

FEDERAL TRADE COMMISSION

PUBLIC WORKSHOP:

POSSIBLE ANTICOMPETITIVE EFFECTS TO
RESTRICT COMPETITION ON THE INTERNET

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FEDERAL TRADE COMMISSION

I N D E X

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13
14
15
16
17
18
19
20
21
22
23
24
25

Contact Lenses -- Page 321

Automobiles -- Page 391

Casket Sales -- Page 459

Online Legal Services -- Page 529

Telemedicine and Online Pharmaceutical Sales -- Page 593

P R O C E E D I N G S

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FIRST SESSION -- CONTACT LENSES

MR. CRUZ: Good morning, everyone, welcome.

I'm Ted Cruz. I'm the Director of the Office of Policy Planning here at the Federal Trade Commission, and welcome to the second day of the FTC's public workshop on possible efforts to restrict competition on the Internet.

This panel is the contact lens panel. We have a very distinguished set of panelists. I'm sure we'll have enthusiastic discussion and debate.

And so, let's move now into that panel. That panel will be moderated by Dr. Jerry Ellig, who is the Deputy Director of the Office of Policy Planning at the FTC and by Maureen Ohlhausen, who's an attorney advisory in the Office of Policy Planning at the FTC.

So, let's get started.

MS. OHLHAUSEN: Well, welcome, everyone. I think this should be a very interesting panel. The contact lens area in Internet sales has been very active. There's been litigation. There's been a proceeding in Connecticut before the Board of Examiners for Opticians, which is actually having a hearing today, and also there's been legislation in the states. Recently a bill was passed in California, and Congress has been

1 considering various bills on this issue.

2 Just to give you an idea of how things will
3 work, we're going to have the panelists speak and I'd ask
4 each panelist to introduce himself and then launch into
5 his remarks. Also, for audience questions, we have staff
6 who will be going around with index cards. So, if you'd
7 like to submit a question, raise your hand, they'll bring
8 you the index card, write out your question, and then
9 give it back to them and they'll bring it up to us.

10 So, I'd like to get started, and first we have
11 Dr. Pat Cummings.

12 DR. CUMMINGS: Good morning. I'm Pat Cummings.
13 I'm President of the American Optometric Association, and
14 we thank you for the opportunity to participate in this
15 workshop. This is a very important issue for our
16 patients.

17 Contact lenses are prescription medical devices
18 regulated by the Food and Drug Administration. They can
19 only be dispensed to patients with valid prescriptions.
20 Last year, the FDA published a consumer advisory telling
21 consumers they should not order contact lenses by mail,
22 phone or on the Internet without a current prescription
23 because of the health risks associated with contact lens
24 wear.

25 As the FTC's staff pointed out in its comments

1 to the Connecticut Board of Examiners for Opticians,
2 there are significant health issues concerning the sale
3 of contact lenses, primary among them being ensuring that
4 contact lens wearers return to their doctors for regular
5 eye examinations.

6 This staff document correctly concludes
7 customers incur health risks if they forego regular eye
8 exams that would allow the optometrist or ophthalmologist
9 to spot emerging health problems in their early stages.
10 That is the crux of the issue of the contact lens sale
11 for the American Optometric Association and its members,
12 not where the patient purchases replacement lenses, but
13 that the validity of the prescription be properly
14 verified by all sellers.

15 There's ample evidence to suggest that this is
16 not always the case. The sellers, many times, provide
17 lenses to patients with long-expired prescriptions or no
18 prescriptions or sell large quantities of lenses as a
19 prescription is set to expire. The FDA consumer advisory
20 noted that while sellers tell consumers they will confirm
21 the prescription with the doctor, this may not always
22 happen.

23 Because of the health considerations that are
24 part of contact lens wear, as well as the history of
25 certain practices by sellers, some states, often in the

1 context of requiring the release of contact lens
2 prescriptions, have enacted laws seeking to regulate, in
3 various manners, Internet sellers of contact lenses.

4 Questions have been raised over whether these
5 state regulations and the inability of patients to obtain
6 their prescriptions have been an impediment to the online
7 sale of contact lenses. Sales figures for online sellers
8 and studies on the release of contact lens prescriptions
9 suggest the answer is no.

10 Internet sellers have reported substantial
11 growth in recent years, and the FTC's own study of
12 prescription release indicated that over 90 percent of
13 contact lens patients who want their prescriptions
14 receive it.

15 At the same time, realizing that the ultimate
16 goal should be to allow patients the ability to choose
17 where they purchase replacement lenses, while at the same
18 time protecting their health by ensuring that the lenses
19 are sold consistent with their status as an FDA-regulated
20 prescription device, AOA believes there's a simple
21 answer: a Federal legislative requirement that providers
22 must release and verify prescriptions and that sellers
23 must obtain positive verification of the prescription
24 before lenses are shipped to patients, with appropriate
25 penalties for both for non-compliance.

1 This strikes us as a balanced and reasonable
2 solution that addresses both the competition and the
3 health concerns, and, in fact, it is consistent with the
4 current policy of a number of Internet sellers.

5 Such a requirement would address the legitimate
6 health concerns that led to enactment of the state
7 regulations being questioned by some. It would then be
8 appropriate for all states to review these laws and
9 regulations to evaluate the need to maintain them. Thank
10 you.

11 MS. OHLHAUSEN: Thank you, Pat. I also wanted
12 to clarify, at this point, that Morris Kleiner is
13 participating by phone. So, while you'll see his name
14 tag, you don't see him, but he's with us. And also, John
15 Tennis, who's the Assistant Attorney General from
16 Maryland, was supposed to participate, but he had a death
17 in the family, so he cannot be here today. But he did
18 file a written statement talking mainly about the multi-
19 district litigation.

20 So, if any of the panelists wanted to include
21 that in his own remarks, that would certainly be
22 appropriate. And, Pat, if at some point you want to
23 circle back to that, that would be fine.

24 Jonathan?

25 MR. COON: Thank you. My name is Jonathan

1 Coon. I'm with 1-800 CONTACTS. We're an online and
2 telephone-based seller of contact lenses. We sell direct
3 to consumers.

4 I know that time is limited, so I'll try to
5 just briefly summarize some of the challenges that our
6 customers face when they try to order their contact
7 lenses online, and I think it's helpful to make sense of
8 some of the behavior that goes on in our industry to
9 understand one of the important underlying issues that
10 shapes it, and that's that eye doctors sell the products
11 that they prescribe, which is unique from just about any
12 area of health care.

13 If you look at the medical industry, there's
14 significant cooperation between a medical doctor and a
15 pharmacy and that's because they don't compete with each
16 other. Doctors don't sell pharmaceuticals. In fact,
17 pharmacies are able to communicate directly with medical
18 doctors. I think many of us have had the experience of a
19 medical doctor calling in a prescription directly to the
20 pharmacy on our behalf.

21 Unfortunately, that's not the experience that
22 we have in our industry with contact lenses primarily
23 because the primary prescriber of contact lenses
24 coincidentally happens to be the primary retailer of
25 contact lenses, and again, that's the optometrist or eye

1 doctor.

2 This creates a conflict of interest that really
3 has been a catalyst that has then created a variety of
4 barriers to competition, including anticompetitive state
5 laws, self-regulation by optometry boards, and it also
6 provides incentive for manufacturers to collude with
7 prescribers, which was the subject of the 32 Attorneys
8 General that sued certain manufacturers and also groups
9 of optometrists and ophthalmologists.

10 Usually what the manufacturer will do is offer
11 to insulate the eye care provider's retail business from
12 competition for the sale of the product if they prescribe
13 a certain brand of product, and this conflict really
14 defines our market. When we contact the prescriber to
15 ask them to confirm a prescription for contact lenses,
16 we're essentially asking our competitor for permission to
17 make a sale. It wouldn't surprise a lot of people to
18 find out that they don't want to give us that permission,
19 and that's really the difference between what we do and
20 others who may participate in our industry.

21 We don't have stores. We don't do eye exams.
22 We don't have in-state locations. We only take orders
23 over the Internet and by phone, with nearly half of our
24 sales online.

25 State laws are set up to protect this conflict

1 of interest so that eye care professionals, in some
2 cases, can avoid competing on the merits, like service
3 and price, and many of them don't have their own web
4 sites. They don't offer evening service, they don't
5 answer their phones on weekends, they don't inventory
6 very many contact lenses and keep customers waiting
7 longer than they might otherwise have to, and many don't
8 offer direct shipment through their offices to the
9 customer's home or office.

10 Many states actually allow these practices --
11 well, allow different practices that help insulate eye
12 doctors from competition. In fact, in many states, eye
13 doctors can simply ignore our request for confirmation of
14 a prescription. Other states are silent on the issue of
15 confirmation. But consumers only have a defined right to
16 their contact lens prescription in half the states in the
17 country and they only have a mandatory right to their
18 prescription in eight states, one of which, California,
19 was just added a couple of weeks ago.

20 Manufacturers, in some cases, can cater to this
21 conflict of interest, some building their whole marketing
22 strategies around capitalizing on it. The reason for
23 that is that manufacturers generate their revenue by the
24 person that prescribes the product, not the person that
25 retails the product. And in our case, we don't do exams

1 and we don't write prescriptions.

2 Prescribers are, in some cases, able to
3 perpetuate this conflict of interest through trade
4 publication, state associations, national trade groups
5 and also through state optometry boards, many of which
6 were the subject, again, of the Attorneys General
7 litigation.

8 Now, in public, the conversation is often going
9 to center around health and protecting consumers' health,
10 as I suspected it already has and will continue to today.
11 Within the trade, however, the conversation is different.
12 It often focuses on ways to avoid competition.

13 I'd like to read a few industry statements that
14 were not intended for consumers to hear and statements
15 that I don't think you'd ever hear a medical doctor or a
16 pharmaceutical manufacturer make.

17 The first one is pretty straightforward. It's
18 an advertisement from a manufacturer that promises to
19 sell their lenses only to doctors. In the title of the
20 ad it says, "Let's See, You'll Make More Money," and goes
21 on to say, "Since Proclear Compatibles are only available
22 through your practice, you'll get what you're looking
23 for: increased patient loyalty and greater
24 profitability." And you'll hear patient loyalty referred
25 to in a lot of trade ads, which is just basically a

1 euphemism for more profits for the doctor.

2 There's another article here written by an eye
3 doctor in a trade journal called, Winning the War Against
4 Mail Order Contact Lenses. That's a pretty
5 straightforward title. This doctor recommends that when
6 a doctor receives a telephone inquiry -- and I'm quoting
7 here -- "for a patient's contact lens prescription,
8 recognize it as an opportunity for a sale. Your contact
9 lens patient is in need of a replacement lens." Now, I
10 doubt that my medical doctor, when they get a call from
11 my pharmacy, recognizes it as an opportunity to make a
12 sale.

13 This doctor goes on to say that you can refuse
14 to release the prescription or confirm for the third
15 party dispenser. Then after you get off the phone your
16 staff, "can call the patient and basically make the
17 sale."

18 The next ad is from a company called Ocular
19 Sciences that also offers to sell directly only to
20 doctors, and a doctor explains why he wants to prescribe
21 a product that can't be purchased somewhere else, and
22 this is quoting, again, from an industry trade article
23 that, you know, of course, doesn't run in national
24 magazines that consumers would see, but just trade
25 journals.

1 It says, we would -- and I'm quoting, "We would
2 get calls from patients and 1-800 CONTACTS asking us for
3 their contact lens prescriptions. I wanted to use
4 another strategy to prevent that from happening." And
5 then he goes on to describe that by prescribing some of
6 these private label lenses that we've brought here, it
7 causes confusion in the patient's mind about whether or
8 not it's the same lens. Then he goes on to say, and I
9 quote, "I often don't give the patients a choice. I
10 don't say this is a private label lens. I just say,
11 quote, 'this is the best lens for you, it's the one you
12 should be wearing.'"

13 And then the last ad that I'll read from is
14 another ad from a company -- another Ocular Sciences ad
15 that says -- I guess this is our industry here. The
16 guy's name tag here says, Mail Order Express, on this
17 roller coaster. And it says, traditional eye care is
18 being challenged, mail order is rampant. Every Tom, Dick
19 and Harry is offering your patients, quote, "low-priced
20 disposables. The system is broken." And it goes on to
21 say, make the system work for you, write prescriptions
22 for our brand and they'll only be sold to those that
23 prescribe.

24 Now, we would agree with this ad in one
25 respect, the system is broken, it doesn't work for

1 consumers, and consumers deserve better. I hope the
2 industry representatives here today will condemn this
3 kind of behavior and offer to address this conflict with
4 solutions that benefit the 35 million Americans who wear
5 contact lenses. Thank you for the time.

6 MS. OHLHAUSEN: Thank you, Jonathan.

7 Gerard?

8 MR. OSTROV: I'm Gerry Ostrov. I'm the Company
9 Group Chairman for Johnson and Johnson Vision Care, and I
10 thank you for the opportunity to address the workshop.

11 First of all, I want to make it clear that we
12 at J&J support Internet sales of contact lenses. We are
13 pro-brand and we're pro-consumer. And, in fact, many of
14 the ads that Jonathan had there are not really targeted
15 at him, they're targeted at my brands. We're the brand
16 leader, and so, they're trying to attract our consumers,
17 not really targeted at him.

18 We also believe that the primary role of
19 Internet in this category is convenience, not price. At
20 J&J at this time we currently sell to 20 Internet
21 vendors. Internet pricing tends to be about average
22 among our customers. Other customers, very significant
23 customers, offer dramatically lower prices than Internet
24 companies of up to 20 to 30 percent less. Our direct
25 pricing to all these companies in all classes of trade

1 are consistent and non-discriminatory.

2 In fact, in this category, many consumers
3 purchase only two or three times a year, sometimes once a
4 year. So, even their convenience needs can be addressed
5 through a multiplicity of retail choices including the
6 Internet.

7 In reading the material provided for this
8 workshop, I think that all the panelists here, from what
9 I read, agree on the consumer's right to quality, to
10 price and convenience, and the role that the Internet can
11 play in achieving this goal.

12 Where we differ, however, is on the
13 responsibilities that we have in this category. We think
14 that we have an active responsibility to be in compliance
15 with FDA prescription law and, of course, all state laws.
16 Frankly, it would be wonderful for us if state law was
17 consistent and unambiguous, so that we could comply
18 simply and uniformly.

19 We also believe that states have a
20 responsibility to enforce the laws that are on their
21 books. It's our belief that at least some states have
22 abdicated their responsibilities in this area.

23 These two issues are related. If prescription
24 verification is passive; i.e., if we just wink at it, and
25 if state and Federal laws are not enforced, than those in

1 the marketplace who do not have the consumers' best
2 health interests in mind are favored and, in fact, have a
3 competitive advantage against those companies, Internet
4 or otherwise, who have a higher ethical standing.

5 There would be no checks and balances
6 controlling their behavior, and as one Attorney General,
7 who has pursued a case in Ohio just a few weeks ago, said
8 in an action brought there, without proper supervision
9 from an eye care professional, consumers risk severe and
10 permanent damage to their eyes. We think that passive
11 verification drives out legitimate competition on the
12 Internet and will be contrary to what this panel is
13 seeking to accomplish.

14 So, active validation is a necessity to protect
15 fair and responsible competition in this business. One
16 might say that no company would practice such unfortunate
17 behavior, but we disagree. In fact, some Internet
18 companies, acknowledge in government filings, the
19 possibility that they regularly do not comply with state
20 laws and with FDA requirements.

21 Our experience with our existing Internet
22 customers is very, very positive. They indicate rare
23 instances of not getting responses from doctors. This is
24 consistent with the FTC study of 1995 that showed 92
25 percent compliance with prescription release. These

1 companies also indicated to us that prescriptions that
2 are not validated often are flawed and represent real
3 issues to be addressed. We thus cannot accept the
4 passive verification system or a wink-at-it system which
5 in the wrong hands could theoretically allow a consumer
6 to avoid eye exams indefinitely.

7 Remember that the eye doctor visit is not just
8 to update prescriptions, but they are crucial to
9 detecting significant health issues. The FDA warns about
10 the importance of regular eye exams. Unfortunately, many
11 consumers will go a long way to avoid these kinds of
12 exams.

13 Regarding prescription release, it's our long-
14 standing policy that the doctor should just say yes. We
15 think that this is good business and it's good health
16 care. We think that for those consumers who cannot get
17 their prescription released, the ultimate outcome, not a
18 very positive outcome, is to find a new doctor, not the
19 Draconian proposals that some advocate of throwing away
20 all caution by not requiring active validation of
21 prescriptions.

22 One last issue regarding the papers that were
23 submitted by Mr. Tennis and some of Mr. Coon's comments.
24 These comments about the lawsuit brought by the states
25 and their class action cohorts we find to be

1 irresponsible and just plain wrong, just as we believe
2 that this entire episode had no basis in fact.

3 Let me put the record straight as someone who
4 inherited this lawsuit well after it was begun, sat
5 through five weeks of trial and negotiated the
6 settlement. There were no agreements between organized
7 optometry and us to prevent sale of contact lenses
8 through mail order or Internet sellers. Consumers did
9 not suffer any higher prices as a result of our business
10 policies.

11 We believed that we were well on our way to
12 winning, to prevailing at this trial. However, we
13 settled with plaintiffs for a sum that was a very small
14 fraction of their demands specifically because this
15 settlement and the settlement terms established good and
16 positive rules regarding the requirements about the
17 Internet class of trade, rules that gave the consumer
18 quality, price and choice in a responsible way.

19 Most importantly, included in the settlement
20 was the accepted responsibility of the Attorneys General
21 to enforce the law.

22 We believe that we have fulfilled our agreement
23 and, frankly, we don't believe that Mr. Tennis and his
24 colleagues have reciprocated. It's really unfortunate
25 that he's not here today. We thought that the settlement

1 would help establish a code of conduct, making the
2 Internet consumer-safe and consumer-friendly. In most
3 cases, it has worked. It has worked very well. But
4 passive validation and the behavior of some AGs seem
5 intent on undermining this outcome. Frankly, we just
6 don't get it.

7 In conclusion, we think the Internet is a very
8 viable class of trade that will continue to be a
9 significant portion of our business. We look forward to
10 a clear, streamlined but responsible platform for
11 Internet sales with responsible companies leading the way
12 forward. Thank you very much.

13 MS. OHLHAUSEN: Thank you, Gerry.

14 Paul?

15 MR. HALPERN: Thank you.

16 I'm Paul Halpern. I'm an executive with
17 America's Best Contacts and Eyeglasses, an optical
18 retailer with locations nationwide and I'm here on behalf
19 of the National Association of Optometrists and
20 Opticians. Our organization represents most of the
21 national chains in the optical business and has for many,
22 many years.

23 The summary of our position is on file. I
24 assume everybody who's really concerned about this panel
25 has already read it, so I'm going to try and avoid

1 repeating that information. I want to talk for a couple
2 of minutes about how I think this debate fits into the
3 pattern of discussions in each of the industries this
4 workshop is looking at and the larger issues generally.

5 You know, these panels are set up a little like
6 there has to be two sides to every question and the two
7 sides in each industry seem to be the whiners versus the
8 innovators. Just for the record, the NAOO is an
9 innovator that has become established because of the
10 success of its innovations. We brought commercial
11 practices to the businesses of optometry and optical
12 sales. We did so in the face of a great deal of
13 regulatory opposition from the states, which continues to
14 this day, and a great deal of business opposition from
15 the competitors that we were displacing, the independent
16 optometrists and opticians who are owner/operators of
17 their own businesses.

18 Having successfully innovated, we suffer from
19 having become established much the way 1-800 CONTACTS
20 having successfully innovated is now a target as a holder
21 of a 7 or 8 percent share in the replacement contact lens
22 business.

23 The other issue, besides whining and trying to
24 innovate, is this question of disintermediation that the
25 Internet is supposed to provide. And in the case of our

1 industry, the problem -- and many other industries as
2 well, the problem is that the intermediaries are there
3 both by the results of the marketplace, and before the
4 Internet the need for intermediaries, and in many cases
5 because governments, at various levels, decided that
6 intermediaries needed to be involved in certain kinds of
7 transactions.

8 The optometrist in the contact lens sale is
9 exactly that kind of intermediary. He is there to
10 fulfill an economic need, a desire of the public for a
11 product. As Mr. Coon pointed out, he sells eyeglasses,
12 and contact lenses in many cases, but he's also there to
13 prescribe, to examine and prescribe. In both cases of
14 eyeglasses and contact lenses, but with particular
15 sensitivity in the contact lens business, he is an
16 intermediary that it's been decided is required for the
17 transaction. His order, his prescription is a necessary
18 prerequisite for someone to buy a contact lens, not
19 because necessarily people will want it that way. And,
20 in fact, people don't. But because for safety and
21 efficacy of the product, that intermediary was determined
22 to be necessary.

23 It's really clear. No one on this panel thinks
24 that he's a necessary, or in every case, desirable
25 intermediary for the sale of the lens. Everybody on the

1 panel seems to agree that one way or another he is a
2 necessary and desirable intermediary at the prescription
3 stage, and that creates a complexity in the business.
4 But what that complexity requires is that our business
5 choices need to be responsible and our regulatory choices
6 need to be careful to protect that role because it is
7 protecting the health and safety of the consumer.

8 The last issue that's been a common theme has
9 been convenience, and the convenience factor is huge in
10 this industry panel because it is both expensive and
11 inconvenient to get an eye exam. It will cost you \$70 or
12 more depending on where you are and where you want to
13 have your exam performed, and it will take you not only
14 the travel time, but probably a good hour.

15 And the Commission's comments to Connecticut
16 had a very interesting discussion of the value consumers
17 place on travel and convenience, and if you consider that
18 examination event and add \$70 of cost to it, you can see
19 that there's a huge incentive for consumers to avoid
20 examinations. Examinations for contact lenses are often
21 in two steps and require two trips, and this becomes an
22 issue in contact lens prescription release all the time,
23 because a doctor wants to examine your eyes, prescribe a
24 lens and then have you come back and look at the lens on
25 your eye after you've worn it for a little while, and

1 that is standard practice. It is part of the care that
2 an optometrist has to provide.

3 What consumers want to do is if they have to
4 pay for that exam and they have to go and see the doctor,
5 at least let it only be once, so they go home with their
6 lenses and they do not have a prescription yet because
7 the doctor hasn't finished his examination.

8 So, there are all of these people who have
9 lenses, have boxes, know what their magic numbers are if
10 they want to repeat that purchase, but do not have a
11 valid prescription. That's why there are so many people
12 out there without a valid prescription, with the
13 information and the desire to buy contact lenses that
14 make prescription verification such a significant issue
15 in our industry.

16 So, that covers intermediation and convenience,
17 and what I want to talk about briefly is anticompetitive
18 barriers, both business practices and regulatory. As I
19 mentioned, our industry has faced enormous barriers in
20 its development and there continue to be irrational laws
21 that restrict the way optometrists and commercial chains
22 can do business that require that the optometrist have
23 not only his own door and his own wall, but his very own
24 bathrooms in his side of the business separate from the
25 door, wall and bathrooms of the commercial business that

1 he's affiliated with. These laws are on the books in
2 dozens of states and interfere with competition and
3 probably violate the Commerce Clause.

4 Specifically with contact lenses, however,
5 these regulations have erected little in the way of
6 barriers to Internet competition. Arkansas is an example
7 that has a very restrictive statute. It says that only
8 optometrists may sell contact lenses, and the Board of
9 Optometry is very clear about what that statute means.
10 However, that statute -- and that statute has been
11 enforced against NAOO members and no NAOO member is in
12 the business of selling contact lenses in the State of
13 Arkansas, and this has led to -- the prices for contact
14 lenses in bricks and mortar locations in Arkansas are
15 higher than in neighboring states.

16 But that same law is not enforced against out-
17 of-state vendors who only ship contact lenses into the
18 state for whatever reasons, political, legal or
19 otherwise. So, that's an example of a regulatory
20 barrier, but it has not had any impact on the development
21 of the Internet channel in this business.

22 The business practices of non-release of
23 prescription. We're having this panel in 2002. If we
24 had had this panel in 1998 or 1996, prescription release
25 would have been a much more real and pressing issue. But

1 consumers want access to their medical information.
2 Consumers believe that they have a right to their medical
3 information, and I don't know of any private or chain-
4 affiliated optometrists today that can maintain good
5 relations with their customers and not give them access
6 to their medical information. So, that issue, though it
7 may have been an issue in the past, is no longer an issue
8 today.

9 Private label as a barrier. It's a very
10 interesting issue because in most industries, certainly
11 in all of the -- in grocery and soft goods, private label
12 is a competitive channel. It's designed to provide
13 consumers a choice, a quality choice and a brand choice,
14 and possibly to save consumers the costs of brand
15 advertising. In every other industry, it seems like a
16 good thing. In the contact lens business, I believe it
17 is just as helpful to competition and choice.

18 We certainly -- the members of the NAOO, most,
19 I believe all, sell private label as well as branded
20 contact lenses, and many customers choose the private
21 label lenses because of cost and quality issues. I don't
22 see how regulating away a choice that has proven popular
23 with consumers and delivers product at lower costs and
24 more choices can possibly be a good solution that reduces
25 barriers to competition.

1 So, those are the points that I wanted to add
2 to my materials. I think that it's very interesting that
3 everybody on this panel speaks in favor of multi-channel
4 sales because, historically, through the nineties, that
5 might not have been true. But today the marketplace has
6 spoken, but the marketplace has also proven that
7 consumers want lenses without prescriptions and science
8 and medicine have shown that that is not a good idea.

9 I think that the current regulatory framework
10 places the responsibility on the seller, distributor, and
11 manufacturer of lenses to only sell where there are
12 prescriptions. I think that's the right place for that
13 responsibility to go. I think that the problem is that
14 there has been what I refer to in my papers as a
15 differential enforcement regime. Bricks and mortar
16 vendors are subject to enforcement of the prescription
17 requirement, and not surprisingly, are committed to the
18 prescription requirement as an ethical business practice.

19 Direct channel vendors of contact lenses have
20 not been subject to enforcement of the prescription
21 requirement, and not surprisingly, have not paid
22 attention to the prescription requirement. And that is a
23 competitive barrier. It has kept NAOO members from
24 entering or building direct channel sales of contact
25 lenses and it has driven NAOO members out of the direct

1 sale of contact lenses during the past several years.
2 That barrier is both a health issue and a competitive
3 barrier that needs to be addressed, and I believe it can
4 only be, as I suggest in my papers, can only be addressed
5 by Federal enforcement of the Federal prescription
6 requirement. Thank you very much.

7 MS. OHLHAUSEN: Thank you, Paul.

8 Morris?

9 DR. KLEINER: Yes.

10 MS. OHLHAUSEN: We're ready for you.

11 DR. KLEINER: Thank you very much.

12 MS. OHLHAUSEN: Thank you.

13 DR. KLEINER: Thank you very much for the
14 opportunity to address the hearings on the possible
15 anticompetitive efforts to restrict competition on the
16 Internet. My apologies for not being present in person
17 to present these remarks.

18 My comments will really be focused on
19 overarching issues of occupational regulation and then
20 present some applications to the contact lens industry.

21 During the last 60 years, there's been a
22 significant increase in the number of occupations that
23 are licensed, as well as a percentage of the work force,
24 that requires a license. Now, in the U.S., there are
25 hundreds of occupations that are licensed in at least one

1 state and more than 18 percent of the work force requires
2 a license in order to do certain types of work. To
3 illustrate the importance of the issue, a higher
4 percentage of workers are licensed than belong to a union
5 or are directly impacted by the Federal minimum wage.

6 Occupational licensing is defined as a process
7 where entry into an occupation requires the permission of
8 government and the state requires some demonstration of a
9 minimum degree of competency. Generally, members of the
10 occupation dominate the licensing boards. The agency is
11 usually self-supporting through the collection of fees
12 and registration charges from the persons in the licensed
13 occupations. Others have commented, if this were really
14 truly a public good, then the public would pay for it
15 rather than the individuals in the occupation.

16 In many states, provisions are established that
17 require a licensed practitioner to be present when a
18 service is provided or when a product is dispensed. For
19 example, in some states opticians must be present when
20 contact lenses are dispensed. In other cases, electronic
21 prescriptions are prohibited.

22 In contrast, certification permits any person
23 to perform the relevant task, but the government agency
24 administers an exam and certifies those who have passed
25 and the level of skill or knowledge. Consumers of the

1 product can then choose whether to hire a certified
2 worker or not. For example, travel agents and mechanics
3 are generally certified but not licensed. In the case of
4 occupational licensing, it's illegal for anyone without a
5 license to perform the task.

6 In terms of the academic studies on the cost
7 and benefits of licensing on consumers and the impact of
8 licensing on the individuals in the occupations, a table
9 that I've submitted to the workshop documents the costs
10 of licensing, that generally it increases the costs to
11 consumers and generally raises the earnings of
12 individuals in the occupation, although there's quite a
13 bit of variation, generally more high-skilled
14 occupations, individuals at the higher part of income
15 distribution tend to gain from occupation regulation
16 relative to those who deal or have lower income and
17 education requirements.

18 In occupations, there is a greater political or
19 economic power by the members of the profession in the
20 state. They're generally able to obtain licensing
21 provisions for their states and eventually economic
22 rents.

23 The economic advantages of the Internet are
24 known and have been well-documented. The ability of the
25 Internet to reduce search costs for products and services

1 has led to the growth of new firms and the expansion of
2 existing firms into the Internet. In addition, the
3 ability to gather information on prices and quality is
4 easier through the Internet than through traditional
5 sources. This leads to more efficient transactions, and
6 rather than having intermediaries, consumers and
7 suppliers can interact directly.

8 Occupational licensing may have a particular
9 impact on this second advantage, which is really unique
10 to the Internet. For example, individuals who purchase
11 products such as insurance through the Internet have
12 about a 5 percent reduction in their prices. Similar
13 reductions, for example, the average price of a six lense
14 multi-pack purchased via the Internet was 19 percent less
15 than the average price for lenses purchased through
16 ophthalmologists, optometrists and optical chains, as has
17 been mentioned, bricks and mortars.

18 The questions that policy makers should ask, I
19 have sort of documented in my report. Some of these
20 questions, in regard to licensing and the Internet, are
21 focused on the potential costs and benefits of the laws
22 and practices. These includes the following. Are state
23 occupational licensing laws reducing the price and
24 quality benefits of Internet transactions? Do these
25 restrictions benefit consumers by protecting product

1 quality? Is the competency of the service enhanced
2 through licensing? And, in particular, which has not
3 been addressed so far, do low income individuals lose
4 relative to high income ones? Are there unintended
5 consequences to others -- such as the spread of disease
6 -- of unrestricted Internet commerce relative to the
7 protections offered by licensing? Are Federal
8 requirements usurping what states view as the optimal
9 amount of regulation in their jurisdiction to the extent
10 that states really reflect their constituents, Federal
11 regulations may be higher or lower than what individuals
12 in a particular area want?

13 How should different or competing state
14 statutes that impact the Internet be treated? As has
15 been mentioned, to what extent should Federal regulations
16 be imposed relative to the state-by-state requirements
17 that are currently in place?

18 And finally, and the issue that has just been
19 addressed, what is the enforcement mechanism to monitor
20 and impose appropriate costs on individuals who choose to
21 potentially violate the state statutes governing
22 occupational licensing requirements?

23 In summary, these questions do not deal with
24 all the legal or economic questions posed by the
25 technology and commerce value of the Internet, but they

1 should help focus on the both commercial and public
2 safety aspects of the use of Internet commerce. Thank
3 you very much.

4 MS. OHLHAUSEN: Thank you, Morris. I wanted to
5 give Pat a chance, since I hadn't mentioned John Tennis
6 not being here before he spoke, that if you wanted to say
7 anything about the multi-district litigation, I wanted to
8 give you a chance to do that now. You're not required
9 to, however.

10 MR. CUMMINGS: I think the only comment that I
11 would have on the litigation is that it was settled.
12 We're very happy with the settlement that we received.
13 There was no guilt found on anybody's part on that
14 particular issue, and we're just glad it's over and ready
15 to move ahead.

16 MS. OHLHAUSEN: Okay, now, Jerry and I have
17 some questions that we'd like to ask the panelists.
18 Basically what I'm going to do is ask a couple people to
19 address each question. But if anyone else wants to weigh
20 in, a good way to get our attention is to turn your name
21 tent up on its side so it catches our eye.

22 DR. ELLIG: Dr. Kleiner, we expect you to do
23 that, too.

24 MR. OHLHAUSEN: Yes, Morris, you'll have to
25 come up with some other signal to us.

1 DR. KLEINER: Hand signals or voice signals?

2 MS. OHLHAUSEN: Voice signals are preferred, I
3 think. Thank you.

4 Well, my first question, that I'd like to
5 address to Jonathan and to Gerard, is, specifically, what
6 types of state regulations limit or currently limit
7 online sales of contact lenses?

8 MR. COON: Okay. Do I still need to turn my
9 tag on end?

10 MS. OHLHAUSEN: No, no, if I said your name,
11 you don't need to turn your tag.

12 MR. COON: I just want to make sure I know the
13 system.

14 Well, there's a variety, as I discussed in my
15 opening remarks, and they really sort of key off of this
16 conflict of interest and build on it. Among others,
17 there's a requirement that contacts only be sold by an
18 in-state licensed practitioner, or requirements in some
19 states, like New Mexico, where only an in-state
20 optometrist or retailer can sell contact lenses. Of
21 course, we believe these laws violate the Interstate
22 Commerce Clause. And then there's some states that just
23 have really restrictive requirements on how a contact
24 lens prescription can be communicated or frankly can't be
25 communicated. Like Georgia requires that contact lenses

1 only be delivered in a face-to-face transaction between a
2 Georgia-licensed optometrist and a Georgia resident.
3 Texas law, specifically written, we believe, to address
4 the Internet rather than to prevent Internet sales as
5 opposed to enabling Internet sales, requires that a
6 contact lens prescription be an original hand-signed
7 copy, which currently we're not aware of any way to
8 transmit that over the Internet. No fax, no phone, no e-
9 mail, only an original hand-signed copy.

10 Now, the doctor can, if they choose to, respond
11 by fax. They've, in fact, been instructed by the
12 optometry board to respond by fax. But that's what the
13 law would at least attempt to require. And there's a lot
14 of others, but they really key off that.

15 And then I'd also add that the states also have
16 state optometry boards which are, in almost every case,
17 dominated by practicing optometrists who own their own
18 retail stores and there's been numerous documented cases,
19 most recently in California, where the law was recently
20 changed to address the issue. The most common complaint
21 in California was refusal to release a contact lens
22 prescription, and they were receiving a couple hundred
23 complaints every year and the optometry board had done
24 nothing to act on those complaints, and so the law was
25 changed to address that in a way that we think benefits

1 consumers.

2 MS. OHLHAUSEN: Thank you, Jonathan.

3 Gerry?

4 MR. OSTROV: Well, at the end of the day, we
5 don't think there are any real barriers based upon state
6 law. I mean, there are some anomalies, but at the end of
7 the day, I think the Internet is doing very well and the
8 state law is not a real barrier, and people who want to
9 do business on the Internet can find ways to use the
10 Internet in an ethical, straightforward and pro-consumer
11 way.

12 MS. OHLHAUSEN: Do you think that's because of
13 a lack of enforcement of some of these laws that are on
14 the books?

15 MR. OSTROV: No, I think it's primarily a
16 function of companies working within the state laws to
17 provide the service, and it can be done and it will be
18 done. I think it's when you try to avoid the law and try
19 to avoid the responsibilities to the consumer that it
20 becomes a barrier. But I think ethical, straightforward
21 companies can do business if they comply with the law,
22 and it can be done and it is being done.

23 MS. OHLHAUSEN: Jonathan, did you want to add
24 something?

25 MR. COON: Yes, I think it's an important point

1 that while the laws may seem reasonable to people who
2 write prescriptions, they do apply unequally to online
3 and telephone-based sellers. The key difference being
4 that we ask our competitor for permission to make a sale
5 and they ask themselves.

6 MR. OSTROV: We don't agree. Our customers
7 have found ways to do business in a very good way and
8 they're happy. All they need is a little effort and it's
9 being done.

10 MS. OHLHAUSEN: Paul?

11 MR. HALPERN: If I could add just a couple of
12 things. New Mexico changed its statute. The 200
13 complaints in California need to be compared to the fact
14 that if there are 30 million contact lens wearers and the
15 Internet channel has a 10 percent share and contact lens
16 wearers purchase between once or twice a year, and
17 California represents a substantial portion of the
18 American population, there are hundreds of thousands of
19 successful Internet purchases of contact lenses in
20 California not complaining about prescription release
21 problems.

22 Georgia law is very restrictive and the
23 opticianry law has aspects of it that we certainly
24 disagree with and might be violative of the Commerce
25 Clause, but it has not, in any way, limited penetration

1 of the Internet and direct service channel of contact
2 lenses to Georgia residents, because there hasn't been
3 any enforcement. So, those barriers are very real, but
4 they're a lot more real where they are enforced, which is
5 as against vendors that have stores in the states.

6 MS. OHLHAUSEN: Thanks. The other thing that I
7 wanted to talk about or find out more about are some of
8 the health justifications supporting these regulations,
9 and I thought Pat might be the person to address that for
10 us.

11 MR. CUMMINGS: Certainly. I think in my
12 travels and in talking with my colleagues, every one of
13 us has had the unfortunate opportunity to have a person
14 that's in our office with a contact lens complication,
15 and there's maybe a couple of us in this room that really
16 have sat in that exam room and looked at that patient and
17 wondered, you know, are we going to be able to preserve
18 the sight of this patient.

19 Those complications, you know, a lot of times
20 can be from the patients wearing their lenses too long,
21 they're wearing a dirty lens, the patient's sleeping in
22 their lenses when they shouldn't be sleeping in them.
23 They've gotten their lenses, and they've not had their
24 eyes checked for a number of years. They may have been
25 in. They've had their contact lens prescription changed,

1 but when they ordered the lenses, the new prescription
2 wasn't sent to them. So, there's all kinds of things
3 that can be happening.

4 But, you know, the bottom line is,
5 unfortunately, for some people who purchase contact
6 lenses without a prescription, in many cases, some folks
7 are never even fit with a contact lens or have a fitting.
8 They can obtain contact lenses over the Internet without
9 a prescription or their prescription is expired or
10 something like that and they do have serious
11 complications and they can be sight-threatening
12 complications.

13 You know, I think the important piece that we
14 always need to remember is the patient. The patient has
15 the right to their contact lens prescription and they
16 should be able to purchase those contact lens or their
17 replacement contact lenses where they choose. The second
18 piece is the patient is entitled to make sure that their
19 prescription is filled properly and that they're wearing
20 the best lens for them at that particular time, and that
21 requires follow-up care and it requires verification of
22 the contact lens prescription.

23 MS. OHLHAUSEN: Thank you.

24 DR. ELLIG: Let me just ask a follow-up here.

25 MR. CUMMINGS: Um-hum.

1 DR. ELLIG: Are there any studies or empirical
2 data that look at whether the mere fact that a customer
3 got contact lenses from an Internet vendor has any
4 differential effect on health?

5 MR. CUMMINGS: No, no, the issue is where the
6 patient purchases the replacement lenses, you know, and
7 there's many -- I mean, the competition is huge in this
8 replacement contact lens market. It's not just the
9 Internet, it's the big box mass retailers, all kinds of
10 folks. So, it's not where they actually purchase the
11 replacement box of contact lenses. The issue is that
12 they have a valid and current contact lens prescription
13 that is verified and they're receiving routine follow-up
14 care.

15 MR. OSTROV: Yes, I just wanted to comment.
16 The issue is not whether there's a differential. The
17 issue is that this is living tissue, your eye is living
18 tissue. We've heard in many pieces of testimony about
19 the risk of not taking care of the eye. There was a
20 sensationalist 20/20 or one of those shows a couple of
21 weeks ago where it showed teenagers -- we're very
22 concerned about teenagers buying lenses in gas stations
23 and things like that. I mean, you can't allow that to
24 happen because you're putting, particularly, kids' eyes
25 at risk. So, there has to be some control in this

1 industry to make sure that consumers do have -- there is
2 some control, which gets them to go back to their eye
3 doctor, and make sure that they have valid prescriptions
4 and that they're having their eyes checked, and it's not
5 just Internet. It's everybody.

6 One of the issues that I think was brought up
7 is that Paul said, I think the more standard classes of
8 trade are regulated and are measured pretty well, and the
9 Internet should not be given a free ride here. They have
10 to be regulated the same as the standard classes of trade
11 to make sure that the consumer's health is not put at
12 risk.

13 MS. OHLHAUSEN: I have a follow-up on the
14 health issue. Some of the literature that I've seen also
15 talks about the risk of consumers over-wearing their
16 disposable lenses if they find it difficult to obtain
17 replacement lenses or expensive to do so. I was hoping
18 someone would address the effects of if it's more
19 difficult or more expensive to obtain your lenses, what
20 are the health effects that can result from that?

21 Jonathan?

22 MR. COON: Sure. Well, the Attorneys General
23 made the argument in the multi-district litigation with
24 the manufacturers and the optometry associations that
25 lower prices for and better access to contact lenses will

1 encourage consumers to replace them more often. That's
2 an important characteristic to identify that these lenses
3 that we sell predominantly are disposable contact lenses.
4 They're not the old hard lenses. The more frequently --
5 it's usually widely recognized that the more frequently
6 somebody throws those away and puts a new clean lens in,
7 the better. In fact, our data supports the Attorneys
8 General position which is the industry average is about
9 28 lenses per year. Our average customer consumes about
10 40 lenses per year of the average disposable contact
11 lenses.

12 MS. OHLHAUSEN: Pat and then Gerry.

13 MR. CUMMINGS: I would support the concept that
14 the more frequent the replacement of the lenses or
15 whatever the replacement schedule is, if it's adhered to,
16 that that is going to be in the patient's best interest.
17 Certainly, if the patient has their contact lens
18 prescription and they have choice on where they can
19 purchase the lens, from the private practitioner or the
20 big box distributors or the Internet or the mail order,
21 then we would hope that they would replace their lenses
22 more often and that we would see less problems.

23 So, we support the concept of the replacement
24 of the lenses on the prescribed replacement schedule that
25 the doctor puts them on.

1 MS. OHLHAUSEN: Thank you. Gerry?

2 MR. OSTROV: First of all, we agree with that.
3 First of all, we created the disposable contact lens
4 business. Lenses used to be worn forever, for a year,
5 because they were so expensive and they were specifically
6 fitted to the consumer. In 1988, we introduced Acuvue,
7 which was the first disposable contact lens, and we have
8 continued to innovate that category over the years.

9 Frequent replacement is the basis of our
10 business, which is a global business. So, we absolutely
11 agree with that. We also believe that that should be the
12 focus of some of our consumer advertising and our
13 consumer communication, and we do do that. We spend a
14 lot of money every year telling consumers that they
15 should change their lenses for both health reasons and,
16 frankly, for economic reasons. We want to sell more.
17 It's good for our business, it's good for our consumers.
18 It's the right thing to do.

19 But third of all, Internet/mail order is not
20 the lowest class of trade. It's not necessarily the most
21 convenient. If people buy two or three times a year,
22 they're constantly in the mall, they can go to any number
23 of places, Sam's, Wal*Mart, Lenscrafters, you know,
24 Pearl, Kohl's, Sears, Target. They're available there.
25 Now, we don't say Internet shouldn't be a class of trade,

1 but it's not the only answer and it's certainly not,
2 despite what I think the doctor said, is not anywhere
3 near the low cost class. So, if consumers want to save
4 money, they can go to just one of those other outlets and
5 save more money in doing that and they can do it as part
6 of a regular shopping trip.

7 MS. OHLHAUSEN: Jonathan?

8 MR. COON: I just wanted to address the issue
9 of cost, and that is that we agree, we're not the low
10 cost provider at present. We're certainly the most
11 efficient provider of contact lenses. By the fact that
12 we only have one store and sell from one location, our
13 rent and payroll combined is about 6 or 7 percent of
14 revenue, whereas for folks that have stores, it can be
15 anywhere from 20 to 35 percent. So, there's no question
16 that we're the most efficient.

17 There's a very good reason, and that's the
18 reason that we're here today, that we're not the lowest
19 cost provider because there's no question that we would
20 be. Our prices should be 15 to 20 percent lower than
21 they are today if not for the fact that some of the other
22 folks represented here today pay 20 to 50 percent less
23 than we do for the exact same products because of the
24 relationship they have with manufacturers, which we
25 don't.

1 MR. OSTROV: We absolutely reject that
2 argument. Jonathan is higher than his competitors, but
3 his competitors are 20 to 30 percent higher than the
4 lowest cost provider, and I think some of the economic
5 models, if you look at a Cosco or Wal*Mart, you know, he
6 runs his business, I don't tell him what to charge, but I
7 don't think he's ever going to be the low cost provider,
8 but we are non-discriminatory in selling to his class of
9 trade. His competitors buy from us basically in a non-
10 discriminatory manner versus our other classes of trade
11 and it's up to them to price it where they think it is.
12 Right now, it's 20 to 30 percent higher than the lowest
13 cost provider.

14 DR. ELLIG: I'd like to address a question to
15 Dr. Kleiner, but if anybody else wants to chime in after
16 his answer, that's fine.

17 Several panelists have mentioned some possible
18 barriers to Internet commerce and contact lenses, and I
19 realize there's some disagreement over how big these are
20 or whether they exist. But, you know, that's something
21 that's possible to check. But, Dr. Kleiner, I just want
22 to ask you about a couple of these barriers.

23 An in-state license requirement, and I guess in
24 some states that might be as strict as a requirement that
25 only an optometrist could sell contacts, but I think in a

1 lot of states we're looking more at some other type of
2 licensee, such as an optician, a bricks and mortar or
3 face-to-face type requirement for contact lenses, and
4 then there are a variety of prescription regimes that can
5 make it easier or harder to get the prescription
6 information to some vendor other than the eye doctor, and
7 we've heard everything from requirements of a signed
8 original copy of a prescription to -- some folks have
9 suggested a system where the doctor just has an
10 opportunity to verify the prescription might be enough.

