Prepared Statement of
the Federal Trade Commission

Before the

Subcommittee on Commerce, Trade, and Consumer Protection
Committee on Energy and Commerce
United States House of Representatives

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I. Introduction

Mr. Chairman, I am Ted Cruz, Director of the Office of Policy Planning of the Federal Trade Commission.(1) I am pleased to appear before the Subcommittee today to testify on behalf of the Commission regarding possible "State Impediments to E-commerce." The Commission thanks the Subcommittee for addressing this important issue, which may have a significant impact on our nation's economy and on the growth of e-commerce. In particular, the Commission would like to thank Chairman Stearns for his leadership in this area, and for his foresight in addressing an issue that is critical to the future growth of e-commerce.

The Internet boom, heralded by many as the next industrial revolution, is transforming society before our eyes. Even with recent economic downturns, it has immense potential as an engine for commerce. Moreover, the Internet also offers consumers enormous freedom. There are, of course, important policy disputes about taxation and privacy legislation. But, aside from those disputes, many think of the Internet as a virtually unfettered free market, a place spawning creativity and innovation and self-expression.

Some observers have suggested, however, that this perception of unfettered competition may not be completely accurate. Instead, these observers assert that existing businesses are seeking to use government authority to impede new entrants from competing. In a number of instances, and in a number of states, pre-existing regulatory regimes have been extended to the Internet, and it bears examining whether particular regimes are pro-competitive and pro-consumer, or whether they eliminate cost savings or convenience without sufficient benefits to justify those losses.

II. FTC Efforts to Foster Online Competition

In response to these concerns, in August 2001, the Federal Trade Commission formed an Internet Task Force to evaluate regulations and business practices that could potentially impede e-commerce. The Task Force grew out of the already-formed State Action Task Force, which had been analyzing the antitrust doctrine concerning state regulations generally, and out of the FTC's longstanding interest in the competition aspects of e-commerce.

Over the past year, the Task Force has met with numerous industry participants and observers, including e-retailers, trade associations, and leading scholars, and has reviewed the relevant literature.(2) The Task Force has been examining state regulations, often enacted for purposes unrelated to competition, that may have the effect of aiding existing bricks-and-mortar businesses at the expense of new Internet competitors. Of course, these regulations may be justified by consumer protection interests or other sound public policy. The Task Force also is considering whether and to what extent private companies may be curtailing e-commerce by employing potentially anticompetitive tactics, such as by collectively pressuring suppliers or dealers to limit sales over the Internet.

To further these efforts, and the important inquiry of the Subcommittee today, in October the FTC will host a public workshop that will focus on two types of possible barriers to e-commerce. One type consists of business conduct barriers that may arise when private parties employ potentially anticompetitive tactics, such as when suppliers or dealers apply collective pressure to limit online sales. The other type consists of state and local regulations, such as occupational licensing and physical office requirements, that may have pro-consumer and pro-competition goals, but that nevertheless may restrict the entry of new Internet competitors or hamper their operations.

The workshop will take place at the FTC from October 8-10, 2002, and will include consumer advocates, industry representatives offering a variety of perspectives, academics, and state government representatives. The FTC is actively seeking perspectives and data from both supporters and critics of these possible restrictions, to understand better their full impact. We have four principal goals for the workshop: (1) to enhance the FTC's understanding of these issues, (2) to help educate policymakers about the effects on competition and consumers of restrictive state regulation, (3) to help educate private entities about the types of business practices that may or may not be viewed as problematic, and (4) to learn of additional avenues to promote competition through e-commerce.[(3)]

III. Online Competition in Different Industries

Each of the industries to be addressed at the FTC workshop has enormous potential for providing goods and services to consumers over the Internet and may be beginning to face significant barriers to expansion. A review of several of the industries follows.

