PLF's testimony regarding HB 2289 and Kansas's Competitor's Veto law

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In practice, Certificate of Need (CON) laws act not to protect the public, but to protect industry groups from fair competition. Pacific Legal Foundation (PLF) supports laws like HB 2289, which remove the requirement that entrepreneurs prove their business is "necess[ary]" and "convenien[t]" before being able to start a business in the state.

CON laws are not ordinary licensing laws. Because they require new businesses to prove that the market needs or can adequately support another participant, they are explicitly aimed at protecting the existing businesses from new competition. Indeed, under CON schemes, even the safest, most efficient entrepreneurs must be denied a license to operate if they will compete with, and therefore "harm," the existing ones. Pacific Legal Foundation (PLF) has extensive evidence obtained from lawsuits across the country that demonstrates how CON laws are used to deprive would-be entrepreneurs of the precious right to earn a living for explicitly protectionist reasons. Kansas's CON law is nearly identical to those challenged by PLF, and acts as an anti-competitive barrier to entrepreneurship in the state.

In a field like the motor carrier industry—which, in theory, has relatively low start-up costs and thus creates a prime opportunity for unskilled or inexperienced workers—the consequences of CON laws are particularly unjust. Historically, the transportation industry has provided a quick path to entrepreneurship for people with fewer skills or less capital. By creating an unnecessary (and often insurmountable) barrier to entry, CON laws eliminate one of the easiest means of starting a business for those who need it most. PLF urges the Committee to restore economic opportunity for transportation entrepreneurs by ridding the state of the "Competitor's Veto."

CON Laws in Theory and in Practice

The theory behind CON laws is explicitly protectionist. CON laws are a relic of the late nineteenth century and were conceived to regulate the railroad industry. At the time, the government granted railroads certain monopoly benefits and, in return, the railroads agreed to abide by various regulations.[1] CON laws protected railroads from competition with operators who might seek a competitive advantage by declining to abide by those regulations—which were often expensive. They were also based on the now discredited notion that "dog eat dog" competition is detrimental. Their specific purpose was therefore to stifle competition.

As technology evolved, CON laws carried over to new methods of transportation—including taxi and moving businesses—more or less as a matter of historical accident. Though the argument was questionable even as it applied to railroads in the nineteenth century, there is no serious

[1] *See* Timothy Sandefur, *A Public Convenience and Necessity and Other Conspiracies Against Trade: A Case Study from the Missouri Moving Industry*, 24 GEO. MASON U. CIV. RTS. L.J. 159, 165 (2014).

economic argument that motor carriers would not exist without government protection and quasi-monopoly rights.

In modern times, proponents often argue that CON laws act as an investigative tool, whereby existing firms help the government police the industry. But this argument overlooks the obvious conflict of interest involved in allowing existing businesses to help decide who may enter the market to compete against them. Moreover, it ignores the fact that in many CON schemes—including Kansas's—the existing firms are not actually required to provide any information related to the applicant's skills or public safety. Instead, they may object on the basis that a new business is not "necessary" because they can handle any existing demand, or that a new business is not "convenient" because it will harm their own business.

Moreover, the protest procedure essentially allows existing businesses to thwart any new competition. Once protested, applicants are statutorily required to prove that their business is "necessary," but it is nearly impossible to prove that a business is needed before actually opening its doors. The only way to determine whether a business is necessary is by entering the market and finding out. Moreover, existing businesses can offer self-serving testimony that no new business is necessary because they are capable of servicing the public themselves. In practice, this means a protest almost always ends with the application being denied.

Thus, while heralded by proponents as an "investigative tool," the protest procedure is the CON scheme's most pernicious feature. It permits competitors to object to an application for a new business for anti-competitive reasons, and it subjects applicants to a hearing requirement that is often insurmountable. For this reason, the process has sometimes been called the "Competitor's Veto."

Litigation from states with CON laws corroborates that these laws are not used to protect the public, but instead to block legitimate competition. Evidence from a lawsuit filed by PLF on behalf of entrepreneur Michael Munie in Missouri shows that from 2005-2010, whenever a CON application was filed requesting permission to operate a new moving company, that application was protested by an existing firm.[2] All 106 objections filed during this time were based on the argument that the applicant would compete with an existing business; not one alleged that the applicant was unskilled or would be dangerous to public safety. Faced with the expensive hearing requirement, almost every entrepreneur withdrew the application. Tellingly, where applicants amended their application to request permission to operate in a small, rural area—meaning they would present less competition—the protestant invariably withdrew its protest. The implication is that the protesting firms were more concerned with the threat of competition than any threat to the public.

