FTC RULEMAKING: HARNESSING FIRE

by

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* The views expressed are my own. They do not necessarily reflect those of the other Commissioners.

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Thank-- you, _____.

I'm here today to tell you about an important part of the Federal Trade Commission's work that doesn't' get much-attention these days: rulemaking.

Only a few years ago, the FTC's rulemaking activity was a subject of considerable controversy. One particularly famous - or infamous - FTC rulemaking was the "Children's Advertising," or "Kid Vid" rule. The Kid Vid proposal - which would have limited or even eliminated television advertising directed at children because it was allegedly unfair - was severely criticized as an attempt to engage in social engineering that went far beyond the FTC's legitimate regulator authority. Largely as a result of Kid Vial, the Washington Post dubbed the FTC the "National Nanny." Those who worked in the advertising agencies of Madison Avenue and in the nearby television studios of "Beautiful Downtown Burbank" no doubt called the FTC even less flattering names - as did used car dealers, food processors, drug manufacturers, funeral directors, and a host of other industries that have been the subject of FTC rulemakings.

The Commission terminated the Kid Vid rulemaking some time ago. Several other proposed rules have met a similar fate. Is rulemaking at the FTC still alive? Should rulemaking continue to play a part in the Commission's enforcement of the FTC Act? My answer is generally yes. However, I do expect Commission rulemaking authority to be used in a more limited fashion than it

has been in the past. We should avoid ill-planned proposals that impose costly and unnecessary constraints on the normal, healthy functioning of the marketplace. Judicious exercise of the Commission's rulemaking authority should benefit all participants in the market -- consumers and businesses alike.

RULEMAKING VS. ADJUDICATION

Before I talk about the past, present and future of FTC rulemaking, let me briefly discuss some of the advantages and disadvantages of rulemkaing. Section 5 of the FTC Act makes unfair or deceptive acts or practices unlawful. (The word "enforce" may sound sinister. Perhaps a more Positive way to describe the Commission's role is to say that it encourages voluntary compliance with the law hut is prepared to take enforcement action against those who engage in illegal conduct.) There are two ways that the Commission may proceed to eliminate and prevent deceptive acts or practices: the first is case-by-case adjudication; the second is rulemaking.

Suppose, for example, You go to a hardware store to buy an extension ladder so You can paint your second-floor windows. The hardware store has 12-foot, 18-foot, and 24-foot extension ladders. The 12-foot ladder is almost certainly too short, while the 24-foot one is longer than you need (and more expensive). That leaves the 18-foot ladder, which seems just right. Unfortunately, you learn when you get home that the ladder is 18 feet long only when its two halves are put end to end. To use the ladder, the two halves must overlap - so the maximum useful,

or working length of the ladder is a couple of feet less than 18 feet. That means you can't reach quite high enough to paint the top parts of those second-story windows.

How could the FTC help correct this problem so that other consumers aren't fooled? The Commission could issue an adjudicative complaint - in other words, initiate an administrative law suit - against the manufacturer who made and labeled the extension ladder. The complaint would allege that the company had engaged in a deceptive labeling practice and would seek an order prohibiting such practices by the company in the future. The company would be given an opportunity to answer the allegations in the complaint at a trial-like hearing. In all likelihood, the Commission would then order an end to the labeling of the company's ladders except in terms of working length.

If the Commission found that the mislabeling of extension ladder length was a common, or prevalent, practice among ladder manufacturers, it could decide that it would be more efficient to issue a generally applicable rule on the subject rather than bring individual cases against individual companies. Indeed, in 1969, the Commission decided to issue a rule applying generally to all advertisers of extension ladders.[1] That rule, like all FTC rules, may be enforced through a relatively simple court action seeking monetary penalties for any violations.

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[1] 16 C.F.R. Part 418 (Deceptive Advertising And Labeling As To Length Of Extension Ladders).

What are some of the problems that arise from using adjudications to clarify and enforce the law as opposed to rules? For the target of an adjudication -- my hypothetical extension ladder manufacturer doing business prior to issuance of the Commission's rule in that area -- the trial and order route may well result in a clear, unambiguous interpretation of the law. Other ladder manufacturers that were not named in the Commission's complaint, however, might be unaware of its issuance and, in any case would ordinarily have no opportunity to provide their views to the agency before an order is issued. Also, an order against one company has little or no legal effect on other companies that also mislabel the length of their ladders.

