EXHIBIT 2

The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection

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I. Introduction

This paper outlines the important role the FTC's unfairness authority can and should play in fashioning consumer protection policy. First, I will discuss the rise, fall, and resurrection of unfairness - focusing on the lessons that the Commission has learned from its early experiences. Second, I will discuss the three elements of modern unfairness: the injury must be (1) substantial, (2) without offsetting benefits, and (3) one that consumers cannot reasonably avoid - as well as the subsidiary role of public policy. Finally, I will use specific examples to discuss the way that the Commission has appropriately used modern unfairness policy to address difficult problems.

II. Unfairness at the FTC: Its Rise, Fall, and Resurrection

It is useful to place the Commission's use of unfairness in historical context.(2) In my view the Commission's unfairness powers have been both used and avoided inappropriately. In the 1970's, the Commission began to use its unfairness authority to legislate against perceived violations of "public policy." This misuse of its unfairness jurisdiction caused consternation in Congress. The Commission's 1980 Unfairness Policy Statement,(3) the Commission's 1982 letter to Senators Packwood and Kasten,(4) the application of the unfairness statement in Commission enforcement and rulemaking actions,(5) and the subsequent codification of those principles in 1994(6) re-established a cost/benefit analysis (injury to consumers not outweighed by countervailing benefits) as the test for unfairness. Unfortunately, the pendulum swung too far the other way and, in the 1990's, the Commission almost entirely avoided the use of unfairness. It became the theory of last resort. Now, however, the FTC is using unfairness to attack practices that cause substantial injury, but that could not be reached under deception theory - at least not without twisting the meaning of deception. The moral of this story is that unfairness can be misused, particularly when there is no principled basis for applying it. When used appropriately, unfairness is an important and useful tool to address difficult problems and improve consumer protection.

A. The Rise (and Abuse) of Unfairness

In 1938, the FTC Act was amended to prohibit "unfair or deceptive acts or practices" in addition to "unfair methods of competition" - thereby charging the FTC with protecting consumers directly, as well as through its antitrust efforts. Prior to 1964, the Commission largely ignored the word "or" in the amendment, and described acts it found to be offensive as "unfair and deceptive" without making any attempt to distinguish between "unfair" on the one hand, and "deceptive" on the other.

In 1964, in the Cigarette Rule Statement of Basis and Purpose, the Commission set forth a test for determining whether an act or practice is "unfair": 1) whether the practice "offends public policy" - as set forth in "statutes, the common law, or otherwise"; 2) "whether it is immoral, unethical, oppressive, or unscrupulous; 3) whether it causes substantial injury to consumers (or competitors or other businessmen)."(7) Thus, a new theory of legal liability was born. From 1964 to 1972, the Commission - perhaps because of hostile Congressional reaction to the Cigarette Rule - rarely used its unfairness authority. In 1972, however, the Supreme Court, while reversing the Commission in Sperry & Hutchinson, (8) cited the Cigarette Rule unfairness criteria with apparent approval for the proposition that the Commission "like a court of equity, considers public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws."(9)

Emboldened by the Supreme Court's dicta, the Commission set forth to test the limits of the unfairness doctrine. Unfortunately, the Court gave no guidance to the Commission on how to weigh the three prongs - even suggesting that the test could properly be read disjunctively.(10) In other words, the Commission now claimed the power to sit as a court in equity over acts and practices within its jurisdiction that either offended public policy, or were immoral, etcetera, or caused substantial injury to consumers. Under the Commission's unfairness authority, thus construed, no consideration need be given to the offsetting benefits that a challenged act or practice may have on consumers.(11)

The result was a series of rulemakings relying upon broad, newly found theories of unfairness that often had no empirical basis, could be based entirely upon the individual Commissioner's personal values, and did not have to consider the ultimate costs to consumers of foregoing their ability to choose freely in the marketplace. Predictably, there were many absurd and harmful results. The most problematic proposals relied heavily on "public policy" with little or no consideration of consumer injury. For example, the Over-the-Counter Drug rulemaking would have required advertisers to use only the precise terms the Food and Drug Administration required on product labeling, because the FDA rules established a "public policy" of how to describe drugs.(12) There was no consideration in the extensive rulemaking record of the likelihood or magnitude of injury to consumers, whether alternative descriptions might actually provide a benefit to consumers, or whether consumers could reasonably avoid any injury caused by a different, but non-deceptive, wording by simply reading the label. The Commission, having by then adopted the Unfairness Policy Statement, with its emphasis on consumer injury, unanimously rejected the proposal in May 1981.(13)

B. The Fall of Unfairness

The most prominent example of overreaching under broad, unfocused, policy-based unfairness also led directly to the downfall of unfairness as a working legal doctrine. This occurred when the Commission tried to use unfairness to ban all advertising directed to children on the grounds that it was "immoral, unscrupulous, and unethical" and based on generalized public policies to protect children.(14) At the same time, Chairman Michael Pertschuk opined that the Commission could use unfairness, inter alia, to regulate the employment of illegal aliens and to punish tax cheats and polluters.(15)

The breadth, overreaching, and lack of focus in the FTC's ambitious rulemaking agenda outraged many in business, Congress, and the media . Even the Washington Post editorialized that the FTC had become the "National Nanny."(16) Most significantly, these concerns reverberated in Congress. At one point, Congress refused to provide the necessary funding, and simply shut down the FTC for several days. Entire industries sought exemption from FTC jurisdiction, fortunately without success. Eventually, Congress acted to restrict the FTC's authority, including

legislation preventing the FTC from using unfairness in new rulemakings to restrict advertising.(17) So great were the concerns that Congress did not reauthorize the FTC for fourteen years. Thus chastened, the Commission abandoned most of its rulemaking initiatives, and began to re-examine unfairness to develop a focused, injury-based test to evaluate practices that were allegedly unfair.

