PROSECUTORIAL DISCRETION

A VIEW FROM THE FEDERAL TRADE COMMISSION

by Roscoe B. Starek, III

THE CONGRESSIONAL REPUBLICAN promotion of regulatory reform initiatives and the Clinton administration efforts to "reinvent government" have sparked renewed attention to an old debate concerning regulatory agencies with law enforcement responsibilities. Just because an independent agency has the authority to enforce given laws, does it have an obligation to do so? Or does the agency have an equally important obligation to exercise discretion in the selection and prosecution of its enforcement targets? A key question has been whether an agency is duty-bound to initiate an enforcement action against any person or firm that, under a strict reading of the agency's statutory authority, can be said to have violated the law; or whether, instead, the agency's case-selection process should involve mitigating criteria?

Another way to approach the issue is to ask if an agency should be obligated to take action in every case it is likely to win in court; or, in addition to evaluating a case's "winnability," should decisionmakers also consider carefully the agency's regulatory objectives, the mistakes of past enforcement, and the risks inherent in market intervention? The better view appears to be the latter—that the agency's ultimate goal, and its duty, must be to exercise prosecutorial discretion to promote the public interest.

THE FTC EXAMPLE

The agency where I serve, the Federal Trade Commission (FTC), provides a convenient vehicle for analyzing those issues. The FTC is an independent federal agency, established over eighty years ago, that enforces the federal antitrust and consumer protection laws. The five Commissioners, nominated by the President and appointed with the advice and consent of the Senate, serve staggered seven-year terms. The Chairman—currently Robert Pitofsky—is selected by the President from among the sitting Commissioners and serves as Chairman at the President's pleasure. In contrast to the narrower authority of other independent regulatory agencies in Washington—over industrial sectors such as securities, communications, or energy—the FTC's antitrust and consumer protection jurisdiction applies to virtually every sector of the economy.

Like many other independent federal agencies, the Commission has adjudicative, regulatory, and prosecutorial functions. It acts as a court when it hears appeals of decisions of the agency's own administrative law judges. It acts as a regulatory body when, as mandated by Congress, it issues regulations that have the force and effect of law. The Commission's primary role, however, is prosecutorial—to act as a civil law enforcement agency.

The Commission acts as a prosecutor in determining which cases to file either in the United States district courts or before its own administrative tribunal. In that role, the Commission functions in the same way as any other prosecuting agency, such as the U.S. Department of Justice or a local district attorney's office.

Although the FTC has enforcement and other responsibilities under nearly forty different statutes, the heart of the Commission's authority lies in Section 5 of the Federal Trade Commission Act of 1914 (15 U.S. Code, Sec. 45). In general, the FTC's antitrust mission derives from that section's prohibition against "unfair methods of competition," while its consumer protection mission is based on language barring "unfair or deceptive acts or practices."

Section 5 is similar in breadth to other American antitrust statutes, such as the Sherman Act of 1890—America's first antitrust law—Section 1 of which makes unlawful every "contract, combination . . ., or conspiracy, in restraint of trade" and Section 2 of which prohibits practices that "monopolize, or attempt to monopolize, . . . any part of . . . trade." Similarly, Section 7 of the Clayton Act of 1914 provides that no person "shall acquire . . . any part of the stock . . . or assets of another person" where the effect "may be substantially to lessen competition, or to tend to create a monopoly."

The Congress left those prohibitions very broadly defined and gave the Commission wide authority and scope so that it could be responsive to a wide variety of business practices and to new insights into market behavior. That interpretation of antitrust laws was upheld by the *Supreme Court in FTC v. R.F. Keppel & Bro., Inc.* (1934) and in *FTC v. Sperry & Hutchinson Co.* (1972).

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Although a law enforcement agency must of course yield to judicial interpretations in cases pending before courts, the agency is not under a similar limitation when it determines what constitutes an offense and whether to prosecute. For example, when an agency is convinced that conduct falls within the proscription of the statute, it can initiate an enforcement action even though no precedent exists involving similar conduct. That is so even when precedent may suggest a contrary result. Indeed, the agency is arguably required to prosecute a plausible violation when the agency determines that such a prosecution would be in the public interest. Section 5(b) of the FTC Act states that "[w]henever the Commission shall have reason to believe [that a violation has occurred], and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, [the Commission] shall issue . . . a complaint . . ."

When it enforces broad mandates such as the antitrust statutes, an agency has a special responsibility to look beyond simply the letter of the law. An agency should not attempt to uncover and attack every technical violator of the law. According to William F. Baxter, Assistant Attorney General for Antitrust from 1981 to 1984, and a principal advocate of prosecutorial discretion, when judicial decisions appear to diverge from what the Congress intended, a federal agency has an equal duty not to exacerbate the problem by prosecuting conduct that violates merely the letter, but not the spirit, of the law.