Rulemaking, on the other hand, is effective against all members of the industry rather than just a particular company targeted for investigation. Rulemaking is, therefore, Potentially a more efficient way to control illegal activity common throughout an industry than are individual adjudications. In addition, comments or testimony by members of the industry might convince the Commission of the merits of a less costly but equally effective remedy than that which the agency might have imposed in an adjudication.

How do these concerns affect consumers? First, prices may increase for particular Products if the Commission issues a rule imposing expensive requirements on all manufacturers of a particular product. If only a single company is forced to take action that results in higher prices, its competitors are free to seek solutions that may be less costly. To the extent that the

Commission's order provide benefits to the consumer, the consumer may be more than happy to absorb the extra cost. Under those circumstances, consumers might be better served by the Commission's issuance of a rule that would apply to the entire industry because the benefits "to consumers might outweigh the increase in price that the rule might generate.

To some extent, the choice between adjudication and rulemaking depends on how widespread a Particular problem appears to be and how difficult it will be to devise an effective means of dealing with the problem. The law clearly allows the Commission discretion to proceed by adjudication or by rulemaking, so it's up to us to decide which one to use.

NOW it's time for a brief history lesson. You Latin scholars out there probably remember that all Gaul was divided into three parts. It's also true that the history of rulemaking at the FTC can be divided into three eras: 1963 to 1975, 1975 to 19$30, and 1980 to the present.

THE 1963 - 1975 ERA

Prior to 1963, the Commission had issued no legislative rules. (By legislative rules, I mean rules that are like laws passed by Congress. The FTC also issues procedural rules - for example, we have a rule on how many pages legal briefs filed with the Commission may contain.) Beginning in 1963, the Commission began issuing legislative rules that were relatively simple and straightforward. For example, rules prohibiting deceptive advertising of tablecloth size and the leather content of waist

belts and restricting the use of terms such as "leakproof" as descriptive of dry cell batteries were issued in 1964.

The FTC's rulemaking endeavors spanned a broad spectrum of subjects, but were relatively uncontroversial. None was seriously contested before the Commission, and none was challenged in court. The rulemaking proceedings by which the Commission developed and adopted these rules were short and sweet, seldom lasting more than more than one or two days.

Eventually, however, the Commission became more intrepid. It issued more significant and controversial legislative rules, such as the rule requiring 3-day "cooling-off" periods before certain door-to-door sales became final , the rule prescribing delivery deadlines for mail order houses, and the rule on the marketing of business franchises.

As the subject matter of its rules became more complex and controversial, the Commission became aware of a tension inherent in the rulemaking process -- a tension between the agency's need to educate itself through the public's participation in the rulemaking process and its need for quick, efficient Proceedings. The more complex the issues became, the more the Commission tried to inform itself about the competing interests of the affected industries and their consumers. The 1964 rule on light bulb advertising was issued after a two-hour hearing and the development of a correspondingly brief record. But the 1972 rule requiring "cooling-off" periods on door-to-door sales went through seven days of hearings and yielded a public record of over 3,000 pages.

Not only did the records increase in volume, but the level of controversy rose as well. Petroleum refiners went to court to challenge the 1971 octane posting rule, which required them to put stickers disclosing the octane rating of gas on gas pumps. The court's ruling that the Commission did have authority to issue legislative rules added another stick to the still small FTC rulemaking fire, kindling new rulemaking zeal.

SECTION 18

Finally, in 1975, Congress stepped in. Having observed the FTC's consumer protection fire growing ever hotter as the agency issued more and increasingly controversial rules, Congress added a new Section 18 to the FTC Act in hopes of ensuring that the agency's rules were carefully designed to be beneficial to the consumer and not unduly burdensome on business.

Section 18 confirmed the Commission's authority to issue legislative rules and established what is known as a "hybrid" rulemaking procedure to be followed by the agency. The term "hybrid" rulemaking means that in addition to the public notice and comment required in all legislative-type rulemakings, potential rules are subjected to scrutiny at an oral hearing, which may include limited courtroom-type cross-examination.

In addition to "hybridizing" the rulemaking process by combining the notice and comment features of basic rulemaking with the courtroom-like features of the adjudicative process, Section 18 added to the Commission's duties to inform the public of its intentions in proposing particular rules. For example,

the basic notice of proposed rulemaking must provide little more than a description of the issues to be addressed by the proposed rule and an invitation to comment. The "hybrid" system under Section 18 also requires a preliminary or advance notice. This advance notice must describe the area to be involved in the rulemaking, outline the Commission's objectives, lay out possible regulatory alternatives under consideration and invite public comment. After the advance notice has yielded its harvest of public comments, Section 18 requires a second notice of proposed rulemaking, which must be quite specific with respect to the text of the proposed rule and the reasons underlying it.

