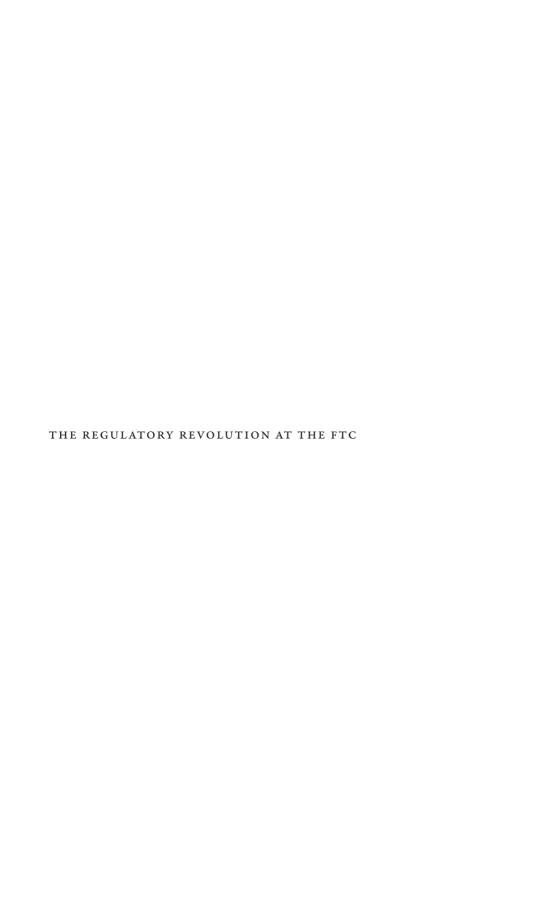
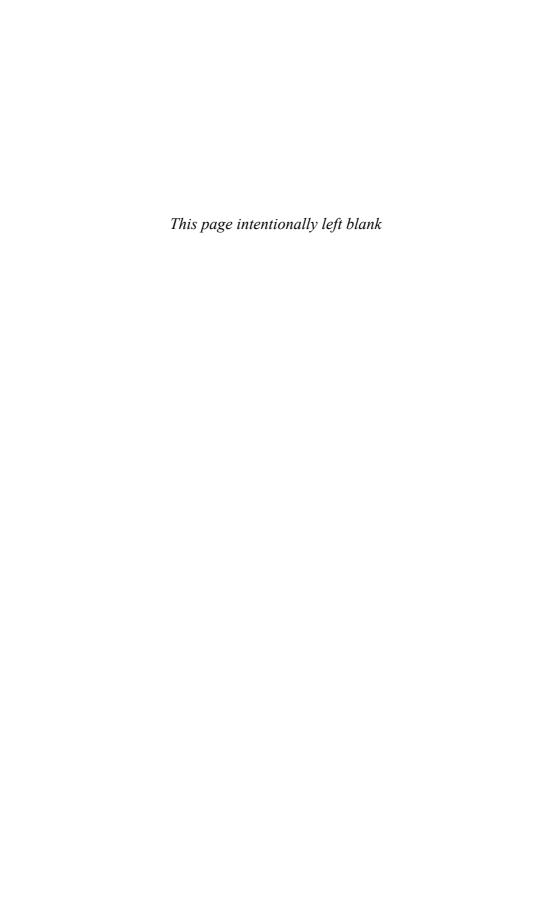
Edited by

