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REGULATING UNFAIR PRACTICES UNDER THE FTC ACT: THE NEED FOR A LEGAL STANDARD OF UNFAIRNESS

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THE FEDERAL TRADE COMMISSION (Commission) has become one of the most powerful consumer protection agencies in the federal government.¹ The source of this wide-ranging authority is the Federal Trade Commission Act (FTC Act),² a broadly worded statute which makes unlawful "unfair or deceptive acts or practices." The courts have interpreted this language broadly to give the Commission considerable leeway in defining illegal practices.³ In addition, recent legislation amending the FTC Act has clarified the Commission's rulemaking authority.⁴ Under this legislation the Commission can go beyond case-by-case prohibitions of unfair or deceptive practices by issuing trade regulation rules which proscribe such practices on an industry-

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¹ For descriptions of the FTC's recently acquired powers, see Nelson, *The Politicization of FTC Rulemaking*, 8 CONN. L. REV. 413 (1976); Kintner & Smith, *The Emergence of the Federal Trade Commission as a Formidable Consumer Protection Agency*, 26 MERCER L. REV. 651 (1975).

² 15 U.S.C. § 45(a)(1) (Supp. V 1975).

³ See *FTC v. R. F. Keppel & Brothers, Inc.*, 291 U.S. 304 (1934) in which a lottery method of selling candy to children was held to constitute an unfair practice. In considering the Commission's authority to define unfair practices, the Court stated: "It is unnecessary to attempt a comprehensive definition of the unfair methods which are banned, even if it were possible to do New or different practices must be considered as they arise in the light of the circumstances in which they are employed." *Id.* at 313.

⁴ According to 15 U.S.C. § 57a(a)(1)(B) (Supp. V 1975), "[t]he Commission may prescribe . . . rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce (within the meaning of Section 45(a)(1) of this title). Rules . . . may include requirements prescribed for the purpose of preventing such acts or practices."

Prior to this enactment, the FTC had issued trade regulation rules under 15 U.S.C. § 46(g) and its authority to do so had been upheld in *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974). Once a rule takes effect, "a subsequent violation thereof shall constitute an unfair or deceptive act or practice in violation of Section 45(a)(1) of this title" unless otherwise provided by the Commission. 15 U.S.C. § 57(d)(3) (Supp. V 1976). It is unclear whether similar rulemaking authority may be utilized by the Commission to proscribe unfair methods of competition. The statute specifically does not affect any existing authority, whatever that authority may be. *Id.* § 57(a)(2).

wide basis. In recent years the FTC also has been given additional enforcement tools to obtain compliance with its orders and rules.⁵

Operating under its broad statutory mandate, the Commission has demonstrated that it will be an aggressive and imaginative rule-maker, particularly in exploring and expanding the definition of "unfair acts or practices." This flexible and elusive statutory standard is being utilized to address many marketplace practices which have not been regulated under traditional theories of deception or unfair competition.

For example, the Commission has promulgated and proposed several trade regulation rules which create new legal standards going far beyond any previously recognized by the Commission. By rule, the Commission has limited the holder in due course doctrine in consumer sales⁶ and proposed to eliminate restraints on prescription drug⁷ and eyeglass⁸ advertising. The Commission has also proposed innovative rules to regulate unfair practices by sellers of hearing aids,⁹ funeral services,¹⁰ and used motor

⁵ In 1973, a rider to the Trans-Alaska Pipeline Authorization Act increased the penalty for a violation of the cease and desist order from \$5,000 to \$10,000 and gave the FTC power to seek preliminary and permanent injunctions. 15 U.S.C. §§ 45(1), 53(b) (Supp. V 1975).

In 1975, the Magnuson-Moss Warranty - Federal Trade Commission Improvement Act was signed into law. The Act provided the Commission with powers to seek a variety of court-ordered remedies for consumers, such as reformation or rescission of contracts, money refunds, damages, return of property and public notification of law violations. 15 U.S.C. § 57b(b) (Supp. V 1975).

The Commission's cease and desist order was traditionally a very weak remedy, requiring only that past unlawful conduct be terminated. In recent years, the FTC has attempted to strengthen its orders by including requirements of affirmative action on the part of respondents, such as corrective advertising to dispel the effects of prior deceptions and restitution to injured consumers. See generally, Thain, *Corrective Advertising Theory and Cases*, 19 N.Y.L.F. 1, (1973); Note, *Corrective Advertising—The New Response to Consumer Deception*, 72 COLUM. L. REV. 415 (1972); Note, *Federal Trade Commission: Developments in Advertising Regulation and Antitrust Policies*, 41 GEO. WASH. L. REV. 880 (1973). The authority to require corrective advertising has not yet been challenged in court. The Commission's power to order restitution in its cease and desist orders, however, was successfully challenged in the single court test of this Commission's power to date. *Heater v. FTC*, 503 F.2d 321 (9th Cir. 1974). The Commission did not seek review of this case by the Supreme Court so this authority remains in doubt. See 700 ANTI-TRUST & TRADE REG. REP. (BNA) F-1 (Feb. 11, 1975).

It is clear that the Magnuson-Moss Warranty FTC Improvement Act was not intended to restrict or limit the Commission's existing powers. The new remedies are "in addition, and not in lieu of, any other remedy . . . provided by State or Federal law." 15 U.S.C. § 57b(e) (Supp. V 1975).

⁶ 40 Fed. Reg. 53,506 (1975).

⁷ 40 Fed. Reg. 24,031 (1975). Proceedings concerning this rule have been postponed indefinitely. The Commission is of the view that the Supreme Court's decision in *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748 (1976), where a Virginia law which banned commercial advertising of prescription drug prices was found to violate the constitutional guarantee of free speech, may obviate the need for FTC action. FTC News Summary (July 9, 1976).

⁸ 41 Fed. Reg. 2399 (1976).

⁹ 40 Fed. Reg. 26,646 (1975).

¹⁰ 40 Fed. Reg. 39,901 (1975).

vehicles.¹¹ Debt collection practices may also be regulated by future FTC rules.¹²

This article will examine the Commission's past and proposed use of the unfairness theory to justify these trade regulation rules. It is the thesis of this article that the Commission has not defined adequately the parameters of the amorphous statutory term "unfair . . . acts or practices" nor analyzed the term sufficiently or consistently in its application to trade regulation rules. By purposefully leaving the unfairness theory vague, the Commission invites judicial reversals of its regulations¹³ and legislative limitations on its authority.¹⁴

¹¹ 41 Fed. Reg. 1089 (1976).

¹² 40 Fed. Reg. 16,347 (1975).

¹³ A court has jurisdiction to review the FTC's rules in accordance with Chapter 7 of Title 5 of the United States Code.

The court shall hold unlawful and set aside the rule on any ground specified in subparagraphs (A), (B), (C), or (D) of section 706 (2) of Title 5 (taking due account of the rule of prejudicial error), or if—

(A) The court finds that the Commission's action is not supported by substantial evidence in the rulemaking record . . . taken as a whole, or

(B) The court finds that—

(i) a Commission determination under sub-section (c) of this section that the petitioner is not entitled to conduct cross-examination or make rebuttal submissions, or

(ii) a Commission rule or ruling under sub-section (c) of this section limiting the petitioner's cross-examination or rebuttal submissions,

has precluded disclosure of disputed material facts which was necessary for fair determination by the Commission of the rule-making proceeding taken as a whole.

15 U.S.C. § 57(e)(3)(Supp. V 1975).

The grounds specified in subparagraphs (A), (B), (C), or (D) of section 706(2) of Title 5 include:

agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law

5 U.S.C. § 706(2) (1970). By using the term "unfair . . . acts or practices" inconsistently, the FTC especially invites judicial invalidation of its rules on the grounds of arbitrary and capricious action in subsection (A) above.

¹⁴ Since the FTC was created by and derives its powers from statutes enacted by Congress, Congress may curtail this power by enacting limiting legislation. One example of such action is the Cigarette Labeling and Advertising Act of 1965, which overruled the FTC's ruling on the same subject matter. See text accompanying notes 15-25 *infra*. Congress may also restrict administrative agencies through its appropriation power. See generally Knapp, *Congressional Control of Agricultural Conservation Policy: A Case Study of the Appropriation Process*, 71 POL. SCI. Q. 257 (1956); Macmahon, *Congressional Oversight of Administration: The Power of the Purse I*, 58 POL. SCI. Q. 161 (1943).

