UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
ATLANTA REGIONAL OFFICE
Room 1000
1718 Peachtree St., N.W.
Atlanta, Georgia 30367
(404) 347-4836

COMMISSION AUTHORIZED

November 28, 1990

Martha G. Wellman
Program Audit Supervisor
State of Florida
Office of the Auditor General
111 West Madison Street
P.O. Box 1735
Tallahassee, FL, 32302

Dear Ms. Wellman:

The staff of the Federal Trade Commission[1] is pleased to respond to the invitation of the Office of the Auditor General of the State of Florida to comment on the possible restrictive or anticompetitive effects of the state's statutes or regulations governing the activities of several licensed occupations and regulatory entities scheduled for "sunset" audit in the near future.

The comments below identify several provisions of the relevant statutes and regulations that we believe may have anticompetitive effects and thereby injure consumers. In Part I of these comments, we identify the interest and experience of the Commission's staff in the area of occupational regulation. In Part II, we examine specific provisions of the statutes and regulations that may have anticompetitive effects.

I. Interest and Experience of the Staff of the Federal Trade Commission

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive practices in or affecting commerce. 15 U.S.C. § 45. Under this statutory mandate, the Commission seeks to identify restrictions that impede competition or increase costs without offering countervailing benefits to consumers. The Commission has sought to improve consumer access to professional services by initiating

[1] These comments are the views of the staff of the Federal Trade Commission's Atlanta Regional Office and Bureau of Competition. They are not necessarily the views of the Commission or any individual Commissioner.

antitrust enforcement proceedings[2] and conducting studies concerning various facets of the regulation of licensed professions.[3] In addition, the Commission's staff has submitted comments to state legislatures and administrative agencies on various issues of professional licensing and regulation.[4]

II. Analysis of the Statutes and Regulations

A. Board of Pilot Commissioners

The Florida statute governing the Board of Pilot Commissioners contains provisions that restrict entry into the business of harbor pilotage. It provides that the board shall determine the number of pilots based on the "supply and demand for public services and the public interest in maintaining efficient and safe piloting services."[5] The statute also contains provisions governing the price of pilotage services. The board is granted power to fix, by order, rates of pilotage to be charged by licensed state pilots after a hearing held pursuant

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[2] See, e.g., Massachusetts Board of Registration in Optometry, 110 F.T.C. 549 (1988); Rhode Island Board of Accountancy, 107 F.T.C. 293 (1986) (consent order); Louisiana State Board of Dentistry, 106 F.T.C. 65 (1985) (consent order); American Medical Ass'n, 94 F.T.C. 701 (1979), aff'd, 638 F.2d 443 (2d Cir. 1980), aff'd mem. by an equally divided court, 455 U.S. 676 (1982); American Dental Ass'n, 94 F.T.C. 403 (1979), modified, 100 F.T.C. 448 (1982), 101 F.T.C. 34 (1983) (consent order).

[3] See, e.g., C. Cox and S. Foster, The Costs and Benefits of Occupational Regulation (FTC Bureau of Economics 1990); W. W. Jacobs, et. al., Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising (FTC Staff Report 1984); G. Hailey, et. al., A Comparative Analysis of Cosmetic Contact Lens Fitting by Ophthalmologists, Optometrists, and Opticians (FTC Staff Report 1983); R. Bond, et. al., Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry (FTC Staff Report 1980).

[4] In the past two years, Commission staff have commented on rules of professional conduct or regulations governing a variety of occupations, including architects, attorneys, auctioneers, chiropractors, dentists, funeral directors and embalmers, dieticians/nutritionists, nurses, nursing home administrators, psychologists, speech pathologists, podiatrists, veterinarians, harbor pilots, foresters, optometrists, pharmacists, physical therapists, physicians (both M.D.s and Osteopaths), real estate brokers, sanitarians and social workers.

[5] Fla. Stats. § 310.061.

to the Florida Administrative Procedure Act.[6] All vessels, except vessels exempted by the laws of the United States or vessels drawing less than 7 feet of water, are required to have a licensed state pilot or certificated deputy pilot on board when entering ports of the state.[7]

It should be emphasized that our analysis is confined to the effects of price and entry regulations and does not address regulations designed to enhance navigational safety. We recognize that safety regulation in the maritime context is necessary to protect seafaring vessels, their passengers and cargo, and the public at large.

Although we do not have expertise in harbor pilotage, and thus cannot predict with certitude the effects of the restrictions outlined above, the effects of price and entry restrictions on harbor pilotage are likely to be similar to those in other markets. Restrictions on entry tend to increase the price of the goods or services provided by a particular line of business. As a general matter, markets are better equipped than regulators to determine the appropriate level of supply of a service, by adjusting the supply in response to changes in demand. Thus, an increase in the use of a particular Florida port, and hence in the demand for pilotage services there, would, all else equal, tend to lead to an increase in the price of pilotage services in that port. Such an increase would, in turn, be expected to attract entry into the pilotage business and lead to the stabilization of the price at the competitive level. Conversely, a decline in the demand for pilotage services would tend to result in a decrease in the price of the service and the exit of some pilots from the business, with the price again stabilizing at the competitive level.[8] Absent regulatory

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[6] Fla. Stats. § 310.151(2).

