

## FTC Hearings on Competition & Consumer Protection in the 21<sup>st</sup> Century

*FTC Project No. P181201*

### **Comments of International Center for Law & Economics:**

#### *The Current Landscape of Competition and Consumer Protection Law and Policy*

*Hearing #1 (Sep. 13, 2018)*

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We thank the Commission for the opportunity to comment on “Competition and Consumer Protection in the 21st Century Hearings, Project Number P181201.”

The International Center for Law and Economics (ICLE) is a nonprofit, nonpartisan research center whose work promotes the use of law & economics methodologies to inform public policy debates. We believe that intellectually rigorous, data-driven analysis will lead to efficient policy solutions that promote consumer welfare and global economic growth.<sup>1</sup>

ICLE’s scholars have written extensively on competition and consumer protection policy. Some of our writings are included as references in the comment below. Additional materials may be found at our website: [www.laweconcenter.org](http://www.laweconcenter.org).

In this comment, we primarily address the first topic highlighted by the Commission (“The current landscape of competition and consumer protection law and policy”). However, our comments also speak to several more specific questions, including:

1. The ambiguous effects of leveraging, consumer lock-in, and network effects (including cross-side network externalities) within the digital economy;
2. The fact that data-intensive industries should not fundamentally alter the balance of antitrust enforcement, and that data is unlikely to constitute a barrier to entry;
3. That policymakers should be careful not to chill the incentives to innovate of firms that operate in rapidly evolving industries;
4. That consumer protection activities should also be guided by an evidence-based approach, relying upon rigorous economic analysis.

Much of our analysis is imbued with discussion of these issues as they relate to communication, information, and media technology networks, many of which are considered “platform businesses.” However, we stress that, while there are issues that are peculiar to certain kinds of businesses, such as platforms – and indeed an entire realm of economic analysis that has been developed to analyze the two-sided markets that characterize such businesses – the fundamental principles of good anti-trust and consumer protection policy are not dependent on the type of business being analyzed. Rather, good policy is undergirded by sound economic analysis and solid empirical evidence, regardless of the type of business being analyzed. The same lessons apply to consumer protection policy.

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## I. Introduction: The rise of the digital economy, and the need for robust policy tools

The FTC Hearings on competition and consumer protection in the 21<sup>st</sup> century could not have come at a more appropriate time. Despite the vast social benefits generated by companies operating in the digital economy,<sup>2</sup> this economic transformation has stoked fears amongst members of the general public, the press, and policymakers. It has led to calls for interventionist policies such as heightened antitrust enforcement, sector-specific regulation, and direct intervention against industry concentration.<sup>3</sup>

Unfortunately, there is insufficient evidence and, at best, ambivalent theory to support any of these proposed policies—and in the absence of a strong basis for adopting them, the proposed policies would do more harm than good. Among other things, economies of scale, economies of scope, network effects, and the like may bring about larger firms and more concentrated markets *along with* considerable consumer benefits.<sup>4</sup> And new markets necessarily imply the consolidation of some firms and the exit of others, as competitors vie to come up with the winning paradigm.<sup>5</sup>

Against the backdrop of this evolutionary process, it is critical that authorities avoid knee-jerk reactions that may impair the long-term welfare of consumers and firms alike.

To steer clear of these acute false positives, we urge policymakers to base their enforcement efforts on the tried and tested “law and economics” approach. This approach seeks to maximize consumer welfare and places a heavy emphasis on evidence-based scholarship. In doing so, it promotes

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<sup>2</sup> See, e.g., Alexander Galetovic, Stephen Haber & Ross Levine, *An Empirical Examination of Patent Holdup*, 11 J. COMPETITION L. & ECON. 549, 565 (2015). (demonstrating that the quality-adjusted price of telephones, portable computers, and desktop computers plummeted between 1997 and 2013).

<sup>3</sup> See, e.g., U.S. Sen. Mark Warner, Potential Policy Proposals for Regulation of Social Media and Technology Firms, Jul. 30, 2018, available at <https://graphics.axios.com/pdf/PlatformPolicyPaper.pdf>. See also, U.S. Sen. Elizabeth Warren, “Reigniting Competition in the American Economy,” Keynote Remarks at New America’s Open Markets Program Event, June 29, 2016, available at [https://www.warren.senate.gov/files/documents/2016-6-29\\_Warren\\_Antitrust\\_Speech.pdf](https://www.warren.senate.gov/files/documents/2016-6-29_Warren_Antitrust_Speech.pdf). See also Commissioner Margrethe Vestager, When technology serves people (June 1, 2018), available at [https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/when-technology-serves-people\\_en](https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/when-technology-serves-people_en) (“After the first thrill, when we discovered what these technologies could do, we’ve started to see that there’s a dark side as well. A side that can challenge our most basic values – our privacy, our freedom to choose, even our democracy. And we’ve started to see that it’s time for people to take control”).

<sup>4</sup> See, e.g., Sharat Ganapati, *Oligopolies, Prices, Output, and Productivity* (Working Paper, Feb. 11, 2018), available at <https://ssrn.com/abstract=3030966> (statistical analysis finding that industry concentration growth is *positively correlated* with productivity and real output growth and *uncorrelated* with price changes).

<sup>5</sup> See Friedrich Hayek, *Competition as a Discovery Procedure*, 5 Q.J. AUSTRIAN ECON. 9, 13 (2002) (Marcellus Snow trans.). See also Steven Klepper, *Entry, Exit, Growth, and Innovation Over the Product Life Cycle*, 86 AM. ECON. R. 564 (1996). See also, David J. Teece, *Profiting from Technological Innovation: Implications for Integration, Collaboration, Licensing and Public Policy*, 15 RES. POL’Y 285 (1986). See also, Harold Demsetz, *Industry Structure, Market Rivalry, and Public Policy*, 16 J.L. & ECON. 1, 1-3 (1973).

innovation and minimizes the costs of policy errors.<sup>6</sup> Following this analytical framework will enable competition authorities to better address issues of exclusion and exploitation – as well as those of innovation and efficiency – in the digital economy.

The following paragraphs summarize some of the important findings which law and economics scholarship can bring to bear on competition and consumer protection enforcement in this space.

## **II. Taking account of the uncertainty of harm, the presence of countervailing benefits & the problems of devising an effective remedy**

Our shared vision of competition enforcement in the digital economy is probably best described in Harold Demsetz’ seminal paper, “Information and Efficiency: Another Viewpoint”.<sup>7</sup> Demsetz famously argued that policymakers should avoid the so-called “nirvana fallacy”. This occurs when government enforcement is based on discrepancies between real-world markets and some idealized and unachievable yardstick (rather than plausible alternatives). The key insight is that there are limits to what can be achieved through state intervention, not least because of limitations on enforcers’ knowledge about the competitive dynamics of the markets they seek to regulate.<sup>8</sup> In other words, policymakers should not ignore the potential drawbacks of enforcement. A practice’s departure from a theoretical competitive benchmark may be inextricably linked to social benefits which it also generates. When this is the case, enforcement may do more harm than good, and effective remedies will prove elusive.

In what follows, we extend this reasoning to four areas of potential concern, namely anticompetitive leveraging, consumer lock-in, network effects, and data collection and use. More specifically, we challenge the idea that these necessarily lead to winner-take all situations where digital platforms exclude their rivals and exploit their users.

