

THREE RULES AND A CONSTITUTION: CONSUMER PROTECTION FINDS ITS LIMITS IN COMPETITION POLICY

WILLIAM MACLEOD, ELIZABETH BRUNINS & ANNA KERTESZ¹

¹ William MacLeod, a former Bureau Director at the Federal Trade Commission, is a member of the law firm, Collier Shannon Scott. Elizabeth Brunins and Anna Kertesz are associates at the firm. The authors would like to thank Steven Freeland and Jason Levine, both of Collier Shannon Scott, for their contributions to this paper.

Since at least the publication of Nader's Raiders expose² and the American Bar Association's critique,³ the 1960s has been regarded as decade of trivial pursuits for the Federal Trade Commission. The Commission's reputation for chasing small-time con-artists, challenging inconsequential business practices, turning a blind eye to politically connected corporations, and doing it all with a lethargy that exemplified popular notions of bureaucratic inertia, earned it the ridicule of consumer activists and the disdain of the regulatory bar.⁴ That the reality is more complicated than the commentators' accounts should come as no surprise to any student of the agency. Other contributors to this volume describe a number of Commission initiatives from the period that evolved into durable and controversial policies. What might surprise most observers is that the decade of the Commission's supposed timidity produced one of the most consequential rulemakings the agency ever conducted. Indeed a credible argument can be made that in six months in 1964, a rule the Commission proposed and promulgated (but never enforced) was the most important in the history of the agency. The effects of the proceeding were immediate, and they still reverberate today, not only in prosecutions and regulations of the Commission, but also in acts of Congress and decisions of the Supreme Court.

The 1964 proceeding produced a rule (the "Cigarette Rule")⁵ requiring health warnings on cigarette advertisements and packages. In the rationale for the rule, the Commission articulated a definition of unfair acts and practices that would tempt the agency to test the statutory and constitutional limits of its powers to regulate advertising. Fifteen years later, a

²EDWARD COX, ROBERT FELLMETH, & JOHN SCHULZ, THE NADER REPORT ON THE FEDERAL TRADE COMMISSION 72 (Barron Press 1969).

³ American Bar Association, Report of the ABA Commission to Study the Federal Trade Commission, Antitrust and Trade Reg. Rep. No. 427 (BNA) (Special Supplement, Sept. 16, 1969).

⁴ See, e.g., MICHAEL PERTSCHUK, REVOLT AGAINST REGULATION 69-76 (University of California Press 1982).

⁵ Unfair or Deceptive Advertising and Liability of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8324 (July 2, 1964).

chastened Commission revamped the definition in the course of another rulemaking – the Children’s Advertising Rulemaking (or “KidVid”)⁶ – when the 1964 formulation proved inadequate to steer the agency within its legal boundaries. The Rule would provoke the first wave of the rising tide of federal legislation that occupies the field of tobacco marketing regulation today.

This article discusses how the legal legacy of the Cigarette Rule grew over the subsequent decades, how the Children’s Advertising Rulemaking drew upon and added to that legacy, and how the Do Not Call Rule of 2003⁷ benefited from the lessons of both. The similarities among the episodes are striking. Each effort was a cause celebre. Each provoked a Congressional response redefining the authority of the agency. Each threatened to transform entire industries. The differences are well known. Their intended remedies were polar opposites; the first one would have mandated messages where virtually none existed, while the other two were designed to staunch steady streams of speech that were flowing too freely for the officials at the agency. And the proceedings could not have concluded more differently. Although the Cigarette Rule itself never took effect, a variation of the Rule became federal legislation – a qualified Congressional endorsement of the Commission’s initiative. The Children’s Advertising proceeding ended in an abandonment of the effort and a Congressional ban against reinstating it – a rare rebuke for a regulatory agency. The Do Not Call Rule was promulgated expeditiously and is enforced actively – with an enthusiastic endorsement from Congress. Most importantly for this discussion, the three rulemakings have changed the powers of the Commission in ways that the agency could not have accomplished on its own. The

⁶ Children’s Advertising, 43 Fed. Reg. 17,967 (Apr. 27, 1978).

⁷ Do Not Call Rule of 2003, 68 Fed. Reg. 4580 (Jan. 29, 2003).

Cigarette Rulemaking helped persuade the Supreme Court to countenance expanded power for the agency.⁸ The Commission's effort to rescue its unfairness authority from the hostile forces unleashed by the Children's Advertising Rulemaking is now embedded in the United States Code.⁹ And Do Not Call has weathered judicial review.¹⁰

One important principle that connected the three rules and helped establish the limits that constrain the modern consumer protection agenda is not, however, apparent in the records of the proceedings. That principle was the economic theory of advertising. As the Commission began to exercise its new unfairness authority, it also began to reassess the economic role of advertising in the marketplace, a development that stemmed from academic research in the 1960s¹¹ and the Commission's pursuit of unfair methods of competition in the 1970s. Advertising at the time of the Cigarette Rule was still largely regarded as a tool of consumer manipulation that raised prices and impeded competition.¹² By the time the Commission confronted the controversy of KidVid, the agency had conducted economic research documenting the ability of advertising to lower prices, had prosecuted competitors for suppressing advertising,¹³ and had proposed rules prohibiting industry-sponsored advertising restrictions.¹⁴ The agency responsible for ridding the media of unfair and deceptive advertising had become a strong protector and promoter of the

⁸ See *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).

⁹ Compare Letter from James C. Miller III, Chairman, FTC, to Hon. Wendell Ford and Hon. John Danforth, Committee on Commerce, Science and Transportation, United States Senate (December 17, 1980), (hereinafter *Unfairness Policy Statement*), with 15 U.S.C. §45(n) (2004).

¹⁰ *FTC v. Mainstream Mktg. Servs., Inc.*, 358 F.3d 1228 (10th Cir. 2004), *cert. denied*, 125 S. Ct. 47 (2004).

¹¹ George Stigler, *The Economics of Information*, 69 J. POL. ECON., 213, 213-15 (1961).

¹² See, e.g., VANCE PACKARD, *THE HIDDEN PERSUADERS* (David McKay Co. 1957); JOHN K. GALBRAITH, *THE AFFLUENT SOCIETY* (Mariner Books 1958); HARVEY J. GOLDSCHMID ET AL., *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* 114-161 (Little, Brown & Co. 1974).

¹³ *American Med. Ass'n*, 94 F.T.C. 701 (1979), *enforced as modified*, 638 F.2d 443 (2d Cir. 1980), *aff'd per curiam by an equally divided court*, 455 U.S. 676 (1982).

¹⁴ *Advertising of Ophthalmic Goods and Services*, 43 Fed. Reg. 23,992 (June 2, 1978).

information that producers provided to consumers. With the new learning about the role of advertising in the marketplace guiding the Commission's competition policy, it was inevitable that the same insights would influence consumer protection.

The inevitable came to pass in the Children's Advertising Rulemaking. Staff regarded the new ideas about advertising as inapplicable to the commercials that it proposed to curtail when it launched the Rulemaking in 1978. According to the staff proposal, children -- unsophisticated, impressionable, and gullible -- still satisfied the precepts of the manipulative model of advertising. The conclusion followed easily that the Commission could ban commercials for kids without offending the premises underlying the pro-competitive view of advertising. This argument was designed to preserve more than consistency between competition and consumer protection policy; the staff was also preparing to defend the constitutionality of the rule. Just two years earlier in *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*,¹⁵ the Supreme Court had decided to extend First Amendment protection to commercial speech -- relying on the Commission's economic studies of advertising to do justify its decision.¹⁶ Courts of appeals had started to use that decision to curtail Commission orders that restricted more speech than necessary to cure deception.¹⁷

Neither the policies of the competition mission nor the warnings from the courts were enough to dissuade the Commission from launching KidVid. But both guided the Commission through its revision of unfairness policy in 1980 and the disposition of the Rulemaking in 1981. The agency abandoned its effort to control advertising to children because it could not conclude

¹⁵ *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748 (1976).

¹⁶ *Id.* at 754 n.11, 765 n.20 (citing Commission staff report on a study predicting that the effect of the free flow of information from advertising consumer drug prices would be substantial).

¹⁷ See *Standard Oil Co. v. FTC*, 577 F.2d 653 (9th Cir. 1978); *Nat'l Comm'n on Egg Nutrition v. FTC*, 570 F.2d 157 (7th Cir. 1977).

that a ban would advance the stated purpose of the Rule or that a ban could target the allegedly offensive messages without suppressing many more messages of value to the marketplace. In other words, the agency compared the restraint's costs to its benefits and found a serious deficit. The staff recommendation did not declare the proposed ban anticompetitive or unconstitutional, but those conclusions were implicit in an analysis similar to that which the agency undertakes in applying the rule of reason in an antitrust case or the commercial speech doctrine under the First Amendment. Every consumer protection rule or enforcement action that restricts speech now has to satisfy a comparable competitive and constitutional review. Relatively few are tested in court, because the analysis performed in the closing of the Children's Advertising Rule is now second nature to the Commission. Do Not Call is one that has been tested, and it has passed.

