

# CAUSE of ACTION

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August 20, 2018

### Submitted Via Email

Federal Trade Commission  
Office of Policy Planning  
Attn: Derek Moore  
John Dubiansky  
600 Pennsylvania Avenue, NW  
Washington, DC 20580  
CCPhearings@ftc.gov

### **Re: Competition and Consumer Protection in the 21st Century Hearings, Project Number P181201**

Dear Mr. Moore and Dubiansky,

I am writing on behalf of Cause of Action Institute (“CoA Institute”), a 501(c)(3) nonpartisan government-oversight organization that uses investigative, legal, and communications tools to educate the public concerning how government accountability, transparency, and the rule of law protect individual liberty and economic opportunity.<sup>1</sup> Thank you for the opportunity to submit comments on the Federal Trade Commission’s (“FTC” or “Commission”) initiative to review its priorities and processes for carrying out its mandate under the Federal Trade Commission Act (“FTC Act”). CoA Institute has significant firsthand experience practicing before, litigating against, and interacting with the FTC. Based on that experience, we are commenting on a range of topics to highlight improvement areas and to curb some of the worst abuses of agency authority that we have combated.

Our comments fall into four broad categories: (1) reforming enforcement processes, (2) increasing transparency, (3) developing a proper understanding of substantial injury, and (4) proposing statutory changes. Namely, we believe the FTC needs to develop specificity in its cease and desist orders; refine its use of *ex parte* injunctions; adopt the Federal Rules of Civil Procedure and Evidence in administrative proceedings; cease demanding legal damages in excess of its authority; and Congress should amend the FTC Act to allow direct appeals to U.S. Courts of Appeals from administrative law judge (“ALJ”) decisions. Further, the FTC should reform its disclosure regime because it fails to provide fair notice of the standards to which regulated parties are expected to conform and should do so by

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<sup>1</sup> See CAUSE OF ACTION INSTITUTE, *About*, [www.causeofaction.org/about/](http://www.causeofaction.org/about/).

proactively disclosing all consent orders, closing letters, and closing memoranda in data-security cases. Finally, the FTC needs to develop a sound interpretation of the concept of substantial injury in Section 5(n) that underlies its enforcement actions.

## **I. REFORMING THE FTC’S ENFORCEMENT PROCESSES**

### **A. The FTC needs to develop specificity in its cease and desist orders.**

In recent years, FTC staff have recommended enforcement actions against dozens of companies victimized by data breaches or allegedly engaged in lax data-security practices, based on staff’s view of “unfair or deceptive” practices banned by Section 5 of the FTC Act. The complaints in these cases typically allege that the business “engaged in . . . practices that, taken together, failed to provide reasonable and appropriate security,”<sup>2</sup> but without specifying what specific practices should have been in place and when. The FTC often alleges that some combination of the unspecified “acts or practices” violates Section 5.

With few exceptions, the accused companies have chosen to resolve these matters through twenty-year consent orders. These orders require the respondent to affirmatively implement “a comprehensive security program” that meets an undefined, ever-shifting standard of “reasonableness,” as well as comply with various reporting and monitoring provisions. Compliance with these orders is costly and burdensome.<sup>3</sup> Because these orders are vague, it is often impossible for companies to know what they are required to do to comply. This is particularly true because the FTC holds the position that “no one static standard can assure appropriate security, as security threats and technology constantly evolve[.]”<sup>4</sup>

The Commission should reevaluate the soundness of this approach following a recent decision by the U.S. Court of Appeals for the Eleventh Circuit, which squarely rejected the FTC’s approach because it “is a scheme Congress could not have envisioned” and orders embracing it are impossible to enforce.<sup>5</sup> The Commission’s approach to Section 5 enforcement should include:

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<sup>2</sup> See, e.g., Compl. ¶ 8, *In re TJX Companies, Inc.*, File No. 72-3055, 2008 WL 903808 (F.T.C. Mar. 27, 2008).

<sup>3</sup> See 1984 Unfairness Statement (“The Commission also takes account of the various costs that a remedy would entail.”), *appended to In re Int’l Harvester Co.*, 104 F.T.C. 949 (1984).

<sup>4</sup> *In re LabMD, Inc.*, Dkt. No. 9357, 2014 WL 253518, at \*12 (F.T.C. Jan. 16, 2014).

<sup>5</sup> *LabMD, Inc. v. Fed. Trade Comm’n*, 894 F.3d 1221, 1236–37 (11th Cir. 2018).

- Complaints should articulate what specifically FTC staff believe a business did or failed to do that, in staff’s view, violates Section 5.<sup>6</sup>
- FTC orders must enjoin specific acts or practices to provide companies with fair notice of prohibited or required conduct and to meet the requirements of Federal Rule of Civil Procedure 65(d).<sup>7</sup>
- Federal district courts should not be tasked with managing the affirmative overhaul of companies’ security practices measured against an indeterminable, ever-shifting “reasonableness” standard.<sup>8</sup>

The Commission’s recent decision to create “a taskforce on how we do our orders”<sup>9</sup> is an important first step toward ensuring that the terms of consent orders and stipulated injunctions provide sufficient notice of prohibited or required conduct. The Commission’s taskforce should incorporate these lessons into its analysis of the appropriate terms of consent orders and provide public guidance to inform staff’s approach in settlement discussions with companies.

