

WASHINGTON STATE BAR ASSOCIATION

TO: WSBA Board of Governors
FROM: Executive Director Terra Nevitt
DATE: August 11, 2022
RE: Proposed Answers to ETHOS Question 3: What is the Ideal WSBA Structure?

ACTION: Adopt a response to the Supreme Court’s question, “Litigation aside, what is the ideal structure for the WSBA to accomplish its mission?”

Background

Since February 2022, the Board of Governors has been meeting in a process called ETHOS (Examining the Historical Organization and Structure of the Bar) to answer three questions posed by the Washington Supreme Court:

1. Does current federal litigation regarding the constitutionality of integrated bars require the WSBA to make a structure change?
2. Even if the WSBA does not have to alter its structure now, what is the contingency plan if the U.S. Supreme Court does issue a ruling that forces a change?
3. Litigation aside, what is the ideal structure for the WSBA to accomplish its mission?

The Board has established an end-of-August deadline to make a recommendation back to the Supreme Court regarding each question. The August 13, 2022, ETHOS meeting is the final, all-day meeting scheduled in this process. With that in mind, and based on input from Board members at the July 23, 2022, ETHOS meeting, members of the Executive Leadership Team and I have worked with members of the Board to bring back three proposed answers to question three for consideration.

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Proposal/Option 1: Status quo (no change to structure)

Description and Rationale

Under this scenario, WSBA would continue as an integrated bar. WSBA would continue legislative activities within the parameters of GR12 and Keller. WSBA would continue to utilize the Keller deduction to refund potentially non-germane activities.

The current structure serves a compelling government interest, most effectively promotes our mission and the regulatory objectives under GR12.1, is favored by some of our most invested members, allows for the most efficient provision of resources to the legal profession in support of the public, is the most fiscally responsible model, and, through self-regulation, most effectively ensures the independence of the judicial branch of government and the ongoing integrity of the rule of law. Moreover, bifurcating WSBA over concerns of commenting on legislation is premature and poses risk of harm to legal professionals and the public.

Mandatory, Integrated State Bars that Engage in Germane Activity are Constitutional and Serve a Compelling Government Interest

The Constitutional right to Freedom of Association is a fundamental and important right but it is not absolute. Mandatory associations are permissible when they serve compelling state interests. Much attention has been focused on the 5th Circuit's recent decision involving the Texas Bar. That decision reaffirmed that integrated, mandatory bars that engage in germane activities serve the compelling state interests of regulating the practice of law and improving the quality of legal services. Texas remained an integrated bar at the conclusion of the case in the 5th Circuit.

Most Effectively Promotes the Mission and Regulatory Objectives of GR12.1

Even under an exacting scrutiny analysis by the 5th Circuit in the McDonald case, almost all of WSBA's regulatory and non-regulatory activities would be considered germane. Moreover, the full scope of these activities most effectively accomplishes the organizational mission and regulatory objectives articulated under GR12.1.

The mission of the WSBA is to serve the public and the members of the Bar, to ensure the integrity of the legal profession, and to champion justice. GR 12.1 states the WA Supreme Court's regulatory objectives. Non-regulatory services and entities (i.e. sections) advance objectives (c) and (f) specifically.

- (c) meaningful access to justice and information about the law, legal issues, and the civil and criminal justice systems;
- (f) efficient, competent, and ethical delivery of legal services.

The Member Wellness Program, Continuing Legal Education, Legal Lunchbox, 3 Free WA Specific Ethics Credits, Practice Management Assistance, mentorship programs, Small Town and Rural Committee, WA Young Lawyers Committee, Fastcase Legal Research Tool, The Council on Public Defense, and WSBA Sections all advance regulatory objectives (c) and (f) by providing services, programs and resources that educate, provide professional development, and support members in the provision of legal services to the public. They also promote the mission of protecting the public by assisting legal professionals in their practices and providing professional development programs and resources that make them more competent professionals. All of these services are designed to increase the competence of legal professionals with the goal of preventing them from harming the public, thereby decreasing the number of disciplinary actions against the profession and resulting harm to the public.

The sections are the experts in their own substantive areas. The sections are responsible for the development of almost all of the substantive CLE programming made available to all WSBA members. Over 400 section members volunteer annually as faculty members and/or CLE Chairs in the production of continuing legal education in all of the various substantive areas. This number doesn't include the work of many others on the various sections Executive Committees who also contribute to the overall functioning of their particular sections that allow this work to happen. It is safe to say that if a WSBA member is learning about substantive areas of the law through a WSBA CLE it is because a section partnered with WSBA to produce it.

All of the sections together share their expertise and knowledge about the various areas of law in which they practice through networking events, CLEs, informal mentoring, over the various list serves, the provision of practice resources to members, and by contributing to the development of WSBA Deskbooks. All of these activities combined ensure that information about the law, legal issues, and the civil and criminal justice systems are being shared with all WSBA members, with the specific goal of improving the competence of the profession in service to the public.

Legal professionals serve the public best when they are provided readily accessible resources that promote and ensure the competence and integrity of their services to the public.

Favored by Some of Our Most Invested Members

Almost all of the sections who have weighed in and voiced their opinions have expressed a desire to stay integrated, as have many of our Supreme Court Boards and Committees. No sections have affirmatively advocated for bifurcation.

Staying Integrated Ensures the Most Effective Provision of Resources and is the Fiscally Responsible Thing to Do

The fiscal analysis of the various scenarios has shown that any scenario involving bifurcation will result in an increase in the licensing fee itself (i.e. the CA Model) or an increase in the overall costs for those members who rely on the non-regulatory services of the Bar. The current structure allows for economies of scale because all of the organizational support resources and infrastructure necessary to support an organization are leveraged by the same organization. In a bifurcated model, the support resources and infrastructure would need to be established and maintained by two separate organizations.

A large segment of members who rely most heavily on the non-regulatory services are small firm or solo practitioners who would be less able to afford the increased costs of services by paying two fees under a bifurcated model (i.e. a solo practitioner that relies on the Fastcase legal research tool would now have to pay fees to two organizations at a greater cost in order to receive the benefit of that resource).

Maintenance of the current structure ensures that all legal professionals have access to the critical services necessary to assure their ability to practice competently and effectively in service to the public.

Self-Regulation of the Legal Profession Ensures the Independence of the Judicial Branch of Government and the Ongoing Integrity of the Rule of Law

What is the danger of losing self-regulation of the profession? It is important to recall that the rationale for vesting the authority over the legal profession in the courts is to help maintain the legal profession's independence from government domination.

“An independent legal profession is an important force in preserving government under law, for abuse of legal authority is more readily challenged by a profession whose members are not dependent on government for the right to practice.” –*Preamble to the Rules of Professional Conduct, Para 11.*

We are talking about the pillars of our constitution and the bedrock of democracy. Losing the integrated bar structure in favor of a strictly regulatory agency, even if under the WA Supreme Court, inches us closer to the loss of independence of the judicial branch of government to the other two branches of government if current members of the Bar seek out the legislative or executive branches for recompense if they feel their voices are not heard by a purely regulatory agency. Members of the public have a fundamental right to obtain legal advice from a lawyer whose duty is to the client, not to any other person and not to the government.

Bifurcating WSBA Over Concerns of Commenting on Legislation is Premature and Poses Risk of Harm to Legal Professionals and the Public:

There is no argument that Keller is not still good law in WA. Bifurcating the WSBA under the false premise that under the current law (Keller) commenting on legislation is not allowed is premature and short sighted. If the 9th Circuit came back with a similar ruling to the 5th Circuit it would be easy to implement a contingency plan. The contingency plan would be to change our policies to restrict lobbying and legislative activities that do not relate to the practice of law or administration of justice. If, after such a ruling is made, sections and other bar entities would like to figure out a way to comment on legislation then options such as PAWL and others similar to it could be explored.

Bifurcating the WSBA and eliminating the provision of all other non-regulatory services that are clearly germane will harm those legal professionals who will now have to pay more to two organizations to receive the same services. If those legal professionals decide not to avail themselves of the critical benefits and services they receive now, it could also harm their clients and the public. In light of a ruling similar to the 5th Circuit, the WSBA (like the State Bar of Texas) would remain integrated, policy changes would resolve the issue in the short term, and steps could be taken after such a ruling to explore other options for commenting on legislation.

Legal Risks in Retaining Current Structure

1. Continuing to limit use of compelled fees to activities necessarily or reasonably incurred for the purpose of regulating the legal profession or improving the quality of legal services available and maintaining an appropriate procedure for members who disagree with the use of fees. (*Keller*)
2. Future development of the “broader free association” cause of action that the 9th, 10, and 5th Circuits state has not yet been decided by the U.S. Supreme Court. (*Crowe, Schell, McDonald, and Boudreaux*)
3. Taking steps necessary to invoke the state action doctrine to limit antitrust issues. (*NC Board of Dental Examiners*)
4. Please See Attachments

Fiscal Analysis

Under this scenario, WSBA would continue to offer the Keller Deduction to members for potentially non-germane activities. WSBA has historically taken a conservative approach to calculating the Keller Deduction. For instance, for the 2022 licensing season the total Keller Deduction was \$390,659.00 and

all legislative activities were included in the deduction. The license fee paying per member deduction in 2022 equated to \$9.02. Over the past 10 years an average of 13% - 15% of eligible members claimed the Keller Deduction. In 2022 the cost to the organization would equate to approximately \$54,000.00. The cost of the Keller Deduction as outlined above would be an ongoing expense if the organization sticks with the status quo.

If the 9th Circuit returns a ruling similar to the 5th Circuit (McDonald/TX State Bar Case) then WSBA would need to change policies/procedures and bylaws to limit activities considered to be non-germane. If this limited legislative/lobbying activities for WSBA in a similar way to TX, then the cost of WSBA's legislative /lobbying activities would likely decrease.

Other Considerations

While the current integrated bar structure is unequivocally the optimal choice for legal professionals and the public, some non-structural changes could enhance the organization's effectiveness:

- Adding public members to the Board of Governors could provide a broader perspective and allow input into the leadership of the profession with a public perspective.
- Proactive Regulatory Management could more effectively integrate some of the purely regulatory and non-regulatory functions to more closely align with the mission of serving members and serving and protecting the public.