I. The Cigarette Rule

The Cigarette Rule set in motion two separate legal developments, both of seminal importance but neither intended by the Commission. As soon as it was promulgated, the Rule precipitated the first specific cigarette legislation in the modern era. Congress, undoubtedly prompted by the Commission, enacted the Federal Cigarette Labeling and Advertising Act ("FCLAA"). FCLAA followed the concept of the Cigarette Rule by mandating disclosures on labeling and advertising, but at least as significant was the effect of the law on all putative regulators of cigarette marketing. FCLAA and its successors guaranteed that no authority other than Congress, at either the state or federal level, would be allowed to engage in substantive lawmaking in the area of smoking and health.

Eight years later, the rulemaking Congress had blocked before it could control cigarette marketing blossomed into a grant of seemingly unbridled authority for the Commission to regulate any other act or practice under its jurisdiction. The Supreme Court, deciding a competition case, adopted the definition of unfair acts and practices directly from the Statement

of Basis and Purpose for the Cigarette Rule and held that the Commission had broader power than the specific proscriptions of existing competition or consumer protection laws.¹⁸ This broad mandate would later invite the Commission to launch its Children’s Advertising proceeding, which nearly cost the agency its ability to regulate advertising under any definition of unfairness.

A. The Commission’s Response to the 1964 Report of the Surgeon General

On January 11, 1964, the United States Surgeon General released the report of the Advisory Committee on Smoking and Health. The conclusion of the report was clear: Smoking causes lung cancer in men. Commissioner Philip Elman assigned his aide, Richard Posner, to draft a proposed rule to advise people of the findings.¹⁹ Seven days later, the Federal Trade Commission issued a *Notice of Proposed Trade Regulation Rule*²⁰ and, in July 1964, promulgated a Final Rule requiring cigarette manufacturers to “disclose, clearly and prominently, in all advertising and on every pack, box, carton or other container ... that cigarette smoking is dangerous to health and may cause death from cancer and other diseases.”²¹

B. Congress Reacts

The Commission had not been proceeding in a vacuum. Tobacco spokesmen questioned the agency’s authority to regulate and threatened litigation to stop the Rule, states began to consider labeling restrictions, and Congress contemplated legislation to authorize the Commission to issue a rule requiring warnings.²² When the Commission did just that, Congress

¹⁸ *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972).

¹⁹ NORMAN I. SILBER, *WITH ALL DELIBERATE SPEED: THE LIFE OF PHILIP ELMAN* 342 (The University of Michigan Press 2004).

²⁰ *See Advertising and Labeling of Cigarettes*, 29 Fed. Reg. 530, 530-32 (Jan. 22, 1964).

²¹ *Unfair or Deceptive Advertising and Liability of Cigarettes in Relation to the Health Hazards of Smoking*, 29 Fed. Reg. at 8375.

²² George Lardner, *Curb Urged on Tobacco Advertising*, WASH. POST, Jan. 12, 1964, at A19. (The bills would also direct the Commission to end its moratorium on tar advertising)

responded with legislation to postpone promulgation of the rule²³ and then requested that the agency postpone enforcement of the rule for six months.²⁴ The Commission complied, and Congress convened hearings to consider various remedial measures. Choosing from among a variety of alternatives (including possible FDA regulation of tobacco), Congress decided to mandate the warnings itself via FCLAA. As the Supreme Court describes it, Congress created a “comprehensive Federal program to deal with cigarette labeling and advertising with respect to any relationship between smoking and health”²⁵ and required that all cigarette packs contain the warning, “Caution: Cigarette Smoking May Be Hazardous to Your Health.”²⁶

While Congress expressly preserved the Commission’s authority under Section 5 of the FTC Act²⁷ to regulate and proscribe “unfair or deceptive acts or practices in the advertising of cigarettes,”²⁸ FCLAA affirmatively prohibited the Commission (and everyone else) from imposing any additional requirements for cigarette labeling.²⁹ Additionally, Congress declared that “[n]o statement relating to smoking and health shall be required in the advertising of any cigarettes the packages of which are labeled in conformity with the provisions of” FCLAA.³⁰ Thus, in response to the Commission’s attempt to regulate cigarette labeling and advertising, Congress modified the outcome of the FTC proceeding, legislated it, and reserved for itself

²³ See Eileen Shanahan, *Court Fight Seen on Tobacco Rule*, N.Y. TIMES, Jun. 26, 1964, at 37.

²⁴ See Associated Press, *House Panel Asks Delay of Warning On Cigarette Packs*, N.Y. TIMES, Aug. 20, 1964, at 41; *Food and Drug Adm’n v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 145 (2000); *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 513-14 (1992).

²⁵ *Brown & Williamson*, 529 U.S. at 148 (quoting Pub. L. No. 89-92 § 2, 79 Stat. 282 1965.).

²⁶ Federal Cigarette Labeling and Advertising Act, Pub. L. 89-92, § 4, 79 Stat. 283 1965.

²⁷ 15 U.S.C. § 45 (2004).

²⁸ Codified 15 U.S.C. § 1336 (2001).

²⁹ Federal Cigarette Labeling and Advertising Act, Pub. L. No. 89-92, § 5(a), 79 Stat. 283 1965.

³⁰ *Id.* at § 5(b).

“exclusive control” over the subject.³¹ This would not be the last time Congress would intervene and amend FTC regulatory activity in the realm of smoking and health.

On July 1, 1969, FCLAA’s prohibition on any additional cigarette labeling and advertising regulations was set to expire.³² Prior to this date, both the FTC and FCC proposed cigarette advertising rules. The FCC’s rule would have banned the broadcast of cigarette advertising on radio and television.³³ The FTC’s proposed rule would have required cigarette manufacturers to disclose on all packages and in all print advertising a warning that “cigarette smoking is dangerous to health and may cause death from cancer, coronary heart disease, chronic bronchitis, pulmonary emphysema, and other diseases.”³⁴

Once again, Congress stepped in and held its own hearings³⁵ which eventually resulted in the passage of the Public Health Cigarette Smoking Act of 1969 (the “1969 Act”).³⁶ The 1969 Act amended FCLAA in certain respects, particularly with regard to congressional preemption. Specifically, Congress extended indefinitely the prohibition on any other regulation of cigarette labeling with respect to smoking and health.³⁷ And while states were barred from imposing any “requirement or prohibition based on smoking and health . . . with respect to the advertising or promotion of any cigarettes the packages of which are labeled in conformity with the provisions” of the Act, Congress again delegated regulatory authority over cigarette *advertising* (not

³¹ *Brown & Williamson*, 529 U.S. at 149.

³² See Federal Cigarette Labeling and Advertising Act, Pub. L. No. 89-92, § 10, 79 Stat. 282 1965.

³³ See Advertisement of Cigarettes, 34 Fed. Reg. 1959 (Feb. 11, 1969).

³⁴ Cigarettes in Relation to the Health Hazards of Smoking, Unfair or Deceptive Advertising and Labeling, 34 Fed. Reg. 7917 (May 20, 1969).

³⁵ See, e.g., *Cigarette Labeling and Advertising – 1969, Hearings Before the House Comm. on Interstate and Foreign Commerce*, 91st Cong. (1969).

³⁶ Cigarette Labeling and Advertising Act, Pub. L. No. 91-222, 87 Stat. 88 1970.

³⁷ *Id.* at § 5(b).

labeling) to the FTC,³⁸ an authority exercised regularly by the Bureau of Consumer Protection,³⁹ and its contingent in the Division of Advertising Practices, headed for many years by a charismatic and aggressive program manager, Judith Wilkenfeld.

C. From FCLAA to Present

In the years that followed, Congress would enact various other statutes regulating the advertising and labeling of tobacco products. For example, in 1984, Congress enacted the Comprehensive Smoking Education Act⁴⁰ which amended FCLAA by requiring cigarette manufacturers to rotate four different health warnings on the labeling of its products warnings bearing the closest resemblance yet to the original rule promulgated by the Commission twenty years earlier.⁴¹ Two years later Congress enacted the Comprehensive Smokeless Tobacco Health Education Act of 1986,⁴² (the “Smokeless Act”) which essentially extended the regulatory provisions of FCLAA to smokeless tobacco products. Like FCLAA, the Smokeless Act prohibited all federal agencies from requiring additional labeling provisions of products that are labeled in accordance with the statute,⁴³ but it charged the FTC with the responsibility for writing the regulations implementing the statute.⁴⁴ Thus, as with cigarettes, Congress reserved for itself

³⁸ Other provisions of the act included: (1) a total ban on cigarette advertisements on any medium regulated by the FCC; and (2) a change in the warning label required on all cigarette packages to: “Warning: The Surgeon General Has Determined That Cigarette Smoking Is Dangerous to Your Health.” *Id.* at § 5(b).