I. EARLY USE OF THE UNFAIRNESS DOCTRINE

A. *The Cigarette Rule*

The Commission's first use of the unfairness theory to support an industry-wide rule occurred in 1964 when it promulgated its Trade Regulation Rule for the Prevention of Unfair or Deceptive Acts or Practices in the Sale of Cigarettes.¹⁵ The rule made it an unfair or deceptive practice to fail to disclose in cigarette advertising and on cigarette packages that cigarette smoking is "dangerous to health and may cause death from cancer or other diseases."¹⁶

In explaining the unfairness theory to support this rule, the Commission listed three criteria by which a practice could be judged unfair:

- (1) whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law, or otherwise—whether in other words, it is within at least the penumbra of some common law, statutory, or otherwise established concept of unfairness; (2) whether it is immoral, unethical, oppressive, or unscrupulous; (3) whether it causes substantial injury to consumers (or competitors or other businessmen).¹⁷

The Commission did not indicate whether one, two or all three criteria must be satisfied to conclude that a practice is unfair to consumers. Furthermore, the Commission provided little insight into its definition of these criteria in applying the unfairness theory to the practices of the cigarette industry.

For example, the first criterion, whether the practice offends "public policy", was not addressed specifically by the Commission. The fact that the criterion is amorphous, of course, does not justify a failure to explain how public policy is to be derived or its significance in the unfairness analysis. Indeed, the nebulous nature of the term demands that it be addressed if it is to be a meaningful criterion of unfairness.

¹⁵ See Trade Regulation Rule for the Prevention of Unfair or Deceptive Acts or Practices in the Sale of Cigarettes, 29 Fed. Reg. 8325 (1964). The rule was an extremely innovative action by the Commission for two reasons. First, the Commission did not rely solely on a deception theory but set forth as an independent basis for the rule the unfairness theory. Second, the Commission acted through substantive rulemaking, although the authority for such action was subject to much controversy at the time. The substantive rulemaking authority was not judicially sustained until 1973, and not until 1975 was the authority established by statute. See note 4 *supra*.

¹⁶ 29 Fed. Reg. 8324 (1964).

Nor did the Commission specifically analyze the second criterion, whether the practice was "immoral, unethical, oppressive or unscrupulous" in reference to practices of the cigarette industry. It did find that advertising without warning of the dangers is "exploitive," particularly with regard to children.¹⁸ Its finding was based on factors such as the attractiveness of the product to children, its widespread availability, the nature of the danger which does not manifest itself immediately, the habit-forming nature of smoking and the advertisements aimed at the youth market.¹⁹

The Commission also found that the marketing of cigarettes without a warning was unfair, although it was unclear by which criterion the Commission was making its determination. It concluded that large scale mass media advertising was unfair to consumers when it had the cumulative effect of creating a "barrier to adequate public knowledge and appreciation of the health hazards of smoking."²⁰ The extensive advertising, the Commission found, gives the advertiser great power *vis-a-vis* consumers and requires "fair dealing" toward them, particularly where a health hazard is concerned.²¹

The Commission did address the third criterion, *i.e.*, whether the practices cause substantial consumer injury. Relying largely on the 1964 Report of the Surgeon General Advisory Committee on Smoking and Health, the Commission found substantial injury to the health and safety of consumers from cigarette smoking.²²

The mix of prominent factors upon which the Commission found unfairness thus included powerful advertising, vulnerable audiences (children and those lulled into apathy by the advertising) and a substantial health hazard. The absence of a public policy derived from "statutes, the common law or otherwise" may have been justified in the Commission's view by the presence of these factors. If such was the case, however, the Commission should have so indicated in order to explain its application of the unfairness theory. In failing to analyze its own criteria of unfairness in adopting the rule, the Commission left many unanswered questions about the theory, the criteria upon which it was based, whether or how these criteria might

¹⁸ *Id.* at 8358-59.

¹⁹ *Id.* at 8357.

²⁰ The Commission concluded that "deception to one side, cigarette advertising by virtue of its magnitude, techniques, content, media, and other factors, and above all by its failure to disclose the dangers of smoking is unfair to the public . . ." *Id.*

²¹ *Id.* at 8357.

²² *Id.* at 8329-32. The Commission also took into account the economic injury to the industry which the rule might engender but found the injury speculative. *Id.* at 8363-64. Thus, although the balance of interests was not prominent in the unfairness analysis, it was a part of the Commission's deliberations.

be balanced against each other, and how the theory might be used to address existing industry practices.

Shortly after promulgation of this rule, Congress passed the Cigarette Labeling and Advertising Act of 1965²³ which effectively overruled the Commission's trade regulation rule. But while the Act overrode the Commission's particular rule concerning cigarette labeling, it also specifically provided that it should not be construed as limiting the Commission's existing jurisdiction or authority.²⁴ Although the Commission thus was free to apply the unfairness theory to practices in other industries, it was several years before the theory again emerged.²⁵

B. *The Care Labeling and Octane Rules*

In 1971 the Commission again utilized an unfairness theory in conjunction with a deception theory to support two trade regulation rules. In issuing both rules, the Commission ignored the cigarette rule criteria and failed to state any new criteria by which unfair practices could be defined. In addition, the Commission's unfairness analyses were inconsistent with each other.

The care labeling rule required a permanently affixed label on clothes providing instructions for care and maintenance.²⁶ The Commission concluded that it was a deceptive practice not to provide this information²⁷ and also "unduly oppressive and unfair to consumers" in that substantial economic losses could occur to consumers who either damage their apparel through improper care or who unknowingly purchase clothing which requires expensive maintenance. The Commission concluded that it could prohibit practices as unfair upon a finding of "substantial economic injury to a significant number of consumers."²⁸

The Commission in fact did consider factors other than consumer injury in issuing the rules, *i.e.*, cost and feasibility of permanent labeling and alternative means of obtaining the desired information,²⁹ but its un-

²³ 15 U.S.C. §§ 1331-1340 (1970).

²⁴ *Id.* at § 5(c).

²⁵ This Congressional reaction to the FTC rule is a reminder that the FTC's legislative rulemaking may be overturned quickly if it is contrary to public policy as perceived by Congress. See also H. R. 12048, 94th Cong., 2d Sess. (1976), a proposal to allow for legislative veto within sixty days of any agency regulation.

²⁶ See generally, 36 Fed. Reg. 23,883-89 (1971).

²⁷ The Commission found that nondisclosure is deceptive "when silence on this subject can either mislead the public into using a care procedure which is harmful, or frustrate a basic assumption inherent in the initial purchase—that no special and costly maintenance will be required. . . ." *Id.* at 23,889.

²⁸ *Id.*

fairness standard as broadly stated did not reveal the weight to be given such factors or whether such factors should be balanced against economic injury to consumers.

The second trade regulation rule, which required the posting of minimum octane numbers on gasoline pumps, like the care labeling rule, was based on theories of deception and unfairness.³⁰ The deception theory was very weak, however, and little evidence was required to support the unfairness theory.³¹ Failure to inform the consumer, said the Commission, resulted in unfairness since "it does not afford to the consumer information with any degree of preciseness as to the range of octane ratings available," and thus could result in the consumer's purchasing higher priced gasoline than was necessary for his car.³² The amount of savings consumers might enjoy as a result of this rule apparently was "speculative", but that factor did not deter the Commission. Even if no savings occurred, "the consumer is entitled to have octane information made available to him, regardless of the amount of money saved."³³ This view seems quite inconsistent with the Commission's focus on "substantial" consumer injury in the care labeling and cigarette rules.

In both the care labeling and octane rules, the Commission concluded in summary fashion that the nondisclosure practices were unfair. The first two criteria of the cigarette rule (public policy and seller exploitation) were not considered at all, and the third criterion (substantial consumer injury) was treated as not essential to the unfairness analysis. The Commission's statements appeared to open the way for a limitless array of rules requiring product information disclosures whether or not such information was vital to consumer interests. The unfairness theory was so vaguely and variously defined by these rules as to result in an unworkable legal standard.

C. *The Equity Court Analogy*

In 1972, the Supreme Court in *FTC v. Sperry & Hutchinson Co. (S&H)*³⁴ affirmed the Commission's broad authority to proscribe unfair practices which are neither directly nor traditionally deceptive, nor anti-competitive. The Court summarized the Commission's authority over unfair practices as follows:

[L]egislative and judicial authorities alike convince us that the Federal

³⁰ Statement of Bases and Purpose, Trade Regulation Rule regarding the posting of octane ratings on gasoline dispensing pumps, 36 Fed. Reg. 23,871, 23,875 (1971).

