The Heritage Foundation

LEGAL MEMORANDUM

No. 150 | MARCH 30, 2015

North Carolina Dental Board and the Reform of State-Sponsored Protectionism

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Abstract

The Supreme Court's February 25, 2015, decision in North Carolina State Board of Dental Examiners v. FTC *has far-reaching ramifications for the reform of ill-conceived protectionist state regulations that limit entry into myriad professions and thereby harm consumers. In holding that a state regulatory board controlled by market participants in the industry being regulated cannot cloak its anticompetitive rules in "state action" antitrust immunity unless it is "actively supervised" by the state, the Court struck a significant blow against protectionist rent-seeking legislation and for economic liberty. The states may re-examine their licensing statutes in light of the Court's decision, but if they decline to revise their regulatory schemes to eliminate their unjustifiable exclusionary effect, there may well be yet another round of challenges to those programs—this time based on the federal Constitution.*

On February 25, 2015, in *North Carolina State Board of Dental Examiners v. FTC* (*North Carolina Dental Board*),[1] the Supreme Court of the United States struck a blow for consumers and economic freedom. The case involved a North Carolina statute prohibiting non-dentists, including dental assistants, from whitening patients' teeth and granting a board that included self-interested dentists the authority to supervise implementation of the statute. The immediate effect of the North Carolina law was to make state dentists into a state-authorized oligopoly over a practice that could be performed by non-dentists without posing any risk of harm to patients; the intermediate and long-term effect was to raise income for dentists at the expense of the public.

This paper, in its entirety, can be found at **http://report.heritage.org/lm150**

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Key Points

- In *North Carolina Dental Board*, the Supreme Court stressed that where a state delegates control over a market to a non-sovereign actor, the state-action immunity doctrine applies only if the state itself accepts political responsibility by actively supervising the private actor's decisions.
- Judicial review of the "active supervision" requirement could invalidate anticompetitive rules under the antitrust laws and discourage the adoption of new protectionist regulations.
- State legislatures must now make it clearer up front that they intend to allow bodies like the North Carolina board to displace competition and subject them to disinterested third-party review.
- Such changes should make it easier to spot harmful regulations and weaken rent seekers' ability to undermine competition through state regulatory processes.
- States that re-examine their licensing schemes might abandon some anticompetitive licensing rules for fear that they will be held invalid on yet another ground.

By ruling that the state dental board was not immune from suit, the Supreme Court's decision has far-reaching ramifications for the reform of ill-conceived protectionist state regulations that limit entry into myriad professions and thereby harm consumers. In holding that a state regulatory board controlled by market participants in the industry being regulated cannot cloak its anticompetitive rules in "state action" antitrust immunity unless it is "actively supervised" by the state,[2] the Court struck a significant blow against protectionist rent-seeking legislation and for economic liberty.[3]

The Supreme Court left to the lower federal courts the responsibility of fleshing out the full details of the "active supervision" requirement in this context. How those courts define that term will greatly affect how much consumers may benefit from the *North Carolina Dental Board* decision.

One way to undertake that analysis is to identify which state goals cannot be justified at all even if the state legislature itself articulates exactly that underlying interest as the rationale for a particular regulatory scheme. In particular, the lower courts may wish to make clear that pure cronyism is not a legitimate state interest. That principle is consistent with the free-market goals of the antitrust laws and is fully in line with *North Carolina Dental Board*'s expressed concern with curbing special-interest rent seeking. Adopting that core principle also would be consistent with recent federal circuit court of appeals' holdings that mere protectionism is not a sufficient "rational basis" for upholding discriminatory state economic regulation under the Fourteenth Amendment's Equal Protection and Due Process Clauses.[4]

Such a modest step would go a long way toward curbing harmful occupational overregulation, thereby benefiting consumers and advancing economic freedom. Appropriately applied, judicial review of the "active supervision" requirement could invalidate anticompetitive laws under the antitrust laws and discourage state regulators from adopting new costly and exclusionary regulatory schemes motivated by protectionism.