After the comments from this second notice are in, the Commission must hold one or more hearings. Interested persons may present their positions to the presiding officer orally or in writing. If the presiding officer determines that there are "disputed issues of material fact it is necessary to resolve," he will permit cross-examination and rebuttal documents to the extent necessary. In addition to these statutorily mandated procedures, the Commission's procedural rules require that both the presiding officer and the rulemaking staff submit reports summarizing the record and making recommendations to the Commission. These reports are published, and any comments received concerning them are included in the rulemaking record for consideration by the Commission in deciding whether to issue a rule. FinalIv, the Commission often allows affected industry members or consumer representations to make in-person presentations to the Commission itself.

THE 1975 - 1980 ERA

The addition of Section 18 to the FTC Act may have made it more difficult for the FTC to issue rules, but that didn't cool down the agency's rulemaking zeal one bit. In the three years following the passage of Section 18, the Commission commenced 22 major rulemaking proceedings. Considering the procedural hoops through which each rule had to jump, it was very brave for a relatively small agency like the FTC to start so many rulemakings in so brief a time. Or was it very foolish? The recently issued funeral. practices rule alone has consumed nearly 64,000 hours of reported staff time since its inception, which works out to about 32 workyears. The used car rule cost another 52,000-plus staff hours -- or 26 workyears - between 1973 (when it was first proposed) and 1985 (when it went into effect).

Today, some 7-10 years after the 22 rules were initially proposed, only seven are even partially in effect. Besides the funeral practices rule and used car rule mentioned above, that group of survivors includes rules that require eye doctors to offer eyeglass prescriptions to patients, restrict certain consumer credit practices, and regulate "R-value" claims for home insulation materials. The other 15 rules proposed in the three years following the enactment of Section 18 -- and I should note that the Commission has initiated only one major new rule-making since 1978 -- have met one of three fates. Five have been withdrawn or terminated (including "Kid Vial" and a proposed rule that would have limited advertising about 'natural" or 'organic"

foods). One - a rule regulating vocational school advertising - is pending Commission action in response to a court decision sending it back for modifications. The remaining eight - including Proposed regulations concerning hearing aid and mobile home sales - are still under consideration by the Commission.

Why did these rules require so much time and effort? A brief chronology of one FTC rulemaking, the used car rule, may help answer that question.

Our tale begins in Seattle in 1973, when FTC regional office lawyers recommended that used car dealers be required to (1) inspect and disclose the condition of 26 major used car components or systems, (2) disclose the identity of the car's previous owner and the nature of the car's prior use (e.g., taxi, rental car, etc.), and (3) warrant certain components for 30 days or 1000 miles. After the Magnuson-Moss Act was passed in 1975, the FTC's Bureau of Consumer Protection formally initiated a rulemaking proceeding. Their proposal, which differed considerable from the original one, would have (1) required disclosure of used car warranty terms and prior uses and (2) allowed prospective buyers to take used cars to independent mechanics for pre-purchase inspections. Later, the staff asked for additional public comment on whether dealers should be required to disclose known defects in the used cars they offered for sale. 1681 consumers, used car dealers, law enforcement officials and others commented in writing on these proposals, and 212 testified in person at the public hearings that were held in

six cities. At this point, the record of the proceeding was over 8000 pages long.

In a 564-page report published in 1978, the FTC legal staff analyzed the record and recommended that the Commission issue a rule requiring dealers to (1) perform an inspection of 14 major component systems (such as steering and brakes) and (2) post on each used car a window sticker disclosing the results of the inspection, the car's prior use, and warranty terms. FTC economists, however, believed that mandatory inspections were too costly and would deter consumers from obtaining inspections from independent mechanics.

Another 1120 comments were filed in response to the staff report. The Director of the Bureau of Consumer Protection agreed with the economists that mandatory dealer inspections should not be required. In 1980, the Commission tentatively rejected the mandatory inspection approach and called for another round of comments. Another 869 comments were received. Later that year, 53 senators sent the Commission a letter warning it not to require inspections.

In 1981, the Commission approved a rule requiring disclosure of warranty terms and known mechanical defects. Used car dealers immediately challenged the rule in court. Resolutions to veto the rule were introduced in both houses of Congress, and eventually approved in 1982 by a better than 2-to-1 margin.

But in 1983, the Supreme Court found that the Congressional veto of the used car rule was unconstitutional. The used car dealers went back to court and reinstated their previously filed

lawsuit. Later that year, the Commission voted to reconsider the rule and allowed the dealers and other interested parties to submit additional evidence.

