Some Thoughts About the Scope of Section 5

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This panel has been asked to consider just how broadly or narrowly Section 5 might reach in relation to the other similar antitrust laws, by which we mean the Sherman Act, sections one and two and the Clayton Act, section three. This is not an easy question. So, although both of us have thought about the issue for some time, we want to say at the outset that the views expressed here are still somewhat preliminary. This remains a work in progress.

We see two very different issues embedded in the question of the scope of Section 5. The first is: how broadly *can* the FTC reach under Section 5? The second, very different question is: how broadly *should* the FTC reach in the exercise of its statutory mandate?

We have focused our remarks here on the second (and to our mind, perhaps more interesting) of these questions. As to the first – how broadly *can* the FTC act under Section 5 -- the simplest approach would be to say that, insofar as its proscriptions on unfairness and deception reach conduct that should be condemned because it is anticompetitive, those proscriptions were intended to be the same as (neither broader nor narrower than) the conduct proscriptions of the Sherman and Clayton Acts. As attractive as this might be from a policy perspective, however, as a matter of statutory interpretation, it seems evident that this is not what the 1914 Congress that enacted Section 5 (and the 1938 Congress that amended it) intended. In a recent pronouncement on this issue, the Supreme Court examined all the legislative history underlying Section 5, and its amendment by the Wheeler-Lea Act, and concluded in no uncertain terms 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." *See FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244 (1972).

Even if the FTC *can* reach conduct not otherwise proscribed by other antitrust laws, the question remains, *should* it? As an initial limiting principle, we would argue that in its implementation of Section 5, the FTC should leave fully intact the current bipartisan antitrust consensus that antitrust is designed to protect competition, not competitors; that it protects against the use of market power, not efficient conduct; and that it seeks to prevent diminution of consumer welfare, and to do no more than that. This consensus is, we think, embodied in such

otherwise disparate key decisions and documents as the Supreme Court's decision in *Leegin*,[1] the D.C. Circuit's *Microsoft* decision,[2] the agencies' Horizontal Merger Guidelines, and the Commission's opinion, affirmed by the D.C. Circuit, in *Three Tenors*.[3] Section 5 should not, we submit, be allowed to impose antitrust liability for conduct that does not threaten these fundamental principles of antitrust – that is, the latitude that Congress built into Section 5 should not be used to sacrifice efficient behavior for insignificant or illusory increases in consumer welfare or to shield competitors from the rigors of efficient competition.

Such a limiting principle is not only right as a matter of competition policy, but we think it is an inescapable requirement of the trilogy of cases, decided in the 1980s, that rejected somewhat extravagant views of Section 5.[4] At a minimum, reviewing judges are likely to hold the Commission's feet to the fire by requiring that competition cases be competition cases – that is, they must rest on proof of probable actual competitive effects, measured by the consumer welfare standard. So, even if the Commission wanted to extend Section 5 to reach conduct not within the ambit of current antitrust policy, we doubt that reviewing courts would permit this, notwithstanding some of the more elastic phrases in cases like *Sperry & Hutchinson*.

As an initial screen, therefore, we would ask: Does the conduct at issue have the same effect, from an economic perspective, as the types of conduct that are subject to liability under the Sherman Act? If the *economic* effect of the conduct is the same, the second step of the inquiry is to ask: Is there nonetheless some *legal* reason to bring the challenge under Section 5 rather than the Sherman Act? We have imagined three different scenarios that might fit these criteria, and believe that they raise different issues and so might usefully be considered separately. We have labeled them "frontier" cases, "gap-filling" cases, and "yes, but" cases.

A "frontier" case is one that meets all of the legal requirements for a Sherman Act claim, but involves new forms of anticompetitive conduct that fall outside traditional categories of antitrust analysis. Former FTC Commissioner Tom Leary has made strong arguments for the application of Section 5 in this context. A "gap-filling" case, by contrast, is one that may satisfy the economic requirements of antitrust, but fails one of the legal elements of Section 1 (usually the "agreement" requirement) or Section 2 (usually the "monopoly power" element). Finally, "yes, but" cases are ones that meet all the economic and legal requirements of a Sherman Act claim, but cannot be brought under the Sherman Act because of legal limitations imposed for reasons unrelated to antitrust.

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[1] *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007).

[2] *U.S. v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc).