### **A. The absence of clear anticompetitive harm**

A necessary, though not sufficient, condition for antitrust intervention is that a practice should be substantially likely to foster anticompetitive harm. Though there are disagreements regarding the exact goals of antitrust law (and thus the harms which it seeks to prevent), there is a wide consensus

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<sup>6</sup> See Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984). Regarding the application of Easterbrook’s error-cost framework to innovative markets; See Geoffrey A. Manne & Joshua D. Wright, *Innovation and the Limits of Antitrust*, 6 J. COMPETITION L. & ECON. 153 (2010).

<sup>7</sup> See Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J. L. & ECON. 1 (1969).

<sup>8</sup> As Richard Schmalensee writes, summing up the state of knowledge on the relationship between market structure and performance, “Inter-industry research has taught us much about how markets *look*... even if it has not shown us exactly how markets *work*.” See Richard Schmalensee, *Inter-Industry Studies of Structure and Performance*, in 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 951, 1000 (Richard Schmalensee & Robert Willig eds., 1989).

that it is designed to protect competition rather than competitors.<sup>9</sup> Accordingly, it is well-established that the mere exit of competitors from the market is insufficient to draw competition liability, in the absence of certain accompanying factors.<sup>10</sup> It is also relatively uncontroversial that a practice's potential effect on prices and output should play a role in this analysis.

With this in mind, a growing body of scholarship suggests that the competitive effects of leveraging, lock-in, and network effects are highly ambiguous. Indeed, such practices are regularly exhibited by non-dominant firms, suggesting that inferring monopoly power from these practices is inappropriate.<sup>11</sup> For this reason we argue that antitrust policymakers should rely on detailed, case-by-case assessments, avoiding any presumption<sup>12</sup> that these phenomena are inherently harmful to competition or that their presence is sufficient to establish dominance.

**Leveraging** refers to a series of potentially anticompetitive practices (such as tying, rebates, and refusals to supply) whereby a firm extends its dominance from one market to another. Crucially, these practices will not always allow a firm to restrict output; they may even have the opposite effect.<sup>13</sup> This remains true even in those instances where competitors are forced to exit the market.<sup>14</sup> Given these findings, authorities should (at the very least) limit their interventions to cases where it is clear that a practice will lead to lower output and higher prices.

Caution in concluding that conduct amounts to anticompetitive leveraging is particularly important within the digital economy where platforms must coordinate the behavior of two (or more) distinct groups of users or inputs.<sup>15</sup> Doing so usually entails some measure of coercion, ranging from simple terms of use (which dictate how users on one side are to behave) to more radical solutions such as vertical integration. Smartphones present a striking example of this range of coordination measures, from Apple's decision to vertically integrate iOS with its own devices, to Google's use of a web of

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<sup>9</sup> See Robert Pitofsky, *Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1064 (1979).

<sup>10</sup> See John E. Lopatka & William H. Page, *Antitrust on Internet Time: Microsoft and the Law and Economics of Exclusion*, 7 SUPREME COURT ECON. REV. 157, 162 (1999).

<sup>11</sup> See, e.g., Joshua D. Wright, *Defining and Measuring Search Bias: Some Preliminary Evidence*, ICLE White Paper 2011-01 (Nov. 2011), available at <https://laweconcenter.org/resource/defining-and-measuring-search-bias-some-preliminary-evidence/>.

<sup>12</sup> See Cyril Ritter, *Presumptions in EU Competition Law*, 6 J. ANTITRUST ENFORCEMENT 189, 189 (2018) ("presumptions could be defined [] as [] several types of logical leaps, automatisms, burden-shifting mechanisms and predispositions").

<sup>13</sup> In the presence of complementary goods, output is higher and prices are lower under a single monopolist rather than two "duopolists". See, e.g., Nicholas Economides & Steven C. Salop, *Competition and Integration Among Complements, and Network Market Structure*, 40 J. INDUS. ECON. 1,105, 106 (1992). See also, Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, 58 J. POL. ECON. 347 (1950)

<sup>14</sup> See Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. R. 837, 839 (1990) (concluding that tying has ambiguous welfare effects, even in those cases where it leads to the foreclosure of competitors).

<sup>15</sup> See, e.g., Paul Belleflamme & Martin Peitz, *Managing Competition on a Two-sided Platform*, AMSE Working Paper (2018), available at <https://halshs.archives-ouvertes.fr/halshs-01833106> (noting that platforms must deal with both cross-group and within-group external effects).

contractual provisions to steer the behavior of OEMs implementing Android OS.<sup>16</sup> In this context, a firm asserting control over one part of a platform (“leveraging”) may simply reflect its effort to maximize the utility of its users by coordinating decisions across the platform, facilitating cross-subsidization, etc.. When such conduct increases output and improves consumer welfare it should not be deemed impermissible leveraging.

Along similar lines, imposing “competitive neutrality” obligations upon vertically integrated firms may have numerous undesirable consequences. Most notably, it may encourage firms to opt for closed systems *ex ante*, and may also hinder the competitive position of firms that have not done so.<sup>17</sup> In both cases, consumers may ultimately be faced with less competition and inferior products. Moreover, equal treatment obligations may have ambiguous effects, both in terms of prices and investments.<sup>18</sup>

**Lock-in** occurs when various costs make it prohibitive for an “installed base” of consumers to switch to a rival’s product.<sup>19</sup> These costs primarily stem from network effects, contractual provisions and path dependence (notably learning costs).<sup>20</sup> Although lock-in is not a standalone theory of harm under European competition law, it can have a significant bearing on the outcome of cases.<sup>21</sup>

As with leveraging, the welfare implications of consumer lock-in are highly ambiguous.<sup>22</sup> Although it may lead to higher prices and fewer choices *once consumers are locked-in*, these effects are often counterbalanced by lower prices overall.<sup>23</sup> The lure of *ex post* profits may induce firms to compete aggressively in order to acquire valuable consumers.<sup>24</sup> Moreover, the ability to lock-in consumers may play a crucial role in launching new products, especially in digital markets.<sup>25</sup>

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<sup>16</sup> See Robert H Bork & J Gregory Sidak, *What Does the Chicago School Teach About Internet Search and the Antitrust Treatment of Google?*, 8 J. COMPETITION L. & ECON. 663, 699 (2012).

<sup>17</sup> See, e.g., Daniel A. Crane, *Search Neutrality as an Antitrust Principle*, 19 GEO. MASON L. REV., 1199, 1209 (2011).

<sup>18</sup> This has notably been shown in the context of the net neutrality debate. See, e.g., Gary S. Becker, Dennis W. Carlton & Hal S. Sider, *Net Neutrality and Consumer Welfare*, 6 J. COMPETITION L. & ECON. 497 (2010).

<sup>19</sup> See generally Joseph Farrell & Paul Klemperer, *Coordination and Lock-in: Competition with Switching Costs and Network Effects*, 3 HANDBOOK OF INDUSTRIAL ORGANIZATION (Mark Armstrong & Robert H. Porter, eds 2007) 1967.

<sup>20</sup> See, e.g., C. SHAPIRO & H. R. VARIAN, *INFORMATION RULES: A STRATEGIC GUIDE TO THE NETWORK ECONOMY* 117 (Harvard Business School Press. 1998).

<sup>21</sup> See Communication from the Commission, *supra* note 9, at § 19.

<sup>22</sup> See, e.g., P. BELLEFLAMME & M. PEITZ, *INDUSTRIAL ORGANIZATION: MARKETS AND STRATEGIES* 167 (Cambridge University Press. 2010).

<sup>23</sup> See Shapiro & Varian, *supra* note 20, at 133. (The authors stress that lock-in must always be addressed by looking at the entire “lock-in cycle”).

