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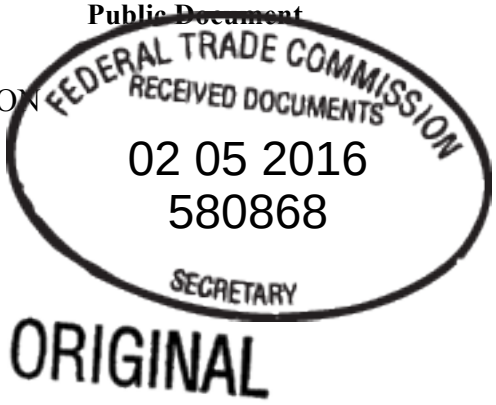

UNITED STATES FEDERAL TRADE COMMISSION

Docket No. 9357

ORIGINAL

In the Matter of

LabMD, Inc.,
a corporation.

Motion of TECHFREEDOM FOR LEAVE TO FILE AMICUS CURIAE BRIEF in support of the position of Respondent Counsel

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February 5, 2016

Pursuant to 16 C.F.R. § 3.52(j), TechFreedom respectfully moves for leave to file an *amicus curiae* brief in this matter in support of Respondent. In support of that motion, TechFreedom states as follows:

1. TechFreedom is a nonprofit, nonpartisan public policy think tank. It encourages development of "simple rules for a complex world" across a wide range of information technology policy issues, including privacy, data security, and antitrust.

2. To that end, TechFreedom has appeared in many federal court cases to advocate for permissionless innovation and policies that promote technological growth and entrepreneurship. These include: amicus brief for the Supreme Court in *Sorrell v. IMS Health* (2011), *available at* https://goo.gl/A2CDEt; amicus brief for the Supreme Court in *FCC v. Fox Television Stations, Inc.* (2011), *available at* https://goo.gl/6DKY4b; amicus brief for the D.C. Circuit in *Verizon v. FCC* (2012), *available at* https://goo.gl/dj1DqR; amicus brief for the D.C. Circuit in *POM Wonderful LLC v. FTC* (2013), *available at* https://goo.gl/ewLJxP; amicus brief for the U.S. District Court for the District of New Jersey in *FTC v. Wyndham Worldwide Corp.* (2013), *available at* http://goo.gl/4EH54G; intervenor brief for the D.C. Circuit in *US Telecom Assoc. v. FCC* (2015), *available at* http://goo.gl/2nBHDE; reply intervenor brief for the D.C. Circuit in *US Telecom Assoc. v. FCC* (2015), *available at* https://goo.gl/8Oi8M1; and amicus brief for the Sixth Circuit in *The State of Tennessee v. FCC* (2015), *available at* http://goo.gl/3rBfO9;

3. How the Federal Trade Commission — the de facto Federal *Technology* Commission — operates is central to TechFreedom's mission. Thus, TechFreedom has, with the International Center for Law & Economics, convened the FTC: Technology & Reform Project, dedicated to studying the details of the agency's operations and proposing reforms to help the agency achieve its mission of maximizing consumer welfare. *See, e.g.,* CONSUMER PROTECTION

& COMPETITION REGULATION IN A HIGH-TECH WORLD: DISCUSSING THE FUTURE OF THE FEDERAL TRADE COMMISSION (Dec. 2013), *available at* http://goo.gl/52G4nL.

4. TechFreedom believes that data security is an issue of national importance. Improper or overreaching regulation will impede technological development, harm consumers and businesses, and interfere with individual privacy and constitutional rights.

5. TechFreedom is concerned that the interpretation of Section 5 espoused by Complaint Counsel in this case will, if adopted by the Commission, lead to improvident and dangerously ineffective and arbitrary regulation that will harm consumers, erode the rule of law, and impair competition — not merely in data security but also privacy and the design of digital services.

6. Ruling against LabMD in this case would be to ignore plain statutory language and instead convert Congress's three-part test for unfairness into one of strict liability — triggered not even by a breach, but by whatever the Commission decides is too great a risk of a breach. This would be a dangerously bad public policy decision, and unlawful.

7. TechFreedom has no direct interest, financial or otherwise, in the outcome of this case. However, although TechFreedom has not reviewed the entire trial record, it has reviewed significant portions of it and followed the matter closely from the time that the complaint was filed. As a result, TechFreedom believes that this case reflects a systemic failure in the FTC's enforcement process, an unlawful overreach and abuse of power, and that dismissal is the only appropriate outcome based on the record evidence.

For the foregoing reasons, TechFreedom respectfully requests an Order for leave to file the accompanying amicus curiae brief in support of the position of Respondent Counsel.

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Respectfully submitted,

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Complaint Counsel's Appellate Brief	"CCAB"
Federal Trade Commission	"FTC" or "Commission"
Initial Decision and Order	"IDO"
LabMD, Inc.	"LabMD"
15 U.S.C. § 45	"Section 5"
Tiversa, Inc.	"Tiversa"

PRELIMINARY STATEMENT

Even Complaint Counsel concedes "[t]here is no such thing as perfect [computer] security." IDO at 82. Yet its legal arguments about the meaning of Section 5 and its burden of proof assume otherwise, that *any* exposure of personal data through less-than-perfect security is potentially a violation of Section 5 — and that the Commission should have the discretion to decide how much risk is "reasonable," rather than whether the requirements of the plain language of the statute have been met.

