Patrick Wyrick
Attorney
Jul 28, 2015 · 6 min read

The Supreme Court Decision That Every Startup Should Know About

If you're a fledgling startup with a disruptive technology that will sooner or later catch the attention of regulators, you have a choice to make. You can either preemptively reach out to the regulators, in an attempt to shape the inevitable regulatory scheme in a way that is favorable to your technology, or you can sit back and let the regulators come to you. In *most* cases, I'd argue the former is the better choice, for reasons I won't get into here.

But having selected this course, you are immediately confronted with a second choice: you can either (1) go to the federal government and ask it to create a nationally uniform regulatory regime, or (2) reach out to state governments and ask them to create local regulatory regimes. The former has some superficial appeal, but in my view, the latter is a far better choice, and this time, I *will* elaborate because the reasons are relevant to what I'll talk about later.

As a nascent startup you probably lack the resources to truly engage the federal government and lobby in an effective way, and if things go wrong, the federal government is a behemoth that can kill you. Don't go to the feds unless you know you can achieve a regulatory outcome that is *at least* survivable, and even then, controllable long-term. Interacting with the federal government is like owning a pet tiger—unless you're Mike Tyson, and put the thing in a chokehold the first time it looks at you like you're a meal, don't do it.

On the other hand, engagement with state governments presents less risk. Some states might treat you poorly, but so what? Take your capital elsewhere, build a great product that people want, and those states will come around. In the meantime, odds are you can convince at least a few states who actually *want* your investment capital to adopt highly-favorable regulatory regimes that provide you with markets where you can grow. To be sure, as companies scale up and saturate all 50 states, incentives shift, and suddenly there are reasons why a nationally uniform

scheme is attractive. But at that point, you have the resources to truly engage the feds and achieve a tolerable outcome.

All that to say: the U.S. Supreme Court decided a case this term that greatly improves startups' ability to achieve favorable outcomes with state regulators. The case is *North Carolina State Board of Dental Examiners v. Federal Trade Commission*, 135 S. Ct. 1101 (2015). In lawyerly terms, the Court's holding was that State licensing boards controlled by market participants active in the market being regulated by those boards are not immune from federal antitrust liability unless they are subject to "active State supervision." In less lawyerly terms, the Court said: if you're a state regulatory board, and a majority of your members participate in the market you regulate, your members can be sued for antitrust violations, unless the State government has someone overseeing the board who can veto any actions you take that are anti-competitive.

This sent shockwaves throughout state governments (trust me, it did). Almost half the States had signed onto a brief in support of the state licensing boards, and for obvious reasons—regulatory boards and commissions are the gears and levers that make much of state government work. Most of those boards and commissions are populated by people who are market participants in the market they regulate.

This isn't necessarily a bad thing: (1) people in the market presumably understand the market best, and bring expertise to bear that a non-market participant simply doesn't possess, and (2) as a more practical matter, it's hard to find people willing to accept positions on many of these boards unless they have a vested interest in the market. Sure, some appointments carry some inherent prestige as a form of non-monetary compensation, but there are literally hundreds of these boards in most states, many regulating quite obscure professions and markets. Those positions are uncompensated, thankless, and hard to fill. If you don't allow market participants to fill them, you potentially have a real problem as a state.

But of course, market participants inherently have incentives that don't necessarily align with the public as a whole, so they can be prone to regulating in a manner that protects their economic self-interests, rather than protect consumers.

It was this concern that caught the Supreme Court's attention in the North Carolina case. The dental board in North Carolina was controlled

by practicing dentists. When standalone teeth whitening shops starting popping up offering teeth whitening at a price significantly lower than the dentists were charging, the dentists on the dental board decided to send cease and desist letters to all of the teeth whitening shops, alleging that they were engaged in the unauthorized practice of dentistry. The teeth whiteners cried foul, the Federal Trade Commission sued the board arguing that they were engaging in anti-competitive activities in violation of the Sherman Act, and the Supreme Court agreed that the board members could be held liable for their actions.

Oklahoma was not one of the states who signed onto the brief in support of the North Carolina board. The reasons why should be obvious (Oklahoma Attorney General E. Scott Pruitt has been a champion of fighting regulatory overreach at both the federal and state level). After the decision, Attorney General Pruitt sent a letter to the state's governor, advising her of the implications of the decision, and urging strong reforms in Oklahoma. Pruitt wrote:

> *The State of Oklahoma has hundreds of boards and commissions and many of them, like North Carolina's Board of Dental Examiners, are controlled by active market participants and not subject to active state supervision for most of their actions. After the Supreme Court's decision, it is clear that many of these boards and commissions are at real risk of being sued under federal antitrust laws for actions that burden competition.*

> *Because many of Oklahoma's hundreds of boards and commissions are controlled by participants in the markets that the boards themselves regulate, they have the incentive to engage in economic protectionism and, as a result of the Supreme Court's recent decision, may be subject to suit if their actions violate antitrust law…all boards and commissions should be reminded and warned that they should not engage in anticompetitive behavior, economic protectionism, or other actions that further the private interests of one group by inhibiting the competition provided by another group unless adequately justified by compelling public need, like the health and safety of Oklahomans.*

The governor's response was predictably swift. She issue an executive order ordering all boards and commisions to submit all proposed individual regulatory actions to the Attorney General for his review to ensure that the action isn't anti-competitive.

It is likely that other states will begin to adopt similar reforms —and we should all hope they do. For reasons described above, many state will likely view it impractical to remake all regulatory boards to reduce membership by market participants. So states will likely follow Oklahoma's lead and instead choose to implement new oversight mechanisms that ensure that entrenched regulators do not engage in regulatory actions designed to squash or create barriers to their competition.

Just a few years ago, this would have been huge to a company like Uber, who repeatedly ran headlong into local regulators who fought to keep Uber out in order to protect the entrenched taxicab industry. Those same regulators will in the future have an enormous incentive—in the form of liability and the threat of treble damages under the Sherman Act—to avoid engaging in such anti-competitive behavior.

So if you're the type of startup I described in my opening paragraph, this is extraordinarily good news. State regulators just became much less likely to throw up hurdles to your disruptive technology. At the same time, you now have (1) a very strong incentive to actively engage with those state officials now exercising oversight over your regulators, and (2) ensure that the positions exercising those oversight powers are filled by people—like Attorney General Pruitt—who are true believers in free market ideals and the power of innovation.

The views expressed here are mine, and mine only, and not the views of the office for which I work.