<sup>24</sup> This notably occurs with exclusivity arrangements, which cause firms to compete aggressively “for the contract”. See Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L. J. 433 (2008).

<sup>25</sup> See Shapiro & Varian, *supra* note 20, at 142 (“Companies unwilling or unable to offer concessions to gain locked-in consumers cannot prevail in a competitive battle”).

For these reasons, we urge antitrust authorities to approach potential consumer lock-in with caution and intervene only if there is clear evidence that lock-in will lead to higher prices over the whole “lock-in cycle”, rather than higher prices at a given point in time. Moreover, policymakers should examine whether there is competition between platforms to acquire new customers, as this will generally constrain their *ex post* behavior.

**Network effects** occur when a consumer’s utility for a good is, at least in part, a function of the expected number (and quality) of other agents using the same product.<sup>26</sup> These valuable users may be located in the same market or on the opposite side of a platform.<sup>27</sup> From a policy standpoint, some scholars have voiced fears that these network effects may lead to highly concentrated markets owing to the presence of positive feedback loops (this is sometimes referred to as “tipping”).

But not all markets with network effects will eventually tip towards a single winning firm,<sup>28</sup> and multi-homing is common, especially among many high-tech platforms including social networks, online marketplaces, online search, and online advertising. Of crucial importance, the presence of network effects and even a lopsided market distribution need not result in anticompetitive effects if there is potential competition from smaller competitors or new entrants. And even where consumer lock-in seems high and multi-homing low (say, across different OS app stores), supplier multi-homing may be common (as it is among developers of the most popular apps), thus enhancing competition “for the market”.<sup>29</sup>

The presence of network effects does not necessarily prevent entry by more-efficient and/or innovative rivals.<sup>30</sup> Nor, importantly, do they preclude the creation of another market entirely through disruptive innovation.<sup>31</sup> On the contrary, network effects are a double-edged sword that can sometimes *hasten* the decline of dominant platforms.<sup>32</sup>

Another crucial point is that, even if tipping does occur, one cannot assume that society will be worse-off as a result. Fragmentation may be just as harmful as monopoly when markets present network effects.<sup>33</sup> A corollary is that higher prices are perfectly compatible with increased output and

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<sup>26</sup> See, e.g., Michael L. Katz & Carl Shapiro, *Systems Competition and Network Effects*, 8 J. ECON. PERSP. 93, 96 (1994).

<sup>27</sup> See, e.g., Jean-Charles Rochet & Jean Tirole, *Platform Competition in Two-Sided Markets*, 1 J. EUR. ECON. ASS’N 990 (2003).

<sup>28</sup> This is especially true in the presence of heterogeneous consumer preferences and differentiated products. See Shapiro & Katz, *supra* note 26, at 106.

<sup>29</sup> See Sami Hyrynsalmi, Arho Suominen & Matti Mäntymäki, *The Influence of Developer Multi-homing on Competition Between Software Ecosystems*, 111 J. SYS. & SOFTWARE 119, 119-27 (2016).

<sup>30</sup> See E. Glen Weyl & Alexander White, *Let the Best “One” Win: Policy Lessons from the New Economics of Platforms*, 10 COMPETITION POL’Y INT’L, 28 (2014).

<sup>31</sup> See, e.g., Thibault Schrepel, *L’innovation de Rupture: De Nouveaux Défis Pour le Droit de la Concurrence*, 42 REVUE LAMY CONCURRENCE 141, 143 (2015).

<sup>32</sup> See, e.g., David S. Evans & Richard Schmalensee, *Debunking the Network Effects Bogeyman*, 40 REGULATION 36 (2017).

<sup>33</sup> See Volker Nocke, Martin Peitz & Konrad Stahl, *Platform Ownership*, 5 J. EUR. ECON. ASS’N 1130 (2007).

consumer surplus. These striking features have even led some scholars to call for a policy that would *subsidize* the formation of “monopoly” platforms, rather than prevent their appearance.<sup>34</sup>

A particular instance of network effects concerns **two-sided markets** where output is related not only to the overall, platform-wide price level, but also to the *distribution* of prices across the two sides.<sup>35</sup> Multi-sided platforms must routinely balance the various sides of the market such that, in many cases, one side subsidizes another.<sup>36</sup>

Contemporary economics provides no basis for assuming that a demonstration of price effects on one side of a two-sided market accurately represents the market-wide effects of a course of conduct.<sup>37</sup> Rather, economics predicts that market-wide welfare might increase, decrease, or remain neutral given price effects. Only an analysis of the market as a whole can illuminate the true competitive implications. As a result, the proper metric by which to judge competitive effects in a two-sided market is market-wide *output*.<sup>38</sup>

This two-sided analysis should also extend beyond mere price effects particularly as, often, some platform users may pay a zero price. One side of the market may experience some burden from a rule or practice – such as the collection of personal data – but a significant benefit on the other may more than offset this inconvenience. Accordingly, it is *necessary* to consider what is happening on both sides of a two-sided platform in order to understand properly the implications of the platform’s conduct.

The upshot is that demonstrating harm on one side of a two-sided platform is not sufficient to establish any presumption that *market-wide* consumer welfare has decreased. The simple reallocation of costs and benefits across the two sides of a two-sided market can be output increasing, output reducing, or output neutral. Looking at effects on one side simply cannot distinguish between these scenarios. Failing to adopt this holistic approach would significantly raise error costs, as authorities risk inferring anticompetitive harm (say, in the form of a price increase on one side of the market) from procompetitive conduct (i.e., conduct that increases output market-wide).

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<sup>34</sup> See Weyl & White, *supra*, note 30.

<sup>35</sup> See Jean-Charles Rochet & Jean Tirole, *Two-Sided Markets: A Progress Report*, 35 RAND J. ECON. 645, 646 (2006).

<sup>36</sup> See David S. Evans & Michael Noel, *Defining Antitrust Markets When Firms Operate Two-Sided Platforms*, 2005 COLUM. BUS. L. REV. 667, 668, 682, 688 (2005).

<sup>37</sup> See Benjamin Klein, *et al.*, *Competition in Two-Sided Markets: The Antitrust Economics of Payment Card Interchange Fees*, 73 ANTITRUST L.J. 571, 599 (2006).

<sup>38</sup> The US Supreme Court reached this same conclusion in *Ohio v. American Express Co.*, 585 U.S. \_\_ (2018).



## B. The presence of significant countervailing benefits

Adding to the ambiguous picture of the previous paragraphs, the above practices may generate significant benefits for consumers.

**Leveraging** by a dominant platform may lead to valuable synergies. For example, the integration of various products into a single suite may greatly simplify users' experience.<sup>39</sup> Along similar lines, firms may use the capabilities they have developed in one market to offer superior products elsewhere.<sup>40</sup> For instance, harnessing user data from one market may allow platforms to deliver a more tailored experience to consumers across their entire product range. With this in mind, "leveraging" may simply reflect consumers' preference for a dominant firm's products, rather than the unfair exclusion of rivals. Importantly, these benefits will not always be attainable through open-market transactions due to transactions costs and the potential for hold-up.<sup>41</sup>

Likewise, **lock-in** and switching costs are often the by-product of important product design choices. Agreeing upon a single, market-wide standard may sometimes delay the introduction of new products and make existing ones less reliable.<sup>42</sup> Similarly, mandated data portability may have negative ramifications as far as security and privacy are concerned.<sup>43</sup> Finally, learning costs will often reflect the rich set of features which a product offers its users rather than a naked attempt to lock them in. The upshot is that policy aimed at undermining switching costs can sometimes be highly counterproductive.