Proposal/Option 2: Create a separate entity (PAWL) to support law-improvement work by sections

Description

A separate legal entity will house all political work that addresses issues of substantive law not closely tied to the regulation of the legal profession or improving the quality of legal services provided to people in Washington. (Note: The WSBA would still maintain a portfolio of government relations and legislative work in areas “germane” to a mandatory bar.) A suggested name for the new entity is the Political Arm of Washington Lawyers (PAWL). Like the Washington State Bar Foundation, PAWL would be legally separate from the WSBA, with its own Board of Trustees. Importantly, PAWL would be self-funded.

Rationale

PAWL is the ideal structure for WSBA for two primary reasons: (1) It reduces potential future risk and (2) It increases the potential effectiveness of collective legislative advocacy by Washington legal professionals.

Reduces Potential Future Risk

Although Keller is still good law in Washington State, the Fifth Circuit has already held that it is unconstitutional to require membership in an integrated bar association that engages in non-germane activity and a case involving similar issues is pending in the Ninth Circuit. Legislative activity is one of the expressive activities that was at issue in the *McDonald* case. In my view, it would be preferable for WSBA to be as close to “Keller pure” as possible. Moving the majority of legislative activity out of WSBA would be a significant step in accomplishing that goal.

Increases Effectiveness of Collective Legislative Advocacy by Washington Legal Professionals

WSBA sections and other entities often want to engage in legislative and political efforts beyond what is permitted by either GR 12 or Constitutional limitations for mandatory bars. This is a source of frustration and tension, as many WSBA members (and leaders) feel compelled to advance/improve substantive areas of law and engage in work of civil rights, for example. By forming a separate, voluntary organization to house legislative/political work, we would better support the critical work of helping the Legislature craft and enact the best laws for the people of Washington.

Legal Analysis

1. PAWL addresses potential risks in non-germane legislative activity, but does not address those same risks in CLE, Bar Publications, and other expressive activities. Some of the same risks in the current structure apply to PAWL.
2. PAWL requires an analysis of “germane.”

Please see attachments

Fiscal Analysis

Under this scenario the nonprofit organization PAWL must be fiscally independent of mandatory license fees. If Legislative Affairs continued to support the organization, most of the program budget would be attributed to PAWL (approximately \$250k) along with administrative costs to support accounting and financial reporting functions and some direct costs for meeting support (approximately \$80k). PAWL would need to generate approximately \$330k in annual revenue to be self-sustaining.

Other Considerations

- The funding mechanism could work much like the Foundation (voluntary donations) and/or membership.
- The Board of Trustees would oversee generation of bylaws and procedures.

WASHINGTON STATE BAR ASSOCIATION

TO: WSBA Board of Governors
FROM: Hunter M. Abell, Governor At-Large
DATE: August 11, 2022
RE: WSBA ETHOS Structure - Recommendations

ACTION/DISCUSSION : Approve recommendations outlined below on Questions #2 and #3 posed by Chief Justice Gonzalez.

I respectfully recommend that the Board of Governors (“BOG”) adopt the following answers to the remaining two questions posed by Chief Justice Gonzalez:

Question No. 2: Even if the WSBA does not have to alter its structure now, what is the contingency plan if the U.S. Supreme Court does issue a ruling that forces a change?

If a change is required, the BOG will generally adopt, revise, and implement the two-part process recently utilized to transition the structure of the State Bar of California. Specifically, the BOG will create a voluntary nonprofit entity while retaining mandatory regulatory functions under the direct purview of the Washington Supreme Court, with the specific revisions referenced below.

The first prong entails creation of a voluntary nonprofit entity that adopts the membership and activities of current WSBA sections. In California, the voluntary entity became known as the “California Lawyers Association.” Similarly, in Washington, such an organization may be known as the “Washington Lawyers Association.”¹

The second prong entails revising the current mandatory WSBA structure to continue executing core regulatory functions, including discipline and licensing, under the direct purview of the Washington Supreme Court. In California, the mandatory entity became known as the “California State Bar.” Similarly, in Washington, the mandatory entity may simply become known as the “Washington State Bar.”² The Washington State Bar would continue to operate the current functions of the Office of Disciplinary Council and the Regulatory Services Department, as well as other departments described below.

While the BOG recommends adopting the overall two-prong process engaged in by the State Bar of California, the BOG also recommends specific revisions uniquely tailored to Washington. A non-exclusive list of specific revisions include the following:

- 1) The Washington State Bar should be directly governed by the Washington Supreme Court, with the Court being advised by a robust, appointed Board of Advisors on all matters within the purview of the mandatory entity. This ensures the Court is well served with input from the profession. Majority

¹ Proposed names are provided for illustrative purposes only. References may be made interchangeably to “the voluntary entity” or “Washington Lawyers Association.” Ideally, any such name would be reflective of possible additional licensee members, such as Limited Practice Officers and Limited License Legal Technicians.

² See above. References may be made interchangeably to “the mandatory entity” or the “Washington State Bar.”

membership of the Board of Advisors should comprise licensed Washington legal professionals, with a certain number of seats allocated to representatives of the voluntary entity.³

- 2) Various WSBA programs should remain with the mandatory entity for further direction or restructuring as deemed appropriate by the Washington Supreme Court, including the following:⁴
 - a) The Access to Justice Board;
 - b) The APR 6 Law Clerk Board;
 - c) The Character and Fitness Board;
 - d) The Client Protection Fund Board;
 - e) The Committee on Professional Ethics;
 - f) The Disciplinary Board;
 - g) The Diversity Equity and Inclusion (“DEI”) Council;
 - h) The Limited Licensed Legal Technician Board;
 - i) The Limited Practice Board;
 - j) The Practice of Law Board; and
 - k) The Professional Responsibility Program (i.e. ethics line).

- 3) Various WSBA programs should transition to the voluntary entity, including the following:
 - a) The WSBA Legislative Program;
 - b) The WSBA’s current member support programs, including, but not limited to, WSBA Insurance Marketplace, the Lending Library, Wellness Program, Fastcase Resource Library, etc.;
 - c) The WSBA’s Committees, including Young Lawyers Committee, Editorial Advisory Committee, Small Town and Rural Committee (“STAR”), Pro Bono & Public Service Committee, etc.; and
 - d) The Member Engagement Council and Long Range Planning Council.

- 4) The funds and activities of the Washington State Bar Foundation, a 501(c)(3) charity, should be re-directed toward support of the voluntary entity.

These revisions would likely entail action by Court rule, and should be accompanied by legislative action to revise the State Bar Act (RCW 2.48).

The BOG requests WSBA staff to prepare a transition plan to effectuate the above acts in a timely fashion in the event of a U.S. Supreme Court ruling requiring a change.

Question No. 3: Litigation aside, what is the ideal structure for the WSBA to accomplish its mission?

See above. Washington is not alone in struggling with the ideal structure of its state bar association. As noted above, California recently went through a similar exercise. As noted in **Exhibit A**, the background and preliminary results of the State Bar of California transition has been largely positive. See **Exhibit A** (*See Lyle Moran, “California Split: 1 Year After Nation’s Largest Bar Became 2 Entities, Observers See Positive Change” available at*

³ Such a process serves to connect the two organizations, likely leading to better communications, coordination, and interaction.

⁴ Entities are listed in alphabetical order.

<https://www.abajournal.com/web/article/california-split-1-year-after-californias-state-bar-became-2-entities-observers-see-positive-changes>).

Roughly 20 states, including states that are arguable peer states for Washington in terms of population, attorney membership, political culture, geography, etc., utilize a mandatory/voluntary model. These states include, but are not limited to, New York, Colorado, Illinois, Pennsylvania, Ohio, and, as mentioned above, California. See RALPH H. BROCK, “AN ALIQUOT PORTION OF THEIR DUES”: A SURVEY OF UNIFIED BAR COMPLIANCE WITH HUDSON AND KELLER, 1 Tex. Tech. J. Tex. Admin. L. 23, 24 n.1 (2000).

Joining these states has at least four positive results: 1) it avoids the constitutional issues associated with the integrated model; 2) it promotes mission focus by avoiding the “distracted regulator” issue of the current structure; 3) it promotes the Court’s direct control and authority over regulatory matters; and 4) it permits the voluntary model to be as legislatively active as it desires, subject to the need to compete for members and member dues. A voluntary model’s ability to promote engagement was specifically addressed in the August 28, 2019 Minority Report to the Washington Supreme Court’s Bar Structure Task Force on the subject. See **Exhibit B**.

For all these reasons, the BOG recommends adopting the plan outlined in response to question number 2 above. The BOG further recommends that, before final action is taken by the Court, any such proposal be placed before the full membership for an advisory vote on the above proposed structure compared to the current integrated model. The results of such an advisory vote, while not binding, would be informative for both the Court and BOG in taking further potential action.

EXHIBIT A



WEEKLY PODCAST DISCUSSING UPDATED LEGAL NEWS
AND EVOLVING METHODS OF PROVIDING LEGAL SERVICE
HOSTED BY MARY VANDENACK

Home / Web First / California Split: 1 year after nation's largest...

BAR ASSOCIATIONS

California Split: 1 year after nation's largest bar became 2 entities, observers see positive change

BY LYLE MORAN ([HTTPS://WWW.ABAJOURNAL.COM/AUTHORS/64793/](https://www.abajournal.com/authors/64793/))

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For nearly 90 years, the State Bar of California hosted an annual convention that brought together hundreds of lawyers for educational programming, keynote speeches and networking.

But amid legislative scrutiny and concerns about optics, the bar's board voted to cancel the 2017 meeting that was to be held at the Disneyland Hotel in Anaheim.

The bar association later decided to stop hosting such gatherings indefinitely, determining they were emblematic of the trade association-like activities it wanted to put in its past.

However, the so-called annual meeting for attorneys and various legal organizations was revived last year by a new group: the California Lawyers Association, known as CLA.

The nonprofit launched in 2018 to house the State Bar's specialty law sections that were split off as part of the agency's legislatively mandated de-unification.

During a swearing-in ceremony for CLA's leaders at the group's two-day convention in San Diego last September, the recently departed chair of the State Bar's board noted the historic handoff taking place.

"The real significance of my presence today is to mark an important turning point in the life of the



Photo illustration by Sara Wadford



Photo of Michael G. Colantuono courtesy of Michael G. Colantuono

California bar,” Michael G. Colantuono told the crowd.

CLA was “accepting an entire role in our legal culture as the leaders of, and the advocates for, the legal profession,” Colantuono said. “The bar will merely regulate it.”