³¹ The deceptive practice amounted to the "failure of marketers to disclose the octane rating" when such information is important to the consumer. *Id.*

³² *Id.* at 23,875.

³³ *Id.* at 23,877.

Trade Commission does not arrogate excessive power to itself if, in measuring a practice against the elusive, but congressionally mandated standard of fairness, it, *like a court of equity* considers public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws.³⁵

This general conclusion was the basis for finding error in the determination by the court of appeals that Section 5 of the FTC Act proscribed only unfair practices which were contrary to the letter or spirit of the antitrust laws.³⁶

The Court did not decide in *S&H* whether the FTC acted within its equitable powers in finding the challenged practices unfair but remanded the case because the Commission in its proceedings had not applied the unfairness theory which it was urging on appeal.³⁷ Once again, the Commission's analysis and application of its theory were inadequate.

Although the Commission won the Court's general approval of its broad statutory mandate, it received little guidance as to how it should have applied its equitable powers in this case, or how it should function in the future. The Supreme Court did not attempt to specify the nature of the "public values" to be considered by the Commission in defining unfairness but it did refer in a footnote to the Commission's own cigarette rule criteria as an example of standards of unfairness.³⁸ Although the court

³⁵ *Id.* at 244 (emphasis added) (footnotes omitted).

³⁶ The Fifth Circuit, with Judge Wisdom in dissent, concluded that:

To be the type of practice that the Commission has the power to declare "unfair" the act complained of must fall within one of the following types of violations: (1) a *per se* violation of antitrust policy; (2) a violation of the letter of either the Sherman, Clayton, or Robinson-Patman Acts; or (3) a violation of the spirit of these Acts as recognized by the Supreme Court of the United States.

Sperry & Hutchinson Co. v. FTC, 432 F.2d 146, 150 (5th Cir. 1970) (footnotes omitted).

³⁷ The Court found that the Commission's opinion was based on "the classic antitrust rationale of restraint of trade and injury to competition." 405 U.S. at 249-50. The thrust of the case was that S&H imposed restrictions on the free transfer and redemption of trading stamps. The FTC did not dispute the appellate court's findings that S&H's practices did not violate the antitrust laws, but urged on appeal that such practices were unlawful under Section 5 of the FTC Act in that they were unfair to consumers. Although the Supreme Court suggested that the Commission's findings of fact might support an opinion resting on the new theory now urged on appeal—*i.e.*, unfairness to consumers—the Commission's opinion was not based on that theory and reconsideration of the case by the Commission was required.

³⁸ 405 U.S. at 244 n.5 citing 29 Fed. Reg. 8324 (1964). In that same footnote, the Court went on to disagree with S&H's position that the FTC had committed itself to the position that conduct found to be injurious to consumers under the third criteria would be "unfair" only if it amounted to misconduct under one of the first two criteria as well. The Supreme Court, quoting the FTC but adding its own emphasis, found that all the FTC had said was that "the wide variety of decisions interpreting the elusive concept of unfairness *at least* makes clear that a method of selling violates Section 5 if it is exploitive or inequitable and if, in addition to being morally objectionable, it is seriously detrimental to consumers or others." 405 U.S. at 244 n.5. Thus, the Supreme Court

did not technically approve the cigarette rule criteria, it left little doubt that the Commission must develop and apply some clear standard of unfairness if its regulatory actions are to be upheld by the Court.³⁹

Shortly after the decision in *S&H*, the Commission in *Pfizer, Inc.* found that it was an unfair practice to make product claims without a reasonable basis to support these claims.⁴⁰ Even though the complaint against the respondent was dismissed for lack of proof, the Commission discussed at length the unfairness theory and emphasized the amorphous nature of the theory. By focusing on the equity court analogy in *S&H* rather than on the Court's implicit direction to establish unfairness standards, the Commission summarized its concept of unfairness as "potentially a dynamic, analytical tool capable of progressive, evolving application which can keep pace with a rapidly changing economy. Thus as consumer products and marketing practices change in number, complexity, variety and function, standards of fairness to the consumer may also change."⁴¹ Although the Commission quoted the cigarette rule criteria in its opinion, it did not utilize those criteria in establishing its unfairness standard for advertising substantiation. In fact, the Commission's statements indicate a dramatic departure from the unfairness theory announced in the cigarette rule.

The standard described in *Pfizer* consists primarily of an economic analysis of marketplace practices, in which the conflicting economic interests of consumers and sellers are balanced against each other, to determine how costs should be allocated between consumers and sellers to promote rational consumer choices and enhance competition. In applying this unfairness standard to the practice of unsubstantiated advertising, the Commission concluded that "economically it is more rational and imposes far less cost on society, to require a manufacturer to confirm his affirmative product claims rather than impose a burden on each individual consumer to test, investigate or experiment for himself."⁴²

seemed inclined to read the FTC's own criteria as broadly as possible, thereby encouraging the development of the unfairness theory.

³⁹ The Court found the Commission's action could not be sustained because the Commission in its opinion had failed to assess the practices in terms of their unfairness to consumers or developed any standards for doing so. 405 U.S. at 248.

⁴⁰ 81 F.T.C. 23 (1972).

⁴¹ *Id.* at 61 (footnotes omitted). The complaint against Pfizer alleged that the company had engaged in deceptive and unfair advertising of its sunburn ointment in failing to substantiate its efficacy claims by scientific tests. The Commission dismissed the complaint, finding there was no deception and that the standard for advertising substantiation had been erroneously stated by complaint counsel. The Commission went on to state that under the unfairness theory, there must be a "reasonable basis" for affirmative product claims which would depend upon such relevant factors as the type of product, the type of claim, consumer reliance, and the consequences of false claims. *Id.* at 64.

⁴² *Id.* at 61.

II. BROAD NEW FOCUS ON UNFAIR PRACTICES

A. *The Holder in Due Course Rule*

Only one trade regulation rule based solely on the unfairness theory has been promulgated since *S&H*. This rule, which is entitled a "Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses,"⁴³ is designed to eliminate three practices, including the holder in due course doctrine, which cut off a consumer's contract claims and defenses while continuing his contractual obligation to pay.⁴⁴

Drawing on the *S&H* decision for its authority, the Commission summarily announced that it had functioned as a commercial equity court, and "weighed competing equities in the market in reaching [the] conclusion that the mechanical abrogation of consumer claims and defenses is unfair to consumers."⁴⁵

In the Commission's view, the unfairness arises in several ways. When a consumer's claims and defenses are cut off, this mechanism too frequently subjects the innocent consumer to substantial unjustifiable losses brought on by the merchant's breach of contract.⁴⁶ Furthermore, consumers, as a result of the great disparity in bargaining power, cannot bargain for alternative provisions to preserve their defenses. Additionally, the holder in due course doctrine protects and encourages disreputable sales practices, since the merchant can sell the promissory notes and continue this source of payment while failing to perform the promises made under the sales contract.⁴⁷

The first objective of the rule is to bring the cost of seller misconduct to the lowest possible level.⁴⁸ This should occur as a result of creditors "policing" the marketplace by not purchasing notes from unreliable mer-

⁴³ 40 Fed. Reg. 53,506 (1975).

⁴⁴ The rule eliminates the use of promissory notes which can be sold to a holder in due course who then is entitled to payment from the consumer, despite the merchant's failure to perform under the sales contract. The rule also eliminates the use of "waiver of defenses" provisions in contracts by which buyers agree to pay the credit company without regard to the seller's breach of contract. Finally, the rule would allow consumers to raise contract claims and defenses against a lender who has extended credit directly to the consumer if the lender shares a course of dealing with the merchant or where the merchant has referred the buyer to the lender (vendor related loans). *Id.*

⁴⁵ *Id.* at 53,523.

⁴⁶ Consumers could be informed of the holder in due course doctrine on the face of their notes and contracts. However, it would be difficult to find appropriate language to apprise the consumer adequately of his liabilities and to assure that the language is read.

⁴⁷ 40 Fed. Reg. 53,509 (1975). While the consumer technically has an action for breach of contract against such a seller, this recourse is not realistically available to assure consumer protection. *Id.* at 53,511-12.

⁴⁸ *Id.* at 53,523.

chants, thus minimizing those losses. Both consumers and reputable merchants should benefit from this effect.

