Department of Justice

BUSINESS SELF-REGULATION: AN ENFORCEMENT POLICY OF CAUTIOUS TOLERANCE

REMARKS

OF

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BEFORE THE

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Introduction

Good morning. It is a pleasure to be here to discuss the antitrust implications of a core function of most trade and professional associations: business self-regulation. There is a great deal that industries legitimately may -- and in some cases should -- do to regulate their own affairs. Many of these activities create significant benefits. And because "self-regulators" are financially affected by the success or failure of their efforts, legitimate, private industry solutions to market imperfections are likely to be far more effective and efficient than the government alternative. Government bureaucrats, however well-intentioned, simply do not have the same incentives to seek the most efficient solution to market failures -- and the track record of government regulation proves it.

As beneficial, and generally preferable, as self-regulation may be, it is nevertheless true that collaboration among competitors to address market failures can threaten the economic welfare of consumers. Under some circumstances, standardization, certification, and other forms of industry-wide self-regulation can have anticompetitive effects that outweigh their benefits. And in particularly egregious cases, such self-regulation can even serve as a smokescreen for a naked restraint of trade among competitors. 1/ Thus, of necessity, antitrust law has a role to play in protecting consumers from anticompetitive self-regulation. But that role is carefully circumscribed to ensure that legitimate self-regulation is not deterred.

Today, I hope to convince you that there is no inherent conflict between the antitrust laws and self-regulation. 2/ The Department of Justice recognizes the benefits of business self-regulation. We are not innatetly hostile to activities of trade and professional associations aimed at producing industry standards, systems of certification, codes of conduct, or similar self-regulatory mechanisms. Unless that activity threatens to harm consumers -- rather than individual competitors -- by restricting industry output and raising price, there is no antitrust problem that arises simply because the self-regulation requires collaboration by competitors.

1/ Virtually any trade association activity would have to generate considerable suspicion on the part of those, and no doubt there are many, who place great faith in the accuracy of Adam Smith's observation that "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." A. Smith, An Inquiry into the Nature and Causes of the Wealth of Nations.

2/ For an earlier, similar statement, see "Standards and Certification: The Role of Antitrust," Remarks of Judy Whalley, Deputy Assistant Attorney General, Antitrust Division, Before the Council on Codes and Standards of the American Society of Mechanical Engineers (Mar. 5, 1988).

Business Self-Regulation

Business self-regulation, of course, is not a private alternative to classic rate-of-return regulation associated with natural monopoly "utilities." Rather than regulating pricing, output, and the allocation of customers, legitimate self-regulation involves the development of "rules" that relate to -- in some instances even determine -- the nature of the product produced and offered by competing firms. Unlike price regulation, self-regulation has its primary and direct effect on supply factors -- like quality and costs -- rather than on demand factors -- like price and quantity. Suppliers of both products and services may legitimately engage in such self-regulation. And while there is a wide variety of self-regulation, for now I will refer to all such activity generically as standards setting.

Private standards setting can perform one or more of three important functions. First, it can serve to produce, marshal, and disseminate valuable information to consumers. That is, the standards can inform consumers of important characteristics of a product and compare those characteristics to other products on a uniform and readily understood scale -- for example, the measurement of oil viscosity based on numbers like 10-W-40. Similarly, standards can serve to certify that a particular product or service meets certain minimum criteria --

for example, the Underwriters Laboratories listing. Such information can reduce transaction costs by avoiding the need for consumers to make apples-to-oranges comparisons and eliminating the need to repeat an evaluation process each time a product of a different manufacturer is considered. By reducing the search costs, this type of standards setting can enhance the demand for, and increase the output of, an industry's product or service. Of course, in some cases, this information may be provided efficiently in the market by third parties -- Consumer Reports magazine is a well-known example. But at times joint standard setting will be more efficient, particularly when free-riding makes it difficult to market the information separately.

A second function of standards is to facilitate the compatibility of products or services in a market. Standards can provide information to suppliers in the form of standard sizes, shapes, characteristics, and systems of measurement relating to any number of products such as connectors like plugs and bolts or networks of communications or computer equipment. Standardization serves to ensure that the inputs provided by many competing manufacturers are equally suitable and that complementary products will function together. They can eliminate wasteful proliferation of designs, facilitate fast and efficient interchange of equivalent products, and encourage entry by small firms that otherwise would have to develop an entire network to ensure acceptance of their product. Moreover, standardization may encourage innovation by allowing new technologies -- like compact discs, direct-satellite broadcasting, or high definition television -- to be disseminated more quickly.