Colantuono was describing what he saw as one of the major shifts brought about by the split of the country’s largest state bar, an action proponents said was necessary for the scandal-plagued California agency to prioritize its regulatory duties.

The separation of the State Bar of California, created in 1927, did not come without fierce internal and legislative battles, though bar leaders and outside groups said the first year of de-unification produced the positive changes they envisioned.

The mandatory bar focused more closely on admissions and discipline for its more than 250,000 active and inactive licensees. In turn, the voluntary-membership CLA got off to a strong start taking responsibility for many of the bar’s trade association-like functions and launching new initiatives.

The case for bar associations: Why they matter (</voice/article/the-case-for-bar-associations>)

Meanwhile, the events in California have attracted nationwide attention as court rulings, active litigation and legislative pressures have prompted many of the 30-plus unified state bars to contemplate what a split would look like in their states. The U.S. Supreme Court's June 2018 *Janus v. AFSCME* decision has played a key role in sparking more urgent nationwide discussions about the long-term future of mandatory state bars.

The court cited the First Amendment in ruling that public sector unions cannot force employees who benefit from a union's collective bargaining agreement but decline to join the union to pay "fair share" fees.

Lawyers have already highlighted the decision in legal filings seeking to overturn compulsory bar fees via First Amendment arguments, and the Supreme Court in December vacated a ruling by the St. Louis-based 8th U.S. Circuit Court of Appeals upholding the mandatory model so it could be reconsidered in light of *Janus*.

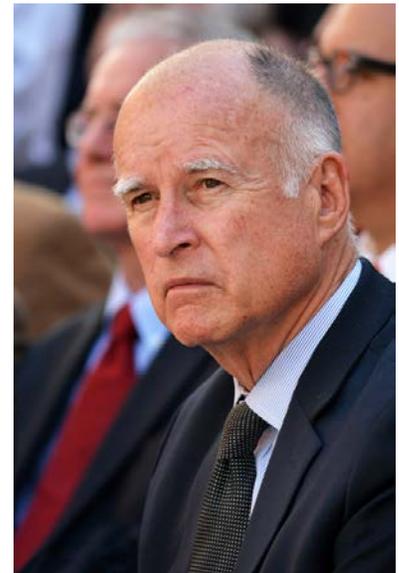
GENESIS OF A SPLIT

In California, then-Gov. Jerry Brown signed the historic legislation separating the State Bar into law on Oct. 2, 2017, and it took effect at the start of 2018.

The bill, SB 36, mandated that the bar's 16 specialty law sections depart the agency and become an independent nonprofit entity.

The sections, which focus on topics ranging from business law to environmental law, are best known for providing members with educational programming and networking opportunities. They were jettisoned to CLA along with the California Young Lawyers Association.

A primary impetus for the bar split was several years of scandals that generated frequent negative headlines and criticism asserting the State Bar was distracted from its mission of protecting the public from unethical lawyers.



Former Gov. Jerry Brown /
Shutterstock

The bar board's decision in late 2014 to fire then-Executive Director Joseph L. Dunn, a former state senator from Orange County, was one major driver of widespread attention to the association's shortcomings. While the bar typically only draws attention from the legal press, the Dunn firing and the ensuing legal battle sparked coverage in mainstream publications, including the *Los Angeles Times* (<https://www.latimes.com/local/california/la-me-state-bar-20141207-story.html>).

Dunn, aided by media-savvy Los Angeles attorney Mark Geragos, immediately filed a suit insisting he was terminated for whistleblowing. Dunn claimed he blew the whistle on then-Chief Trial Counsel Jayne Kim's alleged removal of cases from the bar's backlog of attorney discipline complaints, as well as various financial and ethical improprieties.

The bar denied Dunn's allegations while arguing that he never identified himself as a whistleblower and was fired on the basis of an outside law firm's report. The confidential Munger, Tolles & Olson report was later leaked to the press.

The report's authors accused Dunn of misleading, or failing to inform, the bar's board about several important matters. For example, the report said Dunn misrepresented that California Chief Justice Tani G. Cantil-Sakauye supported a potential relocation of the bar's San Francisco headquarters to Sacramento. Dunn was also accused of misleading the board into believing no bar funds would be used in connection with his travel to Mongolia in early 2014 to help the country set up a lawyer regulation system. (Dunn denied the allegations.)

The legal battle raged on for several years and featured a historic deposition of the chief justice. Other employees with ties to Dunn also filed suits against the bar regarding their terminations.

The bar retained Hueston Hennigan of Los Angeles, led by former Enron prosecutor John Hueston.

Dunn's claims were the focus of a contentious five-day arbitration hearing held in a downtown Los Angeles high-rise building in early 2017 that was open to the press. JAMS arbitrator Edward A. Infante ultimately sided with the bar on Dunn's two remaining causes of action, determining Dunn breached his duties to keep the board fully informed and to maintain a good relationship with the California Supreme Court.

"The State Bar's evidence demonstrates that the board had a legitimate, nonretaliatory explanation for its decision to terminate claimant's employment," Infante wrote in his March 2017 ruling (<https://www.courthousenews.com/wp-content/uploads/2017/03/Dunn-Calif-State-Bar-Dismissal.pdf>).

However, the bar's victory came at a cost that went beyond the hundreds of thousands of dollars it spent investigating Dunn and probing the leak of the Munger Tolles report. The legal dispute was frequently highlighted by lawmakers and other bar critics as a prime example of the agency's dysfunction.

CRITICAL AUDITS AND ARTICLES

Reports from the California State Auditor's Office and news stories also provided plenty of fodder for the bar's detractors.

A June 2015 audit (<https://www.bsa.ca.gov/pdfs/reports/2015-030.pdf>) said that in a rush to reduce its backlog of disciplinary cases, the bar allowed some attorneys who typically would have faced steeper consequences to keep practicing law through "inadequate" settlements. The report also slammed the agency's decision to purchase and renovate a building in downtown Los Angeles for roughly \$76 million instead of using the funds to improve its discipline system.

A 2016 state audit (<https://www.bsa.ca.gov/pdfs/reports/2015-047.pdf>) criticized the bar's generous executive compensation, noting that the maximum salaries for the State Bar's 13 top executives exceeded the governor's annual salary of about \$183,000. The salary for the bar's then-executive director, Elizabeth Rindskopf Parker, was \$267,500.

The state audits also generated unflattering coverage in the mainstream press, including from the *Sacramento Bee* (<https://www.sacbee.com/news/politics-government/capitol-alert/article77225277.html>).

Meanwhile, one of the bar's outside auditors flagged concerns that year about the specialty law sections' alcohol spending, which drew scrutiny from lawmakers, as did the sections' venue choices for certain events.

The bar spent at least \$156,000 on alcohol between January 2015 and late September 2016, most of which was tied to section events, according to information the agency provided to the state Legislature. The bar's board later approved a ban on alcohol spending.

Also in 2016, the *Los Angeles Daily Journal* reported that the bar had allowed hundreds of complaints about the unauthorized practice of law by nonattorneys to sit in drawers for months without investigation. Lawmakers were furious, and the agency's top prosecutor, Jayne Kim, resigned when it became clear she would not secure state Senate confirmation for a second four-year term.

Under the leadership of Parker and then-Chief Operating Officer Leah T. Wilson, the bar also made a legally questionable \$1.6 million transfer from its Lawyer Assistance Program to its Client Security Fund that was later reversed. In addition, the agency was ordered by lawmakers to undo a building loan arrangement in which it pledged future lawyers' dues as collateral.

The revelations gave fuel to those calling for a major bar overhaul.



Heather L. Rosing and Joanna Mendoza publicly advocated for the de-unification of the bar in submissions to the Legislature. Photos courtesy of Heather L. Rosing and Joanna Mendoza

ADVOCATES FOR REFORM

One group that had long called for a bar split with little traction was the Center for Public Interest Law. However, the University of San Diego School of Law-based center gained powerful new allies in 2016 when bar board trustees Joanna Mendoza, Dennis Mangers and Glenda Corcoran—along with former bar vice president Heather L. Rosing—publicly advocated for the de-unification of the bar in submissions to the legislature.

They wrote that splitting off the bar’s trade association-like functions, such as the sections, would allow the agency to stop being a “distracted regulator” known for its “long history of cyclical crisis, reform, neglect and renewed crisis.”

Additionally, they said creating a separate voluntary association for attorneys would ensure better legislative advocacy for the legal profession.

“We foresee a more effective regulator of legal services to Californians, and a more potent and less costly professional association for lawyers,” the group of four wrote in an April 2016 submission to the California State Assembly’s Committee on Judiciary.

Bar executives and other trustees opposed their proposals, with some trustees expressing anger in person and via email.

“This will set access to justice back decades, and hurt the very people that we are charged with protecting. I am sickened to be associated with you,” then-bar board trustee Hernán Vera wrote in a June 2016 email thread, referencing the trustees who advocated for de-unification to the Legislature.

But the reform-minded trustees found a receptive audience among the members and staff of the Assembly Judiciary Committee. The panel—chaired by Assemblyman Mark Stone, a Monterey Bay Democrat—held oversight hearings in which lawmakers slammed the bar and its executive team headed by Parker.

“I’m convinced this year the State Bar is the Titanic, and if we don’t turn it around, we will only have ourselves to blame,” Assemblyman David Chiu, a San Francisco Democrat, said during a May 2016 hearing.

While some members of the Assembly committee were eager to move ahead with a bar split, the panel decided in 2016 that the issue should be studied further by a commission.

Even that was a bridge too far for Senate Judiciary Committee Chair Hannah-Beth Jackson and Chief Justice Cantil-Sakauye. Sen. Jackson, a Santa Barbara Democrat, and the chief were fearful of going down a path that would lead to a less-than-deliberate bar overhaul.

The fiery standoff led to the 2016 legislative session ending without a bill authorizing the bar to collect lawyer fees in 2017 being enacted. In response, the California Supreme Court ordered lawyers to pay a special regulatory assessment to fund the bar’s disciplinary functions.

With the Assembly standing firm in its desire to see major changes at the bar, the resistance to a split dissipated in the ensuing months.

In early 2017, bar executives and the board agreed the agency's sections should be separated off. Jackson and the chief justice were supportive as well. The bill crafted to de-unify the bar sailed through the California Legislature without a "no" vote.

