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SELF REGULATION AND ANTITRUST

Prepared Remarks of

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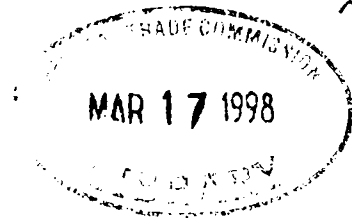

The views expressed are those of Chairman Pitofsky, and do not necessarily reflect those of the Commission or other Commissioners.

Legitimate and fair self-regulation will become more important as the economy grows faster than government regulation. Today I want to share with you some thoughts about the role of self-regulation and how current self-regulatory efforts assist the Federal Trade Commission in meeting its statutory mandate of preventing unfair or deceptive acts and practices. I will then discuss an increasingly common question posed by firms engaging in self-regulatory efforts: Are antitrust and self-regulation at odds? My answer is that antitrust only rarely limits opportunities for genuine self-regulation.

My discussion of this theme will touch on several points familiar to antitrust lawyers. Self-regulation often improves competition by creating or disseminating truthful information, valued by consumers. Associations can implement an enforcement regime in many circumstances without significantly increasing antitrust risks. The use of clear and fair procedures can help prevent abuses of the self-regulation process. On the other hand, self-regulation can provide a dangerous opportunity for rivals, often out of public sight, to damage rivals that they fear they cannot defeat in the marketplace. The courts and the enforcement authorities will not recognize as legitimate "self-regulation" efforts designed to exclude innovative rivals, or to enforce a naked agreement to restrict competition.

My central theme is that while self-regulation programs must be monitored carefully because of their anticompetitive potential, rigid, exaggerated or outdated interpretations of antitrust should not be allowed to block legitimate and well-intended self-regulation efforts.

The Benefits of Self-Regulation

The public and private benefits of industry self-regulation are many. First, self-regulatory groups may establish product standards that often assure safety. The private standards "industry," with groups such as the American National Standards Institute (ANSI) and the American Society of Mechanical Engineers (ASME), promulgates tens of thousands of voluntary standards to promote safety or quality. In turn these standards may facilitate the emergence of markets by establishing minimum levels of product quality, and improving consumers' understanding and trust of new products.

Standard setting also can lower the cost of production. For example, a standard can be established to assist manufacturers in producing interconnecting or interchangeable parts. Especially in high-tech industries, standards assure a manufacturer that if its product conforms, the product will interconnect with complementary or rival products of similar

specifications.

Industry self-regulation also helps consumers evaluate products and services by providing information about the qualities and characteristics of the seller's products. As then- Circuit Judge Breyer explained, the promulgation of standards "provid[es] information to makers and to buyers less expensively and more effectively than without the standard."[(1)] Testing organizations that grade products, such as Underwriters' Laboratories or Consumer Reports, can provide these benefits.

An industry group may engage in self-regulation to enhance its reputation for fair and honest service by establishing ethical standards and disciplining those who do not abide by the standards. Professional associations, for example, often exclude unqualified applicants to assure the public that practitioners possess a minimum level of competence and to protect the associations' reputations as well.

Self-regulation often may deter conduct that would be universally considered undesirable, but that the civil or criminal law does not prohibit. For example, cheating in sporting contests may not violate the law because the improper conduct is not considered sufficiently serious or because no injured party is likely to appear to bring suit. As a result, industry self-regulation may provide the only meaningful deterrent to would-be cross checkers and bean ball artists.

From a public policy perspective, self-regulation can offer several advantages over government regulation or legislation.

It often is more prompt, flexible, and effective than government regulation. Self-regulation can bring the accumulated judgment and experience of an industry to bear on issues that are sometimes difficult for the government to define with bright line rules. Finally, government resources are limited and unlikely to grow in the future. Thus, many government agencies, like the FTC, have sought to leverage their limited resources by promoting and encouraging self-regulation.

Of course, self-regulation can be anticompetitive. Competitors may use the self-regulatory process to disadvantage new rivals or new forms of competition. When that happens, enforcement must be forceful and firm. As the Supreme Court has observed in connection with standard setting:

There is no doubt that the members of [private standard-setting] associations often have economic incentives to restrain competition and that the product standards set by such associations have a serious potential for anticompetitive harm. Agreement on a product standard is, after all, implicitly an agreement not to manufacture, distribute, or purchase certain types of products. Accordingly, private standard-setting associations have traditionally been objects of antitrust scrutiny.[(2)]

And of course, government regulation has advantages of its own, such as the increased chance that a point of view other than the industry's will be considered in developing and applying the standards.