Without standardization, specialization and economies of scale would be difficult to achieve, and markets would be characterized by chaos and confusion. The fact that we benefit from standards daily and with scarcely a thought -- for example, when we buy a light bulb, a set of tools, or a telephone -- is a testament to the crucial nature that such standards of compatibility play in modern life.

Of course, I should note that predetermination of standards for new products will not invariably lead to the optimal standard. At times it may be more efficient to allow the "invisible hand" of supply and demand to establish the superior uniform standard after an initial market contest among competing technologies. For example, it once appeared to "knowledgeable observers" that Beta was the preferable standard format for VCRs; over time, however, consumers have exhibited a preference for VHS. While in theory there is likely some optimally efficient mix of and timing for competition and collaboration in the setting of standards for each industry, it is hopeless to expect antitrust enforcers and courts to discover and enforce that optimal mix. Again, the incentives are strong for those who are subject to the standard to attempt to achieve the optimal degree of competition and collaboration. Moreover, as long as firms in the industry are not coercively and absolutely prohibited from introducing products or services that differ from the jointly established standard, there is the prospect that the market will over time correct self-regulatory mistakes and supplant less-than-optimal standards.

Third, standards that are binding on firms can establish minimum levels of quality necessary to protect consumer health, safety, and the like. Such standards are crucial, for example, where quality is very hard for the consumers to determine and the consequences of failing to detect substandard quality can be disastrous for the consumer (but not necessarily for the supplier who may be able to avoid liability). For example, health and safety standards often address situations -- like the risk of salmonella poisoning, or of a commuter airline crash -- in which potential harms are quite large, identifying the source of the harm is difficult, and receiving compensation for the harm through the tort system would be costly or impossible. 3/ By eliminating or reducing the risks associated with the consumption of certain potentially risky products and services, such binding self-regulation may substantially lower their cost and thus increase their output.

Standards that relate to professional services are generally known as codes of conduct, and the economic analysis of the benefits of such codes is similar to those associated with standards setting. The Code of Professional Responsibility is an example of a code of conduct that is familiar to all lawyers. Similar codes govern doctors, engineers, architects, and many other professionals and tradespeople. While codes of conduct have frequently been the subject of government enforcement actions, they are not invariably anticompetitive. They often are merely competitively neutral, having no real impact on the competitive interactions of members to whom the codes apply. And they can also be procompetitive by facilitating the operation of

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3/ The need for standards relating to product quality to address this sort of failure is significantly more compelling when identifying responsibility for harm is difficult than when recovery via a tort system is difficult because, for example, tortfeasors lack sufficient assets. In the latter case, however, there might still be strong justification for forced compliance with standard bonding requirements and similar "quality" characteristics.

markets, 4/ or by directly benefitting purchasers (clients, patients, customers) -- requiring them to be represented zealously or cared for competently. Such codes can provide an efficient alternative to government regulation, particularly where health and safety are involved. In many cases, privately adopted peer review and grievance procedures for enforcing those norms may be essential to providing minimum levels of competence that cannot otherwise be evaluated by the market or government. 5/ At least, they often provide an efficient supplement to court-administered systems of tort liability and bureaucratic licensing and review procedures.

4/ See Letter from Douglas H. Ginsburg, Assistant Attorney General, Antitrust Division, to James V. Siena, Esq., General Counsel, American Institute of Architects (Jun. 6, 1986).

5/ See "Antitrust Enforcement and the Medical Profession: No Special Treatment," Remarks of Charles F. Rule, Assistant Attorney General, Antitrust Division, Before the Interim Meeting of the American Medical Association House of Delegates (Dec. 6, 1988) ("enforcement officials recognize that legitimate, responsible peer review can keep health-care costs down"); Letter to Kirk B. Johnson, Esq., American Medical Association, from Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, U.S. Department of Justice, December 2, 1986 ("even if a peer review determination does not qualify for [immunity under the Health Care Quality Improvement Act of 1986], that does not necessarily mean that the peer review violates the antitrust laws").

