

AFTERNOON SESSION (12:56 p.m.)

SESSION C: FTC POLICY AND RESEARCH

MODERATOR: MICHAEL SALINGER, FTC

PRESENTER: PAULINE IPPOLITO, FTC

MR. SALINGER: If we can start up again. As we're behind, I promise to be brief. I'm Michael Salinger. I'm the Director of the Bureau of Economics at the FTC. My main role here is just to give you a brief welcome.

The Bureau of Economics at the Federal Trade Commission I think is a really unique institution in that it's important for us to be aware of the most recent developments in the academic literature and development of ideas that relate to our enforcement mission, and it's important for us also to be able to filter what's coming up from academia to figure out what's relevant for -- what's relevant for policy and what's not quite ready for prime time.

And so in this regard, a conference just like this is absolutely essential for us. We're really grateful that we have had such a talented group of people to come here and share with us your expertise and your ideas and your input.

Our next speaker is someone who has spent her career at the Federal Trade Commission and is as good a person as there is on the planet in speaking through what ideas are out there in the

literature that are useful for us in coming up with economically sound public policy, so I'm very happy to present to you our Associate Director for Special Projects Pauline Ippolito.

MS. IPPOLITO: Thank you, and feel free to keep eating if you're still eating. We're trying to slowly get back on schedule here.

What I was asked to do is give you just a very brief tutorial on the law that the FTC operates under in the consumer protection area just so you would have some sense of how the institution thinks about these things and the kinds of burdens that we would face if we were to act on any of your good ideas.

Probably the disclosure I should give you is this is an economist telling you about the law.

So consumer protection at the FTC is basically authorized by Section 5 of the FTC Act, which says: "Unfair or deceptive acts or practices are declared unlawful." Now, that's what you call a broad mandate. There's a lot of room for mischief in that language, and it's very similar to the competition language, so the idea was you had a Commission that had balanced political interest that would have to vote on any ideas, and then over time the courts would reign us in and we would reign ourselves in and through a common law process, we would develop a useful guidance for what these words would mean.

So at the FTC we think of deception and we think of unfairness, so let me talk about deception first, since that's the easier part of this.

When you think about deception, what are you thinking about? Well, if you're thinking about affirmatively false claims, fraud, it's pretty easy from an economist's point of view. The only thing that's interesting about the fraud cases which you behavioral types might help us with is: We look at some of these ads and think, "Who could ever fall for something like this?"

The magnetic bracelet that's going to help you lose weight with no diet and exercise, \$29.95. That's the mystery here. Other than that, the law enforcement is pretty easy.

What gets more interesting, more difficult, more challenging is the misleading claims area, and there we are talking about overstatement. We're talking about implied claims and incomplete claims.

Now, if you look at any marketing, everything is incomplete, and so you can't say if it's incomplete, it's deceptive. There is a real challenge here in developing principles and developing guidance and standards of policy that firms can understand what's expected and that we are disciplined in our use of this policy.

Over time the policy has evolved a great deal. As with any broad language that we had, it started out very broad, and if you

go back to the 1960s and early 1970s, you'll see a very broad interpretation. I put down here -- this is from a case actually that "we would prohibit claims that have the capacity to mislead the 'ignorant, the unthinking and the incredulous.'"

Now, think of any marketing claim. There isn't a lot we couldn't go after with that kind of broad scope, and everybody who has been at the FTC for awhile has their favorite cases. I'll give you two of mine. We had the permanent hair dye case. When the hair grew out what color would it be? We had the automatic sewing machine case. Did you need a person to make the dress with the machine? So you can see the potential for problems.

Through the system we have of feedback to the agency, through the law, we started reigning in that kind of a broad standard, and through the '70s, the cases started putting in place constraints, so that by 1983, the agency issued what's called the Deception Policy Statement, but it really encapsulated what had already been happening in the cases, so it's not just Reagan era results, although Howard will certainly take credit for a lot of it, but it really did represent what had been happening in the legal development.