[3] *In re PolyGram Holding, Inc.*, Docket No. 9298 (FTC), 2003 WL 21770765, *available at* http://www.ftc.gov/os/2003/07/polygramopinion.pdf, a*ff'd, Polygram Holdings, Inc. v. FTC,* 416 F.3d 29 (D.C. Cir. 2005).

[4] *Official Airline Guides, Inc. v. FTC*, 630 F.2d 920 (2d Cir. 1980); *Boise Cascade Corp. v. FTC*, 637 F.2d 573 (9th Cir. 1980); *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984) (*Ethyl* case).

Depending on the facts, each of these different potential rationales for the invocation of Section 5 may come into play with respect to any particular type of anticompetitive conduct. Consider, for example, an action challenging unilateral conduct in the standard-setting area. Former Commissioner Leary has noted that because *Rambus* involved a type of conduct that has only recently received careful antitrust scrutiny, it might have been better to have brought the case exclusively under Section 5 – a "frontier" rationale. In *Unocal*, another case involving standard-setting, a "yes, but" rationale might have been considered in deciding whether to invoke a stand-alone Section 5, because *Noerr* was an important defense asserted in that case. Finally, *N-Data* appears to have been supported by the majority under a "gap-filling" rationale, inasmuch as the majority Commissioners acknowledged that the facts in that case did not support a claim under the Sherman Act.

In our view, the "frontier" and "yes, but" cases seem to be the safest applications of a separate Section 5, at least so long as these rationales are not used to skip over a rigorous analysis of whether the legal elements of a Sherman Act claim otherwise are met. The "gap-filling" cases may provide the greatest potential for mischief, if the scope of such cases is not narrowly and rigorously circumscribed. One of the matters to which the Commission may want to give considered attention are the legal limits that should be imposed on Section 5 in these "gap-filling" circumstances, if important elements such as an "agreement" or "monopoly power" are not present.

In the balance of this paper, we discuss some additional potential examples of each of the types of cases that we have identified.

A. Cases Addressing New Forms of Anticompetitive Behavior

Perhaps the least controversial application of a stand-alone Section 5 claim should be its use in "frontier" settings, where it is as an avenue for redressing anticompetitive acts or practices that have newly emerged and have not yet been fully absorbed into the fabric of the Sherman or Clayton acts. Whether it be the elaborate information dissemination schemes of the 1920s or the unwarranted Orange Book listings of the 1990s, we know from experience that new forms of anticompetitive behavior will arise from time to time. It would appear to be a clear opportunity to take advantage of the FTC's experience as an expert body to bring its analytic resources to bear on such new forms of anticompetitive behavior.

Because courts may be reluctant to impose liability where behavior is new and unfamiliar, Section 5 may have advantages in these "frontier" cases because of its prospective application and lack of damages (much less treble damages). Commissioner Leary gives *Schering*[5] and *Rambus*[6] as examples of cases that might have been better brought exclusively under Section 5, because the Commission "was primarily interested in the establishment of some ground rules applicable to settlement of patent disputes between pioneer and generic drug

[5] *Schering-Plough v. FTC*, 402 F.3d 1056 (11th Cir. 2005).
[6] *Rambus Inc. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008).

manufacturers (*Schering*), or to the conduct of companies who participate in standard-setting bodies (*Rambus*)."[7]

Perhaps the principal risk from a stand-alone Section 5 in this context is that, precisely because the conduct is new, the "frontier" rationale might too easily become a means for the Commission to short-circuit asking the hard analytical questions imposed by the rigorous standards of the Sherman Act – questions that become all the more important when considering new forms of conduct. There is also the risk that, by bringing the case exclusively under Section 5, the Commission ironically might weaken its influence as an expert voice in the antitrust debate regarding the proper application of the Sherman Act. To guard against this tendency, the Commission in "frontier" cases would need to analyze and litigate the case precisely as it would under the Sherman Act, with the only exception being that it would explicitly limit the relief sought because of the novelty of the conduct challenged. Otherwise the Commission might find that even if it is more likely to "win" a pure Section 5 claim, it might come at the cost of having failed to develop a broader consensus that the conduct is anticompetitive.

B. Gap Filling Cases

Unlike "frontier" cases, where the conduct is novel but otherwise satisfies traditional Sherman Act requirements, "gap filling" cases are ones where the conduct at issue does not meet one of the elements of the Sherman Act – most likely the "agreement" element of Section 1, or the "monopoly power" element of Section 2.