[7] Fla. Stats. § 310.0141. Deputy pilots are authorized to pilot vessels only within limits and specifications established by the licensed state pilots at the port where the deputy is appointed to serve. In order to qualify for licensure as a state pilot, an applicant must have served at least two years as a deputy in the port in which license as a licensed state pilot is desired. Fla. Stats. § 310.073(4). The number of deputy pilots appointed in a particular port is subject to board discretion based on its determination of the number of deputy pilots "required" in the respective port. Fla. Stats. § 319.971(2).

[8] The increase or decline in demand referred to in the text must be more than temporary to experience these effects. Obviously, all businesses will experience some day-to-day or month-to-month fluctuations in the demand for their services.

restrictions or other barriers or impediments to entry,[9] markets ordinarily tend to adjust supply quickly to meet a change in the demand for a service.

When the number of suppliers is set according to economic judgments made by a regulatory board, as is the case for pilots who work in Florida's harbors, opportunities for new suppliers who would otherwise choose to enter into the market may be curtailed. As a result, incumbents may be able to charge higher prices than would prevail in a competitive market.

One approach that has been used to prevent prices from rising in markets where entry opportunities are curtailed is price regulation, and Florida law does provide for price regulation of pilotage services. However, there are reasons to be concerned about reliance on price regulation. In otherwise competitive markets, consumers typically benefit from vigorous competition among suppliers that is unimpeded by rate regulation.[10] We have no reason to believe that an unregulated harbor pilotage industry would lack the conditions conducive to competition: ease of entry and exit and the absence of significant economies of scale.[11] Furthermore, even in industries subject to traditional rate regulation, such as public utilities, some studies suggest that rate regulation may not be able to keep prices below the levels that would exist without regulation.[12] To the extent that Florida's law curtails

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[9] Barriers to entry are long-run costs that must be incurred by entrants into a business, but which were not incurred by incumbent firms. Impediments to entry are conditions that necessarily delay entry into a market for a significant period, such as when entry cannot be completed for a number of years. See B.F. Goodrich Co., 110 F.T.C. 207, 295-97 (1988).

[10] The proposition that consumers benefit from vigorous price competition is one of the most widely-accepted principles in economics. See, for example, P. Samuelson, Economics 436-439 (8th Ed. 1970).

[11] This suggests that any removal of price regulations in the harbor pilotage market should also be accompanied by the removal of entry restrictions -- consistent with the continued safe provision of this service -- because such restrictions might permit the existing sellers to price pilotage services above competitive levels.

[12] See, e.g., Stigler & Friedland, What Can Regulators Regulate? The Case of Electricity, 5 J.L. & Econ. 1 (1962); Moore, The Effectiveness of Regulation of Electric Utility Prices, 36 So. Econ. J. 365 (1970); Jordan, Producer Protection, Prior Market Structure and the Effect of Government Regulation,

opportunities for entry, and rate regulation is unable to maintain prices at a competitive level, the law may cause consumers to pay higher prices for pilotage services than necessary for the quantity and quality of services demanded by the public.[13]

Nor is the public only injured by regulated prices established above the competitive level. Insofar as price regulation succeeds in maintaining prices at a lower level than would prevail in an unregulated market, it can reduce suppliers' incentive to provide the quantity and quality of the regulated products or service that consumers desire. Incumbent pilots will also lack the market-based incentives, such as an opportunity to [illegible] market share by offering a service at a lower price, that [illegible] providers to innovate and increase their efficiency. Consequently, Florida's regulation of the licensure of harbor pilots may discourage cost-saving innovations that could lead to lower prices.

B. Board of Medicine

The Florida statute governing the licensure of physicians specifies, as grounds for disciplinary action, a physician's paying or receiving any "commission, bonus, kickback, or rebate," or engaging in any split-fee arrangement in any form whatsoever with [another] physician, organization, agency, or person, either

15 J.L. & Econ. 151 (1972). While the cost and entry conditions of public utilities clearly differ from those of harbor pilotage, these studies do indicate the difficulty in protecting the public [illegible] increased prices through price regulation.

[13] Of course, regulatory policies designed to promote price competition must not compromise Florida's legitimate safety concerns. Rather than attempting to address safety concerns through economic regulation, however, [illegible] preferable. Current statutory provisions empower the Board of Pilot Commissioners to discipline promptly and severely any pilot [illegible] 310.101. Another appropriate safety [illegible] would-be pilots to pass a test demonstrating their competence. Addressing a state's legitimate safety concerns directly, through continued vigorous enforcement of safety regulations such as these, may be more effective in promoting safety than indirectly addressing those concerns through economic regulation. We believe that consumers and competition in Florida will be best served if Florida continues to promote safety directly.

directly or indirectly, for referrals.[14] Prohibitions such as these can be of benefit to patients by preventing deception or abuse of the provider-patient relationship. However, such restrictions also can interfere with legitimate business affiliations between practitioners and other persons or entities, and with the flow of useful, nondeceptive information to consumers about providers. Consequently, restrictions on referral fees should not be broader than necessary to protect the public from harm.[15]

Whether restrictions on referral fees are overbroad would depend upon the potential for harm in their absence. For example, the primary justification usually offered for such prohibitions is that they prevent abuse of the special trust that a patient places in a physician to make appropriate referrals

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[14] Fla. Stats. § 458.331(1)(i).