To illustrate the point: There is a "significant risk" that the FTC, by driving LabMD out of business, impeded the prompt, accurate, and cost-effective diagnosis of potentially deadly cancers. It is "possible" that this interference delayed timely cancer diagnosis and treatment for thousands of consumers. Delayed cancer diagnosis directly correlates with increased treatment costs and morbidity. Therefore, it is "likely" that the FTC has caused substantial injury to consumers — including death.

This argument, that it is "likely" that the FTC's destruction of LabMD caused substantial injury to patients, rests on a firm factual foundation.[1] CC's argument that LabMD's data security is "likely" to cause consumers substantial injury — or that the "significant risk" of harm is subsumed within "caused" harm, as distinct from "likely

[1] *See, e.g.,* (Daugherty, Tr. 942, 950-51, 962, 1063-65); Richards, et al., *Influence of delay on survival in patients with breast cancer: a systematic review*, LANCET 1119 (Apr. 3, 1999) (delays of 3–6 months are associated with lower survival), *available at* http://goo.gl/BXjGNh; Department of Health, *The Likely Impact of Earlier Diagnosis of Cancer on Costs and Benefits to the NHS*, at 6 (Jan. 2011) (economic modeling project concluded "cancer survival rate in England compares poorly" because patients present "when their disease is more advanced, which has an impact on the potential for successful treatment, on patient outcomes, and on resources"), *available at* https://goo.gl/q2eqDk.

caused" harm — does not, as the ALJ recognized.[2] However, as a legal matter, both conflate the "likely" with the "merely possible," and as a result, head down an absurdly slippery slope.

In truth, *any* person who stores *any* personal data *may* cause "substantial consumer injury" to *someone*. Such risk is simply inevitable. *See* Deloitte, *CFO Insights: Cybersecurity: Five Essential Truths* (2014), *available at* http://goo.gl/gfhEiw; Justin (Gus) Hurwitz, *Data Security and the FTC's UnCommon Law*, 101 IOWA L. REV. 102, 103 (2016) (citations omitted). Therefore, the critical legal question is *how much* risk of injury is enough for the Commission to begin to stake out an unfairness claim?

As the ALJ correctly decided, Section 5(n) answers this question, clearly and plainly, setting binding standards that guide and constrain the Commission's discretion. Unless an injury is both "likely" (or actual and proven) and "substantial," the Commission simply does not have unfairness jurisdiction. Because CC cannot meet this threshold test, it asks the Commission to rewrite the law and wrongly redefine the statutory term "likely" to mean "merely possible."

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[2] IDO at 8 ("the credibility and reliability" of FTC's evidence "began to unravel on May 30, 2014…"), 9 (CC "opted not to take Mr. Wallace's deposition… [and] also chose not to cross-examine…"), 14 ("At best, [CC] has proven the 'possibility' of harm, but not any 'probability' or likelihood of harm. Fundamental fairness dictates that… Section 5(n) requires proof of more than… has been submitted by the government in this case"), 83–84 (CC's "experts… failed to specify the degree of risk, or otherwise measure the probability or likelihood" of consumer harm, and based on the testimony, "Mr. Kam's opinion is not persuasive" and "Mr. Van Dyke's 'risk' opinion is even more amorphous than that of Mr. Kam… [and] like Mr. Kam, Mr. Van Dyke is not qualified to assess Respondent's data security…. the only expert… arguably qualified did not opine as to the probability or likelihood that Respondent's computer network would be breached or whether Respondent's data security practices were likely to cause any consumer harm"); 85 (there is "virtually no evidence" to support the FTC's claims of risk); 86–87.

If the Commission adopts CC's proposed construction, then *every* company would be guilty of "exposure of consumers' sensitive personal information" if the Commission decides, after the fact, that its data security was "unreasonable" because, according to CC, "an unreasonable failure to protect the information used to commit [identity theft] unquestionably causes or is likely to cause substantial injury.") CCAB at 21 n. 8. This Mobius-strip reasoning would give the Commission unbounded discretion to wield Section 5 against nearly every business in America.

The FTC has spent millions of taxpayer dollars on this case — even though there were no victims (not one has been identified in over seven years), LabMD's data security practices were already regulated by the HHS under HIPAA, and, according to the FTC's paid litigation expert, LabMD's "unreasonableness" ceased no later than 2010. During the litigation, one Commissioner recused herself due to apparent prejudgment against LabMD. Then a whistleblower testified that the FTC's staff, including lead CC, were bound up in collusion with Tiversa, a prototypical shakedown racket — resulting in a Congressional investigation and a devastating report issued by House Oversight Committee staff. Staff Report, *Tiversa, Inc.: White Knight or Hi-Tech Protection Racket?*, COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM, U.S. HOUSE OF REPRESENTATIVES, 113th Congress, at 16–18, 56–59, 62, 67 (Jan. 2, 2015), *available at* http://goo.gl/EiTmij.