The Supreme Court supports that reasoning. While early interpretations, such as *United States v. Joint Traffic Association* (1897), held that all "restraints of trade" violated the Sherman Act, the Court later modified its position, for example, in *Standard Oil Co. v. United States* (1911), *Chicago Board of Trade v. United States* (1918), and *Business Elecs. Corp. v. Sharp Elecs. Corp.* (1988). In those decisions the Court recognized that almost any conceivable contract, joint venture, or merger restrains trade in some way and held that the Act prohibited only "undue" restraints when measured against a "rule of reason."

RULEMAKING AND DISCRETION

The Congress conferred upon the FTC the power to exercise its prosecutorial powers through two means: (1) case-by-case prosecution and adjudication and (2) the development of broad Trade Regulation Rules.

Federal agencies promulgate rules for basically four reasons. First, rules interpret statutes that the Congress has drafted broadly. In fact, the Congress often requires agencies to promulgate rules to explain precisely what the Congress meant when it enacted a law. Second, rules provide specific guidance to industry on conduct that the agency will consider unlawful. Third, rules can provide examples of conduct that will not be considered violations of the law—a concept that regulators often call the "safe harbor." And fourth, by clearly specifying what is and is not lawful, rules can make prosecution easier.

The Commission has a long and less than illustrious history of creating rules designed to interpret the broad language of the FTC Act. The 1960s and early 1970s marked the heyday of the Commission's promulgation of rules having the force and effect of law. The FTC had confidence in the wisdom and usefulness of developing the law through broad regulatory mandates. Several Commission regulations during that period actually concerned products no longer in commerce. Among the antiquities were the now-repealed rules on "Deception as to Transistor Count of Radio Receiving Sets, Including Transceivers" (1968) and "Failure To Disclose the Lethal Effects of Inhaling Quick-freeze Aerosol Spray Products Used for Frosting Cocktail Glasses," the so-called "Frosted Cocktail Glass Rule" (1969).

Seemingly no issue was trivial or arcane enough to escape the Commission's grasp. Some rules of relatively ancient vintage were aimed at misrepresentations of the sizes of products such as tablecloths (1964), sleeping bags (1963), extension ladders (1969), and television screens (1971). The Commission established industry-wide rules prescribing how those products should be properly measured and how those measurements should be described on labels. The Tablecloth Rule nicely illustrates regulatory overkill: it did not stop merely at requiring disclosure of a tablecloth's exact size, but also regulated disclosure of measurements for "doilies, table mats, dresser scarves, place mats, table runners, napkins, and tea sets." Users of doilies and dresser scarves who were victimized by unscrupulous vendors could rest assured that the federal government was safeguarding their interests.

Many of the Commission's rules no doubt tried to ensure that consumers could make informed choices in the marketplace. But any rule can run the risk of becoming obsolete, or even harmful, when it articulates standards that fail to account for technological change, runs counter to subsequent judicial interpretations of the law, or fails to reflect the evolving understanding of the economic consequences of business conduct. Because of concerns about creating excessively rigid law, the Commission today is more skeptical about the wisdom of using rules, rather than case-by-case prosecution and adjudication, to interpret and implement the FTC Act. The Commission is much more inclined to publish industry-wide guidelines that do not have the force of law but rather seek to explain to market participants the types of conduct that violate the law.

In 1992, the Commission initiated a formal review of all of its rules and guides every ten years with an eye to repealing the obsolete and updating the candidates for refurbishment. Since 1995, the Commission has repealed twelve rules and eleven guides. The proposed repeal of other rules is now under consideration at the FTC. Finally, other FTC rules on various subjects—including wool products (1941), fur products (1952), textile fiber products (1959), and franchising (1978)-are undergoing regulatory review.

LEGAL THRESHOLDS FOR CASE-BY-CASE ENFORCEMENT

Now that the era of extensive rulemaking is over, the Commission interprets and implements the FTC Act primarily through the prosecution and adjudication of individual cases. In determining whether to prosecute a case under the broad mandates of Section 5, the Commission generally must satisfy itself that two legal thresholds have been met. First, the Commission must have "reason to believe" that the law has been or is being violated. And second, it must find that an enforcement action against the violation would be in the public interest.

"Reason to believe," a prerequisite to federal regulatory enforcement actions, has never been defined by judicial opinion. The Supreme Court held in *FTC v. Standard Oil Co. of California* (1980) that courts may not review the adequacy of the Commission's finding that it has "reason to believe" that a violation has occurred. That term does imply that a Commissioner must believe that it is more likely than not that the law has been violated and that evidence supports that belief.

