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HOW DUE PROCESS IN THE DEVELOPMENT OF VOLUNTARY STANDARDS CAN REDUCE THE RISK OF ANTI-TRUST LIABILITY

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AUTHOR'S PREFACE

In a recent article published in ASTM's "Standardization News" (January, 1990 p.46), Ms. Judy Whally, Deputy Assistant Attorney General in the Antitrust Division of the United States Department of Justice, wrote:

> "The U.S. Supreme Court's two most recent antitrust decisions relating to standards -- Hydrolevel and Allied Tube -- have created substantial concern in the standards making community about the risks of exposure to antitrust liability, and concommitant treble damages, for standards making. Some have gone so far as to ask whether there is not an underlying antipathy between the antitrust laws and the whole standards making process. To the extent this concern about antitrust liability deters the legitimate and strongly procompetitive standards setting process, that is an unfortunate result, and one that it is unlikely the Supreme Court in any way intended."

Intended or not, it would be tragic if the recent Supreme Court decisions had an adverse affect on the development of voluntary standards. It would be ironic if this were the case, because the impact of these decisions could and should be quite the opposite. That is to say, if every standards development organization were to examine its procedures from the point of view of fairness, and make whatever modifications were necessary to assure the utmost due process, then the ultimate result of these recent Supreme Court decisions would be to help the standards community, not hurt it. Again to quote Ms. Whally:

> "A standards making body's attention to procedural due process is important not only because it suggests fairness, but because fair procedures are more likely to produce a correct decision, one that the courts need not review. The fairer the decision making process appears, the less inclined the courts will be to question the merits of the standards making decision."

Most of the managers of the voluntary standards development process and the overwhelming majority of the participants in the

process of writing the standards are not attorneys. It is to this group of interested persons -- those affected by the law but not privy to the shaping of it -- that the report is directed. Its purpose is to give to the sponsors and managers of voluntary standards development a working knowledge of how due process affects the process, so that each may be encouraged to review his or her own procedures to determine whether and how additional due process protections might be adopted. The author will consider the report a success if it motivates even one standards developer to review its process in light of the information presented herein.

I would like to thank the Office of Standards Services at the National Institute of Standards and Technology (NIST) for its assistance and encouragement in the development of this study, and for publishing it. The author, of course, bears sole responsibility for the opinions expressed herein, and for any errors of omission or commission.

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I. Introduction

A. Origins of the Study

On June 13, 1988, the U.S. Supreme Court decided the case Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492, (1988). The Court ruled 7-2 that a company can incur antitrust liability for its anticompetititve actions during the development of a voluntary standard. The decision raised new concerns within the voluntary standards development community compounding the consequences of a 1982 Supreme Court decision, American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp., 456 U.S. 556 (1982), which rocked the standards setting comunity with fear and uncertainty. In many ways, the potential impact of the Allied Tube decision on participants in the voluntary standards-writing process is far greater than that of the Hydrolevel decision.

In Hydrolevel, ASME was held responsible under the antitrust laws for the illegal acts of volunteers acting under the apparent authority of ASME, even though their acts violated ASME's rules. In the Allied Tube case, however, the rules of the standards body involved, NFPA, were followed. Thus, Allied Tube stands for the proposition, that unless a voluntary standards body's rules are so fool-proof that they are unlikely to be used to restrain trade or interfere with competition, there is a risk that a lawsuit will succeed, leaving the voluntary standards body, the participating companies, and perhaps even the volunteer participants vulnerable.

It is quite possible that unless the risk is reduced, some companies may have second thoughts about allowing their employees

to participate in the development of voluntary standards. Such an eventuality would be unfortunate, since a viable voluntary standards community is very much needed to further the public interest. Many standards-development organizations, aware of these risks, have adopted excellent provisions in their operating procedures to minimize the potential for abuse. This study identifies some of these provisions and explains why they appear to be effective.

It would be a serious setback if rules of procedure were not updated to permit participants in the voluntary standards-setting process to feel secure against the likelihood of antitrust prosecution. It would be tragic if the result of Allied Tube were to hamper the good work of the voluntary standards organizations by drying up their greatest resource -- knowledgeable participants.

B. Significance of the Hydrolevel and Allied Tube Cases.

Although this study is not intended to be a legal treatise, it is important that readers understand how the cases arose and appreciate the significance of the Supreme Court's rulings for the voluntary development process and for the organizations that develop standards.