The second objective, when seller misconduct costs cannot be eliminated, is to internalize those costs so that consumer prices for credit transactions reflect their true costs. Although not conceding that interest rates will rise as a result of the rule,⁴⁹ the Commission appears to have concluded that any increased cost spread among all consumers who purchase credit is preferable to having large, unexpected losses fall on a small percentage of consumers.

The Commission summed up its philosophy by saying that "only when prices approach or approximate real social costs do consumer choices in the market tend towards optimal allocation of society's resources."⁵⁰ Thus, the Commission, acting like an equity court, reallocated the risks of obtaining and extending credit to the creditor, who is the party in the best position to reduce those risks or spread the costs of those risks. The Commission's rationale is similar to that underpinning the rapidly growing common law doctrine of strict products liability.⁵¹ It also reflects the Commission's adoption of the broad *Pfizer* standard of unfairness with economic and marketplace considerations predominating the Commission's analysis. The consumer's losses, the lack of consumer bargaining power to reduce those losses and the absence of commercial justification for the holder in due course doctrine substantiated the need for the rule.

Public policy consistent with the rule was considered peripherally in the Commission's statement accompanying the rule, and it was found in state rather than federal law. The primary use of the state law developments appeared to be in making the factual determination that credit costs would not increase under the FTC rule since they had not increased under similar state statutes.⁵² The fact that forty states have recognized the holder in due course problem and taken some legislative action, and that many recent judicial decisions hold the doctrine in disfavor, indicated to the Commission "widespread public concern about mechanical abroga-

⁴⁹ Testimony indicated that states which had statutes similar to the FTC rule had not experienced increased cost or decreased availability of credit. *Id.* at 53,520-21.

⁵⁰ *Id.* at 53,523.

⁵¹ See *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 67, 27 Cal. Rptr. 697, 377 P.2d 897 (1963).

⁵² This conclusion was hotly contested by retail merchants, small businessmen and financial institutions who maintained that the rule would damage their businesses. 40 Fed. Reg. 53,517-18 (1975). However, there was substantial evidence, including testimony from proponents of states with statutes similar to the rule, that the rule would not increase costs or decrease the availability of credit. 11

tions of consumer rights."⁵³ However, the FTC rule completely abrogates the doctrine and thus differs from most state restrictions,⁵⁴ and the rule runs contrary to the Uniform Commercial Code provisions⁵⁵ which exist in many states. Thus, this rule leaves uncertain the importance and definition of public policy as a determinant of unfairness.

B. *Proposed Trade Regulation Rules Based on the Unfairness Theory*

The Commission has proposed a number of trade regulation rules based in whole or in part on a theory of unfairness. These rules can be grouped, according to the type of marketplace practices or circumstances which they address, into the following three categories:

- 1) rules to prohibit contractual provisions which favor sellers and creditors and adversely affect consumers;
- 2) rules to promote or require disclosure of material information about products or services; and
- 3) rules to protect particularly vulnerable consumer groups from unconscionable selling practices.

In announcing these proposed rules, the Commission has set forth several different standards of unfairness and, in some instances, it has not yet clearly set forth a standard. An examination of these rules and standards, or lack thereof, follows.

1. Rules to Prohibit Certain Provisions in Consumer Contracts

The Commission has proposed a series of trade regulation rules which address allegedly unfair credit practices.⁵⁶ These rules would make unlawful various provisions in consumer contracts which are now permitted by state statutes or the common law. The proposed rules, *inter alia*, would place restrictions on the amount of a deficiency judgment a seller might recover after debtor default,⁵⁷ limit or restrict provisions requiring that a debtor pay attorney fees or collection costs,⁵⁸ eliminate confession of judgment or other similar provisions,⁵⁹ and bar creditors from communicating with certain third parties in the course of collecting a debt.⁶⁰

⁵³ *Id.* at 53,508.

⁵⁴ *Id.* The Commission concluded that many state statutes are inadequate to afford consumer protection.

⁵⁵ U.C.C. §§ 302-305 (1972).

⁵⁶ Proposed Trade Regulation Rule on Credit Practices, 40 Fed. Reg. 16,347 (1975). See generally, *Symposium on Credit Practices Rule*, 8 CONN. L. REV. 450 (1976).

⁵⁷ 40 Fed. Reg. 16,347 (1975). In determining the amount of the deficiency judgment, the debtor would be given credit for the "fair market retail value" of the property taken by repossession. *Id.*

⁵⁸ *Id.* at 16,347-48.

⁵⁹ *Id.* at 16,347.

In its brief statement of reason for the proposed rule, the Commission cited *S&H* as its authority for acting like an equity court in prohibiting unfair practices.⁶¹ It proposed an unfairness standard which would be met if:

- 1) the creditor imposes upon consumers contracts of adhesion . . . which contain provisions disadvantageous to consumers, or the creditor fails to include in the contracts of adhesion provisions beneficial to consumers, all to the consumers' detriment; and
- 2) this detriment to consumers is not offset by a reasonable measure of value received in return.⁶²

These requirements focus on the power of creditors *vis-a-vis* consumers and the injury suffered by consumers. On its face, the standard does not appear to involve a broad balancing of economic interests suggested by *Pfizer* and the holder in due course rule. Instead, it appears to consist of the second and third criteria of the cigarette rule, *i.e.*, oppressive or exploitive practices and consumer injury. However, the third criterion of the cigarette rule was "substantial injury to consumers" while the criterion here is simply "detriment to consumers," which may imply that a lesser degree of injury is necessary to find unfairness. The first criterion of the cigarette rule, *i.e.*, public policy, is not included in the formulated standard.

The Commission termed its proposed standard, "tentative" and invited public comment and analysis of this theory or other theories of unfairness under Section 5 of the FTC Act.⁶³ In addition, the Commission asked for information concerning effects of the rule on business and the relation of the rule to state laws governing creditor remedies, thereby indicating that it may utilize the interest balancing test of *Pfizer*.

The unfairness standard proposed by the Commission appears to be a departure from that originally suggested by the staff. In its memorandum proposing the credit rules to the Commission,⁶⁴ the staff focused on two criteria of unfairness — public policy and consumer injury — each criterion involving competing interests which must be balanced. For example, if substantial consumer injury is found, it must be balanced against commercial necessity.⁶⁵ In assessing the public policy interest, its importance and relevance must be weighed against the business interest served by the business

⁶¹ *Id.* at 16,348 n.1

⁶² *Id.* at 16,349. These criteria were listed as necessary for the rules dealing with cognovit provisions, attorney fees, and contacts to third parties, among others. Additional considerations were applicable to provisions dealing with deficiency judgments and co-signs. *Id.*

⁶³ *Id.*

⁶⁴ Division of Special Projects of the Bureau of Consumer Protection of the Federal Trade Commission, Creditor Remedies Project 49 (1974) (on file at the FTC, Washington, D.C.) [hereinafter cited as Staff Memorandum].

practice.⁶⁶ In the staff memorandum, it was urged that sources of public policy should be federal and state constitutional doctrines,⁶⁷ statutes,⁶⁸ and decisional law,⁶⁹ but it was not explained how specific or how prevalent a state or federal policy must be in order to support a Commission rule. According to the staff, consumer injury should not be limited to economic losses, but should include damage to the consumer's physical and emotional health,⁷⁰ and outrage, frustration and unrest.⁷¹ The staff did not attempt to quantify these injuries or rank them in importance.

A balancing test which does not include an explanation of the weight and interrelationship of the factors to be balanced permits excessive latitude in defining unfair practices. For instance, under its broad test, the staff proposed one credit practices rule which runs contrary to widespread existing state laws, judicial decisions and proposals for reform. This rule would make it an unfair practice for a creditor in the course of collecting a debt to communicate or threaten to communicate with any third party (other than the debtor's spouse or attorney) who is not liable for the debt, including the debtor's employer.⁷² To justify the proposed rule, the staff balanced very general national policies favoring one's right to privacy and employment⁷³ against policies evidenced by specific state laws and judicial decisions permitting reasonable third party contacts.⁷⁴ The balance was struck in favor of the broad national policies despite the fact that existing state policies and proposals for reform which are contrary to the staff's blanket proposals

⁶⁶ *Id.* at 52-54.

⁶⁷ *Id.* at 55. The concept of "unfairness is not coextensive with unconstitutionality. While the latter test is suggestive, it cannot be dispositive of Commission actions." *Id.*

⁶⁸ *Id.* at 56. State law that "stops short of outright prohibition is nonetheless official recognition of abuses." *Id.*

⁶⁹ *Id.* at 57-58. Examples of equitable principles which the courts have developed are unjust enrichment, unclean hands, and mitigation of damages.

