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Brother, May I?: The Challenge of Competitor Control over Market Entry

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I. Introduction

Good morning. Thank you, Judge Ginsburg and the folks at *Concurrences* and the George Mason University School of Law, for inviting me to speak. As always, I am delighted to return to my alma mater.

Those concerned with restrictions on innovative technologies and business models often decry the stultifying effects of a "Mother, May I?" approach, where the innovator needs government permission to enter a market. These are worthy concerns and, in recognition of them, I have repeatedly counseled what I call regulatory humility, advising regulators to wait to see if consumer harm occurs before enacting new legal obligations.[2]

My remarks today will focus on a related issue, which I call the "Brother, May I?" problem or the challenge of competitor control over market entry. This problem arises when

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[1] The views expressed in these remarks are my own and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner. I would like to thank Gregory Luib for his invaluable contributions to this speech.

[2] *See, e.g.*, Maureen K. Ohlhausen, *Regulatory Humility in Practice*, Remarks before the American Enterprise Institute (Apr. 1, 2015), *available at* https://www.ftc.gov/system/files/documents/public_statements/635811/150401aeihumilitypractice.pdf; Maureen K. Ohlhausen, *The Procrustean Problem with Prescriptive Regulation*, 23 COMMLAW CONSPECTUS 1 (2014), *available at* https://www.ftc.gov/system/files/documents/public_statements/606381/141222commlaw.pdf.

would-be entrants are effectively required to obtain permission from incumbent competitors to enter or expand within a particular market. Whether it is due to a law or regulation, the decision of a financially-interested state board, or conduct by a monopolist looking to maintain its market power, new entrants to a market generally should not have to get their competitors' permission to compete. That such permission is effectively required in an increasing number of situations is inconsistent with the free-market principles that ought to guide our economic policies.

Public choice theory of course recognizes the problem of an industry capturing its regulators. The "Brother, May I?" scenario may be even more troubling as it is effectively "regulatory replacement" rather than capture, with competitors acting directly as a regulator. That such situations may arise likely would not have surprised James Buchanan and Gordon Tullock, the two co-founders of public choice theory, who spent significant parts of their careers on the George Mason faculty and who each, unfortunately, passed away during the past few years. No doubt their presence is missed here.

Before I get too far, let me provide some context for my remarks. I believe strongly in the concepts of a free-market economy and economic liberty for individuals. Those fundamental principles influenced my decision to attend law school at Mason, and they have since guided my views as a policy maker at the Commission. I also view sound antitrust enforcement—that is, enforcement efforts aimed at protecting consumer welfare, while minimizing burdens on otherwise efficient conduct—as a necessary part of a well-functioning free market. Competition is the first line of defense for consumers. Thus, targeted antitrust enforcement is good for the market because it makes other regulation less necessary.[3]

[3] *See, e.g.*, Timothy J. Muris, *Looking Forward: The Federal Trade Commission and the Future Development of U.S. Competition Policy*, 2003 COLUM. BUS. L. REV. 359, 364 (2003) ("Effective antitrust enforcement may preclude direct, command-and-control regulation of sectors of the economy, avoiding the significant inefficiencies such regulation entails.").

In addition, given my time as Director of the FTC's Office of Policy Planning, I have been a strong voice in support of competition advocacy. Such advocacy is necessary in many instances to combat proposed regulatory barriers to entry supported by incumbent interests. Thus, my long history with competition advocacy also shapes my views on these issues.

Finally, I would like to clarify that I am not here to advocate for requiring firms to assist their competitors. The courts, in *Trinko*[4] and other cases, have appropriately limited the general duty of firms to help their competitors compete. Similarly, I have argued against reliance on the essential facilities doctrine—particularly in the intellectual property area—by foreign antitrust agencies.[5] What I will argue here is that firms should not have to obtain their competitors' permission to compete and that the FTC's enforcement and advocacy efforts should seek to eliminate such anticompetitive market distortions. Interestingly, three recent victories by the FTC in the courts—*North Carolina Dental*, *Phoebe Putney*, and *McWane*—all in some way involved the need to seek the permission of competitors to enter a market, and I will address each case in turn.

II. *North Carolina Dental* and State Licensing Boards

One of the clearest examples of the "Brother, May I?" challenge arises in the state licensing of professionals. Here, my—and the Commission's—concern has been the artificial and unjustified barriers to entry erected by some state licensing boards, including, in particular, those composed of active participants in the very markets they regulate. This issue came to a head in the Commission's successful Sherman Act Section 1 case against the North Carolina Board of Dental Examiners (the Board).

[4] *See* Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

[5] *See*, *e.g.*, Maureen K. Ohlhausen, Comm'r, Fed. Trade Comm'n, Testimony on "The Foreign Investment Climate in China," before the U.S.-China Economic and Security Review Commission, at 5-6 (Jan. 28, 2015), *available at* https://www.ftc.gov/system/files/documents/public_statements/621411/150128chinatestimony.pdf.

In that case, the FTC filed an administrative complaint, alleging that the Board—through its dentist-members—was "colluding to exclude non-dentists from competing with dentists in the provision of teeth whitening services."[6] After deciding that whitening teeth constitutes the practice of dentistry, the Board issued letters to non-dentist providers, stating they were illegally practicing dentistry without a license and ordering them to cease and desist.[7] As everyone in this audience is aware, our case ended up at the Supreme Court, which ruled in the Commission's favor earlier this year, holding 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."[8]

A few key aspects of the Court's opinion stand out. First, the Court reiterated the crucial role that antitrust plays in our economy, noting that "[f]ederal antitrust law is a central safeguard for the Nation's free market structures."[9] Second, the Court focused on the important issue of political accountability, explaining that immunity for state agencies "requires more than a mere facade of state involvement, for it is necessary in light of *Parker* [*v. Brown*]'s rationale to ensure

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[6] *In re* N.C. Bd. of Dental Exam'rs, Dkt. No. 9343, Complaint, at 1 (June 17, 2010), *available at* https://www.ftc.gov/sites/default/files/documents/cases/2010/06/100617dentalexamcmpt.pdf. The Board consists of six licensed dentists, one licensed hygienist, and one "consumer member," who is neither a dentist nor a hygienist. *Id.* ¶ 2.