The FTC and Self-Regulation

At the FTC we frequently address self-regulation issues, from both competition and consumer protection perspectives. In our competition role, we seek to prevent self-regulatory restraints that harm the competitive process by denying consumers the full range of choices, or by preventing new forms of competition from emerging. We also play a role in counseling self-regulatory organizations on how they can regulate without raising significant antitrust concerns. In our consumer protection role we work with industry groups to develop sound self-regulatory initiatives, thereby avoiding unnecessary

government regulations. But we are also there to prevent self-regulation that goes too far and unnecessarily restricts competition in the market.

Competition

Let me provide just two examples of our approach to competition and self-regulation. The first involves health care and illustrates a kind of self-regulation that went too far. Until the late 1970s, most physicians practiced solo, fee-for-service medicine. There were few alternative arrangements. There was almost no advertising by health care providers. A significant impediment to the growth of competitive alternatives was the AMA's ethical standards. These self-imposed standards prohibited physicians from engaging in various forms of advertising, providing services to patients under a salaried contract with a "lay" hospital or HMO, "underbidding" for a contract or agreeing to accept compensation that was "inadequate" compared to the "usual" fees in the community, and entering into arrangements whereby patients were supposedly denied a "reasonable" degree of choice among physicians.

In 1979, the Commission held that all of these restraints violated the antitrust laws.(3) Since that time, the Commission has brought a number of enforcement actions to ensure that self-regulation does not harm the emergence of new forms of competition in health care. As important, the Commission has issued several advisory opinions to guide associations such as the AMA in their self-regulation efforts.(4)

A more recent example involves the efforts of the Direct Marketing Association (DMA) to enable consumers to restrict their receipt of unsolicited direct mail or telephone direct marketing, by providing a system that allows consumers to place their names on nonsolicitation lists. DMA submitted a proposal to the FTC that in essence would require member firms not to engage in mail or telephone solicitation of consumers on the nonsolicitation lists. In addition, DMA proposed to require each member to notify consumers of its information practices (for example, that the member sometimes sells its customer list to other firms) and to allow consumers to prevent the sale or other disclosure of their name, address, or other information.

In an advisory opinion, the FTC staff noted that the requirement that DMA members not engage in direct mail or telemarketing solicitation of consumers who request such treatment could be considered a direct restriction on solicitation. The staff suggested that this requirement was not vulnerable on antitrust grounds because it would restrict solicitation only of consumers who affirmatively communicated that they do not want the information that direct marketers would otherwise seek to provide. The restraint did not limit any information consumers desired. From another point of view, the restriction improved the information available to consumers, and gave consumers new choices. Member firms will now disclose their marketing practices to consumers permitting them to opt out. This option was previously unavailable to consumers, and was unlikely to become available absent government or self-regulation. Similar efforts to provide truthful information to consumers and to expand consumers' choices are likely to be found legal, as they would advance the purposes of the antitrust and the consumer protection laws.

Consumer Protection

We have recognized for over a generation that self- regulation can serve as an important complement to our consumer protection enforcement efforts. Often the Commission will supplement self-regulation by providing review of the regulator's final decisions under the laws we enforce.

On several occasions, I have described the advertising industry's self-regulatory program as an effective model. Created in 1971 when the National Advertising Review Council was formed, the National Advertising Division(NAD) expeditiously investigates complaints

against advertisers brought by consumers and other advertisers. An advertiser who disagrees with the NAD's conclusion may appeal it to the National Advertising Review Board(NARB), which includes members from inside and outside the advertising industry.

Compliance with the NAD/NARB process is voluntary. Remarkably, over 3500 cases have been handled since 1971, and in the clear majority of cases, the challenged advertising has been discontinued or modified voluntarily. When an advertiser refuses to abide by an NAD decision, this matter is often referred to the Commission. We take referrals seriously but engage in our own investigation and review of the issues under Section 5 of the FTC Act.(5) Where appropriate the Commission takes enforcement action.