The *North Carolina Dental Board* Case

A North Carolina law subjected the licensing of dentistry to a North Carolina State Board of Dental Examiners, six of whose eight members had to be licensed dentists. After dentists complained to the board that non-dentists were charging lower prices than dentists charged for teeth whitening, the board sent cease-and-desist letters to non-dentist teeth whitening providers, warning that the unlicensed practice of dentistry is a crime. That action led non-dentists to cease teeth whitening services in North Carolina.

The United States Federal Trade Commission (FTC) (which, along with the U.S. Department of Justice, enforces the federal antitrust laws) learned about the board's letters and opened an investigation of the matter. The FTC ultimately held that the board's actions violated Section 5 of the Federal Trade Commission Act,[5] which prohibits unfair methods of competition. The U.S. Court of Appeals for the Fourth Circuit agreed, and the Supreme Court affirmed the Fourth Circuit's judgment, thereby invalidating the statute authorizing the board's threatened actions against tooth whiteners.

The issue in *North Carolina Dental Board* was whether the board's actions were sheltered from review under the federal antitrust laws by virtue of the so-called state-action doctrine, a New Deal–era doctrine first adopted by the Supreme Court in 1943 in the case of *Parker v. Brown*.[6] The state-action

1. 135 S. Ct. 1101 (2015). Justice Kennedy wrote the majority opinion. He was joined by Chief Justice Roberts and Justices Ginsburg, Breyer, Kagan, and Sotomayor. Justice Alito, joined by Justices Scalia and Thomas, dissented.
2. An earlier Heritage Foundation Legal Memorandum discusses the scope of the state-action doctrine, along with other limitations on the reach of the federal antitrust laws. *See* Alden F. Abbott, *Constitutional Constraints on Federal Antitrust Law*, Heritage Foundation Legal Memorandum No. 143 (Dec. 11, 2014), *available at* http://www.heritage.org/research/reports/2014/12/constitutional-constraints-on-federal-antitrust-law.
3. "Rent-seeking" refers to economically wasteful, welfare-inimical efforts by organized interests to obtain government benefits through regulations, handouts, or other methods at the expense of the general good. *See, e.g.*, David R. Henderson, *Rent Seeking*, in The Concise Encyclopedia of Economics, http://www.econlib.org/library/Enc/RentSeeking.html.
4. For an overview of the protection of economic liberty under the Constitution, see Economic Liberty and the Constitution: An Introduction, The Heritage Foundation Special Report No. 157 (Paul J. Larkin, Jr., ed., 2014), *available at* http://www.heritage.org/research/reports/2014/10/economic-liberty-and-the-constitution-an-introduction.
5. 15 U.S.C. § 45 (2012).
6. 317 U.S. 341 (1943).

doctrine renders the antitrust laws inapplicable to an economic regulation adopted by a state in its sovereign capacity.

In *North Carolina Dental Board*, the Court rejected the claim that state-action immunity applied to the board's actions.[7] The Court stressed that where a state delegates control over a market to a non-sovereign actor, as North Carolina did to its board, the state-action immunity doctrine applies only if the state itself accepts political responsibility for its delegation by actively supervising the private actor's decisions.[8]

Turning to the facts of that case, the Court applied its 1991 decision in the *Midcal*[9] case, which held that in order for the state-action doctrine to apply, a state must clearly articulate an anticompetitive policy *and* actively supervise decisions by non-sovereign actors. In *North Carolina Dental Board*, the Court held that entities designated as state agencies are not exempt from active supervision when they are controlled by market participants, because immunizing such entities from challenge under the antitrust laws would pose the risk of self-dealing that *Midcal* sought to fend off.[10]

Here the board did not contend that the state exercised any—let alone active—supervision of the board's anticompetitive conduct,[11] a concession that proved fatal to its case. The Court summarized "a few constant requirements of active supervision:"

