1988

Panel Discussion on Self-Regulation

Robert H. Lande
University of Baltimore School of Law, rlande@ubalt.edu

Recommended Citation
Panel Discussion on Self-Regulation, 57 Antitrust L.J. 809 (1988)

PANEL DISCUSSION ON SELF-REGULATION

Moderator

ROBERT H. LANDE
Professor, University of Baltimore School of Law

Panelists

SUSAN G. BRADEN
Member of the District of Columbia Bar

J. MICHAEL SHEPHERD
Senior Deputy Comptroller of the Currency

CHARLES G. BROWN
Attorney General, State of West Virginia

Commentators

WILLIAM F. BAXTER
Professor, Stanford Law School

ALFRED E. KAHN
Professor, Cornell University

MR. LANDE: The final panel for the day is on self-regulation. Before it starts, I would like to call your attention to all of the superb material contained in the conference volume.[1] As long as I'm urging you to do additional reading in the antitrust/regulated industries area, I'd like to call your attention to articles by three of today's speakers that appeared in a recent issue of the *California Law Review.* While Professor Baxter and others wrote on different antitrust topics,[2] Professor Kahn and Judge Breyer squarely addressed the intersection of deregulation and antitrust.[3] These articles are both brilliant and directly relevant to the topic of this seminar, so I strongly urge you all to read them.

---

[1] ABA ANTITRUST SECTION, THE CUTTING EDGE OF ANTITRUST: LESSONS FROM DEREGULATION, Seminar Course Materials (June 13, 1988).

[2] *See* Baxter, *The Viability of Vertical Restraints Doctrine,* 75 CALIF. L. REV. 933 (1987) and the other articles in that issue.

[3] *See* Breyer, *Antitrust, Deregulation, and the Newly Liberated Marketplace,* 75 CALIF. L. REV. 1005 (1987); Kahn, *Comment: Deregulatory Schizophrenia,* 75 CALIF. L. REV. 1059 (1987).

This final panel, on self-regulation, will be chaired by Sue Braden. It also features two other speakers, Mike Shepherd and Charlie Brown. Both Mike and Charlie are last-minute additions to the seminar so I would like to give them special thanks. I should also like to point out that Michael Meyerson, a colleague of mine at the University of Baltimore School of Law, helped General Brown prepare his outline and talk. Since Mike Meyerson also was brought in at the last minute, I would like to give him special thanks as well.

Sue Braden will start the discussion. She is a partner in the Washington, D.C. firm of Wilner & Scheiner, and had an interesting and varied career before that. Sue has worked at the Federal Trade Commission, as assistant to Commissioner (and, later, acting Chairman) Clanton. She also worked as an assistant to Chairman Miller. Sue has had a number of other interesting jobs and has done an incredible amount of pro bono and bar association work, but to save time I will only mention one other item—her work as a Consultant to the Administrative Conference of the United States on a project to evaluate the competition advocacy and regulatory intervention programs of the Antitrust Division and the Federal Trade Commission. Needless to say, the topic of this panel, self-regulation and the intersection of antitrust and regulation, is an area that she is very familiar with.

Our second speaker will be Mike Shepherd, the Senior Deputy Comptroller for Corporate and Economic Programs at the Office of the Comptroller of the Currency. Mike has responsibility for a wide range of competition policy, economic, and planning activities. He, too, has an interesting background, including private practice and other government service, but there is one item that is of special relevance to today's seminar. In 1980 Mike was Assistant Director for Policy Coordination on the Reagan-Bush Presidential Transition Team, or, in other words, one of a small group who tried to figure out what the Reagan Administration should attempt to accomplish in the areas of competition and regulatory policy and deregulation. Mike was one of the earliest architects of the developments that have taken place in these areas during the past eight years and thus had a crucial effect on the Reagan Administration's accomplishments. So, even though the topic of this panel is self-regulation, I hope Mike can be persuaded to tie into this theme some thoughts about what the Reagan Administration in 1980 hoped it would achieve in the competition/regulation/deregulatory areas, and how much of this it actually was able to accomplish.

Our final speaker is Charlie Brown, the Attorney General of the State of West Virginia. Charlie previously served as an attorney at the Federal

Trade Commission and also has been in private practice. I also should tell you that he is currently the Chairman of the Antitrust Committee of the National Association of Attorneys General. In this capacity he has undertaken a large number of important (if sometimes controversial) tasks and has assumed many vital responsibilities, including spearheading an effort to repeal the McCarran-Ferguson Act. But today he will focus on self-regulation and other competitive issues in another industry he knows quite well, the cable industry, presenting insights he developed together with Professor Meyerson. But first we will hear from Sue Braden.

