

The Federal Trade Commission since 1970

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Economic regulation and bureaucratic behavior

Edited by

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and

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Preface

To those who study or work in government regulation of business, the Federal Trade Commission (FTC) has been of intense interest for over a decade. Regarded in the 1960s as dormant and ineffective, in the 1970s the FTC quickly became a major agency focusing on problems that affect most American consumers and businesses. Our method, conclusions, and suggestions should interest scholars and practitioners in law, economics, political science, public administration, and other disciplines who analyze the operation and impact of the FTC in particular or of government agencies in general.

This book is the first comprehensive attempt to understand the "revitalized" FTC. The study originated in a desire to identify both the impact of the FTC's many projects and the underlying forces that motivated the agency's behavior. Supported by a grant from the Law and Economics Center, we recruited several scholars in the summer of 1977, all with extensive experience in law and economics.

We begin by focusing on the forces external to the agency that determine the parameters within which FTC decision makers operate. Thus, this book concerns institutions and how people react to them. For example, we discuss the extent to which the Congress and the courts affect the FTC. We then examine the impact of several substantive issues that characterize FTC actions since 1970. These issues were chosen to reflect both the types of activities that the Commission pursues and those in which the Commission claims it has made major accomplishments. Finally, we examine how the external forces, the internal operations of the FTC, and the incentives of FTC staff explain agency behavior.

Our research methods were varied. We extensively used the economic literature focusing on government behavior. We read every congressional hearing and report that focused on the Federal Trade Commission during the 1970s. We also examined volumes of internal Commission documents

available from various public sources. We supplemented these written materials through extensive interviews with past and present chairmen, commissioners, directors, bureau chiefs, other top FTC staff, members of Congress, congressional aides, Office of Management and Budget staff, and Civil Service Commission officials. To guarantee frank exchange, we agreed in most cases to avoid quotation. A few footnotes cite interviews (without identifying the sources) when we received important information from at least two reliable sources that was otherwise unavailable in public documents.

All research must end, and we stopped our analysis as of December 1, 1979, with some chapters stopping before then as indicated within their text. The December 1979 cutoff occurred when the FTC was under extreme political attack, threatening for a time to result in legislation curtailing the agency's power. The threat did not become reality. For reasons discussed at length in the book, the provisions Congress adopted leave the FTC as a potent and largely unchecked force.

Throughout our study, we received considerable support. We wish to thank the Law and Economics Center, which generously supported the project, and the authors who contributed individual chapters to this volume. We especially want to thank the numerous personnel at the FTC, Congress, and executive agencies for their candid information about the Commission. We would also like to acknowledge the valuable research assistance of Randy Chartash, Daniel DeWolf, Helen Hauser, Ronald Perkowski, and especially Andrew Caverly. We extend special thanks to our colleagues, Louis De Alessi and Patrick Gudridge, who reviewed extensive portions of the manuscript, and to Judy Miley, who often improved the presentation of our ideas. Finally, we would like to thank Linda Craig and Deebee Watkins for their invaluable administrative and secretarial contributions.

K.W.C.
T.J.M.

1 Introduction

TIMOTHY J. MURIS AND KENNETH W. CLARKSON

Of all the regulatory agencies, the Federal Trade Commission (FTC) is one of the most important, both in its power to influence American business transactions and in its potential to reveal vital information about the regulatory process. Regarded in the late 1960s as inactive and ineffective, the current FTC, buttressed by substantial grants of power from Congress and the courts, is no longer content to concentrate on cases and enforcement dealing with single small firms or narrow areas of law. Rather, it has attacked whole industries, challenging both their structure and practices. Because it can impose wide-reaching rules with the force of law, the FTC has been called “the second most powerful legislative body in the United States . . . [with the power] to alter the structure of an industry.”¹

Two 1969 reports, both highly critical of the FTC, sparked this new approach to regulation. Understanding these reports and their impact is important because of their ultimate effect on the FTC. Section I of this chapter provides this background and briefly summarizes some of the steps the FTC has taken to achieve its current prominence. Section II then presents the plan of study.