Finally, the virtues of consolidation in markets with **network effects** (and by extension in multi-sided platform markets) are by now well-established. As has already been alluded to, fragmentation is potentially more harmful than monopoly in this context.<sup>44</sup> The pursuit of a "structuralist" competition policy, at the expense of a more pragmatic and efficiency-based approach, may thus deprive users of the opportunity to coordinate on a preferred network.

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<sup>39</sup> See Hanno F. Kaiser, *Are 'Closed Systems' an Antitrust Problem?*, 7 COMPETITION POL'Y INT'L. 91 (2011).

<sup>40</sup> See Teece, *supra*, note 5. Teece argues that firms' capabilities are a key driver of innovation. There is no reason to believe that these capabilities could not be leveraged across multiple markets.

<sup>41</sup> See Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937). See also, Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & ECON. 297 (1978). See also, Oliver E. Williamson, *The Economics of Organization: The Transaction Cost Approach*, 87 AM. J. SOC. 548 (1981).

<sup>42</sup> See, e.g., Michael L. Katz & Carl Shapiro, *Product Compatibility Choice in a Market with Technological Progress*, 38 OXFORD ECON. PAPERS, 146, 147 (1986). ("Typically, achieving technical compatibility will be costly").

<sup>43</sup> See Peter Swire & Yianni Lagos, *Why the Right to Data Portability Likely Reduces Consumer Welfare: Antitrust and Privacy Critique*, 72 MD. L. REV. 335 (2012).

<sup>44</sup> See Nocke, Peitz & Stahl, *supra*, note 33.

### C. The difficulty of effective remedies

Leveraging, lock-in, and network effects can each have quite ambiguous consequences. It will thus prove highly challenging for authorities and parties to devise remedies that weed out their undesirable aspects while retaining their pro-consumer virtues. In that regard, we believe the key question is whether, on balance, a proposed remedy truly improves social welfare, or merely ameliorates a specific concern at inordinately high cost.

The pitfalls of designing effective remedies in the digital economy are nowhere clearer than in the case of network effects. Although consolidation within a single platform may give rise to monopoly power, it also generates considerable benefits for users. Artificially constraining the size or scope of a platform's network may impair the very interconnectedness from which users derive value. Moreover, compelling firms to develop compatible standards will tend to reduce product differentiation, facilitate collusion, and reduce or remove "for the market" competition between platforms. Finally, competition history teaches us that breaking up powerful firms is no silver bullet.<sup>45</sup>

Problems also arise when remedies seek to tackle issues of leveraging and lock-in. Forcing dominant firms to open their platforms to downstream rivals can lock in inefficient practices and make it harder to implement new design choices or innovative business models. This, in turn, might impair their ability to compete with rivals. Likewise, the type of compatibility required to alleviate consumer lock-in will often require firms to coordinate with rivals, raising the risks of opportunistic behavior and collusion.

### III. The advent of the "data economy" should not affect the balance of competition enforcement

The rise of large, data-intensive tech companies has been at the forefront of recent competition policy debates.<sup>46</sup> In that regard, an important misconception is the assertion that data-intensive industries necessarily imply significant barriers to entry, and that data routinely constitutes an essential facility.<sup>47</sup> Accepting either of these premises would set a dangerous precedent for future competition enforcement.

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<sup>45</sup> See, e.g., William E. Kovacic, *Designing Antitrust Remedies for Dominant Firm Misconduct*, 31 CONN. L. REV. 1285, 1297 (1998).

<sup>46</sup> See German Bundeskartellamt, *Preliminary Assessment in Facebook proceeding: Facebook's Collection and Use of Data from Third-party Sources is Abusive*, Dec. 19, 2017, available at [https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2017/19\\_12\\_2017\\_Facebook.html](https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2017/19_12_2017_Facebook.html). See also [U.S. Representative] David N. Cicilline & [former FTC Commissioner] Terrell McSweeney, *Competition is at the Heart of Facebook's Privacy Problem*, WIRED, Apr. 24, 2018, [www.wired.com/story/competition-is-at-the-heart-of-facebooks-privacy-problem/](http://www.wired.com/story/competition-is-at-the-heart-of-facebooks-privacy-problem/).

<sup>47</sup> See Maurice E. Stucke, *Should We Be Concerned About Data-opolies?*, 2 GEO. L. TECH. REV. 275, 294 (2018).

The mere fact that an incumbent owns large amounts of data does not constitute a barrier to entry. If everything that improves an incumbent's products and thus makes entry more difficult is counted as a legal "barrier to entry", then all the competitive strengths which set a firm apart from its rivals will fall under this definition. These include superior product design, more efficient marketing teams, an established reputation, better engineers, etc. It is for this reason that Stigler famously argued that the notion of barriers to entry should be limited to production costs "*which must be borne by a firm which seeks to enter an industry but [are] not borne by firms already in the industry.*"<sup>48</sup> Under this definition, a trove of data could count as a barrier to entry only if it proved less costly for the incumbent to amass than for its rivals. As things stand, there is simply no evidence that this is the case for the large tech firms that dominate competition policy discussions.

Indeed, it is virtually always missed that an incumbent's efforts to amass data or other inputs – or innovation by incumbents more generally – may actually *facilitate* entry by rivals. The famous "applications barrier to entry" in the U.S. *Microsoft* case demonstrates this fallacy.<sup>49</sup> New entrants may have faced difficulty attracting developers away from Microsoft's platform that Microsoft, as the dominant platform, did not. But these firms also benefited from an established PC developer ecosystem (built significantly at Microsoft's expense) that Microsoft itself did not enjoy: the existence of "PC app developer" as a viable profession, career guidance pushing new workers into the market, schools aimed at educating developers, consumer facility with and demand for modular operating systems, and on and on. It is by no means clear that the combined effect was the imposition of net costs on new entrants.

Failing to adopt this "Stiglerian" definition of barriers to entry would have severe repercussions. Counting superior efficiency as a barrier to entry (itself a precondition for a finding of dominance and subsequent competition liability) would chill efficient behavior by tech platforms. Moreover, diluting the notion of barriers to entry brings with it an acute risk of confirmation bias on the part of competition authorities, and a significantly heightened risk of abusive complaints or private actions by new entrants seeking a leg up.

It is important not to conflate the factors which make an incumbent strong (we might be tempted to call these "barriers to entry") with the capabilities that rivals may employ to compete with it. In other words, the fact that firm A uses or produces certain data to provide a superior product does not imply that rivals require this or even necessarily similar data to compete. Were it otherwise, airlines would not have outcompeted steam trains, Microsoft would not have bested IBM and Atari, Google would not have upended Yahoo, and Uber would not be challenging the hegemony of taxicabs, etc. The upshot is that authorities should not assume that rivals cannot compete with an incumbent without mimicking its specific competitive strengths. Adopting a naïve notion of barriers

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<sup>48</sup> See GEORGE J. STIGLER, *THE ORGANIZATION OF INDUSTRY* 67 (1968).

<sup>49</sup> See Manne & Wright, *supra* note 6, at 180.

to entry perpetuates this fallacy by focusing only on what makes a defendant appear strong and ignoring its competitive vulnerabilities.