James Campbell Cooper

# THE REGULATORY REVOLUTION AT THE FTC

A Thirty-Year Perspective on Competition and Consumer Protection





# The Regulatory Revolution at the FTC

A THIRTY-YEAR PERSPECTIVE ON COMPETITION AND CONSUMER PROTECTION

Edited by James Campbell Cooper





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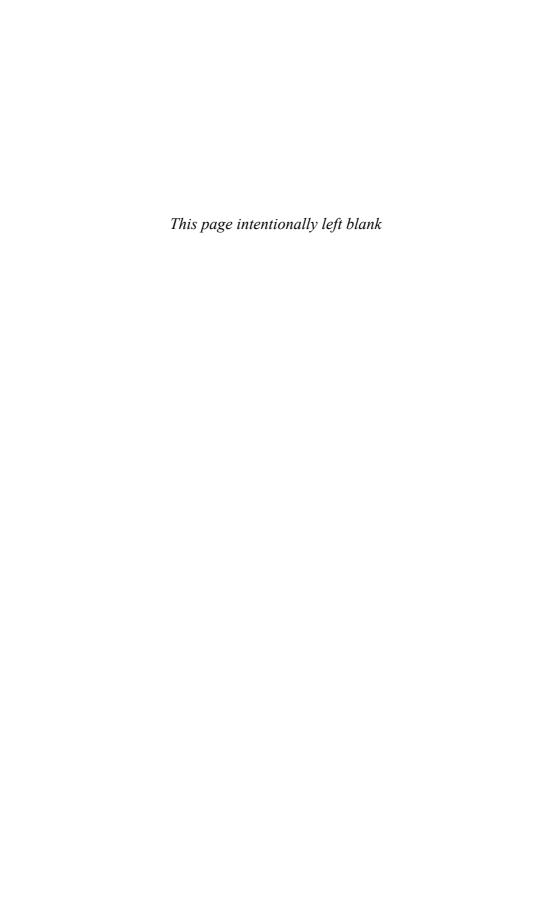
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# Foreword

James Campbell Cooper Law & Economics Center George Mason University School of Law

THIS BOOK COLLECTS papers organized around the themes discussed at the George Mason University Law and Economics Center's (LEC) conference on *Lessons since the Reagan Revolution at the FTC: A Thirty-Year Perspective on Competition and Consumer Policies.* The conference revisited what is sometimes described as the "Regulatory Revolution" (or "Reagan Revolution") at the Federal Trade Commission (FTC), which began in 1981 under the guidance of Chairman James C. Miller. Miller, the only PhD economist to serve as Chairman, revolutionized the way the FTC exercised its broad regulatory mandate by bringing economic science to the forefront of policy making considerations.

The Miller years brought a significant policy shift to an agency that had pursued such an expansive competition and consumer protection agenda that it was almost shut down. In the 1970s, armed with Magnusson-Moss rule making power and a Supreme Court blessing of its claim to broad power to condemn acts and practices as "unfair," the FTC embarked on a frenzy of industry rulemaking. Perhaps the most prominent example of this regulatory overreach was an attempt to ban advertising to children, which prompted the *Washington Post* 

<sup>&</sup>lt;sup>1</sup> In 1964, as part of its cigarette rule, the FTC articulated an extraordinarily broad definition of unfairness, which the Supreme Court appeared to ratify in FTC v. Sperry & Hutchinson Co., 405 U.S. 223 (1972). In 1975, Congress passed the Magnuson-Moss Federal Trade Commission Improvement Act, which gave the FTC authority – subject to a very stringent procedure – to promulgate industry-wide rules. *See* William MacLeod *et al.*, *Three Rules and a Constitution*, 72 Antitrust L.J. 943, 952 (2005), for a full discussion of these events. *See also* John E. Calfee, FEAR OF PERSUASION 11–15 (AGORA Press 1997).

to dubb the FTC the "National Nanny." During the same time period the FTC had used its amorphous antitrust mandate to stop "unfair methods of competition" to challenge the collective dominance of several important industries. These activist policies resulted in severe public criticism and Congressional rebuke, including legislated limitations on its power to regulate and serious calls to eliminate the FTC entirely. Accordingly, it may not be an exaggeration to say the most significant contribution of the economic revolution at the FTC was to save the Agency from extinction. This new approach – centered on economic analysis, and with consumer harm as its touchstone – resuscitated the FTC and provided the sound foundation upon which the modern Commission rests.

The unique contribution of this volume is to assemble a comprehensive treatment of the theoretical underpinnings of the Regulatory Revolution at the FTC alongside sophisticated discussions of its implications for the current and future regulatory landscape. This set of essays—from those who played leading roles in the monumental changes to the Commission in the 1980s, current and past FTC competition and consumer protection officials from the modern era, and top economists and legal scholars—offers a unique, firsthand account of the total impact of the historical changes at the agency: how they came to be, how these changes continue to affect the FTC as an agency—its policies, practices, and national perception—and the likely future path of competition and consumer protection policy in the United States. The chapters in this book are each, in their own right, significant additions to the debates over the FTC's jurisdiction, conduct, and abilities. Collectively, however, these chapters highlight a unifying theme: incorporating economic analysis into the Commission's regulatory decision-making processes is vital to its proper functioning.

