

Testimony of

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Chairman Terry, Ranking member Schakowsky, and members of the Committee, thank you for the opportunity to testify today on the Federal Trade Commission. I am Howard Beales, a professor of Strategic Management and Public Policy in the George Washington School of Business. I have both published numerous academic articles on the FTC, and held a variety of different positions at the agency. Most recently, I was the Director of the Bureau of Consumer Protection from 2001 to 2004.

In my testimony today, I will focus on the FTC's consumer protection mission. That mission is closely related to the Commission's role in protecting competitive markets, because markets organize and drive our economy. Consumer protection policy can profoundly enhance the vast economic benefits of competition by strengthening the market. The policy also can reduce these benefits, however, by unduly intruding upon the market and hampering the competitive process. The Federal Trade Commission has a special responsibility to protect and speak for the competitive process, to combat practices that harm the market, and to advocate against policies that reduce competition's benefits to consumers.

The FTC's consumer protection mission derives from its responsibility to prevent "unfair or deceptive acts or practices."¹ The FTC, and other public institutions, operate against a backdrop of other consumer protection institutions, most notably the market and common law. In our economy, producers compete to offer the most appealing mix of price and quality. This competition spurs producers to meet consumer expectations because the market generally disciplines sellers who disappoint consumers, and thus those sellers lose sales to producers who better meet consumer needs. These same competitive pressures encourage producers to provide truthful information about their offerings. Market mechanisms do not always effectively discipline deceptive claims, however, especially when product attributes are difficult to evaluate or sellers are unconcerned about repeat business.

When competition alone cannot punish or deter seller dishonesty, private legal rights provide basic rules for interactions between producers and consumers. Government also can serve a useful role by providing default rules, which apply when parties do not specify rules. These rights and default rules alleviate some of the problems in the market system by reducing the consequences to the buyer from seller misconduct. Although private legal rights provide powerful protections, in some circumstances – as when court enforcement is impractical or economically infeasible – they may not be an effective deterrent.

When insufficient market forces and ineffective common law remedies leave consumers vulnerable, the Federal Trade Commission can help preserve competition and protect consumers. Without a continual reminder of the benefits of competition, however, consumer protection programs can ultimately diminish the very competition that increases consumer choice. Some consumer protection measures – even those motivated by the best of intentions – can create barriers to entry that limit the freedom of sellers to provide what consumers demand.

By and large, the Commission has done an excellent job in its consumer protection mission. It has pursued fraudulent practices aggressively, and generally adapted well to address newly emerging fraudulent practices that threaten consumer welfare. As the agency approaches its 100th anniversary, however, there are key areas in which it is harming consumer welfare. Recognizing the Commission's generally strong performance, I want to highlight today some areas where improvements are needed.

¹ 15 U.S.C. § 45.

I. The Commission’s Recent Approach to Advertising Regulation Harms Consumer Welfare

First, and most importantly, the Commission has lost its way in its approach to advertising regulation. For decades, the FTC recognized and promoted the central role of advertising in a market economy. It challenged numerous private restrictions on advertising adopted by professional associations under the name of consumer protection. It spoke out forcefully against FDA restrictions that limited consumers’ ability to learn about the relationship between diet and health. In its own enforcement activities, it recognized not only the costs of mistakenly allowing false claims to continue, but also the costs of mistakenly restricting the flow of truthful information. It recognized the difficulties of mass communication, and the reality that even most carefully crafted advertisement is likely to be misunderstood by some consumers. In the words of former Chairman Robert Pitofsky, it engaged in “a practical enterprise to ensure the existence of reliable data,” rather than “a broad theoretical effort to achieve Truth.”²

I first discuss the significance of advertising to competitive markets. I then turn to three problems in the FTC’s recent approach to advertising regulation. Section B discusses the Commission’s recent approach to the interpretation of advertising claims. Section C considers recent orders imposing evidentiary requirements for advertising claims that are likely to do more harm than good. Section D considers the Commission’s recent efforts to obtain monetary relief in traditional advertising substantiation cases.

A. Advertising Is Critical to Competitive Markets

The competitive benefits of advertising are by now well known. In the words of Nobel Laureate George Stigler, “advertising is an immensely powerful instrument for the elimination of ignorance.”³ Informed consumers drive the competitive process, benefitting all consumers as sellers compete for the informed minority.⁴ Numerous economic studies have shown that restrictions on advertising increase prices to consumers, even when advertising does not mention price.⁵

Advertising also stimulates innovation. If sellers cannot advertise innovative products, or if they cannot tell consumers why new product characteristics are important, there is less incentive to make improvements in the first place.⁶ One of the best studied examples involves Kellogg’s 1984 claims for All Bran cereal, conveying the then novel recommendation of the National Cancer Institute (“NCI”) that diets high in fiber may reduce the risk of some cancers.⁷ The science, which was based largely on epidemiology rather than human clinical trials, was uncertain. Citing these uncertainties, the FDA

² Robert Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 Harv. L. Rev. 661, 681–83 (1977).

³ George J. Stigler, *The Economics of Information*, 64 J. Pol. Econ. 213, 220 (1961).

⁴ See, e.g., Alan Schwartz and Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. Pa. L. Rev. 630 (1978-1979).

⁵ The FTC itself has summarized the empirical evidence regarding the impact of advertising on prices. See *In re Polygram*, 2003 WL 21770765 (FTC), Docket No. 9298 (July 24, 2003), at note 52.

⁶ Advertising is an intangible investment, whose value can only be recovered through repeat sales. Sellers invest in and maintain product quality to generate repeat business. See Phillip Nelson, *Advertising as Information*, 82 J. Pol. Econ. 729 (1974).

⁷ The Kellogg incident is discussed in J. Howard Beales, Timothy J. Muris, and Robert Pitofsky, “In Defense of the Pfizer Factors,” in James C. Cooper, Ed., *The Regulatory Revolution at the FTC: A Thirty-Year Perspective on Competition and Consumer Protection* (Oxford University Press, 2013), pp. 83-108.

threatened to seize All Bran as an unapproved new drug. When the FTC and the NCI defended Kellogg, the FDA changed course, launching a review of its policy.

An FTC Staff Report documented the impact of the Kellogg campaign and its aftermath.⁸ Increased advertising about fiber content and its relationship to cancer risks led to significant changes in cereals.⁹ Claims about the relationship between diet and disease increased elsewhere as well, with similar marketplace impacts. For example, claims about the relationship between diet and heart disease rose from less than 2 percent of food advertising in 1984 to more than 8 percent in 1989;¹⁰ consumption of fat and saturated fat, the primary dietary risk factors for heart disease, fell far more sharply after 1985.¹¹ Again, advertising led to beneficial changes in diet.