³⁹ Using its authority to prosecute advertising, for example, the Commission required cigarette companies to disclose the Surgeon General’s warnings in advertising.

⁴⁰ Comprehensive Smoking Education Act, Pub. L. No. 98-474, 98 Stat. 2200 1984.

⁴¹ The warnings include the following: “SURGEON GENERAL’S WARNING: Smoking Causes Lung Cancer, Heart Disease, Emphysema, and May Complicate Pregnancy;” “SURGEON GENERAL’S WARNING: Quitting Smoking Now Greatly Reduces Serious Risks to Your Health;” “SURGEON GENERAL’S WARNING: Smoking by Pregnant Women May Result in Fetal Injury, Premature Birth, and Low Birth Weight;” and “SURGEON GENERAL’S WARNING: Cigarette Smoke Contains Carbon Monoxide.”

⁴² Comprehensive Smokeless Tobacco and Health Education Act of 1985, Pub. L. No. 99-252, 100 Stat. 30 1986.

⁴³ *Id.* at § 7(a).

⁴⁴ *Id.* at §§ 3, 5.

the design of smokeless tobacco regulation, gave the Commission carefully constrained authority (with a minor supporting role for the Department of Justice), and trusted no one else to join the action.

D. The Legacy of the Cigarette Rule

The Food and Drug Administration discovered the lasting effect of the Cigarette Rule when it asserted in 1996 that it had jurisdiction to regulate tobacco products.⁴⁵ Ms. Wilkenfeld had left the FTC and its limited jurisdiction over tobacco to join the FDA, which exercised extensive controls over the marketing of drugs and medical devices. Declaring cigarettes to be a device, the FDA promulgated trade regulation rules affecting nearly every aspect of their promotion labeling and sale.⁴⁶ Tobacco manufacturers, retailers, and advertisers filed suit immediately challenging the FDA's jurisdiction and seeking an injunction against enforcement of the rule. The case eventually reached the Supreme Court, which held that the FDA did indeed lack jurisdiction, in large part because of the Cigarette Rule and Congress's reaction to it.⁴⁷

The Supreme Court began its analysis by looking directly at the rulemaking activities of the FTC after the issuance of the 1964 Surgeon General's Report, and the Court concluded that it had been "[i]n response to the Surgeon General's report and the FTC's proposed rule, [that] Congress convened hearings to consider legislation addressing 'the tobacco problem.'"⁴⁸ The result of those hearings – which included several rejected proposals to give the FDA jurisdiction

⁴⁵ Cigarette Rule, 61 Fed. Reg. 44,396, 44,619-45,318 (Aug. 28, 1996) (to be codified at 21 C.F.R. pt. 801, 803, 804, 807, 820, and 897). This assertion of jurisdiction was based on the FDA's conclusion that cigarettes were a "drug" within the meaning of the Food, Drug, and Cosmetic Act ("FDCA"), 52 Stat. 1040, as amended, 21 U.S.C. § 301 *et seq.*, (2004). and that cigarettes and smokeless tobacco products were "combination products" that delivered nicotine into the body. Cigarette Rule, 61 Fed. Reg. at 44,615-618.

⁴⁶ Cigarette Rule, 61 Fed. Reg. at 44,615-618.

⁴⁷ See *Brown & Williamson*, 529 U.S. at 120.

⁴⁸ *Id.* at 144.

over cigarettes – was the enactment of FCLAA.⁴⁹ According to the Court, by enacting FCLAA, Congress had clearly intended to preclude “*any* administrative agency from exercising significant policymaking authority on the subject of smoking and health.”⁵⁰ The Court went on to note that in addition to prohibiting any additional requirements for cigarette labeling, FCLAA also prohibited any agency from requiring additional health warnings in cigarette advertisements.⁵¹ This entire body of regulation, according to the Court, could be attributed to the FTC’s Cigarette Rulemaking: “Thus, in reaction to the FTC’s attempt to regulate cigarette labeling and advertising, Congress enacted a statute reserving exclusive control over both subjects to itself.”⁵²

Although the Commission was unable to enforce its own labeling initiatives, the effects of the Cigarette Rule have endured. The FTC had taken a bold approach to promulgate rulemaking based on a theory of unfairness and precipitated Congressional reactions that amended but did not repudiate the efforts. To be sure, FCLAA’s mandates were milder than the Commission’s remedies, but Congress largely agreed with the agency that there was an immediate need for regulation of tobacco labeling and advertising.⁵³ The regulatory regime inspired by the Rule remains in effect today.

E. 1970s: The Rise and Fall of Rulemaking

Although the Cigarette Rule would not establish the Commission’s authority to regulate

⁴⁹ *Id.* at 147.

⁵⁰ *Id.* at 149 (emphasis original).

⁵¹ *Id.*

⁵² *Id.* The following year, the Supreme Court once again interpreted and applied FCLAA’s pre-emptive provisions, this time to *state* regulatory efforts against tobacco advertising. *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 533 (2001). Again, after discussing the FTC’s 1960s rulemaking, the enactment of FCLAA, and its subsequent amendments, the Supreme Court held that the state’s regulations targeting cigarette advertising were preempted.

⁵³ In contrast, the draftsman of the original Rule, Richard Posner, subsequently disagreed with the approach the Commission had taken. SILBER, *supra* note 18, at 342.

tobacco marketing, it did arm the Commission with a powerful weapon to wield against other industries. That weapon was given (or rather returned) by the Supreme Court to the Commission just at the time when it seemed that all the agency's constituencies were urging it to realize its full regulatory potential. The consumer movement was capitalizing on the success of Ralph Nader's campaign for automobile safety regulations.⁵⁴ Congress was passing a steady succession of laws regulating the economy.⁵⁵ The new Nixon administration heeded the calls of Nader's Raiders and the American Bar Association and appointed a series of strong Chairmen with a mandate to reactivate and revitalize the Commission.⁵⁶ First Casper Weinberger, then Miles Kirkpatrick (Chairman of the ABA Committee), then Lew Engman, reorganized the agency and began to pursue path-breaking causes in both competition and consumer protection.⁵⁷ The proscription of "unfair" practices in Section 5 was a potentially powerful weapon to use in those cases, but it needed ratification to realize that potential.

The Commission was eagerly anticipating (indeed it had sought) the endorsement of the courts of the Cigarette Rule's definition of unfairness. That endorsement came, not in a consumer protection case, but in the Commission's battle with Sperry & Hutchinson ("S&H") over its competitive practices. The Commission had found S&H's distribution practices to be unfair methods of competition. When the case reached the Supreme Court, the agency argued that it did not have to find that the conduct in question violated the letter or spirit of the antitrust

⁵⁴ PERTSCHUK, *supra* note 3, at 30-33.

⁵⁵ *Id.* at 53

⁵⁶ *See, e.g.* KENNETH CLARKSON & TIMOTHY MURIS, *THE FEDERAL TRADE COMMISSION SINCE 1970* 3 (Cambridge University Press 1981).

⁵⁷ *Id.* at 3-5, 237-38 (citing the antitrust cases against the cereal and oil industries, among the competition initiatives, and the substantiation doctrine in consumer protection).

laws – competition could be unfair independent of the proscriptions of those statutes.⁵⁸ The Court agreed, holding that unfairness depended on the criteria laid out in the Statement of Basis and Purpose to the Cigarette Rule:

(1) “Whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law ... or other established concept of unfairness;”

(2) “whether it is immoral, unethical, oppressive, or unscrupulous;” and

(3) “whether it causes substantial injury to consumers (or competitors or other businessmen).”⁵⁹

While the *S&H* decision gave the Commission the substantive power to consider public values outside the law, “like a court of equity,”⁶⁰ a legislative grant handed the Commission the procedural device to wield this power in numerous rulemaking attempts in the 1970s. That grant was the Magnuson-Moss and Federal Trade Commission Improvement Act (“MMFTCIA”) which articulated detailed procedural authority to promulgate industry-wide rules.⁶¹ The Commission had not quit promulgating rules after the Cigarette Rule. Generally modest efforts did not reshape marketing practices; few had provoked retaliation. But by 1975, another industry had made good on the tobacco companies’ threat to challenge the authority of the Commission to promulgate trade regulation rules. This time the product was gasoline and the rule was the requirement to post octane ratings on gas pumps.⁶² The Commission survived the challenge, but doubt remained about its powers. The MMFTCIA removed those doubts in 1975, and

⁵⁸ *Sperry & Hutchinson Co.*, 405 U.S. at 245.

⁵⁹ *Id.* at 244 (citing *Unfair or Deceptive Advertising and Liability of Cigarettes in Relation to the Health Hazards of Smoking*, 29 Fed. Reg. at 8355).

⁶⁰ *Id.*

⁶¹ 15 U.S.C. § 2301 *et seq.* (2004).

