Statement of Commissioner Joshua D. Wright

Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act

June 19, 2013

Section 5 of the Federal Trade Commission ("FTC") Act provides that "unfair methods of competition in or affecting commerce . . . are hereby declared unlawful."[1] Congress framed the statute in general terms rather than providing a list of unfair methods of competition because any such list necessarily would have been incomplete and likely would have become outdated or left loopholes susceptible to easy evasion.[2] Congress therefore assigned the task of identifying unfair methods of competition to the Commission. This Policy Statement clarifies the standards and limits the Commission will adhere to in exercising its authority to prosecute unfair methods of competition under Section 5.[3]

Congress intended Section 5 to play a key role in the Commission's competition mission by allowing the agency to leverage its institutional advantages in research and reporting to develop evidence-based competition policy.[4] This promise has remained

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[1] 15 U.S.C. § 45(a) (2012). Section 5 also prohibits "unfair or deceptive acts or practices." *Id.* This Policy Statement will focus only upon unfair methods of competition. The Commission has expounded upon its authority to prosecute unfair or deceptive acts or practices in other Policy Statements. *See* Letter from the Fed. Trade Comm'n to Hon. Wendell Ford and Hon. John Danforth, Comm. on Commerce, Science and Transportation, United States Senate, Commission Statement of Policy on the Scope of Consumer Unfairness Jurisdiction (Dec. 17, 1980), *reprinted in* Int'l Harvester Co., 104 F.T.C. 949, 1070, 1073 (1984); Letter from the Fed. Trade Comm'n to Hon. John D. Dingell, Chairman, Comm. on Energy and Commerce, U.S. House of Representatives (Oct. 14, 1983), *reprinted in* Cliffdale Assoc., Inc., 103 F.T.C. 110, 174 (1984).

[2] *See* H.R. REP. NO. 63-1142, at 19 (1914) (Conf. Rep.) (observing if Congress "were to adopt the method of definition, it would undertake an endless task").

[3] This Policy Statement is limited to providing guidance on the Commission's authority to prosecute unfair methods of competition as standalone violations of Section 5. The Commission also relies upon Section 5 as the vehicle for prosecuting violations of the Sherman Act and the Clayton Act. This Policy Statement does not limit the Commission's use of Section 5 in this respect.

[4] *See* William E. Kovacic & Mark Winerman, *Competition Policy and the Application of Section 5 of the Federal Trade Commission Act*, 76 ANTITRUST L.J. 929, 930-31 (2010) ("Through repeated exposure to competition policy problems, the FTC would use distinctive research and data collection powers to develop, apply, and assess doctrine.").

largely unfulfilled for a variety of reasons.[5] In order for enforcement of its unfair methods of competition authority to promote consistently the Commission's mission of protecting competition, the Commission must articulate a clear framework for its application. Such guidance is even more important today in light of dramatic changes in antitrust jurisprudence since the Supreme Court last considered the breadth of the Commission's authority under Section 5 more than four decades ago.[6] Since 1972, the Supreme Court has issued nearly one hundred antitrust decisions. Those decisions are best characterized as incorporating sound economic analysis into antitrust jurisprudence.[7] This Policy Statement benefits both consumers and the business community by relying on modern economics and antitrust jurisprudence to strengthen the agency's ability to target anticompetitive conduct and provide clear guidance about the contours of the Commission's Section 5 authority.

This Policy Statement proceeds in four parts. The Policy Statement first defines the two elements the Commission must show to bring a successful enforcement action pursuant to its authority to prosecute unfair methods of competition: harm to competition and an absence of cognizable efficiencies. The Policy Statement then outlines the scope of the agency's authority under Section 5 by examining court decisions that interpret its text as well as the legislative history of the statute. In the remaining two sections, the Policy Statement describes the elements of an unfair methods of competition claim in detail, providing specific guidance to enable the business community to distinguish between conduct the Commission would prosecute as an unfair method of competition and conduct the Commission would not challenge.

