

Remarks by

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In order to shape the development of competition law, the Office of Policy Planning undertakes targeted competition advocacy and case generation.¹ We are particularly interested in Internet commerce issues and have directed much of our attention to this area. One great aspect of the Internet is its openness. It permits direct access to information and immediate, unimpeded communication in a way that previously was simply not possible. Not surprisingly, there is a broad political consensus that maintaining the Internet as an open, unobstructed medium is an important priority.

However, it is no longer true that the on-line marketplace of the Internet is a completely unobstructed, unregulated space. Though efforts to oppose Internet-specific restrictions have been sustained and largely successful, it appears more and more evident that pre-existing regulatory regimes have been extended to the Internet in a number of ways that could deprive consumers of the cost savings and convenience that should accompany expanded e-commerce. There are also private Internet-specific restrictions that may inhibit or prevent Internet commerce in some goods and services. The entrenched interests who support the outmoded regulatory regimes or private restrictions are often middlemen whose services are being replicated or made unnecessary by Internet-based businesses. Many of today's middlemen would prefer to restrict or eliminate, rather than compete with, their emerging rivals. In fact, some appear to have already chosen this inefficient, anti-consumer, and – in some instances – unlawful route. The Federal Trade Commission is addressing this phenomena in a variety of ways.

Internet Task Force

Concerned by the continuing emergence of restrictive tactics and regulations, the Federal Trade Commission established an Internet Task Force to address the multiple antitrust issues they

¹ The views expressed are my own and do not necessarily reflect the views of the Federal Trade Commission or of any Commissioner.

raise. The goal of the Task Force, stated broadly, is to prevent the erection and maintenance of barriers to low-cost distribution of goods and services via the Internet – including those erected by the aforementioned middlemen.

Thus far, we have found that many of the most harmful barriers were deliberately erected by state regulators to protect specific in-state middlemen. For example:

Autos: In response to vigorous lobbying by local car dealers, laws preventing automobile manufacturers from selling over the Internet are on the books in all 50 states. Direct sales of automobiles by manufacturers, and any other on-line seller, without a dealer presence are banned in every state. Though proponents of these laws argue that they protect consumers from unfair and deceptive practices by manufacturers, it is indisputable that they deprive consumers of substantial savings on one of the most significant purchases that many of them will ever make. A study by the Yale University School of Management concluded that consumers that purchase automobiles on-line pay approximately 2% less than consumers purchasing from traditional dealers. Again, that is a 2% savings on the single largest purchase, after a home, that the average consumer is likely to make. A more recent study by a consumer group, which stated its conclusions in dollar terms, makes this point more dramatically. Its study concluded that restrictions on on-line auto sales add \$2,500 to the cost of an average new car.² While I do not claim that these studies are conclusive, they are at least indicative of the magnitude of savings that the Internet may bring to consumers.

Wine: At least 30 states have enacted laws barring sales of wine and beer over the Internet. Supporters of these naked restraints of trade generally rely on two justifications: (1) that Internet sales would escape taxation, and (2) that Internet sales would enable minors to obtain access to alcoholic beverages. The first of these is questionable, given that concerns about fair and equitable taxation have been addressed, to the satisfaction of all concerned, in a variety of mail order and catalogue contexts. The second, though it has some initial persuasive force, also fails under closer scrutiny. A simple rule requiring that shipments of alcoholic beverages be signed for by an individual of legal age would seem to be a more sensible legislative response than an outright ban on Internet sales. Furthermore, the true motivation of proponents of these laws is revealed by the fact that a number of them ban out-of-state, but not in-state, Internet sales. Though immune from antitrust scrutiny, many of these provisions are currently being challenged on Commerce Clause grounds. In fact, federal courts in Virginia and North Carolina

² Mark Cooper, A Roadblock on the Information Superhighway: Anticompetitive Restrictions on Automotive Markets 38 (Feb. 2001) available at <<http://www.consumerfed.org/internetautosales.pdf>>.

recently struck down such prohibitions in those states, holding that, in light of their unequal treatment of in-state and out-of-state sales, the statutes violated of the Commerce Clause.³