MS. BRADEN: A copy of the *Report on Regulatory Reform*[4] prepared by the Industry Regulation Committee of the Antitrust Section, has been made available to each participant today. This report was put together primarily under Don Flexner's leadership in 1985 and adopted by the Section's Council. The Report sets forth the competitive principles that we think the regulatory agencies should live by. It's a useful reference which contains a good historical summary of how regulation came to be.

I would like to make one or two brief remarks and then turn it over to our panel. Let me begin by reading seven principles to use to analyze the effect of regulation, which come from a book that was recently published on deregulation.

(1) Is the regulation consistent with market incentives, to the maximum extent possible?

(2) Will the remedy work?

(3) Will the chosen remedy minimize the cost burdens of compliance consistent with achieving that objective?

(4) Will the benefits flowing from the regulation go to consumers or will competition substantially exceed the cost?

(5) Will the regulation or remedy adversely affect competition?

(6) Does the regulation preserve the freedom of informed individual choice to the maximum extent consistent with consumer welfare?

(7) States' rights should be considered. The federal regulator needs to ask, "To what extent is this problem appropriate for federal regulation and amenable to a centrally administered national standard, or is it perhaps best left to a local administrative agency?

---

[4] ABA Antitrust Section, Industry Regulation Committee, *Report on Regulatory Reform*, 54 ANTITRUST L.J. 501 (1985).

These seven principles are not too dissimilar from others that you've heard earlier today as "lessons from deregulation." What may shock you is that the author of the book is Michael Pertschuk, and the book was written two-and-a-half to three years ago, at the end of his term as Chairman of the Federal Trade Commission.[5]

It is useful to begin with the words of Mike Pertschuk to demonstrate my belief that deregulation is not a political issue. Deregulation and regulatory reform have a great deal of support from both ends of the political spectrum. I think where the consensus breaks down is on how fast deregulation should proceed and the role of the antitrust laws in implementing deregulation in certain industries. I plan also to talk about that a little bit at the end of our panel's presentations.

Mike Shepherd, as some of you know, currently is the Deputy Comptroller. He will talk about the deregulation experience of the financial institutions industry and share with us some observations from his time in the transition team.

Attorney General Brown, from West Virginia, plans to spend most of his time discussing the deregulation experience in the cable industry.

MR. SHEPHERD: I have been asked to talk about the goals of deregulation from a broader perspective than just banking law, from my tour of duty in the transition team, the Department of Justice, the White House, and now the Treasury Department.

The Reagan Administration was determined to bring about greater regulatory certainty and introduce sound economic analysis, including formal cost/benefit analysis, to regulatory decisions generally. Two of the most important aspects of that initiative were the establishment of the Vice President's Regulatory Task Force, and the issuance of Executive Order 12,291 which created the Office of Information and Regulatory Affairs in OMB. This was the first effort to impose a formal process overseen by an independent office created to carry out the President's wishes in this area, in addition to his reliance on the sound judgment of his appointees.

The Administration's regulatory philosophy was based on the assumption that free market forces allowed to operate without unnecessary interference will provide the best distribution of resources. The only reasons that the market alone cannot be relied on are when there are factors special to that industry that make the operation of the free market inefficient or there are some overriding national interests that can't be

[5] M. PERTSCHUK, REVOLT AGAINST REGULATION (1982).

protected through the operation of the free markets. Those are rare situations. In the case of the continued, heavy involvement of the federal government in the banking industry, there are three basic justifications: (1) the provision of federal deposit insurance; (2) banks and thrifts are considered to merit special attention as the central nervous system of the economy; and (3) the banking system is the principal vehicle through which monetary policy is effected.

Our overall goal can be summed up in James C. Miller's definition of deregulation as "the elimination of government-imposed barriers to competition."

One major achievement in the antitrust area during the Reagan Administration has been candid and predictable enforcement, exemplified through speeches, the Merger Guidelines, and the government's briefs. Clear enforcement policies, with perhaps a more permissive view of nonhorizontal mergers, made important rationalizations possible in many industries.

In many regulated industries, I think technology made deregulation inevitable, or at least caused regulatory principles to be reviewed. This trend is particularly evident in the financial services industry.