I. Definition of Unfair Methods of Competition Under Section 5

To establish an operational framework for applying Section 5, the Commission must define what constitutes an unfair method of competition. Having considered the relevant case law, legislative history, and the vast learning and experience developed by the agency since its creation, the Commission concludes that an unfair method of competition is an act or practice that (1) harms or is likely to harm competition

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[5] *See id.* at 942 ("The Commission has done relatively little to inform judicial thinking, as the agency has not issued guidelines or policy statements that spell out its own views about the appropriate analytical framework. This inactivity contrasts with the FTC's efforts to use policy statements to set boundaries for the application of its consumer protection powers under Section 5.").

[6] *See FTC v. Sperry Hutchinson Co.*, 405 U.S. 233, 244 (1972).

[7] *See generally* Leah Brannon & Douglas H. Ginsburg, *Antitrust Decisions of the U.S. Supreme Court, 1967 to 2007*, COMPETITION POL'Y INT'L, Autumn 2007.

significantly and (2) lacks cognizable efficiencies. Each element of an unfair method of competition claim is discussed separately below.

II. The Commission's Unfair Methods of Competition Authority Under Section 5 Reaches Beyond the Scope of the Sherman Act and the Clayton Act

In establishing an enforcement policy regarding the exercise of the Commission's authority to define and prosecute unfair methods of competition under Section 5, it is useful to explore the breadth of the Commission's authority under the FTC Act as adopted by Congress and interpreted by the courts. Both Congress and the courts have made clear that conduct can be an unfair method of competition even if it would not violate the traditional federal antitrust laws, namely the Sherman Act and the Clayton Act. Neither Congress nor the courts, however, have established the elements necessary for the Commission to challenge conduct beyond the traditional federal antitrust laws.

a. Precedent and Legislative History Support the Commission's Authority to Define and Prosecute Unfair Methods of Competition

The Supreme Court has declared that Section 5 covers "not only practices that violate the Sherman Act and the other antitrust laws, but also practices that the Commission determines are against public policy for other reasons."[8] The Court also has stated that the Commission can formulate competition policy based upon its own experience and expertise, and can enforce that policy using Section 5: "legislative and judicial authorities alike convince us that the Federal Trade Commission does not arrogate excessive power to itself if, in measuring a practice against the elusive, but congressionally mandated standard of fairness, it, 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]

Similarly, a principal sponsor of the FTC Act stated that Section 5 is intended "to make some things punishable, to prevent some things, that cannot be punished or prevented under the [existing] antitrust law."[10] The Commission's authority to determine what constitutes an unfair method of competition was a key consideration in the adoption of the FTC Act. Rather than delineate specific methods of competition deemed to be unfair, Congress "le[ft] it to the [C]ommission to determine what practices were

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[8] *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 454 (1986) (internal citations omitted).

[9] *Sperry Hutchinson Co.*, 405 U.S. at 244.

[10] 51 CONG. REC. 12,454 (1914) (remarks of Senator Cummins).

unfair."[11] The FTC Act thereby addressed the need for an agency with the "information, experience and careful study of the business and economic conditions of the industry affected."[12]

b. The Commission's Institutional Abilities Support Its Authority to Define and Prosecute Unfair Methods of Competition

Congress's delegation of authority to the Commission to define unfair methods of competition also is justified by the Commission's institutional strengths. As some commentators have observed, "Section 5 would be applied by an expert administrative tribunal which had power to impose prospective equitable relief (not damages or criminal sanctions), whose decisions interpreting Section 5 would . . . be reviewed by appellate courts under a deferential standard."[13] The Supreme Court also has recognized it was Congress's intent to defer to the Commission's expertise in applying Section 5 to business practices across industries: it was the "express intention of Congress to create an agency whose membership would at all times be experienced, so that its conclusions would be the result of an expertness coming from experience."[14]

