumer welfare standard and the rule of reason. It was not surprising, therefore, that one of her first acts as Chair was to rescind by a 3-to-2 vote a Statement of Enforcement Principles

Regarding Enforcement of FTC Act that the FTC had issued in August 2015, during the Obama Administration. ("2015 Statement of Principles").

That statement set forth three principles for the Commission to use in exercising its authority to prohibit unfair methods of competition under Section 5 of the FTC Act, principles that at the time seemed non-controversial: First, the Commission would be "guided by the public policy underlying the antitrust laws, namely, the promotion of consumer welfare." Second, any act or practice being reviewed would be "evaluated under a framework similar to the rule of reason," meaning that "an act or practice challenged by the Commission must cause, or be likely to cause, harm to competition or the competitive process, taking into account any associated cognizable efficiencies and business justifications." Third, the Commission would "be less likely to challenge an act or practice as an unfair method of competition on a standalone basis" under Section 5 "if enforcement under the Sherman or Clayton Act is sufficient to address the competitive harm arising from the act or practice."

An accompanying statement that Chair Khan and the other two Democratic commissioners released along with the New Policy Statement emphasized that the reason they had rescinded the 2015 Statement of Principles a year-and-a-half earlier was because, in their view, that statement had "departed from the plain text, purpose, structure, and history of the FTC Act," and had "effectively amounted to an abdication of the Commission's statutory mandate." (*See* Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya On the Adoption of the Statement of Enforcement Policy Regarding Unfair Methods of Competition Under Section 5 of the FTC Act).

At the time they rescinded the 2015 Statement of Principles, Chair Khan and her colleagues promised that they would issue a New Policy Statement outlining how they intended to evaluate business conduct under Section 5. The release of this New Policy Statement fulfills that promise. Here are what we view as the four key takeaways from this New Policy Statement.

1. The New Policy Statement takes an expansive view of the FTC's authority to prevent unfair methods of competition under Section 5.

Section 5 of the FTC Act, which was enacted in 1914 on the eve of World War I, declares unlawful "unfair methods of competition in or affecting commerce" without further defining that phrase. Instead, it provided that the newly created Federal Trade Commission would be "empowered and directed to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce," leaving it to the Commission to define what constitutes an "unfair method of competition." Section 5 gives the FTC authority to order any person found to have used an unfair method of competition to cease and desist from continuing to engage in any such act or practice after a quasi-judicial administrative proceeding but makes its orders subject to review by the federal courts of appeals and the Supreme Court.

The first section of the New Policy Statement, in reviewing the background and legislative history of Section 5, makes it clear that Chair Khan and her fellow commissioners take an expansive view of their authority to use Section 5 to prohibit unfair methods of competition. In it, they emphasize that "Congress's aim was to create a new prohibition broader than, and different from, the Sherman and Clayton Acts." In their view, the FTC's authority under Section 5 "extends not only to 'the letter,' but also to 'the spirit' of the antitrust laws." They emphasize, in addition, that Congress intended to give the FTC authority "to stop monopolies in their 'incipiency.'" They take this to mean that Section 5 does not "require a showing of current anticompetitive harm or anticompetitive intent" before the FTC can issue a cease-and-desist order against conduct it deems to be an unfair method of competition.

Finally, they argue that "Congress intended for the FTC to be entitled to deference from the courts as an independent, expert agency." To support this claim, they cite a series of Supreme Court decisions, mostly from the

1960s and before, to show that "courts have consistently held that FTC determinations as to what practices constitute an unfair method of competition deserve 'great weight.'"

2. The general principles the New Policy Statement enunciates for enforcing Section 5 are broadly consistent with past Commission practice but are likely to create greater uncertainty as to how they will be applied.

The second section of the New Policy Statement seeks to describe the "most significant general principles" the Commission will use in determining whether business conduct constitutes an "unfair method of competition."

- First, the conduct must constitute "a method of competition." This means that it must be "conduct undertaken by an actor in the marketplace—as opposed to merely a condition of the marketplace, not of the respondent's making, such as high concentration or barriers to entry." In addition, the conduct "must implicate competition, but the relationship can be indirect." An example is "misuse of regulatory processes that can create or exploit impediments to competition (such as those related to licensing, patents, or standard setting)." Conversely, "violations of generally applicable laws by themselves, such as environmental or tax laws, that merely give an actor a cost advantage would be unlikely to constitute a method of competition.'
- Second, the conduct must be "unfair" – which the Statement defines to mean conduct that "goes beyond competition on the merits." As examples of competition on the merits, it includes "superior products or services, superior business acumen, truthful marketing and advertising practices, investment in research and development that leads to innovative outputs, [and] attracting employees and workers through the offering of better employment terms."

