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IDENTIFYING AND TACKLING DYSFUNCTIONAL MARKETS

-- Note submitted by the US Federal Trade Commission --

This note is submitted by the US Federal Trade Commission FOR DISCUSSION at the joint meeting of the Competition Committee and the Committee on Consumer Policy to be held on 13 October 2004.

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IDENTIFYING AND TACKLING DYSFUNCTIONAL MARKETS

(Note submitted by the US Federal Trade Commission)

1. The US Federal Trade Commission (FTC) has, when possible, examined suspected dysfunctional markets with an open mind about whether the problems are caused by supply side competition dysfunctions; demand side restrictions on consumer choice, which we think of as consumer protection problems; regulatory dysfunction that prevents markets from protecting consumers as they should; or some other problem. The FTC attempts to craft solutions that respond to the problems identified. The FTC is pleased to be able to share its observations and its experience in the legal services and death services industries.

I. What is a dysfunctional market?

2. A discussion of dysfunctional markets should begin with a general understanding of what the term means. The term is not part of the enforcement vocabulary of competition or consumer protection enforcers in the United States, but the concept is familiar to both.

3. In an ideal world, we expect competition to create conditions that encourage providers of goods and services to enter the market and offer products that consumers want at prices they are willing to pay. Those that produce what consumers want are rewarded with increased profit; those that do not are punished by reduced profit, which creates incentives for improvement. In this ideal world, competition would supplant the need for most consumer protection functions.

4. Of course, the real world sometimes falls short of this ideal. Markets can and do fail for any number of reasons. Competition may not be effective when restricted by governmental or privately imposed measures or when natural monopoly conditions exist. Even when markets are open and contestable, consumers may not always be able to benefit from the choices theoretically available to them. Consumers may be unable to choose between competitors effectively due to deception, confusion, lack of information, or other reasons.

5. From a government enforcer’s point of view, the fact of market failure does not necessarily imply that action is always necessary, however. There are situations where markets do not function ideally, but nonetheless are not good candidates for intervention because any remedy would fail to result in a net improvement. Consequently, concluding that a market is so dysfunctional as to warrant intervention requires determining whether a beneficial remedy is available.

6. Markets may therefore be considered to be dysfunctional when they persistently fail to bring consumers the benefits that would be expected in a functioning competitive market. Using government intervention to address such markets would be advisable, however, only if its benefits are greater than its costs.

II. The US experience in identifying dysfunctional markets

A. Recognising the problem

7. In the United States, competition and consumer protection agencies identify dysfunctional markets in a number of ways. First, agencies can rely on knowledge and experience gained by enforcing competition and consumer protection laws. While a single case in a particular market might represent an isolated practice, a pattern of cases in which the same problem appears in the same industry may suggest that the robust exercise of consumer choice is not sufficient to allow the market to work as it should, and that the market failure goes beyond the conduct of a single firm.

8. Second, consumer complaints may also suggest dysfunctional markets. The FTC receives thousands of consumer complaints, and compiles them in a law enforcement database that it shares with other federal, state, and local law enforcement officials in the United States, Canada, and Australia.[1] The database allows the FTC to monitor trends and identify market failures that might be susceptible to consumer protection law enforcement, consumer education, or advocacy efforts with other government agencies.

9. Complaints that suggest competition problems, on the other hand, rarely come from individual consumers. Instead, they tend to come from relatively sophisticated downstream business customers who are willing to take the initiative to complain about anticompetitive practices that hurt their business. Among other things, FTC and DOJ attorneys and economists who specialise in particular industries maintain contacts with such customers, and receive complaints through them. The agencies also frequently receive complaints from competitors, but they are cautious in discerning true competition problems from competitors' desires to achieve through government intervention what they cannot achieve in the marketplace.

10. Third, potentially dysfunctional markets are also identified through liaison with other units of government and private sector organisations. State and local law enforcement officials, other government agencies, trade associations, and members of Congress regularly contact the FTC about problems with the functioning of markets that might suggest a competition or consumer protection remedy. Trade associations, consumer organisations, and self-regulatory organisations such as the Better Business Bureau and American Association of Retired Persons have also provided useful insights on market failures. For example, the Better Business Bureau's National Advertising Division, the advertising industry's self-regulatory arm, often refers matters to the FTC when it finds that advertising claims are unsubstantiated and deceptive.[2]

11. Fourth, certain studies have identified particular industries where consumer choice is not working for consumers in the way it should. These studies seek to determine whether the problem is a demand side restriction on competition, a supply side restriction on impediments to consumers' ability to make informed choices, a regulatory failure, or something else. Examples of such studies will be discussed in more detail later in this paper.

12. What the US agencies, the Federal Trade Commission and the Antitrust Division of the Department of Justice, do not do is investigate markets simply because prices or profits seem to be unreasonably high. It is well established in US antitrust jurisprudence that "the successful competitor, having been urged to compete, must not be turned upon when he wins."[3] Inquiries based solely upon price and profit would suggest that success, by itself, indicates some illegality. Instead, we seek out markets where there are indicia that competition or the free exercise of consumer choice is being impeded in ways that cannot be explained by fair but earnest competition.

B. What kind of problem is it?

13. The mere fact that a market appears to be dysfunctional does not always tell us what kind of problem exists and what kind of solution might be appropriate. Ideally, once a dysfunctional market has been identified, the first step should be to analyze whether the problem fundamentally results from:

- Limitations on supply, which could suggest a competition problem.
- Limits on consumers' ability to choose among suppliers, which could suggest a consumer protection problem.[4]
- Inappropriate governmental restriction on supply or consumer choice that might suggest a regulatory problem susceptible to competition or consumer advocacy.
- Some combination of the above; or
- Lag time in the market's adaptation to changed conditions of supply or demand.

