
RULES WITHOUT REASON THE CASE OF THE FTC

Timothy J. Muris

IN THE MAGNUSON-MOSS ACT of 1975, Congress confirmed the authority of the Federal Trade Commission (FTC) to enact substantive trade regulation rules—that is, its authority to “legislate” before the fact instead of having to proceed case by case against individual businesses. In a burst of enthusiasm, the agency then commenced sixteen major proceedings within fifteen months and three more before the end of 1978. Subsequently, however, only one important rulemaking has been started. If we examine what happened to the earlier attempts, we may learn why new rulemakings have all but died out.

Of those first nineteen rulemaking proceedings:

- Five resulted in final rules. Two of these rules were remanded, wholly or in major part, by federal appeals courts (the eyeglass and vocational schools rules); one was vetoed by Congress (used cars); one is about to be sent to Congress (funerals); and one has been partially stayed by the commission itself pending possible amendment (home insulation R-values).

- One, an amendment proceeding, has been approved by the commission (without approving extensions in the rule’s coverage) and

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has been returned to the staff for final technical changes (care labeling).

- Four were withdrawn by the commission, either because the proposal turned out to be ill-advised or because events rendered it superfluous (children’s advertising, OTC drugs, prescription drugs, and cellular plastics).

- Nine (plus one of the two remanded by the courts) are still in process within the FTC (credit practices, mobile homes, hearing aids, health spas, protein supplements, holder-in-due-course amendments, antacid OTC drugs, standards and certifications, and food advertising). One of the nine (food advertising) is before the commission for final decision, accompanied by my recommendation that it be dropped.

This is hardly a record to justify the enthusiasm that launched the commission on its one-proposal-a-month binge in 1975. There is, indeed, no way to make the story inspiring. But at least it can be instructive, and the commission, other agencies, and the public can profit from an understanding of what has caused the difficulties. In my opinion, two interrelated causes loom particularly large. First, the evidence gathered during the typical FTC rulemaking proceeding has been inadequate to judge the merits of the proposed rule. Second, this inadequacy has resulted, in part, from the lack of clear theories on why a rule is neces-

sary or appropriate. Let me discuss these two problems in turn.

The Lack of Reliable Evidence

There is little dispute among students and practitioners of regulation that three *questions* are relevant in deciding whether to regulate: Is there a problem sufficiently serious and widespread to warrant an industry-wide solution? To what extent will the proposed solution solve this problem? And at what cost? Given this agreement on the questions, one might think there would also be agreement that the commission should not adopt an industry-wide rule unless it has *evidence* to show that its conclusions are applicable to the whole industry, not just to a few stray firms that could be dealt with by individual orders. In practice, however, the commission has frequently failed to obtain such evidence. As Professor Barry Boyer commented in a 1979 report to the Administrative Conference:

[F]or the most part, the investigational material available to support the first wave of proposed rules consisted of large quantities of almost random information collected for purposes other than that for which it was ultimately used. . . . Such data contain much more fine-grained detail about individual firms and transactions than . . . needed. . . . At the same time, the data were not gathered in accord with accepted sampling techniques and therefore will not support systematic generalization to the industry as a whole [Boyer et al., *Trade Regulation Rulemaking Procedures of the Federal Trade Commission* . . .].

Boyer's point that the commission has often acted on inadequate evidence—a point with which I agree—is controversial. A recent *Washington Post* editorial, for example, argued that my appeal for reliance on more systematic evidence in FTC rulemaking sounded uncontroversial but was in fact an "Rx for Paralysis." To the *Post*, there is no substitute in rulemaking for "good judgment, wisdom and common sense." The controversy stems from the fact that some kinds of evidence are more suitable than others for particular purposes. There are four kinds of evidence, defining the term in its broadest sense, that the commission could use

in reaching its decisions, but three of them are only rarely, if ever, adequate for rulemaking.