#### **B. The FTC should clarify and refine its use of *ex parte* injunctions.**

The FTC “may bring suit in a district court . . . to enjoin” violations of laws it enforces, and the court may grant a temporary restraining order (“TRO”) or a preliminary injunction, on “a proper showing.”<sup>10</sup> TROs and preliminary injunctions are, by their nature, extraordinary remedies for which courts require extraordinary showings, even from the FTC.<sup>11</sup> Through the 1980s, the FTC expanded this authority into the so-called “Section 13(b) Fraud Program.”<sup>12</sup> From the mid-1990s until today, the FTC began routinely initiating Section 5 cases under seal and

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<sup>6</sup> *Id.* at 1237.

<sup>7</sup> *Id.* at 1235.

<sup>8</sup> *Id.* at 1237.

<sup>9</sup> See *Oversight of the Federal Trade Commission, Hearing Before the Subcomm. on Digital Commerce & Consumer Protection of the H. Comm. on Energy & Commerce*, 115th Cong., at 1:21:06-1:21:15 (July 18, 2018), available at <http://bit.ly/2M2IJ60>.

<sup>10</sup> 15 U.S.C. § 53(b).

<sup>11</sup> *Id.* § 53(b)(2) (FTC must show likelihood of ultimate success and balance of equities in favor of preliminary injunction, irreparable harm not required); Fed. R. Civ. P. 65(b)(1) (showing of “immediate” harm required for *ex parte* TRO).

<sup>12</sup> See Howard J. Beales & Timothy Muris, *Striking the Proper Balance: Redress under Section 13(b) of the FTC Act*, 79 ANTITRUST L.J. 1, 3 & n.8 (2013); see also FED. TRADE COMM’N, A BRIEF OVERVIEW OF THE FEDERAL TRADE COMMISSION’S INVESTIGATIVE AND LAW ENFORCEMENT AUTHORITY, at § II.A.2 (Rev. July 2008), <http://bit.ly/2K9V6vs>.

requesting *ex parte* TROs to freeze assets and appoint a receiver.<sup>13</sup> The FTC took this path despite the governing statutes and rules not contemplating *ex parte* TROs in the ordinary course, and authorities expressly criticizing granting them, except in “extraordinary conditions.”<sup>14</sup>

The FTC asserts that *ex parte* asset freezes merely maintain the status quo and, if notice were provided, defendants are likely to dissipate assets otherwise available for consumer redress.<sup>15</sup> First, every subject understands in excruciating detail the extraordinary burdens an asset freeze immediately imposes on ordinary daily activity, from using credit and debit cards to paying for food, cars, mortgages, and attorneys. Second, in some cases, the FTC has proffered no specific evidence that any defendant’s behavior suggests imminent insolvency or likely material or bad-faith dissipation, such as prior secreting of assets or maintaining liquid, movable assets offshore.<sup>16</sup> Regardless of whether such submissions violate Rule 11 of the Federal Rules of Civil Procedure in the specific matters in which they are proffered, they are unnecessarily sharp practice nonetheless.

Due process, the FTC Act, and procedural rules require more before the FTC proceeds *ex parte*. Short of conceding disputes over its current practices,<sup>17</sup> the FTC should publish transparent operating guidelines describing the factors litigation staff must consider when deciding whether to proceed *ex parte*.<sup>18</sup> The FTC should describe the quality and quantum of evidence that staff will deem sufficient to raise

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<sup>13</sup> See Timothy J. Muris & Robert Pitofsky, *More than Law Enforcement: The FTC’s Many Tools*, 72 ANTITRUST L.J. 773 (2005) (FTC “moved advertising cases away from administrative enforcement actions; increasingly, we bring them *ex parte* in federal district court, seeking preliminary relief and asset freezes.”); see also Press Release, Fed. Trade Comm’n, FTC and Federal, State and International Partners Announce Major Crackdown on Tech Support Scams (May 12, 2017), <http://bit.ly/2jPBhBC>.

<sup>14</sup> See Fed. R. Civ. P. 65(b)(1) (court may issue TRO without notice “only if” affidavit or other verified evidence set forth “specific facts” that “clearly show . . . immediate” “harm . . . to the movant . . . before the adverse party can be heard” and certification of “why [notice] should not be given”). TRO may be issued without notice only “when the circumstances warrant”; Beales & Muris, *supra* note 12, at 23 & n.103; *id.* at 28 (Section 13(b) limit of injunctive relief to “proper” case implies improper cases).

<sup>15</sup> See, e.g., Pls.’ *Ex Parte* Mot. for Asset Freeze & TRO, at 27, *Fed. Trade Comm’n v. Vylah Tec LLC*, No. 17-228 (M.D. Fla. filed May 1, 2017).

<sup>16</sup> See, e.g., *Fed. Trade Comm’n v. Vylah Tec LLC*, 727 F. Appx. 998 (11th Cir. 2018) (unfreezing assets of non-owner, non-managing individual defendant and assets jointly owned by non-defendant wife from *ex parte* TRO issued by district court).

<sup>17</sup> See Beales & Muris, *supra* note 12, at 40 (by pushing section 13(b) beyond egregious cases, FTC “runs the risk that the courts will be forced to confront the complexities of the program’s legal authority”).

