Report from North America

Editor: Christopher Pleatsikas

FEDERALISM, STATES' RIGHTS AND THE ANTITRUST LAWS: THE SUPREME COURT INFLICTS PAIN ON NORTH CAROLINA DENTISTS

A recent decision by the United States Supreme Court in the *North Carolina Dental* case[1] regarding State regulation of professions has raised interesting issues that go well beyond the nexus between the regulation of professions and competition in the provision of professional services. In addition, the decision has touched upon controversial subjects such as the division of powers between the State and Federal governments – the so-called "States' rights" issue – and the intent of Congress in enacting antitrust legislation. As a consequence, and not surprisingly, it has led to a bitterly divided decision by the Supreme Court.

THE REGULATION OF PROFESSIONS IN THE UNITED STATES

State regulation of professions in the United States might seem to have only a minor potential impact on commerce, but the reality is far more significant. State regulations affect a wide variety of professions – both in terms of standards of service and control over the qualifications required for entry, expansion and maintenance of business. These range from the higher profile regulation of physicians and lawyers to a host of other business, such as cosmetologists, acupuncturists, and even yoga instructors.

The history of the regulation of professions in the United States is long, stretching back to the colonial era. In the 1600s, concerns about the problems caused by unqualified health practitioners led several of the colonies to adopt medical licensing requirements and other health care regulations.[2] Regulation continued after the formation of the republic, although there was a period during the first half of the 19th century when professional licensing fell out of favour.

Subsequently, advances in medical science led to a reintroduction of medical licensing, so that, by the early 1900s, most States had re-imposed medical and dental licensing.[3] By 1930, many States had expanded the list of licensing requirements to include lawyers, architects, accountants, pharmacists, nurses and some other professions.[4] The United States Supreme Court, in two decisions in the 1920s, recognised the right of States to set standards for the licensing of professionals.[5]

More recently, State regulation of professions has expanded to cover an increasing number and variety of professions. For example, Wyoming, the smallest State in terms of population, lists 19 professional boards on its website, including boards for athletic trainers, midwives and hearing aid specialists.[6] New York State lists 35 professional licensing boards covering more than 50 professions, including shorthand reporters, land surveyors, social workers and massage therapists.[7] California's Department of Consumer Affairs lists 45 different licence categories covering more than 100 professions, vocations and/or businesses.[8]

[1] *North Carolina State Board of Dental Examiners v Federal Trade Commission* (United States Supreme Court, No 13-534, 25 February 2015).

[2] See David A Johnson and Humayun J Chaudhry, *Medical Licensing and Discipline in America: A History of the Federation of State Medical Boards* (Lexington Books, 2012).

[3] Johnson and Chaudhry, n 2.

[4] Johnson and Chaudhry, n 2.

[5] See *Douglas v Noble* 261 US 165 (1923); *Graves v Minnesota* 272 US 425 (1926).

[6] See <http://plboards.state.wy.us>.

[7] See <http://www.op.nysed.gov/prof/>.

[8] See <http://www2.dca.ca.gov/pls/wllpub/wllquery$.startup>.

It has been estimated that about 30% of American workers now require some type of licence in the United States, compared with about 5% in 1950.[9] Approximately one-third of all occupations are licensed at the State level. In the past six years alone, at least 14 States have imposed licensing requirements for yoga instructors. Recent additions to the occupations requiring licences in some States include irrigation contractors, eyebrow threading and art therapists.[10] Moreover, these regulations are becoming increasingly onerous. It has been reported that cosmetologists, for example, are required on average to have 10 times as many days of training as Emergency Medical Technicians.[11]

There are basically three methods by which members of State licensing boards are appointed. In some cases, State Governors have broad authority to appoint members. In other cases, members are elected by members of the profession in that State. In still other cases, Governors appoint members from nominees suggested by local professionals.