11 But in any case, with those kinds of barriers,
12 Dr. Kleiner, as a matter of economic theory, what kind of
13 effect should we expect to see those barriers have and is
14 there any research that tells us what may actually be
15 happening as a result of some of these things?

16 DR. KLEINER: Well, there has been at least
17 some work -- unfortunately, not in the area of optometry
18 and contact lenses, but there's some work that's been
19 done in dentistry in terms of the effect of regulation
20 and there's two potential effects, and it's sort of the
21 old on the one hand, the new on the other, and I'm sure
22 you would like to have a one-handed answer to this. That
23 is, the flow -- regulation certainly has an effect on
24 increasing prices.

25 The impact of that is, as many of your

1 panelists have said, the effect of that is to reduce the
2 quality of care, especially by low income individuals.
3 Individuals wear contacts longer and that has a negative
4 effect on the eye.

5 On the other hand, the overall quality of the
6 service is enhanced by these additional restrictions so
7 that consumers see that as a higher quality product by
8 having these regulations and perhaps they're more likely
9 to go because they see that as being a benefit. So, that
10 enhances the overall quality to consumers of having these
11 additional regulations. And this work has been done in
12 other areas, most notably dentistry. But there hasn't
13 been any comprehensive study in the area that we're
14 focused on this morning.

15 DR. ELLIG: Is there any kind of research in
16 any of these occupational licensing areas or other areas
17 that tries to look more rigorously at the issue of the
18 impact on convenience?

19 DR. KLEINER: Well, there has been. There's
20 been work, in fact, in the 1970s at the Federal Trade
21 Commission, which looked at the impact of average eye
22 exam and eye glass prescription advertising, and
23 certainly part of that was convenience, and found that
24 where areas or cities that had greater restrictions,
25 prices were about 35 percent higher with restrictive

1 commercial practices for optometrists.

2 DR. ELLIG: Okay. Anybody else aware of
3 anything that would help enlighten us on this kind of
4 issue?

5 MR. CUMMINGS: One particular issue that comes
6 to mind, in being a past state board member before I
7 started my AOA career, and realizing that the state board
8 is a governmental agency appointed by the elected
9 officials of the state and that the primary role of the
10 state board of optometry is to enforce the laws and
11 regulations of the laws of the state and protect the
12 health of the public, one of the issues we ran into is
13 that -- and we have what I feel is a very good contact
14 lens release prescription in our state -- is that we
15 would have Internet sellers providing lenses to people of
16 our state without a prescription.

17 The one particular issue that comes to mind is
18 a young lady got her friend's box tops and ordered
19 herself some contact lenses and ran into a problem.
20 Well, our problem was that we could not go after the
21 Internet supplier. Our Attorney General had no recourse
22 because they were not registered in the state, you know,
23 that type of thing. Then we go to the state where the
24 company was located and their Attorney General refused to
25 do anything, you know, because they were too busy, blah,

1 blah, blah.

2 So, I think a lot of times in the interest of
3 trying to protect the public from, you know, the
4 dispensing of contact lenses without a valid prescription
5 some of these rules and regulations arise. And that's
6 why probably a national legislation, a national statute,
7 some kind of requirement on a national level would help
8 solve this particular problem.

9 MR. HALPERN: Just briefly, as far as optometry
10 regulation and its impact goes, I believe that our
11 organization has some evidence that shows that the impact
12 of restrictive optometry law on price is still visible
13 when you compare restrictive to non-restrictive states.
14 But when you get to the contact lens, the direct delivery
15 of contact lenses, it is virtually invisible because
16 until very recently there were, I believe, no major
17 direct channel vendors that followed opticianry laws or
18 prescription requirements. It's only been in the last
19 year that any of the major players have made any good
20 faith efforts to comply with the prescription
21 requirements and licensure requirements, and the largest
22 still don't.

23 So, in that context, the regulations have not
24 had any impact on competition or cost because they
25 haven't been followed or enforced.

1 MS. OHLHAUSEN: Jonathan?

2 MR. COON: Yes. I think this is a very
3 important issue and I didn't recognize that Dr. Cummings
4 had been on a state optometry board before, and it will
5 be helpful to get his view on this. I think, first of
6 all, I'd like to address the comments from -- my
7 apologies, is it Mr. Halpern or Dr.?

8 MR. HALPERN: Mister.

9 MR. COON: Mister, okay. I think it's
10 important, first of all, to discuss what our current
11 system is because I think there may be some
12 misperceptions about it. First of all, our company
13 requires a doctor's name and phone number on every order
14 whether it's online or over the telephone. We then
15 validate that that doctor's phone number is, in fact, a
16 doctor's phone number. Long ago in the past somebody
17 could have put in Starbucks or something, and we found
18 out that was happening 1 or 2 percent of the time and 98
19 percent wasn't good enough, and so we fixed that. So, it
20 bounces it off of a database of valid eye doctors to make
21 sure it is a valid phone number or we don't take the
22 order.

23 We then contact the doctor's office by phone,
24 and in some cases by fax in writing, and request that
25 they confirm the prescription. We're not asking for a

1 release because we already have the information from the
2 consumer. We're asking for them to confirm the
3 prescription.

4 Now, we also inform the doctor that if we don't
5 hear back from them -- and this is what people refer to
6 as passive verification -- that if we don't hear back
7 from the doctor, we'll assume that the information we've
8 received is accurate and we'll ship the order on that
9 basis, and that's what many in the industry are opposed
10 to.

11 What happens is, if the doctor tells us in a
12 reasonable period of time that it's expired or invalid or
13 they get back to us, then we don't ship the order. If
14 they don't get back to us, then as we said, we'd rely on
15 that information and ship the order. That's what people
16 here are referring to as passive verification.

17 Now, that system is already codified in three
18 states. The largest state in the country just made that
19 the system. We've been doing that since 1998 in
20 California, sending faxes out, and then in California
21 just two weeks ago, the governor signed into law that
22 exact system, which is that if we contact our competitor
23 and ask for permission to make a sale and they ignore
24 that request, that by 2:00 p.m. the next business day, we
25 can go ahead and ship the order with no response from

1 that competitor.

2 Now, I just want to make a point because in
3 Texas we had four years of litigation with an optometry
4 board. And I apologize for this, I'm taking a little bit
5 more time, but I think it's important to note that after
6 four years of litigation, we decided to take eye doctors
7 up on their offer. They said, we'll wait. They said,
8 we'll release, we promise we will release, we'll comply
9 with the law and we'll respond to you. They agreed in
10 their statements that if they did not respond to a
11 request from 1-800 CONTACTS representing the customer
12 that it was a violation of the Optometry Act and the
13 Contact Lens Prescription Release Act.

14 So, starting in July of this year, we started
15 waiting indefinitely for an affirmative response and
16 making every request in writing and informing the various
17 optometry members on the state of their obligation from
18 the optometry board. I just want to share with you what
19 the result of that has been. I'm curious to see what
20 everyone's view is on it.

21 Those are the complaints from consumers. These
22 aren't even the complaints that we've filed. Every one
23 of these is hand-signed by a Texas contact lens wearer
24 indicating that their doctor refused to release their
25 prescription or respond to our multiple requests in

1 writing for confirmation of their prescription.

2 Now, that happens over half the time. We're
3 waiting indefinitely. We're canceling half our orders in
4 the State of Texas, and eye doctors are violating the law
5 and refusing to respond. So, I'm just curious to hear
6 from the rest of this panel what they would do to enforce
7 prescription release when there's open violations. These
8 are 1,200 complaints. So, this is just the tip of the
9 iceberg. This is one little company. We're 5 percent of
10 the market. This is one in ten who received a complaint,
11 hand-signed it and sent it in, and some of these have
12 numerous handwritten notes all over them, long stories
13 about how they went an extra month or two without getting
14 their contact lenses.

15 By the way, this didn't succeed in forcing them
16 to go back in for an eye exam. Only a third, months
17 later, went in for an exam. A majority of these
18 customers are still wearing the same pair of two-week
19 disposable contact lenses they were wearing when they
20 called us months before to place this order. There's
21 1,200 complaints here that are hand-signed by customers.
22 This is only 90 days' worth from one company representing
23 5 percent of the market in Texas, which is only 7 percent
24 of the country. So, do the math. Multiply this times a
25 thousand. We're talking about millions of consumers not

1 getting their prescription for contact lenses.

2 And I'm just curious to know from a former
3 board member what should be done to take action against
4 these optometrists.

5 MR. CUMMINGS: I've got a --

6 MS. OHLHAUSEN: Everyone wants to jump in on
7 this one.

8 MR. HALPERN: I just have to say I've seen
9 those letters that you've got. I've never seen one that
10 was signed, but I've seen one that was sent out to one of
11 your customers because I was very interested in
12 understanding how your processes worked. We wasted a lot
13 of time yesterday talking about alcohol stings. So, we
14 can talk about contact lens stings if you'd like because
15 we had a Texas customer with a Texas credit card and a
16 Texas address order contact lenses that had never been
17 prescribed using a doctor's name and phone number that,
18 frankly, never had a doctor at it.

19 They ordered their contact lenses and they got
20 their contact lenses, and a couple of days after their
21 lenses were shipped, a letter was sent to those same
22 customers informing them that, notwithstanding that there
23 had been a shipment, their doctor had never confirmed
24 their prescription and didn't they want to complain to
25 the state board of optometry about that nonconfirmation,

1 when, in fact, it wasn't a nonconfirmation, it was a case
2 of a confirmed non-prescription that had been sent within
3 one business day of the request to the Internet vendor,
4 but the product had actually been shipped before the
5 nonconfirmation had been communicated within one business
6 day.

7 I'm very impressed by your fulfillment
8 procedures that can get product out on a same day basis,
9 but you're getting product out on a same day basis before
10 even your passive verification system can mature, and
11 certainly, notwithstanding the fact that your passive
12 verification system is producing nonconfirmations and
13 then you're soliciting complaints about nonconfirmation.

14 MR. COON: I think it -- if it's okay, I could
15 interject there. I am interjecting.

16 I apologize if I didn't make it clear. We
17 don't have a passive verification system in Texas. It's
18 active. We wait indefinitely until we get a positive
19 response in writing from the eye doctor before making a
20 sale or a shipment. You may be referring to something we
21 did a year ago or a year and a half ago. I'm referring
22 to something that we started doing in July. We wait
23 indefinitely.

24 MR. HALPERN: Well, the Federal Prescription
25 Requirement for contact lenses hasn't changed since the

1 1970s.

2 MR. COON: The Federal Prescription
3 Requirement?

4 MR. HALPERN: The requirement that contact
5 lenses are a prescription product that can only be sold
6 on the order of a licensed professional hasn't changed in
7 decades.

8 MS. OHLHAUSEN: I'd like to jump in here.
9 Several of the panelists during their remarks had
10 mentioned that one of the things they thought might solve
11 some of these problems is a Federal requirement, a
12 Federal law. And what I wanted to talk about was the
13 California bill that just got signed into law which has
14 prescription release and a requirement that the
15 prescriber must attempt to confirm promptly.

16 It says it's a deceptive practice to advertise
17 that lenses may be obtained without confirmation of a
18 prescription. A seller located outside the State of
19 California has to register with the medical board to ship
20 lenses to a patient in the state, and the sellers have to
21 give a toll-free way for prescribers to confirm the
22 prescription. That's just some of the major
23 requirements.

24 I'd like to get people's views on whether they
25 think that's a good model for a Federal requirement or

1 whether there are problems with that model.

2 MR. OSTROV: I'll comment. I think if it's
3 active verification, I think that works. I mean, we
4 think the prescription should be released.

5 But passive verification, I don't know what Mr.
6 Coon is doing today, but I do know that the 20 Internet
7 companies that do business with us report that they
8 basically put their orders through two chutes, one that's
9 verified and the other one it's not verified, and they go
10 and they check back and they do not ship until they get
11 verification, and they are finding significant problems
12 with invalid prescriptions, wrong prescriptions,
13 prescriptions that never existed, and they are curing
14 potential health hazards by dealing with those and,
15 ultimately -- hopefully as quickly as possible -- but
16 clearly to their satisfaction, at least that's what they
17 are telling us. I don't have access to their business
18 reports and I don't ask for them. They're saying they do
19 business in a responsible way and in a successful way.

20 But passive verification, I think if that's in
21 there, it opens the door for people who don't really want
22 to comply to wink at the system and it will give a
23 competitive advantage to people who want to be efficient,
24 who want to be the lowest cost providers, but who don't
25 think that the consumer health is at risk or don't care

1 about the consumer health or for whatever reason, they
2 will not take and spend money on the consumer health
3 aspect and on the concern aspect and the responsibility
4 aspect. They focus on the consumer right aspect and
5 there has to be a balance here between rights and
6 responsibilities.

7 If we don't have a responsibility to make sure
8 that we're doing the right thing for the consumer, at the
9 end of the day, it's going to cost the consumer more
10 because there are going to be some consumers who are
11 going to have health care issues. They're going to go
12 back to their doctor and they may even lose their sight.
13 Now, I don't want to be a sensationalist, but there has
14 been some sensationalist stuff, and frankly, we, the
15 manufacturers, have to deal with that stuff.

16 At the end of the day, we get sued, we have to
17 take responsibility for our products, and we will not
18 ship products to people who we don't think are taking the
19 consumer health seriously.

20 MS. OHLHAUSEN: Gerry, just to follow up on
21 that. So, your distributors or your Internet sellers,
22 are they running into any problems with this active
23 verification? Do they get responses quickly enough?

24 MR. OSTROV: They tell us that they are very
25 happy and that the ability to get active verification is

1 minimal, and it is something that is not a major issue
2 with their business model. Now, they're working with it.

3 I mean, we all have barriers within our
4 business. We want everything to be easy and perfect.
5 Nothing's easy and perfect, but you have these
6 responsibilities. As a business, you have to work
7 through it, you just don't ignore it. If your business
8 model says you don't want to deal with it because it's
9 hard to do, you don't just say I'm just not going to do
10 it, and you don't put a warning in your 10Q that you
11 violate state or Federal law. You just don't do that.
12 You go out and you deal with the issues and you spend the
13 money both in terms of being efficient and in terms of
14 being responsible.

15 DR. ELLIG: Actually, I'm curious. Paul, do
16 any of your members, in states where they can sell
17 contacts, do they run into those sort of prescription
18 verification or prescription information issues or
19 problems or does it not come up because most of the
20 customers coming through the door already have a
21 prescription?

22 MR. HALPERN: No, I think that in particular
23 the big box retailers do a lot of replacement business
24 with customers that have not had their exams in their
25 stores, and certainly to the extent members are in the

1 Internet business, they do some business with people who
2 have not been in their stores. Our experience is that
3 cooperation with the verification process is not a
4 problem.

5 A serious problem is that people wish they had
6 contact lens prescriptions when they don't, that they
7 make up contact lens prescriptions when they never had
8 one, and that years after they've last seen a doctor,
9 they wish that their contact lens prescription were still
10 valid. That is still a problem, people wanting to buy
11 when they do not have prescriptions because of the cost
12 and inconvenience of getting a prescription is a real
13 problem. But finding out about the real status of their
14 prescription from the person they identify as their
15 doctor is generally not a problem today. We expected it
16 to be a much more serious problem than it is.

17 Specifically, when I said that I thought a
18 Federal solution was appropriate, the position that I was
19 trying to explain is that I think the current Federal
20 regulations are sufficient. I don't think we need new
21 statutes, I don't think we need new regulations.
22 However, the FDA has taken the position that we'll just
23 let the states enforce this rule and that has completely
24 failed to produce a consistent and reliable enforcement
25 regime of the prescription requirement.

1 MS. OHLHAUSEN: Pat, I think you signaled you
2 had a comment.

3 MR. CUMMINGS: Sure. On the contact lens
4 prescription release issue, and I've been through this --
5 I went through it in Wyoming and we're looking at it now,
6 again. You know, the pieces that we need to look at on
7 it -- and I'm not totally familiar with the California
8 language at this point, but I think there's some critical
9 pieces that need to go into any contact lens release
10 language or bill.

11 The first being is, obviously, the patient has
12 to have choice. They have to have access to their
13 prescription and they have to have choice of where they
14 can replace their replacement contact lenses.

15 I also firmly believe in that concept that we
16 have to have a positive verification. This truly is in a
17 patient's best interests. Some people will try and get
18 their contact lenses without a prescription, they will
19 try and get them with an expired prescription. To
20 protect the health of the patient and to be continually
21 successful with contact lenses like we have been in the
22 past, then I think we need that safeguard in there to
23 protect the health of the patient.

24 DR. ELLIG: Okay. We've tried to work in some
25 of the issues raised by members of the audience as we've

1 been going along here, but there's another pair of
2 questions that I want to bring up from the audience that
3 introduce a new topic with 10 minutes to go in the panel.
4 It's actually not a brand new topic.

5 But we have a pair of questions, one addressed
6 to Mr. Ostrov, one addressed to Mr. Halpern. But they're
7 both related. They're on the issue of private label
8 lenses.

9 For Mr. Ostrov, the question is, does your
10 company manufacture or market private label lenses and do
11 you think such lenses promote consumer choice?

12 Then for Mr. Halpern the question is, isn't
13 your characterization of private label false in that
14 consumers don't get a choice since there's no
15 substitution of brands?

16 So, if one or the other of you wants to take
17 the private label question first.

18 MR. OSTROV: Okay, the first question is, do we
19 manufacture private label. Absolutely not. We have no
20 interest in it, we never have, we never will. We are in
21 the branded technological development business. We put
22 all of our efforts into new products and into our branded
23 products, and we don't think private label is our
24 business.

25 Do we think private label is valid? Yeah, it's

1 a business. What Mr. Coon was referring to, those ads,
2 were from a company called Ocular Sciences and some other
3 companies who are in the private label business. They
4 try to knock off our brands after we have done a lot of
5 the innovation work and they come up, over time, with
6 reasonable products and we have to keep innovating and
7 improving our products to stay ahead of the game. I
8 mean, this is a tough business, because if you slow your
9 innovation, then your competitor catches up and you'll
10 have that kind of competition. But it's healthy. It's
11 the way the whole economy works.

12 I think private label is a long-standing
13 concept. Giant -- I guess Giant Foods around here, they
14 private label for all sorts of different products, and
15 one of the strategies of private label is to capture the
16 consumer and keep them within your universe. So, okay,
17 they're trying to do that. It's not good for us, but it
18 is a valid piece of the marketplace as long as they don't
19 bend the rules, as long as they make truthful claims, and
20 they're trying to capture that consumer and, yeah,
21 they're trying to keep them away from me, they're trying
22 to keep them away from Mr. Coon. But it's a piece of the
23 marketplace.

24 They offer sometimes lower prices, sometimes
25 not lower prices. But it's a competitive aspect of the

1 marketplace. It's healthy, it keeps us on our toes, it
2 keeps everybody on our toes and it's just something you
3 have to deal with.

4 So, as long as we do a good job, you know, and
5 keep ahead of the competition, we'll do against private
6 label. If we stop innovating, they eat into our market
7 share, and that's the way it is. And I think Mr. Coon
8 has to look at it the same way. They're not evil,
9 they're competition and competition is healthy.

10 MR. HALPERN: I think that the consumer choice
11 question is key. I think that there's no question that
12 private label is designed to provide a different choice
13 in whether it's food or in contact lenses. In contact
14 lenses, the choice needs to be made at the time of the
15 prescription, and that's certainly a fair distinction,
16 that if I want to buy the President's Choice brand of
17 chocolate chip cookie, I can make that choice every time
18 I go to the grocery store. But if I want to choose a
19 branded or private label contact lens, then I have to
20 make that decision not every time I buy the contact lens,
21 but at the time I have the contact lens prescribed.

22 In today's marketplace, the consumer has a
23 great deal of branded contact lens advertising targeted
24 directly at the consumer, whether it's from Johnson &
25 Johnson, the Acuvue brand or it's from Ciba and the Focus

1 brand, there's a lot of brand awareness, and consumers
2 can, based on the information they get in the public
3 marketplace about the branded product, they can and they
4 do ask about the differences in cost and quality between
5 the branded product and private label product that they
6 can choose between at the time of the prescription
7 process, and that is when the consumers make the choice
8 and they are making that choice with -- in concert with a
9 medical professional who is not entirely unbiased, but is
10 a necessary intermediary for the health and safety of the
11 process.

12 So, yes, I do think that, notwithstanding, that
13 once a prescription has been written, the consumer is
14 committed to that lens until he gets another
15 prescription, that there is definitely private label is
16 about consumer choice.

17 MS. OHLHAUSEN: At this point, we have five
18 minutes left and we wanted to give each panelist a chance
19 to sum up. So, with five panelists and five minutes, you
20 each have one minute to make your last statement, and
21 we'll go in the same order.

22 So, Pat, if you would.

23 MR. CUMMINGS: Well, again, thank you for the
24 opportunity to be here. I think we always need to
25 remember one thing. This is about the people. This is

1 about the people who choose to use a vision correction
2 called contact lenses, which with it carries inherent
3 health concerns.

4 The patient is entitled to choice. They are
5 entitled to have that prescription, to purchase their
6 replacement contact lenses where they choose, and in this
7 marketplace, they have a huge amount of options to doing
8 that, not just the private practitioner, but the big box
9 retailers, mass merchandisers, the Internet and mail
10 order. So, they have a lot of choice there.

11 The most important issue to me is that the
12 prescription is filled right, that the patient has a
13 valid prescription and that the patient is receiving
14 appropriate and timely follow-up care, because we've
15 always got to remember, this is ultimately a health
16 issue, that there are some concerns there and we need to
17 not only look at the economic concerns of the patient,
18 but also at the health issue.

19 MS. OHLHAUSEN: Thank you. Jonathan?

20 MR. COON: Thanks again for holding this panel
21 in the first place and for inviting us. Although I'm
22 supposed to be summarizing here, I do want to address one
23 point lest it sort of just be left with silence.

24 There's a little difference between contact
25 lenses and chocolate chip cookies in the sense that at

1 least I'm not aware of anyone writing a prescription for
2 chocolate chip cookies. I suppose that's possible.

3 But once somebody writes a prescription, if
4 they did, for chocolate chip cookies, it would be a shame
5 if I couldn't go buy Chips Ahoy or Mrs. Fields Cookies
6 somewhere else because I had been prescribed Sam's Choice
7 of chocolate chip cookies.

8 So, it's a little bit different. And as some
9 of these panelists have said, well, hey, go see another
10 doctor, you know, get a new eye exam. A hundred dollars
11 may not seem like much to the other folks on this panel,
12 but it's a lot of money to our customers. They don't
13 just go spend another \$100. As you indicated, Mr.
14 Halpern, it's quite inconvenient to go see another doctor
15 and expensive, and it's not just some small task for them
16 to just go get a new prescription for something else so
17 that they can exercise their right to choose.

18 In summary, though, I would say that at least
19 from our perspective and from the perspective of our
20 customers, any solution that addresses this market needs
21 to address the conflict of interest of a prescriber
22 selling what they prescribe, and that is the foundation
23 that creates every problem that's current in this
24 industry. That's why somebody writes a prescription for
25 Target Optical Lenses, that's why somebody refuses to

1 respond. It's why the doctors in the State of Texas
2 violate the law in the hopes that they'll be able to get
3 the order for contact lenses and make money on that
4 customer instead of giving their competitor permission to
5 make a sale.

6 At the very least, contact lens wearers deserve
7 a Federal right to their contact lens prescription like
8 they've had for eyeglasses for over 20 years. In
9 addition to that, we don't think that the competitors
10 should be allowed to veto the consumer's choice to
11 purchase from somewhere else by simply ignoring the
12 request for a prescription. And then, third, we think
13 there ought to be some solution that addresses the fact
14 that because of this conflict of interest, sometimes the
15 practitioner is motivated to prescribe certain brands, or
16 in other words, use their prescriptive authority to
17 prevent the consumer's right to choose. Thank you.

18 MS. OHLHAUSEN: Thanks. Gerry?

19 MR. OSTROV: Yeah, I just want to reiterate
20 that, first of all, thank you. I think this has been a
21 very informative panel.

22 As I said, we do support Internet sales. We
23 think that much of the solution is already in place. I
24 think there are some issues that we're dealing with and
25 it's this issue between the rights and responsibilities,

1 and I think we can't abdicate all of our responsibilities
2 to make sure that the consumer's health is addressed.

3 I think part of the difference you hear here
4 is, you know, some of the Internet sellers want to trust
5 the consumer to choose the Internet, but don't want to
6 trust the consumer to be able to get what they need in
7 terms of choice. If a doctor doesn't perform what they
8 need, the consumer can change doctors. The consumer is
9 informed of brand. They can choose between private label
10 and branded products.

11 So, you got to trust the consumer all the way,
12 and we believe that the consumer and the marketplace
13 will, in fact, produce very good competition. But that
14 doesn't mean that we take out all of the safeguards that
15 we have in there and essentially allow Internet companies
16 to abdicate their responsibilities, to do whatever they
17 want, and essentially to let the consumer, at the end of
18 the day, if they don't want to go back to the doctor to
19 not go back for two, three, four, five years and never
20 change their lenses.

21 So, I think there's a good balance here between
22 rights and responsibilities, and I think that if you just
23 pull that last piece of responsibility, which says that
24 you have to proactively confirm the prescriptions, you
25 have to proactively go out there and help the consumer

1 have good health practices, if you pull all of those
2 safeguards and you allow people who don't want to put
3 those safeguards into their business model, then I think
4 we are going much too far.

5 So, prescription release is good. I think
6 prescription verification should be required, but it has
7 to be active and you have to work with the consumer and
8 help them through that.

9 MS. OHLHAUSEN: Thank you. Paul?

10 MR. HALPERN: Thank you. I think this has been
11 a very illuminating panel. I think that if there's any
12 proof that the Internet channel, the direct channel of
13 contact lenses has gone from being the innovator to a
14 maturing stage in its development, it's that they've gone
15 past don't regulate me with the existing rules because
16 I'm different, and they're now to the next step that an
17 industry evolves to, now it's time to regulate my
18 competitors.

19 The notion that the solution to the failure of
20 Internet sellers to comply with the prescription
21 requirement is to impose a regulatory burden on
22 prescribers is just ironic. I mean, the NAOO has come in
23 front of the Commission in support of expansion of the
24 prescription release requirement and we promote
25 prescription release on request at the end of the

1 prescription process, and we promote consumer choice and
2 competition. Just like everybody else, we believe in
3 mom, too, and apple pie.

4 But we do not believe that -- I think
5 California is a great example because California passes a
6 rule that says, passive verification suffices after a
7 certain period of time, and that's great for California
8 law, but it still does not mean that the sale, pursuant
9 to that California law, is in compliance with the Federal
10 prescription requirement. There is a Federal
11 prescription requirement, and all there isn't to round
12 out the picture is Federal -- consistent Federal
13 enforcement of the Federal prescription requirement.

14 Generally, we do not need or want more
15 regulation, but that regulation was founded strictly on
16 the basis of health by a Federal agency that was
17 virtually uninfluenced by optometrists or their
18 competitive desires and it needs to be consistently
19 enforced if we're going to have a fair and even playing
20 field to maximize competition in this industry.

21 MS. OHLHAUSEN: Thank you. Morris?

22 DR. KLEINER: Yes. Again, thank you for
23 letting me be present even by voice only. In terms of
24 the issues, the question of power of suggestion is huge
25 by doctors, and the ability to influence patients in that

1 way certainly has a great effect in terms of where the
2 patient is likely to purchase the product.

3 The variations in states really make a great
4 deal of confusion both for suppliers as well as
5 customers. Something needs to be done at that level. In
6 general, the studies have shown that low levels of
7 regulation provide the benefits in terms of higher
8 quality and benefits to consumers without the impact that
9 prices which price certain low income individuals out of
10 the market, which variations in states, especially high-
11 regulation states, seem to be able to impact. So that
12 low levels of regulation get you the benefits and
13 variations in states result in a great deal of confusion,
14 and in some cases, companies which try to maintain a high
15 level of quality are at a disadvantage because there are
16 higher levels of costs trying to meet all these state
17 regulations.

18 So, consequently, the FTC really needs to view
19 these issues of what is the optimal level of regulation
20 for consumers in terms of both providing price and
21 quality of care to consumers.

22 MS. OHLHAUSEN: Thank you. I'd like to thank
23 everyone for participating. I think it's been a very
24 informative panel. The record will be open for another
25 30 days, so if you'd like to file additional comments, we

1 certainly would be happy to receive them.

2 We are going to have a very short break and we
3 will reconvene at 10:40 to hear remarks from Commissioner
4 Thomas Leary.

5 (Whereupon, at 10:36 a.m., the first session
6 was concluded.)

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1 **SECOND SESSION -- AUTOMOBILES**

2 MR. CRUZ: Good morning, welcome back. We're
3 ready to start our second industry panel, which is going
4 to be a panel on automobiles. But before we commence,
5 we're going to hear remarks from Commissioner Thomas
6 Leary, who's a Commissioner of the Federal Trade
7 Commission, who also has long-standing experience and
8 familiarity with the automotive industry in particular.

9 So, Commissioner Leary.

10 COMMISSIONER LEARY: Good morning and welcome
11 to the Federal Trade Commission. I asked for the
12 opportunity to kick off this panel because, as some of
13 you may know, I was employed by a car company throughout
14 the decade of the seventies. But I'm out of touch with
15 the auto business and I don't know any better way to
16 symbolize it than to say, well, during the 11 years I was
17 working for General Motors, I drove 45 brand new
18 automobiles; in the last 10 years, I've driven one.
19 So, a whole generation of vehicles have passed me by and
20 I haven't really kept up with the car business at all.

21 But this is obviously a very important part of
22 the extended series that the Commission is doing on
23 private and public impediments to the growth of e-
24 commerce. And it's important not only for us in our role
25 as potential prosecutors, but also in our equally

1 important role, in my view, as kind of a research and
2 think tank and a source of information for people
3 considering matters of public concern.

4 I'm very interested in the whole set of
5 hearings, and for my own reasons, particularly interested
6 in this one.

7 Apart from legal issues, it seems to me there
8 are a number of factual issues that need to be explored
9 in the auto industry. In order to prepare for this five
10 minutes, I happened to read the submission of my old
11 employer and I also read the submission from the auto
12 dealers association, NADA, and one of the immediate
13 reactions that I had -- and I want to present this to you
14 because I'd like some help -- is that they're almost
15 ships that pass in the night.

16 If you read the General Motors presentation,
17 they say how helpful the Internet has been in comparison
18 shopping so that people can get all kinds of information
19 without leaving their homes and they don't have to go
20 from dealer to dealer to dealer. But, of course, the
21 actual transaction has to be consummated at a particular
22 dealership of the consumer's choice.

23 It's not clear to me from reading that
24 presentation what the problems that particular auto
25 company may have with particular aspects of state dealer

1 legislation. Are they concerned that somehow or other
2 some laws may be interpreted in ways that interfere with
3 that flow of information? I don't know, it's not clear
4 to me. And I invite comments from anybody in the auto
5 industry, either today -- I read the transcripts -- or in
6 later submission, period.

7 Now, I read the NADA comment and it's not quite
8 clear to me what their problem is either, because they
9 spend a great deal of time talking about the essential
10 role that dealers play in the consumer transaction. And
11 how it is unlikely that any substantial number of
12 consumers will ever want to buy a car, sight unseen, over
13 the Internet. They will always want to view cars,
14 they'll always want to test drive them and so on.

15 And if that is true, and I suspect it is true,
16 then it's not clear to me why anybody would be interested
17 in legislation that speaks about this matter.

18 And a second major issue that comes up in the
19 NADA presentation is they express great concern, historic
20 concern about company-owned dealerships, and that does
21 not have any direct impact on the subject of these
22 panels, but obviously, it has some indirect connection.
23 I'll tell you how out-of-date I am, when I was working in
24 the auto industry in the seventies, why there were very,
25 very few company-owned dealerships, and I'm not sure

1 whether the dimension of the problem is different now.
2 In any case, the nature of NADA's concern was not clear
3 to me based on their submission.

4 And, again, I would invite comments from that
5 group or any group who feels the same way, more specific
6 comments on what they're talking about. It's not clear
7 to me. I think there are 45 states that have dealer
8 legislation and I assume that some state legislation is
9 more restrictive than others.

10 It's not clear to me from reading just those
11 two presentations -- maybe other folks have things they
12 want to say -- whether there are differences between
13 state laws that bear on the subject of these hearings.
14 Are there some states that are much more restrictive than
15 others and what are the pros and cons of that?

16 And, finally, one of the things that I would
17 invite your attention to is whether it would be useful
18 for the Federal Trade Commission to engage in some
19 factual research, on its own, on this subject. As most
20 of you may know, in 1986, the Federal Trade Commission
21 did produce a study on the consumer cost of state dealer
22 legislation. Of course, that was long before e-commerce
23 was an issue. And that study was criticized. There was
24 a critique of that that was submitted by the -- I guess
25 whatever the parent organization of NADA was, maybe it

1 was called NADA then. I don't remember.

2 There's also been a more recent study by the
3 Consumer Federation of America and I don't know -- I
4 haven't seen any particular critiques of that, but there
5 may be some. And the question I pose for your
6 consideration is whether it would be useful for the
7 Federal Trade Commission, somehow or other, to consult
8 with representatives of the auto industry, dealer
9 associations and consumer associations to see if there is
10 some way that a methodology could be jointly agreed to so
11 that we could get a better handle on what the potential
12 consumer costs are.

13 It's not because we're imperialistic. It's not
14 because we believe that the Federal Trade Commission runs
15 the world. We recognize that states in their sovereign
16 capacity can do what they can do. But I think it might
17 be useful for everybody if we had a more authoritative
18 idea of what the potential benefits and costs are, and
19 that's all I have to say. I will just leave you with
20 those suggestions, and thank you very much for listening
21 to me.

22 MR. DELACOURT: Well, thank you, Commissioner
23 Leary for those remarks. I think we're ready to begin.
24 As you all know, this is the panel on Internet automobile
25 sales. For those of you who were attending the workshop

1 yesterday, you'll recognize that this issue has come up a
2 couple of times and has continued to generate quite a bit
3 of interest, I think, for two reasons.

4 The first is that an automobile purchase is
5 frequently the second largest purchase in a consumer's
6 budget. So, anything that we could do in this area would
7 be very important to the average consumer. The second
8 reason that it's generated so much attention is, I think,
9 that the estimates that have come out about the size of
10 savings that could be achieved by involving the Internet
11 in some aspect of the automobile purchase have been
12 pretty substantial, and I can point to some of the
13 estimates that have been made by our panelists here
14 today.

15 Professor Scott Morton, for example, has
16 estimated that savings could be in the neighborhood of 2
17 percent of the total vehicle's cost and Mark Cooper has
18 estimated that, based on substantially different
19 assumptions, the savings could be in the neighborhood of
20 10 percent. So, in the context of an automobile
21 purchase, we're really talking hundreds, potentially
22 thousands of dollars, and it's nothing to sneeze at.

23 So, I think those are important questions that
24 we need to address today. How were these estimates made?
25 What were the assumptions underlying them and are they

1 still valid? And, I think, equally importantly, whether
2 the Internet business models on which these estimates are
3 based, whether they can be enacted in a way that doesn't
4 repeal or substantially roll back important consumer
5 protection laws that are currently out there for
6 automobile consumers.

7 So, with that said, I think we're ready to
8 begin. I have two final notes. One is that we will be
9 taking questions from the audience today. If you have a
10 question, please just indicate that to an FTC staff
11 member and index cards will be passed out so that you can
12 write down your question and have that passed to the
13 front.

14 The second point is for the panelists. Before
15 you begin your remarks, if you could just identify
16 yourself and then state your organizational affiliation
17 that would be helpful to all of us. So, I guess I'll
18 just go from right to left and start with Jim Lust. Jim?

19 MR. LUST: Thank you, John. I'm Jim Lust. I'm
20 from South Dakota. I've been an auto dealer for some 40
21 years and I represent a franchise system that has evolved
22 over the last hundred years.

23 But my first order of business this morning is
24 to correct a hand-out piece that you have. There's a
25 line in there that suggests that dealers want franchise

1 laws in order to stop the manufacturers' unscrupulous
2 practices with the consumer. This is not true. I've
3 never heard a dealer say that. I've never heard an
4 organization say that.

5 We have our issues with the manufacturers.
6 They may be a little heavy-handed with their dealers at
7 times, but they certainly are not unscrupulous with the
8 consumer.

9 In 1955, 50,000 dealers sold seven and a half
10 million vehicles. Last year, 21,800 dealers sold 17
11 million vehicles. But this is about the consumer and how
12 they benefit from a franchise system. So, let's get on
13 with the question.

14 How do consumers view their new vehicle buying
15 experience? A recent 2002 Consumer Report Survey
16 indicates that 93 percent of new car buyers rank their
17 overall buying and dealership experience from very to
18 moderately satisfying. The new survey shows a 9 percent
19 gain in customer satisfaction since 1995 and a 1.2
20 percent climb from last year. This does not surprise me.
21 There's not a dealer and there's not a manufacturer in
22 the United States that's not working very, very hard to
23 improve what they call the CSI, customer satisfaction
24 index.

25 This upward trend is also reflected in surveys

1 by the Gallup organization and the Worthman Worldwide
2 Organization. These two groups found that more than 90
3 percent of new car buyers were satisfied with their
4 dealership experience in 2001. An article in the August
5 9th issue of the Wall Street Journal reports on the
6 American Customer Satisfaction Index compiled by the
7 University of Michigan.

8 "According to the ACSI survey, consumers are
9 more satisfied with their autos than they are with most
10 other major products. Consumers gave the auto industry a
11 score of 80 out of a possible score of 100, only exceeded
12 by home appliances at 82."

13 Interestingly, to me, computers are rated at 71
14 and e-business as a whole 68.7. J.D. Powers was also
15 quoted in the Wall Street Journal article, and I quote
16 here, "We see satisfaction in the automobile industry to
17 be at very, very high levels compared to other
18 industries."

19 According to the Detroit News, Michael Wosiak,
20 Vice President of Cap Gemini Ernst and Young, found in a
21 survey of 2,250 customers that overall satisfaction with
22 franchise dealers was 87 percent. That's good. That's a
23 consumer point of view.

24 But you might be interested in knowing
25 something about the dealership operating statistics. The

1 average auto dealer net on sales before taxes in the last
2 10 years averaged 1.6 percent. And this is a sum of all
3 their operating departments. This is the new car
4 department, the used car department, service, body shop
5 and parts department -- 1.6 before taxes.

6 The gross profit margin on new vehicles last
7 year was 6.05 percent on an average transaction price of
8 \$25,800. The gross margin percentage has dropped
9 consistently since 1979 when the gross profit margin was
10 9.9.

11 Now, these net and gross margins strongly imply
12 a circumstance that any good dealer knows, that the
13 automobile business and retailing is fiercely competitive
14 and that only the most efficient survive.

15 In my state, when I became a dealer some 40
16 years ago, there were 500 auto dealers. There are now
17 138. Those 362 who are no longer auto dealers are not
18 residing in Palm Springs.

19 An article in the most recent Business Week
20 magazine caught my attention on the discussion of new
21 vehicle affordability. "Even as income surged" -- these
22 are quotes -- "nearly \$800 per capita this year, auto
23 prices dropped an average of \$200 says the Comerica Bank,
24 which tracks auto prices. The result is that car prices
25 hit a 24-year high in affordability."

1 Even with the low gross margins on new
2 vehicles, one point must be stressed and that is, the new
3 vehicle sale is essential to the new car dealer system
4 for two reasons. One, its net profit contribution is
5 important in the total 1.6 overall return on sales that
6 the dealers make, and number two, is it the essential
7 start of our total business cycle, from new to used to
8 service to body shop to parts. Indeed, without new
9 vehicle sales, I don't see how any dealership can or
10 could survive.

11 Internet usage is an interesting subject.
12 Ninety percent of dealers have web sites, nearly all of
13 them interactive, letting potential customers view
14 inventory and check prices. Fewer dealers are using
15 Internet buying services as more have developed their own
16 sales leads online. The percentage of dealers using
17 buying services fell from 54 percent in 1999 to 41
18 percent in 2000 to 35 percent in 2001.

19 Once again, quoting Michael Wosiak of Cap
20 Gemini, he says, "Internet dealers such as Autobytel were
21 responsible for only 1 percent of car sales among those
22 surveyed. The consumer still wants to go to the
23 dealership and test drive the car before he buys it."

24 The Internet is a wonderful source for
25 information on new vehicles. Indeed, I can think of no

1 other retail product where the consumer has the access to
2 the invoice price as they do with automobiles. We have
3 many instances where the consumer literally comes in with
4 the invoice on exactly the vehicle he wants.

5 So, what do dealers add to the buying
6 experience? One, we provide the new vehicle inventory
7 which averages \$3,278,000 per dealer. It gives the
8 consumer a chance to touch and to feel and to drive the
9 prospective purchase. This is important.

10 Art Spinella, General Manager of CNW Marketing
11 Research states, "Excluding fleet and rental sales, the
12 percentage of consumers who order a car just as they want
13 it equipped is about 8 percent. The rest buy off the
14 lot." People just don't want to wait for a new car, they
15 want it now.

16 And incidentally, these inventory costs, the
17 insurance and the interest on those inventories are borne
18 solely by the dealer. We also provide the knowledgeable
19 and trained sales representatives to demonstrate and
20 explain today's complex vehicles.

21 Service and parts and body shop are all
22 essential to the ongoing service of the vehicle after
23 it's sold. And believe me, highly trained technicians
24 are a real premium today. Plus the sophisticated
25 equipment that we need.

1 So, in conclusion, the Internet is an extension
2 of the showroom that has created exciting new avenues for
3 dealers to communicate with the consumers. It cannot
4 replace services provided by the dealers. We are not
5 selling books, CDs or wine, but a very sophisticated
6 product, a sophisticated product that has over 10,000
7 moving parts, electronic and mechanical, with a
8 transaction price averaging \$25,800.

9 This is not the business I entered 40 years ago
10 and it will continue to change and evolve well into the
11 future. Today, the system works well.

12 Heath Green, publisher of Automotive News,
13 recently wrote, "The franchise system has the capability
14 to sell more than 17 million vehicles annually and to
15 service them along with tens of millions of vehicles
16 already on the road." He concludes by saying, "Everybody
17 seems to have figured it out. The franchise system is
18 alive and well in the automobile business."

19 MR. DELACOURT: All right, thanks, Jim. Next
20 we're going to hear remarks from Professor Scott Morton.

21 DR. SCOTT MORTON: Thank you. I'm Fiona Scott
22 Morton. I'm a Professor at the Yale School of
23 Management.

24 I would like to organize my remarks today
25 around two types of web sites that I have done some

1 research on, informational sites and referral sites.

2 Sites that provide only information, for
3 example, Consumer Reports and Edmunds, are not typically
4 a target of regulation, so they may be less of a topic of
5 discussion today. However, they're having a big impact
6 on this industry. They provide characteristics of cars,
7 allow consumers to compare and contrast and they also
8 provide quite detailed prices, invoice prices, holdback,
9 market prices.

10 Notice here the superiority of these Internet
11 sites compared to the previous print publications that
12 they are largely replacing. So, for example, you can get
13 a market price that is specific to the exact
14 configuration of the car you're looking for in the
15 geographic area in which you live at the time at which
16 you're asking, which Consumer Reports simply couldn't
17 provide in a printed version, not with all those
18 dimensions.

19 While the existing dealer system may be
20 wonderful in many ways, as Mr. Lust has pointed out, it
21 does lead to price dispersion because dealers can and do
22 charge different prices to different consumers. Now,
23 under those circumstances with the consumer facing a
24 \$25,000 purchase, information about car prices will be
25 valuable to consumers because it will allow them to

1 search for the lower price.

2 When they can get this information more easily
3 as they can now from these information only web sites,
4 they're not going to be willing to pay as much for their
5 car. There will be fewer people to whom you can charge a
6 high mark-up. And you're going to find then that dealers
7 are going to be able to earn lower profits and this is
8 borne out in the statistics we just heard.

9 So, these information sites are creating
10 pressure on the dealer system, just in terms of
11 profitability.

12 The referral sites do something a little bit
13 different. They put consumers in touch with an
14 appropriate dealer. They link the consumer to the
15 dealer. In my own research I've found, as Mr. Delacourt
16 noted, a 2 percent savings by consumers who use
17 Autobytel, which is one of these referral services.

18 Interestingly, what we find in this research is
19 that these consumers are not the savvy bargainers who
20 would have done well anyway. These are consumers who are
21 disproportionately consumers who would have paid somewhat
22 above average prices, and they go to Autobytel and they
23 end up paying slightly below average prices.

24 This is interesting because it indicates that
25 there's some self-awareness here by these consumers.

1 They understand, perhaps, that they're not good at
2 bargaining or they don't like shopping for a new car or
3 whatever it is and they're turning to a new technology, a
4 new distribution channel.

5 Just an aside, this might actually be true in
6 other markets like caskets, for example. If you're aware
7 that you are aggrieved, you know, you've just lost your
8 sibling or something and you're not going to be very good
9 at bargaining over the price of a casket, it might be
10 that the Internet, with its relatively anonymous and
11 comfortable setting, is something that you would turn to.

12 After we discovered that these consumers were
13 not savvy bargainers, we also turned to look at
14 minorities and women and their experience buying cars and
15 their experience over the Internet. And we found there
16 is a black and Hispanic premium of one and a half to two
17 percent for buying a car offline and that this disappears
18 with online shoppers, so that when the minorities buy
19 online, we don't see this premium. Women have a much
20 smaller premium, about a half a percent and we can't get
21 a good estimate on what happens to them online.

22 So, it appears that Autobytel -- and I can't
23 really generalize to other referral sites because we
24 don't have data for them, but it may generalize -- is
25 benefitting consumers by allowing them to pay lower

1 prices for their cars.