<sup>18</sup> The FTC’s Rules of Organization, Procedure, and Practice already prohibit most *ex parte* communications in administrative adjudications. See 16 C.F.R. § 4.7.

an inference that defendants are likely to dissipate assets. That guidance will increase transparency and reduce mistakes that result in irreparable harm and undue hardship in improper cases, all while ensuring the FTC does not lose access to a necessary enforcement tool.<sup>19</sup> Providing guidance about the evidence and situations that will justify the FTC suing individual defendants, in addition to business entities, would likewise increase transparency without diminishing the FTC's current authority. Currently, the only guidance available suggests that individual defendants will be named whenever defendant entities are closely held.<sup>20</sup>

### **C. The FTC should adopt the Federal Rules of Civil Procedure and Evidence in its administrative proceedings.**

The FTC has established rules of procedure that govern proceedings before an ALJ.<sup>21</sup> These rules differ in material ways from the well-accepted rules of civil procedure and evidence used in federal courts. The FTC's rules give an undue advantage to its enforcement staff and result in outcomes that would never occur in Article III courtrooms. This is contrary to the intent of the law, where the outcome should be same regardless of the venue used.<sup>22</sup> The FTC should adopt, wherever possible, the full Federal Rules of Civil Procedure and Evidence for proceedings before ALJs. Below are three examples of unjust results that would be avoided under the federal rules.

First, FTC rules require that all dispositive motions be directly referred to the Commission, rather than to the ALJ adjudicating the case.<sup>23</sup> This means that a motion to dismiss or for summary judgment is decided by the same people who voted to bring the case in the first instance, effectively rendering these motions futile. This practice is contrasted with that of the federal courts, where dispositive motions are decided by independent judges who took no part in filing the complaint.

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<sup>19</sup> Fed. R. Civ. P. 64 provides a rich panoply of remedies to seize or attach specific assets "to secure satisfaction of the potential judgment." And Federal Rule of Civil Procedure 65(a)(2) provides for accelerating a trial on the merits consolidated with a hearing on a preliminary injunction where time is of the essence.

<sup>20</sup> See FED. TRADE COMM'N, OPERATING MANUAL § 11.3.1.3.2 ("where individuals are likely to be named as respondents (*e.g.*, officers or principals of the closely held corporation)") [hereinafter FTC OPERATING MANUAL], *available at* <http://bit.ly/2JRIkwk>.

<sup>21</sup> 16 C.F.R. pt. 3.

<sup>22</sup> *LabMD, Inc.*, 894 F.3d at 1232 ("It should not matter which of the two forums the Commission chooses to prosecute its claim. The result should be the same.").

<sup>23</sup> 16 C.F.R. § 3.22(a). FTC regulations do allow for the Commission to refer the motions back to the ALJ upon their discretion. *Id.* The American Bar Association opposed these rules when the FTC first proposed them. See Comments of the ABA Section of Antitrust Law in Response to the Federal Trade Commission's Request for Public Comment Regarding Parts 3 and 4 Rules of Practice Rulemaking, at 3 (Nov. 6, 2008), *available at* <http://bit.ly/2M4WWQa>.

The FTC has a long history of *always* ruling in favor of itself, as detailed by former Commissioner Joshua Wright: “[I]n 100 percent of cases where the ALJ ruled in favor of the FTC, the Commission affirmed; and in 100 percent of the cases in which the ALJ ruled against the FTC, the Commission reversed.”<sup>24</sup> Soviet jurisprudence was less consistent. These unjust results could be avoided if the ALJ stood as a true check on the Commission and could rule on dispositive motions.

Second, FTC rules place no cap on the number of depositions—unlike the federal rules, which permit a maximum of ten, absent a court order.<sup>25</sup> The Federal Advisory Committee on Rules created the cap to “emphasize that counsel have a professional obligation to develop a mutual cost-effective plan for discovery[.]”<sup>26</sup> The FTC, a government agency with virtually unlimited resources, can bury a defendant in depositions and related costs, exacerbating an already unfair advantage. For example, in *In re LabMD*, the FTC noticed over twenty depositions at “varying locations all across the country” on the same day.<sup>27</sup> Despite a motion requesting relief from this burdensome discovery, the ALJ allowed these depositions to go forward because the FTC rules do not limit the number of depositions.<sup>28</sup> If a cap of ten depositions, absent unusual circumstances, is sufficient for the complex litigation handled by federal courts, then surely it can work for administrative proceedings before the FTC as well.

Finally, the FTC is permitted to introduce “investigational hearing transcripts” of witness testimony into evidence despite *never* affording opposing counsel the opportunity to cross-examine these witnesses.<sup>29</sup> In *In re LabMD*, the FTC interviewed an expert witness without opposing counsel present. The witness was unable to testify at the trial, yet enforcement staff moved to introduce his testimony. The ALJ—while overruling an objection as to admissibility—said, “I’m not saying I agree with that, but that’s the rule[.]”<sup>30</sup> In an Article III court, former testimony of an unavailable witness is only allowed if it is “offered against a party who had . . . an opportunity and similar motive to develop it by direct, cross-, or redirect examination.”<sup>31</sup> Conversely, the FTC rule denies respondents *any* ability to

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<sup>24</sup> Joshua D. Wright, Comm’r, Fed. Trade Comm’n, *Recalibrating Section 5: A Response to the CPI Symposium*, CPI ANTITRUST CHRONICAL, at 4 (Nov. 2013), available at <http://bit.ly/2c56fOy>.

<sup>25</sup> Fed. R. Civ. P. 30(a).

<sup>26</sup> *Id.*, Note of Advisory Comm. on Rules, 1993 Amendment.