[7] *Id.* ¶ 20. The Board also issued letters to several third parties with interests in shopping malls, stating that teeth whitening services offered at mall kiosks are illegal. *Id.* ¶ 22.

[8] N.C. State Bd. of Dental Exam'rs v. FTC, 135 S. Ct. 1101, 1114 (2015). Justice Kennedy wrote the opinion for the Court and was joined by Chief Justice Roberts and Justices Ginsburg, Breyer, Sotomayor, and Kagan. Justice Alito, with Justices Scalia and Thomas joining, dissented. Among other things, the dissent argued that *Parker* immunizes state agencies, the Board is a state agency, "and that is the end of the matter." *Id.* at 1117-18 (Alito, J., dissenting). The dissent further noted that the regulation of the practice of medicine and dentistry has fallen "squarely within the States' sovereign police power" since before the Sherman Act was passed in 1890. *Id.* at 1119. Thus, the state statutes that created, and conferred regulatory authority on, the Board "represent precisely the kind of state regulation that the *Parker* exemption was meant to immunize." *Id.*

[9] *N.C. State Bd.*, 135 S. Ct. at 1109.

the States accept political accountability for anticompetitive conduct they permit and control."[10] Third, in addressing the states' concern about their licensing boards incurring antitrust liability and damages, the Court observed that states can ensure *Parker* immunity is available to agencies by adopting clear policies to displace competition, and, if those agencies are controlled by market participants, by providing active supervision.[11] Finally, the Court made clear that the critical inquiry 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.'"[12]

The *North Carolina Dental* decision was a crucial victory for competition and consumers. Under our federal system, individual states can do a lot to meddle with the free market; that is their choice to make. However, states need to be politically accountable for whatever market distortions they impose on consumers.[13] Of course, with a nod to George Stigler's insights from the 1970s, the North Carolina Dental Board's conduct can be easily explained as rent-seeking behavior by incumbents to fend off a new source of competition.[14] Where there is a benefit concentrated in the hands of a relatively small number of incumbent providers, in this case dentists, and the competitive harm is dispersed across all consumers of health care services, public choice theory predicts such incumbent exploitation of state licensing

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[10] *N.C. State Bd.*, 135 S. Ct. at 1111. *See also id.* ("*Parker* immunity requires that the anticompetitive conduct of nonsovereign actors, especially those authorized by the State to regulate their own profession, result from procedures that suffice to make it the State's own.").

[11] *See id.* at 1115-16.

[12] *Id.* (quoting Patrick v. Burget, 486 U.S. 94, 100-101 (1988)).

[13] *See e.g.*, FTC v. Ticor Title Ins. Co., 504 U.S. 621, 636 (1992) ("Federalism serves to assign political responsibility, not to obscure it. Neither federalism nor political responsibility is well served by a rule that essential national policies are displaced by state regulations intended to achieve more limited ends.").

[14] *See e.g.*, George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. MGMT. SCI. 3, 5 (1971) ("We propose the general hypothesis: every industry or occupation that has enough political power to utilize the state will seek to control entry.").

laws and regulations.[15] The adverse competitive results of such behavior are manifest.[16] Now, some have described this type of situation as an example of regulatory capture.[17] But, it is more than regulatory capture; it is the regulated replacing and acting as the regulators.

Looking at *North Carolina Dental* and our other recent Supreme Court win in *Phoebe Putney*, which I will discuss shortly, the state action area is one of the best examples of the Commission using its unique institutional features to guide the courts and others in the development of competition law toward better outcomes for competition and consumers. Looking ahead, the Commission should continue to focus both its enforcement and competition advocacy efforts on anticompetitive licensing activities within the states.

Nonetheless, I believe we ought to give the states some breathing room to respond to the changed legal landscape that they now face. As I have discussed elsewhere,[18] the states would appear to have several viable options for avoiding both antitrust liability for, and excessive oversight of, their conduct. These options should not be terribly onerous to implement and should help states retain individuals with sufficient relevant expertise on their regulatory boards.

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[15] *See e.g.*, Steven Menashi & Douglas H. Ginsburg, *Rational Basis with Economic Bite*, 8 N.Y.U. J.L. & LIBERTY 1055, 1087-88 (2014) ("By now, '[a]ll reasonably sophisticated persons know that a well-knit special interest group is likely to prevail over an amorphous 'public' whose members are dispersed and, as individuals, are not in sharp conflict with the organized interest.' The occupational licensing laws recently invalidated under rational basis review are just this type of special-interest legislation.") (quoting Walter Gellhorn, *The Abuse of Occupational Licensing*, 44 U. CHI. L. REV. 6, 16 (1976)); Timothy Sandefur, *A Public Convenience and Necessity and Other Conspiracies Against Trade: A Case Study from the Missouri Moving Industry*, 24 GEO. MASON U. C.R. L.J. 159, 176 (2014) ("Public choice theory predicts that where the government can redistribute wealth or opportunities between private groups, those groups will invest their resources in obtaining favorable legislation that will benefit them or handicap their rivals. Entry restrictions like occupational licenses or CON laws are made-to-order examples.").

[16] *See e.g.*, Daniel J. Gilman & Julie Fairman, *Antitrust and the Future of Nursing: Federal Competition Policy and the Scope of Practice*, 24 HEALTH MATRIX 143, 165 (2014) ("[L]icensure may be used by incumbent professionals to insulate themselves from competition. By restricting the entry of competitors, licensure can restrict supply, which can increase the income of incumbents (at consumer expense) or decrease the pressure on incumbents to improve non-price aspects of their services, such as quality or convenience.") (footnote omitted).

[17] *See, e.g.*, Herbert Hovenkamp, *Rediscovering Capture: Antitrust Federalism and the* North Carolina Dental *Case*, CPI ANTITRUST CHRONICLE (Apr. 2015).

