Legal Backgrounder

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THE FTC AT A CROSSROADS: CAN IT BE BOTH PROSECUTOR AND JUDGE?

by
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Nearly 100 years ago Congress established the Federal Trade Commission (FTC) to protect consumers against unfair, deceptive, and anticompetitive practices. The goal of Congress was to create a single agency with a broad range of powers to address these important policy goals. When it was established in 1914, the FTC was designed to be an investigatory and adjudicative body empowered to clarify and enforce antitrust law. The agency was tasked with identifying and stopping "unfair methods of competition."[1] Part of the reason for the creation of the FTC was the dissatisfaction with the ability of generalist courts to enforce the antitrust laws. To strengthen the role of the FTC, Congress gave it the power to conduct studies, issue reports, and, most importantly, administratively litigate—to bring enforcement actions and serve as an administrative tribunal.

The FTC has met the goals of Congress in many respects. But the role of administrative litigation seems often unfulfilled. For years administrative litigation was criticized because of its glacial pace or the relatively minor cases that were litigated. In the mid-1990s, the FTC adopted a series of carefully structured time limits and other procedural reforms that have shortened and strengthened the litigation process and made it more like federal court litigation. Some observers have noted that FTC administrative litigation is akin to a "rocket docket." Not surprisingly over the past decade, the FTC has concurrently increased the role of administrative litigation.

In one important respect, the administrative litigation role is particularly unsettling. The FTC acts as both prosecutor and judge in administrative litigation. In the past, businesses, the American Bar Association, and former FTC Commissioners have all raised concerns about this appearance of unfairness. Those concerns were tempered in the past because administrative litigation was so slow that often the FTC's five member Commission would change in composition after an administrative trial was held. And more importantly, the Commission frequently held that no law violation occurred. In the past 18 years, however, the Commission has found a law violation in every administrative case. This trend is unprecedented.

This LEGAL BACKGROUNDER addresses the FTC's administrative process and the problem of procedural fairness. It highlights the recent history of the Commission's decision-making and observes how some of the most important decisions were rejected by the federal courts of appeal. Finally, it observes the problems that arise from the appearance of unfairness and how those problems may undermine the FTC's role in antitrust and consumer protection enforcement.

The FTC Administrative Law Process. When the FTC has "reason to believe" an entity is engaged in an "unfair method of competition" or an "unfair or deceptive act or practice," the Commissioners vote to file a complaint against that entity, which becomes known as the respondent. 15 U.S.C. § 45(b). The complaint lists the unfair acts the respondent is accused of and informs the respondent of its opportunity to attend a hearing in front of an administrative law judge (ALJ).

[1] Federal Trade Commission Act of 1914, Pub. L. No. 63-203, 38 Stat. 717 (codified as amended at 15 U.S.C. §§ 41-58 (2006)).

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While the matter is under investigation the FTC Commissioners work closely with the staff in developing the case and directing the investigation. Before a complaint is issued the respondent has the opportunity to meet with the Commissioners and argue why no enforcement action is necessary. In developing the case and issuing the complaint the Commissioners act as prosecutors. The Commissioners' roles change once the complaint is issued. They become adjudicators and there is a wall of separation between them and the staff prosecuting the case (known as "complaint counsel"). There are strict rules preventing communications during the litigation. Some members of the Office of General Counsel may assist the Complaint Counsel in prosecuting the case while others may assist the Commission in its adjudicative function.

When a complaint is issued an administrative hearing is held where the respondent presents reasons why it should not be required to "cease and desist" from its current conduct. *Id*. After the hearing, the ALJ makes an initial determination of whether the respondent engaged in unfair methods of competition. The ALJ's initial decision becomes the decision of the Commission unless the initial decision is appealed. Either the respondent or the FTC complaint counsel can appeal the decision. If upon appeal by the FTC Staff, the FTC Commissioners disagree with the ALJ's decision, the Commissioners may reverse the ALJ. The Commissioners are not required to give any deference to the ALJ's conclusions of law. Additionally, according to the Administrative Procedure Act, the Commissioners are not required to give any deference to the ALJ's findings of fact. 5 U.S.C. § 557(b). The Commissioners retain the authority to decide the facts and law of each case as if the case was originally heard before the FTC Commissioners instead of an ALJ. 16 C.F.R. § 3.54(a).