Across America, CON laws are used in this same, anti-competitive way. A lawsuit on behalf of business owner Raleigh Bruner in Kentucky uncovered that between 2007 and 2012, 114 protests

[2] Sandefur, *A Public Convenience and Necessity and Other Conspiracies Against Trade*, *supra* n.2 at 183.

were filed. Not one alleged that the applicant would present any danger to the public, yet every protested application was denied.[3] Incredibly, the state had never issued a license to a new applicant where a protest was lodged by a competitor.

A lawsuit in West Virginia on behalf of entrepreneur Arty Vogt showed that no new application for authority to operate as a mover of household goods had been granted in the state in 10 years. Between January 1, 2007 and January 1, 2017, 15 applications for new authority were filed and all were protested by a certificate-holder. Ten withdrew or abandoned their application, and of the other 5, all but one were denied on the basis that they failed to prove that the existing service was inadequate (the remaining application was still pending at the time of the lawsuit). The last time an in-state business was able to obtain a new certificate was 12 years prior, in 2005. The last time an out-of-state business was able to obtain a new certificate was over twenty years prior, in 1996. The plaintiff in that case, Arty Vogt, had been denied a certificate on the basis that his business was not "necessary," even though it had operated in the state under different ownership since the early 1900s.

In 2015, Nevada entrepreneurs Ron and Danell Perlman filed an application to expand their Certificate to add additional limousines to their fleet. At that time, there were just 45 licensed limousine companies, 41 licensed moving companies, and 10 licensed taxi companies in a state that had a population of over 2.8 million people.[4] When the Perlmans applied, a competitor protested. After two years of expensive and contentious hearings, the state denied the Perlmans' application on the basis that there was no "need" for additional limousine services, and that the couple would therefore "adversely affect" the market.[5]

While proponents argue that CON laws protect the public, the evidence says otherwise. CON laws forestall the dreams of entrepreneurs across the United States solely to protect incumbents from competition.

The Harm Caused by CON Laws

CON laws create an expensive barrier to entry. Even if applications for CONs are approved, the hearing requirement by itself drives up the cost of starting a business. Many states require applicants to be represented at CON hearings by an attorney, and in others, an attorney is all but necessary to navigating the process anyway.[6] But hiring a lawyer is expensive, and gathering the information necessary to prove that one's business is "necessary" is lengthy and burdensome.

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[3] Timothy Sandefur, *State "Competitor Veto" Laws and the Right to Earn a Living: Some Paths to Federal Reform* (forthcoming) (on file with author).
[4] Nevada Transportation Authority, Active Certificates, *available at* http://tsa1.nv.gov/ActiveCertificates.asp (last visited Mar. 9, 2015).
[5] *See* Nevada Transportation Authority, *In re Application of Ronald M. Perlman d/b/a/ Reno Tahoe Limousine for expansion of authority*, Docket 12-09001.
[6] In re Discipline of Schaefer, 117 Nev. 496, 509 (2001).

Thus, even in cases where a CON is granted, the hearing requirement raises the price of doing business in the state, thereby hampering economic growth.

In addition to harming entrepreneurship, CON laws harm consumers. By eliminating normal, competitive pressures, CON laws reduce existing companies' incentive to cater to consumer demand. And where businesses can bar innovators from entering the market, they deny consumers access to new and improved services. The growth of ride-sharing services like Uber and Lyft, for example, were substantially hampered by CON laws.

Research from the 1970s and 1980s shows that barriers to entry raised prices for intrastate household goods services by anywhere between 25 and 40 percent,[7] and were not associated with any increase in quality.[8] Data from cities that have reduced barriers to entry into the taxicab market likewise show that CON laws raise costs to consumers.[9] After Indianapolis lifted its cap on the number of taxicab permits available, the number of cabs nearly doubled, fares decreased by an average of 7 percent, waiting times were almost halved, and complaints diminished.[10] Other countries have also reported that significant innovations were introduced after deregulation,[11] and findings from other sectors of the transportation industry also show that CON laws tend to raise prices, stifle innovation, and restrict economic opportunity. Because some entrepreneurs will forego the CON process all together, we cannot know for certain the amount of businesses that have been suppressed, and the innovation lost, due to the scheme.