C. The Resurrection: Unfairness Done Correctly

As the Commission struggled with the proper standard for unfairness, it moved away from public policy and towards consumer injury, and consumer sovereignty, as the appropriate focus. In the 1979 Statement of Basis and Purpose for the R-Value Rule,(18) the Commission noted that "the failure of sellers to disclose R-value impedes the ability of consumers to make rational purchasing decisions." The Commission also noted the substantial consumer injury caused by this market failure, and the low cost to industry of complying with such a rule.(19)

On December 17, 1980, a unanimous Commission formally adopted the Unfairness Policy Statement, and declared that "[un]justified consumer injury is the primary focus of the FTC Act, and the most important of the three S&H criteria."(20) The Statement articulated the three-part test that the Commission had applied in the R-Value rule to determine whether the consumer injury a practice causes makes the practice unfair. The injury "must be substantial; it must not be outweighed by countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided."(21) The Statement also addressed the other two S&H criteria. The Commission rejected the "immoral, unscrupulous, or unethical" test - reasoning that such a test had never been relied upon as an independent basis for finding unfairness.(22) The Statement also explained that, in most instances, the proper role of public policy is as evidence to be considered in determining the balance of costs and benefits.(23) The Commission left open the possibility that public policy can "independently support a Commission action . . . when the policy is so clear that it will entirely determine the question of consumer injury, so there is little need for separate analysis by the Commission. The Commission acts on such a basis only where the public policy is suitable for administrative enforcement by this agency."(24)

The Commission further limited the role of public policy, stating that it is not an independent basis for unfairness, in a March 5, 1982, letter to Senators Packwood and Kasten that recommended a statutory definition of unfairness:

. . . [A]lthough it is not a necessary element of the definition of unfairness, the Commission also looks to other established public policies in an effort to determine whether a particular practice is unfair. As the Commission noted in its 1980 Policy Statement, reference to other public policies may provide additional evidence of consumer injury or, conversely, it may influence the Commission to reconsider its tentative view that a practice is injurious in its net effects, and, therefore, unfair. A thorough analysis of such policies "can serve as an important check on the overall reasonableness of the Commission's action."(25)

During the remainder of the 1980s, the Commission applied the newly-honed unfairness theory set forth in the Unfairness Policy Statement and the Packwood-Kasten letter to address problems that caused substantial consumer injury, but that could not be addressed through a deception analysis. In International Harvester, the Commission appended the Unfairness Policy Statement and noted, ". . . the principal focus of our unfairness policy is on the maintenance of consumer choice or consumer sovereignty, an economic concept that permits specific identification of conduct harmful to that objective."(26)

The Administrative Law Judge had found that International Harvester's failure to disclose that the potential risk of explosion from "fuel geysering" on its tractors was deceptive, unfair, and an unfair method of competition. The Commission reversed in part and affirmed in part, finding that the practice was not deceptive, but that it was unfair.(27) The ALJ had found that the respondent's duty to disclose was based on an implied warranty of fitness, but the Commission held that the accident rate - less than .001 % - was so low that it did not breach the implied warranty of

fitness. Therefore, there was no duty to disclose under the Deception Policy Statement, and no deception. The Commission went on to explain that persons injured by respondent's tractors may "deserve legal protection. . . We merely hold here that such cases should not be pursued without undertaking a cost benefit analysis, and that they therefore do not qualify for the streamlined legal procedures of a deception action."(28) The Commission held that the failure to disclose the safety risk met the three-part unfairness test. Although the risk of injury was low, the injury caused was substantial, and the cost to the respondent of making the disclosure was insignificant. Finally, because consumers had no other way to learn about the safety risk, consumers could not reasonably avoid the risk.(29) The practice was found to violate the FTC Act, but only after application of the benefit/cost analysis. If the cost of disclosure significantly outweighed the injury caused by the failure to disclose, or if consumers had access to sufficient information to avoid the risk, then no violation would exist.

In 1984, the Commission applied the unfairness test in the Credit Practices Rule. The Commission explained that it was "exercising its unfairness jurisdiction to determine whether in the consumer credit market there is a market imperfection that is preventing a balancing of costs and benefits to individuals."(30) The Commission found creditors' inclusion of certain post-breach remedies, such as confession of judgment or waiver of defenses, in consumer credit contract boilerplate to be an unfair practice.(31) The Commission evaluated the evidence(32) of the extent and prevalence of consumer injury caused by creditors' contractual remedies and the costs of imposing the proposed remedy to determine whether each practice is "injurious in its net effect."(33)

The Commission also applied the net benefits test to several other proposed rule provisions, and found that the costs to consumers and competition outweighed the injury caused by the practices. For example, the Commission considered and rejected prohibiting consumer credit contract clauses that require debtors to pay attorneys fees incurred by creditors in debt collection.(34) The Commission reasoned that creditors already have an incentive to minimize attorneys' fees, as they usually are not fully reimbursed by defaulters. Any benefit that this provision would provide to debtors would be offset by losses to creditors. Further, such a provision might increase total legal costs by emboldening debtors to raise additional defenses. The Commission "determined that the costs of this provision outweigh the benefits" and accordingly rejected it.(35)

In 1986, the Commission applied the unfairness test to widespread, unilateral breach of contract in the Orkin case.(36) Prior to 1975, Orkin entered into contracts with consumers to provide lifetime termite protection services for a fixed annual fee. There was no contractual basis for Orkin to raise these fees. In 1980, Orkin unilaterally breached 207,000 of these contracts by raising the amount of the annual fee. Although the cost to individual consumers was relatively small (approximately seven dollars per year), Orkin's breach generated additional revenues of over $7.5 million for the company. The Commission found that, although there was no deception in the formation of the contracts, the practice caused substantial, unavoidable consumer injury that was not outweighed by benefits to consumers or competition, and was therefore unfair.

During this period, the Unfairness Policy Statement became accepted as the appropriate test for determining unfairness, and the Commission applied it wisely, if sparingly. The danger of unfettered "public policy" analysis as an independent basis for unfairness still existed, however. Although the Packwood-Kasten letter clarified the role of public policy, the Unfairness Policy Statement itself continued to hold out the possibility of public policy as the sole basis for a finding of unfairness. A less cautious Commission might ignore the lessons of history, and dust off public policy-based unfairness. Certainly, many members of Congress continued to view the Commission warily - largely because of its previous misuse of unfairness. When Congress eventually reauthorized the FTC in 1994, it codified the three-part consumer injury unfairness test. It also codified the limited role of public policy.(37) Under the statutory standard, the Commission may consider public policies, but it cannot use public policy as an independent basis for finding unfairness. The Commission's long and dangerous flirtation with ill-defined public policy as a basis for independent action was over.