A respondent may appeal the Commission's decision to any United States Court of Appeals where the respondent's conduct occurred or the respondent resides. 15 U.S.C. § 45(c). (If the Commission dismisses the complaint the staff cannot appeal that decision). Unlike the Commissioners' de novo standard of review for factual findings, appellate courts must give deference to the FTC. The appellate courts may only disagree with the FTC Commissioners' findings of fact if there is "substantial evidence" that the Commissioners erred.

Appearance of Partiality. Because the FTC acts as both prosecutor and adjudicator, experts have questioned the dual role of the Commissioners. For example, in a thoughtful article four decades ago, former Commissioner Phil Elman noted the institutional and political pressures that make it difficult for the Commission to dismiss a complaint. Dismissing a complaint could be viewed as "an admission of costly error—costly both in time and taxpayer money." Philip Elman, *Administrative Reform of the Federal Trade Commission*, 59 GEO. L. J. 777, 810 (1971). Commissioners may sustain a complaint because they want to keep "staff morale" high or appear successful to the public. *Id*. Because the Commission's dismissals are not subject to judicial review, the Commission may sustain complaints to ensure the courts have an opportunity to weigh in on antitrust policy. *Id*. Finally, the Commission may sustain complaints because they have effectively prejudged the matter – they already believe the respondent violated the law. At a hearing in front of the Commissioners, the burden of proof may "subtly shift[] to the respondent." *Id*.

As a result of these perceived problems, the American Bar Association (ABA) in 1989 assessed whether the FTC should continue to prosecute and adjudicate antitrust cases.[2] The ABA stated: "[N]o thoughtful observer is entirely comfortable with the FTC's . . . combining of prosecutory and adjudicatory functions. Whenever the same people who issued a complaint later decide whether it should be dismissed, concern about at least the appearance of fairness is inevitable." However, the ABA concluded that the benefits and safeguards inherent in the FTC's adjudicatory process outweighed any need to separate the FTC's ability to prosecute and adjudicate.

To support its findings, the ABA noted several factors that appeared to diminish the appearance of conflict. One factor was the length of time an FTC adjudication took to complete. An FTC proceeding could take as long as three years or longer, and by that time the Commissioners who approved the original complaint against a respondent might not be the same Commissioners who would hear an appeal from the ALJ. Commissioner turn-over created a greater likelihood of independence between the prosecutorial and adjudicative roles. Additionally, the ABA took solace in the fact that the Commission regularly dismissed its own complaints. For example, in the 1980s the Commission dismissed over 40 percent of its complaints on the merits. (A recent study found that from 1950-2011 the Commission's reversal rate was over 19%).[3]

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[2] Report of the ABA Antitrust Section Special Committee to Study the Role of the Federal Trade Commission (1989).

[3] Nicole Durkin, Comment, *Rates of Dismissal in FTC Competition Cases from 1950-2011 and Implications for Fairness*, 81 GEO. WASH. L. REV. 101 (2013) (on file with the author). In the 1980s, the period examined by the ABA, the rate was significantly higher,

Under the leadership of Chairman Robert Pitofsky, the FTC began to address the problems of administrative litigation. It began to reform the litigation process to root out delays and make it closer to federal court litigation. It opted to not always pursue administrative litigation in merger cases where a preliminary injunction was denied. And it dismissed complaints after administrative litigation, most prominently the 1995 *R.R. Donnelley* case—a prominent merger challenge that had been litigated for several years.