⁷⁰ *Id.* at 71-76. Mental distress can arise from threats to jobs and wages, in terrorem tactics and harassment during debt collection. *Id.*

⁷¹ The Staff admits that this category is certainly the most difficult to assess, but is "no less real for that reason," and should be weighed in the balance.

⁷² 40 Fed. Reg. 16,348 (1975).

⁷³ According to the staff, the public policy favoring the ban on third party contacts is the policy against coercion, denial of dispute resolution in the judicial system, invasion of one's right to privacy and employment. Staff Memorandum *supra* note 64, at 500-02. Since the Consumer Credit Protection Act, 15 U.S.C. §§ 1601-1681(t) (1970), prohibits an employer from firing the employee once his wages are garnished, *id.* § 1674, the employer may wish to discharge the employee immediately on learning of the debt. Staff Memorandum, *supra* note 64, at 487. Potential loss of a job or less serious injuries, such as embarrassment and diminished reputation, occur with other contacts made to family members and friends. To prevent these injuries, consumers may pay debts they do not owe, and thus be denied access to due process rights. *Id.* at 490-91, 497.

⁷⁴ The Staff provides an extensive listing of cases upholding the creditor's right to make reasonable third party contacts. Staff Memorandum, *supra* note 64, at 492 n.20. 14

against third party contacts would normally be expected to carry a great deal of weight.⁷⁵

The staff also utilized the balancing test to analyze the conflicting interests of consumers and creditors which are affected by third party contacts. In so doing, the staff recognized that third party contacts are advantageous in that they afford an inexpensive collection device for creditors, but found that these advantages were outweighed by consumer injuries such as potential loss of employment, embarrassment, and diminished reputation.⁷⁶

Unless the balancing test is more fully explained in terms of the weight to be given the factors considered and the relationship between these factors, it will appear sufficiently malleable to justify any rule where some consumer injury appears possible.

2. Rules to Promote Product Information Disclosures

For many years the Commission exercised its power to require affirmative disclosures about products,⁷⁷ but until recently this authority has been based on a theory of deception, a theory which over the years took on a very broad meaning. Historically, deception was not limited to false representations by the seller, but included failures by sellers to reveal material facts about which the purchaser had made false assumptions.⁷⁸ It was necessary to show only that the practices had the capacity to deceive consumers, not that consumers were actually deceived or that they had actually made any false assumptions.⁷⁹

Recently, however, the Commission has been utilizing the unfairness theory, rather than the theory of deception, when addressing nondisclosure practices. For example, three proposed trade regulation rules based on the unfairness theory would eliminate, *inter alia*, state- and privately-imposed restraints on advertising the prices of prescription drugs,⁸⁰ ophthalmic goods⁸¹

⁷⁵ Alternative proposals which have been suggested by responsible consumer organizations have not included blanket prohibition against third party contacts. The Consumer Credit Act prohibits "unreasonable publication," and the National Commission on Consumer Finance permits third party contacts when the debtor has not given written consent. *Id.* at 507-09.

⁷⁶ See note 73 *supra*.

⁷⁷ See *J. B. Williams Co. v. FTC*, 381 F.2d 884 (6th Cir. 1967); *Keele Hair & Scalp Specialists, Inc. v. FTC*, 275 F.2d 18 (5th Cir. 1960).

⁷⁸ See *Bantam Books, Inc. v. FTC*, 275 F.2d 680 (2d Cir. 1960), *cert. denied*, 364 U.S. 819 (1960), (deceptive practice to omit on paperback book that it was abridged or re-titled); *Kerran v. FTC*, 265 F.2d 246 (10th Cir. 1959), *cert. denied, sub nom. Double Eagle Refining Co. v. FTC*, 361 U.S. 818 (1959) (deceptive not to label oil as re-refined).

⁷⁹ *Charles of the Ritz Distributor Corp. v. FTC*, 143 F.2d 676, 680 (2d Cir. 1944).

⁸⁰ 40 Fed. Reg. 24,031 (1975).

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⁸¹ 41 Fed. Reg. 2399 (1976).

and funeral services.⁸² For these rules the Commission consistently has set forth an unfairness theory based on two criteria: substantial harm and public policy. Each criterion is to be established by a balancing test which weighs conflicting interests at stake. Nondisclosure of prices, according to the Commission, may be unfair if “[i]t creates substantial harm (i.e., its economic and social utility to the public is substantially less than its economic and social disutility) and it offends public policy by being basically contrary to clear national policy and not vital to achieve important state policy goals.”⁸³

The Commission has not explained why “clear national policy” must be present to justify these rules but not in order to promulgate the holder in due course and credit practices rules. The reason may be that federal antitrust laws reflect a national policy consistent with the provisions of these nondisclosure rules so that this criterion of unfairness can be easily met. To emphasize the public policy criterion only when it can be found in national legislation and to ignore its importance otherwise, however, appears inconsistent and requires some justification by the Commission.

To date, the Commission has not provided the public with a legal analysis of the unfairness theory to support these nondisclosure rules, but in some instances, Commission staff reports containing such analyses have been publicized. They describe the interests to be balanced in assessing whether practices are unfair and also provide a useful insight into the potential development of the theory.

3. Staff Report on Prescription Drug Price Disclosures

In 1975, the staff proposed a rule,⁸⁴ based solely on the unfairness theory, to eliminate state and privately imposed restraints on prescription drug advertising and to establish a required format for discretionary advertising.

In proposing the rule, the staff rejected an “unfair method of competition” theory. It recognized that restraints on prescription drug advertising could be analogized to illegal price-fixing, but because the practices have a direct and immediate impact on consumers, the staff concluded that

⁸² 40 Fed. Reg. 39,901 (1975).

⁸³ 41 Fed. Reg. 2401 (1976). (ophthalmic devices).

⁸⁴ STAFF REPORT TO THE FEDERAL TRADE COMMISSION, PRESCRIPTION DRUG PRICE DISCLOSURES, 289 (pt. IV at 1-2) (1975) [hereinafter cited as STAFF REPORT]. The staff rejected a deception theory, although admitting that the harm to consumers in part comes from mistaken assumptions. The primary injury, however, occurs because the non-disclosures “make it extremely difficult for [consumers] to compare prices to obtain the lowest cost medications consistent with their needs (a ‘marketplace fairness’ consideration) 16
 http://idrc.org/akronlawreview/vol11/iss1/1

complete reliance on the "unfair act or practice" theory was justified.⁸⁵

The staff proposed an analysis which focused first on the myriad ways in which consumers are substantially injured by the practice of nondisclosure of drug prices. Consumers unable to make price comparisons pay millions of dollars more than are necessary for drugs.⁸⁶ The nondisclosure practices also lead to unconscionably high prices⁸⁷ and deceptions by retail sellers.⁸⁸ Furthermore, the group most adversely affected by the practices are the old, infirm, and economically disadvantaged.⁸⁹

Against this harmful effect on consumers, the staff balanced the benefits of the non-disclosure practices. The opponents of the rule forecast numerous adverse results of drug price advertising, such as increased drug abuse,⁹⁰ lowered esteem of the pharmaceutical profession,⁹¹ and a reduction in the drug monitoring of patients by pharmacists.⁹² The staff concluded that these undesirable effects would not emerge as a result of drug price advertising, or, that if minor ill effects were to occur, they would be outweighed by the benefits of the rule.⁹³

⁸⁵ It is not clear that the FTC has rulemaking powers with regard to anticompetitive practices. See note 4, *supra*. The staff recognized this difficulty and recommended proceeding against the non-disclosure practices only as "unfair acts or practices." STAFF REPORT, *supra* note 84, at 320 (pt. V at 1).

⁸⁶ STAFF REPORT, *supra* note 84, at 299-300 (pt. V at 11-12).

⁸⁷ The cost of the same drug may be as much as five times that charged by another druggist in the same community, according to the STAFF REPORT. Although unconscionable pricing was not specifically found in drug retailing, the Commission staff found the practice a realistic possibility where there is no opportunity to compare prices. *Id.* at 302 (pt. V at 14).

⁸⁸ Deceptive representations that drugs are being sold at a low price or discount are fostered by the secrecy of prices, since the claims cannot be verified by the consumer. *Id.* at 303-04 (pt. V at 15-16).

