The impact on competition of standards set by industry associations: "malign" or "benign"?

By Robert Peel

Introduction

Many industries are regulated by industry bodies or trade associations which, at times, are charged by their members with developing standards applicable to industry participants.

Those who seek the benefits associated with membership of an industry body must usually meet the standards set by the particular body, which, when appropriately formulated could improve levels of safety, product quality and expertise. To preserve the integrity of the body, firms which fail to meet the standards will often be excluded from membership.

Where the standard-setting body has sufficient sway over consumers, exclusion could damage a firm's performance in the market. This explains why standard-setting bodies are commonly characterised as "double-edged": while they may provide significant benefits to consumers, they can also be harmful to competition.

This particular species of anti-competitive harm was recently addressed by the South African competition authorities in the *Tracetec* decision, which provides important insights for determining when the conduct of a standard-setting body and its members will be regarded as anti-competitive in terms of competition legislation.

Prudent members of standard-setting bodies will take note of the decision's implications, and the potential liability that could arise from membership to a standard-setting body.

Background to the *Tracetec* decision

The matter concerned a complaint referral against an industry association, the Motor Vehicle Security Association of South Africa (VESA) and three of its members ("the SVR respondents") who were participants in the stolen vehicle tracking and recovery market. The SVR respondents included household names such as Matrix and Tracker.

The standards alleged to have been anti-competitive were those which the SVR respondents and VESA had imposed for membership to VESA's stolen vehicle tracking and recovery sub-committee.

The standards' purported aim was to create an industry with reliable players, whose tracking technology and infrastructure could be depended upon to lead to the successful tracking and recovery of stolen vehicles. Although the criteria were adapted from time to time, membership to VESA's stolen vehicle tracking and recovery sub-committee required

initially, amongst others, that a firm's tracking and recovery device had to have been installed in a minimum of 3 000 vehicles and at least a 100 successful recoveries.

Findings on the standards

The Competition Commission argued that the standards created a "chicken and the egg" scenario, namely VESA only approved a firm's product, amongst others, if it had 3000 customers but without VESA approval a firm would not be able to get the required 3000 customers.

The Competition Commission argued further that the insurance industry created the demand for tracking and recovery products by granting discounts on vehicle insurance premiums to customers who have installed VESA approved tracking and recovery products. Support from the insurance industry was therefore essential in reaching the minimum threshold of 3000 customers. However, insurance companies were loath to endorse tracking and recovery products that were not VESA approved.

Finding in favour of the Competition Commission, the Competition Tribunal held that the standards constituted a barrier to entry which led to a substantial preventing or lessening of competition, which was not outweighed by pro-competitive, technological or efficiency gains. Excluding firms from entry into a market will invariably have an anti-competitive effect, as fewer competitors means less competition. On the Tribunal's factual findings, anti-competitive harm was virtually a foregone conclusion.

The Tribunal adopted a four-step approach to determining if standards were "malign" or "benign", asking the following questions:

- Did a body possessing market power set the standards?
- Did customers, or rivals, set the standards?
- What was the effect of the standards?
- Were the standards reasonable?

The Tribunal's evaluation and conclusion on each of the questions are discussed below.

Presence of market power

An enquiry into market power is a logical starting point. Were a standard-setting body to enjoy little or no support among industry participants (and thus no market power) it would be difficult to conceive of its standard having any effect, let alone one which is anti-competitive.

If a standard-setting body does not have the industry behind it, there is little chance that its standard will be anti-competitive. Since VESA was supported by the SVR respondents, who collectively had an overwhelming share of the market, the Tribunal was satisfied that the standard-setting body had market power.

Whether standards set by rivals or customers

If rivals had set the standards, one could presume that the standards were set in order to prevent other firms entering the market. The SVR respondents shared the same economic interests and as a result, the Tribunal found that the standards were "self-serving".

Conversely, where an association is a broad industry body encompassing companies on different levels of the supply chain with a wide range of interests, one could presume that the standards were not set to achieve any anti-competitive objective. Significantly, the answer to this question only highlights the motives behind a particular standard. What the law requires is proof of an anti-competitive *effect*.

Effect of the standards

The Tribunal noted that the standards did not constitute an absolute barrier to entry, since compliance with the standards was, theoretically, voluntary. While a firm which did not comply with the standards would not be supported by the insurance industry, it was free to seek business in the uninsured market. And where compliance with a standard is voluntary, there is unlikely to be an anti-competitive effect.

The Commission presented a different view, successfully arguing that while compliance was not required by law, the facts were such that compliance was indeed mandatory. It argued that demand in the market was such that without the support of the insurance industry, a reasonably efficient firm could not hope to successfully enter the market.

Reasonableness of the standards

The Tribunal declared that the standards were "irrational" and "unreasonable". As the standards would probably have gone some way to ensuring that a firm's approved product would perform with a degree of success, this conclusion is open to debate. As regards the reasonableness of the standards, the Tribunal concluded that the "most damning" indication of unreasonableness was that VESA had granted special exemptions from the standards for some of the SVR respondents' own products. Therefore, even the products of the incumbent firms with large market shares and first-mover advantages at times failed to meet the standards.

In terms of ruling law in other jurisdictions such as the United States, standard-setting associations ought not to unduly favour any members. They should rather conduct themselves and their proceedings in a disinterested and unbiased manner. The mere existence of rules or a constitution cannot of itself ensure impartiality.

An association should also have mechanisms in place to prevent biased members from hijacking proceedings and using the body for their own anti-competitive interests. Industry associations should, as far is possible, strive for openness and transparency.

Pro-competitive gains

Interestingly, the Tribunal did not canvass in much detail any of the claimed pro-competitive gains flowing from the standards. Industry bodies that engage in standard-setting should nevertheless carefully consider whether their standards could be justified based on their pro-competitive gains or whether they are self-serving.

Conclusion

While standard-setting bodies could play an important role in improving levels of safety, product quality and expertise in an industry, they should guard against imposing standards that are in contravention of competition legislation.

Associations and their members who are found to have contravened competition legislation in the setting of standards could face the prospect of having to pay an administrative penalty as well as reputational damage. In addition, competitors that have suffered damages as a result of having been excluded from the market due to non-compliance with standards that have contravened competition legislation could institute a civil damages claim against the association and its members.

An association and its members should endeavour to conduct their activities impartially. Where standards are set, they should be reasonable in the circumstances.

The Tribunal's decision in the *Tracetec matter* has been taken on appeal to the Competition Appeal Court. The appeal has been set down for 29 and 30 November 2010.

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