But neither of the reasons the ABA cited in 1989 seems to support deference to the FTC today. First, the FTC to its credit has streamlined the administrative litigation process. In reforms instituted in the Bush Administration the FTC set strict deadlines that include requiring the ALJ to issue a decision within 13 months after a complaint is issued. Thus, the glacial pace of litigation no longer serves to protect the appearance of conflict. (Of course, this may cut both ways for respondents: it means they get a decision sooner, but it can also impose incredible burdens as an entire case has to be litigated from complaint to motions practice to document and deposition discovery and through trial in less than a year. The costs can be significant and daunting and in some cases may force respondents to settle claims that lack merit.)

Second, the FTC no longer appears as impartial in evaluating a case after an administrative trial. In fact since the *R.R. Donnelley* decision the FTC has always found a violation. In over 20 cases it has never found for the respondent and has reversed ALJ decisions that dismissed complaints. This FTC "winning streak" is simply unprecedented. There could be several possible reasons for this trend. Perhaps the FTC has only brought cases which are relatively strong and have high odds of success, but as explained below some of its most important cases have been rejected by the appellate courts. Indeed, the Commission's rulings in its own favor often do not stand up on appeal. Studies demonstrate that the Commission is reversed by federal courts of appeals at a far higher rate (over 20%) than district court antitrust decisions (under 5%). Or perhaps the agency may be trying to establish new legal principles or explore new legal avenues. Or the decision-making by the ALJ is inadequate. In any case the FTC's almost two decade history of *always* ruling in its own favor creates a strong impression of unfairness.

Treatment of FTC Administrative Decisions by Appellate Courts. The FTC's administrative litigation process has resulted in several important decisions that have helped develop antitrust jurisprudence. These cases include *Indiana Federation of Dentists* and *Polygram* (on rule of reason analysis), *Ticor* (on state action), and *Hospital Corporation of America* (merger law). But recently the appellate courts have been critical of the FTC's decision-making where it has substituted its fact finding for the ALJ. In those cases the Commission has reversed the ALJ's decision to dismiss a complaint, only to have its decision reversed by an appellate court.

For example, in 2005 the Eleventh Circuit reversed an FTC decision that a pharmaceutical patent settlement was anticompetitive. *Schering-Plough Corp. et al. v. Federal Trade Commission*, 402 F.3d 1056, 1076 (11th Cir. 2005). The FTC challenged a patent settlement that allegedly kept generic versions of the drug K-Dur, a widely prescribed potassium chloride supplement, off the market. The ALJ dismissed the complaint finding that the FTC counsel did not "prove or properly define" the relevant product market; that Schering did not have monopoly power in the relevant product market; and that the evidence did not prove "that the payments were not to settle the infringement cases and for drugs licensed to Schering" or that the agreements served to delay the entry of generic competition. *Schering-Plough Corp.*, (F.T.C. July 2, 2002) (No. 9297), at http://www.ftc.gov/os/2002/07/scheringinitialdecisionp2.pdf.

FTC complaint counsel appealed to the Commission, which overturned the ALJ's decision. In doing so the Commission rejected some of the ALJ's interpretation of the facts. The respondents appealed to the Eleventh Circuit, which rejected the Commission's conclusion. In doing so the court noted that "[i]t would seem as though the Commission clearly made its decision before it considered any contrary conclusion." *Schering-Plough Corp. v. FTC*, 402 F. 3d 1056, 1065 (11th Cir. 2005). The opinion is largely derisive of the FTC's findings, stating that "the Commission relied on somewhat forced evidence" and questioning the Commissions rejection of the ALJ's credibility findings, "instead rel[ying] on information that was not even in the record." *Id*. at 1070.