The Commission's ability to use its institutional capacity to investigate and prosecute unfair methods of competition manifests itself in a number of ways. In investigating potentially unfair methods of competition and deciding whether to bring an enforcement action, the Commission is able to "use distinctive research and data collection powers to develop, apply, and assess doctrine."[15] Further, the Commission's staff of economists experienced in competition matters grants it the technical and

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[11] Report of the Senate Comm. on Interstate Commerce, S. REP. NO. 597, at 13 (1914) ("The committee gave careful consideration to the question as to whether it would attempt to define the many and variable unfair practices which prevail in commerce and to forbid their continuance or whether it would, by a general declaration condemning unfair practices, leave it to the commission to determine what practices were unfair. It concluded that the latter course would be the better, for the reason, as stated by one of the representatives of the Illinois Manufacturers' Association, that there were too many unfair practices to define, and after writing 20 of them into the law it would be quite possible to invent others.").

[12] Report of the Senate Comm. on Interstate Commerce, S. REP. NO. 63-597, at 10 (1914).

[13] Kovacic & Winerman, *supra* note 4, at 930-31.

[14] *FTC v. Cement Institute*, 333 U.S. 683, 720 (1948); *see also id.* ("We are persuaded that the Commission's long and close examination of the questions it here decided has provided it with precisely the experience that fits it for performance of its statutory duty. The kind of specialized knowledge Congress wanted its agency to have was an expertness that would fit it to stop at the threshold every unfair trade practice—that kind of practice which, if left alone, destroys competition and establishes monopoly.").

[15] Kovacic & Winerman, *supra* note 4, at 932.

industry expertise to assess the empirical effects of certain business practices through long-term industry study.

In prosecuting cases, the Commission can take advantage of administrative procedure to ensure that it exercises its authority to prosecute unfair methods of competition through a reasoned process. Unlike federal court proceedings, which typically involve generalist judges untrained in antitrust law and can rely on a jury to find facts, the Commission uses an Administrative Law Judge with substantial experience to make initial findings of fact and conclusions of law in any case alleging a violation of Section 5. Finally, the Commission operates under the Administrative Procedure Act, which has more flexible rules of process and evidence than do the federal courts.[16]

III. Unfair Methods of Competition Must Harm Competition

The first element of an unfair methods of competition claim is that the act or practice in question must result in, or likely result in, significant harm to competition as that term is understood under the traditional federal antitrust laws. The Commission will not consider non-economic factors, such as whether the practice harms small business or whether it violates public morals, in deciding whether to prosecute conduct as an unfair method of competition.[17] This approach is consistent with well-developed federal jurisprudence giving meaning to the concept of harm to competition under the antitrust laws, as well as the legislative history of the FTC Act[18] and with Congress's express decision in 1994 to prohibit the Commission from using a "public policy" rationale as the primary basis for exercising its authority to prosecute "unfair" acts or practices under its broad consumer protection authority.[19]

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[16] Herbert Hovenkamp, *The Federal Trade Commission and the Sherman Act*, 62 FLA. L. REV. 871 (2010).

[17] *See id.* at 8 ("The FTC should expand its reach to bring in some conduct that does not fall within the coverage of the Sherman and Clayton Acts as currently interpreted . . . . [But] the practices it condemns must really be 'anticompetitive' in a meaningful sense. That is, *there must be a basis for thinking that the practice either does or will lead to reduced output and higher consumer prices or lower quality in the affected market*." (emphasis added)).

[18] 51 CONG. REC. 12,220 (1914) (Senator Newlands stating "the legal significance is the same as the economic significance").

[19] *See* 15 U.S.C. § 45(n) (2012); J. Howard Beales, III, Director, Bureau of Consumer Protection, Fed. Trade Comm'n, The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection (June 2003), *available at* www.ftc.gov/speeches/beales/unfair0603.shtm ("Under the [modified] 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.").