Revisiting the revolution at the FTC is not merely an exercise in legal and economic history. Rather, this episode is particularly relevant today, especially with an active FTC consumer protection agenda in the fields of privacy and health claims, and a renewed enthusiasm to expand its relatively undefined anitrust authority to cover conduct that is not illegal under the Sherman Act. Since its nadir, the FTC has grown into a world-class competition and consumer protection agency, due in no small part to its use of economic analysis to guide decision-making. Those who prize the FTC should take note of concerns expressed in this volume to ensure that overreaching never threatens the Commission again.

#### The Chapters

James C. Miller, III provides the introduction to this volume, illuminating the environment that precipitated the Regulatory Revolution at the FTC and highlighting the

<sup>&</sup>lt;sup>2</sup> The FTC as National Nanny, Washington Post A-22 (Mar. 1, 1978).

<sup>&</sup>lt;sup>3</sup> See William E. Kovacic & Marc Winerman, Competition Policy and the Application of Section 5 of the Federal Trade Commission Act, 76 Antitrust L.J. 929, 943 (2010).

<sup>&</sup>lt;sup>4</sup> See id. at 943; MacLeod et al., supra note 1, at 956; William E. Kovacic, The Federal Trade Commission and Congressional Oversight of Antitrust Enforcement, 17 Tulsa L. Rev. 587, 664–67 (1982).

forces that catalyzed this paradigmatic shift in the FTC's focus and enforcement. Miller notes the theoretical underpinnings of the Regulatory Revolution have endured and continue to influence contemporary FTC policy. Furthermore, Miller observes that old questions regarding jurisdiction and judicial deference persist: the appropriateness of dual enforcement of the antitrust laws remains an open question, as does the efficiency of collegial decision making. Miller concludes that the theoretical and practical changes to FTC policy the Regulatory Revolution introduced were essential to preventing the FTC's shutdown.

The second chapter in this volume is a discussion between some who were at the FTC at the time of the Revolution. The panelists delve into the details of the Regulatory Revolution, drawing upon their personal experiences within the agency to elaborate upon both how these changes were implemented and their significance to the agency's credibility and operations. This chapter explores the political forces that spawned the social regulation of the 1970s, as well as how this larger political atmosphere influenced FTC policy and behavior. Finally, it discusses the intellectual foundation of the Regulatory Revolution.

William E. Kovacic discusses the future of the Commission's jurisdiction over both antitrust and consumer protection laws in the book's third chapter. Kovacic draws out several key issues, including the appropriate structure and status of the agency—for example, whether it should be housed within the executive branch or remain an independent agency, and headed by a single or several officers—and the ideal mix of both powers and responsibilities.

In the next chapter, Commissioner Julie Brill examines the wisdom of combining consumer protection and antitrust law enforcement in one federal agency—the FTC. She explores the pros and cons of overlapping antitrust enforcement jurisdiction in the United States at the federal and state levels, and examines some of the criticisms of housing both competition and consumer protection missions in one agency. Commissioner Brill contends that the unique experiences and background of FTC Commissioners bring greater expertise and perspective to the agency. She highlights strengths of overlapping jurisdiction that are often overlooked and discusses the value of having redundancy built into regulatory systems, concluding the operation of government regulation and enforcement should not be expected to operate in the same manner as the marketplace.

FTC Commissioner Joshua D. Wright and Angela Diveley next empirically evaluate the assertion that expert agencies generate higher-quality decisions than federal district court judges. Wright and Diveley's data suggest the Commission, in its adjudicatory antitrust decision-making role, does not perform as well as generalist judges. In light of these findings, they conclude there is little empirical basis for the various proposals to expand agency authority and increase deference to agency decisions.

In Chapter six, A. Douglas Melamed critiques Wright and Diveley's analysis and reinterprets their conclusions. He argues the litigation data Wright and Diveley analyze cannot conclusively disprove the argument that the FTC is superior. Yet, as Melamed notes, other factors reinforce the conclusions of Wright and Diveley. He also points out that the question

of superior adjudicatory skills is probably not the relevant one for those who advocate an expansive reading of Section 5 premised upon Commission expertise in competition policy. The debate about the scope of Section 5 might be best understood as being about different paradigms: antitrust as law enforcement, or antitrust as regulation.