[15] We note that the federal Medicare/Medicaid Anti-Kickback Statute uses similarly broad language in prohibiting any person from knowingly soliciting or receiving any "remuneration (including any kickback, bribe, or rebate) directly or indirectly, overtly or covertly, in cash or in kind" in return for referring an individual for goods or services covered by Medicare or Medicaid or in return for purchasing or arranging the purchase of such goods or services, or whenever he knowingly offers or pays any remuneration to induce such referral or purchase. Violators are subject to a $25,000 fine and five years in prison. Section 1128B(b) of the Social Security Act, 42 U.S.C. § 1320a-7b(b). However, in 1987, in part because of a concern that such a broad statute might restrict legitimate business practices in the health care field, Congress asked the [illegible] Services (HHS) to adopt Department of [illegible] that would not [illegible] Section 14 of [illegible] Act of the Medicare and Medicaid [illegible] 1987, Pub. L. No. 100-93, 101 Stat. 680 (1987). See Comments of the Federal Trade Commission's Bureaus of Competition, Consumer Protection and Economics to the Department of Health and Human Services (December 1987). Significantly, in 1989, HHS proposed a number of "safe harbor" regulations that would specifically protect some of the same types of business practices we express concern about here, including commercial referral services, lease arrangements and HMOs that offer discounts. In addition, HHS stated that many of its proposed safe harbors "would cover many relationships in preferred provider and managed care networks." 54 Fed. Reg. 3088 (1989). HHS has not yet issued final regulations in this area. We would advise that the state contact HHS or await promulgation of final HHS regulations before finalizing its legislation and regulations on referral fees.

based on his or her independent professional judgment of the patient's best interest. An unscrupulous practitioner who stands to receive a referral fee from another provider might possibly refer the patient for unnecessary health care. Even in the case of necessary care, such a physician might be tempted to refer a patient to the provider who pays the highest referral fees, rather than to the most competent one.

In some health care situations the patient's dependency on the provider may warrant the prohibition of referral fees. Harm to patients is less likely to occur when referrals are made among providers in an integrated operation such as a Health Maintenance Organization or a Preferred Provider Organization, or by a commercial referral service. Fees paid to these entities are unlikely to provide an incentive for anyone to refer patients for unnecessary care, since the entity receiving the fee -- the HMO or referral service -- does not receive any additional fees from the patient for a referral.

Prohibitions on referral fees, and on division of fees generally, may interfere with the operation of alternative health care delivery systems (such as HMOs and PPOs) that may have incentive arrangements with health care professionals in which fees are divided between the medical plan and the professionals.[16] Such restrictions may also prevent practitioners from participating in commercial referral services that charge a fee for participation. Referral services can be valuable in helping consumers locate appropriate health care and, by facilitating the gathering of information, such services can increase competition among health care professionals. In such situations, requiring disclosure of the fact that the provider will pay or receive a fee in consideration for a referral should help to prevent abuse or deception and to protect patients from harm. Such a requirement should also provide patients with information to aid in their decision whether to use the recommended provider.

Restrictions on the division of fees can also harm competition and consumers if they are construed to interfere with lease arrangements in which a provider's rent is based on a percentage of gross revenues, with certain franchise arrangements whereby providers pay a percentage of their fees to a franchisor in return for marketing and advertising services, and with the

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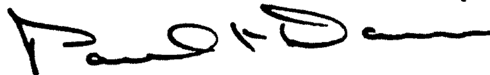
[16] For example, some PPO programs require participating providers to remit to the PPO a percentage of the fees earned from treating PPO patients referred to them through the PPO. Under the above statutory provisions, such a payment might be construed as a fee in consideration for the referral of a patient.

use of a trade name. Such practice arrangements may not pose an inherent danger of reducing the quality of services provided.

III. CONCLUSION

We are pleased to have this opportunity to present our views on certain provisions of some of the occupational licensing statutes and regulations currently in effect in Florida.[17] Our analysis suggests that some of these statutes and regulations could have anticompetitive effects. The Office of the Auditor General might want to reevaluate the costs and benefits of those sections of Florida's various occupational licensing programs that we have discussed.

Sincerely,



Paul K. Davis
Regional Director

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[17] The staff has reviewed the statutes and regulations governing seven licensed occupations. In view of the volume of the materials involved, it is possible that some potentially anticompetitive provisions have escaped our attention. If the Office of the Auditor General has questions concerning provisions not discussed in this letter, we encourage you to contact us for further review.