<sup>27</sup> Order on Resp. Mot. for a Protective Order, *In re LabMD*, Dkt. No. 9357, at 8 (F.T.C. Nov. 22, 2013).

<sup>28</sup> *Id.* at 9.

<sup>29</sup> 16 C.F.R. § 3.43(b).

<sup>30</sup> Tr. of Final Prehearing Conf., at 9, *In re LabMD*, Dkt. No. 9357 (F.T.C. May 15, 2014).

<sup>31</sup> Fed. R. Evid. 804(b)(1)(B). There are other hearsay exceptions, but none applicable here.

cross-examine a hostile witness and preserve due process, something that is foundational to the U.S. justice system.<sup>32</sup>

**D. The FTC should cease demanding legal damages in excess of its statutory authority.**

When it brings actions in federal court, the FTC routinely demands the imposition of personal monetary liability against defendants, which represent legal damages that the agency is seeking in violation of its limited authority under the FTC Act. The Commission should eliminate this practice and instead seek only the injunctive relief that the Act authorizes it to pursue.

Section 13(b) of the FTC Act authorizes the Commission to seek injunctive relief.<sup>33</sup> The FTC has no authority to seek monetary relief under any theory of recovery. Instead, if a monetary award is sought and granted, that award must be ancillary to the grant of an injunction, flowing from the court's equitable power.<sup>34</sup> Because courts routinely grant so-called "equitable" monetary relief, the FTC makes a practice of requesting "restitution, the refund of monies paid, and disgorgement of ill-gotten gains."<sup>35</sup> The language of this demand appears to sound in equity because the enumerated categories are traditional forms of equitable relief. But tone is where the similarity ends. In substance, the actual monetary relief sought by the Commission in many cases is not equitable relief, but rather legal damages, because they impose "wholly pecuniary and personal" liability on defendants.<sup>36</sup> Legal damages are not authorized by the FTC Act and not within the equitable power of the court. Thus, the FTC seeking and courts granting that relief is *ultra vires*.

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<sup>32</sup> *E.g.*, U.S. Const. amends. V, XIV (preserving the right to due process); *id.* amend. VI. (providing a right to confrontation in criminal trials); *United States v. Salerno*, 505 U.S. 317, 328 (1992) ("Even if one does not completely agree with Wigmore's assertion that cross-examination is 'beyond any doubt the greatest legal engine ever invented for the discovery of truth,' one must admit that in the Anglo-American legal system cross-examination is the principal means of undermining the credibility of a witness whose testimony is false or inaccurate.") (citing 5 J. Wigmore, *Evidence* § 1367 (J. Chadbourn rev. 1974)).

<sup>33</sup> 15 U.S.C. § 53(b)(2) ("That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction.").

<sup>34</sup> *Fed. Trade Comm'n v. Verity Int'l, Ltd.*, 443 F.3d 48, 66–67 (2d Cir. 2006) (The "availability of restitution under § 13(b) of the FTC Act, to the extent it exists, derives from the district court's equitable jurisdiction, it follows that the district court may award only equitable restitution.").

<sup>35</sup> *See, e.g.*, Compl., Prayer for Relief ¶ 3, *Fed. Trade Comm'n v. Automated Transaction Corp.*, No. 00-7599 (S.D. Fla. filed Oct. 25, 2000).

<sup>36</sup> *Montanile v. Bd. of Trustees of Nat'l Elevator Indus. Health Benefit Plan*, 136 S. Ct. 651, 661 (2016).

The source of this divergence is twofold: (1) the dual definition of “restitution,” which can be used to describe both equitable relief and legal damages; and (2) a tautology that has emerged within the caselaw in which the FTC’s identity as the plaintiff becomes dispositive of the type of damages sought.<sup>37</sup>

Restitution may be equitable “where money or property identified as belonging in good conscience to the plaintiff could clearly be traced to particular funds or property in the defendant’s possession.”<sup>38</sup> For restitution to be equitable, the funds must be traceable and cannot have been comingled with other funds, so that particularly identifiable property could be returned to a claimant.<sup>39</sup> With a fungible asset like money, it is difficult to establish that traceability. By contrast, legal restitution applies when the plaintiff seeks “to obtain a judgment imposing a merely personal liability upon the defendant to pay a sum of money.”<sup>40</sup> In other words, if the plaintiff does not care where the money comes from, how long the defendant must work to earn it, or whose assets must be sacrificed to pay the judgment, that is the very definition of a cause of action at law.

The Commission regularly seeks *ultra vires* legal damages instead of equitable relief that lawfully could be ancillary to an injunction. The fact that legal damages are truly at stake is evidenced by, among other characteristics: (1) joint and several liability;<sup>41</sup> and (2) personal liability that is unbounded in time and not limited to traceable assets.<sup>42</sup> The use of *ex parte* TROs to freeze personal assets is an aggravated form of this practice because pre-discovery freezes indiscriminately freeze personal assets of any form, age, or source, as well as violating the corporate

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<sup>37</sup> The logical error operates like this: Bobby is only allowed to ride his bike on the sidewalk; therefore, every place Bobby rides his bike is the sidewalk. Similarly, some courts have concluded that because the FTC may only obtain equitable relief, therefore any demand the FTC makes must be for equity. *See, e.g., Verity Int’l*, 443 F.3d at 66–67. This doctrine is especially pernicious because it allows the identity of the government plaintiff to circumscribe the rights of the defendant, including constitutional rights, such as the right to trial by jury.