⁶² *National Petroleum Refiners v. FTC*, 482 F.2d 672 (D.C. Cir. 1973).

precipitated what has been acknowledged by the Chairman who presided over its climax as a rulemaking “frenzy.”⁶³

The Commission proposed rules that would have: imposed disclosures on over-the-counter medicines; required inspections, disclosures and warranties on used cars; established definitions (like “natural”) for foods; regulated mobile home warranties; and banned certain credit practices, just to name a few. A list of major rulemakings in the 1970s reveals a wide array of proceedings that left the Commission with a bulging docket in the late 1970s.

Major 1970s Rulemakings		
	Initial Proposal	Final Disposition⁶⁴
Octane Labeling	1969	Issued 1971
Care Labeling	1969	Issued 1971
Use of negative-option plans	1970	Issued 1973
Cooling-off period for door-to-door sales	1970	Issued 1972
Holder-in-due course I	1971	Issued 1975

⁶³ PERTSCHUK, *supra* note 16 at 54.

⁶⁴ Octane Labeling, 36 Fed. Reg. 23,871 (Dec. 16, 1971) (to be codified at 16 C.F.R. pt. 422); Care Labeling, 36 Fed. Reg. 23,883 (Dec. 16, 1971) (to be codified at 16 C.F.R. pt. 423); Use of negative-option plans, 38 Fed. Reg. 4896 (Feb. 22, 1973) (to be codified at 16 C.F.R. pt. 425); Cooling-off period for door-to-door sales, 37 Fed. Reg. 22,934 (Oct. 26, 1972) (to be codified at 16 C.F.R. pt. 429); Holder-in-due course I, 40 Fed. Reg. 3506 (Nov. 18, 1975), 41 Fed. Reg. 5305 (Feb. 5, 1976) (to be codified at 16 C.F.R. pt. 433); Mail order merchandise, 40 Fed. Reg. 49,492 (Oct. 22, 1975) (to be codified at 16 C.F.R. pt. 435); Franchises and business ventures, 43 Fed. Reg. 59,614 (Dec. 21, 1978) (to be codified at 16 C.F.R. pt. 436); Advertising Premiums to Children, 42 Fed. Reg. 15,069 (Mar. 18, 1977); Vocational schools, 53 Fed. Reg. 29,482 (Aug. 5, 1988); Credit practices, 49 Fed. Reg. 47,041 (Nov. 30, 1984) (to be codified at 12 C.F.R. pt. 227); Mobile homes, 51 Fed. Reg. 39,234 (Oct. 27, 1986); Food advertising, 47 Fed. Reg. 48,927 (Oct. 28, 1982); Hearing aids, 50 Fed. Reg. 44,971 (Oct. 29, 1985); Prescription drugs, 43 Fed. Reg. 54,951 (Nov. 24, 1978); Cellular plastics, 45 Fed. Reg. 3060 (Jan. 16, 1980); Health spas (The termination of rulemaking was decided by a unanimous vote of the Commission and did not appear in the Federal Register. *See, e.g.,* Randolph E. Schmid, The Associated Press, Dec. 18, 1985); Protein supplements, 50 Fed. Reg. 18,118, 18,127 (Apr. 29, 1984); Funeral rule, 47 Fed. Reg. 42,260 (Sep. 24, 1982) (to be codified as 16 C.F.R. pt. 453); OTC drugs, 46 Fed. Reg. 24,584 (May 1, 1981); Holder-in-due course II, 53 Fed. Reg. 44,456 (Nov. 3, 1988); Used cars, 46 Fed. Reg. 41,328 (Aug. 14, 1981) (to be codified as 16 C.F.R. 455); Care labeling, 48 Fed. Reg. 22,733 (May 20, 1983) (to be codified as 16 C.F.R. pt. 423); Ophthalmic practices I, 43 Fed. Reg. 23,992 (June 2, 1978) (to be codified at 16 C.F.R. pt. 456); Antacid advertising, 49 Fed. Reg. 46,156 (Nov. 23, 1984); Thermal insulation, 44 Fed. Reg. 50,218 (Aug. 27, 1979) (to be codified as 16 C.F.R. pt. 460); Children’s advertising (KidVid), 46 Fed. Reg. 48,710 (Oct. 2, 1981); Standards and certification, 50 Fed. Reg. 44,962, 44,971 (Oct. 29, 1985); Ophthalmic practices II (Rulemaking vacated by California State Board of Optometry v. FTC, 285 U.S. App. D.C. 476; 910 F.2d 976; 1990 U.S. App. LEXIS 14881; 1990-2 Trade Cas. (CCH) P69,155 (D.C. Cir. 1990)); *see also* William C. MacLeod & Robert A. Rogowsky, *Consumer Protection at the FTC during the Reagan Administration*, in REGULATION AND THE REAGAN ERA: POLITICS, BUREAUCRACY AND THE PUBLIC INTEREST (Roger E. Meiners & Bruce Yandle eds., 1989). This list does not include numerous initiatives regulating relatively minor aspects of marketing and advertising that flowed from the Commission in the 1960s and early 1970s

Mail order merchandise	1971	Issued 1975
Franchises and business ventures	1971	Issued 1978
Advertising Premiums to Children ⁶⁵	1974	Terminated 1977
Vocational schools	1974	Terminated 1988 ⁶⁶
Credit practices	1975	Issued 1984
Mobile homes	1975	Terminated 1986
Food advertising	1975	Terminated 1982
Hearing aids	1975	Terminated 1985
Prescription drugs	1975	Terminated 1978
Cellular plastics	1975	Terminated 1980
Health spas	1975	Terminated 1985
Protein supplements	1975	Terminated 1984
Funeral rule	1975	Issued 1982
OTC drugs	1975	Terminated 1981
Holder-in-due course II	1975	Terminated 1988
Used cars	1976	Issued 1981
Care labeling	1976	Issued 1983
Ophthalmic practices I	1976	Issued 1978
Antacid advertising	1976	Terminated 1984
Thermal insulation	1977	Issued 1979
Children's advertising (KidVid)	1978	Terminated 1981
Standards and certification	1978	Terminated 1985
Ophthalmic practices II	1980	Vacated 1990

The agency proposed over two dozen industry-wide rules from 1971 through 1980 (ten years that spanned two political administrations), with the great majority riding the wave of the MMFTCIA. And the proposed rules were just a harbinger of what the Commission's leaders had in mind. President Carter's Chairman, Michael Pertschuk, who inherited most of these proceedings from his predecessor, suggested that the Commission was far from done. Whole new categories of potential rules could be based on public policy grounds, he announced – for example, to prohibit businesses from hiring illegal aliens, to prevent companies from cheating on taxes, and to require companies with repeated environmental violations to place an

⁶⁵ The Premium Proceeding would have produced a guide, rather than a trade regulation rule, but a conclusion that premiums were likely to violate section 5 would have had an effect akin to a rule.

⁶⁶ The rule was originally promulgated in 1978, but vacated and remanded in 1979. *Katherine Gibbs Schools (Inc.) v. FTC*, 612 F.2d 658 (2d Cir. 1979), *reh'g denied*, 628 F.2d 755 (2d Cir. 1979).

environmentalist on their Boards.⁶⁷ Whether the nature or the number was more impressive is hard to say:

In the mid-seventies, there were gestating with the womb of the FTC alone as many as thirty to forty major investigations, studies, cases, and rule-making proceedings, each as potentially as significant – and as threatening to some segments of business – as the truth-in-lending bill or the fair packaging and labeling bill, business *causes celebres* of a decade earlier.⁶⁸

Few of these ever made their way into the Federal Register, but the activity underway by 1977 was already enough to foment serious resistance. The Funeral Rule, the Used Car Rule, and the challenges to doctors’ and lawyers’ advertising restraints, among others, had mobilized opposition to the Commission from very powerful constituents in Congressional districts across the land.⁶⁹ There is no question, however, that one rule in particular ignited the controversy that changed the course of unfairness and the Commission’s consumer protection mission.

II. Discovering the Limits of Unfairness With Children

A. The Children’s Advertising Rulemaking Bursts the Regulatory Bubble

As Chairman Muris described it, “The pinnacle of unfocused unfairness theories in rulemakings concerned children’s advertising.”⁷⁰ More than any other initiative, this was the proceeding that would brand the Commission as an undisciplined regulator, and the most indelible brand was applied by a typically friendly observer. The *Washington Post* called it a “preposterous intervention that would turn the agency into a great national nanny.”⁷¹ Well described elsewhere in this volume, the Commission proposed a rule that would ban all

⁶⁷ TIMOTHY J. MURIS & J. HOWARD BEALES, *THE LIMITS OF UNFAIRNESS UNDER THE FEDERAL TRADE COMMISSION ACT 14* (Ass’n of Nat’l. Advertisers, Inc. 1991) (hereinafter 1991 MONOGRAPH).