Subsequent to the codification of the unfairness test, however, the Commission showed extreme reluctance to assert its unfairness authority. Perhaps overly chastened by the reaction to past abuses, the Commission avoided pleading unfairness - sometimes twisting deception theories to get at clearly injurious acts that called for Commission action. (38) Towards the late 1990s, as I will discuss later, the Pitofsky Commission appropriately dusted off its unfairness authority to attack the massive consumer injury caused by telephone-bill cramming.

The Commission under Chairman Muris is now giving unfairness a more prominent role as a powerful tool for the Commission to analyze and attack a wider range of practices that may not involve deception but nonetheless cause widespread and significant consumer harm.

III. Modern Unfairness Summarized

As codified in 1994, in order for a practice to be unfair, the injury it causes must be (1) substantial, (2) without offsetting benefits, and (3) one that consumers cannot reasonably avoid. Each step involves a detailed, fact-specific analysis that must be carefully considered by the Commission. The primary purpose of the Commission's modern unfairness authority continues to be to protect consumer sovereignty by attacking practices that impede consumers' ability to make informed choices.

The first step in the unfairness analysis is to determine whether there has been substantial consumer injury. It can be economic harm, or a threat to health or safety. Substantial injury is an objective test. As the Commission noted in the policy statement, emotional distress is ordinarily insufficient.(39) Substantial injury can consist of small harm to a large number of consumers, or significant harm to each affected individual. Even in the aggregate, total injury may not be large, as in cases when the company is small or the practice is one that creates unnecessary transaction costs. But relative to the benefits, the injury may still be substantial. To qualify as substantial, an injury must be real,(40) and it must be large compared to any offsetting benefits.

Once it is determined that there is substantial consumer injury, the next step is to determine whether the harm is outweighed by countervailing benefits to consumers or competition. High prices, for example, are not unfair in part because they provide important signals to other market participants to reallocate resources in ways that ultimately benefit consumers, such as entering the market or increasing production if they are already in the market. (41) Generally, it is important to consider both the costs of imposing a remedy (such as the cost of requiring a particular disclosure in advertising) and any benefits that consumers enjoy as a result of the practice, such as the avoided costs of more stringent authorization procedures and the value of consumer convenience.

Finally, a practice is only unfair if the injury is not one that a consumer can reasonably avoid. The Unfairness Policy Statement recognizes that the reasonable avoidance prong limits unfairness actions to those where the Commission seeks "to halt some form of seller behavior that unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision-making."(42) If consumers could have made a different choice, but did not, the Commission should respect that choice. For example, starting from certain premises, one might argue that fast food or fast cars create significant harms that are not outweighed by countervailing benefits and should be banned. But the concept of reasonable avoidance keeps the Commission from substituting its paternalistic choices for those of informed consumers.(43) If any institution is to make such decisions, it should be Congress, not the Commission. Unwise consumer choices are a strong argument for consumer education, but not for law enforcement.

Thus, the modern unfairness test reflects several common sense principles about the appropriate role for the Commission in the marketplace. First, the Commission's role is to promote consumer choices, not second-guess those choices. That's the point of the reasonable avoidance test. Second, the Commission should not be in the business of trying to second guess market outcomes when the benefits and costs of a policy are very closely balanced or when the existence of consumer injury is itself disputed. That's the point of the substantial injury test. And the Commission

should not be in the business of making essentially political choices about which public policies it wants to pursue. That is the point of codifying the limited role of public policy.

An understanding of the relative roles of deception and unfairness is also important to make full and appropriate use of the Commission's unfairness authority. Although, in the past, they have sometimes been viewed as mutually exclusive legal theories, Commission precedent incorporated in the statutory codification makes clear that deception is properly viewed as a subset of unfairness.(44) Both focus on preventing injury to consumers.

The criteria for deception are best understood as they seek to identify a set of cases that would pass a benefit/cost test. Material misleading claims prohibited by the Commission's deception authority almost invariably cause consumer injury because consumer choices are frustrated and their preferences are not satisfied. That injury is substantial as long as enough consumers are affected. Moreover, consumers cannot reasonably avoid the injury precisely because the seller misled them about the consequences of the choice.

Thus, the primary difference between full-blown unfairness analysis and deception analysis is that deception does not ask about offsetting benefits. Instead, it presumes that false or misleading statements either have no benefits, or that the injury they cause consumers can be avoided by the company at very low cost. In other words, deception analysis essentially creates a shortcut, assuming that, when a material falsehood exists, the practice would not pass the full benefit/cost analysis of unfairness, because there are rarely, if ever, countervailing benefits to deception.

IV. Unfairness Applied

One benefit of a more reasoned approach to unfairness is that it makes it more likely that the Commission will use its unfairness authority appropriately. I believe it is important to use the legal theory that most clearly focuses attention on the key issues that should determine whether the Commission proceeds. When offsetting benefits of a practice may be important, the legal theory should focus attention on whether the practice is injurious in its net effects. Unfairness does that. Moreover, because unfairness covers a broader range of practices than may be possible under a deception theory, an unwarranted aversion to using unfairness may lead to improper application of deception principles. Straining to find an implied claim that was never made may allow the FTC to proceed in a particular case, but it can quickly lead to the suppression of truthful information. The Commission should confront the question of offsetting benefits directly, rather than relying on a legal shortcut that lets it ignore the issue.(45) Measuring either benefits or costs may be difficult in particular situations, especially when they are most easily measured in different terms, e.g. safety risks versus dollar costs. Nonetheless, such tradeoffs are real. They should be confronted, not swept under the rug.