This case makes sense only when viewed in the context of the FTC's campaign to create *de facto* data security regulation by imposing the same "security by design" conditions on a wide range of companies, regardless of the size or the nature of their alleged Section 5 violation. But essentially the same dynamic would play out in privacy, product design, and any other set of issues the FTC chooses to regulate across a wide range of consumer

technologies. If, in the absence of proof of actual harm, the FTC need not establish the likelihood of *future* harm, then it will have shattered the most important of the limits Congress imposed upon the Commission's discretion — to prevent over-regulation or legal uncertainty that harms consumers and corrodes the rule of law.

If the Commission overturns the IDO, then it will signal to all companies, but most especially small ones, that the FTC can declare their technology practices "unreasonable" at will and force settlements, however legally questionable they may be. The FTC will rule by fear: fear that "what happened to LabMD will happen to you, too — unless you sign here." This dystopian scenario is not merely "Kafkaesque;" it is *precisely* what Kafka describes in his parable about the dangers of arbitrary law:

> Our laws are not generally known; they are kept secret by the small group of nobles who rule us. We are convinced that these ancient laws are scrupulously administered; nevertheless it is an extremely painful thing to be ruled by laws that one does not know…. [I]f any law exists, it can only be this: The Law is whatever the nobles do.

FRANZ KAFKA, The Problem of Our Laws, in THE COMPLETE STORIES 437, 437 (Willa & Edwin Muir trans., Nahum Glazer ed., 1971).

FACTS

TechFreedom incorporates the IDO's findings of fact by reference.

ARGUMENT

I. THE ALJ CORRECTLY HELD THAT CC MUST PROVE ITS CASE BY A PREPONDERANCE OF THE EVIDENCE

CC was obligated to prove Section 5 unfairness, and all of the elements of both Section 5(n) and Section 5(a), by a preponderance of the evidence. IDO at 45 ("It is well established that the preponderance of the evidence standard governs FTC enforcement

actions.") (citations omitted); *FTC v. Wyndham Worldwide Corp.,* 799 F.3d 236, 259 (3rd Cir. 2015) (stating that the requirements of Section 5(n) are necessary rather than sufficient conditions of an unfair act or practice).

The ALJ found that CC failed to carry this burden. IDO at 59–69, 82–84. CC responds by trying to change the rules of the game.

CC claims that the IDO means "that Section 5 cannot be applied where data security failures have not yet resulted in harm that can be expressed as a precise numerical percentage." CCAB at 21. In fact, the ALJ clearly recognizes that Section 5 may cover a harms that have not yet occurred, but are likely to occur in the future – *if* CC prove its likelihood by a preponderance of the evidence. This reveals CC's fundamental confusion over what the plain language of Section 5(n) means: While Congress between harm that has already been "caused" and harm that is "likely" to be caused, CC reads "significant risk" into the first category, thus mooting the second.

CC further misunderstands the ALJ's decision when it claims that the IDO "requir[es] Complaint Counsel to present expert testimony quantifying the probability that consumers will suffer injury as a result of LabMD's data security failures." *Id.* at 6. CC argues that it need only "present 'reasonably available evidence' of the risk posed to consumers." *Id*. at 6–7.[3] In fact, the ALJ ruled that "the opinions of Complaint Counsel's

[3] CC claims the ALJ has "misapprehend[ed] *International Harvester* as requiring injury to be mathematically quantified." CCAB at 20–21. Instead, CC insists it need only "present 'reasonably available evidence' of the risk posed to consumers." *Id.* at 21. On some level, this obviously is true: the evidence of risk needed not *always* be precisely mathematically quantified to establish likelihood, just as the 1980 Unfairness Policy Statement provides that "[e]motional impact and other more subjective types of harm… will not ordinarily make a practice unfair" — but will, by implication, *sometimes* do so. Michael Pertschuk, Chairman, Fed. Trade Comm'n, et al., *FTC Policy Statement on Unfairness* (Dec. 17, 1980), *available at* https://goo.gl/TVjZI4 (codified at 15 U.S.C. § 45(n)). But this is also beside the point, for

experts, upon which Complaint Counsel relies, are insufficient because the experts failed to specify the degree of risk, or *otherwise measure the probability or likelihood* that Respondent's alleged unreasonable data security will result in a data breach and identity theft injury." IDO at 83 (emphasis added). In other words, CC creates a straw man: the ALJ did not require a "precise numerical percentage;" instead he simply required a preponderance of competent and reliable evidence — of whatever kind. He ruled:

> The only expert proffered by Complaint Counsel who is arguably qualified to assess the degree of risk posed by Respondent's computer security practices . . . was instructed to assume that identity theft harm "could occur" if consumers' personal information on LabMD's network was exposed; and that she "assumed" that such harm was likely.

IDO at 84.

Rather than explaining how it proved its case by a preponderance of the evidence in this case, CC invites the Commission to define that burden away – either by reinterpreting the statute or changing its burden of proof. Either would be unlawful. *See* IDO at 45–46 (citations omitted).