The Hydrolevel Case

On May 17, 1982, the United States Supreme Court handed down a 6-3 decision under which one of the country's major certification bodies - The American Society of Mechanical Engineers (ASME) -- was held civilly liable under the antitrust laws for treble damages due to the illegal actions of its volunteer members.

The issue in this case was whether a new product that did not technically meet one of the provisions of the Boiler and Pressure Vessel Code should have been interpreted to be equivalent. With most model code bodies, interpretation letters evaluating whether new products offer equivalent levels of safety are issued by committees made up of volunteer members. In the case at hand, some of these volunteers were found by the court to have had a commercial interest in keeping Hydrolevel's new low-water fuel cut-off device off the market. They subsequently abused their positions of trust in ASME by issuing a letter casting doubt on the safety equivalency of Hydrolevel's competing product.

The case was decided on what lawyers call a theory of <u>apparent authority.</u> That is to say, since ASME held itself out to the public as an organization that issues model codes and interpretations of those codes, it should be liable for the illegal acts of its members even though (1) ASME did not know about those acts, (2) ASME did not ratify those acts, and (3) ASME did not benefit (in fact, was harmed!) by those acts. The reason for such a rule, according to the Court, is that code bodies wield tremendous economic power, even though they themselves are non-profit organizations. Thus the key to the decision is in understanding how the Court perceives code-setting bodies. To quote the Supreme Court:

> "ASME can be said to be in reality an extra-governmental agency, which prescribes rules for the regulation and restraint of interstate commerce....When it cloaks its subcommittee officials with the authority of its reputation, ASME permits those agents to affect the destinies of business and thus gives them the power to frustrate competition in the

marketplace."

The key question facing standards developers after Hydrolevel was this: What can organizations such as ASME do to limit their exposure to triple damage suits?

The Court itself suggested an answer to that question in its decision, namely to tighten the organization's procedures and to include all conceivable due process protections within them. The Court said:

> "Only ASME can take systematic steps to make improper conduct on the part of all its agents unlikely, and the possibility of civil liability will inevitably be a powerful incentive for ASME to take those steps....Indeed, ASME has initiated procedures to protect against similar misadventures in the future."

From all reports, a number of standards developing organizations did indeed re-examine their rules of procedure to see whether they could be easily violated. Then, seven years later, the Allied Tube case, where the rules were followed, came along and posed an even greater threat to standards development organizations than did Hydrolevel.

The Allied Tube Case

In this case, the U.S. Supreme Court ruled 7-2 that a company can incur antitrust liability for its anticompetitive actions during the development of safety or product standards, even though the company is in full compliance with the rules of procedure of the standards-setting organization.

In the Allied Tube case, a manufacturer of steel conduit (Allied) joined with other steel conduit manufacturers in an attempt to exclude polyvinyl choloride (PVC) conduit from the

National Fire Protection Association's (NFPA) National Electric Code (NEC).

This is how the Supreme Court described Allied's efforts to bar PVC's acceptance under the NEC. Allied, alarmed that a subcommittee of NFPA was proposing to allow PVC conduit into the NEC, met with other steel conduit manufacturers to plan a strategy to keep PVC out of the code. They jointly agreed to exclude PVC conduit from the 1981 Code by packing the upcoming annual meeting with new Association members whose only function would be to vote against the PVC proposal at the annual meeting.

In planning the strategy, the manufacturers abided by all the written rules of procedures of NFPA. They "recruited" 230 people to join the Association and to attend the annual meeting. Among the new members were employees, executives, sales agents, and even a relative of a national sales director. Allied and other steel conduit manufacturers paid more than $100,000 for the membership, registration, and attendance expenses of these voters.

At the annual meeting, the newly recruited members were instructed where to sit and how and when to vote by group leaders who used walkie-talkies and hand signals to facilitate communications. None of these new delegates spoke at the meeting to give any reasons for voting against the PVC proposal. With their solid vote in opposition, the proposal was rejected and returned to committee by a vote of 394 to 390. Indian Head Corporation, a major manufacturer of PVC tubing, appealed this membership vote to the NFPA Board of Directors, but the Board

denied the appeal on the grounds that, although the NFPA's rules had been circumvented, they had not been violated.