This applies, *a fortiori*, to the notion of data as an essential facility.<sup>50</sup> It is difficult to imagine that a given dataset could be essential for rivals to compete against an incumbent when competition in digital markets is so heavily based on offering differentiated/disruptive products. Moreover, because so much of the data at issue is created by users' interactions with an incumbent, rather than created exogenously (i.e., there is no data on people's Facebook "likes" without Facebook manufacturing the means to create it), it is virtually indistinguishable from the incumbent's own innovation and investments in product design. And where it is not—where the data is, indeed, exogenous—it is typically easily replicable. For these reasons, treating data as an essential facility will merely diminish firms' incentives to provide superior goods to their consumers, and will offer little in terms of actual competitive benefits.

#### **IV. Competition enforcement should not operate to chill firms' incentives to innovate**

Often efforts to intervene in high-tech markets take the existence of transformative technologies for granted, and ignore the considerable efforts required to create them. Once one accounts for these dynamic effects, however, the harmful potential of leveraging, network effects, lock-in, and data "barriers to entry" becomes even more questionable.

The digital economy is built upon tremendous investments in innovation. In 2017 alone the GAFAM firms invested a combined \$66 billion in research and development.<sup>51</sup> On average, this amounted to 10.6% of their annual revenue. They are not alone. According to a report by KPMG, global venture capital investments reached a record \$155 billion over the same year.<sup>52</sup>

These investments were likely not due to philanthropy. Entrepreneurs will expect to earn a positive return on their outlays.<sup>53</sup> Given the probabilistic nature of innovation (most projects fail, and it is up to the few successful ones to generate a positive return), healthy innovative activity requires that some business ventures earn what might appear to be exorbitant profits. This does not always sit well

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<sup>50</sup> See Giuseppe Colangelo & Mariateresa Maggiolino, *Big Data as Misleading Facilities*, 13 EUR. COMPETITION J. 249, 255 (2017) (the authors' skepticism about data as an essential facility is notably due to its non-rival nature). The fact that one company has collected a given piece of data does not, in itself, prevent its rivals from obtaining the same information.

<sup>51</sup> Google (\$16,625 million, 15%); Microsoft (\$13,037, 14%); Amazon (\$22,620 million, 12%); Facebook (\$2,820 million, 7%); Apple (\$11,581 million, 5%). These numbers are taken from the firms' 10-K filings for year 2017.

<sup>52</sup> See KPMG, *2017 Global Venture Capital Investment Hits Decade High of US\$155 Billion Following a Strong Q4*, Jan. 18, 2018, available at <https://home.kpmg.com/sg/en/home/media/press-releases/2018/01/kpmg-venture-pulse-q4-2017.html>.

<sup>53</sup> See, e.g., Michael E. Porter, *How Competitive Forces Shape Strategy*, in READINGS IN STRATEGIC MANAGEMENT 133 (1989).

with competition law, which often prevents firms from obtaining monopoly profits through various practices.

It is well-established that expected profits are generally a precondition for innovation. Despite their numerous disagreements, Schumpeter, Arrow, Teece, Stiglitz and, more recently, scholars from the endogenous growth school have all arrived at this same conclusion.<sup>54</sup> These findings cover both micro and macroeconomics, theoretical and empirical work, and fields that range from industrial organization to management literature. It is as close as economic research comes to unanimous agreement.

All of this is not to say that competition law is inimical to innovation, but rather that there is a very fine line between punishing anticompetitive conduct and chilling firms' incentives to innovate.<sup>55</sup> Although a firm's presence in multiple markets, consumer lock-in, network effects, and large data holdings may sometimes boost profits (other things being equal), they are not sufficient grounds for antitrust intervention. Acquiring an installed base of consumers, potentially spanning multiple markets, is precisely what spurs firms to innovate in the digital economy.

More generally, and especially when viewed from this dynamic viewpoint, the recent spate of calls for enhanced antitrust enforcement to combat large, profitable firms in allegedly concentrated markets is lacking in both theoretical and empirical support.<sup>56</sup> Higher corporate profits and increased concentration may indeed go hand in hand with superior products and increased consumer surplus.<sup>57</sup>

## **V. Economically Grounded, Evidence-Based Consumer Protection**

Many of the concerns noted above with respect to competition policy also apply to the Commission's consumer protection authority. Most crucially, the discovery, investigation, and remedy of harm to

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<sup>54</sup> See J.A. SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* 77-78 (Routledge, 1976). See also Kenneth Arrow, *Economic Welfare and the Allocation of Resources for Invention*, in *THE RATE AND DIRECTION OF INVENTIVE ACTIVITY: ECONOMIC AND SOCIAL FACTORS* 620 (1962). See also, Partha Dasgupta & Joseph Stiglitz, *Industrial Structure and the Nature of Innovative Activity*, 90 *THE ECON. J.* 266 (1980). See also Teece, *supra* note 5. See also, Philippe Aghion, Nick Bloom, Richard Blundell, Rachel Griffith & Peter Howitt, *Competition and Innovation: An Inverted-U Relationship*, 120 *Q. J. ECON.* 701 (2005).

<sup>55</sup> For a discussion of this difficult balancing act, see, for example, Thibault Schrepel, *The Enhanced No Economic Sense Test: Experimenting with Predatory Innovation*, 7 *NYU J. INTELL. PROP. & ENT. L.* 30 (2017).

<sup>56</sup> See generally Joshua D. Wright, *et al.*, *Requiem for a Paradox: The Dubious Rise and Inevitable Fall of Hipster Antitrust*, George Mason Law & Econ Research Paper No. 18-29 (2018), available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3249524](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3249524).

<sup>57</sup> See Demsetz, *supra* note 5. (Demsetz decisively defeated the negative presumptions regarding high profits and market concentration promoted by the Structure-Conduct-Performance paradigm). See also, Douglas H. Ginsburg & Joshua D. Wright, *Philadelphia National Bank: Bad Economics, Bad Law, Good Riddance*, 80 *ANTITRUST L. J.* 201, 207 (2015) (The "SCP paradigm is now dead and has been for quite some time. Its intellectual influence on modern economics is nil. It is no longer taught in graduate economics courses").

consumers should be informed by economically rigorous theory and driven by evidence-based methodology. Yet this has not always been the case.<sup>58</sup>

Consumer protection policy at the FTC has increasingly been shaped primarily by the FTC's discretion, not by evolution through judicial review or dialogue with economic scholarship. In the last decade, the FTC has increasingly been using its unfairness authority to address cutting-edge issues involving data security, privacy, and other aspects of the modern, high-tech economy. It has even begun pushing the legal boundaries of its authority over deception by extending it beyond traditional advertising claims to privacy policies, online FAQs, and the like. But it has not, to outward appearances at least, similarly enhanced the economic content of its enforcement policy, even as it has delved further into uncharted and uncertain territory.

At the heart of its discretionary consumer protection model is the FTC's ability to operate without significant judicial constraints. Particularly with respect to privacy and data security enforcement, the Commission has not developed a predictable set of legal doctrines – because that would require resolution through court decisions, and the FTC has managed to settle the vast majority of these cases out of court. What some call the FTC's “common law of consent decrees” in its data security cases is, unfortunately, little more than a series of unadjudicated assertions, unsupported by any (publicly disclosed) economic analysis.

The pseudo-common law of un-adjudicated settlements, lacking any doctrinal analysis developed under the FTC's unfairness authority, simply doesn't provide sufficient grounds to separate the fair from the unfair.

Significantly in this regard, the FTC's so-called “common law” decisions identify, at best, only what conduct in specific instances violates the law; they do not identify what conduct does not violate the law. Real common law, by contrast, provides insights into both – offering guidance to firms regarding not only specifically proscribed conduct but also the scope of conduct in which they may operate without fear of liability. Consent decrees tell us, for example, that “invitations to collude” and “deception in standard setting” are violations of Section 5. And thus they are potentially useful guidance for that conduct. But they tell us nothing to very little about the next type of conduct that will be prosecuted under Section 5.