The financial intermediary's role is threatened by online services and other ways of gathering and transmitting information that permits debtors and creditors to interact directly, destroying the intermediary's monopoly on information. Services organizations with their own databases, and the computing power to manipulate the data, coupled with telecommunications, can provide potential investors with the same credit and market information that was once available only to the intermediaries. Intermediation is no longer as profitable, therefore, to the banks or others. While these developments should be heralded for providing important consumer benefits, like other innovations, though, they call into question the old frameworks that were set up after the Depression.

Banks also diversify their activities through securitization and other techniques to rid their balance sheets of certain assets and still maintain fee income. Again, that is technology-driven. Were it not for their tremendous information processing capabilities, banks would not be able to package the deals for investors and then still do the servicing at a profitable rate.

From the perspective of antitrust law, perhaps the principal impact of deregulation has been the expansion of relevant markets. The last eight years have seen a remarkable increase in the number of firms offering financial services, blurring the old lines of demarcation between indutries. The most obvious example is the savings and loan industry—which lost its protected interest rate differential with the elimination of Reg Q, and is now making commercial loans—but breaks have also opened up in the old walls separating investment and commercial banking, real estate, and insurance.

Coupled with reciprocal interstate banking statutes enacted by most states, product deregulation has greatly changed relevant markets. Reorganizing these marketplace conditions, the Department of Justice has indicated that it will allow an additional 200 point increase in the Herfindahl Hirschman Index for bank mergers over the general standards of the Merger Guidelines. It may seem ironic, but I believe that the only mergers that we would either deny or the government would challenge would be between small banks in a very remote location. In approving Wells Fargo Bank's 1987 acquisition of the consumer trust business of the Bank of America, for example, I found that the relevant market was at best the State of California, and noted the existence of substantial non-bank competition, especially from brokerage firms, including those from out of state.

One of the most important examples of deregulation leading to market expansion are the Comptroller's decisions to permit liberalized intrastate branching. We have now approved national bank applications to branch across county lines in Mississippi, Texas, Louisiana, Tennessee, and Florida, and similar applications are pending in nine other states. The federal branching statute, the McFadden Act, permits national banks to branch only to the extent state-chartered institutions engaged in the banking business are permitted to do so. In each of these states, banks were forbidden to branch outside their home counties. We approved the applications, reasoning that, with the broader powers conferred through deregulation, state-chartered thrifts were engaged in the banking business, and noting that they have broader branching authority.

We have constructed elaborate models for how new securities activities would have to be in separately incorporated subsidiaries of banks in order for the banks to be able to pursue their traditional customers, for example, to the commercial paper markets.

Preparing to discuss self-regulation with you, I was reminded of working on a speech for then-Deputy Attorney General Carol Dinkins. She was invited to address a National Association of Self-Regulatory Association's luncheon in Washington, assuming that she would make some wonderful speech about how, "It's great that you self-regulatory associations are filling in now that we're starting to make progress on the deregulation front." Instead, every draft we could get through the Antitrust Division said, "You watch out, you price-fixers . . . we're watching you guys all the time."

There's really something to that. Industry standards can quickly become price standards. Self-regulatory organizations can also be used to otherwise enforce cartel behavior through the management committee of the self-regulatory organization that can work to exclude nonmembers.

While in some situations regulatory agencies may intend to occupy the field and oppose intrusion, there are many occasions where SROs can help to fill gaps or perform services.

The question for the future of deregulation is whether the political momentum can be sustained. I think the technological advancements that I've discussed will continue to push deregulation and continue to mock the outdated statutory schemes under which we still operate. Congressional inaction forces the regulators and the courts to go through greater gymnastics in the interest of overall good of consumer benefits and competition. I believe that deregulation will remain good politics. It doesn't mean de-supervision, and that's important, both in the airline industry and in the banking and savings and loan industry. Just because we're trying to get government out of more things doesn't mean that the remaining things the government does should be done poorly or inefficiently. I think there is a great deal of concern that the safety and soundness of the banking system might be jeopardized by further deregulation. We don't feel that way, so long as adequate supervision is maintained.

