Federal Trade Commission

ANTITRUST IMPLICATIONS IN STANDARD SETTING

Prepared remarks of
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[1] The views expressed are those of the Commissioner and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner or staff.

Thank you for the opportunity to speak with you today. I intend to address a topic of increasing importance in our technology dependent and communications oriented world: standard setting within industries, standards with which competitors comply and, hopefully, exceed.

Standard setting benefits consumers in three fundamental ways:

- First, it increases price competition, because standard technologies and products can be more readily compared and contrasted by consumers;
- Second, standard setting can increase compatibility, allowing new vendors to compete in peripheral products and service markets related to the underlying standard technology; and
- Third, standard setting can increase the use of a particular technology, giving the installed base enhanced economic and functional value to the extent that it is compatible with a large network of applications.

A standard may be simply a technical specification for certain minimum features, such as how a toilet flushes. Or it may be a more complex requirement specifying, for example, the protocol for compressing information and transmitting data from one computer to another in a way that makes the sending and receiving of the data comprehensible to the users on both ends.

Viewed in this way, standard setting is essentially pro-competitive because it gives consumers a baseline to compare increasingly complex items and allows competitors to produce compatible goods.

Standard setting may also have noncompetitive aspects. For example, standard setting can thwart innovation, lead to consumer confusion, and entrench an older standard when a newer, better, or more widely accepted technology is available. Many in this room experienced hesitation and reluctance when, for example, Beta videocassette recorders vigorously competed with VHS; when eight-tracks battled for market share with cassette tapes; or when vinyl finally gave way to compact discs.

The development of a new standard renders, to some extent, the exemplars of the old standard obsolete, resulting in a sometimes costly reinvestment in new equipment. As a result, standard setting can temporarily limit the availability of products that consumers may desire or require, raising the costs of those products.

Standard setting can also provide a forum for collusion as competitors work together and share sensitive information to set the standard. For example, a competitor or group of competitors may attempt to preclude the use or acceptance of another's product or may unfairly exclude a competitor from the standard-setting organization. Such conduct may amount to a boycott or a concerted refusal to deal.[2]

Antitrust enforcers generally uphold standard setting, finding that the consumer benefits of safety and ease of comparison outweigh potential non-competitive harm. But this approval is

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[2] *See, e.g., Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1960) (where association members refused to provide gas to competing gas burners not approved by the association).

not automatic: antitrust claims based on standard setting are evaluated under the rule of reason; that is, the anticompetitive effects of the standard setting must outweigh any legitimate business justification for it.[3] Under the rule of reason, the focus is whether the challenged conduct will substantially restrain competition in a relevant market. If the activity will substantially affect competition, then we must consider whether the activity has a legitimate purpose and is reasonably related to that purpose.

When evaluating antitrust risk associated with standard setting several factors must be examined. Before any standard setting can be considered to have an anticompetitive effect, it must be shown that imposition of the standard could restrain trade or competition. If compliance with a standard is not critical to marketplace acceptance of a product or if there are viable alternative avenues to compliance with the standard, then the standard in question cannot effectively restrain competition. Moreover, a standard is unlikely to produce significant anticompetitive effects in the absence of market influence to exclude nonconforming products.[4] For example, the Court in *Clamp-All Corp.* held that certain segments of the steel pipe market could compete without adhering to special standards. Similarly, in *Consolidated Metals* the court found that no antitrust violation existed, relying upon the fact that certification of compliance with

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[3] *Clamp-All Corp. v. Cast Iron Soil Pipe Institute*, 851 F.2d 478 (1st Cir. 1988), *cert. denied*, 109 S. Ct. 789 (1989); *Consolidated Metal Products, Inc. v. American Petroleum Institute*, 846 F.2d 284 (5th Cir. 1988); *M & H Tire Co. v. Hoosier Racing Tire Corp.*, 733 F.2d 973, 980 (1st Cir. 1984).

[4] *See Northwest Wholesale Stationers, Inc. v. Pacific Stationary and Printing Co.*, 472 U.S. 284, 296 (1985).

the standard was valuable merely for prestige—the institute's standards were not adopted by any governmental entity and certification was not a government or consumer prerequisite for sales.