The statement says "a representation, omission or practice that is likely to mislead the consumer acting reasonably in the

circumstances, to the consumer's detriment."

So it had to be a claim that was important to affecting whether consumers would purchase the product. It wasn't some strange interpretation. It was consumers acting reasonably in the circumstance, so the mass of consumers, and it's likely to misled consumers.

Now, thinking about some of the behavioral ideas we talked about today, acting reasonably in the circumstance I would think wouldn't rule out something that was quite predictable. So if someone was exploiting a bias that consumers would naturally bring to a certain kind of circumstance, this language would not inherently rule it out.

Now, when we look at deception issues that aren't explicit false claims, the first thing we look at is what claims do consumers receive, and that if it isn't obvious on the face of the ad, usually involves copy testing, which is a sort of experimental manipulation, with the targeted consumers. So again it's a behavioral test in the sense that if consumers looking at an ad take a claim from that ad, that would be the basis for a case. We wouldn't ask whether that was a reasonable interpretation of the ad. We would simply test whether the interpretation was there.

The claim is never tested in isolation. It's always tested

in the context of the ad, and it's very well ingrained in case law that the context and the background might matter, so there's a sense in which you don't have to argue about framing here.

In marketing, the packaging of the message is an important part of the communication of the message, so that again is incorporated in how we would judge whether the claim was there.

Then we move on to the harder issues: How many are misled; how many are informed; is there inherent policy trade-off that we have to face; will competition fill in the missing information. If it's a new product, there's a temporary misleading aspect to the ads but we think it's going to be corrected quickly, we might not pursue that case, let the market take care of it.

Does requiring more complete information reduce the incentives to provide the information? Now that's hard to test in the context of a particular ad, but it's something that we've tested in some of the research we've done.

For instance, in the food area where I've done a lot of work, the FDA changed the rules for making comparative claims on nutrients, so where in the past you could say "less fat", now you had to say "30 percent less fat than whatever, they have six grams, we have three." So less fat becomes a long statement.

Is that important? Well, it turns out when you look pre- and post- the rules, we saw a dramatic reduction in comparative

claims, so it is important.

That's deception. Now, unfairness. You think deception raises issues. What's unfair? This is really a hard concept for economists especially to get around. In '64 the criteria developed I think for the Cigarette Rule said -- unfairness could offend public policy; could be immoral, unethical, oppressive or unscrupulous; or it could cause substantial injury to consumers. That was the standard developed for the Cigarette Rule when we were first looking at whether we should provide a health warning on cigarettes.

To economists, this is a scary list. I think the agency folklore is that Richard Posner actually developed this list when he was still wet behind the ears and an attorney advisor to one of our commissioners here, he's matured since then. But it caused quite a fury at the time. The agency was pretty cautious in using it because it had caused such a fury. In the Cigarette Rule case, we never initiated a rule. Congress decided they would rather do it than have us do it, and they ended up mandating the Surgeon General warning you know on cigarettes.

The next big event for using unfairness authority was the Children Television Advertising Rule, which was in the late 1970s where we were going to prohibit food advertising, or sugared food advertising, because of dental cavities for children. We went

through a whole rulemaking which ended up being a major event in the agency's history. We lost our authorization for 12 years after that one.

We were attacked from the left, from the Washington Post. So out of that hub-bub, for the use of unfairness came a lot of thinking about what unfairness should mean and what would be a more disciplined approach.

So the unfairness policy statement issued in 1980 that really came out of the Kid-Vid experience was that unfairness would relate to consumer injury that had to be substantial, not reasonably avoided by consumers themselves, not outweighed by countervailing benefits to consumers or to competition, sort of a cost-benefit test built into the unfairness standard. Because unfairness was so broad, the agency was going to have more of an evidentiary burden before it could use such a broad authority.