Other existing middlemen have taken a more subtle approach. Rather than colluding to drive Internet-based rivals from the market, they have sought to restrict rivals by extending pre-existing licensing and certification regimes, many of which did not initially contemplate on-line distribution of goods and services. For instance, some states have statutes requiring that caskets be sold only by licensed funeral directors that were passed before the advent of free-standing and Internet casket stores. Two courts have recently struck down these statutes on constitutional grounds.⁴ An example that may strike close to home for the average Internet user is the requirement in at least a few jurisdictions that all auctioneers – including individuals offering goods for sale on Internet auction sites, such as eBay, or the sites themselves– be licensed and bonded. The North Carolina Auctioneer Licensing Board initially considered imposing fines of up to \$2000 on unlicensed on-line auctioneers, but deferred any action pending further study. Illinois passed a statute, which has not yet been fully implemented, that may require Internet auction services to have an auctioneer with an Illinois license supervise all auctions in which an Illinois resident might be a bidder.⁵

The policy issue here is not whether the licensing and certification regimes in question should be scrapped completely. The reasons dictating that sellers of real estate, certain insurance products, and a wide variety of other goods and services be licensed still apply. The question is merely whether refusals to permit reasonable modifications of such licensing regimes are motivated by legitimate consumer protection, safety, and other objectives, or by a desire to exclude Internet-based rivals from the marketplace.

The FTC's Office of Policy Planning and the Bureau of Competition have been actively involved in combating the extension of regulatory regimes in order to exclude or hamper Internet-based competitors:

Loan closings: In conjunction with the Department of Justice, we recently filed letters in North Carolina and Rhode Island raising concerns about proposed restrictions on who

³ *Beskind v. Easley*, No. 3:00cv258-MU (W.D.N.C. Apr. 5, 2002); *Bolick v. Roberts*, No. 3:99cv755 (E.D.Va. Mar. 29, 2002).

⁴ See *Craigmiles v. Giles*, 110 F. Supp.2d 658 (E.D. Tenn. 2000); *Casket Royale, Inc. v. Mississippi*, 124 F. Supp. 2d 434 (S.D. Miss. 2000).

⁵ Auction License Act, 225 ILCS §§ 407/5-1 to 407/30-55.

may participate in loan closings.⁶ In North Carolina, a proposed bar opinion required the use of an attorney at all residential loan closings, including simple refinancings. In Rhode Island, a proposed bill contained even more restrictive requirements. Both of these proposals would not only raise costs for consumers, who would have to pay for additional services, but also create an uneven playing field for out-of-state Internet lenders, since in both North Carolina and Rhode Island there were loopholes that allowed some in-state corporations to close loans without attorneys. In North Carolina, the bar has appointed a commission to study the issue and in Rhode Island the bill, which was approved in committee, is awaiting a vote by the full legislature.

Replacement contact lenses: In March of this year, we filed a comment with the Connecticut Board of Examiners for Opticians arguing against the board adopting a requirement that Internet sellers of replacement contact lenses have a Connecticut optician's license, even though such sellers merely mail out prepackaged lenses pursuant to an eye doctor's prescription.⁷ We concluded that such a requirement would increase consumer costs while producing no offsetting health benefits and would be a barrier to the expansion of Internet commerce. Indeed, such licensing could harm public health by raising the cost of replacement contact lenses, inducing consumers to replace the lenses less frequently than doctors recommend or to substitute other forms of contact lenses that pose greater health risks. Current federal and state prescription requirements and consumer protection laws are sufficient to address the health problems associated with contact lens use. Such requirements can be implemented in ways that are either procompetitive or anticompetitive, and the FTC staff urged the Board to implement the prescription requirement in a way that protects consumers health, promotes competition, and maximizes consumer choice. The Board will hold a hearing in June and should issue a decision sometime thereafter.

Overall, whether through outright bans or the imposition of impediments on Internet commerce, such restrictions harm consumers. In fact, The Progressive Policy Institute estimates

⁶ Letter from Charles A. James and Timothy J. Muris to Rhode Island Legislature Re Proposed Bill Restricting Competition for Non-Attorneys in Real Estate Closing Activities (Mar. 29, 2002) <<http://www.ftc.gov/be/v020013.pdf>>; Letter from Charles A. James and Timothy J. Muris to the Ethics Committee of the North Carolina Bar Re North Carolina State Bar Opinions Restricting Involvement of Non-Attorneys in Real Estate Closings and Refinancing Transactions (Dec. 14, 2001) <<http://www.ftc.gov/be/VO20006.htm>>.