Next, Fred S. McChesney focuses upon consumer protection at the FTC during the 1980s, claiming this was the area within which Miller achieved the most important and most durable changes in FTC thinking and practice. McChesney argues the changes at the Commission under Miller were part and parcel of a bottom-up philosophy, reflecting the larger changes in government during this time. He illustrates these points by detailing and analyzing a number of rule-making proceedings at the FTC, notably the Commission's Cooling-Off and Funeral Rules. These rules reflect the Agency overreaching that characterized the FTC of the late 1970s, attempting intimately to control various features of firm—consumer interactions. McChesney articulates how the Regulatory Revolution shifted FTC policy from this aggressive interventionist position to one more aligned with economic theory and new learning, which suggests such micro-decisions are best established by trial and error within the market, rather than by regulatory prescription.

J. Howard Beales, Timothy J. Muris, and Robert Pitofsky next examine one particular aspect of consumer protection law – advertising substantiation, Beales et al. analyze the FTC's 1972 *Pfizer* decision, which established the principle that an advertiser must possess and rely upon a "reasonable basis" to substantiate its advertising claims. They praise the flexibility of *Pfizer*, arguing this doctrine has allowed the Commission to determine on a case-by-case basis whether an advertiser's evidence is sufficient to support its claim without being constrained by overly rigorous or formalistic tests. They discuss its application to the standards developed for health-related claims about food, and present an application of this standard to dietary supplements. Finally, they express concern that several recent substantiation cases appear to have deviated from this flexibility and threaten to limit consumers' access to truthful marketplace information.

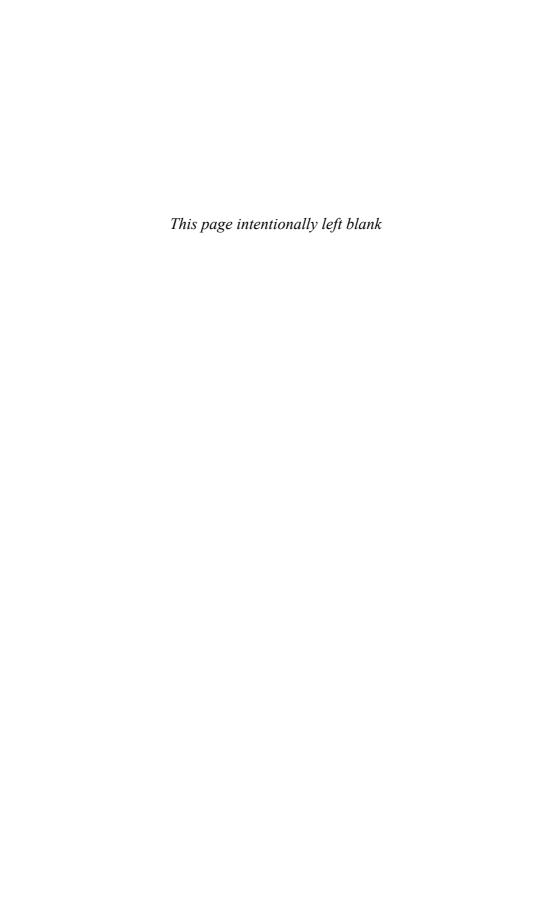
In the following chapter, Paul H. Rubin and Thomas M. Lenard compare how the current Commission is analyzing privacy with their view on how the Miller FTC would have performed the same task. Using a December 2010 FTC Staff Report as their touchstone, Rubin and Lenard fault the current FTC for not undertaking the type of regulatory analysis that the Miller FTC would have considered standard: collecting systematic data on current privacy practices; identifying consumer harm or a significant market failure; evaluating the trade-offs between more privacy and more information; and producing evidence to demonstrate the expected benefits of a proposal would exceed its expected costs.