A. Breach of Contract

The benefits of appropriate use of unfairness and the problems that can be caused by trying to attack "unfair" practices using a deception theory are readily apparent in breach of contract cases. Calling every breach of contract a deceptive practice by the breaching party is fraught with risk. It makes even innocent, subsequent mistakes violations of the FTC Act and disregards the most basic provision of contract law. For example, because breaching a contract is sometimes the most efficient outcome for both parties, the law of contracts permits parties to avoid performance without liability in numerous circumstances. Examples include impossibility, frustration of purpose, and mutual mistake. Even when there is a breach, the remedy is usually damages, not specific performance. To many legal scholars, these contract law doctrines can be explained as sound applications of benefit/cost analysis.(46)

Because many unforseen, intervening events may prevent a party from performing its precise obligation under a contract, it would be unwise to call every breach a per se violation of Section 5 of the FTC Act. Consider, for example, the rationale behind the Commission's Mail Order Rule. The Rule requires a shipper to have a reasonable basis for the shipping claim at the time it is made.(47) If there is no reasonable basis for the claim, there is a violation. That is a deception theory: sellers should not make claims when they themselves have no reason to believe the claim is true.

Nonetheless, if there is a reasonable basis for the claim, a violation only occurs when the late shipper fails to take specified remedial steps, such as notification, that allow the consumer to participate in renegotiating the contract. (48) This approach, grounded in unfairness analysis, is a sound application of benefit/cost principles. It is vastly superior to deeming any late delivery a per se Section 5 violation regardless of the substantiation for the initial claim or the reasonableness of the seller's conduct when it discovered it could not meet the promised shipment date. Unfairness incorporates these critical considerations into our legal theory directly, rather than relying on prosecutorial discretion.

Examining breach of contract cases through a similar lens requires us to analyze carefully all the surrounding facts. In many FTC cases, the respondent never complies with the contract at all and never had a reasonable basis for claiming compliance was possible. In these cases, often frauds, deception is usually the most appropriate theory and there is no need to plead unfairness.

When a seller does have a reasonable basis for making a claim or promise, the Commission should incorporate the contract law doctrines that might excuse breach in its analysis. In these situations, the full benefit/cost analysis of unfairness needs to be applied. Orkin is the seminal example. In Orkin, the promise was made, and honored, for years before Orkin modified the contract unilaterally. It thus strains credulity to view the original promise as deceptive. Not only did the company have a reasonable basis for making the claim, its conduct did, in fact, make the claim true for years. Unfairness is the only appropriate theory for such a case and a benefit/cost analysis was needed before a decision could be reached.

The approach taken in Orkin is reflected in two recent rebate cases.(49) In Philips, for at least some of the late rebates, the Commission alleged the respondent mailed rebate checks months later than promised. As a result, the Commission alleged a large number of consumers suffered significant damages in the form of opportunity costs and reliance costs, satisfying the first prong of the unfairness analysis. Furthermore, because the transaction already had been consummated, there was no way to avoid the harm by choosing a different vendor, and no way to reduce or eliminate the consequences of the breach. Finally, although Philips had some basis to delay payment of the refunds, the benefits did not outweigh the costs to consumers.(50)

Unfairness, unlike deception, allows the Commission to balance the benefits and costs of the challenged behavior. This is especially appropriate in this type of case, where it is easily conceivable that the costs to consumers associated with late rebate fulfillment are slight - as in a case where rebates were sent out a few days late or prompt notification is given to consumers.(51) In such a case, the loss suffered by consumers may be de minimis, even in the aggregate. Similarly, there may be significant unanticipated impediments that would make timely fulfillment of the rebates impossible. For example, a natural disaster at the location of the fulfillment house, or a labor dispute in the transportation industry may prevent performance. Under a deception analysis, all of these subsequent unanticipated events would give rise to per se violations and liability under Section 5.(52) In contrast, application of unfairness analysis allows the Commission to weigh the harms caused to consumers against the cost of preventing them. This approach allows the Commission to protect consumers from injury without imposing costs that are unreasonable and will surely be passed onto consumers.(53)

Another recent example of unfair unilateral breach is FTC v. Certified Merchant Services.(54) The Commission alleged the defendants used third-party salespeople to market their credit card merchant accounts and credit card processing services to small businesses. After the sale was complete, the small businesses started noticing charges that had not been disclosed to them in the sales presentation. These small business consumers were told that the charges were clearly outlined in the contract, and were subsequently sent contracts that contained pages they had never seen. Defendants had thereby unilaterally altered the contracts by insisting on compliance with additional terms that were not part of the original contract. The Commission charged that these practices were unfair. The injury caused by paying the

undisclosed fees, on the one hand, or the cancellation fee on the other, ranged from tens to hundreds of dollars per small business. Because the costs were undisclosed, consumers could not reasonably avoid the injury by purchasing services elsewhere, and there is sufficient aggregate harm to warrant FTC action.(55) The only benefit from this practice is to the defendants - not to consumers and competitions.

B. Unauthorized Billing (Cramming)

One area where past Commission cases have appropriately used unfairness was to attack the sharp increase of unauthorized billing - especially as seen on telephone bills. This practice - known as "cramming" - became a huge problem for American consumers in the middle of the 1990s. As the partial deregulation of the telephone industry led to the opening of the telephone bill for use as a billing platform by entities other than local telephone companies, fraudulent sellers quickly began exploiting this opportunity to fleece consumers. In simple cramming schemes, a fraud operator obtains a large number of telephone numbers - for example, by inducing consumers to write their phone numbers on the back of sweepstakes forms.(56) In cases like this, no phone call was ever made, but charges nonetheless appear on the phone bill without the consumer's authorization. In other schemes, the purported basis for the unauthorized charge was the capture of a consumer's Automatic Number Identification ("ANI") from a telephone call made from that consumer's line (often to access adult entertainment) - but without the consumer's authorization.(57)

In either case, the company would then find a "billing aggregator" that had entered into contracts with the local telephone companies to place charges on their phone bills, and arrange for that intermediary to place relatively small charges on the phone bills of the line subscribers whose numbers it had obtained. Consumers, not expecting to be charged for anything other than their usual, tariffed telephone service, would often fail to notice the fraudulent charge, and would pay it. Other consumers, who did notice and contest the charges, found it frustrating and difficult to have the charges reversed - and sometimes simply gave up and paid the charges rather than risk possible termination of telephone service.

