Remarks of Joshua D. Wright*
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at

The Economics of Digital Consumer Protection: One Commissioner’s View

TechFreedom
and
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Introduction

I am pleased to be here today to kick off today’s panel. I would especially like to thank Berin Szoka and Geoff Manne for the invitation to speak today as well as their efforts to foster informed debate on issues relating to technology and consumer protection. The series of programs put together by TechFreedom and the International Center for Law and Economics could not be more timely. Not only is the Federal Trade

* The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my advisor, Beth Delaney, for her invaluable assistance in preparing these remarks.
Commission commemorating its centennial – a landmark event that merits introspection and review – but also today’s discussion comes at a time when the agency has significantly ramped up its enforcement and policy efforts in the tech sector.

The primary focus of my remarks today will be upon the Commission’s recent enforcement action and settlement with Apple. As many of you know, I was the sole vote against that enforcement action and issued a dissenting statement. The Commission alleged that Apple engaged in “unfair acts or practices” by failing to adequately disclose to parents and other iTunes account holders that they would be billed for in-app purchases that occurred during a fifteen-minute window that began after entering their password to complete a previous transaction.

I dissented from the Commission’s issuance of an administrative complaint and consent order because I felt that the Commission did not adequately weigh the costs and benefits of Apple’s business decisions prior to bringing a case alleging that Apple unfairly failed to obtain express informed consent on its billing platform.

I will also briefly comment upon the Commission’s recent data broker report. In particular, the data broker report offers further opportunity to examine the appropriate role of economic analysis, and cost-benefit analysis more generally, to provide the analytical foundation for Commission policy recommendations. I included several footnotes within the report highlighting areas where I believed the Commission recommended legislative action and promoted certain industry best practices without
first gathering the proper evidence to support such recommendations – that is, evidence that the consumer benefits from those recommended actions would exceed the costs. My remarks today will focus upon my thoughts on the best ways for the Commission to approach unfairness analysis in the digital age, and more specifically, how the Commission should incorporate economic analysis of the costs and benefits of various business practices into its consumer protection enforcement and policy decisions.

The Evolution of the Unfairness Standard

In starting this conversation, some history on the evolution of “unfairness” in the consumer protection context will provide some useful background. The first iteration of the FTC Act – enacted in 1914 – contained only a broad prohibition on “unfair methods of competition.” In these early years, although the agency had the authority to prosecute deceptive marketing practices using the “unfair methods of competition” prohibition, it was somewhat constrained in that courts required a showing of some predictable impact on competition or competitors. In 1938, this constraint was eliminated when Congress amended the FTC Act to include “unfair or deceptive acts or practices.” While the Wheeler-Lea amendments allowed the FTC to pursue “deceptive” or “unfair” acts or practices independently, the agency generally lumped the two together and the two parts were viewed as a single standard.\(^1\)

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\(^2\) ABA SECTION OF ANTITRUST LAW, CONSUMER PROTECTION LAW DEVELOPMENTS 1-2 (2009).
That changed in 1964 when, in the course of its regulatory efforts relating to cigarette marketing, the agency explained the factors underlying an unfair practice in the absence of acts or practices that violated either the antitrust laws or the deception prong. This standard, sometimes referred to as the “Cigarette Rule” unfairness standard, includes an examination of “whether the practice, without necessarily having been previously considered unlawful, offends public policy,” whether the practice is “immoral, unethical, oppressive, or unscrupulous,” or “whether it causes substantial injury to consumers (or competitors or other businessmen).” This older and unbounded standard gives more weight to vague and unspecified public policy considerations, opines on whether practices are “immoral, unethical, oppressive, or unscrupulous,” and uses a substantial injury prong that is devoid of economic analysis – in particular, it does not consider whether the injury is “outweighed by countervailing benefits to consumers or competition.” Because the Cigarette Rule unfairness standard rejects consideration of the benefits of various business practices, it threatened to chill business conduct that enhances competition among firms or otherwise makes consumers better off.

The Commission has a significant history with this unbounded unfairness standard. The application of this early articulation of unfairness resulted in “a series of rulemakings relying upon broad, newly found theories of unfairness that often had no

3 See FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 244 n.5 (1972).
empirical basis, could be based entirely upon the individual Commissioner’s personal values, and did not have to consider the ultimate costs to consumers of foregoing their ability to choose freely in the marketplace.”⁴ As others have pointed out, untethered from a rigorous cost-benefit analysis, this early unfairness standard failed to “reflect the underlying philosophy that [the] ultimate objective of consumer protection is consumer welfare, and that the role of consumer protection laws is to supplement market forces, rather than to entirely displace them.”⁵

Ultimately, in the wake of so-called “kid vid” controversy in the late 70s – during which the Commission attempted to ban the airing of certain commercials during children’s television programming and was subject to considerable popular and political criticism – the FTC abandoned this standard in favor of its Policy Statement on Unfairness in 1980. Under this revised standard, and as subsequently codified by Congress in 1994 in Section 5(n) of the FTC Act, the agency may pursue enforcement action on the basis of “unfairness,” in cases where an act or practice “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by

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consumers themselves and not outweighed by countervailing benefits to consumers or 
competition.”