<sup>38</sup> *Great-W. Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 213 (2002).

<sup>39</sup> *Id.* at 213–14.

<sup>40</sup> *Id.* at 213.

<sup>41</sup> Joint and several liability, in which multiple parties can each be held liable for the entirety of a judgment, is inconsistent with the tracing of assets necessary to equitable restitution because it is impossible for more than one person simultaneously to have the entirety of the relief sought—either the individual has the asset to be returned or they do not; it cannot be both ways at once.

<sup>42</sup> *See, e.g., Knudson*, 534 U.S. at 213 (A claim is considered legal when the plaintiff seeks “to obtain a judgment imposing a merely personal liability upon the defendant to pay a sum of money.”) (citing Restatement of Restitution § 160, Comment a, at 641–42 (1936)). Thus, a judgment that may be enforced against future earnings, which, by definition, are not within the defendant’s possession at the time the judgment is entered, represents legal damages. *See also Montanile*, 136 S. Ct. at 661 (recovery out of general assets was not equitable relief).

form without establishing the facts necessary to pierce the corporate veil. Therefore, the FTC should abandon its practice of improperly extending its authority beyond the equitable relief given to it by Congress in the FTC Act.

## II. INCREASING FTC TRANSPARENCY

The FTC claims broad discretion to regulate what it perceives to be “unfair” data-security practices through rulemaking or case-by-case enforcement.<sup>43</sup> The FTC has never sought to promulgate a rule establishing data-security standards. This is not for lack of authority,<sup>44</sup> but rather is the result of procedural limitations imposed by Congress.<sup>45</sup> As a result, the Commission relies exclusively on enforcement actions in this area.<sup>46</sup>

After investigating an alleged violation of Section 5, the FTC disposes of the matter in one of three ways. First, it may file a complaint in an Article III court seeking an injunction and consumer redress.<sup>47</sup> Second, it may issue a cease and desist order and open an administrative proceeding.<sup>48</sup> The FTC appears to prefer this second approach to litigation, and it usually results in settlement and a consent order.<sup>49</sup> Third, the FTC may close the matter and forego enforcement.<sup>50</sup> This final outcome occurs when an alleged violation is unfounded or the potential respondent is determined to have met its data-security obligations.

### A. The FTC’s current disclosure regime for consent orders fails to provide fair notice of the standards to which regulated parties are expected to conform.

The FTC regularly publishes information about its enforcement efforts, including the contents of administrative complaints and consent orders—the latter being subject to a notice-and-comment process.<sup>51</sup> In particular, the FTC contends

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<sup>43</sup> See generally *Sec. & Exch. Comm’n v. Chenery Corp.*, 332 U.S. 194, 203 (1947).

<sup>44</sup> See 15 U.S.C. § 57a(a)(1)(B) (“[T]he [FTC] may prescribe rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce.”).

<sup>45</sup> See *id.* § 57a(b)–(c); see also Gerard Stegmaier & Wendell Bartnick, *Psychics, Russian Roulette, and Data Security: The FTC’s Hidden Data-Security Requirements*, 20 GEO. MASON L. REV. 673, 691–92 (2013) (describing Magnuson-Moss rulemaking as “inefficient and time consuming”).

<sup>46</sup> Stegmaier & Bartnick, *supra* note 45, at 693 (“[T]he FTC seems to regulate data security primarily through complaints and consent orders.”).

<sup>47</sup> 15 U.S.C. § 53(a)–(b).

<sup>48</sup> *Id.* § 45(b)–(c), (g).

<sup>49</sup> See 16 C.F.R. §§ 2.31–2.34.

<sup>50</sup> See FTC OPERATING MANUAL § 3.3.7.4.1.

<sup>51</sup> 16 C.F.R. § 2.34(c).

that consent orders serve a guidance function to the regulated community about the minimum levels of data security that the FTC believes the law may require.<sup>52</sup> Some commentators have described this use of consent orders as developing a “common law” of privacy,<sup>53</sup> and the FTC itself has readily adopted the analogy.<sup>54</sup>

Yet, the Commission’s efforts to build a body of precedent based on uncontested consent orders and its subsequent reliance on those orders as if they were the equivalent of “common law” is misguided.<sup>55</sup> Consent orders all too frequently contain ambiguities and lack detailed analysis concerning the application of what are alleged to be generally applicable data-security standards. This model of regulation by enforcement mocks the rule of law and is inadequate to provide the requisite notice of the standards the FTC wishes to impose.

Notice, equal enforcement, and independent adjudication are fundamental precepts of the rule of law.<sup>56</sup> The use of consent orders to develop a body of “common law” that is imposed on regulated entities violates all three of these precepts. The precept of notice is violated because consent orders do not promulgate standards. As mentioned, their terms are not of general applicability, nor do they necessarily pre-date the activities of non-parties. If they are used as the basis for imposing liability on others, they may act as *ex post facto* laws. Moreover, there is no basis for non-parties to know that individually-negotiated agreements, made by parties unknown to them, could redefine the scope of a legal duty. Consent orders also are often vague and unclear.<sup>57</sup>

The FTC’s reliance on consent orders as a body of precedent also violates the precept of equal enforcement of the law because consent orders, by their very

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<sup>52</sup> The FTC often points to consent orders as a form of guidance—even if not an exact “blueprint”—along with other FTC-generated informal data-security “best practices,” Internet or social media posts, and Commissioners’ public statements. See Stegmaier & Bartnick, *supra* note 45, at 693, 695.