Agency Expertise. First, the commission could rely on its own "expertise." Some administrative agencies possess special knowledge of the industries they regulate; and, recognizing this, a court will tend to uphold their new rules even when they are based on little formal evidence. As the courts have increasingly come to see, however, the FTC has no substantive expertise about the particular industries that it regulates. The background and training of the commissioners and their staff of lawyers and economists may give the agency a general expertise in accumulating and evaluating evidence, but do not provide special knowledge concerning the problems and operation of care labeling, funerals, food marketing, or any other activity or particular industry. For the FTC to rely on its own expertise is for it to rely on the experiences with a particular industry that the commissioners and the staff are likely to share

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Anecdotes. Of course, the commission can supplement its own knowledge of the marketplace with the experiences of others, by assembling collections of anecdotes—consumer complaints, testimony on individual problems, and the like. In itself, however, this kind of evidence cannot answer any of the questions relevant to the decision to regulate. Anecdotes regarding an activity such as care labeling, involving millions upon millions of transactions, cannot reveal whether the problem is isolated or systemic. Nor can anecdotes reveal the economic source of the problem, or whether the proposed solution is sensible. At best, anecdotal evidence can indicate only that a practice exists and causes injury. It cannot demonstrate that the *rate* at which problems occur is high enough to justify an industry-wide solution that will inevitably impose costs on innocent parties.

Yet the commission has been quite willing to rely on largely anecdotal evidence for its past rulemaking decisions. The recently adopted funeral rule, for example, included prohibitions on various alleged misrepresentations by funeral directors that were, in most cases, supported by no more than a score of anecdotes, a finding hardly significant in an industry with nearly 2 million transactions a year. And in 1980 the commission voted to extend care-labeling requirements from clothing to furniture, carpets and rugs, drapes, yarn, and other products, based almost exclusively on a small number of anecdotes. (Two years later, on a tie vote, the commission refused to allow these rules to become final.)

Legally, the question whether the FTC can act on the basis of anecdotes alone is a subtle one. In the past decade, a number of courts have ruled on the subject of what sort of information federal agencies must collect before they regulate, and the lines are difficult to draw. It seems clear that when urgent questions of human health and safety hang in the balance, fragmentary and uncertain information is sufficient—although the agency has the continuing obligation to improve its data base over time, and obviously should not try to narrow the range of its knowledge to broaden the scope of its discretion. In the case of trade regulation, however, in which life is rarely at stake and delay is unlikely to cause catastrophe, acting on the basis of fragmentary information is less justifiable. This means not that the FTC must subject itself to paralysis by analysis, but that it must use the best information that is reasonably obtainable. In almost every instance, anecdotes are unlikely to meet this test.

Expert Testimony. A third form of evidence on which the commission might rely is expert testimony. Such testimony can be extremely valuable. A rule like the pending regulation on food advertising, tentatively approved by the commission in 1980, can hardly be promulgated without some understanding of the basic scientific evidence concerning, for example, nutrition. On issues of that sort, evidence can be readily obtained from the relevant experts and is likely to be the best available.

Problems arise, however, when the commission heeds testimony from experts on matters not directly related to the experts' exper-

tise. In such cases, the "expert" is not expert at all, but merely another source of anecdotes. Unfortunately, the commission has repeatedly failed to make this distinction. For example, its various information disclosure requirements rest heavily on expert testimony in which the experts often strayed over the line between what information consumers *actually* want and what experts think they *should* want.

Such uses of expert testimony are problematic for at least two reasons. First, consumers necessarily use simplified decision rules to choose among competing products, rules that may be inadequate for the expert's purpose. Consumers and experts need different information because they have different purposes. Second, even though some experts have consumer clients whose experiences they can report, that experience is not likely to represent the needs or desires of the public at large. Consumers who discuss the details of an appropriate diet with their doctor, for example, may well want, and understand, considerably more information than those who have been unwilling to pay a doctor for such advice. Those who buy information presumably value it, but we can hardly assume the same is true for those who choose not to buy.

There are, of course, those who have made it their specialty to study what consumers in general actually do want, and in many instances they are good judges of how consumers are likely to interpret an advertisement, label, or warning. In the case of the food advertising proceeding, however, most of the experts the commission relied on were experts in nutrition, not consumer behavior. Consequently, the information that the rule would make advertisers provide may be incomprehensible to many consumers. None of the evidence in the rulemaking record addresses the usefulness of the information to consumers.

