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

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). 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.

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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.
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: 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.

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.

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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.
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 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.

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\(^6\) *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.
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.

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% — 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

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.

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 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.\footnote{Indeed, after seven years of higher education at a likely cost of well over $200,000, 53.4% of all law school graduates (including many who attended American Bar Association (ABA)-accredited law schools) who 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.} There is no attempted assurance of

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competence in the area of actual practice for the entire career of an attorney.\footnote{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.
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\section*{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 \textit{Noerr-Pennington} antitrust doctrine allows horizontal competitors to collude together to petition government,\footnote{\begin{itemize}
\end{itemize}} 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.\footnote{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.}

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 \textit{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 \textit{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 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

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
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 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

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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).
simply exempting its application in his bill to re-create it.\textsuperscript{16}

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 sunsetting 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.\textsuperscript{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.\textsuperscript{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

\textsuperscript{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 ....”).

\textsuperscript{17} Cal. Bus. & Prof. Code § 473 et seq. (now repealed).

\textsuperscript{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.
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” is sunsetted, there is no readily existing vehicle for governance; deregulation becomes effective because the regulatory provisions become inoperable and effectively void.

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

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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).
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.

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

20 See, e.g., Cal. Bus. & Prof Code §§ 109, 116, 310, 313.1

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).
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 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, the “reconstitution” alternative of the governing body allows for examination of
other flaws, including failure to regulate the market flaw justifying the existence of
the agency. If a board is so sunsetted, its governance would be by bureau. If a bureau
is so sunsetted, it would be reauthorized as a board. The shift in governance control
allows for serious examination of the performance of those currently in control.