In reformulating its unfairness standard, the Commission recognized that in 
utilizing its authority to deem an act or practice as “unfair,” it must undertake a much 
more rigorous analysis than is necessary when it uses its deception authority. As 
Howard Beales, an economist and former Director of the agency’s Bureau of Consumer 
Protection has noted, “the primary difference between full-blown unfairness analysis 
and deception analysis is that deception does not ask about offsetting benefits. Instead, 
it presumes that false or misleading statements either have no benefits, or that the 
injury they cause consumers can be avoided by the company at very low cost.” It is 
also well established that one of the primary benefits of performing a cost-benefit 
analysis is to ensure that government action does more good than harm. Rigorous 
economic analysis protects against the risk that business practices that provide 
consumers net benefits are not erroneously condemned. Cost-benefit analysis is simple 
and straightforward when the practice being analyzed has generates significant harm 
without offsetting benefits. However, nowhere is that risk of condemning consumer-

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8 Beales, supra note 4, § III.
9 Int’l Harvester, 104 F.T.C. at 1070. See also Dissenting Statement of Commissioner Joshua D. Wright, In 
http://www.ftc.gov/sites/default/files/documents/public_statements/dissenting-statement-commissioner-
joshua-d.wright/140115applestatementwright.pdf (“To justify a finding of unfairness, the Commission 
must demonstrate the allegedly unlawful conduct results in net consumer injury.”).
welfare increasing business practices or deterring their creation more salient than when, as was the case in Apple, they provide obvious and intuitive consumer benefits. From an institutional perspective, the FTC is well-positioned to carry out the analysis required to ensure that our digital consumer protection efforts do indeed make consumers better off, with an independent Bureau of Economics and many talented economists within its ranks.

**Revival of Unfairness in the Digital Age**

Before turning to the Apple decision, it is worth exploring a few applications of unfairness analysis that highlight how this authority can be successfully applied in the digital age to reach business practices that harm consumers. The Commission began exploring the use of its unfairness authority in the online context under former Chairman Tim Muris in October 2001. In the so-called Cupcake Party case, the Commission alleged that John Zuccarini, a cyberscammer, used more than 5,500 copycat or misspelled Web addresses to divert Internet users from their intended Internet destinations to one of his sites, and then hold them captive while he pelted their screens with a barrage of ads. It was extremely difficult for website visitors to exit from this programming. Computers would often crash and consumers could lose unsaved work product or otherwise be deprived of the use of their computers. The Commission’s complaint alleged two unfairness counts – one for Zuccarini’s practice of
diverting consumers to his websites, and a second count for his practice of obstructing consumers from subsequently leaving those websites.\footnote{FTC v. John Zuccarini, Civ. Action No. 201-CV-04854-BMS (E.D. Pa. 2007).}

In retrospect, it may seem obvious or trivial that the conduct at issue qualifies as an unfair act or practice or that there is not much to learn from this case in terms of its potential application to other technologies or business practices in the digital age. I disagree. Putting aside the apparent egregiousness of the actions of the players in 

*Cupcake Party* matter, the case is an important illustration of the Commission exercising its unfairness authority only after properly applying the cost-benefit analysis embodied in and required by Section 5(n). Faithful and rigorous application of that standard is a safeguard against its application in a manner that declares unlawful conduct that actually makes consumers better off. While that was not a particularly close call in 

*Cupcake Party*, methodology matters when it comes to unfairness analysis.

First, the aberrant code resulted in substantial tangible injury to consumers – consumers lost work product when their computers crashed, and they were deprived of the use of their computers during these incidents. This injury also was not reasonably avoidable – the defendants specifically targeted unwary misspellers, who were unaware of the misery that was about to befall them. Consumers had no way to avoid the economic harm beforehand, and once the code started running on their computers, they had no way to stop, or even mitigate the injury. Importantly, there was no
evidence that this unavoidable, substantial injury was outweighed by countervailing benefits to consumers or to competition. The *Cupcake Party* defendants did not attempt to show that their practices involved consumer choice or preference, that they had an ongoing relationship with consumers, or even that there was any sort of business justification for their business model.