The practice resulted in significant consumer injury and a tremendous increase in consumer complaints. The Commission was constrained, in part, by its unclear jurisdiction over the telephone companies that were doing the actual billing, but was able to attack the fraudsters, as well as some of the billing aggregators who knew or should have known that they were causing unauthorized charges on consumers' phone bills. Deception is, of course, an appropriate theory to attack part of the problem: the false statements, made by the fraudsters and their intermediaries in response to complaining consumers that they had to pay the charges. Under an unfairness theory, the Commission can prevail even without evidence of such specific misrepresentations. Further, unfairness reaches both the vendor, who initially submitted the charges, and the billing aggregator, who may have handled the consumer complaints and made specific misrepresentations to consumers.

Although the Commission has recognized that unauthorized billing is often unfair, there are prominent examples of misbilling that should not be considered violations of the FTC Act. For example, the entire telephone network is based upon a system - ANI billing - that handles hundreds of millions of transactions everyday. Obviously, in a system this large, errors and even some third-party fraud will occur.(58) Consumers, however, benefit tremendously from the convenience of using their telephones without having to authorize each usage independently through a PIN number or other device. By contrast, the benefits to consumers and competition from the use of ANI billing as an alternate payment system for adult entertainment and psychic services do not outweigh the costs associated with the unauthorized billing that results.(59)

The credit card system provides a similar example.(60) Credit card fraud could surely be reduced by requiring production of the card and photo identification for each use. However, the loss of convenience to consumers, the cost of additional verification procedures, and the impact that such a rule would have on mail order and Internet commerce likely outweigh the cost to consumers of credit card fraud. In most cases, of course, the countervailing benefits will not

be nearly so obvious as in these examples, but the Commission must nonetheless carefully analyze each individual case to assure that consumers will not ultimately be worse off after the Commission acts.

C. Internet Trickery

Fraud artists are adept at exploiting new technologies for their own gain. The FTC has brought over 200 Internet-related enforcement actions. Most are simply online variations of familiar, offline scams. The Commission also see practices that exploit the very technology of the Internet, however, using consumers' Internet connections to take control of their computers. These practices often cause substantial consumer harm, and allowing such practices to go unchecked would almost certainly undermine consumer confidence in the Internet. If consumers feel vulnerable to manipulation by third parties who take control of their computers, they will use the Internet less and be more guarded when they do.

This is an area where increased use of the Commission's unfairness jurisdiction can play a major role. For example, the Commission recently alleged unfairness in a federal court case, FTC v. Zuccarini, challenging the practice of excessive "mousetrapping."(61)Zuccarini registered some 6,000 domain names that were misspellings of popular web sites. Once consumers arrived, Zuccarini's websites were programmed to take control of their Internet browser, and hold the consumers captive while they were forced to view dozens of websites advertising products such as online gambling, psychic services, and adult entertainment. Closing one window simply caused several more windows to open.

The obstruction was so severe in this case that consumers were often forced to choose between taking up to twenty minutes to close out all of the Internet windows, or turning off their computers, and losing all of their "pre-mousetrap" work. Moreover, the injury is especially substantial when multiplied by the many thousands of consumer that were subjected to these practices.

The use of the Commission's unfairness jurisdiction in these circumstances is important because it allows the Commission to distinguish between schemes like those of Mr. Zuccarini, that are clearly harmful to individual consumers, and legitimate business practices that may use the same technology. For example, the technology used to show an unsolicited advertising website by itself is not per se unfair, and techniques such as "pop-up" windows are widely used by legitimate businesses. Properly used, these techniques are relatively simple, cause virtually no injury, and benefit consumers in many of the same ways as the advertising in other media does. In contrast, when, as in the Zuccarini case, the obstruction is so serious that it significantly impedes consumers' ability to browse the Internet, the injury is substantial and unavoidable. Just imagine television advertising if you could not turn off the TV or change the channel. It is the magnitude of the unavoidable injury relative to the countervailing benefits, not the mere presence of the technology, that makes the practice unfair.

The Commission recently used unfairness to attack another high-tech scam. "Spoofing" is the practice of making it appear that bulk, unsolicited commercial e-mail ("spam") comes from a third party to the transaction by placing that person or entity's e-mail address in the "from" line of the spam. As a result, thousands of undeliverable e-mails flood back to the computer systems of these third parties, deluging their computer systems with an influx of spam that could not be delivered to the addressee. In addition, spoofing portrays these innocent bystanders as duplicitous spammers, often resulting in their receiving hundreds of angry e-mails from those who had been spammed.

The Commission alleged that this practice was unfair in a federal district court complaint against Brian Westby, who used spam to direct traffic to an adult website.(62) The spam also contained deception in the subject line, tricking consumers, including children, into opening the e-mail and being subjected, in some cases, to graphic adult images. The Commission alleged that this was deceptive. The deception theory, however, does not provide any relief to those consumers who were "spoofed," because they have not relied in any way upon Westby's deception. Unfairness, however, easily reaches the problem. The harm to those consumers - both economic injury caused by damage to their

computing systems by the huge, unexpected influx of mail, the time spent deleting thousands of e-mails, and the injury to reputation of having their name associated with deceptive adult spam - is substantial. Hiding the real spammer's identity has no benefit to consumers or competition, so the amount of injury, though substantial, need not be high. Finally, there is no way consumers can anticipate and protect themselves from such an invasion. Anyone with an e-mail account is vulnerable.