It's important to note that the major transportation deregulation bills—motor carriers, railroads, and the Airline Deregulation Act—were first discussed under Republican Presidents before Democrat-controlled Congresses, signed by President Carter, and now enforced and expanded in the Reagan Administration. Partisan politics should not stop good developments. Although it's an overused word in Washington, I believe financial reform is a "competitiveness" issue. We have an interest in American firms not being unfairly impeded by the regulatory structures that they have to deal with. In the increasing market and global competition that banks and so many other firms that you all represent face, we don't have the luxury of having an out-of-date regulatory system. Through the Reagan Administration's efforts, and the efforts of academics and practitioners, we have championed free market principles. That's done through regulatory action, through case law, through the amicus program, making the right personnel choices in the Administration and good judicial appointments. I think the battle has been won, in large part, because of the soundness of the ideas from the law schools and the economics departments and the ability of advocates to translate those concepts into meaningful arguments before regulatory tribunals and before the courts.

MR. BROWN: It's hard to be an antitrust lawyer and believe in self-regulation. After all, an economist would point out that there are three ways to run an industry: either regulated, competitive, or a cartel. If we really take that to an extreme, then self-regulation is the cartel. Obviously, in today's complicated economic world, those three choices are not always distinct ones. There are mixtures all the time. Industries are regulated and competitive and self-regulated. Yet, as a general rule, I think we, as a society, certainly favor competition over regulation, and undoubtedly we, as antitrust lawyers, maintain that very overwhelming presumption.

The states are very much in the ball game in terms of antitrust enforcement. I think if we are going to deregulate, then we must recognize that the need for antitrust enforcement becomes much greater. One cannot, for example, deregulate airlines and then allow mergers to a point of reducing overall competition.

When you have so few competitors, the opportuity and the ability to fix prices increases dramatically. Witness the soft drink industry, where a few giants in the marketplace were able to convince the Congress to stop intrabrand competition and limit their territories to absolutes. Thereafter, with two or three companies knowing for certain that they not only were the only competitors in the territory, but that there were also no potential competitors in that area, they could price as they wanted. The ongoing grand juries all over the eastern part of the country bear out that a failure to regulate, combined with an exemption from antitrust enforcement, will only further attempts to restrict competition.

My topic today centers on the effects of deregulation on the cable industry. The effects of cable deregulation have become of great interest to the states. In fact, the Antitrust Committee of the National Association of Attorneys General, which I chair, has set up a five-state working group on cable matters consisting of New York, West Virginia, Ohio, Texas, and Maryland. This working group is looking at the issue of the competitive effects of deregulation on cable television.

Cable television really is a distribution service—a retail business—for cable programming. The cable programming service has traditionally been carried over coaxial wires. There are competitive modes to get cable television into the hands of consumers, but the competitive modes are not yet well developed. Wireless cable and Satellite Master Antenna Television, or SMATV, are examples of these new distribution competitors. We also have seen in rural areas, certainly in my state, the development of satellite dishes as a separate programming delivery option.

Coaxial cable, however, remains the dominant means of distribution and it is a means that by its very nature has been recognized by some courts as a natural monopoly. Yet Congress, through the Cable Communications Act of 1984, has effectively institutionalized that monopoly by preempting state and local control over key regulatory functions—the ability to set rates and the ability to control programming choice.

In the 1984 Act, Congress created a definition of effective competition which has extended deregulation to every television market. The overwhelming majority of television consumers now live in areas where over-the-air reception of signals is impossible and cable is the only viable option for viewing television.

As a response to this wholesale deregulatory agenda, I filed the first antitrust and consumer protection case[6] after the Cable Communications Act took effect. We filed in February of 1987 when the cable company in our state capital did what they call re-tiering—that is, they took a situation where they would offer only a few channels on segregated tiers and they eliminated these options, effectively stating, "Now you're going to have to take all of the programming we give you with a sixty-seven percent price increase to boot." This was true all over the country. Re-tiering took place in a massive way once the Congress gave the cable industry carte blanche to do what it wanted.

Our case proposes a tying theory that claims the cable operator is forcing the consumer to buy a whole host of channels when the consumer previously had the choice just to get a few channels.

We also rest our case on a theory of unfairness. We have a "little FTC Act" as well as a "little Sherman Act," and we are filing it under the concept of unfairness. With the extreme market power that the cable company has in the state capital, we consider the bunching together of channels to be an unfair act or practice. We also allege a deception count in relation to the way in which the whole program was marketed.

We did win our first round. It took a year. But the cable company, not surprisingly, removed to federal court and said, "This whole issue is preempted by Congress. You have used the doctrine of artful pleading. You're really just saying we're deregulated and you're upset about that."

[6] West Virginia v. Americal Television & Communic. Inc., No. 87-C-659 (W. Va. Cir. Ct. Kanawha Cty. filed Feb. 16, 1987) (See Antitrust & Trade Reg. Rep. (BNA) No. 1307, at 559 (March 19, 1987)).