Another area in which the Commission frequently has asserted its unfairness authority is in the context of cases alleging unauthorized billing practices. Indeed, the Commission majority describes *Apple* as a simple unauthorized billing case, describing it as merely reaffirming the concept that “companies may not charge consumers for purchases that are unauthorized.”11 While I obviously disagree with that description for reasons I will discuss shortly, exploring the application of unfairness in a true unauthorized billing case highlights both how the authority can, when applied appropriately, reach conduct that harms consumers and illustrates the obvious differences with the allegations in *Apple*.

In *The Crescent Publishing Group*,12 the FTC filed a three-count complaint in federal district court alleging deception as well as the unfair practice of unauthorized billing. The *Crescent Publishing* defendants operated pornography websites that offered

visitors “free tours” of the content on parts of its websites. In order to take a tour, visitors were required to enter their credit card number. The visitor was assured that the card “will not be billed” during the free tour and told that the credit card number was necessary to verify age. As you might have guessed, despite these representations, many visitors ultimately were charged a monthly membership without their knowledge or consent. In a preliminary injunction hearing, in addition to concluding that the FTC was likely to prevail on its claims that defendants’ representations were deceptive, the court also concluded, after application of the FTC’s three-pronged unfairness test, that the FTC was likely to prevail on its claims that Crescent Publishing’s business practices were unfair.

The court first found that consumer injury was unavoidable because consumers could not decline to “join” because the disclosure that they were joining and agreeing to a monthly membership was either nonexistent or too inconspicuous. The finding that the injury was unavoidable was bolstered by the fact that consumers had difficulty in avoiding or reversing defendants’ bills: consumers were unable to determine who was billing them, what they were being billed for, and how to contest the charges. Furthermore, defendants’ identity was not immediately apparent on the face of the bills because of their practice of billing under various “discreet names for billing descriptors.” Even the consumers that could track down the defendants were denied
refunds. The court then concluded that, “[i]n these circumstances, it is likely that the injury to consumers was substantial in the aggregate.”\textsuperscript{13}

The court also considered potential benefits. While the defendants pointed to length of membership and other data as evidence of consumer satisfaction, the court noted that the evidence submitted by the FTC – a high volume of charge backs and credits “suggested that they also have deceived many others.” In granting a preliminary injunction, the court ultimately concluded that the benefits did not offset the harm caused by the defendants.

The court’s willingness to conclude that Crescent Publishing’s billing practices were unfair was based upon a determination that the defendants were being less than forthright with consumers and that their activities lacked much semblance of legitimacy. For example, the court pointedly noted that the defendants attempted to disguise their charges on billing statements by using pseudonyms, avoided informing consumers what they were being billed for, and engaged in various other behaviors to avoid detection and having to provide refunds. Imagine, instead, a company whose priority is to maintain strong relationships with its customer base, who has established streamlined methods to communicate with its consumers, who touts its identity and promotes its branding, who offers innovative products that its customers clamor for, whose mechanism for initiating purchases is prominent and clear, and who provides

\textsuperscript{13} Id. at 322.
timely billing information as well as refunds. I doubt that in considering such a case the
*Crescent Publishing* court – or any other court for that matter -- would be as sympathetic
to finding the unfairness standard satisfied.

Apart from unauthorized billing cases that are grounded in fraud, the
Commission often exercises its unfairness authority in cases where the business practice
generates relatively obvious harms and little or no benefit. There, the underlying
economic analysis embedded within the unfairness authority is relatively
straightforward. For example, I voted for and have discussed elsewhere my support for
the Commission’s exercise of its unfairness authority in *HTC America* and *Aaron’s.¹⁴

*Apple Dissent*

Now, for the not-so-good news. As you are all aware, this past January, the
Commission issued an administrative complaint alleging that that Apple engaged in
“unfair acts or practices” by billing parents and other iTunes account holders for the
activities of children who were engaging with software apps likely to be used by
children that had been downloaded onto Apple mobile devices.¹⁵ Because Apple did
not expressly inform account holders that the entry of a password upon the first
transaction triggered the fifteen-minute window during which users could make

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additional purchases without once again entering the password, the Commission’s complaint alleged that Apple billed parents and other iTunes account holders for the activities of children without obtaining express informed consent.16

I disagreed. In order to deem a practice as unfair, recall that the Commission must show that it “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.”17 This standard calls for an economic analysis of the allegedly unfair business practice. The economic analysis it invites is an appropriately flexible one – incorporating not only the harms to aggrieved consumers but also any benefits to consumers or to competition more generally.