Potential Anticompetitive Effects

Despite these benefits, of course, self-regulation does have at least the potential to harm competition. The most important competitive threat that can be posed by both the process and substance of self-regulation is collusion. If the self-regulation serves to control the prices and output of the regulated industry or otherwise to eliminate legitimate competition, then the welfare of consumers is endangered and antitrust enforcement is required.

The greatest danger of collusion exists when the members of an industry decide to use self-regulation as a smokescreen for illegal cartel activities. This may occur as the members of an industry use the occasions during which they are ostensibly discussing legitimate self-regulation to set covertly the prices and output in the industry. Moreover, they may adopt self-regulatory provisions solely with the purpose of implementing their cartel by, for example, punishing rivals who lower price or compete for certain customers or by excluding new entrants. 6/ Such sham self-regulation that is nothing

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6/ See, e.g., United States v. Trenton Potteries, 273 U.S. 392 (1927) (finding antitrust violation where defendants attempts to exclude second grade pottery from the domestic market were an integral component of a price-fixing scheme); Standard Sanitary Manufacturing v. United States, 226 U.S. 20 (1912)

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more than a disguise for naked horizontal restraints of trade has no potential consumer benefits and should be automatically condemned.

Self-regulation need not be a sham, however, to pose a threat of facilitating collusion. For example, in certain circumstances -- most importantly, where the industry is highly concentrated and products or services are homogenous -- an information exchange may serve to facilitate tacit collusion (or interdependent pricing), even though the parties have not agreed to fix prices. Similarly, self-regulation may result in standards that so reduce the competitive options for industry members -- for example, the variety of the products, the sale and scope of production, and the terms of sale -- that tacit collusion becomes likely. 7/

6/ Continued

(finding antitrust violation where defendants efforts to eliminate "seconds" and nonstandard products from the market were motivated by an intent to fix prices).

7/ See U.S. Department of Justice Merger Guidelines (June 14, 1984), § 3.411, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,103 (hereinafter "Merger Guidelines") (collusion more likely where products are homogeneous, because it is easier to establish a single price than a complex price schedule reflecting differences among products).

In addition, otherwise legitimate standards can have the effect of excluding some competitors from the market. Competitors that are not allowed to participate in the standards setting or that compete in some way that is inconsistent with the self-regulation may find themselves forced from the market. Even if such an activity only raises the cost of the marginal firms in the industry, prices may rise and the aficionados of raising rivals' costs will cry foul. 8/

Frankly though, one must be very careful in condemning exclusionary self-regulation. First, the raison d'etre of self-regulation is often exclusion -- for example, exclusion of unhealthy and unsafe products or of incompetent professionals. Second, a standard may be established by a consortium of firms that is trying to develop, produce, and market a new technology -- let's say high definition television or operating system software. If, because of the consortium's economic success, the standard they set becomes the industry standard, the

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8/ The recent Allied v. Indian Head case appears to provide an illustration of this effect resulting from the National Electric Code. Allied Tube & Conduit Corp. v. Indian Head, Inc., 108 S. Ct. 1931 (1988). Provisions of that code, adopted by the National Fire Protection Association at the behest of makers of steel electrical conduit -- through which electrical wiring is run within buildings -- disqualified plastic conduit (made of PVC) from serving the market wherever the code was adopted or had persuasive force. Not surprisingly, the PVC conduit was manufactured by a set of firms with less effective representation in the code-making organization.

members may choose to exclude nonparticipants from the standard or at least to treat nonparticipants less favorably than consortium members. Such exclusion or discrimination may reduce output in the short run; however, the consortium's ability to exclude firms that did not share in the consortium's cost and risk may be the key to allowing it to appropriate the value created by its efforts. And the hope of appropriating that value will often provide the incentive that makes the innovation possible in the first place. Antitrust authorities should be very slow to prohibit exclusionary devices -- akin to intellectual property rights -- that enable innovators to earn a return on their beneficial efforts. 9/ This is especially true where the exclusionary standards relate to high technology products, such as computer operating systems software, that are used by firms that are not subject to rate-of-return regulation. Where the firms are rate-of-return regulated, however, there is a greater risk that exclusionary standards are a rate-evasion mechanism that harms consumers.