Systematic Projectable Evidence. Rulemaking is an exercise in generalization. The FTC seeks to determine whether a problem occurs often enough to justify a rule, whether the problem has a common cause in a sufficient number of instances to justify the remedy, and whether that remedy can correct the problems without imposing excessive costs. Because the FTC cannot generalize solely from its own experiences, or from the horror stories of others, or from

the experiences of experts in matters beyond their expertise, it should rely on a fourth type of evidence: systematically collected, "projectable" evidence such as surveys of consumers and econometric studies of industry behavior.

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The problems in FTC rulemaking have stemmed not from too much evidence but from the wrong kind. A survey, after all, is little more than a systematic method of collecting anecdotes so as to project them to the population as a whole with proper statistical safeguards. The records of the commission's proceedings are voluminous indeed, but they are collections of trees from which the size and shape of the forest can seldom be determined.

Survey evidence is easy to obtain. Indeed, the commission routinely conducts systematic surveys to establish a "baseline" for later evaluation of the impact of its rules. The problem is, however, that it conducts the surveys only *after* it has closed the rulemaking record and tentatively decided that a rule is necessary.

There is much to be said for these surveys. They are quite inexpensive, compared with the enormous resources spent in compiling rulemaking records that lack information applicable to an entire industry. Thus, the baseline study for the care-labeling rule cost only \$45,000 and provided much better information on the incidence of problems in the industries involved than any evidence on the record. It revealed, for example, that the overwhelming majority of consumers—generally over 95 percent—were satisfied with their last experience in cleaning the products that the new rule was to have covered; and that a comparable percentage of consumers who had sought cleaning information when they purchased the product had found it, apparently without significant difficulty. Similarly, the baseline study for the funeral rule cost \$65,000, and substantially undercut a major factual premise of the rule—

namely, that funeral directors refused to discuss prices over the telephone.

At the very least, the commission should consider the findings of its baseline surveys when it makes final decisions. Despite the baseline survey in the care-labeling proceeding, two commissioners wanted to promulgate an expanded rule. And in the funeral proceeding, the commission declined even to seek comment on the baseline survey and went ahead with its preliminary decision to regulate the industry.

More important, however, the commission should conduct baseline surveys at the beginning, not the end, of its proceedings. A rulemaking that starts off with a systematic attempt to assess the extent and causes of particular problems is likely to move far more expeditiously than have the FTC's proceedings so far. There is no reason that a rulemaking should last an entire decade, as the funeral inquiry did, and still not produce reliable evidence. It happened in that case not because the commission required too much evidence, but because it was unwilling to require its staff to produce the right sort of evidence.

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Besides surveys, there are other ways of obtaining projectable evidence. Econometric studies of industry behavior may be the most useful evidence available, especially when they are based on so-called natural experiments, as when different states impose different regulatory requirements. In the eyeglass rule, econometric evidence confirmed that states with restrictions on advertising had significantly higher prices for eyeglasses than states without such restrictions. This finding supported the commission's decision to preempt state laws with a rule banning such restrictions. Similar natural experiments are available in the funeral industry: there is apparently more price competition and advertising in some areas of the country, notably California and Florida, than in others. Comparative studies could have helped explain the reasons for these differences, and

that in turn would surely have helped the commission design an appropriate remedy. But such studies were never conducted. Instead, the commission simply assumed that its remedy—primarily price disclosure over the telephone and itemized price lists at the point of sale—would work.

Too often, the commission's failure to rely on this fourth type of evidence has meant that it has regulated without knowing whether the regulation was necessary or would work. The FTC tentatively decided (only to reverse itself later) to extend the care-labeling rule, without evidence that the problems were widespread for any of the products covered and that voluntary labeling was inadequate. It adopted the funeral rule without studying the natural experiment mentioned above. Nor, in that case, did it acquire reliable data on whether funeral directors could easily evade its proposed requirement for itemized pricing simply by setting prices high for individual items and low for packages. In the case of the pending food advertising rule, likewise, the commission lacks evidence on how consumers interpret much of the advertising that the rule would regulate, on whether most of the prohibited practices injure consumers, and on whether the remedies proposed would accomplish their goals.