In 1984, FTC staff recommended that the required disclosure of known defects be deleted from the rule. Instead, the staff proposed that the required window sticker (which disclosed warranty terms) also urge consumers to have the car inspected by an independent mechanic. The Commission approved that proposal and the rule finally went into effect this May. Predictably, some have alleged that the rule is still too burdensome, while other critics - including some within the Commission itself - have charged that the rule has been watered down too much.

Although every FTC rulemaking is different, certain elements - broad regulatory proposals that would substantially affect the way an industry does business, anguished cries from the industry, anguished cries from Congress in response to the anguished cries of the industry, voluminous and repetitive records, lengthy delays, and so on - are recurring themes. With the benefit of 20/20 hindsight, one can see that numerous mistakes were made.

But I prefer to characterize the FTC's performance as an understandable one in light of the circumstances. First, the whole concept of hybrid rulemaking was new and uncharted. So were the Procedures. The agency had to learn -- and it did learn -- by trial and error. Second, too much emphasis was placed on wide-open public participation, and too little attention was given to weeding out redundant or irrelevant material and managing the proceedings efficiently. Third, the Commission bit

off more than it could chew by trying to conduct 22 of these proceedings at once.

The enactment of Section 18 provided the Commission with clear authority to make rules at a time when the Commission was firmly committed to charge ahead on a regulatory course. The Commission appeared determined to use rulemaking to go to the other limits of its jurisdiction, and perhaps beyond. Some called it "Star Trek law enforcement" because it took the agency further than it had ever gone.

As a result, the proposed rules attracted controversy like magnets. Kid Vial, of course, produced the loudest outcry. But other rules also generated their fair share of righteous indignation, particularly from the affected industries.

THE POST - 1980 ERA

As the controversy grew, the political climate in Washington changed. For several years, the Commission had been driving with the pedal to the metal. But in 1980, Congress not only slammed on the brakes but almost took away the rulemaking keys. Congress eliminated the agency's authority to issue advertising rules based on theories of unfairness, as opposed to deception. That took care of Kid Vial. It limited the reach of the proposed funeral. practices rule and it removed authority to issue a rule covering the standards and certification industry. It repealed the language in Section 18 Providing funds to compensate consumer advocates and certain other participants in rulemaking Proceedings. Perhaps most important, it subjected all future

rules to a legislative veto procedure. With enactment of the legislative veto and the other limitations included in the 1980 amendments, Congress finally put out the fire.

Since 1980, some have accused the Commission of, as a recent newspaper editorial put it, "retreating from, its assigned mission by de-emphasizing the regulation of entire industries and emphasizing instead the pursuit of individual violations." One former Commissioner who served during the great rulemaking era of the late '70's has asserted that the Commission has "launched an attack on the entire rulemaking process." But are these valid criticisms? Or is the agency simply trying to respond to a congressional mandate to engage in a 'cooling-off" period of its own ? It is certainly true that the Commission is currently engaged in less rulemaking and more cases involving individual violations than in the late '70's. Given the problems all those rulemakings have given us in the past, perhaps it's best to take action on the existing rulemaking proposals one way or another before commencing another batch of industrywide rulemakings.

Does the Commission's rulemaking authority result in more harm than good? As I have suggested already, rules may be more effective tools for eliminating illegal practices than case-by-case adjudication because they reach all wrongdoers and may impose more cost-effective remedies. But, as we have seen, the procedures by which the Commission must currently go about making rules are flawed.

The principal advantage of the relatively elaborate Procedures in Section 18 is that they encourage industry and

consumer Participation in the rulemaking process. This participation provides a means of testing the wisdom of rulemaking proposals before they become effective. Section 18 ensures t'hat the Commission is well-educated about the industry it proposes to regulate, but the tuition bills the Commission must pav to get that education are pretty steep.

The Section 18 procedure is unwieldy. It can swallow (and has swallowed) substantive concerns raised by particular rulemaking proposals. For example, the individual rulemaking records in these matters have soared well beyond 200,000 pages. I can tell You from personal experience that that's a lot of file cabinets. (Funeral record storyhere?) These enormous records probably resulted from (1) staff's inclination to include every conceivable scrap of information, regardless of importance or reliability, (2) from repetitious submissions from the public, and (3) from unfocused cross-examination. Far from assisting the public, rulemaking records bloated with unindexed and poorly organized material are extraordinarily difficult for members of the public to use. TheCommission needs to take steps to restrain the unnecessary accumulation of material in the records of future rulemaking Proceedings.