The federal judge disagreed, saying that the State Consumer Protection Act and the State Antitrust Act do apply to what the cable companies did, and he remanded the case back to the state court.[7] We had brought the case, and have brought the case, only under state law. We are hoping that case, continuing in the Kanawha County Circuit Court in Charleston, West Virginia, may help develop some of the law in this area.

The essential analytical point to stress is that vertical restraints become very important to a deregulated industry which demonstrates monopoly tendencies. I know the vertical restraint is something that is more frowned on from the national federal government level, but tying is important when you have freed up everything else. In our case, if there is that natural monopoly, then economists would agree that the cable operator cannot use the power in one market to control the next one. That's what tying is all about.

Another area of concern in cable enforcement that has been amplified by deregulation has to do with the vertical integration of large corporations which own multiple cable systems, with cable programming concerns. This overship control beween program producers and program distributors has stimulated accusations, based on some circumstantial evidence, that cable programming is only sold to, and through, coaxial cable operators. If the operator of an alternative cable delivery technology, like wireless cable, would like to get that programming, they have been finding that it has been quite difficult. Likewise, the SMATVs, the apartment building concept, are having that same difficulty; they are unable to get essential programming with any degree of success. The MSO (Multiple Service Operators), in essence, appear to be acting as a bottleneck for programming delivery to the competitive technologies in the marketplace.

What's especially upsetting about these allegations, if true, is that the cable industry originally sold the idea of deregulation to Congress by saying, "We've got all kinds of competition coming on line from new cable delivery technologies and therefore we have to be freed from control of our local operations." Now, with a deregulated monopoly in hand, the cable industry may be attempting to drive out the new competition by wielding their big stick of monopoly distribution in front of vertically integrated cable programmers.

That's why the whole area of vertical restraints—and vertical integration, the vertical ownership that has taken place and continues to take place—has been of real interest to us in the states.

---

[7] West Virginia v. Americal Television & Communic. Inc., No. 2:87-0203 (S.D. W. Va. Feb. 9, 1988). (See Antitrust & Trade Reg. Rep. (BNA) No. 1354, at 331 (Feb. 25, 1988).

I think, therefore, that vertical integration in the cable industry, combined with a deregulated monopoly status for the cable operator in each local community, has produced some issues that are very ripe to be looked at from any perspective. When market power in a natural monopoly is extended to keep out anybody else, one can certainly feel confident in the assertion that deregulation in that instance has failed.

The cable industry is going to be a fascinating industry to be watching and examining. We do have our five-state working group which will be looking at it, and we'll have a report or more at our October meeting.

MS. BRADEN: The final comment I would like to make before we go to our panelist commentators is this: I don't think that deregulation is going to stop, and the reason it won't stop isn't due to antitrust, this panel, or any of the books that some of the people have written. It won't stop because almost all the markets that have been regulated for the past hundred years are changing, and it is in the interest of those players to restructure the rules. As market power erodes in certain sectors and there are new entrants with political power, you will see the rules change; you will see deregulation; and you may see that new regulation—not reregulation, but some other new type of regulation—will come up in its place. I think cable will be an interesting area to watch for this.

The pace of deregulation of industries is going to depend in large part on the effectiveness or the perceived effectiveness of the antitrust laws. If I were to have given any advice to Bill Baxter or Rick Rule, it is that they should have had a Deputy for Marketing, because the perception on the street, as well as on the Hill and other places, is that the antitrust agencies have packed it in; that unless you had people come in to confess price-fixing meetings, the Division simply wasn't going to interrupt its day to be bothered by other types of competitive problems.

However, that perception is not true. Both agencies have tremendously talented staff who have been very aggressive in different areas. But the perception has in part become reality, or the reality is the perception. I believe it is unfortunate, because deregulation now has momentum. As Professor Kahn said, it would be a shame to have this progress reversed because of a misperception as to the commitment of the antitrust authorities to the competitive objectives of deregulation.

Self-regulation is a misnomer. Either you're regulated or you're not, and if you're not, you're subject to the antitrust laws. You can regulate yourself all you wish, but that's not going to change the analysis about whether you have antitrust immunity or not—and it shouldn't. If industry groups want to get together and try to do some good things and keep each other from violating the antitrust laws, that's all to the good. But it doesn't supplant antitrust responsibility, and certainly shouldn't supplant regulation where a case has been made out that it benefits consumers. And I submit that there are probably very few of those left.