[18] *See* Maureen K. Ohlhausen, *Reflections on the Supreme Court's* North Carolina Dental *Decision and the FTC's Campaign to Rein in State Action Immunity*, Remarks before the Heritage Foundation, at 14-16 (Mar. 31, 2015), *available at* https://www.ftc.gov/system/files/documents/public_statements/634091/150403hertiagedental.pdf.

Nonetheless, it will take the states some time to evaluate and modify, if necessary, their licensing boards. In the meantime, as Chairwoman Ramirez mentioned at the ABA Spring Meeting, the Commission has begun an effort to provide guidance to states seeking to satisfy the active supervision prong of the state action doctrine. I have had discussions with representatives from state attorneys general offices, and I hope to continue that dialogue over the next several months.

Now, the economic libertarian in me is hopeful that the states, while assessing the sufficiency of their supervision over licensing decisions, will also reevaluate some of the excessive occupational licensing requirements they have adopted over the years. As the states reconsider the composition and oversight of their regulatory boards, I would recommend that they also take a very hard look at their occupational licensing regimes to see if they are on balance helping or harming their citizens. Among the professions subject to state licensure requirements today are florists, interior designers, tour guides, barbers, hair braiders, and even "shampoo specialists."[19] In fact, roughly thirty percent of U.S. workers are now required to obtain a license to pursue their occupation.[20] Multiple studies have found that prices increase—by as much as thirty-three percent—as a result of occupational licensing.[21] That might be tolerable if those price increases reflected improved quality; however, "economic studies have

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[19] *See* Stephanie Simon, *A License to Shampoo: Jobs Needing State Approval Rise*, WALL ST. J. (Feb. 7, 2011), http://www.wsj.com/articles/SB10001424052748703445904576118030935929752; Melissa S. Kearney, et al., Nearly 30 Percent of Workers in the U.S. Need a License to Perform Their Job: It Is Time to Examine Occupational Licensing Practices, Brookings Institution Up-Front Blog (Jan. 27, 2015 11:00 AM), http://www.brookings.edu/blogs/up-front/posts/2015/01/26-time-to-examine-occupational-licensing-practices-kearney-hershbein-boddy. For a comprehensive review of state licensing requirements, see INSTITUTE FOR JUSTICE, LICENSE TO WORK: A NATIONAL STUDY OF BURDENS FROM OCCUPATIONAL LICENSING (May 2012), *available at* https://www.ij.org/licensetowork.

[20] *See* Morris M. Kleiner & Alan B. Krueger, *Analyzing the Extent and Influence of Occupational Licensing on the Labor Market*, 31 J. LAB. ECON. 175-76 (2013) (findings based on 2008 survey conducted as part of Princeton Data Improvement Initiative).

[21] *See, e.g.*, Morris M. Kleiner, *Reforming Occupational Licensing Policies* 17-22 (The Hamilton Project, Discussion Paper 2015-01, 2015) [hereinafter Kleiner, *Reforming Occupational Licensing*], *available at* http://www.hamiltonproject.org/files/downloads_and_links/reforming_occupational_licensing_morris_kleiner_final.pdf (collecting studies).

demonstrated far more cases where occupational licensing has reduced employment and increased prices and wages of licensed workers than where it has improved the quality and safety of services."[22] Overall, the drag on the economy of excessive occupational licensing is counted in hundreds of billions of dollars annually.[23] Moreover, the increased costs of excessive occupational licensing falls most heavily on those least able to afford them.[24]

A particular concern I have is that the "Brother, May I?" aspect of occupational licensing can create unnecessary barriers to entry for entrepreneurs seeking to take their first step on the economic ladder. This is particularly true for occupations that draw individuals who are just beginning a professional career. Licensing requirements, which often include educational components, can prevent lower-income workers, who may not be able to pay for additional education, from entering certain fields—even at the lowest rungs of the economic ladder. Competition and competitive markets, supplemented by sound antitrust enforcement, where necessary—not excessive licensing—will promote entrepreneurship in this country and provide the best platform for the least advantaged in our economy to prosper.

III. *Phoebe Putney* and Certificate-of-Need Laws

Another example of needing to obtain permission from one's competitors to enter the market is found in certificate-of-need, or CON, laws that remain on the books in over two-thirds

[22] *Id.* at 6; *see also id.* at 12-13 (collecting studies); Aaron Edlin & Rebecca Haw, *Cartels by Another Name: Should Licensed Occupations Face Antitrust Scrutiny?*, 162 U. PA. L. REV. 1093, 1111-12 (2014) ("The work of Kleiner and his contemporaries reveals a consensus in the academy: a licensing restriction can only be justified where it leads to better quality professional services—and for many restrictions, proof of that enhanced quality is lacking.").

[23] *See* Kleiner, *Reforming Occupational Licensing*, *supra* note 21, at 6.

[24] *See, e.g.*, *id.* at 16 ("The net effects [of licensing] can be regressive, as lower-income consumers—who now have to pay higher prices and may have less access to services ranging from haircuts to dental exams—pay more to the regulated practitioners, some of whom are well compensated.").

of the states.[25] Under these laws, would-be suppliers of a host of health care services, from acute care hospitals to nursing homes to rehabilitation centers, must seek approval from a state entity to enter the market. The real issue in a typical certificate-of-need determination is not, however, one of ensuring patient safety or the proper qualifications of the applicant—there are other laws and regulations that typically address those issues more directly—but rather the "need" for a new entrant into the market at issue, as determined by the state entity.[26] As I will discuss, CON laws have outlived their intended use and now effectively serve primarily, if not solely, to assist incumbents in fending off competition from new entrants. The Commission and the public were reminded of the anticompetitive effects of those laws most recently in the *Phoebe Putney* matter.