A second disadvantage of Section 18 procedures is that they do not encourage the Commission to exercise sufficient control over the proceedings to ensure their timely and efficient progress toward a conclusion. Once it votes to issue the notice of proposed rulemaking, the Commission itself is more or less finished with the proceeding until after the comment, hearing and

report process has ended and the record has been closed. Lack of focus in staff recommendations and lengthy delays may be symptomatic of inadequate supervision within the agency.

The major problems that have dogged the Commission's rulemaking efforts, however, have been more substantive. They have centered on the difficulties of determining when particular illegal conduct is widespread or "prevalent" in an industry and, assuming that it is, how best to develop a rule that cures the problem with a minimum of fuss and expense.

If an illegal practice is very common in an industry, rulemaking may be the more efficient way to proceed. If only a few companies are bad apples, case-by-case law enforcement may be more cost-effective.

Evaluations of how widespread illegal conduct is should be based on reliable evidence. But exactly what is reliable evidence? Some would say that testimony of individual consumers about their personal experiences may properly and profitably be depended on. Many of you who frequently receive consumer complaints, however, will probably recognize the hazards of basing conclusions solely on this kind of information. Others would suggest reliance on experts in the particular industry or its products to provide a reliable picture of how the industry operates. Experts may provide much useful. information, but their view may be distorted by narrowness of focus or close ties to the industry or consumer groups. Another source of potentially reliable evidence is surveys. Survey instruments are used to obtain responses to questions from a relatively large number of

persons selected in such a way to ensure as unbiased a sample as possible. Surveys, on the other hand, may be costly and time-consuming.

After determining whether a particular practice is common enough to justify rulemaking, the Commission. must design an appropriate remedy to cure the unfair or deceptive conduct in question. Again, a reliable assessment of various alternatives must be sought. The relative merits of particular types of evidence, however, may differ from those applicable to an assessment of prevalence. For example, testimony on behalf of individual companies concerning the cost and practicably of various regulations may be particularly useful on the question of remedy, while surveys may be more reliable on how widespread a practice is.

"EYEGLASSES II"

I mentioned previously that the Commission has initiated only one rulemaking in recent years. That's the so-called "Eyeglasses 11" rulemaking, which would strike down state-imposed bans on certain commercial activities by optometrists and update a Previous Commission rule concerning vision-care professionals. A brief discussion of "Eyeglasses II" may give you some clues about the future of rulemaking at FTC.

Unlike the post-1975 wave of FTC rules, which contained detailed regulatory provisions limiting certain advertising or marketing practices by businesses, the "Eyeglasses II" rule would partially deregulate the practice of optometry. That is, the

rule would have the effect of erasing current state regulations rather than imposing new federal controls. Future rules probably won't all be purely deregulatory in nature, but I think they will be more narrow and limited in effect than previous proposed rules. "

The "Eyeglasses II" rulemaking is moving more quickly and accumulating less excess baggage than earlier rules. Hearings were held in only two cities instead of the five or six that once were usual in rulemakings. Comments and testimony have focused on expert evaluation of two nationwide economic studies concerning the costs and benefits of the proposed rule, and the record is relatively uncluttered by personal anecdotes or simple expressions of support or opposition to the rule. I think the smooth and efficient progress to date of "Eyeglasses II" gives us reason to hope that we've learned something from our past experiences.

In conclusion, a quick word about the legislative veto. A legislative veto is a mechanism by which Congress can exert direct control over the output of the Commission's rulemaking process. The legislative veto first made its appearance with respect to Commission activities in the 1980 amendments to the FTC Act. That veto provision, which the Supreme Court later found unconstitutional, gave Congress the power to wipe away any FTC rule by a simple majority vote of both houses. I do not oppose a legislative veto that meets Constitutional requirements. I believe, however, that the exercise of an all-or-nothing congressional veto at the end of lengthy and costly

Commission rulemaking proceedings should be a last-resort remedy. If the rulemaking process were reformed and the Commission worked harder to keep things on track, we'd waste fewer resources and produce better rules.

The first era of FTC rulemaking may have been characterized by simple rules that didn't really do very much. The second era is best remembered for "Kid Viii" and other rulemakings that consumed a lot of file cabinets but produced little but controversy. I'm hopeful that the third and current era will be marked by more efficient proceedings and fair, well-designed rules that benefit consumers and businesses alike. That's an ambitious goal, but I think the American public deserves nothing less from the Commission.

Thank You very much.