Advertising is particularly important to less advantaged groups. The FTC Staff Report documented that although fiber consumption increased for all groups, it increased more among racial minorities and single parent households.¹² Another study has shown that the least educated paid the highest increase in prices when eyeglass advertising was restricted.¹³

B. Advertising Interpretation Should Focus on the Ordinary Viewer.

Virtually any communication is subject to misinterpretation. If enough recipients hear or read the message, a minority will likely believe something other than what the speaker intended or what most consumers heard. Moreover, that minority understanding of the message may be completely wrong. This is an inherent problem of all communication and is particularly problematic for marketing messages, which are almost always brief and presented in times and places where consumers may not pay full attention. Marketers frequently devote significant resources to ensure that their advertising conveys the intended message, but however straightforward the message and however careful the execution, some consumers are likely to misinterpret it. In academic studies of brief communications, 20 to 30 percent of the audience misunderstood some aspect of both advertising and editorial content.¹⁴

⁸ Pauline Ippolito & Alan Mathios, Health Claims in Advertising and Labeling: A Study of the Cereal Market, FTC Staff Report (1989), available at <http://www.ftc.gov/be/econrpt/232187.pdf>.

⁹ For example, the fiber content of new cereals increased 52 percent, and the weighted average content of cereals (reflecting both product changes and changes in consumer choices) increased at a significantly higher rate than before health claim advertising began. Ippolito and Mathios, *supra* note 8.

¹⁰ Pauline Ippolito & Janice Pappalardo, Advertising Nutrition & Health: Evidence from Food Advertising, 1977–1997, FTC Staff Report (2002), available at <http://www.ftc.gov/opa/2002/10/advertisingfinal.pdf>.

¹¹ Pauline Ippolito & Alan Mathios, Information and Advertising Policy: A Study of Fat and Cholesterol Consumption in the United States, 1977–1990, FTC Staff Report (1996), available at http://www.ftc.gov/be/consumerbehavior/docs/reports/ippolitoMathios96_fat_long.pdf.

¹² Ippolito and Mathios, *supra* note 8.

¹³ Lee Benham & Alexandra Benham, Regulating through the Professions: A Perspective on Information Control, 18 J.L. & Econ. 421 (1975).

¹⁴ Regarding televised messages, see Jacob Jacoby et al., *Miscomprehension of Televised Communications* 64 (1980). Regarding print communications, see Jacob Jacoby and Wayne D. Hoyer, *The Comprehension and Miscomprehension of Print Communications* (1987). Both studies compare advertisements with excerpts of editorial content designed to be roughly equal in length, and find no significant differences in the extent of miscomprehension.

Meaningful protection for commercial speech requires, at the least, respect for the 70 to 80 percent of consumers who understand the message correctly. If regulators insist on communications that cannot be misunderstood, the result is likely to be communications that are also uninformative.

The Supreme Court has consistently held that the First Amendment does not protect deceptive speech.¹⁵ That conclusion is straightforward when speech deceives most of those who hear it, but it is inherently more problematic when speech accurately informs most, but misleads a few. For example, for any performance claim, roughly half of purchasers will experience results that are worse than the average, but information about the average or expected result is likely extremely valuable to consumers. If the government maintains that providing the average is deceptive because “too many” consumers believe they will actually achieve that result, consumers would lose valuable information entirely.

When it adopted its Deception Policy Statement in 1983, the Commission stated that an act or practice is deceptive if it is likely to mislead consumers, acting reasonably in the circumstances, about a material issue.¹⁶ The Policy Statement cites prior cases in which the Commission evaluated claims from the perspective of the “average listener,”¹⁷ or the impression “on the general populace,”¹⁸ or the “expectations and understandings of the typical buyer.”¹⁹ In a footnote, the Policy Statement acknowledges that “[a]n interpretation *may* be reasonable even though it is not shared by a majority of consumers in the relevant class, or by particularly sophisticated consumers. A material practice that misleads a significant minority of reasonable consumers is deceptive.”²⁰

In the Commission’s recent POM opinion,²¹ the footnote swallows the standard. The case involves exaggerated claims about the health benefits of drinking pomegranate juice. Some claims are broad, both others attempt to convey the limitations of the scientific evidence. Nonetheless, the Commission found essentially all of the advertisements it originally challenged were deceptive, based on its own reading of the ads.

The *most* the Commission claims in its facial analysis of particular advertisements is that the advertisement conveys a challenged claim to “*at least* a significant minority of reasonable consumers.” There is no discussion of the average listener, the typical buyer, or the general populace. Nor is there is discussion or acknowledgement of the problem of (random) background noise – that even in experimental conditions, 20 to 30 percent of consumers are likely to misunderstand the message.

The Commission’s focus on a “significant minority” is particularly troubling because it decides which advertisements are deceptive based solely on a majority of its five member’s own reading of the advertisement, without extrinsic evidence of how real consumers actually interpret the communication. As the Seventh Circuit and the Commission have noted, “implied claims fall on a continuum, ranging

¹⁵ Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n, 447 U.S. 557 (1980).

¹⁶ F.T.C. Policy Statement on Deception (1983), appended to Cliffdale Assoc., 103 F.T.C. 110, 174 (1984), available at <http://www.ftc.gov/bcp/policystmt/ad-decept.htm> (“Deception Policy Statement”).

¹⁷ *Id.* at n. 24, citing Warner-Lambert, 86 F.T.C. 1398, 1415 n.4 (1975).

¹⁸ *Id.* at n. 25, citing Grolier, 91 F.T.C. 315, 430 (1978).

¹⁹ *Id.* at n. 28, citing Simeon Management, 87 F.T.C. 1184, 1230 (1976).

²⁰ *Id.*, note 20 (emphasis added).

²¹ In the Matter of POM Wonderful LLC et al., January 16, 2013, Docket Number 1344, available at <http://www.ftc.gov/enforcement/cases-proceedings/082-3122/pom-wonderful-llc-roll-global-llc-successor-interest-roll>.

from the obvious to the barely discernible. *Thompson Medical*, 104 F.T.C. at 788-89.”²² Requiring extrinsic evidence in all cases would be unnecessary and inappropriate. At the “obvious” end of the implied claim spectrum, there will likely be little disagreement about whether the claim was made, in part because most consumers are likely to make the inference. When the claim is “barely discernible,” significantly more disagreement is likely, and likely fewer consumers actually identify and understand the claim.

In POM, the three Commissioners who voted to issue the original complaint believe that a number of advertisements made deceptive claims that another Commissioner (not a member of the Commission when the complaint issued) and the Administrative Law Judge (who heard the Commission’s case at trial) do not believe are apparent on the face of the advertisements. When reasonable people disagree about a fundamentally empirical proposition – what fraction of consumers are misled, and whether that fraction is significant – empirical evidence is a far more reliable way to resolve the disagreement than taking yet another vote among a different group of a small number of reasonable people (Commissioners or Judges).