⁶⁸ PERTSCHUK, *supra* note 3 at 54.

⁶⁹ *Id.* at ch. 3.

⁷⁰ Chairman Timothy J. Muris, Remarks at the Aspen Summit: Cyberspace and the American Dream (Aug. 19, 2003) (at <http://www.ftc.gov/speeches/muris/030819aspen.htm>) (hereinafter Aspen Remarks).

⁷¹ Editorial, *The FTC as National Nanny*, WASH. POST, Mar. 1, 1978, at A22.

advertising to young children, ban advertising of the most heavily sugared products to older children, and require advertising or Public Service Announcements promoting good health to provide balance against commercials for other sugared foods.

The legal premise for the proposal was a 346-page staff report that concluded children were unable to discern the persuasive intent of advertising, that the sugared products advertised were not desirable, that the advertising caused children to eat more of the undesirable products, and that few if any of the justifications for advertising could be applied to children.⁷² It followed that the advertising was itself unfair and deceptive and that its elimination from the airwaves could curb the incidence of dental caries in children. The Commission had impressive authority on its side; one of the advocates of the Rule was the Commissioner of the FDA, who had urged the FTC to protect kids from the commercials that lured them to caries-causing products. Citing a report from the Life Science Research Office of the Federation of American Societies for Experimental Biology that had attributed dental caries to then-current levels of sugar consumption, the Commissioner wrote:

In view of the large amounts of advertising -- particularly television advertising -- that are directed to children urging them to consume a seemingly endless variety of sugared products and the substantial likelihood that children will be unable to appreciate the long-term risks to dental health that consumption of these products will create, I strongly support action by the Federal Trade Commission to regulate the advertising of these products directed to children.⁷³

After three years of research, hearings, and submissions, the staff possessed a massive record, but all of that evidence failed to establish a link between television viewing by children

⁷² FEDERAL TRADE COMMISSION, FTC STAFF REPORT ON TELEVISION ADVERTISING TO CHILDREN (Mar. 14, 1978) (hereinafter 1978 STAFF REPORT).

⁷³ Letter from Donald Kennedy, Commissioner, Food and Drug Administration, to Michael Pertschuk, Commissioner, Federal Trade Commission 2 (Dec. 19, 1977) (on file with Federal Trade Commission). The letter is reproduced in Appendix A of the FTC Staff Report. (Appendix B contains the American Dental Association's call for a ban of advertising of sugared products on children's television. Council on Dental Health, American Dental Association, Public Message on Sugar and Dental Health (undated)).

and dental caries. The proceeding could not resolve the fundamental question whether a ban would reduce the injury to consumers that the rule was intended to address. There remained, at least among the staff, a deep desire to do something. They were still skeptical about children's ability to understand advertising,⁷⁴ which suggested that suspicion still ran high as to whether the advertising was deceptive. (Congress had since removed the theory of unfairness from the proceeding.) But even if it were deceptive, said the staff, a ban would probably be the only measure that offered any hope of addressing the problem.⁷⁵ Declaring a ban impractical because it would be both over-inclusive and under-inclusive,⁷⁶ the staff recommended, and the Commission decided,⁷⁷ to abandon the rulemaking effort. The Commission concluded that KidVid was "not in the public interest."⁷⁸

B. The Legacy of the Children's Advertising Rule

The termination of the Rulemaking in 1981 seemed little more than an epilogue to a saga that saw its climax a year earlier. The siege of the Commission that had begun with the announcement of the rulemaking would not abate until 1980, when Congressional leaders and the White House compromised on the extent to which the agency's regulatory authority would be restricted.⁷⁹ One of those restrictions was that the Commission would not be allowed to use unfairness as a basis for promulgating any trade regulation rules against advertisements, which

⁷⁴ FEDERAL TRADE COMMISSION, FTC FINAL STAFF REPORT AND RECOMMENDATION, 34-35 (Mar. 31, 1981) (hereinafter FINAL STAFF REPORT) ("In summary, the rulemaking record establishes that the specific cognitive abilities of young children lead to their inability to fully understand child-oriented television advertising, even if they grasp some aspects of it. . . .As a result, children are not able to evaluate adequately child-oriented advertising.")

⁷⁵ *Id.* at 36-47.

⁷⁶ *Id.*

⁷⁷ Children's Advertising, 46 Fed. Reg. 48,710, 48,714 (Oct. 2, 1981).

⁷⁸ Press Release, FTC, FTC Ends Children's Advertising Rulemaking (Sept. 30, 1981) (on file with author).

⁷⁹ The story is colorfully told in PERTSCHUK, *supra* note 3.

left only a theory of deception to justify any proposed Rule. Nonetheless, the staff recommendation to terminate the proceeding was a significant development in its own right. It marked a sharp contrast to the Staff Report that launched the rulemaking, and it was a harbinger of the kind of analysis that awaited the many proposed rules that were fermenting within the Bureau of Consumer Protection.

A comparison of the 1978 Staff Report with the 1981 Final Report reveals remarkable developments in the approach to advertising. The 1978 Report had concluded that none of the classical economic justifications (such as providing information), indeed none at all, justified advertising to children.⁸⁰ The 1981 Report recited the Commission's longstanding recognition of the value of truthful advertising, including advertising to children,⁸¹ and found evidence that children can learn from commercial communications.⁸² The 1978 Report called advertising to kids "unconscionable,"⁸³ a conclusion nowhere to be found in the 1981 Report. In 1978, advertising was blamed for fomenting child-parent conflict,⁸⁴ another finding absent from the 1981 Report. The staff did acknowledge in 1978 that "certain problems will have to be solved in tailoring protections specifically for that part of the audience too young to appreciate...comprehend or evaluate, commercials," but it noted that the Commission would be able to exercise its discretion in drawing such lines, "recognizing that it can never be done perfectly."⁸⁵ In 1981, the staff reached the opposite conclusion about the Commission's ability

⁸⁰ 1978 STAFF REPORT, *supra* note 70, at 226. (citing Joan Ganz Cooney, president of the Children's Television Workshop, and producer of Sesame Street and The Electric Company).

⁸¹ FINAL STAFF REPORT, *supra* note 72, at 5.

⁸² *Id.* at 88-89.

⁸³ 1978 STAFF REPORT, *supra* note 70, at 220.

⁸⁴ *Id.* at 103-4.

⁸⁵ *Id.* at 227-28.

to draw a line,⁸⁶ and the Commission agreed. The 1978 Report found advertising for sugared products to be false, misleading, and deceptive because it appealed to children too young to understand they were being solicited, it influenced their attitudes about the advertised products, and it failed to disclose the harm of eating the advertised products.⁸⁷ In 1981, the staff agreed that some children were too young to understand, but the staff could not conclude that advertising affected their attitudes about food and could not conclude that the advertised foods were contributing to dental caries.⁸⁸

What explains the differences in the two staff reports? The easy answer is that the Commission recognized that the political climate in 1981 (or 1978, for that matter) would not tolerate a National Nanny at the FTC. Former Chairman Pertschuk subscribed to this view.⁸⁹ But nowhere in the 1981 Report can one find the conclusion or implication that the proceeding should be abandoned because it was not politically correct. Instead, the staff undertook a painstaking assessment of the evidence supporting the notion that children relied to their detriment on the advertisements of sugared foods. Because the evidence did not support what had seemed so clear three years earlier, the staff recommended termination, and a relieved Commission agreed. To be sure, the political pressure on the Commission provided the motivation for the principled approach that the agency took in 1981, but it was the methodology of the approach, not any motivation behind it, that influenced consumer protection in the 1980s. In the end, KidVid forced the Commission to choose new principles to govern advertising regulation. Those principles came in part from the agency's own competition policy, and they

⁸⁶ FINAL STAFF REPORT, *supra* note 72, at 36-47

⁸⁷ 1978 STAFF REPORT, *supra* note 70, at 157-69.

⁸⁸ FINAL STAFF REPORT, *supra* note 72, at 48-57, 82-86.

⁸⁹ PERTSCHUK, *supra* note 3, at 47-68.

not only helped change consumer protection at the Commission; they helped change constitutional doctrine at the Supreme Court.

Although the 1978 Staff Report acknowledged in passing and dismissed as irrelevant the “classical justifications” for advertising, the staff devoted a great deal of analysis to explain why a recent Supreme Court decision that had extended First-Amendment protection to commercial speech would not impede the rule. Before 1976, the Commission had seldom confronted constitutional limits to its power to restrict advertising. For decades, the Supreme Court had denied free-speech protections to purely commercial advertisements – *i.e.*, communications that merely proposed commercial transactions – and the Commission was accustomed to regulating them without the Constitutional constraint that is familiar today.⁹⁰ The Supreme Court changed that in *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*, when it reasoned in a passage now famous:⁹¹

Advertising, however tasteless and excessive it sometimes may seem, is nonetheless dissemination of information as to who is producing and selling what product, for what reason, and at what price. So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that those decisions, in the aggregate, be intelligent and well informed. To this end, the free flow of commercial information is indispensable.⁹²

One of the precedents the Court cited for this proposition was the concurring opinion of Justice Harlan in a competition case – *Federal Trade Commission v. Procter & Gamble Company*.⁹³

⁹⁰ One such unconstrained regulation was a Commission request to the cigarette industry to refrain from advertising the health or safety implications of smoking. SILBER, *supra* note 18, at 341. That request ended the era of health claims and tar comparisons that had been increasingly evident in cigarette marketing in the 1950s. See John E. Calfee, *The Ghost of Cigarette Advertising Past*, REGULATION, Volume 20, Number 3, 1997.