2 So, why is this happening? I think a main
3 reason that this is happening is due to a reduction in
4 search costs. So, what economists mean by search costs
5 is the time and the travel needed to get a price.
6 Referral sites drastically lower search costs for
7 consumers, and if you have low search costs and a
8 homogeneous product, you're going to get serious price
9 competition, as we've seen.

10 One question here is whether dealer web sites
11 with their own inventories and posted prices could
12 achieve this same kind of thing, so instead of having to
13 visit the dealer, I can visit the dealer's web site. I'm
14 a little skeptical about this because there's no
15 incentive to enforce it. I mean, why would an individual
16 dealer want to reduce search costs to zero. I mean, we
17 see offline, you know, lots of retailers with bait and
18 switch kinds of tactics. It just isn't in any retailer's
19 interest to reduce search costs to zero. So, I'm
20 skeptical that dealers could do this on their own.

21 The third party referral sites provide some
22 enforcement because if quotes are not honored or if
23 inventory is not available, then they can move the
24 business. Manufacturers might be able to enforce dealers
25 in the same way, but I don't know.

1 Let me just briefly mention the other likely
2 reasons for low prices with these referral services, and
3 that is group purchasing. You know, you've got a whole
4 group coming through the site and you're getting them low
5 prices, and you can move the market share -- Autobytel
6 can move market share across dealers.

7 And thirdly, it might be a more efficient
8 method of selling a car. It might just be lower cost.

9 And just to conclude, some of the comments that
10 I read before I came made by the dealer representatives
11 suggest that if this system is threatened by the
12 Internet, we won't have a good system of distributing
13 cars and consumers will be harmed and the state will be
14 harmed because we won't be able to collect taxes or
15 something like that. I'm not going -- I don't really
16 know much about the logistics of collecting taxes, but I
17 just want to note that it's ultimately in the
18 manufacturer's best interest to have satisfied and happy
19 consumers.

20 So, if the Internet is harming the dealer's
21 ability to distribute cars, and therefore, consumers are
22 upset, I would expect manufacturers to release more
23 resources to dealers or re-organize them or help them in
24 some way to generate those happy consumers because
25 fundamentally that's what manufacturers want. So, I

1 would be less concerned about that myself.

2 MR. DELACOURT: Thank you, Professor Scott
3 Morton. Next we're going to hear from Scott Painter.

4 MR. PAINTER: Good morning. John, thank you
5 for inviting me.

6 I'm really a business builder and as part of my
7 business-building past, I've had 14 different companies,
8 five of which have been in automotive distribution,
9 really alternative automotive distribution. I was the
10 CEO and founder of a company called CarsDirect.com, which
11 unlike the referral sites or the information sites,
12 actually proposed to sell cars and sold them directly to
13 consumers, meaning the customer would pay us for the
14 vehicle and we would arrange for the transaction by
15 working with dealers as partners.

16 It's also important to note I am a dealer. In
17 order to sell cars, regardless of how we got it done, we
18 actually had to comply with those laws, and the
19 distinction being that I'm not a franchised new car
20 dealer. So, I think it's important that today I share,
21 if I can, some of the things that we've learned along the
22 way in terms of our process because what I found is that
23 much of the information around this issue is clouded by
24 mystery and misdirection in many cases.

25 It's also a very emotional issue as it sort of

1 traverses the economic interests of some of the largest
2 companies in the world and certainly some of the most
3 powerful business locally and regionally in terms of
4 manufacturers and car dealers. And we found that it is
5 clearly an emotional issue when you get into both of
6 those backyards in terms of affecting those businesses.

7 At the end of the day, as a business builder,
8 my focus is only on one thing, the consumer. The
9 businesses that I build can only succeed if the consumer
10 has a better alternative than the system that is
11 currently being provided. And one of the things that we
12 saw at CarsDirect, by way of example, is that within 30
13 days of actually launching publicly to the consumer, we
14 had millions of people going online and downloading
15 information, virtually building cars and requesting
16 pricing data.

17 And because we did one additional feature,
18 which was we actually offered the consumer a vehicle for
19 sale and put a price tag on the car, we truly did provide
20 pricing transparency, which is sort of the genie in the
21 bottle that you can't put back. It gives people the
22 ability to go online, look for a price, print out that
23 price and know that if they can't find a better price
24 that they can get the car for that price, which
25 fundamentally changes the negotiating position if

1 somebody then leaves that environment and then goes out
2 to a dealer.

3 There are certain ripple effects of that on the
4 dealer business and there are certainly scaleable issues
5 as it relates to a company like CarsDirect. We would
6 have 80,000 people a day shopping for a car. Most car
7 dealers would love 80,000 customers to walk on their lot.
8 Our close rate on that was between 200 and 300 vehicles a
9 day. That close rate would be miserable in physical
10 senses, but because it didn't cost us anything more to
11 have one customer or 80,000 customers, it was scaleable.

12 And there was a significant investment in order
13 to provide accurate information of that caliber.
14 Literally hundreds of millions of dollars went into the
15 creation of that kind of content because it was not
16 content that was readily available or easily provided by
17 the industry because of how emotional this topic is.

18 What I'd like to do is perhaps just focus on a
19 couple of facts and I'm no longer with CarsDirect, I
20 don't speak for CarsDirect, but I can certainly help to
21 define, I think, some of the issues. There are not
22 currently any national laws that regulate the
23 distribution and sales of an automobile. The national
24 laws tend to rely on the importation, safety and
25 emissions of vehicles. And these are laws that, in the

1 most part, affect manufacturers and manufacturers only.
2 They're all designed to ensure that customers get a safer
3 and more reliable vehicle and that, at the same time,
4 we're doing whatever we can to make a cleaner environment
5 possible. So, that has traditionally been the burden of
6 the OEM.

7 If you flip over to the other side, you look at
8 the car dealer. The car dealer is subject to two types
9 of laws, administrative and franchise. Administrative
10 laws are there really to protect the consumer and to
11 administer the business of selling the car, collecting
12 the tax, collecting the registration and tracking that
13 sale. In that regard, dealers play an incredibly vital
14 role, because they are an accountable group that you can
15 go to and actually train, license, bond and administer.
16 And so, there is a very, very serious role that they play
17 there.

18 The other side of it is franchise law.
19 Franchise law was basically enacted to really protect
20 franchisees from unlawful competition with their
21 franchisers, the OEMs. And there's a whole body of law
22 around it. There's 50 different interpretations of
23 franchise law in 50 different states, and therefore, it's
24 very difficult to do business in a multi-state
25 environment and navigate franchise law.

1 I guess in wrapping all of this up, I think
2 probably the most important thing for this group to look
3 at is how franchise law specifically affects the
4 competitive environment as opposed to whether or not
5 administrative or regulatory guidelines affect the
6 consumer environment because those are there
7 predominantly for consumer protection.

8 MR. DELACOURT: Thanks. Our next speaker is
9 John Whatley.

10 MR. WHATLEY: Thank you. I hope my hay fever
11 doesn't make me choke to death here.

12 I'm John Whatley. I'm with the Alliance of
13 Automobile Manufacturers. Just by way of background, the
14 Alliance was formed in 1999. It's a trade association of
15 12 car and light truck manufacturers. Our companies
16 employ more than 600,000 employees in the U.S. We have
17 250 facilities in 35 states. We represent 90 percent of
18 new motor vehicle sales in this country.

19 A lot of what I'm going to talk about here is
20 going to be history because a lot of what we engage in
21 with franchise law is historical. Let me just say I hope
22 at the end to get to some of Commissioner Leary's
23 comments about what manufacturers want from the Internet.
24 But first, let me give you a little bit of background on
25 this.

1 Manufacturers expect for the foreseeable future
2 to continue using their current distribution network of
3 independent dealers to make new vehicles available to
4 consumers. The system has been around since at least the
5 1920s and it's a mature, fully developed system.

6 That being said, we're keenly aware of the
7 problems caused by burdensome franchise legislation in
8 Internet regulation, and here again, we're dealing with a
9 developed mature system.

10 Franchise legislation has been around since the
11 1950s. There are 49 states with franchise laws. Hawaii
12 doesn't have one. Theirs lapsed and expired, but they're
13 putting it back on the books. All states but one have
14 franchise legislation. This legislation governs
15 practically every aspect of the relationship between
16 manufacturers and dealers. It includes restrictions on
17 termination of dealers, restrictions on our ability as
18 manufacturers to disapprove new dealers. It regulates
19 the reimbursement for warranty work, which is very
20 important, and it has provisions dealing with succession
21 of a dealership because a dealership is a very valuable
22 asset.

23 In addition, these state laws usually have an
24 extensive list of manufacturer-prohibited acts, things
25 the manufacturer can't do. They include everything from

1 unlawful coercion to owning a dealership to selling
2 certain vehicles and products directly to consumers.

3 Historically, some of this legislation was
4 prompted by legitimate concerns at a time when the
5 marketplace was vastly different than it is today. But
6 as is the case with most regular regimes, the laws have
7 unintended consequences, and often, the consequences are
8 not necessarily good. And I'll use an example which has
9 been mentioned before. Some franchise laws have been
10 shown to have anticompetitive effects as that referenced
11 1986 Federal Trade Commission study suggested as to so-
12 called relevant market area laws.

13 It's probably not fruitful to trace this long
14 and arduous history any further. I just would like to
15 note that other industries which use the franchise system
16 are not regulated in the same pervasive way.

17 Manufacturers support their dealers and believe
18 in their expertise in selling and servicing new vehicles
19 is unequaled. Our concern is how governmental regulation
20 of the industry, regulation that cannot accurately
21 predict the future but always attempts to do so,
22 negatively affects manufacturers, dealers and consumers.

23 Having said that, while the Alliance continues
24 to generally oppose franchise legislation, as a practical
25 matter, on a state-by-state basis, we attempt to reach

1 acceptable compromises regarding proposed legislation.
2 We do this for a number of reasons, not the least of
3 which is, if we don't get in there, the law might be even
4 less to our liking than it would be if we're there.

5 Now, let me turn briefly to the Internet issues
6 because I think in the automobile industry, three or four
7 years ago, everyone thought that the Internet was going
8 to produce a sea of change in the way autos were
9 distributed. It hasn't happened, and it hasn't happened
10 for several reasons.

11 Perhaps the most important reason is with a lot
12 of dot-com businesses, the business models didn't work
13 out. The bubble has burst and I think there's a lot of
14 disenchantment now with some of the plans that were laid,
15 including some of those laid by manufacturers a few years
16 ago.

17 Another reason is that automobiles are
18 different. While they are, to some extent, fungible,
19 consumers do feel a need to go in and test drive,
20 vehicles from manufacturer to manufacturer are different.
21 And on top of that, vehicles are different because they
22 require service and they're involved in recalls. It's a
23 very heavily regulated product in that regard.

24 The third reason that the Internet didn't
25 change the world for us is legislation. There are

1 currently, in 48 states, laws that either forbid sales of
2 vehicles and other products, except through franchise
3 dealers, or prohibit manufacturers from owning an
4 interest in dealerships. And at the height of the
5 Internet frenzy, if you can call it that, 25 states
6 passed legislation along those lines.

7 That tidal wave has passed in the last year.
8 In 2002, there's been almost no activity in this area. I
9 think that suggests that the wave has crested.

10 We, however, remain concerned with the
11 regulation of the Internet because the Internet, even if
12 it hasn't re-written the retail model, has produced a
13 fundamental change. It's been referred to already. It
14 has provided consumers with an unprecedented amount of
15 information. It's provided information about vehicles,
16 about financing, about options, the list goes on and on.
17 And manufacturers are concerned about any regulation or
18 any legislation that would threaten that flow of
19 information. I'd like to briefly discuss four issues
20 that rise out of those concerns.

21 But first let me point out that the Alliance
22 members are committed to work with their dealers to use
23 the Internet to the fullest extent possible to meet
24 consumer needs. And I think if you look at the GM
25 written comments that were submitted with the docket and

1 referenced by Commissioner Leary, that's a model for how
2 manufacturers are using the Internet and how they're
3 working with their dealers to use the Internet, and I
4 believe there are other programs by other manufacturers
5 that are similar.

6 That being said, there are four issues I'd like
7 to discuss. One is regulation of other products and
8 services than the new vehicle by dealer franchise law.
9 We've had situations where states have proposed
10 regulation of those products and services. Some of those
11 are distributed over the Internet by manufacturers and
12 we're very concerned in any restrictions on those
13 products and services.

14 Second, there's been legislation that would
15 limit the kinds of truthful price related information
16 that manufacturers can place on their Internet sites. We
17 disagree with that as a matter of common sense, as a
18 matter of public policy and we believe the First
19 Amendment should protect otherwise lawful content on web
20 sites.

21 The third issue is a provision in some state
22 laws that would attempt to deal with what we call leads
23 in our industry and where consumer contact information
24 goes. There have been attempts to direct consumer
25 contact leads to the nearest dealer regardless of what

1 the consumer wants, even if the consumer does not want
2 the contact to go to that dealer. That raises, I think,
3 consumer privacy issues, and also, because we have the
4 technology to direct the leads where the consumers want
5 them, we don't think the states should be in the business
6 of telling us to disregard those preferences.

7 The last issue, which I'd like to briefly
8 mention, is the expansion of franchise statutes to other
9 lines of business beyond the distribution of new
10 vehicles. This has been an issue in several states. In
11 particular, it's been focusing at manufacturer-owned or
12 partially owned companies that deal in other lines of
13 business, like insurance or finance. We remain very
14 concerned about those issues. Again, some of those
15 companies work through the Internet and we'd like to see
16 those lines of commerce stay open.

17 My conclusion would be that manufacturers
18 remain extremely concerned about the adverse consequences
19 not only on us, but on dealers, consumers and the
20 distribution system itself from overly restricted state
21 automobile franchise laws. We will continue to work to
22 improve those laws and continue to work with our dealers
23 in making certain all the time that consumers are the
24 preeminent party here. That should be kept in mind in
25 any discussions. Thank you.

1 MR. DELACOURT: Okay, thanks, John. Our next
2 speaker is Bill Wolters.

3 MR. WOLTERS: Thank you. My name is Bill
4 Wolters. I'm with the Texas Automobile Dealers
5 Association. I've been with them for 20 years. The last
6 15, I was the Executive Vice President. Prior to that, I
7 was with Ford Motor Company for 13 years, and with Ford
8 Motor Company, at one time or another, I franchised
9 dealerships, I was a Business Manager, I worked in the
10 area of distribution as a District Distribution Manager,
11 and I was in the Marketing Division.

12 And in Texas, we have over 1,330 franchise
13 dealerships. They're in 321 cities and towns across the
14 state. Thirty percent of those dealers are in towns of
15 less than 15,000 population. Half of our membership, 653
16 dealers, are in towns of less than 50,000 population.

17 No other entity, no other business has made the
18 commitment to our state that the franchise dealers have
19 made. You won't find the other retailers in those towns.
20 You certainly won't find the big conglomerates in those
21 towns. If our franchise laws didn't allow those dealers
22 to exist, we would probably have 300 dealerships in
23 Texas, and the dealers located on the outskirts of the
24 state -- who, by the way in, towns of less than 15,000
25 population, in our latest study, sold 23 percent of all

1 General Motors products -- those dealers would not exist.

2 Dealerships have an average investment of just
3 over a million dollars in plant and facility and they
4 have about \$5 million in inventory. The manufacturers
5 don't take that inventory back, it's not on consignment.
6 They've got to sell all \$5 million every time it sits on
7 their lot. They will generally have about a 60 to 70-day
8 supply of inventory, usually that is financed. So, they
9 have a huge risk and responsibility in their dealership,
10 and no one has a greater reason to satisfy the customer
11 than the individual brick-and-mortar dealership that sits
12 in that town that is responsible to generations of his
13 customers. If he doesn't sell to those customers, he
14 doesn't stay in business.

15 Franchise dealers operate under a sales and
16 service agreement with their manufacturer or distributor.
17 The manufacturers have specific requirements for dealers
18 to maintain facility, manpower, investment, working
19 capital, equipment, internal systems, tools, training,
20 etc.

21 The Department of Transportation Motor Vehicle
22 Division in Texas governs the actions of dealers and
23 manufacturers. The state requires that dealers be
24 licensed by the Motor Vehicle Division before they can
25 sell vehicles, whether online or in the dealership. To

1 be licensed in Texas requires a dealer to be a full
2 service business.

3 The Texas Motor Vehicle Code, which oversees
4 sellers and producers of vehicles, has as its stated
5 policy and purpose, and I quote, "To prevent frauds,
6 unfair practices, discrimination, impositions and other
7 abuses of our citizens." That's the code promulgated by
8 the State of Texas that governs our dealers.

9 Franchise dealers have effectively served
10 consumers' needs for the past 100 years because like
11 other community institutions such as schools and
12 hospitals, dealers have maintained a physical community
13 presence while embracing advances in technology. Today,
14 that technological advance includes the Internet.

15 Dealers realized early on the opportunity
16 inherent in online marketing. Today, over 1,000 Texas
17 dealers have interactive web sites available for
18 consumers to shop, compare prices, get information and
19 buy vehicles.

20 The combination of a dealership's physical site
21 and an Internet presence ensures that the consumer
22 receives the benefit of online shopping, full service
23 dealership support and the regulatory protection that is
24 present when buying from a franchise dealer.

25 The stability of Texas dealerships guarantees

1 consumers that they will continue to be served whether
2 online or in the store, in their community.

3 There's not a citizen of Texas, unless they
4 live in the Davis Mountains out in Big Ben Country
5 somewhere that doesn't have the opportunity on any day to
6 visit three or four dealerships to compare prices. You
7 can go online or you can go to dealerships to shop and
8 compare prices. I have a grid and I have it here that
9 shows all the dealership locations in Texas. There are
10 321 cities and towns, and I have a green dot for all the
11 dealers that are in towns of less than 15,000 population,
12 and 212 of our 312 cities and towns are in less than
13 15,000 population. So, they permeate the entire state.
14 They're essential to the very fabric of the State of
15 Texas.

16 When you have a product such as a motor vehicle
17 which is mandated to be titled and licensed, which can be
18 dangerous if delivered with a defect, and which can have
19 serious safety issues if not maintained properly, then it
20 requires a brick and mortar presence with trained
21 employees, a dealer who is responsible to the community,
22 and the oversight of a myriad of state and Federal
23 agencies to protect their consumers. The consumer
24 deserves the protection and they can only get that from a
25 franchise dealer.

1 Consumers are already benefitting from the
2 Internet under the current franchise laws. Autobytel and
3 other Internet referral services, which are legal in the
4 State of Texas, are saving car buyers money as are
5 franchise dealers' web sites.

6 The availability of online information assists
7 buyers today with franchise laws in place to protect the
8 consumer. On the other hand, as the sole mechanism for
9 consummating a vehicle sale, we just don't think that it
10 works. You have to go into the dealership to finalize
11 the sale. It's very difficult to buy a vehicle that
12 you've not touched and sat in and driven. If consumers
13 want to do that, dealers can certainly sell them that
14 way. But I called a number of our dealers prior to
15 coming here and as a practical matter, the consumer gets
16 prices and information and sometimes arranges the final
17 price of the vehicle, but they generally always come into
18 the dealership to take delivery.

19 Third party online retailers and manufacturers
20 who want to sell directly to the consumer would depend on
21 franchise dealers to make the transaction work. If a
22 demonstration drive was required and you bought from one
23 of these online e-tailers, the customer would have to go
24 to the dealership and drive the car and then buy from the
25 online retailer. It didn't cost anything to take a

1 demonstration drive. Sometimes dealers will pay you to
2 take a demonstration drive and you can still buy it from
3 someone else.

4 If the vehicle needed to be made ready and all
5 essential systems checked before delivery, the franchise
6 dealer would probably do that. If there were defects in
7 the car when it was delivered, the dealer could handle
8 the repairs. If warranty repairs were necessary, we
9 would send it to the dealer. If there were mechanical
10 and safety recalls, the dealer would fix those. If you
11 take away 88 percent of the dealer's business, which is
12 the vehicle sales share, 88 percent of a dealer's sales
13 volume is from new and used vehicle sales, there would be
14 no dealers available to do this work. If third parties
15 put in place the infrastructure to do these jobs, the
16 system would be inferior and unable to handle 27 million
17 transactions per year in the wide geographic expanse of
18 Texas. And they sure wouldn't go to Haskell and Bolivar
19 and Farmersville and Turkey, Texas.

20 When you buy a book online, the instructions
21 would say, make sure that this is the book you ordered
22 and read it. When you buy a plane ticket online, the
23 instructions would say, here is your confirmation number,
24 go fly somewhere. If a consumer bought a vehicle online,
25 it's a very different issue. If you buy from an

1 unlicensed retailer, a non-franchise dealer with no
2 physical presence in the community, when the vehicle
3 arrives at your home or business, you would need to check
4 the vehicle for defects and safety concerns, check all
5 the fluid levels, check the brakes, the transmission, the
6 electrical systems, check the fit and finish and check
7 all the other operating systems. If there are problems
8 with the vehicle, I'm not sure who would fix those
9 defects and make sure your car is safe to drive.

10 In a dealership, this check of all systems by
11 qualified technicians is called "make ready." It takes
12 two hours. If there's a problem, they fix it and they
13 deliver it to you at no cost for those repairs. They
14 want to make sure your car is safe and ready and like
15 new, as it should be, as you deserve.

16 If there was no dealership, you would find a
17 shop that would have an arrangement with an e-tailer,
18 which may or may not exist, and who may or may not be
19 qualified to perform the repair. If the vehicle needed
20 to be transported back to the factory for repairs, I
21 don't know what that would do to the savings that you got
22 from your online purchase.

23 I'm not sure how practical or convenient that
24 would be, either. If you needed to get to work or to
25 school or to do something with your family and you've got

1 to drive your car back to Detroit --

2 MR. DELACOURT: Bill, could I ask you to wrap
3 up?

4 MR. WOLTERS: Sure. In summary, dealers today
5 bring tremendous value to the vehicle sales transaction.
6 The same value is present whether the customer buys
7 directly from a dealer onsite, online or from a third
8 party referral service working with franchise dealers.

9 Dealers embrace the Internet and online selling
10 of vehicles as they will any future medium that consumers
11 desire. Citizens in 49 states have spoken through their
12 elected legislators that franchise dealers serve their
13 needs and their interests the best. Thank you.

14 MR. DELACOURT: Thanks very much for that. And
15 last but not least, we'll hear from Mark Cooper.

16 DR. COOPER: My name is Dr. Mark Cooper. I'm
17 Director of Research at the Consumer Federation of
18 America.

19 Yesterday, Senator Metzenbaum was asked whether
20 middlemen have a right to exist, and he'll be glad to
21 know that I think he gave exactly the correct answer.
22 They only have the opportunity to earn a profit if they
23 provide a service that is valuable to the public.

24 When anticompetitive laws seek to turn
25 opportunities into rights, we should ask the question,

1 what is the cost to the consumer of the restraint on
2 trade, and that was his answer.

3 Now, the history of the automobile industry is,
4 in fact, a perfect example of why we need to ask that
5 question every day. For about 50 years, as you've heard
6 today, dealers and manufacturers voluntarily entered into
7 agreements for exclusive territories and restrictions on
8 the direct sales of automobiles.

9 Now, one could argue that in the beginning of
10 the industry, the twenties on forward, this was necessary
11 in order to accomplish certain economic tasks, such as
12 induce the investment of local capital to ensure local
13 sales effort to provide stocks to prevent free riding to
14 create a service sector that would support this product.

15 There are some who don't even think it really
16 had those economic functions way back then. But by the
17 1960s, the arrangement had clearly outlived its
18 usefulness. Capital markets were much more developed.
19 Consumers were much better educated. There was a vast
20 and growing independent sector of service. And so, no
21 longer able to have that fundamental economic
22 justification, as you've just heard, the dealers went to
23 their state legislatures and they passed laws which now
24 took those voluntary agreements and turned them into
25 mandatory state laws. The opportunity became a right of

1 a small class of citizens.

2 If you go back and look, every one of those
3 laws was passed in the late sixties and early seventies.
4 Come forward another 40 years and we have another threat
5 to dealers, the Internet, and they have, again, sought to
6 close down the growth of competition, seeking state laws
7 that interfere -- laws that make it absolutely clear that
8 direct sales are prohibited, extending the ban to
9 ancillary services and even, as we've heard, seeking to
10 direct the flow of information, lest manufacturers use it
11 to reward the better dealers in an area.

12 We believe that these restraints on trade
13 impose significant costs on consumers. Yesterday, ACT,
14 with whom I almost never agree on other issues, put the
15 number at \$20 billion, even higher than ours. So, it's
16 wonderful to have somebody out there, farther out there
17 than I am for a change.

18 Now, this \$20 billion number rests on some
19 solid economic analysis and that's really important. A
20 recent report by the Economist identified the sources of
21 inefficiency imposed on the consumer by this restraint on
22 trade, which would be eliminated by Internet-driven
23 sales. And I quote, "Internet-based services provide
24 consumers product information so that the dealer is no
25 longer even asked for such data. The rapid build-to-

1 order system strips away the need for the dealer to hold
2 as much inventory, that's 60 to 70 days, reducing its
3 role as a stockholding point. Better quality cuts away
4 at the dealer's non-warranty repair business as do
5 independent after market players. Used car superstores
6 take the used vehicle business electronic and other
7 channels and permit financing companies to peel away
8 traditional dealer control over finance information and
9 insurance revenue."

10 Now, we said it with a little more flourish.
11 Higher and higher quality, visual and video images that
12 can be tailored and modified during the transaction
13 promise a quantum leap in the quality of marketing and
14 consumer information gathering.

15 Increasing integration of production and
16 consumer preferences identified through online
17 transactions can both dramatically reduce marketing
18 costs, inventory holding costs, and increase consumer
19 satisfaction.

20 Personalized selling and flexible production
21 can combine interactive scheduling to reduce the amount
22 of holding time. In other words, the consumer can get
23 what they want from who they want much more quickly and
24 be more satisfied.

25 Now, without an economic justification, you've

1 heard the residual justifications. We fall back, and
2 here I want to quote from the National Association of
3 Automobile Dealers, quote, "Communities, governments and
4 local businesses have a mutual interest in economic
5 stability, local employment, local tax revenue, the long-
6 term assurance of product maintenance and provision of
7 product and consumer safety." So, those are all the good
8 things I get in exchange for the \$20 billion of
9 inefficiency.

10 In fact, restraints on trade in the sale of new
11 automobiles were never intended to provide those benefits
12 and even if they do make some contribution, there are
13 much cheaper ways to get it.

14 Public health and safety is protected by driver
15 licensing and automobile emissions testing. Consumer
16 protection is provided primarily by lemon laws and
17 warranties which are contracts between manufacturers and
18 consumers, not dealers. They just get in the way with
19 restraints on trade that increase the cost of the
20 warranty work.

21 Long-term maintenance is a manufacturer choice,
22 and most service for long term is done outside of the
23 dealerships. The minute people get off a warranty, where
24 do they go? They don't go back to the dealer. They go
25 to the nearest favorite independent service provider two-

1 thirds to three-quarters of the time. The minute they
2 escape the exclusion, they take their business elsewhere.

3 Consumer protection in this independent sector
4 is, in fact, ensured by certification. The threat of
5 fly-by-nights is simply not existent here, as you've
6 heard suggested. Manufacturers have a brand and they're
7 pretty easy to find, folks. They're big guys. They're
8 not overnight going to disappear on you.

9 Tax revenues are collected at the time of
10 registration, and there's absolutely no doubt that we
11 could have a nice competitive business for registration.
12 So, let's put it out there on the marketplace and see who
13 can convince the consumer to get it registered. And
14 certainly direct sellers will enter into contractual
15 relationships with distribution points and independent
16 service sectors. That's the way the market is supposed
17 to work.

18 Now, finally, with respect to economic
19 stability and local employment. There is absolutely no
20 doubt that if this restraint on trade were eliminated, we
21 would not have nearly as much land devoted to cars
22 sitting deteriorating in the sun and salesmen blathering
23 away in glitzy sales rooms. But that is the point.

24 Those factors of production would be
25 reallocated to the next most efficient uses. Maybe they

1 would be converted to Sears appliance stores or CompUSAs
2 where the salesmen could push washing machines and
3 computers until they're blue in the face. But that is
4 the point. They would create value because they can
5 actually deliver value to the consumer, which is what
6 Senator Metzenbaum suggested yesterday, without the
7 protection of exclusive franchise laws to sort of buck up
8 what they can charge and why they exist.

9 I will answer Commissioner Leary's question
10 directly. If the FTC needs to pick an industry to make a
11 point about restraints on trade, then this is the best
12 candidate. It is a huge purchase, it is mature. There's
13 a service sector out there, there's a finance sector out
14 there, so that people will be able to buy services in a
15 competitive marketplace.

16 And so, let me be specific. I find that bans
17 on direct sales, that exclusive arrangements for warranty
18 work, for finance, and other ancillary services are
19 illegal restraints on interstate commerce, and I firmly
20 believe we will get a substantial part of that \$20
21 billion back into the consumers' pockets. Thank you.

22 MR. DELACOURT: Okay, thank you, Mark.

23 Well, those are certainly very interesting
24 statements and they've given us a lot to discuss. I
25 think for my first question, I'd like to focus on an

1 issue of first principles -- that is, what exactly do we
2 mean when we're talking about an Internet auto sale? It
3 seems to me that we could mean one of three different
4 things.

5 The first would be a dealer referral model, in
6 which a consumer goes to a web site and -- either a
7 manufacturer's web site or a dealer's web site -- and is
8 then immediately referred to the dealer in the region
9 from which the consumer is inquiring.

10 The second would be an independent or third
11 party broker model, in which a consumer goes to a web
12 site and interacts with a broker who would then do some
13 searching to identify the dealer who is willing to offer
14 the consumer the best deal.

15 The third, and perhaps most controversial
16 model, would be the direct-from-the-manufacturer model,
17 in which a consumer purchases the automobile over the
18 Internet directly from the manufacturer.

19 So, my questions to the panelists are: Are
20 these the only three models, or are there others that I
21 haven't considered? What is the cost-benefit profile of
22 each? Which of these is most likely to save consumers
23 the most money? And which raises the most significant
24 consumer protection concerns?

25 Mark, do you want to start off?

1 DR. COOPER: I think all three models ought to
2 be allowed to exist, and the example that I like to use
3 is the PC. If you think back to PC sales in the early
4 1980s, some people thought they would impose a franchise
5 model on them. You'll remember IBM wanted to have
6 franchise stores and the claim was that we had to have
7 exclusions and limits on a number of stores because there
8 would be free-riding. And, of course, the efficiency of
9 distribution in the PC industry absolutely blew that
10 away.

11 But yet, today, if you go down and drive from
12 here out to Rockville, you will pass every form of
13 distribution imaginable. There are little boutique
14 stores that will hold your hand because you need to kick
15 the tires and have a test drive and there are
16 supermarkets like CompUSA where you get absolutely no
17 customer service, but they will, in fact, design and
18 build the computer for you in two days because of their
19 large backroom operation, or, of course, you can stay at
20 home and do it all online.

21 I believe that the automobile industry would,
22 in fact, if the restraints on trade were eliminated,
23 reorganize itself in exactly that rational fashion. That
24 is, there would be every form of distribution. So, I
25 don't see a conflict.

1 If you get rid of the restrictions, you will
2 have all three modes of distribution, some automotive
3 dealers will get bigger, others will disappear. But they
4 can, and in fact, will coexist.

5 MR. DELACOURT: Bill, you're next.

6 MR. WOLTERS: Dealers will disappear in
7 wholesale numbers if that occurs, and state laws are not
8 restrictive. We have 27 million vehicles a year that
9 automobile dealers, franchise dealers across the country
10 deliver. There are 21,800 dealers coast to coast, 1,330
11 plus in Texas.

12 And it's interesting that you would say let's
13 do the build-to-order model. Car dealers would love to
14 do the build-to-order model. Car dealers don't want to
15 spend \$5 million on inventory. That's a huge risk. That
16 is a huge incredible risk for a business that makes 1.6
17 percent return on sales. All of a sudden, if the market
18 goes south and you're stuck with those cars, I don't know
19 what you're going to do with those.

20 So, when build-to-order comes online, dealers
21 will be the very first ones to embrace that. They would
22 love not to have expensive land out by the freeway. And
23 so, that actually has nothing to do with what is going to
24 happen online because dealers sell online as well. So,
25 if you want to buy online, you can. But the truth is the

1 great majority of the people want to come to a dealership
2 and drive a car and compare models, and then go to the
3 next dealership and do the same thing. And you need a
4 representative inventory in order to do that, and that's
5 why dealers do it.

6 Manufacturers do not give them those cars to
7 show people. They have to pay for every one that comes
8 across the block.

9 One other thing, since we're quoting Senator
10 Metzenbaum. Yesterday someone said, in another context,
11 how can the government take care of all these abuses, and
12 Senator Metzenbaum said, well, the government is you,
13 it's the people. So, if the government of 49 states and
14 about to be 50 states says that we need franchise laws to
15 protect the consumer and give some equity to franchise
16 dealers to allow them to operate in the cities and towns
17 across this state, the people have spoken.

18 Car dealers don't speak for that. We're a very
19 small percentage. Of 20 million people in Texas, there's
20 1,300 dealers. We're 1.7 percent of all retail
21 businesses in Texas for gosh sakes. We don't have that
22 much power.

23 So, as it's stated in our franchise laws, it's
24 consumer protection and consideration for the customer
25 that determines that. So, franchise laws don't even

1 mention the Internet. The franchise laws in our state
2 and most of the other states mention brokers and
3 unlicensed sellers of vehicles. If someone wants to sell
4 online in Texas, if they want to get a license to do
5 that, we welcome them. TADA needs more members. I would
6 love to have more car dealers in our state, and the
7 online sellers, if they have a physical full service
8 presence to back up their sales, we would be very happy
9 to welcome them to our state.

10 MR. DELACOURT: Scott, I thought you had a
11 comment on that.

12 MR. PAINTER: Yes. It's interesting. I think
13 your question sort of carries through a couple of
14 different issues, and we should probably define what
15 we're talking about. You know, you've lumped in
16 manufacturer direct sales and, in fact, that's an issue
17 where franchise law has a direct application, as opposed
18 to the protection of consumers, and a lot of the things
19 that have been mentioned about what the dealer does for
20 the consumer, those are true. There's a very, very big
21 distinction between new and used car dealers. Used car
22 dealers are performing many of the same functions as a
23 franchised new car dealer. The only distinction is that
24 a franchised car dealer is the only one authorized to do
25 so. Everyone else but franchised new car dealers are

1 prohibited from selling new cars. That is really the
2 issue in terms of what is competitive and what is not
3 competitive.

4 Now, that's balanced by the issue that there is
5 an absolute contract between the OEM and its franchisees,
6 and that governs that relationship. And I don't think
7 you can simply just say we're going to throw out
8 franchise law. But franchise law was never intended to
9 affect the relationship of the dealer to a third
10 independent party. Its foundation in law is the breach
11 of a contract. There is no foundation in law for
12 franchise law to extend beyond that scope, and there is
13 no law that was drafted by independent consumers to
14 protect franchisees in any state.

15 The laws that are on the books are drafted
16 because of the well-organized and well-funded efforts of
17 dealers to protect that revenue stream and that
18 ecosystem. And it is absolutely anticompetitive in the
19 sense that you have to work within that system. I can
20 tell you from firsthand knowledge that consumers will buy
21 cars without having driven them, and they won't abuse the
22 dealer in every case to go and just drive the car for
23 free and then walk back to the online system to get a
24 better price.

25 What we've seen is that consumers have a

1 certain degree of confidence in the car as a commodity.
2 The technology of making cars has improved. Vehicles are
3 not lemons. They don't require nearly as much work as
4 they did in the past, and so, as the car continues to
5 commoditize, the value that's added in the new car sale
6 being forced through a particular distribution system
7 goes away. But you need to balance that out.

8 And I'll say this as somebody who's been
9 through the building process of an online automotive
10 retailer. You can't do it without the dealer, franchised
11 or otherwise.

12 There is a physicality that goes along with the
13 sale of a new car that absolutely must be completed by a
14 dealer of some sort, and those dealers being licensed and
15 regulated and held accountable so that the consumer is
16 protected is absolutely not what we're talking about
17 here. We're talking about competition -- the ability to
18 get the best possible price and the ability to get the
19 best possible experience. That is really what's
20 fundamental. And I think that you need to sort of peel
21 the onion and get down to what is the real issue.

22 If franchise law is the real issue, then deal
23 with that. But if it's laws relating to anticompetitive
24 efforts to restrict use of the Internet, which is an
25 evolving technology, the only things that are affecting

1 that are uses of franchise law that were never intended.

2 MR. DELACOURT: Okay, Professor Scott Morton,
3 did you have a comment?

4 DR. SCOTT MORTON: I wanted to follow up on
5 Scott's remarks about the value added of the dealer, and
6 actually also Mark's.

7 So, the dealer does several things: repair,
8 which you can do elsewhere; finance, which you can do
9 elsewhere; buying used cars, which you can do elsewhere;
10 and registering and delivering paperwork, which is not
11 terribly complicated and we could imagine a competitive
12 system that did that.

13 What the dealer does do currently that has
14 tremendous value added is estimate demand and order cars
15 from the manufacturer and hold them. And you need
16 knowledge of local markets and local conditions and local
17 demand to do that effectively.

18 I was interested to hear that dealers would be
19 enthusiastic about make-to-order systems. If
20 manufacturers ever get make-to-order systems, then it
21 seems to me that that economic function of the dealer
22 disappears, and then there isn't much value added left to
23 a dealer. And that's a problem for dealers.

24 So, I think that, referring back to John's
25 original question, could consumers buy directly from the

1 manufacturer? The answer is now you can't, and the
2 reason is that manufacturer's build-to-order is a very
3 long time line and so you need to go to your local dealer
4 who is holding stocks and that dealer owns those stocks
5 and is at risk if demand fluctuates and has to be good at
6 setting prices. Every time demand moves, they've got a
7 fixed set of cars and the price goes up and down, and
8 they have to set the price correctly. And that's what's
9 giving them value added, setting those prices and
10 estimating that demand.

11 So, I'm not sure that you could do direct-from-
12 manufacturer pricing right now. Given that brokers have
13 to work with dealers, they're not as efficient as some of
14 these online manufacturers, because if you think about
15 it, brokers have been around for years. You call them up
16 and say, I want this kind of car, find me a good price.
17 Those people are then just calling around dealers, same
18 as you or I and finding a price.

19 An automated model of the kind of referral web
20 site variety is a whole lot more efficient because
21 somebody isn't making a phone call every time. It's just
22 the lead zips electronically over to the dealer and the
23 dealer e-mails you. So, it seems to me, at the moment,
24 the referral model is the most efficient. If we ever got
25 kind of quick make-to-order cars, then that would change

1 drastically. But I don't know when that's going to
2 happen.

3 MR. DELACOURT: Okay, Jim.

4 MR. LUST: I'll go back to your original
5 question, John. We can and do match Internet pricing,
6 broker pricing. Any dealer can do that, and we do. We
7 don't think that that's burdensome. But referral
8 services do not accept trade-ins. Fifty-seven percent of
9 all automobile transactions have a trade-in, and that 57
10 percent is probably low in areas like mine because we
11 don't have a lot of fleet sales. So, we probably have a
12 lot more trade-ins on our sales, and this happens around
13 the country. This is a big factor.

14 Somebody has to make a judgment as to what that
15 vehicle might be worth and then place a bet on that
16 judgment. And at least 10 percent of the time in our
17 area, we're wrong. We lose money on the trade-in. So,
18 there should be a premium for taking a trade-in.

19 That's why I said if somebody comes in with a
20 referral price, we match it every time. There's no
21 problem, because it's a guaranteed profit, we have no
22 risk.

23 By the way, Autobytel, the dealer has to pay an
24 \$837 a month charge or over \$10,000 a year. But I'm
25 going to talk about inventories for just a moment. This

1 is, I think, widely misunderstood. The dealer will have
2 the minimum inventory in order to sell the maximum number
3 of cars. In other words, he's got to cover all the
4 bases. But the manufacturer has a real blessing in the
5 dealer who handles the inventories.

6 There's not a dealer that you'll ever talk to
7 that won't tell you there are times he takes vehicles,
8 not because he wants them, but because he has to take
9 them. Why? Because the manufacturer has much more
10 efficient lines going. They'll produce X number of
11 Tahoes, for example, and they'll go to the dealers and
12 say, we need five Tahoes out of you, we need ten out of
13 you. That's efficiency on their part.

14 So, with respect to inventories, we operate
15 very much like a surge tank. All dealers do. It's been
16 thus forever, and we'd like it -- a perfect situation
17 would be with a customer that comes in, we could build a
18 vehicle to order and deliver it in two weeks. Can't
19 happen. It doesn't happen.

20 I do take issue with the service -- the idea
21 that anybody can do the service. Anybody can't do the
22 service. I disagree with that immensely. Our techs, we
23 have 11 technicians, 10 of them do GM service. Just GM
24 service because it's so specialized to the GM product.
25 Then we have one technician that does relatively minor

1 service on other products. We don't even allow our GM
2 technicians to work on other products. It's a highly
3 specialized business.

4 The warranty business is very difficult. It's
5 not easily transferred to a backyard shop without very,
6 very sufficient sophisticated equipment and training.

7 MR. DELACOURT: Okay. Well, I think there's
8 certainly more that could be said on this issue, but I
9 think we should move on to another question.

10 I'm going to return to a remark that
11 Commissioner Leary made, which was directed at the role
12 of the state here. Commissioner Leary remarked that, in
13 the comment filed by the National Automobile Dealers
14 Association, there was a suggestion that consumers would
15 not be willing to buy a car over the Internet if there
16 was no opportunity to test drive, no opportunity for
17 service, etc. And his reading of that was that it was
18 probably correct.

19 If that is the case, what is the state role
20 here? Can't we just put the Internet models out there
21 and if consumers are concerned about the fact that
22 service won't be available or that they will have
23 problems with the vehicle and nowhere to turn, then they
24 can elect to forego the Internet option and pursue the
25 traditional route?

1 Scott?

2 MR. PAINTER: One of the things we had to look
3 at in our business was, absolutely, will customers buy
4 cars without having test driven them. It was the number
5 one issue to raising money, and we raised more money than
6 any Internet company pre-IPO in the entire bubble,
7 whatever you want to call it. We raised that money
8 because there was an exponential growth in demand for
9 what we were doing, and we simply put the system in place
10 and we let people go in and take a look, and what we
11 found is that inside of six months, we were effectively
12 the largest single point dealership in the world three
13 times over.

14 I mean, if you look at Longo Toyota or Galpin
15 Ford in California, they're both selling between 1,000
16 and 1,500 cars a month. We were selling 300 cars a day
17 within three months of putting up our banner. There's
18 clearly a willingness on the part of the consumer to
19 believe that every make and model of car is like every
20 other similar make and model of car, when it is new. The
21 speculation comes in when you deal with a used car.

22 Now, there is certainly a certain group of
23 people who will want to kick the tires and, I think it's
24 an important note to all of the comments related to the
25 value of the dealer, you can't do it without a dealer.

1 You can't service a car without a dealer. You can't do
2 all of these things. And when we looked into it, what we
3 found is that the amount of money that the dealers made
4 on the sale of the new car was a relatively small portion
5 of the overall profit margin that they made in that
6 relationship with the consumer.

7 And that to the extent our customers were price
8 sensitive on a product that was becoming more and more of
9 a commodity over time, we were simply reducing the least
10 valuable component of the transaction, making it easier
11 for the consumer, but yet deriving all of that very
12 lucrative revenue back to our dealer partners, and they
13 were eager to take trade-ins. You can do a trade-in on
14 CarsDirect.com, but it doesn't come back to us, it goes
15 to our dealer partners. Dealers love trade-ins. They
16 make a lot of money on the sale of used cars, much more
17 than on the sale of a new car.

18 And the service is incremental revenue. If
19 they didn't have to work or advertise or promote to sell
20 that car to get that service business, it is incremental
21 free revenue to them. So, they are very excited about
22 that sale coming to them.

23 I think that there is a very, very harmonious
24 way that everyone can work together and it will require
25 some sorting out, but I don't think the issue is whether

1 to get rid of dealers or not. I mean, I didn't think
2 that was the question. There's clearly, though, a more
3 efficient way to sell the new car and work with the
4 dealers in a way that they can be more profitable. The
5 industry is moving in that direction anyways.

6 MR. DELACOURT: Okay, Professor Scott Morton?

7 DR. SCOTT MORTON: I just wanted to comment
8 briefly on the test drive issue. I think that's very
9 important and that most consumers probably do want to
10 drive the car that they're going to buy at some juncture.

11 I disagree, however, that it needs to be done
12 through dealers. I mean, if you just free yourself from
13 your mind set, from the current situation, and think
14 about other ways consumers can drive cars. They drive
15 them when they rent them. There are amusement parks
16 where, you know, the kids are on the bumper cars and
17 there's a test drive track where adults can test drive
18 new BMWs and things like that. You could imagine a set
19 of cars at a shopping mall that people could test drive.

20 I mean, manufacturers have an interest in
21 making a test drive freely and easily available to people
22 so that they can try out their cars, and you don't need
23 to test drive the car that has the exact configuration of
24 options on it to get a sense of how it drives. So, I
25 think that certain creativity in thinking about the test

1 drive might be helpful.

2 It's also true, however, that there may be a
3 free riding problem. A dealership located in a
4 convenient neighborhood may be providing a lot of test
5 drives for people who then go and buy elsewhere, and
6 manufacturers are going to have to think about that.
7 Those dealerships may eventually not be too excited about
8 serving that role.

9 MR. DELACOURT: Mark?

10 MR. COOPER: Well, our view is that, if you put
11 this model in the world, I think you will explode the
12 variety of myths that you've heard about all these
13 functions dealers provide.