1. Possible sources of dysfunctionality

a. Supply side dysfunction: impediments to competition

14. If firms consistently charge supra competitive prices or do not offer services valued by consumers, supply side competition may be lacking. Of course, the absence of competition could be attributable to market structures that make it difficult for more than one firm to compete effectively, which would not by itself suggest the need for law enforcement intervention.[5] If it appears to be based on exclusionary or collusive anticompetitive behaviour, however, an investigation of whether the market failure is caused by collusive agreements or exclusion of potential new entrants who offer lower prices or better services might be appropriate.

b. Demand side dysfunction: impediments to the exercise of consumer choice

15. The problem may be that consumers are unable to exercise the choice that competition provides them. In the United States this is thought of as a consumer protection problem. Competitive markets can at times fail to protect consumers. Situations arise in which firms find it profitable to provide deceptive information to consumers despite competitive constraints. This can occur, for example, in fraud cases where sellers have no reputational interest and do not intend to be in the market for the long term; in cases of infrequent purchases where consumers have limited opportunity to educate themselves; or in cases where different metrics make comparisons difficult.

16. The most likely problem area, however, concerns markets for goods that have properties that consumers cannot easily verify. The promotion of such "credence" goods can lead to deceptive claims by firms because there is no easy way for buyers to distinguish between different quality levels for a good or service. But a "race to the bottom" is not an inevitable result in the market for "credence" goods. Firms can use indirect ways to communicate quality through the issuance of warranties and by developing reputations that consumers come to rely on. Where these kinds of market mechanisms prove insufficient to protect consumers, however, the appropriate solution may be law enforcement or regulatory action that improves the flow of information - either by prohibiting deception or requiring carefully designed disclosures that restore consumers' ability to make effective choices.

17. In such cases, the FTC typically seeks to impose measures that give consumers the information necessary to exercise informed choice in the market. For example, the FTC has promulgated a trade

regulation rule that requires sellers of home insulation products to disclose the insulating capacity of the products in a standardised way,[6] which enables sellers to advertise those products in a way that facilitates choice. The FTC also issued environmental advertising guidelines that permit firms to compete on the basis of their products' environmental qualities in terms that will allow consumers to comprehend and make choices based on those claims.[7]

c. Regulatory dysfunction: policies that restrict competition and the exercise of consumer choice

18. Regulatory structures should also be examined. The United States experience has been that incumbent firms frequently seek government regulatory action that excludes competitors, such as restrictions on truthful advertising that would enable consumers to choose between competitors. While this kind of lobbying or regulatory conduct is often not subject to US antitrust laws, exclusionary regulatory policy can be addressed through vigorous advocacy by both competition and consumer protection policy experts, as we discuss below in more detail.

2. Studying the problem

19. In some cases, when the problem is large and the issues are complex, the Federal Trade Commission has conducted studies and hearings to explore the problem and identify possible solutions.

20. For example, in the early 1980s, concerns arose about the high cost of ophthalmic goods and services. Concerns also arose about the possibility that private and governmental restraints with the purported goal of consumer protection were preventing the expansion of a more efficient segment of the industry. Consequently, the FTC conducted two in-depth studies. One tended to show that government restrictions on the commercial practice of optometry (*e.g.* bans on the use of trade names, bans on practice in commercial locations, restrictions on branch offices, and prohibitions of optometrists from working for non-optometrists) had little impact on the quality of care that was practiced in restrictive or non-restrictive states, but significantly increased the cost of eye examinations.[8] A second study showed that opticians were able to fit contact lenses to patients as well as optometrists, but that they sold them at lower prices.[9] The studies supported the proposition that restrictions on the commercial practice of optometry reduced competition and increased costs to consumers and rebutted the purported consumer protection justification for the rules.

21. In response to evidence of restrictions on competition and choice, the FTC took action on three fronts:

- First, the FTC brought a case against the Massachusetts Board of Registration in Optometry, a state licensing board composed of practicing optometrists, charging that the Board unlawfully restricted advertising of truthful, non-deceptive information about the price and availability of eye care services. Among other things, the complaint challenged the Board's prohibition on advertising of lawful business affiliations between optometrists and retail optical stores. Significantly, the FTC's complaint alleged that the Board's practices were **both** unfair methods of competition **and** unfair acts and practices. After a trial, the Commission ruled that the Board's ban on such affiliation advertising unlawfully impeded entry by retail optical stores and raised prices for eye care. The Commission prohibited the Board from restricting certain types of advertising and required it to repeal its prohibitions against advertising affiliations between optometrists and optical retailers.[10]

- Second, using its consumer protection jurisdiction, the FTC proposed to amend an existing Trade Regulation Rule[11] by declaring certain state restrictions on the commercial practice of optometry to be unfair acts and practices in violation of the Federal Trade Commission Act.[12]
- Third, the FTC engaged in a vigorous campaign of competition advocacy to persuade state legislatures that anticompetitive regulations that excluded more efficient sellers of ophthalmic goods and services was bad public policy.[13]

22. In the end, most of the positions advocated by the FTC prevailed. The courts struck down the restrictions on advertising by optometrists as infringing the commercial speech rights of non-traditional optometrists.[14] Discount sellers of ophthalmic goods began to prosper. In some cases restrictions were repealed, and in others the sellers found ways to minimise their effects.

23. This effort presents an excellent illustration of how a dysfunctional market may be studied, and complementary competition, consumer protection, and advocacy actions may be collectively used to address the problems identified. While resources do not permit such a holistic approach in every case, this approach has proved a valuable use of the FTC's resources to study the roots of the problem in complex cases where multiple solutions are possible and alternative courses of action present difficult cost and benefit issues.

C. The benefits of being able to examine both competition and consumer protection problems in a co-ordinated fashion

24. As discussed above, dysfunctional markets may present both competition and consumer protection problems. Bureaucratic nature being what it is, competition enforcers may be predisposed to see abuse of dominance or anticompetitive agreements, while consumer protection enforcers may be predisposed to concern themselves with deception, unfairness, and consumer confusion. Without considering the role of the other, there is indeed a risk of applying the adage cited in the Secretariat's note: to someone with a hammer, everything looks like a nail. Antitrust enforcers should not exclude the possibility that an informational remedy is in order to address a problem, and consumer protection enforcers should be prepared to consider the possibility that a lack of competition is the source of consumers' problems. Both need to be cognisant of the possibility that misguided regulation is thwarting competition or consumer choice.