Some of the best work that has been done by both antitrust agencies in the past ten years has been a bipartisan effort in the competition advocacy programs. I have been particularly concerned to see this effort receive such a bad rap on the Hill from the oversight committees of both the Justice Department and the FTC. I believe much of the problem has resulted because this work is misunderstood. The problem is that when the Justice Department intervenes at the FERC and does the excellent work that Don Kaplan and his people have done over the years, they don't come up with a statistic at the end of the day. There is no "Antitrust Division wins one," or the FERC says, "We really appreciated hearing from you today." There's no acknowledgment of the benefit of that advocacy. Therefore, the antitrust agencies have no statistics to take to the Hill to justify what they did with their budget for the last year. So there's no statistical accountability in a sense, which has been one of the problems of being able to justify the legitimate expenditure of funds in these areas.

When Professor Baxter took over the Antitrust Division, there was a lot of brouhaha about his amicus program. This was very valuable work in the deregulatory side. The time and effort spent in intervening in other agency proceedings wasn't being done by any other concern for the consumer. Advocacy before the regulatory agencies was clearly done by people who speak out of self-interest, and there was no one speaking for the public. The agency staff's primary job is not to look at competition problems; their primary job is to see that the "public interest" in a very broad sense is served—and competition is only one dimension of that public interest.

I believe that the antitrust bar needs to support this effort by the antitrust agencies. This should not be a partisan issue. Competition advocacy simply needs to be better understood. It doesn't supplant antitrust enforcement. As a matter of fact, it might enhance or accelerate antitrust enforcement to the extent that you may have deregulation occurring in some areas sooner. For that reason, I think it's a loss that those programs have received short shrift.

The title of my remarks is "Deregulation: Political Test of Antitrust." The perception and understanding of the role of antitrust is very important to the reality of how or if deregulation will continue.

Last week, in the Business Section of the *Washington Post,* this ad by the American Association of Railroads appeared which said: "If Congress passes this bill" (CURE—railroad reregulation) "soon you will see this one." "American consumers for high transportation costs—it's going to cost you $15 billion a year."

If you go back and look at the testimony about the bill, you will see complaints about antitrust problems in isolated geographic sections of the country. The issue is who is going to address these concerns—the regulatory agency or the antitrust authorities and the courts. If the ICC doesn't feel that it can or should intervene, then perhaps we do need to take a look and see what the antitrust agencies can do in this area. And if not, there's a legitimate question as to whether there is a need for legislation. I'm not here to take sides one way or the other, but to use the CURE bill as an illustration of how important it is to realize that the perception of no enforcement remedy for a legitimate concern may result in bad law. If there's a perception that the Antitrust Division and the FTC are not equipped or will not respond, the result may be new regulation.

Tom Kauper said recently that if deregulation is largely a legislative matter—which it is—then the perception of legislators about the effectiveness of antitrust enforcement is absolutely critical. I think he's right, and that the antitrust agencies do need to spend more time being concerned about that perception.

Commissioner Strenio spent a great deal of time talking about strong antitrust enforcement at the FTC. I believe this is accurate. The *7-Up/Pepsi* merger was the highwater mark. If you look statistically at the number of mergers that have been investigated or blocked after that period and other matters that the FTC has initiated, I believe you see a real change.

The situation is really not all that different in the Antitrust Division. The staff, particularly in the criminal area, is outstanding. And while there has been some shift of resources, I think that the antitrust agencies really are doing a very good job. There has been active antitrust enforcement. But there also has been too much loose jargon that has damaged the agencies, as well as the progress of deregulatory efforts.

To the extent that we as members of the ABA and the bar have a duty, it is to be sure that that message gets through to our clients and others that the authorities are doing their job and that the competition advocacy program is part of that effort.

Deregulation will be a political test of the antitrust laws. If there is a perception that the antitrust agencies and the laws are not being enforced, then regulation will slow down, and it may stop for a while. If there is a perception that there is a "hands off" antitrust attitude, you may see reregulation that is unnecessary, and perhaps harmful in the long run.

QUESTIONS & ANSWERS

MR. LANDE: Would any of the panelists like to make another comment? If not, I'll take questions from the audience.

QUESTION: I've been a little disturbed this afternoon on the meaning that is attached to deregulation. I was assuming all along that deregulation refers to price and to entry into markets, and it did not extend to safety. Professor Kahn, for example, has said that deregulation in airlines and trucks has not caused a loss of safety—maybe he's right, maybe he's wrong—but if it has, or if there is a danger of it, we can always add to the safety regulation; we don't have to go back to full industry regulation.