14 Keep in mind, and I want to reiterate, that I
15 haven't called for repealing franchise laws. I've called
16 for repealing three or four clearly identifiable
17 restraints on trade. There are all kinds of contract
18 protections, and actually, I believe that's what the FTC
19 concluded in their 1989 study, that basically franchise
20 law provides a function and, clearly, the relationship
21 between McDonald's and their franchisees is covered by
22 that law and the one thing the state law doesn't say is
23 no Burger Kings.

24 And so, that's what we'd like to get rid of is
25 just those little pieces that would appear to be so

1 anticompetitive. And if you put this model in the world,
2 I believe you will get a whole array of relationships to
3 serve the different kinds and levels of need in the
4 consuming public. One of the reasons I think the
5 industry reacts so aggressively in passing state laws to
6 close any loophole is that I think the emperor really has
7 no clothes and they're just desperate not to let anybody
8 notice that, because once people get the idea, it will
9 become apparent very quickly.

10 MR. LUST: I'd like to respond to that.

11 MR. DELACOURT: Go ahead.

12 MR. LUST: Just quickly. You used the example
13 of McDonald's and Burger King, and I do have a little bit
14 of experience there. If a town is scheduled for two
15 McDonald's, there won't be four. There may be four
16 Burger Kings, but there won't be four McDonald's.

17 The same thing with the relevant market area
18 with General Motors or Ford or Chrysler or any of the
19 auto dealers. Nobody's going to invest, in our
20 particular circumstances, \$5 to \$8 million without some
21 kind of exclusivity for a particular area, just like the
22 McDonald's. He has to put an awful lot of money in that
23 facility, the training and the people, and he can't have
24 a McDonald's down the street or one block away. That's
25 the assurance that he has when he makes the investment.

1 MR. COOPER: That's not enforced by state law.

2 MR. LUST: It's enforced by McDonald's.

3 MR. COOPER: It's not enforced by state law.

4 MR. LUST: Well, in the case of the automobile
5 dealer, relevant market area is very, very important.

6 MR. COOPER: But my point is that you can
7 negotiate that in a private arrangement. It is
8 absolutely not enforced by state law and that is the
9 mistake.

10 MR. DELACOURT: Bill, did you have another
11 comment?

12 MR. WOLTERS: Yes, I do. In that regard, I
13 have a quote here from Senator David Cane from the Texas
14 Legislature on this subject. He said, "We require motor
15 vehicles to be sold through local dealers because it is
16 good policy for several reasons. Consumer protection,
17 local economic development and regulatory oversight among
18 others. This legislature, for many years, has spoken
19 over and over again that it's in the best interest of
20 Texas citizens to have a local dealer in the chain of
21 commerce."

22 And the other issue is about the qualifications
23 of dealers and if someone else could do the work, if you
24 have repairs that need to be done. There are a lot of
25 people that can work on your muffler or balance your

1 tires or change your oil. When it comes to the very
2 complex system in an automobile that has to do with its
3 driveability and safety, automobile dealers are the only
4 ones that are charged by their manufacturer to have the
5 training, the tools, the equipment and the dealership
6 that can give quality service.

7 Cars today are very complex. There are
8 electronic modules. There are fuel injectors. There are
9 anti-lock brake systems. There are so many things that
10 have to do with the safety and the value of the car that
11 you have to have qualified repair to do.

12 Other people have tried to get into the car
13 business, other than our dealers. You know, when you
14 have a single purpose facility that basically can only be
15 used to sell cars, when you have such regulatory
16 oversight, when you have a partner, a business partner
17 that you have to share with, and you have consumers that
18 really need to be happy and satisfied every day, it's
19 really hard to make a profit doing that.

20 It's really easy to sell a lot of cars and it's
21 really easy to make customers happy. But it's really
22 hard to stay in business and make a bottom line profit
23 doing that. Ford Motor Company tried that in the last
24 few years in a half a dozen markets across the country.
25 They wanted to get into the car business. Now they have

1 sold their dealerships back to private capital investors
2 because it is a different animal. It is a very
3 competitive, difficult business.

4 This is a summary of current General Motors
5 vehicle recalls. Some of these are safety recalls, some
6 are not. But this is just one manufacturer in very small
7 print that lists all the vehicles that are subject to
8 recall.

9 If I was a consumer and I drove a vehicle with
10 one of these recalls, I'm not sure I'd want to take it to
11 Brake Check or Aamco or Quick Lube to get it repaired.
12 Automobile dealers are required and prepared to repair
13 the vehicles back to first class condition.

14 A few years ago when one of the manufacturers
15 had a tire problem, automobile dealers changed millions
16 of tires across this country to make people's cars safe
17 to drive. They changed tires that they didn't even have
18 to change because people were so afraid to buy a
19 particular brand of their car. No one came in and saved
20 the day. The manufacturers did everything they could to
21 get tires to dealers, but dealers had to have inventory,
22 that ugly word, they had to have tires in inventory to
23 get you back on the road. They bought tires from outside
24 at retail from tire stores to put on their customers'
25 cars.

1 In our culture today, we see dealers as these
2 big Simon LeGreess. My God, yesterday, they were referred
3 to as the mafia. They said dealing with franchise
4 dealers is as hard as dealing with the mafia. Someone
5 said they just won't go away. These are family-owned
6 businesses. Ninety percent of the dealerships in the
7 State of Texas are family-owned businesses, many several
8 generations old, some that date back to the 1910s, 12s,
9 13s. We have a number of dealers that are older than
10 General Motors, for goodness sake.

11 And the way these people have stayed in
12 business if they've operated on a 1.6 percent profit
13 margin and a 6 percent profit margin on the sale of a new
14 vehicle. That's not exactly gouging a customer. They're
15 doing this with a vehicle that you can find out the
16 wholesale price.

17 We have a ceiling price and we have a bottom
18 price. You can't get that from anyone else. We
19 guarantee our cars for three years. Nobody guarantees
20 anything for three years for goodness sakes.

21 MR. DELACOURT: Our time is short and I just
22 want to squeeze in one final question.

23 The final question is -- actually, it's two
24 questions from the audience both addressing a related
25 issue. The question is, "The discussion has focused on

1 the sale of new cars and the manufacturer/dealer
2 relationship. Does this issue also affect used motor
3 vehicle dealers and used cars? Has there been any
4 research on the used car business?"

5 And then a related question is, "How have
6 dealers and manufacturers been affected by the sale of
7 used vehicles on Internet auction sites such as eBay?"

8 Scott, you want to take a stab at that?

9 MR. PAINTER: Sure. I think that if you look
10 at new versus used, the used category online is
11 incredibly robust by comparison. It's impossible to
12 regulate it because franchise law does not cover it. And
13 so, therefore, it is sort of a much bigger opportunity.

14 There's a real business problem, though, that
15 sort of balances that out, in that when you buy a used
16 car, you must test drive it. There is no question. I
17 mean, a consumer is not going to buy a used vehicle sight
18 unseen, whereas you might buy a brand new BMW 740 sight
19 unseen. If you drove in one or had a friend who had one
20 and you think that that's a great car, you may order it
21 because it's new and there's a certain expectation with
22 it. But in the used market, there is a tremendous amount
23 of competition and it's very robust.

24 You know, a lot of these comments today have
25 sort of talked about what manufacturers would do in terms

1 of build-to-order and whatnot. I actually am running a
2 company called Build-to-Order that's going after these
3 same issues, and I think that it's important to note
4 where the economics in the entire system sort of come
5 into play.

6 Thirty percent of the retail price of a car is
7 tied up in the distribution and sale of that car. Thirty
8 percent. Now, many of the comments today about what
9 dealers can do relate to revenue that comes after the
10 sale of the car. And if you're looking at an opportunity
11 to benefit the consumer, we have examined, in great
12 detail, how we can take that 30 percent cost that most
13 OEMs have to spend towards distribution and retail -- and
14 that's split pretty evenly between marketing and
15 advertising and dealer expense -- and bring that cost
16 down significantly.

17 And that's only one part of the game. The
18 other part is, what can we give back to the dealers that
19 we need to partner with? We're having incredibly robust
20 conversations about giving them that business after the
21 point of sale. But we're not talking about giving them
22 the opportunity to control the distribution and take that
23 customer wherever they want to take them. We want to be
24 in control of that distribution through the point of
25 sale, and we're willing to pay the dealer for it.

1 We're in an interesting position because we
2 don't have any franchisees. We've never transgressed
3 anybody. So, we're examining a lot of the same issues.

4 The one thing that's missing is that there's a
5 great partnership here between dealers, both franchised
6 and used, that people just aren't embracing because
7 they're so worried about protecting the laws as they
8 stand now in order not to lose out on other business.
9 It's a very interesting issue.

10 MR. LUST: The only people that should buy used
11 cars online are the dealers, and they do. They buy them
12 online untested, undriven. But there is also an
13 understanding that those cars are as represented or they
14 go back.

15 MR. PAINTER: Well, we take trade-ins sight
16 unseen as well, and we lose sometimes and we do okay
17 sometimes.

18 MR. DELACOURT: Is there anybody else who has a
19 comment on the used car issue?

20 (No response.)

21 MR. DELACOURT: Well, I guess we'll leave it at
22 that. Our time has come to an end. Thank you, everyone,
23 for participating. There's more that could be said, but
24 we're going to have to wrap up for the time being.

25 Now we are going to break for lunch, and I

1 understand that the next panel will be starting at 1:15.
2 That will be the panel addressing online casket sales.

3 **(Whereupon, at 12:15 p.m., a luncheon recess**
4 **was taken.)**

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1 a one-minute warning and a stop sign when you've reached
2 the time. So, if you would occasionally glance over at
3 him, that would be very helpful.

4 I would like each panelist to introduce himself
5 or herself at the beginning of his or her remarks. I
6 also wanted to mention that Lisa Carlson is supposed to
7 be joining us, but her plane in New Hampshire has been
8 delayed, so she may pop in at the last moment, but we
9 can't be sure until she actually shows up.

10 So, without further ado, Bob, if you would
11 please start off. We'll go from left to right.

12 MR. VANDENBERGH: Good afternoon, Ms.
13 Ohlhausen, staff, members of the Federal Trade Commission
14 and my colleagues on this panel. I truly appreciate the
15 opportunity to participate in this workshop today on
16 behalf of the National Funeral Directors Association on
17 the issue of Internet casket sales.

18 I am Robert Vandenberg, a Certified Funeral
19 Service Practitioner and a first-generation licensed
20 funeral director. I am a past president of the Michigan
21 Funeral Directors Association and currently serve as
22 President of the National Funeral Directors Association,
23 which represents approximately 13,500 members across our
24 country.

25 NFDA is totally committed to protecting the

1 consumer and strengthening their trust and confidence in
2 the funeral service profession. We believe that what is
3 in the best interest of the consumer is also in the best
4 interest of funeral service.

5 NFDA fully supports open competition and
6 maximizing consumer choice in the purchase of funeral
7 goods and services. However, it is the role of
8 government to strike a balance between the two competing
9 and sometimes conflicting interests of competition and
10 consumer protection. This is of particular importance
11 with respect to the sale of caskets. It is important to
12 place the sale of a casket in the context of the funeral
13 service. A casket is not just a commodity like a shirt
14 or a pair of shoes; it is a product for a special
15 specific event at a very sensitive and specific time.
16 Because of this unique nature of funeral service,
17 traditional consumer protection remedies are not always
18 applicable.

19 As we all know, certain funeral practices are
20 regulated by the FTC's Funeral Rule. While this rule is
21 primarily a price, service, and goods disclosure rule, it
22 also covers certain practices as well. The objective of
23 this rule is to provide as much information as possible
24 to consumers so that they may make an informed decision
25 about the purchase of funeral goods and services.

1 However, by definition, the Funeral Rule only
2 applies to funeral homes. It does not apply to those who
3 sell only funeral merchandise or services to the public,
4 such as third party casket stores, crematories, and
5 cemeteries. It also does not cover Internet sales.

6 Over the years, NFDA and various consumer
7 groups have asked the FTC to strengthen the funeral rule
8 to cover all sellers of funeral and burial goods or
9 services to the public. This has not yet occurred. We
10 strongly believe that this rule must be updated to
11 reflect the current marketplace.

12 On the state level, NFDA is unaware of any
13 state that currently restricts, in any manner, online
14 sales of caskets via the Internet. While a handful of
15 states have laws that require an individual to hold a
16 funeral director's license in order to sell caskets in
17 that state, NFDA has no knowledge of any state action
18 against an out-of-state casket retailer offering to sell
19 caskets via the Internet.

20 Therefore, online casket retailers are
21 currently able to freely sell caskets throughout the
22 United States. The unfettered ability of casket
23 retailers to use the Internet as a means of selling
24 caskets to residents of all 50 states and the District of
25 Columbia is readily apparent by a brief visit to the

1 Internet. Placing the word "casket" in a search engine
2 generated a list of well over 100 casket sellers online.

3 It is NFDA's experience that state laws and
4 regulations related to funeral goods are focused on pre-
5 need sales and designed to require that the funds paid
6 for such goods and services are set aside in trusts to
7 ensure that they are available when needed. All states
8 have such trusting laws. However, in some states only
9 licensed funeral directors are subject to these laws.
10 Third party vendors of funeral goods and services, such
11 as casket sellers and cemeteries, either are subjected to
12 laws which have lesser trusting requirements or are not
13 subject to any trusting requirements at all.

14 NFDA strongly believes that trusting laws
15 benefit the consumer and do not have a negative effect on
16 competition or choice or impede e-commerce.

17 There are a few states that currently have laws
18 or regulations that prohibit anyone other than licensed
19 funeral directors from selling caskets. The opponents of
20 these laws often allege that they were enacted to
21 restrict third party casket sellers. In reality, they
22 were put in place well before the emergency of third
23 party sellers in the mid-1990s.

24 Most of the laws resulted because state
25 legislators used broad definitions in funeral licensing

1 laws and incorporated the sale of funeral merchandise as
2 an act which required a funeral director's license. So,
3 only in the past seven years with the emergence of third
4 party sellers have statutes been labeled as
5 anticompetitive attempts by licensed funeral directors to
6 restrict competition.

7 The issue at hand in those states where the
8 third party casket laws are being challenged is an
9 underlying issue which is being dealt with at this
10 workshop. Some states are claiming that licensing
11 restrictions are necessary to protect consumers. But
12 opponents believe the restrictions unduly restrain
13 competition. Steps to adopt a middle ground, such as
14 strengthening the Funeral Rule to make all sellers of
15 funeral goods and service subjected to price disclosure
16 requirements are rejected by federal agencies that
17 advocate wide open competition. At the same time, states
18 are struggling to protect consumers from being abused by
19 retailers operating out of states with little or no
20 regulation.

21 Since the funeral industry is prominent in many
22 markets throughout the country, we believe the role of
23 the state legislature in protecting consumers should not
24 be seceded.

25 Thank you again for inviting me to present the

1 views of the National Funeral Directors Association, and
2 I look forward to participating in the question and
3 answer session. Thank you.

4 MS. OHLHAUSEN: Thanks, Bob. Mark?

5 MR. KRAUSE: Good afternoon, and thank you
6 again for inviting our group to speak to you.

7 My name is Mark Krause and I represent the
8 International Cemetery and Funeral Association. We
9 represent funeral homes, cemeteries, crematories,
10 monument dealers, and other related professionals since
11 1887.

12 Just a little bit about myself and my
13 credentials. I'm a third generation funeral director. I
14 have three traditional funeral homes in the Milwaukee,
15 Wisconsin, area. And interestingly enough, I also own a
16 retail casket and funeral outlet in a strip mall, which
17 is unrelated to my funeral home. So, I think I can kind
18 of give an interesting perspective here on both sides of
19 the equation.

20 In general, I'd just like to make three points
21 in our introductory remarks here. As an association, our
22 group thinks that everyone should be allowed to sell
23 funeral product. It isn't something that needs to be --
24 you don't need to be a funeral director to sell a casket,
25 absolutely not.

1 The laws requiring funeral directors -- in the
2 states that require funeral directors to sell caskets,
3 those are very protectionist. It's different selling a
4 funeral good or product then let's say regulating
5 embalming or something where the public health is at
6 stake. Those are different issues.

7 The second point I'd like to make is I think
8 one area that needs to be addressed very strongly is pre-
9 need casket sales with the casket retailers. What
10 happens if a casket retailer goes out of business and has
11 taken caskets into trust? I think there's some good
12 concerns here, and maybe there needs to be some trusting
13 limits. I don't know exactly what those are yet, but
14 casket retailers tend to fall between the cracks on these
15 things. They're not forced to trust things where funeral
16 homes are, maybe cemeteries might be.

17 Should there be some limits on those trusts?
18 Definitely. But what are those limits? Those are things
19 that we need to answer.

20 Maybe they need to use an insurance product
21 that offers a commission to help pay for the cost of that
22 sale, or maybe they need to purchase warehouses and store
23 these caskets until they're needed. Maybe they shouldn't
24 be allowed to pre-need without any guarantees. I don't
25 know.

1 Then thirdly, I'd just like to mention by
2 owning the casket and the funeral home discount operation
3 that I do, I would just like to say that it's been in
4 business for two and a half years and we take care of
5 about 100 families a year with that operation. If this
6 outlet was dependent solely on casket sales or
7 merchandise sales, the thing wouldn't be in business
8 because there isn't enough volume to generate the
9 existence of it. It wouldn't pay for itself.

10 We sell caskets there. We sell urns. We sell
11 markers. We sell burial vaults. Just the merchandise
12 sales alone wouldn't cover the cost of a person sitting
13 there all day long operating that. I think that's an
14 interesting point to make. It's such a niche market,
15 there just isn't enough volume to justify that. It's
16 because we also sell services with that product that it
17 becomes something that's viable.

18 And on that note, I'd like to pass it along to
19 Clark.

20 MS. OHLHAUSEN: Thank you, Mark.

21 Clark?

22 MR. NEILY: Thank you. My name is Clark Neily.
23 I'm a senior attorney at the Institute for Justice here
24 in Washington, D.C. As some of you may know, the
25 Institute for Justice litigates on behalf of

1 entrepreneurs whose economic liberty is being stifled by
2 government regulations.

3 Casket sales are a perfect example of that, and
4 we've actually been litigating in this area for several
5 years. I'm currently in charge of our case in Oklahoma
6 where we're trying to have casket sales restrictions
7 struck down that forbid anyone who is not a licensed
8 funeral director from selling caskets. It happens that
9 our client in Oklahoma actually operates an online
10 business. It's called Memorial Concepts Online. They
11 don't have a brick and mortar location. They only do
12 business over the Internet.

13 They have been prevented from selling caskets
14 in Oklahoma during the course of the lawsuit and ever
15 since they have been open because in Oklahoma it's a
16 crime to sell a casket unless you are a licensed funeral
17 director.

18 What I'd like to focus on in my remarks are
19 basically two points. First, how those types of
20 restrictions can interfere with online commerce
21 specifically, but also more broadly, what our experience
22 litigating these cases has taught us about some of the
23 things that the funeral industry, together with the state
24 regulatory boards, have been prepared to do in defense of
25 these regulations, which provides a very troubling

1 insight, unfortunately.

2 But let me preface that by saying we have
3 absolutely no problem with the members of the funeral
4 industry who are prepared to focus on the services they
5 have to offer that are genuinely unique. There's
6 absolutely no question that someone who is going to be
7 embalming bodies and arranging funerals ought to be
8 subject to appropriate state regulation. We don't have
9 any problem with that and we've never tried to interfere
10 with those kinds of legitimate regulations.

11 The problem arises when state boards and the
12 funeral industry members that they represent fight hard
13 to keep in place laws that are clearly anti-consumer and
14 were designed to be anti-consumer. What I'm talking
15 about specifically are laws that prohibit anybody who's
16 not a licensed funeral director from selling a casket.

17 What we have seen in the course of our work in
18 this area is that both the state boards and some members
19 of industry, unfortunately, are prepared to go into court
20 and make blatant misrepresentations about the nature of
21 the business in order to try to protect these
22 regulations. So, for example, both in Tennessee and in
23 Oklahoma, our opponents told the courts in both cases
24 that it was important that only licensed funeral
25 directors sell caskets because of various public health

1 and safety concerns.

2 Through the process of litigating these cases,
3 we're able to lay bare the fallacy of that argument, and
4 in Oklahoma, in fact, they have completely abandoned it,
5 finally. After initially raising it in this case, they
6 have essentially conceded that they never did have any
7 factual basis for making that assertion.

8 What's most troubling to me about that is that
9 it is -- in all candor, it's, to me, evidence of some bad
10 faith. It is a willingness to try to pull the wool over
11 the eyes of the court assuming or hoping that the other
12 side will not be able to expose the fallacy of those
13 arguments. We've been able to do that in both cases, in
14 Tennessee and in Oklahoma. Another group, the Casket
15 Royale Company, was able to do that in Mississippi.

16 Another justification that's offered in these
17 cases is that there's this very strong consumer
18 protection angle and that there is something unique about
19 the sale of a casket. Based on my experience litigating
20 these cases, I don't necessarily agree with that, but I
21 do understand how reasonable people could be of two minds
22 about it. There is certainly something unique about the
23 death process and about having to make arrangements.

24 Now, I hasten to add that people who have
25 experienced the death of a loved one are making many

1 arrangements, many of which are not subject to any
2 additional regulation. They're often buying airline
3 tickets, they're reserving hotel rooms, setting up all
4 kinds of activities that are related to the funeral and
5 no one tries to interfere with that or over-regulate it.

6 What happens when you have these laws applied,
7 however, to a casket selling company, particularly on the
8 Internet, such as our clients in Oklahoma, is that you
9 impose on the model that they're trying to do business
10 under, this very streamlined Internet model, an old-
11 fashioned brick and mortar model.

12 So, in Oklahoma, for example, you can't do
13 business. You can't sell caskets unless you have an
14 embalming room, a viewing room, a physical inventory of
15 caskets. And I think this is a problem that expands
16 beyond just caskets. What it is, it is the imposition of
17 old business models on new business plans and preventing
18 companies from realizing the efficiencies that could flow
19 from Internet commerce, but are prevented from doing that
20 because of old-fashioned and outmoded regulations.

21 I think it's very important to go back and re-
22 examine those regulations to determine whether they're,
23 in fact, benefitting consumers or they're only designed
24 to benefit the industries that have fought to keep them
25 in place. Thank you.

1 MS. OHLHAUSEN: Thank you, Clark. David?

2 MR. HARRINGTON: Hello, my name is David
3 Harrington. I'm a visiting faculty member at Claremont
4 McKenna College and I'm a permanent member of the
5 Economics faculty at Kenyon College. I'd like to make
6 six points, hopefully, of 50 seconds apiece.

7 First, I agree with Clark that prohibiting
8 anyone other than licensed funeral directors working
9 licensed funeral homes from selling caskets restricts
10 competition, especially in states where funeral directors
11 must be embalmers and funeral homes must have extensive
12 facilities.

13 My research with Kathy Krynski finds that these
14 latter regulations affect the choice of whether to be
15 cremated or buried, raising funeral costs by at least
16 \$250 million per year. So, I even have copies of the
17 article if anyone's interested.

18 The point is, is that these state funeral
19 regulations have the potential of being very costly to
20 consumers. So, it seems to me we've begun to document
21 the costs, it's very difficult to document the benefits.

22

23 My second point, I believe that restrictive
24 state funeral regulations create an environment where
25 funeral directors find it less costly to make disparaging

1 comments about funeral market innovations like online
2 casket and cremation. If we go back to the states that
3 have very restrictive funeral regulations, they tend to
4 require funeral directors to be embalmers and funeral
5 homes to have very extensive facilities including
6 embalming preparation rooms.

7 That means you get a very homogeneous type of
8 funeral firms in those states, and those firms share
9 similar attitudes and similar incentives, and I believe
10 that those similar attitudes and similar incentives
11 reduce the cost of making disparaging comments about
12 innovative things in the funeral market, like online
13 caskets and cremation.

14 If I'm right, it's just not narrow prohibitions
15 concerning who can sell caskets that affect online casket
16 sales. It's the entire web of state funeral regulations.

17 My third point is, increasing competition in
18 casket markets is not necessarily the same thing as
19 increasing competition in funeral markets. If funeral
20 directors' control of casket sales is not central to
21 their market power, then removing the impediments to
22 online casket sales will have little effect on funeral
23 expenditures.

24 Why? Because funeral directors will be able to
25 raise their other prices to compensate for lower casket

1 prices if indeed more competitive casket markets lead to
2 lower prices.

3 This rests on an interesting thing in economic
4 theory, which I don't think you all want to listen to,
5 and that's the distinction between fixed and variable
6 proportion inputs.

7 My fourth point is, increasing competition in
8 casket markets will, however, probably reduce funeral
9 expenditures, just not as much as some people think it
10 will. Funeral expenditures will fall if funeral
11 directors feel constrained in how much they can raise
12 their other prices. Why might they feel constrained?
13 Because they might fear that higher prices will induce
14 consumers to search for better deals.

15 However, I still think that reducing the
16 impediments to online casket sales will have less impact
17 on funeral expenditures than many people think it will.

18 My fifth point is, despite that it will have a
19 somewhat smaller effect than I think it will, I think
20 it's important for some people, offering the opportunity
21 to search online and to search in an environment where
22 they don't feel pressured, I think is very important to
23 certain people. And so, reducing search costs would be a
24 good thing for the people that would use the Internet
25 services.

1 Secondly, it's also easy to make comparisons
2 across alternative caskets. So, a few weeks ago I went
3 to a bunch of different Internet sites and I was able to
4 look at a lot more variety of caskets than I think you'd
5 find in a typical funeral home.

6 Now, my sixth point is that I do think that
7 there's a potential problem with Internet casket
8 companies free riding on the services of local funeral
9 homes. At about that same time that I searched on a
10 bunch of web sites about caskets, I also went to the
11 Batesville casket site and looked at their site. Their
12 site really isn't very informative about what their
13 different casket options are, and so I called up an
14 Internet casket company and asked them to give me a price
15 on sort of a run-of-the-mill average Batesville casket.
16 The Internet salesperson said, well, you can't really
17 sell caskets that way. There's so much variety in
18 caskets, you've really got to look at them. I'm not sure
19 that they actually used the words "look at them."

20 I explained to them that the Batesville web
21 site doesn't really give me much information on their
22 caskets, and so, eventually we arrived at the agreement
23 that I would go off to a funeral home and look at their
24 caskets and then I'd get back to them about buying one of
25 their caskets.

1 So, that was my sixth point. One last
2 sentence, and that is that as a lot of the other people
3 at some of these other panels have emphasized, although
4 that's a potential problem, there are less severe ways to
5 control that problem than prohibiting Internet casket
6 sales.

7 In particular, Batesville has a strong
8 incentive to create systems whereby the services that
9 funeral homes provide to people are provided for their
10 caskets.

11 MS. OHLHAUSEN: Thank you, David. Steven?

12 MR. SKLAR: Thank you. I'm Steve Sklar. I'm
13 the Director of the Maryland Office of Cemetery Oversight
14 and also serve as Chair of Consumer Affairs in Education
15 Committee for the North American Cemetery Regulators
16 Association. My views today and my statements will be
17 personal and not on behalf of, nor are they authorized
18 by, our National Cemetery Regulators Association.

19 My views are these basically: One, that
20 consumers should be informed and protected under
21 guarantees of state regulation; and two, death care
22 providers are encouraged to succeed and prosper under
23 fair guidelines of operation.

24 I think that what a regulator really should be
25 doing is to see both consumers and providers as

1 constituencies to be advanced and protected.

2 Now, looking at how my colleagues around the
3 country tackle the question of casket sales through the
4 Internet. Generally, we find that the state approach is
5 the same as the approach for regulating land-based or
6 bricks and mortar providers of caskets. So that in
7 states where they don't regulate casket sales at all as
8 third party vendors, that is set aside from either a
9 funeral home or a cemetery, they don't get involved with
10 the Internet sale either.

11 Now, if they're regulating pre-need casket
12 sales for third party providers or other retailers,
13 they'll do that occasionally, as well, through the
14 Internet. One state, Iowa, for instance, they regulate
15 pre-need casket sales from third party vendors. Not
16 land-based in Iowa for at-need sales, but only pre-need
17 sales.

18 So, they require their Internet providers to do
19 the same. They have to trust, they have to be licensed
20 as operators, they have to submit reports and they have
21 to do all the standards of operation that a land-based
22 casket provider selling pre-need caskets in Iowa have to
23 comply with.

24 Now, a state like New York, the regulator of
25 pre-need is not the cemetery regulator, but as it turns

1 out, the Attorney General's office has some jurisdiction
2 over pre-need sales. And if you look around the country,
3 it's not necessarily the death care provider that is
4 regulating the pre-need caskets. Often, it's in the
5 securities division or the banking agency. And this is
6 looked at as a security and not as a death care product
7 to be regulated by the death care providers or regulators
8 already in place.

9 A state like Washington, they regulate pre-need
10 sale of caskets, but the law there requires that it be
11 done by a funeral service provider in a funeral
12 establishment. So, that sort of shuts out the Internet
13 provider of caskets, pre-need or otherwise.

14 You've heard about Oklahoma, Tennessee, the
15 Internet is not permitted to be sold unless they are
16 funeral directors licensed in the state.

17 Maryland takes a different tack. The statute
18 that I operate under, it's about five years old now. It
19 regulates not only the cemeteries but all the monument
20 dealers and any provider of burial goods. They all have
21 to get a license to operate in the form of a permit or a
22 personal registration for individuals who sell or manage,
23 and they all have to follow, regardless if they're
24 storefront casket sellers or whatever, the trusting
25 requirements that go with it and the ethics regulations

1 and professional standards as well.

2 So, we make no distinction. We cover every
3 provider of death care products in Maryland, either under
4 the State Board of Morticians, under the Cemetery
5 Oversight Office, and I get all those in between, the
6 death care providers who are storefronts selling either
7 monuments, memorials or caskets or vaults. That all
8 comes under me.

9 The licensing is not really that. It's more of
10 a registration. There's no training or education
11 requirements, and the permit applications for businesses
12 are rarely unmet.

13 Now, how do we treat the Internet? It's been
14 my decision that since the state statute does not address
15 Internet sales because there's still outstanding
16 questions constitutionally of interstate commerce
17 implications and also because there's a cue from the
18 Congress in prohibiting states from imposing sales taxes
19 on Internet sales. I've taken a hands-off mandatory
20 approach on those kinds of casket retailers.

21 On the other hand, I've made it optional that
22 if out-of-state or -- let's put it this way, out-of-state
23 Internet providers want to voluntarily submit to my
24 jurisdiction and be licensed, I encourage that and I give
25 to them what is an argument that they ought to do that

1 voluntarily, not that they're required, in order to get a
2 competitive edge over their competitors.

3 For instance, if they get licensed in Maryland,
4 they can say this in effect. "We are licensed by the
5 State of Maryland and must comply with the highest
6 standards of performance required by law. If you ever
7 need assistance or information about your contractual
8 rights or ever have a dispute or a complaint about our
9 service, you may contact the Maryland Office of Cemetery
10 Oversight which has full jurisdiction over this
11 transaction."

12 That is a sales plus. There is an inherent
13 reluctance or hesitation or lingering concern still among
14 many, many, many consumers. Even if they use the
15 Internet, they have that difficulty in making a
16 transaction for thousands of dollars or hundreds of
17 dollars, certainly a casket sale, when you don't have the
18 interaction or intervention of state government over that
19 sale.

20 So, our argument is -- and it's been accepted
21 by some providers already -- that if you voluntarily
22 submit to the state regulation, you can utilize these
23 associated marketing benefits to help instill consumer
24 confidence in your transaction and significantly increase
25 your sales in Maryland.

1 We think that as regulators around the country
2 that we need more than just the Maryland approach as a
3 voluntary program of licensure. We're asking the Federal
4 Government to give us some direction. Some people please
5 sort it out for us, Federal Government, on the Internet.
6 Tell us how you want the states to proceed. What is our
7 proper regulatory role in this growing sales medium?

8 In my opinion, and I'll be happy to restate it
9 and discuss it, the Maryland model regulates all
10 providers, and that's open competition as much as it is
11 regulating no providers. Open competition is being
12 treated equally and the same, and that's the way we would
13 do it in Maryland. All vendors of caskets are regulated
14 and licensed and we'd like to see that extended to the
15 Internet, as well, by a Federal direction either from the
16 FTC or by Congress.

17 We think that consumers will be better
18 protected. They'll have the assurance of qualified
19 vendors, contractual disclosures, security of trusting,
20 cancellation and refund rights, real time information and
21 assistance from regulators, the marketing integrity of
22 advertising and representations, the availability of
23 complaint mediation, disciplinary action. Our conclusion
24 is, why would any, any consumer not prefer competitive
25 pricing with universal regulation by their own state

1 government? We think that's the way to increase sales
2 over the Internet.

3 MS. OHLHAUSEN: Thank you, Steve. Betty?

4 MS. BROWN: Hi, I'm Betty Brown. I'm Vice
5 Chair of the National Casket Retailers Association. I'm
6 here with Al Barnes of the California Retailers
7 Association. Thank you first for having us here.

8 I also would like to say when I'm speaking
9 negatively of any funeral directors today, it is not the
10 whole group. Many fine, upstanding people have chosen to
11 work in this field and do it well. As we meet the
12 changing environment and the challenges, it is the NFDA
13 and their like associations who have, I just understood,
14 been offering us a voice, as well as the FTC in these
15 proceedings. So, thank you for that.

16 While it is not below cost pricing that drives
17 the industry to monopolize this field, it is, we can
18 show, groups of firms working together to monopolize
19 these markets in casket retailing and grave liner sales.
20 The dominant casket manufacturers refused to sell
21 directly to casket store owners, such as Batesville,
22 Aurora and York. It is said that they have 80 percent
23 and up of the market when a casket is sold.

24 Some third party retailers can get the dominant
25 casket brands; however, only by the retailer being forced

1 to go through a licensed funeral director that is
2 sometimes found on the Internet or locally and open to
3 making more of an income by acting as a broker.

4 Batesville, a division of Hillenbrand, had
5 sales of \$2.1 billion last year, has in place a
6 distribution policy that only licensed funeral directors
7 in the state that the sale is in will be permitted to be
8 the one ordering the product from the local warehouse
9 servicing that funeral home. This restricts competition
10 considerably.

11 Internet sales have slowed down considerably
12 due to this now being enforced. Lawsuits have also
13 opened up from them to retailers doing business on the
14 Internet to stop the practice of making the product
15 available to the public by casket store retailers not
16 having or owning a funeral home.

17 I, myself, when we started five years ago, used
18 to have more sales to the public in California, over my
19 web site for example, than in Ohio. Now, however, sales
20 tactics by some morticians having the last look by using
21 unfairly a bundled package that I cannot compete against,
22 and this restriction of Batesville's product, our store
23 has not had a sale to a customer in California for over a
24 year.

25 However, recently Jackie Tubbs found us on the

1 Internet at burialitems.com and wrote us a glowing letter
2 stating. "Because of the way the Louisiana laws are
3 written concerning purchasing caskets out of state, the
4 consumer is led to believe they can't do that."

5 The same holds true for those states where this
6 regulation has not been overturned, still trying to
7 restrict Internet sales of caskets by strongholds in
8 place, implying college is needed to sell 120 feet of
9 wood making up a casket.

10 On the Internet and locally we have met
11 roadblocks of a mortician unfairly using his or her state
12 funeral director's license to be the last one to offer
13 the family a discount. Retailers have lost sales due to
14 morticians having the last look by offering the customer
15 a package or a bundled deal that includes a funeral
16 service, against which the casket store owner cannot
17 compete.

18 Let them only have one price, not two sheets,
19 not one to be able to show, a state funeral director's
20 license unfairly competing against us or bundling the
21 goods in with their services.

22 In outer burial container sales, dominant are
23 Wilbert, Doric, Eagle and Trigard.

24 I'm located in Ohio. I have to, unfortunately
25 tell my long distance prospective customer, not always in

1 all states can we find a concrete supplier that will sell
2 to us, a casket retailer. This is due to the market
3 being locked in by those in the field far before us.

4 In going to Funeral.com and doing a search on
5 their site for concrete liners, only the Wilbert brand
6 comes up; however, no simple concrete grave liner, which
7 is, by the way, the standard government issue for all
8 families buried in the veterans cemeteries.

9 In all the Continental United States, there are
10 no territories left for sale. They are all sewed up.
11 One dealer might cover a fifth of a state and another may
12 overlap the area, but no dealer is permitted to install
13 or deliver into another's territory except by a transfer
14 of sale, and any dealer can refuse, and has, a transfer
15 sale once they find out it is from a casket retailer
16 instead of a mortician.

17 Yet requesting a wholesale purchase of a
18 concrete grave liner that does not require a transfer as
19 the main distributor does not even manufacture them,
20 however, though, it is again put up as a restriction.

21 I recently sold a concrete grave liner to a
22 woman in Houston, Texas. I collected \$525 for it. She
23 said I saved her \$400 for a basic concrete vault. When
24 adding the savings on a casket, we are talking a lot of
25 cash, big discounts and frequent blockades in procuring

1 both of these products.

2 The industry is smug in knowing boycotting and
3 dealings go on and might be hard to prove, but it happens
4 often. Funeral directors, casket manufacturers and
5 dealers for vaults are often guilty of abusing so-called
6 monopoly power to stifle competition. There are many web
7 sites that hold up the FTC as an example of the Funeral
8 Rule, and copying in part it says, it may be less
9 expensive to buy an outer burial container from a third
10 party dealer than from a funeral home or cemetery.
11 Compare prices from several sources before you select a
12 model.

13 Sadly, much of the public has no idea what a
14 third party seller or dealer is. If the National Casket
15 Retailers Association web site, www.casketstores.com,
16 information were added to the FTC references, along with
17 those of the NFDA and others whenever the FTC is quoted
18 or read, the public could then find out about the third
19 party sellers and other important information to allow
20 freedom of choice.

21 The Institute for Justice, on their web site,
22 states, the funeral business is big business. Each year,
23 Americans arrange more than two million funerals for
24 family and friends. For most of us, that means about
25 once every 14 years. The estimated 22,000 plus funeral

1 establishments handle most of these two million funerals
2 across America.

3 Nationwide, the funeral business is \$25 billion
4 per year industry. The consumer funeral product market
5 has dominant players, not because their product is any
6 better than others, as evidenced by a class action
7 lawsuit in California against Batesville and SCI about
8 deteriorating caskets to the tune of \$3.75 million, or
9 another action coming up in Missouri against a vault
10 company, but due to the many strongholds and restrictions
11 in place trying to keep profits and prices high.

12 In issues not relevant to selling caskets or
13 funeral product online, on the Internet, name brand is
14 not what is shopped for, or "try before you buy"
15 necessity for size or looks, to desire to be able to try
16 the scent of the perfume or even having massive amounts
17 of the same product available for delivery to any one
18 area.

19 While not all units fit all sizes, the weight
20 and the height of a person is the standard practice to
21 determine which product is best suited because many
22 Internet outlets do not have a store or do not store the
23 product, meaning they drop ship from the source, as do
24 many local funeral directors. Product of every available
25 size, color or manufactured brand on hand is not a

1 requirement. Nor is it an issue on the Internet that the
2 manufacturers' products are being sold for a higher cost
3 than the brick and mortar storefront that's overcharging
4 for goods and giving the firm a bad reputation for
5 Internet sales.

6 It is instead the holding of the price
7 artificially high at the local funeral parlor that makes
8 the customer upset when they see discounted goods online
9 and they need to show perhaps a casket salesperson at the
10 parlor a discounted price in order to get a good deal,
11 then it will automatically be discounted by several
12 hundred dollars, that upsets the public.

13 It could be the practice of the funeral
14 director to use the Internet to direct the public to
15 their brick and mortar offices saying that there they
16 would find a substantial or significant discount for
17 funeral product, but that's not what's done. However
18 it's done, it's practiced that discounts are selectively
19 given only to the consumers who have studied the prices
20 and offered to go outside of the parlor to get a decent
21 price on funeral goods.

22 The whole situation boils down to this. A
23 casket store retailer is simply another way of doing
24 business and offering the public a choice of funeral
25 product, bargains they will never get without competition

1 in the death care industry. Advertising on the Internet
2 is not fair, as well, because many sites don't suggest
3 that the owner is indeed a mortician instead of an
4 independent casket retailer, and I think that's one issue
5 that we have to address.

6 It's like perhaps needing to fill a
7 prescription at a pharmacy. The doctor has offered the
8 patient a choice of a name brand drug or a generic. The
9 pharmacy fills your order, period. One brand is \$81 and
10 the other being equal to or better than, the generic, is
11 only \$28. The druggist offers no resistance to the
12 choice of the generic, no slanderous remarks or upsale to
13 the higher priced name brand, as it should be. While the
14 druggist who has become licensed to do his job may make
15 money on the sale of goods in his store, he allows
16 freedom of choice. As the CVS drugstore tells me, when
17 people have a choice, the purchase of the generic over
18 the higher priced name brand is as high as 80 percent
19 when they elect to go to the savings. We really do not
20 desire to offer our customers the name brands to keep
21 their prices artificially high. We have a product that
22 is equal to or better than at a lesser price.

23 Caskets are not purchased by name brand as a
24 rule, hardly ever, grave liners even less. If so, it is
25 only part of a sales pitch by our rivals. We do,

1 however, want to close that gap when the funeral director
2 says we cannot offer them as one of their selling points.
3 Prices will come back down on those caskets and
4 slanderous remarks will be put to rest. The American
5 people will then only have freedom of choice when they
6 are not held captive to higher prices or monopolistic
7 firms, and that's what this is all about.

8 MS. OHLHAUSEN: Thank you, Betty. It doesn't
9 look like Lisa's going to make it. I'm not sure where
10 she is, whether she's in New Hampshire or at Dulles
11 Airport desperately trying to get here. But we'll
12 proceed.

13 What we're going to do now is I have several
14 questions that I'd like to put to the panelists. The way
15 I'm going to start out is I'll ask one or two people
16 directly about the question and then if anyone else wants
17 to weigh in, turn your little name tent this way and I'll
18 know that you're interested in participating. Then we'll
19 turn eventually to some of the questions from the
20 audience.

21 In my first question, which I'm going to
22 address first to Clark and then to Bob, there is an issue
23 about how much the states actually regulate online sales.
24 They don't say "no online sales", but they say something
25 like, you have to sell it out of a funeral home and you

1 have to have these physical facilities.

2 So, how prominent is that or how prevalent is
3 that and basically how many states do that? Clark?

4 MR. NEILY: Well, certainly in Oklahoma, as I
5 mentioned earlier, it completely eliminates the
6 possibility of doing business in the standard Internet
7 form. You have to have a physical location with all of
8 the types of facilities that a funeral director or a
9 funeral home would have to have, and of course, as I
10 mentioned earlier, that eliminates the possibility of
11 doing business in a brick and mortar -- I mean, in an
12 Internet form.

13 Unfortunately, I can't speak to how many states
14 have similar requirements in terms of the physical
15 facilities, but one thing I can note is a real irony in
16 the regulatory regime in Oklahoma. I think this applies
17 to other places as well. Oklahoma contends that it's
18 very interested in protecting consumers, and particularly
19 from people doing business over the Internet, because of
20 the more difficult enforcement issues that they think
21 might arise. But the real irony in Oklahoma is this. My
22 clients, Kim Powers and Dennis Bridges, are allowed to
23 sell their caskets to any other state apparently in the
24 country despite the fact that they're not licensed
25 funeral directors. Oklahoma, in other words, does not

1 try to regulate those sales, even though they're
2 physically located within the State of Oklahoma.

3 By the same token, the state board, at least up
4 until this point, has taken the position that any
5 licensed -- or any unlicensed person outside the State of
6 Oklahoma may sell caskets to Oklahoma consumers. So, the
7 only transaction that's not regulated by the State of
8 Oklahoma is someone within the State of Oklahoma selling
9 a casket over the Internet or from brick and mortar to a
10 resident of the same state. And I think that completely
11 undercuts the state's purported concern about consumer
12 regulation.

13 If they really thought they had a legitimate
14 consumer regulation motive here, then it seems to me they
15 would regulate all sales even handedly. They don't do
16 that. I think the reason they don't do that is because
17 they understand that the purported consumer protection
18 rationale would just absolutely crumble if they actually
19 had to go in and defend it on the merits as they would if
20 they got into an interstate commerce type claim in trying
21 to defend those statutes.

22 MS. OHLHAUSEN: Thanks. Bob?

23 MR. VANDENBERGH: Well, again, I do not have
24 the statistics regarding the Internet. I know that there
25 are 14 states that have statutes on their books that

1 address third party sales, and I believe that there are
2 four of these states, of which Clark has mentioned, I
3 believe, in his presentation, that actively enforce these
4 rules and regulations. But I have no data on the
5 Internet actual use of it to be honest.

6 MS. OHLHAUSEN: Thanks. David?

7 MR. HARRINGTON: Well, one thing that Kathy
8 Krynski and I did for our paper on the effect of state
9 regulations on the choice of whether to be cremated or
10 buried is that we did figure out which states require
11 funeral directors to be embalmers and which states
12 require funeral homes to have embalming preparation
13 rooms, which tends to be correlated with a lot of other
14 facility requirements.

15 Now, I didn't -- when I read Clark's testimony
16 and Bob's testimony, I didn't go back and compare it with
17 what's in here. But basically the 14 states that have
18 the regulation that you are prohibited from selling
19 caskets unless you are a funeral director overlap almost
20 entirely, I believe, although I haven't checked it
21 exactly, with those states that require funeral directors
22 to be embalmers and funeral homes to have embalming
23 preparation rooms; i.e., the states which tend to be
24 heavily regulated in one dimension tend to be heavily
25 regulated in the other dimension, and so I would think

1 that most of those states that have that prohibition
2 against anybody other than funeral directors selling
3 caskets, are also effectively requiring that those
4 funeral directors be embalmers and be selling it within a
5 facility that has embalming preparation rooms.