However, when an item that may meet performance and safety standards is denied certification, the restraint on trade is clear. Consider, for example, *Allied Tube & Conduit Corp. v. Indian Head, Inc.*,[5] where the Supreme Court noted that the National Electrical Code published by the National Fire Protection Association is the

> most influential electrical code in the nation. A substantial number of state and local governments routinely adopt the Code into law with little or no change; private certification laboratories, such as Underwriters Laboratories, normally will not list and label an electrical product that does not meet Code standards; many underwriters will refuse to insure structures that are not built in conformity with the Code; and many electrical inspectors, contractors, and distributors will not use a product that falls outside the code.

When the imposition of a standard might restrain or prohibit market access, the fairness of the standard setting procedure and the procedural safeguards extended to interested parties will be evaluated to determine whether an antitrust violation has occurred. The the criteria on which the standard is based, who makes the decisions regarding promulgation of the standard, the notice given to interested parties, notice of the actual decision, and the interested parties' opportunity to be heard will be considered. Neutral decision makers and decisions based on expert opinions generally receive more weight than the arguments made by those who perceive an adverse economic consequence.

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[5] 108 S. Ct. 1931, 1934 (1988).

In *Allied Tube*, the Court found antitrust liability in a flawed standard setting procedure. In that case, the makers of steel conduits packed the annual meeting of the National Fire Protection Agency with many new members, "[f]ew . . .[of whom] had any of the technical documentation necessary to follow the meeting", whose sole purpose was to vote against approval of polyvinyl chloride conduits. Standard setting also ran afoul of the law in *American Society of Mechanical Engineers v. Hydrolevel Corp.*[6] There, a firm used its dominant position within the standard setting body to thwart the sale of a competitor's product by claiming that the competitor's product was unsafe and did not comply with the standard. The Supreme Court went on to hold that the standard setting body itself could be found liable for its failure to employ safeguards sufficient to avoid such anticompetitive activity.[7]

As *Allied Tube* and *Hydrolevel* illustrate, the standard-setting process may be used by producers to exclude innovative potential market entrants who threaten to take market share from the dominant producers.

Antitrust enforcers also evaluate whether the standards accomplish their compatibility or health and safety goals in the least restrictive fashion. Voluntary standards are preferred. The strictest antitrust scrutiny is reserved for standard-setting processes in which participants agree not only to incorporate the standard into their own products, but also to enforce the standard and

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[6] 456 U.S. 556 (1982)

[7] The Supreme Court's decision in *Hydrolevel* dealt with the association's liability for the actions of the official who acted on the association's behalf, and did not address the competitive analysis of standard-setting.

not deal with nonconforming producers. Thus, as the Supreme Court wrote in *Allied Tube*, "[c]oncerted efforts to *enforce* (rather than just agree upon) private product standards face more rigorous antitrust scrutiny."[8] Similarly, performance standards are less likely than design standards to be interpreted subjectively or subverted for an anticompetitive gain because detailed design standards that go beyond the compatibility requirements may impede innovation and design improvement. And, of course, "minimum" rather than "maximum" standards, will more likely encourage innovation, attempts to surpass the standard, and attempts to compete.

At times the federal government is called in to prod the standard setting organization when it fails to adequately respond to legitimate requests from its members to certify compliance with a standard. For example, in *American Society of Sanitary Engineering*,[9] the Commission challenged the Society's refusal to approve a new toilet tank fill valve, the Fillpro valve, developed by J.H. Industries, which had a number of performance advantages over the existing technology. J.H. Industries asked the Society to revise its standard or write a new standard to permit certification of its design. The Society refused, in spite of documentary evidence provided by the applicant. The Commission alleged that the refusal to approve the new valve was due to J.H. Industries patent on Fillpro, not because Fillpro did not meet the relevant performance standards. One way of interpreting the Society's actions is that the existing manufacturers did not sanction an innovative product unless they could also produce it. The settlement prohibits the Association from imposing unjustified product restrictions in the future.

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[8] *Allied Tube*, 486 U.S. at 501 n.6 (emphasis in original).

[9] *American Society of Sanitary Engineering*, 106 F.T.C. 324 (1985).