And so in dealing with issues in the behavioral area, if we were -- if they were not deceptive as such, which a lot of these aren't, we would really have a burden that we would have to meet to show that it was a problem that was substantial. It couldn't easily be avoided and that there was a remedy that would be balanced that would not do more harm than good, so a real burden on the agency.

Now, unfairness does let us deal with a lot of things that

you can't get to under deception. The deception statement says omissions are covered by deception, but that's a very dangerous business. Everything that isn't in an ad is an omission, so for the agency to approach all of those issues of potential mandatory disclosures as cases of deception really stretches deception beyond where it's comfortable.

So let me give you some examples where we have used unfairness or could use unfairness. The Credit Practices Rule is a regulation that governs credit contracts. We regulate the non-banks, the Federal Reserve folks regulate the banks, but all of the mortgage companies, the crediting lending institutions and all of those folks. We have a rule that relates to certain kinds of provisions in credit contracts. The agency went through an analysis trying to look at whether certain kinds of provisions really were not -- were really there to terrorize or they weren't efficient or to try to restrain some of those practices that were questionable, trying to do a balancing of these cost issues and then ruled out a lot of other practices as having a good efficiency basis, so they were not prohibited.

The International Harvester case was a case where there was geysering. International Harvester sold tractors I believe it was, and if you opened the radiator, it would spew up and people were severely injured. The question was: Did they have a duty

to warn in that kind of circumstance? We did a cost-benefit analysis, and decided that they did under an unfairness principle.

Then a lot of the mandated disclosures, those itchy labels that drive you crazy, that's us. The care labeling is an FTC rule. Cigarette warnings were an FTC rule and are still partly. Gasoline octane ratings are an FTC rule. The R value for home insulation is an FTC rule.

These are all mandated disclosure rules which if you were to do them today you would probably do under an unfairness authority where you would have a burden to put together the evidence that somehow you needed a metric, the market wasn't generating it, there was an important value to having it, and we would go through a rulemaking.

Spyware is a more recent example. You're on the Internet. Someone installs software on your machine to watch what you're doing. That's not a deception issue. You don't even know it's happening. Should we prohibit it? What would be the criteria? We don't want to prohibit every cookie that goes on your machine, but if they came on your machine and did 27 pop-ups so it was costing the consumer and you had no way to block it, should we make that illegal?

What if they were putting a piece of software on your

machine to watch your key strokes when you dealt with your financial company or your bank? Well, those are issues where you might use unfairness authority to think about the requirements for what you could and couldn't put on a consumer's machine without their permission.

So those are examples of unfairness that we deal with and would have to be done with this kind of evidentiary burden.

Any questions?

MR. LAIBSON: It sounds like convergence has been to both deception and unfairness rules that are basically just cost benefit analysis, that I could replace all of this language and say, today we use cost benefit analysis in all determinations.

MS. IPPOLITO: Deception, once we show that a claim is made and it's material to the likelihood of purchasing a good, we don't actually have to show that it actually influences purchases so we stop short there. There's a presumption of an effect. In the unfairness arena we have to go further probably, but, yes, that's the migration.

MR. LAIBSON: But I guess even in deception, it's only explicit deception that doesn't use cost benefit analysis. The implicit category of deception all seemed also to involve a cost benefit element once you kind of said, Well, is it actually costing the consumer something, what are the harms that are

generated and are there offsetting benefits and how do you weigh them?

MS. IPPOLITO: Yes, yes. That's been the migration. Joel?

JOEL WINSTON (FTC): I think just to clarify, the notion of deception whether it's implicit or explicit, really didn't matter. It's presumed that deception is injurious and net harmful.

It's not something we need to prove, and as I said there's no higher burden of proof in terms of injury when the deception's implied rather than expressed.

MS. IPPOLITO: Right, the burden at that point is proving the claim that is material to the purchase. Joel is a real lawyer. Okay. Well, that's just to give you some background of how the agency would think about things.

(Applause.)