6 MS. OHLHAUSEN: Thank you. Betty?

7 MS. BROWN: First, I want to disagree with the
8 National Funeral Directors Association saying that
9 retailers are freely selling caskets all throughout the
10 United States.

11 Louisiana has a court case against Jerry Womack
12 who was delivering caskets from his daughter's casket
13 store in Mississippi, and they have disallowed him and he
14 has a court date in January against that. And in one of
15 the funeral trade magazines, there is a cemetery who has
16 a court case in North Carolina. He has a cease and
17 desist order, also, to stop selling caskets. So, caskets
18 cannot -- it's selectively, I think, maybe, but they
19 cannot sell caskets really throughout the United States.

20 MS. OHLHAUSEN: Thank you. Another question
21 that is in my mind is, there could be a price effect for
22 consumers from some of these regulations, but there's
23 also an effect on consumer choice, the types and variety
24 of caskets that would be available to them.

25 Mark, I was hoping maybe you could discuss what

1 kinds of caskets are typically carried by a funeral home
2 and then perhaps what kinds are more widely available if
3 you go outside the models that a typical funeral home
4 would carry.

5 MR. KRAUSE: Okay. Well, typically, funeral
6 homes have a wide variety of different caskets from which
7 to choose. Actually, one of the interesting trends out
8 in the marketplace is the elimination of selection rooms
9 and people selecting from books or from computer
10 programs, which really opens up the variety of caskets
11 which can be offered.

12 Even at funeral homes that do have selection
13 rooms, they still have access to catalogs and books and
14 pictures so that there's just a plethora of variety from
15 which to pick from.

16 You know, something I think that's important,
17 that needs to be addressed when looking at caskets and
18 choosing whether it's a wood casket or a metal casket,
19 one that's protective, one that's not, there's just a ton
20 of variety, is that when you're comparing caskets -- and
21 the consumer needs to be wary of this -- is that they're
22 actually comparing apples to apples -- is the oak casket
23 that they can get inexpensively over here, is it the same
24 kind of an oak casket, is the quality the same, is it a
25 veneer oak, is it a solid oak? There's quality

1 differences that the consumer should be wary of and needs
2 to be in tune with.

3 There's different items of personalization that
4 are offered with some caskets that aren't with others.
5 So, there's just a huge variety.

6 The ones that -- interestingly, the casket
7 retailers, they don't seem to be short of any product.
8 There's plenty of product available for them to offer to
9 consumers, also. There's people that will sell them
10 caskets that they can sell over the Internet to the
11 consumers. So, that being an issue why some people won't
12 sell them or this or that, I guess that's for the casket
13 companies. That's their business plan.

14 MS. OHLHAUSEN: Bob, maybe you could address
15 whether, in the training for a funeral director, is there
16 training that is involved with the different types of
17 caskets that are available? Is that part of the standard
18 training?

19 MR. VANDENBERGH: There is. There is
20 usually --

21 MS. OHLHAUSEN: I realize it varies from state
22 to state, of course.

23 MR. VANDENBERGH: Right, and from school to
24 school. And most of the schools now have some sort of a
25 marketing course that students are required to take, but

1 you have to realize that it is very, very rare that a
2 newly licensed or newly schooled person would be involved
3 with the arrangements with the family. And so, it is
4 years of that.

5 As in any product, the casket suppliers do
6 offer workshops and a lot of printed materials that do
7 this. Of course, over the years, too, with the advent of
8 the new laws and things, there are restrictions as to
9 what a funeral director can say. I've been in funeral
10 service for 35 years, and when I first began, you know,
11 sealing caskets were like the new thing then and it was a
12 very big thing and everything -- the best, it was a
13 sealed casket.

14 Well, today, that's not even an issue. Sealed
15 caskets are not an issue. And so, that has changed a
16 lot.

17 Casket selections are family preference. They
18 truly are. I mean, they are. Caskets, as many as there
19 are, they're made out of two things. They're either made
20 out of metal or they're made out of wood, and they're
21 finished different ways and there are some varieties of
22 species of wood. So, it is two basic elements that they
23 come from.

24 But, yes, students are given some direction in
25 this. Whether it actually is used, every funeral home

1 and every funeral director has their own methods of doing
2 that. I mean, an example again, our firm, the family
3 enters a selection room totally on their own and it is
4 totally their decision to make the decisions they wish
5 to. If they have questions, they are helped. But
6 there's no, you know, let's kick this tire, let's look at
7 this one. That's not the way that we operate. And I
8 know there are many other funeral directors in the
9 country that do that same thing. I'm not saying that
10 there aren't those out there that do sell, so to speak.
11 But there are marketing methods, there truly are.

12 MS. OHLHAUSEN: Mark, did you want to say --

13 MR. KRAUSE: Betty was first.

14 MS. OHLHAUSEN: Oh, I'm sorry, go ahead, Betty.

15 MS. BROWN: I just wanted to mention free
16 riding or others pocketing the commission on the sale of
17 goods when others offer the service or support for it
18 does not apply to the funeral related product such as
19 caskets or outer burial containers. They have warranties
20 which are passed on to the manufacturer whenever needed.
21 Support is very limited, I might add, because once in the
22 ground, most often a matter of days after the purchase,
23 not many are ever seen again. So, it cannot be said low
24 service versus high service is an issue.

25 Name brand, we have found, because an average

1 family might only arrange a funeral once every 14 years,
2 they don't have a good history of what was the product
3 they purchased a decade ago. So, it's not name brand as
4 much. In having some restrictions on the Internet for
5 what product we offer or not, we would want to be
6 included because the funeral directors are the only
7 dealers for these products and they have a large
8 marketplace offering their product to their very own
9 select customers.

10 So, if we are permitted to sell that product,
11 then the price would come back down to more reasonable
12 for that different product.

13 MS. OHLHAUSEN: Thank you, Betty. Mark?

14 MR. KRAUSE: Just to reinforce some of the
15 things that Bob mentioned here. The education factor --
16 selling a casket is not rocket science. You don't need
17 to be a funeral director, to be educated at a mortuary
18 school to do these things.

19 Over the course of time, where the focus used
20 to be on the function and the type of casket it was, it's
21 really come back to, the personal choice of the family.
22 Was the guy a cabinet maker? Maybe they want a wood
23 casket. Maybe he worked in a machine shop and wants a
24 stainless steel -- that's really where the focus is. You
25 don't have to be a technician to sell a casket.

1 Absolutely.

2 MS. OHLHAUSEN: Thank you. The other issue
3 that was brought up is the consumer protection angle in
4 casket sales. I was going to ask Steve if he could
5 address some of the problems that consumers do run into
6 when they purchase caskets that you've seen in Maryland,
7 at least.

8 MR. SKLAR: Well, I think if you've seen Six
9 Feet Under, there was a good -- can I allude to that one?
10 Is that all right? HBO.

11 They had a segment on there involving a
12 football player that expired in practice and his parents
13 came into the funeral home to get arrangements made, and
14 they got to the point where the funeral director asked
15 what casket they would want. They said, well, we don't
16 know, what do you suggest. And the director said, I
17 think the Titan would be a good choice for you. And they
18 said, well, how much is that. And he said, \$9,000. They
19 said -- well, you know, the husband looks to the wife and
20 they're of modest means, but he said, well, if that's
21 what it costs, I guess we'll go with it.

22 That's the kind of problem we get, not quite
23 the \$9,000, but we get people who are in the hands of
24 their cemetery salesperson asking for advice. And there
25 are people who would sell them a little higher than maybe

1 a means test would indicate would be appropriate. We
2 found that out, you know, when a surviving child or
3 spouse comes to us with what the amount paid was, and we
4 go back into that transaction.

5 The difficulty is, is that we expect a person
6 who signs a contract -- the law presumes they have the
7 rationality and the capability, the capacity to sign that
8 contract. When we're dealing with this kind of
9 merchandise, and I think that's why we regulate it by
10 statute, we understand in the law implicitly that this is
11 the type of transaction at a time in a person's life
12 where they may not be as rational and reasonable and have
13 the capacity that we presume when they sign a contract
14 and any other transaction.

15 The difficulty with an Internet sale is that we
16 may not have the opportunity for this give and take
17 personal exchange. We don't have a face-to-face meeting
18 where the vendor can assess properly either the composure
19 or the condition of the individual, may not be able to
20 ask about economic means because there will be a few cues
21 there that they would want to ask from observation.

22 It's a little bit of a qualm for us on the one
23 hand to encourage open competition which will drive down
24 prices for consumers on the one hand, and on the other
25 hand, I think Bob's statement indicated that how we

1 adequately protect consumers, as well, in a protectionist
2 mode from government. We want a balance to be there. We
3 want open competition, and yet, we want all competitors
4 to be under the same kind of oversight of government.
5 That's my feeling. That the Internet shouldn't be
6 restricted in any way or prejudiced in any way. They
7 ought to have the same ground rules apply to them as any
8 other provider. And if I felt that the state had
9 constitutional or Federal directives to do that, I would
10 make it mandatory to regulate those providers, too. I
11 would have all providers regulated under the same rules
12 as a protection and a level playing field for not only
13 them, but for the consumers particularly.

14 MS. OHLHAUSEN: Thank you, Steve. I think --
15 David, were you next?

16 MR. HARRINGTON: I don't know. I didn't look
17 to the left.

18 MS. OHLHAUSEN: Okay.

19 MR. HARRINGTON: I just have one small comment
20 to make. I mean, one of the motivations for regulation
21 is because people are vulnerable, and you hear that a
22 lot. But it's possible that these regulations create
23 barriers to the entry of new firms, and so, you have less
24 competition, you have less variety in those types of
25 firms.

1 And so, actually, I think that they can make
2 consumers more vulnerable because consumers don't have as
3 many alternative types of firms because the regulations
4 create a certain homogeneity in the types of firms that
5 are available. I think that if you're actually worrying
6 about vulnerable consumers, you're probably better off
7 having some regulation, but there's no reason, for
8 instance, that every funeral director has to be an
9 embalmer. So, you can license your funeral directors
10 without making them be embalmers and that reduces the
11 entry costs of getting into the industry and will offer
12 far greater variety in funeral directors, and that may
13 actually be better for vulnerable consumers than actually
14 thinking about creating these regulations that create
15 barriers to entry.

16 MR. SKLAR: Well, our barrier system --
17 clarification, Madam Moderator. Our barrier is that they
18 have to be in business and above 21 in age and not be on
19 parole, and they're in. So, that doesn't keep too many
20 people out.

21 MR. HARRINGTON: That seems pretty reasonable.

22 MS. OHLHAUSEN: I'll just go this way. Mark?

23 MR. KRAUSE: A couple of things. I agree with
24 David. There should be separate licenses for funeral
25 directors and embalmists. They're two completely

1 different areas, and I think that's an important point,
2 and thank you for mentioning that, Steven.

3 The best way to protect a consumer is to find
4 out before that awful day happens and educate yourself
5 and compare and shop. I mean, that's the way the
6 consumer can best protect themselves, which kind of
7 brings me back to one of my points at the beginning.
8 With Internet casket sales, how is the consumer's
9 investment in that casket protected if that retailer all
10 of a sudden disappears or goes out of business without
11 any trusting limits?

12 MS. OHLHAUSEN: Thank you. Bob?

13 MR. VANDENBERGH: A couple of things. I also
14 agree with David. In fact, that used to be the practice.
15 It used to be that there were two separate licenses for
16 many years. It was done for a reason, so that a husband
17 and wife could operate a funeral establishment and the
18 wife, necessarily, would never be involved with embalming
19 back then and so she would hold a funeral director's
20 license and could run the business if something happened
21 to her husband. And then as things progressed and it got
22 more technical, they combined the licenses.

23 But now because of the possibilities of
24 shortages of employees, believe it or not, they're
25 starting to revisit this question of should there be

1 separate licenses. So, you may see that.

2 Will it change the entry law? It may, it may.
3 There are some large states that do have those laws and
4 I've watched them go through that.

5 To the competition and the regulation, that is
6 our whole premise. You know, the original FTC rule,
7 which was set up to increase competition, which it did by
8 making prices available to everyone, and it was set up to
9 protect the consumer with disclosures and things, and
10 it's done a fine job doing that.

11 Our contention is the marketplace has changed
12 and there's new people that are into it, and to do the
13 same things, they should all be included underneath this
14 rule now. I mean, we're like any profession. We don't
15 want any more regulation either. But we realize that
16 what is there is good and it's served its purpose and
17 it's doing what it does. However, now, there are these
18 other areas -- and there's nothing wrong with that.
19 Competition is a great thing.

20 In response to Betty's thing, our response was
21 to Internet, Betty, not to the 14 -- we realize that
22 there are states that do have regulations against that,
23 but on the Internet there are none. But our contention
24 is that there are these new people involved in it and
25 that's great. But because of that, the regulations that

1 were good enough in 1984 to protect the consumers and
2 increase competition were good then, they're good today,
3 and they need to be addressed that way.

4 MS. OHLHAUSEN: Thank you. Betty?

5 MS. BROWN: A couple things. Our showroom must
6 be a little bigger than yours, Robert. We offer three
7 kinds of caskets. We have fiberglass, too.

8 MR. VANDENBERGH: We don't show fiberglass.

9 MS. BROWN: But then, also, for protecting the
10 public, I think it's very important that Internet web
11 sites distinguish the difference between a casket
12 retailer and a mortician. I don't think that the
13 mortician always gives the best price, and if a family
14 thinks that they're going to go shopping online and they
15 can see a casket store, not knowing that it's actually a
16 funeral director, then he might stop looking. Where if
17 he's seen on a web site that indeed it was a mortician or
18 an independent casket store, then he would be able to
19 have the opportunity to continue shopping or not.

20 Addressing coming underneath the Funeral Rule,
21 we don't disagree if that was a problem. But in the last
22 six years, retailers have never had any class action
23 suits, we haven't ever gotten any bad publicity or been
24 dragged through the mud. We've been very good about
25 putting the people's product in their hand after they've

1 purchased it.

2 And concerning pre-need, in the State of Ohio,
3 I'm required to trust 100 percent of the funds, just like
4 a funeral director. The Ohio Embalmers and State Funeral
5 Directors Board made that a ruling and, fine, we don't
6 have a problem dealing with that. I don't think the
7 retailers need to go underneath the FTC rule as much as
8 perhaps state rulings for pre-need.

9 MS. OHLHAUSEN: Right now, I wanted to turn to
10 some of the questions that I got from the audience. One
11 says, Mr. Vandenberg says traditional consumer
12 protection remedies are not always applicable in casket
13 sales, and they wanted to know why not? Like, for
14 example, the FTC Act certainly would apply to interstate
15 casket sales. So, what is the difference with casket
16 sales that they wouldn't fall under just the general
17 anti-fraud stuff?

18 MR. VANDENBERGH: The difference that I see in
19 this is the act that is connected with that product,
20 which is truly a unique one. And until you've sat at a
21 table making arrangements for the family, you don't know
22 what that is. It is not something that you can say, next
23 Tuesday, we can have this available for you. It's -- we
24 want this available today. It's a unique situation. I
25 mean, every day we deal with people who are emotionally

1 distraught and they are in a different frame of mind, and
2 we realize that and we have to work with that.

3 So, we have to know that this is a unique
4 situation and we have to be able to and willing to do
5 everything to help them through this situation. So, it's
6 not like we can say, okay, this will be available maybe
7 or this is on sale or this isn't on sale. It's not
8 handled that way. I don't think it ever will be able to
9 be handled that way. Many people today are looking at
10 pre-need as a solution to many things. I mean, people
11 are told over and over again, deal with this before you
12 have to deal with it, and we're seeing more of that. So,
13 that changes this dynamics, also. People come in and
14 they are in a shopping mode.

15 I mean, for our firm today, we see people
16 shopping funerals every day. I had a gentleman come in
17 the other day that had eight general price lists when he
18 came into our building, which was great, you know. And
19 he came and he had all the information and he knew what
20 he wanted, and he was shopping funeral homes.

21 It's different. It is different. And there
22 wasn't this impending need. He had been told his wife
23 was going to die and he needed to do this.

24 So, some of those traditional rules, those
25 things of dealing with the consumer and satisfaction

1 change and we have to be ready and able to meet that
2 need. Sometimes it does cause problems, it does cause
3 problems for us to say, oh, yeah, you want this pink
4 casket, but you want a white interior in it, and it's
5 Sunday afternoon and you want Mom in state tonight, can I
6 do that for you. I don't know if I can or not. It's
7 very important to me. And so, it's a unique sale, but
8 it's -- you've got to view it in the whole concept of
9 what it is that's going on in conjunction with the sale
10 of that product.

11 MS. OHLHAUSEN: So, it sounds like you have now
12 more consumers who are shopping ahead. Do you think that
13 that is because of Internet sales or because of the FTC's
14 Funeral Rule or just consumer awareness in general
15 growing?

16 MR. VANDENBERGH: I think a lot of it is
17 consumer knowledge in general, plus the information is
18 put out. I mean, people hear it over and over again.
19 AARP tells people, shop funerals. Don't necessarily pay
20 them, shop them. You hear this over and over again. And
21 the FTC rule has done that. It has encouraged people to
22 -- because they know they can come and ask for these
23 documents and get them. They're supposed to get them.
24 And it has encouraged that. People know that it is a big
25 purchase. But there's a lot of other things involved. I

1 mean, it's not unusual -- and I'm sure Mark could say
2 this, too, for family to come in and virtually interview
3 me or my staff to see if I'm comfortable with you, you
4 know, are you the person that I want to entrust this to.

5 Is that different? It sure is. Back when I
6 first started, a funeral was kind of a cookie cutter type
7 thing. I mean, it was this way, this way, this way, and
8 this is what people got. Today, that's not. You know,
9 the consumer has been empowered to look at things and to
10 decide whether the dollar that they are spending is the
11 way they wish to spend it. It is not unusual today at
12 all to see that.

13 MS. OHLHAUSEN: Thank you. Mark, did you want
14 to add something?

15 MR. KRAUSE: Boy, I just have to concur with
16 Bob. The consumer is very savvy. Last week, as I'm
17 literally reading testimony, we had a consumer come in
18 with an Internet casket sale, an Internet vault proposal,
19 prices from another funeral home, and sat down and said,
20 now, this is what I can get other places, what will you
21 do for me. And so, as a business person, I made the
22 business decision to match those prices and give him
23 comparable product.

24 I think I'm certainly entitled to do that.
25 It's a business decision at that point and that time, and

1 this happens very, very often. The consumer is coming in
2 looking and they're much more savvy than they were even
3 five years ago. I don't see the trend going in the other
4 direction, I see it continuing. The consumer is going to
5 shop and compare. In this business, we need to adjust to
6 that if we want to stay in business.

7 MS. OHLHAUSEN: Well, it sounds like the market
8 is changing and its in flux and with Clark's able actions
9 down in Oklahoma perhaps another state law will fall. I
10 know that there have been several other states where
11 courts have struck down similar restrictions. I wanted
12 to ask David if he has a prediction of where the market
13 is going and what some of these forces will ultimately do
14 to the market.

15 MR. HARRINGTON: Well, years and years and
16 years ago, I told my mother about how excited I was about
17 Amazon and she told me, well, why don't -- and this was
18 early on in Amazon, and she told me, well, why don't you
19 put \$1,000 into it. And so, I told her about the
20 efficient market hypothesis in economics and gave her a
21 little lecture on it. And for years thereafter, she told
22 me, but look at Amazon's price, it went up and up and up.
23 So, the bubble bursting in the tech stocks was good for
24 my relationship with my mother.

25 But now what I'm saying there is in terms of

1 prediction, it's hard to make a prediction as to where
2 these markets may go. I think that what we want to do is
3 allow them to go wherever they will go with no
4 impediments, only regulations that can be really
5 rationalized as being in consumers' interests. And so,
6 for instance, the fact that Internet companies or casket
7 companies right now make up a very small proportion of
8 the market, it sounds already like other firms are
9 reacting to their existence by, for instance, movement
10 away from selection rooms and maybe recognition that you
11 have to have greater variety and so forth.

12 And so, I think that what we want to do is just
13 basically think about what regulations may impede the
14 growth and where it would go in the most efficient and
15 beneficial way to consumers.

16 MS. OHLHAUSEN: I wanted to ask you a follow-up
17 to that. Steve presented a very interesting model in
18 Maryland where it's a registration kind of model. Is
19 that the kind of regulation that you think would be best
20 for the market in the future rather than the licensure
21 requirements where you have to have a professional
22 license?

23 MR. HARRINGTON: That certainly makes sense to
24 me for selling caskets. I mean, I'd have to --

25 MS. OHLHAUSEN: I just mean casket sales. I

1 don't mean other services.

2 MR. HARRINGTON: Right.

3 MS. OHLHAUSEN: Well, funeral goods, I should
4 say.

5 MR. HARRINGTON: Right. That sounds reasonable
6 to me.

7 MS. OHLHAUSEN: Okay. I think I have time for
8 one more audience question. Several people have
9 mentioned that they think the FTC's Funeral Rule should
10 be extended to sellers of funeral goods. Right now you
11 have to sell funeral goods and services to fall under the
12 rule, so that if you're just a stand-alone casket seller,
13 you're not required to comply. This question
14 asks, extending application of the FTC Funeral Rule to
15 all sellers of caskets and cremation services, et cetera,
16 what do you think the costs and benefits of that would
17 be? So, if anybody wants to weigh in on that?

18 MS. BROWN: Can I mention one thing?

19 MS. OHLHAUSEN: Sure, Betty.

20 MS. BROWN: This is the FTC book that is given
21 freely out, and on page 26 -- and I do think that the
22 Funeral Rule has benefitted shoppers a lot. But I don't
23 think that the Funeral Rule is being implemented the way
24 that it was supposed to have been directed. It states,
25 moreover, you cannot alter your price based upon the

1 particular selections of each customer. We don't believe
2 price matching should be an issue. We think that if you
3 have a license to be a funeral director, you shouldn't
4 use that unfairly to compete. If you have a price sheet
5 for a casket, I think that's what you're supposed to sell
6 that casket for.

7 So, I don't think the Funeral Rule is being
8 closely monitored enough already. I don't think that the
9 casket retailers object to being placed on it, but I
10 don't think, first, there's been a need, and second, I
11 think the budget needs to be a whole lot bigger than it
12 is to make sure that it's being followed for what it's
13 supposed to be.

14 MR. KRAUSE: Betty, I disagree with you on that
15 one. I don't think the rule does state that we can't go
16 above that price, but clearly the consumer is benefitting
17 by competition. This is a free market situation and the
18 FTC rule is actually -- in the shopping situation has
19 actually caused the consumer to benefit.

20 MS. BROWN: But it would be a free trade if I
21 had a funeral director's license as well. But you're
22 having the last look at that sale because you're using
23 your license to compete against me who doesn't have a
24 license. So, it can't be a free trade.

25 MR. KRAUSE: Betty, you can go to school and

1 get a license.

2 MS. BROWN: Four years in Ohio, sure.

3 MR. KRAUSE: Yeah.

4 MS. OHLHAUSEN: Steve, did you have a comment?

5 MR. SKLAR: Yes. The expansion or extension of
6 the Funeral Rule, I think most of our state regulators
7 would say okay, but that's not really as helpful as we
8 think state regulation is.

9 MS. OHLHAUSEN: Right.

10 MR. SKLAR: The real-time assistance, the real-
11 time complaint resolution, the other requirements that go
12 way beyond the pricing and the integrity of advertising
13 that's in -- and the itemization. There are many, many
14 more provisions in competent and comprehensive state
15 regulation that really should be in place than just the
16 expansion of the Funeral Rule.

17 Some information is better than no information,
18 we agree with that. But it's really no substitute for
19 comprehensive and meaningful state regulation.

20 If there isn't an expansion, I would suggest
21 that memorial retailers be involved with any recounting
22 of who's included. The cost of memorialization equals
23 and often exceeds that of a casket, and that is not
24 mentioned in the FTC Funeral Rule today and I think
25 consumers need that kind of protection and information as

1 well.

2 Also, I would suggest if there is a move to do
3 an expansion, that they make it clear that Internet is or
4 is not included. Don't leave it up to interpretation.
5 And that if it is included, this will give a cue to
6 states under their opt-out provision in the Funeral Rule
7 to get into Internet, to get involved with memorial sales
8 and to all death care burial goods or funeral goods
9 providers, for states to assume that regulatory function
10 as being suggested by the FTC's opt-out clause for
11 states, then we could get into a registration model for
12 death care burial goods or funeral goods providers and
13 make a meaningful protection for consumers while also
14 opening competition across the airwaves and for all other
15 types of retailers as well.

16 MS. OHLHAUSEN: Thanks, Steve. Bob?

17 MR. VANDENBERGH: In regards to the rule, our
18 contention is in its semantics, that expansion is not
19 what we would like. We would like strengthening of the
20 rule. We think the rule is a good rule and has done what
21 it wants to do, but it needs to be strengthened to
22 include these other participants now in the marketplace.

23 We are very concerned because of this advent
24 and increasing of the pre-need market, that there is a
25 real problem with this, and it has shown its face in many

1 states across the country. We think that this is a
2 serious thing that needs to be regulated and needs to be
3 controlled.

4 The trusting regulations right now vary. Most
5 states are 90 percent or higher. But there are still
6 some that are 70 percent. There is one state in the
7 country that is 50 percent, and they're trying to change
8 that. But we've learned a lot with what's going on. We
9 learned a lot with what happened in Noble, Georgia. We
10 learned a lot with what has happened in different states
11 in this country. We are truly concerned that with the
12 different players and everyone that is now in this
13 marketplace, that we need to find the ways of protecting
14 these consumers at this difficult time and with pre-need.

15 When people come to me making pre-arrangements,
16 they're biggest concern is that money is going to be
17 there when they need it. In our state, it's 100 percent.
18 So, it's going to be there. They want to know that if
19 they move from Michigan to Florida, they can take that
20 money with them. It is a very, very important thing
21 today, and more and more and more people are doing this.
22 So, we think that rule should be strengthened to make
23 sure that the pre-need situations that can develop are
24 covered.

25 MS. OHLHAUSEN: Thank you. Clark?

1 MR. NEILY: Well, thanks. I think in closing I
2 want to sort of get out what I think is the underlying
3 issue with the idea of expanding or strengthening the
4 Funeral Rule, and that is the real need to tailor
5 regulations to the actual situations that are presented.
6 I know we've heard this both in Tennessee and in Oklahoma
7 that, well, you know, it's not fair because casket
8 retailers aren't covered by the Funeral Rule.

9 If you think about what the Funeral Rule really
10 requires, it's basically price disclosure, no bundling
11 and honest information about what's really required.
12 Well, casket retailers already disclose all their prices.
13 They won't make sales if they don't. You go onto any --
14 almost any Internet casket site and the prices are right
15 there, because how else are they going to sell a casket?

16 In terms of bundling, it's just not something
17 that comes up because they don't do services. And then
18 as to honest disclosure of information, I've never heard
19 that that's been a problem. I certainly am not aware of
20 any casket retailers that are telling people you do or
21 don't have to have a body embalmed because they're not
22 going to make money from doing that.

23 So, again, we've seen this in Oklahoma and I
24 think in Tennessee and I think also we've heard about it
25 here today, where you essentially get an argument that

1 there should be more regulation for regulation's sake,
2 and I think it's incredibly important to reject that.
3 That's a very anti-consumer point of view in my opinion.

4 What's very important is to make sure that
5 whatever regulation you're applying to the industry is
6 one that is specifically tailored to take care of proven
7 abuses or proven problems, consumer protection problems
8 in that industry and not simply imposing further
9 regulations for the sake of imposing regulations, because
10 we know that when that happens, there is very often a
11 special interest lurking somewhere behind that who
12 actually manages to benefit, and usually by exploiting
13 consumers as they have in Oklahoma, as they have in
14 Tennessee and elsewhere. So, I think it's narrow
15 tailoring to protect consumers from proven problems in
16 the marketplace.

17 MS. OHLHAUSEN: Thank you, Clark. We have
18 about five minutes left and what I wanted to do was give
19 each panelist an opportunity just to briefly sum up. So,
20 we'll go around in the same order and, if you would, keep
21 your remarks about one minute, if possible. We'll start
22 with Bob.

23 MR. VANDENBERGH: Thank you. To address what
24 Clark just said, we are not for increased regulation. We
25 are for protection. We, as I stated earlier, believe, in

1 fact, that the original FTC rule was set for that. I
2 mean, it came out of a minuscule amount of complaints.
3 It served its purpose, and the marketplace has changed
4 and it needs to include these folks that are now doing
5 this.

6 There is more involved with that. That rule,
7 even though it addresses these things, means far more
8 than that to the consumer. There is a feeling of that
9 there is protection there for a lot of things, and it
10 needs to be that, all of these people, so that they know
11 whoever they're buying their merchandise from or their
12 services from, that they are protected in some fashion.

13 It truly is, in dealing with people for the
14 years that I've dealt with them, I know that this is what
15 they want. They want to know that they are protected,
16 that their funds are secure, that they are getting what
17 they are being told that they are getting. And it is
18 important. There have been problems. We have third
19 party sellers in our area and there have been lawsuits.
20 There's a huge lawsuit that I know one was involved with.
21 So, there have been problems, and so, that's something
22 you cannot deny or look the other way at.

23 But we are looking for a leveling of the
24 playing field, so to speak, for lack of a better word.
25 But I think it's really truly more than that. Thank you.

1 MS. OHLHAUSEN: Thank you. Mark?

2 MR. KRAUSE: Just to reiterate a couple of
3 points again. Absolutely you don't need a funeral
4 director's license to sell a casket. Internet sales
5 should be allowed, absolutely. The consumer needs to be
6 educated. They need to figure out their funeral before
7 that awful day so that they can make wise decisions
8 without an emotional component there.

9 I think the FTC does a good job. Does the rule
10 need to be expanded? Absolutely not. There isn't any
11 justification for it. Where are the complaints?

12 One thing I would ask, you know, and one of the
13 things that is important is that when consumers are
14 comparing, that they realize that I'm going online, they
15 say I can get this casket and it's so much cheaper, make
16 sure it's apples to apples.

17 On the National Casket Retailers web site, the
18 very first thing, they have a \$5,000 reward being offered
19 by the National Casket Retailers Association for
20 information leading to the conviction of a member of the
21 funeral industry, including trade associations, for the
22 violation of the anti-trust law. Very interesting. I
23 could just see on the ICFA web site our very first thing
24 we put, if you find a casket retailer that is
25 misrepresenting their oak casket, which is an inferior

1 product, possibly, or lesser product, and say, well we
2 can give it to you for this price, we'll reward you
3 \$5,000. That doesn't do our industry well.

4 We need to be informed, we need to be upfront,
5 and I think the FTC does a good job at doing that
6 already. Thank you.

7 MS. OHLHAUSEN: Thank you, Mark. Clark?

8 MR. NEILY: Well, I think the last thing I
9 would want to leave with today is that -- the Internet
10 obviously has been wonderful -- the advent of the
11 Internet has just been wonderful for consumers. It is a
12 tremendously complex system, and one that I think we all
13 ought to bring a measure of humility when we try to
14 figure out how to regulate this thing that is so new.
15 It's not clear what the costs and benefits of the
16 Internet are going to be, and it's specifically not clear
17 what they might be in the sale of funeral merchandise.

18 I think it's very important to approach the
19 regulation of a new system like this with a real sense of
20 humility and not make predetermined assumptions about
21 what consumers can and can't do until there are
22 documented problems.

23 I mean, what we've heard here today, for
24 example, is that the market has changed and you see a
25 much more proactive consumer who goes out and does

1 research. I suspect that's especially true of consumers
2 who go on to the Internet to shop for their funeral
3 merchandise products.

4 And so, I think that, again, we should avoid
5 applying an outdated mode or a model of consumer behavior
6 to a system that is so clearly new and that so clearly
7 brings in a different kind of consumer who brings a
8 different set of tools to that transaction.

9 MS. OHLHAUSEN: Thank you. David?

10 MR. HARRINGTON: I guess what I'd like to leave
11 you with is that basically what little evidence we have
12 about the effects of state funeral regulations is that
13 they're costly. The benefits associated with state
14 funeral regulations tend to be ephemeral and difficult to
15 measure. So, I'm convinced that we've got too much state
16 regulation, not too little, and I think where the FTC
17 could be helpful is in trying to encourage a more -- or
18 to lessen the barriers to Internet sale of caskets. That
19 would be one way of starting the process of reducing the
20 amount of regulation.

21 Now, on some of the other panels, people asked,
22 well, what's the one thing the FTC could do, and the
23 lawyers tend to recommend bring a lawsuit. The academics
24 all recommend do more studies. And since I'm an
25 academic, I'm going to say more studies. It is really

1 amazing how little we know about funeral markets, and in
2 particular, how little we know about the effect of state
3 funeral regulations.

4 So, I think if the FTC was going to do one
5 thing, it would be to start looking at some of these
6 state regulations and what impact they have on different
7 industries.

8 MS. OHLHAUSEN: Thank you, David. Steve?

9 MR. SKLAR: Yeah, I would like to disagree that
10 there's too much regulation. I think there may be too
11 much restrictive, unnecessary legislation, but not too
12 much meaningful, helpful, protective state regulation
13 around the country.

14 Let's understand when we're in a position, as
15 regulators, as to gauge how vendors treat consumers and
16 where the problems come up. We have a pretty good
17 indication of how the market's going. We get hundreds
18 and hundreds and hundreds of inquiries a year, maybe 30
19 percent of those are complaints, others are assistance
20 requests. But we're able to see how people really need
21 information and assistance and objectivity and guidance
22 in there very difficult purchases at different times.
23 And we're not just dealing with people on the Internet.
24 They are sophisticated people, let's admit it. People
25 who are dealing over the Internet are sophisticated

1 people.

2 What we see are the ones who are maybe not so
3 sophisticated. We're seeing the elderly, we're seeing
4 the infirm, we're seeing the uneducated, we're seeing the
5 Alzheimer's, we're seeing the distraught. These are not
6 sophisticated consumers. If we want them to get on the
7 Internet, you know, and we wait for generational changes
8 for people who are used to this medium who are now using
9 it for this, too, that's one question. If we want to
10 accelerate this medium sales, that's another story.

11 We have to be in a protective mode and we have
12 to realize that we're here to help those who need the
13 help. If they want to avail themselves of the Internet,
14 they have to feel that the information they're getting on
15 that other side is fair, it's accurate, it's not
16 deceptive and that they can go to the regulator and take
17 it and say, is this right. That's why we're in place.

18 The expansion of the Funeral Rule to include
19 Internet or not to include it would be helpful to us as
20 regulators, where to take off on our own distinct
21 responsibilities. Please, FTC, act faster on whatever
22 action you contemplate in this matter, faster than the
23 one you've done on the expansion question.

24 MS. OHLHAUSEN: Thank you, Steve. Betty?

25 MS. BROWN: Hi. Thank you for allowing us here

1 again. Mentioning the reward that we offer on the NCRA
2 site, it is because we have had a long rough road even to
3 get in this market. There have been a lot of collusions,
4 there have been a lot of restrictions and things thrown
5 up in our face, even for different associations to say,
6 you know, watch what you're talking about in chat rooms.
7 So, you know that it does go on on how to stop our
8 success.

9 Let me mention, too, overall the Internet,
10 along with the implementation of the Funeral Rule,
11 assisted greatly in allowing prices to come down on
12 funeral costs. Now, however, with firms trying to
13 monopolize the field and funeral director associations
14 becoming teachers of how to slander casket store
15 retailers, these new channels for the public to have a
16 resource for bargains and many other choices are drying
17 up.

18 There are a handful of manufacturers, casket
19 manufacturers, left to resolve the large corporations
20 buying out some of the smaller firms. This also holds
21 true for vault companies. But yet, across the board, all
22 the major dominant vault companies and casket
23 manufacturers refuse to sell directly to casket
24 retailers. How is this possible that these firms are
25 allowed to eliminate the casket store trade and have only

1 licensed funeral directors without it all being a
2 collaboration to do so?

3 Without the knowledge that this happens, others
4 don't think much if one firm sells to another. Now,
5 however, the FTC and others should be very concerned
6 about the players in this marketplace, the sales or
7 purchases of death care industries to another firm. As
8 the sole dealer of these death care products, the funeral
9 directors for dominant brands have market power to
10 boycott and restrict what other players.

11 Some Americans may get out of this world
12 without ever operating a computer, flying in an airplane
13 or even making a telephone call, yet the abuse was there
14 in those industries enough to warrant action by the
15 government. Not many ever die and have final services
16 without a call to a funeral director and those purchases
17 associated with death. If indeed 99.9 percent would call
18 upon a funeral director for services and 70 to 85 percent
19 or more are sales to the dominant funeral good providers
20 in today's market, this is and has become a monopoly.

21 One last short thing.

22 MS. OHLHAUSEN: Actually, Betty, we have to
23 finish.

24 MS. BROWN: Okay.

25 MS. OHLHAUSEN: We have another panel. I want

1 to thank all the panelists very much for coming. I
2 appreciate all of your input. It was very, very helpful
3 to us. Thank you again. I just wanted to let the
4 audience know we're going to have a short break and we'll
5 reconvene at 3:00 when we have the panel for online legal
6 services. Thank you.

7 (Whereupon, at 2:52 p.m., the third session was
8 concluded.)

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FOURTH SESSION -- ONLINE LEGAL SERVICES

MR. CRUZ: Good afternoon, everyone, and welcome. Thank you for being here for this session of the FTC's ongoing public workshop into possible efforts to restrict competition over the Internet. This is going to be a fascinating panel. We're fortunate to have a very distinguished panel discussing online legal services.

I'm Ted Cruz, Director of the Office of Policy Planning at the FTC. This panel is going to be moderated by two attorneys in the Office of Policy Planning, Asheesh Agarwal and Mark Nance. And with nothing further, let's get the panel started.

MR. NANCE: Good afternoon, my name is Mark Nance and on behalf of my co-moderator, Asheesh Agarwal, welcome to the online legal services panel.

I'd like to lay out a few ground rules before we get started. Each panelist will receive three to five minutes for their initial remarks. We have a timekeeper seated in the first row who will display a one minute and then a stop sign at the conclusion of the five-minute period. I'd ask for your consideration for other panelists if you would please keep your remarks within

1 the five-minute period.

2 We will proceed in alphabetical order, and
3 following the conclusion of the prepared remarks, we will
4 have a question and answer period. Audience members will
5 be permitted to submit questions on the cards which are
6 outside the door, and we should have an assistant
7 available shortly to pick those up when you have the
8 questions prepared.

9 Without further ado, I'd like to thank the
10 panelists and begin the prepared comments with Mr.
11 Carlton.

12 MR. CARLTON: Thank you very much. It's great
13 to be here. I appreciate the invitation. I'm A.P.
14 Carlton. I'm a partner in Kilpatrick Stockton, a 520-
15 lawyer international law firm. I'm located in the
16 Raleigh, North Carolina office, and one of my partners is
17 the chair of the state bar's panel addressing our real
18 estate practice. I practice in the area and represent
19 clients before the state bar with respect to unauthorized
20 practice of law, and I am President of the American Bar
21 Association and I am here speaking for the American Bar
22 Association. The American Bar Association has long been
23 an advocate for the promotion of competition in consumer
24 welfare in the nation's economy. Today, the Internet
25 presents an exciting opportunity for creating new

1 competition and distributing both physical and digital
2 products, and in providing services. At the same time,
3 the Internet may pose a threat to the public interests in
4 other respects by undermining sectors of the economy that
5 serve the public efficiently and responsibly.

6 As the world's largest professional bar
7 association and the largest professional membership
8 association, the American Bar Association realizes that
9 there are substantial unmet legal needs in low and
10 moderate income households. The ABA took steps to
11 address this problem by convening a 1993 comprehensive
12 legal needs study. This study demonstrated that a large
13 percentage of the poor ignore and live with their legal
14 problems. Those of moderate income too frequently try to
15 solve the problems themselves without a lawyer and often
16 without the use of the justice system. The study also
17 demonstrated that people did not believe they had
18 adequate access to sources of information about their
19 legal problems.

20 Over the past few years, the Internet has made
21 a significant impact on the legal community. Many law
22 firms, including my own, have utilized technology by
23 developing web sites or listing themselves in online
24 directories. Both the web sites and the online
25 directories are perused routinely by people searching for

1 legal representation and information. In addition,
2 organizations that provide legal services such as Legal
3 Services Corporation, are online and provide increased
4 accessibility to those in under-served communities.

5 Of course, the Internet provides an
6 unparalleled opportunity for people to acquire
7 information in general and to learn more about legal
8 issues in particular. It gives them a full range of
9 options to address these problems often in more
10 affordable ways.

11 People can obtain fundamental information about
12 legal issues in order to make themselves more
13 knowledgeable consumers and to help them make decisions.
14 People can obtain specific information about legal
15 procedures that need to be followed to accomplish a legal
16 task. They can download forms on domestic violence,
17 paternity suits and small claim cases and the like, and
18 even use document assembly software that creates their
19 forms after they answer simple questions. When they need
20 fact-specific advice, people can e-mail lawyers or obtain
21 access to legal hotlines for their insight.

22 The delivery of legal resources in an online
23 world represents a evolutionary change from the delivery
24 of legal resources in an offline world. Some people are
25 intimidated by lawyers and may be hesitant to engage in a

1 face-to-face encounter with an attorney and, indeed,
2 research indicates that. And others who might have legal
3 problems that they consider to be embarrassing may prefer
4 to research their own legal problems through the
5 anonymity of the Internet.

6 While we have not quantified the impact of the
7 Internet on the delivery of legal services to those of
8 low and moderate incomes, anecdotal evidence suggests
9 that it is substantial. However, at the same time we
10 open the door for ready and affordable access to legal
11 services through technology, we also create an
12 exponential expansion of the risk that consumers will be
13 misled or be used by those who are not competent or
14 licensed to provide legal services.

15 The Internet facilitates abuses through its
16 anonymity. Consider the example of Marcus Arnold, the
17 subject of New York Times Magazine article last year
18 called, "Faking It: The Internet Revolution Has Nothing
19 To Do With NASDAQ." Marcus started participating in the
20 Internet knowledge exchange service called Ask Me. This
21 is an online service where people would e-mail questions
22 to experts who would give their advice. Among their
23 experts were Justin Anthony Wyrick who stated that he was
24 "a law expert with two years of formal training in the
25 law." I will help anyone I can. I have been involved in

1 trials, legal studies and certain forms of jurisprudence.
2 Mr. Wyrick answered over 100 legal questions a day. But
3 unfortunately, for anyone who was misled by his advice,
4 he was actually Marcus Arnold, a 15-year-old, whose
5 source of legal information was television shows.

6 This example illustrates a threshold problem
7 with the delivery of legal services. What constitutes
8 legal information as opposed to legal advice? Is the
9 distinction that legal information can be provided by
10 someone who is not a lawyer whereas legal advice requires
11 the skill and judgment of someone who is admitted to the
12 practice of law?

13 I have appointed an ABA Presidential Task Force
14 on the model definition of the practice of law to provide
15 some direction on this issue. I did that because of the
16 four-way intersection we have found where there's a
17 collision of four issues: Multi-disciplinary practice;
18 multi-jurisdictional practice; confidentiality of client
19 information; and, yes, access to legal services.

20 When we have properly defined the practice of
21 law, we will be far better able to determine what the
22 unauthorized practice of law is and thereby inform the
23 debate surrounding those four issues. This is
24 particularly important with the delivery of legal
25 services via the Internet because of the proliferation of

1 entities that provide people with legal assistance
2 online.

3 As a result of the ability to enhance necessary
4 access to legal services combined with risk of abuses,
5 our policies governing the Internet must be calculated to
6 strike a balance that promotes the flow of legal
7 commerce, yet protects the consumer before he or she is
8 irrevocably harmed. Such a balance can be achieved
9 through the states' adoptions of the ABA's Model Rules of
10 Professional Conduct.

11 The Model Rules govern the practice of law.
12 The ABA promulgates the Model Rules which it then
13 encourages states to adopt. The use -- I'm sorry, I've
14 run out of time. I'll submit the rest of my remarks to
15 you. I was not quite through.

16 MR. NANCE: Thank you, Mr. Carlton. Mr.
17 Granat?

18 MR. GRANAT: My name is Richard Granat and I'm
19 President of a legal information company called
20 MyLawyer.com, which provides legal information and
21 document assembly services over the Internet. I also
22 wear another hat. I'm actually co-chair of a unit called
23 the Elawyering Task Force of the Law Practice Management
24 Section of the ABA, which is a unit in the ABA that is
25 concerned with management in technology. The purpose of

1 that task force, it was set up actually several years ago
2 to help lawyers figure out how to use technology to
3 connect with what we call the latent market for legal
4 services.

5 The statement that I prepared is already
6 online, so I'm going to use my three minutes to
7 supplement the statement that you can also read
8 independently. I want to make a couple of particular
9 comments.

10 The first comment is, one of the projects of
11 our Elawyering Task Force, which is now going through the
12 policy process of the ABA, is to develop a set of
13 standards for best practices for legal information web
14 sites. By legal information web sites, we mean the whole
15 proliferation of legal information web sites, which are
16 not law firm web sites, which are now providing legal
17 information to the public. This, essentially, is, in
18 fact, an unregulated area, and we felt, from a lawyer
19 point of view, that consumers need to be more informed
20 about the kind of information that they consume from
21 those web sites in terms of jurisdiction, when the
22 information was developed, who developed it, and whether
23 it was accurate. This is legal information, it's not
24 legal advice.

25 So, our standards are essentially 10 best

1 practices standards. They're not rules and regulations.
2 They're standards which apply to all kinds of legal
3 information web sites to try and increase the quality of
4 legal information that the consumer actually experiences.
5 You can see a copy of those best practices standards on
6 this web site, Elawyering.org, which is a resource for
7 lawyers which our task force has set up on this whole set
8 of issues.