- "The supervisor must review the substance of the anticompetitive decision,"
- "[T]he supervisor must have the power to veto or modify particular decisions to assure they accord with state policy," and
- "[T]he state supervisor may not itself be an active market participant."[12]

The Court cautioned, however, that "the inquiry regarding active supervision is flexible and context-dependent" and that "the adequacy of supervision otherwise will depend on all the circumstances of a case."[13] The Court emphasized that "active supervision" does not mean "potential supervision," stating that "the mere potential for state supervision is not an adequate substitute for a decision by the State."[14]

Justice Samuel Alito, joined by Justices Antonin Scalia and Clarence Thomas, dissented.[15] He reasoned that the Court ignored precedent that state agencies created by the state legislature ("[t]he Board is not a private or 'nonsovereign' entity"[16]) are shielded by the state-action doctrine. "By straying from this simple path" and assessing instead whether individual agencies are subject to regulatory capture, the Court spawned confusion, according to the dissenters.[17] *Midcal* was inapposite, the dissent reasoned, because it involved a private trade association.[18]

Justice Alito feared that the majority's decision may require states "to change the composition of medical, dental, and other boards, but it is not clear what sort of changes are needed to satisfy the test that the Court now adopts."[19] Justice Alito noted that:

> [D]etermining when regulatory capture has occurred is no simple task. That answer provides a reason for relieving courts from the obligation to make such determinations at all. It does not explain why it is appropriate for the Court to

7. *North Carolina Dental Bd.*, 135 S. Ct. at 1110–17.
8. *Id.* at 1111.
9. California Retail Liquor Dealers Ass'n. v. Midcal Aluminum, Inc., 445 U.S. 97 (1980).
10. *North Carolina Dental Bd.*, 135 S. Ct. at 1111–15.
11. *Id.* at 1116.
12. *Id.* at 1116–17.
13. *Id.* at 1116.
14. *Id.* (citation omitted).
15. *Id.* at 1117–23 (Alito, J., dissenting).
16. *Id.* at 1120.
17. *Id.* at 1118.
18. *Id.* at 1121–22.
19. *Id.* at 1122-23.

adopt the rather crude test for capture that constitutes the holding of today's decision.[20]

The "Active Supervision" Requirement

The Court's holding in *North Carolina Dental Board* appropriately limits the scope of the *Parker* state-action doctrine, which shielded from federal antitrust attack a California raisin producers' cartel overseen by a state body, without excessively interfering in sovereign state prerogatives. State legislatures may still choose to create self-interested professional regulatory bodies; their sovereignty is not compromised. Now, however, state legislatures must (1) make it clearer up front that they intend to allow those bodies to displace competition and (2) subject those bodies to disinterested third-party review.

Those changes should make it far easier for parties that would be harmed by special-interest regulation to spot and publicize welfare-inimical regulatory schemes[21] and should weaken the incentive and ability of rent seekers to undermine competition through state regulatory processes. All told, the burden that these constraints will impose on the states is relatively modest and should be far outweighed by the substantial welfare benefits that they are likely to generate.

The Questionable Legitimacy of Protectionism

An additional virtue of the *North Carolina Dental Board* decision is that it will force some states to re-examine and revise their licensing schemes if they wish to avoid antitrust scrutiny. In the process, the states might abandon some anticompetitive licensing practices because of the risk that they will be held invalid on yet another ground.

Recently, numerous commentators have argued that many licensing schemes are not only unwise, but also unconstitutional under various provisions of the Constitution, such as the Equal Protection Clause. As those authors have explained, there is a powerful argument that the government cannot justify blatant cronyism as a legitimate government interest.[22]

That issue is not purely a matter for academic debate. Various parties who were barred from entering a licensed profession have challenged the constitutionality of this regulatory practice in several federal circuits. In each case, the plaintiffs argued that the state cannot adopt and enforce occupational licensing laws that benefit only a select number of license holders rather than the general public.

