

# Product Certification - the next big standard-setting debate?

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## Introduction

The smart phone wars have led to heated discussions over standard setting in technology markets. It seems only a question of time before the standard setting debate spills over into other areas. My personal candidate is the standard setting that underpins product quality, origin and safety certification.

## Certification - where invisible features matter

An average consumer comes face to face with product certification in her local grocery store. Organic meat, cage-free eggs and fair-trade coffee are only a few examples of certified products, which increasingly populate store shelves. The expansion of green markets has also prompted certification and labelling programs for a wide range of products (e.g. natural, recyclable, eco-friendly, low energy, recycled content, non-toxic etc.).

Obviously, the usefulness of certification is not limited to food or eco-friendly market segments. Typically, certification comes into play in industries where the important characteristics of products are difficult to tell after the purchase has been made. We can't verify where the tomato was grown or whether a bulb is really energy efficient. In other words, since the consumer cannot verify the truthfulness of each manufacturer's claims, the goal of product certification is to bridge the information gap.

## What is product certification?

One way of looking at it is to say that the purpose of product certification is to emphasise certain attributes of a product. From the consumer's perspective certification reduces the transaction costs related to information gathering. It offers a low effort solution for consumers willing to make an informed choice (e.g. buy organic vegetable, verify materials used in the construction of a building). As buyers get more information, they can more easily adapt their consumption patterns. Thus, by increasing transparency product certification ultimately increases consumer satisfaction.

On the manufacturer's side certification provides an incentive to develop products with the attributes desired by consumers. Moreover, by raising consumers' awareness of the options open to them (e.g. fair trade coffee) certification can also create demand for a product category which was previously not in demand. Thus, product certification can be used as a differentiation strategy to create niche markets. If a standard is strong - meaning that it provides sufficient transparency and consumers have confidence in its control system - it should allow niche markets to develop and reach their potential. By encouraging the development of new and improved products, standards can in fact stimulate innovation. While a standard is being developed, alternative solutions can compete for inclusion in the standard. Also, even once a standard is agreed, manufacturers still remain free to develop alternative standards that do not comply with the one previously agreed.

Certification can be based on voluntary labelling or public regulations. It is often policed by an independent third party in order to increase its credibility. If designed properly, certification should have a positive impact on the functioning of the markets, since it stimulates competition by increasing transparency.

## Similarities to technology standard setting

The roles of product certification and technology standard setting are ultimately similar - in both cases the goal is to ensure that a given product possesses certain features. Technology standards ensure the compatibility and interoperability of the devices manufactured by different companies. As a result, adoption of new technologies is more rapid (more products can communicate with each other) and consumers' costs related to using such technologies are reduced. Product certification also pursues some level of alignment across the industry, but the reasons behind it are usually more marketing-oriented (by focussing on the policy issues of concern to consumers such as protection of the environment, safety, health).

Both technical standards and certification are usually created with the participation of the members of the industry involved. This ensures that important technical/production aspects are reflected in the standard, but also creates a risk of collusion or disruption of the standard setting process.

In the case of technology standards - as the smart phone wars show - the greatest risk lies in the area of trust. Ultimately, since the creation of a technical standard requires effective collective action, the participants to the standard setting process need to follow the rules when the technical standard is in the making and honour their commitments afterwards.

Certification processes demonstrate somewhat similar vulnerabilities, since they also create incentives for businesses to hijack the collective action by influencing the certification process so that their own products are favoured over competing products. This can be done through a variety of practices, which have one common denominator: raising rivals' costs.

## When certification can become anticompetitive?

How can businesses raise rivals' costs by influencing the design of certification programs? Grollau et. Al. (2007) have identified four strategies:<sup>[fn]</sup>Grollau, G., L. Ibanez and N. Mzoughi, (2007), Industrialists hand in hand with environmentalists: how eco-labeling schemes can help firms to raise rivals' costs, *European Journal of Law and Economics*, vol. 24 pp. 215-236.<sup>[fn]</sup>

**-Lobbying for a narrow product category:** When the category of products is narrow, only a few can benefit from a certificate. The certified products will be compared with as few other products as possible. This, in turn, will result in less competition in the niche market. In addition, rivals, who do not meet the narrowly defined criteria, will not have the opportunity to differentiate their products.

**-Defining criteria which favour certain products:** This is a variation of the previous strategy. In this case, criteria can be designed according to the local conditions disavouring other manufacturing traditions or can give preference to the processes and materials not used by competitors.

**-Creating unfavourable monitoring mechanisms:** This strategy focuses on making competitors' lives more complicated once the certificate is granted. If a monitoring mechanism requires expensive and frequent tests to check compliance with a standard, costs related to such monitoring can be more burdensome for smaller competitors.

**Sending disrupting signals:** This strategy targets competitors who have already obtained a certificate. By disseminating additional information or labelling, or creating uncertainty with respect to the certified attributes, companies can dilute a standard, and thus make it weaker and less profitable to use.

## Assessing Certification Standards

How can we ensure that certification processes are not misused for anticompetitive ends? The Commission's Horizontal Guidelines<sup>[fn]</sup>Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements.<sup>[fn]</sup> which apply also to standard setting in the form of product certification,<sup>[fn]</sup>Horizontal Guidelines, sec. 257: "The terms of access to a particular quality mark or for approval by a regulatory body can also be regarded as a standard. Agreements setting out standards on the environmental performance of products or production processes are also covered by this chapter."<sup>[fn]</sup> offer some helpful guidance in this respect. Where participation in standard-setting is unrestricted and the procedure for adopting the standard in question is transparent, standardizations agreements which contain no obligation to comply with the standard and provide access to the standard on fair, reasonable and non-discriminatory terms (FRAND) will normally not restrict competition.<sup>[fn]</sup>Horizontal Guidelines, sec. 280.<sup>[fn]</sup>

Having said that, the existence of these same guidelines has not prevented bitter disputes arising in other areas, and how the guidelines apply in practice is far from certain. The experience resulting from the technology standard setting debate offers a lot of practical guidance on what it means in practice to provide access to standards on FRAND terms. Those considering this area can guess at how the lessons from the technology sector will apply to product certification, but the kinds of influence that can be exerted from within a standard setting process to skew its outcome are so subtle that general guidelines and lessons from other sectors will invariably fall short. As more standards proliferate, and as better informed consumers become more demanding, so too will the opportunities for companies to mould standards to their best advantage, and stray into competition law grey zones. Only a thorough investigation will unravel all the issues, and it seems inevitable that competition authorities will have to examine the product certification area more closely before long.

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