In another case in 2008, the D.C. Circuit reversed an FTC decision that Rambus, a maker of high-tech computer memory, had "deliberately engag[ed] in a pattern of anticompetitive acts and practices that served to deceive an industry-wide standard-setting organization, resulting in adverse effects on competition and

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perhaps because of the skepticism of the Reagan Administration FTC to cases brought by the Carter Administration FTC.

consumers." *FTC Issues Complaint Against Rambus, Inc.*, Federal Trade Commission, at http://www.ftc.gov/opa/2002/06/rambus.shtm. After 18 months of litigation the ALJ dismissed the FTC's complaint, finding no anticompetitive effects resulting from the challenged conduct. *Rambus Inc.*, (F.T.C. Feb. 24, 2004) (No. 9302), at http://www.ftc.gov/os/adjpro/d9302/040223initialdecision.pdf. The complaint counsel appealed the decision and in 2006 the Commission reversed the ALJ's decision after engaging in its own fact finding, which included reopening the record after the ALJ's decision to admit supplemental evidence.

Rambus appealed the Commission's decision to the D.C. Circuit, which overturned the Commission, finding that Rambus' conduct did not "constitute monopolization" and "express[ing] our serious concerns about the sufficiency of the evidence" the Commission relied upon. *Rambus Inc. v. FTC*, 522 F. 3d 456, 459 (D.C. Cir. 2008). In questioning the Commission's reliability, the court specifically noted that "once again, the Commission has taken an aggressive interpretation of rather weak evidence." *Id.* at 469. The court raised "serious concerns about the breadth the Commission ascribed" to disclosure policies, *id.* at 462, without any formal findings in the record that the policies were so broad. *Id.* at 467.

This is not to suggest that the Commission was misguided in bringing these cases. Indeed, Congress envisioned that the FTC would tackle the truly challenging cases and develop new areas of law. But the perception of prejudgment and the Commission's treatment of the facts severely undermined their decisions.

Why Impartiality Matters. There are five reasons why this appearance of fairness raises substantial concerns. First, it brings into question whether respondents are afforded the right to due process and fundamental fairness. The legal process only works if parties receive the process rights that they are due.

Second, if it appears the outcome is pre-determined, that may force respondents to settle even weak cases. It may also have a broader chilling effect on companies whose conduct may (or may not) have beneficial consumer effects if the company believes that its conduct could get challenged by the Commission—and if it does, it will lose with certainty.

Third, the administrative process is credible only to the extent that it is impartial and there is a sense of fairness. FTC adjudication is not only important for an individual case, but also for interpreting the law and establishing precedent. These functions are diminished when the FTC is seen to lack credibility. For example, in a private case brought while the FTC Rambus decision was on appeal, a district court specifically rejected the FTC's findings because of "the FTC's lack of independence given the fact that the FTC essentially acts as both the complainant and the decision maker."[4]

Fourth, the FTC adjudicative process is tremendously expensive. Fundamentally, if businesses know that they will not be able to appear before a truly independent adjudicator until they can appeal an FTC decision to a court of appeals, this will significantly raise the cost of the FTC process and often force settlement.

Finally, the Antitrust Division of the Justice Department must bring its cases in federal court. This creates a fundamental unfairness between those companies who are subject to the jurisdiction of the Justice Department and those companies that are subject to FTC jurisdiction, since those companies subject to DOJ enforcement can have their day in court sooner.

Conclusion. Because the FTC acts as a prosecutor and an adjudicator, the agency must ensure its procedures are fair and impartial. In the adjudication process the Commission must be willing to admit error and dismiss complaints where appropriate. Without a balanced approach the adjudicative process will be diminished and its enforcement powers undermined.

[4] Order Denying Manufacturers' Motion for *Prima Facie* Effect and Denying Manufacturers' Motion for Collateral Estoppel, *Hynix Semiconductor Inc. v. Rambus Inc*., No. C-00-20905 RMW, 2009 WL 440473 – 2009 at *7 *available at* http://files.shareholder.com/downloads/RMBS/1256054421x0x156792/3614955F-B3A9-4AAE-8288-A0B2134BE4DA/HynixVsRambus211.pdf.