Perhaps the paradigmatic example of a "gap filling" case are invitations to collude, such as the FTC's consent order in *Valassis*.[8] That case involved an alleged invitation to collude in a market that constituted a durable duopoly with high barriers to entry. Invitations to collude do not fit easily within the language of either Section 1 or Section 2, yet there is little doubt that it is conduct that fits comfortably within the ambit of antitrust analysis. The conduct, if consummated, would be illegal *per se*; and even unaccepted, it may facilitate coordinated interaction by disclosing the solicitor's preferences. Meanwhile a simple, naked invitation to collude serves no procompetitive, efficient purpose.

Although invitations to collude are not generally viewed as controversial, the risk of an unbounded application of Section 5 is greatest in these "gap-filling" cases, and the Commission should give careful thought to the imposition of stringent requirements where "gap-filling" is the rationale for the stand-alone use of Section 5. We limit ourselves here to two fact patterns where these issues might be thought to arise.

First, the FTC's *Ethyl* case might have been a candidate, under the right circumstances,

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[7] Thomas Leary, *A Suggestion for the Revival of Section 5*, submitted in connection with the FTC's October 17, 2008 Workshop, Section 5 of the FTC Act as a Competition Statute, at 7-8.
[8] *In the Matter of Valassis Communications, Inc.*, No. 51-0008 (Mar. 14, 2006), *available at* http://www.ftc.gov/os/caselist/0510008/060314cmp0510008.pdf.

for gap filling. Certain kinds of behavior may facilitate oligopolistic price stickiness, without generating any potential cost-saving efficiencies, yet still leave unmet the Sherman Act requirement for an agreement or concerted action. For example, consider refusals to quote other than delivered prices in the absence of any reason to explain why delivered pricing reduces transaction costs or contractually committing with all buyers to announce publicly any price increase before the price increase goes into effect. Under certain conditions, this kind of behavior – if engaged in by most firms in the market – can have serious anticompetitive consequences, even if there is no evidence of agreement on these terms among competing sellers. It would appear completely consistent with the policies underlying the Sherman Act to analyze such behavior under Section 5, although that raises the question of what limits should be imposed if Section 5 were to be used in this way. [9]

Another potential candidate for "gap filling" adjudication under Section 5 would be what is often referred to as "patent fishing." When firms acquire patents and then demand payments from probable non-infringers, but where the payments are much less than the costs of litigation, this behavior -- especially where repeated many times -- can significantly raise the costs of the producing firms. These increased costs are inefficiencies and will also likely yield higher prices and a diminution in consumer surplus. Depending on how the cost increases are spread, the fishing may also create entry barriers and give some firms market power. Yet, because the patent fisher does not itself gain from the market power that its fishing can create (or because the practice may reduce consumer welfare but without yielding monopoly profits to any market participant), it is not obvious that conventional antitrust would speak to this behavior. Section 5 might be an appropriate tool for investigating allegations of such conduct, but again it is important to answer the question what elements must be satisfied to bound this application of the statute.

C. "Yes, but" Cases

A final group of cases that might warrant challenge under Section 5 are what might be called the "yes, but" cases. These are cases where, strictly on the *antitrust* merits and law, the conduct would be condemned, but legal concerns extrinsic to the Sherman cause courts to pull back from recognizing a Sherman Act claim. Such cases are close cousins to the "gap filling" cases, in that they address anticompetitive conduct that escapes Sherman Act condemnation because of a legal shortcoming. The "yes, but" cases, however, involve legal constraints imposed for reasons having nothing to do with antitrust law or policy, and for that reason pose less risk of an unbounded extension of Section. Indeed, for some of these cases, we think, Section 5 might sensibly permit the Commission to take advantage of unique aspects of Section

[9] The *Ethyl* case, *supra* note 4, might well have been another well-grounded gap filling case, given the panoply of interlocking facilitating practices at issue. However, the trial record apparently was insufficient to convince the reviewing Court that actual anticompetitive effects stemmed from the challenged conduct and the Commission was unable to persuade the Court that the practices at issue lacked redeeming procompetitive value. Consequently, on the facts as found, *Ethyl* would not appear to be a candidate for a Section 5 "gap filling" case.