However, the term "economic deregulation" has also been used here to refer to, I think, general deregulation of financial institutions which would involve not only deregulation of their interest rates and whether they need a Certificate of Convenience and Necessity to open up another bank or another brokerage firm, but also to the character of their investments.

We have been passing through a crisis of degeneration of the quality of financial institution assets. The federal government has an obligation not only to protect the creditors of financial institutions, particularly depositors in banks, but also to protect itself, because the government simply cannot—at least, it feels it cannot—allow a large financial institution to fail. To say that these financial institutions should be deregulated and allowed to do whatever the market pushes them to do, seems to me to be creating a great danger.

A commercial bank that invests only in accounts receivable and notes receivable and so on runs some risks, but these can be worked out with deposit insurance on an actuarial basis. But, when the bank is also allowed to invest in long-term securities of underdeveloped countries, in oil drilling ventures, take equity positions in real estate projects, and so on, this is a safety problem akin to that which the FAA has to deal with in airlines.

I was wondering why we should be talking about deregulation of that area, or even allowing banks to go into the brokerage business, it looks like, with ease of entry. Nobody has ever said that there is a serious problem on ease of entry into the brokerage business, so I don't see why a bank has to be given authority to do it.

MR. BAXTER: It seems to me that the failure of a bank is quite unlike an airline accident. Nobody gets killed. I put bank failure very distinctly in the category of financial regulation.

The insurance agencies have created a serious problem by permitting depository institutions to engage in the most fanciful kind of accounting, in the first instance, by being much, much too slow to close failing institutions down. They have also failed to distinguish between institutions that have extremely thin capitalization or a negative capitalization in any reasonable accounting sense, and adequately capitalized institutions. There is no reason to prevent adequately capitalized institutions that are betting their own money from engaging in a wide variety of financial assets.

But we have created a situation in the United States where, as a financial institution approaches failure, it becomes an entirely sensible long-run profit-maximizing strategy to bet on the horses. You take your last final plunge in some highly speculative assets, and if it pays off you are back in great shape. If it doesn't, you slip the bill to Uncle Sam. Now, that does not seem to me terribly difficult to understand. The banking authorities seem to me to have been incredibly slow in facing up to its implications and doing anything about it.

MR. KAHN: I wanted to raise financial markets as a possible case in which deregulation may be discredited. I was hesitant because I don't have a feel for the financial markets, so I don't go around advocating deregulation there.

But the critical question, Bill, that follows from your comment is: Are you suggesting, then, that one can safely permit competition, freedom of pricing, freedom of choosing your assets, freedom to compete in interest rates for deposits, but all one has to have is sufficiently assiduous regulatory scrutiny of a different kind, that is to say, of the capital/liability ratios on behalf of the deposit insurance institutions, the need for which I take it we all accept?

MR. BAXTER: I certainly would accept the need for depository insurance institutions of a certain order of magnitude. I readily accept the idea that the ordinary family cannot be expected to keep track of the solvency of its depository institutions, but nevertheless ought to be able to use one with complete safety. However, the average family does not need a $100,000 limit, much less the incredibly large sums one can get by taking all possible permutations of the family which are allowed. We have permitted the limits to get too large.

I am saying two different things. If you can impose sensible accounting rules and keep track of what is going on well enough to close institutions down before they have substantial negative net worth, then the insurance fund suffers no loss. That's one possibility. A second possibility is to draw a distinction between institutions that are in different ranges of capital adequacy, and either control the assets which they invest differently or vary the insurance premium that is charged for the government insurance, to have something like actuarial reality. We have not done any of those three things.

MR. SHEPHERD: I'd like to just address that briefly if I could. I agree with many of the questioner's points, and I don't think he expects me to. He raises the point I was trying to make when I said that deregulation does not mean de-supervision. It seems to me that, just as further deregulation is tied in part to vigorous antitrust enforcement, so is future deregulation and new powers for banks and other financial institutions tied to both Congress' confidence and the public's confidence in the supervisory process. Assuming that we can do that job effectively, it would be very unfortunate to bar from entry the most likely firms to enter the investment banking business, the commercial banks.

We are, to follow Professor Baxter's point, pursuing both risk-based capital guidelines which discount for certain government-guaranteed assets on a bank's balance sheet and try to achieve some measure of international convergence on capital adequacy.