The evidence certainly supported the inference that the business practice harmed at least some consumers. This is not a surprise. Many business practices that improve consumer welfare overall are also well understood to harm some consumers. The unfairness standard is not a per se rule of illegality or strict liability standard; it does not provide the Commission the authority to deem a business practice unfair merely because some consumers are injured or because the Commission can imagine an alternative business method or product design that might make some consumers better off. The Commission must instead conduct a rigorous analysis of the economic harms

16 Id. at paras. 4, 20, 28.
and benefits of the allegedly unfair practice to safeguard against application of the unfairness authority in a manner that condemns business practices that do in fact make consumers better off overall.

It is important to understanding my concern with the majority opinion to understand that I largely agreed with their view of the evidence of consumer harm. There was no substantial disagreement that there was at least some harm to a group of consumers. Nor was there any disagreement that this was a case involving a miniscule percentage of total Apple consumers – the parents of children who made purchases ostensibly without their authorization or knowledge. The injury in this case was limited to an extremely small – and arguably, diminishing – subset of consumers.

There was also no disagreement that the overwhelming majority of consumers used the very same mechanism to make purchases and that those charges were properly authorized. Indeed, the nature of Apple’s disclosures is an important attribute of Apple’s platform and affects the demand for and consumer benefits derived from Apple devices and services. From an economic perspective, this is really the key point: how and when information is disclosed and passwords are required affects the value of consumers’ experiences on Apple’s platform. Requiring changes in the design of this attribute of Apple’s platform may well make some consumers better off by decreasing the likelihood of consumer harm from unauthorized purchases; however, the same
tinkering will also reduce the value of the platform for some other users. This tradeoff lies at the heart of the economics analysis of information disclosure in cases like Apple.

Unlike Crescent Publishing and other cases generally relied upon by the Commission involving various unauthorized billing practices, here, there is simply no dispute that Apple’s choices with respect to how it designs its product – including when, where, and how Apple would communicate with consumers about billing on the platform for in-app purchases made during the fifteen-minute window – improve some consumers’ experiences and thus enhance the value of Apple’s platform and products. Anybody in the room with an iTunes account, iPad, or iPhone knows that the ease with which users can operate the platform affects one’s experience. Apple knows that too. And Apple had apparently determined that most consumers do not want to experience excessive disclosures or to be inconvenienced by having to enter their passwords every time they make a purchase.

Apple’s product design choices, including the nature of these disclosures and its choice to integrate the fifteen-minute window, are a product of considerable investment and innovation, and provide substantial benefits for consumers who do not want to experience excessive disclosures or by having to enter passwords every time they make a purchase. These product design choices, as I point out in my dissent, implicate economic activity by consumers across the entire Apple platform and not just in-app
purchases.\textsuperscript{18} Recognizing that the overall impact upon consumers from declaring one aspect of Apple’s product design unlawful requires analysis of the entire platform – a common situation in software platforms and multi-sided markets generally – does not require any adjustment in the unfairness standard; it only requires recognition of the simple economic point that Apple’s platform and the sales of its many products and devices through that platform are complements.

To be clear, the fact that Apple makes its own calculus as to how to weigh the costs and benefits to consumers of its product design decisions does not mean that it necessarily has done so in a way that shields it from unfairness liability. But the unfairness standard places upon the Commission the burden of showing that the harms from Apple’s choices outweigh the benefits. But the Commission offered no such evidence. Given the apparent benefits to many consumers and to competition from Apple’s allegedly unfair practices, I strongly believe that the Commission should have conducted a much more robust analysis to determine whether the injury to this small group of consumers justified the finding of unfairness and the imposition of a remedy.

Rather than engage in that form of analysis, I felt that the Commission, under the rubric of “unfair acts or practices,” simply substituted its own judgment for a private firm’s decisions as to how to design its product to satisfy as many users as possible. But, much like for Apple, the fact that the Commission was able to identify some costs

\textsuperscript{18} Dissenting Statement of Commissioner Joshua D. Wright, \textit{supra} note 9, 6-8.
to some consumers of Apple’s product design decisions does not mean that it can
legitimately assign unfairness liability. Indeed, the statute requires the Commission to
weigh those costs against the benefits to consumers – the benefits Apple presumably
took into account in its own calculus.

The methodology adopted by the Commission is problematic and concerning if
continued or applied in other contexts. Here, the Commission found complaints about
a business practice by a small group of consumers sufficient, without more, to establish
unfairness. That economic analysis is much closer in conceptual spirit to the Cigarette
Rule than to what is required under Section 5(n). That approach is especially
problematic in the face of evidence of obvious consumer benefits to some consumers
from the same business practice, and without rigorous analysis weighing those costs
and benefits. Unfortunately, the consent order required Apple to revamp an otherwise
indisputably legitimate business practice in the absence of any such evidence.

