Self-Regulation Is a Tool to Mitigate Litigation

Compliance and Ethics

Litigation and Dispute Resolution

It is easy, especially for attorneys, to be cynical about industry self-regulation. Expecting businesses to hold themselves accountable and resolve disputes autonomously might seem unrealistic, especially when court dockets are full and regulatory oversight is increasing.

However, independent industry self-regulation, when developed and implemented properly, is a powerful tool for enhancing consumer trust in business and protecting consumers. And as we emerge from the reduced trust in government wreaked by the COVID-19 pandemic, it is time for independent industry self-regulation to help solve vexing business problems. In-house counsel can play an important leadership role in those efforts.

What is independent industry self-regulation?

Independent industry self-regulation is a process where a self-regulatory organization (SRO), such as a trade/membership association, a professional society, or a nonprofit:

- Sets standards, guidance, or industry pledges;
- Monitors industry members for compliance; and
- Enforces those standards and other industry rules relating to the conduct of businesses in that industry, typically through an independent third party.

This voluntary — yet accountable — system helps businesses decrease risks to consumers, increases public trust, combats negative public perceptions, and reduces significant litigation expenses, resulting in cost savings.

For example, the BBB National Programs' National Advertising Division was founded 50 years ago to curb misleading advertising. At the time, the advertising industry was facing well-publicized attacks

from the consumer movement for saturating the airwaves with misleading commercials.

Executives and in-house counsel from leading advertisers, such as Procter & Gamble; top officials from the American Association of Advertising Agencies, the Association of National Advertisers, the American Advertising Federation, and the Council of Better Business Bureaus created a dispute resolution forum where advertisers could hold each other accountable by challenging their competitor's misleading advertising.

That forum was the National Advertising Division and its appellate arm, the National Advertising Review Board, comprised of advertising industry and academic members. This independent system of industry self-regulation, a replicable model, run by a non-profit organization, has helped businesses avoid regulatory scrutiny, create a level playing field, build consumer loyalty, and increase advertising truth in the marketplace.

Other examples of successful SRO and government agency partnerships are the Financial Industry Regulatory Authority and its relationship with Securities and Exchange Commission, the RV Industry Association and its relationship with the National Highway Traffic and Safety Administration, the American Bar Association, bar associations, and state supreme courts on attorney ethics rules, and technical rules that trade associations and coalitions create that government agencies look to when adopting standards and regulations.

Benefits of self-regulation

When industries set their own standards, they are often more efficient and predictable, which creates a higher rate of compliance. In addition, businesses have more skin in the game with the ability to help maintain control over the standards to which they are held. This results in building public trust and consumer protection, reinforcing more active business buy-in.

With the help of in-house counsel and compliance professionals, businesses can create efficiencies from adhering to compliance standards. For example, the Financial Industry Regulatory Authority (FINRA) licenses and audits security dealers to ensure compliance with established standards. It also administers arbitration between investors, brokers, and other pertinent parties.

FINRA has the power to discipline registered individuals or firms that violate industry rules. In 2019, FINRA reported that it initiated 854 disciplinary actions, levied fines totaling US$39.5 million, and ordered restitution of US$27.9 million to investors. It also expelled six member firms and suspended another 21, while barring 348 individuals from the securities business and suspending another 415. In 2019, FINRA referred 827 fraud and insider trading cases to the Securities and Exchange Commission (SEC) and other government agencies for prosecution.

Alternative dispute resolution

Another important but often overlooked benefit of industry self-regulation is its ability to mitigate the need for litigation. In-house counsel understand firsthand the need to manage litigation risk. One way to do this is through alternative dispute resolution (ADR). ADR is often a critical part of self-regulation, as it allows businesses to resolve conflicts with both consumers and other businesses directly without going to court.

ADR is generally comprised of mediation and arbitration, with mediation giving parties the

opportunity to try to come to a mutually satisfactory resolution by working together, with the assistance of a neutral mediator. The parties each tell their side of the story or present their evidence and the mediator helps to find a satisfactory solution. Mediation is a viable option for those who want to preserve their relationship with the opposing party and have input in the outcome.

If the parties are unable to come to resolution through mediation, or otherwise via agreement, a dispute can often be decided by a neutral third-party arbitrator. Arbitration is more formal, and it differs from mediation as the arbitrator is the ultimate decision maker.