MR. REIN: I have a question. In the last few minutes we've been talking about goals of economic activity, like safety, or the ability of a small depositor to avoid the informational problem of risk, which appear to be at least suggestions of market failure. That is, if you left the industries alone, somehow, they would not protect fully, at least individually, the interests which we deem to be socially necessary, and that's the reason for safety impositions and special insurance.

Coming back to self-regulation for a moment, suppose that the participants in these industries decided that that was a true problem, one of public confidence, one which could cause it to be reregulated, and they formed a group or association to do some of the things that are socially necessary, and now we have that under the antitrust laws.

One question is: Should we permit them to do that? Let's assume they say, "We formed a trucking safety group and we imposed a lot of self-regulation, and we're going around in a neutral way inspecting trucks, because we're afraid that if we have too many accidents that Congress will reregulate us." This, of course, reduces competition from being the safest trucking outfit and getting the lowest insurance rates, or whatever.

The question is: Do we consider the antitrust laws as they look at this, and under the *Professional Engineers* case[8] it kind of segregates that, because you can look at factors that are socially beneficial versus factors that repudiate competition itself? Are they properly structured to deal with these problems? Must we have a legislative initiative? Should you be able to put those kind of agreements in front of courts and defend them as necessary to preserve the industry against some other kind of government intervention?

MR. BROWN: Sure, you can put any practice—I mean, that's why so much of the antitrust laws are court-made. Congress sets the general law and then we continue to work with it. Under the rule of reason, I think it's "power, purpose, and effect." What is the purpose of the safety rules, what is the effect of them, how much market power is there of the trucking companies who designed the safety rules? I think it goes back to whether they can devise safety rules for the industry. The answer is maybe. I mean, we start designing, we start looking under the rule of reason at all the factors involved. Certainly the lawyers that advise the trucking association should have just as much case law and economic data as those who would look at it from the government side.

MR. REIN: Yes. But I wonder whether you can look at all the factors. For example, what if a trucking company said, "We are excluded from this industry because we can't meet the basic standards and they won't allow us into their group trucking association, and this is impairing our ability to get cargoes from people who don't want to be seen as dealing with a renegade and whose insurance won't cover them if they deal with a renegade." That fellow brings a case and he says, "I am excluded by this agreement, this is an 'essential facility,' and they shouldn't be in the safety business." I'm wondering whether, under *Professional Engineers,* he wouldn't have a darn good argument that all this safety stuff is a repudiation of the market—you can't bring a repudiation of the market into an efficiency defense in an antitrust case; we better go get the Congress to do it. I'm just wondering what the panel thinks the chances are that you could defend that agreement if you are faced with a *Professional Engineers* argument.

I'm reminded of the *NCAA* case,[9] in which the Court said, "You can make all these arguments about the glory of college football, but they don't count, we don't want to listen to them, they have nothing to do with the issue."

---

[8] National Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679 (1978).

[9] National Collegiate Athletic Ass'n v. Board of Regents of U. of Okla., 468 U.S. 85 (1984).

MR. BAXTER: The *Professional Engineers* case said private parties can't limit a particular kind of rivalry on the ground that it is bad for consumers. If your trucking safety committee also includes an agreement that nobody will have their trucks checked more frequently than monthly, or something of this sort, then it seems you have raised a serious question. But if it is merely an agreement that "we will all employ minimum standards and, of course, everybody is free to employ more vigorous ones, or to advertise that he employs more vigorous ones, or to announce that he has better safety results, and so on and so forth," I can't imagine that it would cause a problem. We issued a number of Business Review Letters that would respond to that basic description, although certainly not any dealing with trucking safety.

MS. BRADEN: I would make one other proposal for people to think about. In the middle of the 1970s, there were a set of hearings before the Judiciary Committee on the Competition Improvements Act which would have required regulatory agencies to issue competitive impact statements, like an environmental impact statement, so that when an agency acts there is some public accountability—to show that the agency thought about competitive issues. I would like to see in either a Bush or a Dukakis Administration some effort to look at reopening those hearings and seeing if legislation in that area could help us get a report card on the advocacy programs. At least this would provide a measure of the effectiveness of the deregulation program and help legitimize the antitrust agencies' work.

MR. KAHN: I certainly agree. I think I testified in favor of that bill. A lot of the intention of that bill was incorporated in the standards in some of the deregulation acts, about whether it is necessary and whether it is the least restrictive competition method available. I think it might still be salutary to have a broader application.