The cumulative competitive consequences of these occupational regulations is substantial, raising entry barriers and prices. A recent study concluded that tougher licensing, in the form of lower pass rates on the qualifying exam, increased prices for dental services by 11%.[12] Another earlier study estimated restricting the number of hygienists a dentist may employ increased the cost of a dental visit by 7%, resulting in an estimated US$700 million annual cost to consumers (US$1.7 billion after converting 1982 dollars to 2014 dollars).[13]

Consequently, the economic impact of professional licensing regulations is similar in many respects to cartel agreements. By limiting supply (through exclusion of competitors or through limits on who may compete) and/or by placing limits on the intensity of competition (for example, through restrictions on advertising or on the types and means by which services can be provided), professional licensing regulations may have significant price effects. This is why many economists agree that antitrust oversight of the regulation of professions is warranted.

THE FACTS IN NORTH CAROLINA DENTAL

The facts in the case are relatively straightforward and were not in dispute.[14]

North Carolina has declared the practice of dentistry to be a matter of public concern requiring regulation under its dental practice legislation (the Act).[15] Under the Act, the North Carolina State Board of Dental Examiners is "the agency of the State for the regulation of the practice of dentistry". The Board's primary function is to create, administer, and enforce a licensing system for dentists. It has broad authority over licensees, and, in respect of unlicensed persons, it may file suit to enjoin unlicensed persons from practising dentistry.

Under the Act, the Board is comprised of eight members, six of whom must be actively engaged in the practice of dentistry. They are elected by licensed dentists in North Carolina. A seventh member is a dental hygienist (a dental assistant) who is elected by dental hygienists in North Carolina. The final member is appointed by the Governor and is supposed to represent consumer interests. All members serve three-year terms and cannot serve more than two consecutive terms.

[9] Morris M Kleiner and Alan B Krueger, "Analyzing the Extent and Influence of Occupational Licensing on the Labor Market" (2013) 31 *Journal of Labor Economics* 1.

[10] Angus Loten and Sarah E Needleman, "State Licensing Boards Under Fire From Within", *The Wall Street Journal*, 27 August 2014.

[11] RH Allensworth, E Elhauge and A Edlin, "Brief of Antitrust Scholars as Amici Curiae in Support of the Respondent" (11 August 2014) <http://ssrn.com/abstract=2479114>.

[12] Morris M Kleiner and Robert T Kudrle, "Does Regulation Affect Economic Outcomes? The Case of Dentistry" (2000) 43 *Journal of Law and Economics* 547, 572-573.

[13] J Nellie Liang and Jonathan D Ogur, *Restrictions on Dental Auxiliaries: An Economic Policy Analysis* (Bureau of Economics, 1987) 47.

[14] This section has been adapted from the Supreme Court decision.

[15] The North Carolina State Board of Dental Examiners was created by *Public Laws* 1879, Ch 139. It has been reauthorised a number of times since then, most recently in 2013. See NC Gen Stat §90-22.

In the 1990s, dentists began offering teeth whitening services (including eight of the 10 dentists that served on the Board during the relevant period at issue in the case), earning substantial fees from doing so. By 2003, many non-dentists, including several persons who established operations in kiosks at shopping malls in North Carolina, began to offer teeth whitening services to consumers, at substantial discounts to the services offered by dentists.[16] Some dentists began to complain to the Board about this competition from non-dentists, with most complaints focused on the price competition, although a few dentists raised health and safety concerns.

Responding to these complaints, the Board opened an investigation into teeth whitening by non-dentists. The investigation was headed by one of the practising dentists, with no participation by either the hygienist member or the "consumer" member. The Act did not specifically mention teeth whitening as a dental practice subject to regulation. Moreover, the Board did not seek to issue any type of formal rule that would be subject to review by any independent arm of the State government which would define teeth whitening as the practice of dentistry subject to oversight by the Board. Instead, beginning in 2006, the Board issued at least 47 cease-and-desist orders on official Board letterhead to non-dentists offering teeth whitening services. These letters warned that the unlicensed practice of dentistry is a crime in North Carolina and strongly implied that teeth whitening constituted the practice of dentistry. In 2007, the Board induced the North Carolina Board of Cosmetic Art Examiners to warn cosmetologists against providing teeth whitening services. That same year, the Board sent letters to mall operators asserting that kiosk operators offering teeth whitening services were engaging in the unlawful practice of dentistry and advising the mall operators to expel the teeth whitening service operators from the premises.