There, the FTC challenged a merger involving a local hospital authority in Albany, Georgia. The transaction was viewed by nearly everyone, including the Eleventh Circuit,[27] as a virtual merger to monopoly. As is well known at this point, the Commission litigated this case all the way to the Supreme Court, which ultimately sided with the agency in its unanimous 2013 decision.[28] To be immune from the antitrust laws under the state action doctrine, private and other non-sovereign entities must demonstrate that the state "clearly articulated and affirmatively

[25] *See* National Conference of State Legislatures, Certificate of Need: State Health Laws and Programs, http://www.ncsl.org/research/health/con-certificate-of-need-state-laws.aspx (indicating that 36 states retain some type of CON program as of 2014).

[26] *See, e.g.*, Sandefur, *supra* note 15, at 160 ("Unlike occupational licensing laws, CON requirements do not purport to determine whether a person is educated, trained, or skilled before going into business. Instead, they are expressly aimed at preventing competition against established companies, regardless of quality or skill."); *see also* Roy Cordato, *Certificate-of-Need Laws: It's Time for Repeal* 27 (John Locke Found., Nathaniel Macon Research Paper No. 1, 2005) ("Economist Friedrich Hayek in his Nobel Laureate lecture, 'The Pretense of Knowledge,' argued that central planners, like those charged with determining who should and should not get to provide medical services, can only 'pretend' to have the information necessary to make the kinds of decisions they claim to be making. At best, any determination of 'need' by such planners will be arbitrary and will not reflect actual market conditions. At worst, these planners can become witting or unwitting tools of entrenched interests who wish to keep competition out of the market.").

[27] *See* FTC v. Phoebe Putney Health Sys., Inc., 663 F.3d 1369, 1375 (11th Cir. 2011) (noting that "on the facts alleged, the joint operation of [Phoebe] and Palmyra would substantially lessen competition or tend to create, if not create, a monopoly").

[28] *See* FTC v. Phoebe Putney Health Sys., Inc., 133 S. Ct. 1003, 1017 (2013).

expressed" a policy displacing competition and thus allowing the otherwise anticompetitive conduct at issue.[29] The Court held that a general grant of corporate powers to a sub-state entity, such as a hospital authority, is insufficient by itself to satisfy the clear articulation prong of *Midcal*.[30] The challenged transaction, thus, was not immune from antitrust scrutiny, and the case was remanded for further proceedings.

So far, so good for patients in Albany. The FTC complaint counsel resumed the administrative litigation that had been stayed pending the federal court proceedings. It did not take very long, however, before the agency recognized a potentially insurmountable hurdle to a successful resolution of this case: the Georgia certificate-of-need laws. That is, even if the Commission could have established liability—and that seemed fairly likely, given the facts—the state CON laws would have prevented a divestiture of any hospital assets.

Now, the case took an admittedly circuitous route during its final eighteen months. Unfortunately for consumers of hospital services in the Albany area, a state hearing officer ruled that the CON laws would apply to any divestiture that might take place in this matter. The fact that the Albany region is deemed "over-bedded" made it unlikely that any divestiture buyer could obtain the necessary CON approval to operate an independent hospital. Thus, last March, the Commission reluctantly finalized its consent agreement with Phoebe Putney without a divestiture.[31]

What, then, should we take away from the *Phoebe* matter? First, although it is of little solace to consumers in Albany, the Supreme Court decision narrowing the state action doctrine is

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[29] *See id.* at 1010 (citing Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980)).

[30] *See id.* at 1012.

[31] *See In re* Phoebe Putney Health Sys., Inc., Dkt. No. 9348, Statement of the Federal Trade Commission, at 3 (Mar. 31, 2015), *available at* https://www.ftc.gov/system/files/documents/public_statements/634181/150331phoebeputneycommstmt.pdf.

a significant victory for competition principles and consumer welfare going forward. That decision, along with *North Carolina Dental*, represents the culmination of a decades-long effort by the Commission to narrow state action immunity from the antitrust laws—an effort in which I was proud to participate in several roles.[32] Second, *Phoebe* demonstrates the importance of obtaining preliminary relief when challenging hospital mergers in CON states. By maintaining the status quo, injunctive relief prevents the possibility of competitive harm—sometimes, as in *Phoebe*, irremediable harm—from occurring during the Commission's administrative proceedings and any appeals. Similarly, the outcome in *Phoebe* should give the Commission pause in challenging consummated hospital acquisitions in states with CON laws. Finally, this case is a stark reminder of the anticompetitive nature of such laws.

The Commission—both on its own and jointly with the Department of Justice Antitrust Division (DOJ)—has long advocated that states consider the costs that CON laws may impose on health care consumers.[33] In our most recent advocacy, we argued that CON laws "impede the efficient performance of health care markets," "create barriers to entry and expansion to the detriment of health care competition and consumers," and "weaken markets' ability to contain

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[32] I was a member of the State Action Task Force, which issued a report in 2003 recommending several means for the Commission to narrow the state action doctrine (*see* FED. TRADE COMM'N, OFFICE OF POLICY PLANNING, REPORT OF THE STATE ACTION TASK FORCE (Sept. 2003), *available at* http://www.ftc.gov/os/2003/09/stateactionreport.pdf), testified before the Antitrust Modernization Commission on the doctrine (*see* Prepared Statement of Maureen K. Ohlhausen, Dir., Office of Policy Planning, Fed. Trade Comm'n, before the Antitrust Modernization Commission on the State Action Doctrine (Sept. 29, 2005), *available at* https://www.ftc.gov/public-statements/2005/09/ftc-staff-testimony-antitrust-modernization-commission-concerning-state), and participated in several advocacy efforts at narrowing the scope of the doctrine.

