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before the
Little Hoover Commission
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I. The Purpose of the Hearing

The Commission here addresses a fundamental issue of governance at the heart of its function as an independent check on each of the three branches of state government. At issue is the optimum regulatory policy that advances entrepreneurship and upward mobility and preserves the benefits of a competitive system, while at the same time intervening as necessary in the public interest.

II. Background

The Center for Public Interest Law (CPIL), which I direct, is an academic and advocacy program based at the University of San Diego School of Law that has focused on California regulatory agencies for 35 years. Our law student interns take a yearlong course in Public Interest Law and Practice, flying to board meetings throughout the state, monitoring their operations, reporting on them, and engaging in rulemaking and other advocacy projects under the leadership of Professor Julie D'Angelo Fellmeth. Over 2,000 graduates of our program are now practicing law, many of them in the regulatory and consumer law area. We have operated a Sacramento advocacy office since 1981, and served as the Medical Board Enforcement Monitor and as staff to the Contractors' State License Board Enforcement Monitor — both created by the Legislature to audit and recommend reforms to those programs. CPIL has been involved in over 50 agency rulemaking proceedings and in drafting and/or sponsoring over 50 successful bills relevant to ethics, public interest law, agency transparency, and consumer rights.[1] As necessary, we also litigate; we recently filed and prevailed in an antitrust case against the rental car industry and a state agency.[2]

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[1] My personal background of relevance includes nine years as a state antitrust prosecutor (I was cross-commissioned as a federal prosecutor for two years); faculty teaching at the National Judicial College established by the California Supreme Court to train state court judges, the National College of District Attorneys, and — for over 35 years — the University of San Diego School of Law; published texts in California regulatory and antitrust law, and the current treatise CALIFORNIA WHITE COLLAR CRIME AND BUSINESS LITIGATION (with Thomas A. Papageorge; Tower Publishing 4th edition 2013); service as chair of the California State Athletic Commission, an agency within the Department of Consumer Affairs; and service as the State Bar Discipline Monitor appointed by the Attorney General and reporting to the Chief Justice of the California Supreme Court, the Governor, and the Legislature (1987–1992).

[2] *Shames v. California Travel and Tourism Commission, et al.*, 626 F.3d 1079 (9th Cir. 2010).

III. A Theory of Regulation

We begin with the basics. Attached as Exhibit A is a 30-page article entitled *A Theory of Regulation: A Platform for State Regulatory Reform* published in the CALIFORNIA REGULATORY LAW REPORTER (produced by the Center for Public Interest Law).[3] It is the basis of this testimony and provides a more expansive presentation. It was published in 1985 but is regrettably not outdated. Included as a chart on the last two pages is a matrix listing 70 major regulatory agencies at that time (99% of which still exist, albeit in slightly different names and structure). That list includes boards and bureaus within the Department of Consumer Affairs (DCA). That matrix cross-references as to each agency the possible application of one or more regulatory flaws, some of which pertain to unnecessary regulation and others to corruptive or ineffective structure. Those flaws include agencies that are (a) wholly unnecessary, (b) overly intrusive, (c) corruptively controlled by profit-stake interests, (d) regulating notwithstanding equivalent non-regulatory options, (e) lacking in necessary practical remedies to accomplish the stated purposes, (f) suffering inadequate resources/staffing, (g) imposing unnecessary barriers to entry unrelated to its *raison d'être*, (h) inadequately assuring the performance of those who are licensed, (i) best operating at a different governmental level (federal/state/local), and/or (j) wrongly authorized by the Constitution rather than a more reasonably adjustable statute. The check marks and question marks in that matrix would likely be substantially similar today, although they are properly regarded as areas of inquiry rather than conclusory judgments.

The attached article makes an initial point that there are clear benefits to a free market, and anyone who has visited the Soviet Union or any of the totalitarian socialist states easily appreciates the inefficiency, hardship, and unfairness that those models provide. We have a different construct, one that does not involve government capture of private enterprise, but that keeps the two at a distance — perhaps the most fundamental check in the American system. And as a precursor of what is to follow, I would argue that there is one system that eliminates the basic public/private check more perniciously than does socialism — and that is "*industrial* socialism." In this latter system, the state does not own and operate the means of production; rather, the means of production own and operate the state, performing functions reserved for the representatives of the People. That abrogation of the American check is at the heart of the regulatory dangers and abuses we have today.

We start with the assumption that a democracy vests power in the People, allowing diffuse and future interests — for example, the general citizenry, potential competitors, and future consumers — to receive appropriate attention. We also start by appreciating the benefits of a free competitive system:

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[3] The Commission should also have in its files (a) Aaron Edlin and Rebecca Haw, *Cartels by Another Name: Should Licensed Occupations Face Antitrust Scrutiny?,* U. PA. LAW REVIEW (2014) at 1093-1164; (b) Department of Treasury Office of Economic Policy, Council of Economic Advisers, and Department of Labor, *Occupational Licensing: A Framework for Policymakers* (July 2015); and (c) Michael Asimow, *Top Ten List of Needed California Administrative Law Reforms*, Administrative & Regulatory Law News, ABA Section of Administrative Law and Regulatory Practice, Vol. 41, No. 1 (Fall 2015) at 4-9. These do not address the epochal decision by the U.S. Supreme Court in *North Carolina State Board of Dental Examiners v. Federal Trade Commission ("North Carolina"),* ___ U.S. ___, 135 S.Ct. 1101 (2015), discussed *infra,* but have important background information and analyses warranting the attention of the Commission.

open entry, competition, response to consumer demand from the bottom, and survival and high reward for those who produce and who provide to optimally meet that demand.

A. Market Flaws

Accepting the above assumptions, we also know that the market is not perfect. It is not God. It is a human construct very much influenced by everything from rules of liability guiding our criminal and civil justice systems, to evasion of costs that the production of a widget or its use imposes on others that are not assessed against the perpetrator. So here is the trick. Start with the market, identify the prerequisites for its proper functioning, and then analyze its flaws. Even the most ardent theoretical market economists, starting with Adam Smith, were well aware of the preconditions that are required for the market to manifest its advantages and the flaws that may have to be addressed to prevent its failure. The attached article lists and discusses them, including natural monopoly, imperfect information, scarcity, unfunded external benefits, and external costs. Of course, no system is perfect and some market flaws may be better tolerated than ameliorated — depending on cost and efficacy.

Among the flaws are three especially relevant to regulation: natural monopoly, imperfect information, and external costs. As to the first, where there is only room for one entrepreneur to compete efficiently, there is no functioning marketplace in any sense. That is the flaw justifying the existence of the Public Utilities Commission and its historical authority to set the maximum rates of monopoly utilities. This type of intervention is complicated by technology change. For example, there may be a monopoly on telephone landlines but alternative modes of communication (cable or satellite or cell) may create a mixed system of monopoly, with perhaps limited competition between modes. That partial competition may yield its own abuses. And the related problem of oligopoly, or "shared monopoly," may also arise.[4]

Imperfect information is also a basis for traditional "regulation." This element simply covers the need of consumers to know what they are buying. The issue here may cover the spectrum from knowing what a product or service will do with enough accuracy to make an informed consumer choice to understanding how to choose the optimum or acceptable provider. Certainly, "perfect" information may be unattainable, but information that is substantially ascertainable and accurate strengthens the positive attributes of a market.

The final category is the largest — the problem of "external costs." A manufacturer can cut costs 20% by polluting a nearby river, or by subjecting workers to lung contamination, or by producing vehicles with cheap and defective airbags. A tradesperson or professional can perform deficiently, visiting damage on others that he or she may not have to bear. Such external costs may not be assessed by the market, and that in turn may reward those eschewing such cost imposition with

[4] As with many market flaws, one option here is restructuring such an industry by applying antitrust principles to break up monopoly power where possible, or by controlling the monopoly element to require its use not just by the entity controlling that element but by others as well — indeed, that is an issue that is front and center as "net neutrality" policy is debated. But this Commission hearing is focusing on the occupational licensing boards and commissions; thus, the last two flaws are most germane to the rationale for their regulation.

higher profit or a greater volume of business. Of particular concern are those external costs that visit "irreparable harm" on consumers or patients or clients.

B. Basic Regulatory Options

One way to deal with market flaws is to impose regulation on an area of commerce. "Regulation" is a broad term, and it can include multiple ways to intervene from the traditional format of an administrative agency. We identify three. First, a "permit" system generally allows entry without filtering for competence or other barriers. You must have a permit to engage in a business, but it is easy to get — cheap, quick, and no examination or other onerous barrier to entry. But if you screw up, it can be revoked just as easily. Second, you can create a "certification" which requires proof of a level of competence or utility that allows one to use a certain title in the marketplace (*e.g.*, the "child welfare law specialist" title issued by the State Bar to those who pass an examination and demonstrate a certain level of experience in that specialty). However, the certification is not required in order to practice; it is an informational augmentation.

The most common type of regulation is the third option: "licensure." This combines the element of competence demonstration and "prior restraint" screening — the requirement of approval prior to business entry. What has happened is that licensure has become the presumed type of regulation and is now ubiquitous across the nation. Its justification is usually based on the need for such a "prior restraint" to inhibit dishonest or incompetent practices that afflict consumers with damage, sometimes including irreparable harm. Certainly where there is such a threat of irreparable harm, a "prior restraint" system of training, competence screening, and other limitations may well be warranted.

C. Non-regulatory Alternative (or Supplemental) Options

On the other hand, a large number of societal mechanisms that deal with these flaws may address them more directly, more effectively, and without the substantial competitive restraint costs of prior restraint licensure. Exhibit A includes a list of many of these alternative mechanisms to address market flaws. They may be used singly or in combination, and include:

1. ***Requiring a bond or insurance*** to assure damages recompense where there is error or incompetence — particularly applicable where the damage is not likely to be irreparable. One might not view such an alternative as reasonably sufficient to assure a competent brain surgeon, but a barber or dry cleaner — where repeat business is necessary to survive and irreparable harm unlikely — are good examples of trades where a bond or insurance requirement may obviate the need for licensure.
2. ***Requiring disclosures prior to sale***. Imperfect information and consumer befuddlement may be addressed by such focused disclosure requirements that maintain and enhance the market features that serve us well. We require mileage disclosures on autos, knowing we cannot test them individually; our credit cards must disclose the actual interest rate — usually to our horror; and every can of food must list its ingredients.

3. ***Imposing a rule of liability*** allowing the civil justice system to provide deterrence and recompense. It may be one of strict liability, or one imposing civil penalties. This remedy has some limitations. The Harvard Medical Practice Study indicates that only a very small number of harmful medical negligent acts results in a suit.[5] Further, the system may give disproportionate recompense to a single plaintiff, and where resisted may take many years to effectuate. The most effective civil justice mechanism able to provide relief for the types of problems that give rise to regulation is the class action — now regrettably debilitated by the erroneous U.S. Supreme Court *Concepcion* decision.[6] Nevertheless, rules of liability and civil remedies may have substantial effect, particularly if there is no "terms and conditions" preclusion of a class remedy, or where the problem creates high compensable damages in individual cases, or where an arbitration remedy may be effective.

4. ***A straight prohibition of deficient or risky conduct*** addressable via criminal or civil actions by public prosecutors. Indeed, many of the abuses that are advanced to justify regulation may well be inhibited by federal prosecutors, the Federal Trade Commission, or by state enforcement. This remedy does not depend upon the currently weakened mechanism of private civil class actions. In California, the offices of city attorney in major cities, county district attorney's offices, and the Attorney General are given substantial powers and resources by California's Unfair Competition Law (Business and Professions Code § 17200 *et seq.*). These include the power to represent all victims within the state, to fashion injunctive relief, and to impose substantial costs and civil penalties (both of which may accrue to the specific prosecuting office bringing the action).

5. ***Offer a mix of incentives to stimulate practices that prevent harm*** or provide affirmative benefits. These may take the form of tax incentives, subsidies, and other rewards.

IV. Striking a Balance

How do we balance all of the possibilities to fashion the most effective result — ideally one that either eliminates or compensates for a market flaw and thus preserves optimally the advantages of a free market? Those advantages are many, and go to the heart of the subject of this hearing: the chance to compete, to offer one's services, to perform laudably and serve consumers well, and to lead more consumers to retain those who so perform.

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[5] Harvard Medical Practice Study, *Patients, Doctors, and Lawyers: Medical Injury, Malpractice Litigation, and Patient Compensation in New York* (1990).

[6] *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011). That holding substantially precludes many efficient, mass remedies that can effectively work systemic resolution, recompense, and deterrence. Nevertheless, and particularly if "terms and conditions" that compel arbitration and preclude class actions are not imposed on consumers in a particular area of practice, the class lawsuit is properly considered and can be an effective ameliorating mechanism.

There are situations where even a combination of the above-described non-regulatory and other alternatives will not adequately address the flaws extant, and a regulatory/licensure option is proper — that is, a system of "prior restraint" foreclosure where nobody can perform a certain function without demonstrating their competence, honesty, and other prerequisites in advance of practice and then complying with standards of practice *in situ*. This alternative is most often appropriate where the harm that flows from open entry and lack of continuing supervision is irreparable — as with surgeons, some attorneys, and other professions whose minimum competence cannot easily be judged by the consumer. Some professionals are necessarily relied upon where a lack of skill may cause serious harm and where money recompense is not practical or is not an effective remedy.

In making this evaluation, it is sensible to look not only at the kind of injury that flows from incompetence, but other factors, including the following:

(a) Is this an enterprise not based on the repeat business dynamic (which is likely to filter out the incompetent quickly) but which involves the performance of a single, expensive, and/or complex procedure that may not allow effective consumer response to limit a problem competitor? Arguably, the merits of assuring competence of a neurosurgeon (or the honesty of a real estate broker or even a funeral director, both of whom facilitate infrequent but important transactions) may be more necessary than that of a barber, dry cleaner, or cosmetologist. The latter do not normally visit irreparable harm, and the consumer is able to determine competence. Where repeat business is required to remain in business, those who do not perform tend to be eliminated readily by the market. An incompetent practitioner will be detected by relevant consumers and continued patronage becomes unlikely.

(b) Is this an enterprise where those who are making the decision actually need state or other external assurance of competence? Certainly a consumer may not be able to judge the skill of an accountant, or the competence of an embalmer. But do those who hire petroleum engineers or court reporters really need the state to perform that filtering task?

(c) Is this a regulatory system that can determine advance competence through an examination or other barrier? Can the Board of Psychology easily do so? How accurate and reliable is the filtering system?

Once we agree that (a) the market flaws warrant state intrusion to restore an effective market or prevent abuses, and (b) the relevant consumers need "prior restraint" licensure to effectively provide needed protection, we then proceed to the "how." How intrusive and selective (limiting) should the system of licensure be? Can it be eased through the use of a rule of liability or one or more of the non-regulatory interventions listed above? Can it be directed specifically at the areas where consumers are unable to judge competence, and where the state can assure that competence through its system of licensure?

Finally, if the market flaws and dangers warrant this kind of intervention, how can government then monitor those whom it has allowed to enter (via licensure)? No filtering system is perfect, people change, and if the trade involved is important and the harm significant enough to warrant competence demonstration as a condition of entry, should not those who achieved initial licensure be subject to continued monitoring to remove those who affirmatively prove themselves *post hoc* to be incompetent or dangerous?

A. Failures in Two Directions

There are some clearly necessary regulatory systems, including many in force in California. But we have a twofold problem operating in both directions: (a) unnecessary barriers to entry that are not justified, and (b) regulatory regimes that limit entry but thereafter fail to provide an assurance of competence relevant to the skills that consumers rely upon, or that do not adequately police harmful practices post-licensure. Regrettably, a substantial portion of California regulation falls into one of these two categories.

Those participating in many trades seek licensure of their function; we have seen licensing proposals from everyone from aerobic instructors leading exercises to interior designers to astrologers. Many licensing proposals have been enacted and have resulted in obviously gratuitous barriers to entry unrelated to the merits discussed above. The former Board of Landscape Architects utilized for some years a national examination with a pass rate below 10%[7] — in other words, over 90% of examinees who had completed a four-year degree in landscape architecture and who had worked for two years under the supervision of a licensed landscape architect failed that exam. The Board of Barbering and Cosmetology's insistence that "natural hairbraiders" — a specialty of those serving African-American clients — become licensed as cosmetologists, requiring completion of a 1,600-hour curriculum, led to litigation in which a U.S. District Court judge examined the curriculum in detail and found that only 4% of it (65 hours) pertains to braiding, and even that concerns sanitation and chemical issues not particularly germane to practitioners who neither wet hair nor use chemicals.[8]

Related to such gratuitous barriers is the problem of "territory" where each trade seeks to expand its entry barriers to foreclose those performing related functions – reserving them for the licensees of its system. These "territorial" wars are not rare in California; for example, a great deal of time and attention have been devoted to the cosmic issue of whether those cleaning the teeth of dogs should be licensed as veterinarians. In fact, CPIL has borne witness to this preoccupation with territory and the incursion of others into the "expansive practice" definition each seeks to secure for its own grouping. That is the genesis of the *North Carolina* decision itself, with the dental board's dentist

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[7] "At [the Board's] October 18 [1991] meeting, Executive Officer Jeanne Brode reported that the 1991 pass rate for California takers of [the Council of Landscape Architectural Registration Boards'] Uniform National Examination (UNE), recently renamed the Landscape Architects Registration Examination (LARE), was 9%." 12:1 CAL. REG. L. REP. (Winter 1992) at 66.

[8] *Cornwell v. California Board of Barbering and Cosmetology*, 962 F.Supp. 1260 (1997) at note 7.

members attempting to "protect" consumers from the horrors of non-dentist teeth whitening. Turf battles apply not only to unlicensed practices that may subtract business and profits from a grouping, but also between licensed trades.

One consequence of turfdom is the fragmented creation of boards around small groupings of professionals or trades. Hence, the Medical Board regulates allopathic physicians, while two separate boards regulate osteopathic physicians and doctors of podiatric medicine. These boards are financed through assessments of licensees, and the latter two boards do not have adequate resources to regulate their defined territory given the smaller number of licensees involved. Hence, there could be an appropriate grouping of regulated professions or trades addressing similar kinds of external costs of concern (*e.g.*, medical errors causing irreparable harm). Instead, the empathy groupings dictate a duplicative structure without regard to regulatory efficacy where regulation is merited.

As discussed above, there are issues about whether licensure regulation is warranted given the nature of the market flaw at issue and non-regulatory alternatives, and also about who is to be included in a given regulatory structure. There is also the issue of a profession where regulation is indeed justified based on market flaw consequences, but the precise regulatory program does not function to ameliorate or prevent those abuses, or does so in a manner that creates its own substantial damage. A prime example is our State Bar. We understand the Commission is focusing on DCA agencies, but the Bar is an agency controlled by a strong supermajority of practicing attorneys, many of whom are actually elected by attorneys. Here we have a profession involving practice in one or at most two of 24 specific subject areas. An admiralty attorney, a bankruptcy lawyer, or attorneys practicing criminal defense, real estate law, intellectual property, or juvenile dependency court law will not normally practice competently in more than one or two such markets. So a client relying on an immigration attorney to prevent deportation to Iran may suffer irreparable harm if the attorney is not competent in that subject matter – including knowledge about recent precedents. But the Bar's primary competence assurance mechanism consists of a single examination given generally at the age of 25 and covering general concepts and vocabulary.[9] There is no attempted assurance of competence in the area of actual practice for the entire career of an attorney.[10]

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[9] Indeed, after seven years of higher education at a likely cost of well over $200,000, 53.4% of law school graduates who attended American Bar Association (ABA)-accredited law schools and took the California Bar Exam in July 2015 failed that exam and were denied licensure. Those graduating from non-ABA-accredited schools that the State Bar itself has separately "approved" (allowing tuition collection and qualification to take this examination) had a 21% passage rate on the July 2015 exam. And this is an entry barrier with a tenuous relationship to competence assurance, as described above.

[10] Continuing legal education (CLE) course are required, but at an exceedingly minimal level (only 25 hours during every three-year period) and they need not be related to the area of law in which the attorney practices and holds him/herself out as an expert. There are no further examinations at any point, nor any mechanism to assure competence in the area(s) of actual practice. Exacerbating this failure, the Bar allows its licensees to "run naked" (practice without any legal malpractice insurance coverage) – and about 20% of the profession does so. Finally, the Bar's Client Security Fund provides limited reimbursement to clients who are the victims of intentional attorney theft — but not damages due to negligence.

B. The Underlying Problem: Cartel Control

The reason this happens applies to similar abuses across the spectrum of DCA agencies: the capture of boards by those with a profit-stake in public policy. How this happens is a fascinating study in sociology. By way of background, this problem area represents an underlying challenge to our democracy. We have become increasingly horizontalized. That is, the *Noerr-Pennington* antitrust doctrine allows horizontal competitors to collude together to petition government,[11] notwithstanding a general national policy requiring independent functioning among those competing in the same line of commerce ("horizontal competitors"). Over the last 30 years, trade associations have proliferated in number and political power federally and in most states. In California, the vast majority of the 1,700 registered lobbyists represent trade and professional associations. Most trades have sophisticated lobbies at the State Capitol. Reflecting the political vocabulary of our state, these are the "stakeholders" commonly consulted by a relatively passive Legislature and guiding its decisions. These are the proponents of most of the regulatory boards within the DCA in particular; they have actively lobbied for licensing by boards whose membership and licensing fees (used primarily to police misconduct) they control.[12]

Allow me to acknowledge some very important caveats to these concerns. We agree that expertise can be very important in any regulatory exercise. As Justice Scalia stated during oral argument in the recent *North Carolina* case discussed briefly below, neurosurgeons should have considerable input into identifying the criteria that should be used to determine the competence of those practicing such a difficult task. We agree that having access to experts and consulting with those familiar with actual consequences is extremely important. But it is a *non sequitur* to conclude from that utility the need for those practicing in a trade or profession to set the pass point on the relevant licensing examination, or to actually decide the number of practitioners. Not only is such a delegation contrary to basic principles of democracy, but those with such a conflict may not properly balance the degree of competence appropriately required vis-à-vis the accuracy of that system and the need for additional practitioners. Perhaps an increase in the number of landscape architects resulting from increasing exam passage rates from 10% to 30% may lower prices and facilitate better garden planning for those needing these services. Perhaps that increase will not create debilitating errors borne of incompetence (*e.g.*, some inappropriate cactus placements). What is the impact of entry limitation on supply and hence on costs? We do not want incompetent physicians, but if the pass point is 81 instead of 83, how diminished is resulting competence versus the number of persons lacking any medical attention whatsoever because of undersupply or geographic maldistribution of physicians? Or in reducing prices and medical costs? There are many areas of such undersupply

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[11] The name of this doctrine stems from two U.S. Supreme Court decisions recognizing a First Amendment right to petition government to influence legislation or public policy. *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc*., 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

[12] Interestingly, the "deregulation" proposed by Governor Schwarzenegger in 2005 was quashed not just from opposition by CPIL but more lethally from the very interest groups allegedly being regulated. They support their own regulation, particularly where they can control it through a board controlled by their membership. The Governor would have created bureaus in lieu of boards, adding to gubernatorial control.

applicable to our professions and trades, from pediatric dentists to legal aid attorneys. How do we strike that balance?