The result of these actions was that the Board effectively ended the offer of teeth whitening services in North Carolina by non-dentists.

THE FEDERAL TRADE COMMISSION'S INVOLVEMENT

In 2010, the Federal Trade Commission (FTC) filed an administrative complaint alleging that the Board's actions had violated s 5 of the *Federal Trade Commission Act 1914*.[17] Section 5 of that Act prohibits "unfair or deceptive acts or practices in or affecting commerce" or unfair competition.[18] Under this provision the FTC can issue a cease-and-desist order to stop the unfair action. The FTC contended that the Board's actions were equivalent to a concerted action to exclude non-dentists from performing teeth whitening services.

The Board contended that, under the State immunity principle,[19] the FTC did not have jurisdiction to enforce any complaints about the Board's actions. An Administrative Law Judge denied the Board's contention. The Judge's decision was subsequently sustained by the FTC itself, with the FTC contending that, as a public/private hybrid organisation, the Board required active supervision by the State in order to qualify for immunity and such supervision did not occur in this instance. The Judge then conducted a hearing on the merits and found that the Board had engaged in restraint of trade, in part because there was no evidence that public safety had been compromised by the practice of teeth whitening by non-dentists. The FTC then ordered the Board to stop sending letters and to inform all those to whom it had sent letters that the Board had exceeded its authority.

On a subsequent appeal by the Board, the Fourth Circuit Court of Appeals upheld the FTC's decision in all respects.[20] The Fourth Circuit agreed with the FTC that the composition of the Board – dominated by market participants – required it to be regulated as a "public/private hybrid" that should

[16] The discounts amounted, in some cases, to hundreds of dollars, with the *Wall Street Journal* reporting that non-dentists charged US$100-$200 for the teeth whitening services, while dentists charged US$300-$700: Loten and Needleman, n 10.

[17] 15 USC § 45.

[18] Maureen K Ohlhausen, "Section 5 of the FTC Act: Principles of Navigation" (2014) 2 *Journal of Antitrust Enforcement* 1.

[19] This is essentially a sovereign immunity argument.

[20] *North Carolina State Board of Dental Examiners v FTC* 717 F 3d 359 (4th Cir, 2013), *cert granted*, 134 S Ct 1491 (No 13-534) (US, 3 March 2014).

be subject to direct State government oversight (which was lacking in this case). The Board then appealed the Fourth Circuit's decision to the United States Supreme Court.

THE STATES' RIGHTS ISSUE

The States' rights debate has long been a highly charged issue in American politics. It encapsulates the ongoing debate as to the demarcation line between the powers of the individual States and the Federal government. The debate is still not entirely settled and is as old as the nation itself.

The United States was formed from 13 separate colonies, each of which exercised a form of self-government under British rule prior to independence. While their representatives agreed to co-operate during the revolution, in many ways the people in each of the colonies identified more strongly with the colony in which they lived than the nation as a whole. The first national government formed subsequent to the end of hostilities in the Revolutionary War (under the *Articles of Confederation* in 1781), unsurprisingly, was weak, with most of the powers still exercised by the individual States (each of which was the successor to its colonial predecessor).