Cost-Benefit Analysis in the Policy Context – Data Broker Report

For similar reasons, I also believe that the Commission needs to conduct rigorous
empirical work prior to making policy recommendations. The most recent example is
the data broker report issued this past May.¹⁹ The data broker report serves an
important function in getting descriptive data about the industry out into the world.

Using the Commission’s 6(b) authority, staff was able to obtain some important information about the types of activities in which data brokers are engaging.

However, with regard to policy development, this is an area where I believe it is critical to understand the potential outcome of any proposed course of action to “protect consumers” before making specific recommendations. Serious cost-benefit analysis concerning consumers and privacy requires rigorous study of consumer preferences – this is all the more so in the context of broadly applicable policy pronouncements. What I mean by “serious” analysis is to reject the methodology, often employed in debates over privacy regulation, of merely pointing to survey evidence purporting to elicit consumer preferences by asking consumers whether “they are concerned about privacy.” I would also like to see evidence of the incidence and scope of consumer harms rather than just speculative hypotheticals about how consumers might be harmed before regulation aimed at reducing those harms is implemented.

Accordingly, the FTC also would need to quantify more definitively the incidence or value of data broker practices to consumers before taking or endorsing regulatory or legislative action. The report acknowledges that these practices have some benefits to consumers but does not take on the step of more thoroughly examining their approximate magnitudes.

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We have a lot of work to do on the cost side of the ledger as well. We have no idea what the costs for businesses would be to implement consumer control over any and all data shared by data brokers and to what extent these costs would ultimately be passed on to consumers. Once again, a critical safeguard to insure against the risk that our recommendations and actions do more harm than good for consumers is to require appropriate and thorough cost-benefit analysis before acting. This failure could be especially important where the costs to businesses from complying with any recommendations are high, but where the ultimate benefit generated for consumers is minimal. For example, the costs to effectuate opt-out mechanisms might be high in certain circumstances and yet may not offer consumers any real benefit. If consumers have minimal concerns about the sharing of certain types of information – perhaps information that is already publicly available – I think we should know that before requiring data brokers to alter their practices and expend resources and incur costs that will be passed on to consumers.

**Next Steps – Recommendations for the Commission Going Forward**

Let me close with some recommendations for incorporating economic analysis into Commission decision-making both with respect to application of unfairness to high-tech markets and more generally. With respect to the former, *Apple* illustrates many critical lessons, but I will limit myself to three.
First, as simple as it sounds, the Commission should take seriously the fact that unfairness analysis does not contemplate a rule of strict liability or per se illegality. This is true generally but nowhere more important than in the context of complicated unfairness allegations in high-tech markets. The Commission majority describes the case as merely reinforcing the proposition that “companies may not charge consumers for purchases that are unauthorized.” That proposition sounds like strict liability to me. But the unfairness analysis must be satisfied with economic evidence and empirical rigor rather than analogies to cases like Crescent Publishing with little or nothing to do with the design of Apple’s iPad.

Second, cost-benefit analysis in multi-sided markets and software platforms necessitates analysis of the harms and benefits on all sides of the market in order to fully understand the impact of the practice upon consumers and competition as required. One-sided economic analysis in multi-sided markets is a recipe for a consumer protection policy that does more harm than good. This is especially so in those high-tech and digital markets that are driving economic growth and generating remarkable welfare gains for consumers.

Third, the economics of information disclosure are fundamentally different when the information to be disclosed is a latent defect that can only harm consumers – for example, the hot fuel geysering seen in International Harvester – than when the information dramatically impacts the value of the consuming the product itself, such as
in *Apple*. An economic analysis of the potential harms and benefits must take into account these fundamental differences.

More generally, as an economist, I strongly believe in the implementation of thorough cost-benefit analyses across many areas of the agency’s consumer protection mission, but particularly when the agency uses its unfairness authority, calculates civil penalties, or makes policy recommendations. To that end, it has been one of my priorities to engage the Bureau of Economics in evaluating these matters. As I have mentioned in other contexts, the unique composition of the agency – housing the independent Bureaus of Competition, Consumer Protection, and Economics – has the potential to facilitate informed and well-reasoned decision-making. I continue to look for ways to further integrate economic analysis into agency decision-making and policy recommendations, especially within the realm of consumer protection.

Thank you very much for your time. I am happy to take some questions.

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