"SB 36 supports the State Bar in our ongoing reforms to focus on our mission of public protection," State Bar Executive Director Leah T. Wilson, who replaced Parker in September 2017, said the day the bill was signed into law.

MANDATORY BAR REFOCUSES

Both State Bar leaders and outside groups say the agency has paid greater attention to lawyer admissions and discipline since the split.

For example, the bar spent last summer and fall preparing to implement new and amended Rules of Professional Conduct that became effective Nov. 1, 2018. A bar commission crafted the state Supreme Court-approved rules that led to the first rules overhaul in nearly 30 years.

The agency has also more actively publicized its disciplinary actions against attorneys and efforts to halt the unauthorized practice of law by nonlawyers.

The bar's work in year one of de-unification drew praise from the Center for Public Interest Law, a group willing to criticize the agency when it falls short.

"We are heartened by what can best be described as a cultural shift at the bar—a difference in the language they use, and what appears to be a much more narrowed and clarified focus on public protection and access to justice," said Bridget Gramme, the Center for Public Interest Law's administrative director.

Gramme said she was encouraged the agency has looked to licensing boards from other professions for guidance on best practices and formed a Task Force on Access Through Innovation of Legal Services. "I am hopeful that this work may provide a useful model for other bars across the nation to follow," she said.

Bar board trustee Mendoza, a member of the task force, said the panel is one way the bar is still supporting access to justice despite critics' claims such efforts would suffer if de-unification occurred.

Reforming the agency's various subentities to ensure greater accountability and efficiency was another key bar initiative last year. The work included examining whether more subentities should be split off, or eliminated, with plans to sunset the Committee on Mandatory Fee Arbitration



*Photo of Bridget Gramme
from the University of San
Diego*

moving ahead.

“We are much more sensitive to the fact we can’t let all these various committees perform the bar’s functions without proper oversight,” Mendoza said. “Rather, we have to have our finger on these things if we are going to run a government agency.”

A positive note out of Sacramento was that the bar’s funding bill for 2019 sailed through the Legislature without any lawmaker opposition.

The bill included language changes requested by the bar to reflect that it is a regulatory agency, not a bar association. Licensed attorneys are now officially referred to in the State Bar Act as “licensees” instead of “members,” and they pay “fees” rather than “dues.”

But 2018 was not without its challenges for the bar, including the financial hit it took from the loss of the sections. The bar is seeking to have the Legislature raise the \$315 basic annual fee lawyers are assessed to help it address budget deficits, which the agency says have been exacerbated because there has been no fee increase in 20 years.

Also in 2018, the bar failed to secure state Senate confirmation for its chief trial counsel to serve in the role for the long term. Steven Moawad withdrew from Senate consideration amid his role as a defendant in a federal lawsuit alleging he harassed a Muslim colleague at his previous job. (He denied the allegations.)

CLA GENERATING ENTHUSIASM

Meanwhile, CLA’s leaders said the voluntary bar had a successful launch last year.

By virtue of housing the 16 specialty law sections and the California Young Lawyers Association, the group kicked off in 2018 with roughly 100,000 members, making it one of the largest bar associations in the country. For comparison, the New York State Bar Association has roughly 70,000 members.

Rosing, CLA’s first president, says the opportunity to create a new bar association from the ground up immediately generated excitement in California’s legal community.

“We are finding that our members are enthusiastic and our volunteers are enthusiastic,” Rosing says. “Equally as important, stakeholders across the state are reaching out to us on a daily basis to ask us to partner with them.”

Rosing said those stakeholders include a wide variety of bar associations, the California Supreme Court and the Legislature.

CLA has already established an Office of Bar Relations and Collaboration to partner with other bar associations on programming, education, networking and advocacy. It hired Ellen Miller-Sharp, the former San Diego County Bar Association CEO, to develop those partnerships.

In addition, CLA Initiatives focused on bolstering access to justice, diversity in the profession and



California Chief Justice Tani G. Cantil-Sakauye swears in CLA President Heather L. Rosing at CLA's annual meeting in San Diego in September 2018. Photo by Lyle Moran

civics education in schools are underway. At the group's annual meeting, Chief Justice Cantil-Sakauye called the voluntary bar "a powerhouse with tremendous potential ahead of it."

Rosing said another benefit of being free from the constraints applied to the State Bar as a government agency is that CLA can advocate for legislation in Sacramento that goes beyond merely regulating the legal profession or improving the quality of legal services.

In the last legislative session, CLA supported a bill—that was signed into law—to draw international arbitrations to California. It opposed unsuccessful legislation to tax high-end business services, including legal services.

The various specialty law sections are also continuing to provide technical and substantive assistance to the Legislature regarding their areas of expertise.

While CLA initially leased space from the bar in San Francisco, it moved its operations to Sacramento early this year. "We are purposely positioning ourselves very near the Capitol so we can have easy and constant access to the Legislature," said Rosing, a shareholder at Klinedinst in San Diego.

CLA, which also leased staff from the bar, has ramped up its hiring as well. Ona Alston Dosunmu became CLA's executive director at the start of 2019, replacing Interim Executive Director Pam Wilson. Dosunmu most recently served as vice president, general counsel and secretary at the Brookings Institution in Washington, D.C., capping a 16-year run as a member of the organization's senior executive team.

"The skills she brings with her from the Brookings Institution are going to be invaluable to us as we grow our own membership and expand our member benefits," Jim Hill, inaugural chair of CLA's Board of Representatives, said when Dosunmu's hiring was announced.

ALL EYES ON CALIFORNIA

Leaders of mandatory state bars across the nation said they have been closely watching the events in California amid precarious times for their organizations.

In Arizona, members of the Legislature have unsuccessfully tried in recent years to either abolish or bifurcate the State Bar. Some supporters of an overhaul have argued the mandatory bar model violates the First Amendment right of free association, while others have raised concerns about lawyers regulating themselves.

John Phelps, the State Bar of Arizona's recently departed CEO, says the organization has fended off lawmakers' restructuring attempts by highlighting the bar's successes. But he shared that the legislative maneuverings in his state, litigation in other locales and the changes in California have forced bars to review their structures.

"Those conversations are happening across the country," Phelps says. "In our case, we are doing some contingency planning and asking ourselves what we would need to do if we had to change our current model."

The National Association of Bar Executives has hosted discussions at its meetings about the changing landscape facing mandatory bars, said Janet Welch, the State Bar of Michigan's executive director. She said the topic was scheduled for further discussion at the recent NABE Midyear Meeting in Las Vegas.

Paula Littlewood, the Washington State Bar Association's executive director, said the bar split in California "has set a very strong example" for bar leaders to examine.

Her state even used a document from California listing different bar functions on a spectrum to support a review of its activities.

"Each bar is unique from the next, so what worked in California may or may not work in other states," Littlewood said. "But we certainly tried to educate ourselves a bit about what they did and how they did it."



Photo of Paula Littlewood
courtesy of Paula Littlewood

In September, the Washington Supreme Court announced plans to undertake a comprehensive review of the State Bar in light of both pending lawsuits and recent case law regarding the legal status of bar associations.

The court created a work group that it tasked with recommending a future structure for the bar, such as whether it should be divided into two organizations. The panel was scheduled to start meeting in January of this year, and it is expected to provide recommendations later in 2019.

LEGAL THREATS

One pending case that has drawn the close attention of state bars in the aftermath of the *Janus* decision is North Dakota lawyer Arnold Fleck's federal challenge to the mandatory bar model on First Amendment grounds.

Fleck, represented by the Phoenix-based Goldwater Institute, claimed in his lawsuit he was being forced to subsidize political activities he did not support. He also highlighted that nearly 20 states regulate attorneys with voluntary bars, which he argued was evidence "attorney regulation can be readily achieved without the First Amendment burdens imposed by mandatory bar associations."

Fleck lost at both the U.S. District Court and the 8th Circuit. But he filed a cert petition in December 2017 that sought to have the U.S. Supreme Court overrule its prior support of the mandatory bar model, such as in *Keller v. State Bar of California* (1990).

The U.S. Supreme Court's December 2018 order vacating the 8th Circuit's ruling against Fleck and remanding the case for further consideration in light of *Janus* was hailed by Fleck's lawyers.

"This is a major victory, not just for Arnold Fleck, but for attorneys like him across the nation who have been forced to fund speech they don't agree with," Timothy Sandefur, a Goldwater Institute lawyer, said in a news release (<https://goldwaterinstitute.org/article/goldwater-institute-wins-victory-for-free-speech-at-the-u-s-supreme-court/>) after the ruling.

However, state bar leaders believe strong legal arguments can be made that their organizations are distinguishable from labor unions, so *Janus* protections should not be extended to lawyers.

"Our members are officers of the court, they are not employees of the state," the Michigan bar's Welch says.

Welch says she believes state bars can also compellingly argue that the many ways in which they are integrated into the regulatory structures of government promote speech rather than suppress it. Her bar recently undertook a national survey to get a better sense of just how differently the mandatory bars around the country operate.

Helen Hirschbiel, CEO of the Oregon State Bar, also says mandatory bars stand on solid legal ground.

“We maintain that *Keller v. State Bar of California* is both the appropriate and the controlling case that specifically addresses the lawyer-regulatory environment, as opposed to labor unions and other nonregulatory organizations,” Hirschbiel says.

Her organization is facing a federal lawsuit two Oregon attorneys filed in August in which they point to *Janus* to argue they should not be compelled to pay bar dues. The Oregon bar is seeking to dismiss the suit.



Photo of Janet Welch courtesy of Janet Welch

THE NEBRASKA EXPERIMENT

Foreseeing the type of bar litigation playing out now, the Nebraska Supreme Court decided in late 2013 to de-unify its state bar. The court acted in response to a petition filed by Scott Lautenbaugh, a lawyer who was serving in the state Legislature. He alleged the bar association’s lobbying activities were impermissible under *Keller*.

While the court did not find the Nebraska State Bar Association was violating *Keller*, it did decide to limit the activities mandatory lawyer dues could fund to those regulating the legal profession: chiefly, admissions and discipline.

“By drawing the line for use of mandatory bar assessments well within the bounds of the compelled-speech jurisprudence, we ensure that the assessments—which will be administered by the Supreme Court—will be used only for activities that are clearly germane,” the Nebraska court wrote. “And by drawing the line in this way, we will clearly avoid the morass of continuing litigation experienced in other jurisdictions,” the Dec. 6, 2013 opinion said.