This Part concludes with Paul A. Pautler's analysis of the complications and drawbacks of attempting to incorporate principles of behavioral economics into FTC consumer protection policy. Pautler claims that whether such decision-making foibles might lead to poor market outcomes for consumers in any particular case often depends upon context, and thus that the potential implications of behavioral economics may be more constrained than much of the current behavioral law-and-economics dialogue suggests. Pautler suggests a role for behavioral economics in explaining the FTC's Funeral and Cooling-Off rules. He also posits that the FTC's 2010 Privacy Report (and its 2012 follow-up) may have contained more cost-benefit analysis than Lenard and Rubin contend. He concludes that the FTC persists in its efforts to analyze such emerging issues and potential policy shifts, by asking the right questions.

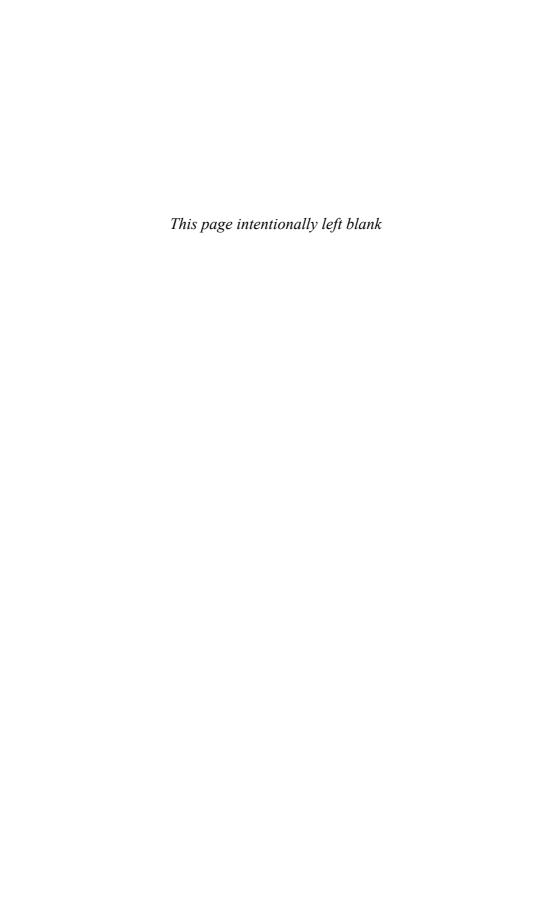
The final Part of this volume focuses upon the FTC's policies regarding, and its enforcement of, competition laws. Richard S. Higgins and Mark Perelman analyze tying and the deadweight losses associated with monopoly pricing. They address both the welfare effects and the profitability of full-requirements tying contracts designed to extract surplus in the tying-good market. Higgins and Perelman demonstrate that whether such tying should be prohibited through antitrust law enforcement depends upon the applicable competitive benchmark. The chapter further addresses the possibility of tying to monopolize the tied-good market, finding that this means of monopolization is equivalent to that of predatory pricing. Ultimately, the authors conclude that tying to monopolize is less profitable than tying solely to extract more fully the area of the demand curve in the tying-good market.

Daniel Crane next focuses on the question of Section 5 enforcement in highly innovative industries. He proposes six contexts in which judicial deference to FTC competition policy norms may be particularly justified. Crane distinguishes between sectors where innovation is persistent but relatively linear or constant, and sectors where the innovation curve is steep—where the rate of innovation is rapidly increasing at the time of the contemplated enforcement action. He suggests that the FTC should receive the most deference under Section 5 for cases involving the former class of industries. Conversely, the Commission should be tied to more traditional antitrust norms when dealing with industries in which the rate of innovation is increasing. Crane examines the pharmacy and computer industries as case studies.

The book concludes with a discussion between current and former FTC Commissioners, including three former Chairmen, about the lessons learned since the Regulatory Revolution, and how these lessons can and should inform the FTC's priorities today and into the future. The panel addresses numerous issues pertinent to the contemporary FTC, including its institutional framework, the incentives deriving from dual-enforcement of competition laws at the federal level, and the delicate endeavor of setting agency priorities in a world that is often highly critical of the Commission.







1

#### CAUSES AND IMPLICATIONS OF THE REGULATORY

#### REVOLUTION AT THE FTC

James C. Miller III

IT IS RARE in government that one sees the spontaneous coming together of women and men of such talent and resolve. Our merry band included people who were lifelong friends, people who had never met, people who were truly "outsiders," and people who were longtime employees of the agency. It was a remarkable team of people with different strengths and weaknesses, who by and large organized themselves according to the principle of comparative advantage, and who, though on occasion disagreed on tactics, always respected each other and stayed true to the shared objective. I want to thank each of you for your time at the FTC, and the country should thank you as well. Specifically, I want to thank you for your sacrifices—not that the work was drudgery, but because of your opportunity costs.