After monitoring these agencies for 35 years, we can assure you that such considerations are NOT part of the process. Why they are not is the subject of our second caveat: Those in a profession or trade who are members of a board engaged in their own regulation do not see themselves as cartel conspirators. They see themselves as good citizens who serve without pay in order to further the public interest.[13] They are insulted by our descriptions of their illegitimate status in exercising the power of the People as their own governors. And this dynamic could well be the subject of interesting sociological/social psychology studies. For the biases they have are particularly dangerous precisely because they are not so recognized. They are not being consciously dishonest. But from a broad perspective, examining them as we have over the years, their development of tribal bias is not only common; it is almost universal. Again, it is not consciously venal: Their respective trade or profession is important. There are good reasons consistent with the public interest for the process that gave them entry.[14]

To illustrate the conflict between the tribal consciousness and the broader perspective likely with decisionmakers looking at regulation from a broader perspective, I again cite the State Bar — simply by way of readily apparent illustration. The State Bar is an extreme example of cartel control, with 13 of 19 members of its Board of Trustees consisting of practicing attorneys (and six of those

[13] Even Justice Anthony Kennedy, author of the majority opinion in the *North Carolina* decision, observed this dynamic: "Dual allegiances are not always apparent to an actor." *North Carolina*, *supra* note 3, 135 S.Ct. at 1111 (2015).

[14] The psychological dynamics of group decisionmaking is fodder for much deserved examination. If the Commission will indulge a general observation: Common and severe cruelties are generated by persons in groups, whether the corner gang of youth, a fevered mob, or — as the human record regrettably documents — by the nation-state. Group decisions — including those made by trade associations (and hence regulatory boards dominated by their membership) — are less likely to manifest ethical concern for others than are decisions made by individuals. For example, the Medical Board (at the behest of the California Medical Association) has historically allowed what is called "diversion" of physicians who are alcohol/drug addicted away from the disciplinary track and into a confidential program that purportedly monitors their behavior and sobriety. Most doctors individually would clearly prefer that their disabled or dangerous colleagues refrain from practice, and perhaps suspend practice while and until they achieve withdrawal and abstinence. But their professional association promotes systems of rehabilitation that involve continued practice, even where the "safeguards" have been shown in successive audits (in this case, five failed performance audits) to be rigged and to allow dangerous physicians to continue practice. Few individual members will agree with the group advocacy that has been a part of over 30 years of public record (and continues to this day), but the group judgment is fidelity to the group. That fidelity will elevate the interests of the group above the general or future interests of others. The representation of its membership grouping as a whole is its empathy line. Again, it is not one that is necessarily acknowledged, nor even consciously there.

CPIL has seen this dynamic manifested widely in trade association politics. The California Teachers Association fights any threat to tenure, regardless of the impact on students of incompetent practitioners; the Service Employees International Union (SEIU) fights to prevent the disclosure of child deaths from abuse where prior reports to its social worker members should have been acted upon to prevent them. Over the last 35 years, CPIL has seen such a high incidence of this psychological orientation that we are regrettably comfortable asserting it as a predictable dynamic. Indeed, the mindset is similar to the more understandable orientation of the criminal defense attorney, who has primary, preclusive "fidelity" to his client, not to past or future victims. Needless to say, we do not vest with such counsel the authority to determine for the state the penalties that should be applied to relevant clients.

attorneys are elected to the Board by other attorneys). We discussed above how the entry system has little to do with assuring attorney competence, and how it does not assure compensation of the victims of attorney incompetence that is its basic *raison d'être*. The tribal consciousness also affects the most important part of post-licensure public policy decisionmaking: The selection of what we look at, at our agenda. The Bar does not pay attention to billing practices, attorney intellectual dishonesty (even to courts), large law firm practices, or a phalanx of issues that those outside the profession are likely to find of rather profound significance.[15]

The members of the Board of Trustees of the Bar, as with the Medical Board and most of the professionals controlling boards within the Department of Consumer Affairs, think and believe they operate in good faith, and represent the general population. But the evidence is contrary.

V. "Sunrise Review" and "Sunset Review" as Mechanisms of Reform

Two mechanisms developed by the Legislature theoretically address the issues raised by this hearing. First is Government Code section 9148 — the "sunrise criteria" that allegedly apply as required condition precedent findings prior to the creation of a new regulatory regime or board. The enactment of these criteria was supported by CPIL; indeed; some of them are framed similarly to the criteria in *A Theory of Regulation* (attached). The idea is to examine some of the issues discussed above: What are the market flaws to be addressed by a new licensing requirement or board? What are the costs of the proposed regulation? What alternatives to a prior restraint regulatory format have been considered and why were they rejected?

We believe that the sunrise criteria may have had some role in lessening what might have been many additional licensing systems. On the other hand, the practical politics allow its evasion as currently constituted. The Board of Barbering and Cosmetology was sunsetted in 1996, and its return should have been accompanied by compliance with these prerequisites. That sunrise barrier is an intentional obstacle to filter out systems that impose unnecessary barriers to entry to the professions and trades. But, interestingly, it is easily evaded, even where creating marginal regulatory entities. For example, Senator Polanco made it his mission to avoid the statute and re-establish the Board, and did so by simply exempting its application in his bill to re-create it.[16]

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[15] For example, the State Bar does not examine hourly billing — an area of common abuse, as most counsel will privately attest. It does not police intellectual dishonesty, even extreme deceit in submissions to the court. It polices very few of the practices of the lawyers in large law firms with substantial legal assets. It does relatively little to assure legal representation for the poor. It does little to prevent the need for attorneys — arguably the ethical obligation of any professional (to eliminate the need for his or her services by preventing the preconditions requiring them).

[16] SB 1482 (Polanco) (Chapter 1148, Statutes of 2002), which re-created the Board of Barbering and Cosmetology after its 1996 sunset, exempted the bill and the Board's recreation from the "sunrise criteria" requirement of Government Code section 9148 (see Business and Professions Code section 7303(a): "Notwithstanding Article 8 (commencing with Section 9148) of ... the Government Code, there is in the Department of Consumer Affairs the State Board of Barbering and Cosmetology ....").

Nor is the Board of Barbering and Cosmetology unique. The Board of Landscape Architects and the Board of Guide Dogs for the Blind were both sunsetted in 1996. They melted into DCA and became bureaus, with the same regulatory barriers but operating outside of the sunshine statutes. Both have reappeared in slightly different format or location. Indeed, it is to be expected that new agencies will simply put in "exception language" as a routine matter of avoidance. While the statute has value as an expression of concern, it is not a securely functioning means to limit regulatory systems that impede competition without sufficient basis.

The creation or re-creation of a marginal or dubious regulatory system is difficult to stop. It is supported by industry. Prospective competitors or consumers who may be affected by its restraints of trade — with higher costs and reduced opportunity/mobility — are often not organized and do not lobby legislators or make campaign contributions to them. The formality of a statutory expression of required pre-conditions has merit, but it would preferably include stronger evidentiary standards.

On the "sunset review" side, the Legislature passed SB 2036 (McCorquodale) (Chapter 908, Statutes of 1994), which created a "joint legislative sunset review committee" to review both the necessity and performance of most DCA agencies at determined intervals, generally every four years.[17] Consistent with Colorado's initial model, this system began in California in 1995 as an examination of the rationale for regulation, with the automatic termination of such prior restraint systems and the removal of their anticompetitive effects unless affirmatively approved for continuation. But California's system tends to focus not on the termination or reduction of a regulatory system and/or licensing requirement, but instead on the termination of the governing "board." The sunset date is inserted into the provision of law creating the board, not the regulatory regime or licensing requirement administered by the board. If the Legislature is unhappy with the board's performance and lets the date pass without extending it (or if the Governor vetoes extension legislation), this relegates such a board to "bureau" status. Lacking a "board," the licensing requirement continues as provided in the relevant regulatory statute, but is administered by a gubernatorial appointee.[18] Hence, the agency may lose its governance by a board dominated by members with a conflict of interest (its own licensees) but it also loses the open government provisions of the Bagley-Keene Open Meeting Act. Decisions of bureaus or departments (as opposed to multi-member boards and commissions) are made in an office without notice, hearing, or public access. And there are few to no *ex parte* contact limitations, allowing the same trade associations providing board members to lobby in that private setting — perhaps an even more consumer-detrimental structure than a board with at least some "public members" and visible decisionmaking. At the same time, if a "bureau"

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[17] Cal. Bus. & Prof. Code § 473 *et seq*. (now repealed).

[18] In the alternative, the Legislature has recently taken to "reconstituting" the membership of boards deemed to be ineffective and/or dysfunctional. This involves the passage of a bill that (a) ends the terms of all existing board members and that of the board's executive officer, and (b) simultaneously creates a new board (sometimes with a different mix of licensee and public members) and requires the appointing authorities to appoint new members. Several DCA boards have been "reconstituted" as a result of the sunset review process, including the Board of Optometry and the Dental Board of California.

is sunsetted, there is no readily existing vehicle for governance; deregulation becomes effective because the regulatory provisions become inoperable and effectively void.[19]

After a five-year hiatus between 2005 and 2010, the Legislature overhauled the "sunset review" process: Non-DCA agencies may be subject to review — at the direction of the Legislature — by a new "Joint Sunset Review Committee" created in Government Code section 9147.7 *et seq*., while DCA boards and bureaus continue to be reviewed by relevant policy committees in both houses (specifically, the Senate Committee on Business, Professions and Economic Development and the Assembly Committee on Business and Professions). These committees require each DCA agency to compile and publish a detailed "sunset report" prior to the stated "cut-off" date, and schedule a public hearing on the subject agency to invite public comment on its performance. These proceedings have been very beneficial to consumer interests. They provide a forum to examine agency performance, including the questions raised by the Commission in this proceeding. Because the elimination or reconstitution of a board is considered rather insulting to its membership, the agency takes the process seriously, and it has led to significant reforms.

CPIL was able to sponsor legislation to sunset the Board of Fabric Care (which licensed dry cleaners) during the 1980s. The facts that Cal-OSHA and the Air Resources Board regulate health and safety operational matters, and that the Board had an anticompetitive effect in an area lacking irreparable harm and requiring repeat business, led to its successful termination. Similarly, the Legislature terminated the Auctioneer Commission (in retaliation for that Commission's lawsuit challenging the transfer of licensing fees from its special fund to the general fund) and two obscure agencies regulating employment agencies and polygraph examiners. Those have disappeared and have not reappeared, with little discernible consumer harm. But other agencies that have been sunsetted over the last two decades have been re-created, often in late-night "gut-and-amend," end-of-session legislation that receives little or no public or media scrutiny.

We would respectfully not recommend a switch to the Colorado "end of regulation" model as the sunset focus, since that may lead to the disaster exemplified by the termination of the Bureau of Private Postsecondary and Vocational Education. Hence, we recommend that the sunset process have a dual dynamic. It should continue to examine whether or not the existing governing body should continue beyond the sunset date. At the same time, it should also consider whether parts of it might continue, or perhaps might even warrant strengthening. Sometimes a regulatory regime that is inadequate can be worse than nothing. One option may be to terminate it. But an ideal option might be to redesign it to work differently. Sunset imposition may be segmented to allow selective continuation (or even strengthening) while other parts end.

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[19] This happened with disastrous results in the past decade. The former Bureau of Private Postsecondary and Vocational Education (BPPVE), a DCA bureau responsible for regulating for-profit educational institutions, was subject to sunset review in 2005–06; multiple bills were drafted to address BPPVE's many problems and continue its existence. Regrettably, in 2006 Governor Schwarzenegger vetoed AB 2810 (Liu), the only one that reached his desk, which wiped out not only the Bureau but the entire law authorizing the state to regulate this troubled industry which has a track record of exploiting veterans and former foster children with high-pressure sales tactics and misleading "disclosures." For-profit schools were entirely unregulated by the State of California from 2007 until 2010 with the passage of AB 48 (Portantino) (Chapter 310, Statutes of 2009).

In sum, sunset review should be a comprehensive process often including multiple trades under multiple types of regulation, with (a) justification for and reduction of regulatory mechanisms that restrain trade front and center, and (b) allowance for a reverse decision to increase regulation or to employ other non-regulatory mechanisms. Choices should be consciously made and should follow evidentiary findings.

VI. Review of Agency Actions by the Department of Consumer Affairs, Office of Administrative Law, and/or Department of Finance

Beyond creation or termination of a regulatory regime is the issue of regulatory decision review. In general, some DCA agency decisions may be subject to limited review by the DCA director.[20] Those limitations, which are substantial, are discussed in the second attachment to this testimony discussed in VII. below.

DCA agency rulemaking is additionally reviewed by the Office of Administrative Law (OAL) and — for some proposals — the Department of Finance (DOF). None of these reviews effectively includes the issues raised by this hearing. The Department of Finance supposedly examines cost issues where the estimated cost of proposed "major regulations" will exceed $50 million.[21] DOF has little expertise in the subject matter of the regulations, and its economic calculations are often dubious. Its scope is direct public cost, and it does not examine the anticompetitive costs to consumers or general anticompetitive effects.

OAL examines each regulatory change adopted by regulatory agencies subject to the Administrative Procedure Act. It does so under six criteria, including authority, clarity, and necessity. OAL consists of generalist attorneys, lacking in subject matter expertise. They are able to effectively examine five of the six required criteria. But the one most relevant to the subject of this hearing is "necessity," and that is not amenable to effective review by generalists who know nothing about the subject matter. Interestingly, we have here two extremes — an agency dominated by special interests with expertise and a conflicting bias proposes the rule change, while the review is performed by those with presumably a broader perspective but lacking in sufficient expertise to effectively review the substance. What OAL then generally does is a competent job looking at authority (based on a legal examination of legislative intent) and clarity. Then "necessity" inevitably becomes a red tape file review. OAL may have no idea whether the Horse Racing Board should ban "erythropoietin," and will focus on the plethora of "impact statements" that must be included in the rulemaking file, and whether the rulemaking file responds to every comment, dots every "i," and crosses every "t."

None of these entities reviews for anticompetitive impact. Although the adopting agency must examine almost a dozen different types of impact, from effect on housing to job creation, it is not currently required to examine whether a rule change restrains trade. Nor are any of those conducting

[20] *See, e.g.*, Cal. Bus. & Prof Code §§ 109, 116, 310, 313.l.

[21] Cal. Gov't Code §§ 113422.548 (definition of "major regulation") and 11346.3(f) (requiring pre-notice review of a "major regulation" by DOF).

the review competent in antitrust law, competition impact, or in the subject matter of the agency. Fortunately, as discussed below, recent U.S. Supreme Court precedent will now require the State to make a choice as to boards of concern to the Commission at this hearing: either end control of the board by current licensees ("active market participants" in the trade or profession involved) or institute "active state supervision" of board actions and decisions by those representing general (non-conflicting) interests. Such review must be active and not merely a formality; none of the existing review processes qualify, as discussed below.

VII. The 100 Elephants in Sacramento: *North Carolina State Board of Dental Examiners v. Federal Trade Commission*, and Antitrust Law as the Progenitor of Needed Reform

We include a second attachment, our letter sent to the Legislature following its recent hearing on the *North Carolina* decision. We understand that the Commission wishes to focus on the issue of regulatory suppression of entry and other anticompetitive impacts. That would include the issues of sunset and sunrise review, as well as review by the three entities listed above. But the Commission should be aware that the primary driver to accomplish effective attention to the subject matter here presented is via the necessary compliance with that decision. It is directly on point.

To summarize succinctly the decision and its implications, we note the following:

1. State regulatory boards necessarily commit federal antitrust violations in the normal course. Indeed, the very issues raised by this hearing lie at the center of antitrust prohibition. The entry requirements of licensure constitute a supply limitation. A supply limitation necessarily artificially affects prices and is automatically a form of *per se* horizontal price fixing. Similarly, the various licensure conditions with anticompetitive impact are likely to qualify as a "horizontal group boycott." A restraint in the *per se* category has special significance. Most restraints are only unlawful if they are "unreasonable" — allowing consideration of positive impacts benefitting society. But *per se* offenses are NOT subject to any such exception. They are by definition "unreasonable" and "unlawful." There is no defense of societal benefit. And violations are felony offenses, also giving rise to treble damages and attorneys' fees.

2. The above has not been a problem for regulatory restraints because of what is called the "state action" defense to antitrust scrutiny. A sovereign state agency may engage in a *per se* antitrust offense so long as it is (a) affirmatively and specifically authorized by state law, AND (b) subject to "active state supervision."

3. The *North Carolina* decision discussed in the second attachment is a 6–3 U.S. Supreme Court decision handed down in February 2015. It is unusually clear and definitive, specifying what will constitute such "state supervision." It is explicitly not confined to its facts but specifies where the lines are for compliance. Critically, an action by the state lacking that "sovereign" status is no different from a group of competitors meeting in a hotel room at the Sacramento Hyatt Regency and agreeing

to a supply restriction or other *per se* offense. There is no defense, when applied to a *per se* antitrust offense, as described above. The Court made it clear that any decision controlled by "active market participants" in a trade or profession lacks such sovereign status. The idea is not complicated. The Court is implementing ninth-grade civics. States may not delegate the power of the People to a cartel with a conflict of interest. The state has a choice: Either convert the composition of regulatory boards and commissions to public member majorities (and they must be public member supermajorities to prevent a majority of a quorum from consisting of "active market participants"), or subject acts and decisions made by boards controlled by "active market participants" and which may have an anticompetitive impact to "active state supervision." That is not merely the presence of a non-active participant in a superior hierarchical position. It must be a review for restraint of trade impact. It must be performed by someone operating in a *bona fide* capacity, presumably with a measure of competence in the subject matter, and the supervisor must have explicit authority to amend, modify, or reject, as the supervisor determines. California law does not require any type of review of regulatory board action that meets the standard now required by Justice Kennedy's opinion and reinforced by a recent guidance issued by the staff of the Federal Trade Commission on its implementation.

As a result of this decision, California is now forced to examine the very issues of concern to this Commission in this hearing We are surveying compliance efforts in all fifty states, and are noticing increasing state interest in designing reforms that require review and approval of agency actions affecting competition. We are also tracking antitrust cases now being filed against state boards. We expect more of both over the next year, including California legislation to bring the state into compliance with *North Carolina*.

VIII. Recommendations

The fact that an active and functioning review mechanism will have to be created over any "active market participant"-controlled board gives this Commission a unique opportunity. The Commission should seize upon this required systemic change to guide it effectively along the "good government" lines that have long been the hallmark of this Commission:

1. Recommend that regulatory agencies be put under the control of public member-controlled boards. That would properly be a supermajority of public members, so that a majority of a quorum could not consist of "active market participants" in the trade or profession regulated by that board. That structure assures public meetings as a part of decisionmaking, subject to the Bagley-Keene Open Meeting Act. At the same time, these public member-controlled boards could be provided with on-point expertise (where needed) so that decisions are made with full information about implications and consequences. Hence, necessary advice may be provided by consultants hired by the Board or by an advisory committee to the board. Ideally, that expertise contribution will no longer take the form of private lobbying. In fact, given the nature of the Internet and the revolution in telecommunications, there is no reason

why communications to board members or board staff should continue to be the product of concealed lobbying by groups who dominate that venue; instead, they should be made public and disclosed. It is no inconvenience to post arguments, concerns, and communications where they are intended to influence a public official. We have seen the consequences of *ex parte* communication violations at the Public Utilities Commission, but such private communications are actually more prevalent and less controlled in the DCA agencies.

2. Where a board remains under the control of "active market participants," California must now provide "active supervision" by the state on behalf of the broader body politic. As discussed above, it is not enough to have a theoretical review, nor to point to some supervening position on an organizational chart. The Commission should recommend that such a review include the full evaluation of any rulemaking for anticompetitive effect by those with applicable antitrust/economic expertise, with full presentation of required impact evidence. Ideally, that process would be managed by the Office of Administrative Law so that it could tie into OAL's existing review of six areas of impact; a seventh area of inquiry into anticompetitive effect could be accomplished within the same review timelines. Hence, it could be accommodated within the existing process without undue complexity or delay.

   We recognize that many non-rulemaking decisions do not pose anticompetitive implications and do not recommend that every agency action be so reviewed. But there is properly a filtering element that receives complaints (*e.g.*, about excessively restrictive examinations or pass points or disciplinary policies) that may be seriously anticompetitive and hence require affirmative review. Accordingly, a receiving and filtering mechanism is best provided to ferret out those non-rulemaking decisions and policies that impose unjustified regulatory restraints. Where there is "strong suspicion" that a practice complained of may have such an unjustified impact, its review should proceed as with all rulemaking.

3. There is a need for legislative oversight involving the strengthening and restructuring of both the sunrise and sunset processes. Ideally, the sunrise criteria should be added to the state Constitution. This would prevent the ad hoc legislative cancellation of its requirements wherever a legislator wishes to cater to a trade or professional grouping by creating a board or new licensing requirement without justification.

4. We recommend that the sunset process be expanded to involve consideration of the sunset of both the governing body and the regulatory scheme. If a regulatory scheme has no merit, both it and the agency administering it should be abolished. At the same time, "reconstitution" allows for examination of other flaws, including failure to regulate the market flaw justifying the existence of the agency. The shift in governance control allows for serious examination of the performance of those currently in control.

Testimony of Robert C. Fellmeth
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before the
Little Hoover Commission
February 4, 2016

Exhibit A

A THEORY OF REGULATION
A Platform for State Regulatory Reform

By Robert C. Fellmeth

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We who grew up in the cold war remember well our ninth grade civics picture of the Soviet state. We were told that you could not be what you wanted to be when you grew up. With special starkness, we could see a young Soviet boy driving a small pedal car up and down his sidewalk. A boy with eyes full of wonder about the big machines which hum down the cold streets. As he grows up he learns how the motors operate and he studies the various models year after year. He decides he wants to run a new automobile sales shop when he gros up. He wants to see and service the Ladka. He cannot raise capital and do it, the sales offices are government owned. He must apply for the position , or one which may lead to it.