It quickly became clear that the *Articles of Confederation* was an unworkable form of national government, as it relied too heavily on voluntary co-operation among the States. Just six years after the Articles went into force, a constitutional convention was convened to restructure the national government. What emerged was a much stronger central government with certain powers ceded by the States to the central authority, but with a vague dividing line between the powers of the national government and those retained by the States. This vague dividing line has been the subject of much debate over virtually the entire period of the United States' existence.[21] The debate has been the cause of much strife over the years, most notably the so-called nullification crisis concerning national tariffs in the first half of the 19th century (when several States claimed the right to nullify national laws deemed contrary to a State's interest) and, looming above all other States' rights issues, the Civil War in the 1860s (fought over the right exercised in numerous States to enslave African-Americans). While subsequent States' rights controversies have been less cataclysmic, they still have been highly contentious and very important (for example, the legislation by the Federal government to override attempts by many Southern States to deny civil rights to minorities).

The backdrop to the *North Carolina Dental* decision places it squarely in the tradition of the debate over States' rights. The federal antitrust laws are mainly concerned with private anticompetitive actions. There is, for example, little evidence that legislators who enacted the *Sherman Act* in 1890 (the seminal antitrust law in the United States) intended it to apply to State action.[22] Moreover, the federal antitrust laws were supposed to apply in cases in which commerce was affected in some significant manner. However, in line with the vague dividing line between federal and State powers, the determination of what actions might "affect" commerce in a significant manner has both been evolving and less than clear.

A series of Supreme Court cases and subsequent actions by the United States Congress have, over time, clarified this dividing line to some extent. Most notably, in *Wickard v Filburn*,[23] the Supreme Court found that certain private actions, while individually only local in impact, should be judged in light of the cumulative economic impact that such actions would cause. In this manner, some local actions would clearly affect interstate commerce. Nearly 40 years later, in the *Midcal* case,[24] the Supreme Court enunciated principles that separated certain State actions that might be exempt from application of federal antitrust laws from other State actions that would not be exempt. A few years

[21] A recent historical musical (*Hamilton*), in part, recounts the early States' rights controversy with a musical debate (in hip-hop) between Alexander Hamilton (an ardent federalist and the first Secretary of the Treasury) and Thomas Jefferson (the third President of the United States and a staunch defender of States' rights).

[22] Municipalities, as opposed to States, have not been accorded the same protection from federal antitrust laws, because they do not have the same sovereign rights.

[23] *Wickard v Filburn* 317 US 111 (1942).

[24] *California Retail Liquor Dealers Assn v Midcal Aluminum Inc* 445 US 97 (1980).

prior to the *Midcal* decision, Congress amended the *Federal Trade Commission Act* to conform more closely to the Court's language in the ruling in the *Wickard* case.[25]

With this backdrop, the Supreme Court's decision in the *North Carolina Dental* case can be seen as further clarification of the dividing line between the appropriate exercise of State powers (even to an anticompetitive end) and private action subject to the antitrust laws.

DISCUSSION OF THE DECISION

Twenty-three States joined North Carolina's appeal to the Supreme Court through amicus briefs.[26] North Carolina contended that the State's Board of Dental Examiners was a State entity, dedicated to protecting the health and safety of the State's residents. Consequently, North Carolina contended that the Board was immune to regulation by the FTC. Moreover, the State contended that antitrust oversight by the FTC of State regulatory agencies would subject decision-makers (in this case Board members) to liability that would make it difficult to attract qualified people to those agencies.

In a 6-3 decision, the United States Supreme Court rejected North Carolina's defences and set out criteria for determining when and under what circumstances State agencies could be subject to regulation under the federal antitrust laws. For the majority, the case revolved around three main questions:

- Should the North Carolina Dental Board's decisions be exempt for review under the antitrust laws (that is, was the Board constituted in a manner that it could properly invoke State action immunity)?
- If not, did the Board exceed its authority to protect the health and wellbeing of the State's citizens?
- If it did, were its decisions in regard to teeth whitening services anti-competitive?

