CENTER FOR PUBLIC INTEREST LAW
University of San Diego School of Law
5998 Alcalá Park
San Diego, CA 92110-2492
P: (619) 260-4806 / F: (619) 260-4753
1107 Ninth Street, Suite 880
Sacramento, CA 95814 / P: (916) 844-5646
www.cpil.org

North Carolina State Board of Dental Examiners v. Federal Trade Commission: A Proposal for Implementation in California

Presented by the Center for Public Interest Law to the

SENATE COMMITTEE ON BUSINESS, PROFESSIONS AND ECONOMIC DEVELOPMENT
and
ASSEMBLY COMMITTEE ON BUSINESS AND PROFESSIONS

October 22, 2015

Introduction

In the Supreme Court's landmark decision in *North Carolina State Board of Dental Examiners v. Federal Trade Commission*, __US ___, 135 S. Ct. 1101 (2015) (*"North Carolina"*), Justice Kennedy makes a critical observation:

> Limits on state-action immunity are ***most essential when the State seeks to delegate its regulatory power to active market participants,*** for established ethical standards may blend with private anticompetitive motives in a way difficult even for market participants to discern. Dual allegiances are not always apparent to an actor. ***In consequence, active market participants cannot be allowed to regulate their own markets free from antitrust accountability.***

Id. at 135 S. Ct. at 1111 (emphases added), *citing California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 106 (1980) ("*Midcal*") ("The national policy in favor of competition cannot be thwarted by casting [a] gauzy cloak of state involvement over what is essentially a private price-fixing arrangement").

Today, many of California's occupational licensing boards are controlled by "active market participants" – licensees who stand to directly benefit from anticompetitive decisions the board makes. Thus, to protect boards and their members from antitrust liability, California must either 1) re-constitute the boards to include a supermajority of non-conflicted "public members," or 2) ensure that all actions of a board dominated by active market participants are subject to a state supervision mechanism that "provide[s] ***'realistic assurance'*** that a nonsovereign actor's anticompetitive conduct 'promotes state policy, rather than merely the party's individual interests.'" *North Carolina,* 135 S.Ct. at 1116, *quoting Patrick v. Burget*, 486 U.S. 94, 100-01 (1988) (emphasis added).

If the legislature considers changing the composition of the boards, it is important to note that a simple majority of public members on a board will not suffice. On October 14, 2015, the Federal Trade Commission – indeed the prevailing party in the *North Carolina* case – issued staff guidance

regarding the implementation of *North Carolina*. *See* Appendix Ex. A. According to the FTC, "[a]ctive market participants need not constitute a numerical majority of the members of a state regulatory board in order to trigger the requirement of active supervision. A decision that is controlled, either as a matter of law, procedure or fact, by active participants in the regulated market (e.g., through veto power, tradition, or practice) must be actively supervised to be eligible for the state action defense." Ex. A at p. 8. [1]

If California chooses not to reconstitute the boards, it must implement a supervision mechanism which reviews "the ***substance*** of the anticompetitive decision, not merely the procedures followed to produce it…" *North Carolina*, 135 S.Ct. at 1116 (citations omitted, emphasis added). Moreover, "the supervisor must have the power to veto or modify particular decisions to ensure they accord with state policy…; and the 'mere potential for state supervision is not an adequate substitute for a decision by the State…." *Id.* The Supreme Court's *Midcal* decision holds that "state supervision" must be specific and *bona fide*; in other words, state "rubber stamping" of a regulatory board's action will not suffice. *Midcal*, 445 U.S. at 105-106.

Anticompetitive regulatory action

Many of the decisions occupational licensing boards make on a regular basis necessarily "restrain trade." For example, they decide who is allowed to practice a trade or profession and who is excluded, with the force of law. They revoke licenses, and specify how the licensees are to practice. These acts, if committed by a cartel – or any private grouping of competitors – would be *per se* antitrust violations under federal law (*e.g.*, Sherman Act, 15 U.S.C. § 1 *et seq*.) For example, licensing boards control supply by limiting entry into the profession or market. These barriers to entry are effectively "group boycotts" and/or price fixing, which, as *per se* offenses, constitute antitrust violations without recourse to their "reasonableness" or other related defenses. The federal remedy for any violation of the Sherman Act includes potential felony prosecution, as well as private civil treble damages relief.