Although some courts have deferred to the Commission’s “expertise” in interpreting advertising, that deference is unwarranted. As former Chairman Robert Pitofsky wrote,

Why questions of meaning should be submitted to the virtually unreviewable discretion of five Commissioners of the FTC has never been articulated. Unlike other instances of deference to regulators as part of the administrative process, there is no reason to believe that commissioners of the FTC have unusual capacity or experience in coping with questions of meaning, nor any indication that successful regulation of advertising requires a balance of related regulatory considerations that commissioners are in a special position to handle.²³

Indeed, even courts that have deferred to the Commission’s interpretations have expressed discomfort. As the Seventh Circuit stated in rejecting Kraft’s argument that the Commission must have extrinsic evidence:

Our holding does not diminish the force of Kraft’s argument as a policy matter, and, indeed, the extensive body of commentary on the subject makes a compelling argument that reliance on extrinsic evidence should be the rule rather than the exception.²⁴

The need for extrinsic evidence is acute when the issue is balancing the need to protect “at least a significant minority of reasonable consumers” against the interest of others who would like to learn about scientific evidence that is “promising,” “emerging,” or “hopeful.” In striking that balance, the Commission should have some sense of roughly how many consumers fall into each group. Even if the Commission can somehow determine that “at least a significant minority” is misled, the size of that minority matters, and can only be determined by empirical evidence. (Moreover, it is essential to determine that the “significant minority” is greater than the 20 to 30 percent who are likely to miscomprehend *any* message.) Good survey research can address precisely this question;²⁵ it is difficult

²² *Kraft, Inc. v. FTC*, 970 F.2d 311 (1992).

²³ Pitofsky, *supra* note 2, at 678.

²⁴ *Kraft, Inc. v. FTC*, 970 F.2d 311 (1992).

²⁵ See Shari S. Diamond, Reference Guide on Survey Research, available at https://bulk.resource.org/courts.gov/fjc/sciam.8.sur_res.pdf. See especially Section IV F, If the Survey Was

to believe that Commissioners can do so based entirely on their own reading of the advertisement in question.

Extrinsic evidence alone, however, is not the entire answer. What is needed is deeper appreciation of the fact that consumers who correctly interpret a message are harmed when the Commission prohibits claims that might be misunderstood by a “significant minority.” For example, in 2012 the Commission brought five cases²⁶ and issued 14 warning letters²⁷ to window manufacturers who claimed that their products would save “up to” a specific amount of energy costs. Although most reasonable consumers surely understand that a claim of savings of “up to” a certain amount is different from a claim that you will save “at least” that amount, the warning letters assert that the two claims are exactly the same. The letter advises sellers that if they make “up to” claims, “your substantiation should prove that *all or almost all* consumers are likely to get that percentage in savings.”²⁸ An express claim about the *maximum* savings can only be substantiated by evidence that the claimed savings are in fact the *minimum* savings.

The FTC points to a copy test showing that if an ad mentions savings of 47%, 22 to 28 percent of consumers say that “all or almost all” consumers will save that much, whether the claim is “save 47%,” “save up to 47%,” or also discloses the average savings. This isn’t a copy test to determine whether consumers actually see a fine print disclosure – “up to” is right next to the 47%, in the same size type, and with the same emphasis. This is a test of how many consumers will play back the proper interpretation of numerical claims after a brief, artificial exposure. Not surprisingly, many do not. That, however, is not an argument for prohibiting numbers, or for reducing numerical claims to those that cannot possibly mislead anyone. Consumers who seriously contemplate spending hundreds or thousands of dollars on new windows are likely to consider the investment more carefully than consumers who are paid \$5 to participate in a mall survey. Importantly, the survey did not find that there was a less misleading way to convey information about savings. Indeed, it found that some consumers misinterpreted all versions of the advertisement that were tested.

The FTC has not yet addressed claims about average performance. Its testimonial guides allow claims about individual results (“I lost 30 pounds”) if the average result is disclosed (“the average user lost 13.6 pounds”). Surely, however, “many consumers” – the standard in the FTC’s warning letters – labor under the misconception that everyone achieves at least the average result. No sensible, or constitutional, regulatory regime prohibits truthfully reporting, based on the average results of users, that “you can save x percent.” According to the FTC, however, if the claim is instead that “you can save up to x percent,” it must be true for virtually everyone – even though it is in fact the average result.

Designed to Test a Causal Proposition, Did the Survey Include an Appropriate Control Group or Question? at 256. Advertising can be deceptive only when it causes a significantly increase in the fraction of consumers who receive the misleading message compared to those who saw a nondeceptive advertisement.

²⁶ See FTC Press Release, Window Marketers Settle FTC Charges That They Made Deceptive Energy Efficiency and Cost Savings Claims, Feb. 22, 2012, available at <http://www.ftc.gov/news-events/press-releases/2012/02/window-marketers-settle-ftc-charges-they-made-deceptive-energy>.

²⁷ See FTC Press Release, FTC Warns Replacement Window Marketers to Review Marketing Materials; Energy Savings Claims Must Be Backed by Scientific Evidence, August 29, 2012, available at <http://www.ftc.gov/news-events/press-releases/2012/08/ftc-warns-replacement-window-marketers-review-marketing-materials>.

²⁸ See, for example, Letter from Frank Gorman to Acadia Windows & Doors Inc., August 17, 2012, available at <http://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-warns-replacement-window-marketers-review-marketing-materials-energy-savings-claims-must-be/120829windowsacadialetter.pdf>.

The Commission needs to return its focus to the average viewer. Extrinsic evidence can help to strike the appropriate balance when, as is often the case, a communication informs some consumers and misinforms others. Crucially, the evidence should be designed to assess whether there is an alternative way to communicate a truthful message that is less likely to be misleading. Prohibiting communications because some consumers will misunderstand is likely to leave the majority of consumers in relative ignorance. That is the opposite of what the Commission should be trying to accomplish.

C. The Commission Is Imposing Overly Burdensome Substantiation Requirements.

The Commission's advertising substantiation doctrine requires that advertisers have a "reasonable basis" for claims before they are made. Traditionally, the core principle of substantiation recognized the uncertainty surrounding many claims, and balanced the benefits of truthful claims against the costs of false ones. In a series of recent settlements and in a litigated case that is currently on appeal, the Commission has moved from balancing toward a rigid rule that requires multiple clinical trials even if the benefits of the claim, if true, overwhelmingly exceed the costs of the claim, if false. If continued, this approach would prohibit claims about the relationship between diet and disease that most scientists regard as prudent public health recommendations despite the absence of two well controlled clinical trials.

Used wisely, laws against deceptive advertising benefit consumers. The historical approach of the Commission allowed the government to balance against two kinds of mistakes: allowing false claims to continue or prohibiting truthful claims. To ensure that information flows are both free and clean,²⁹ the government must consider the cost of each possible mistake, and, *ex ante*, guard against the higher cost mistake. The FTC's traditional approach to advertising substantiation, first stated in the seminal Pfizer opinion,³⁰ reflects the central role of balancing the risks of these two types of mistakes.

Consider, for example, Kellogg's claim about the relationship between diets high in fiber and the risk of cancer. Although the FDA now approves the claim, uncertainty remains. After all, no randomized clinical trials have measured the incidence of cancer at different levels of fiber intake. If the claim is true, however, waiting for the results of such trials would impose substantial costs on consumers, who would lose important information about the likely relationship between fiber consumption and cancer risk. Before such claims were allowed, consumers ate less fiber, and as a result incurred a higher risk of cancer.