5 (prospective relief only; limited to government enforcement) to reach conduct that, but for the invocation of non-antitrust policy considerations, would be condemned as anticompetitive and harmful to consumer welfare. Drawing on recent history, here are some potential examples:

1. Anticompetitive conduct protected by antitrust immunities

The FTC has devoted considerable resources to seeking to restrict the growing scope of doctrines such as *Noerr*, which is a classic "yes but" defense: the conduct is anticompetitive, but non-antitrust concerns are invoked to shield it from Sherman Act scrutiny. Given the substantial differences between the Sherman Act and Section 5, however, might it not be the case that some of the anticompetitive conduct protected by *Noerr* against Sherman Act liability might nonetheless be subject to prospective relief under Section 5?

The *Noerr* doctrine is neither an antitrust principle (note that one of its most recent applications was to the National Labor Relations Act) nor a rule of constitutional law (we know of no one who has ever suggested that all conduct immunized by *Noerr* was already independently shielded from antitrust scrutiny by the First Amendment). *Noerr* is a principle of statutory interpretation, and at least some of the concerns that drove the *Noerr* Court are not applicable to Section 5. For example, to the extent that the *Noerr* doctrine is driven by the fear that antitrust liability will "chill" protected speech, Section 5 cases – limited to prospective cease and desist remedies – should prove much less threatening than Sherman Act litigation.

So, although ultimately the Commission prevailed in the Orange Book listing cases on straightforward Sherman Act grounds, might it not also have made sense to say that there was no reason to prevent the FTC from examining such conduct under Section 5? For another example, several courts have held that threats to litigate can be shielded from antitrust proscription by *Noerr*, and some litigants have even argued that settlements might be *Noerr*-protected. But there can be little question that litigation threats and settlements can, under the wrong circumstances, as we explain below, cause material anticompetitive injury. Such acts are not, in any way shape or form, constitutionally protected petitioning conduct. Whatever the merits of seeking to protect such conduct from the chill of private enforcement, wouldn't the FTC be on firm ground in ordering a firm to cease and desist from threats to litigate if those threats produce only anticompetitive consequences or from settlement of litigation that merely creates, and then distributes the rewards from, market power? Particularly where the anticompetitive consequences are clear, the lack of any justification is evident, and the risk of unlimited liability is avoided, it seems to us that challenging anticompetitive conduct protected by *Noerr* – but not the First Amendment – could be a salutary use for Section 5.

Similarly, the state action doctrine reflects the very sound principle that the antitrust laws should not be read to impose on the states the laissez faire regime of *Lochner v. NY*. [10] If states want to displace competition and actively supervise the resulting regulated markets, then the Sherman Act will not be read to forbid that. Again, however, I wonder whether Section 5 must

[10] 198 U.S. 45 (1905).

have a reach in this area that is only precisely coterminous with that of Section 1. For example, what about the state supervision that is in practice -- for want of a better word -- a sham? In truth, this is what the FTC confronted in the *Kentucky Movers* case.[11] What if the Commission examined into the application, on very specific facts and on a case-by-case basis, of states' certificate of need statutes? Why could the FTC not be permitted to void a specific application of such a statute in order to protect against what turned out to be, upon inspection, nothing more than a raw extension of market power? Particularly where the remedy is a simple cease and desist order, such a case seems to us potentially compelling. Further, providing the FTC – and only the FTC – with authority to examine with greater care the justification for a state's decision to displace competition as a disciplinary force, and effects of that displacement, should avoid fears of permitting anyone aggrieved by a regulatory regime anywhere in the economy to challenge that regime as a violation of the Sherman Act.

We are not experts with regard to statutory antitrust immunities. When enforcing the antitrust laws, if one encounters an immunity, one just moves on. Nevertheless, we do think it might be worthwhile to examine a series of statutory immunities or exemptions to see if they were enacted, for example, because of a fear that private, treble damages actions, perhaps including class actions, would be excessively harmful to the industry, harmful out of all proportion to any harm done. In circumstances where the immunity does not expressly extend to the FTC Act, it might constitute a responsible and modest use of Section 5 to put these otherwise shielded practices under the antitrust microscope for the limited purposes of FTC investigation and potential cease and desist remedies.