The first criterion does not break any new ground. The FTC has regularly exercised its authority under Section 5 to issue cease and desist orders against companies that have misused regulatory processes to create or exploit impediments competition, most notably in its successful string of cases challenging reverse payment patent settlements, which culminated in its 2013 Supreme Court victory in *Actavis*. (*See FTC v. Actavis, Inc.*, 570 U.S. 136 (2013)).

Nor does the second criterion. In fact, despite the New Policy Statement's criticisms of how the courts have enforced the Sherman Act, the test the Supreme Court and lower courts have long used to determine whether a defendant is guilty of monopolization or attempted monopolization is whether the conduct goes beyond competition on the merits. What is somewhat surprising, however, is that the New Policy Statement omits from its list of conduct that represent competition on the merits what is perhaps the most common and important form of competition on the merits – namely, by operating more efficiently in order to offer customers better products or services at lower prices. This omission reflects the same skepticism Chair Khan and her two colleagues express about efficiency justifications for allegedly unfair methods of competition in a later section of the New Policy Statement.

Our concern that the New Policy Statement will create greater uncertainty as to what business conduct may be deemed an unfair method of competition by the FTC stems from the way the New Policy Statement goes on to describe the types of conduct that it believes go beyond competition on the merits.

- "Firstly," it says, "conduct may be unfair if it is "coercive, exploitative, collusive, abusive, deceptive, predatory, or involve[s] the use of economic power of a similar nature," or if the conduct is "otherwise restrictive or exclusionary."
- "Secondly," it says that in order to be unfair, conduct "must tend to negatively affect competitive conditions."

As to the first test, one cannot help but be reminded of Justice Byron White's observation in *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979), more than four decades ago: "Easy labels do not provide ready answers." Since that landmark decision, the Supreme Court has insisted that the lower courts must examine both the purpose and

effect of the conduct at issue before declaring it unlawful under the Sherman Act. The Supreme Court has required the FTC to do likewise in enforcing Section 5 in cases like *California Dental Ass'n v. FTC*, 526 U.S. 756 (1999), and *Actavis*. One would hope the Commission will follow the Court's direction before it attaches one of its six pejorative labels to the methods of competition it examines.

As to the second test, the New Policy Statement risks creating more uncertainty by adopting a new test for unfairness that it has never used before – namely, whether a business practice may "tend to negatively affect competitive conditions." Although one or two Senators may have used this language when discussing earlier versions of the FTC Act that did not give the FTC any enforcement power, there are no FTC or court decisions to our knowledge that have used this language when describing when a business practice constitutes an unfair method of competition. Adopting a novel test for applying Section 5 that neither the Commission nor the courts have used in the more than a century since it was first enacted cannot help but create uncertainty as to how this new test will be applied in practice.

The New Policy Statement's efforts to explain how the Commission will apply this new test are of little help in reducing this uncertainty.

- First, the statement says that the Commission will look at how it affects "consumers, workers, or other market participants" – which could include suppliers, distributors, or competitors.
- Second, the statement says that because "the Section 5 analysis is purposely focused on incipient threats to competitive conditions, its inquiry will not "turn to whether the conduct *directly* caused actual harm in the specific instance at issue," but instead examine "whether the respondent's conduct has a *tendency* to generate negative consequences."
- Third, the statement gives several examples of the types of negative consequences it will examine: "for instance, raising prices, reducing output, limiting choice, lowering quality, reducing innovation, impairing other market participants, or reducing the likelihood of potential or nascent competition."
- Fourth, the statement says that "These consequences may arise when the conduct is examined in the aggregate along with the conduct of others engaging in the same or similar conduct, or when the conduct is examined as part of the cumulative effect of a variety of different practices by the respondent."
- Fifth, the statements adds that a "separate showing of market power or market definition" may not be required "when the evidence indicates that such conduct tends to negatively affect competitive conditions."

None of these five points is anything new. The FTC and the courts have long looked at the effect of allegedly anticompetitive conduct on workers, suppliers, distributors and other market participants (including competitors), in addition to consumers. Similarly, under the Sherman and Clayton Acts, the FTC and the courts have long been willing to enjoin business conduct that is likely to injure competition before it does so. The types of negative consequences the New Policy Statement gives as examples of those it will examine are likewise the same ones the courts and the FTC have routinely examined in the past. It is not a new idea that the potential anticompetitive effects of a defendant's conduct should be examined in the aggregate along with the conduct of others. Nor is it new to forgo a separate showing of market power if the potential anticompetitive effects of the conduct at issue is clear.

Adding to the uncertainty, however, the statement goes on to say that in applying the two new criteria for evaluating whether a method of competition is unfair, the Commission "will not focus on the 'rule of reason' inquiries more commonly used in cases under the Sherman Act but will instead focus on stopping unfair methods of competition in their incipiency based on their *tendency* to harm competitive conditions." But having said that, the analytical framework it then outlines is nearly identical to the framework the FTC and the courts have used to evaluate a defendant's conduct under both Section 5 and the Sherman and Clayton Acts ever since the early 1980s.