I. Transformation of the FTC: 1969–70

A. *The Commission until 1969*

Two aspects of the FTC’s history before 1969 help place the critical reports of that year in context. First, the Commission concentrated on trivia, focusing on small firms and narrow points of law.² Second, scholars often studied the Commission,³ reaching similar conclusions. The Commission, they charged, lacked direction, was poorly managed, and was inadequately staffed. It was political, obsessed with trivia, and woefully inefficient. Nevertheless, many critics added that, as bad as the Commission was, it was improving. For example, the Hoover Commis-

2 Introduction

sion, in referring to an often-cited Commission failure in planning, stated:

Until recently, the Federal Trade Commission had for years allocated its energies on the hit-or-miss basis of complaints with relatively little attempt to assess the significance of the particular proceeding in the light of its limited resources and the over-all objectives of the statutes. Now it has begun to plan its program to use its resources more effectively.⁴

B. Nader and the ABA

In 1969, the Nader and American Bar Association (ABA) reports appeared, echoing the previously discussed failures of the Commission. Rather than conclude that the FTC was improving, however, they declared that the Commission had reached bottom with no sign of change.

Work on the Nader report had begun a year earlier, in the summer of 1968, with seven volunteers called Nader's Raiders. Six were students, or recent graduates, of law school. Although consumerist Ralph Nader himself had little to do with the actual writing, he lent his name and financial assistance to the enterprise, thereby helping to generate considerable favorable publicity. The January 6, 1969, report concluded that the FTC was a failure and in near total disarray.⁵ The FTC had, the authors charged, systematically failed to detect violations, relying instead on consumer and competitor complaints; failed to establish priorities, attacking instead trivia; failed to enforce its statutes, relying instead on voluntary enforcement; and failed to seek the necessary resources and authority, remaining instead content with its nearly worthless efforts.

To the authors, the problem could be summarized in one word: people. Partisan politics and geographic locations determined hiring, not merit. Preferences went to Democrats, nonminorities, and southerners (particularly those from Tennessee, the home state of FTC Chairman Dixon as well as of Congressman Joe Evins, whose subcommittee oversaw the FTC budget). Further, individuals from prestigious schools were so discriminated against that the report concluded that "bright men need not apply" to the FTC.⁶

Rather than abolition, the authors recommended that the Commission be reformed to protect the consumer. Without systematic regulation, they believed that corporations would seriously harm consumers. They recommended increased regulation of modern advertising techniques, better Commission-wide planning, new programs for the ghetto consumer, more information disclosure, criminal penalties for violations of FTC law, and tighter restrictions on the power of the chairman.

Numerous newspaper editorials and magazine articles discussed the study and the reactions of government officials.⁷ At congressional hearings, the report's charges generally received a sympathetic ear.⁸ Praise

came even from within the Commission. Although Chairman Dixon blasted the report as “a summer vacation smear project,” Commissioner Elman, long a foe of Dixon, commended the authors for performing a public service in revealing many of the Commission’s weaknesses.⁹ Further, the report and responses to it encouraged President Nixon to ask the American Bar Association to study the FTC.¹⁰

Reacting quickly to Nixon’s request, the ABA released its report in September 1969. Although more moderate in tone, as well as more scholarly and authoritative than the Nader Report, the 16 practitioners and scholars who comprised the ABA’s special commission were just as critical of the FTC as was the Nader Report. The ABA group concluded that:

It should be the last of the long series of committees and groups which have earnestly insisted that drastic changes were essential to re-create the FTC in its intended image. The case for change is plain. What is required is that changes now be made, and in depth. Further temporizing is indefensible. Notwithstanding the great potential of the FTC in the field of antitrust and consumer protection, if change does not occur, there will be no substantial purpose to be served by its continued existence; the essential work to be done must then be carried on by other governmental institutions.¹¹

Specifically, the report criticized the Commission for ineffective direction, noting that, despite an increased budget, all statistical measures showed decreased FTC activity. The report pointed to mismanagement as the cause of excessive delay and criticized the focus on trivia. Regarding consumer protection, the report condemned the overcommitment to statutes designed to protect specific industries, such as the textile, fur, and wool acts. Regarding antitrust, the report recommended a reevaluation of Robinson-Patman Act cases, a major FTC antitrust activity. Further, the report recommended procedural reforms, such as the delegation of authority from the Commission to its staff, thereby decreasing delay and preventing the Commission from acting as both judge and prosecutor.¹²

C. The FTC responds to its critics

Apparently in response to the barrage of criticism, two important events occurred in 1969. First, the Commission closed some 600 of its investigations.¹³ Although similar to previous purgings of active investigations, this step apparently signaled a shift in attitude and approach: What had been acceptable in the 1960s might be discouraged in the 1970s. Second, President Nixon appointed a new chairman, Caspar Weinberger. In his “Consumer Message” to Congress, presented in the fall of 1969, Nixon stated that “the time has now come for the reactivation and revitalization of the FTC”¹⁴ and that Weinberger was committed to such action. Weinberger considered his mandate from the White House to be “carte blanche,”¹⁵ allowing for major reorganization and wholesale personnel changes. Fur-

ther, he knew that the mandate of the Nader and ABA reports supported such changes. Although Weinberger resigned from the Commission after only about six months, he acted on both fronts.