[33] *See, e.g.*, Joint Statement of the Antitrust Division of the U.S. Dep't of Justice and the Federal Trade Commission before the Illinois Task Force on Health Planning Reform (Sept. 15, 2008) [hereinafter DOJ-FTC Illinois Testimony], *available at* https://www.ftc.gov/policy/policy-actions/advocacy-filings/2008/09/ftc-and-department-justice-written-testimony-illinois; Prepared Statement of the Federal Trade Commission before the Standing Committee on Health, Education & Social Services of the Alaska House of Representatives regarding House Bill 337 (Feb. 15, 2008), *available at* https://www.ftc.gov/policy/policy-actions/advocacy-filings/2008/02/ftc-written-testimony-alaska-house-representatives; Letter from Janet M. Grady, Regional Director, Federal Trade Commission, to the Honorable Mary George, Hawaii State Senate (Mar. 13, 1987), *available at* https://www.ftc.gov/policy/policy-actions/advocacy-filings/1987/03/ftc-staff-comment-governor-mary-george-concerning.

health care costs."[34] As a result, we expressed support for the repeal or narrowing of such laws.[35]

These advocacies have been grounded in large part on empirical studies of the impact of CON laws conducted by Commission economists.[36] Those studies have found that, rather than keeping health care costs down, CON laws and regulations lead to higher prices and expenditures.[37] For example, one study showed that if states substantially relaxed their CON programs to subject fewer hospitals to review, annual hospital expenditures would decrease by 1.4 percent, or approximately $1.3 billion.[38] Studies conducted by several independent commissions appointed by state legislatures to evaluate the impact of CON laws have reached similar conclusions.[39] These results, of course, are rather easily predicted by economic theory. Like any barrier to entry, CON laws prevent or limit the entry of firms that could otherwise provide higher-quality or lower-priced services than those offered by incumbents. In other words, output restrictions lead to higher, not lower, costs; they also result in higher profits for incumbent firms.

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[34] DOJ-FTC Illinois Testimony, *supra* note 33, at 1-2.

[35] *See id.* at 2; *see also* FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, IMPROVING HEALTH CARE: A DOSE OF COMPETITION ch. 8, at 6 (July 2004), *available at* https://www.ftc.gov/reports/improving-health-care-dose-competition-report-federal-trade-commission-department-justice ("[T]he Agencies urge states with CON programs to reconsider whether they are best serving their citizens' health care needs by allowing these programs to continue.").

[36] The CON area is just one example of empirical work conducted by FTC economists lending support to, and thus increasing the effectiveness of, the Commission's competition advocacy efforts.

[37] *See, e.g.*, DOJ-FTC Illinois Testimony, *supra* note 33, at 5 n.16 (collecting studies).

[38] *See* DANIEL SHERMAN, BUR. OF ECONOMICS, FED. TRADE COMM'N, THE EFFECT OF STATE CERTIFICATE-OF-NEED LAWS ON HOSPITAL COSTS: AN ECONOMIC POLICY ANALYSIS vi (Jan. 1988), *available at* https://www.ftc.gov/reports/effect-state-certificate-need-laws-hospital-costs-economic-policy-analysis; *see also id.* at iv ("The study thus finds no evidence that CON programs have led to the resource savings they were designed to promote, but rather indicates that reliance on CON review may raise hospital costs.").

[39] *See, e.g.*, THE LEWIN GROUP, AN EVALUATION OF ILLINOIS' CERTIFICATE OF NEED PROGRAM: PREPARED FOR STATE OF ILLINOIS COMMISSION ON GOVERNMENT FORECASTING AND ACCOUNTABILITY 16 (Feb. 2007) ("A review of the evidence indicates that CONs rarely reduce health care costs, and on occasion, increase cost in some states."); WILLIAM S. CUSTER, ET AL., REPORT OF DATA ANALYSES TO THE GEORGIA COMMISSION ON THE EFFICACY OF THE CON PROGRAM 8 (Nov. 2006) ("CON regulation is associated with higher private inpatient costs. The effect is robust with respect to model specification, measures of CON rigor, and diagnoses.").

Another fairly predictable result of CON regimes is the rent-seeking behavior pursued by incumbents who are able to exploit the regulatory system to their advantage. Using the "Brother, May I?" aspects of the CON process, incumbent hospitals and other health care providers can impose substantial delays on, or thwart altogether, potential entrants into their markets, thus protecting their own supra-competitive revenues.[40] Returning to public choice theory, it readily predicts such incumbent exploitation of CON laws,[41] as well as incumbent efforts to keep such laws on the books.[42]

Let me also address what appears to be the primary argument that states make in support of retaining CON laws: the ability to cross-subsidize care provided to uninsured or underinsured patients.[43] The argument is that, without CON laws, new entrants will engage in cream-skimming by taking the most profitable patients, thus depriving incumbent providers of revenue that is used to provide care to otherwise under-served or unserved patients—particularly at community or safety-net hospitals. Now, the public-policy goal of ensuring access to adequate health care services for patients who cannot afford them is certainly a laudable one. Using the

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[40] *See, e.g.*, DOJ-FTC Illinois Testimony, *supra* note 33, at 7; A DOSE OF COMPETITION, *supra* note 35, at Exec. Summ. at 22 ("Market participants can too easily use CON procedures to forestall competitors from entering an incumbent's market."). Incumbent providers have also entered into anticompetitive agreements that were outside of, but nonetheless facilitated by, the CON laws. *See, e.g.*, DOJ-FTC Illinois Testimony, *supra* note 33, at 7-8.

[41] *See e.g.*, Sandefur, *supra* note 15, at 176 ("Public choice theory predicts that where the government can redistribute wealth or opportunities between private groups, those groups will invest their resources in obtaining favorable legislation that will benefit them or handicap their rivals. Entry restrictions like occupational licenses or CON laws are made-to-order examples.").

[42] *See e.g.*, *id.* at 173 ("Public choice theory would also predict that as economic and technological circumstances change, CON laws would nevertheless remain on the books—vigorously defended by incumbent firms—long after the economic rationales on which they were based were rendered obsolete, even on their own terms.").