In our cold war vision, before he applies, the Soviet youth faces a burly commissar, the quintessential bureaucrat. The boy walks into a sterile room of vaulted ceiling. He has waited for several hours for a 30-second interview. The commissar sheaves through a small stack of papers. Even before the boy reaches the lone chair in front of the desk, the official barks out his name and drones: "food factory canner, case receiver in tomato canning plan in Sochi....next." He then dismisses the boy with a curt wave of the hand.

Most of us have since learned that the repressive Soviet central planning system works less intrusively. Our young boy would not be instructed to be a case receiver. He would not be told at an early age exactly what occupation he would have to take. But he would be told what he could *not* be. If he wanted to be a Ladka dealer he could apply. With the help of the party, a committee is likely to formulate the requirements. Based on *their* view of how many dealers there should be and what they should do to qualify, they would say "no" to all but those persons they select.

Although not totally manipulating, the Soviet system imposes a "prior restraint": people cannot be what they want to be unless they are first given permission. They are not permitted to try on their own calculation of risk and let a marketplace defeat them based only on their failure to perform.

The year is 1984. The place, Thousand Oaks, California. One Paul Rusnak wishes to start a BMW franchise. It has been his lifelong dream. he has learned the auto business with great care. He has saved his money. He has secured the permission of BMW. He knows of many possible customers. He is sure of his market and proud of the product he wants to offer.

He is well aware that government bodies circumscribe much of what he can do: he must be licensed by the Department of Motor Vehicles and by the Bureau of Automotive Repair. He must advertise honestly, obeying the standards of the Federal Trade Commission and the Unfair Competition Act of California. He must honor his warranties and comply with the Magnuson-Moss Act and its state counterpart, the Song-Beverly Act. He must offer financing only under the strict terms of the Rees-Levering Act. And his automobiles must meet the emission standards of the state Air Resources Board and the safety standards of the National Highway Traffic Safety Administration. His own business operations must meet the safety standards of Cal-OSHA and the labor restrictions of the Labor Code. And, or course, he must pay taxes, keeping appropriate records. For local government, he must meet all land use conditions, ranging from parking requirements to the size and candlepower of his sign.

He is prepared to do all of that.

But there is yet another Board, one of many which Californians know little about: the New Motor Vehicle Board. This Board, set up by a trade association of existing car dealers, created a Board of seven members, three of whom are dealers. If any person, including a competing dealer, complains about the plans of someone to open up a new dealership, he or she may protest to this Board, which can then impose a "prior restraint" and say "no" to Paul Rusnak. This Board said no.

Many of us are well aware that lawyers and physicians must be "licensed" by state regulatory boards. And we justify this prior restraint by citing what lawyers like to call "irreparable harm." We must make sure that certain trades and businesses do not operate unless they are competently conducted. This means both keeping out those who might cause severe public harm and excising those who are already in business whose performance falls below minimum standards. But it's not just lawyers and the medical profession who are involved with prior restraints. Our New Motor Vehicle Board is not an anomaly.

The fastest growing and most intrusive part of American government rests within the so-called fourth branch: regulatory agencies. Created by legislative bodies and given quasi- executive, legislative and judicial powers, these agencies increasingly predominate in the lives of our citizenry. Much is written about the so called "alphabet soup" of federal regulatory bodies: the Federal Trade Commission (FTC), Civil Aeronautics Board (CAB), Federal Communications Commission (FCC), Securities and Exchange Commission (SEC), etc. Approximately 20 major regulatory bodies function in a relatively visible and open fashion in Washington, D.C., and through regional field offices. These agencies have been given enormous discretion by the Congress, which fashioned broadly framed mandates, and by the courts which have deferred to their expertise. They are subject to constitutional due process safeguards as to those they most directly affect. They are subject to an Administrative Procedure Act, a Freedom of Information Act, and other statutes. More important, their proceedings draw some interest from American journalism.

What is less known is that the greatest expansion in this fourth branch of government has occurred at the state and local levels, not at the federal level. Furthermore, the sometimes clear rationale for the development of regulatory bodies at the federal level has not guided state and local counterparts. State legislatures create new boards and commissions without considering economic rationale. They are viewed as "free" to the legislators authorizing them since they are "special funded" from the trade or industry subject to regulation. Legislators do not focus on marketplace flaws which might justify regulation, and the fashioning of specific means to compensate for or correct them.

Although new agencies are justified by consumer benefit, their initial proponents are often the trade group to be regulated. Where there is no one organized to oppose a new governmental body and it does not expend general fund monies, approval is not difficult. Legislators tend to count noses: who is for, who is against, and base decisions on the line-up. California now has over 60 regulatory agencies setting detailed policy in insurance, banking, utilities, transportation, and alcoholic beverage sales. Most of the trades are covered by regulatory agencies requiring licensure as a precondition to practice. In addition, agriculture has both state and federal (controlled regionally or locally) "marketing orders" government the promotion, distribution and/or supply of many agricultural commodities.

A typical citizen may be aware that local government regulates land use, that the Air Resources Board, Water Resources Control Board and California Occupational Safety and Health Administration affect the operations of many California businesses. Fewer are aware of the Milk Advisory Board, or the Board of Landscape Architects or the California Beef Council or the Bureau of Home Furnishings.

Co-extensive with a plethora of agencies, boards and commissions for purposes which are not clearly understandable, is the expansion of existing agencies well beyond what might have been a defensible original justification. The numerous existing agencies are very rarely monitored, or ever seen by any outside entity.

On the other side of the same coin is the issue of lack of regulation where regulation is warranted. And related to the problem of underregulation is the artificial creation of a marketplace flaw, the conferral of antitrust immunity and the avoidance of any meaningful substitute for the absent marketplace.

It is time to posit a rational basis for regulation, to develop some kind of defensible theory on which to base a regulatory system and to fashion its limitations.

I. PRESUMPTIONS

Adherents of the Chicago "libertarian" school often define "regulation" simplistically as government interference in which would otherwise be a natural marketplace. It seems to be a libertarian thesis that the "state" is an inherently coercive and dangerous institution, possessing the power to tax, to draft and to imprison. These coercive powers make the limitation of the state *vis-a-vis* private power an essential concern of the citizenry. While there is more than a grain of truth to the libertarian presumption, the allegiance of its adherents to the symbols of the "marketplace," without reference to the mechanisms which make the marketplace work, marks the philosophy as more of a religion than a rational tool for weighing options. The libertarians will often simply define "good policy" as a removal of government to a "marketplace," without reference to what that might mean. It is accepted as an article of faith in the tradition of religious zealotry that the marketplace functions as a proper object of obeisance. Disciplines advocate the simple removal of those institutions which might prevent the "market" from achieving its "natural status."

The world is much more complicated than this. In fact, the condition of the market absent government is the product of custom, language, pre-existing economic power—a human creation. And in fact, private power can coerce and enslave almost as much as the "state" can. Any resident of a one-company town will testify to the power of private interest. Large institutions may interrelate in an extremely adhesive fashion with the common citizenry. A serious marketplace choice may not be actualized. Private parties, increasingly cartelized, and horizontally organized into trade associations, may preclude marketplace choice and otherwise bully the consumer, the taxpayer, the citizen.

It is difficult for any but the most obsequious worshiper of marketplace symbolism to doubt the limitations of the unfettered market as a guarantor of economic freedom, equity or even efficiency. We shall explore the more traditional flaws of the marketplace that preclude its status as a blind object of worship below. However, to the extent it does function to manifest consumer sovereignty and allocation of resources according to informed consumer choice from a wide variety of alternatives, it is a touchstone deserving of presumptive status. Hence, we shall assume that where the marketplace functions to allocate resources efficiently and fairly, where the prerequisites are present for the marketplace to so function, it should be initially relied upon to that end. This reliance is related to the viability of its prerequisites. These prerequisites include the following traditional elements:

1. Many entrepreneurs acting individually and independently in buying and selling.

2. No one buyer or seller able to affect a significant market share.

3. Homogeneous products within types.

4. Perfect information about the characteristics of alternative products.

5. Rational decisionmaking by consumers.

6. No external costs which are unassessed by the marketplace.

Most regulation may be justified because of a breakdown of one or more of these factors, Although it is possible to exaggerate the impact of a marketplace deficiency, and to use it as an excuse to engage in unnecessary intervention, it is also true that where serious deficiencies exist in these prerequisites, the marketplace may not function to allocate resources fairly or efficiently. Where such an event occurs, it is inappropriate to rely on the mere absence of government as the solution. To the contrary, it is a primary function of government, as it provides checks and balances in our system, to intervene in order to restore or substitute for that absent prerequisite. The government should decline to do so only if the indirect and direct costs of that intervention exceed the benefits to be obtained from it. In determining what kind of intervention the government should choose, the benefits and costs of each must be measured. However, it is generally preferable to restore the marketplace, rather than to institutionally cripple it by providing for a substitute which may carry with it its own momentum and *raison d'etre*.

There are four major categories of breakdowns most often justifying some sort of governmental interference: (1) natural monopoly; (2) "scarcity;" (3) adhesive relationships, often accentuated with inadequate or misleading information; (4) external costs. The precise nature of a marketplace breakdown will dictate what is bets suited to either restore the marketplace or to compensate for its absence.

II. WHAT IS REGULATION?

Regulation is not a simply yes-no proposition. There are degrees of regulation. As we are using the term, regulation can mean intervention by the state at any one of three different levels. The most extreme level is "licensing." Here, a regulatory body prohibits the practice of a trade, profession or enterprise until or unless a "license" has been obtained from a governmental body. The existence of this license gives the state a basis for barring entry into the trade or profession, and through its denial, or revocation, confers an ancillary power to promulgate rules. Violation of these rules may be enforced through the draconian denial of that right to practice one's trade or profession.

At a second level, the state can regulate through a system of "permits." Here, no one can practice a defined activity until or unless they have a permit. However, as we are defining the term, there are few barriers to entry to obtain a permit. A system of permits allows entry simply upon the registry of certain required information so the "regulator" knows who is practicing. It gives that regulator the power to suspend or revoke such a permit if certain adopted rules of behavior are transgressed. A system of permits, although little used in the regulatory process, theoretically gives the system an easy in—easy out format. The regulatory body does not bar entry, but once an abuse occurs by a practitioner, the state has the authority to remove the practitioner.

A third level of regulation is "certification." As with "licensing," there is a barrier to entry in order to achieve "certification." One must pass certain tests or otherwise prove special competence in a field. But contrary to a license or permit, one can practice in that field without obtaining "certification." One simply cannot use a defined label or "title" unless one has achieved entry and proven competence. This option involves the state in measuring the competence of various practitioners in order to provide information to consumers by associating the use of a certain "title" with the level of competence that must be obtained in order to use it. A private entity can theoretically "certify" a person, e.g., the use of the term "realtor" granted by a private trade association. But only the state can bar entry by directly prohibiting practice of a trade without prior approval.

Regulation may also take the form of specified maximum or minimum rates. This regulation usually occurs in the context of a "natural monopoly," and then only in conjunction with a "licensing scheme" as we have described.

In addition to the regulation of rates, entry and title use, government has numerous other options where there is a marketplace flaw. Unfortunately, traditionally few of these options are considered. Of course, prior to considering any regulatory alternative, the first priority should be to restore the marketplace by a "structural change" (discussed below) or by antitrust prosecution. Each of the remaining alternatives to traditional "regulation" has advantages and disadvantages, depending upon the marketplace flaw addressed. These alternatives include the following:

III. ALTERNATIVES TO TRADITIONAL REGULATION

A. Bond-Insurance Requirements

A bond or insurance requirement may involve a barrier to entry implicit from its acquisition, but may not involve any further regulation. It need require no government-set standards beyond the bond itself. It is most appropriate where there is the likelihood of incompetence damage and a likely inability by the consumer to collect on a readily obtainable civil judgment, due to insolvency or otherwise.

A bond or insurance requirement guarantees that should there be a small claims court or class action judgment, there will be some recover. This alternative essentially allows the marketplace of bonding companies or insurance firms to regulate without government intervention. Where the courts sanction particular practices, the marketplace of bonds and insurance will reflect those decisions through higher rates or denial of coverage to those entities creating problems.

B. Disclosure

The second alternative is to require disclosure of certain information by business. Disclosure requirements often address information failures or adhesive relationships, but only where there are alternatives in the marketplace. This alternative depends upon a meaningful enforcement system to guarantee the disclosures are made.

It can suffer from inequitable application in situations where failure to disclose carries with it no consumer wrong. The mechanical enforcement of a prophylactic requirement which may often prove unrelated to the wrong being addressed can create injustice. Truth-in-lending may require disclosure of the total finance charge. A one dollar error to the benefit of consumers can result in the mechanical application of a sanction which could gratuitously injure a small business.

C. Rule of Liability

Another alternative societal measure can be a change in a rule of liability by common law evolution or legislative act. Hence, strict product liability may make it easier for victims to recover damages where there has been an injury. The rule of *res ipsa loquitur* has a recovery-enhancing effect. A governmental alteration of the rules of the marketplace, which are themselves the product of custom and state intervention, facilitates the internalization of certain kinds of external costs. The change may utilize the currently existing court system.

Altering a rule of liability carries with it the disadvantage of depending upon the existing court system with all of its drawbacks and deficiencies. These include: enormous transaction costs due to inflated attorneys' fees, interminable delay, often incomprehensible rules of procedure, and in the federal courts, an aversion to the only meaningful way of internalizing many modern external costs through the court system: the class action. Of course, standards of licensing agencies are also rules of liability implicit in the licensing system and are discussed below. These standards are subject to confirmation in the courts and to their own procedural inefficiencies.

D. Straight Prohibition

Yet another alternative is deterrence by formulating broad marketplace rules grounded in fundamental fairness, and the punishment of those who transgress. Sanctions are based on the degree of transgression, the amount of unlawful gain and the extent of harm caused. The use of criminal prosecutions for consumer fraud is an example of such a deterrent-producing alternative. Generally, the deterrent-producing criminal prosecution alternative is under-utilized, even where the harm may be egregious, apparent and the result of *mens rea*.

E. Tax Incentives / Disincentives

Another form of societal intervention is through tax or fee incentives or disincentives. A tax incentive may be viewed as a public appropriation of funds to the extent it defers or excuses taxes by one person performing certain favored acts *vis-a-vis* others. Instead of not taxing citizen X $10,000 by allowing a deduction or credit for a favored private expenditure, we might instead simply take the same amount of tax money from all parties, and then turn around and hand citizen X a ten thousand dollar check. This mode of analyzing tax loopholes, terming them “tax expenditures,” is now widely accepted. Tax incentives, although they produce a strong pull on private behavior, use a bureaucracy: the existing tax bureaucracy. Where this tax bureaucracy has excess capacity and economies of scale justifying further use as a cross-subsidy, it may make sense to use it. And it may also have the advantage of allowing allocation decisions to be made by many private actors in a kind of favor dispensing marketplace, rather than by a government agency.

However, there are several important deficiencies in using the tax system to accomplish cross-subsidies to stimulate or discourage behavior. Because of the progressive nature of the tax system, any tax incentive by way or deductions reduces the progressivity of the system. The tax deduction literally awards one person a greater benefit based on taxable income. Even a tax credit, which overcomes this difficulty, is limited since there are large numbers of people who do not pay taxes and cannot take advantage of the benefit.

Tax incentives or disincentives have a more serious deficiency. A tax incentive, once enacted, continues without further examination. It is often unclear how much it is costing. It does not automatically end until it is affirmatively removed. The benefits are received invisibly and without public scrutiny. If we had to appropriate the $10,000 for Citizen X, we would see who was getting it, why he was getting it and how much he was getting. If we had to give that money year after year, making that threshold decision to so appropriate it repeatedly, we might not make the same decisions we are making through the tax code. Of course, quite apart from the hidden nature of the subsidy, and its proclivity to continue unless specifically ended, we have its contribution to further complexity and inequity in a largely incomprehensible tax system. The current system undermines the legitimacy of all government, and indeed the allegiance of its citizens to the state.

F. Sale of Marketing Rights

Related to tax incentives/ disincentives are the possible sale of marketing rights. The state simply declares a given output allowed and then allocates excess demand to engage in that output by auction. The system is to create an artificial scarcity and allocate the permitted quantity by sale, either by letting those with current rights sell those rights in a marketplace, or by public auction.

G. Subsidy

The state can prevent an external cost or stimulate an external benefit by the obvious device of a direct subsidy. Or it can accomplish the same end with a more seemly appearing loan guarantee, supply limit, direct government purchase, government storage or marketing assistance, import protection, et al.

Despite the disadvantages of each of the seven alternatives we have listed, one or more may be superior to a system of comprehensive regulation. Indeed, the lesser forms of regulation described above may be superior to the more traditionally invoked "licensing" systems currently in vogue.

IV. COSTS OF REGULATION

The traditional comprehensive "licensing" mode of regulation has numerous costs. First is the cost of the regulation itself. Examination licensing fees, renewals and gate taxes, etc. are imposed industrywide by a board or commission under legislative authority. These direct costs of regulation are passed on to the consumer in the form of hidden taxes, although consumers may not identify them as such. Monies are not taken from the general fund for the purposes of financing most occupational licensing regulation, and hence these direct costs are not recognized by legislators either.

The second cost is an indirect cost, but is much more momentous than the direct cost of regulation. The barriers to entry which are created keep out of a trade or industry those who might compete. There is a cost in the denial of entry to those who would otherwise be practicing. There is the cost of overcoming the barrier by those who surmount it. There is the additional cost of the rules which are often promulgated. Because of some history of abuse by a practitioner, the legislature may categorically impose a barrier and exact a serious cost to the system as a whole.

Where there is an alternative more narrowly directed at a wrong, either by rulemaking or by some non-regulatory alternative, the cost may be unnecessary. There is a certain paternalism which pervades regulatory agencies over time and which has been the subject of much scholarly comment. When the optometrists of California were required to take CPR as a condition to obtaining an optometry license one begins to see the general trend.

The California Athletic Commission's concern about too many complimentary boxing match tickets to friends by certain promoters led it not merely to ban excessive gifts of tickets but to the licensing of ticket takers, ushers and even ticket printers! There is a large universe of examples of *in loco parentis*, often well intentioned, and often costly.

Perhaps the final cost is the cumulative effect of closing a large number of occupational and business opportunity doors before they can be tried. The notion of "prior restraint" imposed by the "state" — a kneeling servility to a bureaucratic official before one can start a commercial venture — is antithetical to the American character. Because someone somewhere has done someone wrong, you must be prevented from doing wrong — a wrong you have not done. So you cede to the state the right to deprive you of the chance to offer your services or products unless it thinks you are not likely to do wrong. The American tradition has been: let me do what I want. if I do wrong — then intervene, unless the wrong is so terrible and the state's accuracy in predicting who will do wrong justifies a contrary rule. No one categorically precludes prophylactic state intervention, but, rejecting the presumption of state paternalism, we better have a clear and damned good reason for it.

V. A FORMULA FOR

JUDGING REGULATION

A. Presumption

Rather than using the current formula for evaluating the appropriateness of a new regulatory system by state legislatures (let's count noses, who is for it and who is against it), we might consider some form of rational analysis.

The appropriate societal response to market deficiency depends upon many variables. The first presumption is to employ the market to the extent it functions. This means the restoration of the market. If a market prerequisite is missing, perhaps it can be resurrected, or artificially supplied, to allow informed consumer sovereignty. One has a leak in the basement. One can hire workers to mop, and perhaps regulators to shut down the main water line when water is not needed for showers, drinking or watering. Of course, these moppers and regulators may become a regular part of a rather bloated household budget— unless we can work out a way to socialize their cost. Translated, this means getting others to pay for your lousy plumbing. One does not have to be a libertarian to propose calling in some plumbers, fixing the leak and then getting out of the house.

And our presumption has a corollary: pay for it yourself—unless we are prepared to subsidize a noble end, in which case the gift should be visible, debated and cease unless renewed annually.

B. Prioritization

Chart A presents a rough ranking of societal responses to the five types of market flaw traditionally justifying regulation.

1. Natural Monopoly

A natural monopoly exists, put in the simplest terms, when there is room for only one entrepreneur to operate efficiently, usually because of economies of scale. If it takes a billion dollars to acquire railroad or utility rights of way and there is room for only one such system, or only one is needed to carry all expected traffic, there may be a natural monopoly.

The priority societal response to a monopoly should be to try to restructure the enterprise to make competition meaningful. This could mean allowing new railroads to compete on the lines of another railroad in return for a fair rental charge for using their lines (called “wheeling”). Of course, government intervention would be required to set a fair rental charge.

It could mean public purchase and management of those aspects of the enterprise with high initial fixed costs (which create the economies of scale and the natural monopoly format). Hence, if the government owned railroad rights of way, track and switching facilities, the actual railroad carriage could be undertaken by competing lines. Technological change may also undermine natural monopoly by creating substitutes for the high fixed cost parts of previous monopolies (e.g., long distance telephone service by microwave/ satellite).

Where natural monopoly is inevitable, there is no competition, no natural selection of the most efficient entrepreneur, no competitive price. Once monopoly has been conceded, unless allowed for a limited period as a special socially beneficent reward (*e.g.*, patent awards), there must be maximum rate regulation to preclude excess profits. Note that most natural monopolies are the result of government intervention to facilitate the enterprise (use of land grants, eminent domain powers, et al.).

Maximum rate regulation is not enough to preclude natural monopoly abuse. Lacking any competitor, the monopolist can give short shrift to consumer service, can become inefficient in operations, secure that most expenses will be compensated. The regulator is in a classic catch-22 quandary in attempting to provide an incentive to incompetent monopolists to improve. Although the regulator may inhibit monopoly power profits, it is obliged to provide the utility’s private investors a “fair rate of return” on the investment. More important, the regulator knows well that the long run service depends upon the ability of the utility to attract capital for plant improvement. The denial of an attractive rate of return jeopardizes this utility asset. Yet most regulators believe that the only weapon they have with which to police or discipline utility imprudence is to deny requested rate increases. In so acting they are forced into the cliche to cut off their noses to spite their faces.

Natural monopoly regulation has suffered from a lack of imagination. In the private sector, a failure to perform results in an immediate impact — declining profits. This translates into lower dividends and the dismissal of management. There is a "natural selection" labor market in the competition for superior management. Unfortunately, there is little precedent for regulatory replication of this time-honored marketplace check, but it is easily accomplished.