The "public interest" standard demands more explanation. The agency has no duty to prosecute a case simply because precedent exists that would support a finding of illegality. Nor is the agency required to prosecute a case for which plausible arguments of illegality can be made, unless prosecution would be in the public interest. Indeed, by the very terms of a statute such as Section 5 of the FTC Act, unless the agency finds that prosecution would be in the public interest, it has a duty not to prosecute.

In each case, the agency must evaluate both the short-term and the long-term effects on the public interest of a decision to prosecute. The agency must carefully consider its important role in the evolution of the law and should be wary of establishing precedent for socially harmful intervention. Intervening to prevent socially harmful conduct often bears the risk—and may well have the unintended effect—of deterring socially beneficial conduct. That principle explains why an agency may occasionally find itself in what appears to be an awkward situation. One way to resolve a case short of a full-scale litigation is for the FTC to accept a consent order negotiated with a business accused of violating a law. But sometimes the FTC may decline to seek relief even when its enforcement staff has already negotiated a consent order. One possible reason for such an outcome is that the FTC concludes that the order would not be in the public interest. For example, the Commission might conclude—even in the case of a clear law violation—that the resources required to police compliance with an order would significantly exceed the benefits to be derived from the imposition of the remedy.

Activist regulators disagree with that approach. They take the position that an enforcement agency should act as an interested litigator and should take any settlement it can get—even when the prospects for establishing a violation are far from certain. In the case of the FTC, for example, proponents of that view argue that if there is any possibility of a competitive problem, and if the investigated party offers a settlement that does not put FTC interests in peril—for example, by creating undue regulatory obligations—then the Commission should accept it. But such a shotgun approach is indiscriminate, making no effort to distinguish real from imagined problems or to discover whether a settlement will do more harm than good. In short, that approach does not serve the public interest.

RESOURCE ALLOCATION AND SELECTIVE PROSECUTION

Investigations and enforcement actions consume finite agency resources, so agencies must be selective in initiating investigations and enforcement actions. An agency cannot prosecute every type of conduct conceivably vulnerable to challenge, in some type of "first-come, first-served" approach, lest it deplete too quickly its resources for a particular year. An agency is obligated to exercise prosecutorial discretion, pursuing only cases that promote the public interest rather than any case in which success at trial is predictable.

How does an agency exercise such selectivity? Because every allocation of enforcement resources entails costs and benefits to the economy at large, an agency's selection and pursuit of investigations and law enforcement actions should be guided by the goal of maximizing the difference between the expected social benefits and the expected social costs.

On the benefit side of the ledger, the primary value of prosecution is compelling firms to conform to the norms established by the law. Nor do enforcement actions by the regulator affect only the offender; they also signal to similarly situated firms that the government will enforce the law. The deterrence value of a credible enforcement presence cannot be overstated: the greater an agency's enforcement vigilance is perceived to be, the greater the public's incentive to comply with the applicable government regulation.

Prosecutions help clarify the agency's views of the legal requirements and obligations imposed on private parties. Because resource limitations circumscribe the quantity and types of violations that can be detected and prosecuted, an agency must select its cases to maximize deterrence. For instance, in order to get "the most bang for the taxpayer's buck," the FTC must focus enforcement on practices likely to cause the most consumer harm.

Then, of course, there is the cost side of the ledger. The pervasive fact of limited (or even contracting) enforcement resources means that any new enforcement initiative by the agency will necessarily entail opportunity costs. An increase in resources applied to one substantive area will require the agency to curtail resources applied to another. Significant portions of many agencies' budgets are committed to performing regulatory tasks mandated by the Congress such as merger review, or to undertaking enforcement activities that do not provide for a great deal of latitude.

In addition, regulators must remain aware that all investigations and prosecutions—even successful ones—create social costs by disrupting the conduct of affected firms and markets. Although those costs may result in substantial benefits to the economy if the prosecution is well-founded, it remains true that any government enforcement action diverts valuable time and resources away from economically productive, procompetitive activity.

CONCURRENT RIGHTS OF ACTION

An additional consideration in the allocation of Commission enforcement resources should be whether there are equally or better-positioned plaintiffs that have standing and sufficient incentives to pursue the cases at the local level. State governments, for example, also have certain antitrust enforcement authority. Further, the FTC shares antitrust enforcement authority with the Department of Justice's Antitrust Division. Under a "clearance" procedure that assigns matters on the basis of interest and expertise, the two federal antitrust agencies coordinate their activities to maximize efficiency and avoid duplication of enforcement.