On the other hand, if the claim is false, the consequences to consumers are relatively small. They may give up a better tasting cereal, or pay a little more for a higher-fiber product.³¹ In this case, the far more serious error is mistakenly to prohibit truthful claims. Such a mistake is worth avoiding, even though it increases risk of the far less serious error of a false claim continuing.

Rather than relying on the traditional balancing test, the Commission's recent consents and litigated decision reflect a move to a more rigid standard, one more closely modeled on the FDA's drug approval process. In place of the usual order provision requiring "competent and reliable scientific evidence," the

²⁹ *Va. State Bd. Of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 772 (1976).

³⁰ *Pfizer, Inc.*, 81 F.T.C. 23, 64 (1972).

³¹ Preventing economic injuries such as these is at the core of the Commission's consumer protection mission. Historically, however, the Commission has been unwilling to risk public health consequences to avoid economic injuries.

Commission has instead required respondents to substantiate claims about the relationship between nutrients and disease with two randomized, placebo controlled, double blind clinical trials (RCTs). This standard is excessive in most cases, and is likely to deprive consumers of valuable, truthful information.

Modelling substantiation requirements for claims about diet and disease on the drug approval process is itself inappropriate. Typically, more is at stake in approving new drugs than in whether to allow diet and health claims. The critical issue in both cases is the relative risk of the two potential mistakes, because reducing the risk of one mistake necessarily increases the risk of the other. It is not that foods offer greater benefits than new prescription drugs; rather, unlike prescription drugs, the potential benefits of allowing claims about diet and health, even in the face of uncertainty, are vastly greater than the potential costs of allowing mistaken claims. The potentially large public health impact of mistakenly allowing dangerous drugs on the market is the key reason for the rigorous FDA approval process.

Simply put, the potential consequences of mistaken decisions about what to eat, or whether to take a safe dietary supplement, are not remotely comparable to the potential consequences of mistaken decisions about prescription drugs. Because the costs of mistaken choices about foods and dietary supplements are substantially lower than the costs of mistakes choosing drugs, the value of added testing to determine the likely truth of the claim is lower. To be sure, more information always reduces uncertainty, but with less at stake, there is less reason for the elaborate precautions of the drug approval process.

Congress made that judgment about dietary supplements when it enacted the Dietary Supplements and Health Education Act. That statute removed dietary supplements from the rigorous requirements of the new drug approval process, and allowed claims about the relationship between nutrients and the structure or function of the human body as long as they are supported by a “reasonable basis.” It made a similar decision in the Nutrition Labeling and Education Act regarding foods, when it allowed health claims for foods that FDA found were supported by “significant scientific agreement.” The FTC’s recent orders threaten to reverse these Congressional decisions, restoring the rigors of the drug approval process in everything but name.

The randomized, double blind, placebo-controlled clinical trial is the gold standard of medical research. For some specific questions, it is the only methodology that experts accept as yielding accurate and reliable results. Despite the value of clinical trials, sometimes they are simply not necessary. A systematic review of randomized trials of parachutes, unsurprisingly, could not locate any such trials. Notwithstanding this deficiency, few would recommend jumping from an airplane without one because of the failure to conduct one or more random controlled clinical trials. The authors concluded:

As with many interventions intended to prevent ill health, the effectiveness of parachutes has not been subjected to rigorous evaluation by using randomised controlled trials. Advocates of evidence based medicine have criticised the adoption of interventions evaluated by using only observational data. We think that everyone might benefit if the most radical protagonists of evidence based medicine organised and

participated in a double blind, randomised, placebo controlled, crossover trial of the parachute.³²

Moreover, any trial takes time. As another group of authors noted, “waiting for the results of randomized trials of public health interventions can cost hundreds of lives, especially in poor countries with great need and potential to benefit. If the science is good, we should act before the trials are done.”³³ “Good science” they suggest “is taking the research to the problem rather than conducting the research in the tallest ivory tower the investigator can find.”³⁴

There are also instances in which clinical trials would be unethical or impractical. Thus, there are no randomized clinical trials establishing the adverse effects of tobacco consumption on humans, nor are there such trials of any number of workplace chemicals regulated as hazardous. In other circumstances, clinical trials might be possible conceptually, but are wildly impractical. For example, a randomized clinical trial of whether increasing calcium intake in young adults actually reduces the risk of osteoporosis would have to follow participants for decades.

We learn about the real world in ways beyond clinical trials. Thus, much of what we know about the relationship between diet and disease is based on epidemiology,³⁵ not randomized trials. Trials are frequently a useful supplement, as, for example, with studies that document the short-term effect of diets with different fat compositions on serum cholesterol, but the crucial knowledge about the relationship between cholesterol and heart attacks is epidemiological. Reliance on epidemiology is also common where clinical trials are difficult or impossible. The “best evidence” of workplace hazards is often derived from epidemiologic studies of workers exposed to different levels of suspect chemicals. Moreover, the Commission’s *Dietary Supplements: An Advertising Guide for Industry* explicitly recognizes that epidemiology alone may substantiate efficacy claims for dietary supplements.³⁶

Even the FDA has approved health claims relying on basic science and epidemiology. For example, in 1996 it approved a claim regarding dietary noncariogenic carbohydrate sweeteners and dental caries. The FDA reasoned that it would be virtually impossible to isolate a control group that consumed no foods containing sugars or sugar alcohols. Instead, the FDA relied on evidence from human epidemiological, animal, and in vitro studies related to the association between an individual’s consumption of sugar alcohols in chewing gum and the incidence of caries.³⁷

Similarly, the FDA relied on only one clinical trial in approving a health claim regarding folate and neural tube defects. Even though the study was difficult to generalize to the population because it only

³² Gordon C.S. Smith & Jill P. Pell, Parachute Use to Prevent Death and Major Trauma Related to Gravitational Challenge: Systematic Review of Randomized Controlled Trials, 327 B.M.J. 1459 (2003).

³³ Malcolm Potts et al., Parachute Approach to Evidence Based Medicine, 333 B.M.J. 701 (2006).

³⁴ *Id.* at 702.

³⁵ Epidemiology uses sophisticated statistical techniques to analyze a relationship of interest while holding constant other factors that may influence the result. Epidemiological studies controlling for other possible risk factors, for example, establish that smoking causes cancer in humans.

³⁶ BUREAU OF CONSUMER PROTECTION, DIETARY SUPPLEMENTS: AN ADVERTISING GUIDE FOR INDUSTRY [HEREINAFTER GUIDE] 8 (1998). <http://business.ftc.gov/documents/bus09-dietary-supplements-advertising-guide-industry> at 11, example 14.