But in turning the Nebraska State Bar Association into a voluntary organization, the court created new challenges, including budgetary ones. The voluntary dues assessed were less than the mandatory ones, and lawyers were less likely to pay them, said Elizabeth Neeley, the Nebraska bar’s executive director.

The result was program and staffing cuts, and only a small number of the eliminated positions have been restored. Neeley said her association also had to make a philosophical shift.

“The beauty of a mandatory bar is that it can look outside of itself; and it can support the profession, it can support the court system and it can support the public,” she said. “One of the primary changes when you convert to a voluntary bar is you become member-centric. Your service to the court and service to the public becomes secondary, because if you don’t have members, you can’t do anything.”

Neeley highlighted that change and other issues in a letter she sent to the State Bar of Wisconsin’s CEO in April 2017 amid an effort to make bar dues in that state voluntary.

Asked if she would recommend the Nebraska approach for other states, Neeley said: “I think we have done the best we can with this model. We have really tried to make it work.”



Photo of Ellen Miller-Sharp and Heather L. Rosing by Lyle Moran

MORE CHANGE IN CALIFORNIA?

Ellen Miller-Sharp, the California Lawyers Association’s director of strategic partnerships and initiatives, acknowledges new voluntary bars have challenges they must confront.

But the longtime bar leader with experience at the national, state and local levels said she believes the opportunities for new organizations like CLA are great as well.

“To be able to start now means that you don’t have to do what other bars have done, or what the prior unified bar always did,” Miller-Sharp says. “You get to look and see what the landscape looks like and where could we add value.”

However, the California association may also become the new home for more functions the State Bar decides to spin off.

As with the annual meeting, President Rosing said CLA would welcome bar activities into its fold under the right circumstances.

“The reality is that CLA is well-positioned to take on additional responsibilities and ensure that the attorneys in the state of California continue to receive the services that they have traditionally received through the State Bar,” Rosing said.

Lyle Moran is a San Diego-based freelance reporter who specializes in legal issues. He has previously reported for the Associated Press, Los Angeles Daily Journal, San Diego Daily Transcript and the Lowell Sun.

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EXHIBIT B

August 28, 2019

Chief Justice Mary Fairhurst
Washington State Supreme Court
Temple of Justice
Olympia, WA

Re: Washington Supreme Court
Bar Structure Work Group - Minority Report

Dear Chief Justice Fairhurst:

Thank you for the opportunity to serve on the Washington Supreme Court Bar Structure Work Group (“Work Group”). It was an honor to serve with you and other Work Group members to address important questions about the structure of the Washington State Bar Association (“WSBA”) raised by recent United States Supreme Court cases.

The Majority Report accurately summarizes the Work Group’s process and the information it reviewed. We feel, however, that the Majority Report does not fully capture the strong disquiet felt by some members about the recommendation to maintain, without further discussion, the current WSBA structure. Consequently, we submit this Minority Report for your consideration. The comments below are solely those of the signatories acting in their individual capacities, and do not reflect the opinions of any other outside organizations or entities.

The Court should seriously evaluate whether a voluntary bar association would be more vibrant and engage more members than the existing mandatory association. The information presented by WSBA staff and comments sent by WSBA members raise significant questions about the WSBA’s member engagement, finances, and calculation of the licensing fee deduction for WSBA political activity (“*Keller* deduction”). Each issue is addressed below. Additionally, at minimum, we recommend the Court also address the concerns raised in the June 2014 Governance Task Force Report.

1-Member Engagement.

Emily Chiang, Legal Director for ACLU-Washington, advised the Work Group that the United States Supreme Court decision in *Janus v. American Federation of State, County, and Municipal Employees, Council 31*, 585 U.S. ____ (2018) did not require bifurcating the WSBA. This is only part of the analysis. The other part, and the question for the Court, is whether the WSBA should be bifurcated. Past WSBA President Anthony Gipe notes that

less than 20% of WSBA members vote in elections for the Board of Governors (“BOG”). (Comment 11, Anthony Gipe, Past WSBA President April 30, 2019 Letter). Of the 34 Comments submitted to the Work Group, at least one-third said they wanted the WSBA to become a voluntary bar association. Reasons for this ranged from the amount of bar licensing fees to complaints that the WSBA is too “Seattle-centric” and irrelevant to much of the rest of the State, particularly eastern Washington. This latter opinion reflects the geographic distribution of active lawyers throughout the state. In 2018, of the 26,313 active Washington lawyers, slightly more than 80% were in the seven counties that border I-5. Fewer than 19% of active lawyers are found in the remaining 32 counties. (See Mandatory Insurance Task Force Report, Exhibit B.) If the WSBA cannot meaningfully engage with a majority of its members and develop and maintain the trust necessary to secure broader member support, the Court should consider whether a voluntary association might be more vibrant and responsive.

2-Financial Stability.

In 2014 WSBA’s General Fund was “in the red” \$1.57 million; in 2015 \$2.7 million; in 2016 \$1.84 million; and in 2017 \$554,000. In 2018 the WSBA General Fund had net positive revenue of \$430,000 but the 2019 adopted budget assumed a General Fund loss of \$101,600, and the proposed 2020 budget assumed a General Fund loss of \$560,000.

The WSBA accumulated these deficits even as revenue increased from \$14.56 million in 2014 to \$16.9 million in 2017 and a projected \$20.8 million in 2020. This is not a sustainable path.

3-Keller Deduction.

Ms. Chiang advised the Work Group that *Janus* did not require splitting the WSBA, but reminded members that *Keller v. State Bar of California*, 496 U.S.1 (1990), requires bar associations to allow members to deduct from mandatory dues money spent on activities not related to regulation of the profession and improvement of the quality of legal services.

In 2019 the WSBA *Keller* deduction was \$1.25 for lawyers admitted before 2017, and \$.63 for lawyers admitted in 2017 or later. To many members, this is not credible, particularly in light of *Keller* deductions in other states and the WSBA’s wide-ranging activities. The *Keller* deduction is calculated by bar staff who, while honorable, well intentioned, and experienced, are placed in the untenable position of calculating a *Keller* deduction that may reduce funding of various WSBA activities directed by the Board of Governors and the Court, and employing their colleagues.

The Work Group agreed that the formula used to calculate the deduction needs to be more transparent. Governor P.J. Grabicki, who was not a member of the Work Group but regularly attended the meetings, recommended that an outside accounting firm review the deduction. (Comment 23, P.J. Grabicki, District 5 Board of Governors representative). He noted that, while the deduction survived a challenge brought by a Washington attorney, that attorney did not have the assistance of an accounting expert. Governor Grabicki advised the Work Group that if the Goldwater Institute, which is challenging at least three other mandatory state bar associations, challenges the WSBA's *Keller* deduction, it could bring in significant accounting "firepower."

The Work Group ultimately rejected, by a vote of 6-4, a motion to recommend that an outside accounting firm review the *Keller* deduction. Instead, Work Group members agreed they would offer to review the deduction themselves. Chief Justice Fairhurst reported at a subsequent meeting that members of the Supreme Court were not supportive of this idea. As such, the Majority Report defaults to a recommendation that the Board of Governors and staff "adopt and execute a thorough *Keller* interpretation" when calculating the deduction. *See* Majority Report, at 15. To promote transparency and considering litigation around the country challenging mandatory bar associations, the *Keller* deduction should be examined by an outside expert like the one proposed by Governor Grabicki.

4-Current Board Governance.

In the first eight months of 2019, the WSBA Board of Governors has been sued by a WSBA employee, one of its own members, and by two attorneys alleging that the WSBA must comply with public disclosure requests. The attorneys prosecuting the public records litigation prevailed at the trial level, and WSBA has been ordered to provide Board communications relating to the firing of the former Executive Director. Should the trial court ruling be affirmed, it is probable that the resulting release of emails and other WSBA communications will provoke another uproar from WSBA membership, further undermining institutional trust and stability.

Insisting that there be no changes to the WSBA structure and its relationship to the Court will not re-engage members, resolve financial issues, or provide a transparent and credible explanation of the *Keller* deduction. Instead, it merely postpones important structural reforms that can and should happen now.

One of us has been a member of WSBA for 40 years. It is painful to recommend that the Court consider whether the WSBA should continue in its current form. However, the issues raised during the Work Group and the recommendations of the

2014 Governance Report demonstrate the need for serious consideration of a voluntary bar or other changes to the current structure.

Very truly yours,

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BACKGROUND INFORMATION FOR CONSIDERING CONTINUING OBLIGATION TO COMPLY WITH
KELLER

In 1990, the U.S. Supreme Court announced that “[a] mandatory, integrated bar, may constitutionally use license fees to fund activities germane to regulating the legal profession and improving the quality of legal services.”¹ The Court stated further that a mandatory bar may not use mandatory license fees to fund activities of a political or ideological nature that are not “necessarily or reasonably incurred for the purpose of regulating the legal profession or ‘improving the quality of legal services provided to the people of the State.’”¹

The Court acknowledged that determining what is germane may not be easy:

“Precisely where the line falls between those State Bar activities in which the officials and members of the Bar are actin essentially as professional advisors to those ultimately charged with the regulation of the legal profession, on the one hand, and those activities having political or ideological coloration which are not reasonably related to the advancement of such goals, on the other, will not always be easy to discern. But the extreme ends of the spectrum are clear: Compulsory dues may not be expended to endorse or advance a gun control or nuclear freeze initiative; at the other end of the spectrum petitioners have no valid constitutional objection to their compulsory dues being spent for activities connect with disciplining members of the bar or proposing ethical codes for the profession.”²

In a later case, the U.S. Supreme Court described its *Keller* holding as follows:

This decision fits comfortably within the framework applied in the present case. Licensed attorneys are subject to detailed ethics rules, and the bar rule requiring the payment of dues was part of this regulatory scheme. The portion of the rule that we upheld served the “State’s interest in regulating the legal profession and improving the quality of legal services.” States also have a strong interest in allocating to the members of the bar, rather than the general public, the expense of ensuring that attorneys adhere to ethical practices. Thus, our decision in this case is wholly consistent with our holding in *Keller*.³

In July 2021, the 5th Circuit Court of Appeals interpreted *Keller* as follows:

