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RESEARCH SUMMARY

THE PERILS OF EXCESSIVE DISCRETION: THE ELUSIVE MEANING OF UNFAIRNESS IN SECTION 5 OF THE FTC ACT

BY JAMES C. COOPER

The Sherman Act (1890) sets a famously vague standard prohibiting "unreasonable restraints of trade" and "monopolization" to address antitrust. Over the last 120 years, courts have used the Sherman Act's open architecture to create an antitrust system that provides relatively clear—and for the most part, economically sound—liability standards, successfully avoiding burdening businesses with the uncertainty of such indefinite prohibitions.

The same cannot be said about Section 5, the antitrust provision of the Federal Trade Commission Act. Like the Sherman Act, Section 5 of the FTC Act is a vague standard, prohibiting "unfair methods of competition." Congress intentionally left the term "unfair" undefined, hoping that an administrative body "with broad business and economic expertise" would give it meaning. Unlike the Sherman Act, however, the boundaries of the FTC's authority remain largely unresolved. The FTC has been seeking its elusive competition mandate now for a century.

A new paper by the Mercatus Center at George Mason University examines the current state of Section 5 enforcement and law and how the lack of a competition mandate creates uncertainty and opportunities for rent-seeking by businesses. The study recommends two forms of self-restraint the FTC should consider to address these problems.

A brief overview is below. For the full study, visit http://mercatus.org/research/tech-policy.

KEY FINDINGS

A series of Supreme Court cases interpreting the FTC Act in the first sixty years of its existence—the most recent and widely cited of which is more than forty years old—held that the FTC had

For more information or to meet with the scholar, contact
Taylor Barkley, (703) 993-8205, tbarkley@mercatus.gmu.edu
Mercatus Center at George Mason University, 3351 Fairfax Drive, 4th Floor, Arlington, VA 22201

authority to condemn unfair methods of competition and gave it wide-ranging powers beyond those associated with Sherman Act enforcement. A series of adverse rulings in the 1980s and early 1990s, however, appeared to scale back Section 5's domain. The combination of an amorphous statute and little external guidance coupled with the fact that most parties will prefer a consent order to litigation vests the Commission with wide discretion to define the bounds of "unfairness."

This discretion comes at a price for businesses and consumers.

- It creates uncertainty. If businesses are unsure about where the line between legal and illegal behavior is drawn, they rationally will take socially excessive care to avoid violating the law, which in antitrust can mean competing less aggressively. Less competition generally means higher prices or fewer choices for consumers.
- The more discretion the FTC enjoys to condemn a practice as an unfair method of competition, the more competition will be channeled from the marketplace to lobbying for favors. This type of competition harms consumers because it diverts resources from satisfying their needs.

The recent Google investigation provides some evidence as to just how large this zone of Section 5 discretion may be. Google was alleged to have favored its own properties over those of its competitors when displaying Internet search results, raising the question of whether Section 5 allowed the FTC to impose a requirement that Google must aid its competitors with favorable search placements on a search engine that Google created and voluntarily opened to these competitors.

- Although the Commission eventually decided to close its investigation into Google's search practices after extracting some informal concessions, the Commission's closing statement suggests a belief that Sherman Act precedent involving duties to aid rivals may not apply to Section 5 actions.

- The high costs of litigating Section 5 cases mean that most parties, like Google, prefer to settle with the FTC. Thus, what is considered illegal under Section 5 largely has become whatever at least three commissioners can agree upon. Even though the appellate rebukes of the 1980s provide some clear boundaries on the ability of the Commission to apply Section 5 beyond the Sherman Act, there is still a relatively large zone in which the FTC can develop this quasi-Section 5 common law with little fear of triggering litigation or scrutiny by an appellate court.

RECOMMENDATIONS

The Commission should not use a statute merely because it can or because it receives occasional congressional pressure to do so, especially given the costs associated with undisciplined exercise of such an elastic mandate. The FTC could go a long way toward reducing uncertainty and rent seeking by exercising self-regulation to limit its discretion to stretch its authority for defining "unfair methods of competition."

- One path would be to confine Section 5 to the limits of the Sherman Act. It may well be that the FTC is trying to sell a product that nobody needs. Consequently, the costs of abandoning an expansive Section 5 may be small. Anchoring Section 5 to the Sherman Act will reduce the harmful effects associated with excessive regulatory discretion that comes from enforcing a nebulous statute.

- Another path for the Commission would be to spell out the circumstances under which it would consider a stand-alone Section 5 case. This domain should be narrow, focusing only on conduct that (1) clearly is harmful (or poses a significant threat of substantial harm) to consumers through its effect on competition, (2) is unlikely to generate any cognizable efficiencies, and (3) but for the application of Section 5, would remain unremedied.