A. Retailing

E-commerce retail sales continue to expand rapidly. For example, in the second quarter of 2002, retail e-commerce sales increased 24.2 percent, up to $10.2 billion, from the second quarter of 2001.[(4)] In contrast, all retail sales for the second quarter increased only 2.5 percent from the second quarter of 2001.[(5)]

Nonetheless, in some instances we have seen attempts to limit e-retailing through conduct that raises antitrust issues. For example, in the late 1990s, a group of 25 Chrysler dealers in the Northwest threatened to refuse to sell certain Chrysler models, and to limit warranty service, unless Chrysler limited its supply of cars to an Internet seller. In 1998, the FTC filed an administrative complaint against the dealers.[(6)] The complaint alleged that the dealers had formed an association - Fair Allocation System, Inc. ("FAS") - for the purpose of restricting the number of vehicles available to competing dealers marketing, and offering lower prices, over the Internet. The matter was settled by a consent order which prohibited FAS from participating in, facilitating, or threatening any boycott of, or concerted refusal to deal with, any automobile manufacturer or consumer.[(7)]

Additionally, other reports - some published and some anecdotal - suggest that some distributors may have applied pressure to discourage their suppliers from selling online directly to consumers.[(8)] We intend to examine whether, and in what circumstances, this conduct may raise antitrust issues, or may address legitimate concerns about free riding and channel conflict. We hope to develop a better understanding of the conduct, and reasons for or against limiting retail sales over the Internet.

B. Contact Lenses

Competition has increased dramatically in the eye care marketplace since the 1970s. The most recent step in the evolution of this market is the development of stand-alone sellers of replacement contact lenses. Such firms do not fabricate lenses or fit them to the eye; they sell only replacement lenses for which the customer has already been fitted by an eye care professional. Unlike other eyewear sellers, their business consists simply of shipping to customers lenses that come from the manufacturer in sealed boxes labeled with the relevant specifications. Most of these businesses are located in a single state but ship orders to customers nationwide.

On one hand, some studies suggest that such sellers may be able to provide consumers with substantial cost savings and with greater convenience from delivering lenses to the consumer's door. These factors may also induce consumers to replace their lenses more often, which could have significant ocular health benefits.

On the other hand, some observers believe that online sales of contact lenses may threaten consumer health. For example, online purchases may reduce the number of times that a consumer visits an eye doctor. Some also suggest that state licensing and an in-state presence is necessary to allow a state to regulate effectively in order to maintain quality and truthfulness. Some states have enacted requirements that significantly restrict competition from online lens providers. In other states, regulatory boards are currently considering new requirements that might similarly restrict Internet sales.

In March 2002, the FTC filed a staff comment before the Connecticut Board of Examiners for Opticians, which is currently considering whether to require stand-alone sellers of replacement contacts to obtain Connecticut optician and optical establishment licenses. Working with the Connecticut Attorney General's Office, the FTC staff comment argued that such a requirement "would likely increase consumer costs while producing no offsetting health benefits," and that such a requirement in fact "could harm public health by raising the cost of replacement contact lenses, inducing consumers to replace the lenses less frequently than doctors recommend."[(9)]

C. Real Estate / Mortgages / Financial Services

Consumers can now receive many professional and financial services online. Through the Internet, consumers can get advice from real estate agents, finance a house, or buy stocks through a broker. In addition to convenience, online real estate, mortgage, and financial companies have the potential to offer lower rates because, without a bricks-and-mortar infrastructure, they may have lower costs.

A number of states have adopted regulations that may affect the provision of these services by online, out-of-state firms. In several states, companies must maintain an in-state office as a condition for licensing if the company makes, brokers, or services residential mortgage loans. Many other states require online mortgage brokers to get in-state licenses. Many of these regulations are designed to protect consumers from unscrupulous practices, and may indeed prove substantially beneficial to consumers. They may also, however, have the secondary effect of insulating local businesses from wider competition, or of allowing only national mortgage firms that already have physical offices in all states to sell online in all states.

The Commission and the Department of Justice have expressed concerns regarding one type of state regulation of these services. The agencies jointly filed comments opposing proposals in both North Carolina and Rhode Island to require attorneys to be physically present for all real estate closings and refinancings. These regulations could seriously impede online mortgage lenders, who often rely on lay closers rather than on attorneys with a physical presence in the state. In letters to the North Carolina State Bar and the Rhode Island Legislature, we argued in favor of consumer choice, citing empirical evidence showing that non-lawyer closings can save consumers significant amounts of money, sometimes up to $400 per transaction, and can increase convenience for consumers, because non-lawyers often are more willing to travel and meet consumers after work.[(10)]

D. Casket Sales

Because mark-ups on caskets can be significant, online casket purchases can potentially save consumers substantial sums of money. Additionally, online casket sellers also may be able to offer consumers a greater variety of choices, such as individualized caskets. Some states, however, require that casket purchases be made only through a licensed funeral director at a funeral home.