Another aspect of this self-regulatory system is striking: NAD and NARB decisions are made public. This enhances the credibility of the program and of course provides valuable information to consumers.

Antitrust Risks of Self-Regulation

We frequently hear concerns expressed that the antitrust laws pose obstacles to self-regulation efforts. Some who raise this criticism may refer to several older antitrust cases that might appear to condemn or restrict self-regulation with very broad language. I think those cases, properly understood, do not pose a significant obstacle to legitimate self-regulation.

Justice Black's opinion in Fashion Originators' Guild of America v. FTC can be interpreted as severely restricting the ability of firms to engage in self-regulation.(6) The defendants were makers of "designer" women's fashions, and through their trade association, agreed to boycott any retail outlet that carried imitation designs produced by so-called "style pirates." The Supreme Court condemned the concerted refusal to deal as an illegal group boycott. The defendants' purpose, namely the suppression of style piracy, was not adequate to justify such highly anticompetitive conduct. The Court described the association as an "extra-governmental agency . . . that provides extra-judicial tribunals for determination and punishment of violations, and thus trenches upon the power of the national legislature and violates the statute."(7)

Although Fashion Originators probably would be decided the same way today, I doubt Justice Black's sweeping language about extra-governmental alliances would or should apply with equal force.

Justice Black's broad language should not be read as establishing a government "monopoly" on regulation in the public interest. The presence of government regulation on a given subject does not necessarily "preempt" private efforts to advance similar goals. For example, if the government declares deceptive advertising illegal, a group of advertisers might still take steps, such as the establishment of reasonable guidelines, to prevent specific types of misleading ads.

Of course, self-regulators should not rely on the fact that they appear to be enforcing the law as providing a grant of antitrust immunity. The self-regulators may misinterpret the statute or engage in over-enforcement. As the Supreme Court said in Indiana Federation of Dentists, "[t]hat a particular practice may be unlawful is not, in itself, a sufficient justification for collusion among competitors to prevent it . . . . Anticompetitive collusion among private actors, even when its goal is consistent with state policy, acquires antitrust immunity only when it is actively supervised by the State."(8)

Another case often viewed as posing risks for self-regulation is United States v. National Ass'n of Broadcasters.(9) That case involved a Justice Department challenge to several provisions of the NAB Code that appeared to restrict the amount of television advertising.

In particular, the court held that the multiple product rule, which prevented advertisers from advertising more than one product in a 30-second commercial, was per se illegal since it had the necessary effect of increasing the demand for and price of commercial time.

NAB should not be understood to restrict the ability of broadcasters or advertisers to enter into reasonable agreements. Many other provisions of the NAB code were not challenged.(10) The multiple product rule raised competitive concerns because it was imposed by a group of rival broadcasters and had the effect of artificially increasing the demand for commercial time. Other restrictions, without a similarly clear anticompetitive impact, should survive antitrust scrutiny.

I think an important element of NAB is that, without regard to any potential laudatory goal, the restrictions clearly served the economic interests of the broadcasters. Where this economic self-interest is absent, self-regulation is less likely to raise significant competitive concern. For example, in 1994 the Justice Department approved voluntary television violence guidelines by the Association of Independent Television Stations, which included a series of parental advisories to be used for programs with violent material. In a letter to the association, the department observed that these guidelines "are not intended to, nor can we predict that they would have the effect of, significantly decreasing competition among broadcasters, cable operators or other television media, among program producers, or among advertisers. . . ." Moreover, the guidelines could have substantial procompetitive effects by "disseminat[ing] valuable information on program content to both advertisers and television viewers. Accurate information can enhance the demand for, and increase the output of, the industry's products."(11)

Finally, some have cited the Supreme Court's decision in National Society of Professional Engineers v. United States,(12) which can be interpreted to rule out consideration of non-economic goals such as health and safety considerations in a rule of reason analysis, as a threat to industry self-regulation. In that case, the association attempted to justify a ban on competitive bidding by claiming that competitive bidding would lead to "deceptively low bids, and would thereby tempt individual engineers to do inferior work with consequent risk to public safety and health."(13)

At least part of the purported "self-regulators'" problem in Professional Engineers was that the Court did not believe the best way to ensure safe construction was to agree to ban competitive bidding. As Professor Areeda pointed out, if the Court really believed that competitive bidding would cause buildings to fall down on the heads of occupants, it might have written a somewhat different opinion.(14) More to the point, enforcement agencies have demonstrated in their case selection and advisory opinions that they are not in the business of challenging legitimate and well-intentioned self-regulation because it purports to serve a goal that cannot be strictly interpreted as "economic." We should continue to be skeptical about purported non-economic defenses -- they can often be the last refuge of parties who have little else to say in defense of their behavior -- but absolute refusal to take all such considerations into account seems to me to go too far.