⁹¹ 425 U.S. 748 (1976).

⁹² *Id.* at 765.

⁹³ 386 U.S. 568, 603-604 (1967) (Harlan, J., concurring)

Harlan had agreed with the Court's decision in that case to affirm the Commission's order to block a merger but had criticized the Commission's view of the merits of advertising. In the words that would sway the Court in *Virginia State Board*, Harlan had written:

The Commission – in my opinion quite correctly – seemed to accept the idea that economies could be used to defend a merger, noting that “[a] merger that results in increased efficiency may, in certain cases, increase the vigor of competition in the relevant market.” 63 F.T.C., at .[sic] But advertising economies were placed in a different classification since they were said “only to increase the barriers to new entry” and to be “offensive to at least the spirit, if not the letter, of the antitrust laws.” *Ibid.* Advertising was thought to benefit only the seller by entrenching his market position, and to be of no use to the consumer.

I think the Commission's view overstated and oversimplified. Proper advertising serves a legitimate and important purpose in the market by educating the consumer as to available alternatives. . . . Undeniably advertising may sometimes be used to create irrational brand preferences and mislead consumers as to the actual differences between products, but it is very difficult to discover at what point advertising ceases to be an aspect of healthy competition. See Bork, *Contrasts in Antitrust Theory: I*, 65 *Col. L. Rev.* 401, 411, n. 11. It is not the Commission's function to decide which lawful elements of the “product” offered the consumer should be considered the symptoms of industrial “sickness.”⁹⁴

Procter & Gamble, another product of the Commission's supposedly somnolent sixties, was a merger decision that expanded the limits of the Commission's competition powers to control the structure of industries, but it was not the last time the Commission attacked advertising itself as anticompetitive conduct. For example, the cereal manufacturers facing the KidVid proposal in the Bureau of Consumer Protection were also defending themselves in the Bureau of Competition from allegations that their advertising fueled wasteful “brand proliferation” and raised entry barriers in the Commission's “shared monopoly” case filed in 1972.⁹⁵ But by the mid-1970s, advertising was far more likely to arise in antitrust investigations as an aspect of competition that some group of competitors might be illegally suppressing. The Commission

⁹⁴ *Id.* (footnote omitted)

⁹⁵ *Kellogg Co.*, 99 F.T.C. 8 (1982).

charged that the American Medical Association's ethical rules that prohibited advertising were an unfair method of competition and began considering rules to prevent trades and professions from operating under self-imposed advertising bans.⁹⁶ In fact, the first Magnuson-Moss rule promulgated was a rule to lift various restraints on the information that eye-care professionals provided consumers. And another rulemaking initiative of the Commission gave the Supreme Court in *Virginia State Board* a factual basis to support its conclusion that advertising delivered important benefits to consumers. At stake in the case was a ban on pharmacies' advertisements of drug prices. Noting that expenditures on drugs in the United States exceeded \$9 billion, the Court cited the Commission's work to document the effect that information could have on these expenditures:

The task of predicting the effect that a free flow of drug price information would have on the production and consumption of drugs obviously is a hazardous and speculative one. It was recently undertaken, however, by the staff of the Federal Trade Commission in the course of its report on the merits of a possible Commission rule that would outlaw drug price advertising restrictions. The staff concluded that consumer savings would be "of a very substantial magnitude, amounting to many millions of dollars per year."⁹⁷

The Court recognized that benefits like these could be critical to consumers. "As to the particular consumer's interest in the free flow of commercial information, that interest may be as keen, if not keener by far, than his interest in the day's most urgent political debate."⁹⁸ This interest — an interest in competitive markets — justified extending the First Amendment's protections to commercial speech.

A year later, the Supreme Court reiterated the reasoning of *Virginia State Board* and applied it to advertising by attorneys. Again citing Harlan's concurrence in *Procter & Gamble*,

⁹⁶ *American Med. Ass'n*, 94 F.T.C. 701.

⁹⁷ *Virginia State Board Of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. at 765.

⁹⁸ *Id.* at 763.

and again citing economic work done in connection with the Commission staff's investigation of drug advertising, the Court observed that it "is entirely possible that advertising will serve to reduce, not advance, the cost of legal services to consumers."⁹⁹ Arizona could not ban advertising by lawyers, just as Virginia could not ban advertising by pharmacists, in large part because the new competition policy at the Commission had also become a policy vindicated by the First Amendment.

It did not take long for the implications of this decision to affect the advertising prosecutors at the Commission. In *National Commission on Egg Nutrition v. Federal Trade Commission*,¹⁰⁰ the FTC had issued an order directing the egg trade association to cease advertising that deceptively characterized the science concerning cholesterol, heart disease, and egg consumption. The order required future advertisements by the National Commission on Egg Nutrition to contain a disclaimer that medical experts believe egg consumption may increase the risk of dietary cholesterol and heart disease. The Court of Appeals for the Seventh Circuit overturned that requirement as a violation of the First Amendment. In language that would foreshadow FTC rulemaking and Congress's reaction in the years that followed, the court wrote, "The First Amendment does not permit a remedy broader than that which is necessary to prevent deception."¹⁰¹ The Ninth Circuit pared back another order of the Commission because of similar concerns,¹⁰² and both the Third Circuit and the D.C. Circuit reviewed Commission orders for

⁹⁹ Bates et al. v. State Bar of Arizona, 433 U.S. 350, 378 n.34 (1977) (citing Benham, *The Effect of Advertising on the Price of Eyeglasses*, 15 J. Law & Econ. 337 (1972) and JOHN F. CADY, RESTRICTED ADVERTISING AND COMPETITION: THE CASE OF RETAIL DRUGS (American Enterprise Institute for Public Policy Research 1976)).

¹⁰⁰ 570 F.2d 157 (7th Cir. 1977).

¹⁰¹ See *id.* at 164.

¹⁰² Standard Oil Co. v. FTC, 577 F.2d 653 (9th Cir. 1978).

conformance with commercial speech protections.¹⁰³ Parties representing advertisers in the KidVid proceeding challenged the staff to explain how it could propose a ban in the face of these precedents. The staff did not answer the challenge directly, since it had decided to terminate the rulemaking, but staff clearly responded by acknowledging that it could not fashion an effective ban in the first place. That acknowledgement would have been more than adequate to find any ban unconstitutional.

The absence of any analysis of whether children’s advertising was unconscionable also has a simple explanation. The FTC Improvements Act of 1980 (“FTCIA”)¹⁰⁴ revoked the Commission’s authority to promulgate any rule invoking a theory of unfairness to govern advertising and terminated other proceedings. The Commission had seen this coming and had tried to avert it by narrowing its expansive definition of unfair acts and practices – the definition articulated in the Cigarette Rule and approved in *S&H*. In 1980, the FTC issued its Unfairness Policy Statement, rejecting the “immoral, unscrupulous, or unethical test” of the Cigarette Rule. The Commission explained that the proper role for public policy concerns in an unfairness analysis is in balancing the costs and benefits of any proposed action. The Unfairness Statement laid out a three-part test to determine whether a practice that causes consumer injury is unfair: The injury (1) “must be substantial;” (2) “must not be outweighed by countervailing benefits to consumers or competition that the practice produces;” and (3) “must be an injury that consumers

¹⁰³ *Beneficial Corp. v. FTC*, 542 F.2d 611, 619-20 (3d Cir. 1976), *cert denied*, 430 U.S. 983 (1977); *Warner-Lambert Co. v. FTC*, 562 F.2d 749 (D.C. Cir. 1977), *appeal dismissed*, 435 U.S. 950 (1978).

¹⁰⁴ Pub. L. No. 96-252, 94 Stat. 374 (1980). Some of the other main provisions included the following: directing the FTC to publish a preliminary regulatory analysis for each proposed rule, and a final regulatory analysis for each final rule; requiring a semiannual regulatory agenda listing the rules that the FTC expected to propose or promulgate in the upcoming year; eliminating the existent criminal penalties for failure to comply with a subpoena or lawful requirement of the Commission; suspending the children’s advertising proceeding until the Commission complied with a new rulemaking provision; and directing the FTC to submit any final rule it promulgated to Congress for review.

themselves could not reasonably have avoided.”