In the lower courts, Allied Tube had argued that it should not be held liable for an antitrust violation because it believed it had engaged in what was primarily a "political action" activity; if true, that would have exempted it from antitrust liability. The company's argument was based on the fact that the NEC is ultimately incorporated into most building codes, and its action at the NFPA meeting should be protected in the same way as if the company were to appear before state and local building code officials to oppose PVC conduit.

The court rejected this argument, and further rejected the notion that, because Allied Tube had complied with all the procedural rules of NFPA, it should be immune from antitrust liability. The Supreme Court said:

> "An association cannot validate the anticompetitive activities of its members simply by adopting rules that fail to provide such safeguards. Although we do not here set forth the rules of antitrust liability governing the private standard-setting process, we hold that at least where, as here, an economically interested party exercising decision-making authority in formulating a product standard for a private association that comprises market participants, that party enjoys no...immunity from any antitrust liability flowing from the effect the standard has of its own force in the marketplace (emphasis added)."

It is easy to see why the Allied Tube decision could make some participants in voluntary standards activities nervous about their risk of antitrust liability. In his minority opinion, Justice White speculated on how this might play itself out:

> "The Court's decision is unfortunate....There are now over 400 private organizations preparing and publishing an enormous

variety of codes and standards. State and local governments necessarily, and as a matter of course, turn to these proposed codes in the process of legislating to further the health and safety of their citizens...

There is no doubt that the work of these private organizations contributes enormously to the public interest and that participation in their work by those who have the technical competence and experience to do so should not be discouraged. The Court's decision today will surely do just that. It must inevitably be the case that codes such as the NEC will set standards that some products cannot satisfy and hence in the name of health and safety will reduce or prevent competition, as was the case here. Yet, putative competitors of the producer of such products will now think twice before urging in the course of the code-making process that those products not be approved; for if they are successful (or even if they are not) they may well become antitrust defendants facing treble-damages liability unless they can prove to a court and a jury that they had no evil motives."

The Hydrolevel case forced the voluntary standards community to take a hard look at their rules of procedures to be certain that they were not being violated by members and participants. The Allied Tube case will require these same organizations to take an even closer look at their rules of procedure to be certain that, even when they are followed, they are not abused for anticompetitive purposes.

C. Applicable Legal Principles: The Relationship Between Procedural Due Process and Antitrust Liability

In a March 7, 1989 speech to the American National Standards Institute (ANSI) 1989 Public Conference, Federal Trade Commissioner Terry Calvani spoke about the various ways in which the antitrust laws have an impact on voluntary standards-writing bodies. These were among the points he made:

o The antitrust laws only condemn standards activity when

it unreasonably restrains trade; and

- The reasonableness of standards rests more on whether the standards have a technical basis than on procedural niceties.

These points are important. Procedural safeguards per se do not assure immunity from antitrust liability. Rather, good procedural safeguards need to be thought of as good tools of risk management.

That same thought was expressed even more directly in a November 18, 1988 memorandum to the ANSI Board of Directors from its counsel, Cadwalader, Wickersham & Taft. ANSI's lawyers said:

> "A major objective of the ANSI Procedures has been to minimize the possibility of antitrust liability resulting from participating in voluntary standards activities. By stressing due process, balanced participation, and other appropriate standards development criteria, the ANSI Procedures provide a road map for those who seek to pursue legitimate standards development. At the same time, the ANSI Procedures reflect a system designed to expose potential antitrust problems before they evolve into an actual violation."

The lawyers went on to warn:

> "Even the best written procedures are capable of being circumvented or undermined by a person intent on doing so. For this reason, monitoring to assure compliance will always be of vital importance in the effort to minimize antitrust liability."

The applicable legal principle may be summed up this way. Unreasonable behavior that restrains trade unreasonably can never be legitimized by a defense that is based merely on following the rules of the organization. By the same token, as ANSI and others have stated repeatedly, good rules, well monitored for compliance, can and do protect against both unreasonable behavior and

unreasonable restraints in trade.

II. Design of the Study

Because there are so many different standards-development procedures, it is inappropriate to attempt to produce a "model" set of procedural rules. First, it would be difficult, if not impossible, to draft a "model" to fit the diverse needs of the more than 750 organizations that develop voluntary standards in the United States. Small organizations that produce few standards with limited use are unlikely to adopt elaborate procedures than might be necessary for larger, more market-oriented standards groups. Organizations with full-time professional staffs engaged in standards development have needs different from those of all-volunteer bodies with no staffs at all. Bodies that set standards and also engage in certification activities need to adopt due process procedures that are not required of organizations that only set standards, but which do not certify.