Antitrust Analysis of Self Regulation

Voluntary guidelines

I hope I have assuaged any suspicions that the antitrust laws pose insurmountable impediments to well-meaning self-regulation. Let me now offer some suggestions about how self-regulation can avoid undue antitrust risk.

The courts generally evaluate industry self-regulation under the rule of reason. One factor in determining whether standards will be approved under the antitrust laws is whether those standards are "voluntary." In a 1971 advisory opinion, the FTC took the position that

"all standards must be voluntary,"(15) but the Commission is not likely to take such an absolute position today. Case law and advisory opinions from the FTC and the Antitrust Division, however, suggest that there is virtually no antitrust risk when parties to a self-regulatory regime simply announce general guidelines that ought to apply, or announce such standards and refer departures to enforcement agencies like the FTC, but do not agree to adhere, directly or indirectly, to these standards.

What if an association informs the public about those members who fail to comply with the "voluntary" program?

Does that make the program coercive rather than voluntary? Assuming fair process (which I will discuss below) I don't think it should. Although providing information about firms that do not comply would appear to provide a powerful incentive to comply, such a program may be procompetitive. First, the association has supplied consumers with valuable and accurate information that consumers might not be able to gather on their own. Second, the incentive to adhere is not created by the association, but by the preferences of informed consumers. As the Fifth Circuit put it in the context of standard setting, "a trade association that evaluates products and issues opinions, without constraining others to follow its recommendations, does not per se violate [the Sherman Act] when, for whatever reason, it fails to evaluate a product favorably to the manufacturer."(16) That is, the choice whether to buy the product or not remains with the consumer.

Enforcement of Self-regulation

There is increasing demand for forms of self-regulation that include some level of enforcement. As self-regulation plays an increasingly important role, the desire to permit self-regulators to back up their regulation with enforcement seems to be legitimate. Purely voluntary regimes may not be effective in protecting consumers or fulfilling the other goals of self-regulation. Although the Supreme Court has observed that "[c]oncerted efforts to enforce (rather than just agree upon) private product standards face more rigorous antitrust scrutiny,"(17) that does not mean that associations can or should refrain from implementing an enforcement program.

Adverse Competitive Effects

One critical factor is whether there is any competitive effect from the self-regulatory effort. Self-regulation may affect the competitive process by excluding or competitively disadvantaging a competitor or group of competitors. The question is whether this exclusion is competitively significant.

The focus on adverse competitive effects of industry self-regulation is suggested by the Supreme Court's opinion in Northwest Wholesale Stationers. There the Court declined to apply the per se rule to the expulsion of a stationer from a buying cooperative. The decision holds that the per se rule is not applicable unless the plaintiff provides "some showing . . . that the cooperative possesses market power or unique access to a business element necessary for effective competition."(18) Since Northwest Wholesale Stationers, many courts have focused on the adverse competitive effects from self-regulation, or the lack thereof, in determining whether there is an antitrust violation.

Perhaps the most common antitrust claims in this area involve challenges by competitors who fail to meet an association's standards for certification. These claims almost invariably fail, especially where the firm is still able to compete in the market without the certification.(19)

In other cases, there may be no significant restraint of competition. For example, suppose a group of beer companies decided to enact a code not to advertise on college campuses. The

minimum drinking age currently is 21 in all states, making a large percentage of the college audience too young, by state law, to purchase and consume alcoholic beverages legally, and there is widespread support from consumer groups for some restrictions. Would such an agreement be struck down as an antitrust violation? Critical to finding a violation would be evidence to suggest that the code would likely have an anticompetitive effect. Here that effect is not clear because sales to much of the target audience would be illegal. Competition for illegal sales is not the type of competition the antitrust laws were intended to protect. Nor is it clear how restrictions on campus advertising would adversely affect legal sales, since beer companies would retain many other avenues of advertising to attract the audience of legal buyers. Since the restriction is unlikely to have an anticompetitive effect on legal sales, it could pass antitrust scrutiny assuming there was no evidence of anticompetitive intent.