D. Telemarketing Sales Rule

Whereas the Commission previously looked to statutes for public policy grounds to find a practice unfair, the Commission has recently employed its unfairness authority to assist it in determining its jurisdiction under a statute. The 1994 Telemarketing Act(63) authorizes the Commission to prescribe rules "prohibiting deceptive telemarketing acts or practices and other abusive telemarketing acts or practices."(64) The Telemarketing Act gives the Commission a non -exhaustive list of three items to prescribe as "abusive," but does not otherwise define the term.(65) The three enumerated abusive practices implicate consumer privacy, and the first specifically calls on the Commission to regulate "calls which the reasonable consumer would consider coercive or abusive of such consumer's right to privacy."(66) Congress thus provided the Commission with authority "to curtail these practices that impinge on consumers' right to privacy but are likely not deceptive under FTC jurisprudence."(67) The Commission, exercising its discretion under the Telemarketing Act, prohibits the three enumerated practices as well as five other practices that it deemed "abusive" in the original Telemarketing Sales Rule.(68)

In the amended TSR, the Commission recognizes that certain of the "abusive" practices that it identifies and proscribes do not fall within the penumbra of protecting consumers' right to privacy. These include the previously identified abusive practices related to credit repair services, recovery services, and advance fee loan services. Little justification was given for prescribing these practices as "abusive" in the original rulemaking process. The ability to proscribe acts and practices by an entire industry as "abusive" without any empirical means for determining what is and is not "abusive" leaves open the door for exactly the types of misuse that occurred with unfocused unfairness authority in the 1970s. In the recently published amended TSR SBP, the Commission rectifies this problem by applying the unfairness theory:

When the Commission seeks to identify practices as abusive that are less distinctively within that [privacy] parameter, the Commission now thinks it appropriate and prudent to do so within the purview of its traditional unfairness analysis, as developed in Commission jurisprudence and codified in the FTC Act. This approach constitutes a reasonable exercise of authority under the Telemarketing Act, and provides an appropriate framework for several provisions of the original rule.(69)

Application of the unfairness test to these three fundamentally bogus services - credit repair, recovery rooms, and advance-fee loans - illustrates that each of these practices is, in fact, unfair, and the Commission appropriately deemed them abusive in the original rulemaking.(70)

Using this approach, the Commission also adopted new restrictions on the telemarketing industry's use of "preacquired account" information. In this common practice, the telemarketer already has the information needed to bill consumers' accounts unbeknown to the consumer. The Commission recognized that, in general, the use of preacquired account information is not per se harmful. Rather it is the abuse of preacquired account information that causes harm. The Commission noted that there are many instances where the consumer previously gave the billing information to the seller and understands and expects the seller to re-use the information for an additional purchase with the consumer's consent.(71) In instances, however, where the consumer does not understand or expect the seller to have the billing information or where the consumer does not affirmatively and unambiguously consent to the purchase, the use of the preacquired account information results in an unauthorized charge. The Commission has brought numerous law enforcement actions against entities alleging violations of the FTC Act for the unfair practice of billing unauthorized

charges to consumers' accounts. Because unauthorized billing unequivocally meets the criteria for unfairness, the Commission specified that several practices involving preacquired account information that result in unauthorized billing are abusive practices in violation of the rule. These include disclosing or receiving, for consideration, unencrypted consumer account numbers for use in telemarketing(72) or submitting a charge for payment without the consumer's express informed consent to charge a specified account for the purchase.(73)

V. Conclusion

The unfairness doctrine, as reigned in by the Unfairness Policy Statement and the 1994 amendments to the FTC Act, is an important and useful tool. Attacking deception will always be a high priority for the Commission, and the Commission will continue to rely upon its deception authority to attack fraud and protect consumers from misleading advertising. But the Commission should use the appropriate legal tool for the situation. As demonstrated in the earlier examples, unfairness allows the Commission to attack situations - like widespread unilateral breach of contract, or the cramming of unauthorized charges onto phone bills - where there is widespread consumer injury, but where deception simply does not fit. Further, unfairness, unlike deception, allows the Commission to balance the benefits and costs of the challenged behavior. This approach allows the Commission to provide strong consumer protection against marketplace abuses without prohibiting related conduct that is beneficial to consumers.

Endnotes:

1. Mr. Beales is the Director of the Bureau of Consumer Protection, Federal Trade Commission. The views expressed in this paper are his own, and not necessarily those of the Commission.

2. The history of unfairness set forth in this section is largely adapted from an earlier monograph I co-authored with Timothy J. Muris, The Limits of Unfairness Under the Federal Trade Commission Act, pp. 10-22 (1991).

3. Letter from the FTC to Hon. Wendell Ford and Hon. John Danforth, Committee on Commerce, Science and Transportation, United States Senate, Commission Statement of Policy on the Scope of Consumer Unfairness Jurisdiction (December 17, 1980), Reprinted in International Harvester Co., 104 F.T.C. 949, 1070, 1073 (1984) ("Unfairness Policy Statement").

4. Letter from the FTC to Hon. Bob Packwood and Hon. Bob Kasten, Committee on Commerce, Science and Transportation, United States Senate, Reprinted in FTC Antitrust & Trade Reg. Rep. (BNA) 1055, at 568-570 ("Packwood-Kasten letter").

5. See, e.g., Labeling and Advertising of Home Insulation, Statement of Basis and Purpose, 44 Fed. Reg. 50,218 (1979); International Harvester, 104 F.T.C. 949 (1984); Credit Practices Rule, Statement of Basis and Purpose, 49 Fed. Reg. 7740 (1984) ("Credit Practices Rule SBP"); Orkin Exterminating Co., Inc., 108 F.T.C. 263 (1986); aff'd, FTC v. Orkin, 849 F.2d 1354 (11th Cir. 1988).

6. 15 U.S.C. § 45(n).

7. Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, Statement of Basis and Purpose, 28 Fed. Reg. 8355 (1964) ("Cigarette Rule"). FTC lore holds that the principal author of this document was Richard Posner, then a 25-year old attorney advisor to Commissioner Philip Elman. See The Reminiscences of Philip Elman, Oral History Research Office, Columbia University at 372-373 (1986).

8. FTC v. Sperry & Hutchinson Co., 405 U.S. 233 (1972). Proceedings before the FTC were based on the theory that Sperry & Hutchinson was engaged in an unfair method of competition. On appeal, the Commission argued that S&H was engaged in unfair practices. The Court reversed and remanded because the case was not tried under an unfair practices theory.