The Lack of Clear Theories

Why has the commission failed to require appropriate evidence before it regulates? The chief reason is its use of inadequate theories on what makes a rule necessary. Many of its rule-makings were begun without (1) a clear statement of why the challenged practice violated the FTC Act (and therefore should be regulated) and (2) a clear substantive theory that specified why regulation would solve the perceived problem whereas market forces would not.

Legal Rationales. For many agencies, Congress has provided statutory guidance regarding the legal criteria that must be met before a rule can be promulgated. Although these statutes often allow considerable agency discretion to pursue, for example, the "public interest," at the very least they limit that discretion to a particular substantive area, such as broadcasting or ship-

ping. The FTC Act sets no such constraints. Faced with the vague basic mandate of preventing "unfair or deceptive acts or practices" and no guidance on what criteria it should consider in regulating a particular practice, the commission has repeatedly articulated legal rationales in its initial notices of rulemakings and preliminary staff reports that have left the exact basis of the proposed action uncertain.

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For example, many of the rule proposals listed a series of practices that the staff clearly disliked but relied heavily on general phrases such as "immoral, unethical, oppressive, or unscrupulous" in explaining the appropriate legal standard. Moreover, as Boyer has said:

Even when the Commission's prehearing public documents do purport to state the theoretical basis of particular rule provisions, the discussion may be so vague or incomplete as to leave the reader in a state of uncertainty as to what the doctrinal basis of the rule provision really is.

Professor Teresa Schwartz reached the same conclusion in her 1977 article on FTC regulation of unfair practices.

Too frequently . . . the Commission has not defined the legal theory in its rulemaking proceedings. Additionally, factors which are prominent in one . . . proceeding, such as public policy, are ignored in another or referred to so generally that the factor is rendered meaningless [*Akron Law Review*].

Fortunately, the commission is beginning to restrain this free-wheeling approach. In 1980, it announced criteria for finding that a practice is "unfair." And more recently, it recommended that Congress incorporate these criteria into the FTC statute itself, thereby providing the kind of legislative guidance that would have avoided some of the problems in the first place. However, even though the commission's discretion to find a practice "decep-

“tive” is almost as broad as its unfairness powers, it has yet to take similar steps to specify what deception may mean. Until it does, it will still be free to act on as vague a basis as it pleases, because virtually every action that it can take under its unfairness jurisdiction it can also take under its deception jurisdiction.

Without a clear explanation as to why a particular practice violates the law, knowing what evidence is necessary is difficult. Moreover, if there is no need to establish a sharply focused legal criterion, there is no incentive to remedy defects in the evidentiary record. In fact, at the FTC the incentives have been quite the reverse. If one vague theory turns out to be inconsistent with the facts, another might work out better. So the rulemaking staffs seek evidence for as many theories as possible in the hope of turning up something that will support at least one. As Boyer observes, “the use of ambiguous, multiple theories . . . expands the range of matters in dispute, and the kinds of proofs that might be marshalled to influence the decision.” It also “tends to expand the scope of agency discretion.”

Substantive Theories. In addition to lacking a clear legal theory, the commission’s rulemakings have also lacked a clear substantive theory on why a particular problem merited government intervention and why the proposed remedy would alleviate the problem. The choice of remedies has been viewed as a matter for the commission’s quasi-legislative discretion, not one that requires the development of careful empirical proof. Lacking a theory on why a remedy would be likely to solve the problem, the staff did not feel obligated to gather evidence on the remedy’s effectiveness. Consequently, for many pending rules, there is little evidence indicating whether the remedy will work, how well it will work, or how much it will cost.

Admittedly, the theories underpinning the commission’s proposals have usually been clearer at the end of most rulemakings than at the beginning. Frequently, however, these clearer theories were developed after the record was closed, making them simply after-the-fact rationalizations. Only rarely was evidence gathered specifically to test the theories. Thus, although the final theories may be correct, the evidence that would confirm or negate them is



simply not at hand. The commission therefore has faced the choice either of gathering more evidence or of regulating with inadequate information.