⁸⁹ The significance of the economic injury is not to be viewed only in terms of total dollar loss, but in terms of the severe impact on individuals or groups of individuals that cannot afford to absorb even a relatively small loss. *Id.* at 304-05 (pt. V at 16-17).

⁹⁰ The argument in support of this view is that the rule will lead to increased "promotional" advertising of prescription drugs, which, in turn, will lead to increased demand and improper use of drugs. The FTC staff's view is that the rules relate to the disclosure of factual items such as quantity and price of drugs for the purpose of shopping and not to the promotion of drugs. The staff thus discounts this argument, finding that there is no relationship between price disclosures and drug abuse. *Id.* at 322-70 (pt. V(B)(1), at 1-49).

⁹¹ Even if advertising drug prices would lower the status of the profession, a fact which the FTC staff would not concede, the staff concludes that any negative effects are vastly outweighed by the consumer benefits to be obtained from the rule. *Id.* at 422-32 (pt. V(B)(5), at 1-11).

⁹² According to the opponents of the rule, pharmacists monitor their customers' total drug intake to check for possible drug reactions and interactions. If customers "shop around" for the best price, this service will no longer be possible. The staff found that monitoring practices were sporadic and not very efficient in preventing adverse drug reactions, but that even if price disclosure would decrease monitoring, which conclusion was speculative at best, it should not deter Commission action in light of the benefits to accrue to customers from the regulation. *Id.* at 371-72 (pt. V(B)(2), at 1-25).

Beyond balancing these primarily economic interests of sellers and buyers, the staff analyzed the rule in terms of that elusive term, "national policy." The staff looked to numerous federal statutes which directly or indirectly encourage price competition, such as the antitrust statutes, the Truth in Lending Act and the Fair Packaging and Labeling Acts.⁹⁴ Further, they pointed to governmental rules and regulations issued by the FTC itself and by other agencies, aimed at providing further information to consumers.⁹⁵

Against this federal interest the staff balanced the state laws which run contrary to the rule. State law would take precedence over FTC rule, according to the staff, only if the state law is "vital to achieve . . . important state policy goals."⁹⁶ Since the staff found a substantial federal interest, the "state anti-advertising laws must be essentially indispensable to achieve critical state policy goals if they are to be spared preemption."⁹⁷ Since the staff concluded that the rule would not affect state goals or that alternatives to anti-advertising laws were available to achieve those goals, the federal rule should prevail.⁹⁸

This balancing of state versus federal interests is appropriate in the unfairness analysis, but, again, the analysis fails to take into account the relative importance of the factors to be balanced. For example, it is highly questionable whether the FTC should rely on its own prior non-disclosure rules to find a "public policy" favoring disclosures of material information to consumers. This bootstrap argument should carry little weight. Furthermore, the other sources of public policy, *i.e.*, general federal disclosure statutes, which might include the recent federal warranty law,⁹⁹ could be used to support any Commission disclosure rule and render the public policy consideration almost meaningless. On the other hand, federal antitrust statutes which encourage price competition, and consumer statutes, such as the Truth in Lending Law, which are specifically aimed at assuring clear price disclosures to consumers, should be weighed heavily in that they clearly enunciate national policies closely aligned with provisions of the proposed rules. The unfairness theory will be less elusive and take on more meaning if each interest and source of policy

⁹⁴ Not only did the staff list federal statutes, but it also considered statements by the President, government officials, and textbook authors as to the desirability of low prices and informed consumer choice. *Id.* at 307-08 (pt. V(A), at 19-20).

⁹⁵ *Id.* at 309-10 (pt. V(A), at 21-22).

⁹⁶ *Id.* at 316 (pt. V(A), at 28).

⁹⁷ *Id.* at 317 (pt. V(A), at 29).

⁹⁸ *Id.* at 30.

is evaluated on the basis of its relevance and relative importance to the unfairness analysis.

In addition to the three rules promoting price disclosures, two other disclosure rules have been proposed based on both a deceptive and unfairness theory. In neither instance has the Commission articulated a clear standard for its unfairness theory. The first of these rules requires that certain nutritional information be disclosed in food advertising *if* nutritional claims are made by the seller.¹⁰⁰ The second rule mandates that certain disclosures be available to purchasers of used cars.¹⁰¹

4. Nutritional Advertising Rule

While the Commission has not yet indicated whether or how it might apply the unfairness theory in this rulemaking proceeding, it did publish the staff analysis of the unfairness theory for this rule, which may be useful in forecasting its possible use by the Commission.¹⁰² The staff concluded that unfairness could be established upon a showing that nutritional information is material to consumers, and that absent this information they cannot make basic determinations about the product, such as its value and suitability for their needs.¹⁰³ This simplistic approach is reminiscent of the octane rule theory of unfairness, which was based on "speculative" or nonexistent consumer injury. If the Commission were to adopt such an approach, the unfairness doctrine could easily be applied to a myriad of products without consideration of such important factors as disclosure costs and substantiality of injury to consumers. Fortunately, the staff did not rely exclusively on this approach to unfairness but focused on two other factors: substantial consumer injury and public policy. The staff argued that the practices to be regulated by the nutritional rule are more unfair than those practices prohibited by the octane and care labeling rules in that the injury suffered is not only economic loss, but also may include an unwise food choice which affects health.¹⁰⁴ Additionally, staff argued that food is a major consumer expenditure and a necessity,¹⁰⁵

¹⁰⁰ 39 Fed. Reg. 39,842 (1974).

¹⁰¹ 41 Fed. Reg. 1089 (1976).

¹⁰² 39 Fed. Reg. 39,842 (1974). The staff urged the Commission to propose a rule which would have required nutritional information in all food advertising, not just when voluntary nutritional claims are made. Although the Commission declined to do so, it published the staff proposal and invited the public to comment upon it. *Id.* at 39,851-52.

For a description of the original staff proposals, see Schwartz, *Protecting Consumer Health and Safety: The Need for Coordinated Regulation Among Federal Agencies*, 43 GEO. WASH. L. REV. 1031, 1046 (1975).

¹⁰³ 39 Fed. Reg. 39,858 (1974).

¹⁰⁴ *Id.*

which bolsters the important consideration of whether consumer injury is substantial.

However, if "substantial" consumer injury is a prerequisite to finding a practice unfair, that term may require expansive reading if this rule is to be justified under the unfairness theory suggested by the staff. The health hazard of buying food without nutritional information does not compare to the significant health hazard addressed by the cigarette rule. Furthermore, while food is a major consumer expense, the crucial issue is the economic losses suffered due to lack of nutritional information. If the Commission retains its "substantial injury" criterion as a meaningful determinant of unfair practices, it must determine the extent and nature of consumer injury directly attributable to the challenged practice.

In analyzing national public policy favoring the rule, the staff pointed to the misbranding provisions of the Food, Drug and Cosmetic Act and the nutritional labeling regulations promulgated thereunder by the Food and Drug Administration (FDA). The staff argued that it would be unfair to dilute the impact of the FDA's labeling rule by allowing the advertising of food without nutritional information.¹⁰⁶ This argument is faulty in that it may be sensible to coordinate the FDA and FTC regulations for maximum effectiveness, but it does not necessarily follow that practices which dilute the effectiveness of the FDA's regulations are unfair to consumers. It is the policy enunciated in the Food, Drug and Cosmetic Act and the particular FDA regulations which should be relevant to the unfairness analysis.

Drawing on the unfairness analysis contained in the cigarette rule, the staff also argued that sellers of highly advertised products have a special duty to consumers when they emphasize the desirability and pleasure of their products without reference to health and nutrition.¹⁰⁷ According to the staff, food advertising has blunted public concern over nutrition and encouraged choices in food purchasing which are not healthful.

This analysis aligns the unfairness theory with the deception theory. Although consumers may not be deceived, they arguably have reached the point of not caring about certain information as a result of reliance on a wealth of favorable advertising. In one sense, this theory is more limited than the deception theory, as it is applicable only where there has been massive advertising over a long period of time sufficient to dull consumer interest in important product information. However, the theory may also have broad application, as it could be used to address an abundance of advertising practices which are not deceptive but are simply not in-

¹⁰⁶ *Id.* at 39,859.

¹⁰⁷ *Id.* at 39,858.

formative. In this respect, the unfairness theory may be developed so as to open the way for an array of affirmative disclosure rules governing heavily promoted products. To date, this theory has been included only as an alternative ground for Commission action in the cigarette rule and the proposed nutritional advertising rule. If developed as an independent basis for Commission action under the unfairness theory, however, it has far reaching ramifications for advertising in this country.