Let me caution that in focusing on competitive effects, some might suggest the use of simple safe harbors based on the market shares of the group of firms engaging in the self-regulatory effort. Such an approach will not always provide useful guidance. An association may possess a significant degree of market power indirectly through the incorporation of its standards into law by various jurisdictions. Moreover, proof of actual detrimental effects on the market and on competition may be an alternative to a detailed inquiry into market power and market share.(20) For example, the enforcement of a joint standard may in certain circumstances foreclose a competitor from selling to consumers, limiting the choice of alternative products to the consumer.(21)

Clear, Fair Procedures

The process by which groups engage in industry self- regulation can affect antitrust concerns. Thus, as the Supreme Court has instructed, where standards are "based on the merits of objective expert judgments and [are adopted] through procedures that prevent the standard-setting process from being biased by members with economic interests in stifling product competition," participants in the standard-setting process may not be liable for any possible exclusionary effect of the standard.(22) Cases in which liability has been found have invariably involved serious abuses of process, such as the packing of a standard-setting committee with numerous representatives of a single company,(23) the use of a standard-setting organization's official imprimatur by a competitor to label a rival's product unsafe,(24) or the application of nonobjective criteria by competitors to exclude a horizontal rival.(25)

Prior to the Supreme Court's opinion in Northwest Wholesale Stationers, the absence of appropriate procedures was deemed by many courts to be sufficient to condemn a self-regulatory program. Although Northwest Wholesale Stationers instructs that the issue of process is not dispositive, courts continue to examine whether clear, fair procedures have been afforded to evaluate the reasonableness of a restraint.

Clear and fair process for mandatory self-regulation has several valuable benefits. First, procedural safeguards will often evidence the legitimate purpose of the self-regulatory activity and the organization's commitment to the regulatory goals. Second, providing for a hearing will provide an antitrust tribunal with a record, allowing it to perform its review function more effectively. Third, procedural requirements will encourage the regulatory organization to act in good faith and within its mandate by requiring the presentation of valid reasons for any potentially anticompetitive activity before the act is done. Fourth, procedural requirements may prevent litigation by requiring interaction between the parties that can lead to resolution short of litigation. Fifth, records of past self-regulatory efforts may provide evidence of the reasonableness of a present act or asserted motivation. Finally, a hearing may prevent a simple mistake of fact or impression from resulting in potentially harmful self-regulatory activities by the group.

The procedural safeguards need not be elaborate, expensive, or time-consuming. The group should at least demonstrate a reasonable link between its self-regulatory activity and a policy underlying the need for self-regulatory power. Meanwhile, the prospective excluded party should have an opportunity to dissuade the group from taking the planned action by refuting the justifications advanced by the group. Thus, the requirement of fair process may serve a valuable role in protecting the competitive process when self-regulatory power is exercised.

Where Mandatory Self-Regulation Raises Competitive Concerns

Self-regulation creates competitive concerns in the limited group of cases in which rivals are foreclosed from the market without justification. For example, in Allied Tube, an association that published a voluntary code of standards for electrical equipment was considering standards for electrical conduit, a hollow tubing that is used to carry electrical wires through walls and floors. Although this code was voluntary, it was highly influential in the market and had also been incorporated into safety codes of local governments. The code traditionally required the use of steel conduit in high-rise buildings, but a new entrant had devised plastic conduit, which it claimed was cheaper to install, more pliable, and less susceptible to short circuiting than steel.

The incumbent steel conduit manufacturers agreed to exclude the new entrant's product from the standards code by dispatching to the association's annual meeting new members whose only function would be to vote against plastic conduit. Together they sent 230 persons to the meeting to vote against the plastic pipe.[(26)] With this large contingent on their side, the steel interests prevailed by a vote of 394 to 390 in defeating the proposal to recognize plastic conduit in the code of standards. As a result, the entrant's ability to market the plastic conduit was significantly impaired.