Using the economic concept of harm to competition to give meaning to the term "unfair methods of competition," has the twin advantages of providing guidance to the business community and comporting with recent judicial guidance regarding the Commission's use of Section 5.[20] Focusing only upon conduct that harms competition as understood under the traditional federal antitrust laws will allow the Commission to prosecute conduct that does not necessarily constitute a violation of the Sherman Act or Clayton Act but nevertheless is consistent with a well-developed antitrust jurisprudence. At the same time, the Commission will not challenge conduct as an unfair method of competition where there is well-forged case law under the traditional federal antitrust laws because the Commission does not have an institutional advantage in discerning competitive effects under such circumstances and prosecuting conduct under disparate standards may blur the line between lawful and unlawful behavior.[21]

a. ***Harm to Competition Defined***

Harm to competition is a concept that has long been deeply embedded into antitrust jurisprudence. As the Supreme Court has recognized, "[t]he true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition, or whether it is such as may suppress or even destroy competition," and that such analysis requires the court to "consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint *and its effect, actual or probable*."[22] The Supreme Court also has stated that "Congress designed the Sherman Act as a 'consumer welfare prescription'."[23] In the same vein, the Commission views the FTC Act as a broad mandate to protect consumers against unfair methods of competition and unfair and deceptive acts or practices. With regard to its authority to define and prosecute unfair

[20] *E.I. Du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 137 (2d Cir. 1984) ("As the Commission moves away from attacking conduct that is either a violation of the antitrust laws or collusive, coercive, predatory, restrictive or deceitful, and seeks to break new ground by enjoining otherwise legitimate practices, the closer must be our scrutiny upon judicial review.").

[21] *Boise Cascade Corp. v. FTC*, 637 F.2d 573, 582 (9th Cir. 1980) (stating that where there is "well forged" case law governing the challenged conduct, the Commission cannot prosecute the conduct under Section 5 because doing so might "blur the distinction between guilty and innocent commercial behavior"). For example, the Commission will not bring loyalty discount, predatory pricing, or refusal to deal cases as standalone violations of Section 5 because the courts have examined such conduct and articulated the requirements for finding harm to competition.

[22] *Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 238 (1918) (emphasis added).

[23] *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979).

methods of competition, the key inquiry for the Commission is the market impact of the conduct claimed to be anticompetitive.[24]

As with the Sherman Act, conduct challenged under Section 5 "must have an 'anticompetitive effect.' That is, it must harm the competitive *process* and thereby harm consumers. In contrast, harm to one or more *competitors* will not suffice."[25] The legislative history of the FTC Act supports the notion that harm to competitors alone is insufficient for a business practice to be declared unfair: "The unfairness must be tinctured with unfairness to the public; not merely with unfairness to the rival or competitor . . . . We are not simply trying to protect one man against another; we are trying to protect the people of the United States, and of course, there must be in the imposture or in the vicious practice or method something that has a tendency to affect the people of the country or be injurious to their welfare."[26]

In assessing whether a harm to the competitive process results in a harm to competition, the "inquiry must focus on whether the effect and . . . the purpose of the practice are to threaten the proper operation of our predominantly free-market economy."[27] The key question is whether the practice is one that "restrict[s] competition and decrease[s] output, and in what portion of the market, or instead one designed to increase economic efficiency and render markets more, rather than less, competitive."[28] The Commission may use a variety of indicators to assess whether the practice harms competition, but perhaps the most relevant evidence is evidence that the challenged conduct has a harmful impact on price or output.[29]

More broadly, the Commission has numerous methods and techniques at its disposal to examine the economic evidence and determine the effect of the conduct in question on competition. Conduct that results in harm to competition, and in turn, in harm to consumer welfare, typically does so through increased prices, reduced output, diminished quality, or weakened incentives to innovate.

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[24] *See Cont'l TV, Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51-52 (1977) (analyzing the "market impact" of vertical restraints).

[25] *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc) (per curiam).

[26] 51 CONG. REC. 11,105 (1914) (Remarks of Senator Cummins).

[27] *Broad. Music, Inc. v. Columbia Broad. Sys.*, 441 U.S. 1, 19 (1979) (internal citation omitted).

[28] *Id.* (internal quotation marks omitted).