9/ See "Antitrust and Bottleneck Monopolies: The Lessons of the AT&T Decree," Remarks of Charles F. Rule, Assistant Attorney General, Antitrust Division, Before the Brookings Institution Developments in Telecommunications Policy, 1988 (Oct. 5, 1988) ("were firms penalized for achieving dominance through business acumen or a superior product, consumers would be denied the economic fruits of technological progress"); U.S. Department of Justice, Antitrust Enforcement Guidelines for International Operations (Nov. 10, 1988), § 3.42, reprinted in Trade Reg. Rep. (CCH) Extra Edition No. 24 (hereinafter "International Guidelines") (procompetitive benefits of exclusivity in joint ventures).

General Antitrust Enforcement Approach: The Rule of Reason

Despite its benefits, then, self-regulation is not invariably free from antitrust concern. So the relevant question is how to distinguish the good -- or neutral -- from the bad.

Knowing only what I have already said about the potential efficiency benefits of business self-regulation, it should be clear that the antitrust laws do not -- or at least should not -- automatically prohibit standards setting by businesses or professionals. Antitrust law is concerned only with activity that on balance restricts output and raises price, thereby harming consumer welfare; it does not guarantee that standards will never disadvantage individual competitors. Moreover, properly interpreted and enforced, the law should only condemn standards setting and codes of conduct when they are, on balance, anticompetitive -- that is, even if the activity presents some threat to competition, it should be tolerated if the threat is outweighed by the activity's procompetitive benefits.

Accordingly, the Department does not condemn legitimate standards setting or codes of conduct as per se illegal. 10/

10/ *But see* discussion of sham standard setting, *infra*.

Nor are we unrealistic enough to assume that self-regulation is invariably beneficial. Rather, the attitude of the Department can be characterized as one of cautious tolerance, rather than either outright hostility or naive boosterism.

Avoiding the Harms, Balancing the Benefits

This cautious tolerance manifests itself in the form of an economically defined rule-of-reason approach to legitimate business self-regulation. That approach focuses narrowly on the plausible risks of anticompetitive effects, and balances those effects against the likely procompetitive benefits of the self-regulation. 11/ I want to stress that while we carefully apply the rule of reason to legitimate self-regulation, the operative word is legitimate. If self-regulation is merely a sham used to disguise a naked horizontal agreement to fix price or restrict output, or is used with the intent to facilitate a criminal antitrust conspiracy, the Department will apply a per se rule of illegality and prosecute such conduct as a criminal antitrust violation. In appropriate cases, we will name both

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11/ The general rule-of-reason analysis employed by the Department is described in detail in the recently published International Guidelines, *supra* note 9, at § 3.0. The Guidelines in fact explicitly mention standards setting as a type of collaborative activity to which the rule of reason should apply. *Id.* § 3.0 n.47.

the member competitors and the trade association as defendants. _12_/ The good news is that these kinds of antitrust violations are the easiest to avoid, for competitors generally are well aware that they have entered or knowingly facilitated a price-fixing scheme. _13_/

If standards setting or any other form of business self-regulation is legitimate, the Department will first seek to determine whether it creates, enhances, or facilitates the exercise of, market power -- that is, whether it is likely to restrict output and/or raise price. Only if such an anticompetitive effect is likely will the Department seek to analyze whether there are offsetting efficiencies associated with the conduct. I really do not have anything more to add to what I said earlier about the benefits of self-regulation, except to make one point: If the Department concludes that under the circumstances particular self-regulation will have

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_12_/ Prosecution of a trade association will generally require that the association took actions with knowledge that the result would be to facilitate price fixing on the part of its members.

_13_/ For an outline of the criteria that generally result in criminal prosecution of Sherman Act violations, see "Criminal Enforcement of the Antitrust Laws: Targeting Naked Cartel Restraints," Remarks of Charles F. Rule, Assistant Attorney General, Antitrust Division, Before the 36th Annual ABA Antitrust Section Spring Meeting (March 24, 1988), _reprinted in_ 57 Antitrust L.J. 257 (1988).

significant anticompetitive effects, then the burden is on the self-regulators to establish offsetting benefits. 14/

For the balance of my remarks this morning, I want to focus on the factors relevant to identifying the anticompetitive effects of legitimate self-regulation and the steps self-regulators can take to avoid such effects. As you will recall, I earlier listed two potential anticompetitive effects of self-regulation: collusion and exclusion.