Because of the 1980 FTCIA, KidVid escaped the application of this new unfairness analysis. But there is little doubt that without KidVid, the Commission would not have found it necessary to announce a policy that so significantly limited the agency’s discretion and committed it to an economically based approach to unfairness. So the rule that represented the pinnacle of undisciplined unfairness left us with an unfairness doctrine that would govern the agency for the next twenty-five years.

Interestingly, the FTC’s Unfairness Policy Statement’s three prongs bear more than a passing resemblance to the analysis the Supreme Court requires for extending protection to commercial speech under the First Amendment. Compare the Unfairness Policy’s¹⁰⁵ three elements to the three prongs of *Central Hudson Gas & Electric Corporation v. Public Service Commission*:¹⁰⁶

- Unfairness Policy Statement – declared that unfairness would not be invoked to prohibit a practice unless it caused an injury (1) that must be substantial; (2) not outweighed by countervailing benefits to consumers or competition that the prohibition would displace; and (3) not reasonably avoidable absent the prohibition; and
- *Central Hudson* -- decided in the same year the FTC’s Unfairness Statement was released -- (1) the asserted governmental interest must be substantial; (2) the regulation must directly advance the governmental interest asserted; and (3) the government regulation may not be more extensive than necessary to serve that interest.

In the 1980s, the Commission harvested the fruits of the economic formulation of its unfairness authority.¹⁰⁷ The first economist ever to head the agency, Jim Miller, appointed Tim Muris to direct the Bureau of Consumer Protection. Although not formally trained as an

¹⁰⁵ *Unfairness Policy Statement*, *supra* note 8.

¹⁰⁶ 447 U.S. 557, 566 (1980).

¹⁰⁷ *See* Stephen Calkins, *FTC Unfairness: An Essay*, 46 WAYNE L. REV. 1935 (2000).

economist, much of Professor Muris's work was as suitable for economic journals as law reviews. (One of those publications was a book containing extensive legal and economic criticism of rulemaking at the agency, with whole chapters devoted to certain rules.)¹⁰⁸ More importantly for the Bureau, two of his top appointees reviewing staff recommendations, Howard Beales and Fred McChesney, counted Ph.D.s in economics among their credentials. Another Ph.D., Robert Rogowsky, would succeed them. This team led the effort to apply economic analysis and the new definition of unfairness to the remnants of its 1970s rulemaking, resulting in the cancellation or abandonment of most of those efforts. Abandoned were the rules proposing to regulate over-the-counter drug advertising, food advertising, health spas, hearing aids, and mobile homes.¹⁰⁹

- In response to complaints about malfunctioning hearing aids, the Commission proposed a rule to prevent unfair acts of hearing aid manufacturers. Eventually, the FTC opted for a case-by-case enforcement in lieu of an industry-wide rule, in large part because the evidence did not support widespread unfairness across the industry.
- The health spa rule was designed to prevent allegedly unfair acts of spa owners, such as front-loaded costs of membership, inconvenient hours of operation, etc. But, again, the evidence in the record revealed efficiencies in some of the practices and only instances of questionable activities, not widespread unfair practices across the industry. The rulemaking was terminated.
- The mobile home rule failed because it would have cost consumers twice as much as it might have offered in benefits, and the evidence in the record demonstrated that most mobile home buyers received warranty service within a reasonable time without the rule.
- The staff analyzed numerous requirements on for-profit vocational schools, including a 14-day cooling off period, pro-rata refunds, and mandatory disclosures of dropout and graduation rates. One by one, the measures failed a rigorous cost benefit test, and the FTC abandoned the

¹⁰⁸ KENNETH CLARKSON & TIMOTHY MURIS, *supra* note 55.

¹⁰⁹ *Id.*

rule.

The decision in *International Harvester*¹¹⁰ secured the Unfairness Statement as legal Commission precedent. The precedent became binding on the Commission in Congress's codification of the FTC's 1980 unfairness policy in 1994. In the process, Congress abolished public policy as an element of unfairness, even though the FTC had largely abandoned it from its unfairness test in 1980.

Without the Unfairness Policy Statement, would the Commission have chosen a similar vehicle to revamp its deception and substantiation policies? We cannot say. But it is beyond doubt that the Statement designed to quell the unrest created by KidVid provided a model for all three pillars of consumer protection law. Indeed, the circumstances leading up to the adoption of the Deception Policy Statement involved some of the same constituencies as the debate over unfairness. Miller and Muris came to the Commission convinced that the agency's problems stemmed from the vague and flexible limits of its authority. The Commission had made considerable progress clarifying that authority with respect to unfairness but the law on deception offered great temptation for the Commission staff to find products it deemed undesirable, like those ensnared in KidVid, and declare any advertising for them deceptive for failing to disclose their undesirable features. In a memo to the Commission in 1982,¹¹¹ Muris described numerous cases and proposals that had invoked the FTC Act's sanction against deceptive acts and practices to justify dubious challenges:

- A 1979 Staff report recommending that subjective claims get “closer legal scrutiny.”

¹¹⁰ *In re International Harvester Co.*, 104 F.T.C. 949 (1984).

¹¹¹ Memorandum from Timothy J. Muris, Commissioner, FTC to Federal Trade Commission (March 25, 1982) (on file with author).

- A Deputy Bureau Director suggesting the Commission pursue a commercial showing a happily married couple on the grounds that the advertiser could not prove its product would generate marital bliss.
- A consent agreement prohibiting an auto manufacturer from advertising Road & Track Magazine's reviews of cars unless the manufacturer could back them up.
- A lawsuit against challenging claims that a hair dye was permanent when it failed to color hair yet to be grown.

Muris's remedy to prevent cases like these from distracting future Commissions was to codify the standard for deception. Opposition from then-Commissioner Pertschuk, who stayed on the Commission after Miller succeeded him as Chairman and still wielded some influence on Capital Hill, stymied Congressional action on either unfairness or deception. But the Commission did issue, over his dissent, a Deception Policy Statement that stands as a counterpart to the Unfairness Policy Statement of 1980. Incorporated into the *Cliffdale Associates* case,¹¹² the Deception Policy Statement is now well embedded in federal and state decisions defining deceptive practices. Codification would not achieve much more certainty.

Since the 1994 codification of its unfairness authority for rulemaking, the Commission has been reluctant to use its regained authority to promulgate rules against advertising on the basis of unfairness. It has not been until fairly recently that the FTC's rulemaking would once again spur significant public debate regarding governmental restriction on commercial speech, and this rule was based not on Section 5, but on a specific authorization from Congress. Nonetheless, the rule set the stage for the latest struggle over the constitutional limits of the Commission's powers. The Do Not Call registry from the Telemarketing Sales Rule ("TSR") would test the Commission against the commercial speech doctrine that had grown out of the

¹¹² *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 175-83 (1984).

agency's own competition policy.

III. The Telemarketing Sales Rule (the "TSR")

A. National Do-Not-Call ("DNC") Registry

In 2003, the FTC created the National Do-Not-Call ("DNC") Registry, the result of rulemaking pursuant to the 1995 Telemarketing Act. Its most important features include an opt-out provision, allowing individuals the opportunity to select not to receive telephone calls from solicitors. Conversely, the TSR provides an exemption for telemarketers who have the express permission of the individual call recipient. In addition, telemarketers may call individuals with whom they have an "established business relationship." Solicitations from charitable organizations are only subject to an opt-in company specific do-not-call restriction.

The DNC Rule spurred immediate controversy. Not since the KidVid era had the Commission pursued rulemaking and restrictions on commercial speech with the reach of what had failed two decades earlier; this time, however, the Commission acted pursuant to a Congressional mandate. In response to its proposal for a national DNC registry, the Commission received more than 64,000 comments.¹¹³ While consumers, consumer groups, and state law enforcement agencies generally favored the DNC list, business and industry objected to the proposed restrictions on free speech in an open economy.¹¹⁴ Proponents of the Rule weighed the cost against the benefits, claiming that the value of consumers' privacy outweighed the costs to businesses of a cessation in telemarketing. That is, those in favor argued that the DNC Rule provides a mechanism by which consumers may avoid unwanted interruptions on their time and in their homes. Opponents relied on another cost-benefit test, claiming that the cost of

¹¹³ Do Not Call Rule of 2003, 68 Fed. Reg. at 4582.

¹¹⁴ *See id.* at 4582-83.

suppressing speech generating enormous value to consumers in goods and services subsequently purchased outweighed the benefits to consumers of a quiet telephone. Thus, the battle lines were drawn for the court challenge. After an initial skirmish over whether Congress had authorized the Commission to issue the rule, the issue became not whether the Commission held the authority to enact the Rule but whether it had the power to enact a rule that distinguished between types of speech based on the caller. What began as a clear mandate from Congress to restrict telemarketing sales calls found its way into the courts.