On occasion, the work was particularly difficult to endure, but it had its many rewards, including much levity. Who could forget the frequent letters we received from Bruce Yandle's cousin, commenting on the FTC's "goin's on?" And the Christmas parties, including those Commissioner videos? And Bob Tollison's abolishing the Office of Policy and Planning without telling anyone? And Carol Cawford's penetrating stare, when she would say, "are you sure you want to do this?" Or, simply "why?" Or Chris Brewster's letter, published in the *Washington Post*, written to Merry Spaethe in the voice of a Visigoth? Or Wally Snider's slow, interminable trips through the building to hastily called meetings about health-care issues when actually he was jogging from his office on 12th Street? Or welcoming Joe Califano to the "Star Chamber" during the debate over the proposed GM–Toyota joint venture? Or our running team, named by

Andy Strenio "Commission Impossible?" Or "Gyro Gearloose at the FTC?" Or one night winning a marathon contest with the "learned professions" seeking an exemption from FTC antitrust authority—with not just a little help from the Vice President and Senator Rudman!

What was our objective and what was our game plan? By and large they were the objectives and recommendations contained in the Reagan–Bush Transition Report on the FTC, in which a number of later FTC officials were an integral part. I suspect that this transition report was considered one of the Transition's best, because it was one of only two that were leaked to the press—not by the team working on it, but by the senior Transition operation. Undoubtedly, the transition team's sparkplug was Timothy J. Muris, who had a penchant for walking the halls of the FTC building during the transition and *before* the inauguration exclaiming "We're going to retry *Humphrey's Executor*!"—which made it hard for the team when we arrived!

The transition report concluded that the FTC, as an agency, had put itself in great jeopardy because of its forays into social engineering and the relative neglect of fundamental competition and consumer protection responsibilities. Later, one of our colleagues, Tom Campbell, dubbed this "Star Trek law enforcement"—to boldly go where no man or woman had dared go before. The conclusion was that we should return the FTC to its more traditional role, and to do this with greater effectiveness and at lower cost.

Generally, the transition report concluded that: (a) the FTC should acquire new leadership; (b) it should give economists a greater role in case selection and prosecution; (c) imperfections in regulation should be addressed alongside imperfections in the marketplace; (d) businesses should be given more guidance on how to avoid violating the FTC's statutes; and (e) the agency should show a greater appreciation for the efficiency of free markets versus heavy-handed regulation and recognize, as Ronald Reagan was fond of saying, that sometimes government is not the solution, but rather is the problem.

As you know, the report listed 29 specific recommendations. In three years' time, we had implemented 25 of these, had made substantial progress on two more, had plans to implement another, and had one blocked by Congress. One of my favorite results was a newspaper story heralding: "The FTC Won't Be a National Nanny Anymore."

A few antidotes stick in my mind about things we discovered and addressed at the FTC that were not covered in the transition report. When a senior career official was asked, "What do we own?," he had no idea—said he'd never been asked that question before. Bruce Yandle discovered that the Bureau of Labor Statistics' metric of the agency's productivity was the number of lawsuits it brought per employee—in contradiction of the common-sense notion that a lawsuit is an admission of regulatory failure, not success. A check into "open" cases revealed that there were thousands, the vast majority of which had been dormant for many years. The response was, "But no one being investigated has complained." Yes, and that's like expecting people to complain to the IRS

about why their audit had been put on hold. And, incredibly, we found that there was no tracking system for congressional mail and no guidelines for responses—a shortcoming remedied immediately by Wallace Tinker's weekly visit to those assigned to draft responses.

We did accomplish a lot—redirecting the agency, slowly and methodically, like changing the course of an oceangoing vessel. But we also recognized that such reforms could be undone after we left. Accordingly, we went about trying to prevent recidivism in a number of ways. We endeavored to teach the highly motivated career staff that the approach we advocated to competition and consumer protection matters was the one most efficient is serving the true interests of consumers. We highlighted our constructive engagement approach to business, in hopes that would carry the day among the agency's various constituents, including Congress.