⁷ Comments of the Staff of the Federal Trade Commission, Intervenor, before the Connecticut Board of Examiners for Opticians (Mar. 27, 2002), <<http://www.ftc.gov/be/v020007.htm>>.

that such protectionism costs consumer at least \$15 billion annually.⁸

State Action Task Force

The state action immunity doctrine is the product of the Supreme Court's 1943 opinion in *Parker v. Brown*, 317 U.S. 341, which held that, in light of states' sovereign status and the principles of federalism, Congress would not have intruded on state prerogatives through the Sherman Act without expressly saying so.⁹ The Supreme Court based the doctrine on the relatively non-controversial notion that, in 1890, Congress intended to protect competition, not to limit the sovereign regulatory power of the states. Over time, however, the scope of state action immunity from the antitrust laws has increased considerably, and courts have failed to consider carefully whether the anticompetitive conduct in question was envisioned by the state legislature or truly necessary to accomplish the state's objective.

The state action doctrine is susceptible to being used to protect outmoded regulatory regimes in a way that shelters entrenched interests from Internet-based competition at the expense of consumers.¹⁰ We have thus assembled a task force to take a hard look at this doctrine to see if middlemen are invoking it improperly to shield anticompetitive conduct.

While case law makes clear that the actions of a state legislature¹¹ or a state supreme court acting in a legislative fashion¹² are immune, the law is less clear on immunity for state regulatory

⁸ See Atkinson and Wilhelm, *The Best States for E-Commerce* (Mar. 2002), <http://www.ppionline.org/documents/States_Ecommerce.pdf>.

⁹ In *FTC v. Ticor Title Insurance Co.*, 504 U.S. 621, 633 (1992), the Court's most recent state action immunity opinion, it reiterated, "Our decision [in *Parker*] was grounded in principles of federalism."

¹⁰ The Commission has also convened a task force to examine the *Noerr-Pennington* doctrine, which exempts from antitrust liability a party who seeks anticompetitive action from the government through petitioning. See, e.g., *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 379-80 (1991). In January 2002, a series of lawsuits relating to Bristol-Myers' alleged improper listing of a patent on its branded drug BuSpar presented an opportunity for the *Noerr* Task Force to work to clarify the *Noerr* doctrine through the filing of an amicus brief. The brief drew extensively on the work of the *Noerr* Task Force and ultimately achieved a favorable result. *In re Buspirone Patent Litigation/In re Buspirone Antitrust Litigation*, MDL Docket No. 1410 (S.D.N.Y. Feb. 14, 2002) ("Opinion and Order No. 19").

¹¹ See *Parker*, 317 U.S. at 350-52.

¹² See *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977).

commissions and boards and other special purpose state governmental units.¹³ A key factor for determining whether lesser state instrumentalities have immunity is the degree to which the instrumentality is subject to state control.¹⁴ In *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), the Court held that, to qualify for immunity, restraints implemented by non-sovereign state instrumentalities or private actors must be clearly articulated and affirmatively expressed as state policy and must be actively supervised by the state itself.

This task force is actively considering bringing cases that will clarify the scope of the state action exemption and, we hope, trim it back to its original purpose of accommodating our federal system by shielding actions of the states from Sherman Act liability.

Private Action

In addition to regulatory restrictions, we are also concerned that some private companies have curtailed e-commerce by employing potentially anticompetitive tactics, such as pressuring suppliers or dealers to stop or limit sales over the Internet.¹⁵ This tactic of collectively pressuring suppliers to disadvantage a new competitor is nothing new. For example, in *Toys R Us*,¹⁶ the Commission found that Toys R Us exceeded the protection afforded vertical relationship by *Colgate* and its progeny¹⁷ when it adopted and implemented a policy to force its suppliers to restrict sales to club stores. Moreover, a majority of the Commission also found that Toys R Us built a horizontal agreement to boycott the clubs among its key suppliers, which served as a crucial support for the implementation and enforcement of Toys R Us' vertical club policy.¹⁸

¹³ See, e.g., *Neo Gen Screening, Inc. v. New England Newborn Screening Program*, 187 F.3d 24, 29 (1st Cir. 1999) (“the status of state boards or commissions is open to dispute”).