25. There should be no inherent conflict between the two enforcers' goals. Because competition policy's goal is the promotion of consumer welfare, consumer protection enforcers should embrace competition policy that creates conditions in which consumer choice may flourish. Similarly, competition enforcers should embrace consumer protection measures designed to ensure that consumers can effectively exercise the choice that is necessary to reward the efficient and punish the inefficient competitor.[15]

26. Consequently, there is value in a healthy conversation between competition and consumer protection enforcers, regardless of whether the functions are combined in a single agency. Such a conversation can help both groups of enforcers recognise the true nature of a problem, and to employ competition and/or consumer protection remedies as appropriate. Because the root of the problem may be anticompetitive regulation of business that has the purpose or effect of restricting consumer choice, both policy groups may wish to coordinate a program of advocacy aimed at persuading legislators that such restrictions represent both bad competition policy and bad consumer protection policy.

27. Even if the problem stems from private or public restrictions on competition, consumer protection enforcement has a critical role to play. Most anticompetitive restrictions on consumer choice are

justified in the name of consumer protection. Experience applying consumer protection law can be valuable in assessing the legitimacy of the proffered consumer protection justifications.

III. Legal services

A. The market for legal services

28. Until the 1970s, a combination of governmentally and privately imposed restrictions limited the ability of US lawyers to advertise their services and to compete effectively with each other. Bar association codes of ethics restricted the ability of lawyers to advertise their services. The prevailing view within the legal profession was that it was unseemly for lawyers to advertise their services or to compete with other lawyers for business. The American Bar Association (ABA) issued canons of professional ethics and formal opinions that codified these restrictions. In most states, the public bodies that regulated the practice of law adopted the American Bar Association's restrictions as binding legal requirements.[16]

29. Illustrative of the historical attitude of the organised bar was a 1959 passage by a distinguished law professor, Roscoe Pound:

> *There is no such thing as competition for clientage in a profession. Every lawyer should exert himself fully to do his tasks of advice, representation and advocacy to the best of his ability. But competition with fellow members of the profession in any other way is forbidden.*[17]

30. At its most restrictive point, lawyers were not even permitted to use distinctive typefaces in telephone directories and were required to adhere to minimum fee lists promulgated by state bar associations. Such price lists inhibited lawyers who wanted to offer lower priced legal services.

31. Not surprisingly, the restrictions led to criticisms that the price of legal services was too high for consumers with moderate incomes and that consumers were unable to learn which lawyers might offer services that met their needs. As a result, consumers often did without the service of lawyers when they might have preferred to have them.

32. The environment began to change in the 1970s. In 1975, the United States Supreme Court ruled in *Goldfarb v. Virginia State Bar* that the Sherman Antitrust Act applied to the legal profession and that minimum price lists imposed by a group of competitors - in the form of a state bar association - were *per se* illegal under the antitrust laws. In 1977, the Supreme Court ruled in *Bates v. State Bar of Arizona* that state prohibitions on non-deceptive advertisement by lawyers violated the right of free speech guaranteed by the United States Constitution.[18] In doing so, the Court noted that non-truthful speech was not entitled to constitutional protection, and the states remained free to regulate deceptive communications by lawyers.

33. With lawyers now theoretically free to advertise and compete, some lawyers began to advertise and to promote their services in various media. Some low-cost legal clinics began to enter the market. Many sought to operate high-volume, low-price practices that focused on relatively simple transactions that could be handled on a mass basis - wills, estates, uncontested divorces, bankruptcy, and simple misdemeanours such as driving while intoxicated. Some lawyers attempted to operate on a nationwide basis, but in the end most operate in local markets. Development of such practices required advertising to attract the necessary volume, including advertisement of competitive prices. As with advertisement of all products and services, various advertising techniques were deemed necessary to bring the availability of the advertisers' legal services to consumers' attention.

34. While mandatory minimum fee schedules and outright prohibitions of advertising had been eliminated by the 1980s, considerable debate ensued as to what kinds of restrictions were permissible in

the name of protecting consumers of legal services from deceptive advertising. For example, one state attempted to discipline a nationwide chain of legal service clinics on the grounds that the two out-of-state lawyers whose name the firm bore were not licensed in that state. In another instance, a committee of the American Bar Association recommended that lawyer advertising could include only 11 factors thought necessary for consumers to make informed decisions.[19] Many states adopted rules to that effect. This approach was defended by one state as follows:

> *The regulatory approach whose reaffirmation we recommend protects the potential consumer of legal services against the current trend (stimulated by the directive approach) toward increasing competition among lawyers who advertise emphasizing the packaging rather than the content of the information they disclose - the very antithesis of the public interest in and need for relevant and useful information upon which lawyer advertising is justified.*[20]

35. By 1980, 23 of the 50 states restricted the geographical scope of lawyer advertising (thus effectively prohibiting national advertising), seven prohibited the advertising of contingency fees (a system commonly used in personal injury cases where a lawyer accepts a percentage of whatever money is recovered as a fee in lieu of an hourly or fixed rate), 25 insisted that advertisements be dignified, 36 prohibited the use of trade names, and 15 prohibited television advertising. One state even challenged an advertisement that said "FINALLY! Lawyers you can afford."

B. The FTC study

36. In the midst of this debate, the Federal Trade Commission conducted a study to survey the relationship between restrictions on lawyer advertising and lawyer fee levels. The survey, conducted by the FTC's Bureau of Economics and Cleveland Regional Office, surveyed attorney fees for several common legal services in 17 cities, and compared the prices between states with various types of restrictions of advertisement of legal services.

