

## Trade Associations' Power of Sanction - From the Chinese Perspective

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### Abstract

*Disputes are arising with the increasing litigation disputes caused by punitive action of trade associations in judicial practice, which focus on the legitimacy of punitive measures, the specific manner of dispute resolution, the relationship between punishment and antitrust law and so on. By contrast, there has been a lack of systematic research on the relevant theoretical issues, on which the punitive power of trade association should be focused, the vital theoretical framework of the autonomy and self-discipline of the trade associations should be re-sorted. This study aims at responding to such potential need of the reality. This study analyzes the generation and the balance mechanism of the punitive power under the scrutiny of social exchange theory.*

**Keywords:** Trade Association, Sanction Power, Mechanism

### Introduction

The research on the sanction power of trade association has its unique significance, including the political, realistically and theoretical aspects. "Pluralistic governance" has become the future trend of social governance in China. In recent years, the central leading group has attached significant importance to the cultivation of the autonomous capability of social organization (such as trade associations, etc) in the national policy level, and the institutional system of sanction power of trade associations is an important indicator for its capability of autonomy and self-regulation.

#### 1. The Dynamic Mechanism of the Sanction Power

It is believed that the sources of sanction power come in three different ways, contract theory is the most basic manifestation. However, the civil contract theory only describes the phenomenon of the generation of power, rather than the analysis of dynamic mechanism. The approach of social contract theory involves significant deficiencies which are incompatible with the autonomy nature of trade associations. The social exchange theory is a more adequate approach of explanation. In terms of the mechanism of the organization, the enterprises in the market are facing three kinds of social exchange: exchange with the enterprises within the same industry, the exchange with the national organization, as well as the exchange with the society.

Transaction cost theory explains the generation of trade association from a inside perspective which analyzing the exchange occurring between competitors in the same industry, but as a popular accepted interpretation of "private order"<sup>1</sup>, trade associations are not the only organizational structure aiming at saving transaction cost.

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In practice, the establishment of trade associations is usually driven by large enterprises, with which the theory of transaction costs conflicting.

Therefore, the internal exchange for reducing transaction costs is a basic requirement for the generation of trade associations, but with the absence of other factors, the organization is still in a pending state. Some sudden systematic variables stimulates such sleeping group which existing in the social exchange with the State and society<sup>2</sup>.

Enterprises has a higher dependence on resources during the course of the external exchange, therefore alliances are needed to balance the power brought about by such dependence<sup>3</sup>. In the mean time, the "value consensus" as the intermediary embodied by reputation mechanism determines the organizational process of the individual enterprise, as well as providing the big enterprises with additional incentives. The environmental industry self-regulating program in the U.S. could provide a good example for such explanation<sup>4</sup>. After the foundation of the trade association, the power generates between the organization and its members. The collective goods provided by the organization are likely essential to the members and its replacement costs are too high, on the contrast, the members could not provide resources which is essential to the organization in order to balance such relation of dependence. In the area of this study, such power shows as the sanction power, which is the typical form of autonomy. The trade associations define the application condition, form and degree of rewards and punishments by releasing the organizational rules, implementing social control through supervisions and enforcements.

Because of the diminishing marginal effect, regular rewards raise the datum line of the members' earnings expectations, with which the termination of rewards must be combined. Negative stimuli are the predominance way in the mixture stimulus of rewards and punishments. Compared with the sanctions implemented by the public authorities, penalties carried out by the trade associations are more likely to achieve the win-win results based on its professionalism and information superiority. The sanctions carried out by the trade association could modify the wrongdoing with low cost and high efficiency. Related to the balance of power operation, internal and external exchange should be considered in four different aspects, safeguarding the minimum resource requirements, providing basic alternative opportunity, exploring a relatively uniform measurement techniques and tools, and overcoming the tendency of externalizing costs. According to the traditional system of "public law and private law"<sup>5</sup>, the explanation to the nature of the industry association's sanction power differing in two directions: special administrative theory and the private power theory. A more practical way to achieve the goal of the balance of power might be functionalism.

## 2. The Optimal Allocation and Operation Mechanism of the Sanction Power

The empirical analysis of some guild regulations and bylaws from Chinese shows the defects of the sanction power rule system, which makes them not competent to assist the trade association coordinating collective actions and supporting the industry in autonomy. This phenomenon reflects status quo the weakness of the trade associations in controlling and mobilizing social resources. The optimal allocation and operation mechanism of the sanction power could help the industry associations aggregating resources effectively, and improving its capability of social governance. The categorization of sanction usually includes monetary sanction, reputation sanction, qualifications sanction, boycott and expulsion. Deterrence theory can be applied to analyze the differences of their deterrent power, as well as the boundaries of the severity and other issues. The severity of the sanctions and the detection probability of wrong doings directly affect the effect of optimal deterrence, to which the static rules and dynamic supervision should pay attention.