¹⁴ See, e.g., *Automated Salvage Transp., Inc. v. Wheelabrator Env'tl. Sys., Inc.*, 155 F.3d 59, 70-71 (2d Cir. 1998)

¹⁵ For example, Chrysler and Levi Strauss reportedly acquiesced to their dealers' demands to limit Internet sales in order to protect the dealers' market share. See Atkinson, *The Revenge of the Disintermediated: How the Middleman is Fighting E-Commerce and Hurting Consumers* (Jan. 2001) <<http://www.ppionline.org/documents/disintermediated.pdf>>.

¹⁶ *Toys R Us, Inc.*, No. 9278 (FTC 1998).

¹⁷ *United States v. Colgate & Co.*, 250 U.S. 300 (1919); see also *Monsanto Co. v. Spray-Rite Servs. Corp.*, 465 U.S. 752 (1984).

¹⁸ Commissioner Swindle dissented from the conclusion that Toys R Us orchestrated a horizontal combination on the ground that the evidence of such an agreement was weak and that it was plausible that the manufacturers acted individually to abide by the company's club policy to avoid alienating an important customer.

The Commission majority concluded that the toy manufacturers were unwilling to limit sales to clubs -- a growing part of the market -- without assurances that their competitors would do the same and that Toys R Us put together a horizontal agreement among the toy manufacturers to overcome their reluctance to forgo this opportunity. Toys R Us appealed and the Seventh Circuit affirmed the Commission's decision on all grounds.¹⁹

In the area of Internet commerce, such tactics have already resulted in antitrust investigations and litigation. For example:

- In 1998, the FTC filed an administrative complaint against an association of Chrysler dealers in the Northwest.²⁰ The complaint alleged that the dealers had formed the association – Fair Allocation System, Inc. (“FAS”) – for the purpose of restricting the number of vehicles available to competing dealers marketing, and offering lower prices, over the Internet. The matter was settled by a consent order that prohibited FAS from participating in, facilitating, or threatening any boycott of, or refusal to deal with, any automobile manufacturer or consumer.
- Disagreements between mail order and Internet replacement contact lens sellers, their more traditional competitors, and contact lens manufacturers came to a head in *In re: Disposable Contact Lens Antitrust Litigation*.²¹ In that multidistrict litigation, the Attorneys General of 31 states and a certified class alleged that eye care professionals engaged in an organized effort to prevent or hinder consumers from obtaining their contact lens prescriptions. The complaints alleged two conspiracies: (1) that the practitioners and their trade associations conspired to prevent the release of contact lens prescriptions to consumers, and (2) that the manufacturers, practitioners, and trade associations, including the American Optometric Association, conspired to eliminate sales of contact lenses by pharmacies, mail order, and other alternative sellers. According to the complaints, the conspiracy severely restricted the supply of contact lenses available to alternative sellers, which has hampered the growth of such sellers, decreased the supply of lenses to consumers, and increased the price of lenses. The parties reached settlements, the last of which the court approved in November 2001.

¹⁹ *Toys R Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000).

²⁰ *Fair Allocation System, Inc.*, C-3832 (FTC Oct. 30, 1998)

²¹ *In re: Disposable Contact Lens Antitrust Litigation*, No. MDL 1030, (complaints filed M.D. Fla. 1994).

Upcoming action

The experience gained in examining these situations leads us to believe that we should take a more in-depth look at such trends. In the upcoming months, we will continue to think about the following issues:

What roles do competition and Internet law and policy play in fostering or hindering e-commerce?

How does state regulation affect e-commerce?

What business practices affect e-commerce and raise antitrust issues?

How do regulations and business practices affect different industries?

We hope that our inquiry will educate us about anticompetitive barriers and thus help us determine which ones merit further scrutiny, perhaps leading to cases and advocacy opportunities.

Conclusion

In order to accomplish its objectives, the Internet Task Force will require assistance from a variety of sources. Though the Federal Trade Commission is, indeed, a watchful and diligent agency, it cannot be everywhere at once. In order to identify the restrictions with the greatest impact, as well as those crafted with the greatest subtlety, we will need the assistance of the members of this audience – that is, representatives of industry, think tanks, consumer groups, trade associations, and the private bar. I encourage each of you to contact the Commission's Office of Policy Planning, in the coming weeks and months, with whatever information you can provide on the persistence, scope, and nature of particular restrictions on Internet-based competition. Thank you.