II. THE ALJ CORRECTLY CONSTRUED SECTION 5

The ALJ correctly construed Section 5's operative terms in accordance with their ordinary or natural meaning. *See* IDO at 53–56, 83–87 (citations omitted); 15 U.S.C. §§ 45(a), (n); *FTC v. Wyndham Worldwide Corp.,* 799 F.3d 236, 244-47 (3rd Cir. 2015) (discussing the plain meaning of Section 5); *see also FDIC v. Meyer,* 510 U.S. 471, 477 (1994) ("The first question, then, is whether Meyer's claim is 'cognizable' under § 1346(b). The

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it speaks to the *kind* of evidence CC must provide, not the burden of proof. Whatever the evidence, CC must still make its case by a preponderance of the evidence.

term 'cognizable' is not defined in the Act. In the absence of such a definition, we construe a statutory term in accordance with its ordinary or natural meaning").

CC, however, rejects textual fidelity and ignores controlling Supreme Court authorities. *See, e.g.,* CCAB at 11–22.[4] However, given that the FTC has claimed it may lawfully exercise its enforcement power in the guise of "administrative common law," free from the constraints of *ex ante* rules and without providing ascertainable certainty, Section 5's plain language must control. IDO at 86-87; *see also FCC v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012); *Wyndham,* 799 F.3d at 251–52.[5]

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[4] For example, CC claims "An alternative explanation for Congress's addition of the word 'likely' is that, consistent with its clear intent to codify the Unfairness Statement, Congress simply used a shorter formulation to encapsulate the lengthy test contained in the Unfairness Statement (sic)." CCAB at 16 n.5 (citation omitted). Or, put another way:

> "When I use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean — neither more nor less." "The question is," said Alice, "whether you can make words mean so many different things." *"The question is," said Humpty Dumpty, "which [of us] is to be master — that's all."*

LEWIS CARROL, THROUGH THE LOOKING-GLASS, chapter 6, p. 205 (1934) (emphasis added). A "Humpty Dumpty" construction of Section 5 — designed to avoid the limits it places on FTC's discretion, and to justify this case — will neither serve consumers nor support the rule of law. Instead, it will create massive regulatory uncertainty and undermine the Commission's authority and legitimacy.

[5] As the ALJ explained:

> It is also significant that the Commission, in rejecting Respondent's argument that the unfair conduct claim in this case violated its due process rights to fair notice of what conduct was prohibited, specifically held that "the three-part statutory standard governing whether an act or practice is 'unfair,' set forth in Section 5(n)," provided the required constitutional notice. *In the Matter of LabMD*, Inc., 2014 FTC LEXIS 2, at 46. That three-part statutory standard prohibits conduct that, inter alia, "causes or is likely to cause" substantial consumer injury. If unfair conduct liability can be premised on "unreasonable" data security alone, upon proof of a generalized, unspecified "risk" of a future data breach, without regard to the probability of its occurrence, and without proof of actual or likely substantial consumer injury, then "the three-part statutory standard governing whether an act or practice is

To begin with, Section 5's overriding statutory purpose — competition and protection of markets — is the interpretative touchstone. *Yates v. United States,* 135 S. Ct. 1074, 1081–83, 1090 (2015).[6] Section 5(a) and Section 5(n) should be applied and construed consistently, *Mkt. Co. v. Hoffman*, 101 U.S. 112, 115–16 (1879), and a common meaning construction of the operative statutory terms, including "unfairness," "causes," "likely," and "substantial injury," is proper. *Meyer*, 510 U.S. at 477.

Section 5(n) provides:

> The Commission shall have no authority . . . to declare unlawful an act or practice on the grounds that such act or practice is unfair unless *the act or practice causes or is likely to cause substantial injury* to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination.

15 U.S.C. § 45(n) (emphasis added). Thus, Section 5(n) limits the Commission's threshold unfairness jurisdiction to only those acts or practices that (1) "cause" now or are "likely to cause" in the future "substantial injury" to consumers, (2) which is not "reasonably

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> 'unfair,' set forth in Section 5(n)," would not provide the required constitutional notice of what is prohibited.

IDO at 86–87.

[6] Consequently, the "unfair" act or practice must have a generalized impact on consumers or competition because the lawful exercise of FTC's unfairness authority must be grounded in the "protection of free and fair competition in the Nation's marketplaces." *See United States v. American Bldg. Maintenance Indus.,* 422 U.S. 271, 277 (1975); 15 U.S.C. § 45; *Yates v. United States*, 135 S. Ct. 1074, 1081–83, 91 (2015) (citations omitted); *In the Matter of Int'l Harvester Co.,* 104 FTC 949, 1061 (1984) ("conduct must be harmful in its net effects" because economic issues are the FTC Act's "proper concern").

avoidable" by consumers themselves, and (3) which is not outweighed by countervailing benefits to consumers or to competition.[7]

This is the maximum outer boundary of unfairness, but it is not the end of the analysis. CC, after proving that a challenged act or practice meets the Section 5(n) test, must also prove that the act or practice in question is "unfair" under Section 5(a) — that is, marked by injustice, partiality, or deception. *Wyndham*, 799 F.3d at 244 ("Arguably, § 45(n) may not identify all of the requirements for an unfairness claim."), 257 ("The three requirements in § 45(n) may be necessary rather than sufficient conditions of an unfair practice."); *LeBlanc v. Unifund CCR Partners*, 601 F.3d 1185, 1200 (11th Cir. 2010) ("the FDCPA does not purport to define what is meant by 'unfair' or 'unconscionable.' The plain meaning of 'unfair' is 'marked by injustice, partiality, or deception'… Significantly… we noted in dictum that in the FTC context, '[a]n act or practice is deceptive or unfair … if it has the tendency or capacity to deceive.'") (citations omitted); *see also* S. Rep. No. 74-1705, at 2 (1936).