9 Now, my views that I'm going to express in the
10 following are not the views of the ABA. They're really
11 my personal views and my personal opinions based upon a
12 series of experiences which go back to what I call 10
13 years in the trenches.

14 As the Internet was just taking off, I was in
15 charge of a project at the University of Maryland Law
16 School where we provided standardized forms to people who
17 are filing family matters in Maryland's courts. And we
18 provided, through law students, legal information and
19 actually legal advice. That project served 10,000
20 people. We did an extensive study on the impact of
21 whether those pro se litigants were successful in filing
22 on their own. We then migrated that project to the web
23 with a grant from a foundation and you can go to that web
24 site called the Peoples-Law.com, People's Law Library of
25 Maryland. The forms were done with the cooperation of

1 the Maryland State Courts.

2 Since then, 20 other major court systems have
3 released standardized forms through their court systems
4 in the family law area, because family law filings
5 constitute 50 percent of all state court filings. So,
6 the states, because there's been such a radical increase
7 in pro se litigants, have seen fit to issue their own
8 legal information web sites to support pro se litigants
9 because our research shows and our data shows that the
10 people who are using these set of tools have basically
11 been priced out of the legal market.

12 And we have extensive research which has been
13 kind of sidelined or buried, and a point that I want to
14 make is that, as we make policy in this area, it should
15 be made based upon empirical fact. We can assess to what
16 extent there really is harm if some of these other
17 strategies are implemented or whether if it's harm, maybe
18 the cost is worth the benefit. But we don't really have
19 enough data to really know what happens when we start
20 delivering legal services over the Internet by law firms
21 and non-law firms. There are just no facts.

22 There's just a lot of opinions there that we
23 need to have a boundary and say that, this is the
24 practice of law and only lawyers can do this. We don't
25 have enough data in this country which demonstrates

1 what's the alternative harm. On the other hand, if we go
2 to other Western countries, where there is data which we
3 can look to in this country for entities like the
4 Citizens Advice Bureau in the UK, and for other kinds of
5 entities in both France and Germany, we find that there's
6 a whole variety of other delivery systems which give
7 consumer choice which results in different kinds of
8 results and often at less price.

9 I also want to stress, because I haven't seen
10 it in any of the literature in the U.S., that the UK has
11 recently deregulated their legal profession in a number
12 of ways. They're abolishing the prohibition on fee
13 splitting. They're going to permit lawyers to be
14 employed by non-lawyer entities, such as the equivalent
15 of our Wal*Mart as long as the integrity of the core
16 legal services is really respected. And the reason for
17 that is to enable capital and management technologies to
18 be applied to the delivery of legal services in ways that
19 solo firms and small firms can't really do. And this is
20 a very dramatic departure from our approach to
21 regulation.

22 The theory behind this is that by combining
23 technology and people, we will come up with new delivery
24 systems on the Internet which reduce the price of legal
25 service to the consumers and give consumers more legal

1 choice. I advise the FTC to take judicial notice of
2 what's going on in other countries in its deliberations
3 about regulations in the United States. Thank you.

4 MR. NANCE: Thank you, Mr. Granat. Mr.
5 Johnston?

6 MR. JOHNSTON: My name is James Johnston and
7 I'm a sole practitioner in Washington, D.C. I've also
8 written on this issue and that's the basis for my
9 comments.

10 In my prepared testimony, I bring the metaphor
11 of the tailor. Before there was manufacturing, your
12 clothes, your suits, your dress was made by a tailor.
13 You went to him, everything was custom made. Well, law
14 is still being practiced that way. If you want a will,
15 if you want a contract, you have to go to a lawyer and he
16 custom makes the document for you.

17 So, when you look at the Internet and what it
18 can do, combined with technology, what it can do is give
19 mass production to law. It can allow one lawyer to serve
20 1,000 people or 10,000 people or you can put together a
21 group of lawyers doing smart documents, they can serve
22 tens of thousands of people.

23 We know, for example, with the tax preparation
24 program, such as TurboTax and Tax Cut, that's what those
25 companies have done for the accounting profession. You

1 don't need to go to an accountant to have your taxes done
2 unless you want to, you can do it yourself and you have a
3 smart program to do that.

4 When I started looking at this, the question
5 that came to me was, well, what is the practice of law?
6 I mean, if some smart guy can give you a smart document
7 that will be prepared by you, what is the practice of
8 law. And I went back to history.

9 Originally, the practice of law was appearance
10 in courts. The judge in the specific court regulated who
11 could appear before him. He, frankly, didn't care who
12 wrote wills in the town because his only concern was who
13 appeared in court before him. In the 19th century, bar
14 associations came into being, and in the 20th century,
15 the concept came about of the unauthorized practice of
16 law, that preparing documents, preparing legal documents
17 required someone to be a lawyer and required you to
18 retain a lawyer. But that was a very late development.

19 So, now we're looking at, and I'm focusing
20 particularly on document preparation, is that the
21 practice of law or not? I don't think there's any
22 question that appearing in court and representing the
23 client as an advocate is the practice of law.

24 I think the other issue that one looks at and
25 that we're really facing is, the bar associations and

1 state regulators who will say, you cannot do that online
2 because that is the practice of law. And what they could
3 define as the practice of law is the giving of advice,
4 whether you call it legal advice or legal information, I
5 don't think it's too important. It's information the
6 consumer needs to make decisions and preparing documents
7 for the consumer.

8 I think that those aspects of what have
9 traditionally, at least in the past 70 years, been
10 considered the practice of law probably are not the
11 practice of law and don't require a lawyer with one
12 proviso, and that is the confidential relationship that
13 exists between a lawyer and a client. So that I come to
14 the view that if a person goes online, a web site goes
15 online, offers to prepare for you a legal document much
16 the same way as TurboTax will do your taxes, that as long
17 as that web site is not holding itself out as your lawyer
18 and as long as you understand there is no confidential
19 relationship between you and the propriety of that web
20 site, that that should not be the practice of law.

21 On the way down here I passed a tailor on
22 Connecticut Avenue. He's a custom tailor. I don't know
23 if anybody knows where he is, but Connecticut and L, and
24 he's got a little sign out that says 14 and an eighth
25 neck, 36 sleeve, happy hunting. He's still showing his

1 business in the modern age. He will tailor-make things
2 for you if you can't get them custom made off the shelf,
3 if you can't get a mass producer shirt, he'll sell it to
4 you.

5 But I think in this day and age when we have a
6 technology that, at least, is offering the potential to
7 provide mass production of legal services, we ought to
8 allow that. Thank you.

9 MR. NANCE: Thank you, Mr. Johnston. Mr.
10 Jones?

11 MR. JONES: Thank you. My name is George
12 Jones. I'm a practicing lawyer at Sidley, Austin, Brown
13 & Wood, a partner in that firm. I also serve as
14 President of the D.C. Bar for this year. But I need to
15 say that the views I express are my own, I am not
16 speaking on behalf of the D.C. Bar or the Board of
17 Governors.

18 My interest in this area dates back many years
19 and long before I became President of the Bar, and I
20 didn't forget everything I thought I knew when I became
21 President of the Bar. Today, with a computer, a modem, a
22 touch tone phone line, and an Internet service provider,
23 a lawyer can provide services from virtually anywhere in
24 the world and certainly from anywhere in the United
25 States to anywhere in the United States.

1 Internet technology, as you've heard, offers
2 tremendous opportunities to serve more clients better.
3 In my view, the rules of professional conduct should not
4 prohibit lawyers from using innovative ways to meet the
5 needs of clients efficiently.

6 The ABA's consideration of multi-disciplinary
7 practice provides a very useful backdrop to this
8 discussion, I think. A.P. and I will disagree about the
9 merits of the MDP proposal, but it's certainly relevant
10 here.

11 Twenty years ago, the ABA Kutak Commission
12 proposed eliminating the restrictions in the rules on
13 sharing legal fees with non-lawyers and having non-lawyer
14 partners. The Kutak Commission appears to have
15 recognized that the anticompetitive effects of the rules
16 could not be justified by the principal public policy
17 rationale offered in their defense, namely that the rules
18 were necessary to preserve the ability of lawyers to
19 exercise independent legal judgment. Nonetheless, the
20 ABA House of Delegates rejected that recommendation.

21 The renewed debate about MDP over the last four
22 years, I think, has underscored a fact that has
23 tremendously significant implications for the regulation
24 of the legal profession. With the exception of appearing
25 in most state and Federal courts, there is very little

1 that lawyers do that only lawyers do. Except by
2 expanding the legal monopoly in a way that is both
3 politically and practically infeasible, there's really no
4 way to stop a client from seeking advice from anyone the
5 client believes has the expertise, experience and
6 judgment to be helpful.

7 I think the competition for talent between law
8 firms and non-law firms, not legal ethics rules, will
9 determine where clients go for what we now regard as
10 legal services in the future.

11 During the House of Delegates debate on the ABA
12 Commission's initial MDP proposal, someone quoted the
13 great American philosopher, Groucho Marx. When he was
14 asked for his views on sex, Groucho thought a moment and
15 he said, I think it's here to stay. MDP is also here to
16 stay. It may not be sanctioned as MDP, but the
17 combination of legal and non-legal services to serve
18 clients is a fact today and it will continue in the
19 future.

20 Lawyers need to find ways to provide the
21 services that are important to our clients or we will be
22 watching our former clients obtain those services from
23 others who will. The phrase survival of the fittest
24 expresses a truth, but it's not the strongest or the
25 smartest or the fastest who are most likely to survive,

1 but the most adaptable.

2 Trying to stop MDPs or the many other new
3 vehicles for delivery of legal services that technology
4 makes possible is exactly the wrong focus. The vast
5 majority of people in this country are not wealthy enough
6 to afford to hire lawyers and not nearly poor enough to
7 qualify for free legal services. So, they don't consult
8 lawyers at all. A.P. has sort of summarized some of the
9 research on this issue and it is beyond dispute that
10 tremendous numbers of people simply don't consult lawyers
11 at all.

12 One statistic that struck me was that 50
13 percent of the time of American lawyers is spent serving
14 the wealthiest 15 percent. That's a pretty remarkable
15 statistic. Pricing legal services out of the reach of
16 the majority of Americans in the name of professional
17 ethics is neither professional nor ethical, nor is it
18 particularly professional or ethical to prevent lawyers
19 from competing to provide legal services as efficiently
20 and effectively as possible.

21 I think the most substantial impediment to
22 lawyers fully exploiting the Internet to provide better
23 services to more clients may arise from uncertainty as to
24 the reach of state unauthorized practice rules and
25 statutes. The work of the ABA Commission on multi-

1 jurisdictional practice, MJP, is a very useful and
2 welcome step forward out of the *Bierbrower* morass.

3 Remarkably, however, the MJP Commission does
4 not appear to address any of the multi-jurisdictional
5 practice issues raised by the use of the Internet to
6 provide services except to say a lawyers's presence in a
7 state may be systematic and continuous, even if the
8 lawyer is not physically present in the state. Although
9 it's not clear, the comments suggest that a lawyer might
10 be held to have engaged in the practice of law in a state
11 in violation of the proposed model rule 5.5(b)(1) or
12 other applicable state law even if the lawyer never sets
13 foot in the state. It remains to be seen whether any
14 jurisdiction is prepared to invoke the UPL rules to
15 sanction a lawyer who never sets foot in the state.

16 MR. NANCE: Thank you Mr. Jones. Mr. Lammert?

17 MR. LAMMERT: My name is Tom Lammert. I'm
18 General Counsel of a company in Pittsburgh, Pennsylvania
19 called National Real Estate Information Services. We
20 provide settlement services in 38 states, all 50 states
21 for appraisal, title in 38 states. I'm also a member of
22 a trade association called Title, Appraisal Vendor
23 Management Association. It's in that capacity that the
24 UPL issue, unauthorized practice of law issue, has become
25 a front burner item for me. I have spent the last year

1 and a half on behalf of the association looking at UPL
2 provisions affecting real estate settlement services,
3 title insurance, closing services, disbursement services,
4 and escrow services in a number of states where the
5 primary question seems to be, what is a legal service?

6 It is, to me, remarkable that the states define
7 legal services in the real estate area in as many
8 different ways as they do. In some states, South
9 Carolina, for example, the practice of law includes
10 everything from issuing title insurance to disbursing the
11 money at closing. In other states, Ohio, for example,
12 document preparation is the issue. And it changes.
13 North Carolina is an example. The FTC has been involved
14 in appearing before an ad hoc committee of the state bar
15 in North Carolina on the question of changes that have
16 recently been proposed to the state ethics opinions
17 covering what is or isn't the practice of law, and most
18 importantly, from my standpoint, whether a lawyer is
19 required to be present throughout all of the rendering of
20 the settlement services.

21 This is particularly important as the Internet
22 is coming to real estate and real estate settlement
23 services, in particular. Some of the GSEs, Fannie Mae,
24 are, at this time, beta testing systems for delivery of
25 real estate services from beginning to end, including

1 recording of documents. The physical presence
2 requirement that is under consideration in North
3 Carolina, would really render that a difficult
4 proposition, and indeed, requiring a lawyer's
5 participation in witnessing documents, in disbursing
6 monies, in abstracting, from the standpoint of my
7 company, my business and my industry is quite a problem.
8 I have a difficulty with what other lawyers are
9 suggesting is the practice of law.

10 I work every day with closers and abstracters
11 who are far more qualified than I am despite my nearly 20
12 years of practicing law and my three years of law school
13 to do those same tasks, and I think a number of the
14 panelists here have alluded to that, that there are
15 services that others are as capable of providing and as
16 qualified, if not more qualified, to provide than
17 lawyers. I think that the bar and the various states
18 that regulate the issue and certainly the FTC where the
19 issue is presented should consider whether the public is
20 better served, whether consumers are better served by
21 those services being provided from a more general, a
22 broader array of providers than just the legal
23 profession. Thank you.

24 MR. NANCE: Thank you, Mr. Lammert. Professor
25 Lanctot?

1 PROF. LANCTOT: I'm Cathy Lanctot. I teach
2 legal ethics and constitutional law at Villanova
3 University in Pennsylvania, and although I am a law
4 professor, I will try to keep it brief.

5 I've been doing, for many years, research and
6 writing in the area of legal ethics and the Internet,
7 particularly focusing on the question of how we define
8 attorney/client relationship in the context of the
9 Internet, and most recently, I've written an article
10 about online document preparation and whether or not that
11 implicates unauthorized practice.

12 I wondered whether the FTC realized when this
13 panel was organized that we would be grappling this
14 afternoon with the central mystery of the legal
15 profession, which is what is it that we do. We must be
16 the only profession on the earth that cannot define what
17 we do for a living. It's been a mystery as to why --
18 engineers know what they do, doctors know what they do,
19 janitors know what they do, probably everyone in this
20 room, except for the lawyers, know what their profession
21 entails. But for some reason, we, as a profession, have
22 never been able to, or perhaps more appropriately, have
23 not been willing to limit ourselves by defining the
24 practice of law.

25 What I want to say in my opening remarks is to

1 echo what a number of folks have said. It's going to be
2 critical that we define it because defining the practice
3 of law is going to drive the answers to a lot of other
4 questions on the Internet. If an online exchange between
5 a layperson and a lawyer is the practice of law, that
6 means lawyers can do it and laypeople can't do it. If
7 it's practice of law, it may create an attorney/client
8 relationship that may require confidentiality, loyalty
9 and conflicts checks -- and possible legal malpractice
10 down the line. If it's not the practice of law, then
11 perhaps it stays unregulated or perhaps it's regulated in
12 different ways.

13 But we need to grapple with that question, and
14 it has never been an easy question to address because it
15 raises the twin concerns that I think have cut across all
16 the panels on e-commerce and that is the concern with
17 consumer protection on the one hand and perhaps the
18 restraint of economic competition on the other.

19 I come at this a little bit differently from
20 the panel because my research has looked at what we have
21 said in the past about what is the practice of law,
22 because I don't think we write on a blank slate. If I
23 were queen of the world and I got to say, from this day
24 forth, what is the practice of law, I might have a
25 different answer than what people have said for the last

1 70 or 80 years, but I do think that we can't start from
2 scratch right now. We need to know what the president
3 has said, what the bar opinions have said, what the
4 profession has said.

5 As best I can tell, when specific legal advice
6 is given and professional judgment is brought to bear on
7 a specific set of facts, that's going to be legal advice,
8 that's going to be the practice of law. That's been a
9 determining factor with respect to determining the
10 character of exchanges on the radio, 900 telephone
11 numbers, exchanges in seminars, and even in some of the
12 more recent Internet bar opinions, that's been the key.
13 General legal information isn't practice of law.
14 Specific legal advice is the practice of law.

15 With respect to document preparation that's,
16 again, historically where that line has been drawn.
17 Again, I'm not saying what it should be if we decide to
18 rewrite it, I'm saying what it has been. Preparation of
19 documents by laypeople is okay. If the layperson advises
20 what to put in what box or even which document to pick,
21 that historically has been treated as unauthorized
22 practice of law. Now, maybe we don't like that and we
23 want to change it. That's a little bit different from
24 saying that we're starting on a blank slate because I
25 think we are not.

1 I agree completely with Richard Granat that we
2 need empirical study. I think that we don't know right
3 now what the implications are of consumers receiving
4 legal advice online either from lawyers or non-lawyers.
5 I would guess that the clients of Marcus Arnold, who
6 haunts my dreams as well, who gave advice, were not
7 particularly well served. What was terrifying to me
8 about the Marcus Arnold story was that once it was
9 revealed that he was not a lawyer, he got twice as many
10 requests for information. I tell my students that just
11 as a sad comment, perhaps, on what folks think of
12 lawyers, but I wondered about what that actually meant
13 with respect to what consumers think they're getting
14 compared with what lawyers think they are giving. And
15 so, I think it's essential that we determine what it is
16 that consumers do receive either from lawyers practicing
17 online or from the proliferation of lay services out
18 there.

19 Two other quick points before the dreaded sign
20 goes up, and one is, there's a constitutional overlay
21 here that we don't always look at and that hasn't really
22 been addressed, but there is a First Amendment component
23 to the question of regulating people talking about the
24 law. And that line between advice and information is
25 also going to have some implications about what you can

1 and can't regulate. People have a First Amendment right
2 to talk about the law. They may not have a First
3 Amendment right to practice law. I don't think we
4 disagree on that. But somewhere lurking out there with
5 respect to regulation is the question of being able to
6 define a regulation narrowly enough to get at the
7 unauthorized practice but not get at protected speech.

8 There is the whole debate in Texas over Quicken
9 Family Lawyer that ultimately was settled, but which was
10 addressed in a District Court Opinion. The District
11 Court in Texas did say that Texas could permissibly
12 preclude the sale of a CD-ROM in the state that purported
13 to be selling legal documents. I'm not sure that that
14 was right under the First Amendment, but it does suggest
15 that the First Amendment is something that floats out
16 here that we need to be aware of.

17 Finally, we do need to consider, and this is my
18 last point, is it a good idea for consumers to be
19 relegated to pro se representation. Is that our ultimate
20 goal is to have consumers represent themselves? A lot of
21 folks say that consumers should be empowered to represent
22 themselves and not have to rely on lawyers, and maybe
23 that's true.

24 But there's a flip side to that, which is
25 whether we are writing off an entire segment of the

1 potential legal market and saying, we don't want to serve
2 you, we can't serve you in a cost effective way, take
3 care of yourselves. I don't think we'd like the medical
4 profession doing that. I'm not so sure that's the answer
5 for the legal profession either. Thank you.

6 MR. NANCE: Thank you, Professor. Professor
7 Palomar?

8 PROF. PALOMAR: I'm Joyce Palomar and I was
9 invited to particularly address legal services in real
10 estate transactions and whether state unauthorized
11 practice of law regulations that define title
12 examination, drafting of deeds and mortgages and closing
13 of real estate transactions as the practice of law are
14 barriers to electronic commerce.

15 In 1999, I completed a two-year empirical study
16 and published it in the Connecticut Law Review which I
17 brought three copies of if three people would like to
18 have it. I attempted, in that study, to compare numbers
19 of problems that homebuyers had with their real estate
20 transactions in states that require attorney involvement
21 in residential real estate transactions, to the numbers
22 of claims filed and problems experienced by homebuyers in
23 states where title insurance companies perform the title
24 examination, drafting of instruments and closing of
25 residential real estate transactions.

1 In each particular problem area that I studied,
2 I did find that consumers had fewer problems when they
3 had an attorney in the transaction. But what was
4 somewhat surprising is that the difference was not as
5 great as many in the bar had thought it would be. The
6 percentages of claims tended to be between 6 percent at
7 the greatest and only 1 percent on the lower end greater
8 when title companies handled these matters without
9 attorneys involved than when attorneys were involved.
10 The feeling that that gave me is that while, again,
11 attorneys did do a better job for their clients, was the
12 difference enough to mandate an attorney in every
13 transaction or was the difference small enough that
14 consumers should be permitted to make that choice
15 themselves.

16 I have some charts from that study that I can
17 show later in the question period if someone asks me to,
18 but what I wanted to then go on and address here is while
19 I do think that the study showed that consumers should
20 have the choice in terms of how they want to spend their
21 money and whether they want to spend extra time, if it
22 takes extra time in their state to have an attorney
23 involved, I don't know that abolishing those regulations
24 is going to give much assistance in terms of electronic
25 commerce, because when you take the attorney out of the

1 process, each of the states that have done that have,
2 instead, adopted dozens more regulations of the lay
3 settlement service providers.

4 For example, recently, Virginia and Washington
5 State decided that they would permit lay closing of real
6 estate transactions or assistance with certain aspects,
7 but that new system required the adoption of numerous
8 regulations providing for the educational requirements of
9 the lay title examiners and the lay closers, providing
10 for testing requirements, years of experience
11 requirements. So, in terms of trying to reduce the
12 differences between the states in order to permit
13 national practices, I don't know that you gain anything.

14 As far as some particular figures, in Oklahoma
15 and North Carolina where attorneys are mandated to be in
16 the process, either in the closing or in the drafting or
17 in the title examining, there are 30 to 35 regulations
18 about the title search and title insurance process. But
19 in the states of Montana, Nebraska, North Dakota, South
20 Dakota and Florida, where the attorney is not required to
21 be in the process, there are 187 different regulations on
22 title searchers, title examiners and title insurance
23 companies.

24 So, you still have a party that's going to
25 provide these services over the Internet across the

1 country that is still going to have to have a local
2 provider. You've just switched to a different local
3 provider. You're going to have to have a local provider
4 to comply with these kinds of regulations. And to tell
5 you some of the types of regulations that exist, the
6 majority of states have a regulation requiring that title
7 insurers be monoline insurers. A title insurer cannot
8 issue any other type of insurance, and complimentary
9 regulations prohibit general casualty insurers and those
10 insurers that sell private mortgage insurance from
11 issuing title insurance.

12 There are also regulations that prohibit
13 issuance of a title insurance policy unless an
14 examination of the particular title has been performed.
15 There are also regulations that require that any company
16 issuing title insurance must own or operate their own
17 private title plant of records. Some states only permit
18 certain state approved title insurance forms to be
19 issued. Others regulate the rates that title insurers
20 can charge for the particular coverages. A few states
21 prohibit issuance of title insurance unless an abstract
22 of the title has first been updated and surveyed by an
23 abstracter licensed in the state.

24 So, you have all of those kinds of regulations
25 to consider even if you decide that the attorney should

1 not be a barrier to interstate and electronic commerce.

2 MR. NANCE: Thank you.

3 MR. AGARWAL: Thanks, Professor. We'll now
4 have questions from Mark, myself and the audience, and I
5 might add, any question is open to any panelist. And if
6 you're not able to get our attention otherwise, just turn
7 your tent up and we'll call on you there.

8 The first question is, it seems like we don't
9 have a crystal clear idea as to what the practice of law
10 is. But given that, how possible is it to unbundle legal
11 services, such as real estate closings, from other types
12 of legal advice?

13 MR. LAMMERT: I think in framing the question,
14 you asked the question, which is, is the practice of law
15 or legal services tied to advice or are they something
16 else? I have been arguing that ministerial functions,
17 notary functions, witnessing of documents, clerical
18 functions or accounting functions such as disbursing
19 funds do not involve rendering a professional opinion and
20 therefore ought not come within the purview of
21 unauthorized practice of law provisions.

22 Professor Palomar referenced a litany of
23 regulations governing title insurance and asked if we've
24 got all these regulations, is it meaningful to talk about
25 a service that can be provided on the Internet? I would

1 say, yes, it is, that you can unbundle some of those
2 services and be able to provide a service on the
3 Internet. The real estate settlement function could be
4 provided on the Internet. The title insurance would have
5 to be provided separately or could be, in fact, provided
6 by the same company. It might require a local
7 abstracter. I think that the trend in the industry would
8 be towards online availability of that information.
9 There are several companies out there now that are
10 building that capability.

11 So, the question itself is, is the practice of
12 law more than something that involves a professional
13 judgment or advice? And, again, I would submit that it
14 does not.

15 MR. GRANAT: Several years ago, we had the
16 Attorney General of Maryland issue an opinion
17 interpreting the unauthorized practice statute in
18 Maryland in order to permit domestic violence advocates
19 who are not lawyers to help people in domestic violence
20 court. And the opinion was fairly wide-reaching in the
21 sense that it made a bright line between legal
22 information and legal advice, and legal advice is
23 something that's applied to the specific facts of a case.
24 But a non-lawyer can provide something called non-legal
25 information whether it's a person, a company or so forth.

1 I'm not too sure that has wide currency. In
2 Texas, they came at it the other way. They took a
3 statute which said that if you're software, if you're a
4 book or it's something called legal information, it's not
5 the unauthorized practice of law.

6 On our sites, we have a software only set of
7 tools which are basically expert systems which very
8 personalize the output of the document. I don't lose a
9 lot of sleep about whether that's going to be
10 unauthorized practice of law. Maybe I should, but I
11 don't because I think it's well-protected and it's in
12 that area of legal information that's protected by the
13 First Amendment. There's no person that's involved.
14 There's no personal relationship where somebody's
15 delivering what could be called the application of law to
16 a specific set of facts, which I think is a core meaning
17 of what we really mean by legal advice and professional
18 judgment.

19 MR. JOHNSTON: Well, it seems to me that one of
20 the things you should look at is, what is the concern
21 here. There is, in trying to license lawyers, in the
22 sense that there's a consumer protection notion, and that
23 is, this person has an expertise, he should be trusted to
24 give you good, sound legal advice.

25 There's a separate notion as to whether the

1 person can be trusted in terms of honesty. If you give
2 him money, will he handle it well? If you trust him with
3 your confidences, will he handle those well? I think --
4 at least my sense is, that the consumer protection aspect
5 is something that doesn't really require -- is something
6 that could well be regulated by people other than bar
7 associations and people other than the state court
8 judicial system.

9 If I'm a bad lawyer and I give bad advice, your
10 only recourse against me is to either file a claim
11 against my malpractice carrier or go to the bar
12 association and make a claim against me. It might be a
13 better protection for the consumer if, somehow or other,
14 I were in a free marketplace and people could judge me
15 versus this other lawyer around here and you could see
16 our wares openly and make the standard decision.

17 MR. AGARWAL: A.P., you're welcome to comment.
18 We have a question from the audience addressed
19 specifically towards you, which is, "please ask the ABA
20 President to clarify the ABA's position on multi-
21 disciplinary practice."

22 MR. CARLTON: Thank you. George presumed to
23 assume that we might disagree and I don't think we really
24 do. It bears noting that the D.C. Bar has different
25 rules than the rest of us with respect to fee splitting

1 and they basically are the test tube on that. I think
2 that in terms of the consumer protection aspects of it,
3 it would be good to look at that.

4 The ABA's position on multi-disciplinary
5 practice is an evolving position. The position we took
6 in 2000 was that we recognize strategic combinations, but
7 we felt that the lawyers needed to be in control of the
8 enterprise. That states it, I think, a little bit
9 better. But beyond that, I think there was a feeling
10 that we needed to maintain our professional independence
11 and subsequent events have proved us to be a little bit
12 prescient about that, that we could distinguish ourselves
13 on that basis.

14 I think, and we recognize that there are 42
15 states continuing to study the subject and that it could
16 well be addressed again. I think we got the easy
17 questions answered the first time around, and the
18 question -- and I say this on the stump all the time,
19 that the question of the Main Street lawyer, the
20 chiropractor and the undertaker is still out there and
21 it's still there to be addressed, and I think sooner or
22 later, the state bars are going to be coming back to us
23 and asking us to address that.

24 We know we shouldn't combine legal and
25 accounting. We know we don't combine audit and

1 consulting. The easy part's been done. So now we've got
2 the hard questions coming at us and I think we'll be
3 addressing those. Thank you.

4 MR. AGARWAL: Professor Lanctot had a comment.

5 PROF. LANCTOT: Well, I actually wanted to pick
6 up on a point that both Richard and Jim made and I don't
7 want Richard to lose sleep, but I want to just raise this
8 question, which is the fact of the matter is that in
9 Texas, they had to amend their statute. What I think is
10 troubling is that under the Texas Unauthorized Practice
11 Statute, the sale of a CD-ROM in Texas that permitted
12 consumers to prepare wills that was sold by Quicken
13 Family Lawyer, that was held to be unauthorized practice
14 of law. That was reversed because the State Legislature,
15 under fairly intense lobbying pressure, altered the
16 statute.

17 What that suggests to me is, and I don't think
18 Texas' statute was particularly unique, and so, that if
19 you had aggressive enforcement in other states, other
20 states could go after a service such as yours or Quicken
21 Family Lawyer using unauthorized practice.

22 Now, I'm not saying whether that's good or bad.
23 I suspect Richard thinks that would be bad and I probably
24 would agree with you. But what I am suggesting is that
25 if we're looking for barriers to e-commerce, it's the

1 current status of the way those laws are written.

2 Just to pick up for one brief second on Jim's
3 point about consumer protection and consumers deciding
4 who's a better lawyer. In some ways, it's fundamentally
5 inconsistent with the concept of professional licensing,
6 isn't it, that we have people go to law school for three
7 years, take the bar exam and receive a license from the
8 state to practice law, which presumably gives them, those
9 people who have that license, a monopoly to perform
10 certain services that they are said to be qualified to
11 perform.

12 If we say that everyone can perform those
13 services and the market will sort out who's doing a good
14 job and a bad job, it seems inconsistent with the whole
15 concept of professional licensing. Now, again, that may
16 be an idea whose time has come and gone as well, but it
17 strikes me that that's pretty far down the road from
18 where we are, or am I mishearing you?

19 MR. JOHNSTON: I think only in terms of
20 unauthorized practice of law. In other words, if you say
21 that only lawyers can manufacture cars and manufacturing
22 cars is the practice of law, then, you know, you sweep
23 car manufacturing under professional licensing. My point
24 was that some of these things, document preparation,
25 became the practice of law in the 1920s, 1930s, I agree

1 with you, and has prevailed as sort of a notion, but
2 since the Internet has come along, we really should
3 reexamine whether we want to let that happen.

4 MR. NANCE: There seems to be a bit of
5 difficulty defining exactly what the practice of law is.
6 Maybe another question is, what market is to be served by
7 whatever constitutes this online practice of law?

8 We heard referred to a latent market for legal
9 services. We also heard about certain under-served
10 communities. Exactly what market is impacted most by
11 online provision of legal services or what market
12 segment?

13 MR. JONES: I think the market that is impacted
14 most is the market that's not being served now by any
15 lawyers, people who are middle income, people who make
16 too much to qualify for legal aid, but who can't afford
17 to eat and pay for a lawyer. And there have been
18 repeated studies that show that most people, when they
19 are confronting a serious legal problem, most middle
20 income people do many things other than consult a lawyer.
21 Sometimes they ask a friend, sometimes they go online,
22 sometimes they try and do the research themselves.

23 But I think the market is -- the people who are
24 not in the top 20 percent of the income earners in this
25 country, I think the demand for services like Quicken,

1 the demand for what's called unbundled legal services,
2 where an individual goes to a lawyer and says, look, I've
3 done the drafting and I just want you to do this one
4 thing for me, I want you to look at it and see if I can
5 file it, or I've worked out the deal with my husband, the
6 divorce is done, I just need to make sure that this
7 agreement complies with whatever the appropriate
8 requirements are. The demand for those kind of services,
9 I think, underscores a tremendous unmet need for -- I
10 don't know whether you'd call it legal services or
11 something else. But there are a number of people who
12 could be helped by experience and expertise in matters
13 dealing with the law who can't afford to buy it given the
14 state of things. I think the Internet and online
15 services have the potential to provide that guidance,
16 those services at a cost that people can afford.

17 The state-by-state regulation of the practice
18 of law inhibits that because once you call it the
19 practice of law, you can't provide the service in 50
20 states at the same time. You can't, because if you are,
21 you have to be licensed in all 50 states and not too many
22 of us are licensed. I think that's why the system of
23 regulation that we have impedes the offering of online
24 services.

25 MR. CARLTON: I'd like to agree with George on

1 everything he said. First of all, there's twice as many
2 lawyers in America today as there were in 1975, and the
3 conundrum we have is that we have an over-capacity in the
4 legal profession and we have an under-serviced public. I
5 often ask lawyers I talk to if they can afford themselves
6 and most often the answer is no.

7 So, I think he's right and I think he used the
8 right words. Sometimes the regulations inhibit the
9 delivery. And to us, that's an access issue in the ABA.
10 That's kind of the way we look at it, and that's one of
11 the reasons we've got the model definition task force,
12 and I would invite everybody to send their comments to
13 our task force.

14 But that brings forth the fact that consumer
15 protection is more than just a notion. There needs to be
16 consumer protection. And if you're mass producing legal
17 services, you know, the other word that goes with mass,
18 in my mind, is tort. So, you've got a problem there and
19 you've got the justification, if you will, for some sort
20 of regulatory scheme. So, how you balance that really
21 becomes the question, I think. And that's what we're
22 constantly striving to address in the ABA.

23 PROF. LANCTOT: Just to take a step back with
24 respect to the market. I agree completely that it's the
25 middle income. I think what's noteworthy, with respect

1 to the Internet, is that I'm not sure that seven years
2 ago we would have anticipated the penetration of the
3 Internet into middle income homes. Just generally when
4 it first came out and it seemed like a nice toy and even
5 when it penetrated into upper income, I never thought my
6 parents would be on the Internet. I think most folks
7 have seen the Internet take off in ways that only a few
8 people were visionary enough to see, and I don't think we
9 know now what it will look like five years from now
10 because the changes have been so enormous.

11 I make that point because it's hard to predict
12 in this area because the changes are so rapid, and I have
13 been looking at this area for a while and I find it hard
14 to keep up. But because the other side of that is
15 despite the number of people who flocked on to the
16 Internet, I don't think that anyone, either lawyer or
17 non-lawyer, has yet found the effective way to harness
18 that application to deliver legal services. I think
19 people are trying. I think what Richard is doing and
20 others are doing are good models. But no one has yet
21 found the Amazon.com or some other model, either lay or
22 lawyer, that is going to provide the direct access, and I
23 honestly don't think the issue has yet percolated to most
24 states and most bars -- the issue's below the service --
25 but we have yet to see the possibility of receiving legal

1 services on the Internet really penetrate the public's
2 mind.

3 MR. GRANAT: When you think about legal
4 problems, particularly as it applies to the middle class,
5 there's a certain component of legal problems which I
6 would call digital, digital in the sense that, if you put
7 the right information in the right box, you can get a
8 legal result, like a simple name change, a step-parent
9 adoption, a non-fault divorce, maybe even a Chapter 7
10 bankruptcy. That component of law has become more
11 administrative rather than adjudicative.

12 So, if you help an individual put the right
13 information in the right place, you can get a legal
14 result, and they can get a legal result at much less cost
15 than if a person went to a lawyer. Yet, there's still a
16 need for legal advice to guide that person through that
17 process and we see the need for a relaxation which
18 permits this concept of what we call unbundled legal
19 services.

20 So, I'm interested in putting the lawyer in a
21 new relationship to clients facilitated by the
22 technology. I'm not taking the lawyer out of the
23 process, but making it possible for the lawyer to be
24 competitive and make a contribution to the resolution of
25 legal problems that's appropriate to the price.

1 This concept of unbundled legal services that
2 we've been talking about actually has been the subject of
3 a conference that the ABA sponsored in Baltimore, and
4 there's a web site that you can go to called
5 unbundledlaw.org, which explores these issues about how a
6 person could get some legal advice and then get some
7 digital documents and the result of that is to reduce the
8 price of legal services and, therefore, opening up access
9 and opening up consumer choice, which I think is the
10 other issue that we're really concerned with here.

11 MR. JONES: I think that the example makes the
12 point. If a lawyer is necessary to help the consumer
13 figure out what information to put in the box or which
14 form to use, and he could sit in Baltimore and offer that
15 service to the entire country and do it very efficiently
16 and serve 1,000 people or some number in a day, that
17 would, I think, make that service available on a much
18 wider basis and at much lower cost than it is today if
19 the individuals have to go to single lawyers in each
20 jurisdiction.

21 But if you call it the practice of law, then
22 the individual can't sit in Baltimore, licensed in
23 Maryland, and provide that very basic service to people
24 around the country, even though he is perfectly qualified
25 to do it. And I think that's the real sticky point.

1 Because once you call it the practice of law, then it's
2 balkanized. You can only do it in those jurisdictions,
3 you can only offer the service in those jurisdictions
4 where you're licensed.

5 There's a guy who I heard speak at an ABA
6 meeting and I think his office is in Wisconsin, and he
7 has a very simple will program. It's an interactive
8 thing. People can access it from anywhere in the
9 country. But because of concerns about unauthorized
10 practice, they have to come into his office to sign it.
11 And so, he can serve the people in Wisconsin and the
12 surrounding jurisdictions who live close to the border
13 and who are willing to drive into this office to sign the
14 will and complete it, but if he could offer that same
15 service throughout the country, he could be tremendously
16 more effective and probably offer it at very low prices.

17 I think what he does now is use the will
18 preparation as kind of a loss leader and doesn't charge
19 for it at all. But he says, if you want to complete it,
20 you have to come into the office to sign it.

21 MR. AGARWAL: Let me ask a question about
22 consumer choice, and since we have two law professors
23 with us, let me ask a hypothetical. Say you have a 15-
24 year-old boy who is offering legal advice on the Internet
25 and everybody who's buying from him knows that he's not a

1 lawyer and they have full information about that. Is
2 there a problem if the consumer is fully informed?

3 And the second hypothetical is, say you have a
4 lawyer who on his web site says, look, I'm not going to
5 analyze your problem in any depth, but here's my first
6 cut reaction to your problem, and the consumer has full
7 information about that. Is there a problem in either one
8 of those situations?

9 PROF. LANCTOT: Well, as to the 15-year-old
10 boy, let me answer your question with a question. What
11 if he were taking out appendixes of the neighbors in the
12 basement? If you get my drift. And you can tell me 50
13 reasons why that's not quite the same, but it does strike
14 me that we do have restrictions on people practicing
15 medicine without a license even if they say, you know,
16 I'm not a doctor, I'd like very much to take out your
17 appendix, if you don't mind. We still do restrict, I
18 believe, in most states, that activity. And I think the
19 same is true with respect to the practice of law.

20 I suppose there are a couple things. One is
21 that the consumer may not always have perfect information
22 about what the person can or cannot do for the consumer.
23 And the other is to go back to the point I made earlier
24 about the professional licensing, is as long as the
25 professional licensing system of lawyers means anything,

1 it means that once you get a license, you're authorized
2 to perform some things and laypeople are not. And we may
3 have a philosophical debate about whether or not that's a
4 good idea, but I think as long as we do have that system,
5 there has to be a line drawn between lawyers and non-
6 lawyers.

7 As to the second on -- a lawyer -- I think a
8 lawyer can give general information without triggering
9 anything. I think a lawyer can say, I'm giving you my
10 best first cut at this question. This is not the
11 practice of law. And, in fact, there are sites with this
12 kind of disclaimer all over the Internet. The problem is
13 that lawyers are incapable of just giving general
14 information by nature and by training, I think. So, as
15 part of that, I think is a difficulty, is that it's very
16 difficult for lawyers just to give that.

17 The second thing is, it's not worth anything.
18 It's worth very little to a client. Last week, the Wall
19 Street Journal called me, and a bunch of us at Villanova
20 looked at answers that came in from a survey. The Wall
21 Street Journal columnist sent a legal question, a basic
22 consumer question, to five different Internet sites and
23 got back five different answers, and they were sent to us
24 blind. We didn't know where they came from, and we were
25 asked to evaluate them. And basically, they were five

1 different answers to which the law professors then gave
2 five more different answers as to whether the information
3 was good, bad or indifferent.

4 And what struck me about that exercise, which I
5 thought was really worth doing, was that what the law
6 professors thought was the safest advice was also the
7 most generic, which was I'd have to look at your lease
8 before I can tell you. Well, that's true and that's
9 probably good solid advice, but if a consumer paid \$30
10 for that information, they're not going to think they got
11 anything. What we thought was the most troubling advice,
12 which was suggesting that someone ought to go to small
13 claims court and bluff, even though their claim looked
14 kind of shaky, and this caused, at least those of us who
15 teach ethics, to have minor palpitations. The lay
16 columnist thought that was really great advice because he
17 hadn't thought of that particular strategy for dealing
18 with this problem.

19 MR. CARLTON: Well, that just never happens.
20 Real lawyers never bluff.

21 PROF. LANCTOT: No, no, absolutely not. Well,
22 and you know what our concern was was that lawyers would
23 know that bluff means you can bluff but you can't go file
24 a case that violates Rule 11 and has no basis. But a
25 consumer might hear bluff and hear something entirely

1 different when a lawyer is having that kind of
2 interchange.

3 So, that was a long way of saying that I think
4 lawyers can give general information without triggering
5 anything. But is the consumer getting anything for that
6 interchange? I'm not so sure.

7 PROF. PALOMAR: My response would be that I
8 think the 15-year-old boy likely would have violated
9 regulations designed to protect the public from other
10 types of professional business advice. Even if we took
11 the unauthorized practice of law issues out of the
12 equation, why is the FTC not looking at the licensing
13 requirements for a real estate broker, which he likely
14 has violated? What about the regulations if he were
15 helping somebody to accomplish a real estate transaction
16 and giving some sort of opinion that the title to the
17 property a purchaser was buying was good. He would have
18 also violated states' title insurance regulations for
19 doing this without owning a title plant or without doing
20 an examination of the title and having numerous other
21 qualifications met.

22 There are many ways that we can provide
23 services that may be less onerous in terms of cost than
24 requiring a lawyer to be involved in certain
25 transactions, and yet, it tends to involve other

1 regulation of the lay service providers who are going to
2 be doing that instead.

3 And you have to really ask, in terms of this
4 issue of electronic commerce, do you gain? Yes, you may
5 give the public more choice, and I promote that and I
6 promoted that in my article. That I think is the
7 public's choice. But you do have to have some other kind
8 of regulation. And then, again, that's a difficulty in
9 interstate commerce barriers and barriers of electronic
10 commerce.

11 In addition to having regulations of lay
12 providers of these services, another way that the public
13 protects themselves, when we do not step in to protect
14 them is by using tort law. And for lay title company
15 employees or real estate agents, they can be liable for
16 the tort that's been called real estate malpractice by
17 the New Jersey Supreme Court and the Arizona Court.
18 Basically, if you assume the role of performing a real
19 estate transaction and you are not an attorney, you are
20 still liable for malpractice in the same way that the
21 attorney would have been because you have taken on that
22 role of offering those services and putting yourself out
23 as having that expertise.

24 So, the 15-year-old boy would be liable in
25 tort. If it's not real estate particularly, he still

1 could be liable for giving negligent advice in a business
2 context under Section 552 of the Restatement of Torts.
3 So, the public has -- when we don't force the public to
4 hire a lawyer, the public has other regulations to rely
5 on. They have tort law to rely on.

6 How many of those people who have gotten the
7 advice from the 15-year-old boy are going to feel like
8 they can afford to file a lawsuit against this 15-year-
9 old boy? How much are they going to be able to recover
10 because he's judgment-proof? You have to look at the
11 whole scheme of regulations. If you take out someone,
12 like an attorney who you know has bar support and
13 malpractice insurance and then you put in people who do
14 not have that kind of financial support to indemnify
15 those who have been harmed by their negligence of their
16 lack of knowledge, you need to, again, decide, well, do
17 we need to regulate any Internet service provider and
18 require them to have certain insurance? Again, all
19 you've done, I think in this context, is replace one set
20 of providers with another set of providers, replace one
21 set of regulations with another set of regulations.

22 MR. CARLTON: It then goes beyond occupational
23 licensing, and that's what we're talking about here.
24 Because with attorneys, you have a species of public
25 official, whether we're officers of the court, we're

1 regulated by the court system, which is a third branch of
2 government. It's not the bar associations, it's the
3 courts that regulate the law profession in the 50 states.
4 Sometimes the legislature, as they have in my state,
5 delegates that authority to a statutory body. Our North
6 Carolina State Bar is a statutory body and it's there as
7 a regulator and as a disciplinary agency. And I think
8 for 200 years that system has worked pretty well. We
9 haven't seen any great complaints from the public at
10 large.

11 So, I would take the analysis of one
12 occupational licensing system as opposed to another just
13 a step further because real estate agents, though they
14 are licensed and they are subject to voluntary codes of
15 ethics, are not public officials in the way attorneys
16 are. Thank you.

17 MR. JOHNSTON: Let's assume, for example,
18 Microsoft provided a will program. Who would you rather
19 buy a will from, Microsoft or me? And I think there's no
20 question that the consumer is going to trust the big
21 company and that if you go with online legal services,
22 they're going to gravitate toward corporate delivery of
23 these services, just as we've seen with TurboTax and Tax
24 Cut. And so, the consumer is protected, first of all, by
25 the tendency to go to more deeper pockets, more

1 expertise.