Collusion

The greatest competitive concern of the Department in connection with the analysis of self-regulation is the likelihood that particular standards setting will facilitate collusion (or interdependent pricing). If the group of companies subject to the self-regulation collectively does not have market power, then this danger will not be substantial. For example, if the relevant conduct is a hospital's code of conduct (including peer review) for physicians with staff privileges at the hospital and that hospital competes with several other hospitals, there is little reason to be concerned about the code of conduct's competitive effect even if it is

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14/ *See* International Guidelines §§ 3.0, 3.45..

administered exclusively by the staff physicians. Any restriction of the hospital's output as a result of the code will not likely affect the market's output because competing hospitals will expand their output (or, perhaps admit the excluded doctors to practice on their staffs).

Even if the group of competitors subject to the self-regulation represents a large share -- or even all -- of the market, self-regulation need not facilitate collusion. For example, self-regulation that involves an information exchange and that affects an unconcentrated industry will not likely facilitate collusion. 15/ Moreover, by carefully structuring self-regulatory provisions, such as information exchanges, that have the potential to facilitate collusion, this anticompetitive threat can be removed no matter what the surrounding market conditions are. While I will give you a more comprehensive list of safeguards before I conclude, let me just mention some of the safeguards that might be used in connection with an information exchange. Such safeguards might involve preventing the dissemination of disaggregated, firm-specific information to the members of the industry and

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15/ See International Guidelines, Case 18 ("If the parties to an information exchange collectively do not possess market power, or if the relevant market or markets are not concentrated or are subject to easy entry, then an exchange of information by itself would not likely harm competition.").

employing a third party to collect and "scrub" the information. 16/

Exclusion

While the greatest anticompetitive threat associated with self-regulation is collusion, there is another possible competitive threat: the exclusion of competitors. That exclusion may simply be the means by which a collusive scheme to raise prices is enforced -- punishing cheaters and erecting barriers against new entrants. However, exclusion can at least in theory serve to enhance or maintain market power -- for example, oligopoly pricing -- that exists independently of collusion facilitated by the self-regulation. Moreover, if a firm is excluded by self-regulation from competing in one market that is an essential facility necessary to compete in an adjacent market, the exclusion can harm consumers. 17/ Thus, exclusion can be a competitive concern in and of itself.

16/ See International Guidelines, Case 18 & n.229; Letter from Douglas H. Ginsburg, Acting Assistant Attorney General, Antitrust Division, to Alan M. Frey, Esq., Counsel for PQ Corporation (July 6, 1984) (indicating no present intention to challenge proposed import information exchange where various safeguards would be employed).

17/ "See Antitrust and Bottleneck Monopolies: The Lessons of the AT&T Decree," Remarks of Charles F. Rule, Assistant Attorney General, Antitrust Division, Before the Brookings Institution Developments in Telecommunications Policy, 1988 (Oct. 5, 1988).

On the other hand, as I also mentioned earlier, there are many legitimate reasons for exclusion in the context of self-regulation. Thus, the Department limits its condemnation of self-regulatory exclusion to those cases that truly threaten consumer welfare, as opposed to competitors. 18/ Self-regulation that excludes competitors (and that does not also facilitate collusion) should be condemned only if (1) the structure of the market is such that it appears that market power is currently being exercised (in other words, the market is performing suboptimally from the standpoint of competition); (2) access to the market is dependent on (that is, controlled by) compliance with the self-regulatory regime; and (3) there is no legitimate reason (relating to efficiency or to good faith health or safety concerns for example) for the exclusion.

The first condition for challenging pure exclusion is largely self-explanatory and has been discussed extensively elsewhere. 19/ A few words about the second and third are in order, however.

18/ For a related discussion of the Department's treatment of exclusion in the general context of joint ventures, see International Guidelines § 3.42.

19/ For a discussion of market structure screens used to determine if the structure of a market raises plausible concerns of noncompetitive performance, see *Id*. § 3.32; Merger Guidelines §§ 3.11, 3.12; U.S. Department of Justice Vertical Restraints Guidelines (June 23, 1985), § 4.1, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,105.