Keller did not lay down a test to determine when lobbying is germane and when it is not, acknowledging that the dividing line would “not be easy to discern.” . . . We must do so now. Except as stated below, advocating changes to a state’s substantive law is non-germane to the purposes identified in *Keller*. Such lobbying has nothing to do with regulating the legal profession or improving the quality of legal services. Instead, those efforts are directed entirely at changing the law governing cases, disputes, or transactions in which attorneys might be involved. Lobbying for legislation regarding the function of the state’s courts or legal system writ large, on the other hand, is germane. So too is advocating for laws governing the activities of lawyers qua lawyers. . . . For example, the Bar’s lobbying to amend

¹ *Keller v. California State Bar*, 496 U.S. 1, 13-14 and 16 (1990)

² *Id.* At 14 (quoting *Lathrop v. Donohue*, 367 U.S. 820, 843 (1961))

³ *Harris v. Quinn*, 573 U.S. 616 (2014)

the Texas Constitution's definition of marriage and create civil unions is obviously non-germane. The Bar's presumably less-controversial proposed substantive changes to Texas family law are equally non-germane. The Bar's lobbying for the 'creation of an exemption regarding the appointment of pro bono volunteers,' on the other hand, is germane, because it relates to the law governing lawyers. Its lobbying for changes to Texas law is germane to the extent the changes affect lawyers' duties when serving as trustees, and non-germane to the extent the changes do not. ⁴

The 5th Circuit continued in a footnote:

The Bar contends that its lobbying was germane because "seeking to amend or repeal unconstitutional laws benefits the legal profession and improves the quality of legal services because it reduces the risk that lawyers, their clients, members of the public, or government officials will rely on laws that judicial decisions have rendered invalid." But Keller does not afford the Bar a roving commission to advocate for legislation to "amend or repeal unconstitutional laws" or "clean up legal texts."⁵

In addition to these statement regarding lobbying activities, the 5th circuit also found the following activities germane:

- "The plaintiff's complaint is that some of the convention panels and CLE courses are ideologically charged. Probably so. But that is not the test under Keller. And moreover, any objectionable CLE and annual convention offerings are only one part of a large, varied catalogue, and the Bar includes disclaimers indicating that it is not endorsing any of the views expressed. That is enough to satisfy Keller."⁶
- "The Bar's various diversity initiatives through OMA, though highly ideologically charged, are germane to the purposes identified in Keller. . . .But despite the controversial and ideological nature of those diversity initiatives, they are germane to the purposes identified in Keller. They are aimed at "creating a fair and equal legal profession for minority, women, and LGBT attorneys," which is a form of regulating the legal profession."⁷
- ". . .to the extent the Bar is supporting AJC activities limited to helping low-income Texans access legal services, it is germane. But some of AJC's activities include lobbying for changes to Texas substantive law designed to benefit low-income Texans, not at "regulating the legal profession" or "improving the quality of legal services," so they are non-germane under Keller."⁸

BACKGROUND FOR DISCUSSION OF FREE ASSOCIATION CLAIM -NOT YET DECIDED BY U.S. SUPREME COURT

⁴ McDonald v. Longley No. 20-50448 (July 2, 2021)

⁵ Id at 9-10

⁶ Id at 13

⁷ Id at 10-11

⁸ Id at 12.

In 2021, the 9th Circuit stated:

Accordingly, Plaintiffs raise an issue that neither the Supreme Court nor we have ever addressed: whether the First Amendment tolerates mandatory membership itself—independent of compelled financial support—in an integrated bar that engages in nongermane political activities. . . . Plaintiffs’ freedom of association claim based on the April 2018 Bulletin statements is viable. Because the district court erred in dismissing this claim as foreclosed by our precedent, we reverse and remand. On remand, there are a number of complicated issues that the district court will need to address.⁹

remanded the case of *Crowe v. Oregon State Bar* to the district court to determine:

- Whether *Janus* supplies the appropriate standard for plaintiffs’ free association claim, and if so
- Whether OSB can satisfy its “exacting scrutiny” standard;
- Whether Keller’s instructions with regards to germaneness and procedurally adequate safeguards are even relevant to the free association inquiry.

The remanded case is still pending.

In July 2021, the 5th Circuit addressed the free association issue, holding:

Compelled membership in a bar association that is engaged in only germane activities survives that scrutiny. . . . Compelled membership in a bar association that engages in non-germane activities, on the other hand, fails exacting scrutiny. . . . Although states have interests in allocating the expenses of regulating the legal profession and improving the quality of legal services to licensed attorneys, they do not have a compelling interest in having all licensed attorneys engage as a group in other, non-germane activities.¹⁰

This freedom of association issue has been addressed in two additional cases.¹¹

BACKGROUND FOR ANTITRUST RISK CONSIDERATION

In 2015, the U.S. Supreme Court upheld the Federal Trade Commission’s determination that the North Carolina State Board of Dental Examiners violated the federal antitrust laws by preventing non-dentists from providing teeth whitening services in competition with the state’s licensed dentists.¹² FTC staff issued guidance based on this decision. This risk analysis is from that guidance document.

⁹ *Crowe v. Oregon State Bar*, 19035470 at 27-28 (9th Cir 2021)

¹⁰ *McDonald v. Longley* at 9.

¹¹ *Boudreaux v. Louisiana State Bar*, 20-30086 (5th Circuit 2021); *Schell v. Chief Justice and Justices of Oklahoma Supreme Court*, No. 20-6044 (10th Cir. 2021)

¹² *N.C. State Bd. of Dental Exam’rs v. FTC*, 135 S.Ct. 1101 (2015)

The federal antitrust laws do not reach anticompetitive conduct engage in by a State that is acting in its sovereign capacity.¹³ The NC Dental Board decision reaffirmed that a state regulatory board is not a sovereign and is therefore, not necessarily exempt from federal antitrust liability. The guidance states that:

More specifically, the Court determined that “a state board on which a controlling number of decisionmakers are active market participants in the occupation the board regulates” may invoke the state action defense only when two requirements are satisfied. When the state action defense does not apply, the actions of the state regulatory board may be subject to antitrust scrutiny. The two requirements for invoking the state action doctrine are:

- The challenged restraint is a clearly articulated and affirmatively expressed state policy; and
- The policy must be actively supervised by a state agency that is not a participant in the regulated market¹⁴

The guidance provides additional information on several issues. This analysis includes only summary information on active market participants, and active supervision. The guidance document is attached.

Market participants are participants who are (1) licensed by the board or who (2) provide any service that is subject to the regulatory authority of the board. The guidance notes that this is true whether or not the board members are directly or personally affected by the challenged restraint and even if they temporarily suspend their active participation in an occupation for the purpose of serving on the Board.¹⁵

Controlling Number of market participants can be less than a numerical majority. Factors used to determine the controlling number of market participants include control as a matter of law, procedure or fact, and include veto power, tradition, or practice.¹⁶

Active Supervision. The Washington Supreme Court is the state actor that supervises the Washington State Bar Association. The guidance document sets out the following factors the FTC will use to determine whether active supervision has been satisfied:

- The supervisor has obtained the information necessary for a proper evaluation of the action recommended by the regulatory board;
- The supervisory has evaluated the substantive merits of the recommended action and assessed whether the recommended action comports with the standards established by the state legislature [for the WSBA could be court rules];

¹³ Parker v. Brown, 317 U.S. 341, 351-52 (1943)

¹⁴ *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980)
North Carolina Bd. of Dental Exam’rs v. FTC, 135 S.Ct. 1101 (2015)

¹⁵ FTC Staff Guidance on Active Supervision of State Regulatory Boards Controlled by Market Participants at Page 7 (October 2015)

¹⁶ Id at 8.

- The supervisory has issued a written decision approving, modifying, or disapproving the recommended action, and explaining the reasons and rationale for such decision.

The Guidance document also states that the active supervision must precede implementation of the allegedly anticompetitive restraint. Additionally, a “mere potential for state supervision is not an adequate substitute for a decision by the State.”¹⁷

¹⁷ N.C. Dental, 135 S.Ct. at 116-7

FTC Staff Guidance on Active Supervision of State Regulatory Boards Controlled by Market Participants*

I. Introduction

States craft regulatory policy through a variety of actors, including state legislatures, courts, agencies, and regulatory boards. While most regulatory actions taken by state actors will not implicate antitrust concerns, some will. Notably, states have created a large number of regulatory boards with the authority to determine who may engage in an occupation (*e.g.*, by issuing or withholding a license), and also to set the rules and regulations governing that occupation. Licensing, once limited to a few learned professions such as doctors and lawyers, is now required for over 800 occupations including (in some states) locksmiths, beekeepers, auctioneers, interior designers, fortune tellers, tour guides, and shampooers.¹

In general, a state may avoid all conflict with the federal antitrust laws by creating regulatory boards that serve only in an advisory capacity, or by staffing a regulatory board exclusively with persons who have no financial interest in the occupation that is being regulated. However, across the United States, “licensing boards are largely dominated by active members of their respective industries . . .”² That is, doctors commonly regulate doctors, beekeepers commonly regulate beekeepers, and tour guides commonly regulate tour guides.

Earlier this year, the U.S. Supreme Court upheld the Federal Trade Commission’s determination that the North Carolina State Board of Dental Examiners (“NC Board”) violated the federal antitrust laws by preventing non-dentists from providing teeth whitening services in competition with the state’s licensed dentists. *N.C. State Bd. of Dental Exam’rs v. FTC*, 135 S. Ct. 1101 (2015). NC Board is a state agency established under North Carolina law and charged with administering and enforcing a licensing system for dentists. A majority of the members of this state agency are themselves practicing dentists, and thus they have a private incentive to limit

* This document sets out the views of the Staff of the Bureau of Competition. The Federal Trade Commission is not bound by this Staff guidance and reserves the right to rescind it at a later date. In addition, FTC Staff reserves the right to reconsider the views expressed herein, and to modify, rescind, or revoke this Staff guidance if such action would be in the public interest.

¹ Aaron Edlin & Rebecca Haw, *Cartels By Another Name: Should Licensed Occupations Face Antitrust Scrutiny*, 162 U. PA. L. REV. 1093, 1096 (2014).

² *Id.* at 1095.

competition from non-dentist providers of teeth whitening services. NC Board argued that, because it is a state agency, it is exempt from liability under the federal antitrust laws. That is, the NC Board sought to invoke what is commonly referred to as the “state action exemption” or the “state action defense.” The Supreme Court rejected this contention and affirmed the FTC’s finding of antitrust liability.