2 The second protection you get online is with
3 companies like eBay where you get consumers coming in
4 saying, that guy is a bad vendor, don't buy from him, and
5 they would come in the same way with online law saying,
6 this lawyer is not a good lawyer. I had my will written,
7 I rank him as a number one out of ten. And so, there are
8 various ways you can replace the professional regulation.

9 MR. CARLTON: What happens when the TurboTax
10 program has a glitch in it and what happens when the
11 Microsoft will has an inaptly or inappropriately or
12 enforceable line or provision in it and you replicate the
13 error thousands and thousands of times? That's what I
14 meant when I was talking about a mass tort. So, what
15 happens? Who regulates that?

16 PROF. LANCTOT: Full employment for lawyers.

17 MR. JOHNSTON: Well, the same thing happens
18 there as if there's a defect in a Ford product. You have
19 mass litigation over it. But there is a deeper pocket,
20 you end up with a deeper pocket than you do with a law
21 firm. I mean, he's got malpractice insurance worth a
22 million bucks.

23 MR. CARLTON: But would it not be better to
24 have the consumer protected upfront by a licensing
25 provision?

1 MR. JOHNSTON: Well, I don't think the
2 licensing system really does the same kind of consumer
3 protection that you're saying. I mean, you look to make
4 sure the guy is competent, he goes to CLE classes, but
5 you don't regularly look at him as -- you don't read his
6 wills, you don't read his documents, you don't really
7 have a scrutiny over him to see that he is, in fact,
8 doing a good job.

9 PROF. LANCTOT: There is one area where we do
10 have some empirical evidence which shows some of the
11 pitfalls with lay representation, and I did look at this
12 in my recent article, and that's in the area of
13 bankruptcy preparers, lay bankruptcy preparers where lay
14 people are allowed to assist other lay people with
15 bankruptcy. They're not allowed to practice law. And
16 what I did find is there are an awful lot of cases out
17 there where bankruptcy judges have criticized the lay
18 preparers, and I'm not talking about fraud, outright
19 fraud and outright misrepresentation. I'm talking about
20 lack of competence where they've either been found to
21 have gone over the line to practice law and the
22 bankruptcy judges have said that it was inappropriate
23 because they had been picking forms or advising on the
24 bankruptcy laws. But they also suggest that the
25 consumers were harmed by relying on a lay bankruptcy

1 preparer who didn't know one form from the other.

2 I don't think that's evidence conclusively one
3 way or the other as to how we should proceed here, but it
4 is one area where we do have some data, where there are
5 cases, which is worth taking a look at to see an area
6 where you've had judges repeatedly confronting the work
7 product of lay providers and being less than enthusiastic
8 about a lot of it. So, I think it's worth thinking
9 about.

10 MR. JONES: I bet you could find, if you looked
11 really hard, a few opinions by bankruptcy judges
12 criticizing the work of lawyers who appeared before them
13 as well.

14 PROF. LANCTOT: I'm sure that's true.

15 MR. NANCE: We have a question from the
16 audience for Mr. Lammert. With respect to real estate,
17 obviously, if there was consensus within the bar there
18 wouldn't be any problems with real estate closings right
19 now and there wouldn't be issues before the bar and in
20 the various states. What are the constituents that are
21 opposed to some of the online settlement and closing
22 procedures and what do you foresee the resolution of
23 those being?

24 MR. LAMMERT: I don't think it's been framed in
25 terms of opposed to online services. The issue that I've

1 primarily been dealing with is local or state bar rules
2 where the local real estate practitioners want to provide
3 a service or the state, through either its legislature or
4 through the courts regulating the lawyers, have defined
5 the turf such that only a lawyer can provide the service.

6 Without that, I think that consumer choice
7 would be such that some consumers would still elect to
8 have lawyers provide the services. There might be
9 greater differentiation as to where a lawyer gets
10 involved in the service. One of the issues that comes up
11 repeatedly is the difference between a purchase
12 transaction where you're buying your house outright for
13 the first time and refinances. When you're refinancing
14 it, you're basically doing the same transaction over.
15 Does the consumer need, does the consumer really benefit
16 from having a lawyer look at what our standardized
17 documents that have previously been examined by a lawyer,
18 the bar would say, yes, and they'd say there are issues
19 of predatory lending that should be taken into
20 consideration.

21 There's a whole set of regulations in law
22 concerning predatory lending and my issue with that
23 argument is that's already the subject of laws and
24 regulations that have nothing to do with regulating
25 lawyers. So, the lawyer isn't needed there if that, in

1 fact, is occurring. The FTC, the State Attorney General
2 are already vested with authority for looking into that
3 and there is the tort system.

4 PROF. PALOMAR: I just wanted to add to the
5 comment about refinances. That's one place I've also
6 seen people so frustrated that why do I have to pay all
7 this extra money when it's simply me, I've owned the
8 house for the last two years, I'm just refinancing to get
9 a better rate and I haven't done anything with the title
10 in the meantime, why do I have to pay for a whole new
11 title insurance policy, which is required in some states,
12 the whole premium, or not required by the states, it's
13 required by the insurers.

14 I just want to ask the FTC to remember that
15 perhaps in this context, you want to look at the effect
16 of unauthorized practice laws, but don't stop there. You
17 might also want to look at whether state title insurance
18 regulations should have exemptions for refinances,
19 because recently Norwest decided that they were large
20 enough financially that in refinances they could self-
21 insure as to losses from any mortgage liens that they
22 could not enforce due to a title problem.

23 It wasn't lawyers who sued them to stop them
24 from offering their own insurance to their borrowers as
25 part of the package, it was the state insurance

1 commissions and the trade association for the title
2 insurance companies. Similarly, a company that offers
3 private mortgage insurance wanted to say, well, we can
4 insure not only the mortgage for nonpayment, we can not
5 only insure lenders against nonpayment of the mortgage,
6 but we can also insure the mortgage lien. And, again, it
7 was the state insurance departments and the trade
8 associations for title insurance companies that stopped
9 that process, even though it cost half of the price of a
10 title insurance policy in a refinance and even though it
11 saved significant time because you had one insurer
12 insuring everything rather than having to have separate
13 policies from separate companies.

14 So, don't stop just in looking at attorneys in
15 these areas. You need to look at the entire scheme.

16 MR. AGARWAL: Thanks, Professor. I'd like
17 everybody to answer this final question in 30 to 45
18 seconds. What would you like to see the FTC do, and to
19 the extent the problem depends on getting more evidence,
20 what sorts of evidence should we be looking for?

21 MR. CARLTON: I practiced law pre-Internet, I
22 practiced law pre-fax, I practiced law almost pre-mag
23 card and I didn't practice law pre-telephone, but it
24 seems to me the Internet is a means of communication.
25 And to the extent that we need to have free, full and

1 fair access to it, that's what we ought to have. And I
2 think FTC is justified in perhaps looking at inhibited
3 use of communication caused by anticompetitive
4 regulations. I think you're on the right ground, but I
5 think it's a balancing act. I don't think it's an
6 interference act.

7 MR. GRANAT: As a way for the FTC to get state
8 bar associations to review their ethical codes with
9 respect to the impact on an Internet in an informed way,
10 that would be important. So, for example, in New Jersey,
11 you have to have a physical office. In some other
12 states, you have to have a physical office to practice.

13 Advertising rules are also outmoded. They talk
14 about first class mail and then they talk about
15 archiving. You have classified advertisement. You can't
16 archive a web site.

17 We talk about unbundled legal practice, for
18 example, where the lawyer, under the ethical rules, must
19 represent a client vigorously. That prevents somebody
20 giving limited legal advice if somebody wants to file a
21 bankruptcy petition and lower the cost because the lawyer
22 has to go to court to make a hearing. If it's simple
23 enough, they can do the forms and provide legal advice.

24 So, there are a series of constraints including
25 the bright line between legal information and legal

1 advice. So, we could have law firms maybe do legal
2 information sites without getting caught up in all the
3 ethical rules. So, the whole ethical -- and this is the
4 issue here -- the whole ethical code needs to be looked
5 at in the context of Internet technology, and we don't
6 have enough bar association committees looking at it from
7 that point of view with the impact of the technology on
8 what those lawyers do. Thank you.

9 MR. AGARWAL: Thank you.

10 MR. JOHNSTON: I don't think the Internet is
11 merely a device for communication. I think it's much
12 more powerful than that and it's a way of going -- it's
13 going to change lots of things, including the profession
14 of law. And I think what the Federal Trade Commission
15 could look at, although I'm not advocating that they
16 actually do this at the moment, and that is, defining
17 what the practice of law is online so that we don't have
18 these state regulations and the state actions thwarting
19 the use of this new technology to deliver legal services
20 in a way that has not been done in the past.

21 MR. AGARWAL: Thank you.

22 MR. JONES: I agree with A.P. on the basic
23 proposition that the courts have regulated lawyers since
24 we've had lawyers and that system has worked pretty well.
25 And I think that the FTC's objective ought to be to

1 participate in the discussions before the courts about
2 the anticompetitive impact of particular rules, as you
3 have done, I understand, where attorneys were going to be
4 required in certain transactions or physical presence
5 being required.

6 It seems to me that too often the courts don't
7 think about or think through the anticompetitive effect
8 of their interpretations of their rules. There's
9 absolutely no reason the rules of professional conduct
10 could not be interpreted to accommodate the practice of
11 law on the Internet and if those consequences are taken
12 into account when the rules are being considered, I think
13 we'll end up with results that we can all live with.

14 MR. LAMMERT: I would encourage the FTC to
15 continue with keeping on. The FTC has, at least in my
16 experience, been very active in raising the questions.
17 In our industry, the FTC has, to my knowledge, on at
18 least four occasions, gone to a state bar and said, you
19 ought to rethink what you're about to do, Rhode Island,
20 Kentucky, Virginia and North Carolina, and to a greater
21 or lesser extent has helped the bar and has also helped
22 the consuming public with that definition.

23 I am thrilled to hear about what the ABA is
24 doing and what other groups are doing in terms of trying
25 to look at this issue of what is the practice of law and

1 how it might be a barrier to legitimate competition that
2 would benefit the consumers. And I think the FTC has
3 taken a very active role in helping that process and
4 advancing the competing interests.

5 PROF. LANCTOT: I agree that every state bar
6 ought to be encouraged to look very seriously at the
7 question of how to use the Internet to deliver legal
8 services effectively, both by lawyers, and to the extent
9 that there are services that are not considered to be
10 legal services, encouraging lay providers to step in to
11 fill the gap. I think that's essential.

12 I'm involved with a project that just begun in
13 New York State where an arm of the New York Courts has
14 begun to look at the question of the Internet and its
15 application to the ethics rules there. I think it would
16 be beneficial if every state did that.

17 The other thing I think I'll mention quickly is
18 the FTC ought not to lose sight of the consumer
19 protection half which I know that is paramount in
20 consideration. The question about are we saving people
21 from themselves, should we let consumers just go for it
22 if they have full knowledge. I mean, that's, of course,
23 always a question about any kind of regulation.

24 My own perspective is, is that I spend every
25 day with lay people trying to explain the law to them.

1 They're called law students and sometimes even they've
2 done the reading and it's still hard to explain the law
3 to them. And so, I suppose I come at the whole question
4 of lay people and their handle on the law a little bit
5 differently. I think the law is complex. I think there
6 can be aspects of it that can be deceptively simple, but
7 frequently, once we get past the initial five-minute
8 conversation or the first interchange online, things get
9 more complex very quickly.

10 So, I think it is essential to keep in mind
11 that we aren't talking about contact lenses or caskets or
12 wine bottles, that we're talking about something very
13 different when we're talking about access to the justice
14 system.

15 PROF. PALOMAR: Someone in the last session
16 concluded by saying that lawyers always say we need more
17 litigation and professors always say we need more
18 studies, and being a professor, of course, I do have to
19 fit into that particular role.

20 In most countries in the world -- in fact, I
21 can only think of two other countries where this is not
22 the case. In most other countries of the world, it is
23 the government that provides the conveyancing and title
24 assurance role. They have a registrar, or in some
25 countries, the person is called the public notary who

1 does the title examination, who actually makes the entry
2 in the registry that conveys the title, and then the
3 government has a fund, the three different ways and
4 different types of systems, but it's a fund that is set
5 up so that if a member of the public loses a right due to
6 an error of this public notary or government registrar,
7 then the government indemnifies that person.

8 In our system, we're unique because as
9 weaknesses were revealed in our title insurance and
10 conveyancing system, as early as the 1800s, it was not
11 the government, but it was private enterprise that
12 stepped in to fill the gaps by attorneys learning to
13 search and examine the title, the burgeoning title
14 records as they grew, and with title insurance, stepping
15 in to fill the gap when there were problems and losses
16 that people suffered through defects that no one could
17 find in examining the public record. Having private
18 enterprise fill these roles has permitted our system to
19 be the most creative and flexible and the fastest in the
20 world and has allowed us to be a model for the rest of
21 the world in terms of real estate finance.

22 So, as the FTC looks at this, we want to
23 certainly continue free enterprise in these areas. At
24 the same time, we want to be careful that we don't
25 encourage abolishment of regulations that fit into this

1 scheme that we have developed in this country to protect
2 our land titles, because without security of land titles,
3 we cannot have the continuing commerce that involves land
4 use and land development that we have had for the last
5 100 years.

6 MR. AGARWAL: Thank you very much, everyone.
7 We appreciate the written statements and your testimony
8 today.

9 (Whereupon, at 4:34, the third session was
10 concluded.)

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3 **FOURTH SESSION -- TELEMEDICINE AND ONLINE**
4 **PHARMACEUTICAL SALES**

5 MR. CRUZ: Good afternoon, everyone. I'm Ted
6 Cruz. I'm the Director of the Office of Policy Planning
7 here at the Federal Trade Commission. Welcome to the
8 final panel on the second day of the FTC's workshop on
9 possible anticompetitive efforts to restrict competition
10 on the Internet.

11 For those of you who have been here all day, I
12 commend you on your endurance and fortitude. We've had
13 some terrific discussions on a number of industries, and
14 I look forward to this closing discussion with an
15 excellent panel of experts to discuss telemedicine and
16 online pharmaceutical sales. This panel will be
17 moderated by John Delacourt, who is an attorney in the
18 Office of Policy Planning. With that, let's kick it off.

19 MR. DELACOURT: Thanks, Ted. First of all, I'd
20 just like to say that it's a privilege to be the
21 moderator of this particular panel given that clearly
22 only the most dedicated speakers and audience members
23 would still be here this late in the afternoon. So,
24 again, thanks to everyone for participating.

25 This is the panel on Internet health services,

1 which we have defined as including, principally,
2 telemedicine and online pharmaceutical sales. Like many
3 of the other industries we've talked about in the course
4 of the workshop, expanded use of the Internet in the
5 health care context sets up a stark contrast. On the one
6 hand, it offers great promise. Increasing health care
7 costs and reduced access continue to be significant
8 problems. So, the conventional wisdom is that anything
9 we could do in this area, including expanded use of the
10 Internet, is certainly something that we should consider
11 and think about.

12 On the other hand, the risks are potentially
13 great. We are, after all, talking about potentially
14 reallocating scarce health care resources. In addition
15 to that concern, there is the further concern that we're
16 not just talking about a consumer's pocketbook. We are
17 also talking about potential threats to patient health
18 and to quality of care in general. So, hopefully, in the
19 course of our discussion today, we can talk about some
20 intelligent ways to go about weighing and balancing these
21 two important priorities.

22 But before we begin, I have a couple of
23 housekeeping items. First, we will be taking questions
24 from the audience for this particular panel. If you have
25 a question, please let an FTC staff person know and they

1 will pass you a note card so you can write down the
2 question and have it passed to the front. Second, I will
3 request of the panelists, before beginning your
4 introductory remarks, if you could just identify yourself
5 and state the organization that you're affiliated with,
6 that would be helpful to all of us.

7 So, without any further ado, Carmen Catizone,
8 if you could start off.

9 MR. CATIZONE: Thank you. I am Carmen
10 Catizone, the Executive Director of the National
11 Association of Boards of Pharmacy. We are the
12 international, independent and impartial association for
13 all of the jurisdictions in the United States that
14 regulate the practice of pharmacy, in Puerto Rico, the
15 Virgin Islands, eight provinces of Canada, four
16 Australian states, New Zealand and South Africa.

17 In my remarks today, what I'd like to share
18 with you is our perspective on state regulation and its
19 impact on the competitiveness of the distribution of
20 pharmaceuticals on the Internet. We've been involved in
21 this since the early nineties and our Verified Internet
22 Pharmacy Practice Sites program is recognized throughout
23 the country and we're also recognized by the FDA and by
24 Medicare as a valuable site for consumers.

25 In regards to state regulation of Internet

1 sites in the distribution of pharmaceuticals, all states
2 have in place laws and regulations governing the practice
3 of pharmacy which have been set by the state
4 legislatures. These laws and regulations ensure that the
5 provision of pharmaceuticals and pharmacist care meet
6 accepted standards of practice and protect the public
7 from incompetent or dangerous practitioners and
8 pharmacies.

9 The State Pharmacy Practice Acts and
10 Regulations have been in place since 1871 and have been
11 proven over time effective in regulating the practice of
12 pharmacy without creating undue burden on interstate
13 commerce or competition. The various practice acts and
14 regulations establish the criteria for licensing
15 pharmacists and pharmacies, operating a pharmacy to
16 dispense medication to patients and disciplining those
17 pharmacists and pharmacies who violate state laws and
18 regulations and endanger the public health and safety of
19 the citizens of the states.

20 The states have determined that Internet sites
21 offering prescription medications are engaged in the
22 practice of pharmacy, and therefore, must abide by the
23 same laws and rules that presently apply to pharmacies
24 and pharmacists. Internet pharmacies, although unique in
25 their structure and environment, represent the operations

1 of non-resident or mail order pharmacies. The basic
2 construction of these systems involves the receipt of
3 prescription orders from patients who do not physically
4 deliver the prescriptions to the pharmacy and the
5 delivery of prescription medication to patients who
6 generally reside in locations different from where the
7 pharmacy is located.

8 All activities between these beginning and end
9 points involve the practice of pharmacy and require
10 adherence to present laws and regulations. Only five
11 states have enacted legislation or regulations
12 specifically for Internet pharmacies. The additional
13 regulations enacted in these states reinforce that
14 Internet pharmacies are regulated by the states and
15 establish some notification provisions.

16 The additional regulations are in accord with
17 the regulatory framework for nonresident or out-of-state
18 pharmacies and do not present any additional burden or
19 restraint of competition.

20 One additional state, West Virginia,
21 specifically prohibits online or telephonic evaluation by
22 questionnaire to establish an appropriate patient/
23 practitioner relationship. This is, in NABP's opinion,
24 an appropriate and not an undue burden on Internet sites.
25 All but a handful of states require that nonresident or

1 out-of-state pharmacies license or register with them and
2 comply with their applicable laws and statutes. These
3 laws and regulations have been in place for almost 20
4 years, effectively protecting the citizens of the states
5 without hindering competition in this market segment.

6 What the various laws and regulations govern
7 and what they have restricted is the operation of illegal
8 sites seeking to bypass the regulatory system. State
9 laws and regulations recognize the advantage of the
10 Internet and allow for the practice of telemedicine and
11 telepharmacy. Specific provisions of the majority of
12 state laws and regulations allow for the electronic
13 transmission of prescriptions, shared databases,
14 electronic patient profiles and other advantages offered
15 through the Internet and other electronic means.

16 These laws and regulations do not seek to
17 stifle competition in a marketplace, but transfer
18 existing and accepted standards for patient care from
19 traditional activities to the new nontraditional
20 activities of the Internet. The standards and
21 requirements have not been increased but adapted to the
22 environment.

23 NABP acknowledges that some people regard the
24 dispensing of pharmaceuticals via the Internet as the
25 same process and place for a commodity such as a book or

1 a compact disc, and therefore, should be regulated or not
2 regulated in similar fashion. This is not and cannot be
3 the conclusion drawn by this workshop. Other Internet
4 sites have been unsuccessful, may have engaged in the
5 wrong business model or failed to understand the
6 consumer's prescription medication uses. It has not been
7 the result of unfair regulation.

8 The failure to realize and implement
9 appropriate regulation would endanger the public health,
10 and therefore, we believe that the current regulations
11 and statutes in place are appropriate and do not, in any
12 way, hinder competition among Internet pharmacies. Thank
13 you.

14 MR. DELACOURT: Thank you. Our next panelist
15 will be Harriet Hellman.

16 MS. HELLMAN: Thank you. I'm a full-time
17 clinician. I'm a pediatric nurse practitioner and I'm
18 here as a clinician and also to represent the American
19 College of Nurse Practitioners. I'm a Board certified
20 pediatric nurse practitioner in New York State with an
21 independent pediatric practice of more than 5,000
22 registered patients. I'm a full-time clinician and I
23 examine, treat and prescribe for kids all day, every day,
24 sick kids and well kids. The practice employs three
25 other nurse practitioners and averages close to 10,000

1 documented office visits a year.

2 The American College of Nurse Practitioners
3 represent more than 30,000 nurse practitioners among the
4 100,000 nurse practitioners nationally and serves as a
5 voice for nurse practitioners on public policy issues on
6 a Federal level.

7 Nurse practitioners have been delivering safe
8 and effective health care to people of all ages in both
9 traditional and nontraditional settings for more than 38
10 years. We are licensed to practice in every state and
11 the District of Columbia and are certified by national
12 organizations in a number of advanced practice
13 specialties. We practice both independently and in
14 collaboration with other health care professionals. We
15 write prescriptions in all but one state. In 44 of 50
16 jurisdictions, nurse practitioners are authorized to
17 register with the DEA to obtain the authority to
18 prescribe controlled substances according to the laws of
19 each state.

20 The core problem for us and for many consumers
21 is that many consumers, who are specifically instructed
22 by their health plans to use mail order or Internet
23 pharmacy services, as well as those who choose to for the
24 convenience or the cost savings, are being denied those
25 benefits. This is occurring because a number of the

1 pharmacies nationally are refusing to fill prescriptions
2 written by nurse practitioners.

3 According to the Code of Federal Regulations,
4 Federal guidelines do not, in themselves, prohibit a
5 pharmacist from filling a prescription written by a
6 provider who is legally authorized to prescribe under the
7 laws of a particular state. Some states, however, impose
8 complex and unnecessary restrictions on who can
9 prescribe.

10 In written testimony to the FTC for this
11 workshop, Dr. Byrne and I cite examples of restrictive
12 practices from both state law and online pharmacy
13 business practices. I refer you also to the written
14 testimony of Ms. Winifred Carson, General Counsel of the
15 American Nurses Association, who discusses the legal
16 ramifications of these restrictive practices and who is
17 also present in the audience today.

18 These laws and practices that we cite result in
19 denial to consumers who choose nurse practitioners as
20 their health care providers of the option of filling
21 their prescriptions through use of the Internet. The
22 true impact of these practices, in both economic and
23 therapeutic terms, is unclear. However, anecdotal
24 evidence suggests that the impact may be very great.

25 Scott Levin, a pharmaceutical research firm,

1 projected that nurse practitioners would write in excess
2 of 239 million prescriptions in the year 2000. The
3 numbers in our profession have increased since then. It
4 can be expected that the number of patients who will be
5 unable to fill prescriptions at certain mail order or
6 Internet pharmacies will increase exponentially in the
7 coming years.

8 Access to care is a significant and growing
9 issue in this country. With over 40 million uninsured
10 and many more under-insured, an increasing number of
11 people have the greatest difficulty finding a provider
12 with whom they can maintain an effective therapeutic
13 relationship -- any primary care provider, nurse
14 practitioner or physician alike. Poorly conceived
15 regulations and restrictive interpretations of
16 regulations that prevent access to legally credentialed
17 health care providers are not only unfair and
18 anticompetitive, but needlessly jeopardize the health of
19 consumers.

20 The American College of Nurse Practitioners
21 appreciates the efforts of the FTC to protect consumers
22 in this area, and we request an investigation and speedy
23 resolution of the undue restrictions that are limiting a
24 consumer's choice of pharmacy provider and indirectly
25 limiting their choice of a health care provider as well,

1 remembering that each day, every day, American consumers
2 are losing access to their needed health care benefits.

3 MR. DELACOURT: Thank you, Harriet. Our next
4 panelist is Bob Barton.

5 MR. BARTON: Good afternoon. My name is Bob
6 Barton. I'm the Chief Financial Officer of
7 drugstore.com. Thanks for the opportunity to speak
8 today.

9 I think we all acknowledge the fact that e-
10 commerce is growing rapidly. And, in fact, on a revenue
11 scale, you're looking at 20 to 30 percent growth
12 annually. Pharmacy is following suit.

13 I would say that in this environment, with
14 rapid growth, appropriate regulation is important for
15 consumer safety as well as supporting legitimate
16 businesses. And we take the stand that there is, in
17 fact, appropriate state and Federal regulations that
18 exist to do just this, protect legitimate businesses and,
19 most importantly, the end consumer.

20 What we identify as a key concern is
21 enforcement -- enforcing these laws to ensure that
22 consumers are safe and that legitimate businesses can
23 practice without the competition of an illegal web site,
24 if you will.

25 So, specifically, I've alluded to the fact that

1 there are a couple of issues that I would like to walk
2 you through that tie directly into this issue, the first
3 being the existence of illegal web sites that are
4 prescribing and dispensing prescriptions. The second is
5 a little bit of a different twist, but it has to do with
6 e-prescribing and certain states not allowing electronic
7 prescriptions.

8 Before I get into the details, I would like to
9 walk you quickly through drugstore.com -- who we are and
10 how we practice pharmacy online. Obviously, the name
11 says exactly what we are. We are an online pharmacy that
12 offers health, beauty, wellness and pharmacy solutions to
13 consumers. We've served over 2.8 million customers to
14 date and dispensed over 1.3 million prescriptions.

15 Pharmacy is a key part and a critical part of
16 our business and there's really six pillars, if you will,
17 to support our business. The first thing, it's all about
18 the Web, and this is unique to an online drugstore. It's
19 all about privacy, convenience and personalization.
20 We're available 24 hours a day, seven days a week, and we
21 can actually manage a site that's specific to your needs.

22 We provide information that allows consumers to
23 make informed buying decisions and because of the model
24 that we operate under, we can actually allow consumers to
25 have a choice in regards to prices. We can offer very

1 competitive prices relative to the brick-and-mortar
2 pharmacies. But most importantly, we believe that the
3 safety factors associated with our pharmacy is where
4 consumers actually gain confidence regarding our site,
5 and we're quite proud of the fact that we are one of the
6 first online pharmacies to receive VIPPS certification
7 through the NABP's program that basically distinguishes
8 our ability to provide safe pharmacy practices.

9 How does an online pharmacy work? It's really
10 no different than a brick and mortar pharmacy. The means
11 of communication is a bit different. Rather than walking
12 you through each of the steps, what I would focus on is
13 the fact that before we will dispense a prescription, we
14 require a legitimate prescription to be received by one
15 of our pharmacists at drugstore.com and by an approved
16 authority who prescribes that drug, if you will. That is
17 critical.

18 And, again, the next slide, this really cuts to
19 the chase. We work very hard to follow state and Federal
20 regulations that we think are appropriate to provide
21 consumers a safe solution. Yet, while we incur the costs
22 and do the hard work to meet these regulations, there are
23 literally hundreds of web sites that are in existence
24 that are operating illegally and providing consumers with
25 a potentially unsafe solution. We believe there are

1 actually, as I said, a number of existing state and
2 Federal laws that give teeth to multiple organizations to
3 go after these rogue web sites. But the trick is, in the
4 end, it's all about enforcement and tracking, and with
5 that enforcement, there's really no need for regulation.

6 And I would stand up to say, again, my point is
7 not to eliminate regulation. It needs to be there. The
8 key is the enforcement has to be there as well.

9 In addition, education is very important.
10 These web sites are potentially giving consumers false or
11 misleading information, and at the very least -- I'm
12 getting an indication to stop here, so I'll hurry. At
13 the very least, I would suggest that portal sites --
14 advertising vehicles, if you will -- should be, at the
15 very least, required to provide education to consumers
16 before or as part of the advertisement of their web site.

17 I guess lastly, real quick, to touch on the
18 second issue, there are some differences between various
19 states, and one issue that we would like to bring up in
20 this conference is the differing state laws regarding the
21 receipt or the ability of an online pharmacy to receive
22 an e-prescription or electronic prescription. We
23 currently are unable to do that in the state that we
24 operate in. The regulation is under the guise of
25 protecting consumers and I actually believe this is one

1 scenario where it is anticompetitive because, given where
2 we are located, we cannot do this. And I think, really,
3 the second issue is the fact that it may be counter to
4 its goal in terms of consumer protection.

5 There have been studies that have said that a
6 high volume of errors regarding prescriptions are
7 associated with poor handwriting or illegible
8 handwriting. This is one way to get around that issue.
9 With that, I'll close out and pass it on to the next
10 person. Thank you.

11 MR. DELACOURT: Thanks, Bob. Our next panelist
12 is Meredyth Andrus.

13 MS. ANDRUS: Good afternoon. My name is
14 Meredyth Smith Andrus. I'm an Assistant Attorney General
15 in the Antitrust Division of the Office of the Attorney
16 General in the State of Maryland. I've been asked today
17 to give one state's perspective on the regulation of
18 Internet sales of prescription drugs and I appreciate the
19 opportunity and thank the FTC for inviting me.

20 I have two disclaimers to make today. The
21 first, the views that I express are my own and not those
22 of the Attorney General in the State of Maryland, nor the
23 views of any other states or any other state official.

24 Second, with regard to the subject matter of
25 today's panel, I do not hold myself out to be an expert

1 in any way. Indeed, my knowledge of e-commerce is
2 extremely limited and it's informed primarily by the
3 research that I have done for today's discussion.

4 My knowledge of the pharmaceutical industry is
5 somewhat more extensive, but as an antitrust enforcer, my
6 expertise is accordingly focused. I am also antitrust
7 counsel to Maryland's Health Care Professional Licensing
8 Boards, including the Board of Pharmacy and Physician
9 Quality Assurance, on matters pertaining to state action
10 and so I have looked at online sales of pharmaceuticals
11 from a licensing perspective as well.

12 With those caveats, I hope I can make a valuable
13 contribution to today's discussion.

14 State regulation of Internet sales of
15 prescription drugs takes a myriad of different forms.
16 Generally speaking, states' efforts to address the issues
17 fall under three major categories. The first is the
18 enactment of laws to specifically address pharmaceutical
19 sales online; second is the promulgation of health care
20 professional licensing board policies, rules or
21 statements; and the third is both statutory and
22 regulatory statements.

23 Maryland falls into the second category, that
24 is, the state has not enacted specific new legislation
25 governing online sales of pharmaceuticals, but rather,

1 the Board of Physician Quality Assurance has issued a
2 policy statement interpreting the Medical Practice Act
3 that asserts that health care providers prescribing drugs
4 to Maryland patients must be licensed in the State of
5 Maryland.

6 The existing regulatory structure in Maryland
7 probably is not the most exciting for purposes of today's
8 discussion, but given the budgetary and travel
9 constraints most states are currently experiencing, this
10 panel ended up with a state representative who could
11 drive here.

12 The lack of potential controversy,
13 notwithstanding the State of Maryland treats sales of
14 prescription drugs online just like sales of any other
15 commodity -- that is, any other sales of pharmaceuticals.
16 All sales must comply with state laws governing the
17 practice of pharmacy, the practice of medicine and
18 consumer protection. The Maryland Consumer Protection
19 Act requires that all sales of consumer goods and
20 services in the state must be in compliance with state
21 laws governing unfair or deceptive trade practices.

22 The Maryland Pharmacy Act, real quick, requires
23 that all pharmacists who practice in the state be
24 licensed by the Board of Pharmacy. There are no
25 exceptions for out-of-state pharmacists treating Maryland

1 patients via the Internet. In addition, the Pharmacy Act
2 requires all Maryland pharmacies to acquire a pharmacy
3 permit. Pharmacies located outside the State of Maryland
4 must also obtain a pharmacy permit from the Maryland
5 Pharmacy Board prior to dispensing prescription drugs to
6 Maryland residents.

7 An out-of-state pharmacy or pharmacist must
8 have a Maryland license or permit, respectively, prior to
9 providing any prescription drugs to Maryland patients by
10 Internet, mail or by any other means. Should a pharmacy
11 or pharmacist do so without a license or a permit, that
12 pharmacy or pharmacist would be subject to criminal
13 prosecution and/or administrative prosecution with a
14 possible \$50,000 civil fine per violation.

15 Complaints against an out-of-state pharmacy
16 with a valid nonresident permit must generally be
17 referred first to the state in which the pharmacy is
18 located. If that state does not take action against the
19 pharmacy then, generally 45 days later, the State of
20 Maryland Board of Pharmacy may then take action against
21 the out-of-state pharmacy.

22 The Board of Physician Quality Assurance also
23 requires licensure of all Maryland physicians and
24 certification of all Maryland physician assistants.
25 Again, there's no exception for out-of-state physicians

1 or physician assistants treating Maryland patients via
2 the Internet.

3 As I mentioned earlier, the Board of Physician
4 Quality Assurance has issued a policy statement
5 interpreting the Medical Practice Act to require Internet
6 providers prescribing drugs for Maryland patients to be
7 licensed to practice medicine in Maryland.

8 The adoption of the Maryland Uniform Electronic
9 Transactions Act, signed into law in April of 2000, has
10 facilitated the use of the Internet in rendering health
11 care online and it's expected to continue to do so. The
12 Act provides that records and/or signatures may not be
13 denied legal effect or enforceability simply because
14 they're in electronic form.

15 I've been given the signal to stop, so I'm
16 going to give you a wrap-up, concluding statement.

17 In conclusion, states are struggling to balance
18 the competing concerns of affordable access to
19 prescription drugs on the one hand with concerns of
20 safety and efficacy on the other. On balance, the
21 current regulatory programs I've reviewed do not impose
22 possible anticompetitive harm that outweighs consumer
23 protection concerns and sound public policy legitimately
24 promoted by state government.

25 MR. DELACOURT: Thank you, Meredyth. Our next

1 panelist is Professor Stephen Parente.

2 DR. PARENTE: Well, thank you for requesting my
3 input on this important topic. My name is Steve Parente
4 and I am an Assistant Professor at the University of
5 Minnesota's Carlson School of Management with adjunct
6 appointments in the School of Public Health and Medicine.
7 I am a health economist who has studied health e-commerce
8 business models and their implications for the health
9 care economy.

10 My role today is largely confined to that of an
11 academic, somewhat of a curmudgeon, I suppose, observing
12 an emerging marketplace. However, I also teach a course
13 in health e-business that focuses on critiquing new
14 business models as well as enabling future health care
15 leaders to identify opportunities for new e-health
16 business development. In this role as a preceptor to
17 future leaders, I hope to learn from this exchange in
18 order to challenge my students on how to develop
19 enterprises that in the case of the population's health
20 derive a net improvement for social welfare.

21 The Internet has enabled the medical
22 marketplace to provide new products and services to
23 consumers. Health e-businesses ranging from subscription
24 Web portals to online pharmacies have developed and
25 disintegrated when the global e-commerce bubble burst.

1 Despite the overall downturn in e-businesses, a
2 handful of health-related e-businesses have continued to
3 thrive, particularly online pharmacies. The Internet has
4 provided consumers with a virtual health care sector
5 experience from ordering prescription drugs to seeking
6 physician referrals to buying insurance. However,
7 existing state and Federal regulations governing the old
8 health economy can limit the development of the new
9 health economy. New or revised legislation and
10 regulation may be warranted to protect consumer privacy,
11 minimize fraud and abuse, decrease transaction cost as
12 well as open new markets to competition.

13 Let me focus specifically on competition. With
14 regard to this, there are two major concerns that I think
15 arise in the health e-business marketplace. The first is
16 barrier to entry. Existing state and Federal regulations
17 have limited development of e-business opportunities. An
18 often-cited example is online pharmacy firms that are
19 deemed to be out-of-state enterprises for regulatory
20 purposes and are, therefore, required to provide an array
21 of additional information that may appear to be
22 unnecessary to comply with regulatory obligations.

23 The states' central regulatory tool for online
24 pharmacies is licensure, as it is for medical providers
25 as well as insurers. It is not clear exactly what many

1 online retailers are gaining from this, and in some
2 cases, they may be being done a disservice.

3 One example I hope that I might have an
4 opportunity to come back to in the course of our exchange
5 is a business case -- this is what business professors do
6 -- involving the company Health Market, which is not
7 really on the agenda because we are focusing on online
8 pharmacy and telemedicine. But this is a firm started by
9 Steve Wiggins, the former head of Oxford Health Plan in
10 New York State -- a very large health plan that, to a
11 certain extent, has been somewhat decimated in terms of
12 their business model because of state regulation -- and
13 hopefully, I'll have an opportunity to speak to that.

14 The second competition concern is the danger
15 that information asymmetry and fraud will forestall an
16 informed consumer from making a well, fair and neutral
17 choice. Since Kenneth Arrow's 1963 article in Economics
18 and Medical Care, economists have argued that the average
19 consumer has an information asymmetry problem due to the
20 lack of knowledge of the best pathways to treat a medical
21 condition.

22 Presumably, the information asymmetry problem
23 can be compounded by fraud when someone claims to be a
24 prescribing physician and recommends a prescription
25 online that is completely inappropriate to treat the

1 consumer's ailment. To mitigate information asymmetry
2 issues, government regulations require disclosure of the
3 effects of medical services and licensure, to grant only
4 trained individuals the right to practice medicine.

5 The problem the Internet introduces is an
6 additional opportunity for fraud that is harder to
7 identify and prosecute, primarily because the effort and
8 cost to produce a deceiving electronic storefront is far
9 less than that required to produce a physical plant, like
10 a physician's office, and far less costly to maintain.

11 There are many functions that should be
12 regulated by states rather than the Federal Government
13 because of the operational efficiency that results from
14 the states being closer to the local activity for
15 monitoring and enforcement purposes. Health care has
16 traditionally been a local affair because of the
17 centuries old relationship between a community and its
18 hospital, alms house, or clinic and its medical
19 practitioner. Yet, medical education now is somewhat of
20 a national affair where a doctor can, without many
21 barriers, move about freely to practice around the
22 country. Similarly, a pharmacist practicing in a
23 Walgreen's in San Diego should feel right at home in a
24 Walgreen's in Chicago.

25 Finally, national health insurers such as

1 United Health Group, Aetna, Humana Health Net, Anthem and
2 CIGNA have clearly demonstrated that a Federal
3 infrastructure can be achieved to have appropriate
4 economies of scale in the health insurance market. Why,
5 then, are core medical institutions state licensed rather
6 than federally licensed? The Internet takes this issue
7 even a step further by demanding the consideration of
8 rapid reformulation of state licensure policies with a
9 focus on high level reciprocity to allow states to
10 concentrate on monitoring enforcement of fair practice
11 rather than licensure.

12 And with that, I welcome comments.

13 MR. DELACOURT: Okay, thank you, Professor
14 Parente. Our next panelist is Bob Waters.

15 MR. WATERS: Good afternoon, I appreciate
16 everyone's indulgence in staying so late in the afternoon
17 and I won't suggest that we were "buried" in the program,
18 but I did note that some of the other panelists who did
19 appear before us might make that an appropriate comment.

20 My name is Bob Waters, and I serve as counsel
21 to the Center for Telemedicine Law. The Center is a
22 501©)(3) organization which was established in 1995 by a
23 number of leading major medical centers, including the
24 Mayo Clinic, the Cleveland Clinic, Texas Children's
25 Hospital, as well as some rural health telemedicine

1 providers, including the Midwest Rural Telemedicine
2 Coalition. The purpose of the Center is to take a look
3 at legal and regulatory barriers to help analyze and
4 suggest solutions to those problems.

5 Over the course of the last seven years, our
6 organization has carefully reviewed the development of
7 state laws governing e-health, telemedicine and
8 telehealth. We issued our first report on this subject
9 in 1997 and we've been providing regular updates ever
10 since.

11 As many of you know, telemedicine is exciting.
12 It's changing the way health care services are delivered.
13 A few examples you may be aware of, Dr. Michael Debaki
14 used telemedicine to consult with Boris Yeltsin when he
15 was having his heart problems; the Shriner's Hospital
16 routinely uses telemedicine to follow up on burn patients
17 so the young pediatric patients can be relocated to their
18 homes; radiologists routinely use telemedicine as a part
19 of reviewing films from an emergency room in the evening
20 or on an on-call basis; and the military, Veterans
21 Affairs and many other agencies are using it as part of
22 their own health care delivery systems.

23 The Federal government has recognized
24 telemedicine. In last year's Federal appropriation,
25 there were some 40 special congressional projects related

1 to telemedicine at the local level. There are at least a
2 dozen, maybe two dozen Federal agencies that have
3 provided support for telehealth and telemedicine
4 services.

5 When these services are provided, oftentimes,
6 civic leaders proclaim that the citizens of our community
7 will have access to the world's greatest medical
8 expertise. What they don't say, is oftentimes, is that
9 the world's greatest medical expert cannot answer the
10 phone because they're not locally licensed. Really what
11 you have to understand is the way the current legal and
12 regulatory structure is set up.

13 Health professionals are licensed at the local
14 level. But interestingly over time, particularly for the
15 medical and nursing profession, the standards have become
16 largely uniform. To be licensed as a doctor, you have to
17 pass the same U.S. medical licensing exam in all 50
18 states. It's the same 1,600 questions, it's the same
19 passing score. The same thing is true in the practice of
20 nursing. There is a uniform national exam that has
21 evolved.

22 When these laws were originally developed,
23 there was wide variation in terms of the standards to
24 practice, but now we have simply administrative
25 differences. Each state believes it does a better job of

1 screening candidates and many states require that the
2 candidates appear before their boards to be screened. I
3 know of one radiologist who holds a license in 20 states.
4 It cost him \$20,000 to do that. He had to travel to many
5 states to appear.

6 To expect that the specialist at NIH or at
7 Sloane-Kettering or at the Mayo Clinic will travel to all
8 50 states in order to be available on the off chance that
9 they get a call from one of those remote locations is
10 simply unrealistic. We need a new system if we want to
11 make our nation's medical expertise available to everyone
12 in the country.

13 The Federation of State Medical Boards began to
14 address this issue and proposed a model state statute to
15 accomplish this objective. It basically said that if you
16 were licensed in one state, you would have an opportunity
17 to get an expedited license in any of the other states.
18 Unfortunately, only a handful of states have adopted that
19 model and those are shown on the graph. We would have
20 hoped that it would have been more. It's not a complete
21 solution, but if it would have worked and would have been
22 an expedited system, it probably would help resolve this
23 problem to some degree.

24 When we issued our report in 1997, we actually
25 found that state laws were headed in the reverse

1 direction. They were becoming more restrictive and
2 limiting the ability of telemedicine providers to provide
3 services across the national platform.

4 This gives you an idea. This is a moving
5 target, but most states will now tell you that full
6 licensure is required to provide services to a patient
7 within that state either by board policy, by state
8 statute or by regulation.

9 I'm going to give you some examples. I chose
10 them very carefully knowing that panelists from Florida
11 and Maryland were going to be here. I carefully avoided
12 selecting those states, but let me give you a couple of
13 examples.

14 The State of Oregon is a good example. Oregon
15 passed the Federation Model Act for expedited licensure.
16 It says that if you are licensed in one state, you can
17 get an expedited license to practice telehealth into the
18 State of Oregon. However, in implementing it, the board
19 imposed a rather unusual requirement, and that is that a
20 physician shall examine the patient in person prior to
21 diagnosing, treating or prescribing. So, you simply
22 can't take advantage of that expedited license unless it
23 was already a patient of yours. The specialists at NIH
24 or at Sloane-Kettering or at Mayo will never qualify for
25 that provision.

1 Texas is another example. Texas also passed a
2 version of the Model State Act. But in the implementing
3 rule, they made a special exception. They said you can
4 qualify if you're simply consulting with a local
5 physician. But, of course, you have to pass through a
6 specialist in the same area within our state. It's
7 almost an exit tax or a toll. Talk to a specialist in
8 our state before you go to a specialist outside of the
9 state. And Texas and other states routinely do not
10 license physicians by specialty area. So, there doesn't
11 appear to be a rational basis for that underlying
12 requirement.

13 There's been a growing trend and great concern
14 about rogue Internet sites that offer prescription
15 medication over the net. The knee jerk reaction to that
16 is to simply prohibit all prescribing over the Internet
17 without taking into account what other types of services
18 might be associated with that, whether there would be
19 two-way video interaction, whether or not there would be
20 laboratory tests, how robust the questionnaire is. And
21 in those circumstances, there could be justification for
22 providing access to this tool, which could be stronger
23 than, frankly, the tool that you might get in visiting
24 the doctor's office yourself.

25 So, we're seeing a trend towards requiring a

1 physical examination for prescribing. In some cases, it
2 doesn't suggest how that exam be performed. In other
3 cases, it does.

4 Finally, I'd note that Nevada is a good
5 example. Nevada had the Board of Medicine issue an
6 opinion saying that it was not practicing within the
7 State of Nevada if you sent a radiograph outside of the
8 state and it was read by a radiologist outside of the
9 state. The state legislature stepped in and said, we
10 don't like that, we're concerned about that. So, they
11 passed a law that said, if you electronically transmit
12 the radiograph, you have to be locally licensed if you
13 read it. But they didn't say if you couriered it or if
14 you carried it yourself. So, it was clearly a
15 prohibition against the electronic version of providing
16 the same service that otherwise would be acceptable.

17 What are the solutions? I have outlined five.
18 One is probably scary for some, but it's national
19 licensure, as had been suggested by the previous speaker.
20 It may be a ways off, but frankly, with the harmonization
21 of the standards that are out there, it's something that
22 at least ought to be considered from an analytical
23 perspective.

24 Secondly, incentive grants for state
25 cooperation. The Federation of State Medical Boards is

1 making a great effort to try to harmonize state policies
2 and we think that with additional incentives, state
3 policy boards, medical boards, and nursing licensure
4 boards could harmonize significantly the requirements at
5 the front end.