To resolve those lawsuits, three federal courts of appeals have addressed the issue of whether mere protectionism is a legitimate state interest, and they have disagreed over the answer to that question. In *Craigmiles v. Gilles*,[23] the U.S. Court of Appeals for the Sixth Circuit held unconstitutional a state law limiting the sale of caskets to licensed funeral directors. In *St. Joseph Abbey v. Castille*,[24] the Fifth Circuit agreed with the Sixth Circuit's *Craigmiles* decision,

20. *Id.* at 1123.

21. Both free-market advocacy and litigation organizations (such as the Institute for Justice, *see* http://www.ij.org/) and federal and state antitrust enforcers have been able to spot pernicious regulations and to challenge harmful regulations after their adoption (as the FTC did in *North Carolina Dental Board*). They also have been able to advocate in filings and in testimony before state bodies against the enactment of the regulations in the first place. The second approach, known as "competition advocacy," has been widely used by the FTC (*see* http://www.ftc.gov/policy/advocacy/advocacy-filings) and the U.S. Department of Justice (*see* http://www.justice.gov/atr/public/division-update/2013/competition-advocacy.html).

22. *See, e.g.*, Clark M. Neily III, Terms of Engagement: How Our Courts Should Enforce the Constitution's Promise of Limited Government (2013); Michael J. Phillips, The *Lochner* Court, Myth and Reality 173 (2001); Timothy Sandefur, The Right to Earn a Living: Economic Freedom and the Law (2010); Bernard H. Siegan, Economic Liberties and the Constitution (2d ed. 2005); Roger V. Abbott, Note, *Is Economic Protectionism a Legitimate Governmental Interest Under Rational Basis Review?*, 62 Cath. U. L. Rev. 475 (2013); Norman Karlin, *Back to the Future: From* Nollan *to* Lochner, 17 Sw. U.L. Rev. 627 (1988); Paul J. Larkin, Jr., *Public Choice Theory and Occupational Licensing*, 39 Harv. J.L. & Pub. Pol'y (forthcoming 2016); Jonathan R. Macey, Book Review, *Public Choice and the Legal Academy*, 86 Geo. L.J. 1075, 1079 (1998) (labeling as "deplorable" the courts' current attitude toward judicial review of economic legislation); Wayne McCormack, *Economic Substantive Due Process and the Right of Livelihood*, 82 Ky. L.J. 397 (1993); Guy Miller Struve, *The Less-Restrictive-Alternative Principle and Economic Due Process*, 80 Harv. L. Rev. 1463 (1967); Christopher T. Wonnell, *Economic Due Process and the Preservation of Competition*, 11 Hastings Const. L.Q. 91 (1983); J.R.R. II, Note, *Due Process Limits on Occupational Licensing*, 59 Va. L. Rev. 1097 (1973).

23. 312 F.3d 220 (6th Cir. 2002).

24. 712 F.3d 215 (5th Cir. 2013). The Fifth Circuit in *St. Joseph Abbey* and the Sixth Circuit in *Craigmiles* discussed both the Due Process and Equal Protection Clauses without specifying which served as the basis for its decision. Both provisions forbid arbitrary government conduct, so both provisions could be used to challenge an occupational licensing requirement.

but the Tenth Circuit disagreed in *Powers v. Harris*.[25] The result is that two federal courts of appeals have held that cronyism cannot justify a licensing scheme, while a different circuit has found differently.

Conclusion

The Supreme Court has not yet decided to referee this dispute, but it may not be able to put off forever the need to resolve this important intercircuit conflict. At least for the time being, the Court may not need to resolve this disagreement, because the states may re-examine their licensing statutes in light of the Court's decision in *North Carolina Dental Board*. But if the states decline to revise their regulatory schemes to eliminate their unjustifiable exclusionary effect, it is likely that there will be yet another round of challenges to those programs—this time based on the federal Constitution.

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25. 379 F.3d 1208 (10th Cir. 2004).