Theoretically, a regulator could give an existing management group sufficient time to perform efficiently based on comparable market based standards. Repeated failure to achieve reasonable performance results in the conditioning of a future rate increase on the replacement of upper management with a new group. This is what the free market would do. The regulators do not specify who should be hired, just that there must be a change. The extremely well paid executives of a monopoly utility hold a position without tenure. They have a special duty to perform—since they function without immediate market challenge and often manage the provision of a necessity. As benign as the simple recognition that these positions are not lifetime sinecures may appear to be, there is a universal refusal to choose this regulatory option, even with the most egregious record of executive nonfeasance.

The third alternative, government ownership, is a last resort. The confluence of industry and the state removes a fundamental check in the American system: the independent state. With that precious independence, the citizenry can break through what might otherwise be a coordinated curtain of apologia or deceptive self promotion obscuring failure.

2. Scarcity

The paradigm example of scarcity-based regulation is FCC licensing of radio and television over-the-air frequencies. There are a limited number of non-interfering stations and in many areas more entrepreneurs want to operate than can be supported. How do you decide who gets to broad or telecast? You do not need to limit maximum rates because there is presumably sufficient price competition. But there may be reasons why one does not want to simply allow those who got there first to have or keep these necessarily scare resources.

The preferred method for allocating scarce resources is by auction. Leasing or selling these scarce resources to the highest bidder does two things: provides public revenues and allocates them to those wiling to pay the most — willing to take the greatest risk or able to attract the most capital for the venture based, presumably, on their track record in anticipating consumer demand. To be sure, we may want to advance interests outside consumer demand, but if so, we should be willing to do so by direct and open subsidy.

The allocation of scarcity in the case of FCC regulation purportedly is based on "qualification." Licenses and renewals may be subject to competition along criteria designed to run consonant with the "public interest." In actual practice, with rare exception, the system is actually a "first come first served" system.

The least desirable method of scarcity allocation was illustrated in the gasoline shortages of the late 1970s. Artificial maximum prices prevented market allocation. Supplies were therefore allocated consistent with the Soviet practice: those willing to wait in lines the longest receive the service or product. Limiting demand by making those who wish to purchase something waste enormous quantities of productive time may be one way of seeing to it those who "want" it most (or who have no other demands on their time) get it, but is not the method of allocation favored by a rational society.

3. Adhesion / Imperfect Information

Much of consumer law is concerned with common adhesive relations between merchants and unorganized consumers. Take it or leave it boilerplate contracts imposed on consumers by merchants who spend their livelihood formulating them to their best advantage, has meant abuse. These abuses are often invoked to justify regulatory systems.

Certainly where advertising is misleading, public civil and criminal remedies abound, at least in theory. The preferred remedy is competition: competitors challenge each other's advertising claims with counter advertising and provide product alternatives. And public education funded by the state may increase the consumer's ability to evaluate conflicting claims. Such an effort is especially warranted where purchasing decisions cannot be made easily by individual consumers. How does a consumer evaluate conflicting claims of tire longevity? The consequences of diet choices?

Notwithstanding vibrant competition and public education, imperfect information may warrant further intervention.

It is possible to identify certain kinds of transactions particularly subject to abuse. The most common of these has been in the area of consumer finance. Hucksters advertise "8%" financing but fail to mention that 90% down is required for that rate; others advertise only "5%" down and fail to disclose high interest. A federal truth in lending statute was passed to require amount down, period of payment and interest rate if any one of these three is mentioned in an ad. Although an arguably helpful requirement, the statute then excluded any civil remedy for that requirement.

More typical are the direct "disclosure" requirements of Truth-in-Lending and many state counterparts at point of contract. In one reported case, a consumer bought two trucks with $700 down on each as the disclosures represented on the contract. Because the consumer submitted a check for $1,000 and two others for $200 each, the statute was violated and the merchant severely sanctioned. Certainly requiring standard disclosures may help the marketplace and reduce the need for more intrusive forms of regulation, but the disclosures must be related to consumer need and the remedies must be measured against the wrong. It is better to have a general standard of fairness and hit egregious conduct with harsh sanctions in widely publicized cases than to impose debilitating sanctions on merchants for mechanical bona fide errors of no important concern. Every unnecessary merchant limitation and requirement imposed across an industry or trade is a cost imposed on all consumers.

Where disclosures will not suffice, certification is a possibility. Consumers cannot test many kinds of products individually. Marketplace information about the performance of an automobile in a collision cannot be obtained by buyers directly. The selection of a competent urologist may be a difficult task. In many cases, private groups ranging from Consumer Reports to Underwriter's Laboratory conduct testing to rate and certify performances. But many complex services or products may not be amenable to private testing, and may justify public testing and promulgation of results (as with auto crash results) or publicly funded testing and certification for a "title use" to facilitate consumer marketplace information.

4. External Costs

External costs occur when the purchase or use of a product imposes costs on others which are not reflected in the price of the product. Typical examples include various forms of pollution, hazardous products imposing injury or death losses on others, and incompetent practitioners of essential professions or trades who injure those entrusted with their care. "External costs" justify most state and local regulation! Power plant A produces widgets and pollutes both the air and the water while doing so. Power plant B also produces identical widgets, but controls its pollution. Power plant A passes on certain costs to the environment, fishing interests or to the health and safety of future generations. These costs are not borne by the factory and hence are not internalized in the price of the product. The widgets produced in Factory B may cost a small amount more because of the controls preventing such pollution. Because this cost of control is included in the price of the widgets produced by Factory B, it is driven out of business. Factory A survives, even though the total cost of its production of widgets, including the cost imposed on others through the production or use of the product, is much greater than Factory B.

A possibly preferential way to deal with this flaw is rarely used: the compulsory tie-in. There is a harmful effect in the production or use of a product which is assessed outside the marketplace. Try to find a way to bring it into the marketplace by adjusting market rules, *e.g.*, internalize the cost by direct tie-in. Take, for example, the non-fatal auto accident mission of the National Highway Traffic Safety Administration. We are talking about routine equipment standards, *e.g.*, bumper strength for front end collisions. One can create an agency, hire experts and government civil servants, buy a series of office buildings, buy equipment, meet, hold hearings, establish standards for proper bumper production, inspect bumpers which are produced, test them against those standards and sanction those who fail to meet those standards.

On the other hand, one could simply declare that each automobile sold must include insurance according to very simple minimal standards of collision coverage. No bureaucracy. No standards. No enforcement. Those bumpers which result in the front end self destruction of their accompanying vehicle at a bump under 5 mph (most current vehicles), would and do have horrendous insurance costs. But the manufacturer would have to pay them directly. At present, the external cost of gratuitous damage is cross-subsidized since imperfect information means that after-the-fact damage requires replacement parts whose production is dominated by the manufacturer. The high initial investment in the auto means a partially captive market leading manufacturers to set prices for extraordinary profit. The insurance tie-in requirement means that a manufacturer who designs a useful bumper will be able to offer insurance at a much lower cost than self destructing bumpered autos. A vehicle with a better bumper is quite likely to cost less than one with a worse bumper, giving it a strong competitive advantage. If it does not obtain a competitive advantage, perhaps the cost of the better bumper is not justified.

The goal of the "tie-in" approach is to internalize external costs to let the self-regulating market determine the nature of the ameliorating action taken. There are other ways to accomplish the same end more efficiently than regulation with accompanying prior restraints.

Often, the tie-in cannot simply be legislated. Pollution is a paradigm case. We have listed in Chart A five kinds of measures to accomplish a tie-in or otherwise to ameliorate external damage: tax transfer, marketing rights sale, equipment standards, harm or output standards and a rule of liability enforced through the courts. We believe that the last alternative, often used, is among the least effective or equitable, but preference among the remaining measures is more difficult. We have expressed a certain ordering of priority, but qualify it by briefly explaining the advantages and disadvantages of each:

a. Tax Transfers

Where the harm increases in a relative straight line as the externality increases and where the harm can be measured, it may well be amenable to a tax or fee. Germany and France have used such a technique with some success in pollution control. Pollution emissions from a plant cause variable harm depending upon: the substance emitted, the atmospheric conditions in the locale, the kind of environment receiving the emission and, as many systems ignore, the synergistic effect of pollution mixes, including background pollution. Tax systems can adjust to at least some of these variables.

As with the three measures discussed immediately below, the remedy suffers from the conflict between an easily administered generalized tax by substance emitted and "individualizing" the tax. Theoretically, it could be varied according to: harm caused from a particular substance at a particular location at various levels of background pollution mixes. And it also suffers from the problem of monitoring and accurate assessment.

However, these difficulties are manageable. Perfect external assessment, as with the perfect due process, is a standard for measurement, not a minimum for action, and perhaps never completely achievable. Focusing on the imperfection of a system to correct a marketplace defect distorts the rational inquiry: what are its relative merits compared to the alternatives. The problems of a tax/fee system are formidable. If the rates are to vary by damage category in any detail, a regulatory body will likely have to set them, exercising expertise from specialized staff resources, engaging in public rulemaking hearings. To the extent the rates perfectly reflect individualized harm from emissions, they would vary literally by emitter and could be subject to the political process of advocacy from those larger entities able to afford it. One could even imagine the broadening of the tax-setting deliberation to include the tangential external costs of the tax itself — perhaps the closing of a plant which might entail some alleged externality.

In point of fact, if a polluter is using certain equipment and produces items by known processes, which is usually the case, it is possible to establish presumptive levels of emission. This is how the tax systems of Europe avoid the monitoring dilemma. It appears to be workable, although understandably imperfect. Likewise, the tax may well vary by pollutant and region without difficulty, and approximate the harm caused.

While most other forms of internalization have these same defects, they generally lack some critical advantages to taxes/fees. First, the tax/fee system is efficient. It does not depend upon detection, onerously expensive due process hearings for breach of standards, followed by assessment of unpredictable penalties. The sanction is relatively certain and calculable. Second, the system is continuous. As emissions increase, taxes increase and incentives to install controls may increase. Third, the system does not preclude new technology to control pollution — it stimulates it by providing an incentive-based demand. Fourth, the system misallocates resources less than alternatives by allowing certain emissions where the cost of reduction is extraordinarily high, while the marketplace first reduces emissions where they are gratuitous and more easily cut. Fifth, the system is capable of fine tuning. One can start the system at a politically acceptable low level and gradually increase until major reductions occur, or perhaps gradually decrease as overall air or water are clean enough so that their self-cleansing properties may allow for more emissions of certain types.

Finally, the system generates revenues which can be used to compensate the interests suffering damage from the emissions of those who choose to pay. The assess and pay dual aspect of a tax/fee system is especially attractive. In a sense it can accomplish what rules of liability attempt, except by automatic process without the need for detection, affirmative action by a sophisticated victim or public entity and without costly judicial proceedings.

It is important, however, to establish in advance where the taxes are going, or at least the criteria for tax adjustment. This information enables the private decisionmakers to make more rational decisions. One does not have the spectacle of auto emissions standards tightened so slowly and incrementally that the efficient stratified engine capable of meeting stringent standards is eschewed in favor of a clumsy technology of pollution control devices to meet what turn out to be interim standards.

b. Sale of Marketing Rights

The "public sale of marketing rights" shares many of the advantages of a tax/fee system. This remedy is appropriate where the harm done is closely related to some identifiable quantity of output and where at a certain level, the harm jumps in a curvilinear fashion. If we decide that if we have more than 1,000 taxi cabs serving the airport, the congestion creates an intolerable external cost due to lack of space for them, we can auction off the right to serve the airport to 999 cabs. If the emission of more than 500,000 pounds of sulphur dioxide per year in a given locale exceeds the self-cleansing properties of the atmosphere and creates intolerable harm, we can sell the right to emit sulphur dioxide up to the level, and compensate those possibly affected by more tolerable harm.

c. Standards

Equipment standards and performance standards may be needed where simple prohibition may not be effective by direct criminal or civil liability by statute. These latter remedies may be sought where there is irreparable harm from the breach of definable standards and are discussed below. But it is also possible to set standards administratively through rulemaking to discourage an external cost. It is generally a power implicit in the general power to control entry through the granting of licenses (*e.g.*, certificates of public convenience and necessity). The option of standards allows non-economic prescriptive rules of behavior. They are advantageous only where detailed control is needed, detection of violations is workable and the administrative sanction is efficiently applied or is deterrent-producing. Although there may be some basis for the use of standards to prevent forms of irreparable harm which come from their breach, as a means of internalizing external damage, it generally suffers from inflexibility and inefficiency.

The setting of the standards themselves has the problem of "generalizable rule versus individualized rule" in our tax/fee discussion, except the means of enforcing standard violations makes it more difficult. Should we limit sulphur dioxide total emissions in an area? By plant? By smokestack? Should we vary emissions if a given polluter is producing something which can be made nowhere else and the cost of lessening his emissions is enormous? Should we start granting exceptions? What often happens is the standard-setting system ends up describing through its standards what already exists, with little impact on the external damage. Additional emissions may be discouraged, but the same result would be achieved by freezing emissions at current levels and marketing the right to emit by public sale or from an entity currently emitting.

Where standards are set in too generalizable a manner they may misallocate resources and produce inequitable results. Enforcement is quasi-adjudicatory in nature and invokes the full panoply of due process rights. Due process may condition the sanction on years of discovery, hearings and appeals. Ironically, the chief weapon of the standard enforcer is the enormous cost of exercising these vaunted due process rights. It is precisely because they are too expensive to exercise that the standards have some efficacy. However, where the stakes are high for a private entrepreneur (i.e., under circumstances where the standards may have real import) the cost to the agency to establish the sanction is also high. As the disciplinary records of current state agencies make clear, very little enforcement of standards actually takes place. It is the likely disapproval of one's peers or the public from a prosecution, its cost (and in small measure the possibility of a draconian albeit rarely used license revocation) which gives standards what impact they have.

"Equipment" standards, rather than performance standards, limit many of these problems. However, requiring certain equipment or its equivalent can be accomplished without much regulatory presence beyond the approval of "equivalents." I.e., any equipment requirement should allow for substitute technology "equivalent" in performance to any existing equipment then specified. Review to warrant equivalence should be subsidized to encourage technological innovations. Such an equipment standard is appropriate where a certain kind of equipment precludes an unacceptable minimum external cost in a direct and equitable way, or where there are irreparable external costs without it, discussed below.

d. rule of liability: judicial assessment

One may create a rule of liability which allows those injured by Factory A to file a lawsuit and to use the existing bureaucracy of our legal system to internalize the cost of that damage into the price of the product by assessing damages against Factory A in court. A corollary way of accomplishing the same end is to simply ascertain the amount of damage being caused by Factory A and levy an assessment which would be internalized in the price of the product produced, as we have discussed above.

Whether the assessment is properly made by court adjudication, regulatory process or a more automatic tax levy will turn on a number of variables: the degree and diffusion of the external cost, its ease of calculation, et al. In general, the court system is a poor means to assess such costs where they are regular or widespread because of fundamental deficiencies in the American judicial system: lack of access by the poor or middle class, hostility to the class action mechanism theoretically able to accomplish internalization, unpredictability, the transfer of the dispute into a contest of resource exhaustion and delay, and overwhelming expense. Should a reasonable system of dispute resolution be created, it might be able to internalize costs more effectively. In some jurisdictions, easily detectable damage may be addressed where small claims reforms, alternative dispute resolution experiments or class actions occur meaningfully.

5. External Costs: Irreparable Harm

There are some external costs which cannot be "assessed" by any means of internalization satisfactorily. Attorneys have a concept: "irreparable harm." What do we do about harm which is unacceptable even if it can be paid for? Or harm which simply cannot be paid for? The law allows for preliminary injunctions in civil cases where such harm may befall one of the parties—where the "remedies at law," e.g., money damages, are "not adequate" to provide relief, et al. There are obvious examples at the extremes. Nuclear safety is not a matter to leave for later damage assessment. The harm is irreparable, it must be prevented. Automobile collisions at high speed kill 40,000 Americans or more each year and disable many thousands for life. Preventive action would appear warranted. A consumer entrusts his life to a surgeon and preventive measures to assure a competent professional can be justified.

a. mechanical tie-in

The first checkpoint is the possibility of a "mechanical tie-in." Unlike the tie-in designed to internalize compensable damages, this tie-in seeks to prevent an incompensable cost. In the case of our automobile, a mechanical tie-in may consist of a simple requirement to equip vehicles with air bags. Assuming a benefit-cost ratio can justify a mechanical tie-in, which is rather obvious in the case of the air bag, it can be imposed with a minimum of ancillary or misdirected restraint. As we have noted, it is important to qualify any such equipment requirement with an "or its equivalent" option, requiring regulatory review to certify equivalency; and there is a need for some enforcement means to assure compliance. But these tasks are focused, relatively easy and non-intrusive. They minimize the continuing generalized presence of government over an area of commerce and inhibit the kind of *ultra vires* extension and institutionalization of public bodies of control. And they are usually more effective in accomplishing their focused goals.

b. standards: civil or criminal prosecution

There is no set of equipment which will easily assure the safety of a nuclear power plant, disposal of hazardous wastes or the competence of a surgeon. For many practices which are simply unacceptably dangerous or harmful, a secondary approach might involve the issuance of a straight prohibition or mandatory instruction by statute, if easily articulated, and subject to preliminary relief and deterrent-producing civil or criminal sanctions as appropriate. The disposal of certain listed waste products must be made at specific sites where they are neutralized at a cost borne by those disposing of the products. Where (1) violations are prosecutable without the examination of the defendant, (2) the harm is attributable to individuals deciding to impose an irreparable harm on others, and (3) the danger is substantial, criminal remedies may be appropriate. Where one or more of these factors is absent, a public civil prosecution buttressed by the powers of preliminary injunction, restitution and civil penalties may be preferable. In some circumstances, a private cause of action may be used to assure adherence to a straight prohibitory rule with relaxed standing requirements and "private attorney general" attorney fee award provision.

Where the external harm requires complex and changing prohibitory conditions, e.g., the construction of a nuclear power plant, an agency may be needed to adjust and apply detailed rules of operation with expert staff guidance. Here, the agency applies the rules and the primary remedies for non-compliance, under general statutory authorization.

c. standards: licensing

The final alternative for external costs where there is irreparable harm is the licensing of a trade, profession or area of business. A board, commission, department or bureau prohibits business operations unless and until prior governmental permission is given. This prior restraint is justified so a public agency can filter out those who would cause irreparable harm. The same public purpose gives those public bodies the obligation to excise those who were admitted but who manifest the same danger. We have cited medicine as an example of a justifiable prior restraint, but there are non-health related candidates as well. An incompetent attorney can cause serious irreparable harm and a large number of such practitioners could threaten the efficient operation of a legal system which requires a high level of expertise. As with law, most non-health rationales for prior restraints involve: (1) the consumer lacking adequate information from which to evaluate competence in his or her own self interest, (2) serious irreparable harm flowing from such incompetence, and (3) ability to exclude the incompetent.

VI. FUNDAMENTAL MIS-REGULATION

Using California as a case study reveals a symptomatic array of mis-regulation, not only by the theories set forth, but by any articulable theory.

A. Excessive Licensing to Ameliorate Incompetent Practice: Prior Restraints Gone Wild

The public knows little of the extent of regulation at the state level, nor of the indiscriminatory reliance on the last resort alternative of comprehensive licensing with prior restraints. For California does not just license doctors, dentists and lawyers. It licenses: landscape architects, accountants, boxing promoters, boxers, wrestling promoters, wrestlers, architects, barbers, counselors, psychologists, morticians, collection bureaus, contractors of all types, cosmetologists, polygraph examiners, personnel services, dry cleaners, geologists, geophysicists, nursing home administrators, optometrists, land surveyors, nuclear engineers, petroleum and other engineering title use, shorthand reporters, veterinarians, structural pest control operators, insurance agents, real estate brokers, auctioneers, chiropractors.

Further, within each of these licensing systems, enormous expansion has occurred over time. The Board of Fabric Care began by licensing dry cleaners; now it has separate approval for those who clean hats, those who clean furs. The dental regulators have expanded to license not only those who clean your teeth, but "dental auxiliaries" who put on your bib and show you where to spit. The regulation of boxing promoters resulted in the full scale licensing of everyone connected with the enterprise: matchmakers, timekeepers, even announcers...even the ushers! The Contractors State License Board is playing with separate licensing for each possible trade specialty: brickwork, dry wall taping, solar device installation, etc.

More remarkable has been the continuing addition of new comprehensive licensing systems. There has been a great deal of publicity given to "deregulation," particularly by Republicans. Liberal Democrats have hailed the notion of "sunsetting," setting a date at which time an agency will automatically terminate unless it can affirmatively justify its existence. In fact, we have not been able to find a single licensing agency which has been deregulated significantly, nor one which has been effectively terminated within the past two decades. Even the source of the deregulation "sunset" movement, the state of Colorado, has failed. Although five agencies were terminated amidst much hoopla in the 1960s, we have traced the subsequent reappearance of all five. The trend has been in the opposite direction. And the efforts to expand this most intrusive form of regulation continue unabated. The last several years have seen serious bills to set up yet new boards to comprehensively license: "aestheticians" (people who advise on proper make-up), interior designers (people who advise on attractive interior decor), travel consultants, financial advisers. The most recent bill we reviewed proposed to license "recreational therapists." What is this? Those who: initiate, prescribe, direct, evaluate, educate or participate in any treatment involving "social, play, recreation, sports, game, or leisure oriented activity." Or it means anyone "using leisure education, leisure counseling, activity analysis, and leisure assessment." *Or* it means anyone else who performs: "any service requiring substantial specialized judgment and skills in the use of recreation activities for others based on the application of knowledge of principles of biological, physical, social, psychological sciences and recreation leader studies."

The list of currently licensed entities above is not meant to imply inappropriate government involvement in every case. For some, even a licensing system may be justified. But for most of them there is no justification for licensing under any theory, and for many of them, no need for any extraordinary government involvement. For many agencies with easily recognizable external costs, some irreparable, e.g., the Occupational Safety and Health Administration (Cal-OSHA), water and air pollution control, we may wish to weigh the benefits and costs of the mode of regulation employed. But for many of the occupational and business licensing systems, they flunk a threshold test.

Chart B, below, includes an outlined listing of the regulatory abuses currently extant in California, allegedly a "model" state. The first columns indicate initial errors in regulatory format.

Threshold Test 1: Market Flaw

There is intrusive regulation, including prior restraint licensing, of dry cleaners, barbers, cosmetologists, shorthand reporters, et al. These trades are illustrative of not only low levels of irreparable harm, but of a generic need for repeat business. No drycleaner or barber will remain in business long while incompetently disappointing successive populations of new customers and losing their repeat business. The performance of the tradeperson is readily evaluated by the consumer. The marketplace has no flaw justifying any intervention.