Based on the statutory text, the ALJ correctly held that it was incumbent upon CC to demonstrate "the degree of risk involved." IDO at 82.

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[7] The plain language of 15 U.S.C. § 45(n) was specifically designed to constrain the Commission's unfairness authority. *See* S. Comm. Rep. 103-130, FTC Act of 1993 (Aug. 24, 1993) ("[T]his section amends section 5 of the FTC Act to limit unlawful 'unfair acts or practices' to only those which cause or are likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or competition" and "substantial injury" is "not intended to encompass merely trivial or speculative harm"); Statement of Rep. Moorehead, Congressional Record Volume 140, Number 98 (Monday, July 25, 1994) ("Taken as a whole, these new criteria defining the unfairness standard should provide a strong bulwark against potential abuses of the unfairness standard by an overzealous FTC — a phenomenon we last observed in the late 1970s.").

> As the Commission stated in International Harvester, to suggest that there is a kind of risk that is separate from statistical risk "amounts really to no more than a conversational use of the term in the sense of 'at risk.' In this sense everyone is 'at risk' at every moment, with respect to every danger which may possibly occur. When divorced from any measure of the probability of occurrence, however, such a concept cannot lead to useable rules of liability.

Id. at 82–83 (citation omitted); *cf. Int'l Harvester*, 104 FTC at 1063 n. 52; CCAB at 20–21. Even CC implicitly acknowledges this, when it concedes "[t]here is no such thing as perfect [computer] security." IDO at 82. Yet, having done so, CC claims the discretion to decide how much security is "reasonable," without regard to the statutory requirements of Section 5 and the FTC's burden to prove each by a preponderance of the evidence.

The ALJ correctly held that CC's case was "speculation upon speculation." IDO at 85. There was no evidence of any actual consumer harm and no evidence regarding the probability of the risk of future harm. IDO at 84–86. CC's argument would not only collapse Section 5's three factor test into a strict liability standard, but set the trigger for that standard to the lowest imaginable level: not merely a breach but speculative exposure. This is utterly inconsistent with CC's lip service to the reality that "[t]here is no such thing as perfect [computer] security." IDO at 82.

Although Congress certainly did not intend for FTC to use its Section 5 authority on the basis of speculative harm, *see* S. Comm. Rep. 103-130, FTC Act of 1993 (Aug. 24, 1993) ("[S]ubstantial injury is not intended to encompass merely trivial or speculative harm"), CC argues that it need only show a *possibility* of harm because "there can be no precise calculable risk of injury." CCAB at 21. In other words, again, it asks the Commission to

construe the term "likely" in Section 5(n) to mean "merely possible."[8] *Compare* CCAB at 16 n. 5; *with* IDO at 88 ("While there may be proof of possible consumer harm, the evidence fails to demonstrate probable, *i.e.*, likely, substantial consumer injury.").

But as there is no perfect data security, and because every individual and business — especially including the federal government, whose "unreasonable" data security recently allowed the hack of 21.5 million Americans who had applied for federal jobs[9] — is at risk of a data breach, construing Section 5 as CC suggests and finding against LabMD means granting the FTC the power to investigate nearly every business in America, and the discretion to declare any of them *per se* guilty of an unfair practice simply because they store personal data — regardless of their actual security practices. The FTC need only find some paid expert to testify that a data breach is "possible," and it can ruin a company's good name or, in the cases of small businesses like LabMD, drive them out of business altogether. This cannot possibly be what Congress intended when it enacted Section 5(n) to *constrain* the FTC's unfairness discretion. If "caus[ing] consumer injury" includes *possible* injuries, Congress would not have needed to add "likely to cause" in Section 5(n). This result would

[8] Technically, CC argues that "possible" is a subset of actual harms, and thus distinct from "likely harms." CCAB at 12 ("the Unfairness Statement does not equate 'significant risk of concrete harm' as being 'likely' to cause injury; it states that 'significant risk of harm' is substantial injury in itself."); *Id.* at 14 ("there is nothing inconsistent with the statute's codification of the term 'substantial injury' to include 'significant risk of concrete harm' and its provision of additional, alternative grounds for the Commission to take action against practices that are likely to cause such injury in the future."). But this is a distinction without a difference, as its effect is the same: to render moot the "likely to cause" prong and replace it with the merely "possible," a far lower bar for the FTC.

[9] *See* Joe Davidson, *Months After Government Hack, 21.5 Million People are Finally Being Told, And Given Help*, WASH. POST (Oct. 1, 2015), *available at* https://goo.gl/BBofgh.

nullify limits placed upon the FTC's discretion, and make impossible any useable rules of liability. IDO at 85–86.