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<sup>58</sup> See, generally, Justin (Gus) Hurwitz, *Data Security and the FTC's UnCommon Law*, 101 IOWA L. REV. 955 (2016); Geoffrey A. Manne & Kristian Stout, *When “Reasonable” Isn't: The FTC's Standard-less Data Security Standard*, J. L. ECON. & POL'Y (2018) (forthcoming) available at <https://laweconcenter.org/wp-content/uploads/2017/10/SSRN-id3041533.pdf>; Berin Szóka & Geoffrey A. Manne, *The Federal Trade Commission: Restoring Congressional Oversight of the Second National Legislature*, ICLE FTC Technology & Reform Project, Second Report (2016) available at <https://laweconcenter.org/wp-content/uploads/2017/09/ftc-restoring-congressional-oversight.pdf>; Geoffrey A. Manne, R. Ben Sperry & Berin Szoka, *In The Matter Of Nomi Technologies, Inc.: The Dark Side Of The FTC's Latest Feel-Good Case*, ICLE Antitrust & Consumer Protection Research Program White Paper 2015-1 (2015), available at <http://laweconcenter.org/images/articles/icle-nomi-white-paper.pdf>.

The FTC might be right in some specific cases, of course, but overall, what evolves is not “law.” Rather, it is merely a list of assertions as to what the Commission thinks companies should and should not do. Unfortunately, recent FTC leadership has shown little interest in limiting the agency’s discretion or offering economic grounding for its decisions. In a similar context Commissioner Ohlhausen has pointedly noted:

The guidance in the Policy Statement will be replaced by this view: “[T]he Commission withdraws the Policy Statement and will rely instead upon existing law, which provides sufficient guidance on the use of monetary equitable remedies.” This position could be used to justify a decision to refrain from issuing any guidance whatsoever about how this agency will interpret and exercise its statutory authority on any issue.<sup>59</sup>

Likewise, in his dissent from the Commission’s 2012 Privacy Report, the late Commissioner Rosch warned that the use of unfairness to address privacy issues traditionally in the ambit of deception was tantamount to unmooring the FTC’s approach from sensible, rigorous limitations: “‘Unfairness’ is an elastic and elusive concept. What is ‘unfair’ is in the eye of the beholder....”<sup>60</sup> In effect, Commissioner Rosch was really saying that the Commission had failed to justify its analysis of unfairness. Rosch objected to the Commission’s invocation of unfairness against harms that have not been clearly analyzed:

That is not how the Commission itself has traditionally proceeded. To the contrary, the Commission represented in its 1980, and 1982 [sic], Statements to Congress that, absent deception, it will not generally enforce Section 5 against alleged intangible harm. In other contexts, the Commission has tried, through its advocacy, to convince others that our policy judgments are sensible and ought to be adopted.<sup>61</sup>

Rosch contrasted the Report’s reliance on unfairness with the Commission’s Unfair Methods of Competition doctrine, which he called “self-limiting” because it was tied to analysis of market power.<sup>62</sup> Rosch lamented:

There does not appear to be any such limiting principle applicable to many of the recommendations of the Report. If implemented as written, many of the Report’s recommendations would instead apply to almost all firms and to most information collection practices. It would install “Big Brother” as the watchdog over these practices not only in

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<sup>59</sup> Statement of Commissioner Maureen K. Ohlhausen Dissenting from the Commission’s Decision to Withdraw its Policy Statement on Monetary Equitable Remedies in Competition Cases (Jul. 31, 2012), *available at* [http://www.ftc.gov/sites/default/files/documents/public\\_statements/statement-commissioner-maureen-k.ohlhausen/120731ohlhausenstatement.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-maureen-k.ohlhausen/120731ohlhausenstatement.pdf).

<sup>60</sup> FED. TRADE COMM’N, PROTECTING CONSUMER PRIVACY IN AN ERA OF RAPID CHANGE: RECOMMENDATIONS FOR BUSINESS AND POLICYMAKERS (2012) at C-3, *available at* <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-report-protectingconsumer-privacy-era-rapid-change-recommendations/120326privacyreport.pdf>.

<sup>61</sup> *Id.* at C-4.

<sup>62</sup> *Id.* at C-5.

the online world but in the offline world. That is not only paternalistic, but it goes well beyond what the Commission said in the early 1980s that it would do, and well beyond what Congress has permitted the Commission to do under Section 5(n). I would instead stand by what we have said and challenge information collection practices, including behavioral tracking, only when these practices are deceptive, “unfair” within the structures of Section 5(n) and our commitments to Congress, or employed by a firm with market power and therefore challengeable on a stand-alone basis under Section 5’s prohibition of unfair methods of competition.<sup>63</sup>

Commissioner Rosch was no great fan of the extent of the FTC’s use of economics.<sup>64</sup> But even he was concerned about the development of unfairness enforcement policy in novel areas without rigorous analysis.

### **A. The Absence of Economic and Evidentiary Rigor in the Commission’s Approach to Section 5**

To craft effective policy in this area, the Commission should develop and apply determinate standards in order to ensure that its Section 5 consumer protection authority is used (a) only to address conduct that is demonstrably harmful to consumers and (b) only where other, more-effective mechanisms are not available to achieve that goal. In other words, the Commission should operate under clear standards to ensure that the vast discretion that Congress has vested in the FTC to shape business conduct is not used in ways that harm consumers or firms or for anticompetitive or political purposes.

#### *1. Section 5(n) Unfairness and the FTC’s un-economic approach to data security cases*

The meaning of Section 5(n) has been the subject of intense debate for years.<sup>65</sup> Section 5(n) and the Unfairness Statement gives some contours to a definition, but much fundamental uncertainty remains. In particular, it is unclear whether Section 5(n) defines a test for what constitutes unfair conduct (that which “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers

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<sup>63</sup> *Id.*

<sup>64</sup> See e.g., J. Thomas Rosch, *Litigating Merger Challenges: Lessons Learned* (June 2, 2008), available at [https://www.ftc.gov/sites/default/files/documents/public\\_statements/litigating-merger-challenges-lessonslearned/080602litigatingmerger.pdf](https://www.ftc.gov/sites/default/files/documents/public_statements/litigating-merger-challenges-lessonslearned/080602litigatingmerger.pdf) (“any kind of economic analyses that require the use of mathematical formulae are of little persuasive value in the courtroom setting;” “when I see an economic formula my eyes start to glaze over.”); See generally Joshua Wright, *Commissioner Rosch v. Economics, Again*, TRUTH ON THE MARKET (Oct. 7, 2008) available at <https://truthonthemarket.com/2008/10/07/commissioner-rosch-v-economics-again/>.

<sup>65</sup> See, e.g., Daniel J. Solove & Woodrow Hartzog, *The FTC and the New Common Law of Privacy*, 114 Colum. L. Rev. 583, 596 (2014); Geoffrey A. Manne & Kristian Stout, *When “Reasonable” Isn’t: The FTC’s Standardless Data Security Standard*, *supra* note 58.



or to competition”) or whether it instead imposes a necessary, but not necessarily sufficient, condition on the extent of the FTC’s authority to bring cases.