It is also apparent that different standards organizations are comfortable with different types of standards development processes, and would not be likely to make wholesale changes absent a compelling need. Groups that utilize a balanced committee structure face different challenges than are encountered by bodies that rely on the canvass method in their efforts to assure due process.

For all these reasons, the notion of drafting a model set of procedural rules was rejected.

Instead, it was decided that it would be more productive and useful to examine and comment upon the due process rules and

procedures of a diverse group of voluntary standards developers, small and large, well-known and not so well-known, which individually employ very different methods and procedures, and which collectively represent the procedural diversity that exists within the voluntary standards development community. Therefore, this study highlights a number of <u>different</u> approaches to the assurance of procedural due process. The objective is to allow any standards developer to pick and choose from a wider menu than would be the case if we provided only a single prescribed set of model rules.

The following eleven organizations, listed alphabetically, were selected somewhat arbitrarily to represent a variety of the characteristics mentioned above. Each was contacted, informed of the study and its purposes, and asked to provide a copy of its current rules, procedures and/or regulations: [1]/

- o American National Standards Institute, Inc. (ANSI)
- o American Petroleum Institute (API)
- o American Society of Mechanical Engineers (ASME)
- o American Water Works Association (AWWA)
- o ASTM
- o Builders Hardware Manufacturers Association, Inc. (BHMA)
- o Electronic Industries Association (EIA)
- o Institute of Electrical and Electronic Engineers, Inc. (IEEE)

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[1]/ See Appendix A for the full name, addresses, phone numbers, and person to contact for each of these eleven organizations.

- National Electric Manufacturers Association (NEMA)
- Underwriters Laboratories, Inc. (UL)
- U.S. Department of Commerce, National Institute of Standards and Technology (NIST)

All of them responded in a timely fashion and thereby made this study possible; for that we thank them.

III. The Elements of Due Process as Applied to the Development of Voluntary Standards

There is widespread agreement about what constitutes the elements of due process. In a 1975 ASTM publication entitled The Voluntary Standards System of the United States of America, eight elements are listed, namely:

1. Timely and adequate notice of a proposed standard undertaking to all persons likely to be materially affected by it.
2. Opportunity of all affected interests to participate in the deliberations, discussions, and decisions concerned both with procedural and substantive matters.
3. Maintenance of adequate records of discussions and decisions.
4. Timely publication and distribution of minutes of meetings of both main committees and subcommittees.
5. Adequate notice of proposed actions.
6. Meticulously maintained records of drafts of a proposed standard, proposed amendments, action on amendments, and final promulgation of the standard.
7. Timely and full reports on the results of balloting.
8. Careful attention to minority opinions throughout the process.

A ninth due process element was also identified:

9. A duly appointed review body with authority to set

requirements [2]/ for:

(a) Committee organization and operation

(b) Balance of committee membership

(c) Voting and public review

(d) Resolution of negative votes

(e) Appeals

This list matches up very well with the elements of due process identified in the early 1980's by the Federal Trade Commission during its rulemaking proceeding: Standards and Certification. Notwithstanding all of the controversy and acrimony surrounding that proposed rulemaking effort (which was ultimately abandoned), there was no controversy over the identification of the elements of due proces identified in the ASTM list. [3]/

The American National Standards Institute, in its publication Procedures for the Development and Coordination of American National Standards, provides an excellent list and rationale for each of the elements of due process. ANSI states (p. 7 Procedures):

> "1.2 **Due Process Requirements.** Due process means that any person (organization, company, government agency, individual, and the like) with a direct and material interest has a right to participate by: (1) expressing a position and its basis, (2) having that position

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[2]/ Some of these requirements are germane only to an organization like ASTM which develops consensus standards via a committee method.

[3]/ The staff of the FTC had incorporated additional aspects of due process that were controversial, such as the "duty to act." This study does not include the "duty to act" as an element of due process.

considered, and (3) appealing if adversely affected. Due process allows for equity and fair play."

ANSI then lists these elements:

- Openness
- Balance
- Written Procedures
- Appeals
- Notification of Standards Development
- Consideration of Views and Objections
- Consideration of Standards Proposals
- Records