37. The study, issued in 1984, found that costs of legal services were significantly higher in states that restricted advertising. This relationship was particularly pronounced with respect to contingency fees for personal injury cases. Divorces were found to cost an average of USD 33 more in restrictive states than in liberal states; bankruptcies were USD 44 more expensive in such states, and simple wills were USD 7 more expensive. The study also found an inverse relationship between average costs of legal services and the percentage of attorneys who advertised.[21]

38. The study recognised that several questions were empirically unanswered. For example, although proponents of restrictions on lawyer advertising often argue that they are necessary to protect quality of legal services, the empirical evidence indicated that advertising by professionals did not necessarily reduce quality. In general, however, the report pointed out that competition goes not only to price, but to quality as well, and that increased competition should also lead to increased quality of services. Among the evidence cited for this proposition were the optometric studies mentioned above. In addition, the study did not attempt to measure the degree to which restrictions on advertising themselves had a negative impact on quality, in that consumers who did not obtain legal services as a result of reduced competition and information about legal services may have been negatively impacted.[22]

C. Policy interventions in market for legal services

39. Because the Supreme Court concluded that non-deceptive advertising by lawyers was entitled to constitutional protection, there was little need for the FTC to bring law enforcement actions to remove restrictions on advertising. Private litigation followed the *Bates* case, with the effect that the boundaries of

permitted legal marketing became relatively clear. Most FTC activity in the legal services arena thus took place in the competition advocacy context.

40. Probably the most significant response to the FTC Study of Legal Services has been an active campaign of competition advocacy against restrictions on competition for legal services and the availability of information to consumers. The FTC view has been that such restrictions harm competition without providing any consumer protection benefit. In the years immediately following the FTC Legal Services Study:

- The FTC filed an *amicus curiae* ("friend of the court") brief with the Supreme Court of Iowa arguing that truthful, non-deceptive advertising for legal services should not be restricted merely because it contains more than a single, non-dramatic voice, has background sound and visual displays. Rather, the FTC argued, the advertisements at issue provide useful, non-deceptive information about areas of practice without implying that defendants are specialists.
- The FTC also sent a letter to the Nebraska State Bar Committee on Ethics encouraging the Nebraska State Bar to adopt the ABA's Model Rules of Professional Conduct, which would allow lawyers to use advertising and trade names so long as their use was neither false nor deceptive.
- The FTC also sent a letter to the Alabama Supreme Court encouraging the court to amend its attorney advertising regulations, highlighting the FTC's position that truthful, non-deceptive advertising benefits consumers by promoting competition and increasing information.

41. In the late 1980s, another series of advocacy efforts promoted removal of additional restrictions. For example:

- In comments to the Supreme Court of Kentucky, the FTC urged the Court to take 11 actions concerning the proposed and existing rules that threatened to impose unnecessary attorney advertising restrictions, prevent price competition, discourage referrals and associations between attorneys, restrict development of innovative and efficient legal practice and limit the information available to consumers.
- The FTC also sent a letter to the Supreme Court of Florida supporting amendments to the rules regulating the Florida bar that would relax restrictions on fees and permit more price competition, but discourage the adoption of amendments that would restrict referrals and associations between attorneys and limit the information available to consumers.
- In a letter to the ABA Commission on Advertising, the FTC argued against guidelines respecting dignity in advertising because such guidelines, no matter how they might be worded, would reduce consumer access to truthful, non-deceptive information without providing a countervailing benefit.

42. Another series of advocacy efforts addressed bans on telephone, mail, and in-person solicitation of clients:

- In a letter to the State Bar of California, the FTC supported the proposed removal of restrictions on attorney advertising by the mail and urged California to permit telephone and in-person solicitation by attorneys because it promotes the availability of truthful, non-deceptive information to consumers.
- In a separate letter to the ABA, the FTC also supported the removal of restrictions on attorney advertising by the mail, and urged the ABA not to draft its Model Rules to prohibit telephone and in-person solicitation by attorneys because such prohibitions limit the availability of truthful, non-deceptive information to consumers. Instead, the FTC suggested that the Model Rules

prohibit only *(i)* uninvited, in-person solicitations of people who are particularly vulnerable to undue influence and *(ii)* communications with prospective clients who have made known a desire not to receive communications from a lawyer.

43. Another area in which the FTC, in partnership with DOJ, has conducted advocacy relates to restrictions on who can perform certain services. There are many services traditionally performed by lawyers that do not always require legal training and may be performed by non-lawyers at lower cost to consumers. The FTC has urged regulators of the legal profession to exclude those services from the definition of the practice of law. For example:

- In a letter to the State Bar of Georgia, the FTC and DOJ urged the State Bar to find that preparing or facilitating the execution of a deed is not the practice of law, but instead is an activity that can be performed by lay practitioners.
- In letters to the Rhode Island House of Representatives, the FTC and DOJ urged the House to reject two nearly identical bills that would have amended the definition of 'practice of law' to require lawyers to represent buyers in virtually all aspects of the real estate closing process. The agencies argued that this definition would restrain competition between lawyers and non-lawyers for such services and would likely have resulted in increased costs for Rhode Island consumers.
- In letters to the North Carolina State Bar, the FTC and DOJ encouraged the adoption of a proposed rule that would allow non-lawyers to perform the ministerial functions of closing a real estate deal as long as the non-lawyer did not give legal advice. In an amicus curiae brief to the Supreme Court of Florida, the FTC and DOJ expressed concerns over the competitive and consumer protection impact of an advisory opinion that precluded non-lawyers from preparing the initial drafts of pension plan documents and from making recommendations as to which format and plan provisions would be most suitable to a client's needs.