5. Used Motor Vehicle Rule

This proposed mandatory disclosure rule would require sellers of used cars to place a statement on all used cars which would indicate, *inter alia*, the nature of prior governmental or commercial use of the car, a description of any work by the dealer which may affect the performance of the car or which exceeds \$100, and the make, model and year of the car.¹⁰⁸ The regulation also sets forth specific language to be used by the seller who disclaims any implied warranty.¹⁰⁹

Unfairness to consumers may occur in used car sales, according to the Commission, from withholding "information essential to informed consumer purchase decision."¹¹⁰ Again, there is the absence of a formulated standard specifying criteria for establishing unfairness. Is informed consumer choice a sufficient determinant of unfairness, without substantial consumer injury? As cars are major consumer purchases, the losses to large numbers of individuals arising from uninformed purchases may well be substantial but, if this is important, the Commission should so indicate.

In its statement accompanying the rule, the Commission also referred to the "national policy regarding the protection of purchases of used vehicles,"¹¹¹ although it did not indicate the source of this public policy. The warranty disclaimer provisions of the rule carry out the principles underlying the new Magnuson-Moss Warranty - Federal Trade Commission Improvement Act, but provisions mandating affirmative disclosures seem to go beyond the new law, which requires disclosures only if the seller chooses to provide a warranty but does not apply to the case where the seller elects not to do so.¹¹²

Ultimately this rule may be more than a disclosure rule. A staff proposal, on which the Commission invited comment but which it did not

¹⁰⁸ 41 Fed. Reg. 1089-90 (1976).

¹⁰⁹ The Commission's language both for the statement on the car and for the sales contract specifies that no warranty is given and that the purchaser must bear the entire expense of any repairs. *Id.*

¹¹⁰ *Id.* at 1091.

¹¹¹ *Id.*

incorporate into the proposed rule, would allow an opportunity for the purchaser to obtain a pre-purchase inspection of the used car by a third person.¹¹³ This may be, of course, the most effective way in which to judge a complex product, such as a car, to avoid large losses. Particularly when the implied warranty is disclaimed, it may be desirable to know the true condition of the car "as is," but this requirement, even more than the disclosure provisions, would go beyond the public policy expressed in the new warranty law. Thus, if this provision is adopted, it is incumbent upon the Commission to define with specificity the standard of unfairness utilized to justify this far reaching regulation.

6. Rules to Protect Vulnerable Consumers

Two proposed rules based on unfairness and deception theories address selling practices aimed at vulnerable classes of consumers. The proposed rules would govern the hearing aid industry¹¹⁴ and the funeral industry.¹¹⁵

In proposing the hearing aid rule, the Commission set forth no standard of unfairness. The two factors which appeared to be important were economic injury to consumers and abusive selling practices. Economic injury may occur when consumers purchase hearing aids from which they receive no "significant benefit or additional benefit"¹¹⁶ and may be caused by a combination of circumstances. First, the nature of the product may require actual use by the buyer before its benefits to the individual can be ascertained.¹¹⁷ Second, the class of consumers, which to a great extent is comprised of the old and impoverished, is especially vulnerable to strong sales promotions; the fact that they are also hard-of-hearing compounds the problem.¹¹⁸ To remedy this problem, the rule provides that purchasers be given a thirty-day trial period of actual use of the hearing aid, within which time the buyer may cancel his purchase contract and return the hearing aid.¹¹⁹

The abusive sales practices, judging from the rule's provisions, include deception¹²⁰ and high pressure sales tactics in the buyer's home. The Commission stated that "unfairness to consumers may easily result from sales pre-

¹¹³ 41 Fed. Reg. 1091 (1976).

¹¹⁴ 40 Fed. Reg. 26,646 (1975).

¹¹⁵ 40 Fed. Reg. 39,901 (1975).

¹¹⁶ 40 Fed. Reg. 26,651 (1975).

¹¹⁷ 40 Fed. Reg. 26,647 (1975).

¹¹⁸ *Id.* at 26,651.

¹¹⁹ In contrast, the FTC rule promulgated in 1974 provides only three days in which a consumer may rescind a contract for goods or services valued at \$25 or more which is made in connection with a door-to-door sale. 16 C.F.R. § 429.1 (1974).

¹²⁰ The rule is based on a deception theory as well, and there are numerous requirements for clear disclosures and prohibitions against false claims. See 40 Fed. Reg. 26,646-50 (1975).

sentations to which consumers have had no warning and for which they are frequently unprepared."¹²¹ To remedy this problem, the rule requires that a seller obtain written consent before visiting a buyer's home or place of business.¹²²

The absence of a suggested standard by which to judge the unfairness of the marketing practices is disturbing, particularly in light of the far reaching remedial measures provided in the rule. Some of the practices fall under a traditional deception theory and need little explanation, but others do not. The Commission's lack of a legal standard leaves many questions unanswered. Is it sufficient simply to find consumer injury because the product cannot be judged adequately prior to purchase, or must widespread abusive sales practices exist in order to meet the standards of unfairness? Is the vulnerability of the consumer a significant factor in the standard, and if so, how significant? How are the various factors to be weighed or balanced against each other?

Another proposed rule that deals with vulnerable consumers is the funeral industry rule. As noted above,¹²³ that rule sets forth an unfairness standard for eliminating bans on funeral price disclosures; it also promulgates the following different standard for judging the unfairness of other funeral industry practices:

The practices . . . are unfair if they cause substantial harm (i.e., their economic and social utility to the public is substantially less than their economic and social disutility) and they result from the inequitable use of the superior bargaining position of the funeral service industry members relative to that of consumer buyers.¹²⁴

This standard thus reflects the substantial harm criterion of the price disclosure rules,¹²⁵ but it omits the national public policy criterion of those rules. The superior bargaining factor in the funeral rule was also important in the holder in due course rule¹²⁶ and the proposed credit practices rule.¹²⁷

¹²¹ *Id.* at 26,647. Since the purchaser is in his own home or place of employment, he is in a sense captive to the situation in that he cannot merely leave the premises to avoid the salesman, as he could in a store. His options are to listen to the sales pitch or take the aggressive step of asking the salesperson to leave, a choice many consumers find difficult.

¹²² *Id.* at 26,651.

¹²³ See text accompanying notes 82-83 *supra*.

¹²⁴ 40 Fed. Reg. 39,902-03 (1975). This standard is proposed to address such practices as providing unrequested services such as embalming, failing to comply with customers' requests concerning burial services, overcharging customers for services provided by third parties, such as cemetery charges, and disparaging a customer's concern for price *Id.* at 39,904.

¹²⁵ See text accompanying note 83 *supra*.

¹²⁶ See text accompanying notes 46-47 *supra*.

¹²⁷ See text accompanying note 62 *supra*.

Clearly one factor important to this rule, however, which was missing from the other rules, is the unique vulnerability of the consumers affected by the funeral industry who are largely those whose ability to make reasoned choices is almost non-existent, given time, pressures, bereaved condition of the consumer and lack of knowledge concerning funeral procedures.¹²⁸ The importance of this additional factor is not indicated, although clearly it will be relevant to the factual determination of substantial harm and the inequitable use of bargaining power.

C. *Future Regulation Under the Unfairness Doctrine*

The Commission has initiated investigations into a number of industry practices which could lead to further regulation under the broad unfairness doctrine. Several of these investigations are aimed at ascertaining the need for providing more product information to consumers, thus indicating the Commission's continued interest in increasing informed purchasing decisions. For example, the Commission has authorized its staff to investigate the life insurance industry to determine whether adequate cost information is provided to life insurance purchasers.¹²⁹ At the early investigative stage, it is impossible to know whether FTC regulatory action will be forthcoming and, if so, the legal rationale which will support the action. In keeping with its past disclosure rules, however, such as the octane and care labeling rules, the basis for rulemaking may well be, at least in part, the unfairness doctrine.

In keeping with the Commission's interest in promoting price advertising, the Commission has initiated an investigation into governmental and private restrictions on advertising price information relating to dental services.¹³⁰ This investigation includes a review of numerous practices which have traditionally been viewed as methods of unfair competition,¹³¹ but the Commission may resort instead to the unfair practices theory if it chooses to regulate the practices by trade regulation rule.¹³²

The Commission also has indicated a continued concern for especially vulnerable groups, such as the elderly and the young. It has initiated an investigation into particular activities of the proprietary nursing home in-

¹²⁸ 40 Fed. Reg. 39,904 (1975).