<sup>53</sup> See, e.g., Daniel Solove & Woodrow Hartzog, *The FTC and the New Common Law of Privacy*, 114 COLUM. L. REV. 583, 608 (2014) (“[T]he body of FTC settlements is the functional equivalent of privacy common law.”); see also *id.* at 619–24.

<sup>54</sup> See, e.g., Edith Ramirez, Comm’r, Fed. Trade Comm’n, Unfair Methods & the Competitive Process, Keynote Address at the George Mason Univ. Sch. of Law 17th Annual Antitrust Symposium at 6–8 (Feb. 13, 2014), available at <http://bit.ly/2Lu5ToZ>.

<sup>55</sup> See, e.g., Justin Hurwitz, *Data Security and the FTC’s Uncommon Law*, 101 IOWA L. REV. 955, 984–88, 1012 (2016).

<sup>56</sup> See generally United States Courts, Overview – Rule of Law (“Rule of law is a principle under which all persons, institutions, and entities are accountable to laws that are: publicly promulgated, equally enforced, independently adjudicated, and consistent with international human rights principles.”), <http://bit.ly/2v0ZtEs>. Compliance with international human rights is not necessarily a characteristic of the rule of law and it does not appear to apply here.

<sup>57</sup> See *LabMD, Inc.*, 894 F.3d 1221.

nature, capture only the terms under which a specific accused party has determined that settlement is preferable to mounting a defense. Individual considerations such as wealth, age, opportunity cost, health, reputation, and sophistication of the defendant inevitably inform that decision. The tipping point at which settlement becomes attractive is different for each defendant. Sadly, the weaker the defendant and the less able to confront the power of the Commission, the more likely that onerous terms would be accepted rather than attempting to finance a defense that could lead to bankruptcy, ignominy, and defeat. The requisite adversarial process that is the hallmark of developing common law standards is thus frequently absent from the consent-order process. This results in a body of decisions that lacks reference to standards of general applicability, or even standards that have any basis in logic or public policy; it is only the product of an agency bringing its full weight to bear on a defendant and extracting as much as it can. It is the equivalent of the FTC saying “nice business you’ve got here. We wouldn’t want anything to happen to it.”<sup>58</sup>

Finally, the use of consent orders violates the precept of independent adjudication because, by definition, a settlement is negotiated to avoid adjudication. Where adjudication includes both procedural requirements and substantive legal theories, settlement requires neither. No justification by reference to law, and no recourse to judges, juries, rules of evidence, or other procedural protections limits the potential range of outcomes to ensure that a settlement bears any relation to the existing body of law. While adjudicated cases become part and parcel of the common law from which they emerge, consent orders require no consistency with the law—either procedural or substantive.

Consent orders are, therefore, a poor vehicle to develop a “common law” of data security or privacy as they bear none of the hallmarks of the process by which common law is developed. The FTC should cease contending that consent orders form a meaningful body of decisions that should or does shape future obligations for regulated parties.

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<sup>58</sup> See generally Monty Python, Army Protection Racket Script (“Luigi: You’ve . . . you’ve got a nice army base here, Colonel . . . We wouldn’t want anything to happen to it. Colonel: What? Dino: No, what my brother means is it would be a shame if . . . (he knocks something off mantel)”), available at <http://bit.ly/2Mv5pw1> (last visited Aug. 8, 2018).

**B. In light of current practice, the FTC should proactively disclose all data-security consent orders, closing letters, and closing memoranda.**

To the extent the FTC continues to maintain that consent orders provide the requisite notice of the scope of a regulated entity's obligations to provide reasonable data security, such that they are recognized as having precedential force, then the FTC should ensure that they are proactively disclosed. To date, it appears that the Commission has done a fair job in ensuring this occurs. But the FTC is decidedly less transparent when it comes to matters closed without any enforcement action.

In these latter cases, the Commission typically sends a "closing letter" to the person who identified the potential issue, the potential respondent, their lawyers, and, at times, other interested parties.<sup>59</sup> Because these documents explain why the Commission is abandoning a matter, they form a vital part of the "public record"<sup>60</sup> and, accordingly, they are sometimes posted to the FTC's website.<sup>61</sup> But the FTC does not always disclose a particular closing letter or issue one at all. When it does not issue one, it memorializes its justifications for the termination of the case in a "closing memorandum."<sup>62</sup> These memoranda are not proactively disclosed, but the FTC recognizes them as subject to release under the Freedom of Information Act.<sup>63</sup>

The Commission's decision to keep many closing letters and most, if not all, closing memoranda secret cannot be countenanced. The agency itself has suggested that closing letters operate in the same way as consent orders—they provide public guidance and notice about the data-security practices the FTC believes are required by law.<sup>64</sup> Although consent orders sometimes detail fact patterns that the FTC

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<sup>59</sup> FTC OPERATING MANUAL § 3.3.7.4.5.1.

<sup>60</sup> *Id.* § 3.7.4.5.2.

<sup>61</sup> See, e.g., *Commission Closing Letters*, FED. TRADE COMM'N, <http://bit.ly/2Hs45Xp> (last visited July 23, 2018).

<sup>62</sup> See generally FTC OPERATING MANUAL § 3.3.7.4.1–2.

<sup>63</sup> *Id.* § 3.3.7.4.4.