9. Id. at 244.

10. Id. at 244, n.5.

11. Of course, even courts sitting in equity generally must balance the equities - a sort of cost/benefit analysis.

12. FTC Staff Report and Recommendations: Advertising for Over-The-Counter Drugs (May 22, 1979).

13. Advertising for Over-The-Counter Drugs, 46 Fed. Reg. 24,584 (May 1, 1981). The FDA also reversed itself on requiring approved terms on drug labels, thereby removing the "established public policy" that was the premise for the FTC proposal. Labeling of Drug Products for Over-the-Counter Human Uses, 51 Fed. Reg. 16,258 (1986).

14. See FTC Staff Report on Television Advertising to Children (February 1978); Notice of Proposed Rulemaking on Television Advertising to Children, 43 Fed. Reg. 17,967 (1978). A possible ban was one of three alternative remedies the staff recommended the Commission consider. The other two were a ban limited to advertising of sugared food products thought to pose the most serious dental health risks and/or requirements that ads for sugared food products be balanced by nutritional or health disclosures funded by the industry.

15. Michael Pertschuk, Remarks before the Annual Meeting of the Section on Antitrust and Economic Regulation of the Association of American Law Schools, Atlanta, Georgia (December 27, 1977).

16. Washington Post, March 1, 1978.

17. FTC Improvements Act, Pub. L. No. 96-252 (May 1980).

18. Labeling and Advertising of Home Insulation, Statement of Basis and Purpose, 44 Fed. Reg. 50,218 (1979).

19. 44 Fed. Reg. at 50,222-23. But "public policy" remained an articulated basis, and the Commission went on to briefly opine that the Rule also meets the "public policy" test because of the policy in favor of the "existence and functioning of free markets" and "the strong public policy in favor of energy conservation." 44 Fed. Reg. at 50223. The Commission's primary focus, however, was on unavoidable, substantial consumer injury without offsetting benefits.

20. Unfairness Policy Statement, 104 F.T.C. at 1073.

21. Id.

22. Id. at 1076.

23. Id. at 1075.

24. Id. at 1075-76.

25. Packwood-Kasten letter at p. 8, quoting Unfairness Policy Statement.

26. International Harvester, 104 F.T.C. 949, 1061, n.47 (1984).

27. The Commission did not reach the issue of whether it was an unfair method of competition. Id. at 1055, n.15.

28. Id. at 1063-64.

29. Id. at 1065.

30. Credit Practices Rule, Statement of Basis and Purpose, 49 Fed. Reg. 7740, 7743 (1984).

31. Id. at 7743. See also 16 C.F.R. Part 444.

32. Credit Practices Rule, 49 Fed. Reg. at 7745-76.

33. Id. at 7744.

34. Id. at 7764-65.

35. Id. at 7765.

36. Orkin Exterminating Co., Inc., 108 F.T.C. 263 (1986); aff,d., FTC v. Orkin, 849 F.2d 1354 (11th Cir. 1988).

37. 15 U.S.C. § 45(n).

38. For example, on my first day back at the Commission the staff presented a "mousetrapping" case (attempting to close an internet browser opens multiple new internet browsers - see infra pp. 24-27 for a fuller discussion and an example). The staff was attempting to devise a deception theory that was based upon an implied representation that clicking the "x" in the corner box of the internet window would close the browser. This theory trivialized the harm caused by the practice, and created a blueprint for future mousetrappers to evade FTC enforcement - simply use a symbol other than "x", or don't provide any way to exit the browser. A twisted deception theory was promoted because the working rule was to avoid pleading unfairness if there was a way to shoehorn the practice into a deception count. As discussed in Section IV.C, this practice is appropriately pled as unfair.

39. Unfairness Policy Statement 104 F.T.C. at 1073.

40. Subjective value, as opposed to emotional distress, can be a form of real injury. For example, falsely claiming that a product is kosher would cause real harm to anyone on a kosher diet. See Timothy J. Muris, Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value, 12 J. Legal Stud. 379 (1983).

41. High prices as a result of collusion would qualify as unfair, however. The Commission approaches collusion under its unfair methods of competition jurisdiction, applying a benefit/cost test under the rule of reason analogous to the unfairness test used in consumer protection.

42. Unfairness Policy Statement at 1074.

43. This is analogous to the well-established antitrust concept of cognizability: restraints on competition cannot be defended on the grounds that competition itself will harm consumers. FTC v. Indiana Federation of Dentists, 476 U.S. 447, 462-64 (1986).

44. As the Commission noted:

The Commission's unfairness jurisdiction provisions a more general basis for action against acts or practices which cause significant consumer injury. This part of our jurisdiction is broader than that involving deception, and the standards for its exercise are correspondingly more stringent. It requires the complete analysis of a practice which may be harmful to consumers. To put the point another way, unfairness is the set of general principles of which deception is a particularly well-established and streamlined subset.

International Harvester, 104 F.T.C. at 1060. Similarly, in antitrust, certain practices can be evaluated under a streamlined, or truncated, analysis without resort to the full benefits/cost test of the most elaborate rule of reason analysis. California Dental Association v. FTC, 526 U.S. 756, 769-770 (1999).

45. Of course, with experience in a particular area, relying on precedent will allow the Commission to proceed against the same practice when employed by other actors with very little new analysis of benefits and costs. That analysis, however, is crucial to establish the precedent initially.

46. See Richard Posner, Economic Analysis of Law, §§ 4.4-4.8 (5th ed. 1998); see also Werner Z. Hirsch, Law and Economics, an Introductory Analysis, pp. 134-146 (2d ed. 1988).

47. "An express or implied performance claim capable of objective evaluation carries with it the implication that the merchant has, at the time of making the representation, such information as would under the circumstances satisfy a reasonable and prudent businessman acting in good faith that the representation is true." Amended Mail or Telephone Order Merchandise Rule, Statement of Basis and Purpose, 58 Fed. Reg. 49,096, 49,105 (1993) ("Amended SBP").