¹²⁹ FTC News Summary (Dec. 17, 1976) at 1. The staff had found wide variations in the cost of similar insurance policies and surmised that one reason for such disparities might be the inability of consumers to make cost comparisons due to the inadequate availability of cost information.

¹³⁰ FTC Press Release (Jan. 14, 1977).

¹³¹ The investigation will examine, *inter alia*, barriers to entry into the practice of dentistry, licensing practices and restrictions on ownership of practices. *Id.*

¹³² It is unclear whether the FTC has rulemaking authority to proscribe unfair methods of competition. See note 4 and text accompanying note 85, *supra*.

dustry, such as handling of patients' money, and contractual disclaimers for the health, safety or property of patients.¹³³ A rule governing the nursing home-patient relationship, like the funeral home or hearing aid industry rules, apparently would be based on the need for special protection for a consumer group which is especially in need of protection due to old age, ill health and lack of funds.

Finally, it appears that the Commission is taking a new look at the advertising and marketing of cigarettes.¹³⁴ The investigation now underway at the Commission is intended to determine what motivates people to smoke and to select particular brands of cigarettes.¹³⁵ Such information could well lead to recommendations to curb advertising directed toward the young, or to limit the scenarios of print advertising which imply that cigarettes are safe or that one cigarette is safer than another. The Commission in 1964 found that cigarette advertising is "exploitive" with regard to children.¹³⁶ A similar finding under current standards of unfairness is not unlikely. Exploitative practices combined with serious consumer injury to health might well be viewed as justification for further regulation of cigarette advertising under the unfairness doctrine.

III. CONCLUSION

The Commission frequently has cited *S&H* for its authority to promulgate and propose far reaching trade regulation rules based, at least in part, on the unfairness theory. The Commission, however, may overestimate the significance of *S&H* and the Court's comparison of the Commission to an equity court. *S&H* was a case involving an adjudicative proceeding in which the Commission's role is analogous to that of a court. It is not at all clear that the equity court analogy fits the Commission when it acts as a rulemaker, which is a role more akin to that of a legislature.

The difference between the roles is more than a technicality, and there are reasons why the *S&H* rationale should not be applied to the Commission's quasi-legislative role. In general, an agency's decision has a more powerful effect when it is promulgated as a rule rather than as an order; an entire industry may be subject to a Commission rule, whereas only the parties are subject to the Commission's order in an adjudicated

¹³³ FTC News Summary (Sept. 10, 1976). The investigation will also focus on deceptive practices and nursing home requirements that patients purchase drugs and services from designated suppliers. *Id.*

¹³⁴ BUS. WEEK, July 5, 1976, at 50. The Commission's subpoenas to the six major tobacco companies demand all market research for the past twelve years, thus indicating the broad scope of the investigation.

¹³⁵ *Id.*

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¹³⁶ See text accompanying note 18 *supra*.

case.¹³⁷ More specifically, the FTC has attempted, in some instances of its rulemaking, to preempt state law or create obligations formerly considered within the jurisdiction of the states.¹³⁸ Thus, the arm of this "equity court" has a longer reach than that of any traditional court.

On the other hand, rulemaking does have some advantages over case-by-case adjudication. Rules clarify what practices are proscribed and thereby give fair warning to merchants. Rules also subject the entire industry to the same standards, thus fostering even-handed regulation.¹³⁹ Consequently, from the standpoint of business, regulation by rule may be the fairest, most equitable approach to law enforcement. Other advantages are that it is a more efficient manner of regulation in terms of the agency's resources¹⁴⁰ and the fact finding is more exhaustive, particularly under newly enacted procedures.¹⁴¹

However, to proceed equitably by rule, a legal standard of unfairness must be defined prior to rulemaking in order to advise participants and those to be regulated by the rule of the standards by which the challenged practices will be judged. This was the implicit directive of the Supreme Court in *S&H*.¹⁴² Too frequently, however, the Commission has not defined the legal theory in its rulemaking proceedings. Additionally, factors which are prominent in one rulemaking proceeding, such as public policy, are ignored in another or referred to so generally that the factor is rendered meaningless.

When a standard of unfairness is set forth which varies markedly from prior formulations of unfairness, the Commission has made no effort

¹³⁷ Of course, companies which are not bound by the order recognize the precedential value of the decided case and may conform their practices to the standards enunciated in the Commission opinion.

¹³⁸ See Verkuil, *Preemption of State Law by the Federal Trade Commission*, 1976 DUKE L.J. 225, 247, for the conclusion that the Commission has the power to "preempt state activities that conflict with federal regulations."

¹³⁹ There have been numerous instances where small companies in an industry have been the target of FTC action, which has resulted in an adverse economic impact to them not shared by the larger members of the same industry engaged in the same practices. See *The Escalating Struggle Between the FTC and Business*, BUS. WEEK, Dec. 13, 1976, at 54.

¹⁴⁰ SUBCOMM. ON OVERSIGHT AND INVESTIGATIONS, HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 94th Cong. 2d Sess., REPORT ON FEDERAL REGULATION AND REGULATORY REFORM, (pt. 1, at 78) (Comm. Print 1976). The Subcommittee urged additional use of rulemaking authority in certain areas to more effectively utilize its resources. *Id.* at 83, 86. The legislative intent in the Magnuson-Moss Warranty—FTC Improvement Act also was to encourage the use of rulemaking authority. The Conference Report on the bill stated: "Because the prohibitions of section 5 of the Act are quite broad, trade regulation rules are needed to define with specificity conduct that violates the statute and to establish unlawful conduct." H.R. REP. No. 93-1606, 93d Cong., 2d Sess. 31 (1974).

¹⁴¹ For a full discussion of the rulemaking procedures now in effect, see Nelson, *The Politicization of FTC Rulemaking*, 8 CONN. L. REV. 413 (1976).

to harmonize the variations. Thus, it is unclear whether the latest standard replaces the older standard or is simply an additional standard which has been developed to fit the marketplace practices to be addressed.

This is not to suggest that a rigid definition of "unfair practices" is necessary, but to suggest that a single standard be developed and used in judging the unfairness of practices under Section 5 of the FTC Act. In this author's view, the predominant criterion in this single standard should be substantial harm, involving the balancing test the Commission has announced in several of its proposed rules, *i.e.*, that the "economic and social utility [of the practice] to the public is substantially less than its economic and social disutility."¹⁴³ This criterion gives the Commission considerable latitude but focuses on an economic and social analysis of the marketplace to determine the injurious effects of practices on consumers and businesses and the commercial justification for the practice. In its analysis, the Commission should clarify the nature of the consumer injury directly attributable to the practices. Where noneconomic injury occurs, the Commission should clarify the weight to be given that injury in balancing it against commercial justification. In examining the utility of the industry practice, the Commission should consider the economic consequences to business and consumers of altering those practices to reduce or eliminate consumer injury.

In addition, public policy should be defined and considered in every rulemaking proceeding. Evidence of policies favoring or disfavoring the rule provisions can be found in local, state and federal statutes, regulations, court decisions and a multitude of other sources. The sources of public policy, however, should be identified and their importance evaluated. Where the policy is not widespread or not closely aligned with the rule provisions, it should be weighed accordingly.

The interrelationship between the criteria of unfairness should be addressed by the Commission. Where there is scant evidence of public policy supporting the rule provision, for example, the Commission should correspondingly demand a strong showing of substantial consumer injury without commercial justification to overcome the absence of supportive public policies.

The unfairness theory can be utilized to address a wide array of marketplace practices which are not deceptive or traditionally anticompetitive and has potential as a powerful enforcement tool. At present the theory ap-

¹⁴³ This balancing test was used in proposed rules governing the advertising of prescription drug prices, ophthalmic goods, prices and funeral services. See text accompanying notes 80-83 *supra*.

pears to be undefined, and its content shifts according to which undesirable trade conditions the FTC wishes to regulate. However, the very fact that the theory is so potentially powerful means that the Commission should be restrained in its use of the theory so as to avoid the promulgation of unduly burdensome or arbitrary rules. Such restraint could be accomplished by the development and consistent utilization of a standard of unfairness which requires balancing public injury and public policy as the prime determinants of unfairness. Such a standard should yield rational and warranted consumer protection rules which enhance fair dealing and fair competition in the marketplace without being oppressive to business.