Threshold Test 2: Irreparable Harm

A second threshold test is the existence of sufficient irreparable harm to justify the extraordinary option of blocking entry. Does some incompetence by a landscape architect (persons who plan gardens for hire), a collection bureau, an appliance or electronic repairman, a retailer of bedding (or the drycleaner or barber or cosmetologist needing repeat business) create likely irreparable harm? Are not money damages sufficient? Note that these entrepreneurs are subject to Cal-OSHA regulation for safety and are prohibited by criminal and civil statutes from deceptively advertising or defrauding consumers.

Threshold Test 3: Possible Assurance of Competence

A third test is the ability of the state to assure competence, at least in theory. Can the Board of Behavioral Science Examiners or the Psychology Examining Committee assure competent counselors or psychologists? By a written test? Is the state going to be able to set proper standards for make-up application for “aestheticians” or advisable interior decor of building for “interior designers?”

Threshold Test 4: Inability of Consumers to Judge Competence

There is a fourth group of trades improperly licensed. A number of these may involve encounters between consumers and trade persons where there is *not* a critical need for repeat business because of the one-time nature of each encounter. And there is sometimes the possibility of irreparable harm, perhaps even thought to warrant government intrusion of some sort. But are these situations where a final threshold test is met, an ability by the consumer to evaluate competence? Is assistance from the state needed because the consumer will be unable to make the evaluation himself? The Board of Landscape Architects has considered expansion to license “golf course architects.” How many consumers need the assistance of the state to pick a good golf course architect? Are those who do this hiring in need of such assistance, even assuming irreparable harm from incompetence? What about collection bureaus? Geologists? Geophysicists? Petroleum engineers? Shorthand reporters? Auctioneers? Auto dealerships? Nuclear engineers? Who decides to hire or use these people? Is the role of the state here the assurance of competence or the reduction of competition from out-of-state practitioners?

A prime example of a board coalescing three of the above four deficiencies is the Board of Fabric Care licensing dry cleaners. There is a requirement for repeat business assuring competence, a lack of irreparable harm and a system unrelated to competence. Safety problems are treated by Cal-OSHA. So what has the Board done? It has an interesting record. At its inception and for decades thereafter it focused on price fixing attempts, eventually passing a rule requiring misdemeanor prosecution fo anyone charging less than $1 to dryclean a suit (at a time when such a charge was profitable). Over the past decade it has revoked the license of exactly one drycleaner. But it administers a complex entry system. Cleaners are licensed by type, separately for three categories of clothing. The examination has little to do with competent cleaning or pressing and is not taken by those who *do* the cleaning and pressing, but by licensee “owners.” But the Board manages to keep out of the trade the majority of those who seek entry.

B. Ineffective Regulation to Ameliorate Pollution and Hazard External Costs: Standard Setting Gone Wild

The California Administrative Code is a nightmare of detailed instructions. Boards, commissions and agencies have engaged in rulemaking with little restraint over the past two decades. Boxing promoters are required to file seating charts of the arenas where they hold their matches — repeating charts already on file. Rules concerning ladders at building sites consume over ten pages. Optometrists are now required to know CPR (a rule which interestingly was dropped for physicians by their Board). The consequences of extremely detailed standards are well documented: individualized standards and exceptions often related to the legal resources of the parties involved, gratuitous technology stultification, waste, misallocation, delay.

The agencies of California have not used or even considered seriously non-traditional means to internalize external costs. The Water Resources Control Board, Cal-OSHA covering worker safety, air pollution control agencies, et al., rely on detailed standards and traditional enforcement. The standards not only suffer from the defects we have discussed, but they are not effectively enforced. The tendency is for each of these systems to describe what is now through their standards.

Very few agencies, to the extent they use rulemaking, promulgate generally understood and broad standards related to their mandate and then aggressively follow up with deterrent-producing enforcement. Instead, a “negotiation” pattern is followed. A rule is proposed. A hearing is held. The industry raises problems. Exceptions are drawn to meet those problems. A violation occurs. On the rare occasions where it is detected, the violation is remedied with a warning and request to comply, which, if compliance is difficult, will yield a request to alter the rule accordingly.

The vast majority of standards are only distantly related to a real external harm. Those which are have very little impact on the industry allegedly affected. Of course there are a few exceptions where there has been some impact, but a careful review will reveal that these mostly concern what are actually equipment standards. These have their own disadvantages, but are enforceable enough to check what otherwise might be a degeneration of an external harm. Auto pollution control, minimum sewage treatment processes and electrostatic scrubbers are examples.

It is a vast oversimplification to conclude that standards by an expert regulatory body should never be used. There are criteria which can justify rulemaking, as we have discussed, especially in combination with other mechanisms where there is irreparable harm without them, as with the regulation of physicians, attorneys, et al. But the brunt of standard setting emanates from agencies which, as we note above, do not need to exist in the first place. Where they do need to exist because of a real and irreparable external cost (e.g., Cal-OSHA, pollution control), the use of incentives which continuously and completely cover external cost production, provide relief for victims and do not misallocate resources, are not considered at the state level.

C. Regulatory Charade: Disguised Cartels

There are numerous areas of business suffering from serious market flaws. Some of these justify regulation at some level. But these justifications are often turned upside down by careless legislation and deferential courts. Two massive examples involve the regulation of agriculture and of alcoholic beverages, respectively.

In the case of agriculture, the external cost underlying initial government entry has largely turned on market volatility. Radical supply fluctuations create serious displacement costs as some farmers lacking a deep pocket to outlast an aberrational year are irretrievably driven out. Government intervenes to facilitate survival of small farmers to preserve vigorous competition and to smooth out violent market fluctuations.

At the federal and state levels, farmers were allowed to collude in the marketing of their products. These lawful cartels have functioned in federal so-called "marketing orders" to do far more than limit external costs. They have affirmatively engaged in price-enhancing traditional cartel practices: setting arbitrary "quality" standards and agreeing to limit the supply of their produce.

At the state level some of the same activity has occurred. Milk regulation historically, for example, has meant the division of milk into "classes" and limitations on the quantity and use of milk by collusive agreement of purported competitors. But most activity through state marketing orders has been to promote their product. There is nothing wrong with any entrepreneur promoting his product. But these entrepreneurs use the power of the state. They are able to coercively levy fees on all who produce a given product. Those who pay the tax are quite willing to do so since it is imposed on all competitors and acts as a tax passed on to consumers.

In California, the most active promoters are the agricultural associations promoting beef, dairy products and avocados. The newest board is one created to promote wine ingestion financed by large scale assessment of California vintners. Where is the external cost being ameliorated? Where is the external benefit being conferred? The power of the state is used to collect monies and organize promotion of beef, milk, cheese, avocados and wine. Is there any indication that the diet of Californians suffers deficiencies in these food categories warranting public involvement in their promotion? One would have to guess that these would probably be about the last foods any competent nutritionist would list in need of promotion, given their current levels of ingestion.

Alcohol regulation is an example of more traditional "licensing" which is not based on a market flaw, but which itself creates an unintended defect. Concerned about the proliferation of bars in San Francisco during rather wild times, the state intervened to "cap" the number of liquor licenses at one per 2,500 population for on-site drinking and one per 2,000 for liquor stores. Limits were set county by county except for those who were licensed when the limits were passed. These people were grandfathered in.

The system is now justified on the same basis as was vertical price fixing in liquor: there is an external cost implicit in the drinking of alcohol. Although land use controls limit the location of the bars and stores, limiting the number of licensees makes liquor a bit more inaccessible and expensive, discouraging consumption. (The California Supreme Court has rejected a similar argument on behalf of the fixing of resale prices for liquor by the manufacturer.)

The result of this system is the same as with more artificial barriers, e.g., the New Motor Vehicle Board approval system described above. It raises price. But by creating extra profit it attracts investment to the enterprise, enhancing promotion. The value of a license increases over time, a cost which is borne by consumers but not collected by the state. It is collected by the person selling the license. If one wishes to discourage liquor consumption, a laudable goal conferring an indisputable external benefit, simply increase the tax. Use the proceeds to finance alcohol abuse programs, perhaps even alcohol education efforts to counter state-organized wine consumption promotion.

D. Fraudulent Regulation

Is there another side to the misregulation coin? Are there areas where regulation is warranted, even to the point of comprehensive prior restraint licensing? Of course. We have mentioned medicine and law as two areas where the alternatives at least appear to be unworkable. Where there is such an overwhelming need for competence that we are prepared to violate the basic right of our citizenry to offer their services in the marketplace, we should have a clear reason for doing so. Where we may have such a reason, does it guide our regulatory system? The answer is no.

The two primary examples where the licensing alternative may be justified illustrate the irony of prior restraints. Although we impose licensing on physicians, we confer a single all-purpose license to "practice medicine." Who "practices medicine?" One may go to an internist, a urologist, a dermatologist, a neuro-surgeon. One must have a competent *urologist* if one needs kidney treatment.

There is a connection between a competent urologist and the general state license, but it is very indirect. Certainly, the licensure barrier keeps out those who are of particularly low general aptitude, although certifying medical schools appears to do that. But there is no significant testing of any physician even *measuring* to any relevant degree special competence in the area where he or she will be spending the rest of a professional life. As far as the *state* is concerned, a urologist can perform brain surgery. Perhaps malpractice fears (a rule of liability) or insurance requirements or private (e.g., hospital or private trade association) certification help limit such wandering, but these controls are unrelated to licensing.

Although the medical barriers to entry are severe in difficulty, and only distantly related to actual competence as a physician practices, there is little attention given to ensuring the competence of those who have made the club. Malpractice judgments are not even systematically reviewed.

Unsurprisingly, very few physicians of any description have their licenses revoked for anything short of felony drug or rape offenses.

Although the maintenance of competence in medical specialties requires constant re-education, there is no continuing education requirement. There is no re-testing at any point. (Note that nurses are, in contrast, required to submit to continuing education.)

Virtually an identical critique could be applied to the regulation of attorneys. No attorney practices immigration law, estate planning, criminal defense, patent law, tax law, divorce law and antitrust law. Attorneys may practice in more than one area competently, but no attorney can practice competently in a substantial number of the twenty-odd specialties which have evolved. As far as the state is concerned, they are perfectly free to do so. A patent attorney can defend a capital murder case.

The consumer expects that the onerous prior restraint of licensing assures counsel competent in the area where there is a problem needing services. The state does not do that. As with medicine, the Bar tests graduates on general principles unrelated to particular knowledge in most areas of actual practice. It is true that persons with an ability to answer Bar questions will, in a very general sense, be somewhat more likely to gain competence in a given area of practice. What the state really tests is general aptitude, not relevant competence. A simple alternative to the massive regulatory systems in place: the required disclosure of schools, degrees and grades of physicians and attorneys (based on hundreds of examinations) provides a far better measure of such aptitude and some information about expertise.

As with medical regulation, the Bar does not require specialized competence of any kind, continuing education of any variety or re-testing. And its record of policing incompetence from within the existing profession is virtually non-existent. In California, for example, approximately 25 attorneys have their licenses revoked annually out of over 90,000 members of the Bar. Most of these have their licenses restored in short order. Once again, felony offenses against their own client is the basis of most of the revocation activity, such as it is–although one attorney was recently sanctioned for writing undignified remarks about a judge in an appellate brief.

If state determination of the right to do business is justified, given the extraordinary cost in the sacrifice of a basic freedom, it must occur only because of an extraordinary need for competence to avoid irreparable harm. Such a need means that the system must provide what its justification demands. This can be expected to mean not just a scorpion's club initiation ritual (scorpions are said to form a ring when attacked, like a besieged wagon train, each facing their sting-inducing tail outward toward the intruder). Justification demands proof of competence in the specific areas of practice where reliance occurs, continuing education, periodic testing and the assiduous removal of those who do not maintain their skills.

The message conveyed here can be summarized: use prior restraints only for good and unavoidable reason—but if the reason is there, fashion the system to it in a bona fide fashion. If competent practitioners are critical then by God assure competent practitioners in the areas where they practice and are relied upon.

It is ironic that in the several areas where such prior restraints may be warranted, they are not applied in good faith.

VII. HOW TO REGULATE

Assuming a good faith basis for a regulatory system, particularly one appropriate for a licensing format, how should it be accomplished? How should it be monitored? What ancillary remedies (in addition to licensing powers) may be appropriate? Our watchword in analyzing structure, authority and standards is to preserve the basic check in the American system: the independence of the state. These systems exist because the marketplace is flawed. Its restoration or substitution must be entrusted to those who can represent the interests of the general citizenry in whose interests the intervention occurs.

A. Structure

1. Level of Regulation

State regulation may not be viable where it unduly burdens interstate commerce, or state systems imposed with variations between states affects a highly mobile regulated group. Only a national or international system can prevent jurisdictions from being played off against each other, to gravitate toward the lowest common denominator. E.g., so long as Delaware offers minimal standards for incorporation, to what degree can individual states require more? Perhaps they should not require more, but the false competition for revenue between states is not conducive to a common rule which might ameliorate a market flaw. To impose such a curative rule it must be adopted at a level where it can be effective and cannot be avoided easily.

An Athletic Commission regulating boxing cannot reasonably function where it depends for revenues on gate tax receipts from high attraction matches and promoters can schedule events in any one of fifty different states. Promoters simply avoid the gate taxes, boxer pension systems, or safety-orientated regulations of any given state by seeking the state with the lowest regulatory standard.

Most regulation, however, does not unduly burden interstate commerce and does not involve a highly mobile licensee group. Regulation may involve legitimate differences between the cultures and peoples of the various states. Most regulation may be expected to occur at the state level.

Regulation at the local level may suffer from the same kind of destructive competition *vis-a-vis* the state that state regulation may suffer *vis-a-vis* the federal government. Except such destructive competition is much more likely given the relative mobility of practitioners in commerce within given states. Furthermore, although the nation has a tradition of direct local democracy, in fact, the reality of local government is quite different.

Local governments have been so fragmented by geography, function, and type, that direct democratic response is limited. Although there are equivalent problems at the state level with regard to gerrymandering, campaign contribution influence and other forms of abuse, at the local level these forms of abuse are supplemented by the relative invisibility of local officials. Los Angeles County, for example, includes 342 special districts. Each one of these districts performs a very fundamental and important governmental task. Special district governance at the local level accomplishes everything from mosquito abatement to parks, education, provision of water and other essential functions.

California has 5,000 special districts, 480 cities, and 58 counties. The special district, city and county lines do not follow rational boundaries. Drawing all of the governmental bodies within one urban county on paper would scarcely leave an unlined area. The shapes of the districts are not compact. Cities often run in corridors one hundred yards wide by ten miles long in order to capture a piece of tax-valuable property at the end. The governments of special districts are sometimes elected, and often appointed. The precise boundaries between cities and counties often go down the middle of the street, sometimes to one side, sometimes to the other.

Surveys of citizen awareness of fundamental local government functions has revealed responses concerning who provides basic water, trash, police and fire services approximating what one would expect with a roll of the dice: random guesses. Although local regulation may be advisable in a system where there is a multi-purpose government visibly governing a recognizable and compactly shaped area, that is not what we currently have. Local government, in the area of land use, “exclusive franchises,” the letting out of preferential contracts, et al. manifests the most egregious abuse of any level of government.

Any system of local regulation depositing in the hands of local officials the authority to decide who should or should not practice a trade, who should or should not have a monopoly in a given enterprise, et al., should be accompanied by a state authorizing statute designed to systemically preclude abuses. The statute must specify the restraints of trade to be allowed, and provide for required checks to compensate for the absent marketplace. This minimal requirement is presumably the law of the land. The United States Supreme Court has declared the “state” to be the antitrust gatekeeper. Before a regulatory restraint of trade can contravene the federal antitrust statutes, the state must fulfill its obligations as sovereign. It must specifically authorize any restraint and provide for “independent state supervision,” it cannot deliver a “blank check” to local government.

Examples of abuse proliferate. The starkest is in the area of trash hauling, where a trade association was able to obtain such a blank check for commercial trash hauling, normally subject to competition. The state law simply declared any arrangement approved by any of the 5,000 special districts, 480 cities, and 58 counties immune from antitrust exposure. The law issued such a blank check that monopolies without any possible competition or required rate regulation and lacking even competitive bidding were permitted. Local officials in the fragmented setting of local government could allow only one trash hauler into their jurisdiction to service businesses, apartments and construction sites, and make that monopoly grant worth millions of dollars. The largest firm dominating this industry is now successfully obtaining "exclusive franchises" (monopolies) throughout the state. Such an abdication by the state creates an atmosphere ripe for corruption as well as the violation of the most elementary principles of regulatory law.

B. Who Should Regulate

In most states, regulatory agencies consist of the trade, profession, or industry regulated. Such a system contravenes fundamental constitutional principles. We live in a system where the most fundamental civics concept commands that our government, the "state," represent the people. The state does not represent economic interests with a narrow profit stake in public policy, it represents the general public; the diffuse interests of all of us as citizens. It represents our concerns for the environment, the future and ourselves as a whole. We do not require governmental intervention if all it does is to replicate the functions of a private cartel.

Those persons making decisions on behalf of the public, precisely because the public has an interest separate and apart from the entities of profit stake interests, must have only the public at heart. It should be a fundamental axiom of American government that those regulatory bodies making decisions on behalf of all of us, and invoking the awesome power of the state, must not consist of those with a proprietary profit stake in the public policies being formulated. Yet in California and in almost every state to yet a greater degree, such is the case. By direct operation of law a majority of members of the Board of Medical Quality Assurance in California consists of physicians. The majority of the members of the Board of Accountancy consists of accountants. Even those boards which include "public" members count among them persons (for most agencies they constitute a voting majority of a quorum) with a direct profit stake in the public policies being formulated.

It is one thing for profit-stake interests to form trade associations to provide information, advice and opinion to government decision makers. It is quite another thing for them to be the government decision makers. Such a pattern transgresses fundamental notions of due process and cannot be tolerated in a constitutional democracy.

What is perhaps most interesting about current state regulation throughout the nation is the likely wholesale contravention of federal antitrust and Constitutional principles by these systems. The United States Supreme Court threw out the attempt by the Alabama Board of Optometrists to sanction an optometrist (*Gibson v. Berryhill*). The court held it violated fundamental notions fo due process to have state officials with adjudicatory powers currently competing, however indirectly, with an object of Board enforcement. Most recently, California courts have tentatively voided part of the New Motor Vehicle Board Act because three of the Board's seven members are auto dealers and are therefore institutionally biased. An amendment was then passed precluding the vote by the dealers in any matter involving other dealers, but an appellate court has found that their very presence on the Board taints it. Meanwhile, federal courts are requiring state agencies which restrain trade to be immunized from federal antitrust exposure only if the state provides *independent* state supervision, i.e., supervision by state officials unconnected to those with a proprietary stake in the policies being formulated.

These precedents, if consistently and properly applied, void most of the current state regulatory systems in all fifty states—and they do so quite rightfully.

C. Funding

Almost all regulatory agencies are "special funded." That is, the industry or trade regulated is assessed charges which go into a separate fund financing the budget of the public agency regulating it. On the surface, an industry or trade producing an external cost should not only have that cost internalized if possible, but the cost of doing that internalization should also be internalized. However, the direct tie between fees and budget is improper. The legislature should first decide how an industry's or trade's market flaws should be addressed, determine the amount of money necessary to accomplish that end, and then and only then attempt to assess that industry or trade an amount not too different from that cost.

There are circumstances where such assessments may not be realistic. The Athletic Commission, for example, gains monies from gate tax receipts. Only "big" matches produce significant revenue, but promoters will take those matches out of California to avoid taxes. Where the external benefits of a regulatory system extend to society at large or where destructive interstate competition precludes collection, some contributions form the general fund may be warranted.

The other side of the same issue is the tendency of the legislature to see all special funding as free. A hidden tax without political resistance is considered no tax at all. Hence, any suggestion by a trade or commercial association to set up a licensing system funded by themselves is viewed as a proposal without political liability.

All monies collected from regulatory fees should go directly into the general fund. Budgets should be drawn from the general fund based on the public interest in the expenditures to be made. Then the legislature's finance committees should periodically adjust fees to approximate the money being spent where appropriate, which will usually be the case. The effect of this procedural change is to focus legislative attention on these budgets as public expenditures—which is what they are. They should compete for priority. And agencies should not be in the conflicting position of having to approve an unwise but revenue-producing boxing match or another remunerative examination entry barrier in order to add new equipment or more secretaries for their own shop. Nor should agencies be compelled to eschew removing the incompetent because of budget constraints. The revocation of a license is an expensive proposition. Currently, agencies pay for their own counsel, an administrative law judge and court reporter. For small agencies, the costs are formidable. And they are a very real bar to aggressive internal "clean ups" in the rare cases where the spirit is willing. Where budgets depend upon after-the-fact increased license renewal fees from those currently licensed, the prospects of major increases supported by a trade to finance internal policing are not sanguine.

The funding of such regulatory bodies is one fo the few areas where Parkinson's Law that expenditures rise to meet income should be reversed, income should rise, after the fact, to meet expenditures. This is a very bad idea in public works and benefits budgeting, of course, but not in the financing of regulatory system mechanisms.

D. Bifurcation of Executive/Adjudicative

Regulatory agencies are very special legal creatures. They are given a very general mandate by the legislative branch to address a social purpose — often defined in a single clause. For example, the Federal Trade Commission is empowered to deal with undefined "deceptive advertising" and vaguely defined "unfair acts in competition." Agencies perform a major quasi-legislative role to fill in detailed meaning consonant with their authorizing statute's intent. Agencies "adopt rules." And they adopt thousands of them. State Administrative Codes now rival in extent and certainly surpass in detail the whole body of annually enacted statutes by state legislative bodies.

Rulemaking establishes standards of behavior which are often intended to give predictability and warning to agency action. Where there is a violation of a rule, the remedial powers of the agency may be invoked, powers which vary from the entry of an order to halt a given practice, to revocation of one's license to do business.

In enforcing its rules, the agency performs an executive function. It detects violations. It establishes enforcement priorities. It prosecutes the case. There is no conflict between the rulemaking and enforcement roles. But the regulatory body often fulfills yet a third role, a judicial one. For having decided to prosecute a violation of its statute or rules, it also establishes the procedures for "hearings" on the charges. And it even serves as judge. It may make findings of fact.

The dual prosecutorial/adjudicatory role is a troubling one in a common law adversarial system. Certainly state Administrative Procedure Acts provide due process protection. And there is court review. But the fact remains that the entity who made the rule and who decided to prosecute is also sitting as judge. And court review is a very limited check given the deference paid to procedurally proper agency adjudications.