44. The FTC also has brought competition cases designed to increase competition for legal services. One of these challenged an association of private lawyers who collectively agreed to withhold acceptance of appointments to represent indigent criminal defendants in the District of Columbia until the District of Columbia government agreed to increase the compensation for such appointments. The lawyers contested the FTC's claims on the grounds that the group boycott was necessary in order to ensure higher quality representation of criminal defendants than the low level of compensation permitted. The case was ultimately resolved by the Supreme Court, which ruled that such justifications cannot authorise such an anticompetitive collective agreement between competitors.[23] The FTC brought a similar case in another jurisdiction this summer.[24]

D. Conclusion

45. Today, while exclusionary state bar rules remain a major restraint, the market for legal services in the United States is highly competitive. A review of the "Yellow Pages" in any major city in the United States will reveal page upon page of advertisements for legal services. Advertising is also common on billboards, in transit advertising, in direct mail, and on broadcast media. The FTC Legal Services Study helped make transparent the costs to consumers and competition that unwarranted restrictions on legal services imposed. A vigorous campaign of consumer advocacy helped make the case that consumers would be better protected with vigorous competition.

IV. Death services

A. FTC review of the funeral industry

46. The FTC began an extensive probe into the funeral industry in 1972. The FTC believed that the funeral industry was an appropriate area for scrutiny because of "the large number of consumers annually affected by funeral practices, the fact that purchases of a funeral is one of the largest single consumer expenditures, the condition of bereaved consumers, and the potential level of consumer injury…"[25] At that time, various articles and books, as well as hearings by the Senate Judiciary Committee's Antitrust Subcommittee, suggested the possibility of significant consumer injury from certain funeral practices.

47. The FTC's examination of the funeral industry included analysis of industry publications; interviews with consumers, funeral directors, memorial society members, attorneys, state officials and others; and visits to funeral homes. The FTC staff also conducted a survey of funeral prices in the District of Columbia. After that survey, more than two dozen price surveys were conducted by state and local governments, consumer groups, and journalists.

48. Based on the information collected as part of its initial probe, the FTC issued a proposed Funeral Rule in which it requested comments from interested parties. In response, more than 9 000 comments were received. Fifty-two days of hearings were held during which 315 witnesses presented testimony and exhibits. The hearings produced 14 719 pages of transcript.

49. As a result of its study, the Commission found that advertising was not common in the funeral industry, and in fact, was actively discouraged in many areas of the United States. In particular, the Commission found that the funeral market was characterised by a virtual absence of price information, either in the form of price advertising or price information available to consumers prior to purchasing the funeral arrangements. This lack of information for consumers resulted from several factors.

50. First, FTC staff found that a basic tenet of funeral director professionalism was de-emphasis of the commercial aspects of the business, particularly price advertising and other forms of competitive marketing. This contributed to consumers' difficulty in obtaining price information.

51. Second, there appeared to be a widespread resistance on the part of the funeral industry to provide meaningful information in advance of need. The FTC found that the National Funeral Directors' Association had adopted a policy that its members should not sell contracts for funeral services in advance of death because there was no widespread demand for them. Later, a statement by the Executive Director of NFDA to members more candidly expressed the reason behind NFDA's opposition: "If funeral directors insist in soliciting pre-need funerals, they are in fact pre-arranging the funeral of their profession."[26]

52. Third, many funeral directors were unwilling to provide price information to consumers by telephone. Consumer groups reported overwhelming failures in their attempts to gather funeral price data by telephone for surveys and other informational purposes. Indeed, a large number of funeral directors were opposed to the idea of providing price information by telephone on the grounds that the provision of such information would be impossible, misleading, or confusing.

53. Fourth, the report found that the "bundling" of funeral goods and services into pre-selected packages prevented consumers from picking and paying for only those goods and services they actually wanted to buy. In purchasing package funerals, consumers often incurred expenses for items that were unnecessary, unwanted, or unused. According to evidence FTC staff gathered, over three-quarters of the nation's funeral homes presented consumers with prices only on a "package" basis. Numerous complaints were received from consumers who were forced to pay for package components that were either not

desired or not provided. Even in rare instances when the consumer asked for an itemised breakdown of the goods and services included in the package, funeral directors often refused to provide it.

54. As part of the investigation and rulemaking proceeding, FTC staff also examined existing state and local regulation of funeral directors. Many of the regulations were drafted and sponsored by funeral director associations and were directed toward enhancing the image of the funeral director as a professional. These regulations were found to insulate licensed funeral directors from the pressures of competition. Many of the laws created barriers to entry into the occupation. For example, high educational requirements, apprenticeship responsibilities, and nebulous "good character" requirements were often used to restrict entry into the trade, causing competition to suffer. Virtually every state prohibited solicitation of business, and some prohibited advertising.

55. The FTC has continued to study state laws insulating funeral directors from competition. Even today, most states have regulations dealing with licensing of funeral directors. In approximately ten states, statutes restrict the sale of caskets - generally the single most expensive component of a funeral - exclusively to licensed funeral directors.[27] A number of states impose requirements for licensing that have little bearing on the ability or qualifications of a person to sell caskets. For example, Oklahoma regulations require that an individual graduate from an accredited program of mortuary science, complete sixty college semester hours at an accredited institution of higher education, pass two exams, and complete an embalmer or funeral director apprenticeship, "during which the applicant must embalm 25 bodies."[28] Similarly, in South Carolina, to obtain a license to sell caskets, one must complete an apprenticeship that lasts "a minimum of twenty-four months."[29] Other states require that a funeral director have training in embalming, a specialty that has little relation to selling a casket. In addition, some states also require that a casket seller operate out of a licensed "funeral establishment". Louisiana, for instance, prohibits anyone from engaging in the business of funeral directing "unless such business is conducted by a duly licensed funeral establishment"[30] that has "adequate parlours or chapel," a "display room," and an "embalming room," among other features.[31]

56. According to one study, these restrictions can raise aggregate funeral costs by USD 250 million annually.[32] According to another study, casket sales restrictions may increase funeral costs by 10-15%.[33] This study found, among other things, that "funeral home receipts per death are about 10-15% higher in the states which require the most years of training for funeral directors and also restrict casket sales."