2. Patents/Antitrust Interface

The edges where patent law and antitrust law interface are not smooth. They are rough. The Sherman Act has proven not fully capable of responding to certain challenges stemming from behavior with patents that threatens consumer welfare. One obvious example is patent fishing. We explained above why we think such behavior might be subject to Section 5 on a "gap filling" rationale.

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[11] *In the Matter of Kentucky Household Goods Carriers Ass'n,* Docket No. 9309 (June 2005), *available at* http://www.ftc.gov/os/adjpro/d9309/050622opinionofthecommission.pdf.

For another patent/antitrust example, but of the "yes but" variety: as presently construed, the *Walker Process* doctrine seems to have a legal gaping hole. Most courts read *Walker Process* to require that the antitrust plaintiff prove not only that the patent was procured by fraud on the patent office, but also that the patent was "enforced." Such a requirement must find its justification in some law other than antitrust. If "enforced" means that a lawsuit alleging infringement must have been filed, then antitrust law leaves unremedied the threat of suit, directed at an alleged infringer or (often with even more serious consequences) the customers of the alleged infringer, even though the simple threat can have, under the wrong circumstances, very serious anticompetitive consequences. The Federal Circuit realized this problem in the *Hydril* case.[12] We wonder why Section 5 would not be an appropriate vehicle to inquire into allegations of anticompetitive misuse of patents by means other than enforcement. Nor need such cases be confined solely to patents procured by fraud. Deceptive threats to sue for infringement can have inefficient, anticompetitive consequences even if there are arguably valid patents underlying the threat.

Although we cannot prove it, we suspect that some of the limitations on antitrust enforcement in the patent area, such as those just mentioned, stem from the fear of unbridled liability for what could, on the surface, appear to be simply the exercise of a statutory right. To the extent that this is so, Section 5, precisely because it does not provide for unbounded liability, becomes an even more attractive (or should we say "less unattractive"?) tool for challenging inefficient anticompetitive cost-raising behavior where it occurs.

3. Cheap Exclusion

As most of you know, we have argued elsewhere that combating what we called cheap exclusion should be high on the list of enforcement priorities for the FTC's Bureau of Competition.[13] Exclusionary practices that are both inexpensive to undertake and incapable of yielding any cost-reducing efficiencies are "cheap" in both senses of that term and are most likely to appeal to any firm bent on acquiring market power by anticompetitive means. From what we have already said, we hope it is apparent that it seems to us that Section 5 could be a significant tool in preventing cheap exclusion, although most forms of cheap exclusion can and should be reached via straightforward application of the Sherman Act.

A common objection to antitrust enforcement against some types of cheap exclusion is that it might "make a federal treble damages case out of a common law tort." As we have noted elsewhere,[14] we do not agree with a legal principle that conduct should be immunized because it is already illegal under another legal principle. Nonetheless, to the extent that concerns about private enforcement under the Sherman Act could threaten to turn many state torts into a federal treble-damages claim, it seems to us that Section 5 might provide the obvious means for proscribing conduct that, while tortious under conventional state law, can at the same time create

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[12] *Hydril v. Grant Prideco,* 474 F.3d 1344 (Fed. Cir. 2007).

[13] Creighton, Hoffman, Krattenmaker & Nagata, Cheap Exclusion, 72 Antitrust L.J. 975 (2005).

[14] *Id.* At 993-94

very substantial competitive harm. In such a case, Section 5 would be performing a "yes, but" role, overcoming a legal obstacle placed in the path of Sherman Act enforcement that is unrelated to antitrust law or policy.

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In conclusion, we should stress that although we have suggested a typology for evaluating whether particular might be worthy of scrutiny under Section 5, we are of course only speaking of proscribing behavior that is shown, after trial, to have serious, measurable anticompetitive consequences without any promise of procompetitive benefits. Apart from *per se* cases, which might include certain kinds of egregious exclusionary acts, any case that does not meet that standard should not be brought under any antitrust regime, in our opinion. An interpretation of Section 5 that crossed this line would cause harm to our economy. Finally, although we do believe that Section 5, enforced by the expert FTC, is in fact a good vehicle for what Congress intended -- to define and proscribe forms of anticompetitive conduct, even if they are hard to analyze under existing Sherman Act precedents – the Commission should be exceedingly cautious in resisting the temptation to use Section 5 simply because, as a matter of statutory authorization, it can.