6 Third, interstate compacts. The National
7 Council of State Board of Nurses has adopted an
8 interstate compact. If you're licensed in one of the
9 participating states, you're licensed in all of the
10 states, and they're using the same resources that they
11 would have used upfront to duplicate that effort to
12 enforce at the back end, to go after the bad apples and
13 work with each other.

14 I believe that there is a lot in the FSMB
15 approach to in-person exams that should be commended, but
16 it needs to be read carefully because it imposes a
17 requirement that the physician must obtain a history and
18 physical adequate to diagnose the patient, not that he
19 has to perform it himself.

20 And, finally, I would say it's an issue of
21 where is the patient in this equation. I think the day
22 will come when the patients will say, wait a second, I
23 can get in my car and I can drive over to the next state
24 and there's no requirement that the doctor in the next
25 state be licensed in my state. Now, I have a new

1 mechanism, an electronic mechanism, to see that same
2 physician. Why should I be prohibited from using it?

3 I think there are less restrictive alternatives
4 that would allow that patient to recognize now he's
5 leaving the State of Iowa, he's entering the State of
6 Minnesota and perhaps Minnesota doctors are not quite as
7 well licensed as those in Iowa. And that's a question of
8 information to the consumer. It's not placing a barrier
9 in front of the consumer to prevent that travel. It
10 shouldn't just be Bill Gates and Warren Buffet who have
11 the ability to travel all over the world to get the best
12 medical care. It ought to be available to people of more
13 modest means as well. Thank you very much.

14 MR. DELACOURT: Thanks, Bob. Our next and
15 final panelist is Dr. Gary Winchester.

16 DR. WINCHESTER: Thank you for allowing me to
17 be here today. I always seem to find myself in the
18 position of playing defense and I guess that's where I am
19 already in this meeting today.

20 My experience is that of a family doctor in
21 Tallahassee, Florida. I've been in practice for about 28
22 years. I've been on the Florida Board of Medicine for
23 the last 11 years.

24 During that tour on the Board of Medicine, I've
25 had the opportunity to review 5,000 plus, we'll call,

1 "misadventures" by physicians in our state, as well as
2 physician assistants. It's my concern that seeing the
3 number of things that occur when there is a direct face-
4 to-face event between the doctor and the patient, or
5 provider and the patient, I have a real concern about
6 what might be the case when there is no direct contact.

7 In 1999, the Florida Legislature set up a task
8 force to look at telehealth issues. I was named chair of
9 that task force and we took about a year and had just
10 lots and lots of meetings and talked to every type of
11 person we could think of. In the State of Florida,
12 everything is in the sunshine, so all of our meetings
13 were opened and covered usually by the press.

14 Looking at it without taking the Federation's
15 point of view, it ended up we came up with almost exactly
16 the same recommendations that the Federation had and
17 we're in the process of trying to get that passed through
18 the legislature. I will say that as part of our
19 proposal, which is on the web site, we do exclude
20 consultations as being something that does not have to be
21 licensed with the caveat in Florida that the consultant
22 cannot provide the primary care to the patient, which
23 means that another provider has to be involved. It
24 doesn't have to be a provider of the same type.

25 I'd also comment that I agree with Harriet that

1 we need to be real careful about restricting the trade of
2 nurse practitioners and physician assistants. These
3 folks provide an incredibly important, valuable job and
4 whatever laws and rules are across the states, I think
5 that we need to keep them in mind as we move forward.

6 With that, I will stop. My full comments are
7 on the web site.

8 MR. DELACOURT: Thank you, Dr. Winchester. My
9 first question has two components, as there are two
10 components to the panel -- telemedicine and online
11 pharmaceutical sales. And so, I will pose my question,
12 initially at least, to Bob Barton and Bob Waters. Could
13 you tell us what you consider to be the most significant
14 state regulations that might potentially limit online
15 pharmaceutical sales or telemedicine at the present time?

16 MR. BARTON: I'll go ahead and start. I guess
17 what I would say is I don't know that we actually have a
18 position that there are significant state regulations
19 that are limiting our online sales. I think the biggest
20 issue that's limiting our ability to compete is that we
21 have chosen to be a safe pharmacy and, in fact, we follow
22 the state laws that are set forth to provide consumer
23 safety.

24 Yet, as I said earlier, there are hundreds of
25 pharmacies -- let me be clear here. They're not

1 pharmacies. There are hundreds of illegal web sites that
2 are given the ability to operate under a different set of
3 circumstances than what we are working under. The
4 numbers that I've heard, just in terms of prescriptions
5 that come into the U.S. annually is roughly two million a
6 year, and that is one estimate. And so, theoretically,
7 those are sales that, from a competitive perspective,
8 drugstore.com is losing out on. That is primarily my
9 biggest issue.

10 And the second one, again, as I mentioned
11 earlier, is there are some differences between states and
12 there is one difference that we are dealing with and
13 that's the issue of electronic prescriptions. Again, I
14 think there are roughly 12 states in the United States
15 that do not allow the receipt or acceptance of electronic
16 prescriptions. Our pharmacy resides in one of those, and
17 we actually think there are a number of benefits to
18 consumers in allowing us to process electronic
19 prescriptions.

20 I mentioned one earlier, and that was the fact
21 that handwriting is an issue. We receive a high volume
22 of prescriptions that are not legible and that causes a
23 consumer risk. It's something that we would like to have
24 addressed.

25 MR. DELACOURT: Bob, could you respond on the

1 telemedicine side?

2 MR. WATERS: A couple things are going on out
3 there that I think bear observation. One, we're seeing
4 this sort of rush by many states to basically blanket ban
5 some sorts of Internet prescribing, and I can see why
6 there would be a reaction and concern about that. But I
7 think a little more care should be put into thinking this
8 through because really the question is, does the
9 physician have adequate information to properly diagnose
10 and treat the patient? It's not just prescribing.

11 I mean, there's frankly a lot of other things
12 that a physician could do to a patient that might be much
13 more harmful than running a prescription for Claritin or
14 Viagra or Propecia, in terms of advising them whether or
15 not they have a skin lesion that's cancerous, whether
16 they need to come in and get care, whether they need to
17 follow up with certain other forms of assistance.
18 So, you need to look at the whole picture.

19 One of the issues really is that, to simply say
20 that something should be prohibited because an electronic
21 means was used as part of the process would be a mistake.
22 I think the question is, does the doctor have enough
23 information? When you look at the totality of the
24 information that's available to him, did he
25 videoconference with the patient? Was someone sent out

1 to do an exam of the patient? Maybe it wasn't the doctor
2 himself.

3 But frankly, in our current health care system,
4 in my own group practice, it's very possible that I would
5 be given a prescription by another doctor in the same
6 group -- a doctor who never performed a physical exam on
7 me. We should not set a double standard, with the higher
8 standard for the electronic practice than what you have
9 for the in-person examination.

10 So, I think we need to get it right. We need
11 to not just do Regulation 1.0. We need to think through
12 the second and third steps because this is all evolving
13 fairly rapidly.

14 MR. DELACOURT: I will now pose the flip side
15 to our representatives from the states. Are there
16 reasons to think that, either unintentionally or
17 intentionally, there is, in fact, a higher standard for
18 telemedicine and online pharmaceutical sales, or have the
19 consumer protection regulations already in place
20 adequately accounted for the risks and benefits of
21 Internet services? I guess we'll start with Carmen.

22 MR. CATIZONE: Sure. I think with regard to
23 state regulation, some of the states have not been able
24 to address the Internet as a medium, and therefore,
25 there's a lag time on those regulations and the

1 regulations that exist probably are stifling the efforts
2 of drugstore.com and other legitimate pharmacies from
3 conducting business in a very safe and patient-oriented
4 manner.

5 I don't see a deliberate attempt by the states
6 to impose higher standards on Internet pharmacies and
7 believe that the tide has turned, as Bob Waters has
8 stated, and I think states are now looking at this as a
9 bigger picture issue and are implementing regulations
10 that are more Internet friendly.

11 The other issue, though, about whether or not a
12 practitioner, a pharmacist, a physician, or a nurse
13 practitioner needs to be licensed in that state is an
14 issue that, I think, is going to remain for a long time.
15 And Meredyth may want to comment on that. I don't see
16 national licensure occurring in the near future. To
17 interpret Federal regulations at this point, to allow
18 national licensure, I think, is inappropriate.

19 MR. DELACOURT: Meredyth, do you have a comment
20 on that?

21 MS. ANDRUS: I agree with what Carmen said. I
22 do not think that the restrictions imposed on Internet
23 health care providers are any greater than those imposed
24 on providers residing in the state. I also agree that I
25 don't see that changing any time soon.

1 The third point that you mentioned, Carmen, is
2 that there is a lag time for many states, my own
3 included, in addressing the Internet pharmaceutical sales
4 issue. We have not specifically addressed it. As I said
5 in my remarks, the Board of Physician Quality Assurance
6 has interpreted the Medical Practice Act to require
7 physicians prescribing to patients in Maryland to be
8 licensed in Maryland, but it's not specifically set forth
9 in the statute. I think that's going to take some time
10 both for my state and other states that are struggling
11 with these issues.

12 MR. DELACOURT: Dr. Winchester, do you think
13 there's been some lag time with respect to telemedicine
14 issues and regulation in Florida or do you think that the
15 Board has gone ahead and addressed those issues in a
16 timely manner?

17 DR. WINCHESTER: Well, I would say the Board's
18 probably addressed those issues in a timely manner.
19 What's happened, though, is it usually takes, in my
20 experience, three to four years to get something through
21 the legislature if it's a brand new concept.

22 In contrast, the agencies, whoever they may be,
23 can do things fairly quickly. Like I said, it took us
24 about nine months to look at telehealth from head to toe
25 and come up with some real straightforward suggestions,

1 and they're still floating around in the legislature and
2 probably will be for a while. One of the problems, when
3 you're talking about telehealth, is that topic itself is
4 such a moving target, that whatever we come up with now,
5 five years from now is not going to be the same.

6 I suspect we'll come back to national licensure
7 some more before we're through, but one of the things
8 that I would throw out -- and I think it's something I
9 believe Steve mentioned -- you know, everybody feels like
10 they do the best job in their state of licensing and
11 whatnot. In fact, at a Federation meeting a few years
12 ago, one of the moderators asked, everybody raise your
13 hand who doesn't think they do as good a job as the seat
14 next to you. Of course, there weren't any hands raised.

15 But there is a fairly large variation from
16 state-to-state as to what the legislatures do and,
17 hopefully, that reflects what consumers, the citizens of
18 the state, require. For example, in Florida, there's
19 some very strict requirements for malpractice or
20 financial responsibility. It's my understanding, and the
21 experts can correct me, but it's my understanding that
22 New York, Texas and California do not require malpractice
23 insurance as a matter of licensure. Those are huge
24 issues that I think it's going to be real difficult for
25 the states to come together with and come up with one set

1 of rules.

2 MR. DELACOURT: Dr. Winchester and Carmen have
3 both raised an issue that I think is important to turn to
4 and that's national licensure. I don't want to speak
5 directly to that, but to a broader issue. One of the
6 panelists yesterday -- I can't remember the name, so I'm
7 unable to give proper attribution -- said that it's "very
8 difficult for the Internet to abide 50 different states'
9 laws."

10 I wonder if this is such a situation, where the
11 objection isn't so much to any particular state law,
12 though that may be a problem as well, but rather to the
13 fact such laws, when imposed in an e-commerce context,
14 require telehealth providers and online pharmacies to
15 comply with 50 different standards. Does anyone want to
16 address that issue?

17 DR. WINCHESTER: Well, I would draw an analogy
18 with driving your car. If I'm licensed in Florida and I
19 drive over the line into Georgia, I suspect I'm going to
20 have to abide by whatever rules and laws Georgia has.

21 The licensure process itself and the money
22 that's involved gets to be a little bit stickier, I
23 understand, and \$20,000 to have 22 licenses to practice
24 radiology is a lot of expense and burden. But I think
25 that you have to look at where that money for licensure

1 is going. It goes to two things. One is the process of
2 licensing. But the other thing, it goes into a great big
3 kitty to be used to investigate complaints against the
4 licensees.

5 So, if we had the Federal Government provide
6 the national license, is the Federal Government then
7 going to step up to the states when they start looking at
8 the disciplinary process and pay for it, or does the
9 Federal government want to take on the whole ball of wax
10 and do licensure and discipline from one location?

11 MR. WATERS: It's an interesting model. You
12 mentioned the driver's license model which is, in some
13 part, what the State Nurse Licensure Compact is modeled
14 after, and what you've got is if you have a driver's
15 license in Virginia, you can drive in Maryland, you can
16 drive in the District of Columbia, you can drive in
17 Pennsylvania, but when you're driving in those states,
18 you have to adhere to their rules and requirements. You
19 pay a license fee to your home state, but that license is
20 good in other states, and it provides, if you will,
21 reciprocity, but leaves the enforcement at the local
22 level, leaves the discipline at the local level, and
23 there's a communication mechanism between the states so
24 that, if there is a bad apple, they can communicate with
25 the other states and take appropriate action.

1 I think that's the kind of creative thinking
2 that we're going to have to do if we're going to adapt a
3 state-based licensure system to deal with the new
4 economy, the new e-economy. If we don't, at the end of
5 the day, I fear you're going to find the consumer who is
6 going to get very upset when they find out that they can
7 do almost every other transaction electronically, but
8 you're forcing them to get in their cars and drive in
9 this instance just to avoid the rigidity of the legal and
10 regulatory structure.

11 And so, we've got to be creative. We've got to
12 find ways to modify these rules, and the driver's
13 licenses is maybe a good model.

14 MS. HELLMAN: I would really second that,
15 because I think that the key really is creative thinking.
16 You know, my 87-year-old father didn't have any idea --
17 and he's a scientist -- no concept that we would have the
18 Internet today. He had no concept that if he wanted to
19 consult with a physician at the Mayo Clinic, he could do
20 that via telehealth. He also had no concept of a lot of
21 the professions that exist in the work force today.

22 I think we have to be creative. I think we
23 have to recognize that our health work force is different
24 than it was 50 years ago. It's different than it was
25 when I started 32 years ago. I think that a huge area

1 for all of us is that regulation has to keep up, and if
2 not, then maybe we need Federal intervention to help it.

3 MR. DELACOURT: What about multi-jurisdictional
4 licensing requirements from the pharmaceutical side? Has
5 that been an issue with online pharmaceutical sales?

6 MR. CATIZONE: I'd like to comment from the
7 state perspective and then ask Bob to give a personal
8 perspective. I think the system is already in place.
9 What exists is that Internet pharmacies are considered
10 non-resident or out-of-state pharmacies, and therefore,
11 must register or license with that state to notify the
12 state that they're doing business in that state the
13 driver's license model.

14 All that's required of those pharmacies then is
15 that they adhere to the laws in that state, so that if a
16 pharmacy is going to operate in Illinois and was located
17 in New Jersey, they have to follow the laws in Illinois
18 in order to practice in that state. That's the model
19 that you talked about. That's the model that's in place.

20 Is it difficult to comply with? I think in a
21 pharmacy there's a lot more similarity in the practice
22 actually than perhaps in medicine and so the differences
23 may not be as great, and a corporation like drugstore.com
24 may be able to do that relatively easily. I'm not sure
25 if a small pharmacy that wanted to practice in all the

1 states would have the resources to be able to do that.
2 But perhaps, then, if you don't have the resources, you
3 shouldn't be able to practice in those states if you
4 can't comply with their requirements.

5 MR. BARTON: You know, there are instances
6 where challenges do arise, and we've walked through a
7 couple of those already. But, in general, I think we
8 have been able to meet the requirements. We believe that
9 there is a need, there is an inherent check and balance,
10 I think, in having different regulations or having
11 different states review regulations.

12 I think it's an interesting comment, though,
13 that if the states don't move quick enough, some Federal
14 intervention should take place. I think that's actually
15 very fascinating.

16 MR. DELACOURT: Well, we've been focusing
17 mostly on the competition issues and I guess I'd like to
18 turn to the consumer protection side for a moment. I
19 guess I'd just like to pose to all the panelists the
20 question of whether there's any reason to believe that
21 the delivery of health services, including both
22 telemedicine and online pharmaceutical sales, through the
23 use of the Internet, is any more hazardous or riskier
24 than providing it through conventional channels? Does
25 anyone want to speak to that issue?

1 MS. HELLMAN: Well, it might be risky in my
2 house because we share the computer and I noticed that we
3 got an e-mail recently for Viagra. I'm not sure that I
4 want my husband to have access to it, maybe, we have to
5 discuss that.

6 MR. BARTON: Well, I guess I'd make a comment
7 here. The risks that do show up from our perspective is,
8 can I just get online and order a prescription for Viagra
9 or a number of different drugs without actually talking
10 to a physician? And I would tell you that you can get
11 online on the Web and order a prescription and not have
12 to talk to a physician and not have to talk to a
13 pharmacist. The Viagra will show up at your doorstep.
14 It may come from outside the U.S. It may not be Viagra.
15 It may be something else.

16 Were the proper precautions taken? Was there a
17 drug utilization review? Did we check for drug
18 interactions? Those, I think, are true safety risks to
19 the consumer.

20 MR. DELACOURT: Maybe on the telemedicine side,
21 I can pose a specific example. There was a recent series
22 of articles in the New York Times about the difficulty
23 in accurate interpretation of certain types of
24 radiological images, specifically mammograms, suggesting
25 that correct interpretation of these images required a

1 level of physician expertise that's in short supply.

2 So, my question is, how does an example like
3 that, where the use of telemedicine could make expertise
4 that may be geographically concentrated available on a
5 wider basis, how does that affect the cost-benefit
6 analysis or risk analysis with respect to telemedicine
7 vis-a-vis in person diagnosis?

8 MR. WATERS: Well, I think it definitely should
9 be factored in. Clearly, there are situations where
10 there is not the type of medical expertise in a local
11 community that you would want. There may not be a
12 dermatologist. There may not be a psychiatrist. I know
13 near my hometown there's not a psychiatrist, psychologist
14 or a clinical social worker within 60 or 90 miles.

15 And if the telehealth services make that
16 expertise available, you're probably enhancing the
17 quality of the care, notwithstanding the fact that an
18 argument might be made, depending upon the way the
19 technology is used and when information is transmitted,
20 that there might be some information lost. But if there
21 is some information lost, it may be better than no
22 information whatsoever being provided to the appropriate
23 expert.

24 I've heard countless examples in the
25 telemedicine literature and at conferences of situations

1 where a dermatologist has been successfully able to
2 diagnose a skin disease that someone had that went simply
3 undiagnosed locally.

4 The real question may be, down the road, is, if
5 you have telemedicine equipment in your hospital and you
6 fail to use it and you fail to avail yourself of the
7 remote expert, are you going to be liable for not using
8 the equipment?

9 MR. DELACOURT: Professor Parente?

10 DR. PARENTE: I have a comment. There was
11 actually a study that we did with the local Minnesota VA
12 on a telemedicine application. A VA is a different
13 animal than most health care in the U.S. But what was
14 interesting about it was, we were focusing on diabetic
15 patients who needed to get retinopathy screening
16 procedures done. In the case of Minnesota, they're
17 serving about a five-state region. Patients could be
18 driving in from as far as North Dakota or Wyoming.

19 Now, the VA reimburses for all that travel.
20 And the thought of actually having telemedicine out in
21 those remote locations, though you still have to specify
22 someone at that location who could take the actual
23 digital image, was a huge advance in terms of access to
24 care and quality. In the case of diabetes, they could
25 actually prevent blindness right on the spot.

1 Plus the cost implications, in terms of transport, made
2 it a tremendous cost saving advantage when we sort of ran
3 the numbers, if you will.

4 Two comments about that analysis. One is, it's
5 a great success story about telemedicine as a wonderful
6 thing to do. The second thing, though, is that actually
7 doing some empirical research like that takes some very
8 careful consideration of exactly how the cost benefit is
9 going to weigh in the right way.

10 There's a growing literature -- empirical is
11 what the academic does here. There's a growing
12 literature on what is the cost benefit of telemedicine,
13 but it is a case-by-case basis.

14 And I just want to offer one other comment.
15 The people that are really looking at that growing
16 literature, besides just the state authorities, are
17 Medicare and Medicaid. Medicaid has been considering the
18 use of telemedicine for quite some time. Medicare has
19 been going back and forth about this issue, about whether
20 they will reimburse telemedicine or not, and what demand
21 does it suddenly create. It's almost a case-by-case
22 basis.

23 I think, Bob, you know this better than I. But
24 they are definitely holding down the fort on any sort of
25 the Federal endorsement of telemedicine as a widespread

1 medical therapy.

2 MR. WATERS: Although, actually, Congress in
3 the last session passed legislation that does provide for
4 most of the basic evaluation codes and reimbursement for
5 telehealth services. So, Congress has made that judgment
6 that it would be appropriate, and the Medicare program is
7 reimbursing for a substantial number of the codes, as are
8 many state Medicaid offices. So, it's evolving. But
9 you're right, a year-and-a-half ago, that was not so
10 true.

11 DR. PARENTE: Right. The question of cost
12 benefit, because of Medicare reimbursing -- that
13 basically feeds into the data reimbursement system that
14 ultimately informs public policy analysis. So, you could
15 do evaluations as time goes on even on a more national
16 scale.

17 MR. WATERS: The other thing on this risk
18 question I would raise is that if you did a Lexis search
19 -- which is a computer database that lawyers use to take
20 a look at case law that's out there -- you'd find very,
21 very few cases, if any, dealing with malpractice where
22 telemedicine was the crux of it.

23 Now, that's not to say that there won't be, and
24 undoubtedly, there will be as it becomes more commonplace
25 in terms of the delivery of health care services.

1 However, oftentimes in the use of telemedicine, what you
2 have is more than one doctor involved. You have a
3 consulting relationship and you have a local physician
4 connecting with a specialist. So, you're actually not
5 just having one provider involved, but probably two
6 providers involved in the care of a patient. And
7 presumably, one would hope that that would further
8 enhance the ability to get the right answer.

9 MR. DELACOURT: Dr. Winchester, has there been
10 any concern by the Florida Board that licensing
11 requirements might potentially make important expertise
12 off limits to Florida health care consumers?

13 DR. WINCHESTER: The reality is that this type
14 of practice of medicine has been going on for many, many
15 years. AFIP has been reviewing slides since I was in
16 high school working in the lab in the hospital.
17 Radiology, of course, is a textbook case and you
18 mentioned about mammograms, indeed radiologists reading
19 mammograms are getting out of the business as quickly as
20 they can instead of getting into the business.

21 So, I think there are certain fields that
22 absolutely lend themselves towards telehealth issues --
23 pathology, dermatology, and radiology. But I will say
24 that there are some that I just really have a hard time -
25 - maybe it's just because I'm too old or something -- but

1 I have a hard time understanding how people can get a
2 real good grasp on somebody having a stroke or a heart
3 attack or something like that over the telephone. So, I
4 think it depends on what the subject matter is.

5 But in any case, the protection issue is that
6 either the doctor providing the opinion or his
7 counterpart in that state has got to be liable,
8 responsible for that opinion. And if that's the case,
9 then I'm all for it.

10 I had the opportunity a couple of years ago to
11 visit the University of Vermont. I don't know if any of
12 you all are aware of their program up there. But they
13 have a lot of satellite clinics, basically, that are all
14 tied into the University of Vermont. I was real
15 impressed looking at the nephrologist's ability to look
16 at a dialysis unit 100 miles away, or I guess in Vermont
17 it may have been 50 miles away, but to look at the
18 patient and to look at their shot and see if it's
19 infected and to treat it, you know, over the Internet
20 without that patient having to travel to the University.

21 So, I think there's a lot of good opportunities
22 out there for it.

23 MR. DELACOURT: Turning back to the online
24 pharmaceutical sales side, I don't know how many of you
25 were in attendance for earlier panels of our workshop,

1 but two of the other industry areas that we addressed
2 were online wine sales and online contact lens sales, and
3 it seems to me that these raise similar issues to
4 prescription pharmaceutical sales over the Internet.
5 Essentially, the primary consumer protection goal is to
6 prevent hazardous materials from falling into the wrong
7 hands.

8 I'm wondering if there's anything that is
9 unique about prescription drugs that would set them apart
10 and make the consumer protection requirements different
11 from wine sales or contact lenses.

12 MR. CATIZONE: As you stated, prescription
13 medications are inherently dangerous products, and they
14 need to be regulated from that sense as well as
15 regulating for consumer protection. That's why the rules
16 in place regulating the practice of pharmacy
17 differentiate prescription medications from compact discs
18 or books that you can obtain, even wine, via the
19 Internet.

20 If the pharmacy is properly licensed, if
21 they're adhering to the laws and regulations governing
22 the practice of pharmacy, which include delivery of
23 prescription medications to patients and the safeguards
24 that must be in place for that to occur, then there is no
25 difference between an Internet pharmacy and a traditional

1 brick and mortar pharmacy.

2 If the site is operating illegally or as a
3 rogue site, then all the concerns that you've voiced
4 about prescription medications being delivered
5 inappropriately, maybe to children, exist and there's
6 nobody monitoring or trying to stop that unless somebody
7 stops the activities of those rogue or illegal sites.

8 MS. ANDRUS: Another difference is the
9 interaction of drugs from the two industries that you
10 mentioned.

11 MR. DELACOURT: Okay. And how would that be
12 reflected in the regulation tailored specifically to
13 Internet transactions?

14 MS. ANDRUS: Well, you said, is there anything
15 about pharmaceutical sales that would make it more a
16 subject for regulation as opposed to a product like a
17 contact lens or wine. I'm saying that because
18 pharmaceuticals are inherently dangerous products, the
19 complicating factor is that unlike wine or contact
20 lenses, if the pharmacy is a rogue site, is not
21 monitoring the sales and monitoring what drugs you are
22 buying and how those drugs may interact, that is the
23 factor that I'm trying to say is different about the
24 other products.

25 MR. CATIZONE: The interaction between a Merlot

1 and a Cabernet is a lot different than Cumadin and
2 aspirin in a patient.

3 MS. ANDRUS: Right, right. You might put a
4 left in the wrong eye or whatever, but it's not quite as
5 dangerous.

6 MR. DELACOURT: So far we've spoken mostly
7 about potential state regulatory barriers to online
8 pharmaceutical sales and telemedicine. For a moment, I
9 want to re-direct the discussion and see if there's been
10 any experience or evidence of private restraints. With
11 respects to the industries at issue, it seems to me that
12 different concerns would arise. With telemedicine, I
13 guess the concern would be physician or hospital
14 agreements to permit or not to permit transmission of
15 certain x-rays or other digital images. In the online
16 pharmaceutical context, perhaps the concern would be
17 threats by brick-and-mortar pharmacies to cut off certain
18 drug companies distributing on the Internet.

19 Are these the sorts of restraints that anyone
20 is concerned about or has seen popping up?

21 MR. CATIZONE: Early on in Internet pharmacy
22 history, there was a bit of constraint that occurred when
23 insurance companies were failing to cover the
24 prescriptions issued by Internet pharmacies.

25 MR. BARTON: Thanks for the lead-in. There are

1 a few issues, I would say three, that we run into right
2 now. One is our ability to provide what's referred to as
3 universal coverage -- universal insurance coverage -- and
4 that means you, as a consumer, have an insurance plan and
5 you come to drugstore.com to have your prescription
6 filled and you want to be able to utilize your insurance
7 and simply pay your copay.

8 Well, our ability to accept your insurance is
9 limited to those insurance companies and pharmacy benefit
10 managers that choose to allow us into their network. You
11 know, at this point, the typical brick-and-mortar
12 pharmacy, if you look at their pharmacy sales insurance
13 ratio to cash sales, it's usually a 90/10 scenario. Our
14 business, if you just look at the mail order side of our
15 business, is closer to 80 percent cash, 20 percent
16 insurance. And that's a reflection of the number of
17 insurance companies who will not -- insurance and
18 pharmacy benefit managers -- who will not let us into
19 their network, and in some cases, will agree to put us in
20 their network but at a reimbursement rate that will not
21 allow us to even break even on a script. You know,
22 that's one such issue.

23 You brought up contact lenses. That is another
24 such issue that we have investigated, which would be a
25 perfect product fit for our environment. However,

1 because of fairly complicated state laws and optometrist
2 and manufacturer relationships, we've had challenges
3 getting into that.

4 And the third, interestingly enough, is pet
5 prescriptions, and again, that's the relationships
6 between veterinarians and again manufacturers, where they
7 are maintaining a relationship and are not allowing
8 outside companies to be able to provide services for
9 consumers.

10 MR. DELACOURT: I will pose the same question
11 to Bob Waters and Dr. Winchester. Have you seen any
12 evidence of private constraints in the telemedicine area?

13 DR. WINCHESTER: I would say that I haven't
14 seen that, but at least in Florida in the case of Bealeg
15 vs. TMA, there was a precedent set for economic
16 credentialing by hospitals as being a legal issue, that
17 is, if the hospital feels like somebody on their medical
18 staff is doing something to decrease income to the
19 hospital, they can summarily kick them off staff without
20 any recourse by the provider.

21 So, I could easily see a radiology group
22 getting a better deal maybe on mammograms by sending them
23 to Emery instead of being done at my local hospital, and
24 then the hospital getting upset about it. So, I haven't
25 seen that, but the stage is set in Florida for that to

1 happen.

2 MR. WATERS: I haven't seen any evidence on the
3 private side because I think people don't control the
4 markets the same way as perhaps other industry where
5 they've been able to block or lock people out. There's
6 some anxiety. The latest version of the Joint Commission
7 Rules for Accrediting Hospitals has provisions in there
8 related to telehealth. It has a provision in there that
9 the staff have to pass on what applications are
10 acceptable to be done in the hospital, which, on its
11 face, is a fairly reasonable requirement. It's done in
12 terms of other types of health care innovations.

13 You could envision a situation where a
14 conservative group of physicians who did not want to
15 adapt to new technology would dig in their heels for an
16 inordinate period of time. But I have no information or
17 evidence that that's happened in any particular
18 circumstance.

19 MR. DELACOURT: Professor Parente?

20 DR. PARENTE: It's a question of, do you folks
21 face basically any restrictions from private insurers in
22 terms of reimbursement for services?

23 MR. WATERS: I think there's actually a survey
24 that's being completed right now by the American
25 Telemedicine Association to look at that situation and to

1 examine whether private insurance, how they compare, say,
2 with Medicaid and with the Federal government in terms of
3 reimbursing for telemedicine. My expectation is the
4 results from that survey should be out within the next
5 six months and it's something probably the Commission
6 ought to take a look at as well.

7 I know that in many states when hospitals or
8 providers go to their private insurers and have told them
9 they intend to use telemedicine, in many cases they've
10 said, fine, we do not have a problem with that as a
11 modality, rendering certain types of services.

12 MS. HELLMAN: That's actually been my
13 experience. My office staff did a survey when we were
14 looking at participating in a telemedicine grant and we
15 surveyed our five top insurers that we deal with, and all
16 of them said that they would reimburse for the procedure
17 codes the same.

18 MR. DELACOURT: Bob, you mentioned a survey and
19 that's a nice lead-in to a question that I have from the
20 audience, which is, I think, probably posed by one of my
21 FTC colleagues as it asks about the empirical economic
22 data. And the question is, "Are there studies about cost
23 savings, choice or consumer protection concerns arising
24 from expanded use of the Internet to deliver telemedicine
25 services and online pharmaceutical sales?"

1 MR. WATERS: I'll take a shot at part of it.
2 This is not quite the question, but I guess in preparing
3 for this I was interested in terms of whether or not
4 there's empirical evidence on the economic impact that
5 restrictive state policies would have on the delivery of
6 telehealth services. And the problem with that is you're
7 trying to predict the future.

8 What happens is that if a physician believes
9 that there is any chance, or a nurse believes there is
10 any chance, that their license may be yanked, they
11 usually run pretty hard and pretty fast.

12 So, in terms of interpreting signals that are
13 sent out by the state legislatures, by the licensure
14 boards or other regulatory officials, usually what
15 happens is, with the exception of the most egregious of
16 the rogue sites, you'll find the mainline practitioner
17 running pretty far away and they're not going to
18 challenge it. They're not going to say, hey, I'm going
19 to take this to the Supreme Court and risk my license and
20 risk everything to prove that I ought to be able to see a
21 few patients by telemedicine. So, you have a difficult
22 time developing that kind of data.

23 There is quite a bit of data that is being
24 developed in terms of the cost savings associated with
25 telemedicine, particularly in terms of averted

1 hospitalizations to improve quality of care for patients.
2 Home health is an area that's particularly ripe for that.
3 There's been some significant studies that have been done
4 in the home health area. I would be happy to provide to
5 the Commission some references from many of the papers
6 that are presented at the American Telemedicine
7 Association or in various scholarly journals along those
8 lines.

9 MR. DELACOURT: Did anybody else have a comment
10 on that? I'd be interested to know -- I mean, in both
11 areas, we're talking about relatively new industries --
12 but I'd be particularly interested to know if there had
13 been any studies or thoughts about conducting studies
14 relating to cost savings and other potential benefits
15 that the access in these areas might provide.

16 MR. CATIZONE: I'm not aware of any empirical
17 studies. I've seen newspaper reports that have compared
18 prices of Internet pharmacies versus the traditional
19 brick and mortar. But I haven't seen any empirical
20 studies.

21 MR. BARTON: You know, the only thing I think I
22 can add to this is that we do advertise that our prices
23 are 15 to 25 percent cheaper than the brick-and-mortar
24 pharmacies, and we think our model actually allows us to
25 do that because we don't have a nationwide infrastructure

1 of brick-and-mortar stores, yet we can still serve
2 consumers nationwide. So, there's your data.

3 DR. PARENTE: Can I ask a question on that?

4 MR. DELACOURT: Absolutely.

5 DR. PARENTE: I actually went through a lot of
6 the telemedicine literature before I came here and it's
7 all looking great. That's where all the literature is.
8 There isn't much on the pharmacy side.

9 The question I have is, can the pharmacy side
10 actually provide some of this literature or at least
11 participate in some of this stuff? Because, in theory,
12 if this really is welfare improving to the consumer, then
13 the PMPN that comes back to, say, a managed care firm for
14 folks that are using the online pharmacies versus not
15 should have a net cost savings if you control for their
16 case mix and everything else like that. So, the data is
17 there, at least in many insurance companies that are
18 using your services, that could actually answer that
19 question.

20 MR. BARTON: I think it's still relatively
21 early. We're in the infancy of online pharmacies.

22 DR. PARENTE: Right.

23 MR. BARTON: Drugstore.com is in the process of
24 actually proving out the business model that works and we
25 actually believe we're fairly close to that. But, you

1 know, that aside, I think over time we will be able to
2 prove out that things like accepting e-prescriptions will
3 save costs. So, right now, you get a prescription that's
4 illegible, you've got a 70, \$80,000 a year pharmacist who
5 has to pick up the phone and try to track down a doctor.
6 If you've ever tried to do that before, you realize that
7 that's a challenging task at times. But that costs an
8 enormous amount of money on a contribution margin basis,
9 which is the way I look at our business.

10 So, there will be data that will show that our
11 ability to fulfill a prescription over time versus a
12 standard brick-and-mortar -- the data should prove out
13 that we can be more efficient, more focused, and more
14 streamlined. Transmission of data is more clear, more
15 legible. No need, again, as I mentioned earlier, for a
16 footprint of 4,000 stores nationwide. So, you eliminate
17 a number of administrative expenses and your management
18 of inventory can be much more efficient through a series
19 of one to two distribution centers that fulfill a
20 nationwide sales force, if you will, via the web, as
21 opposed to multiple DCs that fulfill multiple stores
22 which ultimately get to the consumer.

23 MS. ANDRUS: I think one other source of
24 information may be the FDA because I think they have done
25 studies -- primarily on the illegal web sites -- but they

1 have done studies that show that prescriptions online can
2 actually be more expensive than prescriptions bought in a
3 drugstore. And, again, that may be because they're
4 purchased without a valid prescription or without a valid
5 doctor visit or whatever. But I have read those studies
6 as well.

7 MR. CATIZONE: I think what was included in
8 those studies was those rogue sites that were charging
9 \$80 to \$100 fees for the doctor consultations or online
10 questionnaires which inflated the medication prices.
11 When you look at these issues and develop the studies,
12 you have to ensure that the pharmacy's care provided
13 across the board is equal, so that if they're conducting
14 drug use reviews or patient counseling, and you're not
15 just looking at the drug product, you can evaluate the
16 cost of the drug products fairly easily. Such cost
17 evaluations are facilitated by the Internet and the
18 transparency that's been caused with the availability of
19 medications from Canada and other sources that are being
20 sold for 10 to 20 times less than U.S. prescription
21 medications.

22 MR. DELACOURT: We're coming to the end of our
23 time, so I have one final question. And that is, what,
24 for us here at the FTC, should be the next step?
25 Obviously, we've convened this workshop to educate

1 ourselves about what is going on in this area and others,
2 but I'd like to know the thoughts of each of the
3 panelists about what, if anything, the FTC should do
4 next, and specifically whether there are thoughts about
5 filling in some of these gaps that we've talked about in
6 the area of the data. In other words, do any of you, at
7 this time have thoughts about studies that the FTC might
8 conduct?

9 DR. WINCHESTER: Certainly, I think that data
10 is always valuable. In fact, my partner and I have made
11 a practice over the years to totally eliminate our
12 emotions when we were looking at contracting and whatnot
13 and instead go with the data because the data often will
14 show something entirely different than what your emotions
15 said to begin with.

16 I don't know how far you're planning to dig
17 into this, but there are some good sources out there that
18 I'd be glad to share with you concerning the licensure
19 and protection issues from other people. I'd be more
20 than happy to help in any way I can.

21 MR. DELACOURT: Bob, any thoughts?

22 MR. WATERS: I think that this is a place where
23 the FTC could play a constructive role because -- not to
24 suggest that states or the state legislatures or the
25 boards have anything but the best of intentions in mind

1 in terms of trying to protect the health and safety of
2 the residents of their state -- I think these entities
3 could use a little help and a little pushing and nudging
4 to think creatively through how to avoid coming up with
5 more restrictive alternatives when there are better ways
6 to do it that ensure that quality telemedicine is
7 available, and that citizens do have access to those
8 great medical experts and expertise.

9 I gave some examples -- I can give many more
10 examples -- of some of the state laws. It's the first
11 variation. It's their first crude attempt to do it and
12 they need some help and nudging to make sure they move to
13 the higher level, otherwise the system will become
14 stagnant. Providers are not in a particularly good
15 position to push the outside of this envelope. Because
16 they risk losing their licenses, they're going to be
17 very, very cautious. That's where some forward-thinking
18 people need to spend a little time and work with them.

19 I, likewise, can provide you some additional
20 resources of other information, maybe some of the same
21 ones that have already been mentioned, but maybe some
22 others as well.

23 MR. DELACOURT: Thanks very much. Professor
24 Parente?

25 DR. PARENTE: Two points, one directly related

1 and one obliquely. The first is with the issue of online
2 pharmacy evaluation. I think that would be a really
3 interesting thing to follow up on, and maybe working
4 collaboratively with drugstore.com and other vendors.
5 The way the study design would have to work, though, is
6 that you'd have to get an insurance company or two to
7 participate, try to purchase their data or arrange for
8 licensing of their data to evaluate it, and basically
9 compare and contrast right down to the person level,
10 PMPN. Is there a cost savings from an online pharmacy
11 component versus essentially the regular system? It is
12 an evaluation that is easy to do if you have an insurance
13 company that's willing to participate with you.

14 I understand that the industry is in its
15 infancy, but it should at least be something that's set
16 up right now in study design. Also, taking into
17 consideration this survey issue that potentially
18 validates the data, to get at Carmen's issue, about
19 basically these cost mark-ups that might not necessarily
20 be reflected.

21 For drugstore.com, if 80 percent of your
22 business is cash and 20 percent is insurance and you want
23 to prove your cash to insurers, that's one way to do it.
24 If you actually show that PMPN is lower and they have
25 some negotiation room.

1 The oblique comment is the issue I raised
2 earlier in the meeting -- licensure of health insurers.
3 I don't know whether or not there's just too few of them
4 to really care.

5 But I still don't understand why this needs to
6 be at the state level. I mean, I know there's a social
7 mission, but there are national companies doing it on a
8 massive scale, and Health Market was an example of a firm
9 that tried to do this. They actually tried to do the
10 same thing that I think drugstore.com did, which was to
11 go through and basically adhere to state licensing
12 requirements. But in the case of going through health
13 insurance commissioners, it is a big, expensive legal
14 process to do that. They managed to get through six or
15 seven states, but then ran out of venture capital.
16 They're sort of puttering around right now to see if they
17 can actually make it happen.

18 In the meantime, firms like definity.com and
19 Luminesce -- defined contribution health plans -- are
20 basically operating in a world exempt from state
21 regulations and their markets are taking off. If you
22 want to talk further about that, I actually have a study
23 that just got funded on defined contribution plans and we
24 can talk further. That's my personal plug. But thank
25 you very much.

1 MR. DELACOURT: Meredyth, any thoughts?

2 MS. ANDRUS: Like I said earlier, I'm an
3 antitrust prosecutor and I'm also counselor to my state
4 licensing board, so I have a very schizophrenic approach
5 to this whole thing. But I'm a great proponent for state
6 and Federal cooperative efforts to address this. I think
7 that the states can be of assistance to the FTC in this
8 regard.

9 I disagree with you, Steve. I think that the
10 licensing issue should be kept at the state level. It's
11 definitely a concern for state government, in my view. I
12 know there are broad-reaching national concerns, but I
13 think that that's something that we could work on using
14 creative thinking and come up with some solutions
15 jointly.

16 MR. DELACOURT: Thanks. Bob, any thoughts?

17 MR. BARTON: Forgive me, I'm going to read a
18 quote here. Basically I'd ask the FTC to remember the
19 promise it made in the congressional testimony before the
20 Committee on Commerce, Subcommittee on Oversight and
21 Investigations in July of 1999. Specifically, "the
22 Federal Trade Commission will continue to do its part to
23 combat deceptive practices by online pharmacies and to
24 assist other authorities in their investigative works."

25 And that's what, I guess, my request is. I

1 don't know that drugstore.com's role is to dictate safe
2 pharmacy practices. I don't think that's the right
3 thing. I think the NABP can do that. I think state
4 boards, obviously, can do that. But what we're looking
5 for is, if we're going to choose to follow those, if we
6 accept those to be safe practices and we choose to follow
7 those practices, then we'd look to the FTC to help us
8 make sure that other online web sites actually have to
9 follow the same set of criteria, and, secondarily to
10 that, to help us with the push of educating consumers in
11 regards to VIPPS certification and allowing them to
12 identify the difference between a safe practicing
13 pharmacy versus an illegal web site. That pertains
14 directly to those folks who also choose to advertise
15 those rogues, and helping us require those advertisers to
16 provide some level of information or education to
17 consumers regarding the difference.

18 MR. DELACOURT: Harriett, do you have any
19 thoughts?

20 MS. HELLMAN: Sure. Pediatric people think
21 very simplistically because we talk to five-year-olds all
22 day long, and so, to me, it's very simple. My problem is
23 that if a patient is mine and I've seen them for 12 years
24 and I prescribe for them -- and I've been prescribing for
25 32 years -- and their managed care says you need to use

1 an online pharmacy located in this state, state X. It's
2 illogical to me if I'm sitting there with a patient, I
3 know them, I'm prescribing for them well, and their
4 managed care says you must use this channel, that their
5 prescription won't be filled.

6 I think we have to look at the health work
7 force. I think we have to be creative, and I think we
8 have to communicate with other health care providers.

9 I was thrilled to read Dr. Winchester's
10 comments on telehealth that are published on the Web
11 because it used the word, all the way through,
12 "practitioner." I have to compliment the Florida Board
13 of Medicine. I think you really looked at that, and
14 that's very important, because we're all part of a team
15 and that team involves the pharmacist, it involves the
16 legal profession, it involves physicians and it involves
17 other health care providers, and please, let it involve
18 the FTC. Thank you.

19 MR. DELACOURT: Carmen?

20 MR. CATIZONE: From our perspective,
21 representing the state boards of pharmacy, we would
22 request your support in terms of studies and information
23 to support changes in state practice acts and regulations
24 that promote uniformity and creativity among the states.
25 We would ask you to continue your efforts in the area of

1 fraud and deceptive practices, particularly health
2 information and health claims because your leadership in
3 this area has been invaluable to the states and NABP. It
4 has resulted in the prosecution of a number of sites that
5 were dangerous to consumers.

6 Finally, we would ask for your assistance in
7 gaining resources at the state level to close down those
8 rogue and illegal sites that are endangering the health
9 of consumers and stifling the ability of legitimate
10 pharmacies to conduct and practice pharmacy as it should
11 be.

12 MR. DELACOURT: Well, that's the last word, and
13 I'd just like to thank everyone for participating today,
14 especially given the lateness of the hour. We will be
15 reconvening tomorrow morning at 9:00 a.m. The next panel
16 will be on Internet auctions.

17 **(Whereupon, at 6:19 p.m., the workshop was**
18 **adjourned.)**

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2 **C E R T I F I C A T I O N O F R E P O R T E R**

3

4 MATTER NUMBER: P9943125 CASE TITLE: GLOBAL E-MARKETPLACE6 DATE: OCTOBER 9, 2002

7

8

9 I HEREBY CERTIFY that the transcript contained herein is
10 a full and accurate transcript of the notes taken by me at the
11 hearing on the above cause before the FEDERAL TRADE COMMISSION
12 to the best of my knowledge and belief.

13

14

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DATED: October 21, 2002

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SONIA GONZALEZ

19

20 **C E R T I F I C A T I O N O F P R O O F R E A D E R**

21

22 I HEREBY CERTIFY that I proofread the transcript for
23 accuracy in spelling, hyphenation, punctuation and format.

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