The Attorney General's Opinion Misses Two Critical Points

While the Attorney General's Opinion No. 15-402, issued September 10, 2015, provides a thorough and generally accurate analysis of the *North Carolina* opinion, there are two elements that must also be considered when implementing a mechanism for protecting California's regulatory boards from antitrust liability:

1) ***Status Quo Rulemaking Review is Inadequate: Neither OAL nor DCA Currently Reviews Any Board Regulations for Anticompetitive Effect:*** The opinion's finding that "… promulgation of regulations is a fairly safe area for board members, because of the public notice, written justification, [Department of Consumer Affairs] Director review, and review by the Office of Administrative Law as required by the Administrative Procedure Act" (Op. at 8) is inaccurate. In fact, there is ***no entity*** in state government that currently reviews regulations for anticompetitive effect, nor is there an entity which has the power to

[1] Courts look to FTC guidance with deference with interpreting cases involving its jurisdiction. *See Harris v. Home Depot U.S.A., Inc.*, Case No. 15-CV-01058-VC, --- F.Supp.3d ---; 2015 WL 4270313, at *1 (N.D. Cal. June 30, 2015); *see also Chrislensen v. Harris Cnty.*, 529 U.S. 576, 587 (2000) (Although an opinion letter by an agency charged with administering a statute, such as the FTC, is not entitled to "Chevron deference" [] it is well established that it is entitled to "respect" and is persuasive).

modify or disapprove of regulations for anticompetitive reasons. The opinion misses two key factors:

a. ***The DCA Director is not required to review DCA boards' regulations for anticompetitive effect***. *See* Bus. & Prof. Code § 313.1. In fact, that same provision ***precludes*** the DCA Director from reviewing several kinds of regulations at all. *Id.*

b. ***Anticompetitive impact is not one of the six criteria*** reviewed by the Office of Administrative Law (OAL) under current law. *See* Gov't Code § 11349.1, which lists necessity, authority, clarity, consistency, reference, and nonduplication as the six standards which OAL must review under the Administrative Procedure Act (APA).

2) ***Non-DCA Boards Are Excluded from the AG's Analysis:*** The opinion does not consider the impact of the *North Carolina* decision on non-DCA boards -- most significantly, the State Bar of California, whose governing Board of Trustees consists of a supermajority of active market participants, including six lawyers who are *elected* to the Board by lawyers in various parts of the state. The legislature must consider a mechanism to ensure that decisions and acts of the State Bar and other non-DCA boards are actively supervised with respect to anticompetitive conduct.[2]

Independent State Supervision Defined

The FTC also provided specific guidance regarding the post-*North Carolina* features of independent state supervision. *See* Appendix Ex. A at p. 10. Specifically, the following factors determine whether the active supervision requirement has been satisfied:

1) **Consideration of all Relevant Information:** The supervisor must obtain the information necessary for a proper evaluation of the action recommended by the regulatory board, including ascertaining relevant facts, collecting data, conducting public hearings, inviting and receiving public comments, investigating market conditions, conducting studies, and reviewing documentary evidence.

2) **Evaluation of the Substantive Merits**: The supervisor must assess whether the recommended action comports with the standards established by the legislature.

3) **Written Decision:** The supervisor must issue a written decision approving, modifying, or disapproving the recommended action, and explaining the reasons and rationale for such a decision.

The Center for Public Interest Law's Proposal for California:

1) **Ensure expert competitive impact review at OAL:** The Government Code should be amended to ensure OAL is reviewing all rulemaking for anticompetitive effect. For example,

[2] The *North Carolina* opinion expressly includes regulation of attorneys. 135 S. Ct. at 1111, *quoting Goldfarb v. Virginia State Bar*, 421 U.S. 773, 791 (1975) ("'The fact that the State Bar is a state agency for some limited purposes does not create an antitrust shield that allows it to foster anticompetitive practices for the benefit of its members.'").

the legislature could create a panel of economic experts as a part of OAL, and add a seventh criterion to Government Code § 11349.1, requiring the panel or other expert(s) to review all rulemaking for "anticompetitive effect."

a. **Independence:** The expert review panel or any other person/entity that is reviewing these decisions should be independent of any profit stake interest in any matter before it.

b. **Simultaneous Review:** The expert review panel should conduct its review of anticompetitive impact as part of the OAL review process, with OAL simultaneously handling the other six elements as per current law.[3]

c. **Modification/Veto Power**: The expert review panel, unlike OAL, should have broad authority to revise or reject proposed rules, and issue a written decision as to its findings regarding the anticompetitive impact of the rule. This written decision would be included with OAL's final determination.

2) **Create a position at OAL to accept and evaluate complaints regarding non-rulemaking acts and decisions:** Many restraints of trade are accomplished by decisions *other* than rulemaking, including unreasonably difficult licensing exams, patterns of enforcement, or as in the *North Carolina* case, cease and desist letters to non-licensees. Accordingly, the Government Code should be amended to establish a position, also housed at OAL, to accept and evaluate complaints about such conduct. This individual would have a background in the economics of competition, and would refer any board actions that may have an anticompetitive effect to the expert panel for review and final decision. Individual disciplinary decisions would not be referred to the expert review panel unless there is a pattern of revocation or discipline, or a clear anticompetitive motivation beyond an alleged rule or statutory violation. Such a threshold filter will ensure that non-rulemaking activities may be addressed and reviewed, without unduly burdening the expert review panel with complaints about decisions that do not truly have anticompetitive impact.