³⁷ Dietary Noncariogenic Carbohydrate Sweeteners and Dental Caries, 60 Fed. Reg. 37,507 (July 20, 1995) (codified at 21 C.F.R. § 101.80 (2009)).

included women with a history of neural tube defects in pregnancy, it was sufficient for the FDA to conclude that there was a significant risk reduction when women supplemented their diets with high levels of folic acid. Most of the evidence the FDA considered consisted of nonclinical human studies, including four intervention trials with women at a high risk of a pregnancy with a neural tube defect because they had a personal history of such a pregnancy.³⁸

The Commission contends that nothing has changed. It defends the requirement for two clinical trials as traditional “fencing in” relief that imposes special requirements on proven violators that do not apply to other companies. Initially, there is no sound reason to require anyone to meet this higher burden to substantiate the likely truth of their claims. Rather than “fencing in” potential violations, the requirement “walls off” truthful claims that would likely prove valuable to many consumers. Although the scope of the potential harm from such a requirement is formally limited to the covered claims and a particular respondent, incorporating these more rigid standards signals to others in the industry (and, eventually, the Courts) what the Commission expects as adequate substantiation. This is especially true where the reason the Commission offers for this requirement for POM – that a second test might yield a different result – is universally true. Like the clinical trials requirement itself, this is a general rule, rather than a requirement that is unique to a particular respondent.

Moreover, the two clinical test requirement will more likely suppress truthful claims than prevent deceptive ones. If a statistical test that finds a significant difference between two products at the conventional 95 percent confidence level, there is a 5 percent chance that the result is due solely to the peculiarities of the particular sample. Repeating the test would reduce that risk to less than one percent,³⁹ but most likely, it will simply achieve the same result.

A peculiar sample may also fail to detect a relationship that actually exists. Although larger samples could increase the chance of detecting a real difference, they are more costly and the tests frequently take longer. As a practical compromise between these competing objectives, statistical tests and sample sizes are frequently chosen to have an 80 percent chance of detecting a difference (of a specified size) if it really exists.⁴⁰ Thus, 20 percent of the time a test will fail to detect a real difference that in fact exists. Repeating the test will raise the probability that at least one of the two tests will fail to find a difference from 20 percent to 36 percent.⁴¹ *Requiring the second test is therefore much more likely to reject truthful claims than to detect a result that only arose in the first place because of chance.*⁴² Thus the

³⁸ Folate and Neural Tube Defects, 61 Fed. Reg. 8, 752 (Mar. 5, 1996) (codified at 21 C.F.R. § 101.79 (2009)).

³⁹ The likelihood that both tests find a significant difference when in fact there is no difference is .05 times .05, or .0025. That is, only in one quarter of 1 percent of cases will both tests find a statistically significant difference that does not in fact exist.

⁴⁰ The probability of detecting a difference that actually exists is known as the power of the test. “The ideal power for any study is considered to be 80%.” K.P. Suresh and S. Chandrashekar, “Sample Size Estimation and Power Analysis for Clinical Research Studies,” 5 J. Hum. Reprod. Sci. 7 (2012), available at <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3409926/>.

⁴¹ When there is a real difference, the chance of finding the difference statistically significant is .8. The chance of finding it significant in both tests is .8 times .8, or .64.

⁴² A second test is more likely to reject truthful claims even if the chances of failing to detect a difference are the same as the chances of mistakenly finding one. If the chance of either mistake (significance when there is no difference or failure to find significance when one exists) is 5 percent, the chance that both tests will find the difference is 90.25 percent (i.e., .95 times .95). Thus, there is almost a 10 percent chance of mistakenly rejecting a truthful claim. With only one test, there was only a 5 percent chance of mistakenly allowing a false one.

requirement of two RCT's, rather than one, increases the likelihood that truthful claims will be suppressed.

When the Commission rejected a petition to establish more explicit substantiation standards for dietary supplements, it did so in part because of the likelihood of setting a standard that is "higher than necessary to ensure adequate scientific support."⁴³ This risk is no different when the Commission imposes a more rigid standard as an order provision. Indeed, the "competent and reliable scientific evidence" standard itself emerged from a series of orders incorporating that provision. Responsible companies will have little choice but to follow the two RCT requirement incorporated into recent orders, creating exactly the problems the Commission sought to avoid when it rejected the petition in 2000.

Not only is such a requirement harmful, it is unnecessary. When the District of Columbia Circuit rejected the FDA's ban on health claims that were not supported by "significant scientific agreement" on First Amendment grounds,⁴⁴ it did so because it believed that carefully qualified claims could avoid the risk of deception even without significant scientific agreement. The FTC's own empirical studies of qualified health claims support that conclusion.⁴⁵ As the FTC staff commented to the FDA with respect to health claims, "On average, consumers were able to discern clear differences in the level of certainty communicated by these [tested] claims."⁴⁶

Where the policy goal is to maximize consumer welfare by allowing the commercial discussion of emerging scientific evidence, there is no conceptual difference between "two clinical trials" and "significant scientific agreement" as requirements that must be met before certain claims are permissible. Like "significant scientific agreement," the "two clinical trials" standard will likely prohibit carefully qualified claims that are not likely to mislead reasonable consumers.⁴⁷

Moreover, in practical day-to-day decision making, knowing that *precisely one* clinical trial supports an important health-related claim is highly valuable to consumers. The requirement for a second clinical trial appears unnecessary to insure truthful, useful claims. The Commission should return to its traditional balancing test to determine the appropriate level of substantiation for particular claims.

D. The FTC Should Not Seek Monetary Relief in Traditional Substantiation Cases.

Since 1981, the FTC has attacked fraud systematically, successfully using the authority under Section 13(b) of the FTC Act to obtain a permanent injunction "in proper cases" to freeze assets *ex parte* and to

⁴³ Letter Denying Petition for Rulemaking from Donald S. Clark to Jonathan W. Emord (Nov. 30, 2000), available at <http://www.ftc.gov/os/2000/12/dietletter.htm>.

⁴⁴ See *Pearson v. Shalala*, 164 F.3d 650 (D.C. Cir. 1999).

⁴⁵ Dennis Murphy et al., *A Generic Copy Test of Food Health Claims in Advertising*, FTC (1998); Dennis Murphy, *Consumer Perceptions of Qualified Health Claims in Advertising*, FTC, Working Paper No. 277 (2005).

⁴⁶ FTC Staff Comments on Assessing Consumer Perceptions of Health Claims (Jan. 17, 2006), at 12, available at <http://www.ftc.gov/be/V060005.pdf>.

⁴⁷ By its nature, "competent and reliable scientific evidence" requires different amounts of evidence depending on the specifics of the covered claim, because the kinds of evidence necessary to support a qualified claim will frequently differ from what is needed to substantiate unqualified claims. Thus, the standard permits claims that appropriately describe the available evidence even when that evidence would not support an unqualified claim. With a clinical testing requirement, however, any covered claim must be supported by clinical testing, regardless of how it might be qualified and regardless of whether it is misleading.

force disgorgement of ill-gotten gains.⁴⁸ More recently, the Commission has asserted the authority to expand the use of the Section 13(b) program beyond fraud cases, suggesting that it may use Section 13(b) to seek consumer redress even against legitimate companies when there are simply questions about the substantiation for claims made as part of national advertising campaigns.⁴⁹ This use of the Section 13(b) remedial authority is wrong as a matter of law, troubling as a matter of policy, and threatens to undermine the operation of the fraud program, which has proven critical to the FTC's consumer protection mission.