As the Allied case indicates, the self-regulation process may enable producers to exclude from the market the products of entrants that threaten to take market share from the incumbents. In response to the competitive threat of product innovation, incumbent producers may respond by engaging in self-regulation such as promulgating standards that exclude the innovators' products from the market, rather than by improving their own products. Attempts to impede competition on the merits, and without strong justification, is a kind of "self-regulation" that cannot be tolerated.

Conclusion

I hope my remarks have provided some guidance on the importance of self-regulation and how antitrust enforcers analyze the competitive impact of these arrangements. Particularly in the last few years, the antitrust enforcement agencies have shown increasing willingness to provide useful guidance and have approved a wide variety of self-regulatory endeavors. I expect that will continue as self-regulation becomes an even more important means of improving the operation of our expanding economy.

Endnotes:

1. See Clamp-All Corp. v. Cast Iron Soil Pipe Institute, 851 F.2d 478, 487 (1st Cir. 1988), cert. denied, 488 U.S. 1007 (1989).

2. Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492, 500-01 (1988).

3. American Medical Ass'n, 94 F.T.C. 701 (1979), aff'd as modified, 638 F.2d 443 (2d Cir. 1980), aff'd per curiam by an equally divided Court, 455 U.S. 676 (1982).

4. FTC Letter to Kirk B. Johnson, AMA, Feb. 14, 1994; American Academy of Ophthalmology, 101 F.T.C. 1018 (1983).

5. Also, the fact that an advertiser has been through the NAD process and changed its advertising as a result

is no guarantee that the Commission will not investigate.

6. Fashion Originators' Guild of Am. v. FTC, 312 U.S. 457 (1941).

7. Id. at 465(internal citation omitted).

8. FTC v. Indiana Federation of Dentists, 476 U.S. 447, 465 (1986).

9. 536 F. Supp. 149 (D.D.C. 1982), consent entered, United States v. National Ass'n of Broadcasters, 553 F. Supp. 621 (D.D.C. 1982).

10. For example, the Justice Department did not challenge certain NAB restrictions on liquor or cigarette advertising and advertising aimed at children. The cigarette and children advertising restrictions had earlier survived private antitrust challenges. See American Fed'n of Television & Radio Artists v. NAB, 407 F. Supp. 900 (S.D.N.Y. 1976) (restriction on advertising by hosts of children's programs); American Brands, Inc. v. NAB, 308 F. Supp. 1166 (D.D.C. 1969) (cigarette advertising).

11. Justice Department Letter to the Association of Independent Television Stations, Jan. 25, 1994.

12. 435 U.S. 679 (1978).

13. Id. at 693 (footnote omitted).

14. Areeda, 7 Antitrust Law 381-83 (1986).

15. Legality of a Proposed Standard Certification Program, 78 F.T.C. 1628, 1630 (1971).

16. Consolidated Metal Products, Inc. v. American Petroleum Institute, 846 F.2d 284, 292 (5th Cir. 1988).

17. Allied Tube, 486 U.S. at 501 n.6 (emphasis in original).

18. Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 298 (1984).

19. See Sanjuan v. American Board of Psychiatry and Neurology, Inc., 40 F.3d 247, 251 (7th Cir. 1994) (no antitrust violation from Board's refusal to certify psychiatrists because "plaintiffs already are sellers in the market for psychiatric services; turning down their application for certification does not remove their output from the market and therefore does not raise prices to consumers."); Schachar v. American Academy of Ophthalmology, Inc., 870 F.2d 397 (7th Cir. 1989).

20. The Supreme Court has explicitly stated that substantial market power is not always required to find liability under section 1 of the Sherman Act. FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 429-31 (1990); Indiana Fed'n of Dentists, 476 U.S. at 460-61.

21. See Wilk v. American Medical Ass'n, 895 F.2d 352 (7th Cir.) (rule prohibiting physicians from referring patients to chiropractors had an actual adverse effect on consumer choice), cert. denied, 496 U.S. 927 (1990).

22. Allied Tube, 486 U.S. at 501.

23. Id.

24. American Society of Mechanical Engineers v. Hydrolevel Corp., 456 U.S. 556 (1982).

25. Radiant Burners, Inc. v. Peoples Gas Light & Coke Co., 364 U.S. 656 (1961).

26. 486 U.S. at 497.