57. Many state regulations in this area have been adopted on the basis of purported consumer protection justifications. However, there is little or no empirical evidence that these requirements benefit consumers rather than the funeral directors in regard to casket purchases.[34] Most requirements have little relation to the business of selling caskets. For example, some funeral homes and states maintain that consumers could suffer from fraud or other abuses if they buy caskets from independent sources. Casket sellers, however, like any other retailers, are subject to the same general consumer protection laws as any other business, including state contract and consumer protection laws and federal consumer protection laws.[35] Many of these laws provide for private rights of action. Some states and funeral homes also contend that licensing promotes health and safety, because proper disposal of human remains affects the environment and the public. The evidence, however, shows that caskets themselves do not promote health or safety. As one court concluded, "[c]askets have not been shown to play a role in protecting public health, safety, or sanitation, nor have they been shown to aid in protection of the environment."[36]

C. Policy interventions in market for death services

58. The FTC's study of the death services industry fundamentally revealed at least two types of problems: barriers to consumers' ability to choose between competing providers and regulation that acts as a barrier to competition. To address these issues, the FTC has used both consumer protection and competition approaches.

1. Consumer protection remedies

59. Following the 10-year investigation and rulemaking described above, the FTC determined that consumers would benefit from a regulation that would require more price transparency in the funeral industry. As a result, the Funeral Rule, by which the FTC tried to reduce barriers to consumers' ability to choose between competing providers, became effective in 1982.[37] Among other things, the Funeral Rule requires funeral providers to provide itemised price information at the time funeral arrangements are being made and prohibits funeral providers from requiring consumers to purchase goods or services that they do not want as a condition to obtaining a funeral. The Rule focused on two primary goals: first, to provide consumers with timely price information so they could compare prices among different providers; and second, to prevent funeral providers from tying the purchase of particular items to the purchase of other goods or services. The Rule allows funeral providers to offer packages of funeral goods and services at a discounted price, but the providers are also required to "unbundled" those packages and list the prices of each good or service separately so consumers may choose which items to purchase. The FTC theorised that the availability of price information, coupled with the prohibition on bundling or tying, would increase price competition in the provision of funeral goods and services.

60. The Rule was amended in 1994. At that time, the FTC found that, although consumers were more aware of the availability of price information than prior to the Rule's enactment, the increased price competition in the industry had not materialised. One reason for the lack of increased price competition was that funeral providers had begun assessing a so-called "casket handling" fee if consumers purchased a casket from a source other than the funeral home. As a result of this casket handling fee, consumers could end up paying more for the funeral arrangements if they bought the casket from a third-party seller than if they bought the entire package from the funeral home. The 1994 amendment to the Rule prohibited funeral providers from assessing any fee for goods or services purchased from a third-party seller.

61. The FTC continues to review the Funeral Rule as part of a comprehensive program whereby the Commission periodically subjects its regulations and guides to formal scrutiny. As part of this comprehensive programme, the FTC solicits public comments periodically to ascertain whether a rule is still necessary and whether amendments could increase a rule's effectiveness or decrease its compliance burden on industry. Questions have been raised about the effectiveness of the Rule. We continue to examine these issues and the effectiveness of the Rule in achieving its goals.

2. Competition remedies

62. The FTC has taken law enforcement action against state entities for their regulations on funeral advertising that inhibit competition and harm consumers. The FTC recently investigated and settled a case against the Virginia Board of Funeral Directors and Embalmers. In that case, the challenged regulatory scheme relied on industry members to create regulations, which were then enforced by the Virginia government.[38] The Board is an agency of the government of Virginia, but it is composed largely of practicing funeral directors who determine policy by majority vote of the Board. It is authorised by

Virginia statute to promulgate rules and to take disciplinary action against licensees who violate any rule promulgated by the Board.

63. The Board issued a regulation that prohibited licensees from advertising discounts for pre-need funeral services.[39] The regulation at issue prohibited, among other things, advertising of discounts, thus reducing the availability of price information to consumers. The regulation deprived consumers of the benefits of price competition and allegedly resulted in some consumers paying higher prices for funeral services than they would have in the absence of the regulation. The regulation was removed as a result of the FTC investigation.

64. The Virginia case illustrates that taking a close look at industry regulations and ethical rules is one way to identify distortions that can result when markets are regulated by competitors in that market. Ideally, industry self-regulation can be very effective in avoiding dysfunctional markets. Industry members are often the best situated to identify problems in the market and will generally have the incentive to eliminate many of those problems, particularly if doing so will enhance the reputation of the industry and the perceived quality of the products and services they sell. However, industry members may also have an incentive to use self-regulation to reduce competition, particularly price competition. A close look at the regulations and ethical rules in the industry can be a first step in identifying when the effect of industry association rules and regulations is the latter rather than the former.

65. The Virginia case also illustrates the interaction of consumer protection and competition policies, particularly the need to ensure that the competitive analysis of local laws and association rules takes into account any consumer protection benefits of the rule in question. The effect of the rule was to limit price competition rather than to improve competition by restricting misleading advertising. There were a number of factors that proved to be important in making the determination that the effect of the rule was to limit competition. Some of those factors were:

- The restriction totally banned discount price advertising in the relevant market (that for pre-need funeral services) rather than banning only misleading advertising.
- The fact that the restriction was imposed only on the sale of pre-need services (where price competition is most likely to be effective), and not on at-need services (where, by all accounts, the consumer is most vulnerable to deceptive claims), suggested that the effect of the regulation was to restrict price competition rather than to eliminate deception.
- Finally, in Virginia there is a separate regulation that relates to the prevention of false and misleading claims, making the challenged rule unnecessary for that purpose.[40]

66. The FTC has also challenged mergers and acquisitions that could have substantially lessened competition in the funeral services industry. In 1999, the FTC challenged the acquisition of one group of funeral homes by a major chain that would have impacted competition in several markets,[41] and in 2000, challenged the acquisition of a funeral home by the same chain that would have impacted competition in Roswell, New Mexico.[42]

3. Advocacy interventions

67. The FTC has also engaged in an active campaign of advocacy against state regulation of the funeral industry that decreases competition without benefiting consumers. For example, the FTC filed an *amicus curiae* brief in a federal lawsuit brought by plaintiff funeral directors against the Oklahoma State Board of Embalmers and Funeral Directors.[43] The suit alleged that the Oklahoma Funeral Services Licensing Act (FSLA), which requires sellers of funeral goods to be licensed funeral directors, violates the Commerce Clause of the United States Constitution. Although the FTC took no position on the Commerce

Clause argument, the FTC's brief argued that the Oklahoma licensing statute undermined competition, to the detriment of consumers.