"Administrative common law" does not cure this problem as CC claims. *See* CCAB at 21 n. 8. First, Section 5 does not, as CC's Mobius-strip reasoning does, equate "unfairness" with "unreasonableness." Congress never used the word in this way, not in Section 5(a) and not in Section 5(n). "Reasonableness" appears in Section 5(n) only once: an actionable injury must be one that is "not reasonably avoidable by consumers themselves."

Second, the principle of "unreasonableness" does not, and given FTC's flawed enforcement process, cannot, limit bureaucratic discretion or provide regulated companies the ascertainable certainty and fair notice guaranteed to them by basic constitutional principles of Due Process. *See FCC v. Fox Television Stations, Inc.,* 132 S. Ct. 2307, 2317 (2012); *Wyndham,* 799 F.3d at 250; IDO at 86–87.

Third, Congress endowed the Commission with the power to issue regulations and to enforce the law. *See* 15 U.S.C. §§ 15, 57. Congress did *not* endow the FTC with the power to create "administrative common law" and thus the Commission's claimed authority to do so is nothing but an extra-Constitutional power-grab. *See generally* Hurwitz, *Data Security and the FTC's UnCommon Law,* 101 IOWA L. REV. at 102; *Michigan v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001) (explaining that a federal agency is a creature of statute and may exercise only those authorities conferred upon it by Congress).[10]

[10] The idea that an administrative agency may create "common law" on its own, rather than through litigation before Article III courts *on the merits*, is very hard to square with the Constitution's separation of powers. *See, e.g.*, *Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1213 (2014) (Thomas, J., concurring) (discussing ambit of Article III).

If the Commission overrules the IDO, then it will do violence to Section 5's plain language and Congressional intent. Twisting "likely" into "possible"[11] would ratify an opaque and standard-less enforcement process that operates solely on the government's whim and caprice, and it would send a clear and chilling signal that the Commission recognizes no rules and respects no limits.[12] This would greatly increase the *in terrorem* regulatory effect of the FTC's regulation by investigation and consent decree.

III. THE COMMISSION MUST DEFER TO THE IDO

The general rule is that a hearing examiner's fact-finding and credibility determinations will not be disturbed absent a clear abuse of discretion. *See Shering-Plough Corp. v. FTC*, 402 F.3d 1056, 1063, 69–70 (11th Cir. 2005); *In the Matter of Horizon Corp.*, Dkt. No. 9017, 97 F.T.C. 464, 1981 FTC LEXIS 47, at 130–31 (May 15, 1981); *In the Matter of Southern States Distrib. Co.*, 83 F.T.C. 1126, 1172 (1973); *accord NLRB v. Walton Mnfg. Co.*, 369 U.S. 404, 408 (1962); *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 495 (1951); *E. Eng'g & Elevator Co. v. NLRB*, 637 F.2d 191, 197 (3d Cir. 1980) ("Based on our review of the record as a whole, giving due weight to the credibility resolutions of an experienced and impartial administrative law judge, we conclude that the Board's findings are not supported

[11] *See supra* note 8.

[12] Given that Complaint Counsel introduced no competent evidence suggesting the Commission ever undertook a "cost/benefit analysis" in this case (standard-less or otherwise), it failed to comply with the other critical prong of Section 5(n). Therefore, any order against LabMD that is issued under Section 5 will violate due process, be arbitrary and capricious, and violate the Administrative Procedure Act.

by substantial evidence.").[13] CC has not demonstrated that the ALJ abused his discretion, and so the Commission should defer to his fact-finding and credibility determinations.

Additionally, to head off an Appointments Clause challenge and cure a 5 U.S.C. § 554(a) defect, the Commission appointed and ratified the ALJ to hear this case. *See* Order Denying Respondent LabMD, Inc.'s Motion to Dismiss, *In the Matter of LabMD, Inc.*, FTC Docket No. 9357 (Sept. 14, 2015), *available at* https://goo.gl/xaBPkY. Neither 15 U.S.C. § 45(b) nor the APA (5 U.S.C. §§ 554, 555, and 557) required the Commission to appoint an inferior officer to conduct a trial and issue a decision. However, having done so, neither 15 U.S.C. § 45(b) nor the APA now authorize the Commission to review, modify or overrule that decision. The ALJ, by virtue of his appointment and ratification by the Commission, exercised a portion of the judicial power of the United States. Therefore, the Commission, as an Executive Branch agency, is bound by and without the lawful authority to overrule the IDO. *See Freytag v. Comm'r*, 501 U.S. 868, 890-91 (1991); *see also Butz v. Economou*, 438 U.S. 478, 513–15 (1978).[14]