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1Grief, A. Microtheory and recent developments in the study of economic institutions through economic history. In D. Kreps & K. Wallis (Eds.), *Advances in economic theory and econometrics*, Cambridge, England: CambridgeUniversity Press.1997. vol.2:pp79-113.

<sup>2</sup>Blau.Structural Contexts of Opportunities. Chicago: University of Chicago Press.1994: p91.

<sup>3</sup>Richard M. Emerson .Power-Dependence Relations.American Sociological Review.1962.Vol. 27(1): p37.

<sup>4</sup> Michael J. Lenox.Industry self-regulation and adverse selection: a comparison across four trade association programs.Business Strategy and the Environment.2003. Vol.12(6):pp343-356

<sup>5</sup>The Public Law/ Private Law Divide,Une entente assez cordiale?Edited by Mark Freedland and Jean-Bernard Auby.Oxford And Portland.Oregon.2006:p4.

The severity of the sanctions of the trade associations should generally be less than the degree of law on the same or similar acts, measured by the trade association in accordance with the behavior of the members as well as the results of the damage caused by wrong doings. The difference should be made between organizations, larger size ones with higher degree of heterogeneity and the organizations of smaller size low heterogeneity in the punitive methods. The latter should not be set excessive sanctions because of its relational governance model nature.

Generally speaking, warnings and admonitions is the sanction with minimum deterrence, while expulsion is with the highest deterrence.

The deterrence of monetary sanction and reputation sanction are quite different depending on the context of organization, industry and members. Trade Association have got the advantage in understanding and possessing of private information of its members, including potential wrong doing individuals compared to other organizations, therefore, sanctions with different deterrence should be applied accordingly in order to save the costs of enforcement and avoid the elimination of marginal deterrence. Specific punitive benchmarks should be made according to the SMEs members of a large proportion, with the assistance of reputation sanction and expulsion to correct the problem that in sensitivity of large-scale enterprises to some sanctions. It is difficult to construct a constitutive requirements theory of the sanction of trade associations; instead, the procedural control should be focused with the overseeing by judicial review. In terms of operating mechanism of sanction, investigation and internal disputes resolution systems could be effectively correct deviation from the requirements of rationality caused by insufficient information and limited attention, which helps trade associations and its members clarify the specific meaning of the relevant concepts in an interactive forms, solving the problem of ambiguity of organizational rules. The internal supervision and reporting mechanisms could save the cost of enforcement on the one hand, increasing the deterrence of sanctions as well<sup>6</sup>.

### **3. The Guiding Role of Public Authority in Chinese Context**

The guild regulations are the static form of power. Transference of the authority powers and monopoly from the state agencies has become a decisive indicator of resource mobilization capacity, marginalizing the importance of internal collective action. Interactive collaboration between trade associations and the state sectors under the ideas of co-regulation is in line with the development of pluralistic governance idea<sup>7</sup>. The oversight of public power could help curb the free-riding in the collective action of trade associations, stimulate the trade associations carrying out self-regulating. The legislative and administrative measures providing guidance for industry self-regulation could reduce the transaction costs of the rule-making process<sup>8</sup>. The static aspects of "Co-regulation" concern the convergence between the organizational rules and laws, the latter providing guidance system for the sanction rules with the minimum requirements of resources and proper procedural command. In the dynamic aspects, multiple rule-making guidance from the executive power should be focus on, such as the integration of the practical sanction exercise of trade associations in order to develop model texts, as well as enhancing the weights of construction of the sanction system in order to optimize the appraisal index system of the administrative department for the performance of the trade associations. As front-loading guiding measures for the ex post sanction, a two-way interactive consulting and administrative suggestions mechanisms should be established within the antitrust committee of the State council. The compensation to the closely related stakeholders must also be considered.

### **4. The Judicial Review of the Disputes**

The main point of controversy in academia is the proceedings of resolving disputes, that is, in civil procedure or administrative procedure. Functionalism oriented program is a more feasible solution. The sanction power of trade associations possess the risk of imbalance power which can be corrected within the civil procedure. In the jurisprudence of United States, the rules relating to sanction power of trade association are generally considered as contract bounding members and the organization<sup>9</sup>, without antitrust dispute occurring, the courts generally do not review

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<sup>6</sup> John T. Scholz. Enforcement Policy and Corporate Misconduct: The Changing Perspective of Deterrence Theory. *Law and Contemporary Problems*. 1997. Vol. 60(3): pp253-268.

<sup>7</sup> Cowan, S. Alternative approaches to regulation: An economic analysis of light-handed regulation. paper presented to Australian Competition and Consumer Commission Regulatory Conference. Surfers Paradise. 2007. July.