68. The FTC argued that the Oklahoma licensing scheme limited consumer choice of funeral merchandise providers, which in turn insulated the funeral service industry in that state from competition that could lower prices. According to the FTC brief, the licensing requirement "denies Oklahoma consumers the benefits of competition that consumers in many other states currently derive from alternative forms of casket retailing, including casket retail stores, Internet retailers of caskets, and sellers of highly personalised caskets."[44]

69. Many of the FTC's advocacy efforts have focused on the business structures within which funeral providers may operate. In a letter to the Maryland House of Delegates, Health and Government Operations Committee, the FTC supported a Maryland bill that would allow funeral homes to be operated by corporations and limited liability companies. The FTC argued that the bill would remove obstacles to market entry and encourage competition.[45]

70. In testimony before the Committee on Commerce of the Michigan State House of Representatives, the FTC supported a proposed statutory amendment that would remove the restriction against joint ownership/operation of a funeral establishment and a cemetery and would allow for more efficient organisation of these services. The FTC concluded that "[a]llowing joint ownership or operation would remove barriers to new business formats and may promote efficiencies that ultimately could result in lower prices to consumers." Similarly, in a letter to the Michigan State Senate, the FTC supported Michigan bills that would remove the prohibition against joining ownership or operation of a funeral establishment and a cemetery and discouraged an overly broad ban on offering bundled goods and services at a discount. The FTC letter supported this amendment for its benefits to consumers and competition.[46]

4. Conclusion

71. As a result of these activities, we believe that funeral consumers have increasingly become more price-conscious and more aware of their ability to choose the goods and services they want. Compliance with the Funeral Rule seems to have improved, in part due to efforts by the National Funeral Directors Association, which has worked with the FTC on proposals to encourage compliance by its members.[47] In recent years, the industry has seen the rise of more third-party sellers, which have introduced an element of price competition to the marketplace for caskets, urns and other funeral goods. In addition, price advertising by, and the publicity about, these third-party sellers has increased consumers' knowledge about the availability of alternatives when purchasing funeral goods. Indeed, the recent announcement by Costco, a national discount chain, that it would sell caskets at its Chicago store generated substantial press and has been applauded by consumers.[48]

V. Conclusion

72. The FTC's study of optometry services, legal services and death services illustrate well how competition and consumer protection strategies can be used to address problems caused by dysfunctional markets. We in the United States government look forward to continuing to work with other OECD members on promoting linkages between competition and consumer protection.

NOTES

1. See www.ftc.gov/sentinel.

2.. See *e.g.* Dietary Supplement Advertiser Settles FTC Charges of Deceptive Health Claims (FTC Press Release 12 May 1998), www.ftc.gov/opa/1998/05/bogdana.htm, announcing actions by the FTC against manufacturers of certain dietary supplements based on referrals from the National Advertising Division.

3.. *U.S. v. Aluminum Co. of America*, 148 F.2d 416, 430 (2d Cir. 1945).

4. As used herein, the term "consumer protection" focuses on ensuring access to information and policing the market against acts and practices that distort the manner in which consumers make decisions in the marketplace. The practices we attack are those that prevent, or hinder, free competition.

5. Whether such markets should be subjected to regulation in the absence of competitive discipline may be worth considering, but the topic goes beyond the scope of this submission. For a good source of commentary on the interaction between regulation and competition, see the AEI/Brookings Joint Center for Regulatory Studies, www.aei-brookings.org.

6. Labeling and Advertising of Home Insulation, 16 C.F.R. Part 460 (2004).

7. Guides for the Use of Environmental Marketing Claims, 16 C.F.R. Part 260 (2004).

8. FTC Bureau of Economics, Staff Report on Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry (1980).

9. FTC Bureaus of Economics and Consumer Protection, A Comparative Analysis of Cosmetic Contact Lens Fitting by Ophthalmologists, Optometrists, and Opticians (1983).

10. *Mass. Bd. of Registration in Optometry,* 110 F.T.C. 549 (1988).

11. Ophthalmic Practice Rules, 43 Fed. Reg. 23992 (1978).

12. Ophthalmic Practice Rules, 54 Fed. Reg. 10285 (1989). The rules were later invalidated by the courts on federalism grounds. *California State Board of Optometry v. FTC*, 910 F.2d 976 (D.C. Cir. 1990), *reh'g denied*, 8 January 1991.

13. *e.g.* Letter to Kansas State House of Representatives, 10 February 1995, www.ftc.gov/be/v950004.htm; Arizona Board of Optometry, 27 October 1985, www.ftc.gov/opa/predawn/F85/arizona.htm; Letter to Tennessee Senate, 29 April 2003, www.ftc.gov/be/v030009.htm.

14. *e.g. Rogers v. Friedman*, 438 F. Supp. 428, 429 (E.D. Tex. 1977), *rev'd in part on other grounds sub nom. Friedman v. Rogers*, 440 U.S. 1 (1979). That case, however, did uphold restrictions on the use of trade names.