The legislative history surrounding the enactment of Sections 13(b), 19, and 5(m)(1)(B)⁵⁰ has received vanishingly little attention in the cases that have addressed the legality of the Section 13(b) fraud program, even though it sheds considerable light on the proper scope of that provision. There is no hint in the legislative history that Congress intended to grant the FTC broad authority to seek monetary relief when it enacted Section 13(b). In particular, Section 19 limits monetary relief to conduct a reasonable person would know is dishonest or fraudulent. Both injunction and redress authority were included as separate provisions in a bill that passed the Senate in 1971. Although an amended Section 13 was enacted in 1973, and Section 19 was enacted two years later, the inescapable inference from their common origin and the entire legislative history is that Congress did *not* intend to give the Commission blanket authority to obtain redress.

The use of 13(b) against fraud respects the carefully constructed congressional grant of authority to the Commission in part because fraud meets the knowledge test of Section 19. Moreover, using Section 19 alone would require three separate actions to attack a fraud successfully -- a preliminary injunction to freeze assets, an administrative action to determine liability, and then another, independent district court action to seek redress. As Congress itself recognized, district courts may be reluctant to grant preliminary relief when they cannot assure an expeditious resolution of the matter. Thus, fraud cases are "proper" under Section 13(b), but routine use of Section 13(b) to seek redress would read "proper" out of the statute.

One type of case that is not "proper" is the traditional substantiation case. Typically, such cases involves a reputable national advertiser making claims about the features or benefits of its product or services.

⁴⁸ 15 U.S.C. § 53(b).

⁴⁹ Consent Order, Oreck Corp., FTC File No. 102-3033 (Apr. 7, 2011) (\$750,000); Consent Order, Beiersdorf, Inc., FTC File No. 092-3194 (June 29, 2011) (\$900,000); Consent Order, NBTY, INC., FTC Docket No. C-4318, File No. 102-3080 (Dec. 13, 2010) (\$2.1 million). In some cases, the the redress is paid in conjunction with a settlement with other plaintiffs. See *FTC v. Reebok Int'l Ltd.*, No. 1:11CV2046 (N. Dist. Ohio Sept. 29, 2011) (\$25 million); *Order Preliminary Certifying a Class for Settlement Purposes, In re Reebok Easytone Litig.*, No. 4:10-CV-11977-FDS (D. Mass. Oct. 6, 2011); *FTC v. Skechers U.S.A., Inc.*, No. 1:12-cv-01214 (N. Dist. Ohio May 16, 2012) (\$40 million); *Grabowski v. Skechers U.S.A., Inc.*, No. 3:12-cv-00204 (W.D. Ky.). See also *Stipulation and Order, Gemelas v. The Dannon Co.*, No. 1:08cv236 (N.D. Ohio July 19, 2011).

⁵⁰ The second proviso of Section 13(b) states, "Provided further, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." 45 U.S.C. § 53. Section 19 authorizes "such relief as the court finds necessary to redress injury" (45 U.S.C. § 57(b) against any party subject to a final cease and desist order "[i]f the Commission satisfies the court that the act or practice to which the cease and desist order relates is one which a reasonable man would have known under the circumstances was dishonest or fraudulent ..." 45 U.S.C. § 57b(a)(2). Section 5(m)(1)(B) authorizes civil penalties against any party engaged in a practice that the Commission has found unfair or deceptive in a litigated proceeding "with actual knowledge that such act or practice is unfair or deceptive and is unlawful ..." U.S.C. § 45(m)(1)(B)(2).

Although such claims may highlight something new, the product will often have been on the market for many years based on other claims. For example, the Commission's cases against Kellogg involved claims of increased attention in class for children who eat Frosted Mini Wheats for breakfast,⁵¹ and claims that Rice Krispies will help "support your child's immunity."⁵² Even if the claims about the effects of these cereals on enhanced attention or immunity are completely unsupported, such claims generally are not the sole (or even primary) reason that most consumers purchase the products.⁵³ Moreover, such cases often involve disputes over scientific details about the proffered substantiation and the required level of evidence, with well-regarded experts on both sides of the question.

The knowledge that the FTC might seek consumer redress could chill companies from providing consumers with information that they would want to have about the products they are using. The risk is particularly acute when, as discussed above, the traditional standard for substantiation appears to be changing. Even with the "right" substantiation standard, however, uncertainty will exist about how it will be applied in a particular case. With monetary penalties, the increased risk, in combination with the uncertainty, will encourage greater caution about making truthful claims.

Finally, the expanded use of Section 13(b) poses risks to the fraud program itself. Beyond the risk that the current widespread judicial deference to the program might be revisited, a greater risk concerns the judicial determination of the appropriate amount of redress. Although courts have been imprecise about whether equitable awards should be analyzed as "restitution" (which would be based on what consumers paid for the product) or "disgorgement" (which would be based on amounts received by the defendant),⁵⁴ the baseline for redress awards has generally been either consumer loss or the defendant's unjust gain. Because these measures usually coincide, under either measure the defendant can be required to pay amounts well in excess of profits.⁵⁵ Indeed, even if the defendant's gain is the

⁵¹ Complaint, Kellogg Co., FTC File No. 082 3145 (July 31, 2009).

⁵² Press Release, Order Modifying Order, Kellogg Co. (FTC June 3, 2010) (modifying order to cover additional claims), available at <http://www.ftc.gov/opa/2010/06/kellogg.shtm>.

⁵³ Thus, Frosted Mini Wheats have been successfully marketed nationally since 1970, apparently without the need to mention any effects on attentiveness. See Kellogg in the 1970s, <http://www.kellogghistory.com/timeline.html> (last visited Dec. 5, 2011). Rice Krispies have been on the market much longer, first appearing in 1928. See Kellogg in the 1920s, <http://www.kellogghistory.com/timeline.html> (last visited Dec. 5, 2011).

⁵⁴ See, e.g., *FTC v. Wolf*, No. 94-8119-CIV-FERGUSON, 1996 WL 812940, at *9 (S.D. Fla. Jan. 31, 1996) (restitution); *FTC v. SlimAmerica, Inc.*, 77 F. Supp. 2d 1263 (S.D. Fla. 1999) (providing "consumer redress"); *FTC v. Verity Int'l, Ltd.*, 443 F.3d 48 (restitution); *FTC v. Stefanchik*, 559 F.3d 924 (9th Cir. 2009) ("equitable monetary relief"); *FTC v. Bronson Partners*, 674 F. Supp. 2d 373 (D. Conn. 2009) (restitution); *FTC v. Direct Mktg. Concepts, Inc.*, 648 F. Supp. 2d 202 (D. Mass. 2009) (disgorgement).

⁵⁵ See, e.g., *FTC v. Nat'l Urological Group, Inc.*, 645 F. Supp. 2d 1167, 1213 (N.D. Ga. 2008) (noting that "[r]estitution is intended to return the injured party to the status quo and is measured by the amount of loss suffered by the victim" and awarding total product sales over the relevant period); see also *FTC v. Febre*, 128 F.3d 530, 536 (7th Cir. 1997) ("A major purpose of the Federal Trade Commission Act is to protect consumers from economic injuries. Courts have regularly awarded, as equitable ancillary relief, the full amount lost by consumers.").

measure, permissible offsets are generally limited.⁵⁶ That is a reasonable approach for a “Chinese Diet Tea”⁵⁷ promoted as a weight loss product, when few, if any, consumers likely purchased the product because of its inherent value as a beverage. It is not a workable approach for a product like Rice Krispies; an unsubstantiated claim may increase sales somewhat, but is not responsible for the vast majority of the sales that occur. Thus, courts may change their measure of calculating damages, and those changes could complicate the determination of redress in fraud cases, as well.