For example, the New Policy Statement says that in evaluating whether a method of competition is unfair, the commission will apply "a sliding scale" and that "[w]here the indicia of unfairness are clear, less may be necessary to show a tendency to negatively affect competitive conditions." That is no different from what the Supreme Court said in 1999 in *California Dental Ass'n* when Justice David Souter wrote that what is needed is "an enquiry meet for the case."

The statement adds that when conduct is not facially unfair, "more information about the nature of the commercial setting may be necessary to determine whether there is a tendency to negatively affect competitive conditions." This is no different from what Justice Louis Brandeis wrote in *Chicago Board of Trade v. US,* 246 U.S. 231 (1918), more than a century ago, and what Justice John Paul Stevens repeated in *Nat'l Soc. of Professional Engineers v. US*, 435 U.S. 679 (1978), more than half a century ago.

In summary, much of what the New Policy Statement says about how the Commission will apply Section 5 in the future seems consistent with how it has been applied in the past. But since Chair Khan and her colleagues have made their dissatisfaction with how the FTC has enforced Section 5 over the last several decades apparent, one must expect the Commission to apply these tests more expansively than it has for the last several decades. What is more in doubt is whether the courts will allow it to do so.

3. The New Policy Statement exhibits skepticism toward the types of legitimate business justifications companies typically offer for their conduct.

The third section of the New Policy Statement addresses how the Commission will evaluate "Potential Cognizable Justifications" for the conduct under investigation. This section begins by saying that, "In the event that conduct prima facie constitutes an unfair method of competition, liability normally ensues under Section 5 absent additional evidence." It then cites a handful of cases decided more than a half century ago, in which courts "declined to consider justifications altogether." It begrudgingly acknowledges, however, that some "practices may impact competitive conditions in a manner that both harms and benefits market participants other than the party."

Having begun in this inhospitable fashion, the statement says that if parties nevertheless "choose to assert a justification" in such cases, the Commission "will consider their proffered justifications before reaching a final decision." However, it then erects a series of hurdles those parties would need to overcome to rebut a showing that the conduct "prima facie" constitutes an unfair method of competition.

- First, the parties must show that "harmed parties share in the purported benefits of the practice."
- Second, the parties must "show that the asserted justification for the conduct is legally cognizable, non-pretextual, and . . . narrowly tailored to limit any adverse impact on competitive conditions."
- Third, "the asserted benefits must not be outside the market where the harm occurs."
- Fourth, the parties must "show that, given all the circumstances, the asserted benefits outweigh the harm and are of the kind that courts have recognized as cognizable in standalone Section 5 cases."
- Finally, the statement warns that "the more facially unfair and injurious the harm, the less likely it is to be overcome by a countervailing justification of any kind."

These requirements are not materially different on their face from what the current Horizontal Merger Guidelines require parties to a proposed horizontal merger to show to rebut a presumption a merger is anticompetitive based on the level of concentration in the affected markets and the increase in concentration that will result from the proposed merger. Nevertheless, the tone of this section of the New Policy Statement and the accompanying statements made by Chair Khan and Commissioner Bedoya seem to signal even greater hostility to any efficiencies defense to business conduct than either of the two enforcement agencies have exhibited in the past under the Horizontal Merger Guidelines.

4. The examples of potentially unfair methods of competition in the New Policy Statement have all been a frequent subject of litigation in the past with mixed results.

The final section of the new Policy Statement gives some twenty examples of the types of business practices that might be found to be unlawful under Section 5 under the incipiency doctrine because they might serve to create or maintain market power and thereby lead to higher prices that harm consumers or to lower prices that harm suppliers, or that might reduce innovation, lower the quality of products or services, or retard potential competition from new entrants. All twenty are business practices that have been a frequent subject of enforcement litigation in the past, often with mixed results for the FTC and Antitrust Division of the Department of Justice in the courts over the last four decades.

* * * * *

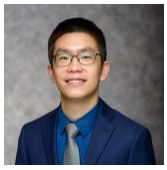
Given the harshness of the criticisms by Chairman Khan and her fellow Democratic commissioners of the enforcement record of the federal antitrust agencies and the courts over the last four decades, one must presume that the purpose of the New Policy Statement is to develop a new framework for enforcing Section 5 that they hope will enable the FTC to challenge conduct as an unfair method of competition more broadly than it has been able to successfully in the past. Whether the courts will allow it to do so remains to be seen.

Related People

William J. Kolasky

Philip A. Giordano

Robert B. Bell



Daniel Chan

Related Areas of Focus

Antitrust & Competition