Self-regulation that does not severely disadvantage a firm's ability to compete -- that is, does not control its access to the market -- raises no concern of exclusion. Where there is no control, a firm can sell into the market even if particular standards disadvantage its product. Competing firms can thus innovate successfully or undercut any collusive scheme -- tacit or explicit -- regardless of the nature of the standards adopted by the rivals who control the standards setting process. The requirement that there be control is consistent with recent case law in the area of standards setting. 20/

Control is obvious when the government mandates compliance with standards that are promulgated privately. In general, businesses will be immune from antitrust condemnation for the effects of standards that derive from their adoption as law by government. As Indian Head made clear, however, the mere fact that government has compelled -- or routinely does compel --

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20/ Courts generally uphold standards where compliance is not required to participate successfully in the market. See, e.g., Consolidated Metal Products, Inc. v. American Petroleum Institute, 1988-1 Trade Cas. (CCH) ¶ 68,051, at 58, 361-64 (5th Cir. 1988) (standard was valuable merely for prestige); Clamp-All Corp. v. Cast Iron Soil Pipe Institute, 1988-1 Trade Cas. (CCH) ¶ 68,115, at 58, 769-70 (1st Cir 1988).

compliance with particular standards does not automatically immunize private standards setting. 21/

Governmental coercion, however, is not the only source of a controlling effect. If, for example, compliance with a particular set of standards is essential to commercial success in a market and standards governing behavior in that market possess natural monopoly characteristics, so that only one set of standards can efficiently exist in the marketplace, the standards setting process will involve control. 22/

On the other hand, the simple fact that consumers rely on the information or certification generated by self-regulation does not mean that the standards control access to the market. Rather, the consumers' reliance on the standards may merely reflect the accuracy of the information conveyed. Finally, it

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21/ See Allied Tube & Conduit Corp. v. Indian Head, Inc., 108 S. Ct. 1931 (1988) (holding standards setting conduct not automatically immune under the Noerr-Pennington doctrine merely because standards were routinely adopted as law by many jurisdictions; immunity depends on context and nature of anticompetitive activity at issue).

22/ See, e.g., American Society of Mechanical Engineers v. Hydrolevel Corp., 456 U.S. 556 (1982) (where widespread but not universal adoption of code by government gave standards effective control over the market); Radiant Burners Inc. v. Peoples Gas Light & Coke Co., 364 U.S. 565 (1961) (per curiam) (where gas companies would not supply gas for use in unapproved gas burner devices).

is insufficient that the standard controls access to a preferable part of the market, but not to the market as a whole. For example, in a large city the fact that a single hospital's peer review panel denies a physician staff privileges does not mean the panel has control if there are other hospitals where the physician can practice.

With respect to the legitimacy of the reasons for exclusion, I think it is important to keep in mind the limited ability of antitrust officials to second-guess the technical merits of an exercise of self-regulation that excludes competitors. While that certainly suggests that some deference to the self-regulators is in order, it would be wrong to conclude that enforcement officials and courts should always accept a technical justification for the exclusion. Rather, antitrust must at times rely on the circumstances of the decision to indicate the credibility of the justification.

<u>Four Safeguards for Self-Regulation</u>

As is the case with the Department's rule-of-reason analysis in other contexts, then, the analysis of the potential for self-regulation to facilitate collusion or anticompetitive exclusion often turns on market structure. And it is difficult and probably unwise to describe a precise formula that incorporates the myriad of relevant factors and provides an easy indicator of whether a particular self-regulatory provision will or will not have anticompetitive effects. As a counseling matter, it is probably more helpful to know what conduct self-regulators should generally avoid to reduce their risk of anticompetitive liability. And in fact, there are a few such rules of thumb that should be kept in mind by those counseling trade associations, professional associations, and the like that engage in self-regulation.