Conclusion

Rulemaking requires evidence that can be projected to an entire industry. Clear theories on why a practice is illegal and why the proposed remedy is necessary and likely to be effective are also essential. Theories alone are not enough, however, for creative theoreticians can fashion a convincing rationale for nearly any scheme. Thus, a proposal should not become a rule until systematic evidence has been collected to test its factual premises. Anecdotes, the commission’s own expertise, and the testimony of experts can rarely, if ever, provide the necessary confirmation. Such evidence may be consistent with the theory, but cannot test it. And an untested theory should not be imposed on society at large.

The contrast between the eyeglass rule and the funeral rule illustrates the value of a systematic effort to collect projectable evidence that tests a clear theory. The eyeglass rulemak-

ing began in September 1975 with a formal investigation and culminated in a rule promulgated in June 1978. It was based from the outset on the theory that restrictions on the provision of information would raise prices. Econometric studies comparing eyeglass prices in states with and without such restrictions confirmed the theory, establishing both that removing the restrictions would work as intended and that significant benefits were likely from doing so. And the rule was issued in less than three years—near record time for a major FTC rulemaking proceeding.

In contrast, the inquiry into funeral industry practices, which ignored these precepts, took ten years. Had it begun, rather than ended, with the baseline survey and had it included studies of the natural experiments discussed above, it is extremely unlikely that it would have lasted so long. Moreover, there would be greater confidence today that the commission had acted in the interest of consumers.

Some have suggested that requiring systematic evidence will put an end to all rulemakings or at least prolong them to absurd lengths. They are wrong. The streamlined used-car rule that FTC Chairman James Miller now proposes is based on reliable surveys showing that used-car buyers frequently misunderstand the extent of their warranty coverage. (Studies of a similar law in Wisconsin also provide evidence that better information can produce benefits exceeding the low costs of disclosure.) Moreover, the FTC's 1964 rule requiring warning labels for cigarettes was, in my view, adequately supported by the available evidence. Finally, the eyeglass rule demonstrates that it is possible for the commission not only to complete a rulemaking proceeding that is based on reliable evidence but to do so quickly. Rulemaking that relies on systematic evidence is quite feasible. It requires only concerted effort.

SOME CRITICS of my position charge that it is revolutionary to ask a body of lawyers and economists not to impose its own view of proper regulation on the world without first systematically evaluating the problem. If so, I must cheerfully admit to being a revolutionary. I doubt, however, that the seditious implications will trouble Congress, the courts, and the public at large. ■

Dress Codes Decontrolled

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ever temporarily. But the process of paper-shuffling was still extraordinarily slow.

Incoming Education Secretary Terrel Bell found that he had to reinvent the regulatory wheel. In April 1981, he published a Notice of Proposed Rulemaking to rescind the regulation, much like the original Califano notice of 1978. The *sans-culottes* were no longer much in evidence: of the fifty-three comments that drifted in on the proposal, thirty-one favored rescission, seventeen opposed it, and five expressed no clear opinion. After the proposal had cleared the necessary internal channels, which took until early fall, it was sent to other agencies for approval: first the Civil Rights Division of Department of Justice, which since 1980 has had coordinating responsibility for all Title IX and other civil rights regulations, and then to the Office of Management and Budget. In September 1982, finally, six years after enforcement was first suspended, local schools recovered their ancient right to require haircuts of little boys.

Certain lessons can be learned from the tortuous history. First, it is often far easier to add nine stitches to the regulatory web than to take out one. Interest groups that never cared much when the dress code rule was added saw rescission as a "retreat" in the supposedly inevitable forward ratchet of history. Opponents of the rule, satisfied by soothing statements of general policy, did not know how to push the process toward actual decision. The rule was also an instance of a sort of "compromise" fairly common in government: overweening regulatory ambition tempered by nonenforcement. Refusing to apply a regulation can seem easier, even less controversial, than proceeding through the cumbersome channels of deregulation. Although the *Adams* orders made that option less comfortable in the case at hand, they obviously did not make it impossible.

Finally, personnel and organizational change can hold up even the most minor deregulatory reform for years; should one link in the succession be unsympathetic, all reform not yet completed can be wiped out, setting the process back to square one. To some extent, it seems, the urge to change letterheads conflicts with the urge to change policy.