The FTC’s consumer protection mission is to prevent unfair or deceptive acts or practices. In giving the FTC the tools to accomplish that mission, Congress struck a delicate balance. It recognized that the FTC must prevent harm to the public and ensure that those who cause the harm are punished; at the same time, it recognized that the FTC could go too far. Imposing monetary penalties on those who did not know their conduct was unlawful could chill the provision of beneficial information and thus hurt members of the public more than it helps them. If companies are afraid that they will be subjected to monetary liability for claims about their products that the FTC ultimately concludes cannot be substantiated, they may not make the claims at all. As a result, consumers could be deprived of valuable information.

II. The Commission Should Restrict Its Privacy Enforcement Actions to Practices that Cause Real Consumer Harms.

In 2001, the Federal Trade Commission adopted a new approach to privacy, based on the consequences of information use and misuse. Most notably, that approach led to the National Do Not Call Registry and a series of cases holding companies liable for their failure to take reasonable and appropriate steps to protect the security of sensitive commercial information. Based initially on deception, when companies breached security promises in their privacy policies and elsewhere, subsequent cases alleged that security failures could also be challenged as unfair practices.

Although the Commission has not abandoned the consequences-based approach to privacy entirely, and cannot, given the statutory constraints under which it operates, it has adopted a new “privacy

⁵⁶ Redress is generally not reduced by the amount of actual operating costs, such as those for manufacturing the product, advertising, processing costs, or taxes. *Bronson Partners*, 674 F. Supp. 2d at 382 (restitution); *SlimAmerica*, 77 F. Supp. 2d at 1276 (“Costs incurred by the defendants in the creation and perpetration of the fraudulent scheme will not be passed on to the victims.”); see generally *Verity Int’l*, 443 F.3d at 68 (noting that in most cases there is no difference between measuring redress according to consumer loss and the defendant’s unjust gain). By contrast, in the cases reflecting the Commission’s new expansion of Section 13(b), see *supra* note 15, the Commission has sought and obtained redress far less than the total sales of the product. For example, in *Skechers*, the Commission obtained \$40 million, which was considerably less than 10 percent of *Skechers’* sales in the peak year of the toning shoe fad alone. First Research, *Footwear Manufacturing Industry Profile* (June 25, 2012), available at <http://search.proquest.com>; Christopher C. Williams, *After a Tough Stretch Adidas’ Run Resumes*, 33 *BARRON’S* 17 (2010), available at <http://search.proquest.com> (sales of toning shoes hit \$1 billion in 2010 and Skechers held 67% market share). Although the Commission’s complaint included a falsity claim regarding alleged serious problems with one study, it apparently rejected other studies supporting similar fitness benefits of rocker bottom shoes. Scott C. Landry, Benno M. Nigg & Karelia E. Tecante, ***Standing in an Unstable Shoe Increases Postural Sway and Muscle Activity of Selected Smaller Extrinsic Foot Muscles***, *GAIT & POSTURE*, June 2010, at 215 (reporting findings that even when standing, muscle activation is higher in rocker bottom footwear than conventional shoes). Moreover, unlike Section 19, both falsity and lack of substantiation are strict liability offenses; the defendant’s knowledge is irrelevant.

⁵⁷ Chinese Diet Tea was the product at issue in *FTC v. Bronson Partners, LLC*, 654 F. 3d 359 (2d Cir. 2011).

framework,” based on what the Commission views as “best practices.” The framework urges “privacy by design,” “simplified choice,” and “greater transparency.” The Commission Report recognizes that some of the practices it urges go “beyond existing legal requirements,” but provides little guidance on the contours of the practices it believes are subject to challenge under the FTC Act.

The FTC’s primary tool to address privacy issues is Section 5 of the FTC Act, which prohibits “unfair or deceptive acts or practices.” Whether the theory is unfairness or deception, injury to consumers is a necessary element of a law violation. As the Commission stated in its Unfairness Policy Statement, “unjustified consumer injury is the primary focus of the FTC Act.”⁵⁸ The injury requirement is explicit in unfairness, and implicit in the materiality element that is necessary to find a practice deceptive.

Some breaches of privacy involve real and concrete harms. Location information in the wrong hands can lead to stalking of a consumer and actual physical injury. Privacy violations may also lead to economic injury. Compromised information may be used for identity theft, for example, acquiring new loans or other accounts in someone else’s name. Simple annoyance can also constitute a privacy harm, as was the case with telemarketing calls before the advent of the Do Not Call registry. The harm to each individual is small, but the aggregate harm is substantial.

Harms are also actionable even if they are difficult to monetize directly. Damage to a reputation or intrusion into private places are not concrete harms in the same sense as the risk of physical or economic injury, but they are real harms nonetheless, widely recognized in tort law.⁵⁹ From the beginning, the harm-based approach to privacy addressed such harms. Indeed, the Commission’s first information security case was against Eli Lilly for inadvertent disclosure of sensitive information: the email addresses of a group of Prozac users.⁶⁰ Such information is sensitive because of the risk of damage to reputations. Similarly, an early case challenged the practice of email “spoofing” – falsifying the return address in spam email – as unfair. The bulk emails used deceptive subject lines to induce consumers to open sexually explicit solicitations to visit adult web sites. As part of the injury to consumers, the complaint cited the reputational harm from being associated with spamming to parties whose addresses were spoofed.⁶¹

Many potential “harms” to consumers involve secondary characteristics of a product or service that do not affect its functionality. Often, such preferences concern how a product or service is produced, rather than the characteristics of the final product. Many consumers, for example, have preferences for products that are kosher. Others may prefer products that are “made in USA” or union made, or free range chickens, or locally grown produce. Although we can determine objectively whether such a claim is accurate, its importance, and hence the magnitude of any injury, depends entirely on the preferences of the consumer. I term these types of preferences subjective, because not all consumers agree that the attribute is important, and because there is no way for an outside observer to measure the magnitude of the injury if they are violated.

⁵⁸ Unfairness Policy Statement, appended to Int’l Harvester Co., 104 F.T.C. 949, 1070 (1984).

⁵⁹ Restatement (Second) of Torts §559 Defamatory Conduct Defined, §652B Intrusion Upon Seclusion, and §652D Publicity Given to Private Life.

⁶⁰ See Complaint at 3, Eli Lilly and Company, No. 123214 (Jan. 18, 2004), *available at* <http://www.ftc.gov/os/2002/01/lillycmp.pdf>.

⁶¹ FTC v. Brian D. Westby et al., No. 03 C 2540 (E. D. N. Ill. Apr. 17, 2003).