There are several ways to cure this imbalance. One is to use the Office of Attorney General or some other independent office as prosecutor. Staff simply turns over information concerning compliance to a separate entity with its own discretion to prosecute or not to prosecute. Another alternative for larger agencies is to restructure the agency as Commissioner Phil Elman has suggested for the FTC and as the California PUC has done: to bifurcate the agency staff. Those who perform as prosecutors or advocates are separated out into their own department with separate lines of authority from the "Commission" and its adjudicatory staff.

A more radical alternative would give a separate "Department of Consumer Affairs," which most states already have created, power to conduct investigations of violations and to prosecute them before the agency.

E. Representation of Diffuse Interests

Regardless of the reforms undertaken, regulatory agencies are bound to reflect "intensity of interest." That is, those with their won stake in agency policy will turn their attention to its influence. Even neutral board members will be subject to the regulatory environmental described below. Trade association advocacy can be expected.

But since the agency exists to counter market flaws, it is critical that information and advocacy not be dominated by those whose interests often represent the very abuses the system was established to prevent or minimize. Several structural adjustments can facilitate a balanced consideration of the more diffuse interests which are otherwise underrepresented.

The first measure is the creation of an adequate and structurally independent staff. The "deferred bribe" of agency apprenticeship followed by trade employment must be precluded by terms of employment which prohibit employment with the trade regulated for at least several years after leaving the agency.

The second structural reform is the stimulation of those diffuse interests affected by an agency's actions to organize and represent themselves to counter the automatically organized profit stake interests. An agency, of course, should comply with the "sunshine" "standards of operation" discussed below. But beyond this, an agency can implement generous standing requirements to appear before it and argue, particularly in the rulemaking area. Proposals for de novo rulemaking should be entertained without standing impediments.

Some agencies can go much further to allow diffuse interests to have a role. The California PUC has allowed the Utility Consumers Action Network (UCAN) to gain access to the bills of the local utility. The bills mailed out to ratepayers have always been financed as an expense item off the top by the ratepayers. The proponent for access proved there was "dead" or unused space in the envelopes requiring no additional postage. UCAN communicated with ratepayers, solicited funds, conducted elections. Over 75,000 ratepayers have joined the organization. The voting percentage of electors in the election of the Board of Directors was double that of the municipal elections. The organization is now funding professional and organized advocacy before the PUC. This organization has democratically institutionalized advocacy of an otherwise underrepresented group. It cost the taxpayers nothing. It cost the ratepayers nothing. The regulator simply used an available asset to facilitate more balanced advocacy before it. The requirements in the proposal for fair elections are of special import. They assure that the advocate is a legitimate representative of the interests it purports to represent and they remove any taint that the regulator may be favoring any particular consumer group in allowing access.

Related to the UCAN reform is intervenor funding, allowing those who are able to represent diffuse interests and who benefit the regulatory process, to recover costs and fees. The California PUC has laudably adopted such a procedure.

Another structural feature which can address the profit stake vs. diffuse interest imbalance problem is a general Office of Consumer Advocacy, either within an agency or within the larger administration. Such an office can professionally represent diffuse interests where they are not capable of organization.

F. Proper Authority

Assuming a structure amenable to regulatory policy in the public interest, how should the authorizing statute be framed?

1. Statutory or constitutional

The first question is where should it exist, in the State Constitution or in statutory law? The answer is in statutory law. States nevertheless are persuaded by interest groups to put enabling provisions straight in the most fundamental document underlying our state. In California, our sacred guarantees or free speech and religion adjoin provisions creating a Board of Chiropractic Examiners, a Horse Racing Board, an Athletic Commission, a Board of Osteopathic Examiners, the State Bar and the Public Utilities Commission. One of the effects of such folly is the creation of regulatory arrogance. The State Bar contends that it is exempt from the open meetings and public records sunshine laws of the state. The Board of Osteopathic Examiners refused to seat two public members appointed by the Governor, contending that it did not have to obey a statute adding two public members to its Board since it was "created in the State Constitution." The Athletic Commission notes that it does not have to comply with the Administrative Procedure Act.

If one were to create an exalted class of platonic regulators, this is not the crew one would assemble. There is no need to put any regulatory system designed to address a market flaw in so basic a document as a Constitution.

2. Specificity

The second feature of the authorizing statute, apart from its creation of *only* public members to make decisions on behalf of the public, is specificity. The means assigned to compensate for a marketplace flaw must be set forth. If one allows a created board to "license" methodone clinics, does that mean it can specify how many staff must be on premises? How many medically qualified patients a clinic may treat? What prices may be charged?

The law must allow for flexible response, but within some range of specified options.

3. Remedies

Confer remedies to address effectively the market flaw. The Federal Trade Commission is given the task of policing deceptive advertising, a task impossible without deterrent punch. Its major remedy is the right to issue a complaint and establish a "cease and desist order." This order takes, on the average, 4.17 years to establish where it is contested. There is no prohibition on advertising and no sanction of any kind unless that cease and desist order is violated (or a similar one you have been served with). Since that will not happen for 4.17 years, what is the message conveyed? Is it, do not deceptively advertise or we shall sanction you more than you would gain? No. The message is: do whatever you want. We guarantee that we shall do nothing to you for four years or more. Only after we get our cease and desist order in place are penalties possible. So our remedy is actually a license to deceive — a grant of immunity.

By the same token, it is a mistake to confer only a single extreme remedy. Boards such as the California Contractors State License Board had only the draconian power to suspend or revoke licenses for many years. It could not fine. There was no gradient of sanctions consistent with the spectrum of wrongs it can be expected to address. Faced with depriving someone of his livelihood or doing nothing, it usually did nothing. Several years ago it was belatedly given the power to fine.

4. Who is regulated

The authorizing statute should define precisely what functions require licensure. The devolution of jurisdictional authority to the agency itself under a vague mandate leads toward excessive regulation. There is a marked tendency for boards and commissions to impose "prior restraint" licensing not only on the fundamental profession or trade capable of alleged irreparable harm, but directly to the ancillary services tangential to the enterprise. Hence, instead of licensing dentists and holding them responsible for their employees, the Board chose to directly license those employees, now under the appellation "dental auxiliaries." Real estate brokers are responsible for any transaction conducted under a broker's license and are fully responsible for the actions undertaken with apparent authority by salespersons working under the "license" of that broker. Nevertheless, the Real Estate Commissioner is licensing all salespersons, several hundred thousand of them. The Athletic Commission, as we have noted, is an extreme example. Although boxing promoters are fully responsible for their events, the Commission has licensed almost everyone they employ, from announcer to ushers, to even the ticket printers.

Some of these paternalistic expansions have occurred by the legislative direction, almost always at the behest of the trade involved. Others have been accomplished by the board or commission operating under an excessively vague statutory charter.

Often the motivation for such expansion is the creation of a "client" group of employees by the prime trade under regulation. Required apprenticeship as a part of licensure qualification can be a cheap source of labor while the apprenticeship is underway. Those who presently practice the ancillary function may support it because they will likely be grandfathered in and the licensing requirements serve as a barrier to entry increasing the long term value of their position. Well intentioned regulators can be persuaded to endorse expansion by a few egregious cases of abuse by these subordinates, and by a natural desire to territorially expand-often for the most beneficent of reasons.

Authorizing statutes should confine prior restraints as narrowly as possible. If there is one trade or profession whose members control an operation, those who are hired by that person, who have their work reviewed necessarily by him or her, need not be separately licensed except in the most extraordinary circumstances. The real estate broker, dentist, physician, etc. is well able to perform a far superior screening function than the mass testing process of standard licensing. Here is the person who reviews background and qualification carefully and individually because he or she is responsible and has both insurance and licensing on the line. The employee must work directly with the prime licensee day by day. A failure to review, an incompetent choice, and resulting harm to those protected by the regulatory system, can give rise to strong sanctions against the persons who are in the best position to hire, supervise the work, judge competency. Such a system avoids prior restraints while making responsible persons far more able to make these decisions than any single testing procedure. License dentists, doctors, brokers, boxing promoters, contractors, and hold them absolutely responsible for persons operating under their respective licenses as employees or subordinate contractors.

G. Standards of Operation

There are too many operational issues for comprehensive treatment in this forum. But two intra-agency issues belong in any discussion of reform.

1. Sunshine

Agencies have an obligation to operate publicly. The sunshine laws of most states which require open meetings and public records are sometimes avoided not only by those agencies with Constitutional identity, but by others subject to the law. To comply with the spirit as well as the letter of the law, members of small boards should not associate socially, the materials used by Board members at meetings should be available to the audience since meetings are incomprehensible without these materials, and document reproduction costs should be reasonable. It is remarkable how much mundane restrictions can bar public access.

2. Entry barriers

Entry barriers are the single most troublesome agency operation. Barriers should be imposed fairly and in a timely fashion. For example, a student attends a law school, an institution the Bar declares is acceptable to it, where a degree is a qualification to take the Bar examination. This institution takes $6,000 to $8,000 of hard-earned money. And it takes one year of his life. The student succeeds, passes basic courses and is promoted to a second year. The same thing occurs. Then into the third year. The student has expended three years of his life, over $20,000 in tuition and many more thousands in lost wages and opportunities elsewhere. But he or she is given a Juris Doctor degree. The university certifies the graduate as qualified not only to practice (which is presumably why people go to law school), but to hold a doctorate degree. Then the Bar flunks a large portion of those people. In California, the majority of those taking the exam are flunked. For some of the twice-yearly exams, the passage rate has been below 40%. For many of the law schools the passage rate is below 20%, for some consistently below 15%. Is something wrong here? To be sure, we inveigh against the state depriving anyone of an opportunity without good reason. But if we have a good reason to limit entry, is there any reason we lead so many down the primrose path for so long? If we're going to say no, why not say no a little earlier on? Why should the Bar preside over the gratuitous tragedy of so many? Why are schools certified which achieve less than 50% passage rates, much less 20%?

To be fair, entry barriers should relate to the kind of competence consumers will be relying upon. They should not be exercises in raising the drawbridge. Is it really necessary for an architect to know about the contents of an Egyptian tomb?

It is amusing to hear some laud the United States Marines who saved the medical students studying in Granada. We hailed as heroes the protectors of those important Americans. Did we do them a favor in allowing them to continue their studies? How many are going to achieve entry into the profession they were there to seek? They will be saved and brought home to White House gatherings, after which state medical regulators will attempt, with predictable success, to bar their entry into the profession.

The entry process itself should somehow measure the skills and information needed to perform. Few entry systems short of apprenticeships assure much more than a commitment to the enterprise and general aptitude.

Perhaps one of the more fascinating examples of entry irrelevance is the real estate sales and brokers exam. This is a multiple choice question examination. The difficulty and ambiguity of a multiple choice question is well known. And the questions are excellent. In fact, there are very few brokers who know the answers to them. The exam is honed by a process of reverse natural selection. Any question successfully answered by a majority of the examinees is dropped and a new one added. One can imagine the breed of those which remain, year after year. So how does one pass? A series of schools send in spies who memorize questions and answers and put together actual test questions and answers from exams going back three or four years. Most of these questions will be on the next exam. They are memorized. The critical barrier to entry is an ability to memorize and a willingness to pay one of the schools their substantial fee. The fee is a barrier to entry, which the state general fund could perhaps better use.

VIII. REGULATORY OVERSIGHT: THE ENVIRONMENT

Regulation exists in a political environment. These are public agencies. They must go to the Governor's Department of Finance for budget approval. They must submit to scrutiny by the legislature. They must deal with the general auditing and review agencies under the legislature and the Governor.

A. Horizontalization

The politics of regulation fully reflect what a sociologist might call the "horizontalization" of our society. We are less a nation of owner-operators than ever before. We are increasingly a nation of employees. We are organized around our peer groups. We identify with our peers. The prosecution of hospital kickback schemes by this author illustrated not only the well-documented vertical alienation between the hospital administrator and patient - but the concern of the administrator over what peer administrators in competing institutions are thinking and doing.

Politically, the horizontalization can be seen in burgeoning trade associations, thousands of them in Washington, D.C., and hundreds in most major state capitols. The massive, modern buildings housing the National Coal Institute, American Petroleum Institute or the American Association of Railroads would not be mistaken for the site of a PTA meeting.

Although we have described the counter measures which can be taken to preserve some balanced advocacy before agencies, the campaign contribution and advocacy imbalance between profit stake interests and the general public interest is more serious in the surrounding legislative environment. On the positive side, the somewhat higher visibility of the legislature and possible contention between a greater mix of interest groups does create opportunities. One might build a coalition of interest groups who are not directly involved themselves in a given issue. If they can be persuaded to participate, they may represent a broader interest than the legislature would otherwise hear from, on issues apart from their primary concern.

However, there are structural and practical obstacles to an independent legislature. At a practical level most states lack even a critical mass of public interest private advocates to build a coalition. One study of land use policies in California surveyed lobbyists before the state legislature. There were 235 representing various profit stake interests. Two represented the general public, the taxpayer, the environment, the consumer, the future. And where an agent for coalition building appears, it is often difficult to persuade a narrower lobby to expend political capital on behalf of a cause outside the narrow mandate of the sponsoring association.

B. Campaign Finance

The direct corruption of campaign contribution influence is more lethal to the integrity of the state than is advocacy imbalance. The impact of more expensive campaigns and trade association contribution dependence has so undermined the independence of the state that the most basic check in the American system is in jeopardy. The solution may be politically difficult without major citizen upheaval. Only the public financing of campaigns, with fair rules for competitors, can remove what is now, at the risk of perceived hyperbole, nothing less than a dagger plunged into America's breast.

California has its quota of Lloyd Connellys, legislators who are willing to do the hard work to pierce into state government on behalf of broader interests. It is important that public financing occur to create more of them and to free those extant from the burden and shame of begging, however dignified it may appear. Contributions, even among the most ethical of legislators, buys at least access. Given time constraints on legislators, that is no small compromising commodity.

C. Oversight

What the regulatory environment needs is independent legislators with time and staff to oversee as well as to service. Rather than the benign nonfeasance of agency attention to keep it out of the general fund or to please a vocal constituent, there should be a schedule of oversight hearings. Each agency should have to expect a tough set of hearings at least once every three years on its performance in what will be a relatively more public forum than the agency's own environment creates. At present, it must account to very few indeed.

D. A Bold Reform: An Office of Administrative Law

One of the major oversight reforms attempted by the legislature created an Office of Administrative Law. This was a bona fide attempt by the legislature to clean up what it believed to be excessive and nonsensical rules by the state regulatory system. Recognizing its inability to oversee with the kind of detail needed to have a real impact on the many agencies , it created an executive branch entity to complete the task. As an experiment in regulatory reform, it was imaginative and bold. And it has achieved some successes. After four years of operation it is now possible to gauge more clearly what such a body can and cannot do responsibly.

The Office of Administrative Law was given the power to review existing rules and to approve new rules as they are adopted. OAL consists of a staff of some twenty young attorneys. They are empowered to use six criteria in reviewing a rule: reference, non-duplication, consistency, clarity, authority and necessity.

One can see the impact such a review may have on rulemaking. For example, conservative scholars have quite rightly critiqued many of these agencies for *ultra vires* rulemaking beyond any legislative mandate. Although there is a basis for legal challenge where an agency acts without authority, who is to sally forth with the challenge where the licensees enjoy a cartel benefit from the rule? In fact, well under 1% of all rules are challenged in court at all. This Office will now review each and every rule for proper authority. That is a momentous change.

Two problems exist which independently threaten this generally thoughtful idea - each will create a monster far worse than any abuse addressed by the new law. First, the sixth criteria, "necessity," is inappropriate for review by the Office. Whether a rule is "necessary" is a shorthand way of saying "sensible," "advisable," "a good idea." But the twenty attorneys who sit in the Office of Administrative Law have no knowledge of the substance of the regulation they are reviewing. They do not attend hearings. All they have before them is a file summarizing public comments and the agency's response.

It is possible that an Office of this kind can perform an academic "legal" review of rules. It can evaluate the statutory authority. It can address the clarity of the rule. It can survey for duplication and consistency. But to give it the authority to reject rules because of its perception that they are not "necessary" is a task which cannot be responsibly performed by them. This inability to second guess in ignorance is one of the reasons courts are not allowed to overturn normally the findings of the trier of fact. Courts, as outside parties not present at the hearings, will examine proper authority and may critique in dicta lack of clarity. But they generally will not intrude into the expertise or fact finding of an agency. And they hesitate for good policy reasons.

Theoretically, the Office could argue that it merely examines the rulemaking file to make sure that there is some factual basis for a rule. But what does this mean? Does it mean there must be some words of justification placed after each clause in a rule? Does it matter what the words say? If it does not matter it is a futile exercise. If it does matter, who is judging whether the words provide justification such that the rule is "necessary" or "a good idea?" How is it making that judgement?

The eventual result of this process is two-fold. First will be the rejection of many rules which are quite necessary because of a technical failure to include a factual justification for a provision nobody contests. The second is the advent of gamesmanship. The agencies learn what words to use to justify what they want to do. Since the Office of Administrative Law lacks any expertise whatever in the area, since the process is not adversarial and the agency can provide whatever it wishes and since factual justifications exist for everything from nuclear war (population control) to banning rock and roll music (damage to the inner ear), a great deal of impressive-looking paperwork will be produced.

Both consequences are now occurring with a vengeance, and the net result is, as the cynics would have predicted, far more red tape and regulatory delay than would now be the case without the reform.

The second flaw is the allowance of ex parte contacts between private parties and the Office of Administrative Law. The Office can and will become a conduit for improper reversal of rules by those who lost in the public forum but who now can meet secretly with officials from this Office and lodge complaints properly rejected or never made in the public forum. The Office in California has not only allowed such improper contacts, it has at least historically encouraged them.

The Office of Administrative Law idea is a reform of some promise if properly harnessed, and of great danger if not itself reformed.

IX. CONCLUSION

A first imperative is to articulate a defensible theory on which to base a regulatory system. The state must identify the flaw to be addressed, and specify a means of amelioration precisely addressing it.

We have created some 60 regulatory agencies in California. They operate largely invisibly, with little legislative or public scrutiny. Many operate where there is no significant market flaw to address or consumer benefit resulting. We have expanded existing regulatory agencies into areas where they have no business. Where we have regulatory agencies with a legitimate purpose and a real market flaw to address, we have avoided that task in favor of cartel practices. And we have the system dominated by those with a narrow profit stake in the public policies they are adopting and imposing on all of us with the force of the law and in the name of the state.

While creating paternalistic rules and raising barriers to entry, few of the boards or commissions in the State of California, even those covering professions which create irreparable harm and whose regulation can be justified, have attempted to remove those currently practicing who are incompetent and who create that irreparable harm.

And the agencies continue to expand and new ones to proliferate. More and more trades and businesses are falling under the rule of "prior restraint." Alternatives are unexamined. We can be a psychologist when and if the state tells us we can, and what is worse, the Committee deciding consists largely of psychologists.

The Soviet system is comprehensive in its stultification. There, prior restraint does not require market flaw justification. It is presumed. And the system has the one failure which has long been anathema to the American experiment: a lack of checks and balances. In socialism there is no check between the state and the means of production. The state owns and operates the means of production. There is one system evolving here which is perhaps worse, and just an inimical to American principles; a system where that check is also obviated, except the means of production own and operate the state.

