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Introduction

Chairwoman Schakowsky, Ranking Member Bilirakis, and members of the Committee, thank you for the opportunity to testify today on the Consumer Protection and Recovery Act. I am Howard Beales, an Emeritus Professor of Strategic Management and Public Policy in the George Washington School of Business. I have spent most of my career either at or writing about the FTC and its consumer protection mission, publishing numerous academic articles and serving in a variety of different positions at the agency. My fifth and most recent position was as the Director of the Bureau of Consumer Protection from 2001 to 2004.

Since 1981, using Section 13(b) to attack fraud in federal district court has been the foundation of the Federal Trade Commission's consumer protection enforcement program. Because courts used that provision to award monetary relief, the program returned billions of dollars to consumers. Successive agency Chairs expanded and strengthened the program, and the agency now coordinates a vast network of local, state, national, and international law enforcement agencies to prosecute the many faces of fraud.

In what became known as the "Section 13(b) Fraud Program,"[1] the FTC filed a single federal action under Section 13(b), seeking an *ex parte* temporary restraining order (TRO) and an asset freeze under Rule 65(b). The district court typically appoints a receiver to secure and monitor the fraudster's frozen assets.[2] At a preliminary injunction hearing, the fraudster can contest the asset freeze, and, if the FTC prevails, the court will continue to monitor the receivership while the parties litigate the merits of the FTC's claim. Upon resolving the merits, the district court issues a permanent injunction and award consumer relief from the fraudster's still-frozen funds. Absent an asset freeze, funds would likely be dissipated or hidden quickly, leaving nothing for defrauded consumers.

The early cases under Section 13(b) recognized its limited availability in consumer protection cases and respected the limits Congress had imposed in requiring that other parts of the FTC Act be used to obtain monetary relief in more complex cases. Faced with egregious frauds, eight Circuit Courts of Appeal had blessed the program, often with broad language that, read outside of the context of the fraud case before it, appeared to approve expansive use of Section 13(b).

The roots of the 13(b) program in attacking fraud had another consequence, related to the determination of damages. When a fraudster uses inflated claims to sell an essentially worthless product, the Commission argued successfully that the appropriate measure of injury to consumers was total sales of the product, and it sought to recover the fraudster's total revenue. Again, numerous courts endorsed that approach in the cases before them. Sensible in the context of fraud, that measure of injury is completely unreasonable when applied to other cases, for example a tangential claim about a new nutritional benefit for a product that has been on the

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[1] See generally David R. Spiegel, Chasing the Chameleons: History and Development of the FTC's 13(b) Fraud Program, ANTITRUST, Summer 2004, at 43.

[2] For an overview of the typical procedure, see Dana J. Lesemann & Peter B. Zlotnick, *Receiverships and Other Shark Tales*, LITIG., Fall 2005, at 48.

market for decades. To date, the Commission has failed to develop a reasonable approach to assessing injury in this situation.

As the Supreme Court noted, the success of the 13(b) program led the agency to expand its use, first to antitrust cases and later to more traditional consumer protection cases. The consumer protection uses went well beyond cases involving obviously dishonest business conduct, including those involving complex issues of advertising substantiation or disputed issues regarding the adequacy of disclosures to consumers that would have been resolved previously with, at most, an administrative cease and desist order. Instead, total sales of the product were now at risk.

A 2013 law review article I coauthored warned that this unwarranted expansion of the agency's authority would jeopardize the heretofore uncontroversial fraud program itself.[3] Unfortunately, that is exactly what happened in the Supreme Court's recent decision in the AMG case.[4] Rather than defending the use of 13(b) in the context of fraud, the Commission argued that it could get monetary relief in any case it thought appropriate. It ended up with nothing.

Given the Court's decision, legislative changes are needed to ensure the continued vitality of the FTC's fraud program. In this legislation, Congress should answer two key questions itself, rather than leaving them to the FTC's discretion. First, when can the Commission get monetary relief? Second, what procedures can the Commission use to do so? I address each of these questions below.

When can the Commission get monetary relief?

As articulated in Woodrow Wilson's 1912 campaign, [5] the FTC was to be an expert body to provide guidance for appropriate marketplace conduct. Because the statutory prohibition of "unfair" conduct[6] was deliberately vague, the only remedy initially available was a cease-and-desist order, with monetary relief eventually made available only for violations of that order.[7] This was a wise approach for many practices, because the line between permissible and impermissible conduct was unclear until the Commission had addressed a particular practice through the administrative process. The possibility of imposing monetary relief for the initial

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[3] See J. Howard Beales III & Timothy J. Muris, Striking the Proper Balance: Redress Under Section 13(b) of the FTC Act, 79 ANTITRUST L.J. 1 (2013).

[4] AMG Capital Mgmt., LLC v. FTC, No. 19-508 (593 U.S. ___ (2021), decided April 22, 2021) (Around the time the Commission's complaint was issued, I discussed a possible consulting role with AMG but was never retained).

[5] *See generally* SIDNEY M. MILKIS, THEODORE ROOSEVELT, THE PROGRESSIVE PARTY, AND THE TRANSFORMATION OF AMERICAN DEMOCRACY (2009). The FTC Act followed in 1914. Federal Trade Commission Act, ch. 311, 38 Stat. 717 (1914).