[29] *See FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 460-61 (1986).

b. Conduct that is Likely to Harm to Competition

The Commission may prosecute as unfair methods of competition those practices that have not yet resulted in harm to competition but are likely to result in anticompetitive effects if allowed to continue. "A major purpose of [the FTC] Act was to enable the Commission to restrain practices as 'unfair' which, although not yet having grown into Sherman Act dimensions would most likely do so if left unrestrained."[30] Accordingly, the Commission may prosecute conduct as an unfair method of competition only if the act or practice will likely harm competition. When the act or practice has not yet harmed competition, the Commission's assessment must include both the magnitude and probability of competitive harm. Where the probability of competitive harm is smaller, the Commission will not find an unfair method of competition without reason to believe the act or practice poses a risk of substantial harm.

There are at least two broad categories of unfair methods of competition the Commission may pursue even though they have not yet caused harm to competition. The first category involves invitations to collude, whereby a firm seeks to form an illegal restraint of trade but its efforts are thwarted before an agreement can be reached. The second category involves the use by a firm of unfair methods of competition to acquire market power that does not yet rise to the level of monopoly power necessary for a violation of the Sherman Act.

The following are examples of business practices that the Commission can and cannot challenge as unfair methods of competition.[31]

> *Example 1:* Firm A has 10 percent of the ice cream market and makes deceptive claims to supermarkets that its shelf-space contracts with the supermarkets allow it to remove Firm B's and Firm C's products from the retail shelf display. Some supermarkets remove Firm B's and Firm C's products in response to Firm A's statements. There is no evidence that Firm A has acquired market power as a result of its deceptive conduct, nor is there any evidence that Firm A's conduct has had an impact on price and output in the ice cream market. The Commission cannot challenge Firm A's conduct as an unfair method of competition because the evidence shows only harm to competitors and not harm to competition.

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[30] *Triangle Conduit & Cable Co. v. FTC*, 168 F.2d 175, 181 (7th Cir. 1948).

[31] The Commission, of course, can still challenge conduct that is not an unfair method of competition for purposes of a standalone Section 5 claim as a violation of the traditional federal antitrust laws. See *supra* note 3.

Example 2: Firm A invites Firm B to fix prices, but Firm B declines. The Commission can prosecute Firm A for engaging in an unfair method of competition under Section 5. An invitation to collude satisfies the harm to competition element of an unfair method of competition—whether or not it ultimately results in increased prices, reduced output, or other harm to competition—because it creates a substantial risk of competitive harm.

Example 3: Firm A has 30 percent of the ice cream market and makes deceptive claims to supermarkets that its shelf-space contracts with the supermarkets allow it to remove Firm B's and Firm C's products from the retail shelf display. Firm A successfully acquires market power as a result of its deceptive conduct. The Commission can challenge Firm A's conduct as an unfair method of competition under Section 5 if there are no cognizable efficiencies arising from its conduct.

IV. Unfair Methods of Competition Must Lack Cognizable Efficiencies

The second element of an unfair methods of competition claim is that the act or practice in question must not generate cognizable efficiencies. The Commission will not challenge conduct as an unfair method of competition if cognizable efficiencies exist. The Commission employs an efficiencies screen to establish a test with clear and predictable results that prevents arbitrary enforcement of the agency's unfair methods of competition authority, to focus the agency's resources on conduct most likely to harm consumers, and to avoid deterring consumer welfare-enhancing business practices. The Commission's considerable experience in identifying cognizable efficiencies also makes the efficiencies screen an effective and practical approach to enforcing Section 5.

a. *Establishing a Clear and Predictable Standard*

The Commission must formulate a standard that distinguishes between acceptable business practices and business practices that constitute an unfair method of competition in order to provide firms with adequate guidance as to what conduct may be unlawful. Articulating a clear and predictable standard for what constitutes an unfair method of competition is important because the Commission's authority to condemn unfair methods of competition allows it to break new ground and challenge conduct based upon theories not previously enshrined in Sherman Act or Clayton Act jurisprudence.[32] In the absence of a clear and predictable standard, firms might engage