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[13] *See also In the Matter of Certified Bldg. Prods., Inc*., 83 F.T.C. 1004, 1973 FTC LEXIS 250, at 43 (1973), aff'd sub nom. *Thiret v. FTC*, 512 F.2d 176 (10th Cir. 1975). There are due process reasons for this. *Cinderella Career & Finishing Schools, Inc. v. FTC*, 425 F.2d 583, 585 & n.3 (D.C. Cir. 1970) ("While the Commissioners may arrive at a different conclusion from the examiner and may thus overturn his decision, they may not do so in conformity with the concept of due process unless they have at their disposal as full an appreciation of all of the evidence as the person whose decision they are overturning."). In this case, for example, "[o]ver 1,080 exhibits were admitted into evidence, 39 witnesses testified, either live or by deposition, and there are 1,504 pages of trial transcript." IDO at 5 n.4. The ALJ made numerous credibility and demeanor findings based on his observations. *See, e.g.,* IDO at 33, ¶ 155 (Wallace), 34, ¶ 167 (Boback). These and other findings regarding credibility, weight, reliability, and disputed facts obtain substantial weight. *In the Matter of Horizon Corp.*, 1981 FTC LEXIS 47 at 130.

[14] For example, ALJs exercise only judicial, not administrative, power. See 15 U.S.C. § 57(c)(1)(A) (providing that only the Commission, not an ALJ, may promulgate a final agency rule). Also, 5 U.S.C. § 554(d) provides that the agency "employee" who presides at the reception of evidence "shall make the recommended decision or initial decision"

IV. CONSTITUTIONAL CONCERNS

This case raises three significant constitutional concerns.

First, the FTC should not base enforcement cases on evidence obtained illegally or wrongfully, or on the fruits of such evidence, as it did here. *Knoll Assocs. v. FTC*, 397 F.2d 530, 537 (7th Cir. 1968); *see also Atlantic Richfield Co. v. FTC*, 546 F.2d 646, 651 (5th Cir. 1977); *FTC v. Page*, 378 F. Supp. 1052, 1056 (N.D. Ga. 1974) (stating that deterrence of governmental lawlessness is served by application of the exclusionary rule regardless of the criminal or administrative nature of the proceedings); Richard M. Re, *The Due Process Exclusionary Rule*, 127 HARV. L. REV. 1885 (2014) (arguing that exclusionary rule is truly a due process rule). Such conduct has a chilling and corrosive effect on regulated companies, empowers fraudsters, and undermines public faith and trust in the FTC itself.

Second, the FTC has never identified the "ascertainably certain" medical data security standards in effect during the relevant time. This violates due process. *Fox Television Stations,* 132 S. Ct. at 2317 ("[T]he due process protection against vague regulations 'does not leave [regulated parties] . . . at the mercy of *noblesse oblige*.'"); *Wyndham,* 799 F.3d at 251. As the ALJ correctly found, if "liability can be premised on 'unreasonable' data security alone, upon proof of a generalized, unspecified 'risk' of a future data breach, without regard to the probability of its occurrence, and without proof of actual or likely substantial consumer injury," this would violate due process for failure to give notice of

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required by 5 U.S.C. § 557(b). However, the ALJ was not a FTC "employee." *See* 15 U.S.C. § 42; 5 U.S.C. § 3105. Furthermore, although 5 U.S.C. § 556(b) authorizes an "administrative law judge" to preside at the taking of evidence, it authorizes only agency "employees" to issue recommended or initial decisions. Consequently, the Commission may not disturb the IDO.

prohibited conduct, IDO at 85; "[f]undamental fairness dictates that proof of likely substantial consumer injury under Section 5(n) requires proof of something more than an unspecified and hypothetical 'risk' of future harm, as has been submitted in this case . . ..", IDO at 87; and "whatever risk might be inherent in Respondent's alleged 'unreasonable' data security during the Relevant Time Period [*i.e.*, January 2005 to July 2010], *the record is devoid of expert opinion as to the degree of risk beyond that period*," (*i.e.*, for over five years). IDO at 87 n. 45. Regulated parties are entitled to know *ex ante* what conduct the FTC believes Section 5 prohibits or permits. The Constitution does not require a truffle hunt through the footnotes of Commissioners' speeches or consent decrees, as the FTC apparently believes that it does, nor does it allow such discretion as has been exercised here.

Third, this case is part of a very ample body empirical evidence demonstrating that the FTC's Section 5 enforcement process is unhealthy and biased, and therefore, constitutionally infirm.

A "fair trial in a fair tribunal is a basic requirement of due process." *In re Murchison*, 349 U.S. 133, 136 (1955). This applies to administrative agencies which adjudicate as well as to courts. *Gibson v. Berryhill,* 411 U.S. 564, 579 (1973). Not only is a biased decision-maker constitutionally unacceptable but "our system of law has always endeavored to prevent even the probability of unfairness." *In re Murchison,* 349 U.S. at 136; *Tumey v. Ohio*, 273 U.S. 510, 532 (1927). Courts use experience to determine when a given situation meets the "probability of bias" test. *Withrow v. Larkin*, 421 U.S. 35, 58 (1975).