[6] As passed in 1914, the FTC Act prohibited only "unfair methods of competition," § 5, 38 Stat. at 719; the prohibition against "unfair or deceptive acts or practices" was added in 1938, Act. of Mar. 21, 1938, ch. 49, § 5(a), 52 Stat. 111, 111–12.

[7] The Wheeler-Lea Act of 1938 first subjected violations of Commission orders to civil penalties. *See* Act of Mar. 21, 1938, ch. 49, § 3, 52 Stat. 111, 111.

conduct could chill otherwise lawful conduct that actually benefits consumers or competition. Although some regard a cease-and-desist order is no penalty at all, giving violators "one free bite of the apple," the evidence is clear that legitimate businesses suffer reputational and financial penalties from FTC cease and desist orders.[8]

This approach remains appropriate today. When I was Bureau Director, for example, we launched the first of many information security cases, alleging that the failure to maintain reasonable and appropriate security for sensitive information was a deceptive practice (or later unfair in certain circumstances). I know of no one who previously thought that information security practices could violate Section 5, and imposing significant monetary penalties for failing to anticipate the Commission's legal innovation would not have been appropriate. Today, civil penalties would be an appropriate remedy for such violations, because estimating actual injury for data breaches is exceedingly difficult.

Nevertheless, by the mid1970s, in some areas the law was quite clear. The FTC fraud program involves business conduct about which there is typically no legal uncertainty, and thus little risk of excessive caution. Section 19, added in the 1975 amendments, recognized the distinction between clear and unclear violations, limiting monetary relief after the administrative process to violations that a reasonable person would have known under the circumstances were "dishonest or fraudulent."[9] The early uses of Section 13b cases respected the Section 19 standard, and it remains an appropriate substantive standard for when monetary relief is appropriate. Fraudulent or dishonest conduct should be subject to monetary sanctions. Conduct where reasonable people may disagree about whether a violation even exists should not.

The distinction between clear and unclear cases has a sound policy basis in protecting consumers. Aggressive penalties applied to practices not previously considered unlawful or to areas of law that often require careful consideration of evidence about which reasonable people may well differ will likely lead to excessive caution from those subject to the law. And excessive caution can also harm consumers.

The FTC's advertising substantiation program perhaps best illustrates this phenomenon. The substantiation doctrine holds that regardless of truth or falsity, an objective claim is deceptive unless it is supported by evidence—a "reasonable basis." For example, an advertiser must have evidence to support a claim that dietary fiber may reduce the risk of cancer, or to claim that masks help reduce the risk of COVID. The typical substantiation case involves a reputable business making claims about the features of an existing product. Even after extensive litigation, money will be available at the end if monetary relief is appropriate, unlike the typical fraudster. Substantively, these cases often turn on disagreements among recognized scientific experts about whether there is adequate evidence to support a particular claim.

Former FTC Chairman Robert Pitofsky wrote that the FTC's advertising enforcement should be "a practical enterprise to ensure the existence of reliable data," not "a broad, theoretical effort to

[8] *See* Beales & Muris, *supra* note 3, at 36–37 & n.166.
[9] 15 U.S.C. § 57(b).

achieve Truth."[10] Pitofsky's last major consumer protection article, joined by another former Chairman and me,[11] supported the agency's traditional substantiation approach that recognized both the risks of mistakenly allowing false claims and the risks of mistakenly suppressing truthful ones. The latter mistake harms consumers, and we warned that increasing the evidence required would inevitably increase the risk of suppressing truthful claims. Just as advertisers who need increased scientific evidence will make fewer claims, increasing the financial consequences of being found to lack substantiation will make them more cautious, potentially denying truthful useful information to consumers. When reasonable experts disagree, it is difficult for even the most scrupulous company to predict Commission decisions. Again, the higher the cost of telling the truth, the less will be the supply of truthful claims.

The concern about chilling truthful claims is not merely theoretical. Consider, for example, the history of claims about the relationship between diet and health, which were illegal on food labels in 1984.[12] That year Kellogg, with the blessing of the National Cancer Institute, began a campaign for All Bran cereal promoting the NCI's recommendation that diets higher in fiber could reduce the risk of cancer. The FDA threatened to seize the product, but when the FTC argued the claim benefited consumers, the FDA instead decided to reassess its policy. The NCI recommendation remains, but in the absence of definitive clinical trials, some scientific uncertainty exists. If such claims are wrong, consumers may give up a better tasting cereal or spend a few pennies more for breakfast. Mistakenly prohibiting such claims, or deterring them because of the risk of severe financial penalties, would deprive consumers of information that may help save lives. Putting the total sales of All Bran at risk from the date the claim first appeared, the FTC's current starting point in seeking equitable relief, would be a severe financial penalty indeed.

Today, advertising that promotes mask wearing to reduce the risks of COVID would be useful to consumers. Early in the pandemic, there was virtually no evidence of efficacy, and indeed the CDC initially recommended against wearing masks. Although more recent evidence supports the benefits of wearing masks, such claims are not supported by the amount of evidence that the FTC typically wants for health-related claims: randomized, controlled, double blind studies of efficacy. Suppressing such claims would harm consumers, not protect them.