48. The Amended SBP discusses unfairness as a basis for the Rule's notification requirements. The Amended SBP cites the original SBP for the proposition that, by making a late delivery "without offering the opportunity to cancel . . . the seller is attempting to impose upon the buyer a contract far different from the one the buyer thought he was entering into." Amended SBP, 58 Fed. Reg. at 49,106.

49. Philips Electronics North America Corp., File No. 022-3095 (2002) (Consent Order); Tim R. Wofford, File No. 012-3191 (2002) (Consent Order). A consent agreement is for settlement purposes only, and does not constitute an admission of a law violation.

50. Of course, the mere fact that the rebator is struggling financially, and cannot honor its contracts and make a profit is not enough. The benefit must be to consumers or competition - not simply the actor. Unanticipated increased cost to the rebator that results in significant delay, and therefore higher costs to the consumer, may not be sufficient, depending on the reason for the cost increase. See infra fn. 51.

51. In many breach of contract cases, prompt notification may enable consumers to avoid the cost that would otherwise result from waiting for performance because they can cancel the contract and attain the goods elsewhere. Notice and the opportunity to cancel are less adequate remedies in rebate cases than in the typical mail order case because the transaction has already been consummated. Moreover, a company that cannot make timely payments of a fraction of the price is unlikely to be able to refund the full price and cancel the transaction.

52. Although it could be argued that this supports an argument that the best approach is prosecutorial discretion, that approach ignores the existence of little state FTC Acts providing for private causes of action - where a plaintiff would not be bound to follow Commission discretion, only Commission law.

53. Although frequently conducted qualitatively rather than quantitatively, unfairness requires in essence a full benefit/cost analysis of the practices the Commission seeks to challenge. Application of this test is necessarily detailed, rigorous and highly fact specific, and the Commission must support its conclusions with evidence. Permitting efficient breach, where strict adherence to contract terms would result in a significant net loss of income to the parties to the transaction taken as a whole, benefits consumers and competition. See Restatement (Second) of Contracts, §§ 261 and 265 (1981).

54. FTC v. Certified Merchant Services, Ltd., et al., No. 4:02CV44 (E.D. Tex. 2002).

55. See FTC v. Klesner, 62 U.S. 19, 28 (1929).

56. FTC v. Hold Billing Services, Ltd., et al., No. SA-98-CA-0629-FB (W.D. Texas 1998).

57. ANI is similar to "Caller ID." ANI permits the recipient of a telephone call, or an entity in the transmission chain, to identify the telephone number from which a call is made. ANI is used by common carriers, such as AT&T and Verizon,

to bill its customers. It can also be used to cram unauthorized charges onto phone bills. See FTC v. Verity International, Ltd., 124 F. Supp. 2d 193, 204 (S.D.N.Y. 2000) (on appeal); FTC v. Sheinken, No. 2-00-3636 18 (D.S.C. 2001) (Stipulated Final Order).

58. Common carriage of telecommunications services (as opposed to non-common carrier activities such as ANI billing for entertainment services) is exempt from FTC regulation. The example is still illustrative.

59. On one side of the equation, the much higher cost of adult and psychic-entertainment services creates stronger inducement for third-party fraud than regular telephone service, and therefore a higher level of unauthorized billing. On the other side, the benefit to consumers of an alternate payment system that enables people without credit cards to make impulse purchases of these services (the benefit articulated by some in this industry), is far less significant than the benefit created by easily accessible, ubiquitous, national telephone service. The use of the telephone as a billing platform for these services is largely a regulatory creation, and does not involve the sort of contractual relationship that is found, for example, with credit cards. ANI billing for entertainment is, therefore, not a market result. The entertainment charges are hidden in tariffed, ostensibly regulated, telecommunications charges. In an open market, this could not occur because it would not be possible to artificially inflate prices for one service to hide the costs of another, but telecommunications is an only partially deregulated industry that inhibits normal market forces.

60. In fact, the FTC has brought numerous complaints alleging unfair, unauthorized billing of credit cards based on the unfair telephone cramming model. See, e.g., FTC v. J.K. Publications, Inc. et al., 99 F.Supp. 2d 1176, 1202 (C.D. Cal. 2000); FTC v. The Crescent Publishing Group, Inc., 129 F. Supp. 2d 311, 313 (S.D.N.Y. 2001).

61. FTC v. Zuccarini (d/b/a Cupcake Party), No. 01-CV-4854 (E.D. Pa. 2001).

62. FTC v. Westby, No. 03-C-2540 (N.D. Ill. 2003).

63. Telemarketing and Consumer Fraud and Abuse Prevention Act ("Telemarketing Act"), 15 U.S.C. §§ 6101-08. The Commission adopted the Telemarketing Sales Rule, 16 C.F.R. Part 310, on August 23, 1995 (60 Fed. Reg. 43,864). The Commission adopted an amended Telemarketing Sales Rule on January 29, 1993 (68 Fed. Reg. 4580) ("Amended TSR").

64. 15 U.S.C. § 6102(a)(1) (emphasis added). See also, Telemarketing Sales Rule, Statement of Basis and Purpose, 68 Fed. Reg. 4580, 4613 (2003) ("TSR SBP").

65. 15 U.S.C. § 6102(a)(3).

66. Id. See also TSR SBP, 68 Fed. Reg. at 4613.

67. TSR SBP, 68 Fed. Reg. at 4613.

68. 16 C.F.R. §§ 310.4(a) and (b).

69. TSR SBP, 68 Fed. Reg. at 4614.

70. In each practice, sellers take consumers money for promised services that they have no intention of providing, and that they do not in fact provide. This causes substantial damage, with no offsetting benefits. "Finally, having no way to know these offered services were illusory, consumers had no reasonable means to avoid the harm. . ." Id. Although false claims in the marketing of these services could be attacked as deceptive, this theory would provide little basis for prohibiting telemarketing of these services entirely.

71. TSR SBP, 68 Fed. Reg. at 4619-20.

72. 16 C.F.R. § 310.4(a)(5).

73. 16 C.F.R. § 310.4(a)(6).

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