Chart A

<u>**Flaw**</u>	<u>**Societal Response**</u>
I. Natural Monopoly	1. Structural Change to Restore Market
	2. Maximum Rate Regulation/Management
	3. Government Ownership
II. Scarcity	1. Market Sale
	2. Qualification
	3. First Come
	4. Line
III. Adhesion/Imperfect Information	1. Structural Change
	2. Consumer Education
	3. Disclosure Requirements with Nonmechanical Remedy
	4. Certification by the State
	5. Regulation by Permit with Rulemaking
IV. External Costs	
A. Damages	1. Internalize through Required Tie-In
	2. Internalize by Tax Transfer
	3. Internalize by Marketing Rights Sale
	4. Equipment Standards
	5. Harm or Output Standards
	6. Internalize by Judicial Assessment by:
	a. Rule of Liability
	b. Procedural Reform
B. Damages with Possible Inability to Assess/Collect	1. Bonding/Insurance Requirement
	2. Preliminary Relief
C. Damages with Health and Safety Irreparable Harm	1. Mechanical Tie-In by Statute
	2. Straight Civil Prohibition with Preliminary Relief
	3. Public Prosecution (Civil/Criminal)
	4. License Revocation

Chart B

California Flaws

List of Agencies	1	2	3	4	5	6	7	8	9	10	11	12
Board of Accountancy	?		✓	✓	✓	✓	✓	✓	?	✓		
Board of Architectural Examiners		✓	✓	✓	✓	✓	✓	✓	✓	✓		
Athletic Commission		✓			✓			✓	?		✓	✓
Bureau of Automotive Repair					✓	✓	✓	✓		✓		
Board of Barber Examiners	✓		✓	✓	✓	✓			✓			
Board of Behavioral Science Examiners	✓	✓	✓	✓	✓	✓	✓	✓	✓			
Cemetery Board				✓	✓	✓	?	?	?	✓		
Bureau of Collection and Investigative Services		?				✓	✓	?		✓		
Contractors State License Board		✓	?		✓	✓	?	✓	✓	✓		
Board of Cosmetology	✓	✓	✓	✓	✓	✓			✓			
Board of Dental Examiners		✓	✓	✓	✓		?	✓	✓	✓		
Bureau of Electronic and Appliance Repair	✓	?				✓	✓	?				
Board of Fabric Care	✓	✓	✓	✓	✓	✓	✓	✓	✓			
Board of Funeral Directors and Embalmers		✓	✓	✓	✓	✓			?	?		
Board of Registration for Geologists and Geophysicists	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
Board of Guide Dogs for the Blind						✓		✓				
Bureau of Home Furnishings	✓	✓	✓			✓	✓	✓	✓			
Board of Landscape Architects	✓	✓	✓	✓	✓	✓	✓	✓		?		
Board of Medical Quality Assurance			✓	✓	✓			✓		✓		
Acupuncture Examining Committee			✓	✓	✓			✓		✓		
Hearing Aid Dispensers Examining Committee	✓		✓	✓	✓	✓		✓				
Physical Therapy Examining Committee		?	✓	✓	✓			✓	✓	?		
Physician's Assistants Examining Committee		✓	✓	?	✓	?	?	✓	?			
Podiatry Examining Committee		?	✓	✓	✓			✓	?			
Psychology Examining Committee	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
Speech Pathology and Audiology Examining Committee		✓	✓	✓	✓	?			?			
Board of Examiners of Nursing Home Administrators		?	?	✓	✓	?	?	✓	?	✓		
Board of Optometry		?	✓	✓	✓	?			?			
Bureau of Personnel Services				?	✓	✓	?	✓				
Board of Pharmacy			✓	✓	✓			✓		✓		
Board of Registration for Professional Engineers and Land Surveyors	✓	✓	✓	✓	✓	✓	✓	✓	?	✓		
Board of Registered Nursing		?	?	✓	✓			✓	?	✓		
Board of Certified Shorthand Reporters	✓	?	✓	✓	✓	✓				?		
Structural Pest Control Board		✓	✓	✓	✓	?						
Tax Preparer Program			?	?	✓	✓	?	✓		✓		
Board of Examiners in Veterinary Medicine		✓	✓	✓	✓	?		✓	✓	✓		
Board of Vocational Nurse & Psychiatric Technician Examiners			?	✓	✓	✓		✓	✓	?		
Department of Alcoholic Beverage Control	✓	✓	✓			✓	?		✓	?		
Banking Department		✓	✓		✓			✓		✓	✓	
Department of Corporations		?			?		✓	✓		✓	✓	
Department of Insurance		✓	✓		✓			✓	?	✓	✓	
Department of Real Estate		✓	✓	✓	✓	?		✓	✓	✓		

Chart B (cont'd)

California Flaws

List of Agencies	1	2	3	4	5	6	7	8	9	10	11	12
Department of Savings and Loan		✓	✓		✓			?	?	✓	✓	
Cal-OSHA		✓				✓	✓	✓		✓	✓	
Department of Food and Agriculture		✓		✓	✓	✓		✓	✓			
Office of Statewide Health Planning and Development		✓			?	✓		✓	✓			
Air Resources Board		✓				✓	✓	✓		✓	✓	
California Waste Management Board						?	✓	✓		✓		
Coastal Commission		✓				?	✓	✓		?		
Department of Fish and Game					?		✓			✓		
Board of Forestry		✓	?			?	?	✓		✓	✓	
Water Resources Control Board		✓				✓	✓	✓		✓	✓	
Auctioneer Commission	✓	?	✓		✓	✓			✓			
Board of Chiropractic Examiners		?		✓	✓	✓			✓	✓		✓
Energy Commission		✓				✓	✓			?		
Horse Racing Board		✓	✓		✓	✓			?		?	✓
New Motor Vehicle Board	✓	✓	✓	✓	✓	✓			✓			
Board of Osteopathic Examiners		✓	✓	✓	✓		✓	✓	✓	✓		✓
Public Utilities Commission		?				?	✓	✓		✓		✓
State Bar of California			✓	✓	✓	?	✓	✓	✓	✓		

1. Agency Wholly Unnecessary
2. Regulation Excessively Detailed
3. Regulation Cartel Oriented
4. Agency Dominated by Profit Stake Interests
5. Agency Includes Profit Stake Interests
6. Agency Purposes Addressable By Non Regulatory Measures
7. Agency Has Inadequate Practical Remedies to Accomplish Regulatory Purpose
8. Inadequately Staffed to Supervise Trade (Assuming Agency Justified)
9. Excessive or Irrational Barriers to Entry
10. Inadequate Quality Control of Existing Businesses/Tradesmen (Assuming Agency Justified)
11. Regulation at Wrong Level of Government
12. Wrongly in Constitution

Testimony of Robert C. Fellmeth
Price Professor of Public Interest Law
University of San Diego School of Law

before the
Little Hoover Commission
February 4, 2016

Exhibit B

November 10, 2015

Honorable Jerry Hill, Chair, and Members
Senate Committee on Business, Professions and Economic Development
Sacramento, CA 95814

Honorable Susan Bonilla, Chair, and Members
Assembly Committee on Business and Professions
Sacramento, CA 95814

Re: Follow-Up to October 22 Informational Hearing on Revised Structure of State Regulation Compelled by the U.S. Supreme Court's decision in *North Carolina State Board of Dental Examiners v. FTC*

Dear Chairs Hill and Bonilla, and Honorable Committee Members:

I write to thank you for holding this important hearing of both committees on the impact of the U.S. Supreme Court's seminal decision in *North Carolina State Board of Dental Examiners v. Federal Trade Commission* (February 25, 2015) (hereinafter " *North Carolina*"), and for allowing the Center for Public Interest Law (CPIL) to contribute to it. This letter supplements the written handout that CPIL submitted at the October 22 hearing (which is attached).

I also write to correct some errors in the testimony you heard, and to clarify some confusion reflected in questions and discussion. Such confusion is understandable given the complexity of federal antitrust law and the "state action immunity" doctrine here at issue. But appreciating the radically altered law following this decision and its implications is properly a high priority for all of us. Failure to accomplish "sovereign status" for Department of Consumer Affairs (DCA) regulatory boards subjects board members and the state treasury to serious liability. And — as discussed below — such liability is not hypothetical; nor may approval by the legislature, agencies, or the California Supreme Court resolve the difficulty, because the application of federal antitrust law supersedes state jurisdiction on this question.

CPIL is familiar with this issue as an active monitor of California regulatory boards for the last 35 years, including attendance at the meetings of most major DCA boards by our law students and staff. CPIL is also familiar with antitrust law and policy.[1] And CPIL has also been active in

[1] Recently, CPIL successfully litigated a federal antitrust action against a California agency that was facilitating price-fixing — a *per se* antitrust violation — by the rental car industry. *See Shames v. California Travel and Tourism Commission*, *et. al*, 626 F.3d 1079 (9th Cir. 2010).

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auditing the enforcement programs of three state agencies (the State Bar, the Medical Board, and the Contractors' State License Board) as "enforcement monitors" under prior legislation. My own background with the antitrust/regulatory interface includes nine years of litigation as a state and federal antitrust prosecutor, publications in the field,[2] service as a member and chair of the California Athletic Commission, sponsorship and drafting of part of the state's Unfair Competition Law,[3] and teaching antitrust law at the University of San Diego School of Law, the National College of District Attorneys and the U.S. Supreme Court's National Judicial College training state court judges.

I write to provide you with an overview of the kinds of decisions by boards that constitute antitrust violations, and to advise you that neither the existing authority of the Office of Administrative Law (OAL), the DCA Director, nor that of other board "advisors" constitutes "active state supervision" of regulatory board acts and decisions, as required by *North Carolina*. Finally, I will summarize CPIL's suggested approaches for compliance with *North Carolina*, and the reasons therefor. In particular, I will discuss why an "active state supervision" mechanism might be efficiently incorporated into the existing OAL.

I. THE UNDERLYING PROBLEM BRIEFLY STATED

Federal antitrust law prohibits "combinations" (including agreements among competitors) that unreasonably "restrain trade." Some federal antitrust violations are deemed so destructive to competition that they are deemed "*per se* violations" — meaning that if the offense is proven to have occurred, no defense or argument regarding the reasonableness of the violation is permitted. Price-fixing (an expansive violation prohibiting any agreement among competitors that affects the price of products or services or restricts supply so as to artificially raise prices) is a *per se* antitrust violation, as is a "group boycott" (a group agreement to exclude a competitor).

Most DCA occupational licensing boards are controlled by licensees of that board who agree to take actions that "restrain trade." The most common restraint of trade exercised by every DCA board is to create entry standards for licensure.[4] These entry conditions necessarily limit supply. They decide who is allowed to practice a trade or profession and who is excluded, with the force of law. DCA board members revoke licenses, specify how licensees are to practice, and control supply by limiting entry into the profession or market. These acts — if committed by a cartel or any private grouping of competitors — would be *per se* antitrust violations under federal law.

[2] *See, e.g., California White Collar Crime and Business Litigation* (with Thomas A. Papageorge) (Tower Publishing, Fourth Edition, 2013).

[3] I contributed to four bills authored by Alan Sieroty in the 1970s which amended the previous Civil Code section 3369 and created most of what is now section 17200 *et seq.* of the Business and Professions Code (the Unfair Competition Law).

[4] Of course, CPIL supports such requirements where they are connected to their intended rationale (*e.g.*, the assurance of competence of practitioners, particularly where involving possible irreparable harm — as with a surgeon or others upon whom the public must rely).

In a series of decisions starting with *Parker v. Brown*,[5] the U.S. Supreme Court ruled that federal antitrust laws do not apply to a state when it acts anticompetitively, provided that two conditions are met: (1) the anticompetitive action must be clearly authorized and affirmatively expressed in state law or policy; and (2) the anticompetitive action must be actively supervised by the state itself. If it met that two-pronged test, a state board alleged to have acted anticompetitively could claim so-called "state action immunity." In *North Carolina*, however, the Court held that a board controlled by "active market participants" in the profession regulated by that board may not claim "state action immunity" to charges of anticompetitive conduct. "State action immunity" is imperative. Thus, this holding appears to leave states with two options: (1) discontinue their historical practice of stacking state regulatory boards with a controlling number of licensees who thus control their own regulation, and/or (2) create a legitimate "active state supervision" mechanism that is authorized to review, veto, and modify acts of state boards that are controlled by "active market participants."

The October 22 informational hearing included much discussion of the "reasonable" character of DCA board members and their general mindset to only fashion restraints that benefit the public interest. Indeed, the DCA witnesses repeatedly cited the "training" of board members as providing such assurance. DCA and the Attorney General's representative at the hearing appeared to opine that minor technical changes to the DCA Director's authority would likely create compliance with the *North Carolina* decision. Regrettably, these contentions are in error.

Critically, and contrary to the discussion at the hearing, there is no such thing as a "reasonable price-fix by horizontal competitors." Most DCA boards are controlled by licensees who are technically competitors, and they engage in *per se* antitrust violations every day. No defense based on the "reasonableness" of the restraint or any of the other factors discussed at length at the hearing are permitted or admissible.[6] Neither the strong merits of the restraint nor the designation of state official titles to those making the decision constitutes a defense. And to repeat for emphasis, it does not matter that board members or the DCA Director (or any other state official) believe in good faith that a restraint is in the public interest, or even that we agree with them. This was the point being made by CPIL's Ed Howard at the hearing. We want some restraints on entry (albeit tied to a proper rationale); we want boards to excise licensees who have become incompetent or negligent; we want board members to feel safe in properly regulating a trade in the public interest. We want to restore "sovereign status" to DCA's boards so they can claim "state action immunity" when they are alleged to have acted anticompetitively. Consistent with the *North Carolina* holding, and to ensure that status, the legislature must either reconfigure the composition of most DCA boards or impose an "active state supervision" mechanism that can review and veto anticompetitive acts of boards that continue to be controlled by "active market participants." That purpose of that review is to ensure that these decisions are, in fact, made by public officials representing the broad interests of the public. [7]

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[5] 317 U.S. 341 (1943).

[6] *See, e.g., U.S. v. Socony-Vacuum Oil*, 310 U.S. 150, 224 (1940) ("Whatever economic justification particular price-fixing agreements may be thought to have, the law does not permit an inquiry into their reasonableness. They are all banned...").

[7] We understand that the October 22 hearing, and the jurisdiction of these committees, is limited to DCA boards. But we reiterate for the record that the decision is equally applicable to the State Bar Board of Trustees (BOT) and to other non-DCA boards that are controlled by "active market participants." The BOT is controlled by a

II. THE BASICS

We briefly and respectfully correct the record as to several comments and assertions made at the October 22 informational hearing:

● **The Holding Applies to California**. Several hearing participants commented that the facts of the *North Carolina* case, including the nature of its dental board and the enforcement actions it undertook, differ from the situation in California. The implication was that the decision may not even apply to our state.[8] However, this seminal 6–3 U.S. Supreme Court decision has a clearly stated holding applicable to every state in the nation.[9] The Court explicitly stated that state boards regulating trades and professions throughout the country will not enjoy "state action immunity" from federal antitrust scrutiny if they are controlled by "active market participants in the trade regulated," unless they are subject to "active state supervision." The specific distinguishing features of North Carolina dental regulation and its alleged violation do not limit the categorically stated requirements of the holding. This is not a narrow "as applied" decision. It spells out the elements necessary for a state board to obtain "sovereign status" and qualification for "state action" exemption from federal antitrust law. To argue otherwise is similar to contending that California police officers do not have to afford *Miranda* warnings because they are highly disparate from the Arizona police officers whose conduct framed that holding. Our police officers could be practicing priests and penitents — and it would not matter.

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supermajority (13–6) of practicing attorneys, and six of the Board's 13 attorney members are — like the dentists on the North Carolina Board of Dental Examiners — elected to the Board by their peers. The Bar has contended that it is supervised by the California Supreme Court. While the Court does in fact review the Bar's changes to the Rules of Professional Conduct and is empowered to review all disciplinary actions of the State Bar Court, the Court is not required to review any Bar action for anticompetitive effect. Inasmuch as the Bar is part of the judicial branch, perhaps the Judiciary Committees will need to explore appropriate means of compliance with the holding in *North Carolina*.

[8] Some hearing participants mentioned the "morass" that the decision might cause. That characterization was contained in the dissenting opinion of Justices Alito, Scalia, and Thomas. The dissent is irrelevant. The majority decision is the law.

[9] To quote the decision: "The Board argues entities designated by the States as agencies are exempt from *Midcal*'s second requirement. That premise cannot be reconciled with the Court's repeated conclusion that the need for supervision turns not on the formal designation given by States to regulators but on the risk that active market participants will pursue private interests in restraining trade. State agencies controlled by active market participants, who possess singularly strong private interests, pose the very risk of self-dealing *Midcal*'s supervision requirement was created to address. ... This conclusion does not question the good faith of state officers but rather is an assessment of the structural risk of market participants' confusing their own interests with the State's policy goals. ... The similarities between agencies controlled by active market participants and private trade associations are not eliminated simply because the former are given a formal designation by the State, vested with a measure of government power, and required to follow some procedural rules. .... When a State empowers a group of active market participants to decide who can participate in its market, and on what terms, the need for supervision is manifest. ... ***The Court holds today that a state board on which a controlling number of decisionmakers are active market participants in the occupation the board regulates must satisfy Midcal's active supervision requirement in order to invoke state-action antitrust immunity***." *North Carolina*}plain , 135 S.Ct. at 1113–15 (internal citations omitted) (emphasis added).

● **The Holding is Unambiguous: If California Wishes to Preserve the Current Composition of its Occupational Licensing Boards, It Must Create an Oversight Mechanism that is Authorized to Exercise "Active State Supervision" for Anticompetitive Effect.** The Court explicitly asserted the prohibition on "active market participant" control of state regulatory boards, and did not choose to make the method of selection of board members a factor. Where such active market participants control decisions, "active state supervision" for anticompetitive impact is required. Justice Kennedy noted that some flexibility exists as to the "how" of that supervision. But he also set forth minimum elements that any such independent review must have, including specific examination for anticompetitive effect by a non-market participant person or group, and clear authority to "veto or modify" board decisions. Importantly, he expressly provided that the state's review for anticompetitive impact must not be *pro forma*.[10] That is important and is well illustrated in one case not discussed at the hearing but cited repeatedly by the Court in the *North Carolina* decision — the leading antitrust case of *Midcal*.[11] In that case, the U.S. Supreme Court looked at an "active state supervision" arrangement — and it happened to be at a California agency. It involved the review of price schedules submitted by wine producers and wholesalers. California's Department of Alcoholic Beverage Control had clear power to review and reject such price schedules, and in fact did review all such prices, but it generally rubberstamped them; it did not change or examine them substantively in depth.[12] The Court rejected such review as inadequate in that case, and reinforced that message repeatedly in the *North Carolina* decision. Interestingly, the recent FTC Staff Guidance on application of this case[13] — a somewhat more complete advisory than the opinions issued by Legislative Counsel[14] or the California Attorney General[15] — advises information-gathering, data collection, public hearings, and written decisions as part of that element.[16]

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[10] To quote the decision: "[T]he question is whether the State's review mechanisms provide 'realistic assurance' that a nonsovereign actor's anticompetitive conduct 'promotes state policy, rather than merely the party's individual interests.' ... The Court has identified only a few constant requirements of active supervision: The supervisor must review the substance of the anticompetitive decision, not merely the procedures followed to produce it [;] ... 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[.]' Further, the state supervisor may not itself be an active market participant." *North Carolina*, 135 S.Ct. At 1116 (internal citations omitted).

[11] *California Retail Liquor Delears Ass'n v. Midcal Aluminum, Inc*., 445 U.S. 97 (1980).

[12] "The State neither establishes prices nor reviews the reasonableness of the price schedules; nor does it regulate the terms of fair trade contracts. The State does not monitor market conditions or engage in any 'pointed reexamination' of the program. The national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." *Midcal*, 445 U.S. at 105–06.

[13] Federal Trade Commission Bureau of Competition, *FTC Staff Guidance on Active Supervision of State Regulatory Boards Controlled by Market Participants* (October 2015).

[14] Legislative Counsel Bureau, California Legislature, *Antitrust Liability: State-Action Immunity*, #1509722 (July 15, 2015).

[15] Attorney General's Opinion 15-402 (Sept. 10, 2015).

[16] FTC Staff Guidance, *supra* note 13, at 10-11.

III. CALIFORNIA ADMINISTRATIVE LAW AND PROCEDURES DO NOT ENSURE "ACTIVE STATE SUPERVISION" OF REGULATORY BOARD ACTIONS FOR ANTICOMPETITIVE EFFECT

Many participants at the October 22 informational hearing surprisingly opined that California's current processes and supervision mechanisms already afford "active state supervision" of regulatory board decisions and actions for anticompetitive impact. Regrettably, that judgment is not close to accurate.

● **The Current Authority of the Office of Administrative Law to Review Board Rulemaking Does <u>Not</u> Constitute "Active State Supervision" for Anticompetitive Effect.** The Attorney General's Opinion draws the unfounded conclusion that the rulemaking process governed by the Administrative Procedure Act (APA)[17] and overseen by the Office of Administrative Law (OAL) "is a fairly safe area for board members, because of the public notice, written justification, [DCA] Director review, and review by the Office of Administrative Law...."[18] Although the Attorney General is correct in that the APA rulemaking process is replete with "review" by non-"active market participants," none of those reviewers is required to, tasked with, authorized to, or trained to review for anticompetitive impact; further, none of them are empowered to "modify" board regulations, as explicitly required by *North Carolina*. OAL's six areas of specified review do not include "anticompetitive" effects at all, nor is it qualified to make such determinations. And while OAL may reject board regulations, it may not modify them. We discuss this issue further below, and outline our proposed changes to the structure of OAL and the APA rulemaking process to efficiently incorporate a review mechanism for anticompetitive impact.

● **The Current Authority of the DCA Director Does <u>Not</u> Constitute "Active State Supervision" for Anticompetitive Effect.** The informational hearing included the acknowledgment by the attending Deputy Attorney General that the current authority of the DCA Director does not satisfy the "active state supervision" requirements of the *North Carolina* decision. He is correct. The Deputy Attorney General noted two deficiencies: (a) the Director's review does not include all of the various categories of board acts and decisions related to licensing examinations and requirements that form the heart of the *per se* antitrust offense often at issue; and (b) the Director does not have the unfettered power to make final decisions in his review function, but may be overridden by boards controlled by "active market participants." Both of these objections are warranted. But they do not reach numerous other deficiencies that clearly defeat any assertion that the DCA Director exerts "active state supervision" of DCA board acts and decisions.

The relevant points not clearly made at the hearing by counsel for the Attorney General or DCA include the following:

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[17] Gov't Code § 11340 *et seq*.

[18] Attorney General's Opinion No. 15-402 at 8.

1) While the DCA Director is authorized to review and reject board rulemaking,[19] the Director is not required to review such rulemaking for anticompetitive effect, as *North Carolina* requires. Nor is the DCA Director necessarily an expert in economics, antitrust law, or other field that might qualify him/her to recognize and meaningfully review any board act or decision for anticompetitive effect.[20]

2) Further, the DCA Director is not authorized to "modify" such regulations, as *North Carolina* requires. 135 S.Ct. at 1116.

3) Several categories of rulemaking involving *per se* antitrust violations are exempt from the DCA Director's review.[21] And, as noted by the Deputy Attorney General, a Director's veto of board regulations may be overridden by a unanimous vote of the usually "active market participant"-controlled board.[22]

4) The DCA Director's "review" authority under Business and Professions Code section 313.1 is limited to rulemaking. Most board acts and decisions do not require rulemaking, and no statute cited in the Attorney General's Opinion[23] either ***authorizes*** the DCA Director to review, amend, or modify non-rulemaking board acts and decisions ***for anticompetitive effect***, or ***requires*** him/her to review such non-rulemaking acts and decisions ***for anticompetitive effect***, as *North Carolina* requires. Indeed, the issuance of cease and desist letters (the very offending conduct at issue in *North Carolina*) are not subject to DCA (or OAL) review under the present scheme.

The statutes at Business and Professions Code section 300 *et seq*. merely ***authorize*** the DCA Director to inquire into many aspects of DCA board activity and decisionmaking. They do not ***require*** the Director to review any board act or decision for anticompetitive impact, nor do they authorize the Director to overturn or modify any non-rulemaking act or decision due to anticompetitive effect. DCA boards are called "semi-autonomous" for a reason: With the sole exception of rulemaking that is not related to licensing exams, licensing requirements, or fees, boards make the final decision and the DCA Director is powerless to "veto or modify" any such decision, as is required by *North Carolina*.[24]

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[19] Bus. & Prof. Code § 313.1.

[20] Indeed, Business and Professions Code sections 150 and 151 contain no substantive qualifications for individuals who may be appointed as DCA Director by the Governor.

[21] Bus. & Prof. Code § 313.1; the Director is not authorized to review and/or reject regulations "relating to examinations and qualifications for licensure," or "fee changes proposed or promulgated by any of the boards, commissions, or committees within the department."

[22] Bus. & Prof. Code § 313.1(e)(3).

[23] *See* Attorney General's Opinion No. 15-402, notes 43–56.

[24] In any event, the authorities set forth in Business and Professions Code section 300 *et seq*. are rarely exercised by the DCA Director. CPIL has been observing DCA boards for 35 years, longer than anyone currently at DCA and/or

Underlining these points is the testimony of the DCA Director at the informational hearing. It included reassurances (repeated by others) that California is a model state that really does not need to change anything. He cited the fact that board members are being trained about the *North Carolina* decision and about the boards' statutory priority for public protection. In fact, the Director conceded that he has never rejected or changed a single decision made by any DCA board or program during his tenure, and is unaware of any such action over the past decade.