Weinberger reorganized the work of the Commission along its two major functions: *antitrust*, for which he created the Bureau of Competition to replace the Bureau of Restraint of Trade, and *consumer protection*, for which he created the Bureau of Consumer Protection to replace the Bureau of Deceptive Practices. He abolished some of the previously existing bureaus, most notably the Bureau of Textile and Furs, which, according to the ABA Report, received far too large a commitment of the Commission's resources. Commission reorganization appears to be a favorite activity of new chairmen, not only because it gives the appearance of activity and purposefulness, but, more important, because it allows a reshuffling of top staff positions. The Weinberger reorganization, however, distinguished itself from many other Commission reorganizations. It improved staff morale by implying that the promise seen in the Nader and ABA reports would be fulfilled.¹⁶ Further, this reorganization indicated that the Commission would deemphasize at least some of the agency's most criticized activities. In addition, it appeared to reinforce the consumerist movement that was then rapidly expanding.¹⁷ Finally, the reorganization facilitated a task that the critics had called essential: hiring new people while eliminating the "dead wood."

This major shift in personnel began under Weinberger, who had to contend with both civil service regulations and powerful congressional friends of some incumbent staff members. Although attorneys do not have extensive civil service protection and thus can be dismissed with relative ease, a lawyer with military experience can be removed only "for such causes as will promote the efficiency of the [civil] service."¹⁸ Weinberger's reorganization facilitated the removal of both veterans and non-veterans by, in effect, abolishing their jobs, concentrating on the top staff. Nonveterans were given 30-day notices. Because of their civil service protection, veterans had to be reassigned, reclassified, or offered retirement. By offering some veterans unattractive positions and persuading others that retirement or resignation was mutually beneficial, Weinberger was able to avoid serious problems with the civil service.

Neither did Congress prove to be a major obstacle. Although some members of Congress apparently tried to protect their FTC friends by cutting the FTC budget, their pressure was generally ineffectual because Weinberger wanted less, not more, money from Congress.¹⁹ In all, 18 of the 31 top-level staff members were discharged.²⁰

Upon replacing Weinberger in September 1970, Miles Kirkpatrick began transforming the remainder of the professional staff. Largely through his executive director, Basil Mezines, he replaced nearly a third of the middle- and lower-level staff. Consequently, the average age of the

staff dropped, and many of the new attorneys were graduates of the more prestigious law schools.²¹ During Kirkpatrick's two-year chairmanship, many of these new staff members were committed to the tenets of consumerism, including the need for greater regulation of advertising and for deconcentration of major industries.²²

The consensus emerged that the Commission was "revitalized" during the Weinberger and Kirkpatrick years.²³ Consumer protection was probably the most publicized activity. As described in Part II of this book, innovative regulatory techniques were applied to advertising. Simultaneously, new emphasis was given to expanding Section 5 of the Federal Trade Commission Act, a step that led to the proposal of several major trade regulation rules during the chairmanship of Lewis Engman. The agency did not slight antitrust, however. In April 1972, the FTC filed a path-breaking complaint to break up the cereal industry because four firms allegedly had a "shared monopoly." In general (Part II again provides greater detail), Commission antitrust shifted to an attack on the structure of American industry, as revealed by the cereals case, investigations of several concentrated industries, and development of the line-of-business program. Moreover, the Robinson-Patman Act (Section 2 of the Clayton Act), a mainstay of FTC antitrust before 1970, was (and continues to be) deemphasized. Despite occasional Robinson-Patman Act complaints and efforts to transform Robinson-Patman matters into cases under Section 5 of the FTC Act, the Commission no longer engages in massive Robinson-Patman enforcement.²⁴

During the chairmanship of Lewis Engman, which began in early 1973 and continued for almost three years, the agency deemphasized consumer protection relative to antitrust, although in absolute terms budgets for both activities grew. The major antitrust initiative involved a suit to break up the eight largest domestic oil companies. Other important investigations of concentrated industries began, and the major case against Xerox ended. The most significant consumer protection development involved the proposal of numerous trade regulation rules designed to transform the practices of entire industries.