[32] *See E.I. Du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 137 (2d Cir. 1984) ("A test based solely upon restraint of competition, even if qualified by the requirement that the conduct be 'analogous' to an

in conduct without any meaningful notice that they may be prosecuted. The Commission therefore creates a clear safe harbor that provides firms with certainty that their conduct can be challenged as an unfair method of competition only in the absence of efficiencies.

b. ***Prosecuting Conduct Most Likely to Harm Consumers***

As with all law enforcement agencies, the Commission must allocate its scarce resources in the manner that most effectively achieves its mission. Congress has charged the Commission with promoting competition and furthering consumer welfare by preventing anticompetitive business practices without unduly burdening legitimate business activity. Given the size of the national economy and the range of business practices employed by firms within it, the Commission must identify those patterns of conduct that are most likely to harm consumers so that it can target enforcement efforts to maximize consumer welfare.

Anticompetitive conduct that lacks cognizable efficiencies is the most likely to harm consumers because it is without any redeeming consumer benefits.[33] Through years of learning and regular application, the Commission has developed a core institutional competency in identifying the presence of cognizable efficiencies.[34] The Commission's expertise in this regard allows it to effectively target enforcement efforts at conduct that lacks cognizable efficiencies. The Commission therefore will focus its unfair methods of competition enforcement on anticompetitive conduct that lacks cognizable efficiencies.

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antitrust violation, is so vague as to permit arbitrary or undue government inference with the reasonable freedom of action that has marked our country's competitive system.").

[33] Such conduct may also be relatively inexpensive to implement, making it a low-cost strategy for firms seeking to avoid or impair the competitive process. The potential prevalence of such conduct makes it an even more appealing target for agency action. *See* Susan A. Creighton et al., *Cheap Exclusion*, 72 ANTITRUST L.J. 975, 977 (2005) (stating that because "firms are likely to prefer low-cost strategies to achieve [market or monopoly power], we expect that, cheap exclusion would be relatively more common").

[34] Since incorporating the concept of cognizable efficiencies into the revised 1997 Horizontal Merger Guidelines, the Commission has regularly applied efficiency analysis as part of its merger review. *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 10 (2010) [hereinafter 2010 Guidelines], *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf (providing guidance on how efficiencies are to be identified); U.S. Dep't of Justice & Fed. Trade Comm'n, Commentary on the Horizontal Merger Guidelines 49-59 (2006), *available at* http://www.justice.gov/atr/public/guidelines/215247.pdf (explaining the analytical process for assessing efficiencies); U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 4 (1992, rev. 1997), *available at* http://www.justice.gov/atr/public/guidelines/hmg.pdf (incorporating the concept of cognizable efficiencies into merger analysis).

c. *Avoiding Deterrence of Consumer Welfare-Enhancing Conduct*

Firms engage in a variety of business practices that create efficiencies and thereby enhance their abilities and incentives to compete. These efficiencies can result in lower prices, improved quality, better services, new products, and other benefits that enhance consumer welfare. Some of these practices also may harm competition and consumers under certain specific circumstances. Where conduct plausibly produces both costs and benefits for consumers it is fundamentally difficult to identify the net competitive consequences associated with the conduct.[35]

This is particularly true if business conduct is novel or takes place within an emerging or rapidly changing industry, and thus where there is little empirical evidence about the conduct's potential competitive effects.[36] Although some conduct is obviously procompetitive, the effect of other conduct may be more difficult to discern but nevertheless generates significant welfare gains for consumers.[37] The Supreme Court has long recognized that erroneous condemnation of procompetitive conduct significantly reduces consumer welfare by deterring investment in efficiency-enhancing business practices.[38] To avoid deterring consumer welfare-enhancing conduct, and to

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[35] *See United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc) (per curiam) ("Whether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern.").