Thus, existing law and DCA practice do not constitute "active state supervision" of regulatory board decisions for anticompetitive impact. Obviously, and as was discussed at the hearing, the statutes conferring (and restricting) the DCA Director's authority as to the semi-autonomous boards within the Department could be amended. However, it will not be enough to simply allow the Director to review examination, licensing, and other regulations where he/she is currently foreclosed, or to give him/her the theoretical power to reject or modify a regulation without board override. The many statutes cited in the Attorney General's Opinion would have to be amended to ***require*** DCA Director review of all acts and decision of all of the Department's boards for anticompetitive effect, and to further authorize the Director to "veto or modify" such acts and decisions prior to their effective date. Some of these changes might be helpful, but — as described below — CPIL believes that the "active state supervision" requirement might more efficiently be incorporated into the existing Office of Administrative Law, which already reviews all rulemaking of all DCA boards and could be supplemented to incorporate review (upon appeal or request) of non-rulemaking acts and decisions of DCA boards for anticompetitive effect.

● **Interaction with DCA Boards by the Attorney General, DCA Attorneys, Board Executive Officers, and/or the Legislature is Inadequate to Provide "Active State Supervision" of Board Actions for Anticompetitive Effect.** The hearing included contentions that various advisors, counsel, the legislature, board executive officers, and/or other non-"active market participants" can and do provide the requisite "active state supervision" over board acts and decisions. The first grouping so identified was attorneys, either those from DCA or from the Attorney General's Office. Counsel properly discouraged such a conclusion at the hearing. These attorneys represent boards as their clients. They have a fiduciary duty to each such client. To be sure, the Attorney General is the chief law enforcement officer of the State and has other over-arching obligations. But these attorneys have conflicts that would prevent them from assuming this "supervision" role. In addition, they lack expertise and obviously do not have the

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on staff of the legislative committees, and the use of these authorities is exceedingly rare. DCA Interim Director Patricia Harris convened public hearings on the enforcement program of the Board of Registered Nursing in 2009 after that *Los Angeles Times* published a series of embarrassing articles about the program. DCA Director Kathleen Hamilton convened a series of public hearings on DCA's complaint disclosure policy in 2001. In 1999, DCA Director Jim Conran required the Medical Board to hold a series of public hearings on MBC's enforcement program in response to a scathing audit of the program; the audit was prompted by complaints to Conran by Medical Board investigators that Board members and senior management were instructing them to throw out complaints rather than investigate them. In the early 1990s, Conran also confronted the Board of Landscape Architects over its use of a national licensing examination with a 6% pass rate. Over the past fifteen years, we can count on one hand the number of times that a DCA Director has vetoed board rulemaking. Regrettably, these authorities are ephemeral and are rarely exercised because DCA lacks general fund money to run an active consumer protection and education program. Little Hoover Commission, *Consumer Protection: A Quality of Life Investment* (June 1998).

authority to reject or modify a board decision. Counsel does not make substantive decisions. His/her recourse — should an agency seek to commit unlawful acts — is to withdraw as counsel.

For similar reasons, board executive officers cannot possibly perform "active state supervision" of board acts and decisions. Executive officers serve at the pleasure of the board members who selected them. They are not even decisionmakers; their job is to carry out the policy decisions of the boards at whose pleasure they serve — a board that is usually controlled by active market participants in the profession regulated by that board. Nor is the legislature in a position to provide such supervision. Certainly its "sunset review" process is important — perhaps a model for legislative review nationally — but it typically occurs every four years. Thus, the legislature is not in a position to examine decisions before they take effect (as *North Carolina* requires), and otherwise lacks a mechanism to provide detailed restraint of trade review.

IV. OTHER ERRORS / OMISSIONS AT THE OCTOBER 22 HEARING

In addition to the misunderstanding of the basics — the explicit requirement of "active state supervision" where there is "active market participant" control — the hearing included numerous arguments and discussion that reflect a misunderstanding of basic, applicable law.

● **Training of Board Members is Admirable but Irrelevant to Compliance**. There was much discussion at the October 22 hearing about how the holding in this decision is being addressed through the training of board members. Such training has undoubted merit but, as discussed above, is irrelevant to the liability at issue. It does not provide a defense to antitrust liability in any way, shape, or form. The Supreme Court did not state that "active market participants may control public policy on behalf of the People if they have been instructed by state officials to defer their proprietary gain in favor of the public good." As the applicable quotes from the decision in the notes above provide, this is a bright-line, categorical prohibition.

● **The Characterization of a Violation as "In the Public Interest" Does Not Provide Immunity, Particularly for Core Agency Decisions that Are *Per Se* Antitrust Offenses**. The hearing included much discussion about how some antitrust violations are permitted, and that "reasonable restraints" are lawful. As noted above, that discussion reflects a misunderstanding of the antitrust law prohibition — particularly the *per se* categories often involved in agency actions. As noted, if a restraint (including the price-fixing of supply control) is *per se*, it is automatically ***unreasonable.*** Assertions and/or defenses that "it is really a good idea" or "the public will benefit" are irrelevant.

As CPIL's Ed Howard repeated at the hearing, CPIL wants boards to make decisions that will be necessarily *per se* violations of antitrust law. To be sure, we want boards to focus on the needed competence for public protection, and not on collateral motivations or effects. Our own experience over the last 35 years, consistent with the holding of this case, is that those in the trade or profession have a self-interested view of entry and other market rules. Sometimes that view is consonant with the public interest. But not always. And the broader perspective that they may understandably not recognize exists in large measure without discussion or even recognition.[25] Do the entry criteria really assure competence? What is the pass rate on the licensing examination? What is the impact of supply limitations on prices? Does the filtering that takes place relate to its purpose? How closely? These are the considerations that underlie the state's proper decisions about supply controls that restrain trade.

The problem is that those in a trade or profession often make tribal assumptions based on common empathy lines. The solution is not to delegate state police power to a self-interested grouping — particularly where such associations have organized to an unprecedented degree in state capitols and in Washington, D.C. — but to draw upon the needed and applicable expertise they or their members may have while giving decisionmaking power to those reflecting the general body politic that is properly the bedrock of a democracy.[26]

● **Valuable Expertise Can Contribute to Decisions Without Ceding Control to a Cartel**. The discussion at the hearing repeatedly emphasized the value that "active market participants" can contribute to board decisionmaking given their expertise in the subject matter. We agree that expertise is important. It allows the consideration of unintended consequences and the full understanding of what may or may not work. But this discussion inflates the benefit of expertise over the issue of state policy control by self-interested participants. There are many ways to avail a board of the expertise of the neurosurgeon or accountant without vesting unto that grouping the power of the State. Perhaps a public member supermajority board could be assisted by a non-voting advisory committee of "active market participants." Or perhaps we should simply recognize that active market participants and their trade associations already heavily lobby board members, attend all board meetings, and offer their expertise as a matter of course. We may want a good CPA to advise on the consequences of various levels of ignorance or on effective ways to test for competence, but may not want a group of CPAs to determine exactly how many new CPA entrants there will be to enhance supply and diminish their market power and hourly rates.

Moreover, not all expertise is the same. Expertise is most valuable where it is "on point." The notion that a physician member of the Medical Board who is a psychiatrist will know the details of optimum practice as a dermatologist is dubious. The assumption that all physicians are beknighted with in-depth knowledge of all specialties of medicine is unfounded, and the same

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[25] Justice Kennedy recognized this dynamic: "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." *North Carolina*, 135 S.Ct. at 1111 (emphasis added).

[26] Note that the hearing focused on medical and accounting regulation where incompetence means irreparable harm. Many DCA boards are not so essential to public protection; barbers, landscape architects, and others do not pose the same level of irreparable harm danger as may be the case with a surgeon. And those sophisticated consumers who hire geophysicists or petroleum engineers arguably do not require the state to assure competence. The motivation for most agencies is a mix of public protection and proprietary tribalism. We agree that the trade association board members are not necessarily venal actors attempting maximum revenue and protection from competition. They certainly do not believe that is what they are about. But there is a substantial difference between the views of a trade association and those that might arise from a more generalist background. The trick is to combine expertise and independence for an optimum outcome. The *North Carolina* decision has drawn a bright line to assure some balance in those judgments by foreclosing unilateral "active market participant" control.

holds true today for most trades and professions. Many are divided into separate areas of expertise. Indeed, the Medical Board recognizes this need by using multiple lists of "medical consultants" in various specialties to advise it on a number of levels. There are ways to tap "on point" expertise that more fully provide that benefit without conferring control of the final decision on active market participants.

● **The Contention that Board Discipline Decisions are Currently Subject to "Active State Supervision" For Anticompetitive Effect is Without Merit**. DCA witnesses distinguished board enforcement action from rulemaking, contending that the former is currently subject to "active state supervision."[27] The discussion included the facts that a board's executive officer controls the prosecution decision, a deputy attorney general is involved at the initial stage of accusation filing, the matter is set for hearing before an independent administrative law judge, and judicial review outside the board is available to all disciplined respondents. However, these elements do not qualify as "active state supervision" of enforcement decisions for anticompetitive effect. First, as noted above, the executive officer serves at the pleasure of the board.[28] Second, the deputy attorney general is counsel for the board — which is the moving party in disciplinary proceedings. It is possible that counsel could refuse to prosecute an individual case, but that is not a realistic check. The deputy attorney general is not in a position to determine prosecution priorities or penalties. Nor does he/she necessarily have expertise in the subject matter of the required review, nor has the Attorney General's Office ever — to our knowledge — examined any agency decision in terms of anticompetitive effect.

The administrative law judge is usually not an "active market participant," but he/she is not in a position to examine the anticompetitive effect of a board disciplinary matter, nor does he/she possess the power to modify an enforcement priority. That judge simply receives evidence and rules whether the respondent violated a law or regulation. Further, as the hearing discussion acknowledged, the ALJ writes only a "proposed decision," and the board — often controlled by "active market participants" — makes the final decision. Nor do courts on writ review of board disciplinary decisions examine anticompetitive effects of those decisions. Courts are passive and are unable to *sua sponte* gather evidence of impact that is required for such a judgment. Their focus is on procedural due process and the existence of facts and evidence that support a violation.[29]

What is important to recognize is that boards controlled by "active market participants" sometimes target discipline at persons providing competition that serves the public but

[27] The Attorney General's Opinion concurred with this position. Attorney General Opinion No. 15-402 at 8 ("broadly speaking, disciplinary decisions are another fairly safe area because of due process procedures; participation of state actors such as board executive officers, investigators, prosecutors, and administrative law judges; and availability of administrative mandamus review").

[28] And some executive officers are required to be licensees of the board. *See, e.g.*, Bus. & Prof. Code § 2708 (executive officer of the Board of Registered Nursing is required to be "a nurse currently licensed under this chapter").

[29] Note that the subjects of the *North Carolina* "cease and desist orders" theoretically had judicial redress — they could have brought a writ to challenge that enforcement action.

undermines maximum profit for the regulated profession (as did the dentists on the North Carolina Board of Dental Examiners). Behind the theoretical discussion of the roles of counsel and courts, the mere decision to bring an action is critical and possibly constitutes an anticompetitive effect. Accused respondents are not provided with counsel. Further, California has a questionable policy of assessing costs and attorneys' fees against respondents who do not win complete dismissal of an accusation.[30] While some wealthy licensees may be able to afford these proceedings, a dry wall contractor or a barber can hardly do so. The power of the accusation process is immense and can be the basis for restraints of trade. Indeed, that was the format of the *North Carolina* case itself.

V. RESPONSIBLE AND EFFECTIVE COMPLIANCE CHOICES

California is simply not compliant with the *North Carolina* holding. Its many "active market participant"-controlled boards lack "state sovereignty" status and are vulnerable to significant federal antitrust liability. This legislature must take action.

The hearing discussion repeatedly noted the historical absence of antitrust suits against state boards. Not entirely. As noted above, CPIL recently filed and won *Shames v. California Travel and Tourism Commission*, an antitrust lawsuit which successfully challenged the facilitation by a state agency of price-fixing by the rental car industry.[31] And some of the factors that precluded

[30] Bus. & Prof. Code § 125.3.

[31] 626 F.3d 1079 (9th Cir. 2010). Additionally, CPIL appeared as *amicus curiae* in support of plaintiff Bonnie Moore, who challenged a regulation of the Board of Accountancy which, composed in supermajority of CPAs (8–4), threatened to enforce a regulation stating that no one but a CPA may use the unmodified term "accountant" or "accounting" in its business name or advertising, even though non-CPAs are statutorily permitted to perform some tasks that can only be characterized as "accounting." CPIL challenged the rule on due process and antitrust grounds. In a 4–3 decision, the California Supreme Court found the rule unconstitutional as overbroad but refused to strike it. In dissent, Justice Mosk agreed with CPIL that "Regulation 2 is itself of questionable validity. In 1948, at the time it was adopted, the Board consisted entirely of licensed accountants. ... [P]resently, it consists of 12 persons, 8 of them accounting professionals licensed by the state, and 4 public members. None of the members of the Board, according to *amicus curiae,* the Center for Public Interest Law, is an unlicensed person performing accounting work. *Amicus curiae* states that a large percentage of the accounting work available is of the type that is performed by both licensed and unlicensed accountants. The Board majority has an obvious pecuniary interest in preventing those without a license from advertising to the public that they are performing accounting services. Regulation 2 furthers that interest. ***The law has long looked with disfavor on rules adopted by a regulatory body the majority of which consists of members of a profession with a pecuniary stake in restricting the rights of competitors**." *Bonnie Moore v. California State Board of Accountancy*, 2 Cal. 4th 999, 1026 (1992) (emphasis added).

As noted in the text, the state of the law prior to February 2015 caused litigants to base challenges to the decisions of "active market participant"-controlled boards on doctrines other than federal antitrust law. There is no shortage of those kinds of cases. *See, e.g.*, *Gibson v. Berryhill*, 411 U.S. 514 (1973) (on due process grounds, U.S. Supreme Court struck abusive disciplinary actions initiated by "active market participant"-controlled Alabama Board of Optometry against competitor corporate optometrists); *Filipino Accountants' Ass'n v. California State Board of Accountancy*, 155 Cal. App. 3d 1023 (1984) (Filipino accountants' association successfully sued "active market participant"-controlled board under civil rights laws for discriminating against Filipino accountants in the licensing process); *Le Bup Thi Dao v. Board of Medical Quality Assurance,* an unreported case brought by CPIL challenging — under federal civil rights laws — the Medical Board's refusal to license 32 Vietnamese physicians in California; the board settled the matter and CPIL was awarded $100,000 in attorneys' fees. This legislature should expect that cases of this type will now freely be filed under the federal Sherman Act, to which (absent curative legislation) state boards will be unable to assert the "state action immunity" defense.

that Commission from claiming state action immunity are now applicable to most DCA entities. One reason there have not been many cases is because of the state of the law prior to the *North Carolina* ruling in February 2015. However, that categorical, generalized, and pervasive "state action immunity" defense asserted by state boards to antitrust challenges is now unavailable, unless this Honorable Legislature fashions a cure — hopefully one that will comply with the spirit as well as the letter of the law.

Having noted that decisions beyond rulemaking may have an anticompetitive effect, we also realize that many anticompetitive decisions can be beneficial (as CPIL's Ed Howard described) and many non-rulemaking decisions should not trigger detailed review with attendant costs and delays. To wit, barriers to entry that restrict supply may be in the public interest where directly related to qualification and competence that are necessary to prevent consumer harm. That is, supply restrictions may be a form of *per se* price-fixing, but are nevertheless needed where regulation and competence assurance is warranted.

Taking into account all of the above, what is the optimum solution to achieve "state sovereignty" status for California's regulatory boards? How do we create effective "active state supervision" that qualifies but does not impede the speed of agency action or the efficacy of what may be justifiable restraints? Our suggestions were contained in our written submission to the committees (attached) but — because of the importance of the problems that require resolution — we respectfully rephrase and clarify the two alternatives there presented.

● **Change Board Composition to a Supermajority of Public Members**. The legislature could restructure the composition of DCA boards so that no more than a minority of a quorum of a board could be "active market participants." That way, no action taken can be controlled by "active market participants." Perhaps one or two public member positions may be designated for retired market participants, or for those who teach in the applicable subject area. They may not be considered "active market participants."

In the alternative, boards could be composed of a simple public member majority (as with the current Board of Accountancy), with the added proviso that no vote shall be effective if conducted by a quorum with a majority of "active market participants" voting.

This option will engender the opposition of the trade associations, consistent with comments made at the hearing by the associations representing the medical, dental, and nursing professions. Such associations (considered critical "stakeholders") have gathered immense political power at the federal level and in most states. But their preference to have the power of the People delegated to their members for the regulation of their own professions does not warrant agreement, and can no longer be lawfully accomplished as a practical matter.

● **And/or Create an "Active State Supervision" Mechanism that Qualifies for Sovereign Status**. The above-described composition change solves the problem. But if *status quo* as to board composition is preferred, then the legislature must provide for actual independent state supervision of both rulemaking and non-rulemaking acts and decisions of boards controlled by “active market participants.”

◆ **As for rulemaking**, the optimum way to provide “active state supervision” for anticompetitive effect is to create a panel of independent experts attached to the Office of Administrative Law (OAL), which — as noted above — already oversees the APA rulemaking process and reviews all regulatory changes of all DCA boards not just for procedural compliance with the APA but also for six substantive criteria under Government Code section 11349.[32] OAL already requires boards to publish numerous impact statements for all rulemaking under the APA.[33] Under the APA, OAL already requires boards to formally publish proposed rulemaking for a 45-day public comment period,[34] affords the option of a public hearing,[35] requires boards to draft a final statement of reasons,[36] and requires boards to compile a rulemaking file which documents procedural compliance with the APA, includes a substantive showing on each of the six criteria, and contains adequate responses to all comments submitted during the public comment period and at the public hearing (if any).[37]

As discussed at the hearing, the current six criteria of OAL do not include restraint of trade impact analysis, nor is OAL empowered to modify a regulation. It would be relatively easy to (1) amend section 11349 to add a seventh criterion: substantive review for anticompetitive impact; and (2) amend section 11346.5 to require boards to add another impact statement: impact on competition. But that does not mean that the generalist attorneys at OAL are qualified to analyze anticompetitive impact. CPIL suggests the creation — within OAL — of an independent panel of experts in economics, competition, and antitrust law. That panel would be required to perform an anticompetitive effect analysis of board rulemaking at the same time a generalist OAL attorney is analyzing the rulemaking file for APA procedural compliance, the six existing criteria, and adequate response to comments. Consistent with *North Carolina*, the panel must also be authorized to modify regulations. Placing such a panel of economic experts within OAL’s structure could achieve efficient and adequate “active state supervision” for anticompetitive effect without undue delay. The panel would have access to the entire rulemaking file, including impact statements, comments and data received during the comment period, and agency response to comments.

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[32] Note that, contrary to the discussion at the hearing and the description of DCA counsel who should know better, OAL does ***not*** just review the “process of rulemaking.” OAL reviews the “authority” of the agency to adopt the rules in question, and even inquires into its “necessity.” Those two of its six review elements go beyond procedure, but OAL does not address anticompetitive effects, nor is it authorized to modify regulations.

[33] *See, e.g.*, Gov’t Code §§ 11346.3, 11346.5.

[34] *Id.* at §§ 11346.4(a), 11346.5.

[35] *Id*. at § 11346.8.

[36] *Id.* at § 11346.9.

[37] *Id.* at § 11347.3.

◆ **Non-rulemaking Anticompetitive Decisions**. The final issue is how to handle all of the non-rulemaking decisions that may restrain trade and are included in the *North Carolina* holding. We agree that the majority of these kinds of decisions do not raise anticompetitive concerns. But they can. Indeed, decisions about examination pass rates and other barriers to entry into a profession are at the heart of agency restraints. So the dilemma of an arena of many decisions without anticompetitive effect and some with a high degree of such impact is resolved by creating a filtering system. We would establish a presumption of no anticompetitive effect for non-rulemaking decisions, but create a nuanced review system that allows that presumption to be overridden. The categorical exclusion of all non-rulemaking decisions from review will not comply with the law as it now exists. Hence, an effective override mechanism to selectively but effectively subject such decisions to review is needed. We suggest the creation of a position or unit within OAL, connected to the expert panel discussed above. That independent unit would receive complaints about anticompetitive effect from a non-rulemaking decision, a pattern of enforcement decisions, a policy or other decision, or may make inquiries on its own. When that unit finds that agency actions create a "reasonable suspicion" that substantial anticompetitive effects are present, it would then refer the matter to the expert panel. A relatively small number is likely to be submitted to such a unit for screening, and an even smaller number would be referred by it to the expert panel for full consideration. The end result would be oversight with filtering to reconcile the requirement of independent supervision with the legitimate need to reduce unnecessary cost, delay, and red tape. Adding the competition review element to OAL will prevent the inadequate and fragmented option of visiting this function on the DCA Director.[38]

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[38] The DCA director review option is unrealistic given his/her limited scope over both rulemaking and non-rulemaking decisions by its boards, and the need for separate review timelines complicating agency approval, including the possible imposition of hearing and decision writing not now a part of his/her review.

IV. CONCLUSION

Failure to comply with the law by the method suggested above or some other effective means subjects board members to theoretical criminal liability.[39] Moreover, it portends treble damage liability that is perhaps more germane and likely. These board members are appointed by this legislature as well as by the Governor, and that liability is not fair. On the one hand, we need to stop the shameful delegation of unchecked public power to those with conflicts of interest; at the same time, we want restraints that do protect the public allowed and rendered enforceable. Both of these missions can be accomplished as outlined above.

Sincerely,

Robert C. Fellmeth, Executive Director
Center for Public Interest Law
Price Professor in Public Interest Law

cc: Honorable Edmund G. Brown Jr., Governor
Honorable Anna M. Caballero, Secretary, Business, Consumer Services and Housing Agency
Honorable Kamala Harris, Attorney General
Honorable Diane Boyer-Vine, Legislative Counsel
Awet Kidane, Director, Department of Consumer Affairs
Bill Gage, Chief Consultant, Senate Committee on Business, Professions and Economic Development
Le Ondra Clark Harvey, Chief Consultant, Assembly Committee on Business and Professions
David Pasternak, President, State Bar of California Board of Trustees
Elizabeth Rindskopf Parker, Executive Director, State Bar of California

[39] We do not expect this option to be exercised by U.S. Attorneys or the Antitrust Division without substantial warning and extreme facts. But the fact of such liability is a legitimate source of concern, as are the more likely litigation consequences from a treble damages-incentivized statute. We know of at least a dozen such suits that have already been filed against "active market participant"-dominated boards across the country.