B. Mainstream Marketing Services v. FTC

Seizing on the distinction made by the FTC between commercial telemarketing and calls from charitable organizations, the District Court in the case of *Mainstream Marketing Services v. Federal Trade Commission*¹¹⁵ found that the DNC list was a sufficiently significant governmental intrusion on commercial speech to warrant First Amendment analysis under *Central Hudson*. Applying *Central Hudson*'s three-pronged commercial speech analysis, the District Court held that the FTC failed to satisfy the second prong: Does the restriction directly advance the government's interest? The court found that by exempting charitable solicitors from the DNC list, the FTC had placed a content-based restriction on the type of calls the consumer may block from coming into his home. Accordingly, the FTC had not given the consumer autonomy to choose what type of calls will be blocked, but had influenced consumer choice, thereby entangling the government in "deciding what type of speech consumers should hear."¹¹⁶ The court granted summary judgment to the plaintiffs, holding the DNC list failed to survive the level of scrutiny required of commercial speech restrictions by the First Amendment. Because

¹¹⁵ 283 F. Supp. 2d 1151 (D. Colo. 2003).

¹¹⁶ *Id.* at 1164.

the Commission recognized that all unwanted calls are invasive of privacy, yet failed to block unwanted calls on behalf of charitable organizations, the court found that the DNC list failed to advance the government’s purported substantial interest – protecting consumers from the invasion of their privacy at home via the telephone.

On appeal, the Tenth Circuit disagreed.¹¹⁷ The Tenth Circuit held that the DNC list passed the three prongs of the *Central Hudson* test because its restrictions provide a reasonable fit between the legislative ends and the means chosen to accomplish those ends. The court determined that *Central Hudson*’s criteria were “plainly” established in this case because, “[t]he do-not-call registry directly advances the government’s interests by effectively blocking a significant number of the calls that cause the problems the government sought to redress. It is narrowly tailored because its opt-in character ensures that it does not inhibit any speech directed at the home of a willing listener.”¹¹⁸

The Tenth Circuit noted that the record demonstrated that charitable solicitations invaded consumers’ privacy significantly less frequently than did calls from commercial telemarketers. Therefore, a commercial solicitation DNC list could advance the government’s interest and objective, because the record demonstrated that commercial callers were primarily responsible for the invasion of privacy via telemarketing. The court differentiated the facts in *Mainstream Marketing* from *Cincinnati v. Discovery Network*,¹¹⁹ which had overturned an ordinance that banned vending stands for advertising flyers but exempted the far-more-ubiquitous newspaper stands. The court reasoned that the DNC list would affect a much greater scope of the targeted problem than the “minute” portion affected by the ban on commercial news racks in *Discovery*

¹¹⁷ *Mainstream Mktg. Servs., Inc.*, 358 F.3d 1228 (10th Cir. 2004), *cert. denied*, 125 S. Ct. 47 (2004).

¹¹⁸ *Id.* at 1238.

¹¹⁹ 507 U.S. 410 (1993).

Network,¹²⁰ and the distinction in *Discovery Network* bore no relationship to the city's interests. In addition, the DNC's commercial/non-commercial distinction was based on findings that commercial telephone solicitation was significantly more problematic than charitable or political fundraising calls.¹²¹

Furthermore, the court held that the registry was narrowly tailored because it did not over-regulate speech. The DNC list was merely a mechanism for allowing consumers to affirmatively avail themselves of a choice to block unwanted commercial solicitations. Additionally, consumers retained the choice to opt-out from specific charitable organizations via a company specific do-not-call list.

In October 2004, the Supreme Court denied the petition for writ of certiorari, leaving the Tenth Circuit's decision intact.¹²²

C. Legacy of the DNC Rule at the FTC

Mainstream Marketing serves as evidence that every FTC consumer protection rule that restricts speech now has to satisfy both a competitive, cost-benefit analysis and a constitutional, First Amendment review. For the DNC Rule, the economic analysis is based on conflicting interpretations of the same costs and benefits. Consumers and their advocates view as benefits permissive speech restrictions to advance individual privacy rights. However, industry views these same restrictions as unwieldy limitations on free speech that are costly to the consumers themselves.

A First Amendment review of the Rule underscores one of the legacies of the KidVid rulemaking. Although the DNC Rule restricted commercial speech that would normally be

¹²⁰ *Mainstream Mktg. Servs., Inc.*, 358 F.3d at 1239.

¹²¹ *Id.* at 1246.

¹²² 125 S. Ct. 47 (2004).

protected, the FTC structured the rule so that it would satisfy *Central Hudson's* three-part test, and thereby withstand an inevitable constitutional test. The Tenth Circuit held that the first prong of *Central Hudson* was met because the FTC had a substantial governmental interest in protecting the privacy of individuals in their homes and protecting consumers against the risk of fraud and abusive solicitation.¹²³ The DNC Rule also met the second prong of *Central Hudson* because the court held that the registry advanced the government's interests in combating the danger of abusive telemarketing and preventing the invasion of consumer privacy. Finally, the Rule met the third prong of *Central Hudson* because it restricted only core commercial speech (commercial sales calls) and therefore did not "burden[] an excessive amount of speech."¹²⁴

1. Could Do Not Spam be in our Future?

In December 2003, Congress passed the: Controlling the Assault of Non-Solicited Pornography and Marketing Act ("CAN-SPAM Act"). Among its provisions, the Act calls for the FTC to consider a Do-Not-Email Registry, akin to the DNC list. The Commission's examination of the prospect does not bode well for a sequel. As noted by Chairman Muris, a Do-Not-Email list would face significant impediments that DNC overcame. First, unlike telemarketers or direct mail users, spammers can easily hide their identity and cross international borders.¹²⁵ "Spammers are technologically adept at hiding their identities, using false header information, and routing their emails across borders and through open relays, making it extremely difficult even for experienced government investigators with subpoena power to track them."¹²⁶ Second, the costs of sending email are miniscule compared to other types of

¹²³ *Id.*

¹²⁴ *Id.* at 1233.

¹²⁵ Aspen Remarks, *supra* note 68.

¹²⁶ *Id.*

marketing.

Because email technology allows spammers to shift the costs almost entirely to third parties, there is no incentive for the spammers to reduce the volume. ... Because there is virtually no marginal cost to increasing the number of messages, fraud artists and pornographers, who generally have little to gain from reputation, profit from extremely low response rates by sending untold millions of messages. If spammers had to pay the actual costs of spam, normal market forces would eliminate much of the spam problem.¹²⁷

In short, spam could qualify as a practice that causes substantial injury, not reasonably avoidable, and not outweighed by benefits to consumers or competition. Yet a Do-Not-Email Rule would likely suffer the same fate as KidVid. If the Commission could not conclude that the rule would likely be effective, the agency would have difficulty demonstrating that it would directly advance the governmental interest asserted. If the rule would impede reputable emailers more than fraud artists and pornographers, it could be both over-inclusive and under-inclusive. The staff that recommended terminating KidVid twenty-five years ago would likely have no trouble recommending the same fate for a Do-Not-Email rule today. And of course, a Supreme Court that follows *Central Hudson*, would likely invalidate the rule if the Commission tried to promulgate it.

D. Conclusion

The success or failure of the three rules featured in this article cannot be explained by their superficial similarities or differences or by a casual assessment of their restraints on speech. Only one rule survived intact, and that one prohibited speech, whether or not it was deceptive. The only rule that predated the commercial speech doctrine probably would have satisfied the standards the Court established a decade later. And a rule that the Commission never promulgated would likely have failed a First-Amendment test, despite the vulnerability of the

¹²⁷ *Id.*

group the rule was intended to protect.

The fortunes of these three rules can be explained by the lessons that a wiser Commissioner Pertschuk (“I was a cost-benefit draft resister.”¹²⁸) recommended after his term as Chairman:

1. Is the rule consonant with market incentives to the maximum extent feasible?
2. Will the remedy work?
3. Will the chosen remedy minimize the cost burdens of compliance, consistent with achieving the objective?
4. Will the benefits flowing from the rule to consumers or to competition substantially exceed the costs?
5. Will the rule or remedy adversely affect competition?
6. Does the regulation preserve freedom of individual choice to the maximum extent consistent with consumer welfare?
7. “States’ rights” may be a tarnished symbol, but the federal regulator needs to ask, “To what extent is this problem appropriate for federal intervention and amenable to a centrally administered national standard?”¹²⁹

Do Not Call and the Cigarette rule would pass these tests. KidVid obviously failed them.

The Supreme Court now requires them. If future Commissioners heed the call from the father of KidVid, the Commission may be able to regard that experience as a short-run detour into ridicule that put the Commission on the road to respectability, and on the winning side of constitutional challenges.

¹²⁸ PERTSCHUK, *supra* note 3 at 139. Miller and Muris quickly learned that Pertschuk did not practice as he preached, for example when he waged a losing battle against the reforms of deception policy and other elements of the Miller agenda.

¹²⁹ *Id.* at 141-152.