15. See Neil W. Averitt and Robert H. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law*, 65 Antitrust L.J. 713 (1997); T. Muris, The Interface of Competition and Consumer Protection, Remarks at the Fordham Corporate Law Institute's Twenty-Ninth Annual Conference on International Antitrust Law and Policy (2002) www.ftc.gov/speeches/muris/021031fordham.pdf.

16. In the United States, individual states regulate admission to practice law, promulgate rules governing the practice of law, and impose discipline on lawyers who violate the laws. In most states this authority is exercised by the highest judicial authority of the state, either directly by delegation of authority to the state bar association. The state bar association is composed of, and governed by, lawyers practicing in the state. Membership is voluntary in some states, mandatory in others.

17. R. Pound, Jurisprudence ' 151 at 677 (1959).

18. 433 U.S. 350 (1977).

19. ABA Section of Economics of Law Practice, Position Statement (1976). The Section would have permitted only advertisement of the lawyer's name, address, telephone number, year of birth, year of admission to practice, years of legal practice, areas of practice, credit card acceptance, office hours, languages spoken, and initial consultation agreements.

20. Comment of Michigan State bar, *reprinted in* 2 American Bar Association, Materials on Model Rules of Professional Conduct (Item No. 537), August 1982.

21. FTC Cleveland Regional Office and Bureau of Economics, Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising (1984).

22. This is not to say that all efforts by trade associations to impose rules on their members are anticompetitive. Indeed, many such rules are pro-consumer and pro-competition. For example, several trade associations require their members to adhere to codes of conduct prohibiting fraudulent and deceptive advertising. The Better Business Bureau, for example, promulgates a Code of Advertising for its members to that effect. See www.bbb.org/membership/codeofad.asp.

23. *FTC v. Superior Court Trial Lawyers Association*, 493 U.S. 411 (1990).

24. *Lewis, Sowder, Wear & Yoseph*, FTC Case No. 031 0155 (14 June 2004), www.ftc.gov/opa/2004/06/clarkcounty.htm.

25. Final Staff Report to the Federal Trade Commission, Proposed Trade Reg. Rule, Funeral Industry Practices at 16 (June 1978) at 415.

26. Id. at 415.

27. Clark Neily, Written Statement 1, www.ftc.gov/opp/ecommerce/anticompetitive/panel/neily.pdf; Mark Krause, Written Statement 3, www.ftc.gov/opp/ecommerce/anticompetitive/panel/krause.pdf.

28. *Powers v. Harris*, No. CIV-01-445-F, 2002 WL 32026155, at *12 (W.D. Okla. 2002).

29. S.C. Code Ann. 19 ' 40-19-230(B)(4) (Law Co-Op. 1976).

30. La. Rev. Stat. Ann. ' 37:848(C) (West 2004).

31. La. Admin. Code tit. 46, ' 101(B).

32. See David Harrington and Kathy Krynski, *The Effect of State Funeral Regulations on Cremation Rates: Testing For Demand Inducement in Funeral Markets*, 45 J. L. & Econ. 205 (2002).

33. Daniel Sutter, State Funeral Regulations, Casket Retailers and the Casket Market (June 2003) (working paper at 1, on file with the FTC staff).

34. See Steven M. Simpson, *Judicial Abrogation and the Rise of Special Interests*, 6 Chap. L. Rev. 173, 179 (2003) ("Laws restricting casket sales to licensed funeral directors are a more recent phenomenon, but their benefit to funeral directors is clear. Casket sales are extremely lucrative for funeral directors").

35. *Casket Royale, Inc. v. Mississippi*, 124 F. Supp. 2d 434, 440 (S.D. Miss. 2000); *Craigmiles v. Giles*, 110 F. Supp. 2d 658, 664 (D. Tenn. 2000).

36. *Powers*, 2002 WL 32026155, at *3. *See also The High Cost of Dying: Rising Prices and Consumer Deception in the Funeral Industry: Proposals for Reform* (New York City Department of Consumer Affairs February 1999) at 20 (noting that "there is no such thing as a 'protective' casket").

37. 16 C.F.R. Part 453.

38. See generally, In the Matter of Virginia Board of Funeral Directors and Embalmers, Analysis of Proposed Consent Order to Aid Public Comment, www.ftc.gov/os/caselist/0410014/0410014.htm.

39. At the outset of the investigation, the regulation provided as follows: "No licensee engaged in the business of preneed funeral planning or any of his agents shall advertise discounts; accept or offer enticements, bonuses, or rebates; or otherwise interfere with the freedom of choice of the general public in making preneed funeral plans." *Id.* at 1.

40. The regulation at issue was the "Solicitation" provision in the Part of the preneed regulations entitled "Sale of Preneed Plans." The Board has a separate set of regulations relating to false advertising generally that does not prohibit price and discount advertising, as long as the representations in the advertisement are not untrue, deceptive, or misleading. *See* 18 Va. Admin. Code ' 65-20-500(3) (West 2003).

41. Service Corp. International, FTC Docket No. C-3869 (1999), www.ftc.gov/os/caselist/c3869.htm.

42. Service Corp. International, FTC Docket No. C-3959 (2000), www.ftc.gov/os/caselist/c3959.htm.

43. *See* Memorandum of Law of Amicus Curiae, *Powers v. Harris*, Case No. CIV-01-445-F, (W.D. Okla. 2002)

44. *Id*. at 15.

45. Letter from Susan Creighton, Director, Bureau of Competition, FTC to Joanne C. Benson, Maryland House of Delegates (2 April 2004) www.ftc.gov/os/2004/04/0404mdfuneralhomes.pdf.

46. See www.ftc.gov/opa/predawn/F93/michiganf5.htm.

47. See Funeral Rule: Hearing Before the Subcommitee on Children and Families of the Senate Committee on Health, Education, Labor and Pensions, 107th Cong. (2002) (statement of the Federal Trade Commission presented by Eileen Harrington).

48. See Amy Sherman, Costco Targets Kmart Location, Miami Herald, 26 September 2004.