On September 5, 2002, the Commission filed an amicus brief in federal district court in the matter of *Powers v. Harris*,[(11)] in which an Internet-based casket seller challenged a state law that requires all sellers of funeral goods to be licensed funeral directors. The Commission's brief stated that the FTC's Funeral Rule was adopted, in part, to open casket sales to competition from sellers other than funeral directors and that the Rule protects consumers by promoting competition among providers of funeral goods, including independent online casket retailers.[(12)]

E. Automobiles

Automobiles represent one of the biggest investments for many households, both in terms of their purchase price and their importance to a family's daily life. A group of Yale economists have concluded that consumers who use Internet purchase referral services to buy a car pay on average 2% less than consumers who do not.[(13)] Moreover, the Consumer Federation of America ("CFA") projects that if the restrictions currently imposed on Internet auto sales were removed, savings of 10% per vehicle are achievable over time.[(14)] At today's prices, CFA estimates that this would amount to savings of $2,500 per car.[(15)] Yet another study has concluded that expanded online auto purchases would especially benefit women and minorities.[(16)]

On the other hand, many dealers argue that they have legitimate reasons for concern about manufacturer Internet sales. The National Automotive Dealers Association argues that franchise laws protect consumers against unscrupulous manufacturers.[(17)] Dealers also argue that Internet sales unfairly undermine their businesses by letting online sellers "free ride" off the dealers' personal services. Further examination of these concerns would be valuable. Currently, all 50 states prohibit manufacturers and online sellers without a franchise presence from selling new cars directly to consumers.

F. Wine Sales

Wine is a good example of how the Internet can permit fundamentally different business models to flourish. Through the Internet, many smaller vineyards, with limited distribution networks, can now market their wines to consumers around the country.[(18)] Consumers also can potentially save money by buying online, avoiding markups by wholesalers and retailers.[(19)]

On the other hand, many states limit or prohibit direct wine sales over the Internet. Under the common "three tier" distribution system, many states require that wine pass through a wholesaler or a retailer before reaching the consumer. These states, and many commentators, contend that the distribution system furthers the state's interest in taxation, advances the Twenty-First Amendment's important public policy goal of temperance, and helps prevent alcohol sales to minors.

Lawsuits are pending in at least seven states regarding the direct shipment of wine. In Texas,[(20)] North Carolina,[(21)] and Virginia,[(22)] federal district courts recently struck down state restrictions on direct shipment of wine on dormant Commerce Clause grounds, while in Florida[(23)] and Michigan,[(24)] federal district courts upheld such restrictions. All these decisions currently are on appeal. In New York[(25)] and Washington state,[(26)] lawsuits are pending in federal district courts.

IV. Additional Industries

At the public workshop, the Commission will also be examining other industries that may raise similar issues. Those industries include the following:

- Healthcare, Pharmaceuticals, and Telemedicine;
- Cyber-Charter Schools;
- Auctions; and
- Online Legal Services.

The Commission expects to learn more about the existence of and relative costs and benefits of any restraints on online competition in these industries.

V. Conclusion

Thank you for this opportunity to share our views on competition and Internet commerce. We look forward to working with the public and with the Subcommittee in understanding these issues and in helping to give consumers the full benefits of online commerce.

Endnotes:

1. The views expressed in this statement represent the views of the Commission. My oral statement and responses to questions you may have are my own and do not necessarily reflect those of the Commission or any individual Commissioner.

2. In particular, the Progressive Policy Institute wrote two comprehensive reports analyzing the trend toward potentially anticompetitive efforts to restrict e-commerce. *See* Robert Atkinson, *The Revenge of the Disintermediated* (Jan. 2001) (first report of the Progressive Policy Institute) ("First PPI Report"); Robert Atkinson and Thomas Wilhelm, *The Best States for E-Commerce* (Mar. 2002) (second report of the Progressive Policy Institute) ("Second PPI Report").