<sup>64</sup> See *Privacy and Data Security: Protecting Consumers in the Modern World: Hearing before the U.S. S. Comm. on Commerce, Sci. & Transp.*, 112th Cong. (June 29, 2011) (prepared statement of the Fed. Trade Comm'n), available at <http://bit.ly/2M5N6Oi> ("Another way in which the Commission seeks to educate businesses is by publicizing its complaints and orders and issuing public closing letters. . . . [T]he public closing letter serve[s] to notify similarly situated businesses that, to the extent they collect information from social networking sites for employment determinations, they must comply with the FCRA. The letter [may] include guidance on the obligations of such businesses under the [Fair Credit Reporting Act]."); see also Lesley Fair, Fed. Trade Comm'n, *Default, Verizon* . . . (Nov. 13, 2014), <http://bit.ly/2xOf1PF> ("The staff decided to close the investigation, but the rationale explained in the closing letter is worth a read. . . . What's the message for other companies? The closing letter spells out why security isn't a one-and-done deal[.]").

views as offending the law, closing letters and memoranda can contain fact patterns where the Commission believes the potential respondent is operating within legal bounds. The agency's failure to disclose those fact patterns gives a one-sided view of both the law and businesses' data-security models. Even in instances where they are less detailed and more formulaic, they can still contain useful details about the data-security standards guiding FTC investigations and prosecutions.

Therefore, the FTC should proactively disclose all closing letters and closing memoranda in a similar fashion to consent orders. These materials should be posted to the FTC's website and, consistent with current practice, released in full and without redaction.<sup>65</sup>

### III. DEVELOPING A PROPER UNDERSTANDING OF "SUBSTANTIAL INJURY"

In a September 2017 speech, former FTC Chairman Maureen Ohlhausen stated that "informational injury" is her "name for the various types of consumer injury addressed [by the agency's] privacy and data security cases."<sup>66</sup> But what the Commission considers to be a significant enough "informational injury" to merit enforcement action continues to be unclear. Because most companies choose to sign consent orders to avoid the time, expense, and reputational damage that FTC actions cause, the so-called common law that the FTC points to as providing standards and guidelines to companies for their data security and privacy practices is in truth chimerical. Further, this body of consent orders does not provide an accurate description of what is considered a "likely" and "substantial" injury, two elements which Section 5 of the FTC Act requires when bringing "unfair acts and practices" claims. Without a clear set of standards and guidelines, the FTC continually bestows itself with unrestricted discretion in defining and redefining what it considers to be a "likely" and "substantial" harm. Private entities are held under a Damoclean sword of uncertainty.

FTC enforcement actions are intended to benefit and protect consumers, but if they stay on the track they are on, using ever-changing and unclear language, they may end up doing more harm than good. If the FTC continues to wield its

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<sup>65</sup> Exemption 6 of the Freedom of Information Act, which protects personally identifying information, does not cover corporate persons or other commercial entities. *Fed. Comm'ns Comm'n v. AT&T, Inc.*, 562 U.S. 397 (2011); *Sims v. Cent. Intelligence Agency*, 642 F.2d 562, 572 n.47 (D.C. Cir. 1980). With respect to Exemption 4, it is unclear how commercial or financial information that may be contained in closing letters or closing memoranda, which effectively confirm the regulated entity's compliance, could be used to disadvantage that entity by a competitor. This is confirmed by the FTC's treatment of closing letters it already has disclosed online.

<sup>66</sup> Hon. Maureen K. Ohlhausen, *Painting the Privacy Landscape: Informational Injury in FTC Privacy and Data Security Cases* (Sept. 19, 2017).

enforcement authority without restraint, companies accused of violating the FTC Act may face unfair, unreasonable, and extreme financial and reputational harms that could prove catastrophic to the company's existence. This has already been the case for cancer-detection company LabMD, which was forced out of business by relentless FTC enforcement actions. Despite the ALJ finding that not a single consumer was injured, the Commission reversed the ALJ's decision and continued to press LabMD for having unfair acts and practices. These persistent and damaging acts by the FTC have proven futile, as the 11th Circuit's recent opinion vacated the Commission's cease and desist order on grounds that the act that it was directing LabMD to cease committing was not an unfair act or practice within the meaning of Section 5. It is crucial that the FTC adhere to a realistic measure of what is considered "substantial injury" and not just rely on prior consent orders that fail to provide an adequate description of harm and allow the FTC to loosely interpret "substantial injury." This will not only allow the FTC to choose cases more efficiently and utilize resource more wisely, but it also will minimize unnecessary economic burdens and help the Commission avoid unreasonably destroying more companies.

In carrying out this strict interpretation of injury, the FTC should conduct a rigorous cost-benefit analysis when examining harm and determining whether to pursue enforcement actions. Section 5 only applies to unfair acts or practices that are "not outweighed by countervailing benefits to consumers or to competition."<sup>67</sup> But the FTC often fails to effectively consider these countervailing benefits.

Former Commissioner Joshua Wright detailed the significance of considering countervailing benefits in his dissent from the FTC's consent order with Apple.<sup>68</sup> In his dissent, he provided a thorough cost-benefit analysis, which the FTC failed to conduct prior to bringing the action, finding that "any injury to consumers flowing from Apple's choice of disclosure and billing practices is outweighed considerably by the benefits to competition and to consumers that flow from the same practice."<sup>69</sup> By conducting this detailed analysis, Commissioner Wright found that the unfairness action in that case was "neither warranted nor in the consumers' best interest" because it lacked evidence proving consumers would be better off if Apple modified its disclosures so that they conformed with the consent order.