Of course, we recognized that some of the changes we had made might rightfully be adjudged in error by future administrations of the agency. We also recognized that issues inevitably would change, demanding a refocus of the agency's attention and resources. But we were quite confident that the *principles* we espoused were correct, that they would endure, and that should the agency stray very far from them in the future, it, as well as the American people, would suffer.

But I do want to acknowledge the constructive contributions of all my former Commissioner-colleagues. We all profited from our frequent exchanges and the hard work they all exerted. Although it was difficult at times, owing to strong personalities and even more strongly held views, it was not, as Senator Jack Danforth once queried at a congressional hearing, a game of "Rollerball."

I also want to salute the Commission's senior staff and advisors to the chairman—those who guided the agency through this controversial time. Among them in the future were: (a) a law-school dean and FTC chairman; (b) a U.S. bankruptcy judge; (c) a law-school professor, business-school dean, and member of Congress; (d) a distinguished university professor and President of the Southern Economic Association; (e) an Associate Director of OMB, an Assistant Attorney General, and a Member of the International Trade Commission; (f) a director of congressional affairs at OMB, an Assistant Secretary of Treasury, and leader of a major lobbying firm; (g) an Administrator of Information and Regulatory Affairs at OMB and Chairman of the Commodities Futures Trading Commission; (h) a prolific writer and dean of the business school at a major university; (i) a distinguished private-sector attorney and Chair of the American Bar Association's Antitrust Division; (j) an Assistant to the President and founder of her own public affairs company; (k) a press secretary for the First Lady; and (l) a General Counsel of OMB, a distinguished private attorney, and a Deputy Attorney General of New York.

This conference is not so much about what the Reagan administration of the FTC did or didn't do, but what came after and why. The presentations teach that: (a) the precursors of the Reagan administration of the FTC were social regulators, generally hostile to

business; (b) the Reagan team changed this—showing, among other things, an appreciation for the "new learning" in antitrust; and (c) by and large the Reagan polices have endured over the years, even been perfected in various ways.

However, adherence to these principles by the current FTC is questionable, as there is considerable overreaching. The major problems are in consumer protection. The ad substantiation program has been tightened to the point that valuable information is being denied to consumers, and in general the staff is not following the kind of explicit or even implicit benefit—cost analysis that is key to sensible consumer protection case selection and prosecution.

The old questions about the appropriateness of dual enforcement of the antitrust laws are still around. The evidence leads to the conclusion that "cooperation" over case selection results in fewer lawsuits at higher cost—which begs the question: is this good or bad? Dual enforcement can lead to problems of inconsistency in policies and their application, thus confusing those subject to the agencies' actions. And finally, there are reasons to doubt the efficiency of collegial decision making.

The open-endedness of Section 5's "unfairness" standard is still a problem for both the agency and for those subject to its jurisdiction. Leaving too much discretion to the agency invites overreaching, and the uncertainty stifles business initiative.

The preliminary evidence is that FTC antitrust decisions (at least since the early 1980s) are less likely to be overturned on appeal than antitrust decisions by district courts. This suggests value in preserving such expertise.

This conference prompts several observations on my part. For example, mention was made of the merger guidelines that the Antitrust Division issued in the early 1980s. There was no mention, however, of the merger guidelines issued by the FTC a few days later and that guided our case selection and prosecution—including settlement negotiations.

On the question of accountability, as I have noted elsewhere, there were times when, as chairman, I despaired of having to answer to 435 members of the House, one hundred senators, and the president of the United States. On the other hand, as long as I avoided much controversy, I felt I answered to no one. This, I submit, is not good government. You shouldn't have unelected officials feeling they are not really accountable.

Of those times where I did feel oversight from Congress, the most difficult were those numerous instances when Members of Congress called to "fix" cases. On each such occasion, I refused, informing the people who called that they were welcome to provide their views, but that these would be put on the record. In some cases, the person protested, but did not get what he or she wanted. On more than one occasion, I was called by a member of the FTC staff, who had been ordered by a member of Congress "to meet with their constituent and 'settle the matter.'" In each case I ordered the official not to go and instead contacted the member myself and informed him or her of the rules. In this, I should note, Committee Chairman John Dingell was a strong ally—offering