Experience and data demonstrate that the FTC's Section 5 enforcement regime displays an unconstitutional probability of bias. To begin with, the FTC's refusal both to adhere to the plain meaning of Section 5 and to properly promulgate ascertainably certain

data security standards has the effect (and perhaps the intention) of freeing the Commission from public accountability, principled decision-making, and clear limits on its power. *See Envtl. Def. Fund, Inc. v. Ruckelshaus*, 439 F.2d 584, 598 (D.C. Cir. 1971). Judicial review after the fact can correct only the most egregious abuses, *id.*, and, without clear standards to constrain the FTC's discretion, administrative process all too easily becomes punishment itself. The data demonstrate that, once the Commission voted out the Complaint against LabMD, the eventual finding that it violated Section 5 was a statistical certainty. *See* Joshua Wright, *Recalibrating Section 5: A Response to the CPI Symposium*, CPI ANTITRUST CHRONICLE, at 4 (Nov. 2013), *available at* https://goo.gl/1pXcrb.[15]

> [I]n 100 percent of cases where the administrative law judge ruled in favor of the FTC staff, the Commission affirmed liability; and in 100 percent of the cases in which the administrative law judge ruled found no liability, the Commission reversed. ***This is a strong sign of an unhealthy and biased institutional process***. … Even bank robbery prosecutions have less predictable outcomes than administrative adjudication at the FTC.

[15]As Malcolm M. Feeley demonstrated in his classic study, THE PROCESS IS THE PUNISHMENT: HANDLING CASES IN A LOWER CRIMINAL COURT (2d ed., 1992) , pretrial process is the primary form of punishment, the ultimate adjudication and sentencing are essentially irrelevant, and the costs associated with being an enforcement target drives substantive outcomes. Wright's FTC scholarship validates Feeley's theory: the FTC's targets "typically prefer to settle Section 5 claims rather than go through lengthy and costly administrative litigation in which they are both shooting at a moving target and may have the chips stacked against them." *See The FTC at 100: Where Do We Go From Here?: Hearing Before the Subcomm. on Commerce, Manufacturing, and Trade of the H. Comm. on Energy and Commerce*, at 3 (Dec. 3, 2013) (statement of Joshua D. Wright, Commissioner, Federal Trade Commission), *available at* https://goo.gl/ccAUS3.

See Joshua Wright, *Section 5 Revisited: Time for the FTC to Define the Scope of Its Unfair Methods of Competition Authority*, at 6 (Feb. 26, 2015) (emphasis added), *available at* https://goo.gl/hCiqBI.[16]

Furthermore, the "combination of investigative and adjudicative functions [in the Commission] necessarily creates an unconstitutional risk of bias in administrative adjudication…." *Withrow*, 421 U.S. at 47. Here, lead Complaint Counsel also directed the investigation against LabMD and worked closely with Tiversa. This proves that "conferring investigative and adjudicative powers on the same individuals [in the Commission] poses such a risk of actual bias or prejudgment that the practice must be forbidden if the guarantee of due process is to be adequately implemented." *Id.*

Plainly, the FTC's "unhealthy and biased institutional process" means the probability of unfairness is unconstitutionally high. *See Withrow*, 421 U.S. at 58; *see also Cinderella Career & Finishing Schools, Inc. v. FTC*, 425 F.2d 583, 590–91 (D.C. Cir. 1970). For the FTC to effectively regulate data security, and to truly promote consumer welfare — the mantle it claims — it must in the first instance regulate, enforce, and adjudicate fairly and transparently. The government cannot do its job if its enforcement process is tainted and its adjudications viewed as a "rigged game" in which the outcome is predetermined. Even if LabMD prevails, the facts of this case, backed by decades of empirical data, illustrate that systematic reform is needed to ensure the FTC's data security and enforcement are fair, prudent, and effective. *See, e.g.,* IDO at 6–8; Wright, *Section 5 Revisited*, *supra*; Staff Report,

[16] *See also LabMD, Inc. v. FTC*, No. 1:14-cv-00810-WSD, 2014 U.S. Dist. LEXIS 65090, at 16 n.6 (N.D. Ga. May 12, 2014) ("The Court believes that the likelihood of a favorable jurisdictional or merits outcome for LabMD [before the Commission] is slight….").

Tiversa, Inc., supra, at 16–18, 56–59, 62, 67 (Jan. 2, 2015); FTC: TECHNOLOGY & REFORM PROJECT, CONSUMER PROTECTION & COMPETITION REGULATION IN A HIGH-TECH WORLD: DISCUSSING THE FUTURE OF THE FEDERAL TRADE COMMISSION (2013), *available at* http://goo.gl/52G4nL.

But if the Commission overrules the ALJ on this law and on this record, then it will be clear that the due process it offers respondents is only an illusion.

CONCLUSION

For these reasons, TechFreedom respectfully requests that the Commission affirm the IDO.

Respectfully submitted,

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February 5, 2016

CERTIFICATE OF SERVICE

I hereby certify that on February 5, 2016, I caused the foregoing document to be filed electronically through the Office of the Secretary's E-filing system, which will send notification of such filing to:

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Pursuant to 16 C.F.R. § 3.52, this brief complies with the type-volume limitation of 16 C.F.R. § 3.52(j), because the brief contains 6,112 words, excluding the parts of the brief exempted by 16 C.F.R. § 3.52(k). This brief has been prepared in a proportionally spaced typeface using Microsoft Word in Calisto MT 12-point font.

/s/ Berin M. Szoka
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Notice of Electronic Service

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