But – at least textually – Section 5 itself actually incorporates sensible economic limiting principles:

The Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.<sup>66</sup>

The core requirements (that injury be substantial, that it not be reasonably avoidable by consumers, and that it not be outweighed by countervailing benefits) serve to impose an error-cost approach on unfairness questions, limiting both the likelihood and harm of erroneous over-enforcement. “To justify a finding of unfairness, the Commission must demonstrate the allegedly unlawful conduct results in net consumer injury.”<sup>67</sup>

In practice, however, the absence of significant institutional constraints from the courts has diluted the effect of these provisions in many cases.

The meaning of “causes” under 5(n) is also unclear because, unlike causation in traditional legal contexts, Section 5(n) also targets conduct that is “likely to cause” harm – an addition that, if too-broadly interpreted, can write the causation requirement out of the statute entirely. Rather, whatever the specific standard for “unreasonableness,” there must be a causal connection between the acts (or omissions) and injury. Even for “likely” harms this requires not merely *any* possibility but some high *probability* at the time the conduct was undertaken that it would cause future harm.<sup>68</sup>

Moreover, if the FTC’s “likely” authority is to have any meaningful limit, it must be understood *prospectively*, from the point at which the FTC issues its complaint. Thus, if an investigative target has *ceased* practices that the Commission claims would “likely” cause harm by the time a complaint is issued, the claim is logically false and, in effect, impossible to remedy: Section 5 is not punitive and the FTC has no authority to extract damages, but may only issue prospective injunctions. In other words, because Section 5 is intended to *prevent* (not punish) unfair practices that harm consumers, if a potential investigative target has *already ceased* the potentially unfair practices, the deterrent effect of Section 5 may be deemed to have been achieved by the omnipresent threat of FTC investigation. This is, in fact, the statute working properly.

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<sup>66</sup> 15 U.S.C. § 45(n).

<sup>67</sup> Dissenting Statement of Commissioner Joshua D. Wright, In the Matter of Apple, Inc., FTC File No. 1123108, at 14 (Jan. 15, 2014), available at [http://www.ftc.gov/sites/default/files/documents/cases/140115applestatementwright\\_0.pdf](http://www.ftc.gov/sites/default/files/documents/cases/140115applestatementwright_0.pdf).

<sup>68</sup> See Initial Decision, *In the Matter of LabMD Inc.*, (No. 9357), 2015 WL 7575033 (Fed. Trade Comm. Nov. 13, 2015) at 54.

Although, as noted, some have argued that the FTC's data security complaints, consent orders, speeches, and Congressional testimony collectively provide sufficient guidance to business, the lack of more-formal guidelines is notable.<sup>69</sup> Moreover, this set of guiding materials is notably lacking any direct discussion of the reasons data security investigations are closed.

In practice, the FTC brings data security cases (under both Deception and Unfairness) based on the alleged "unreasonableness" of a respondent's security practices. But it regularly does so without addressing the actual Section 5 elements (materiality, substantial injury, etc.) and even without connecting them to the unreasonableness standard that the FTC employs in lieu of the statutory language.

There are further problems. In cases where the Agency does act, the FTC's complaints describe numerous potential problems but offer few insights into which ones were particularly important to the FTC's decision to bring an enforcement action. Such lack of guidance could even violate judicial requirements that agencies must, to satisfy constitutional standards of due process, provide "fair notice" of their policies.<sup>70</sup>

Thus, in the data security context the Commission's practice has not evidenced sensitivity to the logical limitations of Section 5. Rather, the FTC's approach has largely become a "strict liability" rule, presuming that *any* loss of data is effectively *per se* proof that a company's data security practices were unreasonable. Unfortunately, there is no evidence that the inherent trade-offs this entails between increased administrability and economic rigor, or between preventing consumer injury and imposing costs on businesses that are ultimately born by consumers, is actually desirable. *How* the FTC weighs those trade-offs may be as important as the substantive conclusion of that process.

## 2. *Materiality and the Commission's lax approach to evidentiary standards*

In order to bring a deception case, the FTC must prove among other things that "[t]he misleading representation, omission, or practice is material."<sup>71</sup> The history of the FTC's deception claims, however, fail to adequately demonstrate to the public what constitutes a "material" act or omission for the purposes of Section 5.

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<sup>69</sup> Some have further argued, in fact, that that the threat of action through speeches, reports and the like is preferable to more concrete statements or guidelines because they are even more flexible. See, e.g., Tim Wu, *Agency Threats*, 60 DUKE L. J. 1841 (2011), available at <http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1506&context=dli>.

<sup>70</sup> See *Amici Curiae* Brief of TechFreedom, International Center for Law and Economics & Consumer Protection Scholars at 6-12, *FTC v. Wyndham Worldwide Corp.*, No. 2:13-cv-01887 (D.N.J. Jun. 17, 2013), available at [http://docs.techfreedom.org/Wyndham\\_Amici\\_Brief.pdf](http://docs.techfreedom.org/Wyndham_Amici_Brief.pdf).

<sup>71</sup> See *Letter from James C. Miller III, Chairman, FTC, to Hon. John D. Dingell, Chairman, House Comm. on Energy & Commerce* (Oct. 14, 1983), appended to *In re Cliffdale Assocs., Inc.*, 103 F.T.C. 110, 174, 175-76 (1984) (decision & order), available at [https://www.ftc.gov/system/files/documents/public\\_statements/410531/831014deceptionstmt.pdf](https://www.ftc.gov/system/files/documents/public_statements/410531/831014deceptionstmt.pdf) [hereinafter "Deception Policy Statement" or "DPS"].

In Congressional testimony in 1982, FTC Chairman Miller proposed that materiality should require some proof of consumer harm, which would have made deception harder to establish and more like the common law (e.g., the torts of deceit or fraud).<sup>72</sup> In the end, the Deception Policy Statement (“DPS”) said instead that materiality was a proxy for harm, which generally the FTC would not separately need to prove: “if the practice is material, [then] consumer injury is likely, because consumers are likely to have chosen differently but for the deception.”<sup>73</sup> This allowed the FTC to retain authority over misleading practices that would not necessarily violate any common law standard.<sup>74</sup>

Where the DPS allows the FTC to presume materiality, however, it makes clear that the presumption is rebuttable: “The Commission will always consider relevant and competent evidence offered to rebut presumptions of materiality.”<sup>75</sup> In few cases, however, has the Commission actually weighed conflicting evidence,<sup>76</sup> and never has the FTC published guidance on what evidence might qualify as “relevant or competent” to rebut the presumption of materiality.

Moreover, those cases that do exist concern traditional marketing claims, not the kinds of novel fact patterns created by cutting-edge companies as was the case in, for example, the Commission’s *Nomi* proceeding.<sup>77</sup> Thus, lawyers advising clients facing a deception enforcement action, or trying to avoid one in the future, must rely primarily on complaints, consent decrees, and agency statements to attempt to predict how the FTC might weigh materiality. Unfortunately, the FTC has effectively stopped issuing closing letters to explain why it decided not to bring an enforcement action,<sup>78</sup> so there is essentially no body of law showing how the FTC decides not to bring an enforcement action regarding a claim (or omission) that was misleading but that the FTC decided was not actually material. Thus, it is hardly surprising that companies settle essentially all cases the FTC brings – which further compounds the problem, by denying other practitioners litigated cases where the issue has been explored.<sup>79</sup>

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<sup>72</sup> See generally Jef I. Richards & Ivan L. Preston, *Proving & Disproving Materiality of Deceptive Advertising Claims*, 11(2) J. PUB. POL’Y & MARKETING 45, 49-50 (1992).