Privacy is one area where such subjective preferences are important. As the FTC’s preliminary report noted in 2010, “for some consumers, the actual range of privacy-related harms is much wider and includes ... the fear of being monitored or simply having private information ‘out there.’”⁶² Consumers may also feel harmed when information is used “in a manner that is contrary to their expectations,” and may have “discomfort with the tracking of the online searches and browsing.”⁶³ Some have summarized these kinds of harms as “creepiness.”⁶⁴

No doubt, there are consumers with such preferences. As with other subjective preferences, the Commission should protect them when they are manifested in marketplace choices. If a company promises “no information sharing,” or no tracking, or kosher, it had better deliver. That was the lesson of Gateway Learning, where the Commission challenged a retroactive, unilateral change in the company’s privacy policy. The policy had provided that “we do not sell, rent or loan any personally identifiable information regarding our consumers unless we receive a customer’s explicit consent.” The company later began renting such information, without seeking consent, and then revised its privacy policy to allow its new practice. The Commission challenged the retroactive application of the new privacy policy as unfair, but it did so without any specific allegations about the consequences of sharing. It was the unilateral modification of the contract that was unfair, rather than the specific modification adopted.⁶⁵ Consumers had been promised one product characteristic, about which they might reasonably care, and were now being offered another.⁶⁶ Because consumers made a choice based on the promises made, the company cannot unilaterally change the deal.

Critical to protecting subjective preferences, however, is the notion that consumers have made a choice based on the promise that a provider will deliver. It does not follow that because *some* consumers have a preference, the Commission should require *all* sellers to satisfy that preference. That argument is simply wrong. Assuring the accuracy of claims that a product is kosher enhances consumer sovereignty – it lets consumers choose what matters to them and what does not. Consumers who believe keeping kosher is important can do so, but they must face the cost of paying attention and finding a seller who promises to provide kosher products. Consumers who think kosher is irrelevant are not burdened in any way.

Requiring all sellers to offer kosher products is another matter altogether. Such a policy imposes the costs of the admittedly real preferences of some on many who do not share them. The FTC Act, however, is about preserving consumer sovereignty, not about substituting the preferences of the Commissioners for those of consumers, or imposing the preferences of one group of consumers on another. The fact that a particular product characteristic, whether related to privacy or religious preference, is important *to me* is a very good reason for protecting affirmative claims about that characteristic. It is a very bad reason for imposing that preference on everyone else.

⁶² Federal Trade Commission, Protecting Consumer Privacy in an Era of Rapid Change, 20, available at <http://www.ftc.gov/os/2010/12/101201privacyreport.pdf>.

⁶³ *Id.*

⁶⁴ Adam Thierer, The Pursuit of Privacy in a World Where Information Control is Failing, 36 *Harvard Journal of Law & Public Policy* 409 (2013).

⁶⁵ See Complaint at 2-6, 13, Gateway Learning Corp., No. 0423047 (Jun. 7, 2004), available at <http://www.ftc.gov/os/caselist/0423047/040707cmp0423047.pdf>.

⁶⁶ The seminal case applying the Commission’s unfairness authority to unilateral contract modifications is *Orkin Exterminating Co., Inc.*, 108 F.T.C. 263 (1986).

For the Commission to protect such subjective preferences, they must be preferences that are actually reflected in marketplace behavior, because that is the only reliable indication that these preferences are real. They cannot be sensibly inferred from survey results where consumers can express a preference without confronting the costs of satisfying it.

The nature of subjective preferences means that an unfairness analysis is particularly inappropriate. Unless there is some reason that a uniform choice is necessary, the essence of the problem is one of matching each consumer to the product or service that best satisfies his or her preferences, a task to which markets are particularly well suited. Determining that a practice is unfair because of some alleged violation of subjective preferences would amount to imposing the preferences of some on others who do not share them, violating the very consumer sovereignty that Section 5 is supposed to protect. The Commission's Unfairness Policy Statement was therefore wise in ruling out use of unfairness to address subjective harms,⁶⁷ and it is difficult to imagine a more subjective harm than "creepiness."

Anchoring the Commission's enforcement efforts to practices that cause harm is important, because the modern information economy is built on data collection and analysis. The commercial use of information contributes to reducing the incidence of credit card fraud, democratizing the availability of consumer credit, and creating fraud detection tools to reduce the risk of identity theft.⁶⁸ It is essential not only for the basic functioning of the Internet, but also in creating value for consumers by supporting advertising, which underwrites the cost of content and services. Data collection and analysis allow tailoring both commercial and non-commercial offerings to meet consumers' specific preferences, and facilitates innovation by new and existing suppliers. Consumer data and feedback also enable the increased customization and personalization of online experiences and offerings for consumers, which is helping to fuel growth in broadband usage and e-commerce.

With data-dependent products and services, it is risky to let artificial distinctions get in the way of efficient market organization. If a use of information by a "first party" is a useful practice that benefits consumers, it does not become any less useful, or any more of a risk to privacy, because the most efficient way to produce those benefits is to share the information with a "third party" who actually does the analysis. A focus on information sharing, rather than information uses, risks creating entirely artificial barriers to innovation that will ill serve consumers in a market environment as dynamic as the internet.

The principle of avoiding the most serious mistake that should be central to advertising substantiation is equally applicable to privacy regulation. Regulation or enforcement that is too stringent may reduce the risk of the particular privacy harms to which it is addressed, but it increases the risk of precluding innovations that would make everyone's life better. Too little enforcement may facilitate innovation, but it also increases the risk of real and concrete privacy harms. The question is one of balance, and should be asked about every potential privacy enforcement action. Is the more serious error failing to regulate, or is overly burdensome regulation the greater risk?

⁶⁷ Unfairness Policy Statement, appended to *Int'l Harvester Co.*, 104 F.T.C. 949, 1070 (1984). ("Emotional impact and other more subjective types of harm ... will not ordinarily make a practice unfair.")

⁶⁸ For an extended discussion, see e.g., J. Howard Beales, III & Timothy J. Muris, *Choice or Consequences: Protecting Privacy in Commercial Information*, 75 *University of Chicago Law Review* 109, 115-117 (2009).

The Commission can reduce the risks of overregulation by focusing on real and identifiable harms. That is a proper role for consumer protection in general, and privacy regulation is no different. Regulation to prevent hypothetical problems, however, poses far greater risks that the next big innovation will be precluded, not because it would have caused a problem, but simply because no one had previously considered the possibility.

Thus, a focus on harm is particularly vital as the Commission examines new issues, such as the “internet of things,” from a privacy perspective. It will be easy to speculate about the potential privacy problems that might result from interconnected devices that talk to each other. Regulation based on speculative problems, however, is far more likely to chill useful innovations than it is to prevent real harms.

For example, when Congress and the Commission first began considering online privacy issues in the late 1990s, few would have imagined that literally billions of consumers would want to post many of the details of their personal lives online for all to see. Facebook and other social media have created tremendous value for consumers by enabling exactly that practice. Regulation based on what some might still consider “creepy” could easily have prohibited a valuable innovation.

Thank you again for the opportunity to testify today. I look forward to your questions.