In this decision, the Supreme Court clarified the applicability of the antitrust state action defense to state regulatory boards controlled by market participants:

“The Court holds today that a state board on which a controlling number of decisionmakers are active market participants in the occupation the board regulates must satisfy *Midcal’s* [*Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980)] active supervision requirement in order to invoke state-action antitrust immunity.” *N.C. Dental*, 135 S. Ct. at 1114.

In the wake of this Supreme Court decision, state officials have requested advice from the Federal Trade Commission regarding antitrust compliance for state boards responsible for regulating occupations. This outline provides FTC Staff guidance on two questions. *First*, when does a state regulatory board require active supervision in order to invoke the state action defense? *Second*, what factors are relevant to determining whether the active supervision requirement is satisfied?

Our answers to these questions come with the following caveats.

- Vigorous competition among sellers in an open marketplace generally provides consumers with important benefits, including lower prices, higher quality services, greater access to services, and increased innovation. For this reason, a state legislature should empower a regulatory board to restrict competition only when necessary to protect against a credible risk of harm, such as health and safety risks to consumers. The Federal Trade Commission and its staff have frequently advocated that states avoid unneeded and burdensome regulation of service providers.³
- Federal antitrust law does not require that a state legislature provide for active supervision of any state regulatory board. A state legislature may, and generally should, prefer that a regulatory board be subject to the requirements of the federal antitrust

³ See, e.g., Fed. Trade Comm’n Staff Policy Paper, *Policy Perspectives: Competition and the Regulation of Advanced Practice Registered Nurses* (Mar. 2014), <https://www.ftc.gov/system/files/documents/reports/policy-perspectives-competition-regulation-advanced-practice-nurses/140307aprnpolicypaper.pdf>; Fed. Trade Comm’n & U.S. Dept. of Justice, Comment before the South Carolina Supreme Court Concerning Proposed Guidelines for Residential and Commercial Real Estate Closings (Apr. 2008), <https://www.ftc.gov/news-events/press-releases/2008/04/ftcdoj-submit-letter-supreme-court-south-carolina-proposed>.

laws. If the state legislature determines that a regulatory board should be subject to antitrust oversight, then the state legislature need not provide for active supervision.

- Antitrust analysis – including the applicability of the state action defense – is fact-specific and context-dependent. The purpose of this document is to identify certain overarching legal principles governing when and how a state may provide active supervision for a regulatory board. We are not suggesting a mandatory or one-size-fits-all approach to active supervision. Instead, we urge each state regulatory board to consult with the Office of the Attorney General for its state for customized advice on how best to comply with the antitrust laws.
- This FTC Staff guidance addresses only the active supervision prong of the state action defense. In order successfully to invoke the state action defense, a state regulatory board controlled by market participants must also satisfy the clear articulation prong, as described briefly in Section II. below.
- This document contains guidance developed by the staff of the Federal Trade Commission. Deviation from this guidance does not necessarily mean that the state action defense is inapplicable, or that a violation of the antitrust laws has occurred.

II. Overview of the Antitrust State Action Defense

“Federal antitrust law is a central safeguard for the Nation’s free market structures The antitrust laws declare a considered and decisive prohibition by the Federal Government of cartels, price fixing, and other combinations or practices that undermine the free market.” *N.C. Dental*, 135 S. Ct. at 1109.

Under principles of federalism, “the States possess a significant measure of sovereignty.” *N.C. Dental*, 135 S. Ct. at 1110 (quoting *Community Communications Co. v. Boulder*, 455 U.S. 40, 53 (1982)). In enacting the antitrust laws, Congress did not intend to prevent the States from limiting competition in order to promote other goals that are valued by their citizens. Thus, the Supreme Court has concluded that the federal antitrust laws do not reach anticompetitive conduct engaged in by a State that is acting in its sovereign capacity. *Parker v. Brown*, 317 U.S. 341, 351-52 (1943). For example, a state legislature may “impose restrictions on occupations, confer exclusive or shared rights to dominate a market, or otherwise limit competition to achieve public objectives.” *N.C. Dental*, 135 S. Ct. at 1109.

Are the actions of a state regulatory board, like the actions of a state legislature, exempt from the application of the federal antitrust laws? In *North Carolina State Board of Dental Examiners*, the Supreme Court reaffirmed that a state regulatory board is not the sovereign. Accordingly, a state regulatory board is not necessarily exempt from federal antitrust liability.

More specifically, the Court determined that “a state board on which a controlling number of decisionmakers are active market participants in the occupation the board regulates” may invoke the state action defense only when two requirements are satisfied: first, the challenged restraint must be clearly articulated and affirmatively expressed as state policy; and second, the policy must be actively supervised by a state official (or state agency) that is not a participant in the market that is being regulated. *N.C. Dental*, 135 S. Ct. at 1114.

- The Supreme Court addressed the clear articulation requirement most recently in *FTC v. Phoebe Putney Health Sys., Inc.*, 133 S. Ct. 1003 (2013). The clear articulation requirement is satisfied “where the displacement of competition [is] the inherent, logical, or ordinary result of the exercise of authority delegated by the state legislature. In that scenario, the State must have foreseen and implicitly endorsed the anticompetitive effects as consistent with its policy goals.” *Id.* at 1013.
- The State’s clear articulation of the intent to displace competition is not alone sufficient to trigger the state action exemption. The state legislature’s clearly-articulated delegation of authority to a state regulatory board to displace competition may be “defined at so high a level of generality as to leave open critical questions about how

and to what extent the market should be regulated.” There is then a danger that this delegated discretion will be used by active market participants to pursue private interests in restraining trade, in lieu of implementing the State’s policy goals. *N.C. Dental*, 135 S. Ct. at 1112.

➤ The active supervision requirement “seeks to avoid this harm by requiring the State to review and approve interstitial policies made by the entity claiming [antitrust] immunity.” *Id.*

Where the state action defense does not apply, the actions of a state regulatory board controlled by active market participants may be subject to antitrust scrutiny. Antitrust issues may arise where an unsupervised board takes actions that restrict market entry or restrain rivalry. The following are some scenarios that have raised antitrust concerns:

- A regulatory board controlled by dentists excludes non-dentists from competing with dentists in the provision of teeth whitening services. *Cf. N.C. Dental*, 135 S. Ct. 1101.
- A regulatory board controlled by accountants determines that only a small and fixed number of new licenses to practice the profession shall be issued by the state each year. *Cf. Hoover v. Ronwin*, 466 U.S. 558 (1984).
- A regulatory board controlled by attorneys adopts a regulation (or a code of ethics) that prohibits attorney advertising, or that deters attorneys from engaging in price competition. *Cf. Bates v. State Bar of Ariz.*, 433 U.S. 350 (1977); *Goldfarb v. Va. State Bar*, 421 U.S. 773 (1975).

III. Scope of FTC Staff Guidance

- A. This Staff guidance addresses the applicability of the state action defense under the federal antitrust laws. Concluding that the state action defense is inapplicable does not mean that the conduct of the regulatory board necessarily violates the federal antitrust laws. A regulatory board may assert defenses ordinarily available to an antitrust defendant.

1. Reasonable restraints on competition do not violate the antitrust laws, even where the economic interests of a competitor have been injured.

Example 1: A regulatory board may prohibit members of the occupation from engaging in fraudulent business practices without raising antitrust concerns. A regulatory board also may prohibit members of the occupation from engaging in untruthful or deceptive advertising. *Cf. Cal. Dental Ass'n v. FTC*, 526 U.S. 756 (1999).

Example 2: Suppose a market with several hundred licensed electricians. If a regulatory board suspends the license of one electrician for substandard work, such action likely does not unreasonably harm competition. *Cf. Oksanen v. Page Mem'l Hosp.*, 945 F.2d 696 (4th Cir. 1991) (en banc).

2. The ministerial (non-discretionary) acts of a regulatory board engaged in good faith implementation of an anticompetitive statutory regime do not give rise to antitrust liability. See 324 Liquor Corp. v. Duffy, 479 U.S. 335, 344 n. 6 (1987).

Example 3: A state statute requires that an applicant for a chauffeur's license submit to the regulatory board, among other things, a copy of the applicant's diploma and a certified check for \$500. An applicant fails to submit the required materials. If for this reason the regulatory board declines to issue a chauffeur's license to the applicant, such action would not be considered an unreasonable restraint. In the circumstances described, the denial of a license is a ministerial or non-discretionary act of the regulatory board.

3. In general, the initiation and prosecution of a lawsuit by a regulatory board does not give rise to antitrust liability unless it falls within the "sham exception." Professional Real Estate Investors v. Columbia Pictures Industries, 508 U.S. 49 (1993); California Motor Transport Co. v. Trucking Unlimited, 404 U.S. 508 (1972).

Example 4: A state statute authorizes the state's dental board to maintain an action in state court to enjoin an unlicensed person from practicing dentistry. The members of the dental board have a basis to believe that a particular individual is practicing dentistry but does not hold a valid license. If the dental board files a lawsuit against that individual, such action would not constitute a violation of the federal antitrust laws.

- B. Below, FTC Staff describes when active supervision of a state regulatory board is required in order successfully to invoke the state action defense, and what factors are relevant to determining whether the active supervision requirement has been satisfied.

1. When is active state supervision of a state regulatory board required in order to invoke the state action defense?

General Standard: “[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.” *N.C. Dental*, 135 S. Ct. at 1114.

Active Market Participants: A member of a state regulatory board will be considered to be an active market participant in the occupation the board regulates if such person (i) is licensed by the board or (ii) provides any service that is subject to the regulatory authority of the board.

- If a board member participates in any professional or occupational sub-specialty that is regulated by the board, then that board member is an active market participant for purposes of evaluating the active supervision requirement.
- It is no defense to antitrust scrutiny, therefore, that the board members themselves are not directly or personally affected by the challenged restraint. For example, even if the members of the NC Dental Board were orthodontists who do not perform teeth whitening services (as a matter of law or fact or tradition), their control of the dental board would nevertheless trigger the requirement for active state supervision. This is because these orthodontists are licensed by, and their services regulated by, the NC Dental Board.
- A person who temporarily suspends her active participation in an occupation for the purpose of serving on a state board that regulates her former (and intended future) occupation will be considered to be an active market participant.

Method of Selection: The method by which a person is selected to serve on a state regulatory board is not determinative of whether that person is an active market participant in the occupation that the board regulates. For example, a licensed dentist is deemed to be an active market participant regardless of whether the dentist (i) is appointed to the state dental board by the governor or (ii) is elected to the state dental board by the state’s licensed dentists.