In the self-regulatory example described previously, BBB National Programs' National Advertising Division plays the role of neutral arbiter between the advertiser and the challenger in each case. Arbitration can be both binding and non-binding, and in some cases, certain parties may choose whether to accept a decision.

In the case of the National Advertising Division, the process is entirely voluntary. However, if an advertiser does not comply with a National Advertising Division recommendation, which occurs in less than 10 percent of cases, the case will be forwarded to the appropriate government regulatory agency for review and possible enforcement action or to platforms like Facebook for review for compliance with their terms of service.

In another flavor of self-regulation, the BBB AUTO LINE program, also part of BBB National Programs, provides independent dispute resolution between 23 participating auto manufacturers and the consumers to whom they sell new (and sometimes used) vehicles still covered under warranty.

In this version of industry self-regulation, the third-party ADR process also helps mitigate litigation by obligating consumers to use dispute resolution before litigation becomes an option. In 2020, 56.2 percent of claims that came through BBB AUTO LINE were resolved through mediation, giving participating auto manufacturers the opportunity to settle disputes directly with consumers before they proceeded to litigation or even arbitration.

When disputes are decided outside of the courtroom, parties have more control over the process and the outcome. With less burdensome rules than those in litigation, the process is faster and easier for disputants to navigate and often there is no need for counsel. This also reduces expenses and fees.

According to the American Arbitration Association (AAA), the benefits of arbitration's streamlined processes can be measured monetarily. In 2017, the economic firm Micronomics studied the differences between litigation and AAA arbitration from initiation of a case to the final determination and found that, on average, federal court cases take around 12 months longer to resolve. Federal and state court cases, when added together, were found to take around 21 months longer to resolve than arbitration.

The same study found that, over a five-year period, the direct losses from delays associated with a case going to trial, rather than arbitration, totaled US$10.9 billion in the United States. When funds are tied up because they are in dispute, neither party can use or invest the funds until the dispute has been resolved. The incentive to resolve disputes with expediency is clear.

Mediation privilege

In addition to having a cost-benefit, many ADR procedures also allow parties to use the mediation privilege. This privilege provides that mediation communications are privileged and confidential, akin

to the attorney-client privilege. The mediation privilege requires that information be kept confidential and not be subject to discovery.

Moreover, the information covered by the mediation privilege is typically inadmissible in court. Therefore, parties can enter mediation with the assurance that, should the dispute result in litigation, the information and communications stemming from mediation will not be used in litigation.

The mediation privilege has been upheld by several courts, including the United States District Court for the Central District of California, which held the federal mediation privilege applies to all communications made in conjunction with a formal mediation proceeding, Similarly, the Supreme Court of California held that evidence of an alleged oral settlement agreement made in mediation was inadmissible and the mediation privilege may only be waived by express agreement.

Although the federal mediation privilege has yet to be acknowledged universally, it is gaining widespread support and adoption through both the courts and state law. In fact, in March 2021, the State of Georgia passed a bill that, in part, outlines the privileges that may be asserted under mediation confidentiality. It is likely that the state rate of adoption will quickly increase due to widespread trial delays, which have led to the increased need for mediation as an alternative to litigation.

There must be consequences for violations

Independent industry self-regulation has the greatest chance of success when its participants act in good faith and put the public's interest before their own. As with internal compliance programs, lack of accountability and enforcement is a common weakness within self-regulation.

Depending upon the accountability program, it can be difficult to compel participants to comply, especially if there are limited sanctions or agreed-upon referrals to government agencies for noncompliance. If there is no accountability, bad actors may ultimately benefit from self-regulation because they use their self-regulatory status as a "shield" yet suffer no consequences for noncompliance.

Successful SROs understand not only the need for standard setting, but also that there must be consequences when these standards are violated. Programs such as the National Advertising Division include a rigorous monitoring component for identifying noncompliance as well as an enforcement component, making non-binding recommendations for voluntary compliance by the advertiser. The support of the FTC as a regulatory agency for noncompliance referrals is key to the success of this longstanding system of independent self-regulation.

While independent guidelines and best practices for the industry can sometimes preempt the need for government to step in, an effective complementary relationship is often preferable. Implemented correctly, independent industry self-regulation is an effective tool used by businesses and in-house counsel to enhance trust with consumers.

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