[36] *See* ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 32 (2007) (recommending that "in industries in which innovation, intellectual property, and technological change are central features . . . antitrust enforcers should carefully consider market dynamics in assessing competitive effects"); R.H. Coase, *Industrial Organization: A Proposal for Research*, *in* POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION 67 (Victor R. Fuchs, ed., 1972) ("[I]f an economist finds something—a business practice of one sort or another—that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be very large, and the reliance on a monopoly explanation, frequent.").

[37] *See, e.g.*, Jerry A. Hausman, *Valuation of New Goods Under Perfect and Imperfect Competition*, *in* THE ECONOMICS OF NEW GOODS 209-47 (Bresnahan & Gordon eds., 1997) (discussing the consumer welfare gains from new product introductions and product line extensions).

[38] *See Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc.*, 555 U.S. 438, 451 (2009) ("To avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low."); *Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 283 (2007) ("[W]here the threat of antitrust lawsuits, through error and disincentive, could seriously alter underwriter conduct in undesirable ways, to allow an antitrust lawsuit would threaten serious harm to the efficient functioning of the securities markets."); *Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004) ("Mistaken inferences and the resulting false condemnations are especially costly, because they chill the very conduct the antitrust laws are designed to protect." (internal quotations omitted)); *Brooke Grp. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) (stating the

focus the Commission's enforcement resources upon conduct that is most likely to be anticompetitive, the Commission will not challenge conduct as an unfair method of competition where cognizable efficiencies exist.

d. ***Identifying Cognizable Efficiencies***

Cognizable efficiencies are conduct-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service.[39] The Commission will credit only those efficiencies that are accomplished with the conduct and unlikely to be accomplished in the absence of either the conduct in question or another means having comparable anticompetitive effects. The Commission will not deem efficiencies to be conduct-specific if they could be attained by practical alternatives that mitigate competitive concerns. Only alternatives that are practical in the business situation faced by the firm are considered when determining whether any proffered efficiency is conduct-specific. The Commission will not compare any efficiencies generated by the challenged conduct to theoretical, but less restrictive, alternatives.

Information relating to efficiencies is often uniquely in the possession of the firm implementing the act or practice under investigation. As a result, it is incumbent on the firm in the first instance to offer any efficiency claims the Commission should consider in determining whether to bring an enforcement action. Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiency claims may be viewed with skepticism when generated

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exclusionary effect in predation cases with above cost pricing is "beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting"). Scholars have also recognized the social welfare costs associated with judicial error in antitrust cases. *See* Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 932, 935 (2001) ("Whenever an antitrust court is called on to balance efficiency against monopoly, there is trouble; legal uncertainty, and the likelihood of error, soar."). Although erroneously failing to identify and challenge anticompetitive conduct also has social costs, market forces offer at least some correction with respect to such errors whereas erroneous challenges of procompetitive conduct has no readily available fix. *See* Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal—Why* Aspen *and* Kodak *Are Misguided*, 68 ANTITRUST L.J. 659, 675 (2001) ("[E]fficiencies are hard to measure, and the benefit of the doubt should go to defendants, not to plaintiffs; otherwise, the continued generation of the large efficiency benefits responsible for raising our standard of living will be jeopardized."); Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 15 (1984) ("[T]he economic system corrects monopoly more readily than it corrects judicial errors.").

[39] The Commission uses the term "cognizable efficiencies" as it is used in the 2010 Horizontal Merger Guidelines. 2010 Guidelines, *supra* note 33, § 10. The Commission has developed significant expertise in identifying the presence of cognizable efficiencies since the concept was added to the revised guidelines in 1997.

outside the usual business-planning process. By contrast, efficiency claims substantiated by past experience are likely to be credited. The Commission bears the ultimate burden in establishing that the act or practice lacks cognizable efficiencies. Once a firm has offered initial evidence to substantiate its efficiency claims, the Commission must demonstrate why the efficiencies are not cognizable.

The following are examples of business practices that the Commission can and cannot challenge as unfair methods of competition.