CON Laws and the Constitution

The Due Process Clause forbids states from imposing occupational licensing requirements that are not related to an applicant's skill in practicing the trade. In *Dent v. West Virginia*,[12] the Supreme Court upheld a licensing requirement for doctors solely because the training and education standards were "appropriate to the calling or profession, and attainable by reasonable

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[7] Dennis A. Breen, *The Monopoly Value of Household-Goods Carrier Operating Certificate*, 20 J.L. & ECON. 153, 178 (1977).
[8] Edward A. Morash, *Entry Controls on Regulated Household Goods Carriers: The Question of Benefits*, 13 TRANSP. L.J. 227, 240 (1984)
[9] *See, e.g.*, Mark W. Frankena & Paul A. Pautler, *An Economic Analysis of Taxicab Regulation* 101 (FTC Bureau of Economics Staff Report, May 1984)
[10] Adrian T. Moore & Tom Rose, *Regulatory Reform at the Local Level: Regulating for Competition, Opportunity, and Prosperity*, Reason Foundation Policy Study No. 238 at 15-16 (1998).
[11] Sean D. Barrett, *Regulatory Capture, Property Rights and Taxi Deregulation: A Case Study*, 23 ECON. AFF. 34 (2003); Organization for Economic Development Policy Roundtables, *Taxi Services: Competition and Regulation* 2007 at 7 (2008); Jason Soon, *Taxi!!: Reinvigorating Competition in the Taxi Market*, Centre for Independent Studies Issue Analysis, No. 7 at 9 (May 1999).
[12] 129 U.S. 114 (1889).

study or application."[13] The Court warned that requirements that lack such a relationship would unconstitutionally "deprive one of his right to pursue a lawful vocation."[14]

The anticompetitive features of CON laws have no connection to a person's fitness or capacity to practice, and therefore no relationship to protecting the public. In 1932, the Supreme Court struck down a law very similar to Kansas's because it prohibited new ice-delivery businesses without a CON and allowed existing companies to block new firms from competing. That law did not protect the public; instead it "shut out new enterprises, and thus create[d] and foster[ed] monopoly in the hands of existing establishments, against, rather than in aid of, the interest of the consuming public."[15]

In 2013 lawsuit brought by PLF, a federal court in Kentucky struck down the state's CON requirement for movers under the Due Process Clause.[16] The court reasoned that the law did nothing to prevent property damage, as other state laws already made property damage illegal. Moreover, skilled movers who were unlikely to damage property could be, and often were, denied CONs without regard to their qualifications.[17] Nor did the Competitor's Veto process decrease administrative costs, because "when a protest is filed, the Cabinet *must* hold a hearing," which actually increased costs.[18] While the state argued the CON permitted interested parties to aid the state in prohibiting bad actors from entering the market, the record further showed that consumers never objected to new companies starting—it was only existing companies who used the law to block new competition. The court concluded that "[n]o sophisticated economic analysis is required to see the pretextual nature of the state's proffered justifications." Rather than protecting the public, the law was a "simple act of economic protectionism" that allowed existing movers to "essentially 'veto' competitors from entering the moving business for any reason at all, completely unrelated to safety or societal costs."

That ruling affirms what the Supreme Court has held for years: to operate a business, and specifically, a transportation firm, one need only be qualified and abide by actual public safety laws. Any regulation which imposes an anti-competitive barrier, divorced from any public safety rationale, is unconstitutional.

Conclusion

While states may use licensing laws to protect the public from dishonest or dangerous practices, they may not use them to protect a favored few against legitimate competition from new entrepreneurs. Evidence gathered from lawsuits across the United Stated, including Missouri,

[13] *Id.* at 122.
[14] *Id.*
[15] New State Ice Co. v. Liebmann, 285 U.S. 262, 278 (1932).
[16] Bruner v. Zawacki, 997 F. Supp. 2d 691, 697 (E.D. Ky. 2014).
[17] *Id.*
[18] *Id.*

Oregon, Kentucky, Montana, and West Virginia, presents a damning picture of how CON laws operate. They stifle entrepreneurship and harm consumers for protectionist reasons.

Several states, including Georgia, Alaska, South Carolina and Maryland, are considering repealing their CON laws in various industries this year. HB 2289 presents an opportunity for Kansas to join these states in restoring economic opportunity to the transportation industry. PLF supports laws like HB 2289, which eliminate the ability of new businesses to thwart legitimate competition and which restore public safety as the primary goal of regulation.