3. *See* 67 Fed. Reg. 48,472 (2002). More information about the workshop is available at the homepage for the workshop, http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm.

4. United States Department of Commerce News, 2nd quarter 2002 release, Aug. 22, 2002, available at http://www.census.gov/mrts/www/current.html.

5. *Id.*

6. *See* Complaint in *Fair Allocation System*, No. C-3832 (1998), available at http://www.ftc.gov/os/1998/9810/9710065cmp.htm.

7. *See* Consent Order in *Fair Allocation System*, No. C-3832 (1998), available at http://www.ftc.gov/os/1998/9810/9710065.do.htm.

8. *E.g.*, Doug Bartholomew, *E-Commerce Bullies*, industryweek.com, Sept. 4, 2000, at 51. *See also* First PPI Report at 14 (noting that, in a survey of 42 retail and manufacturing companies, 74 percent of the manufacturers reported that they do not sell online due to worries about how it might affect their other retail channels).

9. FTC Staff Comment Before the Connecticut Board of Examiners for Opticians (Mar. 27, 2002) available at http://www.ftc.gov/be/v020007.htm. This comment expresses the views of the Bureau of Consumer Protection and the Office of Policy Planning of the Federal Trade Commission. The comment does not necessarily represent the views of the Commission or of any individual Commissioner. The Commission did, however, vote to authorize the Office of Policy Planning and the Bureau of Consumer Protection to submit the comment.

10. FTC/DOJ Letter to the Ethics Committee of the North Carolina State Bar re: State Bar Opinions Restricting Involvement of Non-Attorneys in Real Estate Closings and Refinancing Transactions (Dec. 14, 2001) available at http://www.ftc.gov/be/V020006.htm; Second FTC/DOJ Letter to the Ethics Committee of the North Carolina State Bar (June 11, 2001) available at http://www.ftc.gov/os/2002/07/non-attorneyinvolvment.pdf;

FTC/DOJ Letter to the Rhode Island House of Representatives re: Bill Restricting Competition from Non-Attorneys in Real Estate Closing Activities (Mar. 29, 2002) available at http://www.ftc.gov/be/v020013.pdf.

11. *Powers v. Harris,* No. Civ. 01-445-F (W.D. Okla. filed Mar. 14, 2001).

12. FTC Amicus Brief in *Powers v. Harris* (August 29, 2002) available at http://www.ftc.gov/os/2002/09/okamicus.pdf.

13. Fiona Scott Morton, Florian Zettelmeyer, and Jorge Silva-Risso, *Internet Car Retailing*, 49 J. Indus. Econ. 501, 502 (2001).

14. Mark Cooper, *A Roadblock on the Information Superhighway: Anticompetitive Restrictions on Automotive Markets* 38 (Feb. 2002) *available at* <http://www.consumerfed.org/internetautosales.pdf>.

15. *Id.* at 37.

16. Fiona Scott Morton, Florian Zettelmeyer, and Jorge Silva-Risso, *Consumer Information and Price Discrimination: Does the Internet Affect the Pricing of New Cars to Women and Minorities?* (Oct. 2001) *available at* <http://www.yale.edu/law/leo/papers/scottmorton.pdf>.

17. First PPI Report at 7.

18. *See*, *e.g.*, Second PPI Report at 21.

19. *Id*.

20. *Dickerson v. Bailey*, 212 F.Supp.2d 673 (S.D. Tex. 2002).

21. *Beskind v. Easley*, 197 F.Supp.2d 464 (W.D. N.C. 2002).

22. *Bolick v. Roberts*, 199 F.Supp.2d 397 (E.D. Va. 2002).

23. *Bainbridge v. Bush*, 148 F.Supp.2d 1306 (M.D. Fl. 2001).

24. *Heald v. Engler*, 00-CV-71438-DT (E.D. Mich. Sept. 28, 2001) (unpublished).

25. *See Swedenburg v. Kelly*, 2000 WL 1264285 (S.D. N.Y. Sept. 5, 2000).

26. *See Mast v. Long*, No. CS-01-00298 (E.D. Wash.).