A Controlling Number, Not Necessarily a Majority, of Actual Decisionmakers:

- Active market participants need not constitute a numerical majority of the members of a state regulatory board in order to trigger the requirement of active supervision. A decision that is controlled, either as a matter of law, procedure, or fact, by active participants in the regulated market (*e.g.*, through veto power, tradition, or practice) must be actively supervised to be eligible for the state action defense.
- Whether a particular restraint has been imposed by a “controlling number of decisionmakers [who] are active market participants” is a fact-bound inquiry that must be made on a case-by-case basis. FTC Staff will evaluate a number of factors, including:
 - ✓ The structure of the regulatory board (including the number of board members who are/are not active market participants) and the rules governing the exercise of the board’s authority.
 - ✓ Whether the board members who are active market participants have veto power over the board’s regulatory decisions.

Example 5: The state board of electricians consists of four non-electrician members and three practicing electricians. Under state law, new regulations require the approval of five board members. Thus, no regulation may become effective without the assent of at least one electrician member of the board. In this scenario, the active market participants effectively have veto power over the board’s regulatory authority. The active supervision requirement is therefore applicable.

- ✓ The level of participation, engagement, and authority of the non-market participant members in the business of the board – generally and with regard to the particular restraint at issue.
- ✓ Whether the participation, engagement, and authority of the non-market participant board members in the business of the board differs from that of board members who are active market participants – generally and with regard to the particular restraint at issue.
- ✓ Whether the active market participants have in fact exercised, controlled, or usurped the decisionmaking power of the board.

Example 6: The state board of electricians consists of four non-electrician members and three practicing electricians. Under state law, new regulations require the approval of a majority of board members. When voting on proposed regulations, the non-electrician members routinely defer to the preferences of the electrician members. Minutes of

board meetings show that the non-electrician members generally are not informed or knowledgeable concerning board business – and that they were not well informed concerning the particular restraint at issue. In this scenario, FTC Staff may determine that the active market participants have exercised the decisionmaking power of the board, and that the active supervision requirement is applicable.

Example 7: The state board of electricians consists of four non-electrician members and three practicing electricians. Documents show that the electrician members frequently meet and discuss board business separately from the non-electrician members. On one such occasion, the electrician members arranged for the issuance by the board of written orders to six construction contractors, directing such individuals to cease and desist from providing certain services. The non-electrician members of the board were not aware of the issuance of these orders and did not approve the issuance of these orders. In this scenario, FTC Staff may determine that the active market participants have exercised the decisionmaking power of the board, and that the active supervision requirement is applicable.

2. What constitutes active supervision?

FTC Staff will be guided by the following principles:

- “[T]he purpose of the active supervision inquiry . . . is to determine whether the State has exercised sufficient independent judgment and control” such that the details of the regulatory scheme “have been established as a product of deliberate state intervention” and not simply by agreement among the members of the state board. “Much as in causation inquiries, the analysis asks whether the State has played a substantial role in determining the specifics of the economic policy.” The State is not obliged to “[meet] some normative standard, such as efficiency, in its regulatory practices.” *Ticor*, 504 U.S. at 634-35. “The question is not how well state regulation works but whether the anticompetitive scheme is the State’s own.” *Id.* at 635.
- It is necessary “to ensure the States accept political accountability for anticompetitive conduct they permit and control.” *N.C. Dental*, 135 S. Ct. at 1111. *See also Ticor*, 504 U.S. at 636.
- “The Court has identified only a few constant requirements of active supervision: The supervisor must review the substance of the anticompetitive decision, not merely the procedures followed to produce it; the supervisor must have the power to veto or modify particular decisions to ensure they accord with state policy; and the ‘mere potential for state supervision is not an adequate substitute for a decision by the State.’ Further, the state supervisor may not itself be an active market participant.” *N.C. Dental*, 135 S. Ct. at 1116–17 (citations omitted).

- The active supervision must precede implementation of the allegedly anticompetitive restraint.
- “[T]he inquiry regarding active supervision is flexible and context-dependent.” “[T]he adequacy of supervision . . . will depend on all the circumstances of a case.” *N.C. Dental*, 135 S. Ct. at 1116–17. Accordingly, FTC Staff will evaluate each case in light of its own facts, and will apply the applicable case law and the principles embodied in this guidance reasonably and flexibly.

3. What factors are relevant to determining whether the active supervision requirement has been satisfied?

FTC Staff will consider the presence or absence of the following factors in determining whether the active supervision prong of the state action defense is satisfied.

- The supervisor has obtained the information necessary for a proper evaluation of the action recommended by the regulatory board. As applicable, the supervisor has ascertained relevant facts, collected data, conducted public hearings, invited and received public comments, investigated market conditions, conducted studies, and reviewed documentary evidence.
 - ✓ The information-gathering obligations of the supervisor depend in part upon the scope of inquiry previously conducted by the regulatory board. For example, if the regulatory board has conducted a suitable public hearing and collected the relevant information and data, then it may be unnecessary for the supervisor to repeat these tasks. Instead, the supervisor may utilize the materials assembled by the regulatory board.
- The supervisor has evaluated the substantive merits of the recommended action and assessed whether the recommended action comports with the standards established by the state legislature.
- The supervisor has issued a written decision approving, modifying, or disapproving the recommended action, and explaining the reasons and rationale for such decision.
 - ✓ A written decision serves an evidentiary function, demonstrating that the supervisor has undertaken the required meaningful review of the merits of the state board’s action.
 - ✓ A written decision is also a means by which the State accepts political accountability for the restraint being authorized.

Scenario 1: Example of satisfactory active supervision of a state board regulation designating teeth whitening as a service that may be provided only by a licensed dentist, where state policy is to protect the health and welfare of citizens and to promote competition.

- The state legislature designated an executive agency to review regulations recommended by the state regulatory board. Recommended regulations become effective only following the approval of the agency.
- The agency provided notice of (i) the recommended regulation and (ii) an opportunity to be heard, to dentists, to non-dentist providers of teeth whitening, to the public (in a newspaper of general circulation in the affected areas), and to other interested and affected persons, including persons that have previously identified themselves to the agency as interested in, or affected by, dentist scope of practice issues.
- The agency took the steps necessary for a proper evaluation of the recommended regulation. The agency:
 - ✓ Obtained the recommendation of the state regulatory board and supporting materials, including the identity of any interested parties and the full evidentiary record compiled by the regulatory board.
 - ✓ Solicited and accepted written submissions from sources other than the regulatory board.
 - ✓ Obtained published studies addressing (i) the health and safety risks relating to teeth whitening and (ii) the training, skill, knowledge, and equipment reasonably required in order to safely and responsibly provide teeth whitening services (if not contained in submission from the regulatory board).
 - ✓ Obtained information concerning the historic and current cost, price, and availability of teeth whitening services from dentists and non-dentists (if not contained in submission from the regulatory board). Such information was verified (or audited) by the Agency as appropriate.
 - ✓ Held public hearing(s) that included testimony from interested persons (including dentists and non-dentists). The public hearing provided the agency with an opportunity (i) to hear from and to question providers, affected customers, and experts and (ii) to supplement the evidentiary record compiled by the state board. (As noted above, if the state regulatory board has previously conducted a suitable public hearing, then it may be unnecessary for the supervising agency to repeat this procedure.)
- The agency assessed all of the information to determine whether the recommended regulation comports with the State's goal to protect the health and

welfare of citizens and to promote competition.

- The agency issued a written decision accepting, rejecting, or modifying the scope of practice regulation recommended by the state regulatory board, and explaining the rationale for the agency's action.

Scenario 2: Example of satisfactory active supervision of a state regulatory board administering a disciplinary process.

A common function of state regulatory boards is to administer a disciplinary process for members of a regulated occupation. For example, the state regulatory board may adjudicate whether a licensee has violated standards of ethics, competency, conduct, or performance established by the state legislature.

Suppose that, acting in its adjudicatory capacity, a regulatory board controlled by active market participants determines that a licensee has violated a lawful and valid standard of ethics, competency, conduct, or performance, and for this reason, the regulatory board proposes that the licensee's license to practice in the state be revoked or suspended. In order to invoke the state action defense, the regulatory board would need to show both clear articulation and active supervision.

- In this context, active supervision may be provided by the administrator who oversees the regulatory board (*e.g.*, the secretary of health), the state attorney general, or another state official who is not an active market participant. The active supervision requirement of the state action defense will be satisfied if the supervisor: (i) reviews the evidentiary record created by the regulatory board; (ii) supplements this evidentiary record if and as appropriate; (iii) undertakes a *de novo* review of the substantive merits of the proposed disciplinary action, assessing whether the proposed disciplinary action comports with the policies and standards established by the state legislature; and (iv) issues a written decision that approves, modifies, or disapproves the disciplinary action proposed by the regulatory board.

Note that a disciplinary action taken by a regulatory board affecting a single licensee will typically have only a *de minimis* effect on competition. A pattern or program of disciplinary actions by a regulatory board affecting multiple licensees may have a substantial effect on competition.

The following do not constitute active supervision of a state regulatory board that is controlled by active market participants:

- The entity responsible for supervising the regulatory board is itself controlled by active market participants in the occupation that the board regulates. *See N.C. Dental*, 135 S. Ct. at 1113-14.
- A state official monitors the actions of the regulatory board and participates in deliberations, but lacks the authority to disapprove anticompetitive acts that fail to accord with state policy. *See Patrick v. Burget*, 486 U.S. 94, 101 (1988).
- A state official (*e.g.*, the secretary of health) serves *ex officio* as a member of the regulatory board with full voting rights. However, this state official is one of several members of the regulatory board and lacks the authority to disapprove anticompetitive acts that fail to accord with state policy.
- The state attorney general or another state official provides advice to the regulatory board on an ongoing basis.
- An independent state agency is staffed, funded, and empowered by law to evaluate, and then to veto or modify, particular recommendations of the regulatory board. However, in practice such recommendations are subject to only cursory review by the independent state agency. The independent state agency perfunctorily approves the recommendations of the regulatory board. *See Ticor*, 504 U.S. at 638.
- An independent state agency reviews the actions of the regulatory board and approves all actions that comply with the procedural requirements of the state administrative procedure act, without undertaking a substantive review of the actions of the regulatory board. *See Patrick*, 486 U.S. at 104-05.