> *Example 4:* Firm A develops and sells software and hardware products. Firm A deliberately designs its software to stunt the performance of microchips sold by competitors. Firm A tells customers that its software performs better on its own microchips than on competitors' microchips, but does not disclose that the performance differences actually are the result of Firm A's software inhibiting the operation of competitors' microchips. The Commission determines that Firm A's failure to disclose that the performance differences are the result of its intentional software design rather than a deficiency in competitors' products harms competition. The Commission can challenge Firm A's conduct as an unfair method of competition because deception has no cognizable efficiencies.

> *Example 5:* Firm A joins a standard-setting organization and intentionally and deceptively fails to disclose a patent covering a critical technology that ultimately is adopted as part of a standard. Firm A acquires monopoly power as a result of the non-disclosure because the standard-setting organization's members become locked into Firm A's technology. The Commission can challenge Firm A's non-disclosure of its intellectual property right as an unfair method of competition because the conduct harms competition and lacks cognizable efficiencies.

> *Example 6:* Firm A's intellectual property has been adopted as part of a standard in exchange for a promise to license the technology at a specific rate. Firm A sells the covered intellectual property to Firm B. Firm B announces it will no longer license the technology under the previous commitment, and instead will license it under its own existing royalty rate structure. Firm B's conduct constitutes exercise of pre-existing market power rather than its newfound acquisition. Firm B's conduct does not harm competition as understood by the antitrust laws and thus does not constitute an unfair method of competition. Firm B also offers evidence for why breaching or repudiating the earlier commitment, paying any required damages, and renegotiating a new contract is efficiency enhancing, thus demonstrating cognizable efficiencies. The Commission cannot challenge Firm

A’s conduct as an unfair method of competition because it finds cognizable efficiencies to exist.

Example 7: Firm A develops, patents, and sells a pharmaceutical product. Firm A develops and patents a new variant of the pharmaceutical product that has no obvious consumer benefits beyond the original product. The Commission believes Firm A has developed the new variant solely to extend its patent protection and thus avoid competition from potential generic entrants. Firm A offers as an efficiency claim that the new variant of the product is safer and cheaper to produce. Firm A is unable to offer any internal marketing documents or cost projections to substantiate its efficiency claims. The Commission can challenge Firm A’s conduct as an unfair method of competition because Firm A cannot substantiate its efficiency claims and its conduct harms competition.

Example 8: Firm A develops, patents, and sells a pharmaceutical product. Firm A develops and patents a new variant of the pharmaceutical product that offers some consumer benefits beyond the original product. The Commission believes Firm A has developed the new variant solely to extend its patent protection and thus avoid competition from potential generic entrants. Firm A offers evidence that the new variant of the product is safer and offers a study that shows the safety improvement stems exclusively from a change in packaging rather than as a result of the new product itself. The Commission can challenge Firm A’s conduct as an unfair method of competition because the claimed efficiencies could be attained by alternative packaging that does not require a new patent.

Example 9: Firm A introduces a novel software design encompassing an algorithm that improves its original product, the experience of its users, and the interconnectivity of the software with the microchip it also manufactures. The algorithm also impairs the performance of other competitors’ microchips. The Commission determines that Firm A’s new algorithm competitively disadvantages its microchip rivals, but also recognizes the cognizable efficiencies. The Commission cannot challenge Firm A’s conduct as an unfair method of competition.

Conclusion

Congress intended Section 5 to play a key role in the Commission’s competition mission by allowing the agency to leverage its institutional advantages to develop evidence-based competition policy. This Policy Statement puts the Commission on the path to fulfilling that promise by providing a framework for the Commission’s authority to

prosecute unfair methods of competition. The Policy Statement articulates a definition of unfair methods of competition tethered to the modern economic concept of harm to competition that is well established by the antitrust laws and avoids deterring consumer welfare-enhancing competition while targeting conduct most harmful to consumers. In doing so, this Policy Statement strengthens the Commission's ability to target anticompetitive conduct and provides clear guidance on the contours of its Section 5 authority.