Moreover, private parties often have a right of action. When private parties suffer injury, their incentives to seek redress are often very substantial, particularly in antitrust cases involving the successful plaintiff's opportunity to recover treble damages and attorneys' fees. In those cases, government action may be unnecessary or contrary to the public interest. Cases of that type are often appropriate for the exercise of prosecutorial discretion.

THE CONSUMER WELFARE OBJECTIVE

To maximize the benefit to society, agencies should pursue enforcement actions against types of conduct that present the clearest and most significant threat to economic efficiency and consumer welfare. To the extent that the agencies are now achieving that objective—and assuming no increase in enforcement resources—any reallocation of resources will be less than optimal.

In particular, to the degree that antitrust policy moves away from its current focus on consumer welfare, efficiency and protecting competition and in the direction of political and redistributive concerns and protecting competitors, one should expect an increase in inefficient rent-seeking behavior. For example, at the FTC there have been various proposals to increase enforcement resources in the area of supplier—imposed vertical restraints. Those proposals should be considered cautiously: one factor to consider is that an increase in that area would require a reduction in resources devoted to more unambiguously anticompetitive conduct. Viewed from that perspective, shifting resources is not simply a zero sum game.

A cost-benefit analysis should be a key component of any government agency's decision whether to intervene in the marketplace to address a perceived market failure. Consistent with that notion, the increased use of economic analysis is making the consumer welfare standard operational at the FTC. The American Bar Association's Report of the ABA Section of Antitrust Law Special Committee to Study the Antitrust Role of the Federal Trade Commission (1989) and Report of the ABA Section of Antitrust Law Special Task Force on Competition Policy (1993) both commended the Commission for its increased use of economists for that purpose. In fact, the increased use of economic analysis must be seen as one of the most significant improvements in federal antitrust enforcement in the last decade. "[E]conomists generally bring a cost-benefit mentality" to each problem, noted the 1989 ABA report. Not only does sound economic analysis improve the Commission's ability to avoid intervention when its social costs would exceed its benefits, but it also helps the Commission evaluate the efficacy of contemplated remedies and gauge their potential consequences for third parties and future conduct.

It is not enough simply to identify a legal basis for a specific enforcement action; an agency must also hold the proposed action to a high standard of economic analysis. FTC economists work with attorneys to assess the actual economic consequences of the conduct at issue, and they provide separate views to the Commission regarding the benefits and costs of each proposed action.

Writing in the *University of Chicago Law Review* in 1969, now—Federal Appeals Court Judge Richard Posner concluded that FTC cases were not selected under a public interest standard but were initiated "at the behest of corporations, trade associations, and trade unions whose motivation is at best to shift the costs of their private litigation to the taxpayer and at worst to harass competitors." The landscape today is much changed. Despite differences of opinion on how best to achieve the goal of maximizing consumer welfare, most observers would probably agree that the Commission has become far less hospitable to arguments and interests that do not address that goal. The Commission and its staff always take into account the incentives and interests of third parties that provide information or opinions regarding contemplated enforcement action. In the area of mergers, for example, calls for an enforcement action from competitors of the merging parties may well signal that the merger is likely to increase rather than decrease competition. That follows from the observation that if a merger is likely to reduce competition, then in general the remaining competitors should support the transaction on the expectation that it will enable them to increase prices.

Strategic manipulation of Commission enforcement is much less likely today than when Posner described FTC behavior in terms that others have labeled an "antitrust pork barrel."

LEGISLATION OR DISCRETION?

Some might argue that the problems identified above stem not so much from the exercise of discretion by individual regulators and law enforcers as a from a broader structural deficiency in the Nation's legislative language. Adherents to this view claim that imprecise language, combined with overbroad grants of discretion to the enforcement authorities, has led from time to time to seemingly haphazard or arbitrary results.

We at the FTC are aware of this view. In my judgment, the appropriate response is neither to force the Congress to produce inordinately detailed legislative blueprints nor to tie agencies' hands to the extent that they are deprived of decisionmaking latitude. Rather, the solutions must come from within the administrative agencies, in the form of rigorous cost/benefit analyses and the other tools discussed above, which must be part of the daily decisionmaking process.

CONCLUSION

For a government agency to carry out a coherent and conscientious program of law enforcement, it must exercise its prosecutorial powers with care and with the paramount objective—furtherance of the public interest-uppermost in its institutional mind. In other words, the prudent exercise of prosecutorial discretion is a critical, indeed an unavoidable, component of the agency's job. At the Federal Trade Commission, the role of prosecutorial discretion means that many law violations will be investigated and challenged but some-although infractions of the law in a technical sense-should not be targeted. In a world in which prosecutors must operate under significant resource constraints and, more important, in which they must strive to achieve the best results for society as a whole, that is the responsible course of action.