[43] *See, e.g.*, COMMISSION ON THE EFFICACY OF THE CERTIFICATE OF NEED PROGRAM, AN ANALYSIS AND EVALUATION OF CERTIFICATE OF NEED REGULATIONS IN GEORGIA: FINAL REPORT TO THE GEORGIA GENERAL ASSEMBLY AND GOVERNOR PERDUE xii-xiii (Dec. 2006) [hereinafter GEORGIA COMMISSION REPORT] ("Hospital leaders are concerned that if they lose their ability to cross-subsidize from [the highest-margin] services, they will no longer be able to cover the fixed losses associated with inpatient Medicaid services and care of the uninsured. For this reason, hospitals, whether nonprofit or proprietary, urban or rural, have wanted to see CON rules maintained or tightened in order to maintain regulatory control over the provision of these services in non-hospital-based settings.").

blunt and anticompetitive tool of CON laws, however, is not the answer. Such a use of CON laws flies in the face of any notion of free-market competition.[44]

Clearly, there are a host of difficult issues relating to the payment and provision of health care in this country that go far beyond CON laws and that may not have easy answers. The commission established to study the efficacy of the Georgia CON program in the mid-2000s, for example, was unable to reach consensus with regard to the best policy to address the difficult issue of cross-subsidization of indigent care.[45] As the commission recognized, "When viewed in a vacuum, analysis has shown a relatively weak effect of CON, but the CON program is being used as a regulatory device in an environment involving much stronger forces."[46] Nonetheless, using CON laws as an indirect tax for funding indigent care imposes costs—in terms of price, quality, and innovation—across all consumers of health care services.[47] There are less competitively-restrictive and more politically-transparent means for pursuing the goal of indigent care. In fact, there is some evidence that CON laws do not actually advance the goal of indigent care at general community hospitals.[48] Finally, as the antitrust agencies have noted in their advocacies in this area, CON laws were not adopted as a means of cross-subsidizing health

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[44] *See e.g.*, Sandefur, *supra* note 15, at 170 ("Whatever the merits of the 'cream-skimming' and incentives rationales, they apply only to public utilities, or perhaps to markets that feature some kind of monopoly characteristics. They do not apply to private markets with healthy competition. In these markets, 'cream-skimming' is simply the ordinary competitive process on which the economy depends for innovation and growth, and encouraging investment where market demand is lacking is rightly seen as foolhardy.").

[45] *See* GEORGIA COMMISSION REPORT, *supra* note 43, at xiii.

[46] *Id.*

[47] *See, e.g.*, Cordato, *supra* note 26, at 18 ("If CON laws are being used to hide this tax from the electorate, then not only are they inconsistent with sound economics, they are also inconsistent with an open and democratic political process.").

[48] *See, e.g.*, DOJ-FTC Illinois Testimony, *supra* note 33, at 9-10; THE LEWIN GROUP, *supra* note 39, at ii, 26-28 ("Through our research and analysis we could find no evidence that safety-net hospitals are financially stronger in CON states than other states.") (finding margins for safety-net hospitals in CON states "considerably lower" than margins for safety-net hospitals in non-CON states).

care.[49] That is an ex post rationale identified by CON proponents that is simply inconsistent with free-market principles. More, not less, competition is needed in the health care space.[50]

My recommendation, then, is for the Commission to re-engage with state legislatures on the issue of CON laws. With the *Noerr-Pennington*[51] doctrine rightly protecting incumbents' petitioning activity related to CON applications, there is little, if any, room for law enforcement action in this area. We have not, however, addressed this issue in our competition advocacy since 2008. Of course, the Commission typically issues advocacy comments only in response to invitations from policy makers or requests for public comments. I would urge the agency to continue that practice. Still, we ought to seek out opportunities to weigh in on the adverse impact of CON laws on consumer welfare. The Commission has been on a bit of a winning streak in challenging anticompetitive hospital mergers.[52] It would be unfortunate if any more of those victories for health care consumers were jeopardized by CON laws that preclude any meaningful remedy in those cases.

IV. *McWane* and Exclusionary Conduct by Monopolists

During the remainder of my remarks, I will address a third "Brother, May I?" situation in which a would-be entrant must effectively rely on its competitor's permission before entering or expanding its business. This one involves not state regulation but private conduct by a monopolist that is exclusionary and thus maintains its monopoly and is not justified by a

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[49] *See* DOJ-FTC Illinois Testimony, *supra* note 33, at 4.

[50] *See* A DOSE OF COMPETITION, *supra* note 35, at Exec. Summ. at 4 ("Vigorous competition, both price and non-price, can have important benefits in health care as well. Price competition generally results in lower prices and, thus, broader access to health care products and services. Non-price competition can promote higher quality and encourage innovation.").

[51] *See* E.R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961); United Mine Workers of Am. v. Pennington, 381 U.S. 657 (1965).

[52] *See, e.g.*, St. Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd., 778 F.3d 775 (9th Cir. 2015); ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559 (6th Cir. 2014); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069 (N.D. Ill. 2012).

cognizable efficiency. The end result is that a firm looking to enter the market or expand its sales is at the whims of its monopolist-competitor to succeed in such entry or expansion. The Commission recently encountered this in its Sherman Act Section 2 action against McWane, Inc.[53]

In that case, the Commission issued a seven-count administrative complaint against McWane in January 2012[54]—prior to my arrival as a Commissioner. Ultimately, the Commission dismissed six of the seven counts, finding liability solely on the Section 2 exclusive dealing count.[55] In particular, the Commission found that McWane had used an exclusive dealing policy to prevent its sole rival, Star Pipe Products, Ltd. (Star), from meaningfully competing and thus maintained the monopoly that McWane enjoyed in the market for domestically-manufactured ductile iron pipe fittings.[56] (Although perhaps not the sexiest of markets the Commission has pursued of late, pipe fittings are used by municipal and regional water authorities in crucial waterworks projects.)

The thrust of the case was that McWane, with over 90 percent market share, had imposed a policy on distributors that required them to purchase all of their domestic fittings from McWane; otherwise, they would lose their rebates and be cut off altogether.[57] There were two exceptions to this so-called Full Support Program permitting the purchase of competing domestic fittings: where McWane products were not readily available, and where the customer bought

[53] *See In re* McWane, Inc., Dkt. No. 9351, Opinion of the Commission (Feb. 6, 2014) [hereinafter *McWane* Commission Opinion], *available at* https://www.ftc.gov/system/files/documents/cases/140206mcwaneopinion_0.pdf.