The FTC should conduct a rigorous cost-benefit analysis on each of its potential enforcement actions before it brings them to ensure that the data-security

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<sup>67</sup> 15 U.S.C § 45(n)

<sup>68</sup> *In re Apple, Inc.*, File No. 1123108 (F.T.C. Jan. 15, 2014) (Joshua D. Wright, Comm'r, dissenting), available at <http://bit.ly/2LQK9DO>.

<sup>69</sup> *Id.*

cases they choose to pursue are in fact in the public interest.<sup>70</sup> The agency should also disclose those analyses to the respondent so that it may have an opportunity to review and rebut any claims upon which the agency relies to justify its action.

Under the FTC's Section 5 "deception" authority, bringing an enforcement action only requires a material misrepresentation that is likely to mislead a reasonable consumer, but including the "substantial injury" requirement as a prerequisite to bringing a deception claim would help the FTC choose cases that are in the public interest as well as minimize economic burden. Many cases of deception are not intrinsically harmful, and of those that are, the harm may not be substantial. It is not in the public interest for the FTC to bring actions when substantial injury is not likely. Therefore, a fair assessment of whether a deceptive act causes harm, and if so how much harm, is necessary to ensure the FTC is pursuing cases that are in consumers' best interest.

#### **IV. CONGRESS SHOULD AMEND THE FTC ACT TO ALLOW DIRECT APPEALS TO U.S. COURTS OF APPEALS FROM ALJ DECISIONS.**

While not within the agency's power to enact, there are amendments to the FTC Act that could improve the agency. Under the FTC Act, the Commission may take enforcement action in administrative adjudication within the agency, as well as in the federal courts. In an administrative proceeding, the complaint is first authorized by the Commission, then adjudicated before an ALJ (who is an employee of the Commission), with FTC staff acting as prosecuting counsel. Following a hearing, the ALJ issues an initial decision setting forth findings of fact and legal conclusions. The ALJ's decision is appealable by either the FTC staff or the respondent to the full Commission.

A number of commentators have noted that the FTC staff enjoy disproportionate success in appeals to their own Commission: "until 2014, the FTC's complaint counsel . . . hadn't lost a case adjudicated before the Commission (on appeal from the [ALJ]) in nearly 20 years."<sup>71</sup> Others have argued that, on the basis of numbers of reversals on appeal to circuit courts, that the Commission's review on

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<sup>70</sup> See generally Cass R. Sunstein, *The Real World of Cost-Benefit Analysis: Thirty-Six Questions (and Almost as many Answers)*, 114 COLUM. L. REV. 167 (2014); Cass R. Sunstein, *Health-Health Tradeoffs*, 63 U. CHI. L. REV. 1533 (1996) (discussing cost-benefit and enforcement priorities).

<sup>71</sup> Justin Hurwitz, *Data Security and the FTC's Uncommon Law*, 101 IOWA L. REV. 955 (2016) (citing Joshua D. Wright, Comm'r, Fed. Trade Comm'n, *Judging Antitrust: Remarks at the Global Antitrust Institute Invitational Moot Court Competition 17–18* (Feb. 21, 2015), available at <http://bit.ly/2n2GRQ8>).

appeal of ALJ decisions adds little to the process.<sup>72</sup> This is perhaps not surprising, since the Commission voted to authorize the complaint and enforcement action in the first instance. Their affirmance of their own prior view of the case does not offer the meaningful appellate procedure to which respondents are entitled.

We recommend that the Commission undertake a review of the efficacy of its internal appeal process and whether Commission review of ALJ decisions provides a meaningful check on the agency. The sequence of appeals from an ALJ decision first to the Commission and then to a U.S. Court of Appeals is set out in the FTC Act.<sup>73</sup> Accordingly, legislative action would be required to eliminate the ineffectual appeal to the Commission from the process.

## V. CONCLUSION

In conclusion, I applaud the FTC for reconsidering its priorities, undertaking this series of public of meetings, and accepting public comments. It is an extraordinary initiative that could bolster public faith in the FTC. For too long the FTC has run roughshod over the rights of entities that it believes are subject to its jurisdiction. I urge you to consider the recommendations in this comment to improve the agency's enforcement processes, increase transparency, develop a workable understanding of substantial injury, and to support important statutory changes. I look forward to seeing what reforms develop from this process and am happy to work with the agency to further those reforms.

Sincerely,

  
JOHN VECCHIONE  
PRESIDENT & CEO  
CAUSE OF ACTION INSTITUTE

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<sup>72</sup> See Joshua D. Wright & Angela M. Diveley, *Do expert agencies outperform generalist judges? Some preliminary evidence from the Federal Trade Commission*, J. ANTITRUST ENFORCEMENT (2012), available at <http://bit.ly/2vtX702>; see also WRIGHT, *supra* note 24 and accompanying text; but see Maureen K. Ohlhausen, *Administrative Litigation at the FTC: Effective Tool for Developing the Law or Rubber Stamp?*, 12 J. OF COMPETITION LAW & ECON. 623, 623–59 (2016) (arguing data from a longer period demonstrate that the Commission dismissed complaints in a quarter to a third of cases, and frequently dismisses some charges even when it did not dismiss entirely), available at <http://bit.ly/2LYJgcm>.

<sup>73</sup> 15 U.S.C. § 45(c).