<sup>73</sup> See *FTC v. Sperry & Hutchinson Trading Stamp Co.*, 405 U.S. 233 (1972).

<sup>74</sup> See Richards & Preston at 49-50.

<sup>75</sup> *Id.* at 189 n.47.

<sup>76</sup> See, e.g., *Novartis Corp. v. FTC*, 223 F.3d 783 (D.C. Cir. 2000); *Kraft Inc. v. FTC*, 970 F.3d 311 (7th Cir. 1992).

<sup>77</sup> See generally, Geoffrey A. Manne, R. Ben Sperry & Berin Szoka, *supra* note 58.

<sup>78</sup> See Geoffrey A. Manne & Ben Sperry, *FTC Process and the Misguided Notion of an FTC “Common Law” of Data Security*, ICLE Data Security & Privacy Working Paper (2014) available at <https://laweconcenter.org/resource/ftc-process-misguided-notion-ftc-common-law-data-security/> (“In order to get a better handle on the universe of [data security] cases at the FTC that didn’t result in settlements, we filed a FOIA request with the agency. It showed only seven closing letters and three emails closing investigations without bringing a case.”).

<sup>79</sup> See generally *id.*; Berin Szoka, *Indictments Do Not a Common Law Make: A Critical Look at the FTC’s Consumer Protection “Case Law,”* 2014 TPRC Conference Paper (Aug. 22, 2014), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2418572](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2418572).

But a string of settled cases that provide little in the way of detail that could guide the conduct of future parties does little to advance the FTC's mission of protecting consumers proactively. Meaningful and probative evidence is crucial, particularly in deception cases at the cutting edge as that is where new and unexpected practices could harm consumers – but it is also where, given the cryptic nature of the Commission's body of consent decrees, current practice does least to guide conduct.

This evidence is particularly crucial in those cutting edge cases because, frequently, it is not a single intentional act or omission that is in question, but rather a complicated set of facts that are difficult to evaluate in light of Section 5. Even the Deception Policy Statement notes that:

[T]he Commission will evaluate the entire advertisement, transaction, or course of dealing in determining how reasonable consumers are likely to respond. Thus, in advertising the Commission will examine "the entire mosaic, rather than each tile separately."<sup>80</sup>

Courts have suggested much the same thing:

[T]he tendency of the advertising to deceive must be judged by viewing it as a whole, without emphasizing isolated words or phrases apart from their context.<sup>81</sup>

Yet in *Nomi*, a case that demonstrates well the sort of complex fact pattern that the Commission faces in the modern economy, the majority dodges the key question: whether the evidence that *Nomi* accurately promised a *website* opt-out, and that consumers could (and did) opt-out using the website, rebuts the presumption that the inaccurate, in-store opt-out portion of the statement was material, and sufficient to render the statement *as a whole* deceptive. As Stanford Law Professor Richard Craswell has pointed out:

[S]ome method will have to be devised for determining when a statement that accurately informs in one respect while misleading the listener in another should properly be regarded as deceptive. This determination can be made without any trade-offs only if we are willing to say that any deception of the listener is enough to label the statement itself deceptive, analogous to holding that an advertisement should be deemed deceptive if it deceives even a single consumer.<sup>82</sup>

And in his *Nomi* dissent, former Commissioner Wright argued that

the Commission failed to discharge its commitment to duly consider relevant and competent evidence that squarely rebuts the presumption that *Nomi*'s failure to implement an additional, retail-level opt-out was material to consumers. In other words, the

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<sup>80</sup> Deception Policy Statement, *supra* note 71, at 183 n.31 (quoting *FTC v. Sterling Drug*, 317 F.2d 669, 674 (2d Cir. 1963)).

<sup>81</sup> *Beneficial Corp. v. FTC*, 542 F.2d 611, 617 (3d Cir. 1976).

<sup>82</sup> Richard Craswell, *Regulating Deceptive Advertising: The Role of Cost-Benefit Analysis*, 64 S. CAL. L. REV. 549, 594 (1991).

Commission neglects to take into account evidence demonstrating consumers would not “have chosen differently” but for the allegedly deceptive representation.<sup>83</sup>

Thus, the available evidence suggested that consumers were apparently not particularly affected by the inaccurate portion of the statement. Commission Wright cited evidence that 3.8% of consumers used Nomi’s website to opt-out of data collection – a number considerably higher than the less-than 1% who opt-out from data collection online more generally.<sup>84</sup> From this, Wright noted, it may be inferred that the consumers who read Nomi’s policy and who cared to avoid its technology likely opted out at the website.<sup>85</sup>

It is of course a valid question whether, even in context, the Company’s inaccurate statement amounted to a material deception, and whether the evidence offered by Commissioner Wright was sufficient to rebut the presumption of materiality. But this complexity only demonstrates the need for more-carefully explicated materiality standards when the Commission employs its deception authority.

The majority’s *approach* to answering those questions and weighing the evidence betrayed its implicit rejection of the DPS’s admonishment that context and contrary evidence are essential – its promise that “[t]he Commission will always consider relevant and competent evidence offered to rebut presumptions of materiality.”<sup>86</sup>

The majority *did* offer some theories as to why the inaccurate in-store opt-out statement might have mattered, even to consumers confronted with the additional, website opt-out. Nonetheless, it essentially rejected the idea that there could be a valid trade-off. Instead, the majority seemed content to assert that if *any* consumer might have been misled by the in-store opt-out promise, the statement is material.

In reality, what the DPS requires is a logical weighing of the importance of the inaccurate language against the truthfulness of the statement taken as a whole. In other words, it is not enough to suggest (without evidence, of course, but only supposition) that the inaccurate language could have misled some consumers; the DPS requires a showing that the entire statement, taken as a whole, *tended* to mislead “a consumer acting reasonably in the circumstances.”<sup>87</sup> This is quite a different assessment, and one that the majority failed to undertake.

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<sup>83</sup> *In the Matter of Nomi Technologies, Inc.*, Dissenting Statement of Commissioner Joshua D. Wright, at 3 (Apr. 23, 2015), available at [https://www.ftc.gov/system/files/documents/public\\_statements/638371/150423nomiwrightstatement.pdf](https://www.ftc.gov/system/files/documents/public_statements/638371/150423nomiwrightstatement.pdf).

<sup>84</sup> *Id.* at 3-4.

<sup>85</sup> *Id.*

<sup>86</sup> Deception Policy Statement, *supra* note 71, at n. 47.

<sup>87</sup> *Id.* at 1 (“If the representation or practice affects or is directed primarily to a particular group, the Commission examines reasonableness from the perspective of that group.”)

Such an evidentiary and analytical lapse is insufficient to ensure that the Commission's consumer protection practices are constrained by rigorous analysis and, ultimately, that they serve consumer interests.

## **VI. Conclusion**

In this submission we have argued that competition and consumer protection enforcement should be based on sound, theoretical underpinnings and rigorous, evidence-based analysis. Despite many expressed fears to the contrary, digital markets are not inherently prone to anticompetitive behavior,<sup>88</sup> and the weight of economic theory and evidence offer little support for the asserted risk of harm. Indeed, leveraging, lock-in, network effects, and data-intensive business models are just as likely (if not more likely) to benefit consumers as they are to be anticompetitive. We urge policymakers to consider carefully how little certainty we have about these markets and the effects of challenged conduct within them.

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<sup>88</sup> See Konstantinos Stylianou, *Exclusion in Digital Markets*, 24 MICH. TELECOM. & TECH. L. REV. 181 (2018).