As to the first question, the majority found that, given the constitution of the Board, it was more akin to a private trade association than an arm of the State. In particular, the majority was concerned that the Board was dominated by individuals with a direct interest (especially a financial interest) in the industry that it regulated. Having drawn this conclusion, the Court applied the *Midcal* test, which required that private action in the name of the State must be both authorised by the State and "actively supervised" by it. In the case of the North Carolina Dental Board, the majority concluded that, even if the actions of the Board had been authorised by the State (which was, at best, unclear), the State government had not actively supervised (or even reviewed) the decisions of the Board. This factor was sufficient to subject the Board's decisions to review by the FTC.

The answer to the second question, in the Court's view, was straightforward. Nothing in the relevant statutes in North Carolina referred to teeth whitening. Therefore, the Court dismissed the public health and safety defences raised by the State.

Finally, the Court's majority concluded that the decisions by the Board to try to restrict teeth whitening services to dentists was clearly anticompetitive, as it resulted in reduced competition and increased prices for those services. Even though the effects of the anticompetitive conduct were confined to a single State, the Court found that the anticompetitive nature of the conduct was properly reviewable under the s 5 of the *Federal Trade Commission Act*.

In a strongly worded dissent, Alito J (joined by Thomas and Scalia JJ) contended that State agencies, no matter the composition of their decision-making bodies, deserved immunity from federal review of their decisions. He further contended that the criteria set forth by the majority to distinguish those State agencies that were immune to federal review from those that were not were vague and subject to confusion. Moreover, he contended that the majority was extending the ambit of the antitrust laws beyond the intent of Congress.

[25] H Hovenkamp, "Rediscovering Capture: Antitrust Federalism and the North Carolina Dental Case", *CPI Antitrust Chronicle*, 27 April 2015, 13.

[26] This section, like the section on the facts of the case, is adapted from the text of the Supreme Court decision.

IMPLICATIONS AND CONCLUSION

There are four main implications that follow from the Supreme Court's decision.

First, and perhaps most significant, the decision strengthens the FTC's hand in reviewing regulatory decisions by States even when those decisions have only intrastate economic consequences. While this power has been recognised at least since the *Wickard* decision, it has been used sparingly. There is now a much clearer path for the FTC to follow if it decides to become more active (and activist) in this arena.

Secondly, the decision, while criticised as too vague by the Court's minority, points to potential problems if the membership of State regulatory decision-making bodies (professional or otherwise) is dominated by industry participants. The membership issue points to a problem of regulatory capture that is troublesome precisely because those industry participants can be expected, at least in some circumstances, to act in their own self-interest. Self-interested action can, in turn, have manifold anticompetitive consequences. In fact, as noted above, based on the estimates derived from empirical studies, some professional licensing regulations have significant adverse effects on consumer welfare.

The third and fourth important implications of the Supreme Court's decision in *North Carolina Dental* are closely related. Thirdly, while the Court was not entirely clear in defining what constituted "control" of a decision-making authority (such as a professional licensing board) by "active industry participants", it was clear that active supervision by a superior State authority would immunise any professional boards, no matter their membership structure. The majority listed four minimum requirements for active supervision:

- the review must be substantive, not just procedural;
- the power to modify or reject specific decisions to ensure compliance with State policy must be inherent;
- State supervision must occur with some degree of certainty rather than just exist as a mere possibility; and
- any oversight should not be conducted by active market participants.

None of these conditions was satisfied in the case of the North Carolina State Board of Dental Examiners.

Fourthly, States could reconstitute the membership of their professional licensing boards. While North Carolina contended that reducing the proportion of active market participants could reduce the efficiencies of these boards by foregoing the expertise gained by including so many active market participants, there could be offsetting gains from including more consumer input. In the end, it is likely that a combination of more inclusive membership and more diligent and effective oversight will result from the *North Carolina Dental* decision. To the extent that this reduces entry barriers into various professions without significantly reducing the quality of the services supplied, economic efficiency will be enhanced.

Christopher Pleatsikas
Managing Director, California Berkeley Research Group