3) **Require a "Competition Impact Statement" for all Rulemaking:** The Government Code should be amended to require agencies conducting rulemaking to include a "competition impact statement," similar to the other statements agencies are required to include in their rulemaking file. *See, e.g.*, Gov't Code § 11346.3. The competition impact statement must include the scope and nature of possible restraints; their effect on prices and competition; and any ameliorating exceptions, checks, or public interest justifications.

4) **Require all State Bar Actions to be Reviewed for Anticompetitive Effect:** The legislature must either convert the Bar's Board of Trustees to a public member supermajority, or subject the Bar to the same expert review set forth above. This active supervision could be performed by the OAL panel, or a separate one as the Supreme Court might decide. The State Bar will contend that it is already "actively supervised" by the Supreme Court, but this is not the case. The Supreme Court does review the Bar's proposed

[3] This format is designed to accommodate anticompetitive review within the present structure in order to avoid additional delay. The rulemaking file would be expanded to incorporate anticompetitive impact, and the same rulemaking file would be simultaneously available to OAL and the expert review panel.

changes to the Rules of Professional Conduct (RPC), but the Business and Professions Code only requires the Supreme Court's "approval;" it does not mandate anticompetitive impact review. Bus. & Prof. Code § 6076. Nor does the Supreme Court review any changes to the myriad number of non-RPC rule compilations maintained by the State Bar. And the Court reviews State Bar Court disciplinary decisions, but only if such a decision is appealed to it by the subject attorney and the Court decides to hear the matter; its review of State Bar Court disciplinary decisions is discretionary. California Rule of Court 9.16; *see also In Re Mason Harry Rose V*, 22 Cal. 4th 430 (2000).

CPIL submits that this mechanism will ensure that California complies with the *North Carolina* decision in a manner that uses an existing structure to minimize delay and complexity. It will provide meaningful review for anticompetitive impact, and ensure that relevant information is provided and considered. It will also ensure that individuals who review this conduct have the relevant expertise as well as independence from a profit stake interest in the decision. Critically, this model is fully supported by the FTC guidance on the subject.

Current Examples of Anticompetitive Actions by California Regulatory Boards

- **California Board of Accountancy** ("CBA"): CBA continues to administer the Uniform Certified Public Accountant Examination as a prerequisite to CPA licensure in California. That test is wholly controlled by the American Institute of Certified Public Accountants (AICPA) – a trade association completely dominated by market participants. All national trade associations that once controlled the licensing exam used by states to bar entry into a profession have divested themselves of such control due to the obvious conflict of interest – except the CPA profession. Only the accountancy profession – in the form of the AICPA – retains control over the licensing examination used in 54 jurisdictions to license its members. While CBA will argue it retains the power to supervise the exam, there is no evidence it has actually exercised such supervision in a way that would insulate the Board from antitrust liability as required by *Midcal*. Instead it impermissibly delegates this authority to the AICPA.

- **Medical Board of California's Contemplated Support of the Federation of State Medical Boards' "Licensing Compact":** If the Medical Board enters into this compact developed by the FSMB, it would necessarily delegate some of its licensing authority to other state medical boards and to a new commission within FSMB – all of which are dominated by active market participants in the medical profession.

- **Veterinary Medical Board:** VMB is currently considering proposed regulations mandating that "animal rehabilitation" may be performed by non-veterinarians only under the direct supervision of a licensed veterinarian. These proposed regulations have been challenged by hundreds of individuals and groups which argue that many aspects of "animal rehabilitation" – as defined in the proposed rules – do not constitute the practice of veterinary medicine and may not be restricted by the Board; these commenters also argue that the Board is simply attempting to protect the business of its DVM licensees by limiting business competition from non-veterinarians.

Center for Public Interest Law's Interest and Qualifications

The Center for Public Interest Law (CPIL) is a nonprofit, nonpartisan, academic center of research, teaching, learning, and advocacy in regulatory and public interest law based at the University of San Diego School of Law. Since 1980, CPIL has studied the state's regulation of business, professions, and trades, and monitors the activities of state occupational licensing agencies, including the regulatory boards within the Department of Consumer Affairs (DCA). CPIL publishes the *California Regulatory Law Reporter*, which chronicles the activities and decisions of 25 California regulatory agencies. CPIL's founder and Executive Director is Professor Robert C. Fellmeth, who holds the Price Chair in Public Interest Law at the USD School of Law. Prior to founding CPIL, Professor Fellmeth was an antitrust prosecutor at the San Diego District Attorney for nine years; he was cross-commissioned as a U.S. Attorney so he could bring antitrust suits in federal court. He co-authors *California White Collar Crime and Business Litigation*, 4th Ed. (with Thomas A. Papageorge) (Tower, 2013).

CPIL's expertise has long been relied upon by the legislature, the executive branch, and the courts where the regulation of licensed professions is concerned. CPIL personnel have served as enforcement monitors at the State Bar (1987-1992), the Medical Board of California (2003-2005), and the Contractors' State License Board (2001-2003). These multi-year projects have resulted in numerous reports and successful reform legislation at these agencies.