[54] *See In re* McWane, Inc., Dkt. No. 9351, Administrative Complaint (Jan. 4, 2012), *available at* https://www.ftc.gov/sites/default/files/documents/cases/2012/01/120104ccwanestaradmincmpt.pdf (alleging conspiracy, information exchange, invitation to collude, restraint of trade based on distribution agreement, conspiracy to monopolize, monopolization, and attempted monopolization).

[55] *See McWane* Commission Opinion, *supra* note 53, at 2 & n.1.

[56] *See id.* at 20.

[57] *See id.* at 9, 16.

domestic fittings and accessories along with another manufacturer's ductile iron pipe.[58] The Commission found that, to the extent that Star was able to gain sales, it did so primarily under these limited exceptions, and those sales were insufficient to have a competitive impact.[59]

In finding liability on the exclusive dealing count, the Commission determined that McWane had monopoly power in the domestic fittings market,[60] that the Full Support Program constituted an exclusive dealing arrangement that substantially foreclosed its rivals' access to the most efficient sales channel,[61] and that this resulted in harm to competition and consumers in the domestic fittings market.[62] As the Commission opinion concluded, "[T]he evidence that McWane's exclusive dealing policy significantly impaired the access of McWane's only rival, Star, to the main channel of distribution, thereby increasing its costs and keeping it below the critical level necessary to pose a real competitive threat, is plainly sufficient to meet the standard of harm to competition set forth in the prevailing case law."[63]

At the same time, the Commission rejected the two efficiency justifications proffered by McWane. First, McWane argued that it engaged in exclusive dealing to generate sufficient sales to operate its last domestic foundry. The Commission did not view this to be "a cognizable

[58] *See id.* at 9.

[59] *See id.* at 28-29.

[60] *See id.* at 16-18.

[61] *See id.* at 20-25.

[62] *See id.* at 25-29.

[63] *See id.* at 26. Commissioner Wright dissented from the Commission's opinion in *McWane*. *See In re* McWane, Inc., Dkt. No. 9351, Dissenting Statement of Commissioner Joshua D. Wright (Feb. 6, 2014), *available at* https://www.ftc.gov/system/files/documents/public_statements/202211/140206mcwanestatement.pdf. The scope of the disagreement between the majority and the dissent was largely limited to the narrow, but obviously crucial issue of whether harm to competition from McWane's exclusive dealing had been demonstrated. *See, e.g.*, *id.* at 7 n.14 (assuming monopoly power); *id.* at 27-28 & n.38 (agreeing that Full Support Program amounted to exclusive dealing); *id.* at 33 n.40 (agreeing that "distributors are a key distribution channel"); *id.* at 4 (noting the "ample record evidence demonstrating that the Full Support Program harmed McWane's rival Star"). *See also* Leon B. Greenfield, *Afterword:* Lorain Journal *and the Antitrust Legacy of Robert Bork*, 79 ANTITRUST L.J. 1047, 1062 (2014) ("The division among the FTC commissioners in the recent *McWane* matter illustrates the narrowed scope of today's debates surrounding unilateral exclusion enforcement.").

procompetitive justification for antitrust purposes."[64] More specifically, McWane's increased sales volume did not result from actions, such as a price reduction, that typically promote consumer welfare by increasing overall market output or lowering prices; rather, the increased sales would have come from anticompetitive reductions in Star's output.

The second justification offered by McWane was that the Full Support Program prevented customers from cherry-picking the highest-selling items from Star and forced them to purchase McWane's full line of domestic fittings. That is, if distributors were able to source from multiple suppliers, they would buy the common fittings from the limited supplier (at lower prices) and turn to the full-line supplier for less common products only, which supposedly could lead to the collapse of the full-line seller. The Commission was not convinced that this is a cognizable efficiency under the antitrust laws. To begin with, McWane never explained why it could not compete to sell the more common products by lowering its prices for them and raising its prices for the less common products, thereby reducing an implicit cross-subsidy. In any event, the Commission noted that "[e]ven if selective entry by the full-line supplier's rivals led to the collapse of the full-line seller, that itself would not constitute a harm to the market (as opposed to a single firm)."[65]

Last month, the Eleventh Circuit upheld the Commission's decision, affirming our determinations regarding market definition, McWane's monopoly power, and harm to competition.[66] The court endorsed the approach taken by the D.C. Circuit and several other courts in determining whether a monopolist's conduct has harmed competition, noting, among other things, that substantial foreclosure is just one of several factors in the analysis and that

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[64] *McWane* Commission Opinion, *supra* note 53, at 30.

[65] *Id.* at 32.

[66] *See* McWane, Inc. v. FTC, No. 14-11363, 2015 WL 1652200, at *9-12, *19-21 (11th Cir. Apr. 15, 2015).

harm to one or more competitors is insufficient for purposes of Section 2.[67] The court identified the pricing evidence in the record as the "most powerful evidence of anticompetitive harm."[68] More specifically, the court observed that by keeping Star from becoming a more efficient competitor, McWane's exclusivity policy preserved its ability to charge supracompetitive prices; in fact, McWane was able to raise prices and increase its gross profits, notwithstanding Star's (limited) entry.[69] Finally, much like the Commission, the Eleventh Circuit was not persuaded by McWane's efficiency arguments.[70] I understand that McWane has announced its intention to seek further review of the Eleventh Circuit's decision. I will end my discussion of the *McWane* case here.

Let me make a few general points. First, there is no question in my mind that vertical business arrangements, including exclusive dealing, are much more likely to be procompetitive than anticompetitive. Exclusive dealing can enhance competition in a number of well-documented ways, including by eliminating inter-brand free-riding, reducing the costs associated with demand and supply uncertainty, and intensifying competition for distribution.[71] Exclusive distribution arrangements can be particularly procompetitive where a manufacturer provides dealer support, discounts, or other consideration for the exclusivity, or where there is competition to be the exclusive distributor of a particular product.