American Society of Sanitary Engineering is important in speaking to efforts by older technology producers to use standards to deter the entry or raise the costs of entry of the new technology.

A case currently under investigation at the Commission is illustrative of this potential problem. As part of its participation in setting certain technological standards, a competitor certified to the standard-setting body that it had no patents or other intellectual property rights that it could assert with respect to the standard at issue. Such certification was required in this instance as the standard-setting body in this particular industry allows anyone to employ its standards on a non-patented, royalty-free basis. After the specification became the dominant standard in the industry, the competitor sent letters to rivals who adopted the standard claiming an exclusive use patent. Staff is now considering whether the competitor's deception was an effort to manipulate the standards setting process to adopt a standard that would impose higher costs on its rivals and whether the competitor attempted to monopolize the market for the particular technology at issue.

Finally, membership rules are also considered with respect to the standard setting organization. Antitrust enforcers understand the need for membership rules to achieve the procompetitive goals and economic efficiencies available from standard setting, but require the rules to be reasonably related to these goals and efficiencies. Therefore, a restriction will be upheld if it is "substantially related to the efficiency enhancing or procompetitive purposes that

otherwise justify the practices."[10] Standards will be condemned, however, if they are not "reasonably necessary to the accomplishment of the legitimate goals and narrowly tailored to that end."[11]

Increasingly, old assumptions about standard-setting and antitrust are being turned on their heads. An interesting competition law issue arises, for example, in the software industry. Consumers and courts agree that compatibility and interactivity are fundamental requirements of modern day software. In recent years, court have worked hard to ensure inter-application and inter-platform compatibility by extending the Copyright Act's fair use exception to cover unauthorized copying for the purpose of creating compatible products. In *Sega Enterprises Ltd. v. Accolade, Inc.*[12] for example, the Ninth Circuit allowed one company to copy software code to the extent it was necessary to understand and make use of the functionality requirements needed to build a video game cartridge that would work in the other company's game console. The court reasoned that because computers are essentially "utilitarian," the functional aspects of software are not entitled to copyright protection. And, the court continued, "[i]f disassembly of copyrighted object code is a *per se* unfair use, the owner of the copyright gains a de facto monopoly over the functional aspect of work." The court concluded that "[i]n order to enjoy a

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[10] *See Northwest Wholesale Stationers*, 472 U.S. at 296 n.7.

[11] *Realty Multi-List*, 629 F.2d at 1375. *See also National Collegiate Athletic Ass'n v. Board of Regents*, 468 U.S. 85, 117 (1984); *Cooney v. American Horse Shows Ass'n*, 495 F. Supp. 424, 431 (S.D.N.Y. 1980).

[12] 977 F.2d 1510 (9th Cir. 1992).

lawful monopoly over the idea or functional principle underlying a work, the creator of the work must satisfy the more stringent standards imposed by patent law."

As one might expect, an increasing number of well-heeled software developers are seeking software patents (with somewhat limited success to date). The patent process is time consuming and costly, however, and likely would constrain competition in the software industry. It's impossible to predict, at the moment, where patent examiners will draw the line, but it's clear that consumers, at least, will not welcome a patent regime.

The federal government may be well situated to foster coordination and cooperation of standard setting in areas where competitive forces in the development of new technology will be better served by such facilitation. Two recent examples of such efforts are the Commerce Department's and the Federal Communications Commission's respective calls for cooperative standard setting to ensure interoperability in the Global Information Infrastructure and the development of High Definition Television. In both of these efforts, the federal government recognizes and must respond to the same type of pressures faced by organizations such as yours—competitive concerns resulting from the sharing of information and the potential for one or more actors to hijack the procedure to disadvantage rivals. Just like industry associations, however, the government in these areas recognizes the potential boon to consumers and to national economies concomitant with standard setting. The global marketplace will provide even more opportunities for government to offer such facilitation in similar future endeavors.

In conclusion, as everyday consumer goods become more complex and the need for standardization and compatibility increases, industry participants and their associations are encouraged to set standards. You are also encouraged, however, to be vigilant to ensure that the benefits extend to all members of the industry and that the process of standard setting is not hijacked to disadvantage fellow competitors.