<sup>8</sup> Wotruba. Industry self-regulation: A review and extension to a global setting. *Journal of Public Policy & Marketing*. 1997. vol. 16(1): pp38-54.

<sup>9</sup> Smith v. Kern County Medical Assn. 19 Cal.2d 263 ( 1942)

the reasonableness of the sanction<sup>10</sup>.

In the civil law system, disputes arising from the sanction enforced by trade associations are also examined in accordance with the civil procedure, basically, the administrative review proceedings mostly confined to professional associations<sup>11</sup>.

In fact, the civil procedure will not unduly undermine the protection of members' interests<sup>12</sup>, but also to avoid the adverse effects to the autonomy of trade associations caused by administrative litigation<sup>13</sup>. Disputes triggered by sanctions of trade associations should be resolved in civil litigation in principle, with administrative litigation mode as an exception, not until further expression in the civil legislation; such disputes could be considered as a contract from the perspective of legal hermeneutics. During the judicial review process, in both civil litigation and administrative proceedings, proper procedure shall be the main subject. Under the administrative proceedings, the review should focus on the conformity of the regulation, with the requirement of exhaustion all remedies within the organization as well as the administrative department.

The requirement of the completeness of sanction procedures is lower in civil litigation, but also needs exhaustion all remedies. If the procedural measures are not sufficient to protect the legitimate rights of members in administrative proceedings, or exit mechanisms are limited combined with severe sanction in civil proceedings, the court may review the entity issues which are called the exception of procedural examination.

As far as the relationship between sanction power of trade associations and antitrust law is concerned, the sanction power of the trade association has the natural tendency of restricting competition<sup>14</sup>. The first consideration of the trade associations is the common interest of its members, which also shows the enormous tension between trade associations' collective action and free market competition rules. Restriction of competition with the implementation of organizational sanction covering such a wide range, that this study centered on the principle of regulation. Because of the intention liaison and joint behavior with more pronounced "expressivity", compared with other trade associations restricting competition behavior, it is believed that a closer link between sanction power and restriction of competition industry exists, and more serious injury could be brought to the market competition order.

The application of the rule of reason of the American courts and administrative law enforcement departments has developed from ambiguity to relatively mature categorical filtering technology<sup>15</sup>. From the perspective of normative analysis, there are some differences between EU legislations and the Chinese ones. Decision-making ideas manifested in judicial precedents show the similarity between American judicial and administrative practice and Chinese applications<sup>16</sup>. With the short time of implementation and the lack of experience, the adoption of a relatively cautious attitude towards the allocation of burden of proof in civil proceedings could be regarded as a useful exploration carried out by the judges. In the process of concrete application, sanction merely a means to achieve the goal of restricting competition must be understood. Only if the characteristics of naked price fixing and other agreements so obvious in the enforcement of sanction that per se rule should be applied, otherwise, rule of reason is a more suitable way<sup>17</sup>. Due to the advantages of information, the internal dispute resolution mechanism of trade associations could enhance the speed and ensure the quality of dispute resolution, assessing the losses and deterrence accurately, protecting the trade secrets of the members. Affected by the capital specific investment, external arbitration as an alternative dispute resolution does not have widespread applicability, and universally applicable internal dispute resolution mechanism needs a basic requirements of procedural justice, which can not exclude the application of judicial review.

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<sup>10</sup>Scott v. Lee 208 Cal.App.2d 12.(1962)

<sup>11</sup>Staudinger/Weick, BGB (2004), vor §21 ff Rn 30 ff,35

<sup>12</sup>BGHZ87,337,343=NJW 1984, 918;BGH NJW-RR 1992, 246.

<sup>13</sup>BGHZ29, 352, 354=NJW1959, 982.

<sup>14</sup>Anne K. Bingaman.Assistant Attorney Gen. Antitrust Division. U.S. Dep't of Justice.Address at the Annual Symposium of the Trade Association and Antitrust Law Committee of the D.C. Bar Ass'n.Recent Enforcement Actions by the Antitrust Division Against Trade Associations (Feb. 28, 1996).<http://www.justice.gov/atr/public/speeches/222995.pdf>.

<sup>15</sup>,Herbert Hovenkamp, Phillip E. Areeda. Fundamentals of Antitrust Law. New York: Kluwer.3d ed. 2010;p389.

<sup>16</sup>Michael A. Carrier.The Rule of Reason: An Empirical Update for the 21st Century.GEO.MASON L. REV.2009.vol.16:pp 827- 828.

<sup>17</sup>Andrew I. Gavil.Moving Beyond Caricature and Characterization: The Modern Rule of Reason in Practice.S.CALL.REV. 2012.vol.85:pp733-782.