Calvin Collier became chairman in 1976. During his one-year tenure, no new trade regulation rules were proposed, and the Commission basically attempted to get control of the numerous major projects it had undertaken. President Carter then appointed Michael Pertschuk as chairman. With Pertschuk came further reorganization (as usual) and new efforts to expand Section 5 of the Trade Commission Act beyond traditional consumer protection and antitrust concerns to allow scrutiny of problems such as the alleged political power of large corporations. To date, the major initiative under Pertschuk has been the proposal of a rule to regulate and in some instances eliminate advertising directed at children.²⁵

As the FTC prepared for the 1980s, the agency indeed seemed a potent

force. In 1970, its budget of approximately \$21 million was used to enforce 11 statutes. By the end of 1979, with the budget approaching \$70 million, the Commission had enforced 16 new statutes and had created or proposed more than 60 programs and 40 rules to regulate American business. Further, the Bureau of Consumer Protection had taken bold measures to regulate advertising, credit practices, and warranties, as well as attempting to remedy problems that state regulation caused in the eyeglass and funeral industries. The Bureau of Competition had initiated the largest case in the Commission's history in an effort to break up the nation's largest oil companies.

It is time to evaluate the performance of this powerful agency. What has been the impact of the FTC's efforts? Can we explain why the agency acts as it does? It is to these questions that this study is directed.

II. The plan of this study

The remainder of the book is divided into three parts. Part I identifies the constraints originating from external factors, such as Congress and the courts, that influence FTC decision makers. Only by understanding the environment in which the Commission exists can we begin to understand the agency's behavior. Further, knowledge of the impact of existing institutions on the Commission will assist us in determining how changes in the agency's environment are likely to affect its performance. Part II then examines several substantive activities that the FTC has undertaken since 1970. We chose the activities to reflect both the range of matters that the Commission pursues and those specific activities that the Commission considers its major accomplishments.²⁶ Finally, Part III analyzes some of the reasons for FTC actions and discusses a number of possible reforms.

In our analysis, we assume that FTC decision makers are not motivated by a single concept of the public interest; rather they employ their own self-interested view of the public welfare. The choices they make are designed to further their own satisfaction or utility subject to the constraints that limit options available to them.²⁷ Of course, the preferences of the relevant decision maker influence the choices made, and individuals have different preferences. To the extent that different constraints provide different opportunities, however, knowledge of the relevant constraints allows us to predict patterns of behavior without knowing the identities and preferences of specific individuals. At least, we can exclude certain alternatives from the set that the FTC is likely to follow. Thus, unlike other studies of the FTC,²⁸ we are not exclusively concerned with a description of what the Commission does. Moreover, we do not explain FTC activity solely on the identity of particular chairmen, commissioners, or top-level staff.

The method we employ uses both law and economics. It blends the discipline of law, which creates and interprets constraints, with the discipline of economics, which deduces individual decisions under alternative constraints. Part I employs legal analysis to identify the constraints imposed by the array of regulations emerging from the Office of Management and Budget, the Justice Department, Civil Service Commission, and other executive agencies, as well as by Congress, the courts, state and local governments, business organizations, and consumer groups.²⁹ Legal analysis is particularly suited for this task, because understanding these constraints often requires a technical knowledge of the language of a statute, its legislative history, the regulations promulgated thereunder, and the relevant court decisions. Part II combines legal analysis and economic theory. Legal analysis is first applied to specify the precise form of the Commission's regulation, rule, or activity. Then economic theory is used to predict the consequences of the FTC's action. Many chapters test the validity of the predictions. Finally, Part III focuses on the relationship between Part I and Part II. In particular, we attempt to explain FTC actions, such as those discussed in Part II, as a consequence of the opportunities defined in Part I.³⁰

Thus, the Commission's statutory powers are interpreted in the context of formal and informal legislative, administrative, and judicial contacts that establish FTC constraints. Once the opportunities available to agency decision makers are identified, economic theory is employed to predict how the FTC will act. These predictions are then compared with actual FTC actions, particularly those discussed in Part II. In short, this book uses legal analysis and economic theory to examine the outcomes of particular FTC activities and to begin to explain why FTC decision makers behave as they do.

Part I

The institutional setting