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[67] *Id.* at *16 (citing United States v. Microsoft Corp., 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc)). The Eleventh Circuit also endorsed the D.C. Circuit's causation standard for assessing exclusive dealing claims. *See id.* at *18 ("We agree with the Commission and our sister circuits that in these circumstances the government must show that the defendant engaged in anticompetitive conduct that reasonably appears to significantly contribute to maintaining monopoly power.").

[68] *Id.* at *19.

[69] *See id.*

[70] *See id.* at *21-22.

[71] *See, e.g.*, Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433 (2008) (explaining how exclusivity restrictions intensify competition by manufacturers for retail distribution); Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311, 357-60 (2002) (identifying various procompetitive justifications for exclusive dealing arrangements).

In short, the economic literature clearly supports the proposition that exclusive dealing is likely to be procompetitive.[72] Exclusive dealing thus should not be a significant focus of the Commission's competition enforcement program. Nonetheless, there are some situations—particularly in monopolized markets—in which exclusive dealing can be anticompetitive and serve to maintain a firm's monopoly power.[73] Where the Commission is able to identify substantial harm to competition that is not outweighed by cognizable efficiencies, we ought to pursue such conduct.

Finally, I would like to return to the cross-subsidization point. Whether one refers to it as cream-skimming or cherry-picking, this rationale is unconvincing to me as a justification for either certificate-of-need laws or exclusive dealing by a monopolist. While cream-skimming may be a legitimate concern in very limited circumstances, such as a rate-regulated market with high fixed costs,[74] I have not seen any evidence that would justify either a CON regime or exclusive dealing by a monopolist as a procompetitive response to cream-skimming by competitors. At a more general level, it is antithetical to free-market principles to cordon off significant portions of the market from would-be competitors that may provide lower-priced, higher-quality, and more innovative products and services. Rather, we should be doing everything we can to oppose such market restrictions and to facilitate entry by new and innovative competitors.

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[72] *See, e.g.*, Alden F. Abbott & Joshua D. Wright, *Antitrust Analysis of Tying Arrangements and Exclusive Dealing*, *in* ANTITRUST LAW AND ECONOMICS 183, 200-01 (Keith N. Hylton ed., 2d ed. 2010) ("[T]he potential efficiencies associated with both tying and exclusive dealing . . . lead most commentators to believe that they are generally procompetitive and should be analyzed under some form of rule of reason analysis."); James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639, 658 (2005) ("Most studies find evidence that vertical restraints/vertical integration are procompetitive[.]").

[73] *See* Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 488 (1992) (Scalia, J., dissenting) ("Where a defendant maintains substantial market power, his activities are examined through a special lens: Behavior that might otherwise not be of concern to the antitrust laws—or that might even be viewed as procompetitive—can take on exclusionary connotations when practiced by a monopolist.").

[74] *See, e.g.*, *supra* note 44.

We see this issue in the transportation area, where innovators like Uber, Lyft, Sidecar, and others are disrupting an age-old way of doing business and in the process providing consumers with expanded options, greater convenience, and often lower prices. In short, they are injecting much-needed competition into the market. For that reason, FTC staff has filed several advocacy comments to local authorities recommending that any restrictions on competition from these new transportation providers be no broader than necessary to address legitimate subjects of regulation, such as safety and consumer protection, and narrowly crafted to minimize any potential anticompetitive impact.[75] Implicit in our advocacies is a rejection of the cream-skimming argument made by some taxi competitors[76] and regulators[77] in justifying opposition to Uber and others seeking to enter transportation markets throughout the country. These new firms ought to be treated the same as incumbents, in terms of applying existing regulations; however, they should not be locked out of the market because they are skimming cream or picking cherries. What they are really doing is competing.

[75] *See, e.g.*, Federal Trade Commission Staff Letter to Alderman Brendan Reilly, Chicago City Council regarding Proposed Ordinance O2014-1367 (Apr. 15, 2014), *available at* https://www.ftc.gov/policy/policy-actions/advocacy-filings/2014/04/ftc-staff-comment-honorable-brendan-reilly-concerning; Federal Trade Commission Staff Letter to Jacques P. Lerner, General Counsel, District of Columbia Taxicab Commission regarding Second Proposed Rulemakings regarding Chapters 12, 14, and 16 of Title 31 (June 7, 2013), *available at* https://www.ftc.gov/policy/policy-actions/advocacy-filings/2013/06/ftc-staff-comments-district-columbia-taxicab; Federal Trade Commission Staff Letter to Colorado Public Utilities Commission regarding Docket No. 13R-0009TR (Mar. 6, 2013), *available at* https://www.ftc.gov/policy/policy-actions/advocacy-filings/2013/03/ftc-staff-comment-colorado-public-utilities.

[76] *See, e.g.*, Andrew Zaleski, *Welcome to the Uber Wars*, POLITICO MAGAZINE (Sept. 2, 2014), http://www.politico.com/magazine/story/2014/09/welcome-to-the-uber-wars-110498.html#.VWcQHrHD83E ("'Skimming the cream' is the way [a taxi company executive] describes what Uber does to taxi competitors.").

[77] *See, e.g.*, Community-wide Taxi Service Endangered by "Ridesharing," WHO'S DRIVING YOU? (June 30, 2014), *available at* http://www.whosdrivingyou.org/uploads/2/5/1/4/25145532/community-wide-access-fact-sheet.pdf ("'Uber, Lyft and Sidecar simply do not serve all areas of a community at all hours of the day. By stealing more lucrative fares, they will ultimately leave transportation deserts in underprivileged neighborhoods where people rely on taxicabs for daily errands.'—Robert Werth, President of the Taxicab, Limousine & Paratransit Association.")

V. Conclusion

Thank you for your attention this morning. I hope my remarks have shed some light on the problems that these “Brother, May I?” approaches create for free-market competition and how targeted antitrust enforcement and advocacy, supported by sound economic analysis, can help limit the damage. I also hope that my call to reduce these barriers, which particularly harm those on the bottom rung of the economic ladder, will encourage others to take up the challenge.

I would be happy to entertain any questions you may have.