It is no answer to say that the FTC can use prosecutorial discretion to avoid chilling truthful speech.[13] The record of the last 12 years already demonstrates multiple efforts to expand the FTC's reach, seemingly on the belief that ever-tougher remedies, even in close, complex cases,

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[10] Robert Pitofsky, Beyond Nader: Consumer Protection and the Regulation of Advertising, 90 HARV. L. REV. 661, 671 (1977).

[11] J. Howard Beales III, Timothy J. Muris & Robert Pitofsky, *In Defense of the Pfizer Factors*, *in* THE REGULATORY REVOLUTION AT THE FTC: A THIRTY-YEAR PERSPECTIVE ON COMPETITION AND CONSUMER PROTECTION 83 (James Campbell Cooper ed., 2013).

[12] *See id.* (discussing the Kellogg incident and its effects).

[13] See J. Howard Beales III & Timothy J. Muris, The Obama FTC Departed from Its Predecessors to the Detriment of Consumers, ANTITRUST, Summer 2017, at 66.

are in the consumer's interest.[14] If the agency can always obtain monetary penalties, the default rule will inevitably be that all violators must pay. Prudent businesses, recognizing both the increased financial and reputational penalties from government action, cannot rely on prosecutorial discretion to protect truthful speech.

The distinction between cases where the law is clear and those in which there is legal uncertainty is also relevant in antitrust. For this reason, the Commission's Policy Statement on Monetary Equitable Remedies in Competition Cases, adopted unanimously in 2003, limited use of 13(b) to "exceptional cases" involving "clear violations" of the antitrust laws.[15] The statement was withdrawn, but not replaced, in 2012.[16] Congress should enact the substantive limits adopted in the 2003 policy statement, limiting monetary relief to exceptional cases involving clear violations.

An additional reason for limiting the Commission's ability to obtain monetary relief is particularly significant in antitrust: The Commission's remedies should seek to complement, not compete, with monetary remedies available to private plaintiffs. In antitrust, an active class action bar routinely follows up government findings of a violation with class action lawsuits seeking monetary relief. FTC monetary remedies are only appropriate if they provide added benefits because these private remedies are unlikely to achieve the purposes of the antitrust laws. The same principle is increasingly relevant to consumer protection as well. When the FTC finds a legitimate company in violation and monetary remedies are available, private class actions can, and do, pursue financial relief. If the FTC obtains financial relief, however, private plaintiffs are less likely to find such actions attractive.

What procedures can the Commission use to obtain monetary relief?

Section 19 sets out a specific process for seeking monetary relief in consumer protection cases. The Commission first determines in the administrative process that there has been a violation of Section 5, and, after appeals are exhausted and the order becomes final, files a separate action in federal district court to obtain monetary relief. When the agency seeks monetary relief from legitimate companies, this process is entirely workable. Legitimate companies will still be there when the litigation concludes, and money will still be available to redress consumers. In fact, the overwhelming majority of cases against legitimate companies are resolved through settlement, and there is no substantive difference between a settlement that cites Section 19 as the statutory basis for monetary relief and one that cites Section 13b.

In fraud cases, however, the Section 19 process is likely unworkable. It would require what we have termed a "Triple Hybrid" procedure, involving three distinct legal actions litigated in at

[14] See id.

[15] 68 Fed. Reg. 45821.

[16] Withdrawal of the Commission Policy Statement on Monetary Equitable Remedies in Competition Cases, 77 Fed. Reg. 47071.

least three (but sometimes four or five) separate fora.[17] It would begin with an action under Section 13(b) to seek an ex parte asset freeze and temporary restraining order, assuming such an action is allowed under the Court's reading of 13(b). While the district court monitors the receivership, the Commission would file and litigate an administrative action to adjudicate the alleged violation. After appeals were exhausted and the Commission's order final, the Commission would file a separate district court action seeking redress under Section 19.

It seems unlikely that district court judges would, or should, accept such a process, where they are asked to freeze assets, supervise a receivership, but surrender all ability to resolve the case on the merits. Without an asset freeze, however, there will likely be nothing left for consumers at the end of the litigation.

Legislation should clearly authorize the Commission to use the process of Section 13(b), subject to the substantive limitations of Section 19, to pursue cases in which the Commission believes monetary relief is appropriate. If the court determines that a violation occurred but does not meet the Section 19 standard, it would simply enter appropriate injunctive relief, as it can clearly do under the Court's decision.

Conclusion

Congress should explicitly authorize the Commission to pursue equitable relief under Section 13(b), subject to the substantive standards set forth in Section 19. Congress should set the standards for when money is appropriate, rather than granting an agency unlimited discretion to seek financial sanctions whenever it thinks they are appropriate.

Thank you again for the opportunity to testify today. I look forward to your questions.

[17] For a detailed description, see J. Howard Beales, III, Benjamin M. Mundel, and Timothy J. Muris, Section 13(b) of the FTC Act at the Supreme Court: The Middle Ground, theantitrustsource, www.antitrustsource.com, December, 2020.