(1) First, avoid provisions of self-regulation that seek to control the price or output of members of the industry, even if the industry believes that "unrestrained" competition will lead competitors to provide too little safety or quality. Direct or indirect limits placed on the individual members' pricing and output (in terms of quantity) freedom are going to be hard to justify. 23/ There almost always will be more direct, less

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23/ See, e.g., National Society of Professional Engineers v. United States, 435 U.S. 679 (1978) (finding antitrust violation where code of ethics prohibited discussing "prices with potential customers until after negotiations [had] resulted in the initial selection of an engineer"). On several occasions in connection with the Department's Business Review Procedure, 28 C.F.R. § 50.6, the Department has expressed its intention to challenge standards setting proposals that involved detailed requirements relating to the terms by which members' goods and services could be sold. These instances have included a proposal by an association of commercial vessel suppliers to adopt provisions governing the standard allocation of the costs of delivery and the terms of payment, see Letter from John H. Shenefield, Assistant Attorney General, Antitrust Division, to C. William Brown, Executive Vice President, National

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anticompetitive ways to ensure adequate levels of quality and safety.

(2) Second, avoid processes of self-regulation that encourage or even allow members to discuss pricing, matters bearing on pricing, production levels, terms and conditions upon which a product or service can be sold, geographic areas in which sales are to be made, and specific customers or types of customers to which sales are or are not to be made. Antitrust counsel should be present at meetings of the regulating body to ensure that those meetings do not provide the opportunity for side deals that violate the antitrust laws. Also, consider the possibility of a third party (for example, the trade association's executive director or counsel) to act as an intermediary for any exchanges of information among members. Moreover, keep accurate, written records of all proceedings.

23/ Continued

Association of Marine Services, Inc. (May 8, 1979), and a proposal by an association of mortgage-backed securities dealers that would have imposed margin requirements on customers of those dealers, see Letter from Donald L. Flexner, Acting Assistant Attorney General, Antitrust Division, to Victor S. Friedman, Esq., Counsel for Mortgage-Backed Securities Dealers Association (June 23, 1979).

(3) Third, the nature of the standards matters. Standards that specify detailed design requirements generally pose greater concerns than those that set performance criteria. The latter allow for greater variety -- permitting, for example, competitors to employ different production processes or technologies that each achieve functionally similar results. That latitude also lowers the costs of innovation by permitting a competitor to introduce a new product without first having to alter the existing standard. In the context of codes of conduct, if a provison relates generally to the ethical or professional standards to which members should aspire, it is necessarily of less concern than if it outlines specific prohibitions against certain conduct. For the same reason, it should be obvious that standards that set minimum levels of performance -- or even minimum design characteristics -- are preferable to those that set maxima or both minima and maxima.

(4) Fourth -- and a catch-all -- self-regulators should always act in good faith. That is, they should keep in mind that self-regulation to punish price cutters, to prevent ruinous competition, to exclude innovators, or otherwise to restrict output and raise price is illegitimate and illegal. If it appears that one of these forbidden motivations is behind an exercise of self-regulation, antitrust liability is likely.

It is in this sense that it is relevant to antitrust officials whether a standards setting process or the enforcement of a code of conduct is characterized by due process. The accordance of due process attests strongly to the *bona fides* of an exercise of self-regulation. By saying this I do not mean to encourage the kind of Byzantine procedures that have crippled many governmental functions. Instead, general common sense should prevail. The key elements of due process are, first, procedures that permit the meaningful inclusion and participation of interested parties and, second, legitimate justifications for the choices made in the course of developing standards. The latter generally entails the production of some kind of a "record" substantiating the factual basis of asserted justifications for a particular standard, as well as indicating that those justifications -- rather than a black heart -- motivated the standard. 24/

24/ *Cf*. Radiant Burners Inc. v. Peoples Gas Light & Coke Co., 364 U.S. 565 (1961) (per curiam) (finding antitrust violation where refusal of association to certify competitor's product was not based on "objective standards," but was influenced by the economic interests of plaintiff's competitors).

Conclusion

So what do I leave you with as guidance in setting up regimes of business self-regulation? I hope I leave you with a good deal of general encouragement that the Department recognizes the potential benefits of self-regulation. Indeed, I am confident that self-regulation can in many cases offer a means that is far more efficient, and far less intrusive of personal liberties, than bureaucratic meddling. I also leave you with the Department's assurance that legitimate standards setting will not be attacked without a thorough analysis of its net effects on competition. Finally, I hope that I have provided some suggestions that will enable you to counsel trade and professional associations in ways to engage in legitimate self-regulation without provoking a Department of Justice challenge. After all, antitrust compliance is itself one of the most well-established and important forms of business self-regulation.